Lookers PLC **BUY** **26th Oct, 2017**

Ticker: LOOK LN Yash Sidana (MBA2019)

Recommendation -> Quality 'franchise' available at cheap valuations due to over bearish expectations of near term risks

I think Lookers is a BUY as it is a good quality franchise with strong barriers to entry and growth potential due to industry consolidation. It trades at 6.4x NTM PE, implying an expected de-growth going forward whereas I believe the short term risk is over magnified and the business should have positive organic growth coupled with acquisition led kicker. This company has a fantastic ability to acquire companies for cheap at low margins and turn them around by increasing revenue streams to cover fixed costs, which has led to increased RoCE for Lookers, which I believe is sustainable in future.

Business Description *(Exhibit 7 – 10-year financials)*

Lookers Plc is one of the top 2 car retailers in the UK and sold 210,000 cars in 2016. The company operates through 155 franchised dealerships of 32 brands in 100 locations across UK and Northern Ireland. The product and service offerings majorly include new cars, used cars, and aftersales service. The company was founded by John Looker in 1908 and is headquartered in Manchester, the United Kingdom.

Brief Financials (GBP Mn)	CY14	CY15	CY16	3 yr CAGR	CY17E	CY18E	CY19E	CY20E	CY21E	CY17-21 CAGR
Revenue	3,043	3,649	4,282	**20%**	4,268	4,967	5,686	6,244	6,814	**12.4%**
Revenue Growth	*23%*	*20%*	*17%*		*0%*	*16%*	*14%*	*10%*	*9%*	
Revenue (Ex-Parts)	**2,837**	**3,430**	**4,088**	**22%**	**4,268**	**4,967**	**5,686**	**6,244**	**6,814**	**12.4%**
EBIT	**74**	**79**	**90**	**16%**	**95**	**100**	**107**	**122**	**138**	**9.7%**
EBIT Margin	*2.4%*	*2.2%*	*2.1%*		*2.2%*	*2.0%*	*1.9%*	*2.0%*	*2.0%*	
Adj.PAT	**47**	**49**	**62**	**19%**	**60**	**63**	**66**	**77**	**90**	**10.7%**
Adj. PAT Margin	*1.5%*	*1.4%*	*1.4%*		*1.4%*	*1.3%*	*1.2%*	*1.2%*	*1.3%*	
EPS (GBX)	**11.8**	**12.4**	**15.5**		**15.2**	**16.0**	**16.7**	**19.4**	**22.7**	
P/E			**6.6**		**6.7**	**6.4**	**6.1**	**5.2**	**4.5**	
EV/EBITDA			**5.2**		**4.9**	**4.6**	**4.3**	**3.8**	**3.4**	

Price (GBX)	102
3 yr Target Pr. (GBX)	177
Annualized return (IRR)	24%
Mkt Cap (GBP Mn)	404
EV	465
Public Float	79%
Avg. Traded Vol. (180d)	632k
2016 Dividend Yield	3.6%
P/E LTM	6.7x
P/E NTM	6.4x
52w price range (GBX): 99-131	

Industry Analysis -> Reducing outlets + improved outlet performance + increasing franchisee negotiating power

UK has around 4,500 dealerships (2016) and this number is continuously declining. From around 7,000 dealerships 20 years back to 6,000 in 2006, this number is expected to go further down to 3,000 in the next 10 years *(Exhibit 1-a)*. The market is highly fragmented with Top 10 dealers capturing only 20% of the market and majority of dealerships being family owned single outlets. The market is heated up with large professional dealership groups like Pendragon, Inchcape, Lookers and Vertu on an acquisition spree to consolidate the industry. The major reasons for consolidation in the industry are –

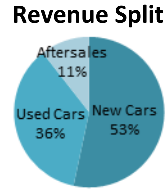
- ✓ Due to heightened OEM competition, customer service has become a major factor and OEMs are looking to partner with professional groups who can provide consistent top quality service.
- ✓ Dealerships are being forced to invest in an omni-channel experience that requires capex and technical expertise. Also, single outlets are not much profitable as they are unable to cover high fixed costs by driving used car and aftersales.

This consolidation has led to enhanced outlet level performance in the last 5 years *(Exhibit 1–b)* and has reduced OEM negotiation power with franchisees. US industry has followed a similar pattern of consolidation that has led to formation of large cap businesses such as AutoNation ($4.7B), Penske ($4.1B) and Lithia Motors ($2.7B). These businesses have superior return on capital and equity (18-20%) and high free cash flow generation and still continue to grow via acquisitions.

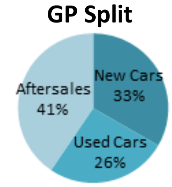
Business Segments & Historical Growth

3 business segments – New Car, used Car and aftersales. They sold off their parts business in 2016 (High margin, low growth, no synergy). The business has majority of sales coming from new cars but interestingly, new cars contribute to only one third of gross profit!

