Internet/e-Commerce

DoL issues ruling on independent contractors, without an ABC Test

Industry Overview

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Equity
United States

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DoL issues new rule on Independent Contractor test

Today, the Department of Labor (DOL) issued an updated ruling on independent contractor (IC) classification under the Fair Labor Standards Act, rescinding the prior rule from 2021. The final rule applies a multifactor analysis similar to what was in place during the Obama administration, with six factors interpreting whether a worker can be defined as an independent contractor: 1) opportunity for profit or loss; 2) the financial stake a worker has invested in the work; 3) degree of permanence of the job; 4) degree of control the employer maintains over work; 5) if the work is essential to the employer's business; and 6) level of worker's skill and initiative. That said, for Uber & Lyft, today's rule does not require any minimum wages, overtime, or PTO, and it does not include an "ABC Test" similar to AB5 in California (which was overturned by Prop 22) and the federal PRO Act (which did not pass the Senate). The rule will be effective 3/11/24.

Avoiding a federal ABC test likely a small win for industry

Gig-economy bears have believed federal legislation could apply an ABC test nationwide, but today's rule suggests ABC tests will not be the case during the Biden administration. The ABC test requires that ICs: (A) Be free from the company's control; (B) Do work that isn't central to the company's business; and (C) Have an independent business in that industry. Federally, an ABC test could only be implemented by Congress, rather than the DoL, and we view that as unlikely given the need for 60 votes in the Senate. That said, we note statute #5 in the multi-factor analysis is fairly similar to the "B" statute in the ABC test (and the "B" statute has been the biggest challenge for gig-industry to meet).

Do not expect material impact from ruling

We do not expect the ruling to impact Uber/Lyft financials or business models, but the rule does provide courts with additional leeway that they could choose to use in a misclassification challenge against gig companies. Lyft has noted the 6 factors can be weighed differently by courts, potentially creating "additional complexities and ambiguities". Ultimately, misclassification cases have been determined by courts under the Fair Labor Standards Act (FLSA), which remains unchanged by today's ruling.

Upcoming gig-legislation ahead, but with IC+ framework

Following today's rule announcement, Uber stock was up 2%, with Lyft down 0.4% (vs. NASDAQ flat). In our view, the rule is not a big change, but the Street may also perceive the lack of punitive or unexpected measures in the new ruling as a positive. We believe less regulatory uncertainty has already been priced into the gig-economy stocks, but there are legislative proposals that could provide greater clarity on worker classification in 2024 in Chicago, Colorado, Massachusetts, and Minnesota. With NY, CA, and Washington state as examples, we think the industry is more likely to reach driver composition deals in advance of the election season (especially as gig-legislation has largely proven unpopular in elections thus far). Maintain Buy on Uber given its platform network effects; Underperform on Lyft given market position.

DoL – Department of Labor

PTO – paid time off

IC – Independent Contractor

Refer to important disclosures on page 3 to 7. Analyst Certification on page 2. Price Objective Basis/Risk on page 2.
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Price objective basis & risk

Lyft, Inc. (LYFT; C-3-9; $13.49)

Our PO of $10.50 is based on our DCF that assumes a Total Addressable Market of $2tn based on 5.4% penetration of the TAM, which implies a ridesharing market of $107bn in 2032. We assume Lyft generates $28bn in bookings in 2032 based on 27% share of the U.S. ridesharing market, and we assume Lyft generates $8bn in revenue based on a 29% take rate. We assume $310mn in operating income in 2032 based on a 4% GAAP operating margin, which implies an approximately 7% EBITDA Margin. We apply a WACC of 15% and a terminal multiple of 9x to determine a market value for Lyft of $6.9bn (which represents $10.50 per share) based on a present value of free cash flows of $3bn and a terminal value of $2bn.

Upside risks are: 1) Poised for multiple inflection in a scenario of easing monetary policy, 2) Easing labor market leads to better driver supply, 3) capable of improved unit economics after fixed cost cuts, 4) still room for mobility recovery.

Downside risks are: 1) Potential for a slowing travel recovery, 2) Quality of earnings with insurance adjustments and high SBC levels, 3) Gas prices still a risk, 4) Narrower focus means narrower TAM, 5) New regulations and fees, and 6) Autonomous operators could become competitors.

Uber (UBER; C-1-9; $60.30)

Our SOTP applies an EV/2025E Revenue valuation of 3.0x for Mobility, 3.0x revenue for Delivery (implies 0.6x bookings), and 1.0x revenue for Freight, which are slight premiums to peers given potential network effects. Our SOTP valuation implies segment values of $88bn for Mobility, $48bn for Delivery, and $6.1bn for Freight, which implies a Total Enterprise Value for Uber of $141bn. Based on Net Debt of $1.1bn and a realizable value of investments of $3.9bn we estimate a target market cap of $144bn. Our Price Objective of $68 is based on 2.1bn shares outstanding.

