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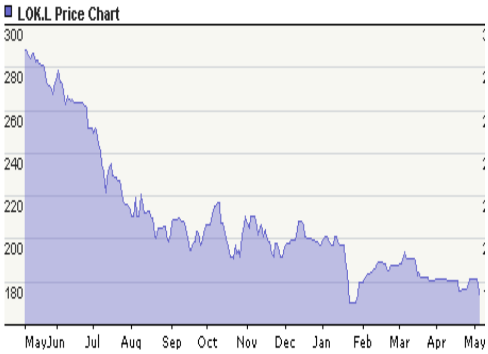
Lok'nStore

A Resilient First Half

171.5p *7 May 2008*



Interim results were flattened by the necessary move to IFRS Accounting and the sale of two mature freehold stores (Kingston and Woking) at the end of the last financial year. Underlying trading progress was actually very good, particularly at the new, larger stores that will be the focus of the roll-out programme going forward. Key points are:

- Excluding the Woking and Kingston stores, H1 sales were up 13% while store EBITDA was 20.3% ahead at £2.34m.
- A record three new stores were acquired in the period increasing the size of the estate by 17.7% to 1.22m sq ft.
- Tangible assets have increased by £42.8m following the adoption of IFRS Accounting Standards as the value of the group's freehold properties are now included in the balance sheet at valuation.
- Adjusted N.A.V per share (based on 31 July 2007 external valuations) is unchanged at 270p suggesting self-storage asset values have held up remarkably well in spite of the current commercial property market slowdown.
- Gearing with freeholds at valuation is still modest at 39% and with undrawn bank facilities of £20.3m Lok'nStore has the firepower to take advantage of softer trading conditions in the investment property marketplace to accelerate the pace of its expansion programme.

Current trading is described as 'resilient' as Lok'nStore enters its key Q4 trading period but nonetheless we are erring on the side of caution and have reduced our estimates. The key point is that the long term fundamentals are sound and the self storage marketplace continues to grow.

Share Price: 171.5p

12m High: 293.50p

12m Low: 164.50p

Market Cap: £46m

Shares in Issue: 26.8m fully diluted

NAV/Share: 270p with properties at valuation

Net Gearing: 39% with freeholds at valuation

Interest Cover: 1.6X

EPIC Code: LOK

Sector: Support Services

Market: London AIM

NOMAD: Investec

PR: Financial Dynamics
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Previous Research Note: 'Reading Planning Decision Worth 15p/share' 198p, 15.1.2008

Analyst: *Sonia Kaur*

Y/E July	Sales £m	Group EBITDA £ m	Declared Profit £ m	Adjusted Profit £ m	Adjusted Eps p	Mkt Cap /EBITDA X	Divi p	Yield %
2006A	8.95	1.59	-0.04	-0.02	-0.5	29	0	
2007A	10.67	2.63	0.95	0.37	1.2	17	0.67	0.4
2008E	10.81	2.46	-0.76	-0.56	-2.1	19	1.10	0.6
2009E	11.60	2.92	-1.01	-1.01	-3.8	16	1.20	0.7

Background

Lok'nStore is the fourth largest self storage operator in the UK by number of stores with a 5% share of UK market.

Its current portfolio consists of 19 trading stores, 15 of which are established (over 5 years old) and probably approaching peak occupancy and 4 newer or 'developing' stores between 2 and 5 years old. The pipeline consists of four sites, three with planning permission. The latest site acquisitions take the maximum lettable area of the estate, once fully developed, to 1.22m sq ft, a rise of 32% over the past two years. Of the 23 stores, 13 are freehold, 10 are long leasehold. The average store size (including pipeline) is now 53,000 sq ft, up from 50,000 sq ft at end January 2007. The business/household split by revenues is 40/60.

Despite growing rapidly over the past couple of years, the UK self storage industry is still relatively immature with approximately 600 stores providing the equivalent of just 0.33 sq ft of storage space per person. This contrasts with the far more developed US market which currently has in excess of 41,000 stores, or 5.54 sq ft of self storage per person.

Interestingly, the five largest players in the marketplace (Shurguard, Safestore, Big Yellow, Access and Lok'nStore) control 50% of the marketplace and all of them are in strong expansion mode in spite of the slowdown in the commercial property market. This suggests to us that a) the self storage industry continues to grow strongly and b) self storage assets are being viewed as a property class on their own, at least for the time being. We believe Shurgard's successful placing of 51% of the company's stock with a US pension fund at a price in line with an abandoned earlier IPO supports this view.