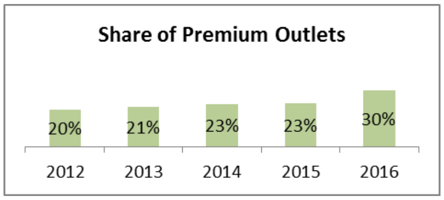
Revenue Split



GP Split



New Cars: Lookers sell over 100k new cars (CY16 sales £950M) each year and currently has around 3.8% market share, which has grown from 2.8% in 2013. New car market in UK is around 2.7M units and have grown in the last 5 years due to low interest costs and the introduction of PCP (Personal Contract Purchase) plan *(Exhibit 1-c – also contains explaination of PCP)*. This segment is highly cyclical in nature with long term growth rates of around 2% *(Exhibit 1-d)*. In the last 3 years Lookers have outperformed market growth on a like to like basis by 5-7% each year. One of the major reason for this outperformance has been Lookers's focus on acquiring and nurturing relationships with premium OEM brands (Audi, BMW, Mercedes, Mini, Landrover, Jaguar). The below table suggests that these brands have grown faster than the market and outperformance to industry growth increases to 7-10% in periods of low to negative growth. Over the last 5 years, Lookers have **increased the share of premium outlets to 30% in number and around 50% in sales** *(per outlet sales for premium brands vs others in Exhibit 1-e).* For eg: Lookers is the largest dealer for Mercedes in UK with £600M in sales - Mercedes is 9% of Lookers outlets but 15% of sales due to higher per outlet sales. These brands have 25% market share in UK new car market. Assuming going forward these brands maintain their outperformance of 7-10%, with the brand mix of Lookers' sales, it would mean Lookers' new car sales will outperform market by 2-3% due to this factor itself. The other reasons for outperformance include better availability of capital compared to single outlet owners to increase store sizes. This segment has low gross margin of 7-8% and is susceptible to declining margins due to high discounting in low growth years.



	2010	2011	2012	2013	2014	2015	2016	9MFY17
Industry growth	1%	-4%	5%	11%	10%	9%	2%	-4%
Select Premium Growth	9%	6%	13%	12%	10%	15%	13%	3%
Outperformance	7%	10%	8%	1%	0%	6%	10%	7%

Used Cars: Used car market (8Mn transactions/yr) is highly fragmented with share of franchised dealership at 40% and Lookers' share at around 1% (CY16 sales of £650M). The outperformance of growth of Lookers in this segment is due to increased finance and PCP deals *(Exhibit 1-f)*, improved web presence (60-70% start their used car purchase journey online) and ability to drive used car sales in acquired franchises. This segment has more stable growth than new cars and has similar margins of 7-8%. In 2008, when new car sales fell by 12%, used cars fell only by 3%. Also, in the Q2 CY17 when new cars fell by 10%, used car segment was flat.

Aftersales: This segment has £21bn market size with Looker's share of around 1% (CY16 sales of £270M). It has high gross margin (45%) with long runway for growth for the large dealerships due to 2 reasons –

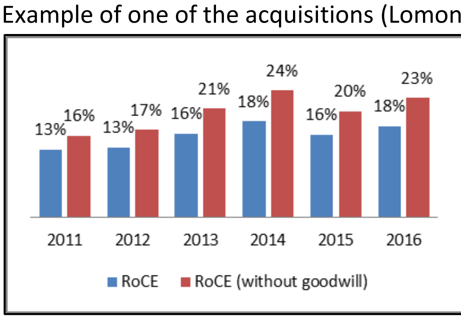
- ✓ Due to high growth of new cars in the last 5-6 years, the number of vehicles in the market (UK parc) with age 0-3 years is at its peak of 7.5M (34 Mn vehicle parc) *(Exhibit 1-g)* – this is the most attractive segment for the franchised dealers and they capture this segment through selling service plans with vehicles. *(Exhibit 1-h)*
- ✓ As increasingly large number of vehicles is sold under PCP (almost 80-90% of new cars), consumers have even more reasons to maintain the car so as to avoid any penalties after the end of contract.

Lookers is able to grow fast in this segment due to the above two tailwinds as well as its ability to induce aftersales in acquired outlets by salesman training.

Business Characteristics

This business has a lot of positives which makes it a good quality business –

- ✓ Market leader with strong barriers to entry in the form of licenses of brands for particular geographies
- ✓ High free cash flow generation (3 year avg pre-acquisition cash flow to net income of 130%), high and increasing RoCE (18%) and RoE (19%) and stable margins
- ✓ Long run way for growth as even though the new car growth is only 2-3% in the long run, higher growth segments of used car and aftersales improve overall growth. Also, since number of dealerships is reducing by 3-4% each year, this adds to organic growth of dealerships that survive.
- ✓ Solid corporate governance for the following reasons –
  - Have grown dividends consistently for the last 8 years
  - Acquisitions have been well thought out and they have been extremely strict on the price they pay. They have achieved **20% RoI on acquired businesses** for cumulative sum of around £190M over the years
  - Top management salary structure inclined for shareholder benefit/performance with total salary having broadly equal components of fixed, performance incentive and employee stock options.
- ✓ Fantastic ability to acquire and integrate in the business. This can be shown by 3 ways –
  - The RoCE of the business has grown in the last 5 years since the company has stepped up the paddle on acquisitions. Growth in both types of RoCEs (with goodwill and excluding goodwill) shows that these acquisitions have been value accretive for the company and they haven't overpaid.
  - Last 2 years have seen a few large acquisitions, with total revenue of almost 30-40% of Lookers' business and EBIT margins in 1%-2% range *(Exhibit 5).* Even with this, Lookers EBIT margins haven't compressed by much (the reduced margins by 0.3% can largely be attributed higher growth of lower margin new car business)
  - Example of one of the acquisitions (Lomond Audi acquired for £15Mn in 2012) of growth & margin uplift –



	2011	2017E	CAGR
New Car Volume	3912	7634	12%
Used Car Volume	1283	4921	**25%**
Aftersales revenue	10.2	22.3	14%
Total Revenue	171.2	362.4	13%
Net Profit	0.66	6.6	47%
New Profit Margin	**0.4%**	**1.8%**	

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Reason for why is it trading cheaply and my thesis

1. Market sees 3 issues with the car retailing industry and hence the NTM PE multiples, industry wide, have shrunken to lower than 7x compared to 10-11x historical long term multiples.

