WeWork: A Turning Point for Global Markets

January 31, 2020

2019 was a volatile year for the public markets, pulled down by the trade disputes between the US and China, and buoyed by a continued low to negative interest rate environment. While the S&P 500 ended at a record high in 2019, the volatility has forced a healthy focus on quality going into 2020, with investors more discerning about individual companies' cash flow, unit economics, and long-term viability.

WeWork's failed attempt at an initial public offering ("IPO") is one example of this. The Softbank-backed coworking company publicly filed for an IPO on August 14, 2019. Prior to its IPO offering, WeWork underwent numerous funding rounds, including a series of debt financing rounds over the past two years. Before its listing application, it held more than US$22 billion of debt on its books, on a run-rate revenue of US$3.3 billion according to the company's prospectus. This meant that the IPO application valued the company at more than 14x of its run-rate sales, despite making a loss of about US$900 million in the first half of 2019. The IPO paperwork further revealed corporate governance questions around Adam Neumann's ownership of several buildings leased by WeWork in addition to millions of dollars' worth of loans extended to him by the company. Within a matter of weeks, WeWork's valuation fell to a fifth of their asking price, leading the company to shelve its IPO completely.

WeWork's spectacular decline demonstrated that loss-making companies are not able to raise indefinite amounts of money without strong corporate governance and a clear path to profitability. We believe that WeWork's setback has been positive for the market as a whole, as investors have become increasingly discerning toward the viability of companies' business models and have taken steps toward a more grounded investment approach.

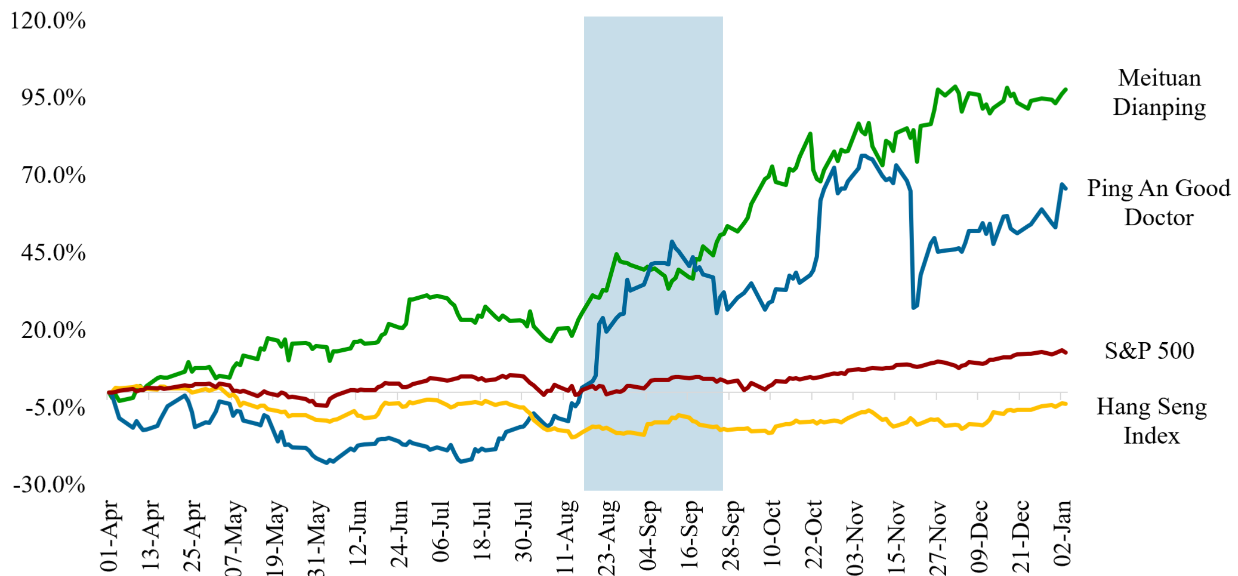
Since WeWork's IPO, some investors have questioned how the sharp fall in its valuations will affect the state of venture capital in Asia and whether this will cause a trickle-down in the exit environment for Asian private equity investments. The short answer is that markets have continued to reward companies with good business models, strong growth and a path to profitability. Despite the valuation uncertainty driven by the WeWork IPO failure (from the IPO filing to the stepping down of CEO Adam Neumann shown as the blue shaded area in Exhibit 1), companies like the

food delivery platform Meituan Dianping and online healthcare services platform Ping An Good Doctor have continued to perform well in the public markets, off the back of positive results.

