



## Company Description:

Domino's Pizza, Inc., through its subsidiaries, operates as a pizza delivery company in the United States and internationally. It operates through three segments: Domestic Stores, Supply Chain, and International Franchise. The company offers pizzas under the Domino's Pizza brand name through company-owned and franchised Domino's Pizza stores. As of November 13, 2017, it operated approximately 14,400 stores in approximately 85 international markets. Domino's Pizza, Inc. was founded in 1960 and is based in Ann Arbor, Michigan.

## BUY

Current Price: \$175.76

Target Price: \$195.31

Market Cap: \$7.69B

Avg Volume: 1.2B

EBIT Margin: 18.3%

Gross Margin: 30.9%

WACC: 10.3%

## Catalysts:

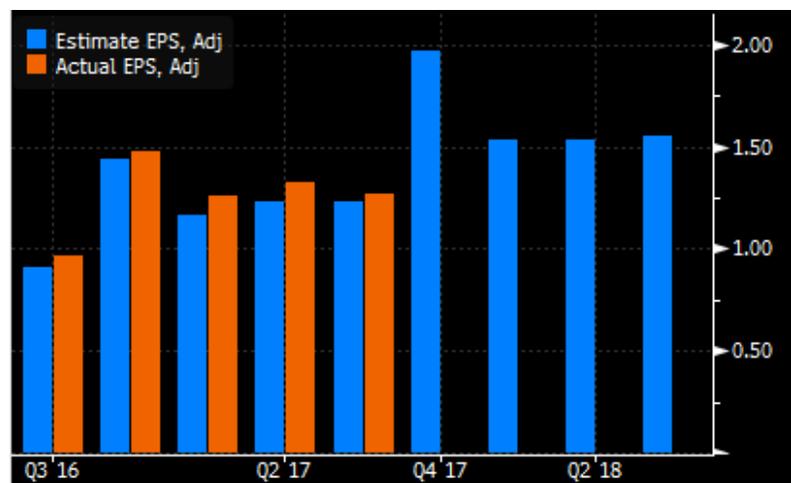
- **Short Term (within the year):** An increase of the Global Online Ordering (GOLO) Fee will drive franchise and company-store income higher.
- **Mid Term (1-2 years):** A large amount of recently opened stores will continue to push revenue growth at the low teens.
- **Long Term (3+):** DPZ's strong franchise model will increase brand awareness around the globe, increasing the number of loyal consumers.



**Thesis:** Domino's has an average growth of 11.6% between 2014 and 2016. This year alone, DPZ has opened 1,804 new locations thus far, generating a 14.7% rise in revenue year-to-date. Strong franchise model will continue to drive revenues higher and continue their domestic and international franchise momentum going at almost no cost on the capex side. Domino's has grown its same-store sales for 95 consecutive quarters in their international stores, while domestic retail sales have been growing at a CAGR of 8.2%, resulting in an exceptional growth record. While being the innovative technology leader at their industry, Domino's have increased efficiency and improved delivery times, reaching a broad range of customers, and keeping up with the advancements of today's technology. I believe that DPZ is a buy at its current price of \$175.73 with a 1-year target price of 195.31.

### 3rd Quarter Earnings Performance:

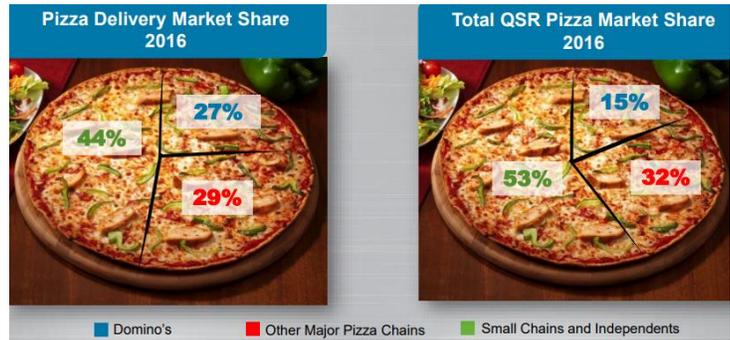
Domino's last quarter performance shows strong growth in same store sales, global store counts and earnings per share. There was an impressive same store sales growth and earnings per share relative to the previous years and previous quarter. There was also a significant increase of number of total stores. Domestic same store sales grew 8.4% during the quarter versus the year-ago period, which represents the 26th consecutive quarter of positive sales momentum in the Company's domestic business. International same store sales grew 5.1% during the quarter, marking the 95th consecutive quarter of positive international same store sales growth. The Company had global net store growth of 217 stores in the quarter, comprised of 53 net new domestic stores and 164 net new stores internationally, and has added 1,182 net new stores over the trailing four quarters. Diluted EPS was \$1.18 for the third quarter, which was up 22.9% over the Company's diluted EPS in the prior year quarter.