Downside risks are 1) multiple compression given macro economic exposure, 2) slowing user/revenue growth due to competitive initiatives from Lyft or DoorDash, 3) new competition from self-driving technology companies, and 4) new regulations, fees, and/or minimum wages.

Analyst Certification

We, Justin Post and Michael McGovern, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Internet Coverage Cluster

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	Alphabet	GOOG	GOOG US	Justin Post
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	AppLovin	APP	APP US	Omar Dessouky, CFA
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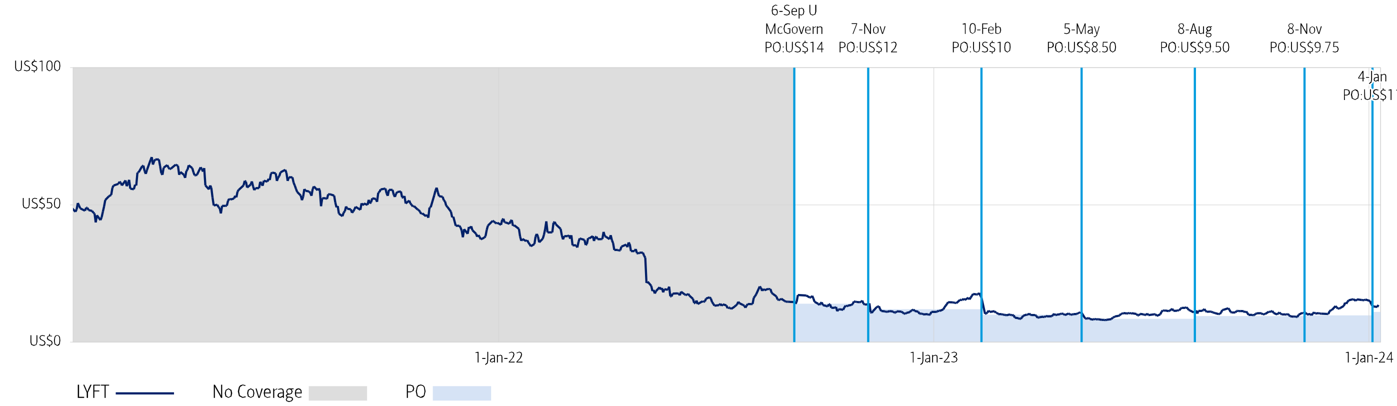
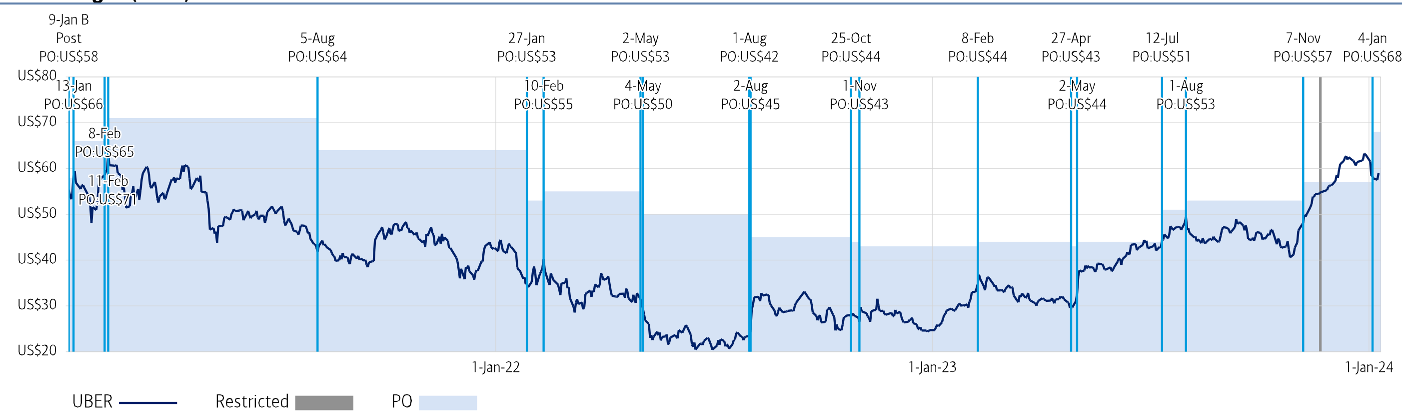
Lyft, Inc. (LYFT) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Uber Technologies (UBER) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

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Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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[R2]Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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