STOCK STORIES

BAD PRESS IS RARELY GOOD FOR A SHARE PRICE

Whether there is merit in the story, the action by many shareholders will be the same…. Sell. Domino's Pizza shares have fallen 30% from a high of $80 last August to $55 in February 2017. In the same month, industry fund First Super, added to the wave of negativity by requesting their investment managers outline why they held Domino's shares. Their inquiry focused on the environmental, social and governance (ESG) practices of the firm.[1]

The concept of ESG as a stock picking tool is a growing trend amongst investors and investment managers. However, within the uncertainty of financial markets, identifying the cause of a material change to a business and its share price can be the outworking of a number of seemingly unimportant individual events. The challenge of making investment decisions for the long term is that the order and course of such events is different for each and every company.

At Redpoint, one of our stock selection tools is our proprietary metric **- the Redpoint Rating**. This incorporates a range of financial statement based measures of company quality and growth together with a set of key ESG inputs.

In combination, we believe that companies that score well on the Redpoint Rating exhibit desirable coupled characteristics of operating and financial strength with positive management practices across important ESG lines.

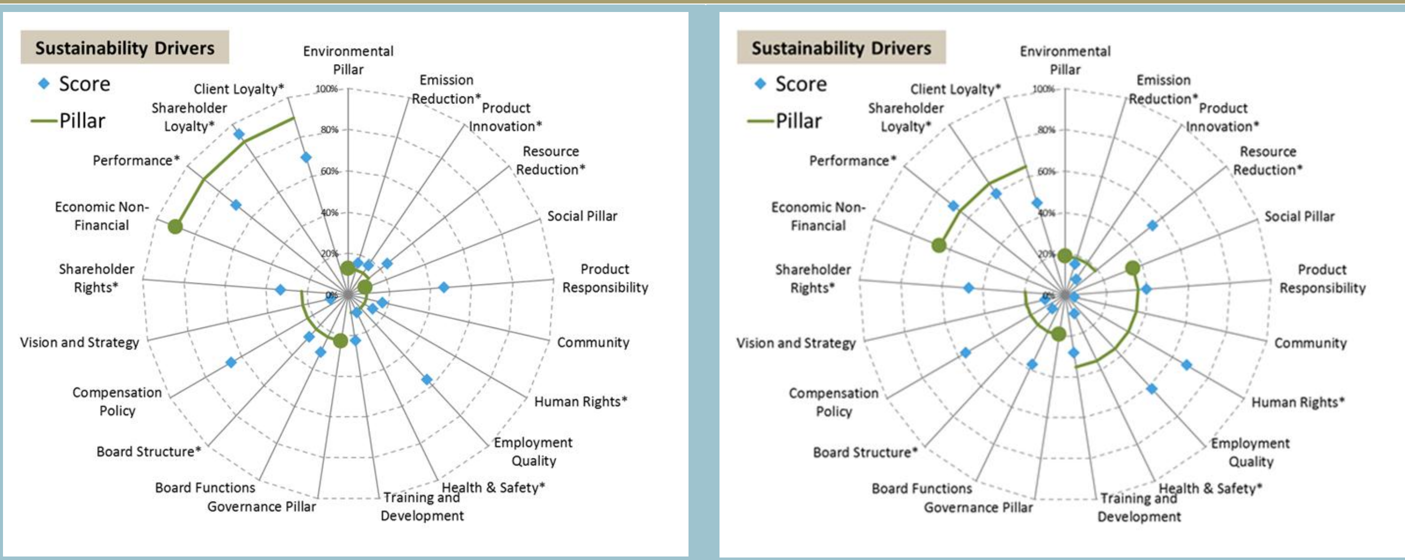
Domino's Pizza joined the ASX100 Industrials Index, the Redpoint SMA Industrial's Model Portfolio's benchmark, on June 22, 2015 at a price of $36.44. At that time, the company scored well in terms of its financial statements' growth – revenues and margins were growing strongly. However, the quality of this growth was not as strong with weaker than expected cashflows, use of accounting accruals and low asset turnover. **More troubling was the company's ESG scores.** The company rated poorly on key issues such as health, safety, human rights, board structure, product innovation and shareholder rights. Based on these metrics the Redpoint Rating indicated to us that we could sensibly de-select the company from our investment universe for the Model Portfolio and look for other investment opportunities.

While the "numbers", shown in Graph 1, gave us confidence in our zero portfolio position the market reaction to Domino's growth was emphatically positive. The stock doubled in price over the next 12 months! The impact of not holding Domino's shares in the Model Portfolio versus the ASX100 Industrials Index was -0.07% (calculated from inception 1 May 2015 to 30 Sept 2016).

[1] http://www.smh.com.au/business/retail/super-fund-questions-dominos-20170217-gufh2d.html

GRAPH 1 – ESG SCORES FOR DOMINO'S PIZZA

June 2015	September 2016



Source: Redpoint investment Management Pty Ltd

(0% = bad, 100% = good) – Items highlighted with an astericks (*) are used in the Redpoint Rating. The "Pillar" is the aggregate of the relevant "scores". The pillars are then aggregated with financial statements measures of quality to determine the final Redpoint Rating.

By September 2016 there was some improvement in their human rights' and shareholder rights' scores. However Board structure, product innovation and health and safety continued to be very low. At the same time the quality of the company's financial outcomes had continued to erode and the share price had run well ahead of any reasonable valuation.

The confluence of these multiple events generally leaves companies vulnerable to downside risk. The past few months for Domino's has seen a large share price fall, a range of difficult questions being posed to management about the sustainability of their business model and a loss of investor confidence.

Not holding Domino's shares added 0.06% to the Model Portfolio from 30 September 2016 to mid February 2017.

As a primary driver of the portfolio positioning of the Redpoint Industrials SMA, the insights embedded in the Redpoint Rating assist us in achieving the key outcomes of the strategy - a risk managed portfolio of better quality companies aimed at delivering the key income and growth outcomes of the benchmark over time with the added tax efficiency of being low turnover.

ESG insights can certainly assist when seeking to better understand the risk management practices and overall quality of company management.

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