WeWork's SPAC merger: its latest attempt to go public

Introduction

WeWork has agreed to go public through a merger with a blank-cheque company BowX Acquisition Corp in a deal that implies an initial enterprise value of approximately $9bn for the office-sharing provider.

Following the high-profile collapse of its IPO attempt in 2019, WeWork is taking advantage of the surge of new SPACs in recent months to go public. The boom in SPACs has resulted in a significant increase of liquidity in the capital markets and the resulting pressure on SPACs to invest has allowed companies that were previously not able to access the public markets via IPO to do so now via a SPAC. The $9bn valuation marks a steep decline from the $47bn the loss-making company was valued at in 2019 ahead of its IPO attempt that dramatically imploded following investors' concerns over the firm's business model and conflicts with its eccentric founder.

The SPAC deal represents for WeWork an opportunity for a huge capital injection that might pave the way for profitability in the long-term. However, despite recent attempts to manage expenses by the new CEO, WeWork continues to report huge financial losses and, as a result, the future of the company remains very uncertain.

About WeWork

WeWork is a US commercial real estate company founded in 2010 by Adam Neumann. WeWork is an office-leasing company: it purchases real estate, renovates the space into small offices or common areas and then rents the desks to groups as well as individual freelancers. WeWork's pitch goes beyond simply offering shared co-working spaces as its members are offered to become part of a "physical social network": companies and individuals can connect and there are a lot of opportunities for WeWork members to benefit from this environment. For example, members can post job opportunities on the company app and WeWork offices hold pitch nights for start-up companies. WeWork's growth was exponential before its initial IPO attempt in 2019 overtaking JPMorgan Chase as New York's largest commercial tenant and controlling more square feet in London than any other private company. Lastly, the firm even expanded into other sectors including education and private rentals.

In January 2019 fundraising, SoftBank injected $2bn into the firm, resulting in an implied valuation of $47bn for the loss-making company and making it the world's most valuable private start-up after Uber. JPMorgan Chase and Goldman Sachs who were running the IPO had previously stated potential market caps as high as $63bn and $96bn respectively. However, upon filing for IPO, WeWork's S-1 revealed many underlying risks of the company. Indeed, investors were disillusioned by the company's grim record of losses as the firm had been in business for nine years and despite raising over $12bn it had yet to make any profit. Investors were also alarmed by the erratic behaviour of Neumann and his potential conflicts with the company: for example, Neumann received personal loans from the company at below-market rates to fund his eccentric lifestyle. In late 2019, executives at SoftBank urged WeWork to abort its IPO plans and Neumann was soon after ousted as CEO. SoftBank intervened to rescue WeWork with multibillion-dollar financing as the company risked bankruptcy, following the implosion of its IPO attempt. In February 2020, SoftBank installed one of its own executives, Marcelo Claure, as WeWork executive chair and real estate veteran Sandeep Mathrani as WeWork CEO.

Under CEO Sandeep Mathrani, the company has placed immense focus on cutting costs, closing many of its locations, renegotiating leases as well as cutting thousands of jobs. The CEO said the company "has spent the last year transforming the business and refocusing its core." However, the recent SPAC deal announcement exposed WeWork's continuing financial struggles: the company posted a net loss of $3.83bn on $3.4bn of revenue for 2020, compared with a $3.78bn loss on a similar revenue level in 2019, while dramatically reducing its capital expenditure to $49m in 2020, from $2.2billion in 2019. WeWork suffered enormous losses as a result of the global pandemic as its flexible business model allowed many tenants to cancel their agreements with as little as one month's notice. Occupancy rates fell to 46% by the end of 2020 from 72% the previous year. WeWork is hoping for a fast rebound of the economy following the pandemic and predicting a rapid return to offices. It told investors it expects occupancy to surge to 70% by the end of 2021. Further projections in the deal announcement include a leap in revenues from $3.2billion in 2019 to $7billion by 2024.

Industry Analysis

The serviced office leasing market consists of a widely differentiated set of companies. Some of WeWork's biggest competitors here are IWG, Servecorp, and Knotel. Some, such IWG or Servecorp, are already well established in their respective markets and have proven themselves throughout various crises. In the years leading up to the pandemic, these firms exhibited steady growth, and more importantly, profit. For instance, in 2019 IWG generated profits of $180m on revenues of $3.5bn. Additionally, it possesses ample cash reserves of $90m and little net debt. On the other hand, there are office space providers such as WeWork or Knotel, that have embraced the Silicon Valley way of doing business, namely by growing as fast as possible. This aggressive growth strategy led to WeWork losing $2.2bn on revenues of $2.5bn in the first three quarters of 2019 alone. Clearly, these different approaches affected how well the companies were prepared for the current crisis.

Unsurprisingly, the office leasing industry as a whole has not weathered the Covid-19 pandemic well. Indeed, most of the big players experienced drops in their stock prices comparable only to those of airlines and cruise operators. Across the globe, locations had to be shut down, at least temporarily, for disinfection purposes, with many of them remaining closed.

All of WeWork's competitors experienced slumps in occupancy rates, but the actual percentage decrease varied somewhat. At the end of 2020, WeWork found its global occupancy reduced to 47%, down from the initial 73%. IWG fared better since it enjoyed a strong Q1 in 2020 that would make up some of the losses during the pandemic. Its occupancy rate was down to 75% from around 80%. What is more, at the beginning of the crisis only around 10% of its customers had signed rent contracts for one month or less, compared to 28% at WeWork. Clearly, a considerable number of those clients decided not to renew the contract, ultimately leading to a larger reduction in the occupancy rate at WeWork than for example at IWG.