### Industry Outlook:

The U.S. Quick Service Restaurants (QSR) pizza category is large and fragmented. It is the second-largest category within the \$281.9 billion U.S. QSR sector. The U.S. QSR pizza category is primarily comprised of delivery, dine-in and carryout. In the United States, Domino's compete primarily in the delivery and carryout segments of the pizza industry. They are the market share leader in the delivery segment and they are amongst the top three chains in share in the carryout segment. Delivery segment sales of \$10.0 billion in 2016 (down

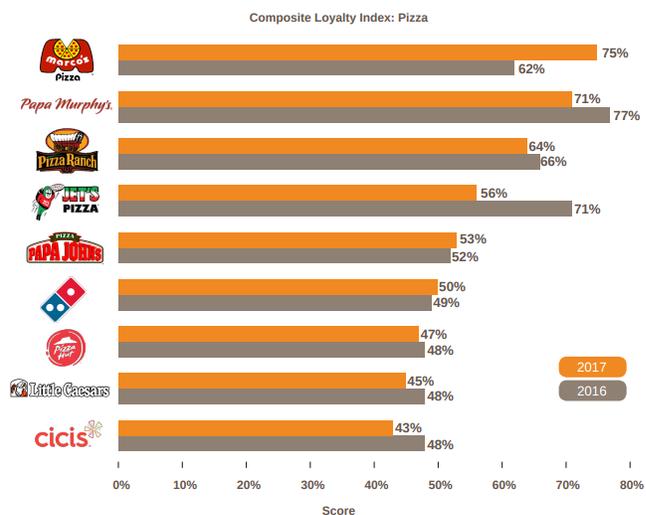
from \$11.4 billion in 2006) account for approximately 28% of total U.S. QSR pizza. Total Number of the Pizzerias in operation in the US, 53% are classified as independent and 47% are classified as chains. Pizza Hut holds the highest market share of the chain Pizzerias (20%), followed by Domino's (15%), Little Caesars (12%), Papa John's (9%), and Papa Murphy's Pizza (4%).



The three industry leaders, including Domino's, account for approximately 56% of U.S. pizza delivery, based on reported consumer spending, with the remaining sales going to regional chains and independent establishments. From 2006 to 2016, the carryout segment grew from \$13.9 billion to \$16.5 billion. The four industry leaders, including Domino's, account for approximately 47% of the carryout segment.

On January 2017, Market Force surveyed 11,319 U.S. consumers and asked them about their QSR dining habits including visit frequency, brand engagement, customer experience, and problem experience. Marco's pizza was ranked #1 pizzeria with a significant score improvement in 2017 compared to the previous year. Domino's is in 6<sup>th</sup> place, above their two largest competitors, Pizza Hut and Little Caesars. According to the survey, Domino's and Marco's Pizza are the only two retailers that have experienced an increase of customer satisfaction in 2017 compared to the previous year. A higher consumer satisfaction score is important to the valuation of this stock since consumer preference is a relevant risk factor in this industry.

Pizza Hut, Domino's main competitor, currently represents 20% of Yum!'s annual operating profit split nearly even between the U.S. and international. During the quarter Pizza Hut U.S. system sales declined 1% with flat same-store sales growth and 2% net unit decline, in comparison with DPZ's domestic same store sales growth of 8.4%. In my valuation, a positive trend in consumer preference alongside a betted same store sales numbers would have a positive impact of DPZ's total revenue going forward, therefore a good investment for the long run.



