

# SilverRail Technologies, Inc.

*November 2009*

Aaron Gowell sat at the desk in his home office. The laptop monitor illuminated the dimly lit room and the pile of papers in front of it. Peering into the screen, Aaron contemplated the rough outlines of a five-year financial forecast for the new venture he would be pitching to venture capitalists in less than two weeks' time. That venture, dubbed SilverRail, would be the first-ever aggregator of rail passenger seats for corporate and online travel agencies, with a focus on the booming market for high speed train travel across Europe. With the glaring exception of rail, every mode of business and vacation travel booking—air, car rental, hotels, and cruises—had moved to the Web. This represented a huge hole that Aaron aimed to fill.

In Europe, train travel was the dominant form of intercity transportation and by 2009, an \$80 billion industry—50 times the size of its U.S. counterpart. Aaron aimed to develop B2B e-commerce software that travel agencies could use to view schedules, prices, and availability, and make reservations—just as they currently did for other modes of travel. Aaron's company would aggregate the inventory from all the different European national railroad systems and make the combined result available to corporate travel agencies like Amex and online travel agencies like Expedia. His new company would receive a commission on all bookings through the system. Even with very conservative assumptions, net revenues and EBITDA could be huge within five years.

Aaron was no newcomer to the online travel business. He had worked the numbers and made successful investor pitches in prior ventures. Now he had to do it again. The question was, would the VCs share his confidence in the future of rail travel, and the opportunity for SilverRail as an inventory aggregator? What would they have to hear and see before they'd open their wallets? And, beyond the pitch, what deals would he have to strike along the way with European rail systems and on-line travel sites to validate the plan?

These thoughts were on his mind as he planned his fund-raising presentation. That presentation would include a pro forma P&L and a set of PowerPoint slides. To spark the interest of venture capitalists in the gloomy economic environment of late 2009, that presentation would have to be *very* powerful.

## Aaron Gowell

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Launching a new business was the furthest thing from Aaron Gowell's mind in the 1980s.

As a member of the U.S. Army's 82nd Airborne Division, Aaron was more concerned with launching himself with a parachute from the belly of a C-130 airplane. But after combat tours in Panama and Gulf War I, he returned to civilian life. Under the GI Bill, he completed college at

Northeastern University with an MS in Finance. Graduating summa cum laude in 1996, he was one of the rare few “coops” who was hired by Bain & Company, a prestigious management consulting firm headquartered in Boston, where Gowell helped found Bain’s highly successful private equity consulting practice that consulted to companies during acquisitions, such as when AOL acquired CompuServe.

Two years later Aaron was on the move, this time to General Catalyst Partners. General Catalyst was a private equity firm with major investments in the travel industry. One of the firms General Catalyst had acquired was a cruise business—National Leisure Group with the idea of turning it into the travel industry’s first online cruise agency. The managing partners of General Catalyst dispatched Aaron to help build the business. He quickly became the chief operating executive. (See Appendix A for an article describing Aaron’s work at NLG). Aaron described his venture capital firm’s activity:

GC decided to buy a small traditional travel company that understood cruises and built an Internet travel company around it. We called it National Leisure Group (NLG), and I was appointed as CEO. I wrote the business plan, raised money, and built a team and the technology—the whole thing.

NLG built the cruise industry’s first online booking system, which aggregated all of the cruise suppliers into one e-commerce platform—and then provided white label Websites to online travel agencies like Expedia, Orbitz, Priceline, and Yahoo! Travel.

Under Aaron’s leadership, NLG grew its business and made a series of strategic investments, increasing employees from 80 to 1,800. It eventually owned or operated 20 private-label vacation brands. The NLG cruise platform was similar to the airline industry’s SABRE system. NLG’s system made it possible for travel agents and on-line Web services to see all available cruise inventory and prices in real time, and then, book customers. As Aaron noted:

NLG specialized in complex travel and grew to be one of the largest travel agencies in the country. Expedia and Travelocity were focused on airlines, cars, and hotels, but they entirely ignored cruise vacations—a \$16B market!

Over the course of six years, Gowell grew the business from \$110M in sales to over \$1B and successfully sold the business in 2006.

Mission accomplished, Aaron returned to General Catalyst as an “Entrepreneur In Residence.” From this perch, he was exposed to all important developments in the travel and vacation space.

One opportunity that caught his eye was a small firm whose R&D unit had developed a beta version of online booking technology for rail travel. “That company had lots of problems,” he recalls, “and General Catalyst withdrew its interest.”

Aaron, however, was intrigued by the possibility of doing for rail travel what NLG had done for cruise vacations, and what Expedia and others had done for air, car and hotel rentals. The little company might have problems as a money-making business in its present form, but Aaron thought the new technology within the company was outstanding.

