20 April 2005

Buy
157p

Target Price: 191p

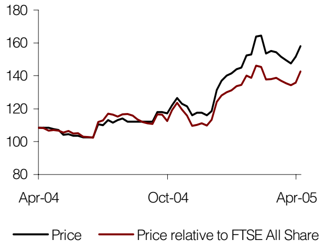
Lok'nStore

Initiating coverage

One To Lok Away

Market Capitalisation	£39.7m
Shares in issue	25.1m
Code	LOK.L
Index	Aim
Net assets (07/05)	£10.5m
Net debt (07/05)	£9.4m
Gearing	90%

Share Price



Source: Datastream

Recent results from Lok'nStore underline the considerable growth the company is achieving in its self-storage operations as the portfolio of stores matures. In addition, the independent revaluation undertaken in 2004 also underlined the long-term value creation, with a significant uplift in value being announced. This should not only enable greater financial flexibility, but also improves the ability to take advantage of what remains a fragmented and under-developed market. We believe this also questions the current valuation of the shares given the potential opportunity for the company to obtain planning permission on a number of sites, and increase value even further as a result. We initiate our coverage with a BUY recommendation and a target of 191p

Table 1.	Sales (£m)	PBT (£m)	EPS (p)	Tax (%)	DPS (p)	Net cash/ (debt) (£m)	PE
July 2004	6.61	(0.42)	(0.16)	-	-	(6.95)	-
July 2005F	7.74	(0.04)	(0.13)	-	-	(9.45)	-
July 2006F	8.51	(0.00)	(0.02)	-	-	(12.27)	-

Source: LoknStore/Numis Estimates

Interim Results. Turnover during the first six months to January 2005 rose strongly, up 24% on the first half of 2004. Operating profits of £0.3m were also announced compared to a loss of £0.1m, and customer numbers rose by 21.2% to almost 5,800. A significant increase in value of the property portfolio was also announced after an independent revaluation, and with planning permission for a high-density residential scheme at the Kingston site there should be a further premium above and beyond this new valuation figure.

Market Dynamics. The self-storage market remains one of the fastest growing sectors of real estate, though the concept in the UK is relatively new compared to markets such as the US. With above average growth in recent years, and increasing levels of both user acceptance and adoption shown by rising customer numbers, we believe that the opportunities for expansion in what remains an under developed market remain considerable.

Investment Case. With a flexible and proven model, we believe the underlying value creation aspect of successful use AND identification of underutilised sites is still to be fully recognised in the share price. With good cash generation and the potential for further corporate activity in the self-storage area as the market develops, we believe that the current level of the shares could offer significant upside. **BUY**.

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Company Snapshot

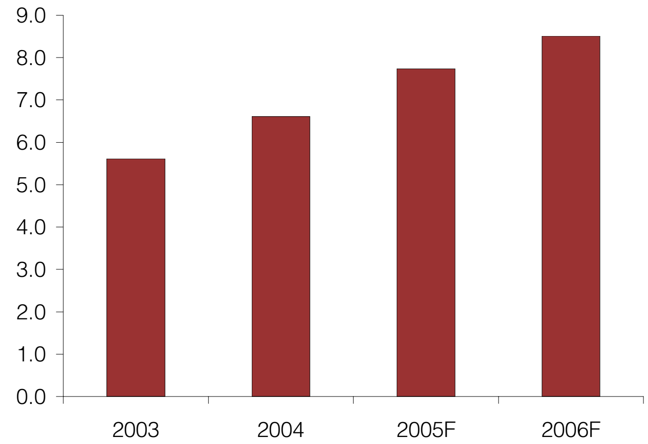
Type Of Business:

One of the leading self-storage businesses in the UK, with 19 sites centred mainly around South East England. The business offers secure, low cost and accessible do-it-yourself storage solutions over highly flexible periods. Customers range from individual householders (just over 50% of turnover), to small businesses, to retail multiples using numerous sites across the Group. The bulk of revenue generation comes from unit rental, though additional revenue is also produced through open storage, parking, container storage, and office rental. Storage revenue accounts for around 90% of total in any given period.

Website: www.loknstore.co.uk

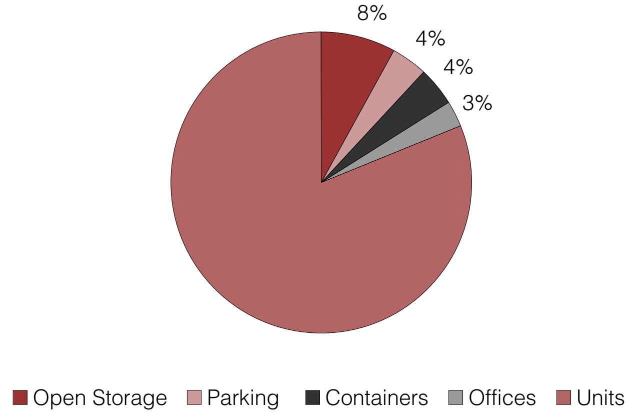
Company Statistics:

Chart 1 -Turnover (£m)



Source: Lok'nStore/Numis Estimates

Chart 2 - Revenue Split H1 2005



Source: Lok'nStore/Numis Estimates

Financial Summary:

Table 2. Year to July	Sales (£m)	Op Profit (£m)	Operating Margins (%)	EPS (p)	Net Cash/ (Debt) (£m)
2003	5.61	0.01	0.2	(1.57)	1.10
2004	6.61	0.12	1.8	(0.64)	(6.95)
2005 F	7.74	0.46	6.0	(0.13)	(9.45)
2006 F	8.51	0.60	7.0	(0.02)	(12.27)

Source: Lok'nStore/Numis Estimates

Management:

Chief Executive: Andrew Jacobs – established Lok'nStore in 1995 after a long career in the City.

Finance Director: Ray Davies – Joined Lok'nStore in 2004 having held a number of senior finance positions in the construction and Health & Fitness sector over the previous 20 years.

