

# Domino's Shareholder Value Analysis in Australian Market

Huan Fang<sup>a</sup> and Yanting Zhang<sup>b</sup>

Guangzhou College of Technology and Business, Foshan 528138, China.

<sup>a</sup>huan\_fh@163.com, <sup>b</sup>zyt621\_3@163.com

**Abstract.** This article aims to assess Domino's shareholder value outcomes and explain why Domino's Pizza has been increased significant shareholder value expectations. Domino's Pizza Enterprises has been creating high performance in terms of shareholder value in recent times. In 2015, its stock price rose by approximately 130% while the financial markets widely expect that Domino's Pizza will continue a sizable shareholder value in the near term.

**Keywords:** Domino's Pizza Enterprises; shareholder value assessment.

## 1. Introduction

Over the past five years, the pizza restaurants and takeaway industry has been changed. IBIS industry report (Ledovskikh 2016) highlights two main factors in the face of dynamic economic situation. The first one describes the changing preferences of consumers. While traditional pizzas are still popular worldwide, consumer's demand becomes diversified by pushing their attention into healthier option. Another factor identifies the tendency of improving business efficiency through technological developments, which could also enhance customers' convenience and ordering experiences. Also, because the competition has been more intense, revenue growth has constrained.

However, Domino's pizza, as the largest pizza chain in Australia in terms of its sales and store numbers, maintained its rapid growth in this five-year period and established competitive advantages to reinforce its highest position in the market. As the shares of Domino's have grown by about 750% in the past five years, analysts at Morgan Stanley increased their price target to \$95, which is 46% higher than the current share price (Mickleboro 2016), and many investors believe the company will create meaningful shareholder value in the near future.

This article will analyses the reasons why Domino's investors have such high expectation among three key issues.

## 2. Why is Domino Expected to Create Such Shareholder Value in the Future?

Dividends and share price growth are two main indexes that shareholders want from the company to get the return on investment and compensate risks undertaken.

Table 1. Dividends and share price growth data

Balance Date	Dividend Type	Cent Per Share
30/06/2016	Final	38.80
30/06/2016	Interim	34.70
30/06/2015	Final	27.20
30/06/2015	Interim	24.60

According to Morningstar (2016), in 2015, a 51.8 cents dividend was paid to Domino's shareholders whilst in next year, the number is increased to 73.5 cents per share, with year-on-year growth of 41.9%.

At the time of writing, DMP (Domino's Pizza) shares were trading at &69.60. Before 18 months, DMP had only \$25 per share, which means if you bought at this price and still hold today, you would gain a 178.4% return.

Based on this information, three key issues that contribute to this attractive and profitable index will be identified.

## **2.1 Issues Related to the Market**

In theory, market variances such as market size and market share, are important because they reveal volume effect in achievement of competitive effectiveness in creating revenues. For Domino's, as an example, its growing operating revenue could be partly explained by market variances.

The revenue growth of the industry as well as external environment bring an enormous potential for Domino's operating profits. IBIS claims that the profitability has rose during the past five years with regard to the increasing prominence of gourmet pizzas that could contribute to higher pricing. Whilst revenue growth number shrinks to 0.9% in 2016-2017 (due to stiff competition), the industry revenue is still expected to grow annually 2.2% over the five years to reach about \$4.1 billion through 2021-22. In addition, Mickleboro (2016) also discovers the brilliant connection between Domino's and the millennial generation in terms of advanced technology and increased disposable income.

Additionally, IBIS reports a consistent growth of Australian population and a trend of urbanization. As Domino's target market is lower middle- and middle-class income group, urbanization will bring benefits for Domino's to expand its business and capitalize on these emerging markets.

Indeed, the slowdown growth in domestic market is insufficient to support such high expectation of Domino's to bring such shareholder value. Gilder and Sun (2016) encourage companies to cultivate a global mindset in current competitive industry. With extended business across seven countries and 13,000 stores worldwide, Domino's is already ahead of the game.

The second reason related to the market is about Domino's dominant market share. In this industry, there are two major payers such as Domino's (25%) and Pizza Hut (10.7%). It is worth noting that Eagle Boys Pizza, with the third highest market share (4.6%), went bankrupt. Palmer (2016) views Domino's as a big winner out of Eagle Boys' collapse. He cited the saying by Thomas Kierath at Morgan Stanley that the collapse could be regarded as a sign of Domino's dominance and generate a 6% opportunity of market share. Moreover, Domino's pricing strategy also assist to the revenue growth. Domino's puts pressure on its competitors through its pricing strategy.

Affordability is the key of this successful brand. With uniform and consistent pricing policy that could maintain the base price in check and attract more customers, Domino's initiates innovative schemes on regular basis; for instance, Domino's offers special discounts at regular intervals such as buy one get one free.

