

Pre-close comment: more value in store

We believe that Lok'n Store is continuing to trade well, against the background of an improving sector environment. The significant further potential uplift in valuations has been highlighted by the news that the property portfolio is being revalued and by the granting of planning permission for Kingston (c.40p per share). The shares have outperformed strongly recently and we believe there will be more upside after the results in two months' time.

Profit and loss

Y/E July	2003A	2004A	2005E	2006E	2007E
Sales (£m)	5.6	6.6	7.7	8.4	9.3
EBITDA (£m)	0.7	0.7	0.9	1.0	1.1
PBT Adj (£m)	(0.03)	(0.04)	(0.20)	(0.09)	(0.21)
Tax (%)	0.0%	0.0%	0.0%	0.0%	0.0%
EPS Adj (p)	(0.09)	(0.15)	(0.81)	(0.38)	(0.85)
CFPS (p)	(6.54)	(27.74)	19.76	(7.32)	(7.19)
DPS (p)	0.00	0.00	0.00	0.00	0.00

Valuation

EV/Sales (x)	7.2	7.3	5.6	5.3	5.0
EV/EBITDA (x)	60.9	70.6	49.4	47.3	44.3
PER (x)	n/a	n/a	n/a	n/a	n/a
Div Yield (%)	0.00	0.00	0.00	0.00	0.00

Source: Baird; Lok'n Store Group

- Valuation uplift: we expect the current property revaluation to result in a c.60% uplift in values on the most recent £20.1m valuation a year ago (including new freeholds and the leaseholds). Additionally the scope for planning gains is underlined by the announcement some weeks ago of planning permission to develop Kingston (est. £10m vs. £1.2m book value).
- Trading well: last month's final results showed EBITDA margin in the eight mature stores steady at 48%, while occupancy rose 17.5% y/y. Quoted and private competitors alike are reporting good progress. Lok'n Store has a low-cost model and underlying store performance continues to improve.
- Strong underlying growth: Lok'n Store is a beneficiary of double-digit demand growth in the immature UK self-storage market.
- Significant deal-flow and real estate re-rating: the share price is underpinned by consolidation and numerous deals, and the real estate sector has re-rated. The Chancellor will be commenting shortly on moves towards REITs – most quoted self-storage companies in the US are REITs.
- Share price target: our raised share price target of 175p is supported by the value of the asset base and also by the potential profitability of the current portfolio, by recent deals, and by our discounted cash flow model.

Neutral

Date **17 February 2005**

Price (16 February 2005) **165p**

Market capitalisation **£41.3m**

FTSE sector **Support Services**

Ticker symbol **LOK**



% relative to All-Share
1m/3m/12m **+6.6%/+31.5%/+26.3%**

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Investment summary

Investment case

Successful business model

Lok'n Store's business model is a low-cost model which accelerates the process of achieving maturity in order to exploit the high level of profitability of mature stores. The group specialises in timely and cost-effective fit-outs, and uses its assets flexibly and efficiently. 50% of the stores are leased rather than freehold.

Growth sector

Lok'n Store is one of four dominant players in the UK self-storage market. This is enjoying double-digit growth on the back of underlying factors (a cost-effective solution given increases in both mobility and numbers of households) and demonstrably under-supplied compared with other global markets such as the US.

Asset play

We expect the current revaluation to result in a significant uplift in valuations as a result of improved capacity utilisation in the eight existing freehold stores, the acquisition of two more stores during the past year, and the potential value of the ten leased stores.

We anticipate a valuation of £30m-£35m, a c.60% uplift since a year ago. The likely disposal of Kingston for c.£10m (now that planning permission has been granted) underlines the conservatism of these valuations (which exclude the potential for planning gains).

Potential target

Corporate activity: the majority of the larger players in the UK have changed hands in the past eighteen months with more deal-flow anticipated as the UK moves towards the adoption of REITs, attractive to potential US buyers. Lok'n Store rejected bid approaches at 115p last year.

Unmerited discount

Given the quality of the business we believe the discount to its major quoted competitor Big Yellow is undeserved.

Investment risks

Risk of economic downturn

In the event of a severe economic downturn, business users would be affected, though this impact would be mitigated to some degree as the business customers (60% of total) close expensive warehouses.

Risk of housing downturn

Given the relatively high exposure of the company to business as against private users the company would be less impacted than its major competitors.

Newsflow

Good news on the trading front and on valuations – with more to come

Anticipated

- **11/04/05:** Interim results. We anticipate a continuation of the good trading reported in December and supportive news on the valuation by Cushman Wakefield Healey & Baker.
- **04/05:** Chancellor reveals next stage of deliberations on UK REITs – tax efficient model for quoted property companies which is widespread in US self-storage sector.