Chairman: Simon Thomas – Joined Lok'nStore in 1997 after a successful career in publishing and finance.

Newsflow:

12th April 2005: Interim Results – Turnover +24%, PBT £75,903 (from -£169,237), customers +21.2%, and properties revalued at £33.6m (+58%). *"Lok'nStore's market position, leading brand and increasing strength of our balance sheet demonstrates that we are well positioned to take advantage of this under-developed market."*

13th December 2004: Planning Permission – The company announces that planning permission has been granted for high density residential development at the Kingston operation extending its space by approximately 7,000 sq ft. *"The enhancement of the value of this property further strengthens our balance sheet and its realisation will provide increased firepower to continue to accelerate the growth of the operation."*

7th December 2004: Property Valuation – Lok'n Store announce its intention to undergo a valuation of the Company's property portfolio. This will include the freehold and leasehold properties, and will be announced with at the interim results in April 2005.

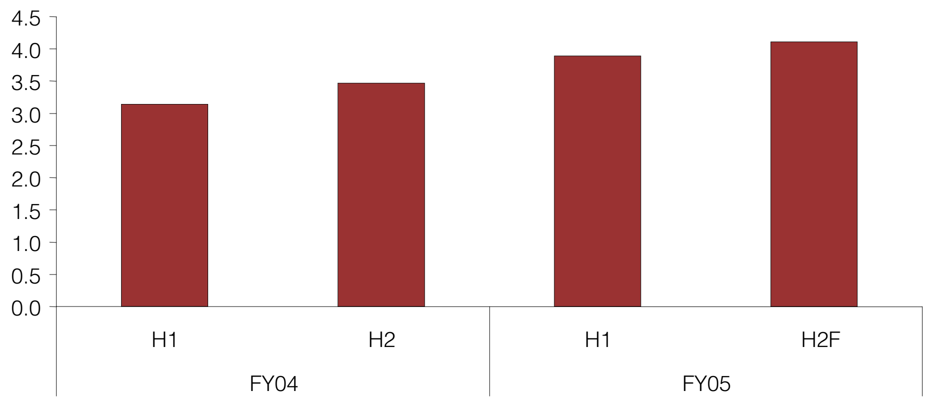
Interim Results

A significant position

We believe that interim results to January 2005 highlight the significant position that Lok'nStore has achieved through careful expansion of its storage operation. We believe that this position leaves it not only with a leading brand, but also with a balance sheet strong enough to take advantage of what could be a number of potential opportunities in the near future.

Turnover in the first six months was ahead by 24%, driven by increased occupancy from a rising number of customers, an increased conversion ratio of enquiries into customers (+2% to circa 60%), and the opening of additional stores. Most impressively, these customer numbers rose during the period by 21.2% to 5,790. Chart 3 shows the steady progress of turnover in recent years that underlines the ongoing growth and improvements.

Chart 3 - Turnover progress



Source: Numis

Losses improved to profits

Operating profit of £320,261 was announced compared to a loss of £131,827 for the comparable period, driven by the drop through of increased occupancy and a higher number of stores trading profitably compared to the previous year. This was achieved despite losses from the newly opened Tonbridge store (as is expected for a new store opening) of £124,296 during the first half period.

Cashflow improved

Cashflow improved significantly year-on-year, with a cash outflow of £153,667 during H1 compared to an outflow of £456,806 in 2004. This occurred despite rising capital expenditure of £804,751 vs. £614,827, leaves debt at the end of H1 at £7.1m, and produces gearing of 66%.

New external valuation

More importantly, an external valuation was prepared in respect of all trading freehold and leasehold properties, which indicated a new property valuation of £31.8m. This new figure (excluding the freehold site at Farnborough acquired in July 2004) represents a significant uplift on the previous valuation, an increase of 58.0%.

Lower gearing as a result

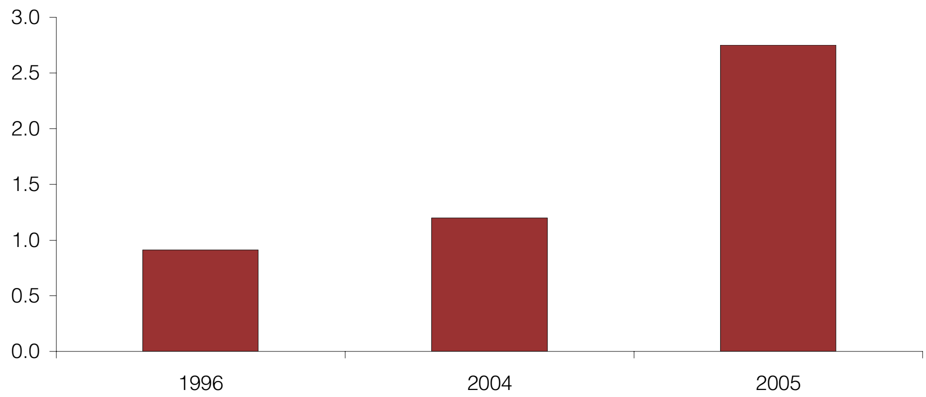
Using this new property valuation, gearing falls to a much lower level of 28%. This of course provides the Group with increased financial flexibility and increases its ability to borrow larger sums if necessary as the business grows. More importantly, we believe that the revaluation underlines both the business strategy and the creation of shareholder value in recent years as the portfolio has grown through purchases at sensible prices.

Planning permission for Kingston

In addition, planning permission had been granted for a high-density residential development at the Kingston operation, a development that we believe goes some way towards highlighting the full potential of the company. With a planning application currently under consideration for the Reading site on a similar basis, we are confident that such ongoing realisations of value could continue to be a feature of the Lok'nStore story.

