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Hubert Horan: Can Uber Ever Deliver? Part Sixteen: Is Morningstar's Horrendously Bad Uber Analysis a Preview of Uber's IPO Propsectus?

Posted on August 13, 2018 by Yves Smith

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Overview

- Morningstar released a research report three weeks ago predicting that Uber would become profitable in 2020 and could achieve an IPO value of $110 billion. Understanding the problems with Morningstar's report is important because it illustrates the exact process and challenges Uber will face when it tries to sell its shares to investors next year
- Morningstar's analysis is horrendously bad. Its profit forecast depends on plugging $4.5 billion in arbitrary and indefensible P&L gains into its forecast spreadsheet. Its valuation estimate depends on the equally indefensible claim that 39% five-year CAGR demand growth will occur independently of pricing, industry profitability or economic conditions. It provides absolutely no evidence substantiating its various claims about Uber efficiency improvements, fails to explain the source of these efficiencies, let alone demonstrate how they could drive powerful P&L gains, or explain why they didn't generate profits until Uber's 11th year of operations. They omit major factors relevant to a legitimate valuation analysis, such as pre-2017 P&L results, cash flows, and the costs and returns from current investments in future businesses such as driverless cars.
- Uber's IPO will be the biggest challenge in its history. Uber's Board believes it needs to achieve an IPO valuation north of $100 billion to ensure all existing investors achieve the profits they are expecting. The IPO process will inevitably result in Uber losing control of their heretofore tightly and effectively controlled media spin. The SEC requires that Uber release detailed, audited historical financial data, and independent financial analysts will be able to scrutinize their IPO forecasts and valuation claims
- As Morningstar's atrocious analysis demonstrates, there is no legitimate way to reconcile a valuation estimate anywhere near $100 billion with objective data about Uber's abysmal economics and financial results.
- For its entire history, Uber has gone to considerable length to evade public scrutiny of its black hole of losses and the dependence of its business on massive, and ultimately unsustainable investor subsidies, most importantly by presenting only fragmentary financial data that is largely non-comparable over time. Uber has succeeded nevertheless in using talking points that plays heavily on Silicon Valley mythology and

libertarian gospel to create the impression that it is a highly successful venture. Uber is likely to rely heavily on PR and propaganda to convince investors it is worth over $100 billion.

- Morningstar's report illustrates how difficult it will be next year for Uber to maintain its sales pitch in the face of hard financial data. A legitimate valuation would consider a wide range of objective evidence and critically scrutinize key company claims. Instead Morningstar's report uncritically repeats longstanding elements of Uber's sales talk. The report is not designed to help potential investors, but to serve as advocacy on behalf of Uber's current shareholders.
- Morningstar's report is potentially valuable to Uber because it allows them to claim that "independent" analysis by an "objective" financial firm endorsed the idea that Uber's is worth more than $100 billion, and that claims Uber is likely to make during the IPO process have been independently verified. Given all of the problems and deficiencies documented here, it is important that no one ever grant any credibility to the profitability, valuation and long-term growth arguments Uber or others might make because Morningstar reached similar conclusions.

Uber's 2019 IPO will be the biggest challenge in its history

Uber plans to go public a year from now. Committing to a 2019 IPO was an essential element of the pact that resolved protracted board-level battles and allowed Dara Khosrowshahi to replace founder Travis Kalanick as CEO. Kalanick believed that Uber was not ready to face full capital market scrutiny, but faced open rebellion from Board members who wanted to convert their paper profits into real money.

Uber's IPO valuation needs to meet two objectives. It must be high enough that all of Uber's current investors can cash out with big profits on the funding (roughly $18 billion) they have provided. However, the share price must also provide IPO investors with the opportunity for additional equity appreciation.

Uber's Board seems to believe an IPO valuation of $100 billion would meet these objectives, and has agreed to pay Khosrowshahi a $100 million bonus if the Uber goes public at that valuation in 2019.[1]

The Uber IPO process would start with the publication of a prospectus that would include much more detailed audited historical financial data than Uber has released to date. It would present a narrative explanation of why investors (despite dismal historical results) should expect the many years of robust, highly profitable growth needed to justify a $100+ billion valuation. It would also need to include pro-forma forecasts of profits and cash flows consistent with the claims in the narrative.

The central question here is how Uber will be able to reconcile these aggressively optimistic pro-formas, narratives and valuation justifications with the documented, audited record of the first nine years of Uber's actual economics and financial results.

Over its nine-year history, Uber has largely succeeded in controlling how the public sees the company. While the press gave extensive and highly critical coverage of sexual harassment and other "cultural" issues at Uber, reporting about the business was almost completely consistent with Uber's positioning. Perversely, the press failed to connect the "cultural" issues with the fundamental businesses strategies that created them.

As Kalanick feared, Uber will no longer enjoy this freedom from scrutiny and level of control over public discussion once the IPO process begins. For the first time, independent outsiders will be able to use objective financial data to scrutinize its historical performance and business model economics, and anyone considering an actual investment will have ample incentive to do so.

If financial analysts and business reporters were to scrutinize the data in Uber's IPO prospectus seriously, it is difficult to see how they could ever reconcile that information with a $100+ billion valuation.

Uber's losses have grown steadily. No previous venture-capital funded company lost over $2 billion in its sixth year of operation and then doubled those losses to $4.5 billion in year eight. It would take one of the biggest corporate turnarounds in world history to rapidly replace those growing losses with growing profits.

In addition, despite numerous attempts over nine years, Uber has never successfully leveraged its car service position into any other businesses. Many of its attempts to expand ridesharing overseas have been spectacular failures.[2]

If investors realize that Uber's economics are far worse than what past press coverage led them to believe and its current performance is totally inconsistent with claims that its equity will appreciate beyond its target $100 billion value, Uber will face an enormous crisis. If IPO investors would accept only a substantially lower valuation, many current investors would lose money. Perhaps even more important, the bubble of favorable Uber publicity would burst, as Uber's claims could no longer be taken at face value.

On the other hand, Uber has survived and grown for nine years despite these abysmal economics and episodes of highly negative media stories. As this series has separately documented, one of Uber's greatest strengths is its ability to construct and promulgate a very positive public image. This image is divorced completely from Uber's performance because the company has successfully gotten the press and public to accept the sort of narratives commonly used in political campaigns. They rely heavily on emotive language to obscure agendas, distract attention from contrary arguments, and conceal the lack of factual support.[3]

Despite ample evidence to the contrary, Uber's executives have convinced the vast majority of interested observers that Uber is an extraordinarily successful company, that its rapid growth was driven by innovative, cutting-edge technology, and that it has transformed urban transport and created massive public benefits. It has even succeeded in portraying the rare voices criticizing Uber as either beholden to corrupt, entrenched interests or ignorant of what it takes to build economic value.

With $100 billion on the line, can Uber develop an IPO narrative that will once again triumph over pesky facts like audited financials?

The Morningstar/Pitchbook Uber Report illustrates the structural approach Uber's IPO prospectus will likely take, and the problems it will likely face

While this series has described why Uber is structurally unprofitable, until now, no one had ever attempted to lay out a detailed quantitative counter-argument claiming that Uber could rapidly become profitable and justify the huge valuation its investors hope to achieve.

On July 19th, Morningstar (and its subsidiary firm Pitchbook) issued the report “Uber may Pick Up Investors, Along With Riders, in its IPO” and subtitled “The ride sharing pioneer is likely to maintain its competitive advantage via its network effect.”[4]

Morningstar did not include detailed historical Uber financial data. But its report covered everything else that a future Uber IPO prospectus would. It included pro-forma Uber financial projections through 2022 that showed Uber producing profits in 2020. The text described how Uber will gain share as it expands globally and thus grow much faster than competitors. The document asserted that there are “narrow moat” protections in the ridesharing market and forecasts profitable growth in food delivery, freight services, bikesharing, other public transit services. It also foresaw huge long term potential for autonomous and flying cars. And most importantly (certainly from Dara Khosrowshahi’s point of view) is the central finding that Uber’s greatly-improved economics justify an IPO valuation of $110 billion.

A review of the Morningstar paper quickly answers the central question. ***There is no way that an honest, rigorous financial analysis could reconcile actual Uber economics with the need to justify the $100+ billion valuation that Uber’s current owners need.***

The challenge here isn’t finding factual or logical flaws with Morningstar’s attempt to do this, but how to sort through and prioritize which of the many egregious analytical errors to document.

The Morningstar report is an embarrassingly shoddy piece of work, and its major conclusions don’t hold water. But it is important to understand why the Morningstar report is so bad: it shows the remarkable number of distortions and omissions that it takes to try to reconcile Uber’s story of an inevitable march to profits to at least some financial analysis.

We contacted the authors of the report, sent a detailed list of questions, and considered their responses. In most cases, the replies appeared to reflect a lack of comprehension of the issues we were raising.

The next two sections look at the problems with Morningstar’s forecast spreadsheet while the subsequent sections will discuss how Morningstar then refocused its efforts on building a propaganda-style narratives tightly aligned with existing Uber PR narratives.

Morningstar’s profit projection depends on $4.5 billion in gains from two huge but totally unjustified spikes in profitability.

To claim that Uber will become a profitable soon enough to justify a high 2019 share price, Morningstar needs to quickly reverse Uber’s $4.5 billion 2017 loss. It did this by making arbitrary, unexplained (and inexplicable) plugs in in 2018 ($1.5 billion) and 2020 ($2.5 billion) forecast numbers.

The table below combines historical data with Morningstar’s forecast, and shows year-over year changes in Uber Revenue and Uber EBIDTAR expenses and the calculated EBIDTAR contribution margin of the each year’s incremental growth.[5]

year-over year change ($m) in	2015	2016	2017	2018	2019	2020	2021	2022
Uber Revenue	1,515	4,440	1,327	4,643	5,381	6,149	7,253	9,044
Uber EBIDTAR Expense	2,270	6,320	1,918	4,654	6,299	4,739	5,681	6,616
EBIDTAR contribution	(755)	(1,880)	(591)	(11)	(918)	1,410	1,572	2,428
EBIDTAR margin of year-over-year growth	(50%)	(42%)	(45%)	(0%)	(17%)	23%	22%	27%
Contrib @ previous year's margin		(2,212)	(562)	(2,068)	(13)	(1,049)	1,663	1,960
Gain from improved EDIDTAR margin		332	(29)	2,057	(905)	2,459	(91)	468

The contribution margin of actual Uber growth 2014-17 improved very gradually, and Morningstar's post-2020 forecast shows similarly gradual EBIDTAR margin gains. But there is a 45 point margin improvement in 2018 growth versus 2017 growth and a 40 point margin improvement in 2020 growth versus 2019 growth, which drive P&L gains of $2.0 billion and $2.5 billion respectively. ***The text fails to mention these huge 2018 and 2020 profit spikes, much the less give any justification for them***.[6]

Morningstar's forecast is based on indefensible claims about exogenous market growth, and Morningstar assumes Uber can grow rapidly regardless of pricing or profitability

Morningstar must show extremely high rates of revenue growth to justify Uber's valuation target. Instead of basing its revenue forecast on Uber's actual past results and analysis of what prices Uber would need to charge to operate profitably in the future, ***Morningstar's forecasts assume demand will grow completely independently of the ability of operators or drivers to make money or the prices customers pay.***

The double-digit demand growth forecasts that drive Morningstar's valuation are based entirely on crude calculations that claim to measure the size of Uber's "addressable markets" (i.e. aggregate market demand for ridesharing, food delivery and other products). Morningstar claims that the overall rideshare market will grow at a 29% five year CAGR (compound annual growth rate) and that Uber will grow at a faster 39% rate. If Uber only grows at a 25% five-year CAGR (Morningstar's "bear-case"), its valuation estimate gets cut in half, to only $49 billion.

Seasoned investors know that trees do not grow to the sky. 39% growth for years for an already large company entering its second decade in a well-established industry is in the category of trees growing to Mars.

For these growth forecasts to be remotely plausible, one would need to provide indisputable evidence of both overwhelming new efficiency advantages (e.g. ecommerce versus brick and mortar) and the huge cash flow/profit generation that would warrant ongoing investment in capacity growth. Morningstar gets the economics entirely backwards. Instead of growth occurring when companies figure out how to exploit major new efficiencies profitably, companies suddenly become efficient and profitable because market demand magically falls from the heavens into their shareholders' laps.

Data on the total market demand for urban car services is extremely limited and unreliable, and revenue data is largely nonexistent. Morningstar extrapolates a single revenue datapoint (New York City taxi revenue in 2014) to a global scale to come up with its ginormous growth forecast.

