

Zipcar Inc (NASDAQ: ZIP): Long

Research Analyst: Harrison Freund		College/School: Commerce			Year: 3 rd			
		FYE: Dec 31	2009A	2010A	2011E	2012E	2013E	2014E
Share Price (11/25)	16.9							
Diluted Shares Outstanding (mm)	39.04	Revenue	131.2	186.1	240	310	390	480
Market Capitalization (mm)	659.8	y/y growth	24%	42%	29%	29%	26%	23%
		EBITDA	-1.8	4.2	9	20	40	60
Total Cash	55	Margin	-1%	2%	4%	6%	10%	13%
Total Debt	62	y/y growth			113%	122%	100%	50%
Minorities / Preferred	0	Adj. EPS	\$ (0.12)	\$ (0.37)	\$ (0.31)	\$ 0.17	\$ 0.45	\$ 0.70
Enterprise Value (mm)	666.8	Con. EPS		\$ (2.74)	\$ (0.38)	\$ 0.11	\$ 0.38	\$ 0.87
		EV/EBITDA	-	158	74	33	17	11
		P/E	-	-	-	99.4	37.9	24.1
		Con. P/E	-	-	-	73.5	40.4	

Core Investment Thesis: Zipcar is a fundamental long because it is the innovative first mover and market leader in car sharing, an area poised for secular expansion.

Key Thesis Points:

Urban and College Demographics Play into Zipcar's Business Model

- The hassles and expenses of owning a car in an urban area or college campus are enormous.
- Examples include: Parking fees, difficulty of finding parking spots, no parking or other special parking zones, high insurance and gasoline rates, urban road rage, driving restrictions and a host of other problems.
- **US Census data reveals the average household spends over 8,000 dollars on car related expenses per year v. Zipcar's 900 dollar annual membership; 'Zipsters' save 7,100 dollars per year based on a 2009 survey, offering customers huge value.**
- The costs do not justify owning a car in urban areas when only used occasionally.
- Also, Frost and Sullivan estimate that **one car sharing auto takes 20-30 cars off busy urban streets.** Thus, Zipcar can aid in reducing urban gridlock.
- In the last two months, Chicago has used Zipcar's services for their city departments and the City of Sacramento has partnered with Zipcar. Other governments have and will sponsor car sharing companies like Zipcar.
- Businesses also love Zipcar because it's a much cheaper alternative than owning a company fleet of cars.
- While traditional car rental companies such as Hertz or Avis focus on airport and other longer-term car rental, their operations are not suited for urban and university environments where people need convenient cars to run errands or make short trips.
- Traditional car rental companies rely on brick and mortar locations whereas Zipcar's fleet is mobile and cars can be moved to critical areas since there are no physical locations.
- **Zipcar provides accessible, cost-effective cars perfect for urban dwellers as well as college students and businesses.**

Zipcar's First Mover Advantage and Superior Technology Result in Dominant Market Share

- **Zipcar controls 75% of the global car sharing market.**
- Zipcar's dominant and growing market share indicates strong customer loyalty and enhances word-of-mouth advertising.
- The only other material US rival is Hertz Connect (20k v Zipcar's 650k members). There are also localized car sharing companies.
- As the first mover, **Zipcar has 10 years' worth of proprietary data** such as when and where reservations are made, what cars were rented and other critical metrics that allows Zipcar's experienced management to data mine and know when and where to expand.
- This best-in-the-industry tech platform gives Zipcar a competitive advantage as rivals cannot copy and use Zipcar's data.

Growth in All Areas: US and University/Business, Europe is to Follow

- Zipcar estimates that there are **10 million drivers who live within a 10 minute walk** from a Zipcar and Zipcar has 650,000 customers.
- **Using the most recent metrics, Zipcar only has a 6.5% penetration rate.**
- Zipcar plans to expand into two cities per year in the US, in addition to bolstering fleets and locations in existing cities.
- According to JPMorgan, there are **"50 cities in N. America and Europe with urban populations of over 500,000 (bigger than Zipcar's smallest market) that present growth opportunities."**
- Frost and Sullivan Consulting determined that **the market for car sharing in the US alone is worth 3 billion dollars, in addition to 3 billion for Europe and 4 billion for Asia.**
- Tapping into the 3 billion dollar market in Europe, Zipcar acquired London's Streetcar and in 2009 invested in 14% of Catalunya Car Sharing, the largest car sharing operator in Spain.