Having purchase the Kingston site in 1996 for £905,000 and used it as part of the self-storage portfolio for 8 years, the site had a book value of £1.2m at 31.07.2004. The revaluation undertaken by Cushman Wakefield Healy & Baker as an operational self-storage site suggested a current valuation of £2.75m, and we would expect the approval of planning permission &/or development/sale of the site to increase this figure once again. We expect more news in due course. Chart 4 shows how this valuation has rise to date.

Chart 4 – increasing valuation of Kingston site (up to 31.01.2005)



Source: Numis

Outlook

With a start to the current year described by the company as "good", the outlook statement was both confident and suggestive of another year of good progress for Lok'nStore.

Background

19 centres well established

Lok'nStore opened its first self-storage centre in Horsham in February 1995. Since then it has grown rapidly to 19 centres based in the South of England (with a 20th planned for Autumn 2005), and has emerged as one of the leading self-storage companies in the UK. Chart 8 on page 9 shows the current locations of the store portfolio, and Table 6 on P14 the market position.

Rapidly rising number of customers

The company now has almost 5,800 customers (up +21.2% y-o-y), ranging from blue chip multinational businesses using multiple sites across the Group to individual household users. The service proposition aims to provide a wide offering of storage solutions ranging from steel storage units, pallet or open storage (available before space is converted to steel storage units generating a higher yield), to contract parking, and even small offices in some locations.

First bid approach….

The group floated on OFEX in April 1997, raising a total of £2.7m in two tranches before moving to AIM in June 2000. Lok'nStore received its first take over approach in 1999 from ACCESS Storage, which at the time was market leader. While this offer was deemed too low, ACCESS took a 29% stake in Lok'nStore as an investment in the business. In July 2002 ACCESS placed its stake, together with a fund raising of £10m.

Second….

In January 2004 the company received its second approach (suitor un-named) at 115p per share. This also failed, but occurred during a flurry of activity in the self-storage sector both Mentmore and Safestore acquired by private equity house Bridgepoint.

Group strategy has been consistent: to focus on maximising growth whilst maintaining as optimal a level of profitability as possible (or, as is the case in the early years, keeping losses as low as possible while occupancy levels increased).

The geographic focus of the group remains in the South-East of England, and we anticipate that the majority of acquisitions and new openings will continue in this area given the higher profile of self-storage here than any other area in the UK.

Steady increase in new outlets

The company has said in the past that it expects to increase the number of outlets by 2-4 units p.a. providing that new openings meet its valuation and location criteria. We expect that this number may vary depending on market conditions in any given year, though this appears to be a realistic average over the medium term.

Management and staff have owned a significant stake in the business since float, and account for 34.5% combined. Within this figure CEO Andrew Jacobs holds 21.2% and Simon Thomas 9.7% directly.

Stronger balance sheet from less activity

Having stepped back from the acquisition trail when expansion was at its peak amongst the quoted self-storage operators, the company resisted purchasing sites at levels it believed uncommercial. This has proved not only eminently sensible, but also resulted in a better balance sheet position than may have occurred otherwise, and in addition a greater uplift on revaluation than would probably have been the case.

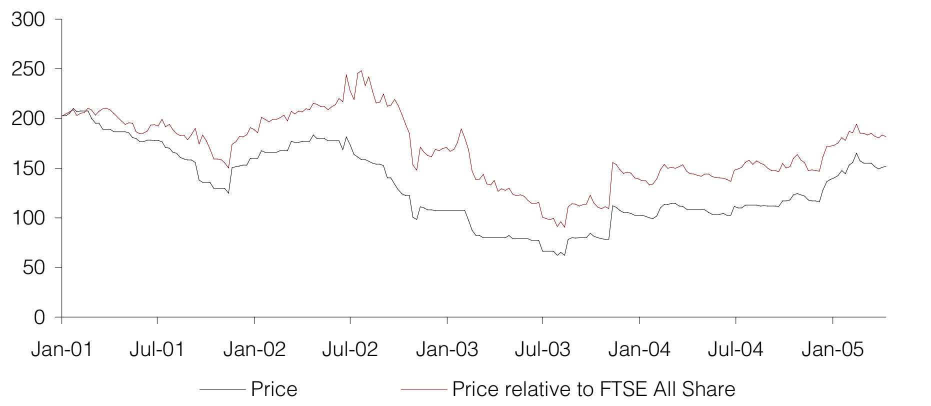
As a result of this careful but steady expansion, Lok'nStore has developed a strong position in the self-storage market, a market where growth has been estimated at 20% p.a. for the last five years. We expect a similar growth figure for a number of years to come. With a number of its sites maturing and producing increasing margins as they do so, the momentum of operating profits and earnings growth at existing stores should start to gather pace. As a result we believe this could be an interesting time to assess the shares.

Investment Case

Huge potential

We believe that Lok'nStore has the potential to become a highly profitable, strongly cash generative, above average earnings growth company. The company has a strong position in a structurally undersupplied market growing at 20% p.a. in which the business model is becoming rapidly proven. Chart 5 shows the share price performance of the group since it was admitted to AIM in 2000.This period includes a take-over approach the company received in 2004 at 115p, deemed too low by the management. This occurred during a flurry of corporate activity in the self-storage market backed by US private equity houses.

Chart 5 – Lok'nStore share price relative to FTSE All Share



Source: Datastream

Key Attractions

Strong growth market

Anecdotal evidence suggests that the UK self-storage market has been growing at circa 20% p.a. over the past couple of years, based on growth rates of the leading players in this space. We believe the market remains structurally undersupplied, and is still a fraction of the size of the US market that has been growing strongly and consistently over the past 30 years.

Lok'nStore is the fourth largest player in the UK market with 5% market share, and is the second largest quoted player behind Big Yellow Group. We see Lok'nStore as one of the key players in this market given its access to capital, with potential for significant margin and earnings growth as its outlets mature. We believe the concept of self-storage could show dramatic growth across a number of industries, and amongst consumers. This should ensure that the attractive growth rates delivered so far should be sustainable going forward.