## Business Model:

Domino's operate in three business segments: domestic stores, international franchise and supply chain. Domestic revenue is generated mostly through the franchise revenue, which consist of 4,979 franchised stores located in the United States. As of January 1, 2017, the average domestic franchisee owned and operated six stores and had been in their franchise system for over 17 years. The company owns 392 locations in the United States. The international franchise segment is comprised of a network of franchised stores in more than 85 international markets. At January 1, 2017, Domino's had 8,440 international franchise stores. During 2016, this segment accounted for \$177.0 million, or 7% of consolidated revenues. The principal sources of revenues from this type of operation is royalty payments generated by a percentage of franchise sales. Domino's developed a cost-efficient store model, characterized by a delivery- and carryout-oriented

store design that offers Domino's significant advantages over the competitors, who mainly focus on dine-in. with a delivery- and carryout focus, Domino's was able to offer a menu option and a more affordable items a consequence of their strategy.



As technology advances, digital ordering is critical to competing in the global pizza industry. Domino's is an innovative technology leader in their sector, and as result, more than half of their U.S. sales came via digital platforms in the past year. DPZ provides their customers with their own online ordering platform, which has enable them to increase profitability and grow the business internally. Domino's mobile applications that cover 95% of the smartphones and tablets on the U.S. market and it has capabilities that allows customers the ability to reorder their favorite order in as few as 5 clicks, or 30 seconds. Over the past five years, DPZ introduced several innovative ordering platforms including Smart TV's, Twitter, and text message using a pizza emoji are some examples of the Domino's technological advantages that attracts the teenagers, busy customers and tech-addicts that love pizza to purchase Domino's pizza.

During 2015, the Company also launched its "Piece of the Pie Rewards" loyalty program, which is meant to reward customers with a program that is simple to understand and easy to use. The loyalty program is a way to retain customers and creates brand loyalty that results in a constant revenue stream.

Domino's PULSE system is designed to drive operating efficiencies for their franchisees and their corporate management and assist franchisees in independently managing their business. Domino's PULSE is installed in every Company-owned store in the U.S., in more than 99% of the domestic franchised stores and in over 65% of their international stores. The success of the PULSE system is directly related to the Same-Store-Sales (SSS) growth over the years. Domino's strong franchise model is seen by an efficient franchise management system that allows franchises to improve their efficiency and profitability, resulting in a constant SSS growth over the years.

## Segment Analysis:

Domino competes primarily in the delivery and carryout areas of the pizza industry. DPZ operate, and report, three business segments: domestic stores (30% total revenue), international franchise (7% total revenue and supply chain (62% total revenue). The domestic stores segments consists of 4.979 franchised stores and 392 domestic company-owned stores, while the international segment only consists of franchises. According to the franchise policy, there is a relatively low initial cost for the investors that want to open a franchise location under the Domino's name, but also they are required to manage a store for at least one year

before being granted a franchise. This way, DPZ's management team has an opportunity to observe and train franchisees to success for the time they open their own location under the company's brand. Strong franchise model has a significant impact on the 95 consecutive quarters of same-store sales. A time-series quarterly EBIT margin for each sector is shown below:

DPZ Annual EBIT Margin							
Segments	2011	2012	2013	2014	2015	2016	Total Growth
Domestic Stores	9.37%	10.12%	10.10%	9.87%	10.52%	10.59%	
GROWTH Y/Y		8.04%	-0.25%	-2.23%	6.58%	0.63%	13.01%
Supply Chain	4.35%	4.96%	5.25%	5.14%	5.29%	5.41%	
GROWTH Y/Y		14.19%	5.85%	-2.22%	2.93%	2.31%	24.47%
International Franchise	5.64%	5.71%	6.03%	6.15%	5.89%	5.59%	
GROWTH Y/Y		1.31%	5.63%	1.97%	-4.20%	-5.07%	-0.76%

