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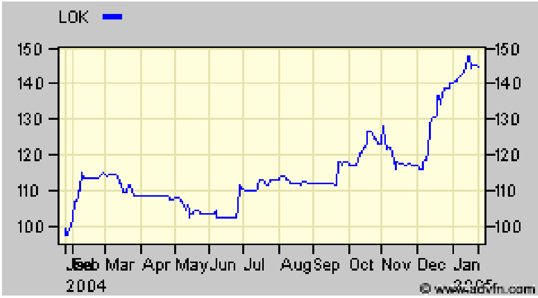
Lok'nStore

144.5p

Significantly undervalued

25 Jan 2005



Lok'nStore is the UK's fourth largest self-storage operator with 20 sites in the affluent South of England. Anecdotal evidence suggests this industry is growing at 20% plus a year, and in light of recent full year results it is clear that profits have the potential to rise substantially as the existing portfolio moves towards maturity. Key points are:

- The company's eight most established stores (over 5 years old) grew occupancy revenues by 17.8% last year and generated EBITDA margins of 48%.
- Currently, 15/19 stores are trading profitably at the pre-tax level and 17/19 are operating cash flow positive.
- Residential planning permission at Kingston could increase net assets per share by 40p on disposal. It is possible that some of these proceeds will be returned to shareholders.
- A re-valuation of the company's 10 freehold stores on an operational basis will provide a further boost to net assets per share in the current financial year.
- Two quoted operators have been taken private in the past two years, and last year Lok'nStore rejected a cash bid at 115p per share. We believe the likelihood of further corporate activity in the sector is high.

Signs of a cooling housing market are a concern, but we do not believe Lok'nStore is overly exposed here. On any valuation metric, this company looks significantly undervalued.

Share Price: 144.5p

12m High: 148p

12m Low: 96.5p

Market Cap: £36.3m

Shares in Issue: 25.1 million

NAV/Share: 38.5p (2004 actual, excluding intangibles)

Including re-valued freeholds: 78.5p

Gearing: 66% (2004 actual, excluding revaluation)

Interest Cover: 1X (2004 actual)

EV/EBITBA: 54

EPIC Code: LOK.L

Sector: Support Services

Market: London AIM

PR: Financial Dynamics

Website: www.loknstore.co.uk

Previous research note: Initiation of Coverage

Analysts: Sonia Kaur/Roger Hardman

Y/E July	Sales £m	Declared Profit £m	Adjusted Profit £m	Adjusted Eps p.	P/e ratio	Div p.	Yield (%)
2003A	5.6	-0.4	0.04	-1.5	-	0	0
2004A	6.6	-0.2	-0.04	-0.1	-	0	0
2005E	7.7	8.7	-0.20	-0.7	-	0	0
2006E	8.4	0.25	0.25	1.0	145	0	0

SWOT Analysis

Strengths

- The UK self-storage market is structurally under-supplied and has grown by 20% plus over the past five years.
- Established stores (over 5 years old) produce EBITDA margins approaching 50%.
- Established stores (over 2 years old) are highly cash generative.
- Low cost operator. This lowers the risk profile and leaves Lok'nStore in a strong position should the industry become price competitive.
- Good track record of acquiring the freeholds on existing leasehold stores. This strategy is attractive because it combines the early cash flow advantages of leasehold stores with the long-term income security and investment potential of freeholds.
- Negligible bad debts.
- Business customers account for just under half of self-storage sales. Lok'nStore's experience shows that businesses let out more space for longer than households.
- Residential planning permission at Kingston could increase net assets per share by 40p on successful sale of the site.
- An imminent property re-valuation will produce an even higher NAV per share in the current year.

Weaknesses

- Lok'nStore is currently loss making at the pre-tax level although it is worth noting that we are forecasting a modest pre-tax profit for the y/e July 2006.
- Visibility in terms of the store roll-out programme is low. There are a limited number of sites in the South of England that meet the company's strict investment criteria.
- New stores take between 12-24 months to break-even at the EBIT level (depending on whether they are freehold or leasehold).
- Unlike quoted rival Big Yellow, Lok'nStore does not pay a dividend.

