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The Big Read Global property

WeWork: the 'hypothetical' company at the heart of the property market

The shared office space provider sees itself as a technology, not a real estate, group

Eric Platt and Andrew Edgecliffe-Johnson in New York JULY 2, 2019

Masayoshi Son, the Japanese billionaire, left an indelible mark on California's property market when he spent a reported $117m on a nine-acre estate in the hills above Palo Alto. It was one of the largest sums ever paid for a home in the US at the time.

But it pales in comparison to the impact the SoftBank boss has had on the commercial real estate world with his $10bn-plus investment in WeWork. In less than a decade, the lossmaking provider of office space has grown from renting a single building in New York's Soho district to become one of the largest tenants in cities across the globe.

Its rapid growth is down to the unbridled optimism of two men: Adam Neumann, the 40-year old entrepreneur and founder of WeWork, and Mr Son, who has egged on his protege's lofty visions. He has also pumped more money into the younger man's company than any other investor, effectively setting its valuation, which at $47bn now eclipses all but a handful of publicly traded property groups.

"What he brought to the table was a bigger thinker, which we thought was hard to find because we thought we were quite big thinkers," Mr Neumann told the FT in an interview in May. "He came in and said, 'Woah, woah, woah, wait. Why [target] only a million members when you can have 5m?'"

WeWork offices in Brooklyn, New York, Minato-ku, Tokyo and Spitalfields, London © Cynthia Van Elk, Androniki Christodoulou, Charlie Bibby/FT

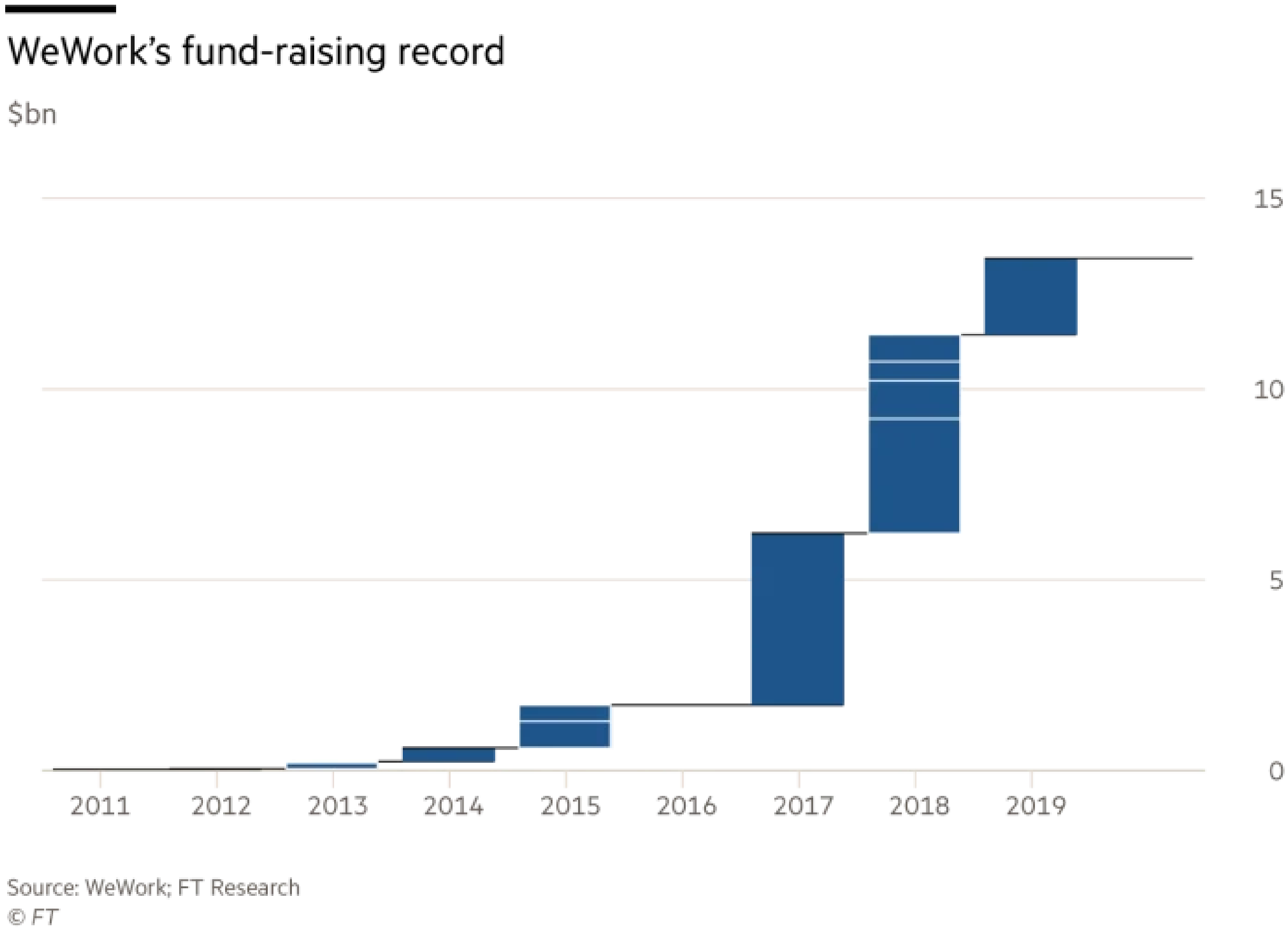
Such conversations between the two men capture both the potential and perils of WeWork as the company prepares for an initial public offering that will test whether other investors share their rosy view of the group’s potential.

