Market Insights

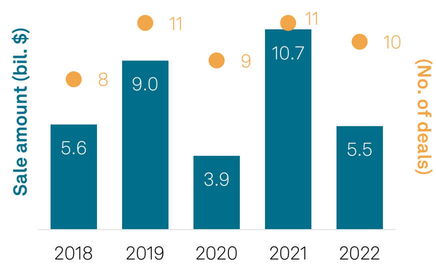
Sector Intelligence | Corporate Securitization

Dec. 9, 2022

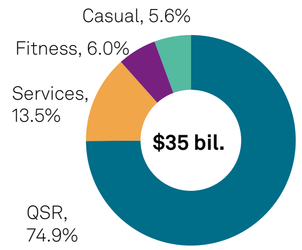
This report does not constitute a rating action

54 Deals	**$35.1 bil.** Rated outstanding bond balance	**10** New deals in 2022	**$5.5 bil.** New issuance in 2022

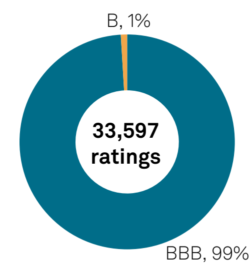
New Issuance



Distribution By Type



Rating Distribution



Note: All amounts of the chart assume fully drawn variable funding notes. Data as of Oct 30, 2022.
QSR- Quick-service restaurants. Source: S&P Global Ratings.

Key Takeaways

- S&P Global Ratings rated 10 transactions in 2022, compared to the 11 transactions rated in 2021. However, the total rated amount in 2021 was nearly twice as large, driven by the DB Master, Domino's, and Taco Bell issuances last year, each of which exceeded $2 billion.
- The performance of quick service restaurants (QSRs, which make up approximately 75% of S&P Global Ratings-rated outstanding transactions); service-oriented business (about 13%), and low-cost gym systems (about 6%) are all expected to perform well despite the continued threat of a downturn in 2023 given the low relative price of the offerings at both the QSRs and the fitness system and the essential nature of the services businesses.
- The casual dining sector (CDR) may be strained as purse strings tighten. This sector has been vulnerable to weakened performance during prior economic downturns as it does not offer the same value proposition as the QSR sector.
- Refinance risk is minimal and not imminent, as there are no master trusts with an anticipated repayment date in 2023.

A Primer To Corporate Securitizations

Corporate securitizations are generally backed by nearly all of an operating company's revenue-generating assets, including intellectual property, existing and future franchise and licensing agreements, royalties (domestic and international), supply chain profits, real estate, and company-owned store EBITDA. Four key factors allow for the differentiation of the credit risk of the operating company from the securitization debt: asset isolation, post-bankruptcy continuity of cash flow, establishment of a back-up manager, and a longer time horizon.

To determine the level of rating elevation above the company's credit worthiness, we consider various factors including the entity's business risk profile (BRP) together with expected and stressed debt service coverage ratios (DSCRs), the transaction structure, and jurisdictional considerations, including bankruptcy regimes. In addition, we analyze the issuer's credit characteristics and performance relative to peers. Please see the criteria, presale reports, and other publications for detailed rating rationales.

A Comparison Of Corporate Securitization Performances

2022 thus far has been another strong year for corporate securitization transactions, with all but three systems (Domino's, Sonic, and Jack-in-the-Box) posting positive year-over-year growth in system-sales. Because Domino's, Sonic, and Jack-in-the-Box all experienced double-digit percentage sales growth the year prior, the small system contraction for this year is not viewed negatively.

DSCRs have been somewhat volatile in the last year, but this is mostly due to an increase in total debt outstanding. Nearly all of the systems that experienced a double-digit percentage decline in DSCR also saw a double digit increase in outstanding debt. These trends are common in the sector because as systems grow, they generally tap the master trust and issue additional debt, increasing leverage and resulting in a decline in DSCR. Amortization is minimal, so this natural de-levering is generally driven by system growth.