Proven model

Lok'nStore operates a business model we believe is becoming rapidly proven, and has produced 9 years of uninterrupted revenue growth. We believe its low cost, flexible approach should put it in good stead for further growth in the future. The Lok'nStore model is less exposed to the consumer than some of its peers, which should not only enhance visibility levels, but also consistency levels given that business customers tend to have a higher average spend than consumers over a longer period of time.

We believe that expansion is likely to be done on an organic basis, and given the company has an excellent track record of selecting new sites through strict investment criteria this should continue to pay off.

Improving cash generation and returns

Outlets operating as part of Lok'nStore's estate for more than 250 weeks typically generate EBITDA margins in excess of 50% (53.6% according to the company at the interim results). We believe these returns are sustainable, with the company seeing no signs of slowdown in average customer spend across its mature sites. Expanding numbers of sites should also enhance returns over time as the company reaps the benefits of economies of scale as it grows in the South East.

However, it is important to note that the freehold/leasehold split here is influential on margins, and while a like-for-like comparison of same stores may show a further increase, an increasing number of leaseholds are expected to reduce this figure by the year-end. With two more leasehold sites by then over 250 weeks old and part of the calculation as a result (making the new split 7 freehold/4 leasehold), we expect margins to fall due to the greater proportional inclusion of sites paying a rental. Of course, with any future leasehold purchase and conversion to freehold, this picture improves.

The company is fundamentally cash generative, with customers typically paying a minimum of one month's rental in advance and every 28 days thereafter. The risk of bad debts is low, with no one customer accounting for more than 1% of turnover.

Asset play

The recent revaluation of its asset base indicated a new total property value of £31.8m, based on ongoing use as self-storage sites. This excludes the recently acquired Farnborough site (which has a current NBV of £1.8m) and represents a significant increase, being some 58.0% higher than that previously calculated.

The announcement of planning permission at Kingston, itself valued at £2.75m under the recent revaluation compared to £1.2m beforehand, should produce a further realisation of value. There have been suggestions that the site could now be worth as much as £10m, though this remains to be seen. Regardless, we believe it is a good example of the hidden value in its estate. We also believe it underlines how conservative even this new valuation could prove to be if other sites also obtain planning permission. With a planning application also submitted for the Reading site for a conversion to residential use, we believe that the ongoing potential for the creation of further value remains very good.

Corporate activity

The relative immaturity and growth potential of the UK self-storage sector has attracted interest from US private equity houses in recent years. This follows the purchases of Mentmore and Safestore during the past 18 months, with Lok'nStore itself facing a bid last year (November). However, the fact that the management team has a large stake in the business means that their interests should be more aligned with shareholders, which we view as encouraging should any further approaches be made.

REITs

In addition, further potential activity in the market on the back of UK adoption of REITs (Real Estate Investment Trusts) could also increase the attraction of the company to investors given the effect this had on companies with an extensive property base in other European markets (notably in France) and on the value realisation which was possible as a result. While we are not suggesting that Lok'nStore is about to convert to a REIT, any activity elsewhere would of course be reflected accordingly.

Business Model

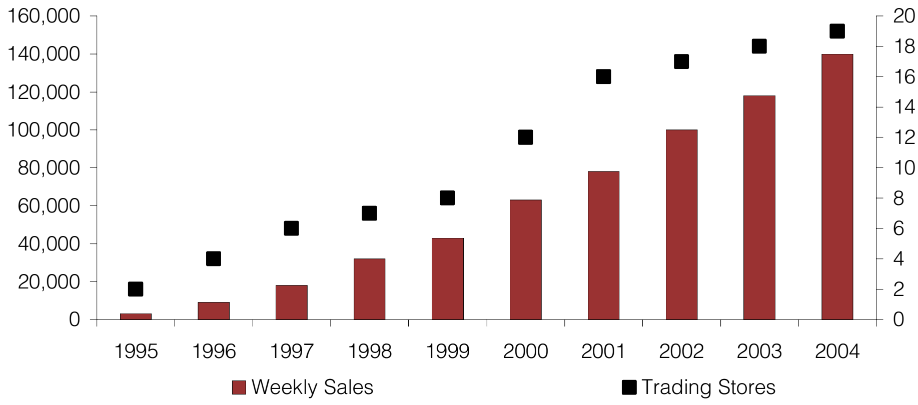
A low cost flexible model

The Lok'nStore business model is a low-cost flexible approach, which enables it to specialise in timely and cashflow-effective fit outs. This approach has enabled it to keep operating costs to a minimum, while also reducing the demand on cash as space is fitted out in stages as demand increases.

As the Group expands and further stores are opened, this costs base is of course spread over a wider area, and items such as marketing costs can also be used more effectively (e.g. *Yellow Pages* ads covering two stores within an area rather than one, etc.).

Chart 6 shows the impressive long-term track record of the company over a 9-year period.

Chart 6 - Growth in sales and stores chart (July 2004)



Source: Lok'nStore

19 existing outlets

The current estate consists of 19 existing outlets, plus a site at Farnborough planned to open in autumn 2005.Table 3 shows a break down of the company's total lettable space by age of store. During the course of the year total area let increased by 21.6% to 489,123 sq.ft. Changes within the portfolio include Poole moving to over 250 weeks during the period, with Luton now moving to over 100 weeks. The data clearly shows that some of the mature sites are able to generate high EBITDA margins as they reach full capacity, and develop an established customer base.

