

JACK IN THE BOX STRATEGY REPORT



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CONTENTS

Executive Summary.....	3
Company Background	5
Financial Analysis	7
Profitability & Shareholder Returns	7
Liquidity & Solvency	8
Competitive Analysis (Five Forces Framework).....	14
Market Definition	14
Internal Rivalry	15
Entry & Exit.....	16
Substitutes.....	16
Supplier Power	17
Buyer Power.....	18
SWOT Analysis.....	20
Strategic Recommendations	24
Company Split.....	24
Qdoba.....	24
Jack in the Box.....	25



EXECUTIVE SUMMARY

Jack in the Box Inc. (NASDAQ: JACK), is a San Diego-based restaurant company that operates and franchises both the Jack in the Box and Qdoba brand of restaurants. As of the end of fiscal year 2012, the Jack in the Box brand included 2,250 restaurants in 21 states, of which 547 were Company-operated and 1,703 were franchise-operated. The Qdoba brand included 627 restaurants in 42 states, as well as the District of Columbia, of which 316 were company-operated and 311 were franchise-operated, making Qdoba the second largest fast-casual Mexican brand in the United States. The firm employs approximately 22,100 people in all of its locations and offices (including franchises).¹ From its inception in 1951, the company has competed with and differentiated itself from the other major fast food restaurants, most directly Burger King and McDonald's.

Between its subsidiaries, Jack in the Box Inc. has both mature (in the Jack in the Box chain), and high-growth (in the Qdoba Mexican Grill brand) businesses under its corporate umbrella. Jack in the Box grew heavily through the 1990s, but the core brand hasn't grown quickly in the last decade, with only 18 stores added in 2012. The firm does plan to continue to open 20-25 new company- and franchise-operated restaurants in fiscal year 2013. The namesake brand offers a large variety of fast foods that compete with McDonalds on quality and "craving factor," with Jack in the Box's menu designed to capture desired uncommon foods for drive-thru menus. Jack in the Box offers an Americanized version of ethnic cuisine - such as egg rolls and tacos, along with breakfast burritos and poppers- cream cheese-stuffed, deep-fried jalapeño peppers. New items come in on a rotation every three to four months. Jack in the Box also carries seasonal items, and in some locations local delicacies are a regular part of the menu. Locations in Hawaii, for example, include the Paniolo Breakfast (Portuguese sausage, eggs, and rice platter) and teriyaki chicken and rice bowl. In the Southern United States, the company offers biscuits and sweet tea. In Imperial County, California, some locations sell date shakes, reflecting the crop's ubiquity in the region's farms. Jack in the Box also offer guests the ability to customize their meals and to order any product, including breakfast items, any time of the day.

Qdoba serves burritos made in the San Francisco burrito style, tacos, quesadillas, taco salads, chile con queso, Mexican gumbo, and fresh guacamole. The restaurant fits into the "fast

¹ Mergent Online Market Research, January 2013 report.



casual" category, offering both quick service and a higher quality of food than typical fast food restaurants. Customers order by selecting an entrée, then choosing its ingredients. All of the items are made in plain view of the customer. The chain's current slogan is "We Live Food." The Qdoba brand is currently opening about 10% of its current number stores each year, with that number planned to increase to 80 per year by 2014. As of the end of fiscal 2012, Qdoba comprised approximately 37% of the firm's total company-operated units, as compared with approximately 6% five years ago.²

Jack in the Box Inc.'s corporate focus has been on the rapid expansion of the Qdoba brand, in direct competition with Chipotle Mexican Grill. As the quick-service Mexican restaurant concept booms across the country, the Jack in the Box brand has been transformed into a mostly franchised business and the current model is to increase profitability in the existing stores. For this reason, Jack in the Box has hired a CEO to run the Qdoba business, while the company's chairman oversees the Jack in the Box chain.

² Jack in the Box, Inc. 2012 annual 10K report



HISTORY

Founded in 1951 by Robert O. Peterson, Jack in the Box is one of the nation's leading fast food chains. The restaurants are known in part for being the first to develop and emphasize drive-thru ordering, most notably with the introduction of the drive-thru intercom to speed up orders and get food to customers faster. Throughout the years, on-the-go convenience has remained a priority for Jack in the Box, with 85 percent of customers buying food via drive-thru or take-out in recent years.³

In 1968, Peterson sold Jack in the Box's parent company Foodmaker Co. to Ralston Purina Co., which led to major expansion and franchising of the Jack in the Box chain in the 1970s. Leading up to this acquisition, Jack in the Box had experienced modest growth from its California roots, expanding into the southwestern region of the United States, but by 1979, the chain had penetrated the eastern and midwestern markets with over 1,000 locations nationwide. After the new restaurants that resulted from this aggressive expansion did not perform well initially, parent company Foodmaker decided to focus its efforts once again on the southwestern region and shut down many of its eastern and midwestern Jack in the Box locations.⁴

As a result of the unsuccessful expansion efforts, in the early 1980s Foodmaker dramatically changed Jack in the Box's marketing strategy and announced that it would no longer compete for McDonald's target customer base of families with young children. From then on, Jack in the Box would aim to attract an older, wealthier demographic with a more upscale menu focused on higher food quality. Jack in the Box restaurants were remodeled and the menu was expanded to be more diverse. Various sandwiches and salads were added to the menu initially, and Jack in the Box continued to introduce additional new items each year, leading to healthy revenue growth throughout the 1980s. Since this time, Jack in the Box's larger range of menu items has remained a characteristic that has differentiated the restaurant from its hamburger chain competitors. Today, Jack in the Box offers a wide variety of unconventional menu options, including tacos, pizza bites and egg rolls, in addition to the traditional hamburgers and French fries.

