KKR

2016 KKR Unitholder Letter

Building Value Over The Long Term

Dear Fellow Unitholders:

As KKR embarks on its fifth decade investing on behalf of clients, we continue to find it remarkable how quickly market sentiment can change.

Last year opened with the worst start for equities in history, and volatility across asset classes continued with the surprising Brexit referendum. Since President Donald J. Trump's election, public markets are more optimistic that policy changes such as tax reform, deregulation, infrastructure investment and a more business-friendly climate will lead to improved economic growth in the United States, which pushed the S&P 500 to all-time highs in early March.

We believe this volatility is likely to continue as investors await the outcomes of elections in Germany and France, grapple with concerns about globalization and uneven growth, and work to adapt to disruptive technologies across industries.

Despite the volatility, our business approach and investment philosophy have and will always remain focused on the long term. We approach our relationships with our partners – companies, management teams, fund investors and others who commit capital alongside our own – with a focus on building value for years to come. We view our business through a similar lens.

We approach our relationships with our partners – companies, management teams, fund investors and others who commit capital alongside our own – with a focus on building value for years to come. We view our business through a similar lens.

KKR is unlike most investment firms. Our model allows us to act swiftly and with scale across the capital structure. The long-term nature and quality of much of our capital means we are not typically forced sellers or buyers. Our funds can invest in multiple situations, in any part of a company's capital structure. Our teams of professionals are ready to support our investments and improve value.

At the same time, we have the ability to invest our own money – in a big way – into everything we do through our $10 billion balance sheet. Our capital markets business operates globally for our portfolio companies and independent corporate clients. These strengths, combined with our people and collaborative culture, inspire some of the most sophisticated investors in the world to entrust us with their capital.

In this year's letter, we'll begin by reviewing our performance in 2016. Then we'll discuss the growth and diversification across our platforms. We'll touch on the key drivers of our success – our people and our culture – and finish with some thoughts on the year ahead.

2016 in Review

KKR's key fundamentals of investment performance, fundraising, deployment and monetization activity were strong during 2016. Our focus on these four key metrics remains paramount since they are the building blocks of our growth as a firm, and the source of our optimistic outlook.

Investment Performance

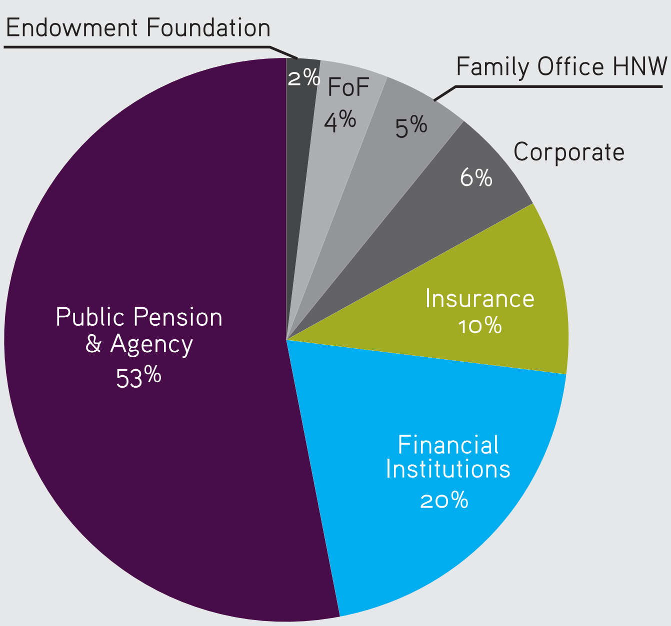
Investment performance for the year was solid as flagship, carry-paying fund appreciation across most of our Private Equity, Real Asset and Alternative Credit strategies were ahead of their respective benchmarks.

Focusing on Private Equity, the portfolio was +11.9% in 2016 compared to the 8.2% increase in the MSCI World Index on a total return basis. Operational improvements and portfolio company growth were key drivers of this appreciation, which contributed to strong, high single-digit private equity portfolio company revenue and EBITDA growth on a year-over-year basis. Additionally, cross-border mergers and acquisitions have allowed several of our portfolio companies to expand into new markets. For example, Panasonic Healthcare's acquisition of Bayer Diabetes Care allowed for one of the largest companies in our Asia Fund II portfolio to expand its reach and drive growth by creating a leading global diabetes care franchise. Companies seeking to enter new markets benefit from the global model and expertise we offer.