Aaron started hitting the Web and making telephone calls. A little research made it clear that rail in auto-centric America was limited to the perennially money-losing Amtrak with no immediate prospects for significant growth. For the rest of the developed world, however, passenger rail travel was huge and growing, driven by new 250 mph trains, often at expense of air travel. Aaron sized the broader opportunity in rail travel this way:

“Whenever rail connects two cities that are less than three hours apart, new high speed trains take most of the market away from air travel between them.” Once the Chunnel was built between London and Paris, 80 percent of travel between those cities shifted from airplanes to trains—and that was the heaviest traveled air route in the world!”

With more and more high-speed rail projects on the drawing boards in Europe and Asia, it was clear that rail's share of the travel market—already substantial—would grow even larger. Fueling the entrepreneurial opportunity was the European Union's push to increase train travel across the continent—because rail had a much lower carbon emissions footprint compared to both air and car travel. Aaron got his hands on the high speed rail installation plan published by the European Union over the coming decade. It was clear that the Chunnel-type projects for intercity travel was a major investment priority for Union members. Other factors, such as the growth of European equivalent on-line travel sites similar to Expedia, Travelocity, and Orbitz, further wetted his appetite.

Aaron thought it was time to approach the owners of the troubled software company with an offer to buy their technology in return for cash and an ownership interest in his new venture. They agreed in principle to the transaction, realizing that their technology would only see the light of day with a person like Aaron behind the wheel. Now it was time to put together a business plan and a presentation to raise the capital to complete the software and create the operations needed to support the global rail marketplace.

## Rail Industry Research

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Numbers to substantiate the market opportunity and prove the addressable market were going to be crucial. Thanks to his Bain training in industry analysis, Aaron had a good idea about how to proceed:

I learned at Bain to get as much information about an industry or company as I possibly could and then develop a story from it.

At Bain we used to say that we could win every argument if we had enough data. If you're going to approach VCs, you'll have much more success if you're in command of all the facts and done all your homework. They have a hard time saying no to a fact-based case.

A self-described “research hound,” Aaron worked hard to gather data on the market size, the forces that were driving more consumers to rail travel, and opportunity to make rail travel information and booking more accessible. Some of the information he needed was available online. He also relied on PhoCusWright, the leading source of data for the online travel industry.

## Current Market Sizes

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These industry data<sup>1</sup> revealed a large and growing market. In 2007, the worldwide market for rail travel was roughly \$300 billion and projected to increase at a compound annual growth rate of 8 percent.

Aaron found great variations in the dollar size of national markets, with small geographic entities have disproportionately large rail travel expenditure in many cases. For example, the tiny Benelux countries accounted for \$7.2 billion in annual passenger rail receipts in 2007, the UK stood at \$12 billion, and Germany led the Euro league at \$23 billion. In total, European spending on rail travel was \$80 billion. In contrast, U.S. travelers spent a mere \$1.6 billion (Exhibit 1).

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<sup>1</sup> “International Railway Statistics” International Union of Railways (UIC), Paris, 2007, and a “Ten Year Growth Report” made available by the Association of Train Operating Companies in June 2007.

USA	\$ 1.6
Canada	\$0.3
Australia	\$ 6.7
Japan	\$ 7.9
Korea	\$12.0
China	\$18.0
Russia	\$16.0
Europe	\$80.9
India	\$20.0

**Exhibit 1** 2007 Spending on Passenger Rail Travel (rounded, billions \$)

Source: "International Railway Statistics," International Union of Railways (UIC), Paris, 2007.

## Rail Versus Air Competition

With all the security in air terminals plus increased passenger volumes in the post-9/11 world, frequent travelers like Aaron were keenly aware of the pain and frustration associated with air travel. They had to arrive an hour before take-off, run a gauntlet of metal detectors and X-ray devices. Passenger volumes in Europe had increased substantially as well with the growth of budget carriers such as Ryan Air, and security had become increasingly tight.

The Europeans were also much further along in rail travel compared to the United States. Major cities were amply linked with rail service. Many of these were high speed and offered passenger amenities that airplanes lacked, such as Wi-Fi access, unrestricted usage of cell phones, laptop power sources, and so forth. And unlike airplanes, these trains traveled between city centers, making long, expensive taxi rides from outlying airports unnecessary. Except for Amtrak's operations in the Northeast Corridor, U.S. travelers had few alternatives to the annoyances of air travel for distance travel.

Given the expanding high speed rail infrastructures of their respective countries, Europeans, Koreans, Japanese, and others were turning to rail travel in high numbers as the preferred alternative to intercity plane flight. Aaron's research revealed that rail's share of the travel market (versus air) was especially high along rail routes greater than 1 hour and less than four hours in duration. This became the sweet spot in his target market. His data sources showed the relationship between rail travel time and rail's market share (versus air) in the EU countries (Exhibit 2). Of the total European market for rail travel of \$80 billion, the one to four hour travel focus still left him with a well-defined addressable market of approximately \$48 billion a year.

Travel Time (hour)	Rail's Share
1.5	90%
2.0	80%
3.0	58%
4.0	40%
5.0	23%

**Exhibit 2** Rail's Market Share Relative to Rail Travel Time

Sources: Thalys NBTA, May 2009; Travel Weekly, 4 December 2009.

