Domino's Pizza Group Q3 Trading Update

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Elias Diaz Sese

Interim Chief Executive Officer, Domino's Pizza Group

Welcome

Good morning everyone. I really thank you for joining our conference call to discuss our Q3 results. I am Elias Diaz, the Chief Executive Officer on an interim basis and I am delighted to be joined today by Edward Jamieson, our new Chief Financial Officer. By the way, this is week four and week five for both of us. Also in the room are Dominic Paul, our outgoing CEO and David Surdeau our outgoing CFO, as well as Will MacLaren our Head of Investor Relations. I would like to take this moment to personally thank Dominic and David for their tremendous contribution to Domino's and for helping both Edward and myself with such a smooth handover. Thank you, Dominic and thank you David.

I am extremely excited to be leading this business having been at the Board for the last three years as well as having been a shareholder of this company for the same period of time. I was part of the Board who helped create the current strategy and I am looking forward to continuing to accelerate its execution alongside our franchise partners, our suppliers, and my colleagues at DPG.

Turning to today's call, Edward and I will give a brief summary of the statement we have released today and then we will answer the questions which have been submitted by all of you this morning. Let me turn to the statement we released this morning.

Q3 Trading Performance

Let me turn to the statement we released this morning, starting with our trading performance. We are very pleased with how we traded in Q3 and the performance in Q4 to date reinforces our view that we will continue to deliver market share gains and increased returns for shareholders. Q3 like-for-like system sales excluding VAT were up 2.4% which compares with 0.9% in Q2. If you compare our total system sales in Q3 with the same period in 2019 they were up 19.6%. We have made a strong start to Q4 with our like-for-like system sales excluding VAT up 10.4% in the first six weeks, with total orders up 2.6%. This strong start has been driven by a focus on service from our franchise partners, our digital strategy, the strong national value campaigns, collections growth and the initial incremental benefit of being on the Just Eat platform. I would like to thank our franchise partners for their extraordinary effort in focusing on service and rolling out the Just Eat platform in our busiest quarter of the year. Thank you to all of you.

We have grown our share of the UK takeaway market, increasing from 6.4% in Q3 last year to 7.2% in Q3 this year, despite the tough comparator period and contraction in the overall market size. As expected, total orders were lower in July due to the tough comparator with the knockout stages of the men's Euros Football Tournament and were muted in August given the staycation impact from the previous year. September was stronger trading month, and this momentum has continued in Q4, as I just explained. Delivery orders declined 12.7% in the quarter due to a tough comparative quarter last year. Collections performed strongly and increased 28.1% in the quarter driven by our strong value message and our continuous strategic focus on this channel.

Digital Progress

I would also like to highlight the continuous digital progress we are making. Over the last year we have significantly upgraded our internal digital team and capabilities. The team have made a phenomenal start but there is a lot more to do. Our app now accounts for 45.7% of our system sales, an increase of 3.7 percentage points compared to the same period last year. In the same period in 2019 the app accounted for 34.8% of system sales. We now have 5.6 million active app customers, and this is an increase of 5% over the last six months. As a reminder, app customers are important as they have higher order frequency and have a higher lifetime value.

Strategic Milestones

Just Eat national rollout

You would have also seen from our statement this morning two important strategic milestones for the business. Firstly, Domino's will be rolled out nationally on Just East following a very successful trial. We started the trial in May to assess whether we can reach in incremental customer base with similar economics for our business. The early results were encouraging, so we extended the trial in August and as a result of the continued success of the trial where we saw we continued to attract incremental customers, we have decided to fully roll out on Just East in the UK and Ireland. As of today, 1,000 stores are now live, and we are targeting the completion of the rollout by the end of the year. Importantly this lengthy data-led trial delivered incremental orders and customers to Domino's and we expect it to be a tailwind to growth in the next year.

Put option exercised in Germany

Secondly, we exercised our put option over our German associate investment which will yield total cash proceeds of between £80 million and £90 million. We expect to receive these proceeds in the first half of the next year, and we will then flow the profits through our capital allocation framework. I will now hand over to Edward who is going to talk throughout guidance and some accounting changes.