DPZ Quarterly EBIT Margin							
Segments	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Total Growth
Domestic Stores	10.73%	10.46%	10.42%	10.78%	10.23%	10.55%	
Growth		-2.44%	-0.40%	3.45%	-5.13%	3.14%	0.82%
Supply Chain	5.35%	5.54%	5.46%	5.77%	5.30%	5.21%	
Growth		3.50%	-1.55%	5.72%	-8.15%	-1.74%	-6.06%
International Franchise	5.88%	5.47%	5.53%	5.32%	5.66%	5.90%	
Growth		-7.02%	1.06%	-3.79%	6.48%	4.25%	7.93%

The Domestic Stores segment currently has the highest EBIT Margin among all the other segments. Domino's have increased their EBIT margins for their two largest segments. Supply Chain currently represents 62% of the company's total revenue, have increased their EBIT by 24.47% in the last five years. Additionally, the Domestic Stores segment, which is the highest EBIT Margin segment, have increased 13.01% in the past five years. In the last quarter, the Domestic and International Franchise segments were the ones that increased their margins the most. The company have pushed to open many stores in the past year, 1,281 new stores for both franchise segments. The new store count have helped the increase of both segment's margins, since there is little cost associated with opening a new franchise. For instance, Domino's have opened over 3,605 new international stores, 954 more than Pizza Hut. Below is an average of DPZ's closest competitors' EBIT Margin.

COMPETITORS Avg Annual EBIT Margin*						
Segments	2011	2012	2013	2014	2015	2016
Domestic Stores	18.07%	16.85%	16.13%	15.60%	13.50%	10.54%
Supply Chain	2.50%	2.55%	2.63%	2.46%	2.73%	2.70%
International	-0.20%	-0.33%	0.10%	0.23%	0.42%	0.45%

\*Competitors numbers include an average of PZZA and FRSH annual EBIT Margins

The competitors show a high EBIT Margin for the Domestic Stores segment, while they in the other segments in comparison to Domino's. Moreover, there has been a decrease from 2011 to 2016 in their EBIT Margin from 18.07% to 10.54% (similar to DPZ's margins). I believe that an fast large increase of DPZ's domestic and international number stores will put some pressure on the competitors EBIT Margin for the two segments while competition's domestic stores margins are have a negative trend and the international side have much lower EBIT margins compared to DPZ's margins.

In the last third quarter earning call, Jeffery Lawrence (CFO) announced an increase of franchise fee from \$0.21 to \$0.25 that will be effective on January 1, 2018. Lawrence mentioned that the increase of franchise fee would not affect the relationship between the company and the franchisee. I believe that the increase of a transaction fee will bring higher revenues to the company from the domestic franchise segment, the operating margins.

## Debt and book value:

Negative book value of Domino's can be worrisome to some investors. In fact, DPZ's book value currently stands at \$-2.8B and Total Debt has grown to \$3.16B, which is about 12x the annual earnings of the company. DPZ's weighted average borrowing rate in the third quarter decreased to 4.1%, according to the Jeff Lawrence, CFO at their Earnings Call.

This large amount of debt is pertinent, and could represent one of the most relevant risk factors associated with the company's success in the future. Higher net interest expense resulting from a higher net debt balance during the period negatively impacted the EPS by \$0.02 and it represents nearly 23% of their operating income. The negative book value and the significant debt load have resulted from the company's willingness to reward its shareholders with dividends, share repurchases and technology investments.

