

Phil Oakley's Weekly Roundup

Exclusively for SharePad and ShareScope users



26th January 2018

Market Overview

Name	Price	%chg 1w	%chg 1m	%chg 1y	1y high	1y low	Date 1y high	Date 1y low
FTSE 100	7615.84	▼-1.11	▲0.305	▲6.3	7778.64	7099.15	12/1/18	31/1/17
FTSE 250	20521.7	▼-0.693	▲0.198	▲13.2	20932.6	18081.8	5/1/18	30/1/17
FTSE SmallCap	5973.25	▼-0.419	▲2.14	▲14	6038.69	5207.06	15/1/18	31/1/17
FTSE AIM 100	5505.91	▲0.882	▲3.55	▲32.1	5531.98	4166.8	23/1/18	25/1/17
FTSE All-Share	4185.04	▼-1.01	▲0.356	▲7.66	4268.89	3858.26	12/1/18	31/1/17
S&P 500	2843.79	▲1.64	▲5.98	▲23.7	2843.79	2278.87	25/1/18	31/1/17
Brent Oil Spot \$	\$70.9045	▲2.57	▲9.01	▲28.2	\$70.9045	\$44.785	25/1/18	21/6/17
Gold Spot \$ per oz	\$1360.66	▲2.46	▲6.83	▲13.3	\$1360.66	\$1188.45	25/1/18	26/1/17
GBP/USD - US Dollar per British Pound	1.42691	▲2.71	▲6.69	▲12.9	1.42691	1.21561	25/1/18	9/3/17
GBP/EUR - Euros per British Pound	1.14235	▲0.594	▲1.41	▼-2.78	1.1972	1.0795	18/4/17	29/8/17

Top Risers

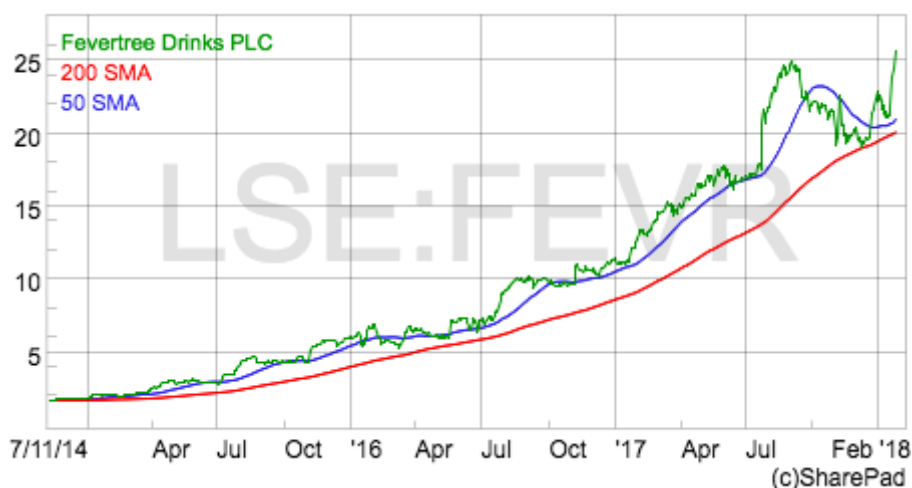
No.	TIDM	Name	%chg 1w
1	OCDO	Ocado Group PLC	▲25.1
2	OXB	Oxford BioMedica PLC	▲12.7
3	DPH	Dechra Pharmaceuticals PLC	▲11.3
4	FDL	Findel PLC	▲9.71
5	EZJ	easyJet PLC	▲9.12
6	SDL	SDL PLC	▲8.29
7	CCFS	Charter Court Financial Servic...	▲8
8	LSE	London Stock Exchange Group...	▲6.41
9	CTEC	ConvaTec Group PLC	▲6.3
10	MGP	Medica Group PLC	▲6.25

Top Fallers

No.	TIDM	Name	%chg 1w
1	DTY	Dignity PLC	▼-51.1
2	CPR	Carpetright PLC	▼-42.2
3	CNCT	Connect Group PLC	▼-28.9
4	LUCE	Luceco PLC	▼-18.5
5	BWNG	Brown (N) Group PLC	▼-18
6	LAM	Lamprell PLC	▼-16.5
7	RSW	Renishaw PLC	▼-13
8	OPHR	Ophir Energy PLC	▼-11.4
9	WMH	William Hill PLC	▼-9.19
10	KAZ	KAZ Minerals PLC	▼-7.5

Fevertree (AIM:FEVR)

Upmarket drinks company Fevertree has released another stunning trading update ahead of the reporting of its 2017 results in March. The company continues to deliver outstanding rates of sales growth on the back of very strong growth over the last few years.



Yet again, Fevertree has said that its profits for 2017 will be comfortably ahead of current expectations. Before Wednesday's announcement the consensus forecast for pre-tax profit for 2017 was £53.7m with EPS of 37.4p. Given the strength of trading, it would not surprise me if actual profits turn out to be closer to the current 2018 PBT forecast of £58.7m or possibly even better.

