SSP Group | 31/05/2018 FAT-UK-735

SSPG | GBP £6.55 | Core | MED. | SH

Time to Take Profits Off the Table

Food Travel business, SSP Group, (LSE. SSPG) recently reported interim results, which continue to exhibit positive momentum. However, given the rise in geopolitical risks and significant growth already priced in, we recommend Members take some profits off the table and Sell Half their position in the company.

What's new?

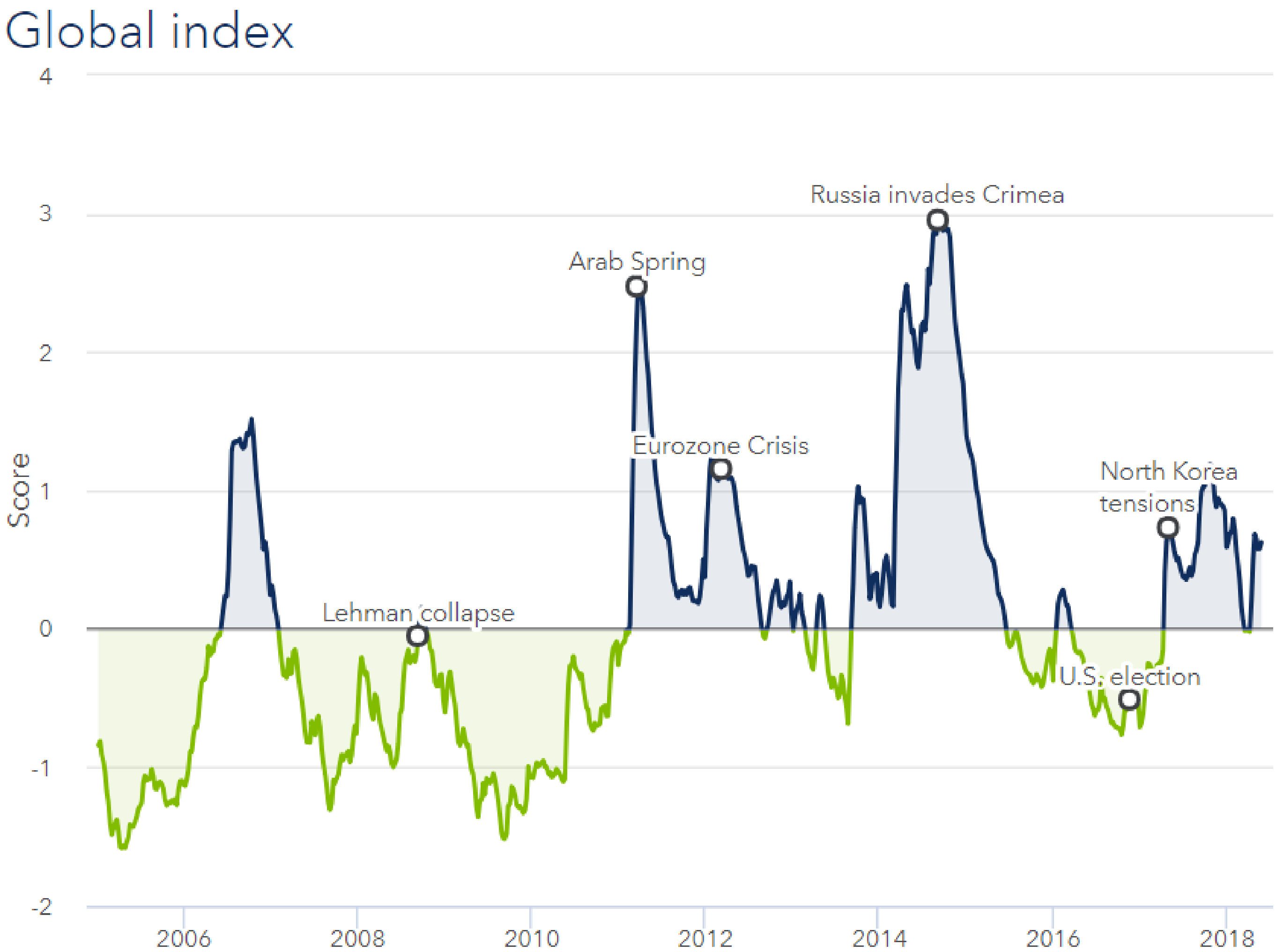
In our last coverage of the Food Travel concessionaire back in March (FAT-UK-725), we covered the company's first quarter (1Q18) trading update. In it, we noted that the company was delivering healthy underlying growth and improving margins. The company had also made solid progress in its new contracts pipeline having booked deals to operate concessions in more locations.

