

# Lookers

FY16 results

## Strategy for driving growth

Lookers continued its impressive development in FY16, delivering yet another record performance. The buoyancy of the UK car market combined with the disposal of the parts distribution business enabled management to further its consolidate and build strategy. The addition of Warwick Holdings and Knights North West are further positive developments, with more acquisitions likely during 2017 adding to organic progression.

| Year end | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | Yield (%) |
|----------|--------------|-----------|----------|---------|---------|-----------|
| 12/15    | 3,430        | 59.6      | 12.61    | 3.12    | 9.7     | 2.6       |
| 12/16    | 4,088        | 64.9      | 13.00    | 3.64    | 9.4     | 3.0       |
| 12/17e   | 4,700        | 76.0      | 15.42    | 3.82    | 7.9     | 3.1       |
| 12/18e   | 4,900        | 78.5      | 15.92    | 4.00    | 7.7     | 3.3       |

Note: \*Continuing PBT and EPS are normalised and fully diluted, before intangibles amortisation, debt issue costs and exceptional items.

## Delivering a more focused retail growth strategy

The disposal of the highly profitable parts distribution business, for an offer management say could not be refused, requires the successful car retail business to step up and drive growth, returns and cash flow. In FY16 Lookers delivered another record performance overall, but 16% of total pre-tax profit has now departed. Full year contributions from the two recent acquisitions should help to fill the gap, but the ongoing activities also need to continue to generate solid like-for-like growth to deliver guidance of higher earnings this year. The SMMT forecast for a 5% decline in new car sales is yet to be reflected in year-to-date demand, with two months sales growing 1.8%. Lookers' order book cover for March is better than in 2016 on higher budgeted sales. Combined with more favourable economic projections for the UK economy in recent weeks, management's view of a flat new car market this year is credible. With used car sales and aftermarket services aided by one- to three-year-old car parc expansion and the increased penetration of personal contract plans (PCPs), the prospects for FY17 start to look increasingly bright.

## Balance sheet supports further investment

The disposal in November of the parts distribution business for £126m has more than funded the two FY16 acquisitions, which cost a total of £92.6m. These, combined with the strong operational cash performance, resulted in net debt at the year-end of £74.1m. With net debt to EBITDA of 0.69x for 2016 (FY15 1.61x), significant financial firepower remains both to support organic investment and to pursue other M&A opportunities as they arise.

## Valuation: Market concerns

The major question for investors is whether the market can support continuing growth by the auto retailers. With Q1 looking to be pulling forward new car sales due to the vehicle excise duty reforms from 1 April 2017, year to date figures are at odds with forecasts for a current year decline in sales. The multiple contraction this has initiated appears overly conservative in light of Lookers' performance over the current cycle, and the potential for continued growth in a challenging year.

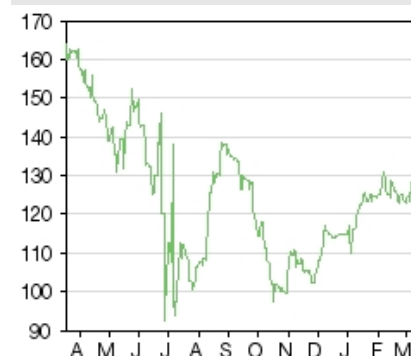
## Automobiles & parts

16 March 2017

**Price** 122p  
**Market cap** £482m

|                                   |        |
|-----------------------------------|--------|
| Net debt (£m) at 31 December 2016 | 74.1   |
| Shares in issue                   | 396.5m |
| Free float                        | 80%    |
| Code                              | LOOK   |
| Primary exchange                  | LSE    |
| Secondary exchange                | N/A    |

## Share price performance



| %                | 1m     | 3m    | 12m    |
|------------------|--------|-------|--------|
| Abs              | (5.1)  | 6.1   | (26.4) |
| Rel (local)      | (5.9)  | 0.5   | (38.2) |
| 52-week high/low | 166.7p | 92.5p |        |

## Business description

Lookers is the second largest UK motor vehicle retailer, with its new car operations supported by the strength of used and aftersales activities. It now operates 160 franchises, representing 33 marques spread across the UK, with strong regional presences in Northern Ireland, Scotland, the South East and across Northern England.

## Next events

|                 |                 |
|-----------------|-----------------|
| AGM             | Late May 2017   |
| Interim results | Mid-August 2017 |

## Analysts

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## Investment summary

### Company description: Leading motor retailer

Lookers is the second largest UK franchised motor distribution group, selling over 210,000 new and used cars and vans. It continues to grow ahead of the UK new car market, with its share rising to 5.5% in FY16 (FY15 4.7%). It has been built by a combination of organic growth and acquisitions, delivering an impressive and consistent trading record over many years. It has strong relationships with its OEM partners and has established a number of key geographical sales territories, from which the group can generate consistent and growing returns. There are key regional presences in Northern Ireland, Scotland, the South-East and across northern England. In addition to new car sales, Lookers operates a growing used vehicle and aftermarket business (servicing, repairs and the provision of franchised parts) in its franchised dealerships, which together contribute 60% of ongoing operating profits. It sold its part distribution operations in November 2016 for £126m.

