Is it possible to grow sales and comps…and still go bankrupt? The Disconnect between P&L and Balance Sheet Management Awareness

Our industry has historically over emphasized sales and unit growth metrics and under emphasized the interrelationship between the P&L and the balance sheet. This results in a fervor rewarding sales and unit growth, and this results in cycles of boom and bust in this business. These cycles are painful for stakeholders—investors, suppliers, lenders, landlords, corporate executives, store managers and hourly employees. These wave trends pressure the industry directly right now in two most sensitive parameters— availability of sites and employees.

An example of this is the lack of reporting of franchisee sales, profit and balance sheet conditions of franchisors, as well as the sales and new unit development numbers reported in the press. That reporting happens because no other data is known or projectable.

The roots of this problem date back to when we were young store managers, when we were taught to closely watch daily sales. Using daily sales report templates that were once created by hand and now maintained by POS systems, we got a sense of the implications of busy or slow. We had to count and then take the money to the bank. Later, with some maturity, we began to understand if it was slow, to cut back on food prep and to cut labor hours, and vice versa. At junior management levels, we were not taught about return on investment, or sales to investment ratios or debt service coverage ratios. That was left to someone else. In time, many of us learned and grew into more senior positions and got the equivalent of masters and doctorate degrees in restaurant management.

In 2018, with almost seventy years of business management science and systems development from the end of World War II, some restaurant companies make the same mistakes as if they had 22 year old executives just out of community college leading the show. The problems are more apparent in young start up firms—with owners with no outside advisors, or PE firm, or attorney or consultant.…and with independent restaurants (still more than 55% of all restaurant counts in the US).

We see evidence of this all the time when we see new restaurants open and close within mere months. The shortest restaurant operating duration I saw was a fast casual pizza franchise operation that was brand new…and built expensively out…and closed for good about 90 days later. This has been evident in the UK, with the Jamie Oliver Restaurant empire building expensive casual dining and fast casual Italian restaurants…. which then close a few years later.

https://www.independent.co.uk/news/business/news/uk-restaurant-chains-losing-money-prezzo-jamies-italian-high-street-crisis-a8236911.html

And recently, a national brewery chain—Green Flash--slid into foreclosure and auction, after closing a $20 million brewery in Virginia that was only 16 months old, and closing another California location and defaulted on a $20M loan with a regional bank. The now displaced CEO wrote the following in April 2018 and is highly instructive:

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Dear GFBC, Inc. Shareholders,

On behalf of myself and the Board of Directors of GFBC, Inc. (the "Company"), I am truly sorry to report that the Company's senior lender, Comerica Bank, has foreclosed on its loans and sold the assets of the Company (other than the Virginia Beach brewery) to WC IPA LLC through a foreclosure sale which closed on March 30, 2018. As such, the Company no longer owns the Green Flash and Alpine businesses. Comerica Bank is currently conducting a separate process to sell the Virginia Beach brewery.

After a general slowdown in the craft beer industry, coupled with intense competition and a slowdown of our business, we could not service the debt that we took on to build the Virginia Beach brewery, and in early 2018, the Company defaulted on its loans with Comerica Bank. While we took substantial efforts to recapitalize the Company over the past several months, both before and after the bank default, we were ultimately unable to close a transaction.

While the Green Flash and Alpine brands will continue they will do so under new ownership, and GFBC, Inc. and Alpine Beer Company will be wound down and dissolved. I sincerely thank you for your support over the years.

Sincerely, Mike Hinkley CEO GFBC, Inc.

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A good recap of the Green Flash story is below:

http://www.sandiegouniontribune.com/business/sd-fi-green-flash-foreclosure-20180403-story.html

As one proposed solution, the education pattern at restaurant focused university programs, professional associations and culinary schools can be enhanced to include a focus to both the income statement and the balance sheet. Here are a few topical suggestions:

•Sales, average ticket, food and labor cost, operating expenses: what is reasonable and necessary to survive.
•How do results from the income statement flow into and affect the balance sheet?
•Is an additional dollar of sales from any source worth the same profit flowthrough to the restaurant?
•What are the consequences of signing a lease, what are the consequences for leasing a small square footage restaurant versus a large restaurant?
•If you are building out a new restaurant and the costs come in much higher than you expected, what do you do?
•How older restaurant equipment and repairs should be funded systematically via a restricted cash reserve.
•What maintenance capital spending items are necessary to prevent further equipment deterioration, and employee or guest liability from injuries?
•In planning for new sales platforms (say, a food truck, or a pick up window, etc), what is the amount of sales lift necessary to really make money?
•If ready to expand to a new or additional unit, how does it get funded? How much debt is too much?
•If expanding from a home base market to an expansion market, how far away is too far?

About the author:

John A. Gordon is a long time industry veteran with 45 years of operations, corporate staff and management consulting experience. He founded Pacific Management Consulting Group in 2002 and focuses on restaurant strategy, operations and financial management topics. He is reachable at jgordon@pacificmanagementconsultinggroup.com; office: (858) 874-6626; website: http://www.pacificmanagementconsultinggroup.com.