# Lookers

Interim results

## Driving forward

Automotive retailers

**A strong first half performance saw Lookers deliver yet another record trading period, overcoming the dilutive effect of the sale of the Parts business in H216. The performance of the continuing activities has been enhanced by the reinvestment of the proceeds in the two new dealership groups last year. In addition the balance sheet remains strong, facilitating both organic investment and M&A, despite the uncertainty that persists in the UK car market. Lookers looks set to continue its growth strategy with a sharper brand focus. The improved prospective yield also has attractions.**

| Year end | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 12/15** | 3,430 | 59.6 | 12.4 | 3.12 | 8.9 | 2.8 |
| 12/16** | 4,088 | 64.9 | 13.1 | 3.64 | 8.4 | 3.3 |
| 12/17e | 4,700 | 76.0 | 15.3 | 4.00 | 7.2 | 3.6 |
| 12/18e | 4,900 | 78.5 | 15.8 | 4.20 | 7.0 | 3.8 |

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. Note: **Continuing operations only.

## First half trading performance is encouraging

The underlying performance in H117 has been encouraging despite a softening of the UK new car market following the record first quarter. Lookers' new, used and aftermarket sales all showed healthy like-for-like growth and even stronger gross profit improvements. This was further enhanced by the acquisitions of Knights and Drayton during H217, which have offset the dilution of the disposal of the highly profitable Parts distribution business last year.

## Sharpening the focus

The capital markets day in May gave clear insights into how Lookers' consolidate and build strategy is developing. Management discussed greater focus on key brands, provided case studies on acquisitions, and highlighted increasing digital development and marketing, with a continued drive for operational performance improvements. These factors should keep Lookers at the forefront of automotive retailing as brand development pressures drive further sector consolidation, likely at the expense of the smaller independents. The aim is to leverage volume across a largely fixed cost base with resultant improvements in competitiveness and returns. While the UK new car market is suffering from lower buyer confidence, economic fundamentals would appear to underpin healthy demand. Despite some negative media, the outlook does not appear to be deteriorating rapidly, although a squeeze on disposable income is evident as inflation rises. Used car and aftersales demand should stay resilient, due to growth in the 0-3 year-old car parc. The strong balance sheet and financing provide the support to pursue the strategic goals.

## Valuation: Sector priced for market collapse

We see no reason to change numbers at present, despite the car market uncertainty exacerbated by the lack of a clear political mandate. We believe the sector is overdue a re-rating, which should occur if the economy remains stable. Lookers' underlying growth warrants the 7% P/E premium to its immediate UK peers.

**22 August 2017**

| | |
|---|---|
| **Price** | **110p** |
| **Market cap** | **£437m** |

| | |
|---|---|
| Net debt (£m) at 30 June 2017 | 61.9 |
| Shares in issue | 396.6m |
| Free float | 80% |
| Code | LOOK |
| Primary exchange | LSE |
| Secondary exchange | N/A |

### Share price performance


| % | 1m | 3m | 12m |
|---|---|---|---|
| Abs | (4.1) | (11.5) | (15.7) |
| Rel (local) | (2.7) | (9.9) | (21.6) |
| 52-week high/low | | 138.5p | 97.5p |

### Business description

Lookers is vying to be the largest UK motor vehicle retailer, with its new car operations supported by the strength of used and aftersales activities. It now operates 155 franchises, representing 32 marques from 100 sites around the UK, with strong regional presences in Northern Ireland, Scotland, the South East and across Northern England.

### Next events

| | |
|---|---|
| Q3 trading statement | November 2017 |

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# Interim trading update

A strong first half performance saw Lookers deliver yet another record trading period, overcoming the dilutive effect of the sale of the Parts business in H216. In part this can be attributed to the subsequent reinvestment of the proceeds in the two new dealership groups last year, Drayton Motors and Knights BMW. However, strong like-for-like performances across the operating segments are also very encouraging during what has been an overall flatter period for the new car market. In gross profit terms, a favourable mix has been delivered by good performances in the higher-margin used car and aftersales segments, which generate almost two-thirds of gross profit, and a robust performance in the smaller leasing activity.