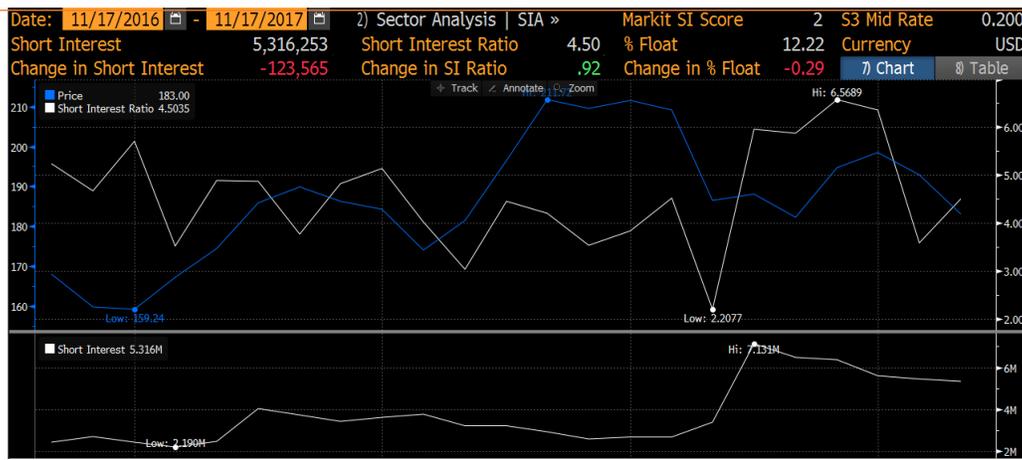
Nevertheless, given the reliable growth trajectory of the company, I believe that its debt should be easily manageable. An increase of the number of franchises in the United States and internationally will guarantee and increase of revenue coming is at a low Capital Expenditure investment For instance, if the company does not issue new debt and keeps growing its operating income at the recent pace for another 5 years, its operating income will be able grow and the interest expense will be eating less of the its operating income. In my opinion, negative equity should not a major headache to investors since there are many other companies with strong business models and confidence in their future outlooks that they are able to manage their debt and continue to increase its EPS.

## Management/Ownership: compared to 6 months out.

Ownership Type	05/07/17	Curr ↓	Change
1) Investment Advisor	80.96	75.50	-5.46
12) Hedge Fund Manager	12.94	17.05	+4.11
13) Pension Fund	1.92	2.05	+0.13
14) Bank	1.86	2.05	+0.19
15) Government	0.37	1.12	+0.75
16) Sovereign Wealth Fund	0.87	0.98	+0.11
17) Insurance Company	0.36	0.45	+0.09
18) Individual	0.42	0.44	+0.02
19) Brokerage	0.08	0.10	+0.02
20) Private Equity	0.09	0.09	0.00
21) Endowment	0.06	0.06	0.00

The ownership type chart is shown above. The majority of DPZ's shares outstanding are held by Investment Advisors at 80.96% and Hedge Fund Managers at 12.94%. In the past 6 months there has been a decrease of the Investment Advisor's ownership (-5.46%), while there has been an increase of Hedge Fund ownership (+4.11%). I believe that an increase of Hedge Fund interest in this stock is a positive sign as they see the market share that Domino's have acquired over the past years and their revenue growth trend.

There has not been much of an overall year-to-year ownership type change. The institutional owners are Vanguard Group (10.03%), Capital Group Companies (6.77%), and Small Cap World Fund (6.24%). DPZ has 99.45% of its shares outstanding as freely floated. The short interest ratio is shown below. Currently the short interest for Domino's is 4.5 days. In the last 12 months, the company's lowest SI was 2.190 while the highest level is equal to 6.57.



## Sensitivity Forecast

The DPZ's stock price is very sensitive to changes of revenue, followed by changes on operating costs. I made a couple scenarios that picture a different outcome compared to my initial prediction. According to my bearish assumption, I assumed that there would be consumer preference change that would result in a lower revenue compared to my assumption. Additionally, I assumed that the company continues to issue more debt and interest expense continues to take away cash from its margins. In this bearish scenario, I assumed that would be a decrease of 1% in total revenue and an increase of 3% operating costs. This would bring the stock value down to \$144.63, a 17.71% decrease from the current price of \$175.76.

On the other hand, assuming that current same-store sales continues to attract more franchisees to join the business, increasing the number of stores and revenue at a lower capital expenditure will increase total revenue, driving the prices higher. Managing their debt and decreasing the interest expense would also increase the value of the company. Technology investments will also payout in the future, decreasing even further the operating costs. My bullish assumption adopts an increase of 2% of total revenue and a decrease of operating costs of 1% relative to my realistic target. My bullish scenario would result in an increase of the stock price from \$175.76 to \$218.39.