Issues	**Mitigation/What do I feel about it for Lookers**
New car sales will tank	Due to higher premium share (50%) which outperforms markets in downturns and impeccable acquisition abilities, Lookers will be able to outperform the market. Also, two-thirds of profit is coming from more stable used car and aftersales segments.
Comments from Bank of England director that PCP has contributed to creating a credit bubble in the economy and with declining residual values of used cars, people will default or hand back the car => increasing used car supply	Firstly, Lookers does not finance the PCP vehicles itself so doesn't bear credit risk. Secondly, recent comments by the BoE director have cleared that 70% of PCP holders are from above average income households and in the world of franchised dealers, the sub-prime loans are less than 0.1%. Balloon payments take 10-15% discount on perceived residual values. Highest ever fall in residual values of 10% in UK and 6% in US happened in 2008 *(Exhibit 1-i)*. Hence, there is sufficient positive equity of PCP holder to cover for significant fall.
With Brexit, risk of increasing prices by up to 10% as cars assembled in UK but parts are manufactured in EU	This is a real risk but due to prevalence of PCP finance plans. a 10% increase in car price will only add about £30 per month to monthly EMI of £320 for buying a Audi A1 sport back on PCP vs the impact of price increase by £2000. This lowers the impact!

2. Immense acquisition opportunity - Rising technology costs and declining margins are pressuring smaller independent franchisees, incentivizing them to come to the bargaining table, especially as industry demand slows. Moreover, larger well-capitalized dealer groups are able to realize scale benefits (CRM systems, HR, advertising, accounting, financing) and share their best practices to generate strong returns on acquisitions by increasing revenues from used car sales and aftersales. BMW has asked Lookers to increase their number of dealerships from 3 to 10+ (equal to Audi's and Mercedes). **Lookers has very low debt/equity of 17% with bank loans commitments of £260Mn (of which £170M is utilized) locked in till Mar 2020**.
3. High RoCEs to be maintained due to the following reasons –
    a. They acquire cheap (RoCEs have improved in the last few years of acquisitions). In fact, they may get opportunity to buy cheaper if market falls a lot.
    b. They increase margins by adding revenue streams of
        i. used car by integrating them on their website (1Mn unique visitors and 27% visitor growth in 2016) and in their deals with major used car websites
        ii. aftersales by providing training to the staff on how to attach service plan on cars sold

Valuation & Returns *(Exhibit-2 and 3)*

I have a private equity approach to valuing public market companies – long term view and IRR approach (over 3-5 years). I have forecasted the business in 2 ways – with no acquisitions and with moderate amount of acquisitions. The following table gives the CY20 revenue and Net income in the two cases and the Bloomberg consensus estimate. US car dealerships trade at 12x NTM PE and have traded at similar multiples in the past *(Exhibit 4).* UK ones have traded at 10-11x long term NTM PE but currently trade at 6.5-7.5x due to discussed risks. Consensus estimates flattish revenues for next few years and declining profits. I think in bear case of no acquisitions, company will be able to increase profits and due to high FCF generation will be able to increase dividends by 10% each year. Lookers seem best placed of the UK dealers as it has the scale, highest margins and lowest debt to equity. **In steady state this business should trade at 10x NTM PE as I don't believe the business is going through any structural pain point**. I have used 8x as exit PE as a margin of safety in my analysis, which gives 24% return in base case (with acquisitions) and a decent 17% return in bear case. In the realistic scenario, if it does trade at 10x NTM PE, it will give 30%+ returns over a 3 year period.

CY20 (£M)	**CY16**	**Bloomberg**	**My estimate – No Acquisition**	**My estimate – With Acquisitions**
Revenue	4,282	4,487	4,525	6,244
Net income	62	59	67	77

Catalyst

I believe the biggest catalyst for this stock will be the next two quarterly results. New car industry sales have already turned red in Q3CY17 by de-growing 10%. If the company shows resilience in results, stock will re-rate.

