

The \$10 billion question

Can office-sharing star WeWork, a "unicorn" in Silicon Valley for its skyrocketing mega valuation, survive a downturn?



WeWork co-founder Adam Neumann

By KONRAD PUTZIER

When news broke in November that the shared-office provider WeWork raised \$150 million from a number of high-profile investors, including Boston Properties' Mort Zuckerman, the deal valued WeWork at \$1.5 billion and catapulted it into the limelight. It was suddenly a "unicorn," Silicon Valley-speak for a company that races to a \$1 billion-plus valuation based on fundraising.

Over the next few weeks, there was little news from the startup, save for a couple of conference talks by co-founders Adam Neumann and Miguel McKelvey and a new lease signing at the Durst Organization's 205 East 42nd Street. Then, on Dec. 15, the firm

made another announcement: It had just raised an additional \$355 million, valuing the company at \$5 billion.

In just 10 months — from the first announcement in February 2014 to December of that year — WeWork had tripled in value. It was suddenly worth more than twice as much as global brokerage giant Cushman & Wakefield. And if that isn't enough, at press time the firm announced yet another round of funding that valued the company at a staggering \$10 billion.

Real estate is a slow-moving business. Skyscrapers take years to build. Families amass fortunes over decades, and hold on to them for generations. By these standards, WeWork, launched just five years ago, is the

industry's equivalent of Jamaican sprinter Usain Bolt, widely considered the fastest runner on Earth.

The firm has leased more than 3 million square feet of office space globally, with 1.85 million square feet of that in New York, making it one of the city's largest office tenants. But its impact eclipses its physical footprint. Landlords now say WeWork shapes their design decisions, and it's changed the way startups think about their office needs.

"There are a lot of companies that start out in a WeWork environment, and that has influenced the design of our building," said developer Toby Moskowitz, CEO of Heritage Equity Partners, who is planning an office project in Williamsburg.

Budding real estate entrepreneurs are also eager to piggyback on the company's success, with "We're like WeWork, but for..." becoming a common sales pitch. WeWork, it seems, is everywhere.

But is it here to stay? Some argue that the firm's lightning growth makes it vulnerable.

"I definitely don't think that now, at an all-time high [for office rents], they should expand," said Juda Srour, founder of rival shared-office provider Jay Suites. "There's a huge risk."

Others consider the firm overhyped and overvalued.

So will WeWork continue speeding ahead, or is it bound for a crash? *The Real Deal* took a closer look at the budding giant to get to the bottom of its business, its numbers and its prospects for the future. What emerges from talks with insiders, onlookers and investors is the portrait of a company that is less vulnerable than one might think.

Strength in numbers

If you think a multi-billion dollar valuation seems lofty for a startup, you're not alone.

"I don't understand their valuation," said a real estate tech entrepreneur who spoke on the condition of anonymity. "They seem to be valued the way a tech company is valued, but they are a commercial real estate company."

Even Neumann, in an interview with the *Wall Street Journal* after the \$5 billion valuation, acknowledged that if it were viewed as a traditional real estate concern, its valuation wouldn't be as steep.

WeWork declined to provide any information for this article, and doesn't disclose its earnings, but sources said at \$5 billion it was valued around 100 times earnings.

That's an extraordinarily high price tag and is even higher with the latest infusion of cash. SL Green Realty, the city's largest commercial landlord, currently trades at 20 times its earnings. Regus, the world's largest shared-office provider and a WeWork rival, trades at 34 times earnings. The average for all stocks listed on Nasdaq is 23.

And yet, the valuation is hardly an outlier during a venture-funding boom that has some observers worrying about a new dot-com bubble.

"At least from a dollars and cents perspective, we've seen crazier things," said a partner at a venture capital firm that hasn't invested in WeWork but holds stakes in other real estate tech startups. Another venture investor, also unaffiliated with WeWork, said the valuation is high but "could be very justified" in the long run. (Both were speaking after the \$5 billion valuation.)

Tech startups attract funding based less on their current earnings and more on the promise of future growth. And if Neumann has his way, the growth will be immense. "In the next five years, we're going to take over more than 50 million square feet [of office space]," he said at the TechCrunch Disrupt technology conference in May.

WeWork rents out large tracts of office space with terms of 10 to 15 years, and then sublets small chunks to firms on a month-to-month basis. In exchange for this flexibility, as well as a plethora of amenities and networking opportunities, WeWork's customers, dubbed members, pay a significant premium.

Zachary Ehrlich, founder of brokerage Mdrn., estimated that he pays up to \$200 per square foot at WeWork's 261 Madison Avenue location. WeWork pays rents starting in the low-\$40s per square foot for the space, according to real estate data firm CompStak. This very likely allows for a comfortable profit margin, even after accounting for the company's large investments in renovations, on-site management and amenities.

In some cases, landlords provide WeWork with discounted space in exchange for its commitment. Rudin Management, for example, gives WeWork a discount at 110 Wall Street. Michael Rudin, a vice president at the family firm, argued that the discount makes business sense because WeWork is leasing the entire 300,000-square-foot building — which was previously 60 to 70 percent occupied — and is assuming much of the cost of renovation.