Assumption	Current Price	1-yr Target Price	% Change
Bearish	\$ 175.76	\$ 144.63	-17.71%
Realistic	\$ 175.76	\$ 195.34	11.14%
Bullish	\$ 175.76	\$ 218.39	24.25%

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## Summary:

In summary, I believe that the Domino's franchise model has ensured that same-store sales consistent growth over the past years, alongside an increase of franchise fees will continue to improve revenue numbers to years to come. An increase of number of stores will improve brand awareness increase consumer loyalty. An increase of consumer preference and return on the technological investments will increase total revenue. I am long DPZ at a 1-year target price of \$195.34.

**Domino's Pizza, Inc. (DPZ)**

**CENTER FOR GLOBAL FINANCIAL STUDIES**

**BUY**

Analysis by **MARCO**

Current Price: **\$175.76**

Intrinsic Value: **\$171.32**

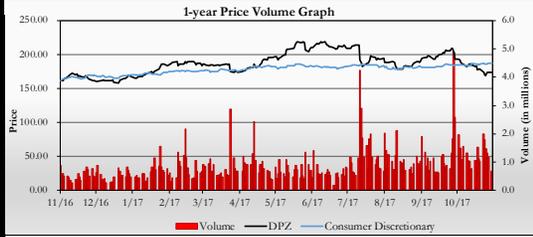
Target 1 year Return: **0%**

11/17/2017

Divident Yield: **1.1%**

Target Price: **\$195.34**

Probability of Price Increase: **90.44%**



**Description**  
Domino's Pizza, Inc., through its subsidiaries, operates as a pizza delivery company in the United States and internationally.

**General Information**  
Sector: Consumer Discretionary  
Industry: Hotels, Restaurants and Leisure  
Last Guidance: November 3, 2015  
Next earnings date: February 24, 2018  
Estimated Country Risk Premium: 8.77%  
Effective Tax rate: 24%  
Effective Operating Tax rate: 24%

**Market Data**

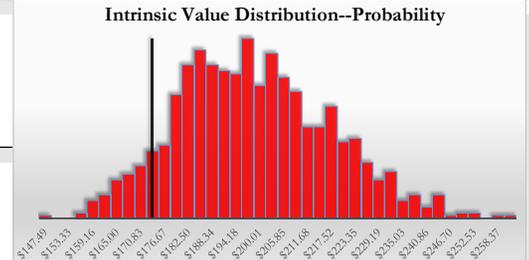
Market Capitalization	\$7,688.87
Daily volume (mil)	0.96
Shares outstanding (mil)	43.75
Diluted shares outstanding (mil)	48.99
% shares held by institutions	86%
% shares held by investments Managers	69%
% shares held by hedge funds	22%
% shares held by insiders	0.56%
Short interest	12.15%
Days to cover short interest	4.46
52 week high	\$221.58
52-week low	\$156.26
Volatility	23.49%

**Past Earning Surprises**

Quarter ending	Revenue	EBITDA
9/11/2016	4.33%	3.80%
1/1/2017	3.85%	-2.47%
3/26/2017	1.01%	0.43%
6/18/2017	2.97%	-3.04%
9/10/2017	2.56%	1.89%
Mean	2.94%	0.12%
Standard error	0.6%	1.3%

**Peers**

Chipotle Mexican Grill, Inc.
Yum! Brands, Inc.
The Wendy's Company
Red Robin Gourmet Burgers, Inc.
Buffalo Wild Wings, Inc.
Jack in the Box Inc.
Restaurant Brands International Inc.
Texas Roadhouse, Inc.

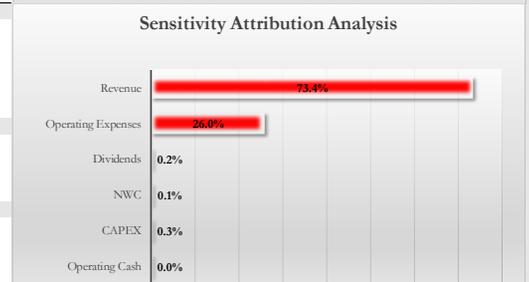


**Management**

Management	Position	Total compensations growth	Total return to shareholders
Doyle, J.	Chief Executive Officer, Pre	6.35% per annum over 5y	19.12% per annum over 5y
Lawrence, Jeffrey	Chief Financial Officer and	N/M	0% per annum over 0y
Werthausser, Judith	Chief People Officer and Exe	N/M	0% per annum over 0y
Weiner, Russell	President of Domino's U.S.A.	4.55% per annum over 5y	19.12% per annum over 5y
Allison, Richard	President of Domino's Intern	-1.11% per annum over 5y	19.12% per annum over 5y
Vasconi, J.	Chief Information Officer an	N/M	N/M