This is ironic in that New York City, having recognized the destructive impacts of a massive oversupply of unprofitable capacity, is considering limiting the number of Uber drivers.

Using ginned-up global numbers allows Morningstar to grossly inflate its growth multipliers, by combining demand for transport in hundreds of huge, rapidly growing non-US cities with the much more mature transport markets in the US.

This distortion also allows Morningstar to ignore the fact that with a handful of possible exceptions (e.g. London) the available evidence suggests that Uber's efforts to penetrate these faster growing markets have been financially disastrous.[7]

Finally, this approach also ignores evidence that (like many other startups) Uber's rate of revenue growth has slowed over its nine years of operation and was only 20% in 2017, in part due to efforts to reduce its financial losses. Nothing in Morningstar's report explains why, despite large continuing losses, Uber will suddenly increase revenue growth to 60% in 2018.

Morningstar's car service revenue analysis never mentions the word "price" and its report completely ignores the fact that its historical revenue growth was largely driven by multi-billion dollar subsidies. Readers have no way of knowing whether Morningstar's forecast of five year 39% revenue CAGR is due to market stimulation from increasingly lower prices, from Uber's ability to charge increasingly higher prices than customers they pay today, or whether Morningstar ever even considered these issues.

Morningstar's forecast of aggressive Uber growth in non-car service markets also depends on totally ignoring the economics of those industries. Its optimistic view of food delivery demand growth is based on a single article noting that Uber has rapidly captured share from a financially struggling (but still much larger) competitor. Morningstar has no evidence that Uber Eats generates positive cash flow or actual GAAP profits, or that the business is rapidly moving toward GAAP breakeven.

Morningstar's paper best seen as as PR and propaganda, not financial analysis

Morningstar's effort confirms that there is no legitimate way to reconcile financial forecasts that would justify a $100+ billion IPO valuation with Uber's economics. As discussed earlier, if honest financial analysis cannot justify a $100+ billion IPO valuation, the alternate path is to focus exclusively on boosterism.

The vast majority of Morningstar's report is pure narrative that is almost entirely disconnected from any specific spreadsheet numbers, and many of the critical numbers the spreadsheets are not explained in the text. In fact, the the apparent purpose of the spreadsheets is to create the appearance that the report's conclusions were based on legitimate financial analysis.

The next three sections will discuss specific components of Morningstar's narrative in greater detail—the emphasis on "network effects" in lieu of actual evidence of operational efficiency, the misrepresentation of the driver's role in Uber's business model, and how discussions of autonomous and flying cars are intended to create the vague impression of long-term growth potential but misrepresent their impact on Uber's actual value.

Morningstar's narrative depends on totally unsubstantiated claims about Uber efficiencies driven by "network effects"

Morningstar's central claim that Uber efficiencies are driven by "network effects" is false. Worse, Morningstar's attempt to imply that "network effects" could explain either a rapid $4.5 billion profit improvement or profitable growth at 39% CAGR over five years is complete nonsense.

Morningstar's paper mentions "network effects" over 40 times. Evidently they believe the use of Silicon Valley buzzwords has a talismanic effect and eliminates the need for economic evidence.

The authors fail to explain where these alleged network benefits come from, how they actually drive cost efficiencies or increased revenue, or whether they create any material, sustainable advantages over competitors. Morningstar presents absolutely no evidence linking any operating efficiencies to the dramatic revenue growth and profit improvement they are claiming. In keeping, they cannot explain why these effects have failed to produce profits over the past nine years, let alone why they will suddenly gain immense power. Nor do they provide any other examples where a new entrant with "network effects" was able to drive incumbent operators out of business and create $100 billion in corporate value.

They claim that "Uber's network effects benefit drivers and riders; the benefits for each create a continuous virtuous cycle" and cite Facebook's network effects as a comparable example of network benefits for consumers.

But Uber has ***none*** of Facebook's network economies, where (following what is known as "Metcalfe's Law"), each additional user makes the company and its platform more valuable to all other (existing and potential) users.[8]

Uber users may like its prices and service, but they do not care how many other people download the app. Aside from purely digital companies like Facebook and Ebay, no consumer companies with app-based platforms have created the tens of billions in corporate value that Uber falsely attributes to "network effects."

Similarly, if Uber "network effects" created meaningful (and steadily increasing) benefits for drivers, there would be corresponding evidence of better (and rapidly improving) driver economics and work satisfaction.

In fact reports of drivers having to sleep in their cars are becoming more common. Driver take-home pay has fallen below minimum wage in most large cities,[9]and as Morningstar acknowledges, 96% of drivers quit Uber within the first year.[10]

"Network effects" supposedly explain Uber's capacity utilization advantage, as they eliminate the "need for bright yellow cars to roam about, waiting for a hand in the air to match with it." In fact Morningstar has no evidence that Uber has a capacity utilization advantage over traditional taxis that could have any material bearing on its growth and profitability forecasts. The only relevant data Morningstar actually provides shows Uber utilization falling 7% in 2017.[11]

Morningstar badly misrepresents the economics of Uber's drivers

As readers of this series, know, the Uber/driver split of gross passenger fare revenue is critical to any discussion of Uber's economics and profitability. To stem losses, Uber had been unilaterally increasing its "commission" from 20% to 30% while also eliminating many driver incentives. These changes resulted in the driver share falling from 83% in 2014 to 68% in 2016.

That increased Uber's EBIDTAR contribution by over $2.6 billion, and improved EBIDTAR margins from (118%) to (50%). But Uber would have still had triple digit negative margins if the driver share had remained above 80%. The only major progress Uber has made towards a breakeven P&L required pushing driver compensation to (or below) minimum wage levels.

Morningstar's forecast ignored the importance of the Uber/driver revenue split to Uber's bottom line, and asserted that 21-22% Uber shares (similar to 2017 actuals) will remain stable for the next ten years.

Even though it would be arithmetically impossible for both Uber and drivers to increase their share at the same time, Morningstar set that forth as a scenario. The report made the absurd claim that as pressure to increase driver pay increased (as seems likely given tightening labor markets, regulatory pressures and widespread driver recognition of the raw deal they've gotten), Uber would respond by simply increasing its share of passenger fares from 20% back towards 30%.

More fundamentally, this intelligence-insulting narrative illustrates either Morningstar's ignorance of Uber's business model or its willingness to flagrantly misrepresent it.

Morningstar insists Uber is not a transportation company but a software company, and its software serves as a passive intermediary between passengers and wholly independent drivers. Aside from eliding questions about depriving drivers of basic labor law protection, Uber drivers are not economically independent; Uber's business model ties them into vehicle financing obligations. Uber could not have imposed $2.6 billion in unilateral compensation cuts on truly independent drivers.

The fiction that the drivers are "independent" conceals the fact that Uber's drivers contribute 83% of what passengers are paying for, and that the overall Uber-driver business model cannot survive unless both parties can earn satisfactory returns on what they contribute to the business.

Morningstar's narrative badly misrepresents the impact of Uber's autonomous car and flying car programs on its corporate value

Morningstar provides detailed arguments about Uber's long term potential to exploit businesses such as autonomous vehicles (AVs) and flying cars (Uber Elevate) but then totally excludes the cost of developing them from their valuation estimates. One might argue that these investments will increase the value that IPO investors will get (long-term potential greatly exceeding near-term costs) or that they will actually decrease Uber's value (the low probability of far-off returns doesn't justify the costs and risks), But it is unacceptable for Morningstar to claim a specific ($110 billion) Uber value while pretending none of these issues exist.

Morningstar defense of Uber's AV program rests on Dara Khosrowshahi's false claim that autonomous vehicles would allow Uber to reduce the price of rides by 60%.[12]Drivers do account for roughly 60% of the costs of a traditional taxi operation, but the introduction of autonomous vehicles would significantly increase other costs (vehicles, databases, communication links, machine leaning systems, vehicle planning and control systems, new safety/insurance models, etc).

More important, a shift to autonomous vehicles would also require Uber to become a highly-capital intensive business, since it could no longer push all the costs and risks of AVs onto its drivers. It is not clear whether Uber has the management skills or strengths appropriate to the challenges AV or flying car businesses would pose. Since Morningstar ignores the questions of what would be required to succeed in those businesses or how long it would take to determine who the competitive winners would be, it is impossible for a reader of this report to have any idea whether Uber's current investments make any sense.

Uber has openly acknowledged that Khosrowshahi's narrative is the primary driver of its AV and flying car investments. As one interview reported, "… working on flying cars is important to the Uber narrative, according to Uber COO Barney Harford.. 'I think being able to demonstrate [to investors] that we are a company that is able to deliver multiple growth engines and is able to incubate and execute upon a few different opportunities, I think that's a really important story.'"[13]IPO narrative imperatives have led Uber to claim it can have flying cars in full revenue service within five years, a ludicrous claim given the immaturity of the technology, the huge public safety and infrastructure implications, and the well-established rigor of aviation regulatory requirements.[14]

Khosrowshahi has acknowledged that his original plan after joining the company was to cancel both programs given their huge cash drain and uncertain returns, but changed his mind once he recognized that the IPO pitch required giving investors the prospect of growth beyond ridesharing.[15]That narrative transforms Uber's rideshare ordering app into the gateway to all forms of urban transport, and transforms Uber into "..the Amazon for transportation."[16]

Lots of investors might be interested in investing in the "Amazon of transportation". But a good-faith valuation analysis of this opportunity would examine whether Uber's economics gave it the same potential to profitably expand across new transport modes that Amazon demonstrated when it expanded from bookselling into other ecommerce fields. Morningstar fails to provide that legitimate valuation analysis.

Morningstar's evasiveness here is designed to prevent its readers from understanding a fundamental contradiction in Uber's pursuit of a $100+ billion valuation. There are many things Uber could do to improve short term profitability, such as abandoning unprofitable overseas markets, eliminate spending on AVs and flying cars, but all of them would directly undermine their long-term growth narrative. Hypothetically, one could show strong 2018-19 P&L improvements, or one could show the investments Uber thinks will be required to become the "Amazon of transportation" but under no circumstances could one show both.

The report shifts Morningstar from independent analysis of Uber to proactive advocacy on behalf of Uber's shareholders

Regardless of the size of the final estimate, even if it were supporting a strong, positive valuation, the text explaining a bona fide valuation analysis would show how it had considered a wide range of objective evidence (historical financial trends, sensitivities to external factors, comparisons showing how claimed strengths/risks affected similar companies) supporting it and that it had critically scrutinized key company claims.

Morningstar's narrative did not do any of these things. Reading it one gets the impression that it started with its bottom-line conclusion (a $110 billion valuation), worked backwards and plugged

numbers into a spreadsheet that would produce that bottom-line, and then filled its paper with unsubstantiated but pro-Uber opinions roughly in line with its positive valuation.

Much of Morningstar's story line repeats longstanding elements of Uber's talking points uncritically, without any attempt to provide objective supporting evidence. Thus Morningstar's report should not be seen as independent analysis designed to help investors but as proactive Uber advocacy, in support of the number 1 priority of current Uber shareholders, an IPO valuation north of $100 billion.

Uber wants people to believe that its growth was driven by powerful operational efficiencies derived from things like "network effects" "capacity utilization" and "synergies between ridesharing and food deliveries." Morningstar simply repeats Uber's preferred messaging, without providing any evidence that things are real or economically important, or explaining why they won't produce profits until Uber's 11th year of operations.

Uber wants people to believe it is a technology company, and not a company that provides rides in automobiles. Morningstar simply repeats the claim that Uber is a software company, and that independent drivers freely chose its software because of the huge benefits it provides them, without showing any tangible evidence of these benefits, or explaining why their well-documented experience blatantly contradicts the idea of driver benefits.

Morningstar emphasizes that "ridesharing" is significantly different economics than "taxis" even though it has not done any analysis of the competitive economics of the two approaches.

Morningstar then claims that the companies with the most comparable economics are Facebook, Microsoft and Google. This serves Uber's theme that its IPO value should not be based on comparisons with any other transportation companies but only with reference to the most elite companies in the Silicon Valley.

Morningstar does not explain why Uber is many years behind these "most comparable" companies in terms of the scale economies needed to convert growth into profitability, in terms of generating enough positive cash flow its core business to fund all its future growth, in terms of achieving dominant market positions or being able to go public.

As with any propaganda-based approach, distracting attention from the issues Morningstar (and Uber) don't want investors to think about is just as important as the positive impressions that one is trying to create.