Guidance

Edward Jamieson

Chief Financial Officer, Domino's Pizza Group

£20 million Share Buyback

Thank you Elias. Good morning everyone. I am Edward Jamieson the Chief Financial Officer of Domino's and I am delighted to be here today. I would also like to echo Elias's comments and reiterate my gratitude to Dominic and to David for the smooth and seamless handover. We are pleased that following our recent strong momentum and confidence in the future today we are announcing a new £20-million share buyback which is effective immediately. This is in line with our clear capital allocation framework and our commitment to distribute surplus capital to shareholders.

Growth Investment Framework

At the end of last year, we agreed a new growth investment framework with our franchise partners. At the time we committed to invest an additional £20 million across areas such as technology, digital acceleration, and the e-commerce development. As a result, we have recently started projects to develop and implement two new cloud-based IT systems, a new e-commerce platform and a new enterprise resource planning or ERP system. These projects will enable us to capture growth and drive efficiencies in the future and they will impact the 2022 results as follows. For the e-commerce platform, circa £1.5 million of costs which had previously been expected to be capitalised in 2022 will now be expensed. In addition, an impairment of £1.5 million will be taken over assets which will no longer be useful following the implementation of the e-commerce platform. On the ERP, circa £3 million of costs which had previously been expected to be capitalised in 2022 will now be expensed. Furthermore, the introduction of the ERP system will result in a further £0.5 million of accelerated depreciation in 2022.

Guidance

Now turning to our guidance for this year. We expect underlying EBITDA to be in the range of £125-135 million in line with current market expectations. This is despite the investments we are making related to the growth investment framework that we agreed with our franchise partners, including the project costs I have just talked to you about. Excluding the impact of the investment project costs I have just outlined above, underlying EPS is also expected to be in line with current market expectations.

Now moving to modelling guidance. Underlying depreciation, amortisation and impairment is expected to be circa £22 million. Underlying interest excluding foreign exchange movements is in the range of £9 million -11 million. Estimated underlying effective tax rate is circa 17% for the full year. Capital investment of circa £21 million now reflects the updated treatments of project costs. Net debt at year-end is around £255 million reflecting the new buyback programme which we announced today. I look forward to meeting you all in person soon and I will now hand back to Elias.

Closing Remarks

Elias Diaz Sese

Interim Chief Executive Officer, Domino's Pizza Group

Thank you very much Edward, great to have you here as my partner at Domino's. As we look ahead at next year, notwithstanding the macro challenges, we remain confident that our resilient asset-light business model, our focus with our franchise partners on service, our digital platform and strategy, national value campaigns, collections growth combined with our new store openings, the benefit of the Just Eat platform and our products together with the alignment we have with our franchise partners will deliver market share gains and increase returns for our shareholders.

We will now turn to the Q&A. Will, could you please have the first question for us?

Q&A

Will MacLaren (Head of Investor Relations, Domino's Pizza Group): Thanks Elias. Our first question comes from Wayne Brown at Liberum. He has got three questions here so I will read them out one by one so you can answer them. First questions is, 'If you are gaining share when orders are strongly down and like-for-like double-digit down, and consumers were not yet feeling the pinch in Q3, Q4 will be fine due to the World Cup but surely this means the outlook for the next year is woeful. Please can you give me your thoughts?’

Elias Diaz Sese: Thank you Wayne for the question. The answer to this question is that the results pre–World Cup during the last six weeks have been very promising. Indeed almost 3% customer growth, so I believe that what is starting to happen is that the strategy that the team has put together is seeing success and starting to give the right results. Let me explain the reason why. Number one has been the focus of the team on digital. Number two has been the promotions, the national value promotions that have been executed together with our franchise partners. The focus on service, as I said before. Collections and incrementality that we are getting from the Just Eat implementation. The growth that we are seeing in Q4 is very promising, is the result of the success of the strategy and is going to be the momentum that we are going to be getting into next year.

