

Food & Beverage - Cash Is King? - By Joe Dunbar  
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A well lubricated restaurant model should pump buckets of cash into the bank.

Once a unit's fixed investment stabilizes, a decent sales volume will start producing positive cash flow. The Wall Street people monitor a key indicator of business health - EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization). EBITDA eliminates many of the financing and accounting policies from the income statement model. EBITDA is not the same thing as cash flow.

If you want to eliminate just the impact of depreciation and amortization from the income statement, OIBDA (Operating Income Before Depreciation and Amortization) is the measure for your report. The starting point in OIBDA is Net Operating Income. Just add back depreciation and amortization.

Once a new restaurant begins experiencing positive OIBDA, they are contributing to interest expenses, debt repayment and the fixed investment made in FF&E (Furniture, Fixtures and Equipment) and Leasehold Improvements (expenses needed to change the space which stay with the property). The operator rarely has any income taxes at this point in the evolution of the business. Depreciation and amortization will swallow up these profits.

After many discussions with new restaurant owners and franchisees, I believe OIBDA less interest expenses may be the best solvency measure. This requires a healthy business with a sales volume high enough to cover current operating expenses and interest on your loans. Operating Cash Flow (OCF = EBIT + Depreciation + Amortization - Taxes) is closely related to my measure. In the formative days, taxes are probably irrelevant. OCF must simply be large enough to cover interest expenses.

A business producing positive OCF has the opportunity to approach other investors to convert debt into equity. They have almost reached the end zone.

With one final push, achieving positive OIBDA less interest expenses, restaurateurs do not need to attract new investment. They have covered themselves and can focus on growth strategies. Their work has produced a "Survivor" model. This is a tremendous accomplishment for the boot strap organizations.

Successful restaurant investors pay income taxes. This cost is a tribute to the operation's ability to cover all operating expenses, the periodic write-downs on investment in the infrastructure and interest payments to the bank. These savvy operators can now look to a second location.

Thanks!!!

Joe

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