Recent

- **04/02/05:** Mercury Special Situations raises stake to 9.12%.
- **04/02/05:** 28.1% of Big Yellow, Lok'n Store's only quoted competitor, placed at only a 7% discount to the share price.
- **18/01/05:** Competitor Big Yellow says sales up 40% y/y and customer numbers +24%.
- **13/12/04:** Planning permission granted for 78 private apartments in two buildings on Kingston site. Book value £1.2m, likely disposal value c.£10m.
- **07/12/04:** New property valuation to be undertaken by Cushman Wakefield Healey & Baker, to be announced in April '05 with interim results. Last valued at £20.1m in April 2003. New valuation @ £30m-plus?
- **06/12/04:** Mercury Special Situations raises stake to 3.4%.
- **03/11/04:** Final results. Sales +18%, customers +28%, occupancy +26% and 85% in the mature stores. New Farnborough store will open in autumn '05. Confident prospects statement.
- **12/08/04:** IPO of \$US250m market cap Extra Space Storage on NYSE.
- **03/08/04:** Two new sites – Farnborough (freehold) and Tonbridge (leasehold).
- **28/04/04:** Safestore (acquired by Bridgepoint in 2003) acquires Mentmore, the largest UK quoted self-storage business.
- **07/03/04:** Acquisition of Poole headlease (cost of £2.5m) with option to buy freehold in the future.
- **23/03/04:** H1 results (sales +11%). New Eastbourne site trading well ahead of expectations.
- **10/02/04:** Announces property revaluation by specialists in self-storage.
- **09/01/04:** Company terminates offer talks, rejects 115p bid.

Effective operating model

One of only two quoted players, with a value-driven model

Lok'n Store is one of only two quoted leaders in the UK self-storage market with a clearly targeted, value driven approach. It has chosen a model which focuses on accelerating the progress to maturity as much as possible, and now has 20 self-storage stores with total square footage of 840,000 ft². The company focuses exclusively on the area around London and the South East, with a relatively high exposure (45% by value, 31% by volume) to business as opposed to personal storage, a defensive characteristic in the event of a housing downturn.

While this is not a rigid rule (one store is much more sizeable), Lok'n Store has specialised in stores in the 30,000-40,000 ft² range, which can be filled more speedily than a larger store, and which should be filled within three or four years at the outside. For a similar reason, Lok'n Store's speed to opening is probably shorter than the industry average, with some operators of larger stores taking up to six months to open a store. Lok'n Store's model is highly flexible, allowing for partial fit-outs and imaginative and commercial use of the remaining space, while speed to opening can be as little as two months. The company is also relatively restrained in its investment criteria, looking to buy a leasehold for £1m-£1.5m where possible – much higher prices are paid in the industry. Better still, it has on occasion been able as the incumbent to seize the opportunity to convert a leasehold into a freehold, an extremely cost-effective way of acquiring a freehold site.

These characteristics distinguish the Lok'n Store model from those of many of its leading competitors, including Big Yellow and other leading players such as Shurgard or Access. Illustrating the flexibility of the model, however, Lok'n Store has gradually been increasing the proportion of its stores which are freehold and, like its large competitors, can boast some prominent and highly visible sites.

Figure 1: Peer comparison

Company	No. stores	Area (000 ft ²)	Av. size (000 ft ²)	Freehold (%)	Speed of opening	Costs per store (£/ft ²)
Lok'n Store	20	840	42	50	2-3 months	20.0-30.0
Big Yellow	43	2,600	60	74**	6 months [#]	c.75.0

** As at 31/03/04[#] In line with industry average
Source: Company; Baird

The record

Sales growth 32% p.a. compound

Over the past eight years, Lok'n Store has grown the number of stores by 10% p.a. (CAGR), and from this has built annual increases in area and sales of 12% and 32% respectively, an impressive achievement. Growth has necessarily been lumpy as there is faster growth in the periods when more stores are coming on stream. Typically the company buys or leases at least two sites per year. However when more industrial properties become available at the right price, this can rise to four as in '00 and '01. EBITDA has remained relatively steady in recent years around the £0.5m/£0.7m level, while the healthy profits generated by the mature stores are ploughed back into the business.