Will MacLaren: Thanks Elias. The second question is, ‘Where are franchisee margins now? We estimated these were at mid-single digit at the exit of H1, so it must be worse now. Declining order count and deep discounting will impact franchisee margins further. Please can you give me your thoughts?’

Elias Diaz Sese: Sure, Wayne. Like any other business the cost pressures are in all of our P&Ls. From a restaurant perspective our franchise partners obviously are suffering them; and that is why I think that the strategy that the team took together with our partners to bring a delivery charge was the right thing to do in order to be supporting and helping the margins. Let me remind you of a couple of points. Number one, the franchise profitability at a store level is ahead of the franchise profitability in 2019. That is the first point that I would say. Coming from the industry and many other businesses that I have been working with in the market, I have to say that the margins in this business are excellent. I am extremely excited by the market share that we are starting to see because this is going to be definitely helping from that perspective all our franchise partners.

Will MacLaren: Then finally, this is actually two questions here but, ‘If you gained market share in a market despite your like-for-likes of circa 10% and a very poor market, what are your thoughts on outlook and if delivery is just too expensive?’ Then linked to that delivery point, ‘Has the delivery charge hurt volumes in Q3?’

Elias Diaz Sese: Thank you Wayne again. Look, as we expected, there were going to be tough comparatives for everyone post-Covid impact. That was something that everyone expected. On top of that, as I said in the introduction, tough comparators both in July and August, July because of the impact of the Euros tournament last year and August because of the staycation impact that you have seen also in many other earnings calls from other competitors in the business. I have to say that after the situation normalises, we really believe that we are very competitive. Two main reasons for that. The first one is value. Overall, we really believe that we are very competitive from a value perspective. The strategy that my partners, Sarah Barron and the marketing team are working together with the franchise partners is extremely strong also on value campaign messaging. Both of them together I believe that makes us very competitive. Number two, service. We are the only ones delivering our product directly to our customers. We feel extremely strongly that the experience of our partners in delivering this product is putting us in a much more competitively advantageous situation than many others. Yes, they were tough. We expected them to be tough, but we believe that once they normalise, we will be competitive.

The other part of the question that you had I believe was around delivery charge. On this point as I said before, Wayne, I really believe that it was the right thing to do by the team in alignment and working together with our franchise partners. By the way, it is one of the many examples that I have seen of this great job that the team has done in order to make sure that there is a good collaborative work with our partners. However, I would say it was the right thing to do because it is supporting our franchise partners from a P&L perspective.

The delivery charge is very aligned with what is happening in the market. Indeed, I believe it is relatively small vis-à-vis others. It is around £2 and being cheaper than many of our competitors I really believe that it was the right thing to do from a strategic point of view. It is helping us to really bring our value message in a very strong way. By the way, it is pushing collection. If you see the numbers, we have 28.1% growth on collection which is very important and is going to be very critical for us next year as a value proposition considering the environment for our customers. Overall, the right thing to do, it is supporting us from a value message perspective, and it is pushing collection which is a very strategic pillar. David and the rest of the team have been working hard over the last two years and it is starting to deliver results. Thank you, Wayne.

Will MacLaren: Thanks Elias. We have got the next question coming from Richard Taylor at Barclays. It is, 'Please can you break down the reasons for the improvement in like-for-likes in Q4 to date? Would the largest part of this improvement be the partnership with Just Eat or are there other areas such as marketing?'

Elias Diaz Sese: Thank you Richard. I appreciate it. Obviously Just Eat has had an impact on these results and it will continue to deliver these results. That is why it has been very important for the team and for our franchise partners to work again in collaboration in a tremendous effort to implement Just Eat in 1,000 stores in such a short period of time. I could not be prouder of the team. Clive West and the rest of the team have been working extremely hard to make this happen, and our franchise partners have been doing this in the busiest time of the year. Very excited for that and yes obviously it is delivering results. It is going to continue to deliver results.

