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PE in Emerging Markets:

Can Mekong Capital's Operating Advantage Boost the Value in its Exit from Golden Gate Restaurants?

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Note: This case contains fictionalized material for a board meeting to deepen the problem-solving perspective.

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On a balmy evening in July 2013, Chad Ovel, a Partner at Mekong Capital, Vietnam's first private equity firm, sat at his desk in the firm's Ho Chi Minh City headquarters. The air-conditioned comfort of the office was a far cry from how the day had started. At 4 am he had been in the central kitchen of the Golden Gate Group, a restaurant chain operator, observing a manager taking shipments of produce and checking inventory levels. Over the previous two days, he had visited the kitchen of every Ho Chi Minh City outpost owned by Golden Gate.

Mekong Capital had held a 15% growth equity stake in Golden Gate for the past five years, during which the group expanded profitably from one restaurant concept with five locations to 10 concepts and 58 locations. By 2013, Golden Gate was on track to generate $6.3 million in EBITDA, representing a 34% annualized increase in traffic and a 33% annualized increase in EBITDA since Mekong Capital's initial investment. The window to realize a return on its stake in Golden Gate was fast approaching.

Private equity fund limited partners (LPs), which typically consist of pension funds, sovereign funds, family-office capital and fund-of-funds investors, expected to exit their investments within five to seven years, if not sooner. Chad found himself thinking that although growth was impressive at Golden Gate, were the restaurant operations optimized sufficiently? Was the management team ready to show a new owner that a solid platform for future growth was in place? These were the questions the team needed to focus on, but being new to the restaurant trade and from an operational background, he wondered whether Golden Gate management – much less the team at Mekong – would pay heed to his concerns.

When a business grows substantially (as was the case with Golden Gate), LPs expect cash-on-cash returns to increase. Despite Golden Gate's expansion, it was still subject to the usual emerging market investment challenges – an addiction to growth, elusive profits and even rarer exits. Indeed in 2012 Golden Gate had disappointed in terms of both profitability and same-store sales in many of its locations. If I were the acquirer or an underwriter, Chad asked himself, would I believe that this past success would continue or not? Would I be comfortable bidding for the restaurant chain? And if I did, would I pay full price?

Fifteen years running Vietnamese businesses and a successful experience as a turnaround CEO led Ovel to question the restaurant chain's 'readiness' before its investor's exit. After what he had seen in the kitchen that morning, he was convinced that it was not positioned to maximize value. More importantly, he could see how operations could be enhanced in a relatively short period of time to attract multiple buyers and warrant a premium offer, or persuade an underwriter to launch an IPO and support serial sales of Mekong-held shares.

Until now, the management team had championed continuation of its expansion plans as the best way to create value for shareholders. Tomorrow morning, Ovel would propose a radical shift in Golden Gate's strategy—to stop opening outlets. He would call for a moratorium on new locations and hone in on back-of-the-house improvements, convinced that incremental improvements in the supply chain and kitchen would drive the most value – not only for Mekong before exit but the remaining Golden Gate shareholders over the long term.

As this was his first major initiative since joining Mekong Capital as a partner and assuming the role of deal leader on Golden Gate, Ovel knew he was taking a risk by going against the prevailing pursuit of 'growth for growth's sake'. Golden Gate's board consisted of five members – Ovel, one other outside director, and three members of the Golden Gate management team. Golden Gate management was passionate about finding new locations and developing new concepts – it was their main strength. Would they, he wondered, be willing to listen to him, being new to the situation and having an operational rather than an investment eye? With the right incentives in place it might be possible, but he would have his work cut out for him in the coming months as he managed the exit process.

Ovel took a deep breath as he left the office and hailed a cab to the airport for his trip to attend the Golden Gate Board meeting in Hanoi. He hoped the overnight flight would be uneventful – tomorrow was going to be a test.

Private Equity in Asia

Investment tends to take a different form in emerging markets. Over 88% of the deals done across Asia to date have been "growth equity", a term denoting a minority investment in which the invested capital is used primarily to fund growth rather than buy out existing shareholders. As a growth equity investor, a PE firm must persuade the management team to take them seriously (as opposed to control investments where PE firms can force decisions if necessary). While agreed-upon rights exist for minority investors, their enforceability is questionable. This is in contrast to US management buyouts, where gaining control is the model on which the PE phenomenon is built. And different from the venture capital industry, where an entrepreneur's ownership is diluted, often to less than 50%, by multiple investment rounds as the start-up grows. The popularity of growth equity in emerging markets was in part a product of the business culture – founders and owners (often families) were extremely averse to giving up control.

Exiting such investments could prove challenging. Markets tended to be less liquid and less developed, making public offerings difficult, and there were fewer trade buyers capable of executing a third-party sale. Often a family was reluctant to sell its entire business to a trade buyer because of the family legacy embedded in it, preferring an IPO which left family members in charge and enhanced their prestige in the community. In 2008 when Mekong first invested in Golden Gate, the relatively young PE firm had no track record of exiting investments. Later it developed one of the best track records in achieving realizations from all of its emerging market investments, exiting or partially exiting 19 of its 26 investments by 2014.

Background: Mekong Capital

Founded by Chris Freund in 2001, Mekong Capital was an early mover as a local Vietnam-focused private equity firm. Like many emerging market investment sponsors, the early days involved trial-and-error experiments. Mekong's first fund invested primarily in the low-cost manufacturing sector, with limited success.

Shift to a Consumer-Focused Strategy

Mekong's 2008 investment in Golden Gate was part of its second investment vehicle, MEF II. After studying Mekong's previous successes and failures, Freund saw that the majority of his achievements had come from investments in consumer-facing businesses. Over time the firm would focus entirely on this segment, in part because Vietnam had the fastest growing middle class and affluent consumer base in the region (See Exhibit 1).

Another key consideration was that exit possibilities in the consumer segment were more robust: acquirers and stock markets had proved to favour consumer-driven businesses. Also, there was very little government intervention in the sector and ample investible opportunities. As Mekong continued to develop sector know-how and operational expertise, it believed it could offer entrepreneurs incremental capabilities as distinct from investors that simply offered capital.

