

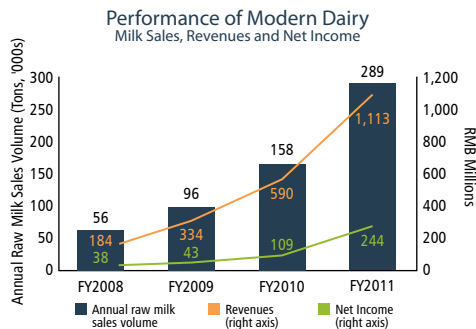
# Case Study: Modern Dairy (China)

## Modern Dairy's Story

As China develops, the growth of large-scale dairy farming is an important priority. Such facilities provide more stable and higher-quality raw milk supply than do smaller, individual farmers through more advanced breeding and feeding technology and disease control programs. This growth is recognized as being in China's public interest.

The largest of these facilities is Modern Dairy, headquartered in China's eastern province of An'hui. Modern Dairy's first farm was built in 2006 and started full operation in 2007. An important part of the company's growth and future plans is built around its partnership with KKR. Modern Dairy's founders recognized the growth opportunity presented in creating a professionally managed, large-scale dairy farming company that would meet the public's demand for safe and high-quality milk. KKR has provided important operational support, expertise and capital to Modern Dairy, enabling them to seize this opportunity.

Since its first farm in 2007, Modern Dairy is now the largest dairy farm business in China, both in terms of herd size and, according to the China Dairy Association, in terms of raw milk production. It has increased its top line revenues from RMB184 million in FY2008 to RMB1,113 million in



FY2011—representing a CAGR of 82%—while expanding net income from RMB38 million to RMB244 million over the same period.

As China's raw milk industry consolidates—currently, individual farmers supply 95% of China's raw milk, compared to roughly 50% in the United States—Modern Dairy aspires to strengthen its position as the market leader in China's large-scale dairy farming industry. Throughout the process, Modern Dairy plans to develop new products to capture revenue from a broader customer base while enhancing the company's operating efficiency, and continuing its incident-free record of food quality and safety.

## The Role Played by Private Equity

**Julian Wolhardt of KKR's Greater China team first met the future Chairman of Modern Dairy, Mr. Deng Jiuqiang, in 2001 while working on an investment in a different Chinese dairy company. That transaction was a success and was a critical foundation for KKR to work with Modern Dairy over a six-month period to create the company's business plan.**

Following the investment, the KKR team worked closely with Modern Dairy to identify operational priorities, develop Key Performance Indicators (KPIs) and implement a rigorous monthly monitoring system, all of which were tied in to a new long-term equity incentive plan for management. KKR also helped Modern Dairy

secure insurance coverage for its dairy cows, and played an instrumental role both in advising on strategic acquisitions and in securing a 10-year offtake agreement with Mengniu Dairy, the leading branded milk player in China, to ensure 100% offtake of Modern Dairy's production.

KKR Capstone, a dedicated operations team that works exclusively with KKR's portfolio companies, spent 16 months on the ground working side-by-side with Modern Dairy's management team to identify and implement operational efficiencies and productivity improvements. This work included feed purchasing, breeding improvement, disease reduction, and risk prevention to manage dairy farm-specific risks such as disease and food safety. ▶

### The Company



### Essentials

**Company:** China Modern Dairy Holdings Ltd., [www.moderdairyir.com](http://www.moderdairyir.com)

**Country:** China

**Sector:** Agribusiness

**Business focus:** Dairy cow farming and milk production

**Size:** Revenue RMB1,113 million (US\$172 million, FY2011); 16 large-scale farms across China

**Investor:** Affiliates of Kohlberg Kravis Roberts & Co. L.P. (together with its affiliates, "KKR"), a leading global investment firm established in 1976, with US\$61 billion in assets under management ([www.kkr.com](http://www.kkr.com))

**Date of commitment:** June 2008

**Investment:** KKR invested US\$150 million for a 33% stake

### Impact Highlights

Modern Dairy's revenues grew from RMB184 million (US\$27 million) in FY2008 to RMB1,113 million (US\$172 million) in FY2011, representing a CAGR of 82%

