

Holland Views – Domino Pizza: Price: 285p; MCap: £1.4bn

Counter Punching

In the last few days, others have assessed Domino Pizza's outlook as being a little less rosy than the future we outlined in our recent work (*Holland Views – Dominos – Built to Last, May 2017*). Whilst not specifically commenting on others work we will make a couple of points post a number of observations and queries that have been raised with us in recent days.

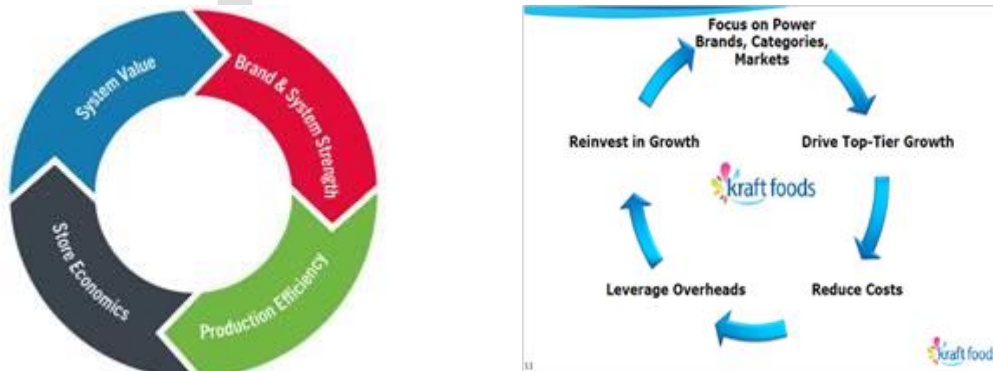
Long term or short term focus

The approach that we take in assessing companies tries to take a decidedly long-term view. That is why we spend so much time on searching for Franchise-type characteristics as these will likely define whether a company has the business model and culture to keep evolving and growing over the very long term. As Holland is our own company this is something perhaps a little easier for us to do, for we have no parent company or sales colleagues telling us they want more actionable ideas. This is not meant to criticise others' work - for we have made many a mistake by ignoring shorter-term weak trading in companies that actually foretold real trouble. The point is more that by looking for the right characteristics that a complex company should have in order to secure lasting success, it becomes easier to see maybe why they have done so well in the past if you find these traits present.

This is very much the case for us with Dominos. It's moves into mobile ordering and great marketing campaigns along with well-aligned franchisees did not all happen by chance; most were a function of good planning and longer-term thinking towards what customers (both the end customers and franchisees) wanted. We illustrated in our recent price the wheel of re-investment and innovation that many franchises employ –showing that we thought Dominos was doing so in words and deeds. For the business to regress to a more muted level of growth we think those that criticise it need to demonstrate a break in this circle. More often than not such a break would come from a challenge from a new competitor with a new angle of attack that changes the market or a technological change that alters the competitive environment (think Amazon over Tesco).

Whilst there are observations made of better trading at Pizza Hut of late vs. Dominos we have seen little evident of the sort of challenge that would concern us.

Fig.1: Common characteristics of great businesses – e.g. brand re-investment:



Source: Dominos (2016) & Kraft (2010)

Additionally, the recent strength of businesses such as just eat or Deliveroo we see as complimentary to Domino's rather than undermining it as they re-enforce the mobile app and delivery model that drives Dominos growth.

What price growth?

The second point we would comment on is the price an investor is willing to pay for a defined level of growth. That LFL sales growth in coming years could be lower than current analysis forecasts of course could occur, but that in and of itself is not assessing price and value. In our recent piece we showed the following extract of our simple Domino's model (which we are happy to share).

Fig.2: Holland Advisors – simple model of Dominos Pizza Group

		UK Target given of 1600									
		1	2	3	4	5	6	7	8	9	10
	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec	Dec
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Outlets UK	950	1015	1080	1145	1210	1275	1340	1405	1470	1535	1600
added in year	81	65	65	65	65	65	65	65	65	65	65
%	9%	6%	6%	6%	5%	5%	5%	5%	4%	4%	4%
Outlets Other	113	124	137	150	165	182	200	220	242	266	293
added in year	11	12	14	15	17	18	20	22	24	27	27
%		10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
Sales UK	319	351.1	384.7	420.1	457.3	496.3	537.3	580.2	625.3	672.5	722.0
% rise		10%	10%	9%	9%	9%	8%	8%	8%	8%	7%
Revenue Per outlet UK	335,789	345,863	356,239	366,926	377,934	389,272	400,950	412,979	425,368	438,129	451,273
rise		3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
EBIT UK	79.2	86.01	96.18	107.13	118.90	131.53	145.06	159.56	175.08	191.67	209.39
Mgn	25%	25%	25%	26%	26%	27%	27%	28%	28%	29%	29%
Other Sales	41.5	54.0	62.0	71.3	82.1	94.4	108.5	124.8	143.5	165.0	189.8
% rise		30%	15%	15%	15%	15%	15%	15%	15%	15%	15%
Revenue Per outlet											
rise		5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Total Sales	360.50	405.00	446.78	491.48	539.35	590.68	645.79	705.02	768.80	837.56	911.83
Other EBIT	6.6	8.8	10.5	12.4	14.7	17.4	20.5	24.2	28.6	33.7	39.7
Mgn	16%	16%	17%	17%	18%	18%	19%	19%	20%	20%	21%
PBT	85.7	94.9	106.7	119.6	133.6	148.9	165.6	183.8	203.6	225.3	249.1
Group Mgn	24%	23%	24%	24%	25%	25%	26%	26%	26%	27%	27%
Tax	-17.4	-19.0	-21.3	-23.9	-26.7	-29.8	-33.1	-36.8	-40.7	-45.1	-49.8
rate	-20%	-20%	-20%	-20%	-20%	-20%	-20%	-20%	-20%	-20%	-20%
PAT	68.3	75.9	85.3	95.6	106.9	119.1	132.5	147.0	162.9	180.3	199.3
Gwth		11%	12%	12%	12%	11%	11%	11%	11%	11%	11%
Payout ratio	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%	80%
Payout in £m		60.71	68.27	76.51	85.50	95.29	105.97	117.62	130.33	144.22	159.40
Assumed PE	22	22	22	22	22	22	22	22	22	22	17
Implied Mcap	1503	1669	1877	2104	2351	2620	2914	3234	3584	3966	3387
PE on Today MCAP	22.9x			16.3x		13.1x		10.6x			7.8x
						IF PE= 22				IF PE= 17	
						Upside 100%				Upside 54%	
						5y IRR 15%				2nd 5y IRR 9%	

Source: Dominos, Holland Advisors

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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