Evolution to a Hands-on Operating Improvement Strategy

Over the years, the firm had grown the depth and breadth of its operating involvement. Helping businesses improve operationally had become the cornerstone of Mekong's value-creation strategy. At first, Mekong provided assistance with accounting normalization, governance structure, enhanced reporting measures and goal setting. Little by little, it added other services as the need arose. It began to recruit executives for portfolio companies, as finding talent became increasingly challenging. As of June 2015, over 65 executives recruited by Mekong's talent team were deployed at its portfolio companies. In turn, operating advisors were engaged with functional or sector expertise.

Recruiting Chad Ovel was an extension of Mekong's operating-centric vision. Although Ovel joined Mekong in 2013, Chris Freund had met him in 2004. A native of Iowa, Ovel had been in Vietnam since 1996, learning fluent Vietnamese while working in a number of managerial and business development roles. When Mekong founder Chris Freund first met Ovel, he was running the largest furniture exporter in the country. Freund appreciated Ovel's depth of experience and practical leadership, and recruited him to lead the turnaround of AA Corporation, a Mekong portfolio company. In six years as CEO of AA, he revived the struggling company, growing revenue 12-fold and generating a 50%-plus EBITDA annualized growth rate. When Freund asked Ovel to join Mekong Capital in 2013, he did not realize how fruitful the relationship would be.

VOB is Formed

To formalize the structure, with the help of a retired partner from Clayton, Dubilier & Rice (CD&R), the first US-based operating-centric PE firm, Mekong Capital created a value optimization board (VOB). The VOB structure gave Mekong and its portfolio companies access to world-class expertise that was otherwise unavailable in the local market (see Exhibit 2). For example, around the time of Mekong's Golden Gate realization, Pete Bassi, former CEO of Yum! International joined the VOB board. As chairman and president of Yum!, he had overseen more than 12,000 restaurants (60% KFC, 38% Pizza Hut, 2% Taco Bell) spread across 100 countries, representing over $10 billion of sales and $500 million in profits annually. Bassi had personally led the expansion of KFC and Pizza Hut across Asia, opening over 1,100 new units each year around the globe.

A VOB director's responsibilities can be broad—they range from sourcing new investments, providing and evaluating operating initiatives to increase value, and working with the firm's management teams to drive operating gains throughout the life of the investment. Moreover, to ensure VOB directors' are compensated in a way that aligns their interests with those of

Mekong Capital, each member of the VOB earns carried interest and is accountable for results. Ovel explained:

> *"Our VOB has decades of experience between them. It would be difficult to recruit this level of talent on the ground, or find a consultant with the same credibility. Also, unlike working with a consultant, we have a long-term relationship with our VOB directors and they want to see us succeed."*

Deal Origination

Reading the Tea Leaves

Mekong Capital's deal origination strategy evolved towards a top-down approach, looking for the best management teams and potential sector winners while developing long-term courtships. Its calling card was its reputation for building the best-managed businesses in Asia, while the firm provided wealth-creation opportunities for managers and co-owners. This went a long way to creating preferred positions when investment opportunities arose. At the time of Mekong's investment in Golden Gate, however, intuition played a key role in identifying the opportunity. Freund recalled how, in July 2007:

> *"I was in our Hanoi office, drinking tea. I looked at the label - Cozy Tea - and on a whim I thought there might be an investment opportunity in the tea company… their website redirected to Ashima [which became Golden Gate's first restaurant brand]. Vinh was the founder of both the restaurant and the tea company. We did a bit of research and thought the restaurant looked like a more interesting opportunity… The sector was attractive to us but there was not a lot of validation in Vietnam because there were no public restaurant groups. There was really only one other fairly big chain and it wasn't profitable."*

Courtship Inspires a Deal

Following up for Freund, Tran Thu Hong, Mekong Capital's Hanoi-based deal leader, reached out to the founder Vinh (see Exhibit 12 for an index of names). At the time, Vinh was not looking for equity investment and had rebuffed several other suitors, as Tran Thu Hong explained:

> *"Although Vinh was not interested in an investment, we had a mutual friend so Vinh was willing to meet me just to chat. We started discussing his business on a regular basis. We talked about his vision, what he wanted to achieve. He already had another concept in mind…. I encouraged him to think bigger and we spoke about expanding to 50 locations."*

Through their weekly conversations, Vinh started to refine his vision for Golden Gate's growth and to realize he might need an equity partner. But it wasn't until he spoke to a fellow entrepreneur that he decided to move forward with Mekong Capital. The firm introduced Vinh to Nguyen Duc Tai, CEO of another portfolio company, Mobile World. Vinh recounted:

> *"[Tai] told me his story. After speaking with him I believed that going with a private equity fund was the right thing to do. I also knew that Mekong Capital was interested in more than just making money on its investment. They would help me build my business and lend outside credibility. Another thing that attracted me was Chris Freund's reputation for integrity. I felt that while we may have disagreements over direction in the future – as is true in any venture – his word was good. Having a firm I could trust as a partner was critical to me."*

Negotiations were short and sweet (see Exhibit 9 for an overview of negotiations in Asia)**.** According to Vinh,

> *"I didn't see valuation as the primary issue… I was selling a stake to bring in a partner that could help me grow faster than I could on my own. That was the bet. I was more interested in whether or not Mekong Capital could help me make my business better or not than I was in selling a minority position for the highest price. We would make far more from our remaining ownership if they were as good as I thought they were in helping me develop the business to its full potential."*

After several months of due diligence, Mekong Capital purchased a 15% stake for US$1.5 million in January 2008.

Golden Gate and Growth

The Opportunity

Despite a lack of viable restaurant chains, the Vietnamese dining sector was aided by attractive economic and demographic trends: it was the 13th most populous country in the world, with 89 million[1] people as of 2013 with an average age of 29. (See Exhibits 3-5 for additional economic and demographic data.) Since initiating economic reforms in 1986, Vietnam had been slowly transitioning from a centrally-planned economy to a free-market economy. With the transition had come strong growth in exports, as well as in the industrial and consumer sectors. According to the World Bank, in 2014, GDP grew 6% in 2014 and the rate was expected to continue through the next year and accelerate in 2016. Vietnam had also managed to improve its macroeconomic stability, curbing inflation to a manageable 4.1% in 2014.

The food service sector had grown 9.2% between 2006 and 2011, one of the fastest rates in the region.[2] Yet competition in the seated casual dining space was limited. While KFC had been present in Vietnam since 1997, McDonalds did not open its first location in the country until 2014. Nearly 80%[3] of local Vietnamese restaurants outlets were kiosks or food stalls with little indoor seating.