### Valuation: Multiple contraction may prove overdone

The UK motor retailing subsector has seen multiples contract sharply since the Brexit decision. Given historical cyclicalities this is perhaps unsurprising, but the real questions of whether a downturn is imminent and how severe that will be are yet to be determined. Lookers has underperformed the car retail segment over the last year, which we suspect is largely the result of the dilutive disposal of the parts business. We feel guidance for growth and the ability to invest in organic and M&A growth is not currently reflected in Lookers' rating. With the multiple contraction likely to unwind should sector performance prove to be more resilient than reflected in current ratings, the 35% 2017 P/E discount to the FTSE All-Share General Retailers Index should start to close.

### Financials

- Underlying pre-tax profits rose by 7% to £77.1m in FY16, modestly ahead of market expectations, although slightly below our own. Adjusted EPS rose 4% with the full year dividend increased 17%. Guidance for 2017 year is refreshing despite caution surrounding the sector due to uncertainty arising from Brexit influences. In contrast to the SMMT, Lookers expects a robust new car market this year and says it is ideally positioned to grow and increase earnings.
- Net debt fell by 54% to £74.1m (FY15 £161.7m), mainly reflecting the disposal of the parts distribution business and despite the partial reinvestment in the two new acquisitions.

We have marginally reduced our EPS estimate by 3% for FY17 and publish FY18 estimates:

| <b>Exhibit 1: Estimate changes</b> |                                  |       |        |                   |      |        |             |       |        |
|------------------------------------|----------------------------------|-------|--------|-------------------|------|--------|-------------|-------|--------|
|                                    | Adjusted EPS (fully diluted) (p) |       |        | Adjusted PBT (£m) |      |        | EBITDA (£m) |       |        |
|                                    | Old                              | New   | % chg. | Old               | New  | % chg. | Old         | New   | % chg. |
| 2016*                              | 15.90                            | 15.55 | -2.2%  | 78.0              | 77.1 | -1.2%  | 113.0       | 113.2 | +0.2%  |
| 2017e                              | 15.90                            | 15.42 | -3.0%  | 78.0              | 76.0 | -2.6%  | 113.5       | 112.0 | -1.34% |
| 2018e                              | N/A                              | 15.92 |        | N/A               | 78.0 |        | N/A         | 114.6 |        |

Source: Lookers, Edison Investment Research. Note: \*Includes discontinued businesses for comparison.

### Sensitivities: Exposure to UK consumer confidence

In theory, motor retailers would be expected to see their fortunes fluctuate with shifts in consumer confidence. In practice, the market has been remarkably resilient, with its highly fragmented nature enabling the leading operators to respond effectively to predictable challenges. The UK new car market is mature; it recorded new vehicle registrations in 2016 above the 2003 sales peak. Market

consolidation introduces an element of execution risk. However, there is more to motor retailing than new car sales: used car and aftermarket operations often experience different cycles.

## Maintaining the record performance

In FY16 Lookers continued to evolve its strategy, increasing the focus on organic development of its dealership network combined with value-added acquisitions to extend the geographic reach and brand portfolio, enhancing shareholder value. Helping to facilitate this, it completed the sale of its specialist, high-margin automotive parts distribution business on 4 November for a cash consideration of £126m, representing a multiple of 10x FY15 operating profit.

The proceeds enabled management to pursue its consolidate and build strategy. To this end Warwick Holdings Ltd, a West Midlands based Mercedes-Benz and Smart dealership group, which trades as Drayton Motors at seven locations, was purchased for £56.3m on the same day. A further £26.6m was invested in Knights North West Limited, which added another seven Mercedes-Benz and Smart dealerships as well as three BMW and three MINI dealerships. Ten underperforming dealerships were disposed of during 2016, with more optimisation of the portfolio expected this year.

