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TECH

A Look at WeWork's Books: Revenue Is Doubling but Losses Are Mounting

As part of bond offering, the startup reveals it is incurring hefty construction costs for offices it is opening

A WeWork space in Austin, Texas. PHOTO: ILANA PANICH-LINSMAN FOR THE WALL STREET JOURNAL

By Eliot Brown

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A bond-offering document from WeWork Cos. this week provides a glimpse into the finances of one of the world's most valuable startups, showing how the shared-office company is rapidly expanding revenue—and incurring heavy losses.

WeWork raised $702 million in its first bond sale as it continues to plow money into expansion through acquisitions and new shared-office locations around the world. The eight-year-old company has typically raised money through direct investments, attracting more than $6 billion in investment, most recently at a valuation of about $20 billion.

After analyzing the offering documents on Tuesday, S&P Global Ratings assigned WeWork a rating of B, five notches below investment grade into junk territory, while Fitch Ratings gave the company a BB-minus.

MORE ON WEWORK

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Investors have rushed into WeWork in the hope that it will be able to sustain its rapid growth; it has roughly been doubling its revenue and memberships every year. Last year, WeWork's revenue doubled to $866 million, according to the offering documents. The revenue comes mostly from monthly rental payments it calls memberships, as well as sales of some services such as business software.

But losses also more than doubled to $933 million as the company incurs hefty construction costs for most of the new offices it opens. WeWork spends millions of dollars renovating new offices with glass walls, modern lighting and furniture, investments the company says will pay off in the future. Discounts are often used to fill new offices.

The financials underscore WeWork's vast market opportunity as well as the high cost of its growth. The company rents office space with long-term leases, then subleases it out a month or year at a time. Its millennial-friendly vibe—fruit water and beer are dispensed at no charge—has proven popular with startups, and, increasingly, with bigger corporations.

WeWork has previously said its offices that have been open for at least a year have high occupancy rates and strong profit margins, so it is investing to gain scale. Rating agency S&P, in a note Tuesday, called WeWork's growth "well measured."

In the offering documents, WeWork went to unusual lengths to show ways in which the company would be profitable. While many companies typically offer "adjusted" earnings, WeWork offered three different layers of adjustments.

It called the fully adjusted number "community adjusted Ebitda," by which it subtracted not only interest, taxes, depreciation and amortization, but also basic expenses like marketing, general and administrative, and development and design costs. Those earnings were $233 million, WeWork said. ?

WeWork co-founder Adam Neumann. The shared office company is one of the world's most valuable startups.
PHOTO: CASSANDRA GIRALDO FOR THE WALL STREET JOURNAL

"I've never seen the phrase 'community adjusted Ebitda' in my life," said Adam Cohen, founder of Covenant Review, a bond research company.

The numbers offer some positive signs for WeWork. Its net construction costs per desk fell 22% in 2017 to $5,631. And its corporate business—as opposed to revenue from freelance and small companies—appears to be growing well, as rating agency Standard & Poor's said in its analysis. The agency said it expects large corporations will occupy 50% of WeWork's desks within two years, up from 25% today.

There also are concerns for investors in WeWork's growth trajectory. Its revenue per user fell 6.2% to $6,928 in 2017, while sales-and-marketing costs more than tripled to $139 million, representing 16% of revenue, up from 9.9% in 2016.

S&P said it expects "meaningfully negative" cash flow this year and next as the company expands. It said the company had $2 billion of cash on hand at the end of 2017.

Taking on debt adds risk to a company whose business model hasn't been tested in a downturn. Given that its members typically sign monthly or annual leases, a drop in demand during a recession would mean the rents it charges tenants would fall, while the payments it owes to landlords would stay constant.

Debt adds another liability beyond leases—a factor that has hurt serviced office companies in the past. Former executives at HQ Global Workplaces LLC—an office-space provider that rose to prominence during the dot-com boom and tumbled into bankruptcy after the bust—have said that layering debt on top of long-term leases was a big factor behind the company's downfall.

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