³ JackintheBoxInc.com "About Us."

⁴ JackintheBoxInc.com "History."



In 1995, the now-iconic, humanized Jack character was born as part of a new advertising campaign intended to provide a fresh company image after an outbreak of E. coli in 1993 caused major damage to the restaurant's reputation. With an oversized jack-in-the-box-style head on top of a human body, Jack was presented as the restaurant's founder and CEO with a passion for offering the finest food to his guests. The campaign was hugely successful, and the series of commercials has since won multiple advertising awards. Subsequent his introduction, Jack has remained the centerpiece of Jack in the Box's advertising.⁵

In 2003, Jack in the Box acquired Qdoba Restaurant Corp., which operated and franchised Qdoba Mexican Grill restaurants. Unlike the fast food style of Jack in the Box, Qdoba is a fast-casual restaurant, and it emphasizes fresh ingredients and inviting service. In 2008, Jack in the Box discontinued the operations of its 61 Quick Stuff convenience stores, which include a major-branded fuel station developed adjacent to a full-size Jack in the Box restaurant. In Jan. 2011, the company formed Jack in the Box Franchise Finance, LLC. The move is designed to facilitate the further growth of franchise restaurants as opposed to strictly corporate-run locations.

⁵ JackintheBoxInc.com "History."



FINANCIAL ANALYSIS

Profitability & Shareholders Returns

In the fiscal year 2012 (ending Sep. 30), Jack in the Box reported total revenues of \$1.55 billion, down from the \$2.20 billion earned in 2011. In fact, over the past five years, the fast food corporation has experienced a steady decline in yearly revenues. Earnings per share in 2012 were \$1.40, down 21 cents from \$1.61 the previous year. Here are the quarterly and annual revenue/earnings data since 2008:

Revenues/Earnings Data Fiscal year ending Sep. 30						
Revenues (Million \$)						
	2013	2012	2011	2010	2009	2008
1Q	465.5	652.7	664.7	681.3	776.7	777.0
2Q	--	506.6	505.1	529.7	578.4	588.0
3Q	--	501.8	519.3	523.3	575.7	591.9
4Q	--	357.6	504.2	563.2	540.3	582.7
Year	--	1,545	2,193	2,298	2,471	2,540
Earnings per Share (\$)						
	2013	2012	2011	2010	2009	2008
1Q	0.54	0.27	0.61	0.43	0.49	0.59
2Q	--	0.48	0.13	0.32	0.51	0.44
3Q	--	0.26	0.38	0.44	0.57	0.51
4Q	--	0.39	0.49	0.07	0.70	0.47
Year	--	1.40	1.61	1.26	2.27	1.99
Next earnings report expected: Mid May						
Historical GAAP earnings are as reported.						

Source: Standard and Poor's Stock Report



Liquidity & Solvency

Below is a table with some of the key annual financial figures (2008-2012) for analyzing the current financial status of Jack in the Box Inc.:⁶

Key Company Financials					
Per Share Data/Valuation Ratios (\$)	2012	2011	2010	2009	2008
Cash Flow	3.58	3.53	3.08	4.02	3.69
Dividends	NA	Nil	Nil	Nil	Nil
P/E Ratio:High	21	15	21	12	15
P/E Ratio:Low	15	11	15	7	6
Income Statement Variables	(in millions)				
Operating Income	206	187	213	253	251
Net Income	63	80.6	70.2	131	118
Balance Sheet/Other Miscellaneous Data	(in millions)				
Current Assets	231	254	275	300	350
Total Assets	1464	1432	1407	1456	1498
Current Liabilities	275	283	283	338	316
Long Term Debt	400	441	353	348	516
Cash Flow	161	177	172	232	219
Current Ratio	0.8	0.9	1	0.9	1.1
% L.T. Debt of Capitalization	48.4	50.9	39.8	37.1	50.5
% Net Income of Revenue	4.1	3.7	3.1	5.3	4.7
% ROA	4.4	5.7	4.9	8.9	8.2
% ROE	15.4	17.4	13.4	26.7	27.1

Source: Standard & Poor's Quantitative Stock Report

⁶ (Note: Jack in the Box Inc.'s 10K was released on November 21, 2012. Fiscal Year ended on Sept. 29th and most recent quarter ended Jan 20th.)



The current ratio is used to help determine solvency risk. It is derived by dividing a company's current assets by its current liabilities. In effect, it indicates whether one's short-term assets are easily available to pay off short-term liabilities. A higher current ratio indicates is better, while a ratio of greater than one generally is a sign of good financial health. Jack in the Box's current ratio has been hovering around one for the past five years but has experienced a downward trend the past three years, from 1 to 0.8. This may be a cause for concern as the company might be piling on more short-term debt than it can handle.

