INVESTORS CHRONICLE
25 Sept – 1 Oct 2009

SUPPORT SERVICES

SPICE (SPI)

BUY

Added Spice

Bull points

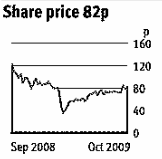
- Good order visibility
- Industry changes boosting demand for outsourcing
- Cross-selling opportunities
- Undemanding share rating

Bear points

- Weakness in gas and facilities management
- Defensive stocks out of favour

Businesses producing reliable growth have been largely ignored this year, as investors looked to cyclical stocks in the hope of rapid economic recovery. Utility outsourcing specialist Spice is one such neglected company, rated far more lowly than cyclical stocks, despite offering defensive growth credentials they can only dream of.

Share price 82p



Spice's facilities management business has not fared well in the recession, nor has its gas business. Although Spice generates less than 10 per cent of cash profits from these areas and has delivered against market expectations, these minor problem areas have proved a drag on its share price.

That could be because Spice's wide-ranging portfolio of business lines has disguised the tantalising prospects hidden with the group. So, management's decision to improve clarity by reorganising the group into two divisions looks sensible. Spice now reports its white-collar and blue-collar activities separately. The supply division provides white-collar services, ranging from billing services to energy procurement and energy-efficiency consultancy – these generate 35 per cent of the group's underlying cash profits from 9 per cent of the turnover. Legislation is becoming an increasing driver of growth through schemes such as the Climate Change Agreement and Carbon Reduction Commitment.

The white-collar arm is benefitting from cross-selling opportunities to customers from its high-volume, low-margin blue-collar business, which provides services such as meter installation and reading, and accounts for the bulk of group sales and profits.

Demand for outsourced work in the supply division and the blue-collar distribution division is likely to be spurred by new five-year regulatory reviews in the water and electricity sectors. The initial plans from both reviews look as though they will put increased pressure on companies to make savings, with outsourcing a key route to achieve these efficiencies. Already the distribution division is reporting good levels of bidding opportunities related to the reviews, and has won an overhead lines contract with Scottish Power and an engineering services contract with CE Electric.

Other industry developments also look set to benefit Spice, such as the rollout of smart metering. This could prove a boon, not least for Spice's training business in Corby. It is estimated by broker Investec that 9,000 engineers will need to be trained by 2015 if smart metering is rolled out across the country by 2020.

While the group clearly has a number of long-term opportunities, the work that underpins much of its growth this year and next is already booked in, which means analysts' forecasts come with a good degree of certainty attached. And Spice's end market is one of the few areas of the UK economy that still looks reasonably defensive, as much of the spending utilities undertake is underpinned by regulatory requirements.

Spice's shares have rallied recently, but still look under-appreciated against the ratings being applied to cyclical stocks, which to our mind factor in too much hope of an imminent economic recovery. Its shares trade on a PE ratio of less than 12 times Investec's underlying 2009 EPS forecast of 7.1p, well below the average cyclical rating of 14. Buy.

Spice

Ord Price: 82p **Market Value:** £285m
Touch: 81-82p **12-Month High:** 127p **Low:** 34p
Dividend Yield: 2.0% **PE Ratio:** 13
Net Asset Value: 54p* **Net Debt:** 51%
*Includes intangible assets of £275m, or 79p a share

Year to 1 May	Turnover (£m)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2006	133	6.8	2.52	0.52
2007	228	10.1	3.30	0.80
2008	310	15.2	4.61	1.20
2009	386	23.3	5.48	1.50
2010**	430	30.7	6.10	1.62
% change	+11	+32	+11	+8

Normal market size: 5,000 Matched bargain trading Beta: 0.8
**Investec forecast Last IC view: Buy, 72p, 9 Sep 2009