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1 World Development Indicators, World Bank.
2 East West Hospitality Group Report
3 *Ibid.*

Successful examples from other parts of developing Asia had shown the restaurant business to be highly scalable. Hotpot restaurants like Ashima were especially attractive, with relatively low start-up costs and limited kitchen equipment required. In Thailand, local restaurant companies such as Thai-Chinese-Japanese hotpot restaurant Coca Group and multi-concept Syndicate Public Group had each established over 50 locations. Syndicate Public was even traded on the Thai Stock Exchange. In China, by 2007 the Forever Pride (Little Sheep) hotpot chain was ranked the number two retail chain with over 400 company-owned outlets (see Exhibit 6).

Even within the restaurant segment, Golden Gate stood out for its strong management team and modest start-up costs. "Vinh and his co-founders were clearly A-players," said Freund. "There was a real leadership team, and the decision-making process was very collaborative."

Meagre Beginnings

In 2003, Vinh started a teabag company in Vietnam marketing directly to consumers. Although Cozy Tea became Vietnam's second largest teabag brand, stiff competition from Lipton made it difficult to translate market share into profitability. In 2005 while still managing the tea business, Vinh decided to open a restaurant in Hanoi that served mushroom hotpot and featured vibrant interior design and exotic ingredients.

Even though the price point initially seemed beyond the reach of the average Vietnamese consumer, Ashima became a huge success overnight. It took only three months for the restaurant to pay back the initial investment (compared to an average of 2-3 years for quick-service restaurants in the USA). He quickly shifted his attention from the struggling tea business to the restaurant sector, opening additional locations. When Tran Thu Hong first contacted him, the company had five Ashima restaurants in Hanoi and Ho Chi Minh City.

Adaptability and Expansion

After Mekong's investment (2008), Mekong and Golden Gate agreed on two priorities: First, they decided to continue building out locations to reach an ambitious expansion target of 50 locations by 2012. Second, to strengthen the management team.

Golden Gate was already planning to launch a second concept, Kichi Kichi, a conveyor belt hotpot chain with an average ticket of US$11, less than half that of Ashima. Freund commented:

> *"At the onset, one of my biggest concerns was the leap to multiple concepts. Golden Gate had always been excited about multiple concepts and at the time they had only had one."*

Launched in 2009, Kichi Kichi was not an immediate success. Its first outlet, located inside a mall, failed. After revisions to the initial concept and the decision to choose street-front locations, Golden Gate was able to open several successful branches of Kichi Kichi, as Freund affirmed:

> *"Golden Gate proved to be really good at experimenting. They were always tinkering with décor, menus, and concepts."*

Golden Gate's adaptability was well-suited to the changing tastes of Vietnam's rising middle class. Diners were hungry for new experiences, many having limited travel experience outside of Vietnam. According to market studies, the Vietnamese consumer was value driven (focused on both quality and price), with a preference for Asian cuisine while open to new concepts. Younger consumers were rapidly developing brand awareness and loyalty. Golden Gate played to these trends. A year after the Kichi Kichi launch, it started Sumo BBQ, a Japanese table-side grilling restaurant. A year later, it introduced Vuvuzela's, an upscale Western-style sports bar offering draught beer and Asian and Western food (see Exhibit 7 for its restaurant concepts).

This rapid expansion was not without growing pains, as Vinh recounted the story about his failure to dig roots in Singapore:

> *"After we got investment, we started to think we were a big company and had to think global. We made the decision to go to Singapore. We thought it would be a great market to bring a Vietnamese concept to a global audience, but we simply were not ready."*

After the failure in Singapore, Golden Gate refocused its attention on the domestic market, where it now had to keep pace with the ultra-competitive market for real estate and talent in Vietnam's two largest cities, where all its restaurants were located. In 2013, its home city of Hanoi had 6.9 million residents and per capita income of US$2,985. Ho Chi Minh in the south boasted 7.8 million residents and per capita income of US$4,513, more than twice the national average. The relatively strong buying power of Vietnamese consumers in these "tier-one" cities made them attractive, but their robust economies also made competition for locations and people particularly fierce. It was difficult to procure sites suitable for restaurants, as Ovel explained:

> *"Vinh had specifically asked for the authority to take locations whenever he could. Taking locations is very opportunistic… he didn't want to have to take it to the board; he needed to make decisions quickly."*

Building Talent

Finding talent also was an issue, especially in Ho Chi Minh City. With Hanoi and Ho Chi Minh City more than 700 miles apart, each required its own central kitchen and managerial staff. Vinh and his cofounders, all natives of Hanoi, found that "the experience in Ho Chi Minh was totally different [than Hanoi]. We struggled for five years to find the right management." Freund recalled how Golden Gate needed talent to fuel its expansion strategy:

> *"Early on, I worried about the management team. Are they going to recruit professionals? They had fairly junior marketing and finance staff. It was a slow build, but eventually they were able to create a great team."*

With Mekong's help and suggestions, Golden Gate recruited a new COO, CFO, and HR director. A big breakthrough came in 2011, when Golden Gate recruited Nguyen Cao Tri, a food service veteran from KFC, to run its Ho Chi Minh operations. Vinh explained:

"[Tri] saw everything wrong with the structure, marketing, operations. He brought best practices from KFC, and he was motivated."

Missed Target

In 2012, despite growing from four to eight concepts and increasing the number of outlets from 36 to 41, Golden Gate's customer traffic slid (see Exhibit 8). While still profitable, it missed its earnings targets in 2012 and same-store sales growth declined across many of its established outlets.

Adding to the tensions, Freund had verbally agreed to Vinh's proposal made earlier in the year, that the company would buy back 11% of its shares from one of his co-founders based on a US$27 million valuation at a P/E ratio of 6x, which in turn was based on the expected 2012 net profit target. As the year progressed, net profit performance was significantly off track, such that the P/E of the buyback at the agreed valuation ultimately looked to be a P/E ratio of 10-12x – nearly double that of what was previously agreed. Expecting the buy-back proposal to be submitted to the board and that the terms would not be finalized until approved, Freund then learned that the agreement had already been executed and board approval was merely a formality.

The resulting deadlock took several months of discussions to resolve. Ultimately, Freund took responsibility for not having communicated clearly with Vinh that his initial support for the plan was "on principle", and that the final terms would have to be approved by the board before the buyback was executed. Freund ultimately agreed to do the buy-back at the $27 million valuation. Vinh acknowledged:

"Chris's reputation for integrity was impeccable. He did not disappoint. While we may have different opinions, we could trust that his intentions and objectives were for the good of the company."