| <b>Exhibit 2: Preliminary results</b>  |                  |                  |                  |                             |
|--|------------------|------------------|------------------|-----------------------------|
| <b>Year end 31 December</b>  | <b>2014 (£m)</b> | <b>2015 (£m)</b> | <b>2016 (£m)</b> | <b>2016/2015 change (%)</b> |
| <u>Revenue</u>   |                  |                  |                  |                             |
| New cars   | 1,476.5          | 1,835.3          | 2,206.1          | 20%                         |
| Used cars  | 1,008.5          | 1,212.1          | 1,437.2          | 19%                         |
| Aftermarket  | 352.4            | 382.9            | 444.9            | 16%                         |
| <b>Motor division</b>  | <b>2,837.4</b>   | <b>3,430.3</b>   | <b>4,088.2</b>   | <b>19%</b>                  |
| Parts division – discontinued*   | 205.5            | 218.8            | 193.5            | -12%                        |
| <b>Group revenues</b>  | <b>3,042.9</b>   | <b>3,649.1</b>   | <b>4,281.7</b>   | <b>17%</b>                  |
| <u>Operating profit</u>  |                  |                  |                  |                             |
| <b>Motor division</b>  | <b>67.0</b>      | <b>74.9</b>      | <b>82.6</b>      | <b>10%</b>                  |
| Parts division – discontinued*   | 12.2             | 12.6             | 12.1             | -4%                         |
| Operating profit before unallocated costs  | 79.2             | 87.5             | 94.7             | 8%                          |
| Unallocated costs  | (2.6)            | (1.6)            | 0.0              |                             |
| <b>Group operating profit</b>  | <b>76.6</b>      | <b>85.9</b>      | <b>94.7</b>      | <b>10%</b>                  |
| <u>Adjusted pre-tax profit</u>   |                  |                  |                  |                             |
| Motor division   | 58.3             | 64.5             | 69.2             | 7%                          |
| Parts *  | 12.2             | 12.6             | 12.1             | -4%                         |
| Pre-tax profit reported  | 70.5             | 77.1             | 81.3             |                             |
| Adjustments  | (5.5)            | (5.0)            | (4.2)            |                             |
| <b>Normalised profit before tax</b>  | <b>65.0</b>      | <b>72.1</b>      | <b>77.1</b>      | <b>7%</b>                   |
| Gross margin continuing division – discontinued activities   |                  | 11.4             | 11.0             |                             |
| Gross margin – group (%)   | 13.0             | 12.4             | 11.8             |                             |
| Gross margin – continuing activities   |                  | 2.1              | 2.0              |                             |
| Operating margin – group (%)   | 2.5              | 2.4              | 2.2              |                             |
| Source: Lookers trading statement. Note: *10 months of trading in FY16, sold on 4 November 2016. Before intangibles amortisation, debt issue costs, pension costs and exceptional items. |                  |                  |                  |                             |

In terms of the trading performance for the ongoing business, FY16 was another successful year for the company. Lookers performed strongly once again, taking full advantage of a robust trading environment, and achieving record profitability for the eighth straight year. Revenues rose by 17% to £4.3bn, with 8% like-for-like growth further boosted by acquisitions' contributions from a full year of Benfield and the two Q416 acquisitions. Gross margins slipped back from 12.4% to 11.8%, largely as a result of the mix of business shifting further towards vehicle sales and exacerbated by the shorter period of consolidation of the parts business. Gross margin for the continuing Motor division activities was 11.0% compared to 11.4%. Operating margins for the continuing business edged slightly lower, but remained healthy at 2.0% (2.1% 2015), while there was a similar impact on continuing adjusted pre-tax margins, down from 1.6% to 1.5%; these margin movements

continued the recent trend, stemming from a more competitive new car market and the improved availability of used cars up to three years old. Underlying pre-tax profits rose by 7% to £77.1m from £72.1m, slightly below our £78m estimate. Adjusted diluted EPS rose by 4.5% to 15.55p (FY15 14.88p). The dividend was raised 17% to 3.64p, soundly covered 4.4x by adjusted earnings.

## Motor division makes strong progress

Following the disposal of the parts distribution business, the Motor division now accounts for all of the continuing group activity. It now consists of 160 franchised dealerships operating from 102 locations across the UK and Ireland and representing 33 brands. In FY16, revenues rose by 19% to £4.09bn, with pre-tax profits up 7% to £69.2m. Market conditions remained favourable throughout the period, although there was a clear slowdown in retail demand during H2. However, with continuing strong support from the OEMs, UK new car registrations are forecast to rise by 2.3% to 2.69m, with most of the growth arising in the fleet segment. As always, statistics on used car transactions are less easy to calculate; the consensus view in the motor market is that volumes rose modestly. There was a further small recovery in the parc of vehicles up to three years old, suggesting improved conditions for aftermarket sales.