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Opportunities

- The possibility of further planning gains, particularly at Reading, is strong
- Cash proceeds from the sale of the Kingston site could be returned to shareholders in the form of a special dividend or via a share buyback.
- Corporate activity has been strong in the sector and Lok'nStore is a prime bid target
- Competition for new sites is becoming less intense and we would expect Lok'nStore to take advantage of this to grow its self-storage portfolio.

Threats

- A protracted slowdown in housing transaction volumes will hit occupancy levels. That said, with its higher proportion of business customers, Lok'nStore is probably less vulnerable than rivals here.
- Further moves into the UK by established US operators could intensify the competition for prime sites.
- Long planning permission lead times *could* slow the store roll-out programme.
- Our forecasts are highly dependent on less established units tracking the performance of the eight stores over 5 years old.

Company Background

Lok'nStore owns 20 self-storage units in the affluent South of England. CEO Andrew Jacobs founded the business in 1995 and the first warehouse to be converted into a self-storage centre opened in Horsham in February of the same year. Colin Jacobs (now Acquisitions Director) has been with the group since its inception, while Simon Thomas (now Chairman) has held an equity stake in the business since July 1995.

In April 1997 Lok'nStore floated on OFEX raising £1.1m at 38p per share. This was followed closely by a second fundraising in March 1998 that raised £1.15m at 60p per share and increased the size of the portfolio from 4 to 6 self-storage units with a total lettable space (when fully built out) of 170,000 sq ft.

A takeover approach in November 1999 sparked the first round of consolidation in the industry. ACCESS Storage, the then number one operator in the UK and subsidiary of US self-storage giant Storage US approached Lok'nStore shortly after acquiring rival UK operators Abacus and Acorn. While management rejected this offer on the grounds that the price offered was too low, a compromise deal that led ACCESS to take a 29% stake in the business in return for a cash injection of £4.77m was subsequently agreed.

In June 2000 Lok'nStore moved to the London Alternative Investment Market (AIM). No new funds were raised at the time of the move to AIM, but since then a placing of the ACCESS stake together with a £10m fundraising at 155p per share in July 2002 have bought a number of quality investors onto the share register. Gartmore Investment Management is the largest with 9.2%, followed by Atlantic Value Fund with 8.6%, Mercury Real Estate Advisors LLC with 7.2% and the Universities Superannuation Scheme with 6.8%.

Management and staff own 36.5% of the company so their interests are suitably aligned with those of shareholders.

A second cash bid at 115p per share was rejected by management in January 2004. The identity of the bidder was not disclosed, possibly because management did not deem the approach to be a 'serious' offer. In the wider sector however, it is noteworthy that rival Safestore was taken private in a deal funded by private equity just two years ago and then successfully bid for Mentmore.

Lok'nStore shares are currently trading at a 26% premium to last year's cash bid price, largely on the back of positive newsflow. In February 2004, external surveyors valued its eight freehold stores on an operational basis at £20.1m, double the historical depreciated value of these sites and in March 2004 Lok'nStore bought back 3.4m shares for cancellation at 112p per share.

Management will be re-valuing its freehold and leasehold stores in the current year and we expect more on this at the half-year results announcement in April.

Huge in the US, gaining ground here too

Self-storage is big business in the US where it has been established for over 40 years and everything we are seeing anecdotally suggests the concept is gaining in popularity here too.

The concept of self-storage is simple enough. It is basically do-it-yourself warehouse storage space for businesses and households on a pay-as-you-go basis. Every customer is provided with a set of keys and access to goods is 7 days a week. The installation of CCTV cameras, fire alarms and remote monitoring systems provides for high level security at all times. Our research indicates that the average price for a 50 sq ft box is £65 per month, dependent on location, so this is a low-ticket item. In addition demand tends to be price-inelastic because it is based on the growing need for flexibility.

Key industry growth drivers include a rising level of consumer familiarity, an active housing market, increasing population mobility and cultural changes that have led to a rise in the divorce rate and single parent families. In the business category, Lok'nStore says retailers, removal companies, manufacturers and even councils and universities are all using self storage to cope with peak trading periods such as the run up to Christmas, for instance.

Latest industry estimates suggest the US has over 35,000 self-storage centres, or c.4.5 sq ft per head of population. The numbers for the UK are c.400 self-storage centres providing the equivalent of c. 0.2 sq ft per head of population. Lok'nStore management believe the UK could potentially support at least 1,500 self-storage sites.