Maximizing Value and Creating a Profitable Pathway for Future Owners

Growth vs. Value: Changing tack?

By 2013, Golden Gate had 10 concepts and 58 restaurants. The company had grown into one of the only multi-concept chains in Vietnam and had a professional management team. But needless to say, the cloud of the 2012 performance still lingered on in the mind of Chris Freund. He and his new partner Chad agreed that Ovel should take over as Mekong's deal leader for Golden Gate:

"We had agreed that Mekong Capital's exit from Golden Gate was to be imminent. It was surprising… here was a very good business, yet no one here could generate what a clear investment thesis for a new buyer looked like."

In order to create a compelling value proposition for the next owner or for public shareholders, Ovel's first order of business was to understand Golden Gate from top to bottom, from customers to suppliers:

> *"None of my predecessors at the firm had been to the central kitchen or looked into the supply chain in great depth. Interactions had been limited to the board room, the head office, and casually visiting some of the restaurants."*

While Ovel was new to restaurants, he was well-versed in working capital and supply chain management. After a few days visiting Golden Gate kitchens, he believed fundamental changes in the back-of-the-house could make Golden Gate a more profitable and desirable acquisition target:

> *"There is a tendency to focus on what is going well: great interior design, great locations, and great menus. The front of the house was working well but everything else was delegated to someone else. I was convinced the back of the house was the number one driver for margin expansion. We could increase profitability, improve working capital and improve the customer experience – ensure faster service times and deliver every item on the menu – if we focused on the kitchen and supply chain, and created the right KPIs…."*

> *"At the time, there was no demand forecasting from restaurants to the central kitchens. All communication was paper and email. With nearly 60 stores, I couldn't believe there wasn't an IT system in place. And then there was the supply chain. If a vendor would turn up with a truck full of lettuce and the kitchen didn't need it that day, they'd say they were rejecting the shipment due to poor quality. This kind of practice just amplified the inefficiencies."*

To date, Golden Gate's success formula had emphasized top line growth. Vinh's team were considered 'tastemakers', skilled at launching new concepts. Managers were rewarded based on store traffic and footprint expansion. Ovel believed that if Mekong's exit were to occur via a trade sale, it would be efficiency, not topline growth, which would command a higher price. He was convinced that implementing a new set of operational value key performance indicators (KPIs) around wastage, spoilage, input costs and optimizing payment terms with vendors was a critical first step. In order to measure KPIs at a store level, he would have to work with Golden Gate's CFO to design an adequate cost-accounting system and establish a basic enterprise resource planning (ERP) system.

Ovel also believed a supplier education programme could improve the quality of ingredients. In Vietnam there were few farms large enough to be Golden Gate's sole supplier, so Golden Gate had to work with many small suppliers for every ingredient, reducing consistency. By working closely with farmers, he thought Golden Gate could get produce and other key ingredients delivered to its own specifications.

Operating Advisors and External Visits

Mekong Capital brought in a number of its operating advisors to present to Vinh, including prominent restaurant consulting groups from the US and Hong Kong. Ovel explained the tactic:

> *"We couldn't be relevant in the same way [as restaurant experts]; we couldn't provide companies best practices from their industry. For Golden Gate, we could tell them how to make an investment report, build a company culture … but we*

> *couldn't tell them to restructure their kitchen or cook a sauce…. So we looked for consultants who could provide sector insight, operational depth, and had the credibility to drive change."*

'Seeing is believing' for many management teams in an emerging market. Most are very inward-facing with little exposure to best practices and formal training. Golden Gate's senior management team visited Hong Kong-based Maxim's, Thailand's Central Group, and Chicago-based Lettuce Entertain You. Said Vinh:

> *"Visiting restaurants overseas gave me new ideas… it helped to see it for myself. After my trip to Chicago [to visit Lettuce Entertain You], I wanted to change [Golden Gate's organizational] structure. Golden Gate had a 'top-down' system, where regional and store managers reported to headquarters. As Golden Gate grew in size and complexity, it was increasingly difficult to maintain the centralized structure. Lettuce Entertain You had more than 40 concepts. They could have more concepts because they were organized with a bottom-up profit sharing structure. The back office just supported them, it didn't command them. People at the restaurant level became decision makers and were able to develop their creativity."*

Ovel's proposed change in KPIs dovetailed with Vinh's proposed organizational shift as both required new reporting processes and systems in order to move accountability to the restaurant level.

One of Mekong's operating advisors, Joel Silverstein of East-West Hospitality Group, was brought from Hong Kong to review operations. Silverstein's verdict was that "Golden Gate was a pretty well-run chain before I walked in the door. We were making incremental improvements… nothing that would double or triple their income overnight." He outlined additional measures to consider*:*

- **Buying "the whole cow":** Golden Gate sourced its beef from North America and Australia, and used this as a key part of its advertising around quality ingredients. Beef accounted for nearly 40% of Golden Gate's costs, since most of their businesses were beef-related and beef prices were at a 25-year high. Silverstein recommended they buy "the whole cow" and increase the yield to 90-95% of each cow using special butchering techniques.
- **Developing a recipe management system:** This would allow Golden Gate to see critical operational metrics (such as waste and cost of each menu item) on a dish-by-dish basis, even more granular than the systems Ovel was proposing.
- **Lowering pricing:** All of Golden Gate's concepts had an average ticket of over $10, which Silverstein believed killed scalability. By contrast, the average ticket at a competing Vietnamese chain, Al Fresco's, was US$5, while Pizza Hut's was $6-7.
- **Expanding beyond Tier One cities:** Silverstein believed Tier Two Vietnamese cities were under-penetrated. Comparing his experience in Thailand and China, he foresaw good development opportunities in the next 5-10 years, although affordability would be key.

More Expansion Now?

Expanding beyond Hanoi and Ho Chi Minh (Tier One cities) had been in the back of everyone's mind for some time. Over 80% of Vietnam's population lived outside of Hanoi and Ho Chi Minh City. In the second tier were two cities with over one million inhabitants, as well as several other larger conurbations. Few international or national restaurant chains operated in these markets, leaving them relatively untapped.