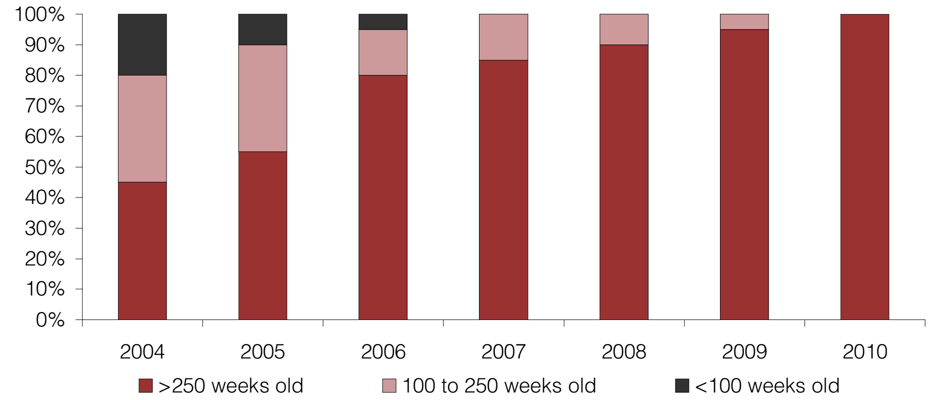
Table 3. Operating Performance of Stores

January 2005 Stores	>250 weeks old	100 to 250 weeks old	<100 weeks old
No of Stores	9	8	2
Maximum Lettable Area '000 sq.ft	370	342	80
Maximum Lettable Area % Occupancy	67	52	30
Sales £'000	2,003	1,600	187
EBITDA £'000	1,074	271	(112)
EBITDA Margins (%)	*53.6*	*16.9*	*(59.6)*

Source: Lok'nStore

Chart 7 shows the age profile of existing Lok'nStore outlets through to 2010, which could alone lead to a significant increase in margins, as well as a material uplift in EBITDA and EPS growth.

Chart 7 - Age profile of existing Lok'nStore centres

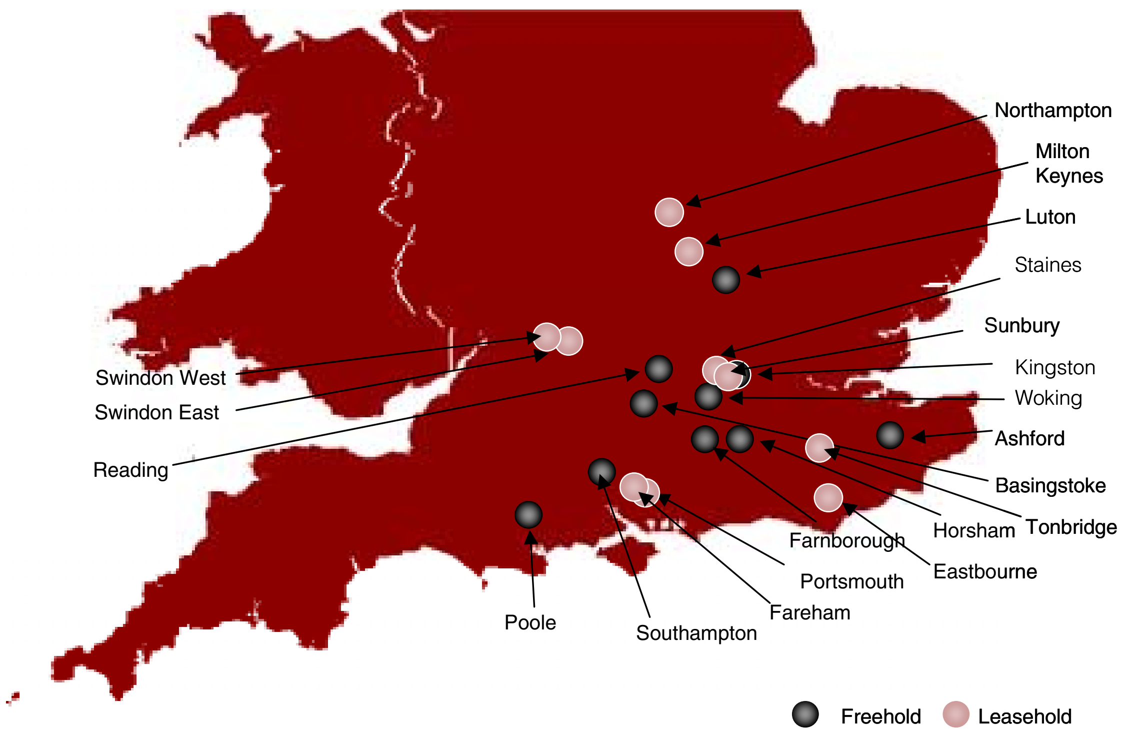


Source: Lok'nStore

Southern bias

As shown by Chart 8, the current sites are based mainly around London and the South East. The rationale behind this is that not only are these chosen locations more affluent (therefore producing higher than average spend), but they should also attract businesses targeting the more densely populated areas of the country. In addition, we believe self-storage has a higher profile in the South than anywhere else in the country at present given the need for additional space of many householders.

Chart 8 – Store Locations

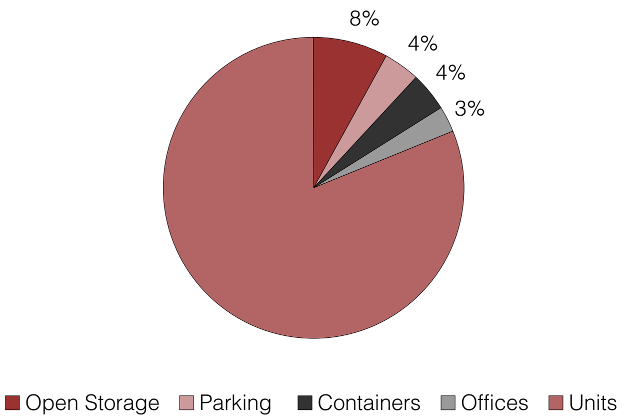


Source: Lok'nStore

Revenue split

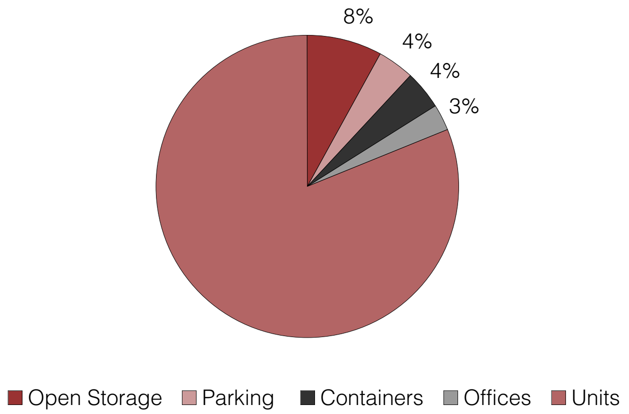
The current revenue split of the Group is 53/47 household/business (Chart 10, though by number of users this is 70/30), which compares well to other operators who tend to be more household biased. As you can see from Chart 9, storage accounts for nearly 91% of total revenues (unit + open storage).