**Profitability**

	DPZ (LTM)	DPZ (5 years historical average)	Peers' Median (LTM)
Return on Capital (GAAP)	40.6%	32.12%	11.70%
Operating Margin	8%	6.51%	4.06%
Revenue/Capital (GAAP)	5.13	4.93	2.88
ROE (GAAP)	-11.4%	-12.6%	2739.8%
Net margin	9.3%	8.2%	6.1%
Revenue/Book Value (GAAP)	-1.23	-1.53	446.33

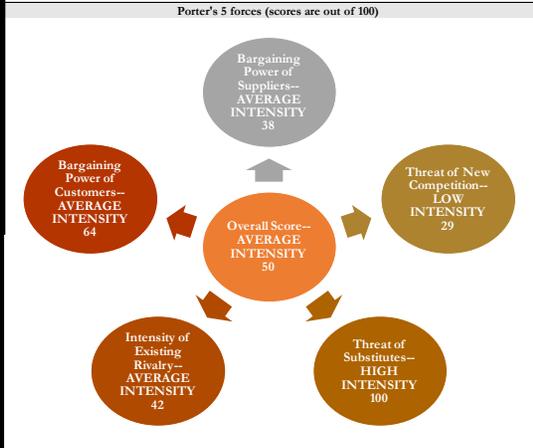


**Invested Funds**

	DPZ (LTM)	DPZ (5 years historical average)	Peers' Median (LTM)
Cash/Capital	27.9%	11.3%	4.5%
NWC/Capital	8.9%	47.2%	0.1%
Operating Assets/Capital	61.2%	37.8%	61.8%
Goodwill/Capital	1.9%	3.7%	33.6%

**Capital Structure**

	DPZ (LTM)	DPZ (5 years historical average)	Peers' Median (LTM)
Total Debt/Market Capitalization	3.97	3.87	0.84
Cost of Existing Debt	4.3%	6.0%	4.7%
CGIS Rating (I-score, Z-score, and default Probability)	A	A	BBB
WACC	10.3%	9.2%	7.3%



**Revenue Growth Forecast**

Period	Revenue Growth Forecast
Base Year	13%
9/10/2018	14%
9/10/2019	14%
9/10/2020	12%
9/10/2021	11%
9/10/2022	10%
9/10/2023	9%
9/10/2024	7%
9/10/2025	6%
9/10/2026	5%
9/10/2027	4%
Continuing Period	2%

**Valuation**

Period	Return on Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	71.2%	10.3%	\$170.87
9/10/2018	89.1%	9.8%	\$196.24
9/10/2019	52.5%	9.9%	\$222.13
9/10/2020	38.3%	9.8%	\$248.86
9/10/2021	31.1%	9.9%	\$276.63
9/10/2022	26.6%	9.9%	\$305.05
9/10/2023	23.3%	9.8%	\$333.99
9/10/2024	20.6%	9.8%	\$363.37
9/10/2025	18.5%	9.8%	\$393.08
9/10/2026	16.8%	9.7%	\$423.01
9/10/2027	15.4%	9.7%	\$453.04
Continuing Period	14.0%	9.6%	

**Revenue to Capital Forecast**

Period	Revenue to Capital Forecast
Base Year	4.56
9/10/2018	5.53
9/10/2019	3.17
9/10/2020	2.27
9/10/2021	1.80
9/10/2022	1.51
9/10/2023	1.30
9/10/2024	1.14
9/10/2025	1.01
9/10/2026	0.90
9/10/2027	0.82
Continuing Period	0.73