Morningstar presents no pre-2017 Uber financial results, and heavily emphasizes size metrics, in order to distract attention from the nine years of huge, steadily increasing losses in pursuit of growth-at-all-costs. This also allows Morningstar to conceal the huge discrepancy between recent P&L trends and the sudden $4.5 billion profit spikes it has forecast for 2018 and 2020. Morningstar asserts that "network effects" fully explain Uber's ability to capture share from yellow taxis in Manhattan, in order to distract attention from the huge subsidies that actually created Uber's price and service advantage.

Although Morningstar's methodology statement opens with "At the heart of our valuation system is a detailed projection of a company's future cash flows" its report does not actually include projections of Uber cash flows. These would seem to be critical to any investors trying to evaluate Uber's future value, but Morningstar wants to distract attention from the nearly $11

billion in cash[17]Uber has already burned through so far, the continuing operating losses Uber needs to fund, and the huge cash requirements of its longer-term growth opportunities that Morningstar failed to analyze.

The Morningstar does mention a variety of widely-known negative Uber issues (low entry barriers in ridesharing, the failure of Uber China, the pedestrian killed by an Uber AV, growing legal/regulatory threats, etc.) But it ignores other important issues such as Uber's open pursuit of quasi-monopoly industry dominance and artificial market power, the huge sensitivity of the P&L to driver compensation changes, and Uber's inability to produce urban car services as efficiently as the traditional taxi operators it has been driving out of business, and makes only passing reference to its largely dysfunctional management and corporate culture.

Morningstar's worst case scenario does not consider the possibility that it may take years longer to reach breakeven, or that full-time Uber drivers win the labor law protections of other full-time employees, or that its autonomous and flying car programs fail to ever generate positive cash flow. The only downside Morningstar quantifies is that 2018-22 Uber revenue grows at a 25% CAGR, instead of 39%.

It is not obvious as to why Morningstar chose to publish an Uber IPO valuation estimate a full year before they go to market, although the report would seem to be highly useful for Uber as its builds its own valuation PR/propaganda narrative. The Morningstar report will allow Uber to claim that "independent" analysis by an "objective" financial firm has directly endorsed the idea that Uber's 2019 IPO might yield a valuation north of $100 billion and that many of the justifications Uber is likely to use have been independently vetted. One can expect that as the actual IPO approaches, more seemingly "independent" voices will endorse the idea that Uber has a value north of $100 billion, with many years of robust, highly profitable growth ahead of it.[18]Given all of the problems and deficiencies documented here, it is important that no one ever grant any credibility to the profitability, valuation and long-term growth arguments Uber or others might make because Morningstar reached similar conclusions.

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[1]Kolhatkar, Sheelah, "At Uber, a New C.E.O. Shifts Gears", New Yorker, 9 April 2018. https://www.newyorker.com/magazine/2018/04/09/at-uber-a-new-ceo-shifts-gears?currentPage=all

[2]Source references for evidence and arguments presented in prior parts of this series will not be repeated here. All of the central arguments about Uber's economics, and Uber financial results through mid-2017 are documented in my Transportation Law Journal article *Will the Growth of Uber Increase Economic Welfare? 44 Transp. L.J., 33-105 (2017)* which is available for download at SSRN*:* *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933177* Uber financial results for full year 2017 and the first quarter of 2018 were presented in this series in Part 13: Even After 4Q Cost Cuts, Uber Lost $4.5 Billion in 2017 (16 Feb 2018) and Part 15: Uber's Q1 Results – Reporters Show They Aren't Up to Reading Financials (24 May 2018)

[3]The evidence showing that Uber's communication efforts fit academic definitions of propaganda, and the actual development of Uber's PR/propaganda narrative over time is laid out in part IV of the Transportation Law Journal article.

[4]The 48 page report can be downloaded at https://pitchbook.com/news/reports/3q-2018-morningstar-pitchbook-uber-may-pick-up-investors-along-with-riders-in-its-ipo. The authors are listed as Ali Mogharabi, Julie Bhusal Sharma, Asad Hussain and Brian Colello. Three of the four work for Morningstar; for the sake of brevity I will refer to this as the Morningstar report instead of the Morningstar/Pitchbook report.

[5]It is not possible to prepare a similar table showing year-over-year changes in total revenue versus total expenses because Uber has never disclosed total expense or net income data for 2016.

[6]I sent Morningstar's authors (via email) the table shown here and asked them to explain how their of 2018 and 2020 forecasts could diverge by $2+ billion from the P&L trends in every other year between 2015 and 2022. Their answer completely ignored the question I had posed and simply repeated the following text from their report: "Besides the driver take rate, which is netted out of Uber's net revenue, we believe a portion of Uber's cost of goods sold is fixed and revenue will grow at a faster pace than these costs, leading to gross margin expansion. We also project that Uber will benefit from operating leverage in the years ahead. The firm might be able to increase revenue at a faster pace than selling, general, and administrative costs, especially in the sales and marketing lines, while also having to spend relatively less on operations and support costs. However, we anticipate that R&D will remain elevated as Uber invests in new ventures, resulting in only slight declines in R&D as a percentage of net revenue."

[7]Given the failure of Uber China Morningstar does exclude China ridesharing demand from its claimed "total addressable market" but it did not exclude other markets Uber has already abandoned (Russia, Southeast Asia) or is rumored to be failing badly (India) markets where it has been totally blocked (e.g Japan), or where it is facing much better financed competitors such as Didi Chuxing. Morningstar fails to disclose what portion of its future Uber revenue estimates are domestic and foreign.

[8]Andreessen Horowitz, *All about Network Effects*, 7 March 2016; http://a16z.com/2016/03/07/all-about-network-effects/ Noah Smith, Uber Still Doesn't Look Like the Next Facebook—it lacks the powerful network effects that compel customers to stick with it, Bloomberg 6 June 2017; https://www.bloomberg.com/view/articles/2017-06-06/uber-still-doesn-t-look-like-the-next-facebookMany companies have app-based platforms that generate no network economies. For example no airline passenger or pizza consumer cares how many other people use the American Airlines or Domino's Pizza app. Consumers may derive benefits from the size of these companies (enabling them to offer more flights or take-out locations) but those are scale economies, not network economies.

[9]Mishel, Lawrence, Uber and the labor market: Uber drivers' compensation, wages, and the scale of Uber and the gig economy, Economic Policy Institute, 15 May 2018; https://www.epi.org/publication/uber-and-the-labor-market-uber-drivers-compensation-wages-and-the-scale-of-uber-and-the-gig-economy/

[10]Amir Efrati, How Uber Will Combat Rising Driver Churn, *The Information,*20 Apr 2017; https://www.theinformation.com/articles/how-uber-will-combat-rising-driver-churn Chantel McGee, Only 4% of Uber drivers remain on the platform a year later, CNBC, 22 Apr 2017 https://www.cnbc.com/2017/04/20/only-4-percent-of-uber-drivers-remain-after-a-year-says-report.html

[11]This is shown in Morningstar's Exhibit 11.The issue isn't that Uber might not have some utilization advantages in some situations, but that there is no public evidence supporting the broader claim, and no evidence that it has a powerful impact on overall cost competitiveness.

[12]Amir Efrati, Uber Seeks Deal for Waymo Cars, *The Information*5 Mar 2018 https://www.theinformation.com/articles/uber-seeks-deal-for-waymo-cars

[13]Johana Bhuiyan, Uber wants to sell a flying car service in five years — but we don't know if the tech (or the law) will happen by then, Recode 11 May 2018 https://www.recode.net/2018/5/11/17332646/uber-flying-car-vtol-barney-harford

[14]Bhuiyan 11 May, also Sean Captain, How Uber Plans To Get Flying Taxis Off The Ground, Fast Company, 2 May 2018. https://www.fastcompany.com/40522758/how-uber-plans-to-get-flying-taxis-off-the-ground

[15]"To Kalanick, the autonomous-driving unit was the jewel of the company. When Khosrowshahi took over, he considered closing the program, since it could potentially cost billions of dollars." Kolhatkar, Sheelah, "At Uber, a New C.E.O. Shifts Gears", New Yorker, 9 April 2018. "Khosrowshahi now believes Elevate fits into Uber's mission to be a platform for all types of transportation."What you're trying to do as a company is take growth that is coming in today and stage them and invest them in forward opportunities down the road … opportunities four years and six years and eight years from now," he said." Johana Bhuiyan, Uber's CEO says he's willing to lose money on flying cars — at first, Recode 9 May 2018. https://www.recode.net/2018/5/9/17337764/uber-ceo-dara-khosrowshahi-flying-cars-elevate-vtol "

[16]"Khosrowshahi says he wants to transform Uber into a multi-modal company that connects people to bikes, buses, car rentals, and maybe even flying taxis" Andrew Hawkins, Uber CEO: Our Future Won't Just Be Cars, The Verge, 15 May 2018. https://www.theverge.com/2018/5/15/17340064/uber-ceo-dara-khosrowshahi-interview-elevate-flying-cars "..we wanna kinda be the Amazon for transportation." Swisher, Kara, Uber CEO Dara Khosrowshahi at Code 2018, Recode, 31 May 2018 https://www.recode.net/2018/5/31/17397186/full-transcript-uber-dara-khosrowshahi-code-2018

[17]King, Ian & Newcomer, Eric, "Uber Spent $10.7 Billion in Nine Years. Does It Have Enough to Show for It?" Bloomberg, 6 March 2018 https://www.bloomberg.com/news/articles/2018-03-06/uber-spent-10-7-billion-in-nine-years-does-it-have-enough-to-show-for-it

[18]This is consistent with Uber PR/propaganda techniques previously documented in this series. Part Eight of this series (Brad Stone's Uber Book "The Upstarts"– PR/Propaganda Masquerading as Journalism, 16 Feb 2017) describes how Uber got a seemingly independent journalist to write an entire book promulgating Uber's main PR/propaganda narratives while ignoring all contrary financial and economic evidence. Part Six (Latest Data Confirms Bleak P&L Performance While Stephen Levitt Makes Indefensible Consumer Welfare Claims, 12 Jan 2017) illustrates how Uber paid a seemingly objective outsider to make (largely specious) claims about how Uber created huge consumer welfare benefits, and then how press reports and articles by Uber supporters amplified the findings and created the appearance that it was a widely-held consensus view.

https://www.nakedcapitalism.com/2018/08/hubert-horans-quick-take-ubers-second-quarter-results.html

Hubert Horan's Quick Take on Uber's Second Quarter Results

Posted on August 16, 2018 by Yves Smith

From Hubert via e-mail:

Uber released 2Q P&L results Wednesday.

1. GAAP Net Loss for the quarter was $891 million. This was significantly worse than its 1Q $551 million loss.

The (paywalled) WSJ story, Uber's Revenue Growth Keeps Up Fast Pace includes a link to the detailed P&L data.

Bloomberg's press report, Uber CEO Embraces Losing Money With Revenue Growth Slowing, had a bit better balance.

2. Unlike 1Q, reported 2Q results did not appear distorted by any major accounting games. In 1Q Uber sold failing Asian operations to Grab, and asserted the Grab shares it obtained in the transaction were worth $3.0 billion, producing a 1Q accounting profit of $2.5 billion. Many (but not all) of the media reports of Uber's 1Q results fell for the "Uber is now profitable" gambit. Press coverage generally emphasized the "2Q losses increasing" point, reversing whatever short-term PR benefits Uber might have gotten from its claims of 1Q "profit".

3. Uber's GAAP net loss for the year ending June 2018 was $4.00 billion. Its net loss for the year ending December 2017 was $4.46 billion. So losses are shrinking very slowly; at this rate they might achieve breakeven in their 15th year of operations. This dramatically contradicts the Morningstar claims (discussed in Part 16 of our series last Monday) that Uber would achieve a 45 point margin improvement in 2018 versus 2017, and achieve breakeven in 2020.

4. Uber supporters tend to emphasize revenue growth, while ignoring the profit problems. But Uber Net Revenue for the year ending June 2018 had increased 28% over Net revenue for the year ending December 2017. But Morningstar had predicted 2018 net revenue would be 60% higher than 2017. Without this type of rapid revenue growth, their entire case for a $100+ billion IPO valuation totally collapses. Other recent pro-Uber press reports have claimed extremely strong growth for Uber's food delivery service. None of these claims have been substantiated, but they raise concerns that growth in Uber's core car service business may be even less than 28%

5. A (paywalled) Tuesday piece in the tech site The Information — usually a reliable source of pro-Uber spin — reported that Uber was losing $125-200 million a quarter ($500-800 million annualized) on its driverless car efforts.