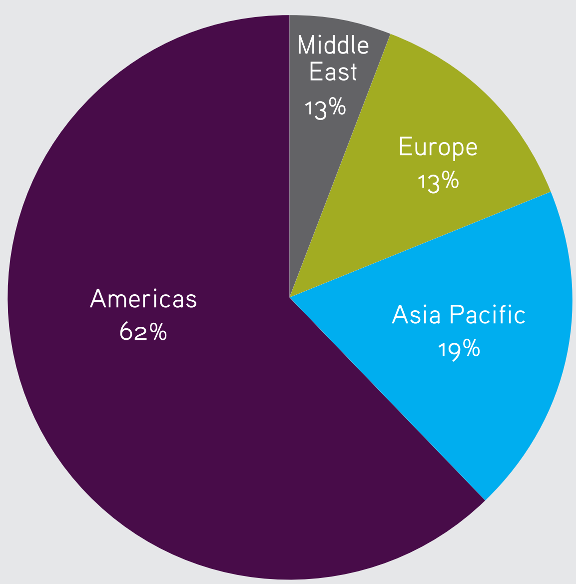
Fundraising

Over the last six years, we are pleased to have nearly tripled the number of fund investors who have entrusted us with their capital. Today, our clients include some of the largest public pensions and sovereign wealth funds in the world, and we're successfully partnering with new fund investors:

Investor Base by Type[1]



Investor Base by Geography[1]



High net worth and retail investors accounted for 12% of fee-paying asset under management (AUM) inflows in 2016, and we believe there is significant potential for further growth.

(1) As of December 31, 2016. Based on the assets under management of our Private Markets investment funds, Private Markets co investment vehicles, and Public Markets separately managed accounts and investment funds. These charts exclude general partner commitments, assets managed through collateralized loan obligations (CLOs), and assets managed by other asset managers with which KKR has formed strategic partnerships where KKR does not hold more than a 50% ownership interest. Allocations are assigned to a type or geographic region according to subscriptions received from a limited partner.

In 2016, we raised a record $29 billion of new capital, driven by inflows to our private equity, growth equity, real estate, CLOs and alternative credit vehicles. As evidenced by this broad set of strategies, we're beginning to see the benefits of KKR's investment in distribution and focus on scaling newer initiatives. As a result, fee-paying assets under management and management fees in 2016 were the highest ever. Americas Fund XII, the second-largest private equity fund in the firm's history and the largest Americas-focused private equity fund currently investing, should result in a further increase in management fees.

The client growth we've experienced has contributed to a progressively diverse capital base, with Public Markets strategies contributing more than 40% of firm-wide management fees in 2016, up from 13% just six years ago. Public Markets combined with our Real Assets strategies represented half of firm-wide new capital raised during the year, and combined for more than half of firm-wide AUM as of year-end.

Deployment

This year, we deployed $11 billion of fund capital across strategies globally. Within private equity, we closed on more than $5 billion of equity commitments. Large-cap North American and Japanese corporate carve-out opportunities exemplify the broad investment themes and regions where we've been busy. We've also invested in several Southeast Asian companies, including an integrated poultry producer in Indonesia that we believe is well positioned to leverage the country's increasing gross domestic product and rising middle-class population.

Within Public Markets, we've found opportunities in alternative credit – specifically direct lending – in which we've negotiated senior debt financings for small- and medium-sized enterprises unable to obtain attractive financing elsewhere. As an example, our capital markets team received a mandate to undertake a refinancing for AM General, the manufacturer of Humvee vehicles. Leveraging a dialogue that developed earlier in the year, the company reached out to us after a traditional syndicated deal was unsuccessful in the markets. Our credit and capital markets teams worked hand-in-hand to provide a comprehensive solution that included an investment by our credit funds and managed accounts, with KKR Capital Markets acting as the sole arranger for the rest of the investment. Our model – and specifically our ability to offer a hybrid solution through our long-term pools of capital, structuring and syndication capabilities – made this possible.

