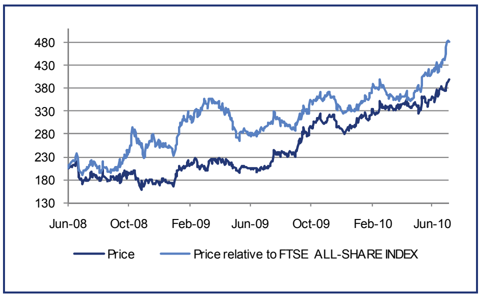
STILL HOT

DOM's H1 results, due Monday, should provide another opportunity for the market to upgrade estimates. This should not be a surprise, given the benefits from its 'Two for Tuesday' campaign, the World Cup and Britain's Got Talent. However, we believe the upside is probably greater than anticipated and in the uncertain consumer environment ahead, we believe the attractions of the stock are still very strong. We are raising our TP by 31% to 490p and remain buyers of the shares.

- DOM's H1 results, due on Monday, are likely to beat consensus estimates of about £16m. A number nearer £17m seems more likely to us. Our actual H1 estimate of £16.7m (+22.9%) has allowed for a slowdown in Q2 2010 LFLs to 8.0% (versus 10.5% in Q1), which in itself could prove conservative, given the benefits of the 'Two for Tuesday' campaign, the World Cup and the benefits of sponsoring Britain's Got Talent.
- Given this potentially strong H1 performance, it seems likely that our previous full-year PBT estimate of 'just' £34.4m looks too low. Even allowing for a slowdown in H2 LFLs to just 4% (from 9.25%E in H1) to take account of the tougher comparatives (Two for Tuesday started on 30 June 2009), we still need to upgrade our FY 2010 PBT to £35.3m. This upgrade of 2.6% could still prove insufficient if the company announces more promotional and trading initiatives for the remainder of the year. Consequently, the earnings risk, in our view, is still on the upside.
- The company's strong fundamental performance so far this year, combined with the weak performance from the market, has led to very strong outperformance, with DOM's shares appreciating by 32% year to date versus the market down by 8.7%. Ordinarily, from this point, a period of consolidation could be expected; however, we believe that potential upgrades and the lack of growth elsewhere within the consumer/leisure space make it very likely that DOM will continue to outperform the market.
- We have increased our EVA-based TP from 373p to 490p, mainly as a result of extending our valuation time horizon from a single year to 2 to 3 years, and then discounting the value back. This change in approach is to reflect the fact that it will take 2 to 3 years for the returns from the new commissary to reach normalised levels; valuing the business before that point would therefore be unduly conservative.
- Longer term, given that the company is only about half way towards its maturity target of 1,200 stores, our DCF valuation of 768p provides ample further upside for the shares (even before any further upgrades) beyond our current time horizon.

Rating	**BUY**
Target price (p)	**490**
Current price (p)	395
Upside/downside (%)	24.1%
Main listing index	FTSE 250
Reuters/Bloomberg	DOM.L/DOM LN
Sector	Travel & Leisure
Shares in issue (m)	160.8
Market cap (£m)	635.3
Current EV (£m)	636.2
FY 2010 (debt)/cash (£m)	-0.9
Free float (%)	72.5%
52 wk range (p)	400–205
Next event: H1 2010 results	12 Jul'10

Y/E Dec (£m)	**2009**	**2010E**	**2011E**
Revenue	155.0	173.5	191.4
EBITDA	32.0	37.9	42.9
EBITA	30.0	35.5	40.0
PBT	**29.9**	**35.3**	**39.5**
Net (debt)/cash	-15.7	-0.9	23.1
Net pen. def (IAS19)	0.0	0.0	0.0
Net assets	32.2	48.4	65.8
Dil EPS (p)	**13.5**	**15.7**	**17.5**
EPS growth	*26.0%*	*16.3%*	*11.8%*
DPS (p)	7.8	9.3	10.7
FCF (p)	19.0	21.8	25.0
P/E (x)	**29.3**	**25.2**	**22.5**
EV/EBITDA (x)	20.5	16.8	14.3
FCF yield (%)	4.8%	5.5%	6.3%
Dividend yield (%)	2.0%	2.4%	2.7%
Dividend cover (x)	1.7	1.7	1.6
Net debt:EBITDA (x)	0.5	0.0	-0.5
Interest cover (x)	209.8	177.5	79.9
Fixed CC (x)	3.7	3.8	3.9
ROIC (%)	56%	48%	57%