Both Hardee's and ServiceMaster experienced a decline in DSCR of over 10% with little-to-no increase in debt. Hardee's' decline in DSCR was driven by a small drop in store count and a decrease in average unit volume. ServiceMaster also experienced a small decline in the number of stores. We do not believe these movements signal a systemic change in the risk profile, but we will continue to closely monitor transaction performances.

Table 1

Peer Comparison – Third-Quarter 2022

System name	Concept type	No. of stores	% franchised	% international	BRP at last rating action	Current rating*
Applebee's Funding LLC	CDR	3,238	93	--	Fair	BBB (sf)
Arby's Funding LLC	QSR/sandwich	3,579	69	3	Satisfactory	BBB- (sf)
DB Master Finance LLC	QSR/beverage	20,990	100	45	Satisfactory	BBB (sf)
Domino's Pizza Master Issuer LLC	QSR/pizza	19,519	98	66	Satisfactory	BBB+ (sf)
Driven Brands Funding, LLC	Services/auto	3,486	83	18	Fair	BBB- (sf)
Five Guys Funding LLC	QSR/Burger	1,766	66	16	Weak	BBB- (sf)
FOCUS Brands Funding LLC	QSR/multi	6,430	99	27	Fair	BBB (sf)
Hardee's Funding LLC	QSR/burger	3,829	93	27	Fair	BBB (sf)
Jack in the Box Funding LLC	QSR/burger	2,181	93	--	Fair	BBB (sf)
Jersey Mike's Funding LLC	QSR/sandwich	2,313	99	--	Weak	BBB (sf)
Jimmy John's Funding LLC	QSR/sandwich	2,667	99	--	Satisfactory	BBB (sf)
Planet Fitness Master Issuer LLC	Fitness	2,353	90	4	Fair	BBB- (sf)
ServiceMaster Funding LLC	Services/restoration	2,487	100	14	Weak	BBB- (sf)
SERVPRO Master Issuer LLC	Services/restoration	2,051	99	1	Weak	BBB- (sf)
Sonic Capital LLC**	QSR/burger	3,548	91	--	Satisfactory	BBB (sf)
Taco Bell Funding, LLC	QSR/Mexican	7,074	93	--	Strong	BBB (sf)
TGIF Funding, LLC	CDR	693	77	56	Vulnerable	B (sf)
Wendy's Funding LLC**	QSR/burger	7,040	94	15	Fair	BBB (sf)

*On all series in the master trust. **Second-quarter. BRP--Business risk profile. QSR--Quick-service restaurant. CDR--Casual dining restaurants. LTM--Last 12 months. DSCR--Debt service coverage ratio. Source: S&P Global Ratings.

Table 2

Peer Performance Comparison – Third-Quarter 2022

System name	LTM system-wide sales Q3 2022 (bil. $)	YoY change in system-wide sales (%)	Total ABS debt outstanding Q3 2022	YoY change in total ABS debt (%)	Issuer DSCR Q3 2022 (bil. $)	YOY change in issuer DSCR (%)
Applebee's Funding LLC	7.58	11.22	1.39	7.77	4.15	(13.36)
Arby's Funding LLC	4.57	0.91	0.81	(1.01)	4.80	4.12
DB Master Finance LLC	14.34	6.98	4.15	(1.01)	4.14	11.29
Domino's Pizza Master Issuer LLC	17.60	(1.06)	5.04	0.17	3.57	2.88
Driven Brands Funding, LLC	4.59	19.70	2.24	18.24	3.31	(6.50)
Five Guys Funding LLC	3.03	16.13	0.79	32.83	4.75	(23.26)
FOCUS Brands Funding LLC	3.85	13.36	1.18	36.88	3.41	(9.55)
Hardee's Funding LLC	4.74	3.48	1.15	(1.02)	3.03	10.88)
Jack in the Box Funding LLC	4.11	(1.07)	1.85	43.06	2.94	(35.53)
Jersey Mike's Funding LLC	2.54	23.15	0.99	98.75	5.69	(7.03)
Jimmy John's Funding LLC	2.35	3.85	1.07	122.77	3.03	(56.65)
Planet Fitness Master Issuer LLC	3.83	17.78	2.03	14.10	3.66	27.08
ServiceMaster Funding LLC	3.59	4.34	1.08	(1.01)	3.88	(23.32)
SERVPRO Master Issuer LLC	3.57	8.96	1.02	35.12	4.00	(20.00)
Sonic Capital LLC*	5.58	(8.16)	1.46	36.18	3.57	(22.56)
Taco Bell Funding, LLC	13.33	8.63	3.77	(1.02)	3.99	9.02
TGIF Funding, LLC	1.59	20.96	0.31	(13.57)	1.59	34.75
Wendy's Funding LLC*	12.80	4.00	2.81	19.85	4.36	(9.73)