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- These two investments are the springboard into Europe's three billion dollar market for car sharing where tight, urban conditions are more conducive to car sharing.
- There is also growth in the University/Business segment, which currently represents 10% of revenues.
- Students will become familiar with Zipcar at college and they will continue to use Zipcar in the cities where they move.
- **Bottom Line: Zipcar is positioned for sustainable growth in both the US and in Europe for the foreseeable future.**

High Operating Leverage will Generate High Returns for Patient Investors

- Zipcar has high fixed costs in purchasing cars (financed by 60% by an ABS facility) and setting up locations.
- However, once Zipcar membership and use rises, the fixed costs will be covered (*the company estimates this takes about 3 years*) and additional revenues will have a powerful impact on financials.
- Margins will further improve as Zipcar will use an ABS program to purchase cars, utilization rates will improve and high margin fee revenue will become a larger part of Zipcar's topline.

Misperceptions

- Due to rapid growth leading to tight margins, the buy-side tends to be bearish in their valuation and ratings.
- **Unit Economics—Not as rosy as sellside/management expectations but it's not negative as buy-side says.**
- Zipcar estimates a 86% IRR with leverage, I estimate 8.3% IRR with leverage (see Appendix 2). The buy-side predicts a 2% to negative IRR on unit economics.
- Zipcar has already captured the 'low hanging fruit' and future expansion into less populous cities will be difficult to attain.
- The above is false because even in mature, profitable markets (NYC, BOS, DC, SF), the addition of more cars per location and increased market penetration will result in continued growth. Less populous early-stage markets have the opportunity for tactical expansion in downtown areas for urban dwellers and businesses.
- Analysts think that low cost car sharing companies with societal goals will out-compete Zipcar. However, these non-for-profits tend to be in smaller cities where public transportation is limited, not in larger cities that Zipcar targets.
- Short-term investors see more equity financing and lockup expiration as a negative (see Catalysts Section). These two factors have no bearing on company fundamentals however.
- Still in its infancy, European growth is not priced in as investors focus on US operations.

VAR (see Appendix 1 for VAR)

How It Plays Out/Catalysts

- Expansion and growth continue in all sectors having a direct impact on improving the bottom line and multiples.
- With more expansion in the works and possible M&A, the company will need to acquire more (equity) financing.
- Short term, this dilution will cause shares to dip, but creates a buying opportunity for the long-term investor.
- Lockout expires and executives dump shares, creating a buy-in point.
- Strategic acquisition by a 'traditional' car rental rival.
- Margins improve and the company will have better unit economics numbers causing the buy-side to cover their short positions.
- More analyst coverage and once Zipcar proves itself as profitable, the sell-side will switch ratings from neutral to buy.

Risks

- Competition heats up: Hertz' Connect and Enterprises' WeCar offer car sharing in addition to numerous local car sharing hubs.
- Inherent risk in M&A might be a speed bump in European expansion.
- Valuation is worrisome; Zipcar currently trades at 74X 2011E EBIDTA.
- The company has only one quarter with net income and management predicts another net loss in 2011.
- Unit economics projections may be incorrect.
- Zipcar may be unable to pass on higher gasoline or insurance rates.

Signposts / Follow-Up

- Monitor key company metrics such as ending members, new members added, fleet numbers, retention rates, revenue per car per day
- Make sure Zipcar doesn't overleverage itself to fund expansions
- Monitor unit economics trends
- Perform basic due diligence; monitor earnings calls and read quarterly reports/earnings
- Check-up on Zipcar's European expansion strategy

Company Description

Founded in 2000, Zipcar is the largest car sharing company that had its IPO in April 2011. Zipcar offers two memberships, occasional and extra value. Membership fees include the cost of renting the car along with gas and insurance. After signing up, each customer receives a Getaway card. Customers reserve cars through their (smart) phone or internet and use their Getaway card to unlock the car. Zipcar is established in 16 metropolitan areas, 250 college campuses, with 650,000 total customers.