Investment Risks

- Prolonged de-growth in new cars and loss in consumer sentiment affecting both new car and used car sales
- Rapid entry of electric vehicles and rapid shift of consumers into car sharing will lead to a structural problem for the industry of low demand of car per household and increasing life of the car.
- Inability to turnaround a large future acquisition can lead to margin decompression

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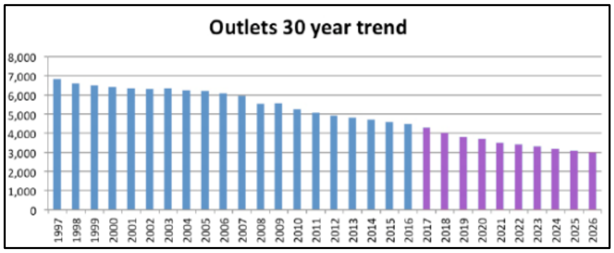
<u>Exhibit – 1</u>

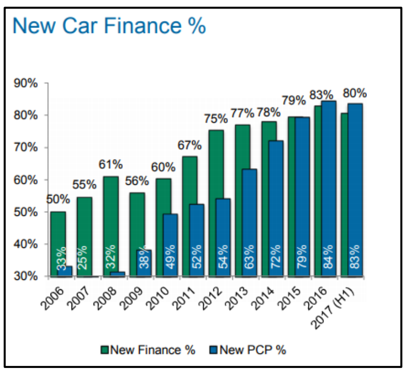
a. Trend of Dealerships (Source: Lookers)



b. Lookers' per outlet performance (Company Data)

	2011	2016	CAGR
Outlets	124	155	25%
Turnover (£M)	1,899	4,282	**126%**
Per outlet turnover (£M)	15.3	27.6	80%
GP	253	504	100%
GP per outlet (£M)	2.0	3.3	**60%**
PBT	31	68	117%
PBT/outlet (£M)	0.253	0.439	**73%**

c. PCP penetration for Lookers in New Cars (Source: Lookers)



<u>Explanation of PCP Contract</u>

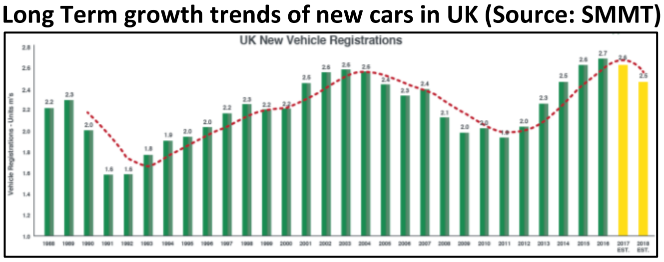
- ✓ Assume Price of a car = £20,000, Upfront Payment = 10%, 3 yr out residual value estimate = £12,000, Balloon payment set = 85% of residual value
- ✓ The loan amount is only of the differential amount of Price – deposit – Balloon, hence lower EMI compared to full car loan.

At the end of contract, customer can –

- ✓ Pay the balloon payment and buy the car
- ✓ Give the keys and go home
- ✓ Use the extra equity in the car (residual value – balloon value) to roll over another PCP contracts

As balloon payments are always lower than expected residual value, the customer has equity in the car at the end of tenure and he doesn't want to forego that and hence rolls over the contract.

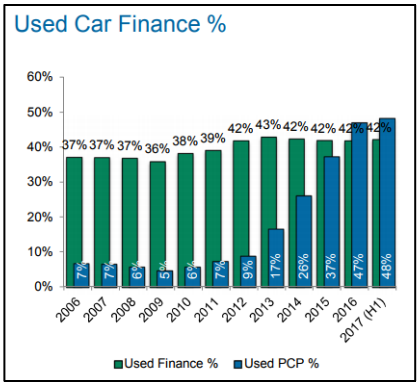
d. Long Term growth trends of new cars in UK (Source: SMMT)



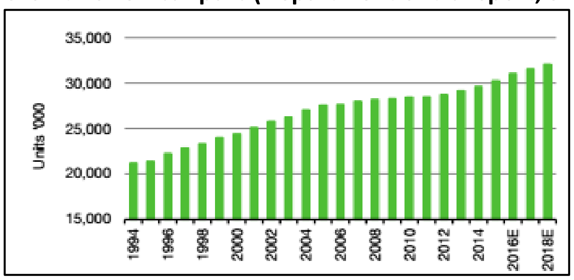
e. Sales per outlet – Brand Level (Source: Lookers)

Manufacturer	Number of Sales Points	Retail Registrations	Average Retail Registrations per Sales Point	Fleet Registrations	Average Fleet Registrations per Sales Point	Total Sales	Average Total Registrations per Sales Point
Audi	115	85,100	740	92,204	802	177,304	1,542
Mercedes Benz	125	76,700	614	93,127	745	169,827	1,359
Volkswagen	191	99,411	520	107,617	563	207,028	1,084
BMW	146	66,210	453	116,383	797	182,593	1,251
Land Rover	118	46,251	392	33,287	282	79,538	674
Nissan	195	74,574	382	77,951	400	152,525	782
Vauxhall	344	114,154	332	136,798	398	250,952	730
Ford	481	147,329	306	170,987	355	318,316	662
Porsche	36	10,592	294	2,505	70	13,097	364

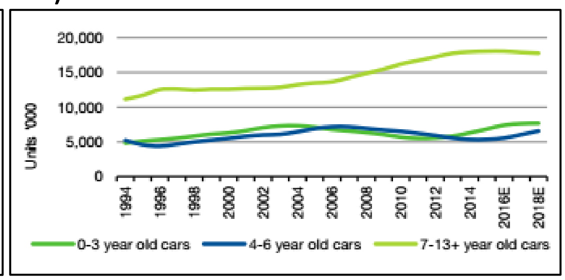
f. PCP penetration for Lookers in Used Cars (Source: Lookers)



g. Growth of UK car parc (Department of transport, SMMT)