*Second-quarter. YoY--Year over year. ABS--Asset-backed securities. QSR--Quick-service restaurant. CDR--Casual dining restaurants. LTM--Last 12 months. DSCR--Debt service coverage ratio. Source: S&P Global Ratings.

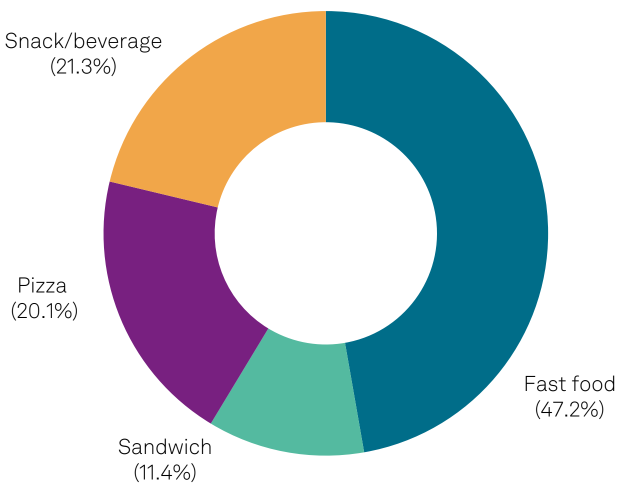
Quick Service Restaurant (QSR) Market Updates

QSRs constitute approximately 75% of the S&P Global Ratings-rated outstanding transactions. This sector has proven resilient during economic downturns and other stressful periods as value and convenience are critical for their customers. Most recently, during the COVID-19 shutdown, many QSRs maintained system-wide sales by placing even greater emphasis on take-out and delivery.

Below, we provide a breakdown by QSR product type and highlight certain other key developments in this segment.

Chart 1

QSR Bonds Issues Distribution (%)



QSR--Quick-service restaurant. Source: S&P Global Ratings.

Royalty cash flows, the foundation of most corporate securitizations, are expected to remain strong

Price increases enacted by all systems to counteract rising costs of labor and supply will result in strong securitized net cash flows (SNCFs) as long as volume does not dramatically decline. So far, volume remained stable in 2022 despite an increase in prices of 10% or more across most of the QSR systems. Going forward, we expect that system-wide sales will remain stable or grow because QSRs remain a comparatively low price option.

Company-owned stores revenue and product revenue margins expected to decline

Many systems are reaching a point where they can no longer continue to raise prices to offset supply cost and wages without impacting sales volume. As a result, margins are compressing and may be further compressed if the minimum wages continue to rise (see below). The impact will vary across systems as this margin compression will depend on the portion of the SNCF that is non-royalty-based revenue and what other actions the company can take (for example, automation) to offset increased costs.

To account for such risks, in our criteria under our downside-scenario assumptions for QSRs, we assume a 30% decline in these "other" cash flows, as opposed to the 15% stress on the royalty-based cash flows.