### Exhibit 3: Lookers divisional analysis

| Division                          | Turnover (£m)               |              |            | Gross profit (£m)               |            |            | Gross margin (%)               |              |            |
|-----------------------------------|-----------------------------|--------------|------------|---------------------------------|------------|------------|--------------------------------|--------------|------------|
|                                   | 2015                        | 2016         | % change   | 2015                            | 2016       | % change   | 2015                           | 2016         | change bps |
| New cars                          | 1,835                       | 2,206        | 20%        | 145                             | 161        | 11%        | 7.9%                           | 7.3%         | -60        |
| Used cars                         | 1,212                       | 1,437        | 19%        | 90                              | 105        | 17%        | 7.4%                           | 7.3%         | -12        |
| Aftersales                        | 319                         | 365          | 14%        | 141                             | 166        | 18%        | 44.2%                          | 45.5%        | 128        |
| Leasing & other                   | 64                          | 80           | 25%        | 14                              | 17         | 21%        | 21.9%                          | 21.3%        | -63        |
| <b>Group – continuing</b>         | <b>3,430</b>                | <b>4,088</b> | <b>19%</b> | <b>390</b>                      | <b>449</b> | <b>15%</b> | <b>11.4%</b>                   | <b>11.0%</b> | <b>-39</b> |
| Parts division – discontinued     | 219                         | 193          | -12%       | 62                              | 55         | -11%       | 28.3%                          | 28.5%        | 19         |
| Group                             | 3,649                       | 4,281        | 17%        | 452                             | 504        | 12%        | 12.4%                          | 11.8%        | -61        |
| Division                          | Like-for-like turnover (£m) |              |            | Like-for-like gross profit (£m) |            |            | Like-for-like gross margin (%) |              |            |
|                                   | 2015                        | 2016         | % change   | 2015                            | 2016       | % change   | 2015                           | 2016         | change bps |
| New cars: retail                  | 1,277                       | 1,375        | 8%         | 130                             | 135        | 4%         | 10.2%                          | 9.8%         | -36        |
| New cars: fleet                   | 736                         | 831          | 13%        | 26                              | 26         | 0%         | 3.5%                           | 3.1%         | -40        |
| Used cars                         | 1,341                       | 1,437        | 7%         | 98                              | 105        | 7%         | 7.3%                           | 7.3%         | 00         |
| Aftersales                        | 337                         | 365          | 8%         | 153                             | 166        | 8%         | 45.4%                          | 45.5%        | 08         |
| <b>Group – cont. (ex leasing)</b> | <b>3,691</b>                | <b>4,008</b> | <b>9%</b>  | <b>407</b>                      | <b>432</b> | <b>6%</b>  | <b>11.0%</b>                   | <b>10.8%</b> | <b>25</b>  |

Source: Lookers, Edison Investment Research

**New cars:** New car revenues rose by 20% to £2.21bn. On a like-for-like basis, the group reported revenues up by 9% and gross profits by 6%, indicating a modest reduction in margins. We had expressed a cautious note this time last year, with the targets being set by the OEMs likely to put pressure on retail margins, while the shift in the market toward fleet would also have led to reduced returns. In addition, increased sales of higher-value vehicles involved increased profit per vehicle, but at a reduced margin. Retail sales rose by 8% and fleet by 13%; growth in the latter stems from a strategic move to concentrate on smaller fleet buyers, including the supply of light commercial vehicles, for which there has been a resurgence in demand.

The support from the OEMs, largely in the form of vehicle finance offers (PCPs), remained a key factor in keeping vehicle ownership costs at attractive levels. Many commentators have expressed concern about the impact of the weakness of sterling relative to the euro, which is narrowing OEM margins. Lookers' management remains optimistic, given the perceived quality of the UK market and continuing global manufacturing overcapacity.

Industry estimates suggest a 5% fall in new car registrations in 2017. The year has started well, with indications for the crucial March trading month looking encouraging. Margin pressures will continue, but we believe that Lookers will deliver further progress.

**Used cars:** Lookers has built further on the strong performance of the previous three years. Used car revenues rose by 19% to £1.44bn, including a 7% like-for-like rise in revenues. Like-for-like

gross profits also rose by 7%. In the context of an indicated modest rise in used car volumes and the higher average price per vehicle, the group appears again to have lifted its market share without yielding margin, despite the increasing vehicle availability.

This progress stems from consistent recent investment involving improved vehicle sourcing, with greater attention paid to the inventory profile and a much improved stock turn. More significantly, Lookers has responded to the changing market dynamics, improving the quality and reach of its website – visits to the website rose by 25% last year to 11.9m, while we understand that the number of unique leads rose more sharply, indicating an improving conversion rate.

Used cars is still seen by management as a fundamental medium-term growth opportunity. The variation in performance between the franchises is significant. The 1.2:1.0 average group ratio between used and retail new car unit sales is less than half that of the group's most successful outlets; action to narrow this gap can be expected to build further on the consistent lift in used car unit sales achieved in recent years. With the growing involvement of the OEMs to offer PCPs on newer used cars, we look for continued increases in market share over the next two to three years, at sustained margins.

**Aftermarket:** The fundamental factor for the group's aftermarket operations has been the recent recovery in the size of the parc of vehicles up to three years old. During the previous period when demand was drifting, Lookers invested in CRM, including electronic vehicle health checks and the sale of service plans on used cars, to extend its customer profile to include an increasing proportion of older vehicles to sustain profits.

Revenues rose by 14% to £365m last year, including like-for-like revenue growth of 8%; with gross margins widening, gross profits rose by 18%, including 8% like-for-like. Investment continues, with online service bookings now available, while attention to detail in terms of customer management extends further the positive customer experience. The improved trading climate enables us to look ahead with confidence for the current year and into the medium term.