"At the end of the day, we have this growing company that's taking the entire building and doing a nice buildout, and we are spending significantly less than we would have with a complete repositioning," Rudin said. "Worst case, if WeWork went out of business, we would be left with a better building than before Hurricane Sandy."

WeWork is getting similar discounts at a minimum of six of its 15 current New York locations, according to CompStak. Observers guess that each location generates millions in profits for the company, and its potential for profitability only increases with each new location, as does the appeal of its much-touted member network.

Jason Bauer, whose brokerage Voda Bauer is headquartered at a WeWork space on East 42nd Street, said the rent premium he pays is more than offset by the business he gets from other WeWork members. Voda Bauer is WeWork's official residential partner in New York, giving it first crack at a huge pool of potential clients.

The founders' unusual backgrounds — Neumann grew up on a kibbutz in Israel, McKelvey in a five-mother collective in Oregon — led WeWork to place huge emphasis on community, something that has clicked with investors.

"I thought they really did think not just about real estate space but about establishing a community, which I thought then, and still think now, would attract a lot of people," Mort Zuckerman, co-founder and chair of Boston Properties, told *TRD*. He said he chose to invest based on his belief in both WeWork's business model and in Neumann, whom he described as "enjoyable," "inspiring" and having "a great feel" for his work.

"I am, shall we say, very happy [with the investment]," Zuckerman added.

The test to come

Rapid growth and glowing assessments like Zuckerman's have led many to con-

clude that the future belongs to WeWork. It's certainly managed to attract top talent.

Recent hires include Arthur Minson, former CFO of Time Warner Cable; Michael Gross, former CEO of Morgans Hotel

by Bloomberg.

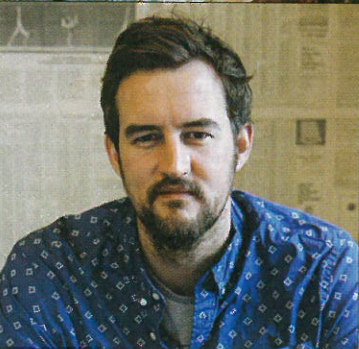
"Everyone said our business wouldn't succeed then because it's a downturn," he said, referring to WeWork's predecessor Green Desk. "And now they're saying it

because it seems like there are not just tech startups there. I think they've done a pretty good job of building out their diversity."

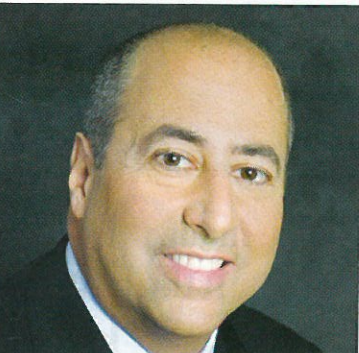
WeWork is often portrayed as a haven for tech startups, but that's only partially



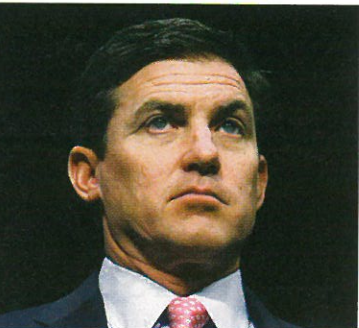
An office at the WeWork location at 1 Little West 12th Street in the Meatpacking District



WeWork co-founder Miguel McKelvey



WeWork's Todd Bassen, former head of New York acquisitions for Invesco



WeWork's Arthur Minson, former CFO of Time Warner Cable



The lounge at WeWork's Soho West location at 17 Varick Street

"Everyone said our business wouldn't succeed then because it's a downturn. And now they're saying it won't succeed because it's a bubble. I think that whole idea is bullshit. Because as we all know sitting in this room, the world has changed completely."

MIGUEL MCKELVEY, WEWORK

Group; and Todd Bassen, former head of New York acquisitions for Invesco.

But doubts persist about WeWork's ability to weather a downturn. The firm is signing long-term leases at historically high rates, despite the favorable terms it may get. Will it still be able to charge members, who make only short-term commitments, the rates it needs to stay profitable if the real estate market, or the economy as a whole, tanks?

At an April event in Brooklyn, McKelvey addressed this question, as first reported

won't succeed because it's a bubble. I think that whole idea is bullshit. Because as we all know sitting in this room, the world has changed completely."

A third venture investor unaffiliated with WeWork, also speaking on the condition of anonymity, said he goes "back and forth" on the question of the company's viability.

"Because you look at their spaces," he continued, "and it's all these small businesses, and if there's a major downturn in the economy, do they get fucked? I don't know,

correct. Walking through the hallways one is also likely to see lawyers, flacks, budding hoteliers and tailors, among others. What is true though, is that small businesses make up the bulk of WeWork's membership.

Conventional wisdom says that small firms are vulnerable to downturns. However, a look at the available data shows that heavy reliance on small businesses may not be a disadvantage during tough economic times — on the contrary.

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