Interim Results

	6 Months to end Jan 2008 £ m	6 Months to end Jan 07 £m	Headline Increase/ (Decrease) %	6 Months end Jan 2007 (Excl Kingston & Woking) £m	Like-for-Like Increase /(Decrease) %
Sales	5.5	5.3	4.2	4.89	13
Store EBITDA	2.3	2.2	7.3	1.95	20.3
EBITDA	1.42	1.43	(1.1)	1.20	18.2
Operating Profit	0.75	0.77	(2.7)	0.55	35.5
Pre-tax Profit	0.22	0.32	(31)	0.10	-

The interim results, reported under IFRS Accountancy Standards for the first time, showed a modest 4% increase in sales and a 1.1% dip in operating profits at the headline level. It should be pointed out that the group sold two freehold stores (Woking and Kingston) at the end of its last financial year introducing a significant distortion to the comparatives. Whilst profitable, Woking was the smallest store in the group's portfolio with little scope for further growth or expansion. Kingston was sold to a developer after obtaining high density residential planning permission generating a one-off property profit of £10m in FY 2007. We understand many of the vacating Kingston customers were relocated to the group's Sunbury store.

Stripping out the contribution from these stores, H1 sales rose 13% to £5.5m and Store EBITDA – a key measure of progress - was 20.3% ahead at £2.34m.

The improved result was driven by a robust 6.3% increase in prices year-on-year to £17.75 per sq ft. Even after the latest increase, Lok'nStore's average price per sq ft remains below the UK industry average of £20.63 providing scope for further price increases for several years to come.

Breaking down the results, we found the performance of the 'developing stores' between 2 and 5 years old particularly impressive. The four stores in this category (which include the two large, purpose built freehold stores in Farnborough and Crayford) reported a 39.1% increase in sales and an average EBITDA margin of 45.3%. This is higher than the average EBITDA margin of the established estate (H1 2008: 42.4%) and bodes well for the future profitability of the group if the next new freehold store openings (Harlow and further out Portsmouth North Harbour) follow a similar trading pattern.

Sales in the established estate rose 7.4% which we believe is a credible performance given that many will be close to peak occupancy (85%).

The depreciation charge, already a major item, was higher than we expected. This is because, under IFRS, the depreciation charge taken through the p & l account must now reflect the freehold properties at valuation rather than net book value. Our spreadsheet model predicts the depreciation charge will rise from last year's £1.3m to £1.5m in FY 2008 and £1.83m in FY 2009.

One-off charges relating to the successful transfer of customers from the group's existing leasehold store in Portsmouth to the new freehold store amounted to £29k in first half. The Lok'nStore p & l account has historically been free of non-recurring charges (previously known as 'exceptional items' under UK GAAP) but in the current year we expect these to total £200k. Of this total £90k relates to the cost of moving customers into the new store; the balance is an estimate of the dilapidation costs involved in exiting the lease – currently under negotiation. We understand that in successfully transferring 96% of the customers from the old leasehold into the new freehold premises management have generated an immediate and significant uplift in the value of the new freehold store.

The £11.3m spent on capital expenditure in the half led to an increase in the interest charge because Lok'nStore conservatively expenses all interest costs relating to its properties, including those in development, through its p & l account. The big increase in interest received in the half reflects interest on the deferred element of the Kingston sale proceeds (£4m).

Pre-tax profit for the year was £216k and once again there is no tax payable due to carried forward tax losses. We welcome this profit figure but re-iterate our view that the short-term earnings profile is largely irrelevant. The key point is the value being created by the new store roll-out programme in a market that continues to grow.

Balance Sheet and Cash Flow

The adoption of IFRS Accounting has had a significant impact on the end January 2008 balance sheet and will require Lok'nStore to revalue its properties annually from now on. The two main changes are as follows:

- Freehold properties are now included on the balance sheet at valuation. This has resulted in an £42.8m uplift in the value of the group's assets based on the external valuation by Cushman & Wakefield at end July 2007. The key variables in the valuation model are estimated occupancy at maturity, price per sq ft at maturity and yield shift. The commercial property market has slowed significantly since the group's last valuation in July 2007 so it will be interesting to see what impact, if any, this has on the July 2008 external valuation.
- The flipside is that the revaluation gains generate a liability for deferred tax. This amounted to a heavy £14.7m in H12007, £2.7m of which relates to the tax payable on rolled over gains following the sale of the Woking and Kingston stores. Lok'nStore is required to make full provision for this tax even though it is unlikely to ever be paid.