## **2.2 Issues Related to the Ability to Convert its (Sales) Outputs into Shareholder Value Outcomes**

Shareholders that provide capital with a company, expect a meaningful return on their investments; in other words, the firm that investors are interested, should be able to create profits that could also compensate the cost of the capital employed. Therefore, the ability of Domino's to deliver considerable return must be high enough to attract investors' attentions.

### **2.2.1 Strong Profit Generation**

According to Domino's annual report, in 2016, the company generates \$1,964.1 million (32.7% on the prior corresponding period, PCP), \$92.0 million of Net Profit After Tax (43.6% PCP), which both exceed Group guidance. These numbers indicate a strong organic growth of Domino's.

### **2.2.2 Sustainable Shareholder Value**

There are two measures that reflect the ability of a firm to generate profits.

The first one includes several accounting metrics. For instance, 41.95% of the return on Investment, 31.99% of return on assets and 92.2 cents of diluted earnings per share are evidences to explain the ability to generate shareholder value. However, because the business risk is excluded under accounting policy, it may produce distortions when measuring shareholder value.

Thus, another system that incorporates risks associated with the company is Economic Value Added (EVA), which calculates the differences between Net Operating Profits After Taxes (NOPAT) and the cost of Capital Employed by both debt and equity holders.

According to Morningstar's data (2016), the EVA of Domino's during the past five years is calculated in the following table.

Table 2. The EVA of Domino's during the past five years

(\$ millions)	2012	2013	2014	2015	2016
NOPAT	29.09	34.89	57.51	78.94	113.31
Capital employed	131.08	142.25	379.30	429.89	716.34
EVA	15.85	20.52	19.20	35.52	40.96

Notes: due to the lack of direct data of NOPAT, use NOPLAT instead (assume adjusted tax = tax); the WACC number (10.1%) is from Morgans's research (2016).

This table shows a positive EVA during this period, which means that shareholder's value has added by generating returns from compensating risks. In short, Domino's has paid its investors' operating and capital costs as well as generated additional wealth. Moreover, since 2014, the EVA has increased that shows an improved profitability of Domino's operation.

### 2.3 Issues Related to Efficiency/Productivity

As stated above, the pizza restaurants and takeaway industry has been becoming competitive, which drives product innovation and technological development. In particular, Domino's initiates customer-inspired innovative product and gains a competitive advantage of technology such as GPS pizza tracking and the mobile applications for consumers to order pizza online.

Domino's lists and briefly introduces ten innovative projects announced by Domino's (Domino's pizza 2016; cited in Homewood 2016). In related to operating efficiency, three of them are picked to present in the following.

#### 2.3.1 Estimated Delivery Time

This is the latest update to the Pizza Tracker, which is set for customers to track each stage of the pizza order in real time. It further provides consumers a more accurate time for the delivery. For customers, this addition could increase customer experience; for Domino's itself, it also increases efficiency by reducing the waiting time of the deliveryman.

#### 2.3.2 Project 3/10

This reflects the new philosophy of the company – 'Slow Where It Matter, Fast Where It Counts.' That is, Domino's staff could not only be slow in taking time to correctly make the pizza, providing the considerate service with customers, but be fast in the hustle times and be able to streamline operational procedures by applying Domino's time crunching technology developments. Due to the technology, Domino's is able to control their performance with giving consideration to efficiency.

#### 2.3.3 Domino's Data

Because of the excellent sales of the company, Domino's has accessed the big volume of data of its customers. Along with a new targeting system that is created by Domino's, the company could provide customers with more relevant and personal content and therefore, to ensure its tailoring customer orders. This allows Domino's to enhance customer experience and increase efficiency by grasping the accurate consumers' information.

Technological development is one of advantages Domino's has to compete with its competitors. This also helps the company to gain such high revenue as indicated above. Don Meij, Domino's chief executive has claimed that Domino's is not just a food company but also one of the best technology companies. The pursuit of technology could be seen on their website – they are 'committed to being at the forefront of technology innovation.

These are supposed to assist the efficiency of the company; however, some accounting matrixes do not reveal the same story (data from Morningstar 2016).

Table 3. Some accounting matrices data

	2012	2013	2014	2015	2016
<b>Invested Capital Turnover</b>	4.95	3.70	8.51	5.82	3.06
<b>Asset Turnover</b>	1.23	1.29	0.86	0.91	0.67

Notes: Invested Capital Turnover measures the value of operating revenue that the company has created each unit of capital invested in the business (Morningstar 2016), while Asset Turnover measures efficiency that is ability to generate revenue from its total assets (Fairfield and Yohn 2001).

According to this table, especially for asset turnover, the numbers are lower since 2014. This means company did not perform more efficient than before whilst as shown above, Domino's announced many useful innovations.

### 3. Summary

In conclusion, by analyzing the reasons why investors raise shareholder value expectations of Domino's in terms of its performance, for the company itself and an executive, in order to deliver considerable shareholder value, the most importance is to make a good decision by accurately grasping external situations and trends and managing the performance such as setting strategic priorities. For Domino's, the most priority is to focus on value proposition to consumers and cost efficiency.

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