Fevertree Sales Growth (%)

Period	Total	UK	Europe	North America	ROW
2017	66	96	42	39	57
H117	77	113	64	43	45
2016	73	118	39	55	88
H116	69	108	42	59	73
2015	71				

I've included a table above to show just how impressive Fevertree's sales performance has been in recent years. The UK and premium tonic drinks continue to be the main driver of sales growth as it benefits from the growth in gin drinking - and premium gin in particular - across the world.

The Fevertree brand is now firmly entrenched with consumers as the go-to mixer of choice. So much so that it is now the number one mixer drink in the UK by value in the off trade (supermarkets and convenience stores).

This is an impressive performance especially as the price differential between Fevertree tonic (£1.69 per 500ml in my local Co-op) and Schweppes (£1.42 per litre in the same store) is large. Yet despite the supposed fight back by Coca-Cola owned Schweppes there is little evidence of it eating into Fevertree's sales momentum. If anything, based on what I can see a bigger share of shelf space is being allocated to Fevertree products in supermarkets.

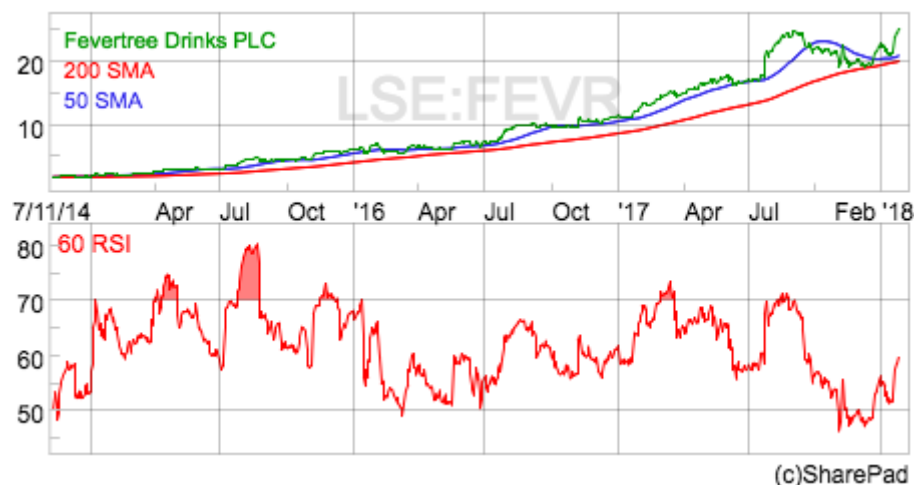
This kind of sales momentum when placed on top of an asset-light business model - Fevertree outsources bottling and distribution to third parties - contributes to outstanding profitability and returns on capital employed (ROCE). It's the kind of business that most investors would like to own a slice of.

Fevertree Drinks PLC (FEVR)						
FORECASTS			£ millions unless stated			
Year	2017		2018		2019	
Turnover	160.5	+56.9%	189.7	+18.3%	220.9	+16.4%
EBITDA	55.6	+57.2%	60.7	+9.3%	70.1	+15.4%
EBIT	54.1	+57.5%	59.1	+9.2%	68.3	+15.6%
Pre-tax profit	53.7	+56.5%	58.7	+9.3%	67.6	+15.2%
Post-tax profit	43.4	+59.5%	47.3	+8.9%	54.5	+15.3%
EPS (p)	37.4	+59.4%	40.6	+8.6%	46.8	+15.3%
Dividend (p)	9.5	+52.0%	10.4	+9.5%	12.4	+19.2%
CAPEX	1.1	+32.1%	1.2	+6.7%	1.2	+5.6%
Free cash flow	31.7	+60.7%	42.0	+32.5%	49.1	+16.7%
Net borrowing	-49.8	+85.3%	-80.1	+60.8%	-116.0	+44.8%

The obvious question is how long can Fevertree keep on growing at very impressive rates? Sales growth has moderated slightly but surely there's only so much gin and tonic that UK consumers can shove down their gullets?

The company is investing in the US to drive growth there. It has also said that some of its other drinks - such as cola, ginger ale and lemonade - are seeing decent rates of growth (though not disclosed) and that the brand is attracting younger consumers.

Fevertree's valuation already prices in a decent amount of future growth. Let's say for argument's sake that forecasts move forward one year and the current 2019 forecast EPS of 46.8p becomes the new consensus EPS estimate for 2018. At a share price of £25 this would give the shares a forward PE of 53.4 times - slightly lower if cash balances are taken into account.



This valuation will be too rich for many investors but short-term traders will not be concerned.

Fevertree remains a quality momentum share which does not look overbought on simple technical indicators such as RSI. As long as analysts keep on upgrading forecasts there is likely to be some upwards pressure on the share price.

A problem will occur when growth slows and profit forecasts stop being upgraded. Who will be the buyer of the shares then? It won't be momentum investors and value investors are unlikely to be interested. This could see Fevertree shares take on similar share price characteristics to a business like boohoo.com.

By that, I mean a very good business that is richly valued but with no short-term catalyst to drive the share price higher. See boohoo's one year share price chart to get a feel of what I am suggesting here.



What about a takeover bid for Fevertree?

There were some thin rumours about this circulating last week - mainly because someone from Unilever had become a non-executive director - but I remain sceptical.