An expansion strategy seemed especially timely in early 2013. Golden Gate management had heard rumours that the largest property developer in Vietnam, VinGroup, was about to announce the building of 22 new shopping malls in Tier Two cities throughout Vietnam by the end of 2016. VinGroup's malls would focus on entertainment and dining to drive traffic. Aside from fast food companies, Golden Gate and its multiple brands would be the perfect tenant for VinGroup. The potential could be anywhere from 50-75 new restaurants, as each mall could easily house 2-4 different Golden Gate concepts. Once Golden Gate had a reason to reach into Tier Two cities, they could piggyback on the new supply chain to add high-street locations in each major Tier Two city, easily resulting in 200-plus restaurants by the end of 2017.

But this strategy was not without its risks. Urbanization was only slowly chipping away at the rural population and per-capita income was significantly lower in these secondary markets, as Ovel explained: "Expanding operations in Tier Two was unique and different in many respects than toiling in the Tier One markets where managers had been concentrating on to date." The logistics of supplying restaurants hundreds of miles apart could be challenging, and recruiting and training talent might be difficult.

Preparing to Exit

Ovel started working with Golden Gate's CFO to get the books in order. He had been working in parallel with Golden Gate leadership to put together a stock incentive plan for key employees, as he believed certain employees, such as Tri (director of Ho Chi Minh City operations) were the key value-builders of the business. No matter which avenue – optimization or expansion – Golden Gate pursued, these were necessary steps before an exit could be completed. Just as Ovel had brought in operational advisors to help formulate a plan, he sought their counsel as to the efficacy and value that could be achieved by both exit pathways to hear their recommendations before the upcoming board meeting.

The Board Meeting

Exit Advice Prior to the Board Meeting

Ovel spoke with Nguyen Son Duy, who covered the consumer sector for Hanoi Securities, a leading local investment bank, to get his assessment of taking Golden gate public 12 months out. Enthusiastic at the possibility of underwriting the IPO, Duy met with Ovel and several Golden Gate board members, sharing a brief pitch outlining the process and considerations for taking Golden Gate public. In it, he explained how Mekong could sell all of its stock in the IPO offering, or sell a portion in the IPO and hold out for a higher valuation later, offering secondary shares down the road. It was Duy's opinion that the highest ultimate value for the business was through public ownership, given the emerging bull market in Vietnam. He believed that after going public, Golden Gate could gain a premium over the market price as part of a trade sale down the road, in essence double dipping on value. If Golden Gate were to continue on its aggressive growth path, Duy estimated that the company could be worth at least $300 million if ownership was retained and the company sold to a strategic acquirer in five years (Exhibit 10 summarizes his valuation).

The Hanoi Securities pitch was circulated to the entire Golden Gate board. Several members had already indicated agreement with the bank's analysis that an IPO and aggressive growth strategy represented the best avenue for value maximization.

In terms of operating strategy— the dilemma whether to focus on either expanding units or focusing on margins in existing locations over the near term— Duy was unequivocal in recommending footprint expansion as a priority. Moreover he was a strong advocate for entering the Tier Two market in full force, explaining it would make a better story for the IPO. Privately, Duy shared that the glamor of being a first mover in these huge untapped population clusters would make their job easier in attracting growth-minded investors; the IPO buyer in this market was conditioned to favour aggressive growth stories and loved 30%+ growth rates. Although there were no major restaurant group IPOs he could cite as an example, Duy mentioned several recent listings of consumer goods companies that had experienced major pops in value, and referred to the success of food & beverage listings on the neighbouring Thai Stock Exchange, such as S&P, a quick-service restaurant with a market cap of over US$100 million.

Ovel was not so sure. From informal conversations at a recent Asian Food & Beverage Convention he believed a number of international restaurant groups and possibly private equity firms with existing restaurant chains in their portfolio would be interested in Golden Gate. In order to get a complete perspective on a sale to another industry player or PE buyer, he contacted several global investment banks with food sector expertise.

One Hong Kong-based banker took the view that unit profitability and same-store sales growth would be the cornerstone of value for an acquirer, and sent along a research note on the food service sector which seemed to support this idea. If Golden Gate were sold in a trade sale, recent disappointing same-store results would be a deterrent to maximizing value, he explained. Moreover, while the Tier Two expansion was an attractive part of the Golden Gate value proposition for a trade or PE buyer, they would likely appreciate the potential growth without Mekong Capital having to actually prove it. Indeed, the risks of opening a small sample of Tier Two locations might be too great to make this a viable short-term strategy.

Finally, Ovel sought the advice of selective restaurant leaders who had bought other chains like Golden Gate. Exhibit 11 includes examples of acquirer criteria from industry expert Pete Bassi, based on his extensive acquisition experience when expanding YUM! International's Pizza Hut and Kentucky Fried Chicken across all of Asia.

Anxious Moments Preparing for the Debate

Settled in his hotel room in Hanoi, Ovel began to gather his thoughts for the meeting ahead. He mulled over the exit alternatives. Were the pros and cons of each option laid out sufficiently? Were the risk/reward assessments clearly identified by the board from the conversations with the underwriter and acquisition experts from the global firms (see Exhibit 12 for index of names)?

An IPO was intriguing, but was the Hanoi Securities' assessment focused more on current market conditions than longer term profitability fundamentals? Stock market sentiment was fickle: sooner or later the underlying existing unit underperformance – if not rectified – would detract from the value on the stock market.

Could the management team handle at the same time growth in new markets and improving efficiency? Was it more prudent to focus on improvements first and look to an acquisition as the most likely and timely route to exit? How convinced should he be that Tier Two expansion was the right move before fixing existing units? How big of an operational leap was involved in opening in more rural locations? Was postponing near-term cash realization the right thing for his investors?

From stimulating same-store sales growth, to introducing new KPIs, to creating a supplier education program, there had to be priorities. Many of these improvements were worthwhile and could be part of a compelling value proposition for an acquirer, but Golden Gate would have to prioritize. It simply did not have the resources to undertake them all at once.

Ovel was hoping for board buy-in the next morning but realised it would be difficult to get. These were two very promising exit pathways with diametrically opposed operational implications. "How should I frame my presentation?" he wondered.