Importantly, even though these companies are listed in Hong Kong, the protests that began in end-March have not dented their public market performance. Both companies have outperformed the Hang Seng Index, indicating that public market investors clearly separate the prospects of a company's underlying business geography as opposed to its listing geography. Our view is that exit markets in Asia remain healthy, and that many investors and media sources may have overplayed the severity of the Hong Kong protests' impact on the region's financial markets. We believe that the actual economic impact of the Hong Kong protests is largely contained within the city of Hong Kong, as shown by the Hang Seng Index's ("HSI") sluggish performance due to its heavy exposure to local real estate and banking companies (Exhibit 1).

Exhibit 1: High quality companies invested in favorable secular trends still perform well despite being listed in Hong Kong

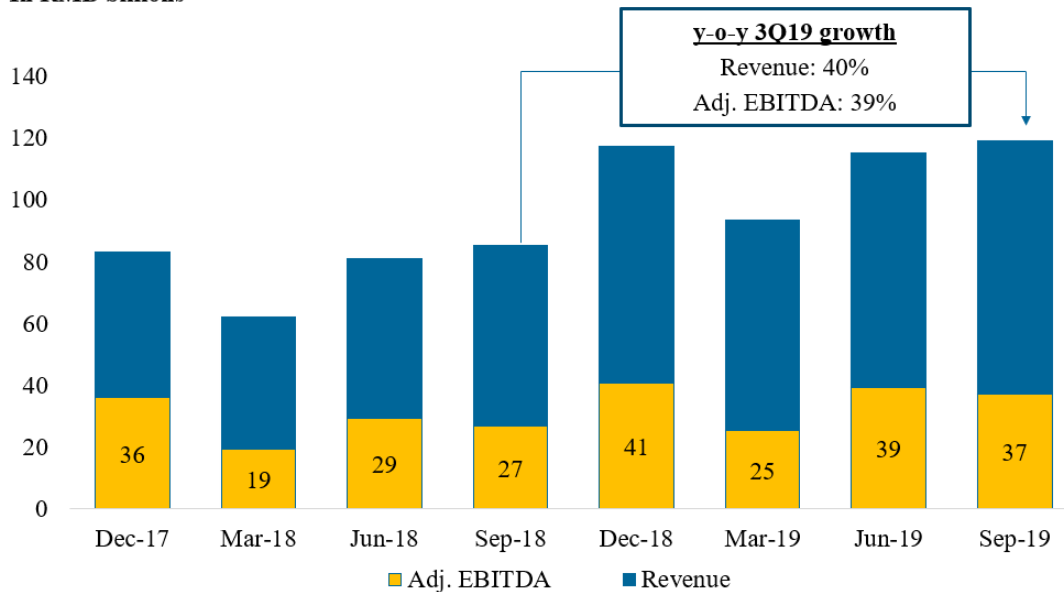
Share price performance (normalized)



Source: Capital IQ, data as at Jan 6, 2020.

Indeed, the protests have not prevented high quality companies with good growth stories and business models from thriving despite being listed in Hong Kong, and neither has it dampened the region's IPO environment. The HKEX booked the world's largest IPO in 2019 to date in November (later outranked by the Saudi Aramco listing) with Alibaba's secondary listing in Hong Kong. Alibaba's consistent, high quality growth and healthy cash generation as shown in its 3Q 2019 results appealed to local investors who wanted to participate in Asia's growth story. Alibaba's strong performance is a good indicator of the resilient consumption growth trends in the Chinese economy (Exhibit 2).