A bid can never be ruled out but the current rich valuation makes the numbers hard to stack up unless growth continues to roar ahead. I've no doubt that a business such as Coca-Cola with its marketing and distribution strength could buy Fevertree and make a great success of it. Whether it would want to given its ownership of Schweppes is another matter.

JD Wetherspoon (LSE:JDW)

Disclosure: I own shares in JD Wetherspoon

Pub group JD Wetherspoon is firing on all cylinders at the moment in a challenging market.



The company started its 2017/18 well with like-for-like sales growth of 6.1% in the first quarter and this has continued with 6% growth in the second quarter. This compares very favourably with the 3.3% like-for-like sales growth seen in the first half of last year and is a lot better than most pub operators are currently achieving.

JD Wetherspoon is very good at telling its shareholders what's going on within its business. It has previously said that LFL sales growth of 3-4% would be needed during 2017/18 in order to maintain the previous year's pre-tax profit due to cost pressures from rising wages, business rates and sugar taxes. Given the current rates of sales growth it now believes that profits for the year will slightly ahead of current expectations (see below).

This is a cautiously optimistic outlook but sales comparisons do get tougher in the second half of the year - LFL sales increased by 4.9% last year - and there is also the unknown impact of the World Cup on sales. Wetherspoon usually does not have TV sets in its pubs so it is likely to lose market share to rivals when big football matches are being televised.

Wetherspoon (J D) PLC (JDW)

Year	2018		2019		2020	
Turnover	1,684.7	+1.4%	1,743.1	+3.5%	1,796.7	+3.1%
EBITDA	205.3	+1.6%	211.7	+3.1%	218.1	+3.0%
EBIT	128.7	+0.1%	132.8	+3.2%	136.1	+2.5%
Pre-tax profit	100.1	-0.3%	102.0	+1.8%	105.4	+3.4%
Post-tax profit	75.2	-1.0%	76.6	+1.9%	78.9	+3.0%
EPS (p)	68.8	+0.7%	70.3	+2.2%	73.8	+5.0%
Dividend (p)	12.1	+0.8%	12.2	+0.8%	12.3	+0.8%
CAPEX	105.2	-43.9%	103.1	-2.0%	79.2	-23.1%
Free cash flow	82.2		83.6	+1.7%	87.9	+5.1%
Net borrowing	711.2	+2.1%	687.6	-3.3%	648.9	-5.6%
NAV	-		-		-	
Like for like sales growth %	3.8		2.9	-24.6%	2.5	-14.1%

Despite this, the company is clearly taking market share from its rivals at the moment. Some of the success has been put down to a new smartphone app that allows customers to order food from their phones without queuing at the bar. Yet Wetherspoon already has a very good track record in growing sales from its existing pubs due to the value for money it offers with its cheap drinks and branching out into other areas such as breakfasts and coffee.

Profits growth from this business is likely to be very modest for the next few years. One of the reasons is increased cost pressures mentioned above but another is the fact that the size of the Wetherspoon pub estate is not growing. In fact it has been shrinking over the last couple of years.

The bonus for investors is that the quality of the pub estate is improving. Poorly performing pubs are being sold off which is increasing the average profit per pub. The company also continues to buy the freeholds of previously leased pubs which improves the asset backing of the business and gives it more flexibility - it can sell poorly performing pubs and avoid being tied to rental agreements and expensive exit clauses.

Assuming a modest upgrade in EPS forecasts to 71p, the shares trade on a 2018F PE of 18.5 times at a share price of 1313p. That's pretty punchy but those earnings are backed by impressive cash generation and a business that is taking market share.

It's hard to make good money from pubs but Wetherspoon along with Fuller Smith & Turner and Young's remain the most likely companies in the sector to do so in my opinion.

Revolution Bars (LSE:RBG)

After a tough 2017 which saw a large profit warning and a badly handled takeover bid, Cuban-themed bar operator Revolution Bars seems to have steadied the ship.



Trading over Christmas has been pretty decent with a four week increase in LFL sales of 5.9%. The company gave a variety of LFL sales numbers which probably confused many people. Here's my take on what has been going on during the first half of its 2017/18 year.

- Weeks 1-13 +0.6%
- 4 weeks Christmas to New Year +5.9%
- Weeks 13-27 +3.1%
- Q2 10 weeks excluding XMAS +2%

I have estimated weeks 1-13 and the 10 weeks in the second quarter excluding Christmas. These second quarter figures are probably not as good as they look as an extra week was tagged on to the trading statement (27 weeks instead of 26)

so that trading on New Year's Eve could be included which will have boosted sales as it actually falls in the second half of the 2017/18 financial year.

My view is that this trading performance is alright but nothing to shout about. The company again made no mention of costs - which are rising across the industry - but if Wetherspoon's comments of 3-4% LFL sales growth being needed to maintain profits is true for all pubs then Revolution's sales performance is not good enough to stop profits from its existing pubs from falling. Unless of course it has taken a chunk of costs out of the business to offset rising costs elsewhere.

Profits are expected to be in line with analysts' expectations due to the extra profit contributions from newly opened and maturing bars.