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MATRIX

08 JULY 2010

INVESTMENT BANKING

H1 2010 PREVIEW

Summary estimates and assumptions:

1) Q2 2010 LFLs of +8.0% giving +9.25% for H1 2010
2) Last year's Q2 2009 LFL comp was quite weak at about +5.0%.
3) System sales of £224.0m, implying growth of 14.1%.
4) Number of DOM stores added in H1 assumed to be 23 (same as last year).
5) DOM revenue: £83.1m (+12.7%).
6) EBITDA £17.9m +24.3% (£14.4m).
7) EBIT (inc JVs): £16.8m (+22.6%).
8) PBT: £16.7m (+22.9%).
9) EPS: 7.4p (+19.7%).
10) Div: 4.20p (+20.0%).

Assumptions and estimates for FY 2010 onwards:

The following tables reflect our main assumptions over the next three years (to FY 2012). In summary our main assumptions are:

1) The company expands its shop portfolio by 55 units pa.
2) Following a strong H1 2010 we expect H2 2010 LFLs to slow to around 4% (especially following the anniversary of the 'Two for Tuesday' campaign at the end of Jun 2010). This would leave full year LFLs at +6.5%. In terms of sensitivity, 1% extra on full-year LFLs is worth about £300k to PBT.
3) For similar reasons we expect LFL growth to become tougher in FY 2011 at +3.0% before recovering to a more normal growth rate in FY 2012 of +4.0%.
4) Following the development and opening of the new commissary we expect commissary GPs to improve from 36.0% to 36.4% this year and then remain at that level in FY 2011 and FY 2012. We estimate that the commissary generates about 70% of group gross profits.
5) On the franchise operations, we expect a minor reduction in margins as a result of the 'adverse' mix effect of generating a smaller proportion of high-margin services (such as computer services and property income) and a higher proportion from lower margin 'normal' royalties. Consequently we assume margins will slightly decline in this area from 55.1% in FY 2009 to 54.3% in FY 2012. Franchise income accounts for about 30% of group gross profits.

Figure 1: Domino's Pizza – Store Numbers and LFL Assumptions

Unit data	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
No. at start of period	318	357	407	451	501	553	608	663	718
No. added	40	50	46	50	52	55	55	55	55
No. closed	-1	0	-2	0	0	0	0	0	0
Period end no. of units	**357**	**407**	**451**	**501**	**553**	**608**	**663**	**718**	**773**
Avg. no. of units	338	382	429	471	527	580	635	691	745
Change in avg. units		13.2%	12.3%	9.8%	11.9%	10.2%	9.5%	8.7%	8.0%
LFL sales – total	**6.6%**	**7.1%**	**8.0%**	**14.7%**	**10.0%**	**8.4%**	**6.5%**	**3.0%**	**4.0%**

Source: Company data, Matrix estimates

Figure 2: Domino's Pizza – Divisional Analysis of Revenues and Profits

Y/E Dec (£m)	2007	2008		2009		2010E		2011E		2012E	
Revenues											
Franchise system	20.7	24.2	16.9%	27.5	13.6%	31.4	14.1%	34.9	11.2%	38.8	11.4%
Commissary	79.2	96.7	22.0%	110.7	14.5%	127.0	14.8%	140.3	10.4%	154.0	9.8%
DP Realty	9.2	10.9		12.2		13.4		14.5		15.7	
Others	0.8	0.4		0.3		0.3		0.4		0.4	
	109.9	**132.1**	**20.3%**	**150.7**	**14.0%**	**172.1**	**14.2%**	**190.0**	**10.4%**	**208.9**	**10.0%**
Gross margin											
Franchise system	57.8%	54.9%		55.1%		54.8%		54.6%		54.3%	
Commissary	32.8%	34.0%		35.6%		36.0%		36.4%		36.4%	
DP Realty	9.7%	9.5%		9.0%		8.6%		8.6%		8.6%	
Avg.	**35.5%**	**35.9%**		**37.1%**		**37.4%**		**37.8%**		**37.8%**	
Gross profit by activity											
Franchise system	12.0	13.3	10.9%	15.1	14.2%	17.2	13.5%	19.0	10.8%	21.1	10.8%
Commissary	26.0	32.9	26.5%	39.4	19.7%	45.7	16.0%	51.1	11.8%	56.1	9.8%
DP Realty	0.9	1.0		1.1		1.2		1.3		1.4	
Others	0.1	0.2		0.3		0.3		0.4		0.4	
	39	**47.4**	**21.7%**	**55.9**	**17.9%**	**64.4**	**15.1%**	**71.7**	**11.4%**	**78.9**	**10.0%**
Op. profit by activity											
Franchise system	7.2	8.1	12.7%	9.7	19.9%	11.4	17.3%	12.9	12.4%	14.2	10.5%
Commissary	16.1	21.7	34.4%	26.6	22.9%	31.3	17.5%	35.2	12.5%	38.6	9.8%
DP Realty	0.4	0.5		0.6		0.6		0.7		0.8	
Others	-0.1	0.0		-0.3		-0.3		-0.3		-0.3	
	23.6	**30.3**	**28.1%**	**36.7**	**21.2%**	**43.1**	**17.4%**	**48.5**	**12.5%**	**53.3**	**10.1%**
Less central costs	-5.3	-6.8	28.5%	-7.2	5.9%	-8.0	10.0%	-8.8	10.0%	-9.6	10.0%
Clean EBIT	**18.3**	**23.4**	**28.0%**	**29.4**	**25.7%**	**35.1**	**19.2%**	**39.7**	**13.1%**	**43.7**	**10.1%**

