FORTUNE

WeWork's Options for Raising Cash Are Narrowing Fast Ahead of Its IPO

September 11, 2019
By Erik Sherman

What if they threw an IPO and nobody came?

In a week marked by "will they are won't they" speculation about an upcoming IPO, and leaks that the We Company is considering slashing its once $47 billion valuation to some $20 billion—or maybe less—questions surround the high flying company's future prospects.

But what might be the more pressing issue is how the company plans to solve its ravenous cash flow needs—now.

WeWork needs cash

The need for an IPO or some alternative all comes down to WeWork's need for cash. Money has been flying out the door. In the company's amended S-1 filing with the Securities and Exchange Commission, We saw in the first six months of 2018 a loss from operations of $678 million on $774 million in revenue. By the same period in 2019, it was a $1.4 billion operations loss on $1.5 billion in revenue.

In theory, WeWork could *make* money, according to Barry Oxford, who covers real estate for D.A. Davidson. "WeWork's office space in and of itself is cash flow positive," he said, comparing the revenue and operating expenses of the spaces. Oxford does worry about how well the business model would work in a recession. "Can WeWork get to cash flow positive and have enough of these spaces up online and stabilized before a recession or does the recession hit them before they're stabilized, causing a lot of disruption to their business model," he said.

The company has aggressively tried to build out its presence and secure more regular revenue, gobbling up cash in the process.

"This company right now probably needs to raise money to be around in five years ... based on what they disclosed in their registration statement," said James Cassel, chairman and co-founder of investment bank Cassel Salpeter & Co. "Their business model is to lock into these 10-, 15-, 20-year [building] leases." Doing so allows the company to spread expenses for building out its co-working spaces over time, making the expense manageable. But the constant expansion means a need for ready cash.

We's cash flow isn't enough to keep things going. In the first six months of 2019, the company showed a net positive cash flow increase of $844.7 million, but only because it received $3.4 billion in cash from financing. Without the infusion, the company would have seen a decrease of more than $2.5 billion. As of June 30, 2019, We had cash and cash equivalents of just under $2.5 billion. In other words, without an infusion from financing of that size, We would have been out of money and, potentially, out of business.

We is spending so much on marketing, overhead, and capital expenses for new locations, it doesn't have enough operating profits to cover the bills. To keep on its current course, the company absolutely needs enough extra money to see it through the next few years until—hopefully—business dynamics turn around in its favor.

How much is WeWork worth?

An IPO was an obvious choice, especially at the $47 billion valuation the company sought. Additionally the company had lined up a $6 billion credit line from a group of banks, contingent on a successful IPO, Bloomberg reported.

But WeWork's image has taken a beating with guaranteed control and sweetheart deals for CEO Adam Neumann. Many investors and market watchers pored over the S-1 and balked.

There were reported talks of at least two valuation downgrades in an attempt to make the deal more palatable, possibly bringing the IPO down to as little as a third of its original size. However, major investor SoftBank Group would have had to take a $4 billion write down and a $5 billion loss on its Vision Fund investment vehicle, according to Bloomberg. That would be particularly problematic as SoftBank is trying to raise money for a second fund.

"The fact that [We is] even considering going out with a valuation of a third of the last round suggests that the additional infusion is important to them," said Chester Spatt, a professor of finance at Carnegie Mellon University. "These losses are clearly putting pressure on them to find some sort of funding solution."

WeWork's Strategy

The circumstances raise the question of what else We can do to bring in the money it needs. One approach could be to change the business model and stop the current drive for growth. "Then they have the ability to [plan] and see what they need to do to be able to get their existing operations cash flow profitable," Cassel said. But Neumann doesn't seem likely to scale back.

Another possibility is going to debt markets to sell bonds, which may be harder than it sounds. Data from Bloomberg shows that a bond that WeWork had issued in 2018 with a date of 2025 had been trading a few percent above its face value since the company released its IPO filing. News of the potential IPO postponement caused the value to drop below face value by 2.5% before returning to face value at the end of Tuesday trading. As of midday Wednesday, the bond was down an additional 3.4%

"It means they won't be able to borrow money [easily or cheaply] as a private company," said Barrett Cohn, CEO of private market investment bank Scenic Advisement.

Or there could be a rescue, possibly by SoftBank, either through financing for a bridge period so the company could stay afloat or an outright takeover. That would take billions and would seem unlikely to appeal to SoftBank, which would rather start its new fund than prop up the existing one.

The other options don't look good. Or, as Cohn said, "They need to IPO." Whether investors will show up is another matter entirely.