THE DEAN OF THE DEAL

How the Cypress Group facilitated the biggest deal in franchising

Written By **EDDY GOLDBERG**

Dean Zuccarello, CEO and founder of The Cypress Group, played a key role in completing this record-breaking transaction. We asked him to recount his role, his experience, and what a mega deal like this says about the state of franchising in 2021.

What role did you play in Flynn Restaurant Group's acquisition of more than 1,100 restaurants from NPC International?

Before the bankruptcy, NPC had hired a couple of advisory groups to help them with their situation. AlixPartners was hired as NPC's financial consultants in terms of restructuring, and Greenhill & Co. was their bankruptcy investment advisor. Alix and Greenhill were initially brought in to deal with the upside-down capital structure and how to best navigate through it. Weil was brought in as their pre-bankruptcy counsel. At that stage, the bankruptcy route had been discussed and was certainly on the table, but a final decision to take the company into Chapter 11 had not been made.

We got a call in February 2020 from Houlihan Lokey, the financial advisor to the lender group. At that point, the lender group wanted Cypress to be involved in what was going to be an M&A process for the restaurant assets in the transaction. We were hired shortly thereafter to act as co-manager with Greenhill on the M&A aspect of the deal.

Why you?

Folks at the lender group had reached out to several people who recommended us as the best company to represent the M&A transaction. Given our 30-plus years of specialization in franchising and restaurants, our M&A experience, and our relationships in the industry, we have developed a strong reputation in this area.

Once you were formally engaged, then what?

Very early on in the engagement, and before we were "in the market," we reached out to a limited number of select groups we knew would be interested, just to give them a heads-up that the transaction would be coming down the road. Greg Flynn was one of the people we spoke with at that time.

I had conversations with Wendy's as well because we have relationships there. We wanted to start a dialogue with them early, as we knew they would have an interest in the outcome of the process. We weren't going out on a broad basis by then, but a handful of what we would call "logical suspects" got a phone call that said, "Hey, by the way, we've just been engaged on this. We're not sure how it is going to unfold, but you might want to get it on your radar."

That was at a very early stage of the process. Pretty quickly after we were engaged, we started developing the book, the CIM (Confidential Information Memorandum),

with the intent of going to market. We were working with the Alix and Greenhill teams, as well as with NPC management—going through what the trailing numbers looked like, and the future numbers and projections. All this happened pre-bankruptcy while preparing to go to market.

Fairly early on, in March 2020, we had our model and our book pretty much done and were ready to go to market when the pandemic hit hard. Given the uncertainty around Covid, everyone collectively decided we needed to hit the pause button, but there were ongoing conversations to get ready for the eventuality that we would come back to market. There was a period last March through April where nobody really knew what was going to happen in the world.

Looking in the rearview mirror, we were pleased to see the traction QSR gained during the pandemic; that after the initial shock of restaurants closing, people in the QSR segment were finding ways to serve customers, primarily with drive-thrus. I don't recall if they were doing takeout at that point. Regardless, the upward sales trend continued to build upon itself to the point where the stakeholders of NPC reevaluated the pause in May and said, "We think this is on the right trajectory for us to go to market." The company filed for bankruptcy at the beginning of July and we immediately launched the M&A process for the Wendy's assets.

This sounds exciting!
It's the biggest deal Cypress has ever been involved with. We were involved in a large securitization deal, about $700 million to $750 million, 10 to 15 years ago. But from an M&A standpoint, this is certainly the biggest. In 2018, we managed the sale of US Beef, which at the time was the largest franchisee transaction in the industry, so we certainly had experience in this size arena. Now NPC is the largest. So from Cypress' standpoint, NPC is now our largest transaction on record, which is indeed quite exciting.

What happened next?
Up to that point, we had been doing all the normal things we would do in an M&A process in terms of the strategy: deciding who we would be going out to, compiling our target prospect lists, getting the materials ready, and so on. Once the decision was made, we started the process of reaching out to the folks on our target prospect list.