Revolution Bars Group PLC (RBG)						
FORECASTS						
£ millions unless stated						
Year	2018		2019		2020	
Turnover	145.6	+11.6%	160.9	+10.5%	177.3	+10.2%
EBITDA	16.1	+22.4%	17.6	+9.1%	19.0	+7.9%
EBIT	9.8	+28.9%	10.8	+10.2%	11.6	+7.1%
Pre-tax profit	9.7	+30.7%	10.6	+8.8%	11.3	+6.9%
Post-tax profit	-		-		-	
EPS (p)	15.3	-4.0%	16.6	+8.5%	17.8	+7.2%
Dividend (p)	5.3	+7.1%	5.6	+5.7%	5.8	+3.6%
CAPEX	12.8	+0.2%	13.7	+7.0%	14.2	+3.4%
Free cash flow	10.5		10.2	-2.9%	11.8	+15.7%
Net borrowing	5.8	+82.3%	7.0	+21.4%	6.7	-4.3%

Revolution's business model does not appeal to me. I have great difficulty in accepting that selling expensive cocktails mainly in provincial UK towns and cities is a long-term winner. The fact that the company's profits have struggled to make much progress at all in recent years - despite opening more bars - supports that view.

I am also not a fan of leasehold pub chains as there is no asset backing to the business and it limits the flexibility to exit poorly performing sites.

That said, it would be wrong to say that Revolution was a basket case of a business despite falling EBITDA margins and returns based on a rough and ready

approximation of cash return on cash capital invested (EBITDA as a percentage of average gross tangible fixed assets).

Revolution Bars EBITDA return on Gross Tangible Fixed Assets

Year	Sales	Adj EBITDA	Margin	Avg GTFA	ROGTFA
2012	97.2	13.7	14.09%		
2013	104.5	11	10.53%	94.42	11.65%
2014	112.3	13.2	11.75%	93.18	14.17%
2015	111.8	14.6	13.06%	94.49	15.45%
2016	119.5	12.1	10.13%	100.53	12.04%
2017	130.5	13.7	10.50%	112.90	12.13%

Bar opening costs have been deducted from EBITDA in 2016 and 2017 as I see this as a cost of doing business.

Its return on gross tangible fixed assets is not out of kilter with much of the sector - in fact in many cases it is slightly better - but the returns in themselves are hardly impressive. Note that these returns are nowhere near the c40% ROCE claimed by the company on new bar openings as recently as last spring.

Despite my relatively downbeat opinion of this business in its current form, I am not really sticking my neck out much by saying that under different management these assets can perform a lot better.

The management of Stonegate and Deltic who both recently bid unsuccessfully for Revolution clearly think they can do better and make a go of the pubs in some form of another. Deltic has a 3% shareholding in the company whilst respected fund manager Keith Ashworth Lord has also upped his stake in the company to 6.2%.

Interestingly, Revolution is still without a chief executive with the chairman currently running the company. This company looks like it will eventually be taken over by another party and probably at a higher price than the current 167p. The expectation of a takeover is the best reason for owning these shares in my view.

SSP Group (LSE:SSPG)

I first came across Select Service Partner over 20 years ago when looking at the shares of Compass Group (LSE:CPG). Back then it was a minor part of the contract catering company's business. It was sold off by Compass to a private buyer and then listed on the stock exchange back in the summer of 2014.



It sells food and drink in travel locations across the world - such as airports, train stations and motorway service areas. It is granted concessions to operate in these locations by the owners of them.

The company has three prominent own brands in Upper Crust (baguettes and bakery products), Ritazza (coffee) and Le Grand Comptoir which is a food and wine bar. It also runs outlets of other prominent global food and drink brands such as Starbucks, Burger King and Yo Sushi.

It doesn't have particularly high profit margins (around 7%) or particularly high returns on capital employed (around 10% when adjusted for leases) but this hasn't stopped its shares more than tripling in price since its IPO as profits have grown at a decent rate.

This week's first quarter update was reasonably reassuring with modest LFL sales growth (+2.7%) and a good contribution from new contracts and acquisitions. Total sales growth was 12.2%.

What intrigues me about this business is that its shares trade on a one year forecast rolling PE of nearly thirty times earnings according to SharePad.

SSP Group PLC (SSPG)						
FORECASTS			£ millions unless stated			
Year	2018		2019		2020	
Turnover	2,524.2	+6.1%	2,645.8	+4.8%	2,769.0	+4.7%
EBITDA	279.0	+6.6%	298.3	+6.9%	317.8	+6.5%
EBIT	178.2	+8.4%	191.4	+7.4%	206.9	+8.1%
Pre-tax profit	164.8	+13.8%	179.7	+9.1%	196.4	+9.3%
Post-tax profit	107.2	+15.5%	117.0	+9.1%	127.9	+9.4%
EPS (p)	22.0	+14.6%	24.2	+10.0%	26.4	+9.1%
Dividend (p)	9.0	+11.1%	9.6	+6.7%	10.6	+10.4%
CAPEX	126.6	+10.1%	123.2	-2.7%	126.0	+2.3%
Free cash flow	108.1	-0.2%	132.8	+22.8%	167.0	+25.8%
Net borrowing	287.0	+5.3%	212.1	-26.1%	142.7	-32.7%
NAV	-		-		-	
Like for like sales growth %	2.5		2.4	-3.2%	2.4	-2.1%

Trading profits are expected to grow in the mid to high single digit percentage range over the next few years which is alright but nothing stellar. So what's behind the very high valuation of the shares?

