LYFTING OFF? THE FIRST RIDE SHARING IPO!

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The Opening Salvo

- Last week, Lyft became the first of the ride sharing companies to announce plans for an initial public officering, filing its prospectus.
- It is definitely not going to be the last, but its fate in the market will not only determine when Uber, Didi, Ola and GrabTaxi will test public markets, but what prices they can hope to get.

I. The Rise of Ride Sharing

- The most impressive statistic, for ride sharing companies, is not just the growth in revenues, which has been explosive, but also how much it has become part of day-to-day life, not just for younger, more tech savvy individuals but for everyone.
- While the growth was initially in the United States, ride sharing has taken off at an exponential rate in Asia, with India (Ola), China (Didi) and Malaysia (GrabTaxi) all developing home grown ride sharing companies.
- The regulatory push back has been strong in Europe, slowing growth, but there are signs that even there, ride sharing is acquiring a foothold.

Reasons why..,.

1. Status Quo stunk: The taxi business in the 2009 had changed little in decades, refusing to incorporate advance in technology and shifting tastes.
2. Regulatory arbitrage: In most cities, rules and regulations that were throwbacks in time or lobbied for by special interests handicapped taxi operators and gave ride sharing companies, not bound by the same rules, a decisive advantage.
3. Excess Capacity: Automobiles are underutilized resources for the most part, since most cars sit idle for much of the day, and ride sharing companies took advantage of excess capacity, by letting car owners monetize it.
4. Underpriced drivers: Individuals often under price their time and do not factor in long term costs in their decision making and the ride sharing companies have exploited that irrationality.

The Bad News

- While revenues have come easily, the companies have struggled with profitability, reporting huge losses as they grow.
  - Lyft reported losses of $911 million in 2018, in its prospectus, but Uber's loss was $1.8 billion during 2018, Didi almost matched that with a $1.6 billion loss and the only reason that Ola and GrabTaxi lost less was because they were smaller.
- While some of this can be attributed to growing pains, that will ease as these companies age and grow bigger, a significant portion of the profitability shortfall can be attributed to how these businesses are designed. The low capital intensity and drivers as contractors model made growth so easy but has made profitability difficult.

II. The Playing Field Today

- I argued, with tongue only half in cheek, that one possible model for the ride sharing companies to develop sustainable businesses was the Mafia's mostly successful attempt to stop intrafamily warfare in the 1930s by dividing up New York city among five families, giving each family its own fiefdom to exploit.
- It is interesting that in the years since, Uber has extricated itself from China, leaving that market to Didi, in return for a 20% stake in the company and then from South East Asia, in return for a share of GrabTaxi.
- In fact, the United States may be the most competitive ride sharing market in the world, with Uber and Lyft going head-to-head in most cities.

Uber versus Lyft

- While Uber and Lyft are ride sharing companies, their evolution over the last decade offers a fascinating contrast in business models, for young companies.
  - Uber was the "big story" company, telling investors that it wanted to be in all things logistics, expanding into delivery and moving, and all over the world.
  - Lyft was the "focused story" company, setting itself apart from Uber by keeping its business in the United States and staying with car service, as its primary business.
- I argued in 2015, that given how the two companies were priced, I would rather be an investor in Lyft than Uber.

Since 2015…

- While Uber's bigger story gained it a much higher pricing from investors, it has also brought the company a whole host of troubles, ranging from being a target for regulators to management over reach.
- Lyft has stayed true to its US and car service focus, and it has paid off in a higher market share in the market.
- Both companies have jumped on the bike and scooter craze, with Uber buying Jump and Lime and Lyft acquiring Motivate.