Like the SoftBank boss, Mr Neumann is considered by supporters to be a visionary who is applying the disruptive instincts and dynamism of the technology sector to a much more staid industry. But to their critics, both are salesmen who have been able to hype their businesses in an era of endless cheap money but who will be found out when circumstances are less favourable. In Mr Neumann’s phrasing of its mission, WeWork is “elevating the world’s consciousness”. To his detractors, it is an overvalued property company.

The question of who is right is of pressing importance to both the global property sector and the US equity market after WeWork secretly filed paperwork with US securities regulators to go public late last year. WeWork is now the largest tenant in New York and one of the biggest in London. If the company can continue to expand, reduce its losses and convince investors that it has a powerful, long-term business built around technology, WeWork will help to underpin the market for office space in many of the world’s main cities.

But if investors doubt the company’s model — which combines long-term leases on office buildings with shorter-term contracts with clients — then the impact will be felt across property markets. Co-working, after all, has grown far beyond WeWork’s 485 offices. At least 350 other venture capital-backed companies have leased thousands of buildings for the same purpose, according to Andrea Chegut, a research scientist at the Massachusetts Institute of Technology.

“Adam Neumann is getting in a room and telling investors a story along with his financials. That story he is telling . . . it is something,” she says. “Real estate always had a subscription model, it was a rent contract. [WeWork] just changed the time period of the subscription and gave you a really easy way to access this. They allowed you to click to buy.”



The question hanging over the IPO is, as analysts at CB Insights put it two months ago: “Is WeWork’s business model just a ‘house of cards’ fuelled by ‘Silicon Valley pixie dust,’ as critics have claimed? Or do millions of square feet of office space, hundreds of thousands of members, and an ever-expanding repository of data add up to more than the sum of its parts?”

Their conclusion was that the company may yet live up to its valuation, but it needs time that it may not have for its model to gain traction, as well as further infusions of cash. “So much about the company,” the analysts wrote, “is still hypothetical”.

Mr Neumann, who walks round WeWork’s Chelsea headquarters in gold-speckled Nike training shoes and logo-embossed T-shirts, was not the first to try to profit from co-working spaces. But the scale of his vision and unabashed hunger to succeed initially attracted employees, and then investors like Fidelity and T Rowe Price which soon followed.

WeWork's sales keep growing; last year the company generated $1.9bn © Cynthia Van Elk, Androniki Christodoulou, Charlie Bibby/FT

While his earlier ventures failed, including a company that sold women’s shoes with collapsible heels and another that made baby clothes with knee pads, WeWork has turned the kibbutz-raised Israeli into a paper billionaire. He is, however, known to be unpredictable, bending the company to his own interests as when he banned employees from expensing meals containing meat or bought a manufacturer of wave-making machines. It is a trait that has raised tensions for some investors who hope to soon sell their holdings.