I can see the attraction of running a business in areas of high footfall with a captive customer base. If I compare it with something like WH Smith's Travel business then there should be good money to be made providing passenger numbers hold up.

Admittedly these businesses are not directly comparable as SSPG is selling food and not books and magazines but they have the same favourable market backdrop. Out of interest, SSPG is run by Kate Swann who used to run WH Smith.

Undoubtedly there is scope to grow further by winning more concessions and operating contracts but I am struggling to be convinced why anyone would pay nearly 30 times earnings for this blend of quality and growth.

Another point to bear in mind is that around two thirds of its sales are made outside the UK with 40% in Europe. At current exchange rates, sales growth would be reduced by around 1.5% this year. The lack of a currency aided tailwind will make it harder to grow when results are translated back into pounds.

Connect Group (LSE:CNCT)

Generally speaking very high yielding shares should be seen as a red flag rather than a screaming investment opportunity.



High yields are usually associated with businesses which at best are struggling to grow or have serious issues with their business models. Carillion is a classic example of both these scenarios.

Up until this week, I don't think it would have been unfair to have said that Connect had a growth problem.

Its core news distribution business has been in decline for years. Cost cutting and a series of acquisitions have helped it to broadly maintain profits. Attempts to diversify into related logistics businesses have not paid off with previous purchases being sold off after a few years of ownership.

This week's trading update was a bit of a shocker. News distribution has held up reasonably well as usual but its Pass My Parcel click and collect business offered to retailers is not doing well. The sales mix has had too many low margin return items in it which means that losses are not expected to improve from last year's £6m.

Trading in its bulk parcels business has been tougher than expected and cost savings are not coming through in the amounts expected.

Consequently, pre-tax profits for 2018 are expected to be in the range of £42m to £45m compared with previous expectations of £49m. This is not what is needed when a business already has wafer thin profit margins of 2.6%.

I have learned to stay clear of investing in businesses like this. Wafer thin margins can disappear completely if trading gets really tough. I don't think they will in Connect's case but the risks are too high for me.

Connect Group PLC (CNCT)						
Year	2018		2019		2020	
Turnover	1,548.8	-2.9%	1,505.2	-2.8%	1,458.1	-3.1%
EBITDA	66.0	-10.4%	66.5	+0.7%	69.6	+4.8%
EBIT	48.9	+18.3%	49.2	+0.8%	51.8	+5.2%
Pre-tax profit	43.6	+29.0%	44.1	+1.2%	46.6	+5.5%
Post-tax profit	35.0	+32.3%	35.5	+1.4%	36.6	+2.9%
EPS (p)	14.2	+32.7%	14.3	+0.7%	15.1	+5.6%
Dividend (p)	9.7	-1.0%	9.8	+1.0%	9.9	+1.0%
CAPEX	15.0	-20.2%	14.8	-1.7%	13.7	-7.3%
Free cash flow	31.4	+14.5%	34.6	+10.2%	41.5	+20.1%
Net borrowing	78.9	-4.9%	77.7	-1.5%	73.5	-5.4%

What's concerning is that not much of a recovery in profits or a reduction in net borrowings is expected in 2019.

If that wasn't bad enough, the £11m that was expected from selling the Books division now looks as if it isn't going to come through any time soon as the buyer has informed Connect that it doesn't have the money to buy it from them.

So where do these events leave Connect's dividend?

Safe for now is the likely answer. This means that the shares are offering a forecast dividend yield of over 13% at a share price of 74p. They would still offer a yield of more than 6.5% if the dividend pay-out was halved. The shares now trade on just 5.2 times forecast EPS.

Does this mean that the shares are incredibly cheap?

Yes it does. I can see how the yield and low valuation will tempt bargain hunters. They may even end up making a decent amount of money from current levels if trading conditions improve.

That said, I view Connect as the equivalent of a very cheap bottle of wine you might put in your supermarket trolley. There's a very good chance that you won't like the taste of it much and most of the bottle will end up being poured down the kitchen sink. A more satisfying experience is usually had by paying up for something of superior quality.

WH Smith (LSE:SMWH)

In my newsletter of 20th October last year, I wrote about how good WH Smith had been at defying the naysayers over the last decade. It had cut costs and changed the sales mix of its high street business towards more profitable items whilst growing its more lucrative Travel Business.



This strategy had kept profits growing and produced large amounts of free cash flow for shareholders. Large chunks of this free cash flow had been used to shrink the number of shares outstanding which in turn gave an extra kicker to the share price.

The Travel business has been the main driver of profits and shareholder value for some time now. What's been very helpful is that profits at the high street business have not acted as a drag on the business.

At least not until now that is.