This would confirm the argument laid out in [Monday's Part 16 of our series on Uber's economics] that there is a fundamental contradiction between actions Uber might take to stem short term losses, and Uber's need to promulgate an IPO narrative highlighting years of robust, profitable growth. Morningstar's $100+ billion valuation estimate was based on ignoring the huge costs of developing these highly speculative future businesses. Even normally pro-Uber media outlets are beginning to recognize that they can't continue to ignore $500-800 in annualized expense.

https://www.nakedcapitalism.com/2019/02/hubert-horan-can-uber-ever-deliver-part-seventeen-ubers-2018-results-still-show-huge-losses-slowing-growth-ipo-approaches.html

Hubert Horan: Can Uber Ever Deliver? Part Seventeen: Uber's 2018 Results Still Show Huge Losses and Slowing Growth as IPO Approaches

Posted on February 16, 2019 by Yves Smith

By Hubert Horan, who has 40 years of experience in the management and regulation of transportation companies (primarily airlines). Horan has no financial links with any urban car service industry competitors, investors or regulators, or any firms that work on behalf of industry participants

Overview of Uber 2018 results

Uber released a brief summary of its fourth quarter and full-year 2018 P&L results on Friday.

Excluding claimed benefits from the first quarter sale of its failed Southeast Asia operations to Grab, Uber had a 2018 GAAP loss of $3.3 billion. [1] 2018 losses would have been $3.7 billion but were reduced by an unexplained $400 million reduction in fourth quarter tax liability.

Although Uber had provided reporters with detailed 2017 financial data, in recent quarters it only released five P&L numbers making it impossible to explain changes in reported totals. This is the first time year-over year total Uber GAAP losses have actually declined. Uber lost $2.5 billion in 2015, and $4.5 billion in 2017.

Uber has obvious interest in reducing losses prior to its IPO but there is no way to tell whether the improvements in 2018 were due to improved ridesharing efficiencies or the elimination of very unprofitable markets, or reduced spending on future markets and growth.

Uber's fourth quarter GAAP loss was slightly lower than both its third quarter loss and its 2017 fourth quarter loss, but would have been worse without the income tax liability change. Uber remains hugely cash flow negative, and cash from operations worsened to ($645m) in the fourth

quarter versus ($487m) in the third quarter. However Uber's total cash on hand increased to $6.4 billion (from $5.9 billion at the end of 2017) thanks to new investment and borrowing.

Given nine years of abysmal profitability, Uber's public statements have emphasized revenue growth, but that growth has continued to slow down. Fourth quarter net revenue was $3.0 billion, a year-over year gain of 24%, but the first quarter's year-over-year gain had been 70% and the quarter-to-quarter gain was only 2%. Comparisons are complicated by the growth of Uber Eats, which appears to be growing much faster than Uber's core taxi business. Uber has been aggressively trying to capture food delivery share from Grubhub and other incumbents. But Uber didn't provide any data that would allow one to identify the separate impacts of taxi service, food delivery or scooter rentals other businesses on their total results.

Press Coverage Increasingly Negative

All of the major business and tech industry publications that follow Uber immediately reported the P&L results including:

https://www.bloomberg.com/news/articles/2019-02-15/uber-results-show-revenue-growth-slows-amid-persistent-losses

https://www.nytimes.com/2019/02/15/technology/uber-stock.html

https://www.wsj.com/articles/uber-sales-growth-slows-further-as-ipo-nears-11550253602?mod=searchresults&page=1&pos=1

https://www.ft.com/content/aa76c512-30eb-11e9-8744-e7016697f225

https://techcrunch.com/2019/02/15/uber-reports-3b-in-q4-revenue-rising-operating-losses/

While these reports appropriately focused on the data Uber released, it is worth noting that coverage was much more critical than the reporting that would have been seen a year or two ago.

The Wall Street Journal highlighted the revenue growth slowdowm; its lede was "As it steers toward a planned initial public offering later this year, Uber Technologies Inc. is hitting a bumpy patch on sales."The Financial Times' lede was "Uber's revenue growth slowed and costs rose in the final three months of 2018, as the ride-hailing company spent money on price wars around the world."

The headline in the Times was "As Uber Prepares for I.P.O., Its Losses Pile Up." It speculated that Uber had been unable to take a higher share of ridesharing revenue due to growing competitive pressures and that lower Uber Eats margins had also hurt results. It also reminded readers that the post-IPO stock price of companies like Snap who went public while still making sizeable losses had collapsed badly when those losses persisted.

Both Bloomberg and Techcrunch highlighted the unexplained income tax liability adjustment and wondered how potential IPO investors would react to the results. Bloomberg suggested that

"News that the company is still burning through more than $1 billion annually may give some investors pause" and might be unhappy with Dara Khosrowshahi's approach since he was hired 17 months ago. "At the time, investors expected Khosrowshahi would focus on stemming losses. Instead, he has prioritized fending off rivals like Lyft and investing in areas of growth like food delivery."

Everything Is Still Riding on the Upcoming IPO

As previously discussed in this series, this year's IPO will be the most important event in Uber's history. Roughly two-thirds of the cash Uber has raised came from investors who bought shares after 2015, at prices closely linked to its current $70 billion valuation. These investors were not established Silicon Valley venture capitalists (who had provided Uber's original funding at much lower prices), but investors willing to pay much higher prices once Uber had become a hot, glamorous company and the biggest unicorn of all time.

The 2017 Board rebellion, that led to the sacking of Travis Kalanick and the hiring of Khosrowshahi, was not due to the sexual harassment issues Susan Fowler had raised, but because Kalanick knew that Uber was not ready to withstand serious capital market scrutiny and refused to initiate an IPO. Khosrowshahi was hired after promising the Board he would complete that IPO during the second half of 2019. The Board set bonuses for him that made it clear they wanted to achieve an IPO valuation north of $100 billion, which would provide those later investors to achieve the huge returns they had been promised. An IPO valuation of merely $70 billion would mean these later investors would have been better off stuffing their cash into their mattresses. Morgan Stanley and Goldman Sachs, the two firms competing to run Uber's IPO process, both claimed that Uber could go public at $120 billion (Morgan Stanley was selected).

Uber accelerated the process when Lyft began its own IPO process in December, which it hoped would be finalized in March or April. Lyft's ridesharing business model is identical to Uber's and is pursuing a much more modest valuation (currently $15 billion).

Uber realized it would lose control of the public narrative. Investors might conclude that a ridesharing business might be worth $20 billion (but not much more) or might review the financial data in Lyft's prospectus and realize it was worth even less than that. Uber and Lyft both recognized that the overall tech equity bubble might be bursting in light of growing awareness that long-term growth and profit expectations at companies like Facebook, Twitter and Amazon may not have been firmly grounded in reality. Uber and Lyft will also be competing with companies like Palantir, Airbnb, Slack and Postmates for investors attracted to prominent tech unicorns.

Companies who want to go public make an initial confidential filing with the Securities and Exchange Commission. Filings must include detailed, audited financial results (which neither Uber nor Lyft has ever released), pro-forma forecasts of future results, and a written discussion of business risks and why the company could achieve the profitable growth it has forecast. The SEC has 30 days to review initial filings, but can ask questions and demand changes before final approval. This schedule was delayed by both the government shutdown, and the need to update filings with the latest (full year 2018) financial data. Once approved, companies can release the

prospectus (known as the S-1 filing), and conduct a public roadshow to convince investors to buy the stock, and gauge what price the markets will accept.

If Uber is satisfied it can achieve the $100+ billion valuation they need, they can announce the final price and pull the trigger on the actual stock sale. That would require convincing investors that the stock has significant appreciation potential above the IPO price. This means they need to demonstrate that Uber can quickly achieve breakeven in its core car service business, can steadily increase taxi revenues and profits for many years, and can also quickly achieve rapidly growing profits in a variety of other businesses (e.g. food delivery, scooters, driverless cars). The simple counter-example is Amazon's IPO, where they had already demonstrated the ability to produce strong positive cash flow from their core bookselling business, demonstrated that their sophisticated ecommerce platform and warehousing/distribution infrastructure gave them powerful competitive advantages, and that their existing investment could easily be leveraged into profitable growth into a wide range of other retailing markets.

As readers of this series will understand there is no objective, verifiable evidence at hand that any claims about rapid Uber profit growth in ridesharing or any other business are likely to be true. Additionally, Uber faces a Catch-22 type dilemma. There are spending cuts Uber could make to goose the short-term P&L numbers, but these would show Uber was not investing in the profitable long-term growth it was promising. Likewise, increased investment in speculative future new businesses would make the (already awful) short-term P&L and cash flow numbers even worse.

Uber's accelerated IPO schedule means it has had less time to clean up its results and forecasts, and develop a more convincing explanation as to how it will suddenly become "the Amazon of Transportation."

Today's P&L announcement sheds no light on how they might approach the IPO. It is unclear why Uber released such limited financial data when the public release of much more detailed, audited data is imminent. IPO investors will need clear information about revenue and spending broken down by each current and prospective future line of business. They will need to be able to track trends for key items such as rideshare prices, driver compensation and incentives, marketing and IT expenditures. They will need to see whether actual spending and margin changes are aligned with management's explanation of how it can achieve strong profit growth in the future.

Over its ten year history, Uber has built a reputation as a highly successful and valuable company based on manufactured narratives, and propaganda techniques that hid (or diverted attention from) evidence about its lack of competitive economics and its terrible financial results. Over the past two years, this series has attempted to explain why Uber (as Travis Kalanick had predicted) was unlikely to survive capital market scrutiny once detailed financial evidence became widely available.

Perhaps Uber's proven ability to manufacture narratives will convince investors to put up $100 billion in real money for the company's shares. Perhaps Uber can get away with an IPO prospectus that doesn't answer any of these critical questions about the company's economics. If

Uber raises the money they are hoping for, the Uber "problem" simply shifts from the current investors to the new public shareholders.

If Uber gets significant pushback from investors who don't find its prospectus narratives convincing, things would become very messy very quickly. Cutting the valuation much below $100 billion, or significantly delaying the IPO could restart the Board battles that crippled the company in 2017. Major pushback from investors could completely burst the longstanding perception that Uber is a powerfully innovative company that has huge long-term profit potential. If the public begins to realize that none of those narrative-driven perceptions were true, Uber has no "Plan B" to fall back upon.

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[1] The $3 billion first quarter profit gain was based on Uber's assertion as to what the Grab shares it obtained (in exchange for quitting the market) would be worth someday. See *Uber's Q1 Results – Reporters Show They Aren't Up to Reading Financials*, Naked Capitalism, 24 May 2018

https://www.nakedcapitalism.com/2019/03/hubert-horan-can-uber-ever-deliver-part-eighteen-lyfts-ipo-prospectus-tells-investors-no-idea-ridesharing-ever-profitable.html

Hubert Horan: Can Uber Ever Deliver? Part Eighteen: Lyft's IPO Prospectus Tells Investors That It Has No Idea How Ridesharing Could Ever Be Profitable

Posted on March 5, 2019 by Yves Smith

By Hubert Horan, who has 40 years of experience in the management and regulation of transportation companies (primarily airlines). Horan has no financial links with any urban car service industry competitors, investors or regulators, or any firms that work on behalf of industry participants

Can Silicon Valley investors create $125-150 billion in ridesharing market value out of thin air?

This series, since the first Naked Capitalism post in 2016, has focused on Uber as the dominant and strategically pioneering ridesharing company, and as the only source of public data that could support independent analysis of ridesharing economics.

Last Friday, March 1st, Lyft issued its Form S-1, also known as a prospectus[1], significantly expanding our base of objective data about ridesharing. This post will analyze Lyft's key claims. Reports indicate that Lyft is pursuing an IPO value of $20-25 billion, while Uber may be pursuing as much as $125 billion from its upcoming IPO.

Uber claimed that the "ridesharing" industry it had pioneered had substantially superior economics based on major technological innovations that explained its disruption of the traditional taxi/urban car service industry. This series presented evidence showing that those claims were nonsense and that ridesharing companies were actually less efficient than the traditional companies they were driving out of business.

It is important to understand Uber and the other privately-owned ridesharing companies since their impacts extend far beyond urban transport. One of the central themes of this series is that they have (and will continue to) significantly reduce overall economic welfare, and represent a major attack on the idea that the actions of consumers and investors in competitive markets can allocate capital to more productive uses.

The critical characteristic of ridesharing companies (such as US based Uber and Lyft, or Asian based Didi, Grab or Ola) has nothing to do with smartphone apps or competitive advantage or operational efficiency. It is the fact that they are backed by billions in cash from venture capitalists who have been willing to subsidize years of massive losses. Instead of consumers choosing the most efficient car service, those subsidies led them to choose the company that didn't charge them for the actual cost of the service, and provided far more capacity than could be economically justified. Instead of funding the companies with the strongest sustainable competitive advantage, those subsidies led investors to fund the companies with the artificially inflated growth rates that suggested a path to quasi-monopoly market dominance.

