Eating In, Eating Out and Eating Technology

COLLINS SARRI STATHAM INVESTMENTS

Research Report

Report Date

7th November 2017

Analyst

Ravi Lockyer MSc Llb

Collins Sarri Statham Investments Ltd

Note revised from previous report of 6th October 2017

How to profit from Millennials' lower propensity to cook

A vouchercodes.co.uk survey (February 2017) put the UK national average weekly restaurant spend at £44 with 18-29 age bracket happy to spend £88. The reasons given for this spend commitment sound incredulous using my Gen-X mentality. 44% do not have "enough food at home"; 38% "do not want to have any washing up"; 20% "never learned how to cook"; 14% want to "keep the house tidy"! Still that is the survey evidence.

When asked to compare their dining habits in the 1980's, many responders said eating out back then, "eating out" was done primarily on special occasions.

Whilst demand factors are strong, so is cover supply. A good eating out concept quickly mushrooms. The king of the "Fast-Casual" market, "Nando's" grew from 1 branch in Johannesburg in 1987 to 1,094 globally with 339 (31%) in the UK after opening 2 branches in 1992. This heavy UK exposure reflects the relative attractions of the UK eating out/ takeaway market.

Short-term headwinds exist. Higher payrolls, workplace pensions, higher input costs and a squeeze on disposable income. This explains the sector's move recently.

Domino's Pizza – UK250 – BUY

Domino's flagged slower UK trading (c.4% pizza delivery) a function of the cooling of the very high 14% growth rate observed over 2014-2016. Base rate increases/ higher inflation are likely to temper growth going forward to low/mid single digits.

The weak consumer response to "Winter Survival Deal" suggests Domino's high pricing is impacting demand. The board responded with "Walk in Wins" and "BoGoF" which obtained a better response. This is encouraging as pricing had become problematic for the customer base in some areas.

A major benefit of Domino's franchisee model is its ability to obtain upfront payments from new franchisees, i.e. third party funding of Domino's growth. Store expansion (950 +9.3% in 2016) and (990 + 4.2% H1 2017) has been rapid. Domino's recent acquisition of 75% of its largest London franchisee for £24m is more opportunistic / higher risk expansion.

Domino's expansion abroad is mid stage (revenues £23.8m 4.35% / 8.2% of store footprint is located in Switzerland, Lichtenstein, Luxembourg, Norway, Iceland and Sweden) with recent investment increasing stakes in operating subsidiaries (£21m was spent taking the majority interests in Norway and Sweden to 71% and the Icelandic business to 51%).

Consensus profit estimates; Domino's Pizza							
Year End	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)	Share Price (p)

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Dec-16	360.5	85.7	13.6	8.0	21.3	2.76	290
Dec-17	441.7	89.9	14.4	8.25	20.1	2.84	
Dec-18	486.3	97.0	15.6	9.2	18.6	3.17	

Source: Fidessa

The consensus forecasts suggest 16% revenue growth over 2017-2018 with EPS growth accelerating in FY18 after a tough FY17.

Company	Domino's Pizza	**Key Catalysts**
Share Price	342p	Clear evidence of improved trading in some of the overseas territories would be positive for Domino's. The business now encompasses a number of disparate overseas territories moving at different speeds. UK saturation is a concern, at Domino's. Recent moves to bolster shareholder returns i) £15m share buyback (1.05% share capital) ii) 15.6% dividend increase suggests a board keeping focused on returns.
Target Price	400p	
52 Week Hi/Low	394p/263p	
Shares O/S	492m	
Market Capitalisation	£1.67bn	
Avg. Daily Volume	1.61m	
Dividend Yield	2.40%	

Source: Fidessa

Key Risks to Price Target

i) Competitive pressures in UK pizza delivery
ii) Concerns over branch saturation in the UK and price sensitivity
iii) Recent acquisition of Dolly's Dimple adds integration risks and will require development capital

Restaurant Group– UK 250 – BUY

Restaurant Group is a UK diner with a number of brands, Frankie & Benny (F&B), Chiquitos, Garfunkels, Coast to Coast, Joe's Kitchen alongside its pubs and concessions business. Typically these are in high footfall areas, such as UK airports and shopping centres.

New CEO Andy McCue, former CEO of Paddy Power arrived to turn around Restaurant Group after a tough 2016. During FY2016, Restaurant Group closed down 37 underperforming restaurants incurring total exceptional charges of £116.7m related to early lease termination and impairment charges. McCue stuck to the new opening plan, opening 24 new restaurants. Key to profit improvement is the recovery of the largest brand, F&B (258 sites) where customers had reacted badly to price hikes. McCue cut prices at F&B introducing a 2 course £9.95 meal offering.