This week's trading update showed that Travel - which accounts for two thirds of total profits - is continuing to prosper. Total sales for the first 20 weeks of 2017/18 were up by 7% with LFL sales up by a healthy 3%. Passenger numbers at airports

are helping to grow sales and gross margins are higher year on year. With 15 new units expected to open this year, the Travel Business looks to be in good shape and adding more value.

The high street business is continuing to shrink with LFL sales down 4%. The company has been able to increase gross margins in this business but not by as much as it wanted to as fewer higher margin humour books were sold. Cost savings for the year are expected to be around £12m - a bit more than expected - which might offset most of the effect from slightly weaker gross margins.

Last year, profits in the high street business were flat. It can only be a matter of time before they start falling as cost cutting cannot last forever and gross margins cannot keep going up to offset lower volumes. However, some analysts were making these predictions a decade ago.

However, I do think that WH Smith will find it hard to preserve profits in this business which means that it has the potential to dilute the growth in Travel.

WH Smith PLC (SMWH)						
FORECASTS			£ millions unless stated			
Year	2018		2019		2020	
Turnover	1,252.5	+1.5%	1,278.0	+2.0%	1,308.6	+2.4%
EBITDA	190.7	+6.6%	199.8	+4.7%	208.6	+4.5%
EBIT	147.7	+7.0%	155.8	+5.5%	162.9	+4.6%
Pre-tax profit	146.3	+7.6%	154.0	+5.2%	161.6	+5.0%
Post-tax profit	120.2	+7.3%	127.2	+5.8%	132.6	+4.3%
EPS (p)	109.4	+9.4%	117.6	+7.5%	123.8	+5.3%
Dividend (p)	51.6	+7.1%	55.7	+7.9%	59.8	+7.4%
CAPEX	47.6	-0.9%	46.3	-2.7%	47.0	+1.5%
Free cash flow	110.1	+50.9%	118.5	+7.6%	125.5	+5.9%
Net borrowing	-22.1	+452.6%	-23.5	+6.2%	-33.0	+40.7%

EPS growth is expected to moderate but is still expected to grow faster than pre-tax profits due to the ongoing reduction in the number of shares. Free cash flow is expected to be strong and still grow.

Yet, WH Smith shares trade on a one year forecast rolling PE of around 19 times. That's not particularly cheap. However, given the struggling high street business and

the lowish valuation that would command as a standalone business, the implied valuation of the Travel division at the current share price is quite high.

What I will try and do is to back out the valuation of the Travel business using a sum of the parts valuation and the current valuation of the whole company.

Ideally I'd use 2018 forecasts for both trading divisions but as I haven't got those I will use the profits for 2017 instead.

GBPm	2017	2016	Growth %
Travel trading profit(1)	96	87	10%
High Street trading profit(1)	62	62	—%
Group profit from trading operations(1)	158	149	6%
Unallocated costs	(16)	(16)	
Group operating profit	142	133	7%

To simplify things further I will allocate the unallocated costs pro rata to the two businesses on the basis of their contribution to total trading profit. This means that £9.7m will be taken away from Travel profits and £6.3m from High Street. This gives adjusted trading profits as follows:

- Travel £86.3m
- High Street £55.7m

Now we have to try and work out what a realistic valuation might be for the High Street business if it was quoted separately on the stock exchange or sold to a trade buyer.

As I am using trading profits in my valuation and I want to stay away from the distorting effects of debt levels and different tax rates on EPS and therefore PE ratios, I will look at EV/EBIT multiples of FTSE 350 General Retailers as a guide. I can easily calculate this in SharePad by using a sector filter and then adding an EV/EBIT column.

✓ Sector includes **General Retailers** Edit 🗑️

No.	TIDM	Name	Close	Market Cap. (m)	PE roll 1	PE roll 2	fc Yield	EV/EBIT
1	JE.	Just Eat PLC	801.6p	£5450.5	47.6	34.0		60.9
2	BME	B&M European Value Retail SA	415.6p	£4158.3	20.0	17.5	1.8	21.3
3	SMWH	WH Smith PLC	£21.32	£2347.7	18.9	17.8	2.4	17.0
4	JD.	JD Sports Fashion PLC	375p	£3649.6	14.5	13.2	0.4	14.4
5	DNLM	Dunelm Group PLC	649p	£1309.1	12.8	11.7	4.2	13.7
6	PETS	Pets at Home Group PLC	192.8p	£964.0	14.3	13.9	3.9	11.2
7	BWNG	Brown (N) Group PLC	231.4p	£658.2	9.9	9.5	6.1	10.5
8	MKS	Marks & Spencer Group PLC	307.8p	£6118.0	11.3	11.2	6.0	10.4
9	DTY	Dignity PLC	997.5p	£498.1	8.1	9.7	2.6	10.3
10	HFD	Halfords Group PLC	355.4p	£707.7	11.6	10.8	4.9	10.3
11	NXT	Next PLC	£49.00	£7115.0	12.0	11.7	3.2	9.7
12	INCH	Inchcape PLC	736p	£3054.5	11.2	11.1	3.7	9.4
13	CARD	Card Factory PLC	200p	£682.9	10.6	10.2	12.0	9.3
14	SPD	Sports Direct International PLC	375.4p	£2035.6	17.2	14.2		9.1
15	KGF	Kingfisher PLC	341p	£7388.2	12.1	11.0	3.1	8.8
16	SAGA	Saga PLC	118.4p	£1326.4	9.0	8.8	7.5	8.5
17	DC.	Dixons Carphone PLC	207.1p	£2388.3	8.0	7.9	5.3	6.8

I think a business that isn't growing does not deserve a high multiple. I'll try not to be too unkind and use a valuation of 9 times - similar to Kingfisher and Sports Direct. That doesn't seem to unreasonable to me.