Now that this was officially a bankruptcy process, we wanted to go to market in a fairly broad fashion in order to reach out to more potentially qualified buyer candidates. Due to the confidentiality constraints in many M&A processes, we distribute to a far smaller group, but this was a big deal—it was already out in the world, and everybody knew about it. That was Step A. Then it was just the normal blocking and tackling in the M&A process in terms of managing those discussions and negotiations.

The book and the process that we produced, specifically on the Wendy's side of the business, had 8 distinct markets. We looked at the possibility that those markets might be sold individually in 8 separate transactions or some subset of that, or there might be a buyer interested in the whole thing.

Who were the interested buyers?
We had great participation in the process. There was a tremendous amount of interest across the board from a diverse group of candidates that all showed interest in the transaction at varying levels. It was the logical suspects: existing franchisees either already in the Wendy's and/or Pizza Hut systems, or in other systems looking to get into a different brand and who understood franchise restaurants or the franchise model; private equity groups, some that had a tremendous amount of restaurant franchise experience and some that did not; family offices; SPACs; and large strategics like Greg Flynn and others who were interested as well.

Needless to say, we found ourselves juggling a number of different groups. Some wanted to buy specific markets in the Wendy's process, while others wanted to buy all the Wendy's, and we even had groups that wanted to buy Wendy's and Pizza Hut, even though the Pizza Hut process hadn't even formally started yet.

So that was the undertaking, managing through what would ultimately be the best solution for NPC, taking into consideration the proceeds, confidence of closure, franchisor concerns and their approval rights, and all of those kinds of things. NPC, as the seller of the assets, needed to have the approval of the lender group because they were the ones holding all the paper. Everybody had to be aligned. This was a central part of the process.

What criteria did you use to evaluate the potential buyers?
You start with the valuation. At the end of the day, it's not *all* about the money, but it's primarily about the money, especially for the lenders in the bankruptcy. The bankruptcy process is designed to provide the best recovery for the company and its creditors. Thus, it starts with the highest quote and the best proceeds.

But that's not the exclusive goal. You also have franchisor approval dynamics, so a crucial part of the process is taking into consideration who might be friendly; a group the franchisors would prefer or endorse, versus somebody they might object to.

There's also the surety of closing—which is essentially selecting a group that you feel is going to get the deal done at the end of the day. The bankruptcy process forces that a little more than a traditional M&A deal, where you may have some wiggle room for buyers to bail. If you fail to perform in the bankruptcy process, the consequences are far more severe. You lose a lot of money, and the consequences for failing to perform can be harsh. There is a lot of due diligence, and those issues must be completed in advance of a selection process, which can be different from a traditional M&A transaction.

Therefore, selection starts with the quantitative factor, with the money, and who has an acceptable purchase price that ultimately makes sense for the company and for the creditors to accept. Then it moves on to deciding who we feel from a qualitative standpoint is going to be the best buyer. Who's going to get the deal done? Who's going to appeal to the franchisors, who want to make sure that, culturally, this would-be new franchisee is the right fit within their organization?

The goal at the end of the day is to find a collaborative solution that works for the seller, the company, the lender group in terms of proceeds, the buyers, and the franchisors, who have a seat at the table. The ultimate goal is to get everybody nodding their heads in the same direction. Thankfully that's how this deal ended up: we got everybody to consent to the transaction.

In any deal, no one party ever gets 100% of what they want, but at the end of the day, I think that the outcome here was positive for everyone.

Why was the decision made to sell Wendy's first?
Strategically, at the time the initial decision was being made, the Wendy's assets were viewed as more valuable and better performing than the Pizza Hut assets. NPC and the lenders had decided that they should start this process with a higher

level of recovery by pursuing the Wendy's transaction first.

At that point there was some discussion internally about whether to even sell the Pizza Huts. "Do we wait? Do we see Pizza Hut as a brand that has some improvement down the road that we can benefit from?" Those kinds of questions. There were also questions around the overall Pizza Hut portfolio, which at the time was more than 1,200 restaurants.

With the Pizza Hut brand starting to improve and getting some positive momentum in Covid, paired with the fact that NPC was able to reach an agreement with Pizza Hut on the closure of 300 units, the overall portfolio became significantly more attractive.