Presently, 70% of the available sq ft in the UK is based in the South of England, partly because of high catchments of A-B-C socio-economic groups, but also because of high penetration rates that allow for multiple stores in any one location.

Obtaining external estimates on the growth of the UK self-storage industry is difficult – this is an immature market that has only truly been established since the early 1990's. Anecdotal evidence from the industry's 5 biggest players, Shurguard, ACCESS, Safestore/Mentmore, Big Yellow and Lok'nStore (which between them control 45% of the market in terms of developed space) all point to growth of 20%

plus over the past five years however, and most industry observers believe this trend is set to continue. In its latest results to end March 2004, Big Yellow reported sales growth in its mature outlets of 17% while the growth reported by Lok'nStore's eight stores over 5 years of age in the year to end July was 17.8%.

Below the 5 leading players, we believe the self-storage market in the UK is still very fragmented with a high proportion of small operators running between one and five units.

Company Structure

	250 wks	100-250 wks	<100 wks
July 2004 (actual)			
No of Stores	8	8	2
Max lett area '000 sq ft	305	365	80
July 2005* (static)			
No of Stores	10	7	2
Max lett area '000 sq ft	359	352	80
July 2005 (Hardman est)			
No of Stores	10	7	3
Max lett area '000 sq ft	359	352	120
July 2006* (static)			
No of Stores	14	5	1
Max lett area '000 sq ft	565	225	50
July 2006 (Hardman est)			
No of Stores	13	5	3
Max lett area	533	225	130

Source: Management Accounts, Hardman & Co forecasts

Lok'nStore's 20 self-storage sites are all located in prominent positions in key retail towns in the South of England. 19 are currently trading and a flagship site in Farnborough is expected to open late 2005. This will also, we suspect, be the new head office for the group following a successful sale of the group's current head office in Kingston.

The table above breaks down the company's total lettable space by age of store. In the static projection, we have mapped out how the estate will develop over the next two years if no new sites are acquired. The breakdown labelled Hardman Est, is our view of how the store maturity profile will develop assuming two new sites are acquired at the back end of the current y/e July 2005 and a further two are acquired, but not opened, in 2006.

Current total lettable space is 840,000 sq ft including Farnborough, 790,000 sq ft excluding it, while the average store size is between 40 - 45,000 sq ft. There is some variation around this figure; one of the group's earliest sites in Woking is just 18,700 sq ft and the largest in Southampton is 83,000 sq ft, although it should be said that these stores are outliers.

The store portfolio is evenly split between short leaseholds and freeholds following the acquisition of the freehold interest in three stores in Horsham in 1998, Reading in 2000 and most recently Poole. This strategy of acquiring the freeholds on leasehold stores is attractive because it combines the early cash flow advantages of leasehold stores with the long term income security and investment potential of freeholds. Residential planning permission is being sought at Reading for instance, and we believe Lok'nStore will continue to actively pursue opportunities in this area.

Full year results in July 2004 showed year end occupancy at 472,000 sq ft, giving an occupancy rate at the period end of 60%. While at first glance this appears low for the sector it is important to exercise care here because Lok'nStore's total lettable space includes 50,000 sq ft relating to Farnborough and another 80,000 sq ft representing two stores that are less than 100 weeks old. Average occupancy in the more established stores over 5 years old, a figure which in our view is subject to less distortions, was 75% in the year to July 2004.

Of the total 472,000 sq ft of occupied space, around 400,000 sq ft is let out as closed self-storage and the rest is open storage. The average cost per sq ft in the year ending July 2004 was £8.53 per sq ft, while the average price per sq ft achieved on the 400,000 sq ft of fitted storage was £16.00 per sq ft. The average price per sq ft on open storage was almost half this for obvious reasons.

Despite granting discretion to individual store managers on prices, management say yields remained broadly flat in 2004 because Lok'nStore is committed to offering customers a lowest price guarantee. Given that less established stores make up more than half of the total store portfolio and that the costs in self storage are largely fixed (the only variables being rent and utility costs), growing occupancy levels as opposed to yield income to gain economies of scale appears to us to be an utterly sensible strategy.

Self-storage accounted for 90% of sales last year, followed by merchandise sales at 8.4% with the balance coming from open storage. The consumer/business split is 55/45 by sales and 69/31 by numbers – unlike the company's competitors where households make up a much higher proportion of the sales mix and swings in housing market transaction volumes have a noticeable impact on occupancy rates. That said, Lok'nStore would not be immune to a protracted slowdown in housing market transaction volumes and we await developments here with interest.