Richard, remember the strategy that we have taken together over the least two years. If you see that strategy, it was very clear from the very beginning that there were going to be other pillars that would be needed to deliver these results and it is happening. Number one, value. The strong value messaging that the franchise partners and our team are pulling together is extremely strong. Collection. As a pillar, it is very important for this year but will be even more important for next year and 2024. Finally digital. If you think about the efforts that our partner, Nick Bamber and the rest of the team have been doing during the last 11 months, it has been extremely strong. As I said before, it is already 45.6% of our sales. It is a growth of 5% in the last six months. As you know, from a lifetime value perspective and from a frequency point of view this customer is much stronger than the one coming through the app so they are very, very important. Then remember what Dominic and David communicated on the last earnings call. That we were going to be investing much more on marketing and that is exactly what we have done. That is exactly what is starting to deliver those results and will continue to be doing so in the rest of Q4 and coming into 2023. Obviously yes Just Eat has been very important but the bigger marketing expenditure, collection platform, digital, value and as I said at the very beginning of this call the incredible focus of our partners on service. Service has been very important. Thank you, Richard.

Will MacLaren: Thanks Elias. The next question comes from Ross Luckman at Panmure Gordon and it is, 'Given the slower store openings in 2022, what gives you confidence in opening 70 new stores by the end of next year?'

Elias Diaz Sese: Thank you Ross. I appreciate it. A couple of comments on this one. Let me go through the facts and then my impressions because I have been already for five weeks in this role and I have been travelling all around the country meeting my franchise partners. Let me start by saying, number one, the new stores are performing very well. I think that that is the most important thing. The fact that the stores that we are opening are performing very well is the most important thing for our franchise partners and it is what needs to be continuing to happen. That I am very excited about. Number two, the underlying business is also performing very well which is also very important from that perspective. The franchise partners, coming back to the point that I have been travelling and meeting them, are willing to open the stores. Yes, there has been a little bit of delay from a planning perspective but by the end of the year you will see that we will have a very strong Q1 as a consequence of this from an openings perspective. Now, another element that I have to say that is very important is that 24 franchise partners are going to be opening these stores. That is one third of our franchise partners willing to open stores. As a consequence of the framework that the team has put together with the franchisees. Again, I feel confident. Yes, there has been a delay. It will come in Q1 next year, but I am very excited to see that these openings are happening. They are spread across the system. One third of our franchise partners are opening restaurants today in this environment with confidence for the business. Yes, probably I am visiting all of them. I see willingness and they are keen to continue to be doing this in 2023 and 2024. I am excited for these new store openings. Thank you, Ross.

Will MacLaren: Thanks Elias. The next questions have come from Doug Jack of Peel Hunt. There are four questions here which I think are split across yourself and Edward. First question is, 'To what extent has advertising and local store marketing accelerated?'

Elias Diaz Sese: Thank you, Doug. Our franchise partners have stepped up their investment from a local store marketing perspective. There are local deals happening across the country and there is a very strong strategy by them on messaging our customers directly in order to attract customers into the business. Yes, step up on investment, lots of local deals and messaging to our customers. I think that these combined, as I said before, with the strategy that Sarah Barron and the team are having from a national point of view both from a brand, digital and also value messaging becomes a very strong partner.

Will MacLaren: Then the second question is, 'What is the likely tax liability from the German JV sale?'

Edward Jamieson: Good morning, Doug, let me take that one. We are not currently expecting a tax liability for the sale. We expect to receive a substantial shareholding exemption. We are going to HMRC at the moment for early clearance on that and so it is subject to that confirmation. Just to reiterate, we are not currently expecting a tax liability for the sale.

Will MacLaren: Thanks, and the second follow up question from Doug is, 'How high is input cost inflation and are there any supply issues?'

Edward Jamieson: Clearly, this is a market and a macro factor question given the dynamics that we have seen. We have certainly seen inflation and that is similar to the levels that we have talked to you about previously. I think it is just worth emphasising a few points on this. We are a very significant purchaser in the categories in which we buy. We have very established relationships with our suppliers and our Procurement works very closely with those suppliers to ensure the continuity of supply. We also have an efficient production facility to ensure that we minimise the impact of cost inflation to produce as efficiently as possible. Let us also bear in mind that our model is that we pass through costs to franchisees.