Return on Equity (ROE) measures the returns management can earn on a company's existing capital base. In the restaurant industry, a percentage greater than 20% is considered above average. Jack in the Box has experienced a considerable drop-off from 2008 through the past fiscal year.

All else being equal, a rising L.T. debt to capitalization percentage indicates greater financial risk. Increasing debt leverage without an accompanying rise in ROE raises warning signs of potential cash flow problems. In general, percentages above 40%-50% can also be considered a warning. L.T. debt to capitalization has been hovering around 50% for the past two years for Jack in the Box, while ROE seems to have concomitantly risen and fallen with it since 2008.



Direct Competitor Comparison					
	<u>JACK</u>	<u>BKW</u>	<u>MCD</u>	<u>YUM</u>	<u>Industry</u>
Market Cap:	1.48B	6.45B	101.34B	30.10B	6.44B
Employees:	22,100	10,870	440,000	78,450	10.87K
Qtrly Rev Growth (yoy):	0.02	-0.3	0.02	0.01	0
Revenue (ttm):	1.55B	1.97B	27.57B	13.63B	1.97B
Gross Margin (ttm):	0.23	0.42	0.39	0.27	0.23
EBITDA (ttm):	222.39M	639.00M	9.85B	2.87B	639.00M
Operating Margin (ttm):	0.08	0.27	0.3	0.16	0.09
Net Income (ttm):	74.97M	117.70M	5.46B	1.60B	N/A
EPS (ttm):	1.48	0.33	5.36	3.38	0.66
P/E (ttm):	23.01	55.79	18.85	19.76	20.6
PEG (5 yr expected):	1.69	1.35	1.87	1.83	1.35
P/S (ttm):	0.95	3.28	3.68	2.2	0.78
% ROA (ttm):	5.51	5.87	15.29	15.6	NA
% ROE (ttm):	17.81	10.58	36.82	76.06	29.4
Debt/Equity Ratio (mrq):	93.12	259.52	89.14	127.25	76.63
Operating Cash Flow (ttm);	198.9M	224.40M	6.97B	2.29B	NA
Levered Cash Flow (ttm):	137.72M	122.14M	3.17B	910.25M	NA

Source: Yahoo Finance (data obtained from S&P Capital IQ)

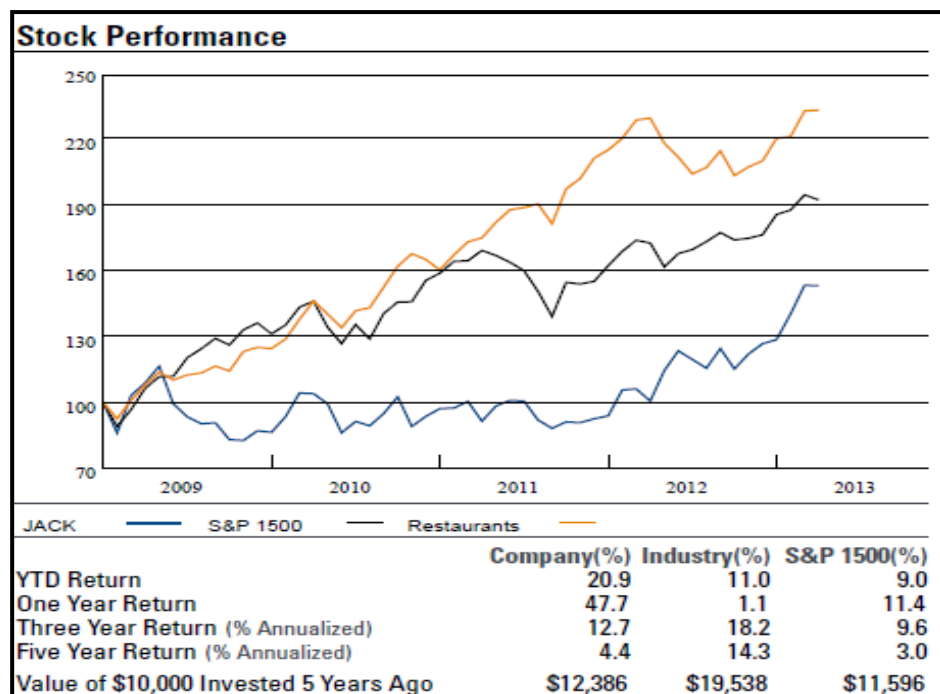
A great way to assess Jack in the Box's financial performance is to compare it to major competitors, as well as to the fast food industry averages. Some of Jack's direct competitors include Burger King Worldwide, McDonald's Corp., and Yum! Brands (owns Taco Bell, Pizza Hut, and KFC...). Jack's operating margin is 0.08, compared to Burger King (0.27), McDonald's (0.30), and Yum (0.16). Jack in the Box is less successful with generating money for each dollar of sales it makes. Jack's ROA is 5.51% and ROE is 17.81%. ROA gives an idea as to how efficient management is at using its assets to generate earnings. According to the data in the table, JACK is less efficient than its direct competitors at generating earnings from invested capital. Jack's ROE was better than BWK's



(10.58%), but worse than YUM! (76.06%) and MCD's (36.82%). This means that Jack was better at generating profits with the money invested by shareholders than BWK was. JACK's P/E Ratio is above the industry average (23.01 to 20.6).⁷

Jack's operating cash flow (ttm) was 136.73 million with a levered free cash flow of 67.61 million. Approximately 51% of cash was used toward capital investment, while around 48% of cash (224 M & 117 M) was used for more capital investments for BWK. These numbers weren't available for MCD. YUM had operating cash flows of 2.29 billion and free cash flow of 915.88M (60% of cash flow devoted to capital investments). JACK had lower debt/equity ratio (102) than BWK (260) and YUM (127), slightly higher than McDonald's (95),.