In Lok'nStore's experience, businesses rent out more space for longer periods of time. In 2004 for example, the average spend per business customer was £2,000 v £675 for the average household customer.

Recent Full Year Results

The full year results to end July 2004 were encouraging on a number of fronts. Sales grew 18% to £6.6m and more importantly the most established stores (over 5 years old) kept pace with this growth, reporting sales up 17.8% to £3.1m – all occupancy growth led. This growth has continued into the current year with annualised revenues reportedly running at £7.7m.

At the EBITDA level (and ignoring exceptional items) profits climbed 15.2% to £0.81m during the year. The key driver was a strong performance from the eight stores over five years old, which produced EBITDA margins of 48%. Furthermore, of these eight stores, the oldest four produced EBITDA margins of 52%. On this basis it is abundantly clear that if the portfolio matures successfully, profits will rise substantially.

Of the 18 trading stores, 12 traded profitably at the pre-tax level and 14 were operating cash flow positive. Since then, we happen to know that those numbers have risen to 15/19 and 17/19 respectively. Meanwhile store occupancy rose by a record 96,900 sq ft to 472,000 following a 7% increase in the customer conversion ratio to 57%. With bonus payments now more directly linked to sales growth and an advertisement budget of c.5% of total sales, this should be capable of further improvement, possibly to 60% by the end of the current y/e July 2005.

Despite the strong progress made, rising interest costs to fund the share buyback and acquisition of two new sites resulted in a small pre-tax loss (once again stripping out exceptionals and goodwill) of £0.17m. No corporation tax was paid during the year and with carried forward tax losses of £2.7m we are forecasting a zero tax charge in both the current financial year and the y/e July 2006.

Balance Sheet and Cash Flow

The end July 2004 balance sheet showed fixed property assets of £18.2m and a net asset value, excluding intangibles of 38.5p per share. The true value of these assets will be much higher of course, because Lok'nStore holds all of its freehold properties in the balance sheet at historical cost net of depreciation and the commercial property market, particularly in the South, has been buoyant over the past couple of years.

Indeed, on 31 January 2004 Lok'nStore commissioned external surveyors Cushman Wakefield Healey & Baker to revalue the company's eight freehold properties as trading self-storage businesses based on the same methodology as that used in the more mature US market. The results then indicated a value of £20.1m, £10.2m in excess of the net book value of these properties, giving a NAV per share of 78.5p. Following expansion of the freehold estate from eight to 10, another property re-valuation has been commissioned for the current year to end July 2005.

2004 was a good year for the commercial property market and the industrial property market (according to Bizspace) and given the strength of trading within the estate, we believe this will produce another useful increase in net assets per share in the current year. As with the previous re-valuation, Lok'nStore is not intending to take any uplift in value to the balance sheet.

In terms of cash flow, there are no significant working capital issues in the self-storage industry as payment is in cash or near cash and all customers are required to pay a minimum of one month's rental in advance. Cash inflow from operating activities before interest and capital expenditure, was just under £1m in 2004, compared to £0.3m in 2003 and a 2004 EBITDA of £0.81m.

Gearing, excluding the property re-valuation was 66% at the year end, 33% including it.

Roll-Out Programme

Lok'nStore's original target when it floated on AIM was to open 50 stores in the South of England. However, a combination of factors including increasingly competitive property markets in 2001 and protracted property negotiations have led to a slower rollout programme than anticipated. We now think the group will hit its target of 50 stores by opening (rather than acquiring) two to four new sites a year. Organic roll-out of the portfolio is preferable to acquisition for four main reasons:

- Firstly, Lok'nStore's policy is to buy industrial space and fit it out according to how fast it can fill the space. This keeps the operating costs per sq ft low and reduces the risk profile of the business. Acquiring existing outlets would mean acquiring units where the space is already fully fitted thereby adding an immediate high fixed cost base to the business at sub-standard occupancy rates.

- Secondly, Lok'nStore has a strict site selection policy.
- Thirdly, store quality is a key differentiating factor in the self-storage market. Many of the incumbent operators have a high proportion of sites in poor locations with low technical specifications that would fit uncomfortably with Lok'nStore's existing estate.
- It is lower risk.

