EDISON

Lookers

Q3 trading update

Piercing the gloom

Automotive retailers

Lookers issued a Q3 trading statement that reaffirmed management expectations for 2017. It also indicated the initiation of a share buyback programme, as in the absence of any immediate M&A opportunities the recent fall in the share price has made the returns compelling from such an allocation of capital. Clearly, new car sales in the UK are persistently lower year-on-year, with confidence declines among consumers and businesses taking their toll. However, the strength of higher-margin used car demand and aftermarket sales continue to deliver a positive mix. Overall, the rating appears undemanding and the yield attractive.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15**	3,430	59.6	12.4	3.12	8.1	3.1
12/16**	4,088	64.9	13.1	3.64	7.6	3.6
12/17e	4,575	73.0	14.7	4.00	6.8	4.0
12/18e	4,654	73.6	14.8	4.20	6.8	4.2

Note: *PBT and EPS (fully diluted) are normalised, excluding amortisation of acquired intangibles and exceptional items. Note: **Continuing operations only.

Robust used and aftersales development

Unlike some of its peers, Lookers does not appear to be seeing any undue read across from weaker new car sales to its used car activities. In addition, the growth of service operations continues to reflect the growth in the overall UK vehicle parc driven by strong markets in recent years. SMMT figures showed continued sharp declines in new car and van sales in October as confidence continued to wane. However, Lookers continues to outperform the new car market and is still displaying strong growth in its higher-margin used and aftersales businesses in H217, which between them account for almost two-thirds of gross profit,

Share buyback to be initiated

Management also indicated that it is to launch a share buyback programme, although the scale and details have yet to be published. While the company clearly considers organic investment and focused acquisitions as being the preferred use of available capital, the current share price level makes this a compelling alternative. However, an upper limit on the buyback price will be set to ensure investment returns remain above predetermined levels.

Valuation: Discounting considerable turmoil

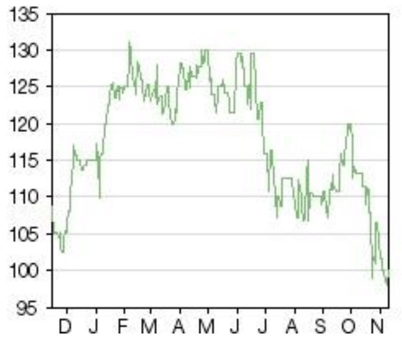
We have reduced our EPS by 4% and 6% for FY17 and FY18, respectively, to reflect softer new car volumes, but even so the recent price weakness in response to a peer's woes seems unwarranted. The market is correct to be concerned about developments in new car markets. However, in our view, sentiment seems to be underplaying the supportive economic fundamentals and business trends for the higher-margin businesses, while prioritising confidence-eroding issues that have yet to prove significant. With Lookers management adding to the cash returns for shareholders, the current rating appears both undemanding and discounting a lot of as yet unseen turbulence.

13 November 2017

Price	**100.00p**
Market cap	**£397m**

Net debt (£m) at 30 June 2017	61.9
Shares in issue	397.2m
Free float	80%
Code	LOOK
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(8.7)	(8.1)	(6.1)
Rel (local)	(8.4)	(8.1)	(14.3)
52-week high/low		131.0p	98.0p

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

FY17	March 2018

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Q3 trading performance

Lookers has issued its Q3 trading statement as usual, indicating trading performance aligned with previous management expectations for 2017. The new car market continues to be influenced by domestic political uncertainty that is increasingly affecting confidence among consumers and businesses. It is exacerbated by the continuing concerns surrounding the use of personal contract plans (PCPs) and emissions, especially for diesel. While the latter should be largely a matter of substitution in the short term, it is clearly disruptive as cars are produced in advance of sales. In terms of the PCP debt issue, we are not convinced that the worries over debt levels warrant the level of concern that has arisen. The larger dealerships such as Lookers tend to be supplying better rated consumers, with credit checks systematically applied. The contracts are relatively short term in duration and have fixed levels of affordability, and the retailers are not providing the finance backing or residual guarantees. Indeed the PCPs continue to generate strong and high-quality used car returns, while allowing the customer to commit proportionately less capital to new and nearly new car purchases. At present the high levels of employment may indicate some decisions are being deferred due to a lack of real income growth.

New car segment (35% of gross profit)

Revenues from new car sales increased by 10% in the first nine months, the same pace of growth as seen in the first half of the year. Like-for-like growth decelerated to 5% compared to 7% in H117, reflecting the progressive weakening of retail and fleet demand during the year. With the UK new car market down 9% in Q317, Lookers is clearly continuing to outperform. Acquisitions last year were made towards the end of the year so Q4 growth is likely to reflect the like-for-like year-to-date development. Gross margins have improved modestly year-on-year and gross profit growth of 15% (6% like-for-like) for the period compares to 16% (5% like-for-like) in H117. The margins and profit per unit metrics increased for both the retail and fleet subsegments.