Under private ownership, the claims that the ridesharing companies had created unprecedented levels of economic value ($70 billion for Uber, $15 billion for Lyft) had never been subject to any broad-based analyst or investor scrutiny. This series has argued that the unprecedented accomplishment of ridesharing is that its entire valuation was manufactured out of thin air. The valuation of other large Silicon Valley based companies (Amazon, Facebook) may be seriously inflated, but they had clearly established legitimate economic foundations, including powerful product and operational innovations, profits and strong cash flow.

This series has documented that Uber has no economic foundation, aside from its predatory use of billions in subsidies. None of its claimed technological innovations allowed it to produce car service at lower cost than incumbents, or create sustainable advantages over future competitors. It would still require billions in new efficiencies to reach operational breakeven, and billions more to economically justify the funding its investors provided. [2]

Lyft's IPO kicks off the endgame of the "ridesharing" corporate value creation process

As discussed in Part Seventeen of this series [3], both Uber and Lyft filed preliminary, confidential prospectus data with the Securities and Exchange Commission in December, kicking off a race as to who would go public first. Travis Kalanick did not feel Uber was ready to face full capital market scrutiny, triggering a rebellion of Board members who impatient for actual returns on their investment. Kalanick was replaced by Dara Khosrowshahi in late 2017, who committed to take Uber public in the fourth quarter of 2019. Lyft wanted to go public first, to avoid the expected glut of IPOs this year (including Pinterest, Slack, Postmates and Airbnb) and to minimize direct comparisons with Uber. When word leaked that Lyft was targeting a first quarter IPO, Uber accelerated its filing plans but Lyft won the race.

The public release of Lyft's S-1 filing will be followed (apparently starting the week of March 18th) with a series of investor roadshows. Based on investor feedback, Lyft and its lead investment bankers (JP Morgan, Credit Suisse and Jefferies) will set final prices and terms, and the date for the actual IPO.

Last Friday was the first time investors ever had the chance to review actual Lyft financial results. In the next few weeks they will have to decide whether they want to risk real money on the chance that Lyft's value will continue to appreciate above the IPO price. If investors line up to buy Lyft stock at the company's hoped-for $20-25 billion valuation, then the efforts to create ridesharing value out of thin air have succeeded, and it will make it much easier to Uber to achieve a strong valuation.

Significant investor resistance to Lyft's valuation objectives could cause serious problems for both companies, and could possibly burst the widespread public perceptions about ridesharing.

Four key questions potential Lyft IPO investors will want the S-1 to answer

1. Does the prospectus provide data showing that Lyft have a clear path to convert its current losses into ongoing, growing profits? Is there data showing exactly which factors (e.g. the ability to raise prices, the ability to capture market share, the ability to increase operational efficiency due to scale economics or new innovations) are likely to drive years of profit improvement?
2. Is there data showing that aggregate demand for ridesharing is likely to grow strongly for many years? What might drive future demand growth (expansion into untapped markets, the ability to continually lower prices, capturing demand currently using other transport modes)?
3. If Lyft could achieve sustainable profitability in its core ridesharing market, is there evidence showing how it could leverage its existing infrastructure and rapidly build profitable positions in other markets?
4. As Uber will always be larger, is there evidence showing that both a primary and secondary competitor can profitably coexist without ongoing destructive market share battles?

Lyft's prospectus doesn't answer any of these questions

Lyft's prospectus provides absolute no data demonstrating that it has the ability to profitably raise prices over time, increase operational efficiency or win significantly greater market share. It cites "growing the rider base" as the first plank of its future growth strategy, but provides no data showing what it thinks its current share of the market is, no estimates of future aggregate market growth, no evidence of what might drive that growth, and no explanation of what its future growth potential might be. Lyft makes no attempt to lay out a possible path to future profitability, or even a timeline as to when breakeven might be achieved.

The prospectus narrative includes a large number of claims that are completely unsubstantiated. Lyft says it has "continually improved rideshare marketplace efficiency" but provides no evidence of how its innovations or other claimed improvements actually reduced costs. It claims that "we expect our Contribution Margin to increase over the long-term as we scale and increase the usage of our platform" but provides no evidence showing how increased platform usage can drive significant margin improvements.

It highlights actions taken to "increase driver utilization when on the platform" without providing any data about actual driver utilization. It points out that "maintaining an ample number of drivers to meet rider demand" is one of the most critical drivers of performance, but provides no data on mix of drivers needed to meet that demand, and no data on driver turnover. It acknowledges "our need to provide larger incentives to drivers to help keep up with rider demand" but fails to explain how it can meet expected demand growth (or capture share from Uber) without directly reducing profitability.

The prospectus mentions several new markets Lyft is pursuing (scooter rentals, autonomous vehicles) but says absolutely nothing about the economics of those businesses, their near-term capital requirements or how they might contribute to future profitability. It acknowledges that the scooter business is currently an immaterial part of the business, but makes no attempt to explain where returns from its recent scooter company acquisition might come from, or when scooters might become a material part of the business. It mentions investments in a new "autonomous vehicle engineering center" and several AV-related joint ventures, but doesn't say how big those investments were, or how they might eventually contribute to profitability.

The prospectus claims that "within 10 years, our goal is to have deployed a low-cost, scaled autonomous vehicle network that is capable of delivering a majority of the rides on the Lyft platform."

But it provides absolutely no explanation as to why investors should believe that Lyft will be able to more profitably operate much more expensive and risky new technology than the other companies pursuing this (still hypothetical) opportunity. It doesn't even bother to explain why investors should believe Lyft's claim that widespread commercial use of AVs will be possible in this timeframe, given that just two years ago Lyft was predicting this would be achieved just two years from now. [4]

Lyft's IPO is structured so that its current senior executives will get "B" class shares that have 20 times more votes than the "A" class shares the public can buy. Thus anyone buying "A" shares must have complete faith that the current owners can lead the company to sustainable profits and steady equity appreciation. The prospectus provides no explanation as to why investors should have this level of faith in current CEO Logan Green (age 34) or President John Zimmer (age 34), who will control the majority of voting shares.

Lyft's prospectus describes a company with negative cash flow, growing annual losses that have reached nearly a billion dollars, and declining rates of revenue growth

Lyft lost nearly a billion dollars in 2018, 32% more than it did in 2017, and the prospectus acknowledges that "[s]ince our inception, we have generated negative cash flows from operations." The three years of results presented in the prospectus show that Lyft significantly benefited from Uber's 2017 *annus horribilis,*when it faced ongoing negative publicity about its Board turmoil and problematic corporate behavior. [5] This allowed Lyft to achieve a one-time growth spurt without having to spend as much on passenger discounts, driver incentives and advertising.

	2016	2017	y-o-y	2018	y-o-y
Total Lyft revenue (000)	$343,298	$1,059,881	209%	$2,156,616	103%
Total Lyft expense (000)	$1,035,901	$1,768,153	71%	$3,134,327	77%
% expenses covered by revenue	33%	60%		69%	
Lyft net income (000)	**($682,794)**	**($688,301)**	1%	**($911,335)**	32%
Lyft net margin	**(199%)**	**(65%)**		**(42%)**	

2018 revenue growth was only half of 2017's rate, while expenses grew slightly faster. Uber''s travails allowed Lyft to cover 60% of its expenses with revenue in 2017 (versus only 33% in 2016) and cut its GAAP net margin to negative 65%. Further (but much smaller) improvements were achieved in 2018, with expense coverage improving to 69% and net margin improving to negative 42%.

Lyft's prospectus shows that its largest source (over $1 billion) of recent margin improvement– cutting driver take home pay to minimum wage levels—is unsustainable

Lyft's reported results would actually be substantially worse if it had not imposed unilateral cuts to driver compensation. These were achieved by charging drivers more for using Lyft's software. [6] In 2016 Lyft kept 18% of gross passenger fares (excluding tolls, tips and discounts). The other 82% were gross driver receipts before their vehicle, insurance, maintenance and fuel expenses. Lyft increased its share of gross fares to 23% in 2017 and to 27% in 2018. This represents a $925 million transfer from drivers to Lyft's shareholders. Had the 2016 driver/Lyft percentage split remained in

place, Lyft's 2018 net loss would have been $1.6 billion, and its net margin would have been negative 65% instead of negative 42%.

The Lyft prospectus provides the first public data on the actual volume of ridesharing trips; Uber has never published any volume data that would allow one to calculate average prices or unit costs. Lyft passengers paid $11.73 per trip (excluding tolls, tips and discounts) in 2016 and paid slightly higher (4-6%) prices in 2017/18. But 2018 gross fare payments were 323% higher than they had been in 2016.and total Lyft revenues increased 528%. But what drivers got per ride had actually declined from $9.61 to $9.52. The entire value of the (very small) passenger fare increase and the (very large) total volume increase went to Lyft, while individual drivers gained nothing.

	2016	2017	2018	18 vs 16
Total rides (000)	162,400	375,600	619,400	281%
Gross Pax fares paid (x-$000)	$1,904,700	$4,586,700	$8,054,400	323%
Total Lyft revenue (x-$000)	$343,298	$1,059,881	$2,156,616	528%
Lyft share	18%	23%	27%	49%
Driver share	82%	77%	73%	(11%)
Gross pax fare per trip	$11.73	$12.21	$13.00	11%
Lyft revenue per ride (x)	$2.11	$2.82	$3.48	65%
Lyft expense per ride	$6.38	$4.71	$5.06	(21%)
Driver gross revenue per ride(x)	$9.61	$9.39	$9.52	(1%)
Lyft Rev @ 2016 18%/82% split	$343,298	$825,606	$1,449,792	322%
Lyft Net Income @ 2016 split	($682,794)	($922,576)	($1,618,159)	
Lyft gain from driver pay cuts	0	$234,275	$706,824	

x-excluding driver/rider incentive impacts

The $925 million impact shown in the table actually understates the magnitude of the labor to capital wealth transfer because Lyft's data misrepresents what passengers actually paid and what drivers actually received. Passenger discounts and driver incentives should be included in any calculation of prices or compensation, but are included in "Sales and Marketing Expenses" ($434 million in 2016, $804 million in 2018) along with advertising costs. Sales and Marketing expense per passenger trip fell from $2.67 to $1.30 and was the only expense category where Lyft achieved major unit cost reductions. Much of this was likely due to driver incentives cutbacks, producing even larger reductions in driver revenue per trip than shown in the table. The prospectus describes these unilateral pay cuts as management actions to "improv[e] the efficiency and effectiveness of certain driver incentives."

While driver welfare may not be a major concern for some of the investors evaluating Lyft's IPO, they should be able to recognize that there will be very little potential to use even deeper driver pay cuts to improve unit economics going forward. Lyft's recent emphasis on ensuring the driver/vehicle capacity needed to capture additional share from Uber suggests that Lyft's unit economics will likely worsen, and its margin gains cannot be extrapolated into the future.

Lyft's data demonstrates that its business model has the same structural flaws as Uber's

The table below combines the last five years of (unaudited) Uber data presented earlier in this series with the newly available three years of Lyft data. The same patterns appear in both sets of data, although the timing varies due to Uber's faster early development and its 2017 travails.

Margin improvement at both companies was primarily driven by unilateral driver pay cuts. Uber achieved $3 billion in P&L gains after cutting its driver share of passenger fares from 83% to 68% between 2014 and 2016, similar to Lyft's 2016-2018 cuts. [7] Uber was forced to partially rescind these cuts as it fought to stem driver and traffic losses in 2017. Uber's problems allowed Lyft to increase its share of the two company's revenue from 5% to 12% in 2017, which made it easier for them to cut back on driver incentives. [8] The comparison further confirms that further margin gains from driver pay cuts are likely unachievable, and that any market share battles will likely require both higher driver pay and increased rider incentives.

None of this data suggests that either company has any of the powerful scale economies needed to rapidly "grow into profitability." Obviously, the ability to unilaterally cut driver pay is not a "scale economy" and if legitimate scale economies existed, evidence of strong margin improvements would have appeared by now.