The turnaround plan includes 7% average price cuts at both F&B and Chiquitos. The business is broadening Chiquitos (79 units) appeal to include Tex-Mex/ Californian cuisine and a competitive menu. McCue has also reduced central roles/ overheads by

£10m via streamlining roles/ supplier rationalization.

Restaurants Group's revenue growth is derived primarily from new openings (16-20 new units are planned for 2017) costing £16m-£20m. It remains in a transitional period in 2017 as it absorbs purchasing cost increases, higher payroll and rates bills. The valuation is depressed given the uncertain timetable to volume growth and the resumption of price growth.

Consensus profit estimates; Restaurant Group							
Year End	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)	Share Price (p)
Jan-16	710.7	77.1	29.8	17.4	10.4	5.6	310
Jan-17	673.4	56.3	22.1	17.4	14.0	5.6	
Jan-18	692.8	58.1	22.9	17.4	13.5	5.6	

Source: Fidessa

Whilst a recovery in profits to their levels in 2015 is still a way off, the consensus forecasts envisage an EPS rebound in FY18.

Company	RTN	**Key Catalysts**
Share Price	296p	Recent interims showed operations were stable with decent cash generation and £16.3m reduction in Restaurant's bank debt to £19.3m. This is partly attributable to a better response to the new menu.
Target Price	400p	
52 Week Hi/Low	395p/ 287p	
Shares O/S	201.06m	The board needs to show volume/ pricing growth in the key brands alongside delivery of the £10m savings plan (c. 20% of operating profit).
Market Capitalisation	£596.7m	
Avg. Daily Volume	280k	
Dividend Yield	5.85%	M&A activity is prevalent, and RTN is vulnerable to a takeover approach.

Source: Bloomberg

Key Risks to Price Target

i) Cost/ margin pressures, higher payroll costs, workplace pension, Apprenticeship Levy, higher costs for food & wine
ii) Customer response to F&B menu changes early stage
iii) Growth in EPS might only resume in 2019

Just Eat – UK 250 – BUY

Food ordering website Just Eat typically charges each takeaway a joining fee and a cut of every order (c. 12%) with supplementary charges to appear higher up in the online list. Just Eat also encourages its listed businesses to offer discounts on online orders during quiet periods. The board also point to significant marketing savings for restauranteurs using the Just Eat website.

Prior to Just Eat a takeaway would have the evening trade, the retail client, phone orders and online orders assuming they had installed their own website ordering. Just Eat's access to 27,000 restaurants enables very quick consumer choice and delivery to the location of your mobile home. The benefit for many takeaways is the ability to lift prices, under the guise of the improved IT/ deliverability.

Partner growth (no of Just Eat website listed restaurants jumped to 75.4k + 9.2k at H1 2017. Just Eat interim revenues (£276m+44%) and pre-tax profit (£49.5m +46%) represent a split of 57% UK / 43% international locations. Just Eat has a market leading position in Canada and Denmark. Just Eat is expanding into Spain, Italy and Mexico where the online ordering concept is under developed.

Strong revenues have yet to translate into shareholder dividends as Just Eat prefers to chase market share in undeveloped markets, it agreed to invest £100m into technology, marketing following the acquisitions of "SkiptheDishes" and "Hungry House".

Consensus profit estimates; Just Eat							
Year End	Revenue (£m)	Net Profit (£m)	Adj. EPS (p)	DPS (p)	P/E (x)	Yield (%)	Share Price (p)
Dec-16	375.7	104.5	12.0	-	57.8	-	694
Dec-17	515.1	144.1	16.6	-	41.8	-	
Dec-18	625.7	189.4	23.0	-	30.1	-	

Source: Fidessa

Just Eat is expected to grow EPS in 2018 by 38.5% hence the premium rating – the board is not expected to introduce a dividend over 2018.

Company	Just Eat	**Key Catalysts**
Share Price	813p	New CEO Peter Plumb joined on 18th September and should confirm 2017 revenue guidance of £500m-£515m with underlying EBITDA of £157-£163m.
Target Price	950p	
52 Week Hi/Low	814p/496p	
Shares O/S	679.63m	Competitive pressures appear to be building which could involve partner migration at some point. Just Eat might respond with more M&A activity, it has only tentatively completed acquisitions to date.
Market Capitalisation	£5.53bn	
Avg. Daily Volume	1.63m	
Dividend Yield	0%	

Source: Bloomberg

Key Risks to Price Target

i) Internet based business model has low barriers to entry and competitive pressures will build

ii) High valuation of £5.5bn equates to 10.8x sales

iii) Significant earnings growth at Just Eat is priced in hence any earnings disappointment would be taken badly.

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Just Eat	**Relevant disclosures: <2>**
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