Management have a tactical approach to the acquisition of freeholds and leaseholds and while interested in acquiring highly visible freehold sites will always consider leasehold stores. Freehold sites will typically have a footprint of 20,000 sq ft, giving a net lettable area of 43,000 sq ft plus once fully built out, including mezzanines.

Capital expenditure per store on leaseholds is approximately £500,000 - £750,000 plus operating losses of c. £300,00-400,000 in the first two years. The capital expenditure on freeholds is closer to £2.75m-£3m – a figure which we believe to be significantly lower than the competition. Lok'nStore aims to open a store within 8 weeks of acquiring it by only partially fitting out the space and building mezzanine levels according to demand. This is so as to maximise each store's revenue generating capacity.

Breakeven at the EBIT level is between 12-18 months on a typical freehold site and 18-24 months on a typical leasehold. Consequently, expansion can a heavy drag on profits. In Lok'nStore's case, we believe this will become less of issue as the existing store portfolio matures and as the total net lettable space increases providing the group with greater economies of scale. In our spreadsheet on page 10 we have assumed head office and central overhead costs remain stable in the medium term.

After a quiet 2003, Lok'nStore took a more aggressive approach to its expansion programme in 2004 (acquiring sites in Farnborough and Tonbridge), and management have also indicated that the competition for sites appears to be easing. Nonetheless, we believe visibility of the roll-out programme remains low.

Our forecasts assume Lok'nStore will acquire one freehold site and one leasehold site in 2005 for a total of £2.2m. In addition, we are assuming £3.8m of fit-out capital expenditure relating to the existing estate, split £1.9m on existing stores and £1.9m on Farnborough.

Lok'nStore currently has a £10m revolving credit facility with the RBOS paying LIBOR + 1.75%, repayable in March 2007. Net debt was £6.9m as at July 2004, and despite our store roll out projections we are forecasting the company will finish the current year to end July 2005 with net cash of £5.76m as it books the proceeds from the sale of Kingston (see below). Furthermore, it is worth noting that the £10.1m excess over book value of the group's eight freehold stores (excluding Farnborough and Poole) provides the group with financial strength should management decide to step up the expansion programme.

Planning Gains

While Lok'nStore's primary focus is on acquiring new sites and developing existing ones, it is clear that selective disposals where this would yield greater returns for shareholders will always be looked into.

In this respect, Lok'nStore has already successfully obtained planning permission at its Kingston site to build 124 flats in two blocks, 78 of which will be market flats with the balance being allocated for social housing and key worker units. Lok'nStore acquired the Kingston site for £905,000 in 1996 and the current book value of the site following fit out capex is £1.175m. In the year to end July 2004, Kingston generated sales of £407,000 and EBITDA of £221,000.

Very crudely, if we assume the market rate for a typical two-bedroom flat in Kingston is £145,000 and the market rate for a typical two-bedroom key worker/social unit is say £90,000 then the total worth to a developer would be £30.9m. According to our sources, the standard industry practice on commercial property deals is for landowners to realise one-third of the potential realisable value. On this basis, Kingston could sell for £10.2m and if the possibility of an on-site doctor's surgery is included - permission for which has already been obtained - the potential proceeds from disposal rise to £10.5m. Deduct professional fees of £500,000 and you arrive at net cash proceeds of £10m – a figure which we view as being reasonably conservative. Management is hopeful that sale of the site could be finalised by end the end of the current financial year.

Residential planning permission is also being sought at the group's site in Reading. The site itself is split into two buildings, one of which is operating as a self-storage centre and another building located across the road that is currently being rented out to a company with 4 years left on the lease. We believe Reading will be a more testing application than Kingston largely because the site itself is already surrounded on three sides by housing and the Council will need to be assured of the need for further housing before planning permission is granted. That said, Reading is well established as a centre for technological excellence and management believe it is only a matter of time before the need for additional housing is reassessed. In our best estimate Reading could sell for £5m, generating a profit on disposal of £4.4m.