In 2020, Servecorp experienced a 3% decrease in occupancy rates, from 72% in 2019 to 69%, however, it remained profitable with a net profit of $15.6m. This was largely due to a strong performance in markets such as the Middle East and North Asia, excluding China.

Knotel, the start-up that after WeWork's troubles in 2019 were considered a favourite to become the leader in the sector, has recently filed for bankruptcy. While its problems did not start with the pandemic, it is still a good example of how this crisis can disrupt even the biggest firms in the industry. However, most of the Top-10 in the sector can also still rely on long term contracts with major corporations that are unlikely to default on their commitments. This is not the case for the roughly 80% of the office space providers that do not operate at the scale of the top players, but rather depend on start-ups and SMEs in specific locations. Consequently, many of them may not last through the crisis.

Nevertheless, those who survive through the pandemic might be in a better position than ever. There will be significantly more companies that do not want to commit to long-term leases anymore and instead choose flexible contracts. After last year many will want to maintain financial flexibility. What is more, working from home will not simply go away but persist for years to come. Therefore, it is probable that several firms will switch to a hybrid form of working. The industry was already predicted to increase in size as much as four times by 2027, and if hybrid working becomes the norm even larger growth might become possible. WeWork for instance assumes a 90% occupancy rate, higher than before the pandemic, already by 2022.

Deal Structure

In the past year, we have witnessed a remarkably strong market for flotations, notwithstanding the pandemic. In large parts, this was because of a massive increase in SPACs. Indeed, more than 50% of all flotations worldwide were in the form of a SPAC. Furthermore, their average size has increased, and they are increasingly being run by mainstream PE funds such as Apollo or TPG. Given these market conditions, it is understandable that WeWork chose this method to become a public company.

At an implied enterprise value of $9bn, WeWork will merge with SPAC BowX Acquisition, which will ultimately enable it to raise $1.3bn in cash. $483m of that will be sourced from the funds BowX received during its IPO, while institutional investors like Fidelity, BlackRock and Starwood Capital will contribute $800m.

BowX is a SPAC created by, among others, Vivek Ranadive of the venture capital fund Bow Capital. Before founding Bow Capital, Ranadive was the founding CEO of TIBCO, a multi-billion software integration company. WeWork's knack for innovation and digitization were supposedly BowX's biggest incentives for the merger.

Both boards already agreed on terms and the transaction should be closed in the third quarter of this year. Current WeWork CEO Sandeep Mathrini will continue to oversee the office space provider, while Vivek Ranadive will join the board.

Public Listing Rationale

WeWork, which is pitching itself as a "technology company" rather than a traditional landlord, is far from reaching the 70% physical occupancy of its offices needed to reach break-even, mainly because of the general lockdowns and restrictions imposed with the spreading of the Covid-19 pandemic. In addition to that, because of its history of lavish spending and mounting losses, now WeWork is finding itself in a very tough situation characterized by a shortage of liquidity.

WeWork, which expects to generate $7bn in revenues by 2024, registered losses for $3.2bn in 2020 as a result of the restrictions imposed by governments to curb the spread of Covid-19. Moreover, the American commercial real estate company has burnt more than $6.2bn of cash in the past two years. After the huge drop in valuation from the $47bn of summer 2019, Softbank has assisted WeWork with a multibillion-dollar rescue financing and, to cut costs, WeWork has laid off thousands of workers and closed underperforming buildings. It has also sold properties such as The Wing, a women-focused office space provider, and Teem, an online scheduling company. Furthermore, Mr Mathrani announced that the company has agreed to exit more than 100 of its properties and has renegotiated leases on more than 150 of its offices.

The SPAC deal represents for WeWork an opportunity for a huge capital injection that might pave the way for profitability in the long term. In its 5-year strategic and financial plan, WeWork announced that further investments in the business are required to increase the company's membership offerings which will include: office equipment customization, a network that offers insurance benefits and payroll services, and an on-demand feature for desks, and conference rooms are all open to all. Upon completion of the transaction, WeWork is projected to have approximately $1.9 billion in cash on the balance sheet and $2.4 billion in overall liquidity, including a $550 million senior secured notes facility offered by SoftBank Group. SoftBank and its Vision Fund will have a minority representation on the board after the deal closes in the third quarter of 2021.

Marcelo Claure, the Executive Chairman of WeWork stated that by going public WeWork is taking another step towards making its vision a reality. Furthermore, he added that the injection of liquidity will help the company to position itself properly to meet rising demand in a dynamic market.

Market Reaction

WeWork is just the latest in a long line of high-profile businesses to take the SPAC path to market. After the announcement, the shares of BowX rose about 5% in early trading on the Nasdaq. As of today, approximately one week after the announcement, the share price has further risen reaching a high $11.

The value of the company's debt has risen in reaction to rumours that it was close to a deal to go public earlier this year. According to Finra trading records, the $669 million bond, which matures in 2025, traded at 98.5 cents on the dollar after the deal was announced last Friday, up from 68 cents at the start of the year.

Advisors

WeWork has chosen PJT Partners as its sole financial advisor and Skadden, Arps, Slate, Meagher & Flom LLP as its legal counsel. Whereas, BowX has chosen UBS Investment Bank as its sole financial advisor and Cooley LLP as its legal counsel.

TAGS: WeWork, SPAC, SoftBank, listing, BowX, PJT, UBS, office, co-working, physical social network, technology, Fidelity, Black Rock, Starwood capital, Neumann, Mathrani, occupancy rates