## 2017 profit outlook

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While UK specific concerns have arisen due to the Brexit vote, we are currently a long way from the global economic meltdown seen in 2008 and 2009. Certainly there is upward pressure on new car pricing due to the fall in sterling, and economic prognoses for the UK since last June have been generally less favourable. However, more recently, economic performance and experience are suggesting a much more robust performance by the UK than many had assumed. Hence the recent OECD and HMG upgrades to UK GDP growth expectations.

GDP growth tends to go hand in hand with the key economic drivers of UK car market demand, consumer confidence, rising real wages and low unemployment, which together with the still favourable interest rate regime encourage a greater level of aspiration and thus velocity of demand.

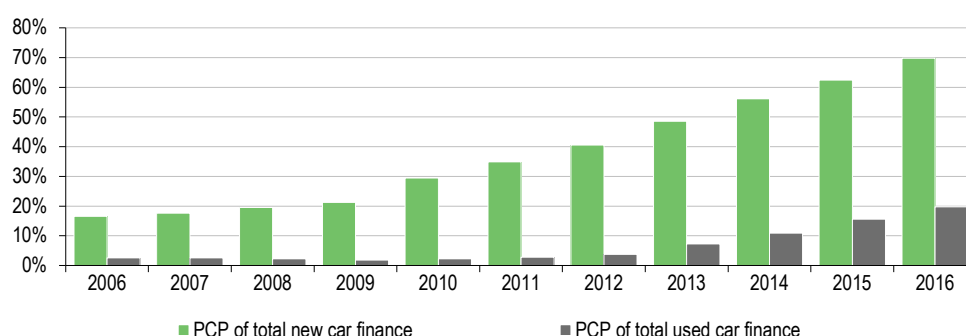
The UK new car market has started the year strongly, with registrations up in the first two months. However, the new vehicle excise duty regime in the UK starts at the beginning of April, placing a significant financial penalty on purchases of less environmentally friendly models in the first year of ownership. It is likely that this may be pulling forward some sales into Q117, which may have some ramifications for the full year. The SMMT is still forecasting a 5% decline in UK new car sales for the year, which would imply significant softness as the year progresses and most likely to be reflected in Q2 performance. However, as the economic predictions for the UK since the referendum last June have been overly pessimistic, it is possible that new car demand may yet surprise to the upside.

Indeed Lookers is expecting a flat new car market for the full year. The view is supported by positive trading so far in Q117, and the strong order cover for the all-important March selling period. The indication from management is that this is at a higher level than a year ago, despite being based on an increased sales budget.

One major reason for relative comfort even if car demand is softening is the increasing penetration of personal contract plans (PCPs) as a form of financing for both new and, increasingly importantly, used car markets. PCP penetration is cited by most in the trade as being a major reason for relative comfort when worrying about cyclical development of the UK motor retail industry when compared to previous shocks.

Lookers is no different, with 70% of new car and 20% of used car customer financing now using PCPs. This compares to 17% and 3%, respectively, a decade ago. With 50% of customers now rolling to new contracts at the end of existing terms, PCPs are increasingly not only assisting a sustainment of new car sales, but also supporting used car sales, with a growing stream of high-quality, relatively young product, as well as supporting service operations. Indeed while most worry about the impact of increasing new car prices on demand, few consider the potentially beneficial impact on residuals in the used car market. Lookers sold 1.4x as many used vehicles as new in FY16 on average.

**Exhibit 4: PCP finance option as a proportion of total finance for new and used cars**



Source: Lookers

Lookers thus looks well positioned to continue growth, with flows in the used car and aftersales activities likely to rise consistent with the increase in the one- to three-year-old car parc, and following new car sales higher. While there will be substantial ongoing debate about whether we are close to a peak in new car sales, there is little doubt that Lookers continues to perform well at present and will benefit in 2017 from significant contributions from Drayton and Knights, which should largely offset the dilution from the disposal of the parts business.

## Sensitivities

- **Performing in a mature market** – Management has acted to preserve and build share in a mature and competitive market. While the very severe market conditions encountered in 2008 and 2009 affected all motor dealers, Lookers' management has since invested in increasing the sizes of its franchise territories, enabling the group to employ local management more effectively. At the same time, Lookers has consistently extended its used car and aftermarket operations across the network, adding considerable gross profit, without a commensurate rise in establishment costs.
- **Macroeconomic factors** – Like other dealership groups, Lookers cannot be immune from either a major downturn in demand or an unexpected downturn in used car values (as



happened in 2008). However, because vehicles deteriorate with age, there is a built-in replacement cycle (usually up to three years), to which many motorists seem to subscribe. Registration plates showing the age of a particular vehicle seem to encourage this trend to continue, while the company car is still seen as one of the most important business perks. The UK automotive market is mature, having peaked previously at around current levels in 2003. High levels of immigration in recent years suggest that the market will stabilise at around current volumes.