It is worth pointing out that the leasehold stores continue to be valued at historic cost. Given that the portfolio consists of 10 leasehold stores (including the two in the pipeline) the balance sheet still under-estimates the true break-up value of the group.

The interim results statement contains a directors' valuation of N.A.V per share based on the 31 July 2007 valuations. It includes the leasehold stores at their July 2007 market value of £9.4m, the stores under development at cost and an additional £525k to reflect the granting of residential planning permission at Reading to give an adjusted N.A.V per share of 270p that concurs with the end July 2007 valuation. Allowing for the full deferred tax provision, N.A.V per share is 213p. It goes without saying that both these values compare favourably to the current share price of 171.5p.

Net debt at the end of the first half was £19.7m, giving gearing of 39% including the freehold stores at valuation. Undrawn bank facilities at the year end were £20.3m, enough to fund four full sized freehold units or a significantly higher number of leasehold stores.

The cash flow statement shows a net cash outflow from operations of £1.2m but this was distorted by a one-off £1.7m VAT payment on the sale of the Kingston site. The cash inflow from operating activities before movements in working capital was unchanged at £1.5m. After allowing for the £11.3m capital investment charge but including the £4m banked on the sale of Kingston and £8.8m brought in from the draw down of bank facilities the net decrease in cash during the year was £0.4m.

New Stores

The pace of the group's expansion programme accelerated in the first half with Lok'nStore acquiring a record three new sites in Portsmouth North Harbour, Northampton and Maidenhead. The total store development pipeline is currently 264,000 per sq and will deliver 1.22m sq ft of lettable space once fully fitted out.

Portsmouth North Harbour. Portsmouth North Harbour is a 2 acre freehold site opposite a busy retail area fronting the A27 and with close links to the M27. It will house a new build store providing 60,000 sq ft of lettable space at a total cost of £6m, the equivalent of £100 per sq ft. At the current £17.75 per sq ft and assuming 85% occupancy at maturity (in line with the Cushmam Wakefield model), this suggests a gross yield on the property of 15%.

Maidenhead. This 1.6 acre, 68 year leasehold site is located in a high visibility, high footfall area opposite a busy retail park. An 83,000 sq ft new build unit is planned for the site which will open in Summer 2009 subject to planning permission. The lease was acquired for £2.5m and the total build and fit out cost is estimated at £4.5m giving a total cost for the completed facility of £84 per sq ft.

Northampton. Northampton is a 20 year leasehold site. With a total lettable area of just 36,000 sq ft it will be one of the smallest units in the portfolio when it opens this Summer just six months after its acquisition. The branding and fitting of the existing building will cost £900k, or £25 per sq ft, and we expect £70k in respect of Northampton to be expensed through the p & l account in the current financial year.

Two new stores will open this summer, the large (69,000 sq ft) purpose built freehold store in Harlow and Northampton. Our estimates model on page 6 includes a sales contribution of £445k from these two stores flowing through to an operating loss of £356k for FY 2009.

Reading Disposal

Lok'nStore has been granted planning permission to build 112 flats on the 1.63 acre site currently occupied by its Reading self storage unit store. The book value of the two properties at Reading is £2.1m but the planning permission only relates to one of them. The Cushman & Wakefield valuation for the site as a residential development is £5.25m which we think is about right. Assuming we are correct, this would generate a one-off future property profit of £4.25m.

Lok'nStore will build a new, larger, 53,000 sq ft self storage unit on its other Reading site but development here cannot start until 2009 at the earliest because this is when the lease term expires. The existing Reading store is unlikely to be sold until mid 2010.

Current Year Prospects and Beyond

We have pulled back our estimates for the current year ending July 2008 for four main reasons.

