Key Questions

Should We Worry About WeWork?

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No. But there are some important implications that need to be acknowledged.

In 2009, following a pair of business failures including a collapsible high heel shoe concept and a baby clothing company, an eccentric entrepreneur named Adam Neumann founded a company today known as WeWork. His idea was to secure long-term office leases, or acquire properties outright, and then sublet space to short-term tenants. WeWork would provide facilities ranging from individual desks to fully customized corporate headquarters and serve organizations of all sizes, from grassroots non-profits to Fortune 500 companies.

As Neumann later described it: "There were these empty buildings and people freelancing or starting companies. I knew there was a way to match the two. What differentiates us, though, is community and our mission which is to elevate the world's consciousness."

To his point, WeWork offers state-of-the-art office space, pays all the associated utility bills, ensures that every office is fully furnished including working Wi-Fi, and provides all the necessary office supplies and various other accoutrements. Offices also feature common areas that contain leisure activities such as foosball, arcade games, and bocce greens to facilitate interactions amongst its tenants.

In its ten-year history, WeWork acquired more than 500 locations (with another 300+ "coming soon") in over 110 cities and nearly 30 countries.

WeWork Valuation

Funding Stage	Date	Company Valuation (in billions)
Series A	4/2009	$0.1
Series B	10/2010	$0.4
Series C	12/2014	$5.0
Series D	6/2015	$10.2
Series E	7/2015	$15.8
Series F	8/2017	$21.1
Series G	1/2019	$47.0
IPO "whisper"	9/2019	$95.0
SoftBank "take under"	10/2019	$8.0

With its growth, based on private capital invested into the company, WeWork's imputed valuation (or investors' infatuation) grew at a torrid pace as depicted above.

This past summer, WeWork submitted the necessary documents to sell its shares to public investors. Initially, investment bankers argued the company should be worth between $90-100 billion — roughly double the price investors valued WeWork at the beginning of the year and nearly ten times the price at which investors valued WeWork less than five years earlier.

As investors dissected WeWork's business model and accounting, however, many questioned the company's valuation and expressed concerns over large losses the company had recognized along with an unclear path to future profitability. A deeper dive into the company's financials revealed high vacancy rates and significantly higher-than-anticipated operating costs.

Moreover, apprehensions over several instances of self-dealing, glaring conflicts of interest ,and weak corporate governance practices reached a crescendo at the time that many of Mr. Neumann's quixotic ambitions came to light. It was reported, for instance, that he possessed aspirations such as living forever, expanding WeWork to the planet Mars, and becoming both the world's first trillionaire and "president of the world."

Ultimately, the initial public offering was withdrawn, Neumann was forced to relinquish the company, and SoftBank, a large institutional investor that had made previous investments in WeWork, injected new capital into the company. SoftBank obtained an 80% ownership stake in the company but at a discount of 83% to WeWork's prior valuation. In an instant, over $40 billion in value vanished.

Venture capital and private equity are known for the potential for outsized returns and outsized losses. But WeWork will likely stand out in many ways. Importantly, however, most investors should not be overly worried because of WeWork's financial fall from grace in our view. In fact, they should celebrate it because it proved the system worked: Bad companies and bad actors (both management and the oversight board) deserve, and in this case seemingly secured, their fate.

Furthermore, while a loss of $40 billion is substantial, it is manageable relative to the global financial market. It poses virtually no systemic risk as the losses are borne by the underlying investors, as opposed to cases such as Enron and other financial charlatans where the broader investing public suffered large losses.

Still, there are important implications that need to be acknowledged. Chief among them is the fact that private capital is a dominant force in today's capital markets. Twenty years ago, there were approximately 1,000 private equity firms. Today, there are over 7,000.

Simultaneously, in an environment defined by low yields, investors have had to reach for returns, and the amount of money invested in private equity and venture capital has climbed to record levels. And with this abundance of capital, the multiples that venture firms are paying for their underlying investments, on average, are also at all-time highs.

It is not surprising, therefore, that some capital allocation decisions may not always be optimal. Thus, when considering such investments, skepticism is warranted and selectivity is of paramount importance. This is relevant for all investors as, in some instances, investments in privately held businesses such as WeWork reside in open-ended mutual funds, which requires scrutiny, robust analysis, and an in-depth understanding of a fund manager's portfolio -– all central elements of our manager due diligence process.

When writing about WeWork, a well-respected market strategist offered the following assessment: "WeWork has every right to raise money and we wish them and their investors well. What we don't wish, and what puts the integrity of our capital markets at risk, is the tendency to use the public markets as a game that allows a fast talker to cash out rather than a means to grow large enough to distribute profits and contribute to our world's economic health."

We could not agree more.

For more information, please contact your Key Private Bank Advisor.

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