THE RIDE SHARING BUSINESS: IS THIS A BAR MITZVAH MOMENT?

Disruption is easy, making money of disruption is difficult.

The Ride Sharing Business - My October 2015 perspective

- I valued Uber at about $23 billion and Lyft at close to $5 billion, on the presumption that the disruption of the ride sharing (or other related) businesses was well under way.
- The ride sharing business, though growing fast, has not found a pathway to profitability.

The Possible Pathways to a Viable Business Model

1. Winner takes all: The "winner takes all", where one ride sharing company emerges as the winner and takes the bulk of the ride sharing market.
2. The Loser's Game: The game boils down to two or a few ride sharing companies that constantly compete for each other's resources and customers, making this a loser's game.
3. Divide and Rule: The two or few ride sharing companies come to a truce, where they divide the market into fiefdoms and respect the borders.
4. The Game Changer: Recognizing that the ride sharing business is not a sustainable model, a company (either within the existing market or from outside) comes up with a new business model.

1. Ride Sharing continues on a growth path

Year	Number of US ride sharers (in millions)	% of US adult population
2014	8.20	3.40%
2015	12.40	5.00%
2016	15.00	6.00%
2017	17.00	6.70%
2018	18.20	7.10%
2019	19.40	7.50%
2020	20.40	7.80%

2. Globalizing Fast

- Didi Chuang, the Chinese ridesharing company, completed 1.43 billion rides just in 2015 and it now claims to have 250 million users in 360 Chinese cities.
- Ride sharing is also acquiring deep roots in both India and Malaysia, and is making advances in Europe and Latin America, despite regulatory pushback.

3. Expanding Choices

- The choices in ride sharing are becoming wider, to attract an even larger audience, from carpooling and private bus services to attract mass transit customers to luxury options for more upscale customers.
- In addition, ride sharing companies are experimenting with pre-scheduled rides and multiples stops on single trips to meet customer demand.

4. Devastating to the Status Quo

- Even hardliners in the taxicab and old time car service businesses recognize that ride sharing is not going away and that the ways of doing business have to change.
  - The price of a New York city medallion which was in excess of $1.5 million before the advent of ride sharing continues its plunge, dropping to less than $500,000 in March 2016.
  - The price of a Chicago cab medallion, which peaked at $357,000 in 2013, had dropped to $60,000 by July 2016.

A Flawed Business Model

1. The Business Model Characteristics
   - Raising capital at a breathtaking pace
   - At sky high prices, attached to the companies
   - With capital from public market investors
   - While burning through cash quickly
2. A Cash Burn test

Assume that the growth ends in the ride sharing business tomorrow and that the ride sharing companies were to compete for existing riders. Do you think that the pieces are in place for these companies to generate profits?

A Bar Mitzvah Moment

- Early in a life cycle, young companies are judged based upon metrics that eventually can be translated into earnings and value. Those metrics vary across businesses, but in ride sharing, it has been about cities, drivers and rides.
- There is a point in time in their lives when the focus shifts from these raw metrics to more bottom line numbers. That is the **bar mitzvah moment**.
- The key to success in a young company is to manage it at two levels, delivering the raw metrics that investors care about early while also working on creating pathways for converting these metrics into profits.

Why now?

- Public Investor time horizon: The first factor is that the public investors who have put their money into the ride sharing companies operate under shorter time horizons than many VC investors and the fact that an IPO is not imminent in any of these companies adds to their impatience to see tangible results.
- No winner-take-all: The second factor is that the belief that there will be a winner-take-all, who can then proceed to charge what the market will bear, has receded, as all of the players in the market continue to attract capital.
- Big Players coming? The third factor is that the possibility that big players like Apple and Google will enter the market is becoming a plausibility and perhaps even a probability and their technological edge and deep pockets could put existing ride sharing companies at a disadvantage.