At the full year results, management were candid that the proceeds from disposals could be spent in one of three ways:

- Returned to shareholders in the form of a special dividend. Assuming half of the (assumed) £10m in cash proceeds from the sale of Kingston were handed out to shareholders in the form of special dividend, this would result in a windfall payment of 20p per share. This is the equivalent of 14% of the current share price.
- A share buyback. Alternatively, £5m spent on a share buyback at 150p, would result in 3.33m shares being taken out circulation and an 8% increase in eps. With a continuing authority to purchase 5,845,299 shares for cancellation, this is a feasible option, although it is worth noting that the shares have risen quite a bit since the last buyback at 112p per share.
- Acquisition of new stores where the return on capital is 19%.

Valuation Methods

There are four possible ways of valuing Lok'nStore. They are as follows:

1. Looking at the value placed on self-storage sq ft in the UK by analysing recent deals in the sector.
2. A comparison with quoted rival Big Yellow.
3. By assuming that the current portfolio of 20 stores is matured and run for cash.
4. Forecasting an adjusted NAV per share.

What have others paid?

The quoted self storage sector has halved over the past two years to leave just two operators, Lok'nStore and Big Yellow in the quoted company space.

Safestore, an AIM quoted operator with 24 stores and a total lettable area of 700,000 sq ft was taken private in August 2003 in a deal funded by US private equity house Bridgepoint Capital. The price paid was £38.5m, or £55 per sq ft of total lettable space. Most industry observers agree however, that this was a very opportunistic buy. Transactions since then, most notably Safestore's acquisition of listed rival Mentmore have taken place at higher multiples. Mentmore eventually agreed to be acquired in June 2004 for £209m in cash, pointing to a value of £80 per sq ft. This price was achieved despite the fact that Mentmore had a high proportion of secondary sites with low technical specifications (including a total of seven sites in France).

In contrast to Mentmore, Lok'nStore owns 20 high quality sites in the South of England. If we therefore take £80 per sq ft as the minimum amount Lok'nStore could expect to realise for its 840,000 sq ft of total lettable space, this would suggest that the underlying market value of its assets is £67.2m. Considering the current enterprise value is £43.3m, Lok'nStore looks appreciably undervalued.

What is the current portfolio worth?

Instead of looking at the market value of the assets, it is possible to build a very simple model that looks at how much the company is worth by assuming the current portfolio is matured and run for cash. Our model assumptions are:

- 20 stores with a total lettable space of 840,000 sq ft
- No new sites are acquired and none are sold for alternative use
- All stores are achieving occupancy at maturity of 85% (it should be borne in mind that none of Lok'nStore's sites are currently achieving this occupancy rate)
- Average price per sq ft is £14
- Operating costs before depreciation are £5.8m (2004 actual)

On the basis of the above, total sales from these stores at maturity would be £9.9m, generating an EBITDA of £4.1m.

If we take this 'terminal store' EBITDA and further assume the yield on self storage is similar to the yield on property at say 7%, this would suggest a value of £58.6m for the current portfolio - the equivalent of 233p per share. It goes without saying that the current share price compares very favourably to this indeed.

The Quoted Competition

	LOK July 2004	BYG Mar 2004
No of Trading Stores	19	29
Total Number of Stores	20	38
Market Cap (£m)	35.3	182
Enterprise Value (£m)	42.2	250
Total Sales (£m)	6.6	23.8
Total Operating Costs (£m)	6.4	19.1
EBITDA (£m)	0.81	8.6
Total Sq ft	840,000	1.8m
Total Occupied Sq ft	472,000	1.3m
Average Occupancy	56%	72%
Total Fixed Assets (£m)	18.5	132
EV/EBITDA	54	29
Gearing on B/S	66%	116%
Tangible assets/Total Sales	2.8	5.5

**Based on share prices as at 24 January 2005*

Big Yellow (BYG) is the UK's second largest self-storage operator by number of units, is profitable and pays a final dividend. As at end March 2004, the company had 29 open and trading stores and 9 committed stores, giving a total lettable capacity when fully built out of 2.3m sq ft. Since then the number of open or committed stores has risen to 43 – with a target of 44 to 48 by the y/e March 2005. Big Yellow's core focus is on London and the South of England, but it has also just acquired its first site in the North of England, in Leeds. Only a small number of its stores overlap with existing Lok'nStore units.