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Exhibit 1

Middle Class and Affluent Population of Vietnam

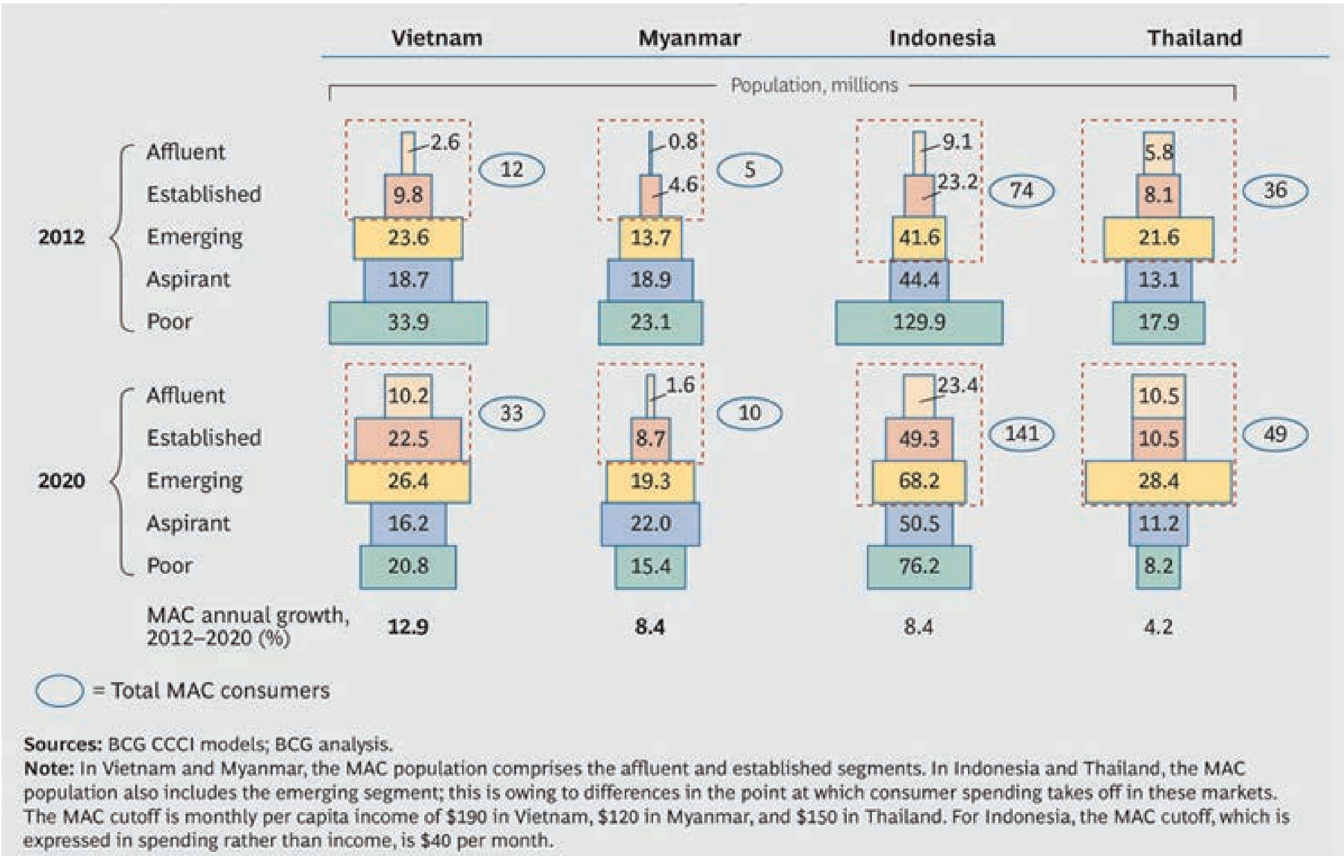

Exhibit 2

Value Optimization Board at Mekong Capital (May 2015)

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Exhibit 3
Gross National Income per Capita (Thousands USD, PPP), 2005-2013

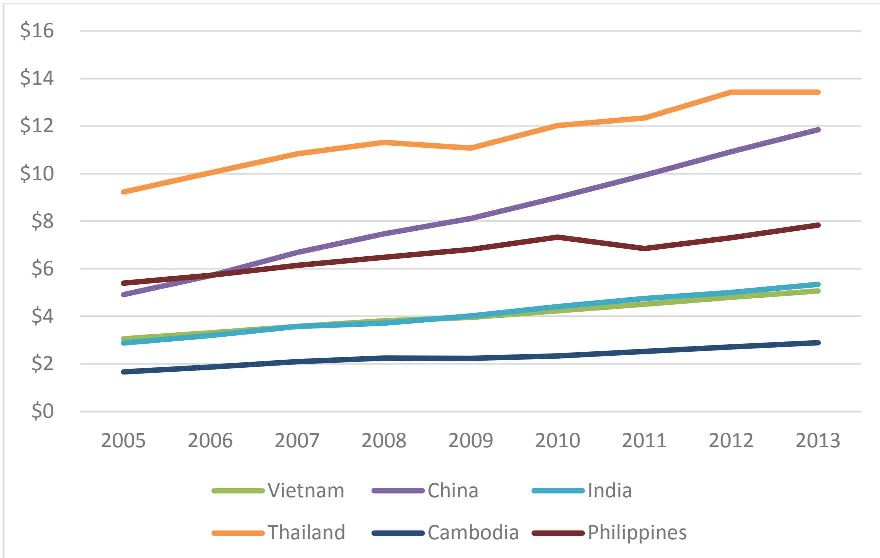

Exhibit 4
2013 Population (in millions) for Select Countries

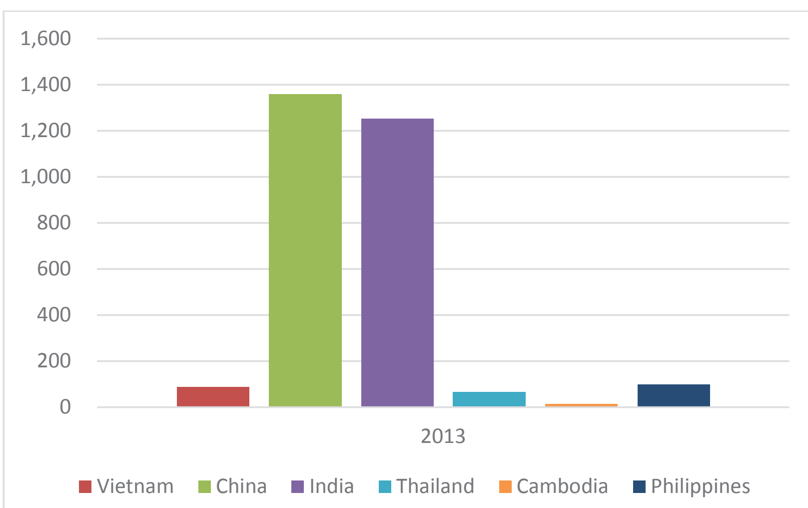

Exhibit 5

Real GDP Growth of Southeast Asia, China and India (annual percent change)[4]