Since then, the most salient development was the company's release of its interim results (1H18) which provide more colour on the company's financials and will be the focus of today's report. The share price has barely inched up since our last report indicating the market has already factored in strong performance in advance.

Recognising this fact, and though we continue to like the company and its long-term potential, the SSP Group, after all, is operating in a cyclical business and it seems that it has reached the top end of the cycle near-term with its FY18 P/E valuation at 27.3x , which is a substantial premium to the broader sector's median P/E of 18.8x.

In addition, the company is operating in an increasingly risky environment with the rise of geopolitical risks which may reduce the travel activity. The looming Brexit being one of the key issues to address, as this could significantly disrupt travel within the region. Fragmentation across the Eurozone, though unlikely as of now, will also be a key issue to monitor with the rise of populist (and xenophobic) governments not to mention diplomatic spats between the US and other players (Russia, China, North Korea and Iran to name a few).

The chart below shows the increasing geopolitical risk environment:



Source: Blackrock Investment Institute, Thomson Reuters

In light of these facts, and with valuations at the top end (i.e. growth already priced in) amidst rising geopolitical tensions, **we believe it is the best time to take some profits and accordingly recommend a SELL HALF on SSP Group at current levels.**

Without further ado, we look at the company's interim results:

1H18 Results Snapshot

Starting from the top and revenues remained solid increasing 9.8% year-on-year to £1,177.8 million. The company benefited from new locations in North America with the opening of new outlets in air travel hubs like San Francisco, Toronto and Newark. The company is also making steady progress in Asia as well with new contracts in China (Shenyang), Thailand (Phuket), and India (Delhi).

Adjusting for currency fluctuations, revenues were in fact stronger, up 11.9% while like-for-like (LFL) sales growth was at 2.8%, with a side benefit from the timing of Easter. LFL sales growth in the **Air business** segment came in at a faster pace due to increased travelling via airlines while the **Rail business** remained soft, likely a side effect of relatively cheaper airfares during the year prompted by lower oil prices.

£m	H1 2018	H1 2017	YOY bps Change Constant Currency	YOY bps Change Reported FX Rates
Revenue	1,177.8	1,072.5		
Gross Profit	821.5	*738.8*		
% Sales	*69.8%*	*68.9%*	*100*	*90*
Labour Costs	356.7	*327.5*		
% Sales	*30.3%*	*30.5%*	*30*	*30*
Concession Fees	222.3	*195.5*		
% Sales	*18.9%*	*18.2%*	*(70)*	*(70)*
Overheads	139.6	*129.0*		
% Sales	*11.9%*	*12.0%*	*10*	*20*
Depreciation & Amortisation	47.7	*44.1*		
% Sales	*4.1%*	*4.1%*	*0*	*0*
Operating Profit	55.2	*42.8*		
Operating Margin (%)	*4.7%*	*4.0%*	*70*	*70*

Source: 16 May 2018 Company Presentation

Moving on, the company posted strong net contract gains which were up a solid 7.1% year-on-year with a strong contribution from North America (+31.1% yoy) while the Rest of the World (RoW) reported a steady 9.5% year-on-year increase. The expansions in Chicago Midway and JFK Terminal 7 have reported their full year of results following their openings in the second half of last year. RoW data also benefited from the openings in Asia.

Going forward, the company announced more growth coming from North America with new contract pipelines at Phoenix and Seattle, while booking another location in San Francisco. The company is also making progress in Eurasia with a contract in the works at the Sheremetyevo airport in Moscow.

On profitability, the strong relative performance in the Air business led to gross margin improvements of 100 basis points year-on-year while the company's focus on operational improvements ultimately expanded operating margins by 70 basis points to end with operating profit growth of circa 29.0% year-on-year to £55.2 million.

