

30 September 2010

## Eco City Vehicles

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/08	19.0	(0.70)	(0.23)	0.00	N/A	N/A
12/09	24.7	(0.19)	(0.06)	0.00	N/A	N/A
12/10e	26.5	0.18	0.06	0.00	95.8	N/A
12/11e	30.0	0.80	0.26	0.00	22.1	N/A

Note: \*PBT and EPS are normalised, excluding intangible amortisation and exceptional items.

### Investment summary: Steady progress

Despite the tough trading climate, Eco City Vehicles (ECV) remains on course to deliver underlying profits in the current year. A revenue shortfall, relative to expectations, has not impaired gross profits and the medium-term outlook continues to improve. Developments in the group's aftermarket business should lift margins over the next few years, but gearing remains very high.

#### Underlying profits

Interim figures show a reduction in the underlying pre-tax loss to £78k. Vehicle sales are usefully higher despite the challenging trading conditions. A decision to trade-in much of the incoming inventory of used vehicles has held back the increase in revenues, but the group has placed itself in a position to deliver profits during the second half. We do not propose to adjust our full year target of modest profits.

#### Aftermarket opportunity

ECV has secured an aftermarket franchise for light Mercedes Benz commercial vehicles. This should quickly add useful incremental turnover at useful gross margins. With the Bethnal Green workshops already equipped to handle the Vito taxi, there is relatively little capital investment necessary to meet customer requirements.

#### Borrowings higher

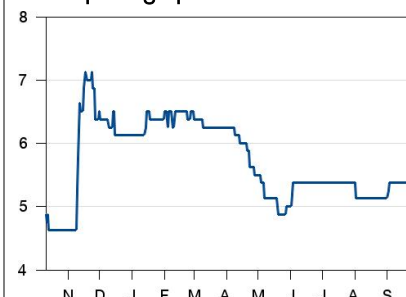
Net borrowings are slightly higher over the half year, while equity funds were again reduced by non-recurring costs. The appointment of a new FD in April suggests stronger internal financial controls, although we reiterate our earlier view that an injection of new equity funds would provide greater comfort into the future and enable management to tackle its opportunities from a stronger base.

#### Valuation: Rating justified by potential

It is still inappropriate to compare the ECV rating with that of other motor distributors. Action taken by management needs to deliver profits and generate cash as an essential component to achieving a rating. Assuming our estimates can be delivered, the City can look more optimistically at the real potential inherent in the business.

Price 5.75p  
Market Cap £17m

#### Share price graph



#### Share details

Code ECV  
Listing AIM  
Sector Retailers (Automotive)  
Shares in issue 302m

#### Price

52 week High 7.12p Low 3.50p

#### Balance Sheet as at 30 June 2010

Net debt/Equity (%) 1,159  
NAV per share (p) 0.1  
Net borrowings (£m) 2.87

#### Business

ECV has exclusive UK distribution rights for the Mercedes Benz Vito taxi and is looking to extend the business into electrically operated light commercial vehicles.

#### Valuation

	2009	2010e	2011e
P/E Relative	N/A	N/A	140%
P/CF	1.3	N/A	2.0
EV/Sales	0.8	0.8	0.7
ROE	N/A	39%	64%

#### Geography based on revenues (2009)

	UK	Europe	US	Other
100%	0%	0%	0%	0%

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## Progress towards profitability

ECV's interim results were largely in line with City expectations. While the performance was undermined by certain factors outside of management control, the Vito taxi continued to raise its market share. Moreover, management has concluded a fundamental franchise agreement with Mercedes Benz which should produce meaningful higher margin revenues into the future. We remain optimistic that the group will deliver underlying pre-tax profits in the current year and into the future.

### Steady progress

A combination of outside factors, notably the change in VAT rates (which brought forward a number of planned January sales into 2009) and the impact on the market of the appalling winter weather and the volcanic ash cloud held back progress in the current year. In addition, a decision to trade-in used LTI taxis meant that revenues were some way short of our earlier expectations. However, a 17% rise in gross profits was much in line with our earlier estimates and provided a firm indication that the group is moving steadily towards profitability.

#### Exhibit 1: Revenue breakdown

	2010 H1 £m	2009 H1 £m	Change %	2009 Full year £m
New vehicles	7.2	6.7	+7%	14.50
Used vehicles	2.4	2.2	+6%	4.02
Parts	1.6	1.4	+14%	2.94
Aftermarket	1.6	1.7	-4%	3.21
Other	0.0	0.4		0.01
	<b>12.8</b>	<b>12.4</b>	<b>+3%</b>	<b>24.67</b>

Source: Company announcements

The declared half-year loss from continuing activities was £0.340m. However, this figure was struck after non-recurring items of £0.155m and a fair value adjustment in interest charges of £0.107m, suggesting an underlying pre-tax loss of just £0.078m. While seasonal factors normally tend to favour first half trading, action taken by management suggests a stronger second half; we have cut our revenue target to £26-27m, but believe that our earlier full year target of underlying pre-tax profits of £0.25/0.30m still looks achievable.