California minimum wage

The state of California's minimum wage is set to rise to $15.50, but each county has its own minimum wage that is typically much higher. For example, Los Angeles County's 2023 minimum wage is $16.04 plus the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), which was 7.9% as of October 2022. In addition to this, California recently passed a law that could Increase the 2023 minimum wage for QSR workers up to $22.00, adding further pressure to restaurants. However, this is currently being contested by a coalition of restaurant trade groups. We believe that other states will gradually increase their minimum wage rate as well. In the near term, geographic diversification of store locations mitigates this risk for most transactions. In transactions where we believe store concentration presents incremental risk, we may make additional adjustments.

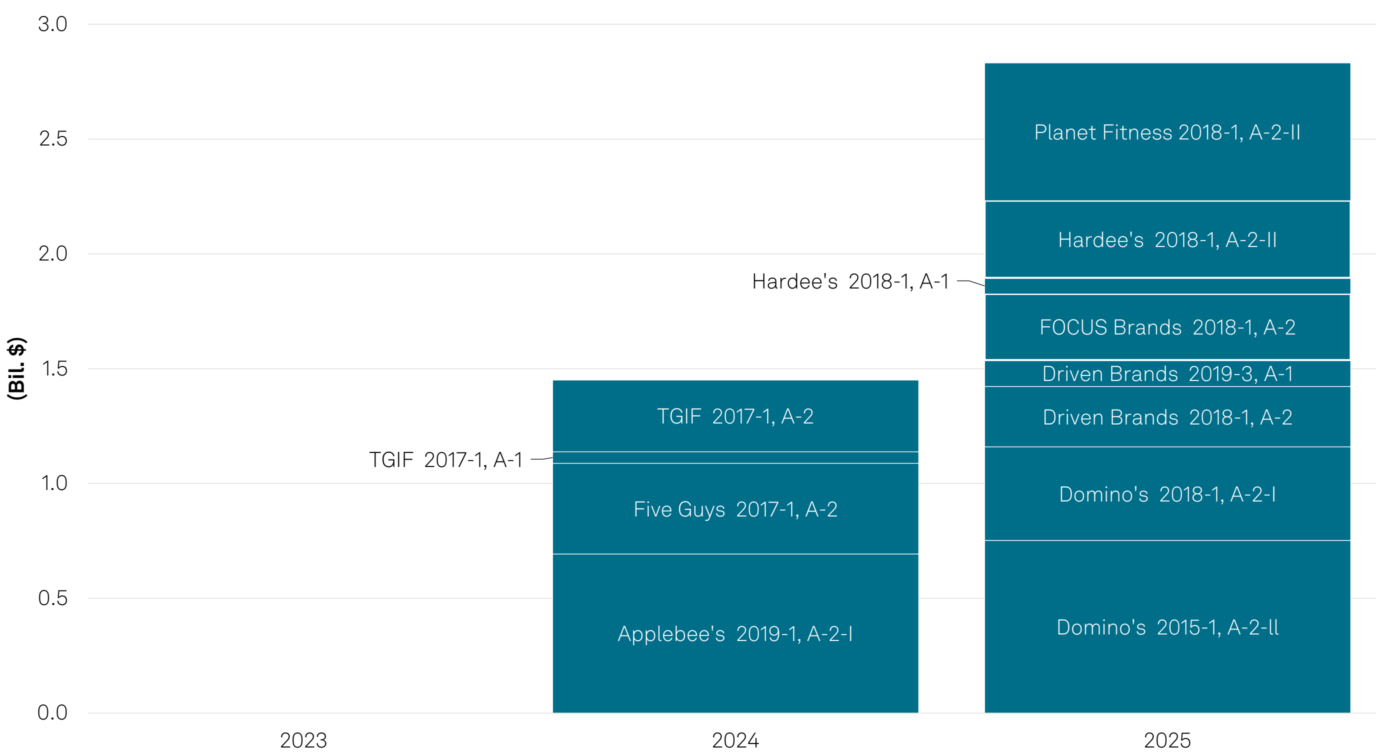
Anticipated Repayment Date (ARD) Analysis

It appears that the issuers have planned well for the current rising rate environment, as there are no corporate securitization notes that have an ARD in 2023 and only $4.5 billion in the next three years.