Source: Company data, Matrix estimates

It should be noted that the revenue and EBIT figures shown in the above table do not fully agree with what is shown in the P&L a/c because the P&L a/c includes some revenues from various JVs and subsidiaries that are not included in the analysis that the company provides above. The differences are quite small (c. £0.1m in 2009 and £0.2m in 2008) and, over time, DOM intends to dispose of these remnants of its former 'corporate' stores.

Figure 3: DOM – Summary Profit & Loss a/c

Y/E Dec (£m)	2006		2007		2008		2009		2010E		2011E		2012E	
System sales	240.1	19.6%	296.3	23.4%	350.8	18.4%	407.0	16.0%	470.5	15.6%	527.3	12.1%	592.4	12.3%
Group turnover	95.0	0.0%	114.9	21.0%	136.0	18.4%	155.0	14.0%	173.5	11.9%	191.4	10.3%	210.3	9.9%
Cost of sales	-57.8		-70.7		-85.2		-95.6		-105.6		-116.1		-127.9	
Gross profit	**37.2**	**13.0%**	**44.2**	**18.8%**	**50.8**	**15.1%**	**59.4**	**17.0%**	**67.9**	**14.2%**	**75.2**	**10.8%**	**82.4**	**9.6%**
Gross margin	39.1%		38.4%		37.4%		38.3%		39.1%		39.3%		39.2%	
Distribution costs	-8.2	-4.2%	-9.2	13.1%	-9.2	-0.7%	-10.0	8.8%	-10.9	8.6%	-11.9	9.4%	-13.0	9.2%
Admin expenses	-15.0	10.8%	-16.2	8.5%	-18.1	11.4%	-20.0	10.6%	-21.7	8.8%	-23.6	8.7%	-25.7	8.9%
Group 'clean' EBIT	**14.0**		**18.7**	**33.2%**	**23.6**	**26.1%**	**29.5**	**25.1%**	**35.3**	**19.8%**	**39.7**	**12.6%**	**44.8**	**12.8%**
Exceptional admin expenses	-0.5		-0.5		-0.1		-4.0		0.0		0.0		0.0	
Group reported EBIT	13.5		18.2		23.5		25.5		35.3		39.7		44.8	
Share of JV profits	0.2		0.2		0.2		0.6		0.2		0.2		0.2	
Total clean EBIT	**14.2**		**18.8**		**23.7**		**30.0**		**35.5**		**40.0**		**45.1**	
Reported total EBIT	13.7		18.3		23.7		26.1		35.5		40.0		45.1	
Other exceptional items	0.6		0.3		-0.5		15.1		0.0		0.0		0.0	
Net interest costs	-0.1		-0.1		-0.4		-0.1		-0.2		-0.5		-0.4	
Clean PBT	**14.1**	**28.9%**	**18.7**	**33.1%**	**23.4**	**24.7%**	**29.9**	**27.8%**	**35.3**	**18.2%**	**39.5**	**11.8%**	**44.7**	**13.2%**
Reported PBT	14.2		18.6		22.8		41.0		35.3		39.5		44.7	
Clean tax rate	29.8%		28.6%		28.0%		27.8%		29.0%		29.0%		28.0%	
Clean tax charge	-4.2		-5.4		-6.5		-8.3		-10.2		-11.4		-12.5	
Clean attributable profit	9.9		13.4		16.8		21.6		25.1		28.0		32.2	
Avg. shares in issue (m)	162.0		158.0		154.7		156.1		156.0		156.0		156.0	
Avg. diluted no. shares (m)	165.0		160.8		156.9		159.8		159.7		159.7		159.7	
Clean dil. EPS (p)	**6.0**	29.1%	**8.3**	37.8%	**10.7**	**28.6%**	**13.5**	26.0%	**15.7**	16.3%	**17.5**	11.8%	**20.1**	14.8%
DPS (p)	**3.1**	35.2%	**4.4**	43.7%	**5.9**	**34.1%**	**7.8**	31.4%	**9.3**	20.0%	**10.7**	15.0%	**12.3**	15.0%