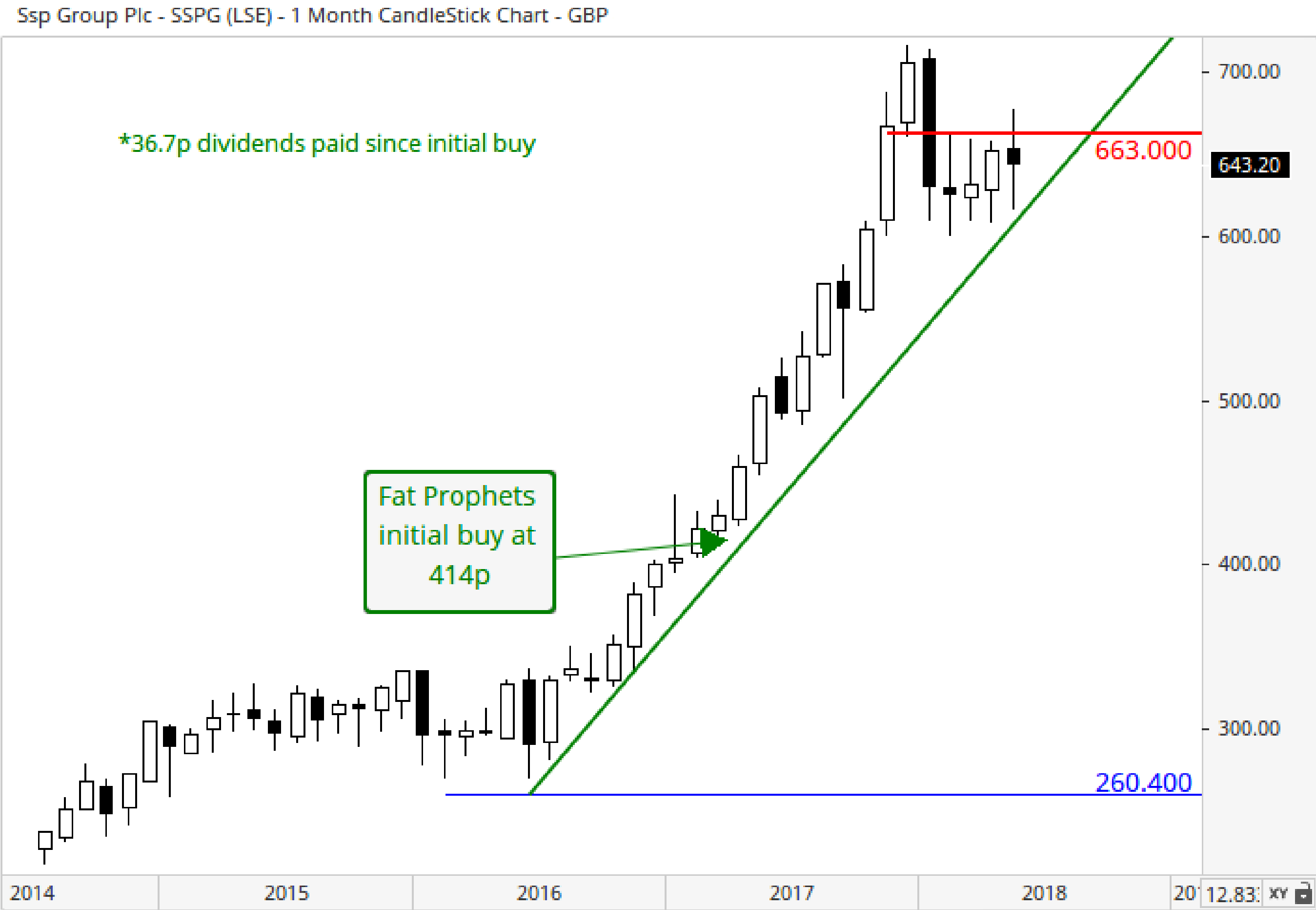
Adjusting for the acquisitions of TFS (Travel Food Services) in India and Stockheim in Germany shows a much larger year-on-year improvement in underlying operating profit, expanding 32.6% year-on-year.

£m	H1 2018	H1 2017	Change (%)
Operating Profit	55.2	42.8	29.0%
Net Financing Cost	(6.7)	(8.8)	
Share of Associates	0.2	0.7	
Profit Before Tax	48.7	34.7	40.3%
Tax	(10.7)	(7.6)	
Non-Controlling Interests	(11.1)	(7.3)	
Net Profit	26.9	19.8	35.9%
Earnings per share (p)	5.6p	4.2p	33.3%
Dividend per share (p)	4.8p	3.2p	50.0%

Source: 16 May 2018 Company Presentation

Moving on down to the bottomline and **group net profit after tax came in 35.9% higher year-on-year to £26.9 million.** The solid performance was helped by lower finance costs as management renegotiated debt covenants leading to amendment and extension of the company's debt facilities. Earnings per share rose at a similar pace, up 33.3% year-on-year to 5.6p.