Figure 2: Financial record 1997-2004

Y/E July	1997	1998	1999	2000	2001	2002	2003	2004	CAGR
Sales (£m)	0.7	1.4	1.9	2.9	4.0	5.0	5.6	6.6	32.4
Change (%)		82	39	54	36	26	12	18	-
EBITDA (£m)			0.4	0.8	0.7	0.5	0.7	0.7	-
No. stores	6	7	8	12	16	17	19	20	9.7
Area (ft ² 000)*	186	226	344	570	726	759	775	840	12.3
Change (%)		22	52	66	27	5	1	9	

* Potential lettable space
Source: Company; Baird

Growth opportunity

High-growth sector,
driven by convenience,
flexibility and
demographic factors

Future growth of the company is underpinned by the rapid underlying growth of the sector, which is based on the key growth drivers of convenience and lack of space. Businesses which are familiar with the model prefer to store goods cheaply and flexibly in self-storage centres rather than using expensive warehouses. For individuals self-storage makes it possible to de-clutter a house, to have access to one's property while renting, or to move to smaller accommodation. For such individuals, self-storage represents a cheap, practical and effective solution, and underlying the convenience of using self-storage are demographic factors such as the rapid growth in single person households and increasing work-related mobility. The key barrier to growth is familiarity with the product, and this is being rapidly increased as prominent sites are set up near motorway junctions and on the outskirts of towns, and as leading players advertise their wares.

Massive market in the
US

The opportunity is particularly striking if the UK is compared with \$10bn-plus US market. There are only around 350-400 stores in the UK and UK penetration is therefore a fraction of the levels achieved in the US, which has 35,000-plus – about 5% of the US in per capita terms. A long-term UK target of 3,000 stores would still represent per capita utilisation of only a quarter of US levels. This estimate allows for greater mobility within the US and for the high proportion of small businesses, traditionally good users of self-storage.

Recent results

The company last updated the market in early December, when it reported final results. The headline figures were ahead of expectations, with an 18% increase in revenues, a 26% increase in store occupancy and a 28% increase in customer numbers. However behind the headline numbers there was extremely good progress within the stores, with a 178% increase in the levels of EBITDA generated by the more mature centres, illustrating the gearing as the stores become increasingly full. Year on year the company succeeded in virtually doubling the square footage in the Phase 3 areas.

Figure 3: Sales/EBITDA movement within the sites (2004 vs. 2003)

	y-07/04			y-07/03		
	Phase 3 (<250 wks)	Phase 2 (100-250)	Phase 1 (<100 wks)	Phase 3 (<250 wks)	Phase 2 (100-250)	Phase 1 (<100 wks)
Sales (£m)	3,105	3,159	270	2,119	3,255	183
Change (%)	11%	13%	694%	-	-	-
EBITDA (£m)	1,491	536	-271	1,087	166	-139
Change (%)	178%	518%	n/a	-	-	-
EBITDA margin	48.0	17.0	-	11.1	3.1	-
Ft ² *	305	365	80	182	405	80
No. stores	8	8	2**	6	9	2

* Max. lettable sq ft ** Tonbridge excluded as opened in August '04
Source: Company; Baird

Valuation

A variety of methodologies

Conventionally Lok'n Store has been valued on a DCF basis, which assuming a 10% discount rate (long-term risk-free rate of 5%) on our numbers will generate 200p-plus. Alternatively there is scope to value the business by assuming no more site acquisitions and running the existing business full – on a Safestore exit PE of 9x this implies a share price target around the 180p level – but this is historical and ignores the significant re-rating in the real estate sector that has taken place since the deal.

Assets underpin value of company

Most recently the focus has been on the value of the assets which underpins the valuation of the company (even while it is not, fundamentally, an asset play). The recent announcement about the property valuation was very supportive. Lok'n Store does not fully value the property in its books, valuing its property assets at only £12.7m in the 2004 balance sheet. The January '04 valuation was conducted in line with US (and Big Yellow) practise in valuing self-storage assets, on the basis of the returns made by the business, and with planning gains therefore excluded.

New valuation plus planning gains

We expect the new valuation to deliver a £10m-plus uplift on the April 2004 valuation of £20m, as (1) there is higher occupancy within the portfolio, (2) there are new sites, and (3) leaseholds will be included this time round. If planning gains are taken into account there is further value: Kingston, where planning permission was announced last month, should exceed £10m. Further down the line Reading could be worth a further £5m-£10m (assuming more than one hundred apartments, which seems highly likely).

Price target in line with composite value post the new valuation

Further newsflow on the valuation is anticipated at the '05 interim results, to be announced in April. Assuming a £10m uplift to the April 2004 valuation, a £10m valuation for Kingston, and a £5m-plus valuation for Reading, the composite value, subtracting the trading/business value of the two sites, would be at least in the £45m-£50m range (180p-200p). We have conservatively set a new 175p price target.

