STOCKS DOWN UNDER

11 APRIL 2022

ASX Top 200 Stocks Down Under

> *No matter how bad a crisis gets...any sound investment will eventually pay off.*

- Carlos Slim Helu (b.1966), Mexican business magnate and investor

DOMINOS

Will it realise its vision?

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Stocks Down Under rating: ★★★★

ASX: DMP
Market cap: A$7.0BN
Dividend yield: 2.15%

52-week range: A$75.81 / A$167.15
Share price: A$80.71

Which company has been the best ASX IPO this millennium? Dominos (ASX: DMP) would have to be up there. Since listing in 2005, it has expanded rapidly and made solid returns for shareholders rising from $2.20 per share to over $80 today. And the pizza chain is not satisfied, with further expansion plans over the next decade. You might forgive investors for being sceptical of growth companies in a rising interest rate environment. But unlike others, this company has a proven track record and the recent share price dip might be a chance to buy in at a cheaper price.

Share price chart

Source: Tradingview

A long-term success story

Dominos began in the American state of Michigan in 1960, although the entity listed on the ASX isn't the parent company, but the world's largest Dominos franchisee outside the USA. It holds the exclusive master franchise rights for 10 markets - Australia, New Zealand, Belgium, France, the Netherlands, Japan, Germany, Luxembourg, Denmark and Taiwan. Dominos in turn franchises its stores to franchisees who run the stores and pay day to day costs. Dominos earns 7% of gross sales in royalties and a further percentage (up to 6%) towards national advertising. It pays a royalty to the parent company in America of 2-3% of sales dependant on market conditions.

The Australian company was founded by Don Meji who is still with the company after 35 years in the industry. He worked as a delivery driver with Silvio's Dial a Pizza before rising through the corporate ranks until Silvio's bought Dominos in 1993 and he became General Manager. Today, Meji is CEO and chairing the company is Jack Cowin who, in a previous life, founded Hungry Jacks and is the largest shareholder in Dominos.

In 2005, Dominos had 375 stores, a market capitalisation of $132m and a net profit of $5.8m. By FY21, it had nearly 3,000 stores, a market capitalisation of over $11bn and a profit of $193.1m. Only 722 of its stores are in Australia – it has a larger store count in Japan as well as in all its European markets combined.

It is also a reliable dividend payer; it paid 173.5 cents a share in FY21 and in FY22 has increased its typical payout ratio from 70% to 80%. In FY22, it is expecting to reach $4bn in global food sales and over $3bn of this is expected to be online. The company is also looking to the longer term – expecting to operate over 6,650 stores by 2033.

A tougher short term

Despite its financial performance, COVID-19 was not completely smooth sailing for the company. Its share price was hit in the initial Corona Crash and after more than tripling in the following 18 months, the recent Omicron wave has sent its share price below $80. The company's higher reliance on online sales helped cushion the blow of lockdowns, but some jurisdictions, such as New Zealand, even banned takeaway food. And just prior to COVID-19, there was legal action launched against the company by franchisees as to if an enterprise agreement was applicable across all stores of a subset. Cases remain before the courts, with the matter listed for trial in November 2022 and Dominos is defending the case.

Dominos' share price has been rising in recent days, but less than the ASX 200 average. You might argue investors didn't like its recent 1HY22 results and have turned off growth stocks now in a rising interest rate environment.

Overall, we believe the results weren't bad - the company grew its sales by 11% and its store expansion numbers were on track to hit its ~500 expansion target for FY22 (with 285 opened). The company maintained its guidance of 3-6% same store sales growth, 9-12% annual store growth. But its EBIT fell 5.7% to $144.7m. This appeared to stem from margin drag in some of the less mature stores, particularly in Japan. That is where the bulk of stores were opened in 1HY22 and this has continued into H2 – the company opened its 900th store in Japan last month, has a presence in all prefectures and wants 2000 stores in the Land of the Rising Sun by 2033.

Long term growth you can trust

Consensus estimates call for $2.7bn in revenue and $494.2m in EBIT in FY23, up 12% and 16% from FY22 estimates. At 33.5x P/E and 17.3x EV/EBIT right now, Dominos' multiple may look expensive at first glance considering its year-on-year growth from FY22 to FY23. But we think it can be justified on the basis of its resilience to COVID-19, long term growth ambitions and the fact that these ambitions are credible thanks to its track record. We also note that DMP's growth from FY22 to FY23 is higher than FY21 to FY22 – its estimated revenue for FY22 is up ~8% and EBIT is flat. Looking further ahead, the company is expected to have $672.9m in EBIT in FY26, which would represent 9.5% CAGR over that horizon and gives it an EV/EBIT multiple of 12.7x and P/E of 23.6x.

Dominos is far from the only ASX company with long term growth aspirations, but it won't be needing capital raises every year to fund it. Dominos is targeting $100-$150m of net capex, which is at levels that won't dent profitability, even with rising inflation. Even in 1HY22, the company's Return on Equity is 48% and Return on Capital Employed is 18.1%.

While Dominos isn't facing the smoothest competitive environment, we think we can trust the management team to deliver in both the short and long term. Four stars from us.

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Stocks Down Under gives you an information advantage to better invest and trade in ASX-listed stocks!