Going forward, management maintains an optimistic outlook stemming from a healthy pipeline of contracts, however, they did provide some caveats with higher inflation from labour and food inputs and slightly tempered expectations given the increased geopolitical risks.

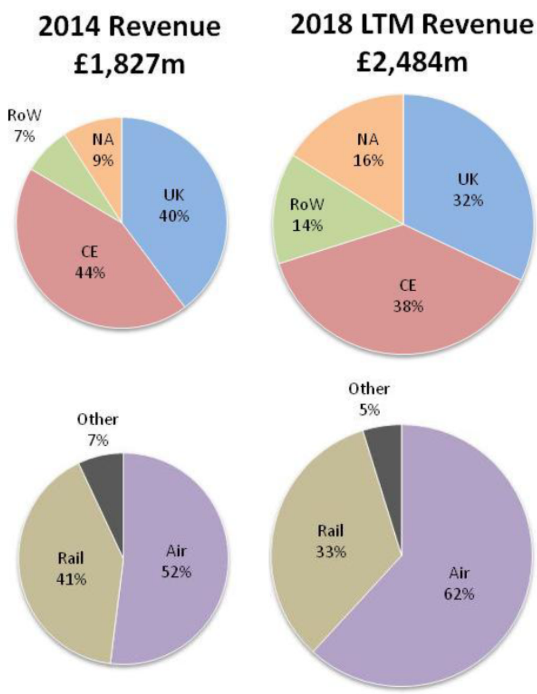


Summary

Overall, the company continues to exhibit solid performance with like-for-like sales growth and prudent expansion into regions expected to see more travel activity. As shown in the graphic below, since the company's IPO, it has made solid progress with revenues up circa 36% and a growing contribution from Airports which are increasingly becoming the norm for travel.

Regional update progress since IPO

- Strong revenue growth since IPO, up 36%
- More balanced business, better geographic diversification
- Fast growth in North America and ROW, now c30% of the Group
- Air sector now 62% of SSP
- Further opportunities to grow



Source: 16 May 2018 Company Presentation

Over the longer term, we believe trends in travel will support SSP Group and we maintain our optimistic view of the company, however, recent valuations indicate that the company is trading now at a high point with the forecast price-to-earnings ratio at 27.3x compared to the sector's Median of 18.8x. The company's price-to-book value is at 12.4x compared to the sector's Median of 1.8x.

Geopolitical risks are also rising indicating the increased likelihood of reduced travel. Armed with these facts and knowing that the company is part of a cyclical business, we believe it is appropriate to take profits off the table. **Accordingly, we recommend Members to Sell Half their position in SSP Group at current levels.**

Holdings, Development Securities, Dragon, Enquest, Esure, Euronext, FedEx, Fresnillo, Ibiden, Infosys, Glaxosmithkline, Glencore International, Goldbridges Global Resources, Google (Alphabet), Grainger, Gulf Keystone Petroleum, Highland Gold Mining, HSBC,ICICI Bank, Ironveld, iShares Physical Metals, J Sainsbury, JKX Oil & Gas, John Wood Group, Kazakhmys, Legal & General, Lloyds, Low and Bonar, Market Vectors Junior Gold Miners, Market Vectors Oil Services, Market Vectors Vietnam, Marstons, Medusa Mining, Mitchells & Butlers, Mitsubishi Tokyo Financial, Mitsubishi UFJ, National Grid, Nippon Telegraph and Telephone, Panasonic, Paragon Group of Companies, Petra Diamonds, Petrofac, Petropavlovsk, PICC Property & Casualty, PPHE Hotel Group, Randgold Resources, Rank Group, Reckitt Benckiser, Royal Dutch Shell, Solgold, Sony Corporation, Standard Chartered, STV Group, Sylvania Platinum, Tata Motors, Tencent, Tertiary Minerals, Teva Pharamaceutical, Toyota Motor, Tullow Oil, Unilever, Vedanta Resources, Vodafone, Walt Disney, Zillow.

Snapshot SSPG

SSP Group

Latest Closing Price: £6.5452

SSP Group plc is an operator of food and beverage concessions in travel locations, operating restaurants, bars, cafes, food courts, lounges and stores in airports, train stations, motorway service stations and other locations. The Company's segments are the UK, Continental Europe, North America and the Rest of the World (RoW).

Market Capitalisation:£3.04b

	FY1	FY2
Price to Earnings	27.3	24.8
Dividend Yield (%)	1.5	1.6
Price to Book	12.4	10.7
Return on Equity (%)	22.3	23.1
EV/EBITDA	11.7	10.9