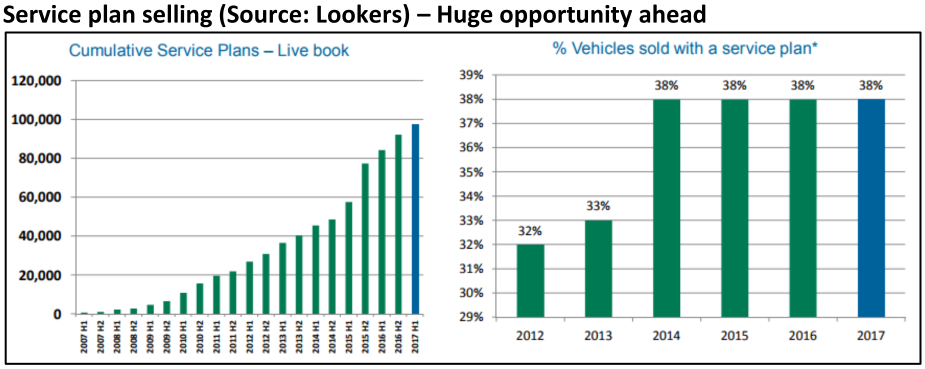


Total UK Car Parc



Car Parc by age

h. Service plan selling (Source: Lookers) – Huge opportunity ahead



i. Used Car residual value change in US (Source: Manheim Reports)

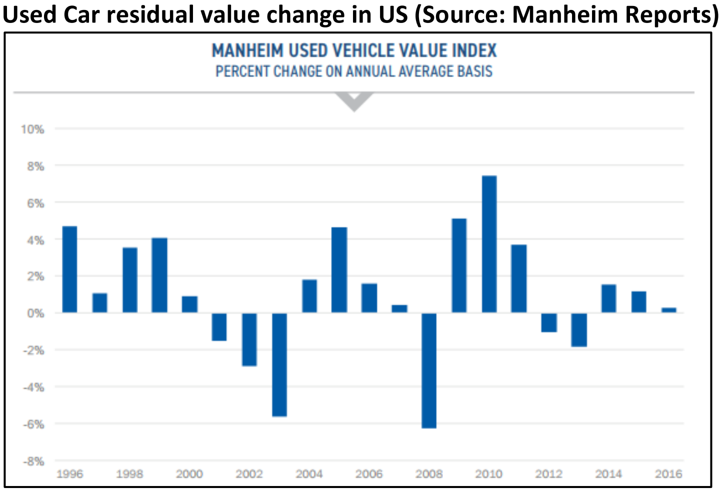


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Exhibit - 2

BASE case - Brief Financials – Projections – With Acquisitions

Assumptions	**CY14**	**CY15**	**CY16**	**CY17 H1**	**CY17E**	**CY18E**	**CY19E**	**CY20E**	**CY21E**
New Car growth - Industry		6%	2%	-1%	-3%	-5%	0%	1%	2%
LFL Sales Growth - Lookers		9%	9%	7%	4%	1%	1%	3%	3%
Outperformance (O/p)		**3%**	**6%**	**8%**	**7%**	**6%**	**1%**	**2%**	**1%**
LFL Growth									
New Car		11%	10%	8%	5%	1%	1%	3%	3%
O/p to industry		*4%*	*7%*	*9%*	*8%*	*6%*	*1%*	*2%*	*1%*
Used Car		4%	8%	7%	3%	1%	1%	3%	3%
Aftersales		5%	1%	8%	6%	4%	4%	5%	5%
LFL Gross Margin									
New Car	7.8%	7.6%	7.3%		7.2%	7.2%	7.1%	7.1%	7.1%
Used Car	7.5%	7.3%	7.3%		7.2%	7.2%	7.1%	7.1%	7.1%
Aftersales	42.2%	45.4%	45.5%		45.5%	45.5%	45.5%	45.5%	45.5%

Brief Financials (GBP Mn)	**CY14**	**CY15**	**CY16**	**3 yr**	**CY17E**	**CY18E**	**CY19E**	**CY20E**	**CY21E**	**CY17-21**
Revenue	3,043	3,649	4,282	**20%**	4,268	4,967	5,686	6,244	6,814	**12.4%**
Revenue Growth	*23%*	*20%*	*17%*		*0%*	*16%*	*14%*	*10%*	*9%*	
Revenue (Ex-Parts)	**2,837**	**3,430**	**4,088**	**22%**	**4,268**	**4,967**	**5,686**	**6,244**	**6,814**	**12.4%**
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EBIT Margin	*2.4%*	*2.2%*	*2.1%*		*2.2%*	*2.0%*	*1.9%*	*2.0%*	*2.0%*	
Adj.PAT	**47**	**49**	**62**	**19%**	**60**	**63**	**66**	**77**	**90**	**10.7%**
Adj. PAT Margin	*1.5%*	*1.4%*	*1.4%*		*1.4%*	*1.3%*	*1.2%*	*1.2%*	*1.3%*	
Dividend per share (p)	2.6	2.9	3.3	12%	3.7	4.0	4.4	4.9	5.4	10.0%
Growth	9%	12%	14%		10%	10%	10%	10%	10%	
Net Debt/Equity	20%	54%	22%		11%	18%	15%	5%	-5%	
Gross Asset Turns	2.7	2.3	2.5		2.5	2.5	2.6	2.6	2.7	
Working Cap Days	5	9	-2		-2	-2	-2	-2	-2	
CFO	56	1	138		84	94	101	113	127	
Capex	43	139	4		40	110	80	50	50	
FCF	**13**	**-138**	**134**		**44**	**-16**	**21**	**63**	**77**	