Before we try and work out the implied valuation of the Travel Business we need the following numbers:

- Market capitalisation is £2314.3m at 2102p per share with 110.1m shares in issue.
- Pension deficit of £5m
- Net cash balances of £4m.
- The current Enterprise Value is therefore £2315.3m - mkt cap less net cash plus pension deficit.

Now let's see what implied valuation we get for Travel when we plug these numbers into a sum of the parts valuation model.

This gives an implied EV for Travel of £1814m or an EV/EBIT multiple of 20.9 times.

	EBIT	Multiple	EV
High street	55.7	9	501.3
Implied Travel	86.7	20.9	1814
Total EV			2,315.3
Net cash			4
Pension Deficit			-5
Market Cap			2,314.3
Shares in issue			110.1
Share price (p)			2,102

To help clarify this valuation a bit further, I'll calculate a debt adjusted PE by taxing Travel's operating profits at a rate of 20% and dividing the post tax operating profits into the implied EV we have just discovered.

This gives an implied PE of $1814/69.4 = 26.1$ times.

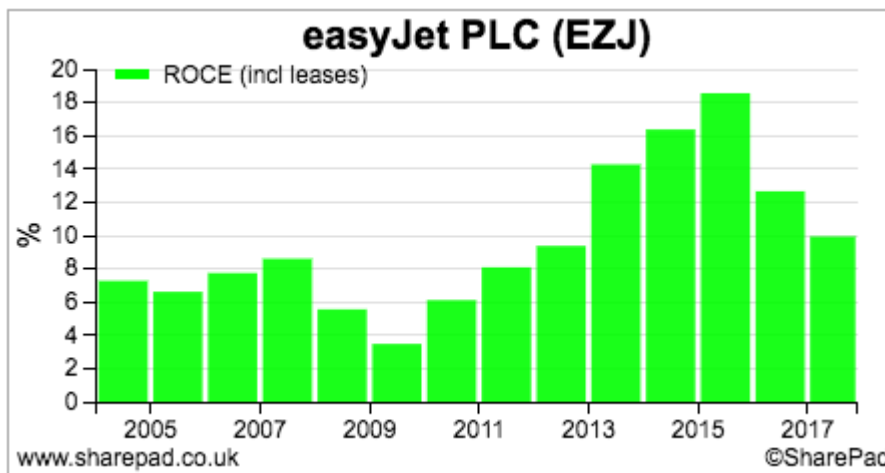
That's pretty punchy. Not as punchy as SSPG discussed above but quite high nonetheless. I'll leave you to decide for yourselves if this valuation is justified or not.

easyJet (LSE:EZJ)

For someone who will avoid getting on an aeroplane if at all possible (I'm not frightened of flying, I just hate all the hanging around in airports) I quite like easyJet. This is for the simple fact that it flies people to where they want to go to and not to where it will get the cheapest landing fees.



I used easyJet as an example of a good business in my book '[How to pick Quality Shares](#)'. Up until a couple of years ago it had been a great example of a company that had been able to grow by investing lots of money and earning a decent and rising ROCE on it.



Then it hit a sticky patch.

One of the main problems with the airline business as far as I'm concerned is that it's relatively easy for new planes to enter many markets. Quite often you can end up with too many planes chasing too few passengers and fares have to be slashed to keep the planes as full as possible.

This tends to trash an airline's profits as it costs nearly as much to fly a plane empty as it does full due to a very high level of fixed costs. Put simply, the gap between the revenue earned per seat flown and the cost per seat gets smaller as ticket prices are reduced. This is what had been happening in European markets until quite recently.

easyJet has been one of the main culprits in making things worse by adding new planes to its fleet in recent years and it overdid things slightly. By slashing fares to keep them as full as possible, its adjusted trading profits fell from £698m in 2015 to £432m last year.

Now it seems that the company's fortunes are on the up again helped by the bankruptcy of airlines such as Monarch, Alitalia and Air Berlin as well as problems at Ryanair. This has balanced up the number of seats and the number of passengers more evenly. That said, easyJet got its hands on Air Berlin's planes by buying the business last year.

easyJet's key performance numbers for its first quarter trading are shown in the screenshot below. I've highlighted the most important numbers in red.

It's worth stressing here that easyJet is a seasonal business, It makes most of its money in its July to September quarter when lots of people are going on their summer holidays

To summarise, these figures show a big improvement compared with a year ago:

- Passenger numbers increased by 8%.
- The planes were 92.1% full on average compared with 90%.
- Revenue per seat (tickets plus food and drink and commissions) was up by 8.4%
- Cost per seat was up by 1.6%.
- The profit per seat was £1.65 compared with a loss per seat of £3.57.