Short-haul high speed rail between major European cities would clearly disrupt the trend of low cost air carriers that had emerged over the past decade. Europe had 3,700 kilometers of high-speed rail in 2009, but was projected to have 9,000 kilometers by 2020.<sup>2</sup> Aaron recalls:

Based on these data, I estimated that high-speed rail would effectively eliminate air travel as a competitor between routes of 600 kilometers or less. All of that business would be captured by trains.

## Supporting Factors Behind the Business Opportunity

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A number of political and environmental factors pointed to a rosy future for passenger rail. Many governments were pushing their citizens toward rail travel as a solution to climate change, highway congestion, and to reduce their dependence on foreign oil.

As a centralizing decision-making authority, the European Union was moving strongly towards rail. It had made the bold decision to begin to deregulate the European rail industry in 2010, making it possible for carriers to compete across borders. The plan would allow a German carrier, for example, to take passengers all the way from Munich to London, competing directly with French or Dutch or Belgian or English carriers along the way.

This would be an enormous change from the two centuries of history where strong national governments established dominant national governmental organizations to build and operate rail travel for passengers and freight. Rail gauges were often deliberately built in different sizes to disrupt resupply by rail from invading forces. Booking systems were different, currencies were different, and in more recent decades, computer systems were different. Now, all of this was going to change.

The EU had stepped up and committed \$250 billion to develop new high-speed rail infrastructure across the continent! That is compared to the meager \$18 billion plan presented for high speed rail in the United States. Globally, Aaron's research showed an expected 4x increase in high speed track over the next 15 years.

Using mostly freely available Web sources, Aaron found evidence of other factors that favored train travel:

- Rising fuel costs—rail was more fuel efficient per passenger miles than air or autos. Some researchers had found that rail moved people at *700 miles per gallon of fuel*—far better than all other modes of transport.
- Climate issues—*rail produced 89 percent less CO<sub>2</sub> than air travel* and 70 percent less than automobiles on a per passenger mile basis
- Shorter travel times for consumers versus air on most routes of 300 miles or less due to no early security checks, and city center-to-city center routes.
- Greater passenger comfort and more on-board amenities provided in trains compared to no-frills budget air carriers that had emerged across Europe.
- New 250 mph trains, allow travel times to compete with air travel.

These finding pointed to the simple, powerful conclusion that rail travel in Europe and Asia was already huge and growing. One study forecasted a growth rate of 8 percent per year over

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<sup>2</sup> International Union of Railways data.

the next 15 years.<sup>3</sup> This signaled a healthy and buoyant environment in which to launch a passenger rail-related venture.

## Booking Rail Travel: Industry Research

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Aaron's vision was to create a Global Distribution System (GDS) for booking rail travel. Here, thanks to his past experience as CEO of National Leisure Group, he had substantial working knowledge of the industry and well as existing relationships with many of the key players in the channel.

For the U.S. and Europe, Aaron's research showed that the travel booking market was estimated to be \$600 billion per year. It included air travel, car rentals, hotels, cruises as well as rail. Over 50% of that travel was booked through two competing channels: corporate travel agencies and online travel agencies.

## Corporate Agencies

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Corporate travel agencies are companies that sell travel products and services to business travelers on behalf of suppliers: airlines, car rentals, cruise lines, hotels, etc. Notable agency examples include American Express, Hogg Robinson, and Carlson Travel.

All of these travel agencies source the product info through the GDSs that included SABRE, Amadeus, and Galileo. These GDSs aggregate the inventory from suppliers and make it easily available for search and booking by the travel agents. The GDSs' business model is to charge booking fees to the supplier equivalent to roughly 5% of sales on anything booked through their systems.

There were GDSs for air, hotels, rental cars, and so forth, *but none yet for rail travel*. While agencies could book rail by communicating directly with the individual rail supplier, there was no single source to see open seats from all rail carriers. Each customer inquiry required a separate phone call or online check with a particular rail service. If a customer needed to travel between different countries, that meant a number of phone calls or Web checks to different systems—and then, the skill and knowledge on how best to put forward an integrated itinerary for the customer. This was highly inefficient. The result is that in spite of the fact that travel agencies sold >50% of all travel, they sold less than 1 percent of rail travel! These agencies knew that they were missing out on a large and growing segment of the travel industry.