Given that Lok'nStore is still loss making and Big Yellow has only just started making a profit at the pre-tax level, a comparison using the p/e multiple is invalid. For interest, Big Yellow is trading on a 2005 p/e multiple of 96, assuming the consensus of 2p a share for the current year is achievable. Other ways of looking at the business of self storage, are provided below:

Valuation by Total Number of Stores

Company	EV Per Store, Open	EV Per Store, Total
Lok'nStore	2.2m	2.1m
Big Yellow	9.03m	6.9m

In terms of valuation by number of stores, Lok'nStore is considerably cheaper than Big Yellow. Some allowance must be made for the fact that the average Big Yellow unit is 20,000 sq ft larger than the average Lok'nStore unit. The average Big Yellow unit also achieves a higher average price per sq ft of space. Nevertheless we feel such a wide discount, given the sales growth and cash generation of Lok'nStore's portfolio, is difficult to justify.

Operating Margin Per Sq Ft

	LOK	BYG
Average Price per Sq ft (£)	14	18.7
Average Op Cost per Sq ft (£)	8.5	10.60
Average Op Margin Per Sq ft (£)	61%	57%

Looking at average price per sq ft of occupied space and comparing this to the average operating cost per sq ft of total lettable space is one way of getting round the issue of store size. On this basis Lok'nStore not only appears to be making a slightly higher average operating margin per sq ft than Big Yellow, it is also achieving this margin by spending £2.10 less per sq ft.

Low cost base

Lok'nStore has opened 19 stores from a total capital base (debt + equity) of £19.5m, the equivalent of just over £1m per store. The comparative figure for Big Yellow is £4.5m. Some of the difference can be explained by the fact that Big Yellow operates bigger stores, of course. It is also true that Lok'nStore operates a phased fit out of its stores, while Big Yellow tends to incur all costs upfront. Nonetheless, should this industry become price competitive, Lok'nStore's low cost base will provide a useful competitive advantage.

Valuation by NAV

Looking at an adjusted NAV per share that takes account of the expansion of the estate, the imminent re-valuation of the freehold and leasehold estate, the likely disposal of Kingston and the possibility of the same at Reading is another way of valuing the business.

On this basis, the acquisition of sites in Farnborough and Tonbridge for £4.3m and the purchase of the freehold interest at Poole for £2.55m, adds £6.8m to the value of net assets, or 26p per share. Disposals at Kingston where residential planning is in place, and Reading where an application is pending, could add a further £15m, or 60p per share. We have ignored the prospect of capital gains tax on these sale proceeds because we understand roll-over relief is available to the company, assuming all proceeds are re-invested in the portfolio, of course. The re-valued freeholds together with the re-valued leasehold estate could conservatively add another £7m, or 28p per share.

If our calculations are broadly correct this would suggest an NAV per share, after deducting net debt of £6.9m, of 165.5p per share - more than double the current NAV of 78.5p per share.

Prospects

Annualised sales of £7.7m suggest trading in the current year has got off to a good start. If the sale proceeds at Kingston are realised (as we expect them to be), 2005 will also be a very profitable year for the group at the declared pre-tax level. Stripping out the profit on the disposal of Kingston (which most investment managers will rightly view as an exceptional item) and goodwill, we expect Lok'nStore to report a (modest) pre-tax loss of £184,000.

The Kingston proceeds will also have implications for the balance sheet. By our calculations, Lok'nStore will finish the current year debt free with a net cash balance of £5.76m. We have not forecast payment of a special dividend or share buyback in 2005, but it is worth remembering that both are possible if Lok'nStore is unable to acquire good quality sites at affordable prices. This is not a company that will overpay for sites.

2006 could herald the start of sustainable earnings growth at the pre-tax level. By this time we forecast thirteen sites will have been open for five years or over, five will have been open between two and five years and three will have been open for two years, or less.

Conclusion

Lok'nStore shares have had a good run since the end of December, rising from 115p to the current 145p. Despite this, they still look significantly undervalued, both on a mathematic basis and in comparison to quoted competitor Big Yellow. As the UK's fourth largest self-storage operator, we also believe Lok'nStore could make an appreciable difference to performance at Safestore/Mentmore or indeed to any of the US based operators looking for more exposure to this fast growing sector.