Exhibit 2: Strong continued 3Q 2019 revenue and EBITDA growth by Alibaba



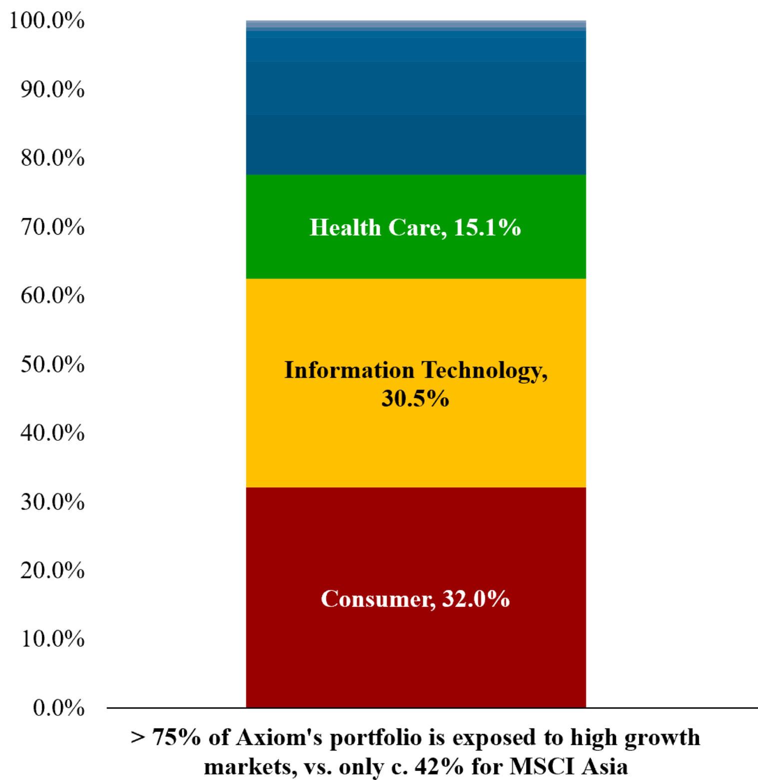
Source: Company filings.

As Asia's economy continues to grow and local middle classes start to accumulate the excess savings to invest in financial assets, we expect Asia's exchanges to become larger and provide more avenues for Asia-based businesses to exit.

Additionally, with the liberalization of the mainland's rules on foreign stock ownership, a fund manager does not need to be physically present in Hong Kong or mainland China to get exposure to Hong Kong or mainland-listed equities. International funds like Fidelity can purchase stocks in Hong Kong and mainland China without restriction after Beijing scrapped the foreign investment limit for institutional investors in September this year, making the listing geography relatively less important. Already, according to Ernst and Young ("EY"), the Asia Pacific region led global IPO activity in 3Q 2019.[1] By volume, seven of the region's exchanges made it to the top 10 exchanges globally, with 173 IPOs and US$23.7 billion in proceeds during the quarter.

[1] "APAC Leads Global IPO Activity in Q3, SEA Rebounds: EY", Deal Street Asia, Sep 25, 2019.

Exhibit 3: Axiom's capital is highly exposed to high-growth sectors driven by domestic consumption and secular trends



> 75% of Axiom's portfolio is exposed to high growth markets, vs. only c. 42% for MSCI Asia

[1] Axiom's exposure was calculated using capital invested in all UPC companies by sector on a gross basis.
Source: MSCI AC Asia Pacific Index, data as at Dec 31, 2019; Axiom Asia, data as at Sep 30, 2019.

Axiom has focused principally on domestic demand driven themes since our inception, and its large exposure to high growth sectors and secular trends rooted in income growth, consumption upgrade and an increasing focus on health in Asia (Exhibit 3) has paid off. These are resilient trends driven by factors such as the incidence of diseases and rising wealth levels that are not linked to external shocks such as the US-China trade tensions. We are confident that this strategy will continue to allow us to reap the best returns Asia can offer.

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