News

STRUCTURED WEEKLY: Jack in the Box Refinancing ABS Deal

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- Latest fast food chain to securitize everything in deal
- Franchise fees, IP, license agreements among collateral

By Adam Tempkin

(Bloomberg) --

Fast food chain Jack in the Box is the latest company looking to re-bundle nearly all of its revenue-generating assets into a securitized bond in a bid to access cheaper funding amid strong investor demand for yield.

On Thursday, the fast-food restaurant started **selling** $1.25 billion of debt known as a whole-business securitization, its second such deal. It will price next week. The bond, which received BBB grades from S&P Global and Kroll Bond Rating Agency, will refinance a portion of its 2019 **inaugural** whole-business transaction, as well as fund its **planned acquisition** of Del Taco Restaurants, one of the largest fast food chains in the country.

Companies ranging from **gyms** to **housecleaners** have sold whole-business securitizations recently, which helped bring total sales of asset-backed securities last year to a post-crisis **record**.

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By effectively mortgaging most of the assets of its business, Jack in the Box can sell investment-grade notes instead of junk debt. Investors are clamoring for these kinds of securities as they look for relatively high yields during a time of high inflation.

“From the standpoint of companies that do WBS, by doing a securitization instead of a conventional secured credit facility, they tend to get much cheaper pricing than they would otherwise,” **Patricia Lynch**, a partner at the law firm Ropes & Gray specializing in securitization, said in an interview. “Because all of the revenue-generating assets collateralize these bonds in a special purpose vehicle, investors are much more comfortable with the credit risk of lending to these vehicles.”

Fast food chains such as **Wingstop**, **Church's Chicken**, and **Arby's** have done whole business securitizations in recent years as investors, seeking yield and inflation protection, have become more comfortable with the transactions. The Jack in the Box collateral includes existing and future franchise and license agreements, company-operated restaurant royalties and profits, some owned real estate, real estate income, and intellectual property. Guggenheim and Bank of America are arranging the deal.

Franchise Risk

Restaurant chains that issue whole-business securitizations **suffered** at the beginning of the pandemic as consumers sheltered at home, but have since bounced back. Sales at Jack in the Box stores open at least a year **could rise** by low single digits in 2022, fueled by price increases, greater digital sales, store remodels and expanded operating hours, especially late at night, according to Bloomberg Intelligence.

Still, there are always risks associated with these deals.

“The assumption is that based on past performance and contractual arrangements, that franchisees will continue to pay franchise fees,” said Lynch. “With IP-like arrangements in place, there are similar assumptions. But if there's a major shock to the industry or major issue at a specific company that serves as the manager of these assets, that could adversely impact the cashflows, which is the source of repayment of the bonds.”

Like other highly franchised companies, Jack in the Box has faced disputes with franchisees from time to time, according to Kroll. In 2018, the National Franchise Association, a group purporting to represent a subset of the company's franchisees, raised grievances with the company's management team via letters to the board of directors, according to a presale report for Jack in the Box's 2019 deal.

Through its refranchising program, Jack in the Box has increased franchised ownership from 76% at the end of fiscal 2012 to 93% today, according to deal documents. The company controls the underlying real estate on 86% of all restaurants, and the top 10 franchisees operate on average 87 restaurants and have been in the system for an average of over 20 years.

Relative Value: CMBS

- As the market enters a Federal Reserve rate hike cycle, Bank of America strategists are bullish on floating-rate commercial mortgage backed securities, including senior CRE CLOs and SASB bonds, according to BofA's weekly securitization report
- CMBS spreads didn't react negatively to Fed rate hikes in prior cycles, and they only started widening when the market thought the Fed had gone too far
- The bank has a neutral outlook across private label and agency CMBS deals as there is "no clear catalyst on the horizon for spreads to move significantly in either direction" the strategists said

Quotable

"I think that the market is reacting to the potential for an earlier, and more significant (Fed) balance sheet reduction than many people were expecting," said **Scott Buchta**, head of fixed income strategy at Brean Capital. "It is also possible that this wind down may be more MBS-centric than many people had been expecting as well"

What's Next

ABS transactions in the queue for next week include Jack in the Box (whole business ABS), American Car Center (subprime auto), Navient (student loan ABS), and Kapitus (small business ABS)

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