Will MacLaren: Thanks Edward and then the final question from Doug is, 'Can you expand on the costs and benefits of the Just Eat trial?'

Elias Diaz Sese: Sure, Doug, I will take this one. Let me remark another point on this last question which is that we are at 99.9% availability right now in the system. That is world class standard within the industry. Kudos to Pete Trundley and the team, doing this even with the growth that we are seeing in sales, very strong from that point of view.

Now on Just Eat, we have seen incrementality. We see customer growth and we see incrementality. That is why in partnership with our franchise partners, we have taken the decision to extend this test and launch it in the market, partnering right now with Just Eat. We see a very important and relevant incrementality from a customer growth perspective. Obviously, Just Eat has been a great partner but also after Covid they have been growing their customer base. That is going to be helping us a lot in order to continue to bring this growth not only in the short-term but most importantly in the medium-to-long term. Definitely 2023 and 2024 are going to be very good evidence of this partnership.

Edward Jamieson: Let me just comment further and then there was a cost question within that. To be clear about the model, there are no costs for us as DPG. There is a commission that is paid by franchisees to Just Eat on every order taken.

Will MacLaren: Thanks Edward. Moving on to the next set of questions there from Richard Stuber at Numis. There are three questions here. The first question is, 'What benefit will you get from the IT spend and what will the impact be for this year from next year onwards?' Then specifically, 'Will this additional £4.5 million opex recur in 2022?'

Edward Jamieson: Okay. As previously communicated in the growth investment framework agreed with our franchisee partners, we are investing in IT within the additional £20 million investment envelope. The e-commerce platform will provide a scalable world class e-commerce backend hosted in the cloud which enables us to deliver improvements quickly and more cost efficiently than our current platform and future proofs our e-commerce platform for future development. The new ERP system enables us to standardise operating practices and drive efficiencies across the business to enhance our overall control environment. Both systems are part of the foundation for our next stage of growth. As I have covered earlier, in 2022 we will see an impact on profit before tax of circa £6.5 million. This is the £4.5 million of costs expensed that were previously expected to be capitalised this year. This is largely due to advice guidance around the accounting treatment of costs associated with cloud platforms. This guidance affects a number of companies developing solutions and new cloud platforms. This reduces capital expenditure and increases operating cost above EBITDA. Secondly, there is then circa £2 million in non-cash accelerated appreciation and impairment. The cloud computing costs in both the ERP and the platform will continue through 2023 and guidance will be provided at our full year results next year. In future years, there will be an ongoing annual financial benefit from the lower amortisation charge because we have expensed the greater portion in 2022 and 2023.

Will MacLaren: Thanks Edward. Next question is, 'If the Just Eat trial has been a success, would you consider extending this to other aggregators, i.e., Uber Eat and Deliveroo, or does your partnership with Just Eat preclude this?'

Elias Diaz Sese: Thank you Richard. We are focused right now on maximising the partnership with Just Eat. That is where we are focused and that is the effort that we all internally and with our franchise partners are putting together right now. That is the priority. May we look into this in the future? Yes, we may look into this but right now it is focusing on making sure that our partnership with Just Eat is continuing to have the success that it is having right now.

Will MacLaren: Then Richard's final question is, 'Given the cost headwinds facing franchisees, where do you see franchisee profitability heading this year and next? Will you provide any support over and above what has been agreed in the franchisee resolution?'

Elias Diaz Sese: Thank you, Richard. The framework that we have aligned with our partners, the team under the leadership of Dominic have aligned with our partners will continue and is delivering the results that we wanted to have. That is what we are going to continue to be doing which is maintaining the collaboration with the spirit that has been created. Working together with them under the same framework next year and the following years to come. We continue to grow this business thanks to that partnership together with them as we are starting to see. Again, once more, a big thank you from that perspective for the leadership of Dominic, David and the rest of the team in making this happen and to our franchise partners to work with us in order to make it happen.

