Hardman & Co

Leaders in Corporate Research

Tel: 020 7929 3399
Fax: 020 7929 3377

www.hardmanandco.com
email: research@hardmanandco.com

4 -5 Castle Court
London EC3V 9DL

Lok'nStore

191.5p

Material uplift in NAV - Upgrade

13 November 2006

Full year results from this self-storage operator were ahead of our expectations and we are upgrading our estimates.

Sales rose 15% to £8.95m in the year to end July 2006 compared to our estimate of £8.6m while store EBITDA grew a healthy 24% to £3.1m against our estimate of £2.8m. The improved performance has been driven partly by increased occupancy levels and partly by price increases. Importantly, the most established stores over 250 weeks continue to perform well generating EBITDA margins of 49%. This is up from 48% in 2005 and strongly demonstrates the profit potential of the group as the stores move towards becoming fully established.

We found the results of the latest property valuation by independent surveyors Cushman Wakefield Healey Baker impressive. It pitched the value of the group's properties at £66.6m, compared to a net book value for these sites of £25.2m. Included in this valuation is a 33% like-for-like uplift in the value of the trading properties. The valuation also takes account of new stores in Farnborough and Crayford, the granting of residential planning permission at Kingston and a 'hope' value for potential residential development at Reading.

The new valuation equates to a net asset value of 200p/share on a fully diluted basis, a 4% discount to the current share price. For comparison, at the current 556p, quoted competitor Big Yellow is trading at an 87% premium to NAV. Our calculations, based on the assumption that the current 21 store portfolio is fully established and run for cash, suggests long term fair value for the shares is closer to 282p. This represents a 41% premium to NAV.

Share Price: 191.5p

12m High: 196p

12m Low: 143p

Market Cap: £49.8m

Shares in Issue: 26m fully diluted

NAV/Share: 41p

Including revaluation: 200p/fully diluted

Gearing: 123%

Including revaluation: 25%

Interest Cover: 1.2X

EV/EBITDA: 36X

EPIC Code: LOK.L

Sector: Support Services

Market: London AIM

PR: Financial Dynamics

Website: www.loknstore.co.uk

Last research note: 'Stepping up the pace of expansion' published on 5.5.06

Analyst: Sonia Kaur

Y/E July	Sales £m	Declared Profit £m	Adjusted Profit £m	Adjusted Eps p.	P/e ratio	EV/EBITDA (X)	Divi p.
2005A	7.77	0.11	0.14	0.5	383	46	0
2006A	8.95	0.12	0.15	0.2	938	36	0
2007E	10.3	0.38	0.40	1.5	125	25	0
2008E	11.16	0.91	0.94	3.6	52	20	0

Full Year Results

Lok'nStore has produced a good set of results for the full year to end July 2006 with sales, EBITDA margins and profits all exceeding our expectations.

Revenues grew 15% to £8.95m during the year. This compares to our estimate of £8.5m and reflects growing volumes (occupied space increased by 9%) and a 4% increase in prices. Despite this price increase, the first above inflation rise implemented by the group in several years, Lok'nStore's average price per sq ft at £16.40 remains comfortably below the industry average of £18.29. It is also worth pointing out that with the UK self storage market currently growing at an estimated 15% a year, the price rises do not appear to have cost the company market share (this currently stands at 5%). As a result we believe further gentle price rises are likely over the next couple of years, particularly at the newer, higher specification centres in Farnborough and Crayford.

Breaking down the sales performance shows the 15 established centres over 5 years old continue to grow strongly with like-for-like sales in these centres increasing by 9.2%. The established estate now accounts for over 80% of group sales and generates excellent EBITDA margins of 40%. Elsewhere, sales at the four centres with 100 to 250 weeks trading grew 42.3% while the two new stores in Farnborough and Crayford are said to have made an 'encouraging' start.

At the EBITDA level overall margins rose 2.2% to 34.6%, ahead of our estimate of 32.8%. Once again, the most established stores in the estate showed good forward progress. Specifically, EBITDA margins in the 11 most established stores rose 1% to 49% during the year, and we understand some stores are currently producing EBITDA margins of up to 60%. Including the four leasehold stores that joined this category during the year, the overall EBITDA margin for stores over 5 years old grew 2.1% to 39.8%. The reason for this is that leasehold stores are lower margin than freehold stores as rental payments tend to outweigh the financing costs on freehold units.