Chart 9 - 2005 Lettings Revenue



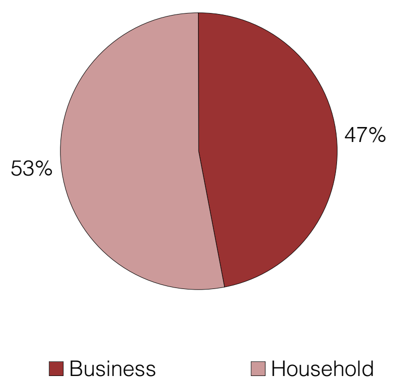
Source: Lok'nStore

2004 Lettings Revenue



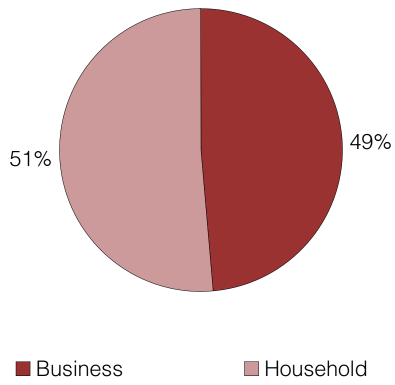
Source: Lok'nStore

Chart 10 - 2005 Business to Household Split by Revenue



Source: Lok'nStore

2004 Business to Household Split by Revenue



Source: Lok'nStore

Longer term from business users

Business users tend to use self-storage facilities for a longer period of time, and we believe tend to spend 3x more than individual users over the course of a rental. In the year to July 2004, average spend per business customer was £2,076 vs. £676 for the average household customer.

Table 4. Average Rate of Stay

	Average Weekly Rate (£)	Average Length of Stay (Weeks)	Average Total Value (£)
Business			
Active	33.05	73.98	2,445.21
Vacated	41.35	37.68	1,558.01
Total	**37.20**	**55.81**	**2,076.48**
Household			
Active	18.23	49.57	903.86
Vacated	22.05	23.50	5,186.19
Total	**20.71**	**32.63**	**675.94**
All customers			
Active	23.27	57.76	1,343.81
Vacated	25.30	26.94	681.56
Total	**24.82**	**34.15**	**847.75**

Source: Lok'nStore

An even freehold/leasehold split

The split between freehold and leaseholds is fairly even. This helps the company to adopt a flexible approach, allowing it to expand the number of its outlets and drive returns as quickly as possible, while maximising the value of the sites over the longer term.

The company has also indicated that it will continue where possible to acquire the freeholds on leasehold stores, which provides the flexibility and security of owning a freehold with the initial cash flow advantages of owning leasehold assets. At present, there is an even split between the two, though we anticipate that this could change over time.

Table 5. Stores Snapshot

Freehold	Leasehold
Horsham	Staines
Kingston	Swindon West
Woking	Fareham
Reading	Swindon East
Basingstoke	Northampton
Southampton	Milton Keynes
Ashford	Sunbury
Luton	Portsmouth
Poole	Eastbourne
Farnborough*	Tonbridge

**Farnborough under development*

Source: Lok'nStore

Expanding portfolio

We expect the company to add more sites to its portfolio as the year unfolds given the 2-4 new openings per year in recent years. With strict investment criteria driven primarily by rate of return, site location and visibility, we believe the company prefers an organic rollout, as it is able to fully control the cost per square foot and the utilisation of space.

Overall, despite some concerns from a cooling housing market that in past periods have influenced sentiment towards storage businesses (less housing moves, etc.), we believe Lok'nStore's proven model and higher exposure to business customers should leave it more resilient than some of its competitors. We expect the rollout of new outlets to continue, and see the group well placed to deliver significant growth over the coming years.

This looks especially evident where the potential to acquire freeholds exists given the recent announcement regarding the Kingston site planning permission and subsequent increased in value.

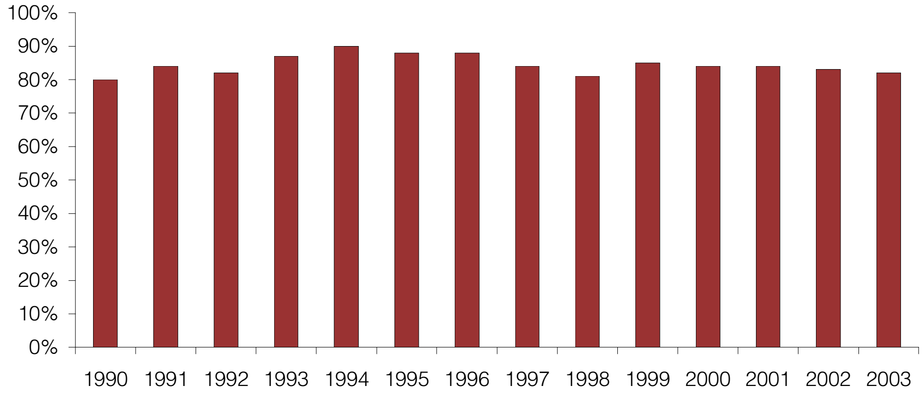
Market Dynamics

Background

One of the fastest growing sectors

The self-storage market is one of the fastest growing sectors of real estate development in the US. This is a concept that has been established for more than 30 years and comprises an estimated 40,000 properties with average occupancy levels approaching 85% according to recent industry estimates. The long-term track record of occupancy levels in the US self-storage market has been stable over a period of time covering more than one economic cycle, as illustrated in chart 11.