**New Vehicles** – ECV delivered 234 new Vito taxis to the market in the first half of 2010, representing a 40% increase on the 167 delivered during the corresponding period of 2009. In addition, the group delivered just three TX4s (50 in 2009), the remaining inventory following the changed status of the group's franchise with LTI. Gross margins rose from 8.7% to 10.7%, as the group emphasis moved away from the more heavily discounted LTI vehicle.

Market conditions remained challenging throughout the period, with SMMT figures suggesting that UK new taxi registrations fell back by a further 3.5% over the period; the Vito again raised its market share, with the trading statement referring to Public Carriage Office Licence data indicating a rise in the group's London market share from 20.2% to 26.8%. SMMT figures are based on national registrations and suggest a lower market share, although the trend remains positive. These figures should be viewed in the context of the continuing recession and the impact on demand of

the other external factors mentioned above. By the end of the current year, there ought to be well over 1,000 Vito taxis in circulation; production was stepped up by some 50% to 12 vehicles per week earlier this year, which is a clear indication of management optimism.

In the medium term, the Mayor of London's Office is looking to tighten regulations about the use of older vehicles, while the likely positive impact of the Olympic Games is getting closer. The group is also moving its export ambitions forward. A left hand drive version of the Vito taxi has recently been developed, with the first prototype now fully operational.

**Used vehicles** – Used vehicle sales increased from 158 to 198 units, with gross margins also higher. The return to profit achieved during the second half of last year has clearly been sustained. We had been expecting a much sharper rise in revenue, with the increased Vito sales leading to a rising number of trade-ins. However, the heavy discounting of new LTI vehicle prices undermined used vehicle values and management decided to avoid the uncertainty by trading many of these vehicles in.

It is still too early for there to be much volume in the used vehicle market in Vito taxis and, with the overall market remaining unsettled, we do not expect to see much progress in the used vehicle segment in the immediate future.

**Parts and service** – Again, there were mixed performances from parts and service. A 4% fall in aftermarket revenues stemmed, in part, from a shift in demand as many taxi operators responded to the recession by moving their service work to the smaller 'under-the-arches' operators; lower revenue streams mean that work can sometimes be carried out free of VAT. Moreover, the impact of poor weather and the volcanic ash was lower airport business and a reduction in mileage, exacerbating the quiet market. By contrast there was a 14% rise in parts revenues as the group supplied these smaller local repair shops with increasing numbers of parts/spares. More significantly, there was growing new business in both areas associated with the Vito taxi.

There was a significant move during the half-year, with ECV recently securing an aftermarket franchise from Mercedes Benz for light commercial vehicles at its Bethnal Green facility. Appropriate equipment is largely already in place to service the Vito taxis, while there is ample capacity to build a meaningful business for the only franchised aftermarket operation in Central London. It is difficult to assess the speed with which revenues will build, but early indications are very encouraging, with a useful increment to the group bottom line expected in the current half year.

**Low emission vehicles** – Progress continues towards the introduction of electric vehicles to the London market. The all-electric Vito taxi prototype was unveiled early this year, generating considerable interest. However, the speed and extent of the take-up of the vehicle remains to be seen. Costs to the taxi driver are currently perceived to be rather high, but local and national government support is also evident.

A similar comment applies to the Mercedes Benz commercial vehicle project. The group took delivery of a 3.5 tonne hybrid truck last year, which generated useful feedback. Current plans

involve the imminent introduction of a 7.5 tonne vehicle. The potential is again quite considerable, but the timetable for revenues is currently difficult to gauge.

## Finance

Net borrowings increased over the half-year from £2.42m to £2.87m; shareholders' funds came back from £0.57m to £0.28m over the same period. Gearing rose sharply to reflect the relative nominal nature of shareholders' funds, but we are hopeful that second half profitability will lead to an improved situation at December 2010.

On present indications, we expect the group to be largely cash neutral during the second half. Cash flow ought to be higher, but there is probably a limit to the extent to which inventories can be held down.

As we indicated in our earlier reports, the ambitious medium- and longer-term plans involving acquiring further shares in One80 and developing the commercial vehicle aftermarket franchise would be better managed if the group were able to secure further equity funding. The support of Mercedes Benz remains a key factor in the future evolution of the group.

