Holland Views – Domino's Pizza Group plc – Price: 280p; MCap: £1.3bn

Volte face

Our detailed work on Domino's plc in March and some follow up commentary we made over the summer is re-attached below. In light of yesterday's news from the company we feel this work is well worth investors re-reading. In it we observed a number of key points:

- We liked Domino's as a business despite its senior management – which we felt had to be changed urgently.
- The distrust between management and franchisees was a key source of the current conflict. It is as much about the individuals involved as it is about the economics.
- Yet, it was notable that the company was(is) still growing UK LFL sales at 3% pa in such a confrontational corporate environment.
- We observed that the company needed to do three things to improve the risk reward for investors:
  1. Change the executive team
  2. Go back to better capital allocation, i.e. not wasting core cash generation on corporate ambition and vanity projects such as the Scandinavian asset purchases.
  3. Clean up the Income Statement so that we are presented with simple reported earnings and good cash conversion once again (not a whole lot of one-off costs).

Our reflections today

Today we suggest that we are 2/3's of the way there. With both CEO and Chair announcing during the summer that they will retire, now we have yesterday's announcements of the closure or sale of the International (non-UK/Irish) business.

What follows might seem an uncharitable observation bearing in mind that David Wild has agreed to be replaced at the end of the year, but we found yesterday's Volte Face from him a remarkable moment in corporate decision making. It is a highly unusual event for an executive who was the main driver of a decision to deploy shareholder capital in such as expansionist way only 3 years ago, to now admit failure so quickly. Whilst we admire this in a way, it clearly it reminds us this is not the sort of decision maker/capital allocator we want running such a business.

> *"We are delighted to be investing in these exciting markets, which hold great potential for the Group. Our skills in e-commerce, marketing and supply chain will complement the excellent local know-how of our partners in Iceland, Norway and Sweden and help to grow the Domino's brand. This is a great deal for everyone concerned and we look forward to welcoming our new colleagues and customers."* **– David Wild June 2016 on the acquisition of EU businesses.**

In truth we had expected such a decision to made by Domino's, but assumed it would only happen once a new team were installed. In short, this is both a telling reversal of strategy, but a welcome one for those wanting to own a pure play franchising business that organically grows, generates cash and potentially allocates it well.

SAMPLE

Relationships Matter

Our second observation is that we think analysts are still focused on the wrong questions when they ask about franchisee relationship resolution. One of their greatest points of upset franchisees have with the parent is the arrogance of the corporate team they have had to deal with. Mr Market might shrug when a CEO changes tack as sharply as Mr Wild has done today, but business relationships at a personal level do not mend as quickly. We strongly believe that a new Chair and CEO combination should be able to find a resolution that suits all parties. In our work from March we showed an illustration of how an improvement in economics might work for the spilt stores – we would recommend investors re-visit this work. The cost of achieving such a reconciliation is we estimate, far lower than many fear.

The bearish view today that there needs to be some form of wholesale change in the commission agreement between the corporate and franchises is, we think, flawed. The reason we have this view is due to the still excellent economic returns franchisees make from running existing stores. The deadlock between franchisees and the corporate has always been more about how the economics of new stores (Greenfield or 'Splits') work on any future roll-out. But as the lower share price over the last year has discounted less future growth, we have felt the risk reward of the shares to be vastly improved. I.e. as less rollout growth is in fact now discounted. Analysts like to analyse tangible data points, but the resolution to this problem lies with people and relationships and some required give and take (sound familiar?!!).

A new CEO and Chair now have one less decision to make, i.e. the EU expansion strategy has been curtailed before they even start work. Many might see the franchisee resolution problem as a greater hurdle, but if those appointed have the right skills we think the opposite. Crucially this business that is arguably in state of disarray (no store openings and franchisees refusing to take part in national advertising campaigns) is still highly resilient with 3% LFL sales growth. The threat that the aggregators bring to this business is seemingly real, but the rhetoric of the damage they may be causing to Domino's fits a little too nicely for a management team under pressure who have to answer to why sales have slowed. We think this company is still very well positioned in a growth market that is a beneficiary of mobile and other trends. We think an aligned Head Office and franchisee relationship might well see LFL sale growth double (3% to 6%). Were it to do so we think Mr Market will once again see all these companies as winners (i.e. the aggregators and Domino's). At that moment if its profits are clean and well allocated we think the shares will be priced nearer a 20-25x PE again.

SAMPLE

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

Disclaimer

This document does not consist of investment research as it has not been prepared in accordance with UK legal requirements designed to promote the independence of investment research. Therefore even if it contains a research recommendation it should be treated as a marketing communication and as such will be fair, clear and not misleading in line with Financial Conduct Authority rules. Holland Advisors is authorised and regulated by the Financial Conduct Authority. This presentation is intended for institutional investors and high net worth experienced investors who understand the risks involved with the investment being promoted within this document. This communication should not be distributed to anyone other than the intended recipients and should not be relied upon by retail clients (as defined by Financial Conduct Authority). This communication is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose. This communication is provided for information purposes only and should not be regarded as an offer or solicitation to buy or sell any security or other financial instrument. Any opinions cited in this communication are subject to change without notice. This communication is not a personal recommendation to you. Holland Advisors takes all reasonable care to ensure that the information is accurate and complete; however no warranty, representation, or undertaking is given that it is free from inaccuracies or omissions. This communication is based on and contains current public information, data, opinions, estimates and projections obtained from sources we believe to be reliable. Past performance is not necessarily a guide to future performance. The content of this communication may have been disclosed to the issuer(s) prior to dissemination in order to verify its factual accuracy. Investments in general involve some degree of risk therefore Prospective Investors should be aware that the value of any investment may rise and fall and you may get back less than you invested. Value and income may be adversely affected by exchange rates, interest rates and other factors. The investment discussed in this communication may not be eligible for sale in some states or countries and may not be suitable for all investors. If you are unsure about the suitability of this investment given your financial objectives, resources and risk appetite, please contact your financial advisor before taking any further action. This document is for informational purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Holland Advisors and/or its officers, directors and employees may have or take positions in securities or derivatives mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). Holland Advisors manage conflicts of interest in regard to this communication internally via their compliance procedures.

SAMPLE