Lok'nStore			**25.1.05**	
July £'000	**2003A**	**2004A**	**2005E**	**2006E**
Sales				
Self Storage Income, Stores > 250 wks	2119	3105	3667	5143
Self Storage Income, Stores 100-250 wks	3255	3159	3633	2725
Self Storage Income Stores < 100 wks	183	270	324	454
Rental income	55	77	77	85
Total Sales	**5612**	**6611**	**7701**	**8406**
Sales Change (%)				
Self Storage Income, Stores > 250 wks		47%	18%	40%
Self Storage Income, Stores 100-250 wks		-3%	15%	-25%
Self Storage Income Stores < 100 wks		48%	20%	40%
Rental Income		40%	0%	10%
Total Sales		18%	16%	9%
Operating Profit (EBITDA) Margins				
Self Storage Margin, Stores > 250 wks	51%	48%	50%	50%
Self Storage Margin, Stores 100-250 wks	5%	17%	20%	19%
Self Storage Margin, Stores < 100 wks	-76%	-100%	-100%	-100%
Rental Income	100%	100%	100%	100%
Store Operating Profit (EBITDA) Margin	21%	28%	30%	32%
Operating Profit (EBITDA) £'000				
Self Storage EBITDA, Stores > 250 wks	1087	1490	1834	2571
Self Storage EBITDA, Stores 100-250 wks	166	537	717	518
Self Storage EBITDA Stores < 100 wks	-139	-270	-324	-454
Rental Income EBITDA	55	77	77	85
Trading Stores Operating Profit (EBITDA)	1169	1834	2304	2720
Head Office and Central Costs	446	1024	1125	1200
Depreciation	622	664	800	1100
Goodwill Amortisation	24	24	24	24
Group Operating Profit/Loss	77	122	355	396
Profit / (Loss) on disposal of fixed assets	-404	1	8825	0
Exceptionals	-64	-127	0	0
Net Interest Charge	39	163	525	150
Pre-tax Profit	-430	-169	8655	246
Adjusted Pre-Tax Profit	**38**	**-41**	**-170**	**246**
Tax (%)	0%	0%	0%	0%
Tax Charge	0	0	0	0
After Tax Profit (Reported)	-430	-169	8655	246
After Tax Profit (Adjusted)	38	-41	-170	246
Dividend Payments	0	0	0	0
Retained Earnings	-430	-169	8655	246
Average Number of Shares, Fully Diluted (m)	28511	27436	25048	25048
Adjusted Profit Per Share p. (Fully Diluted)	**-1.5**	**-0.1**	**-0.7**	**1.0**
Dividend Per Share p.	0.0	0.0	0.0	0.0

Summary Cash Flow Statement

July £'000	2003A	2004A	2005E	2006E
Group Operating Profit / (Loss)	77	122	355	396
Exceptionals	-64	-127	0	0
Group Operating Profit / (Loss) After Exceptionals	13	-5	355	396
Depreciation	622	664	800	1100
Goodwill Amortisation	24	24	24	24
Increase in stocks	39	2	1	5
Increase in Debtors	272	421	151	200
Increase/(decrease) in creditors	-59	675	605	500
Operating Cash Flow	289	935	1632	1815
Capital Expenditure	2100	1100	3800	2000
Net Interest	39	122	525	150
Tax	0	0	0	0
Free Cashflow	-1850	-287	-2693	-335
Cash Impact of Exceptionals	0	0	0	0
Acquisitions/Disposals	0	-4329	7800	-2200
Issue of Shares / (Buybacks)	0	-3428	0	0
Dividends	0	0	0	0
Change in Net Debt	-1850	-8044	5107	-2535

Key Balance Sheet Items

July £'000	2003A	2004A	2005E	2006E
Intangible Assets	407	383	359	335
Tangible Assets*	13399	18163	21163	22063
Stock	102	104	105	110
Trade Debtors	519	642	700	800
Other Debtors	1009	1307	1400	1500
Net Cash / (Debt)	1102	654	5761	3226
Trade Creditors	837	1010	1200	1400
Other Creditors	1499	2085	2500	2800
Net current assets / (liabilities)	396	-388	4266	1436
LT Debt	0	7600	2493	5028
Net Debt/(Cash)	-	6946	-3268	1801
Shareholders' Funds (ex-intangibles)	**14202**	**10558**	**23295**	**18807**
Gearing % / (Net Cash)	-	66%	net cash	10%
Shares In Issue, No. 000	28511	27436	25048	25048
NAV/Share p. (ex-intangibles)	49.8	38.5	93.0	75.1

* Group's eight freehold sites independently valued at £20.1m in Jan 2004, against a book value of £9.9m. These values have not been taken to the balance sheet

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