- **Performance of individual marques** – Specific company performance is likely to be affected by the variable performances of individual marques, related to the timing of new model introductions, temporary reliability problems and the effectiveness of sales incentive schemes for dealers. However, there is a greater degree of immunity in larger dealership groups such as Lookers because of the spread of its business, so that any adverse impact with one OEM will be balanced by the stronger performances elsewhere. Another factor will be the trend in consumer preference in respect of prestige models. The two years to 2014 saw a shift towards upmarket models, partially prompted by strong finance offers. While there was a brief reversal of this trend in 2015, the shift toward higher specification vehicles looks set to continue. Lookers' portfolio of franchises is balanced between volume and prestige vehicles, with much recent investment aimed at the latter segment of the market.
- **Pension deficit** – Lookers operates three defined benefit pension schemes, each of which is closed to new entrants. The combined actuarial value of liabilities and the fair value assessment of the scheme assets decreased modestly over the year to December 2016. At that date, there was a net deficit, after deferred tax, of £64.7m.

## Valuation

Share prices have fallen across the motor retail subsector over the past year. The Lookers share price is down by 20% since our report accompanying the FY15 figures, underperforming an average 15% shortfall. While for many years motor retailing had been considered the poor relation in the retail sector, a recovery in the relative rating over the year to March 2015 has been reversed, reflecting vehicle pricing fears and other more general concerns engendered by the Brexit referendum result. The average prospective P/E rating for 2017 is now some 35% below the 11.0x of the FTSE All-Share General Retailers Index. The market appears to be taking a far more cautious line than it is with other types of retailer. However, we prefer to look at the improved quality of management at the quoted dealership groups and the change in industry dynamics, whereby the sector leaders have the opportunity to build market share, largely at the expense of independent retailers. Consolidation across a very fragmented market has been a feature in recent years; we believe that this process may accelerate over the next two years, as the challenges for the independent operators intensify.

**Exhibit 5: Peer group comparison**

|   | Price | Market cap | Revenue | P/E (x)     | P/E (x)     |
|---|-------|------------|---------|-------------|-------------|
|   | (p)   | (£m)       | (£m)    | 2017e       | 2018e       |
| Cambria Auto                                  | 64.5  | 65         | 614     | 7.8         | 7.6         |
| Lookers                                       | 122.5 | 486        | 4,282   | 7.9         | 7.7         |
| Marshall Motor                                | 163.5 | 127        | 1,232   | 6.8         | 6.4         |
| Pendragon                                     | 33.0  | 480        | 4,537   | 8.5         | 7.9         |
| Vertu Motors                                  | 50.0  | 200        | 2,423   | 7.9         | 7.5         |
| <b>Simple average</b>                         |       |            |         | <b>7.8</b>  | <b>7.5</b>  |
| <b>FTSE All Share General Retailers Index</b> |       |            |         | <b>13.0</b> | <b>12.0</b> |

Source: Bloomberg, Edison Investment Research. Note: Prices at 7 March 2017.

Ratings across the sector do not vary materially from the simple average. Lookers has performed consistently over many years, delivering record pre-tax profits in 2009, the year after the major

industry profits setback. It has since more than doubled those profits, delivering record profits in each subsequent year in a mature market that has seen UK new car registrations recovering to little more than the record achieved back in 2003. We sense that the underperformance over the past year reflects the dilutive impact of the disposal of the group's independent parts division; estimates have been reduced despite group operations performing at least in line with earlier expectations. Lookers' management has demonstrated an ability to grow the business over many years despite challenging trading conditions. As indicated above, we believe that numerous acquisition opportunities can be expected to emerge in the coming months. Lookers has the financial strength to respond quickly to the benefit of earnings.

## Financials

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While substantially reduced at £74.1m, FY16 year end net borrowings came in above our own and market expectations. Once again this was largely due to working capital flows with the major acquisition of Benfield in 2015 as well as the more recent acquisitions. Funds generated from operations rose strongly to £140.9m as working capital decreased £33.3m during the period, compared to an outflow of £32.7m in 2015.

The company has continued its high level of investment in both facilities and IT systems with £36m invested in 2016. There was also a modest investment in the hire fleet. The dividend payments increased by £5m and tax and interest absorbed an extra £6.7m. With the disposal of fixed assets and M&A generating aggregate proceeds of £140.4m, offset partially by £92.6m invested in acquisitions, the reduction in net debt was £87.6m. Gearing at the year end had fallen to just 22% from 54% a year earlier.

The high levels of investment in digital marketing and higher standards of customer facilities will continue for the next few years. We believe this programme together with working capital demands can be financed from cash flow and still leave substantial funds available for other types of investment, including acquisitions.

Net debt to EBITDA at 0.7x at the year end was towards the lower end of the targeted range of 0.5x to 1.5x. With significant financing facilities also available, Lookers is well positioned to invest in appropriate M&A opportunities as they arise.