According to an S&P Report published on April 6, 2013, Jack in the Box's stock price has been on a slow, but steady rise with several peaks and troughs. Jack's stock has risen 18% over the past six months (4Q 2012 – 1Q 2013) and 29.5% over the past year. When analyzing returns on investment over the last three and five years, respectively, one can see that Jack's returns are below the fast food industry averages:



Source: Standard and Poor's Stock Report

⁷ Standard & Poor's Net Advantage



Same-store sales at Jack in the Box company-operated restaurants increased 4.6% in 2012 and 3.1% in 2011, driven primarily by transaction growth and price increases. Same-store sales at Qdoba company-operated restaurants increased 2.8% in 2012 and 5.1% in 2011 primarily driven by price increases in 2012 and a combination of transaction growth, pricing and higher catering sales in 2011.

Jack in the Box experienced a drop in same-store sales in 2009 and 2010 (ranging from approx. 1.3%-8.2%), but positive changes in the same category in 2011 and 2012 (1.8%, 3.4%). Qdoba restaurants experienced a drop in same-store sales in 2009, but positive changes from 2010-2012 (2.8% to 5.3% to 2.4%). The increases were primarily driven by price increases and transaction growth.

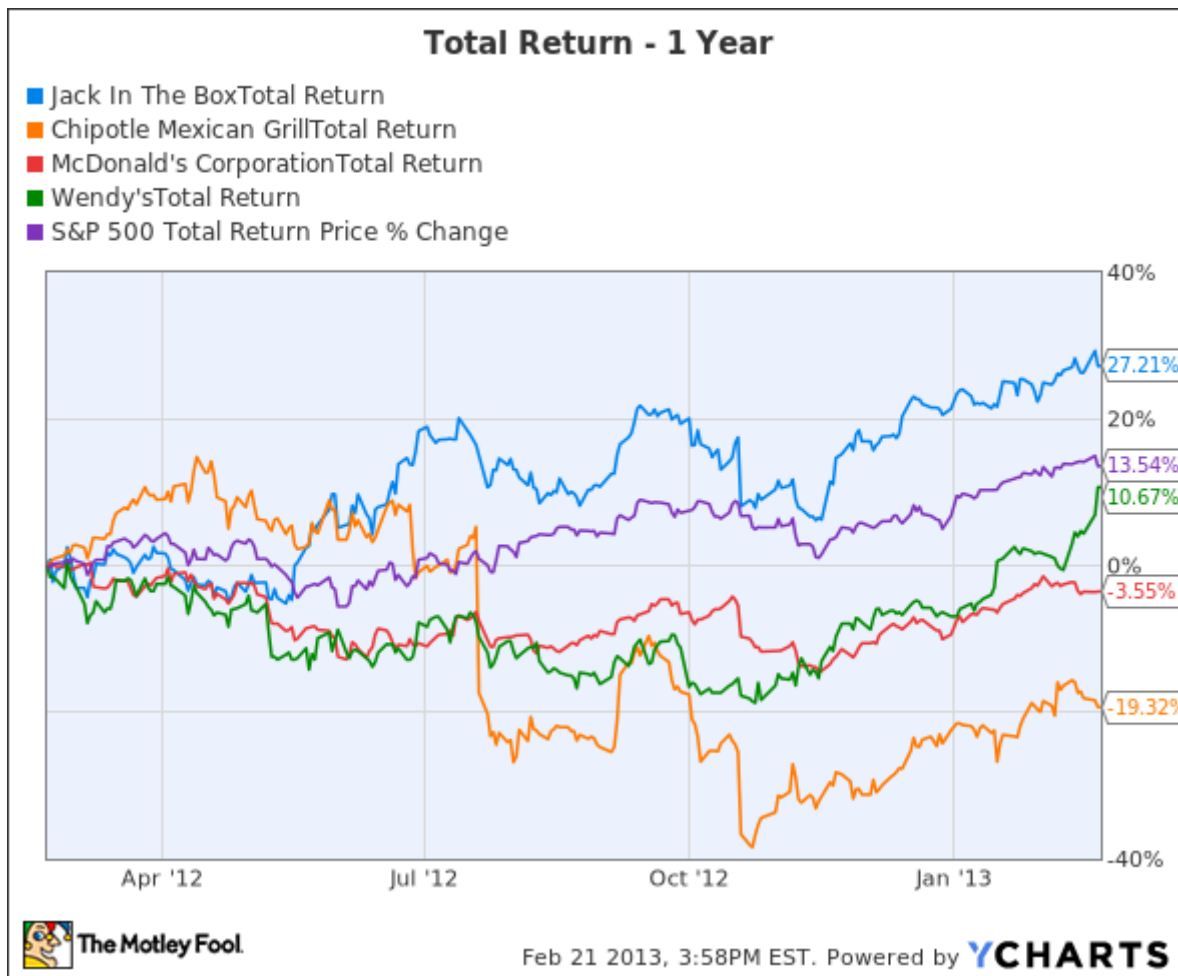
- **Restaurant Sales.** Sales at restaurants open more than one year (“same-store sales”) changed as follows:

	2012	2011	2010
Jack in the Box:			
Company	4.6%	3.1%	(8.6)%
Franchise	3.0%	1.3%	(7.8)%
System	3.4%	1.8%	(8.2)%
Qdoba:			
Company	2.8%	5.1%	0.8 %
Franchise	1.9%	5.4%	3.6 %
System	2.4%	5.3%	2.8 %

Source: Jack in the Box 10K (2012)

Jack in the Box Inc. reported a first-quarter net income that was nearly double that of last year. Sales, however, dropped considerably in January as consumers faced higher payroll taxes, higher gas prices, and delayed tax refunds. In recent years, Jack has modified its menu, upgrading core item quality, reducing service time, and promoting the value of bundled meals. There was an increase in same-store sales for both Jack in the Box and Qdoba. One of the central goals at Qdoba in 2013 is to drive traffic. They have made a conscious promotional effort to differentiate the brand, which has, so far, helped to increase their sales, despite increased competition from Taco Bell and Chipotle.⁸

⁸ www.nrm.com



Source: www.insidermonkey.com



COMPETITIVE ANALYSIS

Market Definition

The restaurant industry is a highly differentiated industry, with products varying in price, taste, style, availability, and intended purpose. Jack in the Box, Inc. competes in the quick-serve/fast food segment, which targets a lower price range, with simpler menus and casual dining options. The industry exists in virtually every geographic area and socioeconomic market, with chains operating identical stores in truck stops and wealthy residential neighborhoods.





Internal Rivalry – High

The industry is comprised mostly of companies with national scale. The fifty largest fast food restaurants in the United States have an average of approximately 900 locations.⁹ There is pressure on quick-serve restaurants to have strong brand recognition, which drives the quick growth of new companies in the market. For this reason, the fifty largest firms also average approximately \$1 million per store in annual sales, which drives the constant growth of new brands, particularly when a product idea catches on quickly.

The US fast food and quick-service restaurant industry includes more than 200,000 restaurant locations with combined annual revenue of about \$190 billion. Major companies include McDonald's, Burger King, Chick-fil-A, McDonald's, Wendy's, and YUM! Brands. McDonald's is the largest fast food corporation in the United States, with annual sales of \$27.5 billion, and 440,000 employees, claiming 14.5% of the market. Jack in the Box, Inc. ranks 7th among all US fast food companies, and 5th among restaurants that primarily offer burgers. The eight largest fast food restaurant corporations control approximately 27% of the market by revenue, making the industry only moderately concentrated.

The market concentration of the eight largest fast food companies does not fully reflect the industry's full competitiveness. The quick-serve restaurant (QSR) segment, like the rest of the restaurant industry, is highly competitive with respect to prices and menu selections. Consumers have a growing number of options to get quality food served quickly at reasonable prices, which places great demands on fast food operators to offer the highest levels of service and food quality. Limited-service eateries compete with other fast food restaurants in the area, as well as a growing number of grocery stores and convenience stores offering deli foods and other prepared food options.

⁹ QSR Magazine "Top 50 Quick-Serve and Fast-Casual Brands" 2/3/2013



Entry & Exit – High

Jack in the Box, Inc.'s subsidiaries are both examples of how easy it is for new entrants to compete in local markets and expand their brands quickly. The industry is characterized by simple menus with items that appeal to a broad consumer base, which leaves little room for success as a large fast food chain other than building brand recognition. Companies like Qdoba grew quickly out of a successful business model, often evident after just one location. Qdoba's first location in Boulder, Colorado had sales of \$1.5 million in its first year, immediately motivating its founders to expand and eventually get bought out.

The entry costs are also relatively low, with restaurants running only in the hundreds of thousands of dollars to open new chains. Qdoba grew from its first restaurant to over 600 locations nationwide in only 16 years, which makes the industry both extremely responsive to niche markets and creative restaurant ideas.

Substitutes – High

Fast food outlets typically try to appeal to the largest number of consumers by offering popular menu items at a modest price. Customer attitudes and tastes change over time, however, meaning that some food items may fall out of favor with the general public. The recent trend in quick-serve sit-down burrito and Baja-style fresh Mexican food exemplifies the ways in which consumer taste trends affect the QSR market.

Restaurant goers are being treated to an explosion of new concepts and menus, especially within the limited-service segment. Some new concepts are being inspired by international cuisines, such as Korean barbecue and other street foods, while others are looking to re-introduce some old favorites like hot dogs and grilled cheese sandwiches by giving them the gourmet treatment. Another new quick-service option sweeping the nation is the food truck: mobile eateries and trailers allow new and existing restaurateurs to set up shop without the expense of a permanent place of business.

