SSP Group 02/08/2018 **FAT-UK-744**

SSPG GBP £6.87 Core **HIGH** S

Fat Prophets Take Profits

Travel caterer, SSP Group (LSE.SSPG) recently released its third quarter (3Q18) numbers and growth remained positive. However, there is information that foreshadows increased uncertainty in the sector while valuations remain high and out of sync with peers. In light of that fact, we believe that it's the right time to take profits and fully exit from the position.

What's New?

In our previous coverage of the company back in May (FAT-UK-735) we looked at the travel caterer's interim performance and noted that the developments remained positive.

However, considering the rise in global tensions along with the looming Brexit see us revisit the case for the company and we noted that such events are likely to hinder travel and negatively impact earnings over the longer term. Furthermore, the company operates in a cyclical business which has reached the top end of its cycle, thus we opted to reduce the position by half and observe the developments in the space.

Since then, there have been numerous developments globally that may have an impact in the sector and today we focus on some of the more salient developments and weigh in on the stock.

First off, the company released its 3Q18 update, noting that air travel during the period was particularly robust. Revenues for the quarter were up 7.3% year-on-year on a constant currency basis and after factoring in currency movements, it was up 5.8% year-on-year. Net Contract Gains (NCG) – a measure of revenues in outlets operating for less than a year – were up 3.3% and already factors in the Stockheim acquisition impact of 1.3%.

That said, though management called this result as "encouraging progress" the business is beginning to show a slowing pace as previously revenues were growing at a double-digit pace and NCG has since halved.

We believe that the recent trends indicate the start of a slowdown, with the travel sector reaching its high point. Note that this result comes in the wake of record travel figures amidst intensifying competition amongst airlines keeping fares low and encouraging more people to travel.

In fact, the latest data from the Office for National Statistics (ONS) show that annualised tourist numbers have hit over 39.2 million – its highest ever – while spending a sizable £24.5 billion, up 9% year-on-year.

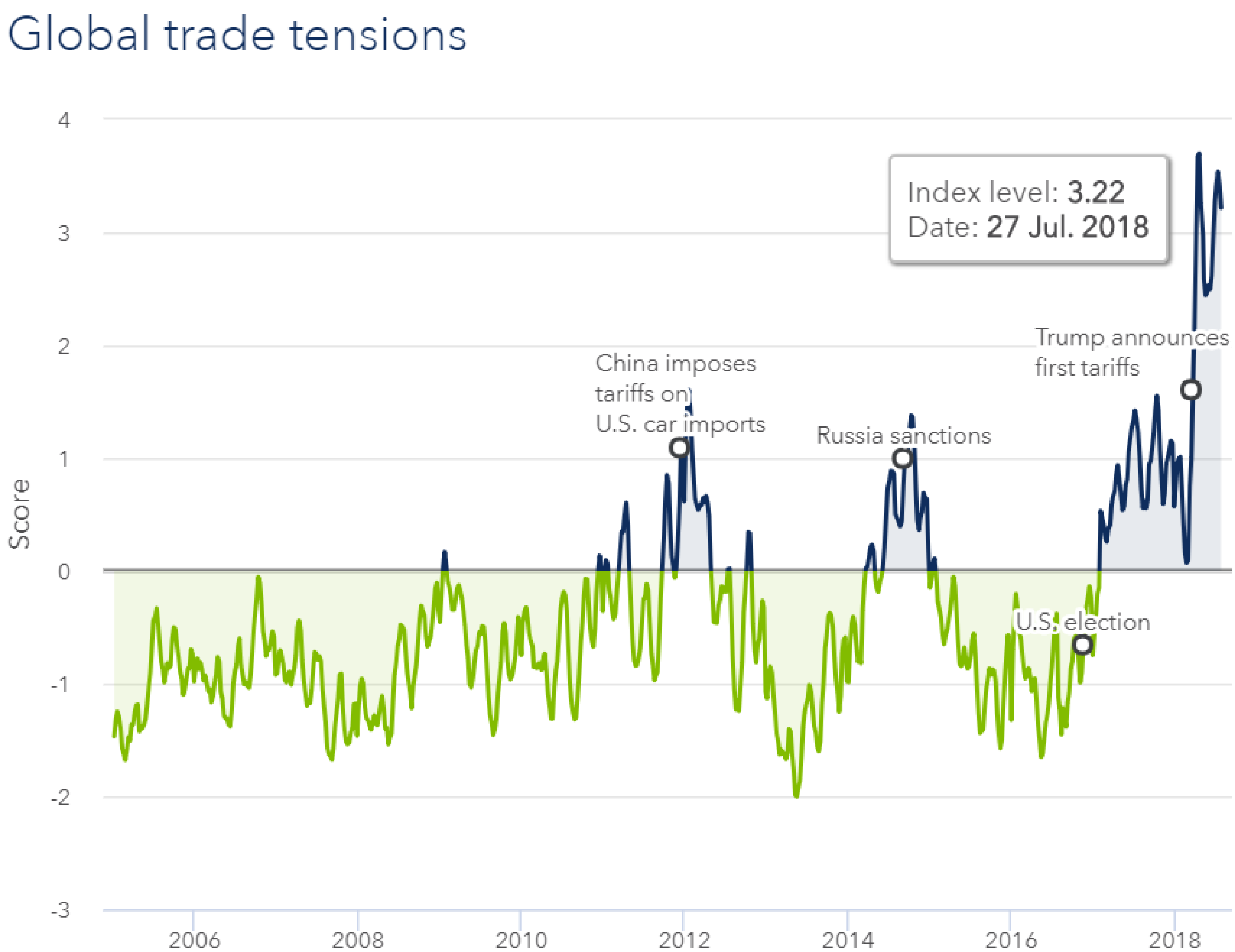
An overwhelming majority of travellers cited the visits as "holiday reasons" instead of business (which continue to fall) indicating that these trends may not be sustainable. Consider that "holiday travellers" are more volatile and react at a more rapid pace to external events and are more price sensitive as opposed to business travellers.

