Domino's reaffirms earnings guidance with positive sales momentum

Domino's Pizza Enterprises Limited **(ASX: DMP)** today reaffirmed NPAT[1] guidance of in the region of +20%. Driven by menu innovation and operational improvements, adding sales in all markets and delivering higher Half Year earnings for the Group.

Network sales for H1 increased +7.1% (+$82.8m) on the prior corresponding period (pcp) to $1,248.9m, +4.0% on a Same Store Sales (SSS) basis.

Domino's reported Net Profit After Tax (NPAT) of $62.9m, on Group Revenue of $567.6m. After normalising for share buy-back costs, NPAT was 7.0% up on pcp

Domino's Group CEO and Managing Director Don Meij said an expanded store network (2,193 stores at H1 end), coupled with a relentless focus on continuous improvement – including reduced delivery times, and exciting new products – would deliver stronger growth in H2.

Mr Meij said: "Our goal is to give existing and new customers more of what they want; menu options, cooking times and a simplified ordering experience that exceeds expectations and the response from our customers demonstrates the importance of this approach."

In November, Domino's highlighted at its Annual General Meeting that profit growth would be appreciably lower in H1, predominantly due to the pcp's exceptionally strong SSS growth in Australia/New Zealand, and some foreign exchange weakness in Japan and New Zealand.

Mr Meij said the results of H1, and trading results for the first five weeks in H2, supported this view.

"Our initiatives this Financial Year are focused on continual improvements in operations, food and digital technology– with our teams in each of our seven markets equipped with the experience and autonomy to execute on these key areas.

"As we enter H2 our targets are designed to set new benchmarks for performance, which we believe are achievable based on our forecast improvements in Same Store Sales growth across our network.

"Management is confident the initiatives in place in all markets are already delivering for our customers, our franchisees and our shareholders, and we look forward to delivering on our plan," Mr Meij said,

The Company will pay shareholders an interim dividend of 58.1 cents (40% franked), up +20.0% on the interim dividend paid in the pcp. The interim dividend will be paid on 08 March 2018 with a record date of 21 February 2018.

Australia and New Zealand (ANZ)

ANZ sales increased +$36.8m to $557.8m for H1, an increase of +7.1% on the pcp (+3.7% on a SSS basis).

Domino's ANZ CEO Nick Knight said the 799 stores in the region were recording strong sales, but growth was appreciably lower in H1 versus the H2 forecast because of the significant growth recorded in H1 17.

Domino's ANZ stores delivered revenue of $173.9m, up +15.8% on the pcp, and EBITDA of $64.1m, (+16.2%).

"Our hard-working franchisees and team members have continued to grow the Domino's business, after lifting SSS +17.4% in H1 17, they grew sales further +3.7% in H118," Mr Knight said.

"The result was slightly softer than we anticipated, but we remain committed to exceeding our customers' expectations with a menu and customer experience that listens to, and exceeds, our customers' cravings.

[1] Net Profit After Tax (after minority interest)

"Adding avocado, Extreme Desserts, and our very first Dessert Pizza, typified this approach, and we rounded out H1 by adding our 16" New Yorker range, that met a previously unsatisfied demand.
"We have the foundations in place for an even stronger performance to deliver a more significant SSS growth increase in H2 compared to H1.

"We have a positive sales momentum leading into H2, we are rolling over a +10.0% increase in sales (versus +17.4% in H1), and we are excited about the products and initiatives we believe will deliver even stronger results."

The ANZ network added 25 organic new stores in H1, and the Company has reaffirmed it expects to open a record number of stores by 01 July 18.

"Our existing franchisees and team members are well placed to decide whether our business is a rewarding investment, and in H1 96% of franchisees were from internal applicants (up from 87% in the pcp)."

Domino's Australian employees also recently voted in favour of a new Enterprise Agreement, an important next step in becoming one of the first Australian quick service restaurants to offer employees a fully modernised agreement, offering terms better than the Modern Award.

The Company has been putting in place strategies to ensure franchisees not only remain profitable but grow profitability and continue to prosper with the new wages in place. Domino's reaffirmed the impact at a store level was in line with previous guidance.

The Company continues its effort to remove wages underpayments from its system, with the nationwide assessment close to completion. Of the stores assessed, breach notices for four franchisees (with 15 stores) have been issued, and three full external audits are currently underway.

"The audit results support our view that this behaviour is the activity of the minority and, while their presence and actions in our business are deeply disappointing, it should not reflect on the positive work of the majority of our franchisees."

Domino's is conducting some trials with order aggregators, to test whether they add incremental sales, work for our operational model, and benefit local franchisees.

Key to this approach would be retaining Domino's core competencies - making, and delivering, hot, fresh food fast, and safely, to our customers. Initial trial results have found order aggregators may reach a new type of customer, that uses these platforms as a 'search engine for food'.

Should any of these trials meet these objectives and proceed to implementation, Domino's will update the market.

Domino's today announced a trading update for the first 5 weeks of trading[2] in H2 18, showing SSS in ANZ increased +5.9% (pcp).

The Company has updated SSS guidance for Australia and New Zealand, now expected to be +6-8% for the Full Year versus +7-9%.

Europe

European network sales increased +€33.4m to €298.0m for H1, an increase of +12.6%[3] on the pcp (+7.7% on a SSS basis).

CEO Domino's Europe Andrew Rennie said the Company's 891 stores across Europe had delivered a solid performance, with standout SSS growth from the Netherlands and Belgium.