Returns

3 year Return - With Acquisition

No. of shares	397	
Market Price	102	*GBX / share*
Market Cap	404	*GBP Mn*

Multiples	**LTM**	**NTM**
Adj. P/E	6.7	6.4
CY20 exit P/E		8.0

	Oct-17	**Oct-18**	**Oct-19**	**Oct-20**
Investment	-404			
Dividend		16	18	19
Exit Value				704
	-404	**16**	**18**	**723**

Implies a price of 177 GBX

IRR	24%
MoM	1.9

Exit Multiple

	24%	**7**	**8**	**9**	**10**	**11**
Entry Price	**80**	29%	35%	40%	44%	49%
	90	24%	29%	34%	39%	43%
	102	19%	24%	29%	33%	37%
	110	16%	21%	25%	30%	34%
	120	12%	17%	22%	26%	30%

Margin of Safety

1. Very conservative slowdown of outperformance of new car sales growth over industry growth
2. Gross margins reduced (anticipation of lower dealer margins on new cars in slow growth market and reducing residual values of used cars) even though 3 large acquisitions in 2015, 2016 were low margin businesses which are expected to turn around – so in effect, the gross margin contraction is higher built in than it seems
3. Projected similar level of goodwill to acquire the franchisees as in the past. With stressed market in near future, Lookers can acquire at lower goodwill than in the past.
4. Even at 7x multiple at exit, the investment returns 19% annualized return!

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Exhibit - 3

Bear Case - Brief Financials – Projections – No Acquisitions

Assumptions	**CY14**	**CY15**	**CY16**	**CY17 H1**	**CY17E**	**CY18E**	**CY19E**	**CY20E**	**CY21E**	
New Car growth - Industry		6%	2%	-1%	-3%	-5%	0%	1%	2%	
LFL Sales Growth - Lookers		9%	9%	7%	4%	1%	1%	3%	3%	
Outperformance (O/p)		**3%**	**6%**	**8%**	**7%**	**6%**	**1%**	**2%**	**1%**	
LFL Growth										
New Car		11%	10%	8%	5%	1%	1%	3%	3%	
O/p to industry		*4%*	*7%*	*9%*	*8%*	*6%*	*1%*	*2%*	*1%*	
Used Car		4%	8%	7%	3%	1%	1%	3%	3%	
Aftersales		5%	1%	8%	6%	4%	4%	5%	5%	
LFL Gross Margin										
New Car	7.8%	7.6%	7.3%		7.2%	7.2%	7.1%	7.1%	7.1%	
Used Car	7.5%	7.3%	7.3%		7.2%	7.2%	7.1%	7.1%	7.1%	
Aftersales	42.2%	45.4%	45.5%		45.5%	45.5%	45.5%	45.5%	45.5%	
Brief Financials (GBP Mn)	**CY14**	**CY15**	**CY16**	**3 yr**	**CY17E**	**CY18E**	**CY19E**	**CY20E**	**CY21E**	**CY17-21**
Revenue	3,043	3,649	4,282	**20%**	4,268	4,325	4,383	4,525	4,671	**2.3%**
Revenue Growth	*23%*	*20%*	*17%*		*0%*	*1%*	*1%*	*3%*	*3%*	
Revenue (Ex-Parts)	**2,837**	**3,430**	**4,088**	**22%**	**4,268**	**4,325**	**4,383**	**4,525**	**4,671**	**2.3%**
EBIT	**74**	**79**	**90**	**16%**	**95**	**93**	**90**	**98**	**106**	**2.6%**
EBIT Margin	*2.4%*	*2.2%*	*2.1%*		*2.2%*	*2.1%*	*2.1%*	*2.2%*	*2.3%*	
Adj.PAT	**47**	**49**	**62**	**19%**	**60**	**59**	**59**	**67**	**75**	**5.8%**
Adj. PAT Margin	*1.5%*	*1.4%*	*1.4%*		*1.4%*	*1.4%*	*1.3%*	*1.5%*	*1.6%*	
Dividend per share (p)	2.6	2.9	3.3	12%	3.7	4.0	4.4	4.9	5.4	10.0%
Growth	9%	12%	14%		10%	10%	10%	10%	10%	
Net Debt/Equity	20%	54%	22%		11%	4%	-9%	-20%	-30%	
Gross Asset Turns	2.7	2.3	2.5		2.5	2.5	2.5	2.6	2.6	
Working Cap Days	5	9	-2		-2	-2	-2	-2	-2	
CFO	56	1	138		84	85	84	92	100	
Capex	43	139	4		40	40	10	10	10	
FCF	**13**	**-138**	**134**		**44**	**45**	**74**	**82**	**90**	

Returns

3 year Return - No Acquisition

No. of shares	397	
Market Price	102	*GBX / share*
Market Cap	404	*GBP Mn*

Multiples	**LTM**	**NTM**
Adj. P/E	6.7	6.8
CY20 exit P/E		8.0

	Oct-17	**Oct-18**	**Oct-19**	**Oct-20**
Investment	-404			
Dividend		16	18	19
Exit Value				592
	-404	**16**	**18**	**611**