- Margins in the established estate will be diluted by the loss of the freehold Woking and Kingston stores (which achieved above-average EBITDA margins of 50% plus) and the entry of the 39,000 sq ft leasehold store in Luton.
- FRS 20 share based payments and the depreciation charge will both be higher than we expected following the adoption of IFRS. The interest charge will also be higher because post the end of the first half management purchased 800,000 shares at 181p per share for treasury. This takes the total number of shares held in treasury to 1.14m, equivalent to 4% of the total number of shares in issue.
- Our new estimates contain £200k of non-recurring costs relating to the transfer of customers from the old leasehold store in Portsmouth to the new freehold.
- Our previous sales forecasts were too bullish. Whilst current trading is described as 'resilient' as the company enters its key Q4 trading period (housing market activity tends to pick up at

this time of year and many households undertake their annual ‘spring’ clean) we believe it is too early to say whether the ‘noticeable’ increase in enquiry levels over the past few weeks will translate into a rise in new business.

We now look for FY 2008 sales of £10.8m, Group EBITDA of £2.5m and pre-tax losses (adjusted for non-recurring charges) of £361k. Pre-tax losses will widen in FY 2009 as the group absorbs the initial start-up losses on the new store openings in Northampton and Harlow.

Quoted Company Comparisons

	Lok'nStore	**Safestore**	**Big Yellow**
EPIC Code	LOK	SAFE	BYG
Financial Year End	Jul 07	Oct 07	Mar 07
Total No. of Stores	23	122	73
Total Lettable Area Sq. ft. (Operating & Pipeline) m	1.22	5.34	4.5
Avg. Price per Sq. ft. (£)	17.75	23.08	23.79
Share Price p.	171.5	152.5	385.75
% change in SP (6 months)	-18.3%	-9.0%	-14.0%
Mkt Cap £m	46.0	286.9	445.2
Net Debt £m	10.46	225	192.2
Gearing %, on Re-valued Properties	15%	91%	39.40%
Enterprise Value, £m	56.74	511.91	637.42
Adjusted NAV per share p.	270	199	472
Sales	10.7	74	51
EBITDA Before Exceptionals (£m)	2.63	40.7	29.5
Dividend p.	0.67	4.5	9
EBITDA Margin %	25%	55%	58%
Adjusted EPS p. (2008E)	-2.1	8.9	8.6
P/E 2008 E (consensus forecast)	-	17	45
Mkt Cap/EBITDA, X	17.5	7.1	15.1
EV per Store (Total) £m	2.47	4.20	8.73
EV per sq ft Op & Planned £	47	96	142
(Discount)/Premium to NAV	-36%	-23%	-18%

Lok’nStore shares are currently trading at a bigger discount to N.A.V. per share than both Big Yellow and Safestore. The company also has the lowest Enterprise Value per sq ft of storage space (planned and operational) and per store in the quoted sector. With the proportion of larger freehold stores as a percentage of the total estate set to increase over the next couple of years we believe the current valuation disparity between Lok’nStore and its peer group is too wide.

07.05.2008

Lok'nStore

July £'000	**2006A**	**2007A**	**2008E**	**2009E**
Total Sales	**8946**	**10667**	**10810**	**11602**
Sales Change (%)	15%	19.24%	1%	7%
Store Operating Profit (EBITDA) Margin	34.6%	42.3%	42.6%	43.7%
Trading Stores Operating Profit (EBITDA)	**3076**	**4485**	**4569**	**5032**
Rental Income EBITDA	58	60	75	85
Head Office and Central Costs	1384	1642	1850	1900
FRS 20 charge	165	276	330	300
EBITDA	**1585**	**2627**	**2464**	**2917**
Depreciation	875	1292	1500	1830
Goodwill Amortisation	24	24	0	0
Group Operating Profit/Loss (EBIT)	**686**	**1311**	**964**	**1087**
Non-recurring items	0	605	200	0
Net Interest Charge	727	966	1525	2100
Interest Cover X	0.9	1.4	0.6	0.5
Declared Pre-tax Profit	-41	950	-761	-1013
Adjusted Pre-Tax Profit	**-17**	**369**	**-561**	**-1013**
Tax (%)	0%	6%	0%	0%
Tax Charge	100	55	0	0
After Tax Profit (Reported)	-141	895	-761	-1013
After Tax Profit (Adjusted)	-117	314	-561	-1013
Dividend Payments	0	177	295	322
Retained Earnings	-141	718	-1056	-1335
Average Number of Shares, Fully Diluted (m)	25979	26344	26800	26800
Adjusted Profit Per Share p. (Fully Diluted)	**-0.5**	**1.2**	**-2.1**	**-3.8**
Dividend Per Share p.	0.0	0.67	1.10	1.2