**Exhibit 2: Financials**

<b>PROFIT &amp; LOSS</b>	<b>£'000s</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010e</b>	<b>2011e</b>
Year end 31 December							
<b>Revenue</b>		<b>27,268</b>	<b>41,893</b>	<b>19,026</b>	<b>24,672</b>	<b>26,500</b>	<b>30,000</b>
Cost of Sales		(23,299)	(35,805)	(14,928)	(20,544)	(22,000)	(25,000)
Gross Profit		3,969	6,088	4,098	4,128	4,500	5,000
<b>EBITDA</b>		<b>399</b>	<b>1,175</b>	<b>(395)</b>	<b>191</b>	<b>545</b>	<b>1,140</b>
<b>Operating Profit (before GW and except.)</b>		<b>275</b>	<b>1,044</b>	<b>(580)</b>	<b>72</b>	<b>425</b>	<b>1,000</b>
Goodwill Amortisation		0	0	0	0	0	0
Exceptionals		(519)	(3,982)	(564)	(622)	(200)	0
Associate income		0	0	(90)	(40)	0	0
<b>Operating Profit</b>		<b>(244)</b>	<b>(2,938)</b>	<b>(1,234)</b>	<b>(590)</b>	<b>225</b>	<b>1,000</b>
Net Interest		(77)	254	(33)	(218)	(250)	(200)
Associates		0	0	(90)	(40)	0	0
<b>Profit Before Tax (norm)</b>		<b>198</b>	<b>1,298</b>	<b>(703)</b>	<b>(186)</b>	<b>175</b>	<b>800</b>
<b>Profit Before Tax (FRS 3)</b>		<b>(321)</b>	<b>(2,684)</b>	<b>(1,267)</b>	<b>(808)</b>	<b>(25)</b>	<b>800</b>
Tax		34	(6)	20	14	0	0
<b>Profit After Tax (norm)</b>		<b>232</b>	<b>1,292</b>	<b>(683)</b>	<b>(172)</b>	<b>175</b>	<b>800</b>
<b>Profit After Tax (FRS3)</b>		<b>(287)</b>	<b>(2,690)</b>	<b>(1,247)</b>	<b>(794)</b>	<b>(25)</b>	<b>800</b>
Average Number of Shares Outstanding (m)		240.0	252.4	302.1	302.1	302.1	303.1
<b>EPS - normalised (p)</b>		<b>0.10</b>	<b>0.51</b>	<b>(0.23)</b>	<b>(0.06)</b>	<b>0.06</b>	<b>0.26</b>
<b>EPS - FRS 3 (p)</b>		<b>(0.12)</b>	<b>(1.07)</b>	<b>(0.41)</b>	<b>(0.26)</b>	<b>(0.01)</b>	<b>0.26</b>
Gross Margin (%)		14.6%	14.5%	21.5%	16.7%	17.0%	16.7%
EBITDA Margin (%)		1.5%	2.8%	(2.1%)	0.8%	2.1%	3.8%
Operating Margin (before GW and except.) (%)		1.0%	2.5%	(3.0%)	0.3%	1.6%	3.3%
<b>BALANCE SHEET</b>							
<b>Fixed Assets</b>		<b>429</b>	<b>3,471</b>	<b>3,947</b>	<b>3,686</b>	<b>3,666</b>	<b>3,676</b>
Intangible Assets		0	0	0	0	0	0
Tangible Assets		429	2,516	2,837	2,616	2,596	2,606
Investment in associates		0	955	1,110	1,070	1,070	1,070
<b>Current Assets</b>		<b>4,765</b>	<b>5,705</b>	<b>6,423</b>	<b>5,331</b>	<b>5,263</b>	<b>7,545</b>
Stocks		1,099	2,527	4,228	2,689	2,700	3,257
Debtors		2,163	1,916	2,148	2,386	2,463	2,888
Cash		1,503	1,262	47	256	100	1,400
<b>Current Liabilities</b>		<b>(2,679)</b>	<b>(6,550)</b>	<b>(8,996)</b>	<b>(8,425)</b>	<b>(6,333)</b>	<b>(7,825)</b>
Creditors		(2,594)	(6,489)	(5,886)	(5,768)	(5,500)	(6,226)
Short term borrowings		(85)	(61)	(3,110)	(2,657)	(833)	(1,598)
<b>Long Term Liabilities</b>		<b>(128)</b>	<b>(42)</b>	<b>(23)</b>	<b>(21)</b>	<b>(2,150)</b>	<b>(2,150)</b>
Long term borrowings		(100)	(8)	(9)	(21)	(2,150)	(2,150)
Other long term liabilities		(28)	(34)	(14)	0	0	0
<b>Net Assets</b>		<b>2,387</b>	<b>2,584</b>	<b>1,351</b>	<b>571</b>	<b>446</b>	<b>1,246</b>
<b>CASH FLOW</b>							
<b>Operating Cash Flow</b>		<b>937</b>	<b>754</b>	<b>(2,988)</b>	<b>1,311</b>	<b>(111)</b>	<b>885</b>
Net Interest		(77)	254	(31)	(218)	(250)	(200)
Tax		(90)	0	0	0	0	0
Capex		1	(2,217)	(506)	(52)	(100)	(150)
Acquisitions/disposals		0	(955)	(245)	0	0	0
Financing		0	0	0	0	0	0
Dividends		(150)	(300)	0	0	0	0
Net Cash Flow		621	(2,464)	(3,770)	1,041	(461)	535
<b>Opening net (debt)/cash</b>		<b>723</b>	<b>1,318</b>	<b>1,193</b>	<b>(3,072)</b>	<b>(2,422)</b>	<b>(2,883)</b>
HP finance leases initiated		0	0	0	0	0	0
Other		(26)	2,339	(495)	(391)	0	0
<b>Closing net (debt)/cash</b>		<b>1,318</b>	<b>1,193</b>	<b>(3,072)</b>	<b>(2,422)</b>	<b>(2,883)</b>	<b>(2,348)</b>

Source: Edison Investment Research, company accounts

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