## Online Booking

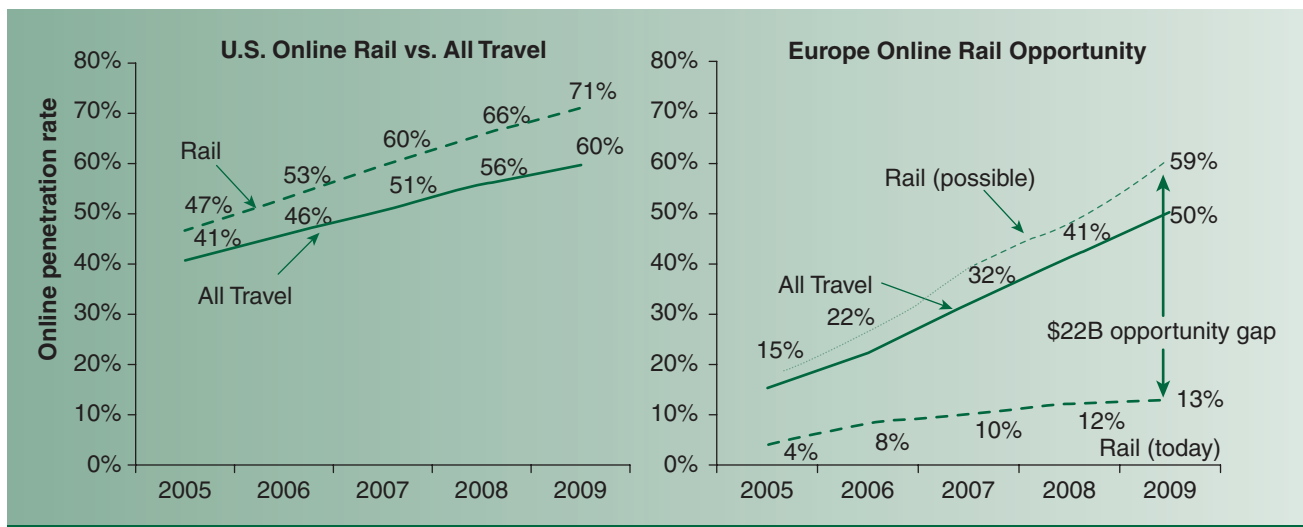
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By 2009, online travel agencies (OTAs) such as Travelocity, Orbitz, Expedia, and PriceLine had taken a huge chunk of commission business from traditional travel agencies. Increasingly, the consuming public was Internet savvy. In 2009, 60 percent of all U.S. travel was booked online; in Europe the percentage was 50 percent. And for the U.S., 71 percent of non-commuter trips were booked online through Amtrak's Website. All of these various percentages were climbing year-over-year.

Like their corporate agency rivals, online travel agencies relied on the same GDSs, and gave customers information and booking access to the same range of travel products and services. And, like their corporate rivals, the on-line travel portals lacked access to a rail travel GDS aggregator and booking broker.

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<sup>3</sup> Association of Train Operating Companies; Amadeus Rail Market Whitepaper.



**Exhibit 2** Percentage of European Online Bookings: Actual and Possible a \$48B market\* with only 13% booked online for travel between 1 to 4 hours

\* Long distance leisure + business, excludes commuter and regional

Sources: PhoCusWright 2007 Travel Report, PhoCusWright 2007 EU OTA Travel Report.

In Europe specifically, only 13 percent of rail travel was booked online. The more Aaron thought about Europe as an initial target market, he saw a huge gap between actual rail travel and the percentage of that travel booked online, particularly in his sweet spot of travel between 1 to 4 hours in duration. (Exhibit 2)

The only way to bring online rail books in line with other travel—and with its potential—was through a GDS such as the one Aaron wanted to create. Without it, rail bookings would remain complex and frustrating for agents and consumers doing it on their own.

To prove his point, Aaron developed a range of use case scenarios for booking travel between cities within and between different European countries, counting the number of steps required to book each trip using various national rail and travel agency Websites. He found that to travel from London to Brussels, for example, required seven steps, and from Brussels to Cologne, nine steps! Even going from Manchester, England to London required seven specific steps. So, if a passenger wanted to travel from Manchester, England to Cologne, Germany, 23 separate steps were needed. That included three separate rail bookings, using three different Websites, and two currencies. Aaron noted:

That includes three credit card transactions. You have to buy UK tickets in pounds and other tickets in Euros.

One of Aaron’s industry sources indicated that two-thirds of attempted rail books in Europe *failed* due to a combination of booking and financial transaction complexity. He remarked:

“That’s as clear a customer need as you will ever find. The rail supplier sites present information on travel in ways that are not uniform or easy to understand. There’s no Expedia to clean it up and make it easy. The result is a terrible consumer shopping experience.”

This situation reminded Aaron of one of entrepreneurship’s Golden Rules: Opportunity lurks wherever you can save a customer time or money, eliminate pain, and remove frustration.