Encouragingly, head office and central costs continue to be tightly controlled at 15% of sales (2005: 16%) as Lok'nStore begins to gain some small economies of scale with critical mass.

The pre-tax profit for the year was £124k, slightly ahead of last year's level and compares to our estimate before the pre-close trading statement of a pre-tax loss of £297k. The £100k tax charge to the p & l account is a technical tax adjustment based on the movement in deferred tax arising on capital allowances in excess of depreciation. Even if Lok'nStore was to stop expanding altogether, carried forward tax losses of £3.4m means the company is not expected to pay tax for several years.

Balance Sheet and Cash Flow

Operating cash flow for the year was £1.6m, slightly below the £1.9m produced in 2005 owing to working capital movements arising from the new store build programme. Adjusting for these distortions, underlying operating cash flow was actually ahead of last year. After allowing for capital investment, but including the £5.5m brought in from the draw down of bank facilities, the net increase in cash during the year was £0.5m.

In terms of the Balance Sheet, net debt stood at £13.2m at the year end. This gives gearing of 123% based on the net book value of the group's assets at £25.2m. However, according to the latest independent valuation by Cushman Wakefield Baker Healy the true value of the group's tangible assets is significantly higher at £66.6m, the equivalent of 200p/share on a fully diluted basis. Included in this 2006 valuation is a 33% like-for-like uplift in the value of the group's trading properties. Of this increase 20.2% is the result of operational performance; the balance is yield shift reflecting strong trading conditions in the commercial property market. The 2006 valuation also includes the new stores in Farnborough and Crayford, which in combination have been valued at more than double NBV, the granting of residential planning permission at Kingston and an additional 'hope' value for potential residential development at Reading. It should be noted that the previous property valuation of £31.8m at January 2005 did not include these last three items.

Calculated on a re-valued assets basis, gearing falls to 25% providing plenty of headroom as the group looks to 'accelerate' its growth rate.

More Growth in Store

The successful opening of the group's first purpose built self-storage centre in Farnborough on time and to budget has provided Lok'nStore with a new roll-out strategy capable of producing noticeably higher average margins.

In the past Lok'nStore has concentrated on acquiring existing freehold and leasehold industrial buildings with B8 planning permission and then converted these units into self-storage centres by phasing the fit-out programme to match demand. In this way, the company has generated letting revenues from each unit almost immediately so the fit-out of each of its store has largely been funded from existing resources.

But as the company looks to expand the average lettable space of its stores from the present 43,000 sq ft to closer to 60,000 sq ft (as evidenced by the new stores in Farnborough and Crayford and the latest new 60,000 sq ft freehold site acquisition in Portsmouth), finding suitable sites at sensible prices in South East England is likely to become increasingly difficult. Moreover obtaining planning permission remains a significant obstacle for most operators in this space.

The self-build model – where Lok'nStore buys the land, obtains planning permission and then designs and builds a store to its own specification gets round the problem of finding existing giant warehouses for conversion. It also enables the group to replicate its successful Farnborough centre to create larger centres that maximise available letting space and command higher than average prices. This combination of larger stores and higher prices has the potential to deliver substantially higher EBITDA margins.

The Chairman's Statement refers to 'further sites in the pipeline' which are expected to be signed in the current financial year. We understand the target is to open a minimum of 2 new centres a year with a strong focus on larger centres and new builds. However, predicting the timing of new openings with precision is difficult and so to avoid ambiguity our forecasts on page 4 are based on the current portfolio of 21 stores. We will of course, look to update these as and when new centres are announced.

Forecasts

We are upgrading our sales and pre-tax profit estimates for the current financial year to end July 2007 and have introduced new estimates for 2008.

Our 2007 sales estimate is upgraded from £9.4m to £10.3m – a figure which we believe could turn out to be conservative given that annualised sales are currently running at this level. Even in the absence of new store openings, we understand good opportunities exist to add new space to some of the group's older centres. As an example, Poole enjoyed a 30% increase in business levels last year after the group purchased the freehold and fitted extra space.

With 19 of the 21 stores now EBITDA positive we are also substantially upgrading our 2007 store EBITDA margin estimate, from 33.8% to 38.6%. As mentioned earlier, Lok'nStore has plenty of scope to push through price rises by more than inflation over the next couple of years and the underlying operating performance of the established estate over 5 years old also continues to improve.