His management style is likely to be a focus for other shareholders weighing whether to buy in to WeWork’s IPO, according to David Erickson, a University of Pennsylvania fellow and former Lehman Brothers and Barclays banker. “When investors buy IPOs they invest in companies that have strategies that can be executed by strong management,” he says. “The more and more I hear about the team here . . . the more uncomfortable I would be as a potential public investor.”

Mr Neumann has added more experienced executives, his defenders note. Internally, some employees refer to Jen Berrent and Artie Minson, the company’s co-president and chief financial officer as Mum and Dad, according to several people who spoke on the condition of anonymity. They are seen, one added, as responsible for keeping Mr Neumann focused on the core business and for intercepting off-beam projects that interest him, though WeWork contests this characterisation.

More conventional Wall Street investors seem unconvinced by talk of elevating consciousness, but when asked whether he would change his messaging to persuade his new audience, Mr Neumann replied with a smile: “Are you asking am I going to sell out? No, we’re not going to sell out.”

“The only thing I’ll do differently, I will take a pause before I communicate,” he said. “I will be more thoughtful about how it comes out, and I will ensure to come with data to the table.”

Bankers have for weeks been pitching their services for the upcoming IPO. The critical question they will confront is whether the institutional investors who can make or break a new offering agree with WeWork’s characterisation of itself as a tech company or measure it against the far more lowly-rated real estate sector. Even the research analyst covering WeWork for JPMorgan Chase, one of the banks angling for the mandate, has purview over property, not tech.

That distinction has already proven a thorn to some early investors trying to sell down their stakes. Mr Son’s latest investment, which raised the headline valuation to $47bn in January, included $1bn to buy out existing investors at a $20bn price. Broker documents seen by the FT showed institutional investors were willing to trade the company’s stock at a heavy discount to the higher of those valuations, with $23bn marking the midpoint of the range for some investors.

If WeWork were to secure a valuation of around $47bn, it would be in the same league as FedEx and General Motors. Even at half its current valuation, the company would vault the likes of Boston Properties and Vornado, two giants in the property business. But unlike those blue-chips, WeWork haemorrhages cash. In the first quarter, it blew through roughly $700m.

The difference in valuation comes down to growth: WeWork’s sales keep doubling. Last year they reached $1.9bn and in March the company said it was on pace to generate more than $3bn of revenues over the following year. It is growth that even Facebook and Google would envy.

“Because it is physical, people immediately assume there isn’t technology,” says Ron Fisher, SoftBank’s vice-chairman and a WeWork board member. “Look at what is happening behind the scenes, from when they start to design a building [to] how they communicate with each other . . . They have so many services that can improve [members’] lives and be very profitable.”

WeWork is likely to divide the investment world long after it floats. But there is a growing camp of investors and analysts who believe its heavy investment have given it market power; not only do they think that WeWork has changed how people and companies search out office space, but they believe it has become such an important tenant to landlords that it can begin to dictate its own terms and be able to renegotiate leases in a downturn.

To justify its valuation though, it will need to show a path towards profitability. So far, it has only moved an inch in that direction. Since 2016 it has racked up a deficit of more than $3bn; last year it accumulated losses to the tune of $220,000 every hour of every day. Those narrowed slightly in the first quarter of 2019, to just under $219,000 an hour in the 12 months to March.