That was all transpiring while we were already out in the market with the Wendy's portion, and this is what ultimately resulted in the Pizza Hut process being undertaken as well. It was this plus the fact that we had groups like Greg's and a few others that had indicated they were interested in the whole enchilada, even before Pizza Hut was technically for sale.

Flynn said adding those two brands was a perfect fit for his group.

Yes, which is why he was one of my early phone calls. It was pretty clear to me that from a portfolio standpoint, this would be a really nice fit for him. Greg didn't have pizza and he was already in the Yum! system, so he had a relationship with one of the franchisors. He didn't have a QSR hamburger concept either, and Wendy's is a very attractive, well-performing QSR hamburger brand.

I think my initial question was, "Does he have the appetite for it?" You could make the argument that strategically it made sense portfolio-wise, but would he be interested in pursuing it? I got a sense early on that he saw the value in doing this deal and was going to move forward on it. He had done very well with his organization. His financial partners were also very supportive. If they weren't, I don't believe he would have been able to get it done. So all of those things were positives for him. Greg is also a top-notch operator, which certainly helped with franchisor approval.

How do you view this deal as an indicator for the future of franchising?

Clearly, we are going to continue to see consolidation because the franchise model supports it, the unit economics support it with efficiencies of G&A, etc. That being said, franchisors have grown concerned with overall franchisee size and geographic diversification, so there will be some constraints from the franchisor's standpoint in terms of what they're going to allow in future mergers. But generally, we are going to continue to see this trend of consolidation.

However, there's another piece I don't think people are talking about. I also think we are going to see some level of *de*-consolidation in the future. People like Greg, or other large franchisees, people who have amassed hundreds of restaurants, might unwind those holdings—not as total portfolios, but in smaller transactions. For example, who do you sell to if you're Greg Flynn? Some kind of behemoth private equity firm? Well, that's going to create all kinds of consternation with the franchisors, so an exit strategy might be to sell Wendy's off in 3 transactions, Arby's in 5 transactions, and so on. I truly think we are going to see an element of that as well. When bigger operators reach the point where they are looking for an exit strategy, we might see some deconsolidation.

We will also continue to see consolidation in the "normal" types of transactions—franchisees selling 20, 30, or 40 units getting picked up by other franchisees looking to get bigger.

Clearly something learned from the pandemic was the huge value of having a drive-thru or being in the QSR segment. The risk tolerance of that segment has opened a lot of people's eyes. When Covid hit, the hamburger and pizza places were still surviving while the sit-down places were not. I think that continues to resonate with a lot of people, even people who know that at some point the pandemic is going to be behind us.

People will go back to sit-down restaurants, but I still think we are going to see a climate of increasing valuations in the QSR segment. The valuation trends will continue to soar for QSR because of the risk testing we saw through the pandemic. The world partially shut down, but they were still selling pizzas and hamburgers.

You've been involved in a lot of franchise restaurant deals over the past 30 years. Besides the size of this one, what was most interesting for you?

The different number of groups involved. You had two separate franchisors with their financial advisors and investment bankers. Within our side of the transaction, we had the company advisors, the lender advisor groups, and everybody had lawyers. At certain times that can be very frustrating and challenging, but it's an interesting dynamic to work through, especially when you're able to come out the other end with a successful transaction, having effectively dealt with all of those different factors and variables. When it's done, you sit back and say, "Wow, we really learned something through that process!" It was really interesting how it all came together, given all the diverse viewpoints and interests.

So when you got involved in February 2020, did you think it would all work out?

We had confidence in the process from the beginning. We liked the brands. Wendy's was certainly doing extremely well. Pizza Hut had some recent hiccups, but they seemed like they were trending in the right direction. So from that standpoint, we felt good about it. Covid just threw everybody a curveball. Nobody had any idea that was coming, and when it showed up, what its subsequent impact would be. For all we knew, all restaurants would be shut down and there would be nothing to sell. For Wendy's and Pizza Hut, it turned out to be just the opposite: they were the beneficiaries of the pandemic. It's quite fascinating when you look back at it all. ■

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