The costs of building out the new centres in Farnborough and Crayford will mean an increase in the net interest charge this year, possibly to £950k. Nevertheless, in the absence of new store acquisitions the group should still be capable of producing a declared pre-tax profit of £397k. Investment managers should bear in mind that this estimate takes no account of any sale proceeds that may arise from the sale of the Kingston site, though with the S106 agreement now executed negotiations with developers are well underway. Assuming the site is sold outright for cash, this could generate net proceeds of between £8m and £10m and give a one off profit on disposal of £8.8m if the top end of our valuation is realised.

Top line sales growth from the 21 store estate will be less exciting in 2008 as occupancy levels at the stores over 5 years old move towards their peak (at 85%). Declared pre-tax profits could more than double to £912k however, because the high fixed cost element to the cost base means further margin increases will fall almost entirely through to the bottom line.

Valuation

We have looked at two possible ways of valuing Lok'nStore. They are as follows:

Valuation by NAV. Taking the new property valuation into account Lok'nStore shares are currently trading at a 4% discount to NAV. This is in sharp contrast to quoted competitor Big Yellow, which, at the current 556p, is trading at an 87% premium to NAV. While some element of a discount to Big Yellow may be expected given Lok'nStore's relative size (21 centres v Big Yellow's 37 centres), Big Yellow's development pipeline (21 centres of which 14 require planning permission) and the freehold/leasehold mix (11/21 freehold stores for Lok'nStore v 49/58 freehold stores for Big Yellow), we believe the current disparity is too wide and that positive newsflow on acquisitions and the sale of Kingston will narrow this gap over time.

By assuming the current 21 centre estate is fully established (occupancy of 85%) and run for cash. On this basis our calculations suggest long term fair value for the shares is closer to 282p – a 41% premium to NAV.

July £'000	2005A	2006A	2007E	2008E
Total Sales	7774	8946	10320	11161
Store Operating Profit (EBITDA) Margin	32.4%	34.6%	38.6%	41.7%
Trading Stores Operating Profit (EBITDA)	2477	3076	3962	4628
Rental Income EBITDA	123	58	58	58
Head Office and Central Costs	1240	1384	1500	1550
EBITDA	1360	1750	2520	3136
Depreciation	729	875	1170	1200
Goodwill Amortisation	24	24	24	24
Group Operating Profit/Loss (EBIT)	607	851	1326	1912
Exceptionals	0	0	0	0
Net Interest Charge	493	727	950	1000
Declared Pre-tax Profit	114	124	376	912
Adjusted Pre-Tax Profit	**138**	**148**	**400**	**936**
Tax Charge	0	100	0	0
After Tax Profit (Reported)	114	24	376	912
After Tax Profit (Adjusted)	138	48	400	936
Retained Earnings	114	24	376	912
Average Number of Shares, Fully Diluted (m)	25847	25979	25979	25980
Adjusted Profit Per Share p. (Fully Diluted)	**0.5**	**0.2**	**1.5**	**3.6**
Dividend Per Share p.	0.0	0.0	0.0	1.0
Summary Cash Flow Statement				
Group Operating Profit / (Loss)	607	851	1326	1912
Depreciation	729	875	1170	1200
Goodwill Amortisation	24	24	24	24
Decrease / (Increase) in Stocks	15	10	-15	-25
(Increase) / Decrease in Debtors	263	-330	-300	-450
Increase/(Decrease) in creditors	345	171	400	475
Operating Cash Flow	1983	1601	2605	3136
Capital Expenditure	2294	6273	2200	1400
Net Interest	501	770	950	1000
Tax	0	52	0	0
Free Cashflow	-812	-5494	-545	736
Acquisitions/Disposals	0	0	4200	0
Financing	581	5989	5000	0
Change in Net Debt (- = worsens, + = improves)	-231	495	255	736
Key Balance Sheet Items				
Intangible Assets	359	335	311	287
Tangible Assets*	20033	25430	30660	30860
Stock	89	78	93	93
Trade Debtors	600	800	1050	1350
Other Debtors	1085	1223	1350	1500
Net Cash / (Debt)	425	922	1000	1000
Trade Creditors	1236	1400	1500	1700
Other Creditors	2500	2478	3000	3400
Net current assets / (liabilities)	-1537	-855	-1007	-1157
LT Debt	8150	14067	18812	18076
Net Debt/(Cash)	7725	13145	17812	17076
Provisions	0	100	0	0
Shareholders' Funds	**10705**	**10743**	**10841**	**11627**
Gearing % / (Net Cash)	72%	122%	164%	147%