Barron's Feature

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Is Zipcar's New Model Reliable?

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A hot IPO put the stock into the fast lane. But it won't stay there unless the unconventional car-rental company shows it

Correction: *Tesla Motors' Model X is a crossover SUV, scheduled to be produced in 2014 or 2015. Pricing for it has not been announced. In addition, a production date has not been disclosed for Tesla's third-generation vehicle, which will be sold for roughly $30,000. The models were incorrectly described in last week's "Bad News, Good News on Batteries" article.*

Zipcar's hot initial public offering this month turned a clever concept–rental cars available by the hour in cities like New York, Boston and Washington–into a $1.2 billion stock-market value.

The company, however, is in the red. Despite its significant expansion, Zipcar's IPO prospectus warns that it doesn't "know if our business operations will become profitable." And it projects another loss for 2011.

Zipcar cultivates a hip, eco-friendly image, in part by featuring vehicles like the Mini, shown here.

Growing competition in hourly-rental from conventional rental-car companies like Hertz and Enterprise could make it tough for Zipcar (ticker: ZIP) to generate sufficient earnings to justify its lofty market capitalization. The stock, which went public at 18 and now trades near 29, looks richly priced. Zipcar offered 9.7 million shares in the IPO, including 3 million from shareholders who had paid an average of just $5 per share. Venture capitalists, including former AOL CEO Steve Case's Revolution Living, are sitting on big profits from the deal.

FOUNDED IN 2000, Cambridge, Mass.-based Zipcar dominates its relatively small niche but hasn't been able to turn a profit, losing $4.6 million in 2009 and then $14 million in 2010. Even using a generous measure of profit favored by Zipcar called adjusted Ebitda (earnings before interest, taxes, depreciation and amortization) that excludes certain noncash expenses, Zipcar made just $4.2 million in 2010. To support a $1 billion market value, it ultimately must produce $100 million of after-tax profits. That's a long way off–if it's achievable at all. Tangible book value is only $3 per share.

Revenue last year totaled $186 million, up from $30 million in 2006. Assuming a 10% net margin, Zipcar would need $1.2 billion in sales—more than five times last year's total—to produce $100 million in after-tax profits. Most rental companies have sub-10% net margins. It's logistically and financially challenging to run a car-sharing business, given that more members means more vehicles, insurance and parking costs.

Zipcar's slogan is "wheels when you want them." It now has 560,000 members, or "Zipsters," and operates 8,250 cars in 14 metropolitan areas and on 230 U.S. college campuses. In the New York area, it has 2,000 cars.

Zipcar at a Glance

Recent Price	$29.15
Change since IPO	62%
Market Value	$1.2 Bil
2010 Revenue	$186 Mil
2010 Net Loss	$14 Mil
2010 Cash Flow	4 Mil
Tangible Book Value per Share	$3.00
Zipcar Members	560,000
Cars	8,250
Key Markets	N.Y., Boston, D.C., S.F.

Sources: Bloomberg; company reports

Members pay $60 a year to join, and can reserve cars via phone or online for an hourly rate of $8.50 from Monday through Thursday, and $13.25 from Friday through Sunday. Daily rates are $81 during the week or $104 on Friday and weekends. Members pick up their cars at garages or parking lots by swiping their cards on a windshield reader; they return them to the same site. Zipcar includes gas and insurance, plus 180 miles per day, free of mileage charges.

But will Zipcar's concept work outside New York, Boston, Washington, Chicago and San Francisco–each of which has a decent public-transportation system and lots of young, affluent, educated adults without cars? "I think they're going to rapidly run out of cities where this works," says an investor who has shorted the stock. In most cities, employed people can't get around without a car. It's unclear whether Zipcar will succeed in Baltimore, Philadelphia, Pittsburgh and Atlanta, where it also operates now.

"The driver you want is a young Harvard graduate in Manhattan who needs a car to go to Jones Beach for the day. You probably don't want a construction worker from West Philadelphia who's going to the Jersey shore," this investor says. Sorry, *Jersey Shore* fans.

Zipcar has benefited from strong used-car prices–it typically keeps its cars for two to three years and then sells them. A weaker used-car market would hurt it. So would persistently high fuel prices. And there's a possibility that revenue-hungry local governments will heap special taxes on its rentals, as many do on conventional ones.

The Bottom Line

Zipcar shares, originally priced at 18, have quickly soared toward 30. But the company is unprofitable, and might never move into the black. For now, the stock is a speculation.

Zipcar's daily rates are comparable to a traditional rental company's. However, it welcomes 21-to-25-year-old drivers, a group other companies shun. But Zipcar won't rent to anyone with a history of accidents or moving violations. It projects a hip, eco-friendly image—its fleet includes Priuses and Minis—while avoiding the hated added fees (extra liability insurance, fuel surcharges) that other rental-car companies routinely try to foist on consumers.

Big companies have taken notice of what Zipcar is up to. Hertz now claims to have 700 hourly cars in New York and in London, and Enterprise has launched its Webcar brand, though it's mainly at universities.

BULLS MIGHT ARGUE that Zipcar, as market leader, has pricing power, and in its prospectus the company cites its "first-mover" advantage and says its global opportunity is huge. (It established itself in London by buying a car-sharing outfit there last year.) Zipcar also points to a study that says the North American business could generate $3.3 billion in revenue by 2016, versus $253 million in 2009.

While Zipcar's member base has doubled in the past two years, key measures like daily revenue per car—$59 in the fourth quarter—and quarterly revenue per member—about $100—were little changed. In what it calls its four established markets—New York, Washington, Boston and San Francisco—pretax profits for the four cities combined totaled $23 million last year, up from $16 million in 2009. But until Zipcar shows that it can make money outside those cities, prudent investors will steer clear.

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