Shifting attitudes about health and diet can also affect the popularity of certain foods. Recently, McDonalds rebranded itself with new advertising color schemes and menu items that



highlight quick and cheap fresher, healthier food for on-the-go eaters. Qdoba's menu is designed to appeal to that healthier trend, with simple ingredients and highlights of produce and vegetables in menu items.

QSR operators generally try to monitor changes in consumer attitudes; some chains invest heavily in research and menu development efforts. Jack in the Box utilizes an advanced software information system designed by Windows to give the firm day-by-day detailed consumer choice information.

Supplier Power – Moderate

Most chains have their own suppliers, with prices of inputs not fluctuating much compared to changes in the price of goods in the open market. Larger fast food chains have an easier time managing input costs because they negotiate multibillion-dollar contracts with suppliers for many locations. Currently, 91% of all Jack in the Box locations use the same supplier for their food needs. Larger chains enjoy the ability to choose between suppliers, which gives them chances to negotiate down price and increase the responsibility of suppliers to deliver high quality goods on time.

However, rising commodity prices have also significantly crunched many fast food franchises. With food and beverage inputs making up approximately 33% of costs, higher prices for livestock, corn, wheat and more have seriously shrunk margins over the past decade. In such a fiercely competitive space it is impossible to force a price increase on customers, so profit margins are often below 10%.¹⁰ The recent economic recession did lower commodity prices, but the recession brought on its own complications, and now prices for commodity inputs are on the rise again.

¹⁰ Hoover's industry survey of fast food and quick-serve restaurants



Buyer Power – High

Restaurant-goers have extremely high buying power, particularly in the QSR and fast food sector. Products are virtually homogenous, a unique characteristic in the entire restaurant industry. Chains compete with each other on brand recognition and price, which drives up marketing costs and drives down profit margins. “Dollar menus” are now competing not just on price of goods, but also breadth of options offered at extremely low costs. As buyers seek out healthier options, the major fast food chains are starting to compete with one another on the quality of food offered, and particularly how cheap one can offer high-quality food. McDonalds, the industry leader in innovative fast food quality and pricing, now offers premium coffee at a highly discounted price relative to its self-described competitors Peet’s Coffee & Tea and Starbucks.

Typically highly processed and industrial in preparation, much of the food at QSR chains is high in fat and has been shown to increase body mass index (BMI) and cause weight gain. Popular books such as *Fast Food Nation* and documentaries like *Super Size Me* have increased public awareness of the negative health consequences of fast food. Fast food companies have responded by adopting healthier choices and have had some measure of success, but the shadow of bad press still hangs over the industry. Thus, buyers demand for specific chains is extremely elastic.

To combat the elasticity of demand for fast food products, QSR chains are increasingly adopting social media strategies into their marketing efforts to reach primarily younger consumers. About 20 percent of restaurant patrons would like to receive daily specials in the form of text alerts, while another 30 percent would like to get alerted about specials via email, according to a survey by the National Restaurant Association. Restaurant customers can leave reviews and make recommendations on Facebook and get the latest news about restaurant offerings via Twitter. Creating apps for iPhones and other devices can also help increase customer loyalty.

Jack in the Box’s CEO has said she plans to actually increase the scope of appeal for fast food restaurants by making the company’s menu more enticing for adults age 18 to 50+, not just the typical young male fast food customer. Qdoba offers a simple, fresh and widely appealing menu that caters to slightly older crowds in being more expensive than drive-thru chains. As a sit-down restaurant, Qdoba offers an improved customer experience over traditional fast food eateries. The



higher item prices also makes the chain more weighted to late-in-the-day meals, which consist of larger portions and a desire for higher quality.

The Jack in the Box chain seeks to compete for a broader customer base by offering a range of items that appeal to dieters, classic cheeseburger lovers, snack food eaters, and specific specialty cravings (like the jalapeño poppers and cheesecake bites).



SWOT

Strengths <ul style="list-style-type: none">• Higher quality compared to peers• Franchising builds strength• Low risk exposure• Skilled Franchisees	Weaknesses <ul style="list-style-type: none">• Not recession-proof• Saturated markets
Opportunities <ul style="list-style-type: none">• Health foods• Expanded product line• Diversification• Technology	Threats <ul style="list-style-type: none">• Food safety• Labor Costs• Shifting Consumer Tastes• Financial crises

Strengths

Both Qdoba, which offers an alternative to more expensive sit-down restaurants, and Jack in the Box, which offers more exciting menu items than its competitors, do well with customers who seek higher quality fast food at reasonable prices. Jack in the Box is unique among its competitors because it serves higher quality food, but not necessarily healthier.

Franchising cushions the firm from full exposure. Jack in the Box, Inc. is a proponent of the franchising model because it makes restaurants more closely-managed. It also helps the corporate level by putting pressure on franchise owners to stay as profitable as possible, without putting the company in a position to incur large losses due to exposure to the real estate and entire assets of the restaurant locations. The firm has very well managed franchises, due to strong relationships with its franchisees. Many franchise owners have dozens of stores, and center their operations in a specific geographical submarket. The franchise system gives Jack in the Box, Inc. flexible and dependable managers on location who know the area well, and know how to make individual restaurants successful in the local business climate.