Current trading/forecasts

We believe the company continues to make good progress and we expect sales growth for the year to continue at similar levels to last year (forecast: +17%), with the usual seasonal weighting towards the second half (c.54%). Our capex assumption of £6m is based on £2m spend on the new Farnborough site, and one further new freehold site at £2.5m (there are several in the pipeline). The capex on the existing stores is c£1.5m.

As ever we expect the company to be cash-generative, with a £0.3m positive movement in working capital and EBITDA of £0.9m. In terms of the working capital, the fundamentals of the business are positive, given that Lok'n Store's clients pay them for the space they hire up-front, including a deposit. Since the last results the number of stores which are cash-generative has increased from 12 to 14.

SWOT analysis

Strengths

- Top four player with a good network of sites in the South of England.
- Committed, entrepreneurial and experienced management.
- Low-cost and flexible business model.
- Relatively low exposure to private sector (more volatile on back of housing market).
- Owner of valuable property.
- Shareholder management (31%) is aligned with investors.
- Fragmented market with few competitive pressures.
- Highly profitable business when stores are full (45% EBITA margin).

Weaknesses

- Half the portfolio are leases not freeholds – but this creates more flexibility.
- Missing out on North of England etc. – but plenty of potential in their home territory.
- Not all the freeholds are as valuable as Kingston.
- Self-storage not well understood in City.
- Bad news flow from sector historically.
- Difficult to value – but valuation techniques being imported from US.

Opportunities

- UK very immature – high-growth sector.
- Highly profitable once all the sites have become mature.
- Participate in the ongoing consolidation process in the sector.
- Roll out the model in other geographical areas.
- Reinvest substantial planning gains – Kingston c.£10m, Reading probably £5m.
- Revaluation underway will show increased value in portfolio.

Threats

- Competitive pressures could increase – but UK a long way from maturity.
- Increasing investment requirements as the sector moves to a higher service level (not a key driver).
- Housing market collapse reduces demand (though this could have the opposite effect).
- Surge in industrial property prices makes buying new sites uneconomic.

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Profit & loss account (£m)

Y/E July	2003A	2004A	2005E	2006E	2007E
Total sales	5.6	6.6	7.7	8.4	9.3
Cost of sales	(5.6)	(6.5)	(7.7)	(8.4)	(9.2)
Gross profit	0.0	0.1	0.0	0.0	0.0
SG&A costs	0.0	0.0	0.0	0.0	0.0
EBITDA	0.7	0.7	0.9	1.0	1.1
Depreciation	0.6	0.7	0.9	0.9	1.0
Amortisation	0.0	0.0	0.0	0.0	0.0
Operating profit	0.0	0.1	0.0	0.0	0.0
Interest	(0.0)	(0.2)	(0.2)	(0.1)	(0.2)
PBT (adj)	(0.0)	(0.0)	(0.2)	(0.0)	(0.2)
Goodwill	0.0	0.0	0.0	0.0	0.0
Exceptionals	(0.5)	(0.1)	0.0	0.0	0.0
PBT FRS3	(0.5)	(0.2)	(0.2)	(0.1)	(0.2)
Tax	0.0	0.0	0.0	0.0	0.0
PAT	(0.0)	(0.0)	(0.2)	(0.1)	(0.2)
Minorities	0.0	0.0	0.0	0.0	0.0
Dividend	0.0	0.0	0.0	0.0	0.0
Retained profit	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Basic EPS	-	-	-	-	-
FD EPS adj	(0.09)	(0.15)	(0.81)	(0.38)	(0.85)
FD EPS FRS3	(1.74)	(0.62)	(0.81)	(0.38)	(0.85)

Cash flow summary (£m)

Y/E July	2003A	2004A	2005E	2006E	2007E
Operating profit	0.0	(0.0)	0.0	0.0	0.0
Depreciation	0.7	0.7	0.9	0.9	1.0
Working capital	(0.4)	0.3	0.3	0.3	0.4
Other	(0.0)	(0.0)	0.0	0.0	0.0
Operating cash flow	0.3	0.9	1.1	1.3	1.4
Interest	(0.1)	(0.1)	(0.2)	(0.1)	(0.2)
Taxation	0.0	0.0	0.0	0.0	0.0
Capex	(2.1)	(5.4)	(6.0)	(3.0)	(3.0)
Dividends	0.0	0.0	0.0	0.0	0.0
Acquisitions/disposals	0.0	0.0	10.0	0.0	0.0
Net cash flow	(1.9)	(4.6)	4.9	(1.8)	(1.8)
Shares issued	0.0	(3.4)	0.0	0.0	0.0
Net loans	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Change in net debt	(1.9)	(8.0)	4.9	(1.8)	(1.8)