Domino's Europe recorded revenue of $188.5m, up +14.8% on the pcp, and EBITDA of $34.7m, (+16.3%).

[2] 01 January – 4 February 2018
[3] +16.9% on an AUD basis

Mr Rennie said management in each country was focused on leveraging the single Domino's brand, developing and implementing technology innovations, and tailoring menus to meet the unique requirements of their local markets.

"I am pleased that across Europe our sales have performed in line with, or exceeded, expectations," Mr Rennie said.

"We have the largest presence in the Group by store count, and our focus is on lifting sales through increased customer counts, higher order frequency and increased order sizes – we are on track to achieving our goals.

"We know this requires the right pricing and product for each market; as one example, we have targeted the lunch market in the Netherlands and doubled this component of sales in the past year.

"The online issues we previously identified in France have been overcome, allowing us to concentrate on increasing brand awareness and delivering value for customers. Indeed, we've grown online sales in France 40% year-on-year, and more than 50% of sales in H1 were driven from online.

"As a result, we've delivered strong Same Store Sales growth in a market where we have three times as many stores as the next biggest pizza company."

In Germany the very early stages of the acquisition of Hallo Pizza are progressing well and Domino's has reaffirmed its conversion target of c. 130 stores; already 115 Hallo Franchise stores have signed.

"We have had very positive feedback from Hallo Pizza franchisees, who are excited about their opportunity to join the market leader in Germany and lift their profitability and sales, benefiting from our economies of scale and aligning with Domino's High-Volume Mentality."

The Netherlands and Belgium reported a strong performance, opening an organic 23 new stores (a record for H1), surpassing Pizza Hut in Belgium by sales, and we are on track to become the largest QSR business by store count in the Netherlands this FY.

The first 5 weeks of trading[4] in H2 18 show SSS in Europe were up +6.9% (pcp) and, following an upgrade in guidance in November, are now expected to be +6-8% for the Full Year.

Japan

Japan sales increased ¥289.3m to ¥21,037.9m for H1, an increase of +1.4%[5] on the pcp (-1.9% on a SSS basis).

Accounting for the seasonality of the holiday trading period, SSS on a 27th week basis were -1.0% lower.

The subdued performance was predominantly due to depreciation of the Yen vs. AUD and a Christmas-only menu promotion that did not meet expectations

Domino's Japan 503 stores recorded revenue of $205.3m, down -8.8% on the pcp, and EBITDA of $23.5m, (-24.3%). EBITDA was -17.3% lower in local currency, however a depreciation of the Yen versus the Australian dollar, accounted for a translation loss of $2.2m.

Mr Meij said the performance in Japan did not meet expectations, and an action plan was in place to improve performance in H2 through improved order count and sales.

"We looked to the lead of other QSRs in the market when we launched a reduced menu over the Christmas period, with the aim of achieving better execution. Our regular customers rejected this approach, and we corrected this in the first week of January.

"Our sales have been flat in Japan and we expect an improved performance in the market.

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[4] 01 January – 4 February 2018
[5] -7.2% on an AUD basis due to a weaker Yen vs AUD

"This will be made possible because of the implementation of OneDigital, allowing us to integrate our online platform with marketing in a way not previously possible, backed by our first 20-minute service guarantee.

"New leadership, led by experienced, long-term Domino's executive Josh Kilimnik, has put new focus around creating order count growth that has had an immediate effect, and we expect this to continue in H2."

Mr Kilimnik said management was determined to challenge the assumptions of the Japanese market, where weekly order counts are lower than in other markets, and order seasonality is more pronounced.

The first 5 weeks of trading[6] in H2 18 have demonstrated these efforts, with SSS up +9.0% (pcp).

"The conversion of stores to carry-out friendly locations, and an increased focus on franchised stores (now 39% of the system) means we are well placed to approach this challenge," Mr Kilimnik said.

"We are taking a back-to-basics approach, targeting delivery customers with our first 20-minute guarantees, made possible not only by the introduction of OneDigital, but also (in 27 stores) 3:30-minute ovens, the fastest in our business.

"Management's goal, working in partnership with engaged franchisees, is to approach this market with a view that we can, and will lift customer counts and sales."

New store openings will be higher in H2 than H1, however the Full Year organic new store openings will be lower than in the pcp while management focuses on franchisee profitability and lifting customer count and sales in existing stores.

Guidance

Domino's reaffirms NPAT growth guidance to be in the region of +20% with ongoing improvements to Same Store Sales in all markets, supported by customer focused initiatives including menu items that introduce, and retain, new customers.

Domino's has updated SSS guidance for ANZ to +6-8% (down from +7-9%). SSS Guidance for Europe and Japan are reaffirmed at +6-8% and +0-2% respectively.

FY18 Guidance on new store openings is between 310-330 for the Group, including Hallo Pizza conversions.

The Group store count target remains at 4,650 stores by 2025. This number includes 1,200 stores in ANZ, 2,600 throughout Europe and 850 stores in Japan.

~ENDS

Domino's Pizza Enterprises Limited (DMP) is Domino's largest franchisee outside of the USA. It holds the master franchise rights to the Domino's brand and network in Australia, New Zealand, Belgium, France, The Netherlands, Japan and Germany. Today, DMP has a network of over 2,200 stores. For more information visit www.dominosinvestors.com.au

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[6] 01 January – 4 February 2018