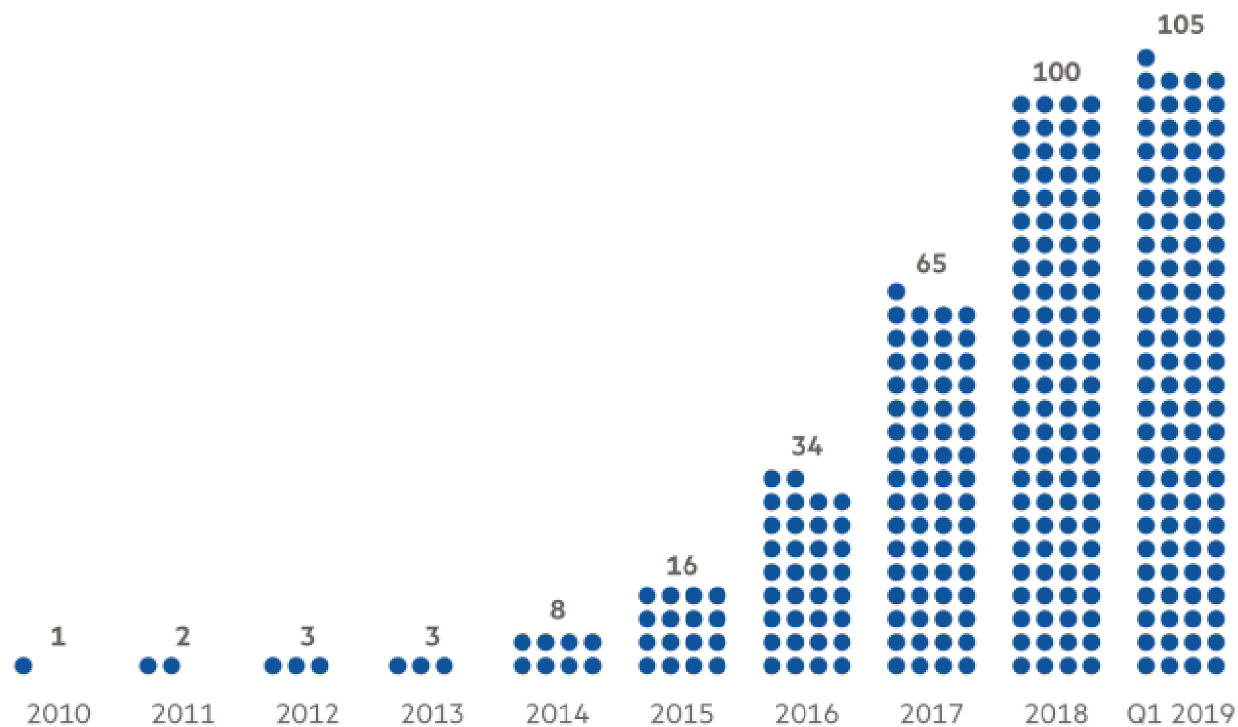
“The lossmaking is very real but it has everything to do with the pursuit of growth,” says Jeffrey Rayport, a professor at Harvard Business School, noting that public market investors supported

Amazon even as it lost money for years after its IPO. “The rationale on the SoftBank side is that this is an opportunity on an Amazonian scale . . . that it’s basically a $1tn market cap opportunity.”

Not all investors are convinced. One, who spoke on the condition of anonymity, described the initial post-IPO falls in shares of ride hailing apps Uber and Lyft as a harbinger of things to come for WeWork. Regardless of its model’s merits, WeWork will not be immune to the broader market mood about new listings by lossmaking darlings of the private markets.

WeWork has “got a tech multiple on a CBRE business,” says the investor, referring to the real estate group. “Uber and Lyft just shat the bed and not because the IPO market isn’t good, but because there are fundamental questions about the unit economics. As a shareholder, Uber and Lyft are disastrous for our stake in WeWork.”