	2012	2018	2014-18	2000-07
ASEAN-6 countries				
Brunei Darussalam	1.0	2.4	2.3	-
Indonesia	6.2	6.1	6.0	5.1
Malaysia	5.6	5.3	5.1	5.5
Philippines	6.8	5.9	5.8	4.9
Singapore	1.3	3.1	3.3	6.4
Thailand	6.5	5.3	4.9	5.1
CLMV countries				
Cambodia	7.2	7.1	6.8	9.6
Lao PDR	7.9	7.5	7.7	6.8
Myanmar	-	7.0	6.8	-
Viet Nam	5.2	6.0	5.4	7.6
Average of ASEAN 10	5.5(*)	5.6	5.4	5.5(**)
2 large economies in Emerging Asia				
China	7.7	7.5	7.7	10.5
India	3.7	6.1	5.9	7.1
Average of Emerging Asia	6.4	6.9	6.9	8.6

Exhibit 6

Asian Casual Dining / Hot Pot Chains (2008)

China	715 outlets	185 outlets	413 outlets
Thailand	50 outlets	278 outlets	120 outlets
Vietnam	40 outlets	60 outlets	40 outlets

In Thailand, the Coca Group – a Thai-Chinese-Japanese hotpot cuisine restaurant group – had firmly established a position with more than 50 outlets nationwide and internationally. S&P, a 278-outlet chain of quick-service restaurants, listed on the Stock Exchange of Thailand, had a market capitalization of US$100.9M in October 2007. In China, the 200-outlet Ajisen (China) chain was among the nation's top five restaurant chains with estimated revenue of $121M in 2007.

In Vietnam, there were no multi-concept restaurant chains at the time of Mekong Capital's initial investment in Golden Gate. KFC was the only major Western quick-service restaurant active in the market.

4 Source: OECD Development Centre

Exhibit 7

Golden Gate Concepts (2013)

ASHIMA Avg. Check: $23	KICHI KICHI Avg. Check: $11	SumoBBQ Avg. Check: $18	Vuvuzela Avg. Check: $13	i Sushi Avg. Check: $22
Hotpot serving mushroom and other specialty items that are traditionally perceived only for the royalty and the wealthy	Extensive hotpot options delivered via rotating conveyor - at a fixed price	Japanese BBQ, served tableside, featuring imported beef from Australia/USA	Lively western style bar offering various types of food and draught beer	Authentic Japanese-style food including Sushi and Tepanyaki
# of units: 5	# of units: 22	# of units: 12	# of units: 6	# of units: 2
Ba Con Cừu Avg. Check: $13	**37th Street Avg. Check: $7**	**Daruma Avg. Check: $9**	**GoGi house Avg. Check: $10**	
Mongolian lamb hotpot featuring specialty soup and imported lamb from Australia	A modern interpretation of traditional street food capturing the spirit of the 36 quarters of old Hanoi	Japanese Bistro offering a novel Japanese fast food serving style	Traditional Korean-style BBQ	
# of units: 4	# of units: 1	# of units: 1	# of units: 5	

Source: Company Data, # of units as of 2013 year end, excluding one unit to be closed in Q4 2013

Exhibit 8

EBITDA Growth, 2008- 2014(e)

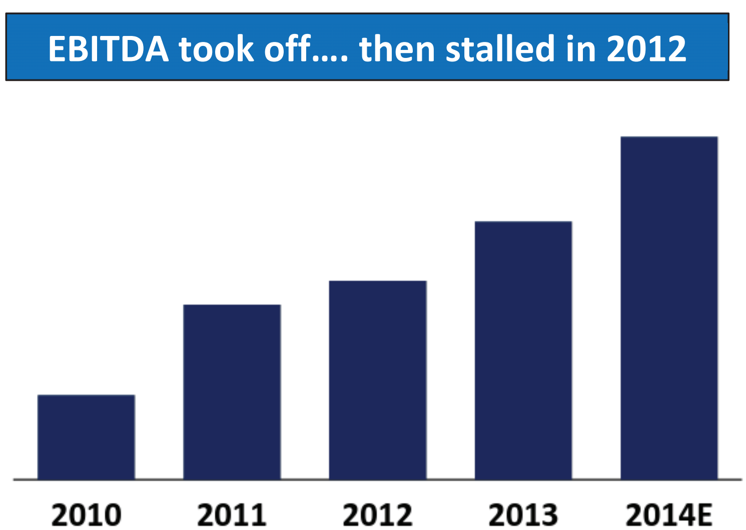

Exhibit 9

The Eight Keys to Successful Negotiations in Asia
(adapted from The Chinese Negotiation, John L. Graham and N. Mark Lam, October 2003, Harvard Business Review)

1. Personal Connections

Asian business people prize relationships among friends, relatives and close associates. Favours are always remembered and returned, though not necessarily right away. Ignoring reciprocity is considered immoral.

2. The Intermediary

Introductions are essential during meetings with strangers. This trusted business associate connects you with his trusted associate, creating a personal link to your target organization or executive. Intermediaries interpret negotiators' moods, body language and facial expressions. They—not the negotiators—first raise business issues for discussion, and often settle differences.

3. Social Status

Casualness about social status doesn't play amount people who value obedience and deference to superiors. Sending a low-level representative to a high-level negotiation can kill a deal.

4. Interpersonal Harmony

Relationships of equals are cemented through friendships and positive feelings, generated during months of visits and long dinners. Any attempt to do business without first establishing harmony is rude.

5. Holistic Thinking

Asians discuss all issues simultaneously in apparently haphazard order—emphasizing the whole package over details. Nothing is settled until everything is. This holistic thinking contrasts with the linear approach of some Westerners—and spawns the greatest tension between negotiating teams.

6. Thrift

Asians bargain intensely over price, padding offers with room to manoeuvre and using silence and patience as tactics. They expect both sides to make concessions—often after weeks of haggling.

7. "Face" or Social Capital

A broken promise or display of anger or aggression causes mutual loss of face—disastrous to any deal.