($ millions)	2014	2015	2016	2017	2018
Uber gross pax fares	$2,957	$8,900	$20,000	$36,180	$49,560
–% change year over year		*201%*	*125%*	*81%*	*37%*
Uber % pax fares retained by drivers	83%	77%	68%	79%	77%
Uber total revenue	$495	$2,010	$6,450	$7,778	$11,359
–% change year over year		*306%*	*221%*	*21%*	*46%*
% Uber expenses covered by revenue	42%	43%	62%	64%	82%
Uber GAAP net margin	(136%)	(132%)	(62%)	(57%)	(35%)
Lyft gross pax fares			$1,905	$4,587	$8,054
–% change year over year				*141%*	*76%*
Lyft % pax fares retained by drivers			82%	77%	73%

Lyft total revenue	$343	$1,060	$2,157
–% change year over year		*209%*	*103%*
% Lyft expenses covered by revenue	33%	60%	69%
Lyft GAAP net margin	(199%)	(65%)	(42%)
Lyft % combined gross fares	9%	11%	14%
Lyft % combined revenue	5%	12%	16%
Lyft % combined net losses	15%	13%	19%

The rate of revenue growth has steadily declined at both companies, further underscoring that investors should not extrapolate recent margin gains many years into the future. Given its earlier growth, Uber's deacceleration appears to have started a bit sooner. Past growth rates cannot be used as the basis for future forecasts because they are not based on either the ability to provide this capacity profitably, or the powerful scale economies that would drive profitability by rapidly reducing unit costs. Ridesharing growth is simply a function of investor willingness to fund losses in pursuit of market share or the growth rates that naive investors might misperceive as an indicator of future value.

Lyft's business model also has a major weakness Uber does not face

As discussed previously in this series, there is no evidence that Uber's investors ever believed they could achieve sustainable profits from efficient ridesharing operations in competitive markets. Uber was always pursuing the quasi-monopoly industry dominance that would (hypothetically) allow them to exploit platform-driven artificial market power.

All of the other large ridesharing companies in other markets (Didi, Grab, etc.) have been similarly focused on using predatory subsidies to pursue market dominance. Many of Softbank's ridesharing investments were designed to accelerate the process of consolidating around dominate national/regional companies.

While these strategies were based on serious misconceptions about network economies, and none of these companies have shown any signs of sustainable operational profitability, they at least had some plausible logic behind them. Almost all of the smaller companies that attempted to compete with them (including Uber in China, Russia and Southeast Asia) have given up and sold out.

Lyft is the only large scale ridesharing company that claims it is worth tens of billions of dollars but does not have, and will never have a dominant market position, and has never attempted to explain how a secondary position could become viable. Even if one ignores more fundamental economic problems (such as the inability to produce car service at a cost consumers are willing to pay for) Lyft's future viability depends on the ability of both Uber and Lyft to achieve sustainable profitability. Ridesharing has none of the characteristics (profitability, market maturity) that allow other competitive industries to maintain a stable pricing/competitive environment.

The dueling Lyft-Uber IPO process has demonstrated the instability of the current market. Lyft has aggressively worked to maximize the market share numbers it can present to investors, but this has

already triggered worries about a fare war [9] and concerns that Lyft's prospectus has materially overstated its actual market share. [10]

On what basis does Lyft argue that investors should value it at $20-25 billion?

Lyft's prospectus makes no attempt to provide investors with data-based explanations of how it could achieve sustainable profitability or strong ongoing equity appreciation. One presumes that the stated $20-25 billion valuation targets simply reflect the financial ambitions of Lyft's owners and investment bankers. Even if one uses the crude metrics such as multiples of revenue often used for valuation guestimates, these targets implausibly imply future appreciation potential stronger than Facebook's. [11]

Undoubtedly some investors may buy the stock based on purely speculative logic, hoping for short term appreciation based on pent-up demand for new IPO issues, or mass market misperceptions about ridesharing. But the economics of ridesharing are not that complicated, and any investor willing to do a bit of research will fail to find evidence of sustainable profitability, much less the evidence that could justify these extremely rich valuations.

Lyft's central prospectus claim is that investors should anticipate huge future growth because "Transportation is a Massive Market Opportunity" ("twice as large as healthcare"), because Lyft's real business is "transportation as a service (TaaS)" and "we are one of only two companies that have established a TaaS network at scale across the United States. This scale positions us to be a leader in the transportation revolution."

This claim is complete garbage. Lyft's only business is its highly unprofitable urban car service, unless one wants to give them credit for their (currently immaterial) scooter rentals. The prospectus makes no effort to explain what a fully developed TaaS business might look like, or the investment future shareholders would be required to fund in order to create it. Lyft began publicizing its "vision" about a "transportation revolution" several years ago, [12] but fails to explain why none of its revolutionary predictions ("By 2025, private car ownership will all-but end in major U.S. cities") have any chance of becoming true.

No other urban car service operator has ever profitably expanded into a wider range of transport services. Uber's investors used to make similar claims that their true potential should be based on the entire urban transport market, including cars and mass transit. [13] Even though Uber continues to (unprofitably) invest far more in auxiliary businesses such as scooters and food delivery than Lyft does, it stopped making broader claims about its ability to grow across the transportation world years ago.

As with Uber's past claims, Lyft's TaaS "vision" rests on the false supposition that ridesharing will not only achieve sustainable profitability, but will continue to drive its costs down so dramatically that ridesharing becomes more economical than transit and car ownership. Instead of laying out delusional fantasies about the long-term future, Lyft might more usefully explain how it might someday drive its costs down to the level that the typical Yellow Cab company achieved years ago.

Lyft's IPO prospectus appears targeted at investors who are willfully ignorant of industry economics but are willing to risk their capital on the basis of emotive narratives.[14] People willing to respond to long term industry "visions" but unwilling to think about the (false) claims about cost competitiveness they are based on, or recognize that the predictions based on that vision were all wrong. People willing to respond to claims about "core values focus on authenticity, empathy and support for others" but unwilling to recognize that the IPO that could make its founders billionaires depends on having unilaterally cut driver take-home pay down to minimum wage levels.

[1] Lyft's S-1 can be downloaded from the SEC's Edgar website at https://www.sec.gov/Archives/edgar/data/1759509/000119312519059849/d633517ds1.htm#toc633517_12

[2] All of the central arguments about Uber/ridesharing economics are documented in my Transportation Law Journal article *Will the Growth of Uber Increase Economic Welfare? 44 Transp. L.J., 33-105 (2017)* which is available for download at SSRN*: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933177*

[3] Can Uber Ever Deliver? Part Seventeen (February 16, 2019)

[4] Andrew J. Hawkins, *Lyft's president says 'majority' of rides will be in self-driving cars by 2021*, The Verge, 18 September 2016

[5] The Uber board turmoil and the events that triggered 2017's negative publicity were discussed in Part Ten(June 15, 2017)

[6] While Lyft's prospectus maintains the legal fiction that its revenue comes from the voluntary payments from independent driver/entrepreneurs who have chosen to purchase Lyft's software, Lyft's drivers are obligated to use this software, and to accept whatever "software charges" (commission rates) and trip fares Lyft choses to impose. Under the Uber/Lyft business model, drivers who wish to drive on anything more than a casual basis must incur significant vehicle costs and financing obligations, and Uber and Lyft use this artificial power to lock-in drivers who might want to quit when they realize how low their actual take-hoe pay is or when that pay is unilaterally cut. Nothing in the prospectus suggests that these increased "software charges" had been justified by anything Lyft did to make its software product more valuable to drivers.

[7] See in particular Part Eleven (December 12, 2017) and Part Sixteen (August 13, 2018). The key study documenting take-home pay below minimum wage levels was Lawrence Mishel, *Uber and the labor market: Uber drivers' compensation, wages, and the scale of Uber and the gig economy*, Economic Policy Institute, 15 May 2018;

[8] The data strongly suggests that Lyft might not have survived without Uber's 2017 public ugliness. Lyft was holding discussions with potential acquirers before realizing its windfall revenue growth. Jordan Golson, *Lyft reportedly declined GM's $6 billion acquisition offer*, The Verge, 29 August 2016.

[9]Amir Efrati, Lyft Kicks Off Price War With Uber Ahead of IPOs, The Information, 25 February 2019; Kate Clark, Here's why you're getting all those sweet Uber and Lyft discounts, Techcrunch, 26 February 2019

[10] An independent firm measured Lyft's US share as 29%, versus the 39% claimed in the prospectus. Alison Griswold, How Lyft stacks up against Uber, Quartz, 1 March 2019

[11] Eric Newcomer & Olivia Zaleski, Lyft Touts Growth to IPO Investors as Losses Near $1 Billion, Bloomberg, 1 March 2019. At $25 billion, Lyft would match Snap, which had the highest ever revenue-multiple based valuation at the time of its IPO. Potential Lyft investors might consider that Snap's equity value collapsed from over $24/share to under $6/share in the nine months following its IPO. Kurt Wagner & Rani Molla, *Two years after going public, Snap's problems are still all about growth*, Recode, 1 March 2019

[12] John Zimmer, The Road Ahead, Medium, 18 September 2016

[13] Bill Gurley, *How to Miss By a Mile: An Alternative Look at Uber's Potential Market Size*, Above The Crowd(July 11, 2014)

[14] Perversely, if Lyft's IPO is successful, it will be largely due to artificially constructed narratives about the wonderful economics of ridesharing that were developed and promulgated by Uber, not by Lyft. See Part Nine (march 15, 2017)

https://www.nakedcapitalism.com/2019/04/hubert-horan-can-uber-ever-deliver-part-nineteen-ubers-ipo-prospectus-overstates-its-2018-profit-improvement-by-5-billion.html

Hubert Horan: Can Uber Ever Deliver? Part Nineteen: Uber's IPO Prospectus Overstates Its 2018 Profit Improvement by $5 Billion

Posted on April 15, 2019 by Yves Smith

By Hubert Horan, who has 40 years of experience in the management and regulation of transportation companies (primarily airlines). Horan has no financial links with any urban car service industry competitors, investors or regulators, or any firms that work on behalf of industry participants

Uber released its S-1, its IPO filing with the Securities and Exchange Commission, on April 11th.[1] Press reports indicate Uber is seeking to raise $10 billion and achieve a valuation close to $100 billion. To succeed, investors will need to believe that despite losing roughly $14 billion in the last four years, Uber not only warrants a current valuation that would make it the second most valuable startup IPO in US history (after Facebook) and the second most valuable publicly traded transportation company in the world (after Union Pacific), but that its stock will continue to steadily appreciate once it becomes publicly traded.

Uber's biggest IPO challenges are to convince potential investors that it has already made substantial progress towards reversing its recent massive losses, and that its businesses have the ability to generate strong, sustainable profits.

Uber's S-1 not only fails to present any credible evidence about future potential profits, but its presentation of historical results is designed to mislead potential investors about recent improvements that did not actually occur.

Nobody believes Uber's claim that it earned a billion dollar profit in 2018

Uber's S-1 claims that it achieved a $5 billion profit improvement in 2018, moving from a $4.03 billion loss in 2017 to a $997 profit in 2018. Uber's efforts to manufacture artificial accounting profits that gullible outsiders might not immediately see through first surfaced with the release of its first quarter 2018 results, when a claimed $3003m gain from the sale of its failed Southeast Asia operations to Grab converted a huge loss into a small profit. A fair number of the reporters actively following Uber saw through the original first quarter ambit [2] and the vast majority of reporters following the S-1 ignored the reported $5 billion improvement.

Many current reports have still misreported the 2018 profitability of Uber's ongoing operations in ways that incorrectly showed meaningful year-over-year profit improvement [3] because Uber was deliberately making it difficult for outsiders to understand those numbers. But most realized that any reported profitability numbers needed to exclude items such as the Grab gain.

All previously released Uber P&L data were based on actual worldwide operations.[4] Uber decided to recast all of its S-1 financial reporting to segregate results from countries (China, Russia, Southeast Asia) where it failed dismally and sold its remaining operations to the dominant local company. This would be reasonable if done transparently and consistently, as it might help potential IPO investors better understand the past performance and future profit potential of the parts of the business that haven't failed.

If Uber's intention were to help these investors, the S-1 would have included clear warnings that the 2018 "improvements" were the result of the decisions to abandon these failed markets. Uber didn't do that, because they are trying to give outsiders the impression that profitability is on a strong upward trajectory.

Uber overstated its 2018 profit improvement of its ongoing operations by $5 billion; ongoing operations lost the same $3.5 billion that they had in 2017.

Uber's S-1 P&L says that "Net Income From Continuing Operations" improved by roughly $5 billion, from a $4 billion loss in 2017 to a $987 profit in 2018. This is not true; the actual net income from continuing operations in 2018 was negative $3.5 billion, virtually the same as 2017's result. Uber mischaracterized $5 billion in gains from discontinued operations as gains from continuing operations in order to mislead IPO investors into thinking that the performance of its ongoing business was rapidly improving.