**Exhibit 1: Lookers first half key data (continuing activities)**

| Year to December<br>£m | 2016<br>H116 | 2017<br>H117 | %<br>Change |
|---|---|---|---|
| Revenues | 2,225.3 | 2,458.5 | +10.5 |
| Adjusted operating profit | 51.6 | 58.1 | +12.6 |
| Profit before tax (adjusted) | 42.6 | 50.2 | +17.8 |
| Net income (ongoing adjusted) | 34.7 | 41.6 | +19.9 |
| EPS (p) – reported | 7.9 | 9.1 | +14.8 |
| EPS (p) – ongoing adjusted | 8.76 | 10.49 | +19.7 |
| DPS (p) | 1.28 | 1.41 | +10.2 |
| Net debt | 74.9 | 61.9 | -17.4 |
| Freehold/long leasehold property per share (p) | 60 | 74 | +23.3 |
| NAV per share (p) | 78 | 93 | +19.2 |

Source: Lookers reports

Revenues in the first half rose by 5% to £2.46bn, although stripping out the H117 contribution from the Parts business the continuing activities delivered growth of over 10%. For the continuing business, group gross profits rose 17%, adjusted profit before tax was 18% higher and adjusted EPS rose by 20%, which enabled a 10% increase in the dividend despite the current uncertainty around end market demand.

**Exhibit 2: Lookers segmental analysis (continuing businesses only)**

| Year-end December | 2016 | | | 2017 | % change |
|---|---|---|---|---|---|
| (£m) | H116 | H216 | FY | H117 | H117 vs H116 |
| New Car – Retail | 730 | 645 | 1375 | 822 | 13% |
| New Car – Fleet | 458 | 373 | 831 | 490 | 7% |
| Used Car | 809 | 629 | 1437 | 887 | 10% |
| Aftersales | 189 | 176 | 365 | 216 | 14% |
| Leasing | 39 | 41 | 80 | 44 | 13% |
| **Group revenues** | **2,225** | **1,863** | **4,088** | **2,459** | **10%** |
| Gross profit by segment | | | | | |
| New Car – Retail | 60 | 75 | 135 | 71 | 18% |
| New Car – Fleet | 15 | 11 | 26 | 17 | 13% |
| Used Car | 56 | 49 | 105 | 69 | 23% |
| Aftersales | 84 | 82 | 166 | 98 | 17% |
| Leasing | 8 | 9 | 17 | 9 | 10% |
| **Group gross profit** | **225** | **226** | **449** | **264** | **17%** |
| Gross margin | | | | | |
| New Car – Retail | 8.2% | 11.6% | 9.8% | 8.6% | |
| New Car – Fleet | 3.3% | 2.9% | 3.1% | 3.5% | |
| Used Car | 6.9% | 7.8% | 7.3% | 7.8% | |
| Aftersales | 44.6% | 46.7% | 45.5% | 45.8% | |
| Leasing | 20.5% | 22.0% | 21.3% | 20.0% | |
| **Group gross margin** | **10.1%** | **12.1%** | **11.0%** | **10.7%** | |

Source: Lookers reports

Like-for-like revenue growth was 7%, with the retail segment of new cars showing the strongest improvement at 9%. A more selective approach in new car fleet sales still delivered 5% like-for-like growth in the period, while used car sales of 7% was, we believe, also well ahead of market growth.

In like-for-like terms, the gross profit growth was 9% higher for new cars retail, flat for new cars fleet, up 13% for used cars, with a 7% rise for aftersales. Gross margins increased in all of the segments except for leasing. The 120bps increase in aftersales margins to 45.8% is particularly encouraging given the rising number of service plans, which now total close to 100k and the high level of personal contract plan (PCP) financing that helps to retain customers in the service network. Similarly, the used car segment benefits from the increasing numbers of cars coming off PCPs, which are high-quality, with margins up 90bps aided by stable residual values.

The company also continues to invest in both new technology and the operations. A new website with improved functionality is being launched, providing greater functionality for customers' online search experience with an upgraded mobile app. Capex was broadly maintained during the period at £19.7m as part of the ongoing improvement programme for dealership facilities. Some £3m of surplus property disposal proceeds was received during the period, but the previously extensive list has now been largely disposed of. At 295m, or 74p per share, the value of the freehold and long leasehold property portfolio represents 80% of total net assets, and further indicates the robust structure of the balance sheet. Net debt fell by £12.2m during the first half to £61.9m.