**Exhibit 6: Financial summary**

| Year end 31 December                            | £m | 2010      | 2011      | 2012      | 2013      | 2014      | 2015      | 2016      | 2017e     | 2018e     |
|---|----|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Accounting basis                                |    | IFRS      | IFRS      | IFRS      | IFRS      | IFRS      | IFRS      | IFRS      | IFRS      | IFRS      |
| <b>PROFIT &amp; LOSS</b>                        |    |           |           |           |           |           |           |           |           |           |
| Revenue   |    | 1,884     | 1,899     | 2,057     | 2,465     | 3,043     | 3,649     | 4,282     | 4,700     | 4,900     |
| Cost of Sales                                   |    | (1,623.2) | (1,645.9) | (1,753.3) | (2,128.7) | (2,646.8) | (3,196.9) | (3,777.5) | (4,170.0) | (4,350.0) |
| Gross Profit                                    |    | 260.6     | 252.6     | 303.3     | 335.8     | 396.1     | 452.2     | 504.2     | 530.0     | 550.0     |
| EBITDA  |    | 54.7      | 54.5      | 60.0      | 67.7      | 87.0      | 99.6      | 113.2     | 112.0     | 114.6     |
| Operating Profit (pre amortisation and except.) |    | 46.9      | 45.2      | 49.2      | 58.4      | 76.6      | 85.9      | 94.7      | 92.0      | 94.1      |
| Intangible Amortisation                         |    | (1.3)     | (1.3)     | (1.1)     | (1.1)     | (1.2)     | (1.6)     | (1.7)     | (2.1)     | (2.1)     |
| Exceptionals                                    |    | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | (1.9)     | 22.3      | 0.0       | 0.0       |
| Other   |    | (1.2)     | (1.1)     | (2.6)     | (3.1)     | (3.5)     | (4.3)     | (4.1)     | (4.0)     | (4.0)     |
| Operating Profit                                |    | 44.4      | 42.8      | 45.5      | 54.2      | 71.9      | 78.1      | 111.2     | 85.9      | 88.0      |
| Net Interest                                    |    | (13.3)    | (11.4)    | (11.2)    | (10.3)    | (11.6)    | (13.8)    | (17.6)    | (16.0)    | (15.6)    |
| Profit Before Tax (norm)                        |    | 33.6      | 33.8      | 38.0      | 48.1      | 65.0      | 72.1      | 77.1      | 76.0      | 78.5      |
| Profit Before Tax (FRS 3)                       |    | 31.1      | 31.4      | 34.3      | 43.9      | 60.3      | 64.3      | 93.6      | 69.9      | 72.4      |
| Tax   |    | (8.2)     | (6.2)     | (8.0)     | (7.7)     | (12.4)    | (12.0)    | (10.5)    | (13.6)    | (14.1)    |
| Profit After Tax (norm)                         |    | 25.4      | 27.6      | 30.0      | 40.4      | 52.6      | 60.1      | 66.6      | 62.4      | 64.4      |
| Profit After Tax (FRS 3)                        |    | 22.9      | 25.2      | 26.3      | 36.2      | 47.9      | 52.3      | 83.1      | 56.3      | 58.3      |
| Average Number of Shares Outstanding (m)        |    | 383.5     | 383.8     | 387.1     | 388.1     | 389.2     | 394.4     | 396.4     | 396.4     | 396.4     |
| EPS - normalised (p)                            |    | 6.62      | 7.19      | 7.72      | 10.36     | 13.52     | 15.24     | 15.87     | 15.74     | 16.25     |
| EPS - normalised fully diluted (p)              |    | 6.49      | 7.02      | 7.56      | 10.16     | 13.21     | 14.88     | 15.55     | 15.42     | 15.92     |
| EPS - FRS 3 (p)                                 |    | 5.97      | 6.57      | 6.77      | 9.28      | 12.31     | 13.26     | 20.97     | 14.20     | 14.71     |
| Dividend per share (p)                          |    | 1.80      | 2.18      | 2.35      | 2.58      | 2.84      | 3.12      | 3.64      | 3.82      | 4.00      |
| Gross Margin (%)                                |    | 13.8%     | 13.3%     | 14.7%     | 13.6%     | 13.0%     | 12.4%     | 11.8%     | 11.3%     | 11.2%     |
| EBITDA Margin (%)                               |    | 2.9%      | 2.9%      | 2.9%      | 2.7%      | 2.9%      | 2.7%      | 2.6%      | 2.4%      | 2.3%      |
| Operating Margin (before GW and except.) (%)    |    | 2.5%      | 2.4%      | 2.4%      | 2.4%      | 2.5%      | 2.4%      | 2.2%      | 2.0%      | 1.9%      |
| <b>BALANCE SHEET</b>                            |    |           |           |           |           |           |           |           |           |           |
| Fixed Assets                                    |    | 255.1     | 253.3     | 273.3     | 292.1     | 329.8     | 441.2     | 536.5     | 556.8     | 563.2     |