III. The Lyft Valuation - Story

- It will stay a US transportation services company: The total market that I assume for US transportation services is $120 billion at the moment, well over two and a half times larger than the taxi cab market was in 2009.
- In a growing transportation services market: Ride sharing will continue to draw new customers, from mass transit users to self-drivers, causing the transportations services market to double over the next ten years.
- With strong market-wide networking benefits: I see only two or three ride sharing companies dominating the US ride sharing market, in steady state. In my story, I see Lyft as one of the winners, with a 40% market share of the US transportation services market.
- A sustained share of Gross Billings: Lyft, in 2018, reported revenues of $2,156 million on gross billings of $8.054 million, working out to a 26.77% share. I will assume that as Lyft continues to grow and offers new services, this number will revert back to 20%.
- And a shift to drivers as employees: As the number who work for ride sharing companies rises into the millions, states are already starting to push back, and in my view, it is only a matter of time before ride sharing companies are forced to deal with drivers as employees, causing operating margins in steady state to drop to 15%.

Loose Ends

- Cost of capital: I will take a short cut and give Lyft the cost of capital of 9.97%, at the 75th percentile of all US companies at the start of 2019, and assume that this cost of capital will drift down towards the median of 8.24% for all US companies as Lyft becomes larger and profitable.
- Sales to capital: I will assume revenues of $2.50 for every dollar of capital invested, in keeping with what you would expect from a technology company.
- Failure rate: Given that Lyft continues to lose money, with no clear pathway to generating profits, I will assume that there is a 10% chance that Lyft will not survive as a going concern.
- Share Count: Lyft posits that it will have 240.6 million shares outstanding, including both the class A shares that will be offered to the public and the class B shares, with higher voting rights, but I will count deep in the money options and RSUs, to arrive at a total share count is 279.03 million.

Lyft, The US Car Service Company (March 2019)

The Story

Lyft is a company focused on the transportation business in the US, taking advantage of a shift away from not just taxi service but also from private cars and public transporrtation. With strong networking benefits, it will end up as one of the two or three dominant players in the market, with high market share but a shaky transition to profitability, fending off competitors and also dealing with legal and regulatory changes that increase costs. While there is a clear pathway to being a going concern, the cash burn over the next 3-5 years ezposes the firm to failure risk.

The Assumptions

	Base year	*Years 1-5*	*Years 6-10*	*After year 10*	*Story link*
Total Market	$120,000	Grow 10.39% a year		Grows 2.75% a year	US car service
Gross Market Share	6.71%	6.71%>40%		40%	Network benefits winner
Revenue Share	26.77%	26.77% -> 20%		20.00%	Market dominance keeps billing share high.
Operating Margin	-42.25%	-42.25% ->20%		15.00%	Legal & regulatory changes
Reinvestment	NA	Sales to capital ratio of 3.00		Reinvestment rate = 7.5%	Low capital investment model
Cost of capital	NA	9.97%	10%->8.00%	8.24%	At 75th percentile of US firms
Risk of failure	10% chance of failure, if pricing meltdown leads to capital being cut off				Cash on hand + Capital access

The Cash Flows

	Total Market	*Market Share*	*Revenues*	*EBIT (1-t)*	*Reinvestment*	*FCFF*
1	$ 132,468	10.04%	$ 3,470	$ (887)	$ 526	$ (1,413)
2	$ 146,231	13.37%	$ 4,969	$ (965)	$ 599	$ (1,564)
3	$ 161,425	16.70%	$ 6,668	$ (886)	$ 680	$ (1,566)
4	$ 178,197	20.03%	$ 8,587	$ (614)	$ 767	$ (1,382)
5	$ 196,712	23.36%	$ 10,744	$ (109)	$ 863	$ (972)
6	$ 217,150	26.68%	$ 13,158	$ 673	$ 966	$ (293)
7	$ 239,712	30.01%	$ 15,850	$ 1,783	$ 1,077	$ 706
8	$ 264,618	33.34%	$ 18,840	$ 2,120	$ 1,196	$ 923
9	$ 292,112	36.67%	$ 22,149	$ 2,492	$ 1,324	$ 1,168
10	$ 322,462	40.00%	$ 25,797	$ 2,902	$ 1,459	$ 1,443
Terminal year	$ 331,330	40.00%	$ 26,506	$ 2,982	$ 410	$ 2,572