Lookers retains substantial headroom in its existing debt financing facilities, which total £230m with a potential extension of £30m if required for M&A. Net debt to trailing 12-month EBITDA fell to 0.54x during the period, a very comfortable level. While nothing appears imminent, management continues to track opportunities for further consolidation, and has the wherewithal to participate in any opportunities should they arise.

The 10% increase in the interim dividend 1.41p per share is also encouraging given current market uncertainty. If repeated for the full year, Lookers would yield 3.6%, an attractive income in the current low interest rate environment.

# Outlook

## Lookers' strategy consistent and financially robust

The capital markets day in May provided a positive update on Lookers' growth strategy, and progress in this regard was apparent during the first half. Lookers appears well placed to continue to deliver a sharper brand focus, and the withdrawal from selling PSA product in Great Britain (the multi-franchise site in Belfast is retaining the brand) is a further step towards the aim of concentrating on fewer leading franchises. The ultimate ambition is to focus sales on fewer larger dealerships, which is key to Lookers' strategy as it increases revenue across the largely fixed cost base of its dealerships, providing operational gearing. It will be delivered by both organic and acquired development, with a focus on cost management and the increasing use of technology to achieve optimal customer engagement.

The investments required in updating franchise quality and the development of technology increasingly favours financially robust, larger retailers such as Lookers, which expects a continuing decline in the overall number of dealer outlets in the UK to around the 3,000 level by 2026, a fall of around 25%. While the car manufacturers may have to accept a higher proportion of distribution being controlled by individual franchise groups for this to occur, it appears to be the inevitable trend in an increasingly connected world.

Acquisitions continue to deliver value to shareholders. Lookers has a return on investment target on acquisitions of 15% and the return on acquisitions since 2011 has to date been almost 20%. M&A

will thus remain a key feature for Lookers. Management is likely to remain selective as to which opportunities to pursue, and walk away where value creation is not demonstrable. Increased competition for targets may be a feature as the number of potential consolidators capable of meeting brand investment requirements diminishes. However, this trend may also throw up further opportunity as the OEMs may in time accept that fewer partners are capable of meeting the changing requirements of the car retailing environment.

## Car market trends overall remain encouraging

New car registrations through July were just off record levels, at 1.56m vehicles according to the Society of Motor Manufacturers and Traders (SMMT), down 2.2% on 2016. While Q117 benefited from the pull forward of registrations ahead of the vehicle excise duty changes on 1 April, increased uncertainty following the election has led to four months of decline. In May the SMMT had improved its 2017 forecast for new car sales slightly, from a 5.0% decline at the start of the year to just 2.6%, but it has now reverted to a 3.7% drop, implying a 6.3% decline in new car sales in H217.

Although confidence has fallen among private and corporate buyers as inflation and political uncertainty has increased, the economic backdrop would still appear quite stable. Falling unemployment and historically record levels of employment suggest an underpinning of new car markets and upgrades in the second-hand market. In addition, the low interest rate environment continues to assist affordability, and in the absence of any near-term economic shock we would expect new car sales to remain near current very high levels, or indeed possibly start to improve. Such a view is slightly at odds with the current SMMT consensus, which envisages a further modest drop in new car sales in 2018.

While new cars grab the headlines, used sales and aftersales are more profitable. Volume drivers for both these activities appear robust at present with a growing car parc of 0-6 year-old vehicles due to the record level of new car sales in recent years.

In this environment, we expect Lookers to continue to make steady progress, ahead of the overall market.

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### Exhibit 3: Financial summary