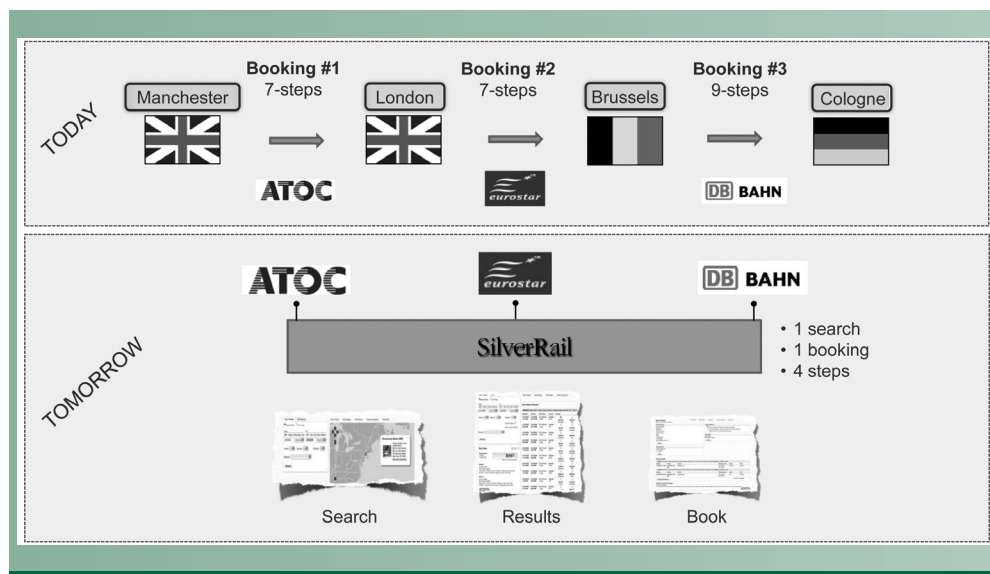
Going after the \$48 billion addressable market in Europe, Aaron figured that if his venture could capture, and apply the 5 percent fees charged by other GDSs, he could realize a

whopping \$3.5 billion in annual revenues! Even if he could only get a third of the booking, his business could still become another NLG.

## The SilverRail Solution

With the U.S.-based technology he knew he could purchase as the software GDS engine, Aaron set out to build an “aggregator” that would contain all seats on all routes offered by European rail lines—a rail version of the SABRE GDS that every travel agency and every online ticket service used to serve their air travel customers.

Though train companies in the UK, Germany, France, and other nations maintained separate databases, Aaron knew that his software had the flexibility and power to bring all these data together, store them in a standard, accessible format, and present easy-to-use screens for users. With this integrated system, a customer taking Aaron’s hypothetical trip from Manchester to London to Brussels to Cologne could book the trip with one search and four



**Exhibit 3** The SilverRail Solution: All suppliers, one system, one booking

ATOC, Eurostar, and Bahn are current national rail travel booking Websites, each with different formats, and representing two different currencies.

steps—not three searches and 23 steps required previously! (Exhibit 3) Customers would see a booking page very similar to those used by Expedia and other online systems (Exhibit 4).

Would the travel agencies and online ticketing services be interested? His inquires through old NLG contacts returned nothing but enthusiasm. The travel agents knew they were not participating in Europe’s hottest travel segment. The online travel portals were seeking to simplify complexity, reduce cost, and increase their business in cross-national rail travel. Aaron’s venture would put money on each of their respective tables.<sup>4</sup>

<sup>4</sup> While Aaron’s focus was to be a B2B GDS travel services provider, he learned that if he wanted to be licensed as a GDS doing business in Britain, he would also have to create a B2C direct consumer site. This raised the potential of competing with his channel partners and he had to make sure that they knew that his consumer site was a regulatory requirement. This B2C rail travel site, Quno, was launched in the first year of business.



The screenshot displays the Expedia.co.uk website interface for rail travel. At the top, there's a navigation bar with links for HOME, DEALS, FLIGHTS, HOTELS, RAIL, CARS, FLIGHT + HOTEL, PACKAGE HOLIDAYS, ACTIVITIES, INSURANCE, and BUSINESS TRAVEL. A banner for Mexico is visible on the right. Below the navigation, there's a search form titled "Search for Rail only" with options for "Rail Only" and "Rail + Hotel". The form includes fields for "Leaving from:", "Going to:", "Departing:", and "Returning:", along with a "Search" button. To the right of the search form, there's a promotional banner for Eurostar titled "Book your rail adventure online with Expedia" featuring a photo of two men on a train and the text "Europe, from your doorstep". Below this, there's a "Rail + Hotel Deals" section listing destinations like Dublin, Cape Town, New York, and Rome with their respective prices. At the bottom left, there's a "Travellers' Tools" section with links for "Bookmark Expedia", "Currency Converter", "Destinations", "Insurance", "Maps", "Passport & Visa", "Airport Guides", "Arrivals/Departures", and "Flight Timetables".

**Exhibit 4** Booking Page With a SilverRail Channel Partner

## The Financial Forecast

Aaron now had to create a compelling story around the data he had assembled. He could imagine how his VC audience would respond even to such compelling market data: “That’s interesting Aaron, but how will you make money from all this—and how much?”

To answer that question convincingly, he would have to build and refine a financial forecast that was reasonably conservative, *yet* contained the expectation of a very high return.