Furthermore, we believe the increase in "holiday travellers" were mainly people wishing to make the trip ahead of the Brexit. Thus, one can imagine that traveller numbers next year will be lower as many simply moved their plans a year ahead and this will impact volume expectations for SSPG.

The company also foreshadows this in its outlook commentary that in the "short term" it expects a "degree of uncertainty" around passenger volumes but waves this away by noting the "structural growth opportunities" – another way of saying long-term.

In light of that, we do not wish to give up the gains we've made since recommending the stock and thus believe that it's best to take profits. In addition, there are some other bigger picture trends that indicate that the fundamental outlook may see a longer down cycle for the travel sector.

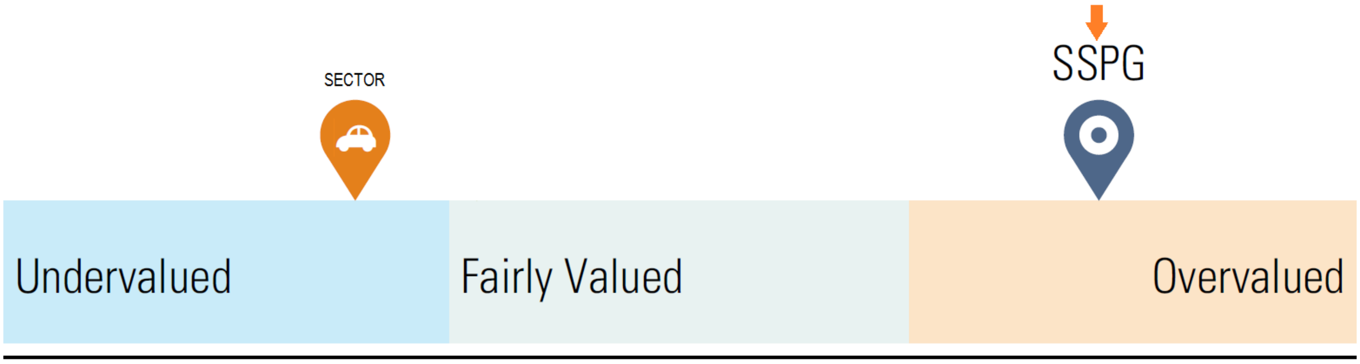
First off is that the company is operating in an increasingly risky environment with the rise of geopolitical risks which may reduce the travel activity. The developments over the past few months show that things have worsened. The chart below shows the increasing tensions:



Source: BlackRock Investment Institute, with data from Thomson Reuters. Data as of July 27, 2018.

