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SoftBank, WeWork and Sunk Costs

SoftBank's latest investment into WeWork doesn't only represent a hit to its value, but also to its reputation for investing acumen

By Jacky Wong

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SoftBank Group, 9984 -1.77% ▼ one of the world's largest and supposedly savviest investment firms, looks like it is making a classic rookie error by succumbing to the sunk-cost fallacy.

The Japanese technology conglomerate said Tuesday it will double down on its ill-fated investment in office-sharing company WeWork after investors gave its planned initial public offering the cold shoulder last month. The investment package includes a \$5 billion loan, a \$3 billion tender offer to buy shares from existing shareholders and moving up a \$1.5 billion equity infusion it had originally scheduled for next year. All these will take Softbank's stake in WeWork to 80%, from around one-third currently. But bizarrely, Softbank claims it won't have control of the company and therefore isn't required to consolidate WeWork's heavily indebted balance sheet, mainly from its lease obligations, onto its own.

Separately, SoftBank will give a \$1.7 billion windfall to co-founder Adam Neumann, who was forced out as chief executive last month, including buying nearly \$1 billion of his shares and a \$185 million consulting fee. Mr. Neumann's absolute control of WeWork through his supervoting shares helped him to extract such a lucrative deal on his way out despite his significant responsibility for the debacle.

That looks like a classic case of throwing good money after bad. The latest deal values WeWork at \$8 billion, which still would imply hefty paper losses for SoftBank; it last invested into the company at an implied \$47 billion valuation in January. SoftBank, and its nearly \$100 billion Vision Fund, had sunk nearly \$10 billion into WeWork before the latest infusion, including investments in some regional joint ventures.

While the latest deal would rescue SoftBank's existing investment for now, it isn't clear how long the \$5 billion loan can sustain the money-losing real-estate firm: WeWork burned through around \$2 billion in cash in the 12 months through June. The company could perhaps lower its sights, turning itself into a more boring, less cash-hungry shared-office-space company, like its



SoftBank Chief Executive Masayoshi Son PHOTO: KIM KYUNG HOON/REUTERS

London-listed competitor IWG. But that would mean much lower growth, undercutting not only the rationale, if there ever was one, for a \$47 billion valuation, but even \$8 billion. IWG is valued at only \$4.5 billion, even though its revenue was 30% higher than WeWork's as of June.

SoftBank's investors clearly don't like the latest deal: Its Tokyo-listed stock fell 2.5% Wednesday, bringing its retreat

in the past six months to around 30%. It is now trading at a deep discount to its net assets, which include a \$110 billion stake in Chinese e-commerce giant Alibaba. But the gap is appropriate as the WeWork debacle casts serious doubt on its investment approach and on its prospects for raising a second \$100 billion technology investment fund.

Losing money is forgivable, but needlessly compounding those losses is another matter entirely.

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