| Intangible Assets                               |    | 60.5      | 62.2      | 76.2      | 87.5      | 114.2     | 158.3     | 217.4     | 222.7     | 224.6     |
| Tangible Assets                                 |    | 194.6     | 191.1     | 197.1     | 204.6     | 215.6     | 282.9     | 319.1     | 334.1     | 338.6     |
| Investment in associates                        |    | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       |
| Other   |    | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       |
| Current Assets                                  |    | 428.6     | 480.1     | 559.2     | 659.3     | 791.2     | 1,143.9   | 1,171.3   | 1,217.2   | 1,292.6   |
| Stocks  |    | 292.3     | 349.6     | 423.5     | 499.6     | 605.9     | 883.0     | 906.5     | 935.7     | 992.5     |
| Debtors   |    | 104.2     | 109.1     | 123.8     | 154.0     | 179.4     | 252.6     | 225.0     | 231.8     | 248.3     |
| Cash  |    | 24.3      | 17.9      | 8.7       | 5.2       | 5.9       | 8.3       | 39.8      | 49.8      | 51.8      |
| Other   |    | 7.8       | 3.5       | 3.2       | 0.5       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       |
| Current Liabilities                             |    | (387.0)   | (433.5)   | (513.0)   | (610.3)   | (725.2)   | (1,085.4) | (1,130.3) | (1,170.1) | (1,219.8) |
| Creditors/Other                                 |    | (372.9)   | (424.9)   | (497.3)   | (595.8)   | (705.0)   | (1,002.0) | (1,105.2) | (1,138.7) | (1,195.0) |
| Short term borrowings                           |    | (14.1)    | (8.6)     | (15.7)    | (14.5)    | (20.2)    | (83.4)    | (25.1)    | (31.4)    | (24.9)    |
| Long Term Liabilities                           |    | (115.1)   | (102.8)   | (115.7)   | (113.1)   | (138.9)   | (201.9)   | (235.8)   | (183.8)   | (175.8)   |
| Long term borrowings                            |    | (66.8)    | (48.8)    | (41.2)    | (33.8)    | (37.6)    | (86.6)    | (88.8)    | (80.8)    | (72.8)    |
| Other long term liabilities                     |    | (48.3)    | (54.0)    | (74.5)    | (79.3)    | (101.3)   | (115.3)   | (147.0)   | (103.0)   | (103.0)   |
| Net Assets                                      |    | 181.6     | 197.1     | 203.8     | 228.0     | 256.9     | 297.8     | 341.7     | 420.1     | 460.2     |
| <b>CASH FLOW</b>                                |    |           |           |           |           |           |           |           |           |           |
| Operating Cash Flow                             |    | 49.3      | 40.8      | 48.4      | 55.9      | 55.1      | 58.0      | 131.2     | 100.2     | 93.5      |
| Net Interest                                    |    | (13.2)    | (11.4)    | (12.4)    | (10.3)    | (11.6)    | (13.8)    | (17.6)    | (16.0)    | (15.6)    |
| Tax   |    | (5.9)     | (6.7)     | (7.8)     | (8.1)     | (8.9)     | (11.3)    | (14.2)    | (12.8)    | (14.0)    |
| Net Capex                                       |    | (5.3)     | 1.5       | (11.6)    | (3.8)     | (10.0)    | (28.0)    | (16.9)    | (45.0)    | (32.0)    |
| Acquisitions/disposals                          |    | 0.0       | 0.2       | (17.4)    | (19.3)    | (24.5)    | (104.4)   | 18.9      | 0.0       | 0.0       |
| Financing                                       |    | 0.0       | 1.5       | 0.4       | 0.3       | 1.6       | 0.9       | 0.0       | 0.0       | 0.0       |
| Other   |    | 0.0       | (1.1)     | 0.1       | (0.1)     | (0.1)     | 0.4       | (0.6)     | 0.0       | 0.0       |
| Dividends                                       |    | (2.3)     | (7.7)     | (8.4)     | (9.5)     | (10.4)    | (11.6)    | (13.2)    | (14.7)    | (15.4)    |
| Net Cash Flow                                   |    | 22.6      | 17.1      | (8.7)     | 5.1       | (8.8)     | (109.8)   | 87.6      | 11.7      | 16.5      |
| Opening net debt/(cash)                         |    | 79.2      | 56.6      | 39.5      | 48.2      | 43.1      | 51.9      | 161.7     | 74.1      | 62.4      |
| HP finance leases initiated                     |    | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       |
| Other   |    | 0.0       | (0.0)     | (0.0)     | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       | 0.0       |
| Closing net debt/(cash)                         |    | 56.6      | 39.5      | 48.2      | 43.1      | 51.9      | 161.7     | 74.1      | 62.4      | 45.9      |

Source: Lookers reports, Edison Investment Research. Note: Includes discontinued businesses.

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