Source: Blackrock Investment Institute, Thomson Reuters

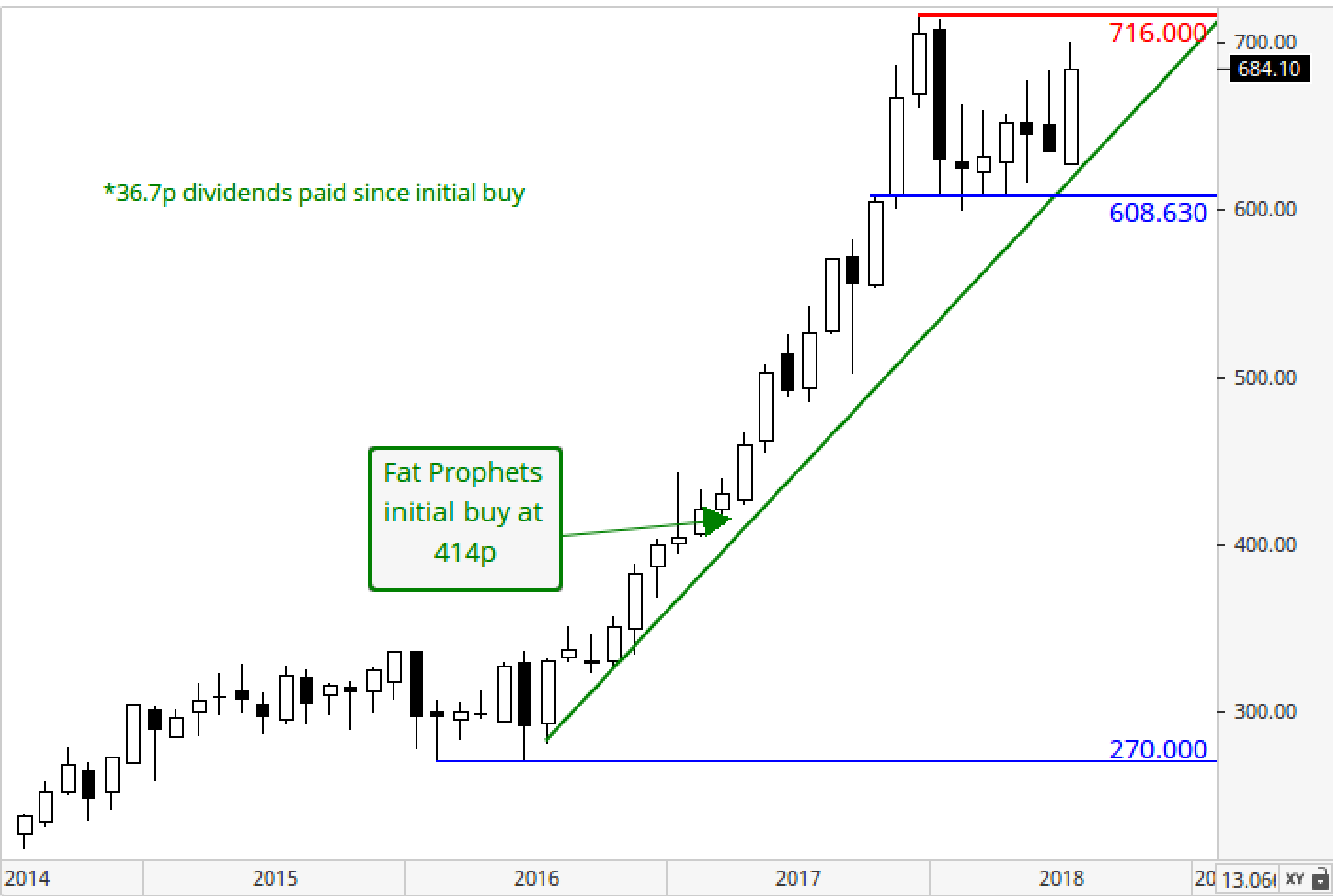
That aside, on a valuation front, the company trades at a substantial premium to the sector.



Source: Morningstar

<u>The rest of the sector has now moved to undervalued territory at 14.1x, likely reflecting the reduced expectations in the following year</u>. However, **SSP still trades at peak level with FY19 expectations at 28.6x** with the market likely valuing it at a premium due to "growth" though this has already shown signs of slowing down. <u>Note that once expectations (which are already high) are dashed, this will likely lead to a substantial downward rerating of the shares</u>.

Ssp Group Plc - SSPG (LSE) - 1 Month CandleStick Chart - GBP



Summary

Based on the recent 3Q18 update, the company continues to exhibit a decent performance reporting growth on the topline, however, this is likely a reflection of unusually high travel figures and the result of many bumping up plans given the looming Brexit. Going forward, our expectations for travel are lower amidst rising global tensions.

Furthermore, the company continues to trade at a high valuation, out of sync with the sector which has already priced in lower expectations. The forecast PE ratio for SSP is at 28.6x compared to the sector's

Median of 14.1x. The company's price-to-book value is at 7.9x compared to the sector's Median of 1.8x.

Accordingly, we recommend Members take profits and Sell their entire position in SSP Group (LSE.SSPG). We will cease coverage of the stock and remove it from the Fat Prophets Portfolio.

Snapshot SSPG

SSP Group

Latest Closing Price: £6.868

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:£3.2b

	FY1	FY2
Price to Earnings	28.6	26.0
Dividend Yield (%)	1.4	1.5
Price to Book	7.9	
Return on Equity (%)	29.4	23.3