Weaknesses

Fast food had been thought to be largely recession proof, and indeed the industry did not suffer nearly as much as other discretionary spending sectors. In fact, there was some increase in consumer visits as people choose cheaper fast food options over fast casual or traditional restaurant choices. But overall, the recession hurt spending, and consumers overall purchased less with each trip. Fast food franchises fared reasonably well but still felt some pain.

Market saturation is also a relevant issue in the fast food industry today, at least in the U.S. There is a McDonald franchise in almost every town, and it usually sits in a row with several competitors. With so many competitors who offer similar products there are fewer customers per location. Increasingly fast food restaurants are also losing market share to fast casual, a relative newcomer in the restaurant space.

Opportunities

Busy citizens still need quick meal options, and fast food restaurants are fighting these challenges with gusto. Now offering healthy choices to battle the stigma of unhealthy food, some quick service restaurants now focus on fresh or organic products. From franchises focused solely on salads or healthy wraps to the lower calorie options offered at traditional burger franchises such as Wendy's or McDonald's, consumers are able to make better choices on quick food, if they want.

Fast food franchises are also focusing on expanding into new product lines, such as the coffee initiative in the McCafe. Intended to offer competition to Starbucks, McDonalds is luring customers back into their stores, hoping they will purchase food as well. Many franchises have been exploring other meal times such as breakfast and the mid-afternoon snack for growth opportunities and to increase real estate utilization.

The industry is most effectively battling saturation within the United States by creating a much more diverse range of offerings. Sure, there is a McDonalds in every town, but there are very few crepe franchises yet. From new cultural cuisines to fresh takes on a traditional story, there are any more types of quick service restaurants than ever before.



Can Qdoba use wide-open world market for California burritos to its advantage? The Asian and Euro markets love technology. Maybe a great intro to these markets with high-tech customer experiences would capture large market share.

Threats

Food Safety and Quality — Like most other food service outlets, fast food restaurants are highly vulnerable to reports of food contamination that might result in sickness, injuries, or other adverse health effects. Contaminants such as e-coli, salmonella, and hepatitis can seriously affect the health of consumers who ingest contaminated food, leading to loss of business due to restaurant closures and bad publicity. Most restaurant chains go to great lengths to ensure their employees and suppliers follow safe food handling regulations.

Labor Costs — The cost of labor is a significant component of operating expenses for most fast food restaurants. Minimum wage increases enacted by federal, state, or local authorities can have a serious impact on costs and restaurant profitability. Other government regulations that mandate worker compensation or benefits can also impact the bottom line for QSRs. Since fast food restaurants generally depend on teenagers and part-time employees, high turnover rates mean increased costs for hiring and training new workers.

Shifting Consumer Tastes — Fast food outlets typically try to appeal to the largest number of consumers by offering popular menu items at a modest price. Customer attitudes and tastes change over time, however, meaning that some food items may fall out of favor with the general public. Shifting attitudes about health and diet can also affect the popularity of certain foods. QSR operators generally try and monitor changes in consumer attitudes; some chains invest heavily in research and menu development efforts.

According to a November 2011 study by Accenture plc, entitled “Retailing in the World of Bifurcated Customers Segments,” the US middle-class segment of the market, which has been shrinking for a long time now, is gradually disappearing, thus leading to a clear bifurcation in the market between two segments— high-end and low-end customers. The widening gap between the two segments is evident based on various factors. For instance, the top 20% of households earned a



50% share of total income in 2010, compared to 44% of total income in 1988. For the bottom 40% of households, the income share dropped from 14% in 1988 to 12% in 2010. This widening gap is resulting in the elimination of the middle 40%–50% of households that have reduced their spending and are focusing more on value amid a weaker jobs market and a slower housing market recovery.

This study corroborates the findings of a survey conducted by NPD Group in December 2011, *National Household Survey 2011*. This survey finds the market to be divided among different sets of consumers— Optimistic, Cautious, and Hunkered-Down—based on their dining choices and spending habits. Optimistic consumers, constituting around 21% of the adult population and comprised of the more affluent, believe that their income is going to increase and, therefore, have not reduced their spending. Cautious customers (about 42% of the adult population) have cut back their spending slightly as they are unsure about an economic recovery. In contrast, the Hunkered-Down category (37%) has reduced its spending significantly.

Retailers that understood this bifurcation, and delivered their services focusing on either of these segments, have gained compared to those who focused on the middle-class segment. For the three years from September 2008 to September 2011, high-end retailers delivered a total return to their shareholders of 89% and a revenue gain of 19%, while low-end retailers' total return was 78%, with a revenue gain of 19%. During the same period, retailers serving the middle class delivered a negative 5% return and reported a revenue gain of only 6%.



STRATEGIC RECOMMENDATIONS

Split Jack in the Box and Qdoba

Jack in the Box, Inc. CEO Linda Lang is implementing a plan she helped map several years ago to build a multipronged restaurant company that does not depend solely on burger sales to young men. In the process, she's taken on Qdoba as a partial answer to her quest.

Besides its Jack in the Box stores - which now sell more expensive sandwiches and salads as well as standard fast food fare - the company is expanding its Qdoba Mexican Grill chain to more directly compete in the fast-casual segment against rivals like Chipotle.