When Uber abandoned its failed Chinese, Russian and Southeast Asian operations, the dominant local companies gave Uber equity and debt instruments to partially compensate it for providing them an easier path to market dominance. These non-tradeable instruments only exist because of Uber's decision to discontinue operations, but Uber includes their $5 billion value in "Net Income From Continuing Operations"

The current accounting value of these assets is based entirely on Uber's judgement as to what paper issued by companies currently losing massive amounts of money might be worth someday. [5] ***If one takes Uber's judgements at face value, one could conclude that Uber's only profitable activity is getting paid off for discontinuing staggering unprofitable markets.***

In addition to misleading investors about the proper distinction between the results of discontinued and ongoing operations, Uber inappropriately combines the hypothetical future value of non-tradable paper on the "Other Income" line with items that legitimately reflect current year business activity such as interest income and foreign exchange impacts. Uber undoubtedly needed to assign and record a value for these assets somewhere on its financial statements. The problem is Uber's failure to sufficiently highlight the problematic nature of the assigned values and to ensure investors clearly understood that they had nothing to do with the performance of its current marketplace activities.

The table below summarizes the differences between the 2018 Net Income for discontinued and ongoing operations shown on Uber's S-1 P&L statement (roughly zero and positive $987 million) and the actual numbers based on other data reported in the S-1. The $5 billion year-over-year profit improvement misstatement results from understating 2017 ongoing profitability by roughly $500 million (because losses from discontinued Russian/Southeast Asian operations had been included with other ongoing operating results) and overstating 2018 by $4.5 billion. Uber's desire to mislead

investors about the actual split (and its failure to improve the profitability of its ongoing operations in 2018) is further illustrated by the fact the numbers for discontinued operations were spread across six different subtables and footnotes. [6]

	2017	2018	y-o-y
Net Loss From Discontinued Operations(S-1)	0	10	
Net Operating Loss-Discontinued(notes 13,15)	(536)	(131)	
Other income, tax provisions(p.19,119)		(582)	
Gain--non operating CN (notes 3,9)		1,996	
Gain--non operating RU/SEA (note 3)		3,214	
subtotal--discontinued $ shown as ongoing	(536)	4,497	5,033
Net Income From Continuing Operations (S-1)	(4,033)	987	5,020
Corrected Net Income From Ongoing Operations	(3,497)	(3,510)	(13)

Uber's S-1 provides no evidence that its international operations are anything other than financially disastrous

One of the major risk factors identified in the S-1 is that "Our business is substantially dependent on operations outside the United States, including those in markets in which we have limited experience" with 74% of total trip volume currently coming from outside North America. Footnote 2 notes that only 54% of Uber's revenue comes from outside North America, suggesting that foreign market and competitive conditions substantially reduce average revenue per trip.

Uber's S-1 claims operating losses of over $3.5 billion from two and a half years of operations in China and two and a half years of operations in Russia and Southeast Asia. Unbelievably, the S-1 claims the discontinued operations incurred significant expense but had almost no revenue. Footnote 15 explicitly says Uber's had over $1.5 billion in operating expenses in China in 2016 but only $1 million (with an m) in operating revenue. 2016-18 operating results from Russia and Southeast Asia shown in Footnote 18 are similarly anomalous. Uber's accountants apparently saw no need to explain why Uber was conducting a large scale business that had no revenue, but the reported data contributes to the appearance of large subsequent profit improvements.

CN discontinued (note 15)	total	2015	2016	2017	2018
Operating Revenue		15	1		
Operating Expense		1,085	1,514		
Net Operating Loss		(1,070)	(1,513)		
RU/SE Asia discontinued (note 13)					
Operating Revenue			(49)	(55)	(4)
Operating Expense			229	481	127
Net Operating Loss			(278)	(536)	(131)
Combined operating impact	($3,528)	(1,070)	(1,791)	(536)	(131)

The combination of these data points should serve as flashing neon warning lights to investors trying to understand Uber's future growth and profit potential.

But Uber doesn't present any evidence in the S-1 that would mitigate concerns about the international operations it hasn't yet abandoned. These three markets might have been Uber's worst, or they might be the only markets where a larger operator was willing to offer Uber a deal including non-tradable paper allowing face-saving claims of hypothetical future gains if they abandoned the market.

Unsubstantiated press reports suggest certain markets (such as India) are especially problematic, and that meaningful competition precludes the possibility of profitability anywhere. Most foreign markets enforce regulatory and safety requirements that Uber freely flouted or nullified in the US.

A further hint that a lot of Uber markets may have especially weak financials is the disclosure that 24% of all Uber trips occur in just five especially dense and wealthy cities (Los Angeles, New York San Francisco, London, Sao Paulo). There is no way to access whether certain type of markets offer Uber the path to profitability that it has clearly been unable to find broadly. Uber's failure to provide any objective data about profitability by market suggests that it may not have any data that could address these concerns.

Uber's S-1 does not provide any information that would help investors understand driver economics, or the relative profit performance of Uber's different ongoing businesses.

All of the Uber economic and financial analysis presented in this series since 2016 has been based on published taxi industry data and the limited Uber P&L data released to the press. Usually the publication of a 300 page IPO prospectus would give outsiders a trove of new data permitting much more detailed and sophisticated analysis of the company's economics.

That is not the case here. Uber's S-1 data does not allow outsiders to evaluate the current profitability or the profit trends of any of Uber's lines of business (car service, food delivery, scooters, etc.). It does not allow outsiders to evaluate whether observed revenue changes are due to pricing or demand or competitive changes, or to understand whether pricing or other marketing changes increased or decreased operating losses. As already noted, outsiders have no way of knowing whether there are significant differences in revenue per trip or profitability by country or by markets within countries, and no way of evaluating what factors might drive those differences.

Uber's business model depends on a massive number of allegedly "independent" drivers. Uber's S-1 provides no information (such as base and incentive earnings, turnover, driving patterns, utilization rates, costs of acquiring new drivers) relevant to whether they can continue to provide the capacity that Uber's customers are paying for. Prospectus readers have no idea whether how driver take-home pay compares to minimum wage levels or alternative low wage jobs, or how much driver compensation has declined. Prospectus readers can't tell how Uber changed base and incentive compensation in response to marketplace challenges (such as the terrible publicity Uber received in 2017, or local market share battles) or whether Uber has any potential to reduce the driver share of passenger fares going forward. Prospectus readers have no idea what portion of drivers work very long hours, what portion only work during demand peaks and what portion only work occasionally, and have no idea whether these driver patterns align with demand patterns.

Lyft's IPO prospectus presented ridesharing unit revenue data but Uber did not. Uber only presented the sum of car service and food delivery trips, so prospectus readers couldn't figure out what customers were paying for the two services separately, or how prices for the two services have changed. The combined data suggest that both growth rates and pricing was declining in the second

half of 2018, but prospectus readers have no way to identify the underlying problems, or whether those problem are likely to get worse.

Uber's S-1 provides absolutely no data on operational efficiency. Its claims about synergies and scale/network effects are completely unsubstantiated. It says, "Our strategy is to create the largest network in each market so that we can have the greatest liquidity network effect, which we believe leads to a margin advantage" and that synergies "across our platform offerings …effectively lower our costs and allow us to invest in a scalable way that becomes increasingly efficient as we grow with each new product or offering." But Uber fails to provide any supporting evidence about productivity gains or actual margin improvements.

The S-1 highlights the importance of "technologies" that allow better matching of supply and demand and more optimal pricing. But it makes no effort to demonstrate whether these technologies are any better than tools used by other companies and presents no evidence showing that the alleged better matching of supply and demand actually reduced unit costs or how its sophisticated pricing systems actually increased unit revenues. Although Uber's entire legal defense of its "independent contracting" model is that it is a software company and not a transportation provider, the prospectus does not even pretend that it is a software company.

Uber claims it benefits from significant scale economies saying "we believe that the operator with the larger network will have a higher margin than the operator with the smaller network" but presents no evidence showing that size is the primary driver of profitability. In reality, other factors such as the ability to maximize the revenue utilization of assets and labor against complex demand patterns are far more important drivers of transport profitability. Since Uber is already orders of magnitude larger than any previous urban car service operator, if size was the critical driver one would think these powerful margin effects would have shown up by now.

Uber's claims of powerful network effects are nothing more than the assertion that some drivers can carry both passengers and food deliveries and that "Uber Eats is used by many of the same consumers who use our Ridesharing products." Uber has no evidence that its platform increases the loyalty of either drivers or customers. The most likely explanation for the rapid recent growth of Uber Eats is not that customers are locked in to an app they like, but that customers got the same massive subsidies that drove the early growth of Uber's car service. Airline passengers also buy hotel rooms and rental cars and restaurant meals But airlines understand that the synergies of combining these products within a single smartphone app owned by a single corporate entity are trivial.

Uber has internal data that could address all of these efficiency, pricing and margin questions in great detail. One can reasonably presume that they chose not to include any of it in the IPO prospectus because it would raise serious doubts about the company's future growth and profit potential.

Since the prospectus fails to make a legitimate, compelling case for strong near-term profit improvements, its other shortcomings can be ignored.

Numerous other sections of the prospectus fall somewhere on the scale between "should raise red flags" (Uber has over $1 billion in San Francisco real estate commitments) and "argument too ludicrous to take seriously" (Uber's true growth potential is defined by the worldwide market for urban travel). Again the question is not whether Uber might someday reach breakeven, but whether investors see enough robust long-run revenue, profit and equity growth to justify making Uber the second biggest startup IPO in US history and the second most valuable publicly traded transportation company in the world.

Uber correctly notes that all of its expansion opportunities involve industries with much more challenging economics and much more efficient incumbents than ridesharing. The IPO is clearly dependent on investors who think that years of powerful revenue growth can drive equity values even without profits, and the prospectus strongly emphasizes that Uber has yet to achieve a 1% share of its near-term market potential. But Uber fails to tell investors how much capital will be required to fuel this long-term growth (it already has $7.5 billion in debt), or how long it will take to earn returns on that capital.

Uber notes that it has already invested $475 million in autonomous car development, but doesn't say how much more investment will be required, how its approach offers greater promise than what its competitors are doing, how long it will take before it believes autonomous cars can begin to produce meaningful revenue, and makes no effort to explain why Uber's investments are likely to succeed given the huge technological, legal and competitive obstacles. There are various unsubstantiated claims about "synergies" between scooters and taxis, but absolutely no explanation of the current economics of scooters or how they might someday become a profitable business. The prospectus briefly mentions Uber's investment in flying cars, but seems to be hoping nobody notices.

Growth beyond Uber's core taxi business requires being able to profitably produce services substantially cheaper and more convenient that existing options such as private car ownership and public transit. Since Uber is still billions away from being able to produce profitable taxi service, there is little need to spend time evaluating Uber's long-term growth claims.

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[1] The Uber S-1 can be downloaded at https://www.sec.gov/Archives/edgar/data/1543151/000119312519103850/d647752ds1.htm

[2] Can Uber Ever Deliver Part Fifteen–Uber's Q1 Results – Reporters Show They Aren't Up to Reading Financials (May 24th, 2018)

[3] Most news reports, including the New York Times, Washington Post, CNN and Fox Business have reported a headline $1.8 billion loss. This is a non-GAAP EBITDA contribution measure, not a GAAP profit measure. A couple others reported Uber's $3.0 billion loss from operations, which is also not a true profit measure.

[4] Uber financial results through mid-2017 are documented in Hubert Horan, Will the Growth of Uber Increase Economic Welfare? 44 Transp. L.J., 33-105 (2017). Available for download at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933177. Subsequent P&L data can be found in other parts of this series including Can Uber Ever Deliver? Part Thirteen: Even After 4Q Cost Cuts, Uber Lost $4.5 Billion in 2017 (18 Feb 2018) and Can Uber Ever Deliver? Part Seventeen: Uber's 2018 Results Still Show Huge Losses and Slowing Growth as IPO Approaches (16 Feb 2019)

[5] The S-1 notes that neither the 2016 Didi transaction nor the 2018 Grab transaction have been approved by the local competition authorities. Rulings that these deals unacceptably exploited the elimination of competition would presumably reduce these hypothetical paper values to zero.

[6} There are several discrepancies in the data Uber reports. Footnote 3 says the gain from the Yandex transaction $1234m; footnote 9 which says the value was $954m. The $2328m Grab number in the S-1 is inconsistent with all previous releases of 2018 Uber P&L data which said the Grab value was $3003m. Presumably Uber's accountants could explain these discrepancies, but

they demonstrate that those accountants were going to great lengths to make it difficult for S-1 readers to figure out the actual financial split between discontinued and ongoing operations.

https://www.nakedcapitalism.com/2019/05/hubert-horan-will-the-train-wreck-uber-lyft-ipos-finally-change-the-public-narrative-about-ridesharing.html

Hubert Horan: Can Uber Ever Deliver: Part Twenty: Will the "Train Wreck" Uber/Lyft IPOs Finally Change the Public Narrative About Ridesharing?

