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LOOKING BEYOND THE P&L

by John A. Gordon, principal and founder of Pacific Management Consulting Group

We've all been taught for years to focus very closely on the restaurant profit and loss statement. We dream about these numbers at night and, pass on the lessons and awareness from generation to generation.

But sometimes, one must look beyond the P&L. There are both expenses (Generally Accepted Accounting Principles (GAAP) expenses, like labor or advertising) and costs, like principal debt repayment and capital expenditures that are outlays of cash. When restauranteurs just focus on the P&L expenses, outlays that really form the basis for the economics of restaurants, gets overlooked.

I hope to show some new patterns of thinking about these numbers. One topic is restaurant marketing and capital expenditures, grouped together. As Nation's Restaurant News pointed out recently, creation of functional and attractive physical plants was the top investment priority, according to the Nation's Restaurant News 2016 Operator Survey. See http://nrn.com/operations/restaurant-operators-have-designs-remodels#slide-0-field_images-162991

Capital expenditures don't have the visibility, or budget discipline that the P&L does. Consider how little discussion and visibility capital expenses have, when say, compared to P&L cost elements. As can be seen from restaurant investor presentations, earnings calls, and the like there is some talk but little.

The table below shows capital expenditures and advertising outlays for a representative high unit sample of U.S. publicly traded restaurants, 14 separate from 2010 to 2014. This table lays out CAPEX next to advertising/marketing expense, and sums the two expenditures. Advertising was listed as a parallel outlay because advertising and capital spending both are useful to the brand by displaying the brand to customers at our best.

Restaurant Capital Spending (CAPEX) and Advertising

% of Sales, 2010-2014

Segment	#	CAPEX	Advertising	Total Outlay
Coffee	1	6.10 %	1.50%	7.60%
QSR	5	6.30%	4.00%	10.30%
Fast Casual	2	6.80%	1.80%	8.60%
Total Casual Diners	6	8.10%	2.90%	11.00%
Normalized Casual Diners	4	5.60%	2.90%	8.50%

Notes and Sources: Securities and Exchange Commission 10Ks, Piper 2015 Cookbook, Pacific Management Consulting Group. Coffee segment is SBUX; QSR is ARCO, TAST, DPZ, JACK and MCD; Fast Casual is CMG and PNRA; Casual Diners includes BJRI, BLMN, EAT, BWLD, DRI, TXRH, Normalized excludes BWLD and BJRI. Values are annual averages.

A few observations can be seen from the detail:

- In examining the brand's advertising expense pepercentages yeary year, it was astounding to note almost no variation in percentage year by year over the five year period. Panera and Bj's were rising and Darden falling but the others varied little over the 2010-2014 period. In my opinion, this is an accident of the budgeting process, and not what we would expect. We would expect waves of marketing expense rising and falling with new products, new social media tools, new messages, election year inflation—but that did not happen.
- As we might imagine, QSR brands had the highest combined outlay—10.3% of revenue, despite franchising and the presence of combined franchisor ad funds. McDonald's (MCD) was the highest at 14.7% and Dominos (DPZ) the absolute lowest in the QSR group (and of the entire 16 brand survey), at 4.1%.

- The coffee segment, just represented by Starbucks (SBUX) in this sample, was the lowest at 7.60% combined outlay. This is despite Starbuck's heavy company operations model; it does not need to advertise much. The value of a smaller store box is also apparent.
- Two casual diners that have ramped up unit growth recently, BJ's (BJRI) and Buffalo Wild Wings (BWLD) were outliers with heavy CAPEX but low advertising, at a 2.6% combined average.
- The two fast casuals in this survey, Panera (PNRA) and Chipotle (CMG) had only an 8.6% total combined outlay. The lower advertising expense was meaningful.

Thinking more broadly, restaurant capital expenditures and advertising need not be separate line items that never see the light of day together. They both can be managed as an outlay cluster to optimize the brand presentation to the consumer. You get the idea; as one goes up and other can moderate.

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