The push for diversification is taking away from each of the two enterprises. Jack in the Box and Qdoba need very different approaches. Jack needs to reign-in menu and offer more agreeable generalized items that appeal to a sense of freshness. Qdoba needs to be able to compete with Chipotle's brand image and increase revenues per store by getting customers to not only choose Qdoba over chipotle, but also over fast food restaurants in other food categories. Splitting the firms will be better for shareholders, as one stock will be a high growth stock and the other will be focused on large profits and dividends (as the Jack in the Box brand matures and finds its balance).

Qdoba

Qdoba needs to appeal to health food craze

This late in the game, it is hard to brand a chain as a mirror of Chipotle and expect to get as great of returns on assets. It is much better to try to differentiate slightly. Adopting sustainable and eco-friendly business practices could help fast food restaurants attract more business while cutting costs. QSRs that promote their use of locally sourced ingredients can tap into a growing segment of customers concerned with sustainability and food quality. Meanwhile, installing energy efficient equipment, solar panels, or other green technology can help restaurants cut energy costs while possibly entitling those businesses to various tax breaks. Sustainable and ethnic is a great combo!



Qdoba needs to increase customer visits

According to QSR Magazine, Chipotle garners \$2.013 million/store/year while Qdoba gets only \$.961 million/store/year. Chipotle also has double the number of locations as Qdoba. Chipotle had a 23.56% growth in sales in 2012, where Qdoba had only 10% (still high, but trailing its target competitor).¹¹

Many Qdoba locations serve alcohol. Can they have an alcohol happy hour? Qdoba needs to build a loyal base around people who want cheap food that is high quality and fun to eat. The environment needs to be relaxed and positive enough to justify going out to a Qdoba for drinks and a burrito after work or with friends in college. If they can make that mealtime situation work for them, the brand will build on its food and service model and have an appeal as a place people would think of first when considering where to go out for drinks.

Qdoba needs a robust customer loyalty program. Along with the happy hour offering, the brand name desperately needs a technological makeover. The firm needs to use targeted social media to promote food items and the brand image. Qdoba could run ads on Facebook for mealtime specials. The advertisements could be anything from an informational promotion to a special coupon offer for certain menu items only available through the Facebook ad.

Jack in the Box

What is the firm moving toward?

The flagship chain needs to reevaluate its competitive position in the major hamburger fast food industry. Is it able to balance the CEO's goals with a reasonable menu? Not at the moment. The firm should have a flagship item or menu shortlist. Without a singular thing to point toward as the "Jack" food, it is hard to get customers thinking about Jack in the Box when deciding where to go for food. The problem is people don't go to a restaurant because they know the menu items are good. Customers first make a decision on the type of food they want to eat, then evaluate their

¹¹ Chipotle annual report 2012



options from there. If a restaurant doesn't stand out as an excellent option for the craved food, it won't be considered. Jack in the Box faces this issue.

New menu items should seek to fill cravings while appealing to a broad consumer base by not being "guilt food." The Jack in the Box menu changes so rapidly that many items are put on and taken off the list without consideration for the food's likability in a broad national consumer base.

Jack in the Box needs to offer more deals. Standard & Poor's reported a sharp slowdown in menu deals among top fast food chains. This is a huge strength for Jack, which targets customers who want customized combo meals. Evidence exists in most large fast food chains that the race to the bottom on price as made value menus the stars of most companies' offerings. However, discount items have much smaller margins. Customers who purchase value items are not persuaded to combine them with other items, which makes the per-customer margin low. If value menu is tightening margin, Jack in the Box needs to actually tighten the size of the items on the value menu. Customers should be persuaded to order two sandwiches instead of one because they are slightly smaller than the item on the high priced menu.

Jack in the Box has been praised in the past for its witty advertisements, but the fact is its ads are not effective at creating a memorable brand with memorable food items. Jack in the Box ads should target customers based on time of day. It has differentiated itself from other major fast food brands by having a large offering of specialty snack food items. If it wants to increase sales, it needs to be able to effectively target customers with simple ads that show great food at the time of day it would be most craved. Companies can drive traffic during nonpeak periods by offering snack menu items. Almost half of consumers say they snack at least twice a day, and more than 20 percent of snacking purchases are made at a restaurant, according to research from Technomic. To capitalize on this trend, fast food establishments can offer smaller servings or versions of traditional menu items, such as miniature wraps and sliders, to better target snacking occasions.

According to a July 2012 "Mobile Path to Purchase" study conducted by Nielsen for xAd, a mobile-local ad network, and Telmetrics, a mobile researcher, customers are using mobile as a medium to look for restaurants. The study noted that mobile searches for restaurants have a 90% conversion rate to a final order, a much higher rate than searches for any other category such as travel. In addition, the 90% of the searches that are converted get executed by the end of the day



itself, while 64% of the users visit a restaurant searched immediately or within an hour's time. This indicates that the users have a sense of urgency when they search using a smartphone or a tablet. Jack in the Box can create some sort of "Jackapp" locator that gives users notifications of "real time" happy hour or one-hour specials at a nearby locations, primarily at peak meal hours and late night snack time.

In the same vein, it is definitely worthwhile for Jack in the Box stores to bring back "free item" gift certificates when customers purchase one item. Carl's Jr. does this. Starbucks gives a free drink a lot of the time on bottom of receipts.