KEY FIRST QUARTER FINANCIALS

Three months ended	31 Dec 2017	31 Dec 2016	Change Fav./ (adv.)
Passengers (million)	18.8	17.4	8.0%
Seats flown (million) (3)	20.4	19.3	5.5%
Load factor (%) (4)	92.1	90.0	2.1ppts
Total revenue (GBP million)	1,140	997	14.4%
Passenger revenue (GBP million)	914	809	13.0%
Ancillary revenue (GBP million)	226	188	20.4%
Total revenue per seat reported (GBP)	55.99	51.64	8.4%
Total revenue per seat constant currency (GBP)	55.03	51.64	6.6%
Headline cost per seat reported (GBP)	(54.34)	(55.21)	1.6%
Headline cost per seat at constant currency (GBP)	(53.40)	(55.21)	3.3%
Headline cost per seat excluding fuel at constant currency (GBP)	(42.53)	(42.12)	(1.0)%

I can see why the share price reacted positively to these results and analysts upgraded their profit forecasts.

easyJet PLC (EZJ)

FORECASTS

£ millions unless stated

Year	2018		2019		2020	
Turnover	5,643.0	+11.8%	6,206.2	+10.0%	6,675.2	+7.6%
EBITDA	720.9	+15.0%	860.1	+19.3%	953.8	+10.9%
EBIT	488.2	+13.0%	614.1	+25.8%	693.2	+12.9%
Pre-tax profit	477.7	+15.7%	595.6	+24.7%	667.3	+12.0%
Post-tax profit	395.4	+18.8%	496.2	+25.5%	543.3	+9.5%
EPS (p)	99.2	+18.3%	120.6	+21.6%	133.4	+10.6%
Dividend (p)	44.9	+9.8%	61.1	+36.1%	75.0	+22.7%
CAPEX	1,198.1	+90.2%	850.2	-29.0%	950.7	+11.8%
Free cash flow	-584.5		-96.9	-83.4%	-105.0	+8.5%
Net borrowing	318.2	+22.4%	646.4	+103.1%	780.3	+20.7%
NAV	-		-		-	
Like for like sales growth %	19.3		9.5	-50.8%	6.0	-36.8%

The shares have been on a cracking run since last autumn and have strong momentum at the moment. Further upgrades cannot be ruled out in my view.

Airlines are cyclical businesses whilst the industry has a frequent tendency to trip itself up. This makes it hard to view airline shares as buy and hold investments once they have got past an initial growth phase.

At 1679p easyJet shares trade on a one year rolling PE of 15.8 times, with EPS growth of 18.3% and 21.6% expected in the next couple of years. This puts it on a PEG ratio of less than 1. Perhaps these shares have further to run?

Pets at Home (LSE:PETS)

Back in early June last year I gave a fairly downbeat assessment of Pets at Home. My chief concerns were:



- Previously owned by a private equity firm which looks to have sucked a lot of value out of the business leaving not much left for new shareholders. The fact that the share price is still below the 240p IPO price is a sign of this.
- Modest ROCE and falling profit margins.
- Rising competition in pet food from the likes of Amazon and Zooplus.
- Profits far too reliant on pet food.
- Changing sales mix towards vet service and grooming which have lower gross margins.

This week's third quarter trading statement struck quite an upbeat tone. Like-for-like sales were up by 7.2% with good performances in merchandise (+6.8%) and an even better one from specialist services (+10.1%).

It seems as if the strategy of cutting prices in pet foods has made the business more competitive whilst the roll out of grooming and vet services is going well and meeting targets.

Pets at Home Group PLC (PETS)						
FORECASTS			£ millions unless stated			
Year	2018		2019		2020	
Turnover	892.6	+7.0%	935.2	+4.8%	976.0	+4.4%
EBITDA	123.9	-5.0%	125.4	+1.2%	128.8	+2.7%
EBIT	89.1	-11.6%	88.4	-0.8%	90.5	+2.4%
Pre-tax profit	85.0	-11.7%	85.1	+0.2%	87.3	+2.5%
Post-tax profit	69.0	-9.4%	68.9	-0.2%	71.0	+3.1%
EPS (p)	13.6	-10.3%	13.5	-0.7%	14.0	+3.7%
Dividend (p)	7.6	+1.3%	7.5	-1.3%	7.6	+1.3%
CAPEX	40.0	-2.2%	39.0	-2.5%	39.0	0.0%
Free cash flow	58.8	-10.7%	67.3	+14.6%	75.8	+12.6%
Net borrowing	135.3	-16.0%	107.9	-20.3%	74.8	-30.6%
NAV	911.0	+3.2%	942.0	+3.4%	977.0	+3.7%
Like for like sales growth %	-		-		-	

Despite this commendable effort by the company and its employees, profits were said to be in line with current expectations and consequently the shares have not moved much.

Pets still looks like a business that is running hard to stand still. It has sacrificed high gross margins in merchandise such as pet food for some growth whilst the growth in services dilutes its profit margins. Analysts expect minimal profits and dividend growth out to 2020.

At 182p and a one year rolling PE of 13.7 times, it's quite difficult to see much value in the shares given the poor growth outlook.