Source: Company data, Matrix estimates

Figure1: DOM – Summary Cash Flow

Y/E Dec (£m)	2006	2007	2008	2009	2010E	2011E	2012E
Operating profit (after except)	13.6	18.2	23.5	29.5	35.3	39.7	44.8
Depreciation	1.7	1.5	2.0	2.0	2.4	2.9	3.0
Amortisation of intangible assets	0.2	0.0	0.0	0.0	0.0	0.0	0.0
EBITDA	**15.5**	**19.7**	**25.5**	**31.5**	**37.7**	**42.6**	**47.8**
Working capital	3.2	3.8	-1.3	3.5	1.0	1.1	1.1
Other	0.3	0.9	1.1	1.9	2.1	2.3	2.5
Clean Op cash flow	**19.0**	**24.4**	**25.3**	**36.9**	**40.8**	**46.0**	**51.5**
Exceptional spend	0.0	0.0	-1.0	-1.2	0.0	0.0	0.0
Reported free cash flow	19.0	24.4	24.3	35.6	40.8	46.0	51.5
Interest & divs	0.0	0.0	-0.3	0.3	-1.2	-1.1	-1.0
Tax	-3.8	-4.3	-6.0	-5.5	-3.5	-3.9	-8.9
Maintenance capex	-2.2	-2.5	-2.5	-2.0	-2.0	-2.0	-2.5
Clean Free Cash Flow	**12.9**	**17.6**	**16.5**	**29.7**	**34.0**	**38.9**	**39.0**
Total free cash flow	12.9	17.6	15.5	28.4	34.0	38.9	39.0
Dividends	-4.2	-5.8	-8.0	-10.5	-13.1	-15.0	-17.3
	8.7	**11.7**	**7.5**	**17.9**	**20.9**	**23.9**	**21.7**
Asset sales	0.5	0.3	1.0	2.0	0.0	4.0	0.0
Business disposals	-0.2	1.1	0.0	0.0	0.0	0.0	0.0
Expansionary capex	-0.9	-1.5	-8.9	-20.5	-8.3	-6.0	-5.0
Repayment of loan from JVs	0.1	0.2	0.1	0.1	0.0	0.0	0.0
Net proceeds from franc. loans	0.3	-0.2	0.0	-0.1	0.0	0.0	0.0
Acquisitions	-0.1	0.0	0.0	-0.7	0.0	0.0	0.0
New equity	0.4	0.7	0.7	2.1	2.1	2.1	2.1
Purchase of shares for EBT	0.0	0.0	-4.3	-7.6	0.0	0.0	0.0
Share buy-back	-10.2	-8.3	-3.8	0.0	0.0	0.0	0.0
Other	0.0	-0.1	1.1	-0.7	0.0	0.0	0.0
(Inc)/dec in net debt	**-1.4**	**4.0**	**-6.6**	**-7.5**	**14.8**	**24.0**	**18.8**
Opening net (debt)/cash	-4.1	-5.6	-1.6	-8.2	-15.7	-0.9	23.1
Closing net (debt)/cash	**-5.6**	**-1.6**	**-8.2**	**-15.7**	**-0.9**	**23.1**	**42.0**
Net debt:EBITDA	**0.36**	**0.08**	**0.32**	**0.49**	**0.02**	**-0.54**	**-0.87**

Source: Company data, Matrix estimates

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Company	Disclosure
Domino's Pizza	3

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