## The Revenue Model

Aaron had the data to show that the worldwide market for rail travel was about \$300 billion. As a startup, he was also in no position to address the world market right away. As he saw it, the best initial opportunity was Europe. This represented \$80 billion in annual rail bookings. The one to four hour sweet spot gave him 60% of that number, or \$48 billion. Next, the “opportunity gap” he had discovered between possible and current online rail bookings was about \$22 billion (47% of the \$48 billion, as shown in Exhibit 2). That \$22 billion was what he would use for his initial addressable market. Then, he would expand to other regions of the world. Aaron noted,

“When pitching VCs, it’s very important not to talk about tackling the whole market, but to segment the market down into something more believable and achievable—it builds credibility with the VCs who are tired of companies pitching them on how they’re going to “capture just 2% of the total market,” which is simply not a believable approach. If you talk about tackling the whole market, you’re going to get kicked out of the room. The more detailed you are in your segmentation, the more credibility you gain.”

Industry practice in air, rail, and cruises awarded GDS operators 5 percent of booking, and Aaron had assure himself through contacts with rail companies that they would pay him the same percentage if he could create a system that would make online bookings easier for travelers and agencies.

With the 5% standard industry commission for GDS providers in other travel segments, Aaron had his annual revenue target: \$1.1 billion in annual revenue for his new venture.<sup>5</sup>

Next, Aaron knew that VCs tend to think in 5 year windows for exit valuations. Based on this, Aaron figured that:

If I estimate capturing more than 10 percent of the \$1.1 billion by the end of Year 5, they won't believe me. If I estimate less than 10 percent, they'll think I'm not sufficiently aggressive. \$110 million in revenue seems a very achievable target. If we knock it out of the park, we might even get to \$300 million.

Aaron then ran detailed projections on the revenues possible from selling rail through the major European corporate and online travel agencies. This more granular revenue projection also got him into the hundreds of millions of dollars by the end of Year 5.

He also knew that his percentage of market capture would have to ramp up to that 10 percent by Year 5. It wouldn't happen overnight. Starting at 1% in Year 1 seemed reasonable. Assumptions would have to be made for Years 2 through 4. He further assumed that software development would take yet another six months from the point of Series A financing to create a better user interface as well as greater scalability in the database design. When revenues did begin, the ramp would be slow for the next three months as the first customers went live with a few kinks to be resolved. Aggressive ramp up of sales would then start in the last three months of the first year and continue forward.

Looking at the end of the five year planning horizon, Aaron figured that 10 percent of the \$22 billion market in year 5 would give SilverRail *gross* bookings of \$2.2 billion. And if suppliers would pay him 5 percent of that amount, the new venture would be looking at *net* revenues of \$110 million. This calculation, however, did not account for the anticipate 8 percent annual growth in rail bookings indicated by his research. Aaron went back and recalculated his total and addressable market figures to reflect that growth.

Aaron also found out that wholesalers/brokers in the travel business could expect a 40 day average receivables period from agents. Not ideal, but still, manageable in terms of preserving working capital in the business with appropriate funding.

## The Path to Profitability

Aaron continued with his five-year financial forecast, estimating anticipated costs for scaling up SilverRail's technology systems and the venture's general and administrative expenses. He developed detailed monthly forecasts for systems operating costs (which were integrating data from the various national railroad systems and hosting the GDS with trusted third parties), programming and customer support staff, as well as other types of GS&A expenses. The results of this planning are provided in Exhibit 5.

Within the GS&A were extraordinary year-one costs for setting up business in Europe. This included:

- \$200K in legal expenses
- \$80K in travel costs
- \$120K in recruiting costs
- \$200K in computer hardware
- \$100K to set up a UK office

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<sup>5</sup> One would think that over a billion dollars of annual, recurring revenue would be enough to whet any VCs appetite, but Aaron had to make 36 different presentations to VCs before he got his Series A financing—from presentation #37! “Raising \$6 million for a startup during the economic downturn since the Depression was incredibly hard,” he noted. “My combat experience came in handy.”

	Year 1	Year 2	Year 3	Year 4	Year 5
Systems operating costs	\$283,000	\$7,053,000	\$22,323,000	30,913,000	\$40,374,000
GS&A expenses	\$2,148,000	\$5,184,000	\$5,836,000	\$5,848,000	\$5,941,000

**Exhibit 5** Estimated Costs and Expenses

Subtracting these expenses from projected net revenues would give him annual EBITDA figures, from which a valuation could be estimated, using a travel industry multiple. Based on his research of comparable ventures, Aaron determined that multiple to be eight times EBITDA.

## The Series A Capital Structure

Aaron needed to raise money to complete the purchase of the booking software, create an R&D team to scale and otherwise improve it, and build a marketing and operations capability in Europe. Looking at his cashflow projections, he thought that \$5 million should be sufficient for the first round, which should last him 18 months before a second round was needed— hopefully at a much higher valuation than the first round. Being an experienced entrepreneur, Aaron also wanted to leave himself a cash cushion for unexpected expenses during those first 18 months. He thought that an additional \$1 million would be sufficient for that purpose. He knew that in the present economy, raising a \$6 million Series A would be no small feat, even for an individual with a track record such as his own. He was prepared to visit dozens of venture capital firms over the next two months.