Monetizations

Behind a healthy level of monetization activity and management fee growth, we reported total after-tax distributable earnings of $1.5 billion in 2016. Our private equity funds distributed $12 billion of capital to investors during the year – including more than $2 billion from 10 Asian portfolio companies – that cumulatively generated more than $1.2 billion of realized carry. Exits across the portfolio were broad-based geographically, with a blend of secondary and strategic sale activity contributing to the 23% year-over-year increase in realized performance income.

The largest contributor to cash earnings in 2016 was the sale of our stake in Walgreens Boots Alliance. We exited part of our investment in Alliance Boots through a cash and stock sale to Walgreens in 2012, which was renamed to Walgreens Boots Alliance after the transaction. The combination created a global leader in health and wellbeing retail and the largest global pharmaceutical wholesaler. We are proud of our investment in Alliance Boots and subsequent investment in Walgreens, which returned more than $7 billion to support the retirement and livelihoods of our limited partners and the more than 50 million pension beneficiaries invested in or indirect beneficiaries of returns from KKR's 2006 Fund and European Fund II.

For 2016, we reported after-tax economic net income of $576 million despite a volatile first quarter. Performance rebounded over the second half of 2016, with more than $900 million of after-tax economic net income due primarily to strong portfolio performance.

KKR Capital Markets

While not reflected in our fee-paying assets under management, our capital markets capabilities are generating real economics and adding value to the companies they support.

KKR Capital Markets enhances the firm's ability to compete for investment opportunities. Strong industry relationships allow the capital markets team to syndicate equity in investments in excess of our fund mandates. They also provide creative solutions for portfolio companies and independent corporate clients.

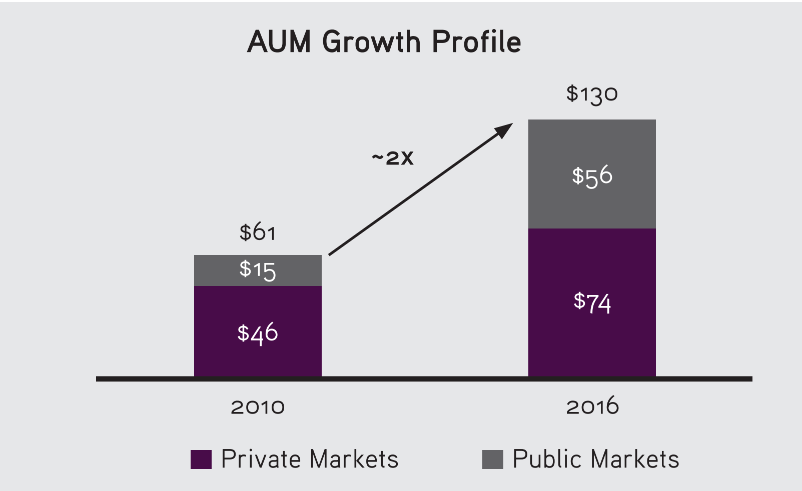
KKR's team of 40 equity and debt structuring specialists has proven to be a key resource for our portfolio companies, and for other companies seeking traditional and nontraditional capital solutions. The team helps guide KKR companies through initial public offerings, refinancings and capital structure issues. In aggregate, KKR Capital Markets participated in $65 billion in equity and debt financings in 2016. During that period, nearly a third of the revenue generated by our capital markets business stemmed from work supporting the needs of independent, non-KKR backed companies.