Implies a price of 149 GBX

IRR	17%
MoM	1.6

Exit Multiple

	17%	**7**	**8**	**9**	**10**	**11**
Entry Price	**80**	22%	28%	32%	37%	41%
	90	18%	23%	27%	31%	35%
	102	13%	17%	22%	26%	30%
	110	10%	14%	19%	23%	26%
	120	6%	11%	15%	19%	23%

Margin of Safety

1. Very conservative slowdown of outperformance of new car sales growth over industry growth
2. Gross margins reduced (anticipation of lower dealer margins on new cars in slow growth market and reducing residual values of used cars) even though 3 large acquisitions in 2015, 2016 were low margin businesses which are expected to turn around – so in effect, the gross margin contraction is higher built in than it seems
3. Even at 7x multiple at exit, the investment returns 13% annualized return!

Exhibit – 4

Comparable Sheet

Company	Market Cap (GBP/USD Mn)	Growth		2016 (GBP/USD Mn)						NTM PE		
		H1 CY17	3 yr	Sales	EBIT%	PAT%	RoE	RoCE	Div. Yield	Current	5 yr Median	10 yr Median
UK Comps												
Pendragon	350	6%	6%	4,537	2.2%	1.2%	15%	16%	6%	6.9x	10.5x	8.4x
Lookers	404	10%	20%	4,282	2.1%	1.4%	19%	18%	3%	6.7x	10.9x	9.4x
Vertu	184	-1%	19%	2,823	1.1%	0.9%	11%	16%	3%	7.4x	10.9x	10.3x
Median		**6%**	**19%**		**2.1%**	**1.2%**	**15%**	**16%**	**3%**	**6.9x**	**10.9x**	**9.4x**
US Comps												
CarMax Inc.	13,523		8%	15,875	6.7%	3.9%	21%	17%	0%	18.6x	18.6x	18.6x
AutoNation	4,689		7%	21,609	4.1%	2.0%	20%	22%	0%	12.2x	13.4x	13.6x
Penske Automotive	4,112		11%	20,118	2.9%	1.7%	19%	24%	2%	10.6x	11.8x	11.9x
Lithia Motors	2,740		29%	8,678	3.9%	2.3%	23%	18%	1%	12.1x	13.3x	12.1x
Group 1 Automotive	1,417		7%	10,889	3.1%	1.3%	11%	18%	1%	9.6x	11.4x	11.4x
Median			**8%**		**3.9%**	**2.0%**	**20%**	**18%**	**1%**	**12.1x**	**13.3x**	**12.1x**

Within UK dealers, Lookers has the best growth, margins and return on capital and equity. Compared to US dealers, it trades at 40% discount with similar return metrics and higher growth.

Exhibit – 5

Acquisition History

In £M	2007	2013	2013	2014	2015	2016	2016	Median
Name	Dutton	Chipperfield	Shields	Colborne	Benfield	Draytons	Knights	
Price Paid	54.9	10.4	8.8	27.4	87.5	56.3	26.6	
Revenue	396	30	26	259	771	295	232	
EBIT	3	1	1	3	9	6	3	
Tax		0	0	1	1	1	0	
PAT		1	1	1	6	4	2	
EBIT%	0.8%	4.7%	3.4%	1.0%	1.1%	2.0%	1.4%	**1.4%**
PBT%		4.7%	3.4%	0.7%	0.9%	1.7%	0.8%	**1.3%**
PAT%		4.3%	3.1%	0.5%	0.7%	1.3%	0.7%	**1.0%**
Sales/Acquisition price	7.2	2.9	3.0	9.5	8.8	5.2	8.7	**7.2**
EBIT/Acq Acquisition price	6%	13%	10%	10%	10%	11%	12%	**10%**

<u>Exhibit – 6</u>

Latest Balance Sheet (Source: Lookers)

	Unaudited 30 June 2017 £m	Unaudited 30 June 2016 £m	Audited 31 Dec 2016 £m
Non current assets			
Goodwill	107.6	96.4	107.6
Intangible assets	113.6	64.0	109.8
Property, plant and equipment	328.0	268.9	319.1
	549.2	429.3	536.5
Current assets			
Inventories	857.1	797.1	839.4
Trade and other receivables	320.4	330.0	225.0
Rental fleet vehicles	67.5	63.9`	67.1
Cash and cash equivalents	72.7	27.1	39.8
	1,317.7	1,218.1	1,171.3
Total assets	**1,866.9**	**1,647.4**	**1,707.8**
Current liabilities			
Bank loans and overdrafts	51.8	20.6	25.1
Trade and other payables	1,199.5	1,081.0	1,087.5
Current tax liabilities	14.4	17.6	14.7
Short term provisions	-	0.6	-
Derivative financial instruments	3.0	4.8	3.0
	1,268.7	1,124.6	1.130.3
Net current assets	49.0	93.5	41.0
Non current liabilities			
Bank loans	82.8	81.4	88.8
Trade and other payables	35.0	34.6	33.6
Retirement benefit obligations	75.3	77.8	78.4
Deferred tax liabilities	34.3	20.8	35.0
Long term provisions	-	0.7	-
	227.4	215.3	235.8
Total liabilities	1,496.1	1,339.9	1,366.1
Net assets	370.8	307.5	341.7
Shareholders' equity			
Ordinary share capital	19.9	19.8	19.8
Share premium	78.4	77.8	77.7
Capital redemption reserve	14.6	14.6	14.6
Retained earnings	257.9	195.3	229.6
Total equity	370.8	307.5	341.7