Zipcar Inc (NASDAQ: ZIP): Long

Appendix 1: Value Added Research

Contact Type	Contact Information	Key Quotes
Customer	Private Businessman in New York City	“I used to use Zipcar a lot. I really liked it. It was really convenient. Later, the company I work for gave us a special rate for car rental so I stopped using Zipcar. But if the company didn’t give us that deal, I’d still be using Zipcar.”
Employee	Andrew Paez Head of College Sales	“Sorry, I can’t speak about the growth of the company. You have to read the IR portion of our website or the SEC filings.”
Customer	Joe Agnello UVA Student	“The MD’s and associates loved them.” (The Blackstone employees in the Boston Office used Zipcar to get around town.) “It’s a great company.”
Competitor	Becca Van Dyke Vermont Car Sharing	“We’re a non-profit model, Zipcar is for profit.” “I think Zipcar grew too fast, added too many cars. They’re doing ok in bigger cities but haven’t been profitable.” “A for-profit model is not successful in smaller cities.” “Sidney, Australia invested a lot in car sharing and San Francisco did in the US as part of their transportation.”
Company and Industry Expert	Mark Chase Director of Business Development & Planning Zipcar (2000-2004) Founding Team of Zipcar	“One reason Zipcar isn’t profitable is that they’re expanding. High burn rate. Once they stop, they’ll grow. Need 500 cars before you start recovering overhead.” “Zipcar’s core markets, those are highly profitable. London too, still figuring out.” “Critical variable for Zipcar is that people are able to live without a car most of the time.” “Parts of small cities where you can do that. Barriers are more cultural, people feel like they have to own a car. For Zipcar to work you need a large number of people who don’t own cars.” “Million dollar question, certainly possible for European expansion. Can they execute? All about local knowledge, so far Zipcar has acquired other companies, gives local expertise.” “Fits perfectly with off-demand period, residents use nights, weekends, businesses use during day.” “Unit economics, beauty is cars are moveable, if a location is doing well, add cars, locations have strict margin on each car. More cars you have, more you can push utilization. If you have 3 cars, 2 are out and one is still there, 66% utilization. If there are 20 cars and 19 are out, utilization is 95%, you can push the margin as you add cars. You want a giant grid so that if a lot are out, you can still get one. Scale is important for margins.”
Buyside Analyst	Private	“University and Commercial markets could be really good for the company.” “In a sense, they are always expanding because the cars have to be recycled every 2 years. They will always have a really capital intensive business. I just don’t think the return on capital of business (i.e. the cash on cash return per car) is good enough to justify this valuation. But yes, growth will help them. I just don’t think they can hit a switch and be a high margin business like a software company.” Caveat: “I like Zipcar the company and have used their service before as a consumer. It’s great. But so are Pandora and Groupon. Just because it’s a good consumer experience doesn’t mean it will be a great investment.”
Competitor	Annie Bourdon Board of Directors San Francisco City CarShare Founder of Car Share Vermont	“Car sharing is gaining momentum. Growth is a reflection that it’s effective.” “Profitability is possible—there are different models for different communities.” “Lots of towns would benefit, not profitable without density to support large operations, 50k and under where public transport is limited.” “SF City CarShare is thriving and financially self-sufficient.”

Channel Checks New York City (a ‘mature market’)

Observations: I went to two Zipcar locations in the midtown area of New York. Zipcar rents space in commercial garages for its cars throughout the city. There are no signs indicating Zipcars are present; one has to know Zipcar is in the particular location. This reduces advertising expenditures. One garage attendant in a Central Park South location said all Zipcars were out and one further down said only two cars out of 9 were in. Granted, it was a summer weekend and probably saw increased demand, but it was encouraging. (I saw a few Zipcars on city streets too.)

In contrast to the ‘bare bones’ Zipcar model, I saw Hertz ads covering an entire subway car. Hertz was advertising easy car rental in many locations throughout the city, like Zipcar. Hertz promised that there were no sign-up fees, unlike Zipcar. Hertz’s traditional advertising may create problems for Zipcar which sticks to cost-effective forms of advertisement such as word-of-mouth advertising and Facebook.

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Appendix 2: Unit Economics and Valuation

Zipcar Unit Economics Analysis				
	Year 0	Year 1	Year 2	Year 3
Average Cost	-20000			
Financing	12000			
Revenue per Vehicle		24000	24000	24000
Cost per Vehicle (ex dep)		-12000	-12000	-12000
Interest Cost (7%)		-840	-560	-280
Proceeds on Sale				10000
Debt Payments		-4000	-4000	-4000
Marketing cost		-733	-733	-733
Cash Flow Per Vehicle	-8000	6427	6707	16987

*numbers from CFO pre IPO
conference/company reports*

86%	IRR Bull Case (JPM/Management)
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Zipcar Unit Economics Analysis Realistic Scenario				
	Year 0	Year 1	Year 2	Year 3
Average Cost	-20000			
Financing	12000			
Revenue per Vehicle		21200	21200	21200
Cost per Vehicle (ex dep)		-16200	-16200	-16200
Interest Cost (7%)		-840	-560	-280
Proceeds on Sale				12000
Debt Payments		-4000	-4000	-4000
Marketing cost		-989.55	-989.55	-989.55
Cash Flow Per Vehicle	-8000	-829.55	-549.55	11730.45

Adjusted revenue to match realistic and conservative revenue per day of 58 dollars v. optimistic company projections of 66 dollars per day

Assuming 35% increase in costs from company projections

35% of new member join through word-of-mouth but increased assumption to be in line with bearish buy-side customer advertising costs projections