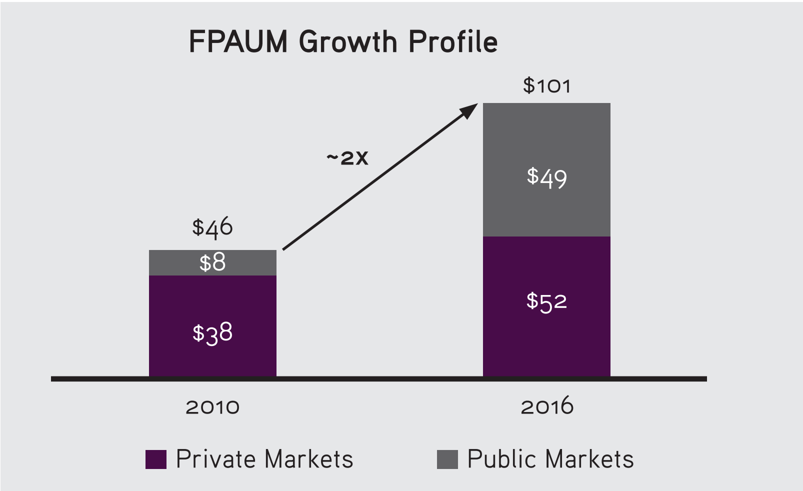
Our capital markets business offers tailored solutions. These activities are generating meaningful revenue for the firm and, especially during periods of market volatility, have played a critical part in helping secure investment opportunities that otherwise might not have been available to our fund investors and KKR.

Growth and Diversification

KKR is a company that has grown meaningfully. We have evolved from a U.S.-focused private equity firm into a global investment firm, providing financing solutions and long-term partnership well beyond traditional buyouts. We are able to invest in all parts of the capital structure at various points in the economic cycle due to the variety of our investment funds and strategies.

The following chart illustrates this trajectory during the last six years. AUM and fee-paying AUM have both more than doubled since 2010, with a meaningful part coming from diversification across our Public Markets segment: A catalyst to our asset growth and diversity has been our balance sheet, which has played the lead role in seeding new strategies, funding strategic M&A and supporting our funds through general partner commitments. Opportunistic real estate, real estate credit, healthcare growth equity, and technology, media and telecommunications growth equity – strategies initially seeded with balance sheet capital – continue to show promise, and we believe will further enhance fee-paying AUM and future carry potential over time.





Note: amounts in billions

With more than $12 of book value per adjusted unit and $3.4 billion of cash on our balance sheet as of year-end, one way we're investing in growth is via significant commitments to our funds, as we've done recently with a $1 billion commitment in Americas Fund XII. We believe that larger commitments demonstrate stronger alignment with our fund investors, support our fundraising and simultaneously enhance the diversification profile of the balance sheet, which we believe should reduce investment income volatility over time.

Through the combination of our capital markets capabilities, our balance sheet and our investment funds, we have the ability to quickly and sizably take advantage of opportunities that offer differentiated solutions. This has increased our capabilities to operate meaningfully across the capital structure, and is an important driver of the growth and diversity we've experienced in recent years.

[Through the combination of our capital markets capabilities, our balance sheet and our investment funds, we have the ability to quickly and sizably take advantage of opportunities that offer differentiated solutions.]

Growth at KKR, however, is measured in more than just dollars. While bottom-line growth remains essential in gauging performance, we also partner with our portfolio companies to analyze thoughtful approaches and solutions to some of society's most pressing challenges. Whether it's improving municipal water treatment facilities or funding the development of solar energy, incorporating responsible environmental, social and governance (ESG) practices is a focal point throughout the lifecycle of an investment. These initiatives often have tangible commercial benefits, and our progress on this front is a contributing factor to capital inflows in recent years.

Our Culture

Culture is the fiber of any organization. It ensures we are all working together and guided by the same value system. Our culture is grounded in trust, integrity, partnership and accountability. When we started KKR we wanted to build a collaborative firm, one where everyone is an owner and shares in what we do. We did that in 1976 and it is still the same today. We design and operate our disparate but connected businesses to foster a collaborative and aligned approach where our teams are incentivized to work together, as appropriate, to perform for you and our fund investors.

Today, the firm and our employees invest in everything we do. We are all unitholders. And, as general partner, we are directly tied to our funds, with many of our employees investing personally. As of December 31, 2016, KKR, employees and other personnel had approximately $13 billion invested in or committed to our funds and portfolio companies, including $7.5 billion funded from our balance sheet, $2.6 billion of balance sheet commitments to investment funds and nearly $3 billion of personal investments and commitments.