Exhibit – 7

Last 10-year Financials

											CAGR		
In GBP Mn	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	3yr	5yr	7yr
Revenue	**1,680**	**1,776**	**1,749**	**1,884**	**1,899**	**2,057**	**2,465**	**3,043**	**3,649**	**4,282**	**20%**	**18%**	**14%**
Revenue Growth	*17.8%*	*5.7%*	*-1.5%*	*7.7%*	*0.8%*	*8.3%*	*19.8%*	*23.5%*	*19.9%*	*17.3%*			
New Cars		787	784	844	943	954	1,130	1,477	1,835	2,206	19%	16%	
Used Cars		557	543	595	531	647	794	1,009	1,212	1,437	22%	15%	
Aftersales		302	268	268	239	270	343	352	383	445	13%	7%	
Parts		130	154	176	187	187	197	206	219	194	1%	3%	
Gross Profit	**207**	**242**	**261**	**261**	**253**	**272**	**336**	**396**	**452**	**504**	**15%**	**15%**	**10%**
Gross Margin	*12.3%*	*13.6%*	*14.9%*	*13.8%*	*13.3%*	*13.2%*	*13.6%*	*13.0%*	*12.4%*	*11.8%*			
Operating Income (EBIT)	**42**	**30**	**29**	**46**	**44**	**48**	**57**	**74**	**79**	**90**	**16%**	**15%**	**17%**
EBIT Margin	*2.5%*	*1.7%*	*1.7%*	*2.4%*	*2.3%*	*2.3%*	*2.3%*	*2.4%*	*2.2%*	*2.1%*			
PBT	**27**	**9**	**11**	**31**	**31**	**35**	**44**	**59**	**61**	**68**	**16%**	**17%**	**29%**
PBT%	*1.6%*	*0.5%*	*0.7%*	*1.7%*	*1.7%*	*1.7%*	*1.8%*	*1.9%*	*1.7%*	*1.6%*			
PAT	**16**	**-16**	**8**	**23**	**25**	**27**	**36**	**47**	**51**	**81**	**31%**	**26%**	**39%**
PAT Margin	*1.0%*	*-0.9%*	*0.5%*	*1.2%*	*1.3%*	*1.3%*	*1.5%*	*1.5%*	*1.4%*	*1.9%*			
Adj PAT	**20**	**5**	**8**	**23**	**25**	**27**	**36**	**47**	**49**	**62**	**19%**	**20%**	**34%**
Adj PAT%	*1.2%*	*0.3%*	*0.5%*	*1.2%*	*1.3%*	*1.3%*	*1.5%*	*1.5%*	*1.4%*	*1.4%*			
Adj EPS	0.11	0.02	0.03	0.06	0.07	0.07	0.09	0.12	0.13	0.16	**19%**	**19%**	**28%**
Dividend per share	0.03	0.03	-	0.01	0.02	0.02	0.02	0.03	0.03	0.03	**11%**	**11%**	
Total Dividends	6	7	-	2	8	8	10	10	12	13	**12%**	**11%**	
Dividend Payout	28%	133%	0%	10%	31%	31%	26%	22%	24%	21%			
Total Assets	712	665	635	684	733	833	951	1,121	1,585	1,708			
Net Debt	125	150	79	57	40	48	43	52	162	74			
Debt/Equity	112%	180%	49%	31%	20%	24%	19%	20%	54%	22%			
WC Days	2	3	8	8	4	5	3	5	9	-2			
Total Asset Turn	2.4	2.7	2.8	2.8	2.6	2.5	2.6	2.7	2.3	2.5			
Profit Margin	1.2%	0.3%	0.5%	1.2%	1.3%	1.3%	1.5%	1.5%	1.4%	1.4%			
Leverage	6.4	8.0	4.0	3.8	3.7	4.1	4.2	4.4	5.3	5.0			
RoE	**18%**	**5%**	**7%**	**13%**	**13%**	**14%**	**17%**	**19%**	**18%**	**19%**			
RoCE	**14%**	**10%**	**7%**	**12%**	**13%**	**13%**	**16%**	**18%**	**16%**	**18%**			
RoCE (without goodwill)	**16%**	**12%**	**9%**	**14%**	**16%**	**17%**	**21%**	**24%**	**20%**	**23%**			
CFO	**40**	**-6**	**-2**	**35**	**40**	**32**	**60**	**56**	**1**	**138**			
Capex	**82**	**15**	**5**	**5**	**11**	**42**	**41**	**43**	**139**	**4**			
Acquisitions (Incl. goodwill &	*73*	*7*	*0*	*0*	*-1*	*19*	*19*	*25*	*107*	*102*			
FCF	**-42**	**-21**	**-6**	**29**	**29**	**-10**	**19**	**13**	**-138**	**134**			
FCF (Ex-Acquisition)	**31**	**-14**	**-6**	**29**	**28**	**9**	**38**	**38**	**-31**	**235**			