The Value

Terminal value	$ 46,848
PV(Terminal value)	$ 18,992
PV (CF over next 10 years)	$ (3,567)
Value of operating assets =	$ 15,425
Probability of failure	10%
Value in case of failure	$ -
Adjusted Value for operating assets	$ 13,883
+ Cash on hand	$ 518
+ IPO Proceeds	$ 2,000
Value of equity	$ 16,401
Value per share	$ 58.78

IV. Lyft - Pricing

- When the stock opens for trading on the offering day, it is not value that will determine the opening bid, but pricing. In the pricing game, investors look at what others are paying for similar companies, scaling to some common operating variable. With Lyft, investors will face two challenges.
  - The first is that it is the first ride sharing company to list, and the only pricing that we have for other ride sharing companies is from venture capital rounds that are sometimes dated (from the middle or early last year).
  - The second is that every company in the ride sharing business is losing money and the book values have no substance.

But they will try anyway

Company	Gross Billings	Revenues	erating Profit (los	# Riders	VC Pricing	Price/Billing	rice/Revenues	Price/Rider
Lyft (Prospectus)	$ 8,054.00	$ 2,156.00	$ (978.00)	31	$ 11,000.00	1.37	5.10	$ 354.84
Uber	$ 50,000.00	$ 11,300.00	$ (1,800.00)	100	$ 72,000.00	1.44	6.37	$ 720.00
Didi	$ 48,000.00	$ 10,000.00	$ (1,500.00)	600	$ 56,000.00	1.17	5.60	$ 93.33
Grab	$ 5,000.00	$ 1,000.00	$ (250.00)	125	$ 10,000.00	2.00	10.00	$ 80.00
Ola	$ 1,200.00	$ 250.00	$ (100.00)	40	$ 4,300.00	3.58	17.20	$ 107.50
Global Average						**1.91**	**8.85**	**271.13**
Global Weighted Average	$ 112,254.00	$ 24,706.00	$ (4,628.00)	$ 896.00	$ 153,300.00	**1.37**	**6.20**	**$ 171.09**
Uber - Rumored IPO Pricing	$ 50,000.00	$ 11,300.00	$ (1,800.00)	$ 100.00	$ 120,000.00	2.40	10.62	$ 1,200.00

Pricing Lyft

	Estimated Lyft Pricing with		
	Price/Billing	*Price/Revenues*	*Price/Rider*
With Uber - Last VC Pricing	$ 11,597.76	$ 13,737.35	$ 22,320.00
With Uber- Rumored IPO Price	$ 19,329.60	$ 22,895.58	$ 37,200.00
With Global Average	$ 15,392.45	$ 19,090.83	$ 8,405.17
With Global Weighted Average	$ 10,998.97	$ 13,377.92	$ 5,303.91

And there will be feedback..

- I think of pricing as a ladder, where if you move one rung of the ladder, all of the other rungs have to move as well.
  - If investors price Lyft at $25 billion, about 12 times its revenue in 2018, Uber will be quicker to go public and will expect markets to attach a pricing in excess of $130 billion to it, given that its revenues were more than $11 billion in 2018.
  - If investors price Lyft at only $12 billion, Uber may be tempted to wait to go public, and continue to tap into private investors, with the caveat being that those investors will also lower their pricing estimates.
- The Asian ride sharing companies, where rider numbers are high, relative to revenues, will try to market themselves on rider numbers, though it is not clear that investors will buy that pitch.
- The pricing ladder can lead prices up, but they can also lead prices down, and timing is the name of the game.

The Waiting Game

- While some of the uncertainties will not be resolved in the near future, we will learn more specifics about the offering itself, including the amount that Lyft plans to raise on the offering day, over the next few weeks.
- Sometime soon, we will also get the a pricing of the company from the bankers that have been given the task of taking the company public.
  - The bankers' job is to price the company for the IPO, not value it.
  - Not only should any talk of value from them be discounted, but if you do see a discounted cash flow valuation from a bank for Lyft, you can almost bet that it will be a Kabuki valuation, where they will go through the motions of estimating valuation inputs, when the ending number has been pre-decided.