As part of this financing, Aaron had agreed to give the former owners of the technology a 10% equity position in the business, post Series A financing. In addition, Aaron researched the market average for employee ownership in new ventures such as the one he wished to start, and found that 30% ownership for the team was reasonable. The result was that he was prepared to provide 60% of the business to investors for \$6M, giving him a post-money Series A valuation of \$10 million.

It was time to get to work preparing the investor pitch. Now that he had thought through the various elements of his presentation, Aaron was ready and eager to put everything together in a compelling and convincing package. “If I have enough data,” he reminded himself, “I can win any argument.”

## Student Assignment

Put yourself in Aaron’s shoes. Using the information provided in the case, do the following:

1. Develop an outline of Aaron’s verbal presentation to venture capitalists (less than one page). What should be his major points?
2. Create a set of presentation slides for his pitch.
3. Prepare a five-year financial forecast in the form of a P&L. Be sure to account for the 8 percent CAGR estimated for passenger rail travel over the planning period.
4. Determine the year in which the venture will be cash positive.
5. Calculate the SilverRail’s value at the end of year five, using a multiple of 8 times EBITDA. Assume two rounds of investment: a Series A from one VC at the start for \$6 million and 60% of the stock, and a Series B in Year 2 for \$15 million for another 25% of the stock (\$5 million from the first VC, and two \$5 million tranches from two additional VCs for expansion of services beyond Europe.) What would the founders’ and investor’s stock be worth if your Year 5 company valuation became an actual exit point?

# NLG ready to top \$1B, eyes larger share of the market

BY JILL LERNER  
JOURNAL STAFF

WOBURN — After making waves with a \$110 million acquisition late last year, officials of Woburn-based cruise and vacation company National Leisure Group Inc. say they are poised to sail near the \$1 billion sales mark this year.

In November, privately held NLG acquired the U.S. cruise division of Del Ray Beach, Fla.-based MyTravel Group, rendering the Woburn company — which owns or licenses approximately 20 private-label vacation brands, including Filene's Basement Vacation Outlet and 1-800-CRUISES, one of the largest providers of cruise vacations in North America.

The acquisition increased NLG's total employment rolls to 1,800 nationwide, including 400 in Massachusetts.

But despite its size, NLG still only commands about 1 percent to 2 percent of the \$150 billion U.S. leisure-travel market, and its young co-CEOs say there is opportunity to grab a bigger share by taking advantage of dramatic shifts in the way consumers buy travel, and the resilience of the cruise industry amid a generally sluggish travel market.

About 60 percent of NLG's revenue comes from sales of cruises, with the balance coming from other vacation services.

"The room for growth is tremendous," said Brad Gerstner, 32, who along with Aaron Gowell, 35, helms the company.

Venture capitalists Joel Cutler and David Fialkow started NLG in 1986 as a means to resell excess travel inventory in bulk at reduced rates. Later that year, they joined with Filene's Basement to

open a second brand, Vacation Outlet, in the downtown Boston store.

In 1995, they sold the company, and in 2000, they began their Cambridge venture firm, General Catalyst Partners. Throughout the 1990s, NLG added brands, such as BJ's Vacations and the Vacation Store, to its portfolio, and in 2000, in conjunction with Newton-based private equity firm Softbank Capital Partners, Cutler and Fialkow's firm bought it back for \$125 million.

Following the untimely death of company president Greg Davis, the investors installed Gerstner and Gowell as co-CEOs in 2002.

"It was very clear to David Fialkow and me ... the migration from off-line to online travel was very real," said Cutler.

"Buying back the company seemed to make more sense than doing a raw start-up," he added.

In recent years the company has invested heavily in technology, growing its staff of technologists from 10 to 120, in order to capitalize on market shifts in the way consumers buy travel, said its CEOs.

"As of the late 1990s, you still had a local travel agency on basically every street corner in America. ... We realized the desire to buy travel online would drive massive consolidation," said Gerstner.

In fact, traditional travel agencies nationally continued to fold last year, with the number of agencies dropping to 25,620 from 29,522, according to the Airlines Reporting Corp.

A big factor in the decline is consumers' shift to e-commerce travel sites like those operated by NLG, which can provide vacations at lower prices because technology



Aaron Gowell and Brad Gerstner, co-CEOs of Woburn-based cruise and vacation company NLG, say they are on track to generate \$1 billion in sales this year.

lowers their costs for distribution.

Additionally, whereas traditional agents often re-sell vacation packages, NLG negotiates its own wholesale agreements

with its lodging and transportation suppliers, further reducing the prices it can offer.

NLG charges fees for its services and says margins are about 20 percent.

Another key factor in the company's success is the resilience of the cruise industry.

"The cruise industry ... remains the fastest-growing segment of the travel industry," said Brian Major, a spokesman for the New York City-based Cruise Lines International Association, who noted cruise vacation retailers continue to consolidate.