Will MacLaren: Thanks Elias. The next question comes from Hari at Deutsche Bank. I think we have covered some of this, but I will read it out because he is asking additional points here. 'What is driving the 10.4% like-for-likes in Q4 to date? What explains the huge difference versus +2.4% in Q3? Any indication on price versus volumes here would be helpful.'

Elias Diaz Sese: Sure, thank you Hari. Let me start with the first one. I think that we have already shared this across the questions and also on the statement, but I will go through them. Again, the strategy that the team has put together is delivering the results. It is starting to deliver those results both from a frequency growth perspective and a convenience point of view. Number one, the focus of our partners from a service point of view. That is critical. It has been critical and is going to continue to be very important moving forward. Number two, the value messaging in order to attract more customers into our stores and to increase that frequency. The digital strategy that has been put together by Sarah, Nick and the team. Really important if you think about that being already at almost 46% of our sales on the app. Taking that into consideration that those customers bring more frequency and that their lifetime value is higher is important. The results that the collection platform is starting to deliver through very strong work by the team and by the focus that has been placed on this one and how this will be important for next year as a value platform or a value messaging to our customers. The higher expenditure from a marketing point of view in the second half of the year, as was communicated in previous calls. Last but not least, and obviously excited that it will continue to deliver results next year, yes, our partnership with Just Eat and the platform that we have increased. Those are the elements. Service, value messaging, digital, collection, more marketing expenditure and Just Eat.

The second question was talking about price and volume. I will tell you, the results are combination of the two, price and volume. What I am very excited to see is that we are seeing customer growth at levels of almost 3%. I think that that is the result of what I just said or more importantly four elements of what I just said: service, digital, value and Just Eat. Yes, it is a combination of both of them and definitely excited by seeing growth in terms of customers at almost 3%.

Will MacLaren: Thanks Elias. The second question is, 'How is the marketing campaign for the World Cup progressing and would you expect Q4 like-for-likes to trend higher than the 10.4% on the back of the World Cup?'

Elias Diaz Sese: As I said before, the campaign is going very well. The team is getting ready from an operational perspective and ready to execute in this campaign. I think that the results that you are seeing right now are going to be continuing for the rest of the year and in Q1 of next year. A strong campaign, ready to continue to execute it and I believe we are going to continue to deliver the results that we are seeing.

Will MacLaren: Then the final question is from Roberta at Investec. It is, 'Could you give more colour on the 10,000 hires planned for the World Cup/Christmas season? How many are expected to be permanent and in general how do you expect the World Cup to impact your business this year given it is a winter rather than summer event?'

Elias Diaz Sese: Thank you Roberta. This question is interesting. It is very similar to Richard's last question, and this is our collaboration with our franchise partners. I think that that is another evidence of the great success from us working together. To have the team at DPG pulling together on a strategy to support the franchise partners and the franchise partners working with us on that strategy. Why? Because the recent recruitment initiative that we have been having has been a tremendous success. We have seen a significantly bigger pipeline of colleagues coming into our stores. From a driver, from a shift manager, from a runner and from a store manager perspective. That is extremely important. That together with the fact that my partner Nicola Frampton and the rest of the team from an operational point of view have been delivering excellent workshops with our franchise partners in the field in order to get ready for what is going to be a very successful World Cup, I am completely sure, has been very important. Again, extremely excited about that. September and October have been record numbers from a recruitment perspective; so that means that the initiative that both of us have been working together has been very successful. Quite honestly, I am very excited about the World Cup and the fact that it is happening in November and December which is obviously our busiest time of the year. Yes, very excited about that and focusing every day on making sure that we are ready from that point of view. Thank you, Roberta.

Will MacLaren: There are no further questions Elias at this stage.

Elias Diaz Sese: Thank you. Thanks a lot Will for everything and getting everything ready. Thank you very much for dialling into the call this morning and for your questions. This concludes the call today. Goodbye and have a good day to everyone.

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