Chart 11 – US Occupancy Levels (%)



Source: Lok'nStore/Numis

Early stages of development

The market in the UK remains in the early stages of development with just 400 facilities, and remains fragmented despite the rapid growth of the top five players in recent years. Currently, we believe the largest 5 players control circa 45% of the market.

Lok'nStore believes that the UK market could support at least 1,500 sites, which can be justified comparing usage levels in the US. The US market caters for 4.33 sq ft of self-storage per capita, whereas the UK caters for just 0.26 sq ft per capita.

What is self-storage?

A DIY concept

The concept of self-storage is used to describe facilities that offer do-it-yourself storage space for individuals and businesses to rent on a monthly or longer-term basis. A user typically rents a secure room of a pre-determined size for a pre-determined period of time, paying an initial 4 weeks security deposit (returned on vacation), a month's rental in advance, then every 28 days after that.

Good cashflows

As a result, cashflow is normally very good and bad debts low, with the operator retaining rights over the goods in storage in lieu of any unpaid rent, and having the ability to lock units and prevent removal of goods if rent goes unpaid.

Each customer has their own key and is able to keep it with them at all times in order to come and go as they please to access their storage unit. Their rights and belongings are protected by a rental agreement provided by the self-storage operator, and most facilities feature heightened security including coded access gates and video surveillance.

Who uses self-storage?

The users of self-storage vary from individuals to large blue-chip organisations.

Business users

For businesses examples of usage for self-storage space can also vary significantly, but typically include:

- Retailers storing stock and shop fittings.
- Sales representatives storing stock, samples and display aids.
- The storage of excess items owned by Councils, Hospitals, Universities and the Police.
- Manufacturers storing stock, machinery and raw materials.
- Removal companies.
- Archiving of general office documents that needs to be stored in hard copy format for a period of time.

Private users

Typical examples of consumers using self-storage include:

- Those moving house.
- Those de-cluttering houses to get a quicker sale/higher price during the sale process.
- Those creating more space at home, often as families expand.
- Students storing possessions over the holidays.
- Storing bulky sports equipment, hard tops for sports cars, etc.
- Those in the process of/recently divorced.
- Those storing personal belongings for an extended period of time e.g. those posted overseas for a period, travellers on world trips, etc..

Growth Drivers

Ongoing need for storage

Due to the high cost of land and density of population, we believe that there is an ongoing need for self-storage in the UK, and we expect recent growth levels to be sustained over the medium term. Given the immaturity of this industry, it is difficult to find a definitive figure for market growth, though anecdotal evidence from some of the larger players suggest that the market has been growing at c20% p.a. over the past couple of years.

US a comparable?

Using the US market as an example suggests that the scope for growth in the UK and Continental European market remains significant. To place this into context, there are 280 million people in the US served by an estimated 40,000 storage facilities compared to Europe where 350m people are currently served by fewer than 400 storage facilities. We believe the US industry remains in excess of 100x times larger than that in the UK.

Other growth drivers

Other growth drivers in this industry include an active housing market, changing demographic factors, increasing divorce levels, and increasing population mobility. Clearly, an underdeveloped market could result in further consolidation in the sector given the economies of scale possible, though this fragmentation could of course also give opportunity for significant growth for some of the larger players in the market.

In addition, ever improving familiarity with self-storage should continue as big players expand and brand profiles increase.

Market Positioning

Well-positioned in UK & Europe

Table 6 illustrates the largest players in the UK and European market, and by most industry standards this remains a fragmented market. In the UK, we believe the top five players control around 45% of the market. Beyond this operators tend to run 1-5 sites, which gives obvious scope for consolidation for the larger players.

Table 6.

Position	Company	UK Sites	Total in Europe (incl UK)
1	Shurgard	16	130
2	Safestore	69	74
3	Precis/Access	44	44
4	Big Yellow	31	31
5	City Shelf-Storage	0	26
6	**Lok'nStore**	19	19
7	City Box	0	12
8	Keepsafe	8	8
9	Space Maker	6	6

Source: www.askactive.com

Following the sale of Safestore and Mentmore to US private equity house Bridgepoint, the only other quoted player in the UK apart from Lok'nStore is Big Yellow (BYG.L). Interestingly, Big Yellow has just been reclassified from Support Services to the Real Estate sector. We suspect this is to encourage the City to value the business on net asset value as opposed to underlying cash flows, and underlines the NAV story.

Forecasts & Valuation

While first half figures were ahead of most expectations with the announcement of a pre-tax profit for the first time, we assume a small loss for the current year to July given our expectation for H2 bonuses resulting in higher operating expenses during the second half of the year.

Our top line assumption of 17% growth y-o-y assumes some H2 slowdown in the rate of growth given the 24% achieved H1, though still comfortably ahead of last year and assumes another period of half-on-half growth. We conservatively forecast top line growth of 10% for the year to July 2006.

We also anticipate that operating margins will continue to rise, to 6% for the current year followed by 7% in 2006. With capital expenditure during 2005 and 2006 influenced by the opening of the Farnborough site later this year (albeit much of the fit-out cost rolling over into 2006), we anticipate rising debt this year (and an associated increase in the interest charge as a result), forecasting some £9.5m by the year-end. We assume 2006 will see a further outflow of cash, though have factored in no freehold purchases that could of course occur, or any further site purchases.

To value the shares we have looked at a range of different alternatives, and while we believe that there is little to favour one method over another the conclusion is the same – that the shares are undervalued.