Building a Business Model

- Increased Switching costs: The ride sharing companies are working on ways to increase the costs of switching to their competitors, both among drivers (who I described in a prior post as uncontracted free agents) and customers.
- Cooperation/Collusion: Uber's decision to abandon the Chinese market to Didi in return for a 20% ownership stake in that company, in particular, seems to be designed to stop the mutually assured destruction that a free-for-all fight with Didi will create.
- Higher Capital Intensity: Ride sharing companies now recognize that their absence of tangible assets and infrastructure investment can now operate as an impediment to building a sustainable business.

Uber: Changes in last 12 months

- Revenues: Growth continues but decision to leave China will reduce total market potential.
- Competition: The good news in the China deal is two fold. First, by removing the costs associated with going after the China market from the equation, it increases the odds of Uber becoming profitable. Second, its peace treaty with Didi Chuxing and its 20% stake in the company, does put the smaller players at risk. Lyft, Ola and Grabtaxi, all companies that Didi invested in to stop the Uber juggernaut, may now be left exposed to competition.
- Costs: On the cost front, the ride sharing business continued to evolve, with most of the changes signaling higher costs for the ride sharing companies in the future.
- Imminent competition: The Silicon Valley gossip continues about Apple and Google preparing to enter the ride sharing market. To compete, the ride sharing companies will have to step up their investment in technology and infrastructure.

Uber, The Global Logistics Company (August 2016)

The Story

Uber is a logistics company, doubling the market size by drawing in new users. It will enjoy weak global networking benefits while seeing its slice of revenues slip (85/15), higher costs (with drivers as partial employees) and low capital intensity.

The Assumptions

	Base year	*Years 1-5*	*Years 6-10*	*After year 10*	*Story link*
Total Market	$180,000	Grow 10.39% a year		Grow 1.5% a year	Logistics + New users - China
Gross Market Share	4.71%	4.71%>40%		40%	Peace treaty with Didi Kuaidi
Revenue Share	20.00%	20% -> 15%		15.00%	Lower revenue share
Operating Margin	-23.06%	-23.06% ->20%		20.00%	Cost pressures continue
Reinvestment	NA	Sales to capital ratio of 3.00		Reinvestment rate = 7.5%	Higher capital intensity model
Cost of capital	NA	10.00%	10%->8.00%	8.00%	At 75th percentile of US firms
Risk of failure	No chance of failure (with equity worth zero)				Cash on hand + Capital access

The Cash Flows

	Total Market	*Market Share*	*Revenues (15% of Gross)*	*EBIT (1-t)*	*Reinvestment*	*FCFF*
1	$ 198,702	9.42%	$ 3,650	$ (479)	$ 494	$ (973)
2	$ 219,347	12.82%	$ 5,342	$ (540)	$ 564	$ (1,104)
3	$ 242,137	16.22%	$ 7,264	$ (516)	$ 641	$ (1,156)
4	$ 267,295	19.61%	$ 9,437	$ (386)	$ 724	$ (1,110)
5	$ 295,067	23.01%	$ 11,882	$ (127)	$ 815	$ (943)
6	$ 325,725	26.41%	$ 14,623	$ 284	$ 914	$ (630)
7	$ 359,568	29.81%	$ 17,684	$ 877	$ 1,020	$ (144)
8	$ 396,927	33.20%	$ 21,088	$ 1,681	$ 1,135	$ 546
9	$ 438,167	36.60%	$ 24,859	$ 2,731	$ 1,257	$ 1,474
10	$ 483,693	40.00%	$ 29,022	$ 4,063	$ 1,388	$ 2,675
Terminal year	$ 490,948	40.00%	$ 29,457	$ 4,124	$ 309	$ 3,815

The Value

Terminal value	$ 58,687	
PV(Terminal value)	$ 23,904	
PV (CF over next 10 years)	$ (2,442)	
Value of operating assets =	$ 21,461	
Probability of failure	0%	
Value in case of failure	$ -	
Adjusted Value for operating assets	$ 21,461	
+ Cash on hand	$ 1,500.00	
+ Cross holdings	$ 5,000.00	
Value of all assets	$ 27,961.46	VCs priced Uber at about $62,500 milllion at the time