8.30%	IRR Realistic Case
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Valuation									
Implied Share Price on 2012E					Implied Share Price on 2012E				
P/E	90.0x	85.0x	80.0x	75.0x	EV/EBITDA	45x	40x	35x	30x
Share Price	\$20.75	\$19.60	\$18.44	\$17.29	Share Price	\$26.08	\$23.00	\$19.93	\$16.85
Implied Share Price on 2013E					Implied Share Price on 2013E				
P/E	45x	40x	35x	30x	EV/EBITDA	25x	20x	17x	15x
Share Price	\$24.21	\$21.52	\$18.83	\$16.14	Share Price	\$27.87	\$21.98	\$18.44	\$16.09

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Appendix 3: Relevant Charts

Table 3: ZIP's Daily Revenue per Car Is Well Above Traditional RAC Competitors'

	2008	2009	2010
ZIP			
Daily Revenue Per Car	\$52.00	\$56.01	\$62.12
HTZ			
Daily Revenue Per Car	\$42.88	\$42.20	\$42.16
US			
Daily Revenue Per Car	\$50.14	\$43.70	\$47.16
DTG			
Daily Revenue Per Car	\$43.82	\$48.11	\$48.55
CAR			
Daily Revenue Per Car	\$39.41	\$42.22	\$41.70
Int'l			
Daily Revenue Per Car	\$43.40	\$42.36	\$47.75

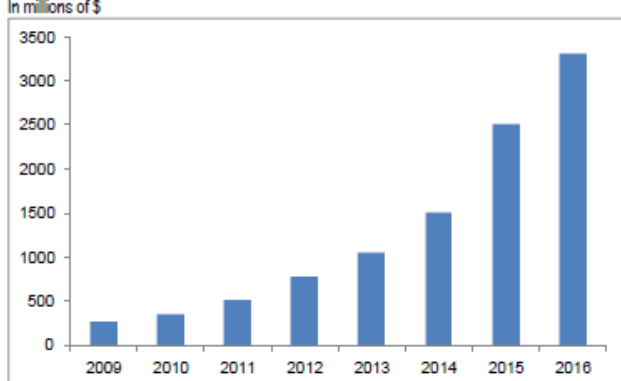
Source: Company reports.

Figure 11: Zipcar's Technology Portfolio Spans Multiple Domains



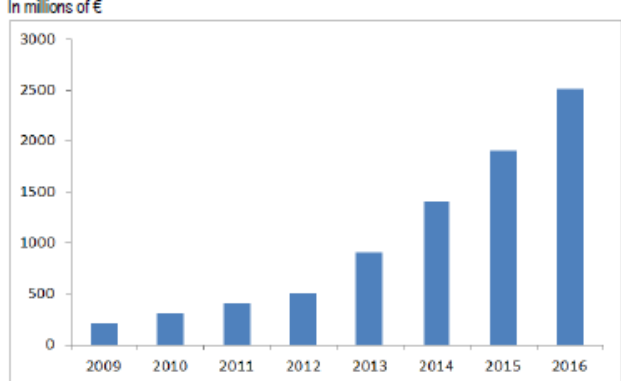
Zipcar's has an Industry Leading Revenue per Car and Technology Platform

Figure 9: N.American Car-Sharing Revenue Is Expected to Grow at a 44% CAGR to \$3.3B in 2016
In millions of \$



Source: Frost & Sullivan.

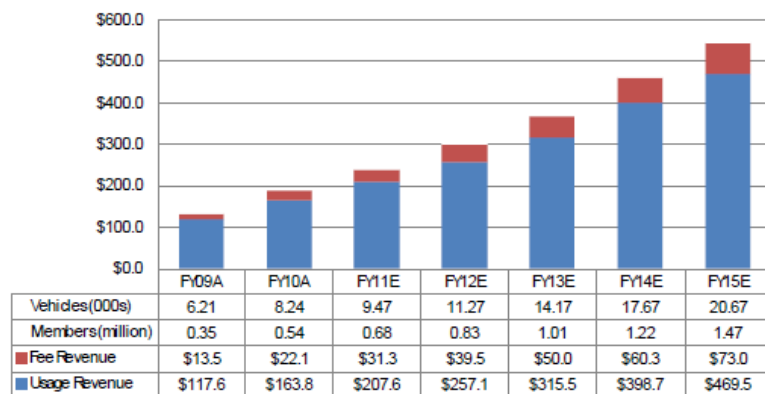
Figure 10: European Car-Sharing Revenue Is Expected to Grow at a 43% CAGR to €2.5B (~\$3.5B) by 2016
In millions of €



Source: Frost & Sullivan.

Figure 2: Long-Term Revenue Forecast

\$ in millions



Source: Company reports, J.P. Morgan estimates.

Zipcar's Solid Revenue Growth and More High Margin Fee Revenue Will Boost the Bottom Line