With corporate action a feature of the sector in recent years (with the take-overs of Mentmore, Safestore), we believe that the growth potential in a market that remains under-developed may produce further activity. While Lok'nStore has already received two approaches, the fact that management and staff control 34.5% of the equity will of course be a swaying factor in determining whether any deal may be done, which in almost all cases results in a healthy premium. With the most recent transaction being that for Mentmore at a value of circa £80 per sq ft, this suggests a valuation for Lok'nStore in the region of £67.2m, or 245p per share. However, property valuations have risen somewhat since the Mentmore deal, and on this basis the valuation could be even higher.

With a number of investors looking at self-storage as property plays (and indeed, closest quoted UK comparison Big Yellow recently reclassified into the Property Sector), NAV may be more important. While Big Yellow had an NAV figure of 175p as of Nov 2004 (compared to its share price now of 203p now, a 16% premium to NAV), Lok'nStore's NAV at the last results (including revaluation) was 103p. This figure included no increase in valuation as a result of the Kingston planning permission, an event that could add as much as a further 40p per share to NAV. Assuming this NAV *could* be 143p as a result, leaves the shares standing at a 9% premium (at 157p), albeit that Big Yellow's premium may be influence by a higher percentage of freehold sites than Lok'nStore. This also takes no account of the impact on NAV of further freehold purchases &/or planning permission for existing sites.

Traditional PE valuations appear little use at present given the ongoing rollout of stores and the start-up losses incurred as a result (e.g. Tonbridge lost £124,296 during H1 in its first 5 months since opening), though the impact of running the 20 stores in operation by the end of the current calendar year to maturity (i.e. in excess of 250 weeks of operation) would give a fairer picture. If this were the case, extrapolation of the current results for stores over 250 weeks old suggest operating margins for the Group in excess of 50% (H1 margin on mature sites 53.6%), albeit that occupancy for the 9 stores in question has been running at 67% compared to over 80% in the US where the industry is significantly better established.

Assuming no further uplift in sales (unlikely, even if only inflation adjusted) & assuming 840,000 sq.ft., produces eps of 12.7p on a fully charged basis. While this is unlikely to happen given the organic roll out and attempts for planning permission on a number of sites, it does highlight that that a current PE of 12.3x on this basis remains a sub-market valuation for an above market margin/growth position.

However, we believe a more simple comparison tells a more obvious story. With 32 stores as of January's trading statement and 1.91m sq.ft, Big Yellow has a current EV in the region of £289m (at 203p). This values each Big Yellow store at an average **£9.1m** for an average 60,000 sq.ft, with occupancy at 74%. A similar comparison with Lok'nStore shows 20 stores with 840,000 sq.ft, valued at £46m EV (at 157p). This values each Lok'nStore store at an average **£2.3m** for 42,000 sq.ft., albeit with a lower occupancy of 54%. Clearly, a huge disparity between ratings that we believe looks too wide to be explained by company size alone.

We initiate with a target price of 191p, being the lower of a rating of 15x mature store earnings (of 12.7p, which = 191p) and an increase in the valuation of each sq.ft. of space to equate to 50% of Big Yellow's sq.ft. valuation of £151,600 (we choose 50% as a conservative figure). Applying this valuation to Lok'nStore - at £75,000 sq.ft instead of £55,800 - would produce a share price circa 223p. Significantly higher.

We initiate with a **BUY** recommendation.

Table 7. Profit and loss

	2003	2004	2005F	2006F
Turnover:				
Continuing Operations	5.61	6.61	7.74	8.51
growth (%)		*17.8*	*17.0*	*10.0*
Total Turnover	**5.61**	**6.61**	**7.74**	**8.51**
growth (%)		*17.8*	*17.0*	*10.0*
Operating Expenses	(5.60)	(6.49)	(7.27)	(7.91)
Exceptional Item				
Operating Profit	**0.01**	**0.12**	**0.46**	**0.60**
margin (%)	*0.2*	*1.8*	*6.0*	*7.0*
Loss on FA Disposal	(0.40)	(0.00)		
Interest	(0.04)	(0.16)	(0.50)	(0.60)
Profit Before Tax	**(0.03)**	**(0.04)**	**(0.04)**	**(0.00)**
Tax	-	-	-	-
Dividends	-	-	-	-
Retained Profit	**(0.03)**	**(0.04)**	**(0.04)**	**(0.00)**

Source: Company data / Numis Securities

Table 8. Cashflow

	2003	2004	2005F	2006F
Operating Profit before interest	0.0	(0.0)	0.5	0.6
Depreciation	0.6	0.7	0.8	0.9
Amortisation	0.0	0.0	0.0	0.0
(Profit)/Loss on sale of fixed assets				
EBITDA	**0.7**	**0.7**	**1.2**	**1.5**
Working Capital	(0.4)	0.3	0.3	0.3
Other	(0.0)			
Operating Cash Flow	**0.29**	**0.93**		**1.8**
Net Interest	(0.0)	(0.1)	(0.5)	(0.6)
Tax Paid			-	-
Gross Cash Flow	**0.3**	**0.8**	**(0.5)**	**1.2**
Cap Expenditure & Invt	(1.3)	(5.4)	(2.0)	(4.0)
Free Cash Flow	**(1.0)**	**(4.6)**	**(2.5)**	**(2.8)**
Acquisitions (net of debt)				
Dividends				
Equity	(0.9)	(3.4)		
Financing	0.0	0.0		
Currency Translation				
Other				
Net Debt Movement	**(1.9)**	**(8.0)**	**(2.5)**	**(2.8)**
Opening net debt	3.0	1.1	(6.9)	(9.4)
Change over year	(1.9)	(8.0)	(2.5)	(2.8)
Closing net debt	**1.1**	**(6.9)**	**(9.4)**	**(12.3)**

Source: Company data / Numis Securities

Note: The main sources of this research note are the interim results and last full year accounts.