Cities with WeWork locations



Source: company
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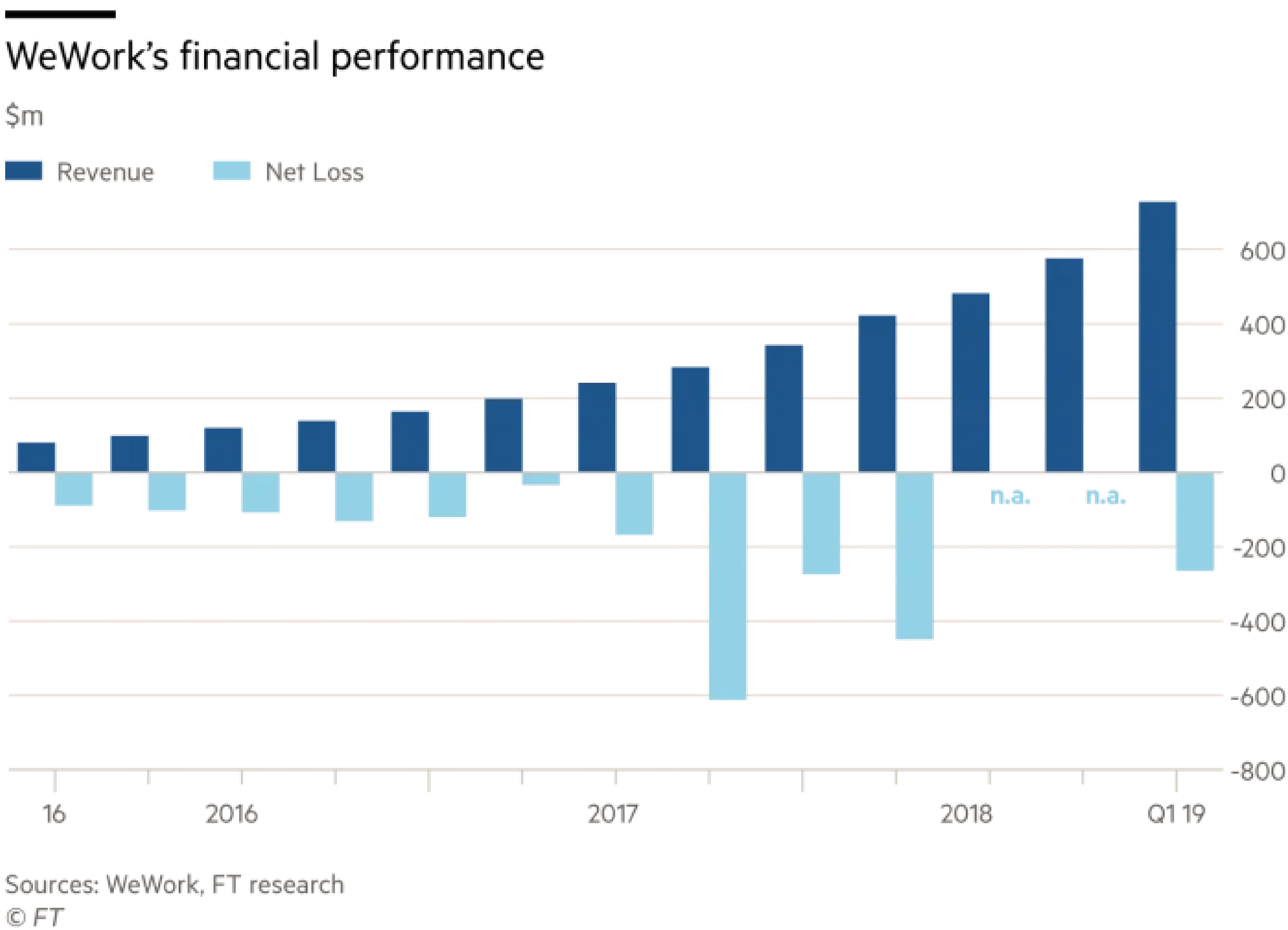
Then there is the question of how WeWork would survive a major economic downturn. Global property markets are showing signs of strain. And while stock markets remain buoyant, some investors caution the bull-market run is losing steam. Mr Neumann says the company has survived local slowdowns and would prosper in a recession because many companies will move employees out of higher rent locations into WeWorks. But sceptics warn freelancers could simply work from home and WeWork’s growing corporate client base could still fall under the axe.

WeWork has outrun its losses so far because SoftBank and other investors kept pumping money in. The company was worth less than $17bn before SoftBank and its Saudi-backed Vision Fund first invested $4.4bn in 2017. But the infusions from Mr Son transformed that valuation, allowing WeWork to enter new markets in Asia, Europe and Latin America. As Mr Rayport notes, "you can brute force your way to a winning position with capital".

That enthusiasm lasted until January, when the company tried to raise new funds. Mr Son had initially been ready to spend $10bn of SoftBank's capital buying out early WeWork investors while injecting another $6bn into the company. However he then had a change of heart.



With concerns about the concentration of WeWork in SoftBank's portfolio and disagreements over its value, Japan's second wealthiest man decided to invest just $2bn more, half of which was used to buy out existing shareholders. The shift sent shivers through WeWork's bondholders — and served as a reminder that the company's valuation will soon be set by someone other than Mr Son.

The IPO will provide one extra shot of capital to the business, money that lenders and investors hope will give WeWork the time to plug the metaphorical holes from which that cash has gushed.

Ever the optimist, the case Mr Neumann makes for WeWork is not based on how much he might extract during his next meal with Mr Son. Instead, he is looking further over the horizon and is not looking to sell a single share right now: "This company is so early, I want to give it a second and really see it start maturing into the beginning of its potential. And I think our peers and our investors would be wise to do the same."