8. Endurance, Relentlessness

Asians prize relentless hard work. They prepare diligently for negotiations and expect long bargaining sessions. Demonstrate your endurance by asking many questions, doing your research and showing patience.

Exhibit 10

Hanoi Securities' IPO Suggested Valuation

	IPO-HOLD *New growth Trade Sale Year 5*	SALE *Exit Now*
Proceeds	Reinvested	Distributed
# of Restaurants	300	60
Revenue	$350 million	$70 million
EBITDA	$ 30 million	$10 million
EBITDA Multiple	10x	10x
Value: PV in 5th year sale vs exit now	**$300 Million**	**$100 million**

Exhibit 11

Restaurant Acquirers' Perspectives on Value[5] *(adapted from interview with Pete Bassi, Retired Chairman and President YUM! International)*

When a buyer enters a new market like Vietnam, there are several key criteria they might use to determine both level of interest and to define the value of an acquisition target. A buyer will want to see that the existing business is on a stable footing, and unit profitability is fully developed, with credible plans for future growth. Some of the questions/metrics the buyer might emphasize include:

Unit Economics and Forecasting Assessment

- **Same-Store Sales Growth (SSS):** How are the existing locations trending? A buyer might conduct an analysis of comparable stores in order to segregate to isolate the "honeymoon" experienced by new stores. A buyers' analysis might be categorized by relevant mix issues: region, vintage, management spans, turnover etc. He might compare base SSS to like duration to better determine how each development program is actually performing and will most likely perform in the future.
- **New Unit Returns:** This includes detailed tracking/analysis of opening results. It is important to quarantine the pattern of a new store's "trial period," as well as understanding the pattern of sales erosion. A buyer might develop a new unit return model based on empirical data: Sales erosion, margin stabilization, unit cash-on-cash returns in terms of investment payback, etc.
- **Stability of Unit Margins:** What is the stable-state margin and how long does it take to achieve it? Usually this is a couple of years out from opening and the acquirer is looking for 20%-plus cash margin. This is important to a buyer because if it takes a year or more to reach a stable margin the company needs to absorb the incremental hit in its costing of its development program. A buyer will want to understand the fixed and variable cost components, and their influence on margin and price elasticity. Again a buyer might segment

5 Notes from Professor Goodson's Interview with Pete Bassi

this analysis by relevant mix issues: region, vintage, management span, turnover etc. are fundamental. What are the patterns: are there key performance differences; are there location inferences or operational mix implications?

- **Capital Efficiency:** What is the cash-on-cash payback period for new site openings by mix? Is it on average under 12 months or can it be brought to this standard? How much new capital investment from the acquirer, if any, will be required to support buyers forecast? What local capital is available from franchising, lending sources to fund growth internally, if any?
- **Supply Chain Effectiveness:** How much of the supply chain is localized, and what are the foreign exchange and pricing implications? What is imported? What is the historical cost of goods sold inflation rate? How concentrated is supply? Any scale issues with suppliers? What ERP process or simple planning systems exist? A buyer would look to review the distribution system in terms of quality, efficiency and scale. What are the processes on contracts: duration, terms and approvals? Are there sufficient back-up suppliers to offer steady supply if needed and keep the pressure on costs?

Strategic Efficacy

- **Customer Knowledge:** Does a seller use customer analytics or do they rely on seat-of-the-pants judgments? What attracts customers? How does the customer view the restaurant in the marketplace? How do they develop customer feedback: process used and accuracy history? What creates frequent customers?
- **Incentive linkage to value drivers:** Do they create actionable KPI's that measure the right stuff? Are a few high-impact metrics linked to compensation in a meaningful manner?
- **Footprint- Growth Potential:** What is the opportunity for expansion by theme? How tough is the competitive landscape for talent and location. Does the customer's pocket-book and preference indicate strong future demand for the restaurant concept and price point? Is the supply chain capacity enough to support the growth? Are there aggregation or central kitchen opportunities?
- **Multiple Concept Capability:** Does management have the bandwidth to innovate, develop and support more themes or are they limited to existing concepts? Do they jump to new themes before they develop what they have to stable and profitable levels? Who are the key taste/menu/site entrepreneurs and how good are they? Have they shown innovation in menu creation and introduced new entrees successfully over time?
- **Key Talent Retention/Development:** Most emerging market teams require significant gap-filling. How willing is management to bring in real talent? Who are the "must-have talents" throughout the organization? How are they locked in if a deal takes place? From employee conversations and triangulating answers: Who is continuously referenced as the best at developing supply chain sources/buying? Who is the best menu innovator? Who is the best at training staff, and why? Who are the best site managers, and why?

Exhibit 12

Cast of Characters

- Chad Ovel: Mekong Capital's newest Partner and Deal Leader for Golden Gate Group.
- Chris Freund: Founder of Mekong Capital, who initially sourced the Golden Gate investment.
- Pete Bassi: Former CEO of Yum! International; serves on Mekong Capital's Value Optimization Board
- Dao The Vinh (Vinh): Founder and CEO of Golden Gate Group
- Tran Thu Hong (Hong): Mekong Capital Deal Leader, who built relationship with Golden Gate
- Nguyen Duc Tai (Tai): CEO of another Mekong portfolio company, Mobile World
- Nguyen Cao Tri (Tri): a manager recruited from KFC to run Golden Gate's Ho Chi Minh operations
- Joel Silverstein: Operating advisor from East-West Hospitality Group, who was engaged to review Golden Gate's operations
- Nguyen Son Duy (Duy): Hanoi Securities investment banker

Golden Gate Restaurant Themes

- 37th Street – a modern-oriented but traditional street food restaurant
- Ashima – the pioneer mushroom hotpot restaurant chain in Vietnam
- Ba Con Cuu – Inner Mongolia hotpot restaurant chain
- City Beer Station, an affordable beer garden
- Daruma – Japanese sit-down restaurant
- Gogi House – Korean BBQ restaurant chain
- iCook – a Japanese fast-food
- Isushi - buffet à la carte of Japanese cuisine
- Kichi-Kichi – rotary express hotpot restaurant chain
- Sumo BBQ – grill & hotpot restaurant chain
- Vuvuzela – beer club chain, delivery concept

Restaurant Management Training Visits

- Central Group –Thailand-based restaurant group
- Lettuce Entertain You – US-based restaurant group
- Maxim's – Hong Kong-based restaurant group