Balance sheet (£m)

Y/E July	2003A	2004A	2005E	2006E	2007E
Opening shareholders' funds	15.7	14.2	10.6	20.3	19.5
Shares issued	0.0	(3.4)	0.0	0.0	0.0
Retained profit	(0.1)	(0.1)	(0.8)	(0.4)	(0.8)
Other	0.0	0.0	0.0	0.0	0.0
Closing shareholders' funds	14.2	10.6	20.3	19.5	21.2
Opening net cash/(debt)	3.0	1.1	(6.9)	(2.0)	(3.8)
Net cash flow	(1.9)	(8.0)	4.9	(1.8)	(1.8)
Movement in debt/leases	0.0	0.0	0.0	0.0	0.0
New finance leases	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0
Closing net debt	1.1	(6.9)	(2.0)	(3.8)	(5.6)

Source: Baird; Lok'n Store Group

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Financial Summary

Profit & Loss Y/E July	2003A	2004A	2005E	2006E	2007E
Sales (£m)	5.6	6.6	7.7	8.4	9.3
EBITDA (£m)	0.7	0.7	0.9	1.0	1.1
Margin (%)	11.7%	10.3%	11.3%	11.3%	11.3%
EBITA (£m)	0.01	0.12	0.01	0.01	0.01
Margin (%)	0.2%	1.8%	0.1%	0.1%	0.1%
Interest (£m)	(0.04)	(0.16)	(0.21)	(0.10)	(0.22)
PBT FRS3 (£m)	(0.49)	(0.17)	(0.20)	(0.09)	(0.21)
PBT – Adj (£m)	(0.03)	(0.04)	(0.20)	(0.09)	(0.21)
Tax rate (%)	0.0%	0.0%	0.0%	0.0%	0.0%
EPS FRS3 (p)	(1.74)	(0.62)	(0.81)	(0.38)	(0.85)
EPS – Adj (p)	(0.09)	(0.15)	(0.81)	(0.38)	(0.85)
CFPS (p)	(6.54)	(27.74)	19.76	(7.32)	(7.19)
DPS (p)	0.00	0.00	0.00	0.00	0.00

Growth rates

Sales (%)		18%	17%	9%	11%
EBITDA (%)		4%	28%	9%	11%
PBT – Adj (%)		n/a	n/a	n/a	n/a
EPS – Adj (%)		n/a	n/a	n/a	n/a

Valuation ratios

EV (£m)	40.2	48.2	43.3	45.1	46.9
EV/Sales (x)	7.2	7.3	5.6	5.3	5.0
EV/EBITA (x)	3112.5	396.0	8565.7	8939.9	5026.1
EV/EBITDA (x)	60.9	70.6	49.4	47.3	44.3
PER (x)	n/a	n/a	n/a	n/a	n/a
PCF (x)	(25.2)	(5.9)	8.4	(22.5)	(23.0)
Div. Yield (%)	0.00%	0.00%	0.00%	0.00%	0.00%

Operating statistics

Net cash/(debt) (£m)	1.1	(6.9)	(2.0)	(3.8)	(5.6)
Shareholders funds (£m)	14.2	10.6	20.3	19.5	21.2
Gearing (%)	n/a	-65.8%	-9.9%	-19.7%	-26.5%
Interest cover (x)	0.3	0.7	0.02	0.02	0.02
Cash interest cover (x)	-	-	-	-	-
ROCE (%)	n/a	n/a	n/a	n/a	n/a

Business activity

Lok'n Store is one of only two quoted leaders in the UK self-storage sector, with 20 self-storage centres in Southern England. They have a low-cost business model, leading to a c.50/50 mix of leased and owned sites.

Share and shareholder information (%)

Andrew Jacobs (CEO)	21%
Merrill Lynch	11%
Simon Thomas (Chairman)	10%
USS	9%
North Atlantic Smaller Cos Inv Trust (Hambro's)	9%
Gartmore	7%

Key dates

Last finals	3 November 2004
Last AGM	16 December 2004
Last interims	23 March 2004
Next results expected	Interims – 11 April 2005

Recommendations

O – Outperform

Expected to outperform, on a total return basis, the broader UK equity market over the next 12 months

N – Neutral

Expected to perform in line with the broader UK equity market over the next 12 months

U – Underperform

Expected to underperform, on a total return basis, the broader UK equity market over the next 12 months