With support from KKR, management and operational systems have been implemented in line with global best practices, resulting in EBITDA margins for FY2009, FY2010 and FY2011 of 17.8%, 20.5% and 28.3%, respectively

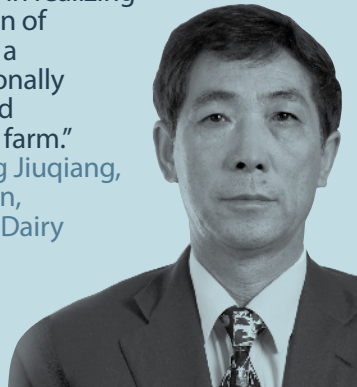
Management incentives and a commitment to quality and risk mitigation have enabled Modern Dairy to maintain an incident-free record of providing safe milk to consumers

Improved milk yield by 26% via improved nutrition, breeding, and reduced disease rate

# The Company View

“KKR has been integral to our business from inception. It has helped us to develop international best practices with local application, which have enabled us to expand quickly. They are true partners, working alongside us at every stage of Modern Dairy’s development. They have proved themselves more than able partners in realizing our vision of creating a professionally managed industry farm.”

Mr. Deng Jiuqiang,  
Chairman,  
Modern Dairy



“Modern Dairy is well-positioned to seize the long-term market opportunity in China to deliver high quality dairy products. We have been honored that they have chosen to work with us on key business strategies and operational improvement plans. Years after investment, our partnership continues. Going forward, we continue to look forward to working with them hand-in-hand as they continue along that path.”

Mr. Julian Wolhardt, Member, KKR

▶ Taking feed purchasing as an example, the KKR Capstone team helped the company redesign and implement an end-to-end process all the way from demand estimation and supplier identification to processing and storage. All purchasing managers at HQ and in every farm now use exactly the same process and tools to conduct their daily work. As a result, not only was the company able to secure the best quality feeds for cows, it also reduced cost by 3% and drove an estimated 4% increase in Modern Dairy’s EBITDA in 2010.

Moreover, as a team, Modern Dairy and KKR Capstone developed Standard Operating Procedures (SOPs) covering all key aspects of dairy farm operation such as breeding, nutrition, feeding, purchasing, and disease management. Combined

with the company’s modern technology and infrastructure, these SOPs allow Modern Dairy to expand rapidly by replicating its operating and managerial models in new markets. It now has 16 farms and a total herd of approximately 110,000 cows. It plans to build a total of 30 farms by 2015.

Following the company’s successful IPO in November 2010, which raised US\$448 million, KKR is gradually transitioning from a role of day-to-day operational support to on-going counsel. KKR plans to continue working with Modern Dairy’s management team to ensure existing operational initiatives generate sustainable results, and to provide an intensive support role whenever necessary. In addition, KKR will also continue to work with Modern Dairy on its environmental initiatives.

“KKR has brought in not only capital, but more importantly, international best practices and expertise in the dairy farming industry that have helped us at Modern Dairy to develop world-class facilities and meet our growth ambitions.”

Ms. Gao Lina,  
CEO, Modern Dairy



## Beyond the Bottom Line

**In recent years, the Chinese dairy industry has garnered international attention following melamine milk tainting episodes. Modern Dairy, with its priority focus on providing safe, higher-quality milk to customers in China, was not implicated in these scares. The company’s management works to ensure food safety testing is conducted on-site, and to provide a secure supply chain for milk in transit from the farm to the distribution centers. Moreover, safety is a critical KPI and incentive for Modern Dairy’s management; if there is a single incident regarding food safety, managers will lose at least the entire year’s bonus.**

In addition, Modern Dairy has developed a program of working with local farmers to procure silage for the dairy cows’ feed. Together with KKR, Modern Dairy is educating local farmers on how to increase their crop yields and production. These activities are increasing local farmers’ incomes while securing a cost-competitive high quality feed supply for Modern Dairy’s continued growth.