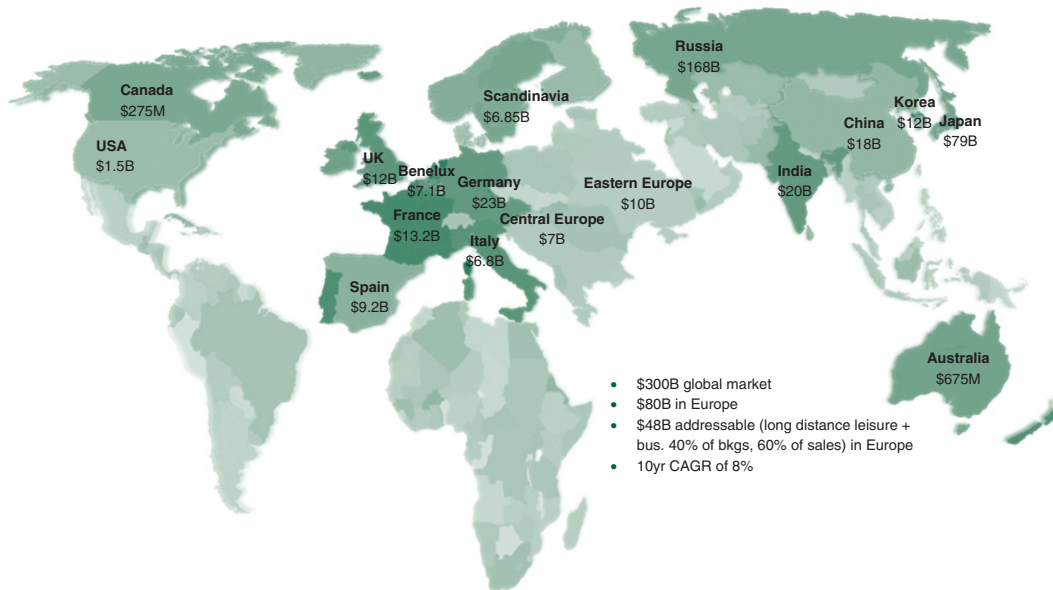
Last year saw the launch of 14 new ships, and in 2003, the industry increased its passenger load by 11 percent, according to the American Society of Travel Agents.

Fifty-six percent of people who have ever cruised have done so in the past five years, according to CLIA.

Cutler, who says the business is "nicely profitable," says Gerstner and Gowell's performance has "far exceeded anyone's expectations," and the co-CEOs themselves are bullish on NLG's market opportunity.

The company is going after JetBlue Airways Corp.'s vacation service, and executives say they plan to increase their marketing budget by 25 percent this year to promote existing brands.

## Appendix 2



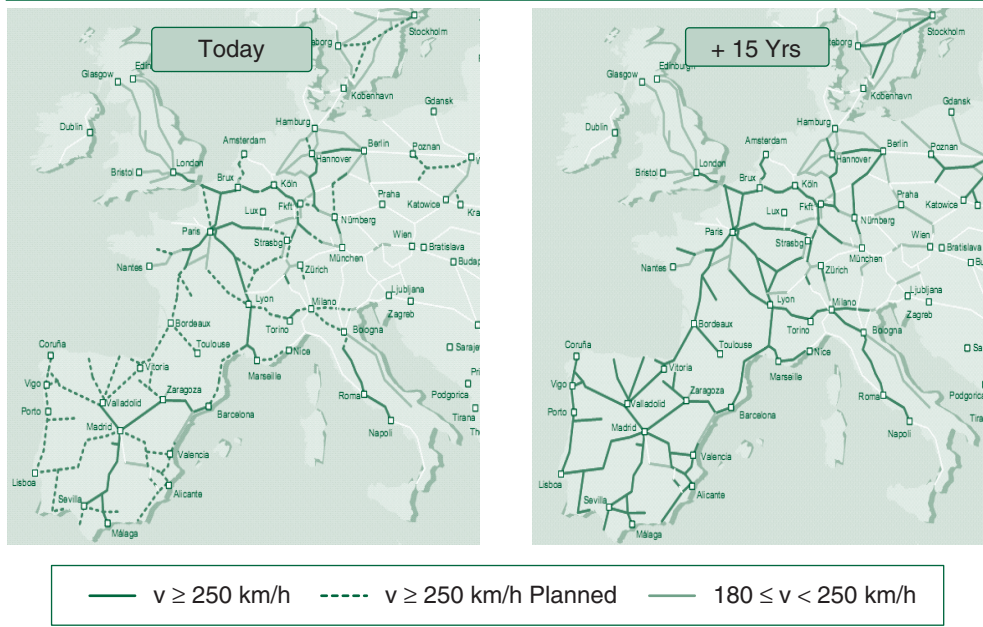
Rail travel in major national markets (2007)

Sources: UIC "International Railway Statistics" (2007); TOC "Ten Year Growth Report" (6/07).

## Appendix 3

High Speed Rail is transforming the travel landscape. In 10 years, European air travel on routes <600km will be virtually eliminated.>

3,700 mi of HS track at end of 2009, 9K mi by 2020 (\$250B investment)



The Growth in European High Speed Rail

Sources: UIC "International Railway Statistics" (2007); TOC "Ten Year Growth Report" (6/07).