While our ratings address the timely payment of interest and ultimate payment of principal by legal final maturity, we closely monitor ARDs. The refinancing of the notes at a higher rate would put increased stress on the entire master trust and could lead to rating implications for either the securitization and/or the corporate rating on the sponsor. Alternatively, if the notes are not repaid or refinanced prior to their ARD, a rapid amortization event would be triggered for the entire master trust.

Chart 2

Three-Year Outlook On Anticipated Repayment Dates By Class



Source: S&P Global Ratings.

Table 3

Treasury Yield

	2023	2024	2024
10-year treasury	3.9%	3.4%	3.3%

Data as of Nov. 28, 2022. See "Economic Outlook U.S. Q1 2023: Tipping Toward Recession," published Nov. 28, 2022.
Source: S&P Global Ratings.

Table 4

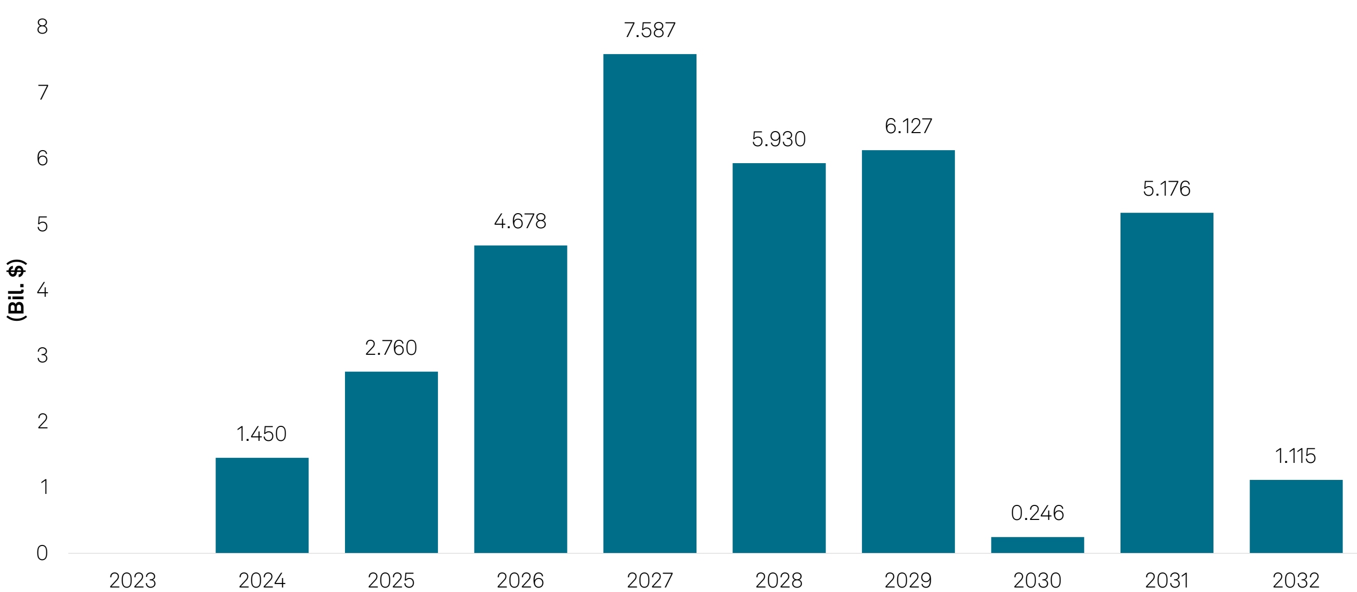
Outstanding Balance For Notes Within ARD Year