Management also points to the supportive actions of key manufacturer partners who are reducing targets, increasing tactical incentives and aiding cost reduction initiatives designed to help mitigate the effect of lower volumes,

Used car segment (25% of gross profit)

Unlike some peers, Lookers has seen an acceleration of used car sales during the third quarter. Nine-month turnover in the segment increased by 24% (like-for-like +14%) compared to just 10% (7% like-for-like) at the half year, aided by strong lead generation. While gross margin was a little softer in Q3, gross profit for the nine months still rose 20% (12% like-for-like) compared to 23% (13% like-for-like) after six months. A new website launch at the beginning of 2018 is expected to continue the improvement in lead generation that has already been apparent.

Aftersales (40% of gross profit)

Sometimes overlooked in the debate on the sector that often reverts to new car markets, aftersales revenue development continues to benefit from the increased penetration of PCPs and service contracts on both new and used car markets as well as the increasing vehicle parc due to recent record levels of overall new car sales. Turnover for the nine months was up 11% compared to 14% after six months, with like-for-like growth maintained at 4%. Gross profits rose 15% (6% like-for-like) compared to 16% in H1 17 (+7% like-for-like). Given gross margins of around 45%, this represents a continued healthy additional element of earnings and cash flow growth. Even with the market flattening off, overall car sales will still be at historically high levels of around 2.5m to 2.6m in 2017, driving continued car parc growth next year.

Earnings revisions

We have reduced our expectations for new car sales through the final quarter and for 2018, reflecting the persistent weakness currently being experienced in the new car market. We have also slightly reduced our anticipated growth rate for aftersales to reflect the level of activity through the first nine months. The changes are reflected in Exhibit 1 below.

Exhibit 1: Financial summary

Year to December (£m)	2017e			2018e		
	Prior	New	% change	Prior	New	% change
New	2,488.3	2,370.7	(4.7)	2,538.1	2,323.3	(8.5)
Used	1,718.2	1,718.2	0.0	1,842.8	1,821.3	(1.2)
Aftersales	405.5	398.2	(1.8)	424.1	414.1	(2.4)
Leasing	88.0	88.0		95.0	95.0	
Sales	**4,700.0**	**4,575.1**	**(2.7)**	**4,900.0**	**4,653.8**	**(5.0)**
EBITDA	**108.7**	**105.2**	**(3.2)**	**111.2**	**105.5**	**(5.1)**
Underlying EBITA	**91.6**	**88.6**	**(100.0)**	**93.8**	**89.0**	**(5.1)**
Underlying PBT	**76.0**	**73.0**	**(4.0)**	**78.5**	**73.6**	**(6.2)**
EPS - underlying continuing (p)	**15.3**	**14.7**	**(4.0)**	**15.8**	**14.8**	**(6.3)**
DPS (p)	4.0	4.0	0.0	4.2	4.2	0.0

Source: Company reports, Edison Investment Research estimates

Exhibit 2: Financial summary

£m	2015*	2016*	2017e	2018e
Year end 31 December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	3,430.3	4,088.2	4,575.1	4,653.8
Cost of Sales	(3,039.6)	(3,638.7)	(4,035.3)	(4,104.6)
Gross Profit	390.7	449.5	539.9	549.1
EBITDA	84.4	97.6	105.2	105.5
Operating Profit (before amort. and except.)	73.4	82.5	88.6	89.0
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	77.5	77.7
Net Interest	(13.8)	(17.6)	(15.7)	(15.5)
Profit Before Tax (norm)	59.6	64.9	73.0	73.6
Profit Before Tax (FRS 3)	50.3	79.6	61.9	62.2
Tax	(9.4)	(7.9)	(12.5)	(12.6)
Profit After Tax (norm)	50.2	53.3	59.8	60.3
Profit After Tax (FRS 3)	40.9	71.7	49.4	49.7
Average Number of Shares Outstanding (m)	394.4	396.4	396.9	396.9
EPS - normalised (p)	12.7	13.4	15.1	15.2
EPS - normalised fully diluted (p)	12.44	13.13	14.7	14.8
EPS - (IFRS) (p)	10.4	18.1	12.4	12.5
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	563.7	585.3
Intangible Assets	158.3	217.4	221.8	221.0
Tangible Assets	282.9	319.1	341.9	364.3
Investments	0.0	0.0	0.0	0.0
Current Assets	1,143.9	1,171.3	1,246.6	1,263.8
Stocks	816.0	839.4	869.3	866.5
Debtors	319.6	292.1	317.5	327.5
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)	(1,163.6)	(1,172.0)
Creditors	(1,002.0)	(1,105.2)	(1,163.6)	(1,172.0)
Short term borrowings	(83.4)	(25.1)	0.0	0.0
Long Term Liabilities	(201.9)	(235.8)	(271.5)	(269.0)
Long term borrowings	(86.6)	(88.8)	(122.8)	(118.6)
Other long term liabilities	(115.3)	(147.0)	(148.7)	(150.4)
Net Assets	297.8	341.7	375.2	408.2
CASH FLOW				
Operating Cash Flow	32.9	130.5	105.6	102.6
Net Interest	0.0	(13.8)	(17.6)	(15.7)
Tax	0.0	(17.3)	(12.5)	(12.6)
Capex	(36.0)	(45.5)	(49.4)	(43.9)
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	11.1	14.3
Opening net debt/(cash)	51.9	161.7	74.1	63.0
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	63.0	48.8

Source: Lookers reports, Edison Investment Research estimates. Note: *Continuing operations only.

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