| £m | 2015 | 2016 | 2017e | 2018e |
|---|---|---|---|---|
| Year end 31 December | IFRS | IFRS | IFRS | IFRS |
| **PROFIT & LOSS** | | | | |
| Revenue | 3,430.3 | 4,088.2 | 4,700.0 | 4,900.0 |
| Cost of Sales | (3,039.6) | (3,638.7) | (4,145.4) | (4,321.8) |
| Gross Profit | 390.7 | 449.5 | 554.6 | 578.2 |
| EBITDA | 84.4 | 97.6 | 108.7 | 111.2 |
| Operating Profit (before amort. and except.) | 73.4 | 82.5 | 91.6 | 93.8 |
| Intangible Amortisation | 0.0 | 0.0 | 0.0 | 0.0 |
| Exceptionals | (9.3) | 14.7 | (11.1) | (11.3) |
| Other | 0.0 | 0.0 | 0.0 | 0.0 |
| Operating Profit | 64.1 | 97.2 | 80.5 | 82.5 |
| Net Interest | (13.8) | (17.6) | (15.6) | (15.4) |
| Profit Before Tax (norm) | 59.6 | 64.9 | 76.0 | 78.5 |
| Profit Before Tax (FRS 3) | 50.3 | 79.6 | 64.9 | 67.1 |
| Tax | (9.4) | (7.9) | (13.0) | (13.5) |
| Profit After Tax (norm) | 50.2 | 53.3 | 62.3 | 64.3 |
| Profit After Tax (FRS 3) | 40.9 | 71.7 | 51.9 | 53.7 |
| Average Number of Shares Outstanding (m) | 394.4 | 396.4 | 396.9 | 396.9 |
| EPS – normalised (p) | 12.7 | 13.4 | 15.7 | 16.2 |
| EPS – normalised and fully diluted (p) | 12.4 | 13.1 | 15.3 | 15.8 |
| EPS – (IFRS) (p) | 10.4 | 18.1 | 13.1 | 13.5 |
| Dividend per share (p) | 3.1 | 3.6 | 4.0 | 4.2 |
| Gross Margin (%) | 11.4 | 11.0 | 11.8 | 11.8 |
| EBITDA Margin (%) | 2.5 | 2.4 | 2.3 | 2.3 |
| Operating Margin (before GW and except.) (%) | 2.1 | 2.0 | 1.9 | 1.9 |
| **BALANCE SHEET** | | | | |
| Fixed Assets | 441.2 | 536.5 | 564.4 | 587.1 |
| Intangible Assets | 158.3 | 217.4 | 221.8 | 221.0 |
| Tangible Assets | 282.9 | 319.1 | 342.6 | 366.1 |
| Investments | 0.0 | 0.0 | 0.0 | 0.0 |
| Current Assets | 1,143.9 | 1,171.3 | 1,279.0 | 1,327.0 |
| Stocks | 816.0 | 839.4 | 893.0 | 912.4 |
| Debtors | 319.6 | 292.1 | 326.2 | 344.8 |
| Cash | 8.3 | 39.8 | 59.8 | 69.8 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 |
| Current Liabilities | (1,085.4) | (1,130.3) | (1,195.3) | (1,234.0) |
| Creditors | (1,002.0) | (1,105.2) | (1,195.3) | (1,234.0) |
| Short term borrowings | (83.4) | (25.1) | 0.0 | 0.0 |
| Long Term Liabilities | (201.9) | (235.8) | (270.3) | (265.4) |
| Long term borrowings | (86.6) | (88.8) | (121.6) | (115.0) |
| Other long term liabilities | (115.3) | (147.0) | (148.7) | (150.4) |
| Net Assets | 297.8 | 341.7 | 377.7 | 414.8 |
| **CASH FLOW** | | | | |
| Operating Cash Flow | 32.9 | 130.5 | 108.5 | 107.8 |
| Net Interest | 0.0 | (13.8) | (17.6) | (15.6) |
| Tax | 0.0 | (17.3) | (13.0) | (13.5) |
| Capex | (36.0) | (45.5) | (50.5) | (45.9) |
| Acquisitions/disposals | (104.4) | 18.9 | 0.0 | 0.0 |
| Financing | 0.9 | 0.0 | 0.0 | 0.0 |
| Dividends | (11.6) | (13.2) | (15.1) | (16.2) |
| Other | 8.4 | 28.0 | (0.0) | 0.0 |
| Net Cash Flow | (109.8) | 87.6 | 12.3 | 16.6 |
| Opening net debt/(cash) | 51.9 | 161.7 | 74.1 | 61.8 |
| HP finance leases initiated | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 0.0 | 0.0 | 0.0 | (0.0) |
| Closing net debt/(cash) | 161.7 | 74.1 | 61.8 | 45.2 |

Source: Lookers reports, Edison Investment Research estimates

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