Bettering our communities

At KKR we recognize that how we engage with our employees and our communities is a critical component of our long-term growth and success. Good governance and a strong culture of citizenship are important to the foundation and the future of our firm.

KKR's citizenship platform is designed to harness the enthusiasm, commitment and potential of our employees in order to better support nonprofit organizations and community causes. That is why we're maximizing our corporate engagement efforts including our Matching Gifts program, 40 for 40 volunteer effort in which employees receive 40 hours of paid time to volunteer and give back to their communities, nonprofit board placement, technical assistance projects and more. For example, through our Matching Gifts program, we have made grants to organizations supporting everything from children's education to environmental conservation to public health and housing. Our portfolio companies have hired more than 48,000 veterans and military spouses through KKR's Vets@Work program, targeted to helping those who have served our country find and keep jobs.

At KKR, we feel it is our responsibility not only to serve our investors through strong investment returns but also to support them by advancing our communities.

Looking Ahead: Building on Financial Strength

As we look to 2017 and beyond, we do so from a position of financial strength. As of the end of 2016, we had $38 billion available to invest across asset classes. With continued performance, we believe there is a compelling opportunity for significant firm-wide growth in the near future. This narrative, coupled with continued cash generation and the power of compounding dollars over long periods of time, is a promising one.

There is no question that the macro environment and volatile political dynamic impacts our outlook. Paired with proposed policy reform in the U.S. and broader economic shifts globally, today's uncertain backdrop makes for a tricky investing environment. However, uncertainty and complexity can create meaningful opportunity for those with patient capital and who have an understanding of the macro, geopolitical, industry and policy trends that create volatility. We have several trends we are excited about globally across asset classes as we shift focus to 2017, a few of which we'll detail here.

We are frequently asked about the opportunity for private equity in the United States. It's hard to ignore that U.S. equity markets may be high and valuations, in many instances, appear steep. Our focus within Americas private equity is to continue to identify fundamentally good businesses that we can make better.

We continue to be enthusiastic about investing in family-owned businesses which have demonstrated strong track records in their local markets and are well positioned for continued growth.

We continue to be enthusiastic about investing in family-owned businesses which have demonstrated strong track records in their local markets and are well positioned for continued growth. Two recent investments, Mills Fleet Farm and Cardenas Markets, meet this criteria. By partnering with their management teams to enhance operational improvements such as inventory management, merchandising and store operations, we have the opportunity to increase their strength and value over time.

An additional area of focus for us is follow-on investments within our existing portfolio. By providing incremental capital in this manner, we can support the growth initiatives and strategic objectives of companies and management teams that we know intimately.

We've also continued to evaluate and invest in opportunities in attractive growth industries. Mitchell and Internet Brands, investments in our North America Fund XI, embody the broad characteristics we seek when investing in these industries: a large market opportunity, strong organic growth, and unique, scalable platforms in a space with good secular tailwinds. We continue to focus on opportunities with comparable prospects.

In Asia we see Japanese conglomerates increasingly willing to shed non-core businesses creating compelling opportunities for firms with deep industry specializations and localized investment teams. We expect this trend to continue, and we feel well positioned to partner with companies seeking to expand their customer bases and distribution networks while accelerating revenue growth and margin improvement. We have two recent investments that fall into this category, where we acquired businesses from household names Nissan and Hitachi.

Turning to credit, we have seen a significant shift in the financial markets where alternative capital providers have become significant and, in some cases, primary sources of capital for companies seeking financing. We believe this change is secular and that our opportunities in this area will grow as volatile markets underscore the value of private sources of capital. As these opportunities in private credit have grown, we think we'll continue to see more attractive economics and better security and protection in larger deals. Simply put, supply/demand is resulting in larger transactions providing, we believe, better returns and less risk.

And through it all, we will be focused on building value for our unitholders and fund investors over the long term.

We thank you for your partnership,

Henry R. Kravis
Co-Founder, Co-Chairman, Co-CEO

George R. Roberts
Co-Founder, Co-Chairman, Co-CEO