ARD year	Deal name	Series	Class	Outstanding balance (mil. $)	% of master trust capital stack	Coupon (%)	Current rating
2024	Applebee's Funding LLC	2019-1	A-2-I	693	43.0	4.19	BBB (sf)
	Five Guys Funding LLC	2017-1	A-2	395	46.9	4.60	BBB- (sf)
	TGIF Funding, LLC	2017-1	A-1	50	13.8	3M LIBOR+3.25	B(sf)
	TGIF Funding, LLC	2017-1	A-2	312	86.2	6.20	B(sf)
2025	Domino's Pizza Master Issuer LLC	2015-1	A-2-ll	752	14.2	4.47	BBB+ (sf)
	Domino's Pizza Master Issuer LLC	2018-1	A-2-I	408	7.7	4.12	BBB+ (sf)
	Driven Brands Funding, LLC	2018-1	A-2	263	10.5	4.74	BBB- (sf)
	Driven Brands Funding, LLC	2019-3	A-1	115	4.6	3M LIBOR+2.25	BBB- (sf)
	FOCUS Brands Funding LLC	2018-1	A-2	288	23.6	5.18	BBB (sf)
	Hardee's Funding LLC	2018-1	A-2-II	336	27.6	4.96	BBB (sf)
	Planet Fitness Master Issuer LLC	2018-1	A-2-II	598	28.5	4.67	BBB (sf)

ARD--Anticipated repayment date. 3M--Three month. Source: S&P Global Ratings.

Chart 3

Outlook On Anticipated Repayment Dates By Balance



Source: S&P Global Ratings.

Surveillance Action

Year to date in 2022, we downgraded one rating on Jimmy John's Funding 2017 notes back to its original rating of 'BBB- (sf)', following an increase in leverage from additional issuance. These notes were previously upgraded to 'BBB (sf)' following a large voluntary prepayment in March 2021. There were no other surveillance rating actions in 2022.

Our surveillance process includes quarterly portfolio reviews (QPRs) and annual reviews (ARs) on all outstanding ratings, in addition to event-driven reviews (EDRs) and matters brought to our attention if a rating agency condition or notification concerning existing ratings apply. For example, we typically conduct a no-harm analysis on outstanding transactions in a master trust at the time a new issuance occurs from the same master trust.

QPRs involve a high-level analysis of each sector, during which the analysts will determine if the current performance metrics warrant a referral to committee. Any deal referred to committee must be reviewed within six months of the date of referral.

ARs are completed for each sector once per year and involve an up-to-date analysis of all five pillars we use in our structured finance committees (cash flow and payment structure, credit, legal, counterparty, and operational risk). During an AR, the analysts will determine if a deal should be referred to committee. Any deal referred to committee during an AR must be reviewed within six months of the date of referral.

EDRs are typically triggered by specific events and are usually held in a committee setting.

Related Criteria

- Criteria: Global Methodology And Assumptions For Corporate Securitizations, June 22, 2017

Related Research

- Economic Outlook U.S. Q1 2023: Tipping Toward Recession, Nov. 28, 2022
- U.S. Holiday 2022 Sales Outlook: Santa's Bag Will Be Smaller This Year, Nov. 10, 2022
- Industry Top Trends Update: Retail and Restaurants- Credit quality is at a turning point, July 14, 2022
- One Rating From Jimmy John's Funding LLC Series 2017-1 Lowered, Off CreditWatch Neg; One Rating Withdrawn, March 16, 2022

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Analytical Contacts

Christine Dalton
New York
christine.dalton@spglobal.com

Jay Srivats
New York
jay.srivats@spglobal.com

Christopher Plumb, CFA
Chicago
christopher.plumb@spglobal.com

Eric Pettinelli
New York
eric.pettinelli@spglobal.com

Research Contributors

Deegant Pandya
New York
deegant.pandya@spglobal.com

Sahay Senathikagu
New York
sahayajayaseelan.sen@spglobal.com

Bushra Dawawala
Mumbai
bushra.dawawala@spglobal.com

Investor Contact

Kieran Mcshane
New York
kieran.mcshane@spglobal.com

Media Contact

Jeff Sexton
New York
jeff.sexton@spglobal.com

Commercial Contact

Ryan Erb
New York
ryan.d.erb@spglobal.com