Posted on May 30, 2019 by Yves Smith

By Hubert Horan, who has 40 years of experience in the management and regulation of transportation companies (primarily airlines). Horan has no financial links with any urban car service industry competitors, investors or regulators, or any firms that work on behalf of industry participants

Long time readers of the Naked Capitalism series know that much of the evidence and explanation for points mentioned below are found in earlier parts of the series or in my 2017 Transportation Law Journal article, [1] The NC and TLJ material, which now runs to over 100,000 words, provides the detailed documentation of Uber's lack of competitive economics and the origins and early success of its propaganda/narrative based public communication approach.

Readers looking for a more manageable (a mere 9,000 words!) overview of the central issues should see "Uber's Path of Destruction" which I have just published at the American Affairs Journal.[2] That article does not include any material that long-time NC readers won't have already seen, but it should provide a better introduction to Uber for people who have not painfully waded through what I have published over the last four years.

The stock market valued Uber and Lyft at roughly half of what their owners and bankers were expecting

The path to the recent IPOs was triggered by the 2017 rebellion of Uber Board members frustrated by their inability to covert the paper gains on their investments into real money. Uber CEO Travis Kalanick, who knew that Uber was not ready to face full capital market scrutiny, was replaced by Dara Khosrowshahi, who promised an IPO by the end of 2019, and was promised a $100 million bonus if the IPO achieved a valuation of $120 billion.[3]

Khosrowshahi's plans for a 4th Quarter 2019 IPO were upended at the end of last year when Lyft announced that it would go public early in the 1st Quarter. Lyft hoped that going first would give it an advantage over Uber and other expected 2019 IPOs. Uber immediately accelerated its own filing process but would not be able to beat Lyft to the market.

Companies seeking these types of stratospheric IPO valuations need to make powerful cases that their core business is not only capable of producing years of robust profits, but that profitable expansion into a range of other businesses will fuel even greater rates of growth. Lyft laid out its investment case in its IPO S-1 prospectus on March 1st[4] which provided the first public documentation of its huge losses. Lyft's S-1 made no attempt to explain how the ridesharing business could ever be profitable for anyone, much less how it could covert billion-dollar losses into years of sustainable profits in the face of competition from a much larger Uber.

Lyft began trading on March 29th. After claiming that its public placement was hugely oversubscribed, Lyft raised its offering price from $65 to $72 per share (targeting a $25 billion valuation) and generated about $2.3 billion in new investment. By design the price popped another 20% (to $87.24) immediately after trading began. This allowed favored insiders to capture huge artificial profits, and for one minute Lyft was valued at $30 billion, double its last private valuation.

But Lyft's value fell 10% that afternoon, and continued to decline as shorts borrowed a half-billion dollars to bet against the stock. It reached a low of $47 on May 13th, after it reported poor 1st Quarter results, a 45% decline from its first day high, although it has been mostly trading in the mid-$50 range since early April. Mainstream news coverage of the Lyft IPO did not directly address whether it had failed badly versus expectations, but the factual points highlighted (e.g. "Lyft's Stock Drops Below I.P.O. Price in Second Day of Trading", "Lyft falls to fresh low, extending its post-IPO plunge to 35%") left no doubt that it had.

When Uber's released its S-1 on April 9th; the public was already aware of its multi-billion dollar losses, but Uber attempted to obscure the exact magnitude by misrepresenting paper gains from untradeable securities as profits from ongoing car service operations.[5] Its primary pitch to investors was the wholly unsubstantiated assertion that it could become the "Amazon of Transportation" and that it had incredible growth potential because to date it had only penetrated 1% of its total addressable market. As one observer noted, that market definition (transport plus food delivery) included nearly 10% of global GDP.[6]

Given Lyft's terrible performance, Uber abandoned its original $120 billion valuation objective. As it began its roadshow, it announced a $90 billion target ($55 per share) designed to raise over $10 billion in new investment. Despite claims that the offering was oversubscribed three times over, it later cut the offering price down to $45.

When trading began on May 9th, Uber shares not only failed to get the initial price pop its investment banks were supposed to engineer, but they opened at $42, and steadily declined down to a low of $36. ***This meant that over 80% of the $29.5 billion invested in Uber over time was now underwater.*** Uber's 2015 investors had lost 15% over a period when the S&P 500 rose 50%. Given the lower price, Uber raised $2 billion less new capital than expected.

Press coverage of the Uber IPO explicitly acknowledged that it had been a "train wreck." Vanity Fair's headline said "Uber's Colossal IPO Flop May Be the Worst Ever on Wall Street" while Gizmodo had no doubt that it was "The Worst Performing IPO in US Stock Market History."

Uber’s value had fallen roughly 35% from its mid-April target, and 50% from what Uber and their investment bankers said the value was at the beginning of the year.

Since they created roughly $80 billion in corporate value out of thin air, these “train wreck” IPO results were actually an unprecedented achievement

As this series has discussed at length, Uber and Lyft were seeking to create huge corporate value and private wealth out of thin air. Neither company has any hope of achieving sustainable profits in competitive ridesharing markets as neither can produce their service at costs consumers are willing to pay. There is no evidence that they can ever profitably expand to any other markets (food delivery, driverless cars, etc.). Losses and cash drains are far worse than any previous Silicon Valley funded startup, and these companies have none of the economic characteristics that allowed companies like Amazon or Facebook to quickly grow into profitability and drive strong public equity appreciation.

These IPO results were obviously not the best case outcome for prior investors who were seeking roughly $145 billion ($120bn Uber, $25bn Lyft). But relative to Uber and Lyft’s actual (nonexistent) economic fundamentals getting independent investors to buy stock at prices that yield a combined valuation of $80 billion ($65bn Uber, $15bn Lyft) seems to be amazing accomplishment. The qualification is necessary since final judgements about the value created will need to wait until after the SEC mandated six month lockup period for pre-IPO shares expires (end of September for Lyft; early November for Uber).

Another obvious caveat is that this is not a positive accomplishment. From society’s standpoint it represents a massive misallocation of resources that significantly reduces overall economic welfare and raises troubling questions about the workings of capital markets. But it is an important and unprecedented accomplishment.

Uber and Lyft have spent nine years evading and actively subverting competitive market discipline

In a more ideal world the link between corporate value and economic fundamentals is (loosely) enforced by competitive capital and consumer markets. In order to allocate resources efficiently those markets depend on information about efficiency and other economic fundamentals (e.g., prices, financial results, investment requirements, media reports about company strategies and performance) being reasonably accurate.

Building a company with strong fundamentals and strong potential for long-term profitability is extremely hard. Uber is the breakthrough case of a company that skipped the difficult process of finding legitimate efficiency advantages, and used tens of billions in predator investor subsidies to fuel its rapid growth. These subsidies distorted normal price signals which in turn subverted the ability of consumers to allocate resources to the most efficient competitors.

This also subverted capital markets, as these artificial subsidies also exploited the myopic focus of Silicon Valley venture capitalist on top-line growth. While certain types of tech startups had used rapid early growth as a path to profitability, Uber insisted that its subsidy-fueled growth

was actually evidence of powerful Amazon/Facebook-type scale and network economies that it did not actually have.

Remaining private for nine years created further distortions. Uber and Lyft could easily raise money from tech oriented investors obsessed with rapid revenue growth, which allowed them to avoid capital markets discipline based on public information about actual economic performance. And there wasn't any way for the private investors to mark their investments to any actual market valuation.

As one observer noted, Uber and Lyft spent nine years living in "the Enchanted Forest of the Unicorns."[7] In the Enchanted Forest, your corporate value is whatever you say it is, and there are no independent investors who can wager money that you are wrong. In the Enchanted Forest, there are no audited financials that would allow anyone to challenge your narratives claiming your growth was driven by technology-driven efficiencies and powerful network economies.

Alas, Uber and Lyft could not remain in the Enchanted Forest forever, although that was what former Uber CEO Travis Kalanick wanted to do. So The Uber Board sacked Kalanick and hired a new CEO who promised to deliver the Enchanted Forest caliber returns they felt they were entitled to.

In addition to the general desire to cash in their paper gains, the 2017 Uber board rebellion was driven by conflicts between early investors, and post-2015 investors (including Saudi Arabia's Public Investment Fund, Vanguard and T. Rowe Price) who had paid much higher prices for their shares. For all prior investors to at least break even, Uber needed an IPO valuation of roughly $90 billion. The $120 billion target that the Board gave Khosrowshahi was the valuation that would have provide healthy returns for all prior investors.[8] The two investment banks bidding for Uber's IPO work (including Morgan Stanley, which won the work) recognized the Board's expectations and both publically claimed Uber was actually worth $120 billion.[9]

Uber and Lyft's owners seemed to have understood that the IPO was their last best chance to realize large payments for their shares before the markets began to recognize their real value. There is no evidence any prior investors bought shares at the IPO price, so apparently none of them expected strong future equity appreciation above that price. If the owners thought rapid, dramatic near-term profit improvement was likely they would have delayed the IPOs. One can raise a lot more money after demonstrating strong profit improvements than after reporting annual losses of $3 billion (Uber) and $1 billion (Lyft).

Much of the Uber/ridesharing story can be seen as a battle between perceptions based on the artificial, manufactured narratives that the media has embraced, and perceptions based on economic/financial evidence.

The narratives Uber has successfully manufactured are the key to how $80 billion was created out of thin air and key to the subversion of the market discipline that would normally limit these resource misallocations and welfare losses.

Uber is the breakthrough case where the propaganda-type narratives that dominate partisan political coverage successfully developed a multi-billion dollar private company from scratch. Uber not only manufactured powerful narratives, but deftly manipulated the mainstream business and tech industry press into endorsing and promulgating them, and ignoring all of the economic evidence contradicting them.[10]

Few, if any of Uber's narrative claims were objectively true. Hype about powerful, cutting edge technological innovations that could overwhelm incumbents in any market worldwide helped hide the fact that Uber was actually higher cost and less efficient than the operators it had driven out of business. Stories about customers freely choosing its superior products in competitive markets helped hide Uber's use of massive subsidies to subvert market price signals and mislead investors about its growth economics. Misleading accounts about driver pay and working conditions helped hide the fact that most margin improvement was due to driving driver take-home pay down to minimum wage levels.

Uber was never going to dominate driverless cars and displace private car ownership, but these tales created false impressions about robust long-term growth. But all of these claims were uncritically repeated in the mainstream media, and over time they shaped the powerful general perception that Uber was "successful, efficient and highly valuable."

The formula Uber used to build powerful, effective narratives was copied directly from what is widely used in partisan political battles. It combines significant resources (money and communication channels), the emotive, us-versus-them propaganda-style techniques demonstrated to be effective, and (Travis Kalanick's contribution,) the willingness to deploy them in a ruthless, monomaniacal manner. The formula is especially effective when the interests that might disagree or challenge those claims were significantly less organized or funded.[11]

The effectiveness of Uber's storytelling critically depended on having them endorsed and repeated by seemingly independent voices in the elite, mainstream media. Having the technology reporters for multiple national publications tell readers that Uber's growth has been driven by the technology in its great app was far more powerful than a report that passively quotes an Uber executive's assertion that its growth was driven by its cutting edge technology.

This type of narrative promulgation directly exploits the erosion of journalism standards. It is far easier for a reporter to repeat a pre-packaged spiel about heroic disruption than to independently research the competitive economics of the industry being disrupted.

Uber was able to trade favorable stories for access to insiders, and took advantage of reporters who had adopted some of the biases and ideological preferences of the tech industry and the Silicon Valley finance worlds they covered. Most media outlets also proactively conceal that many sources are paid advocates for well financed corporate or political interests, giving their claims much more credibility in the eyes of readers. This allows journalists to present themselves as impartial arbiters of dispassionate experts, rather than note takers for powerful companies who have spent millions to push manufactured narratives.

The mainstream media's IPO coverage illustrates these media biases and the residual power of Uber's "successful, efficient and hugely valuable" narratives

The coverage of these IPOs illustrates many of the journalism problems Uber was able to exploit over the years and the residual power of the narrative-driven perception that Uber is "successful, efficient, and highly valuable."

Prior to the IPO, mainstream stories never challenged conventional wisdom, either through independent analysis of the valuation issues, or by presenting a range of differing views. Even after the IPO results demonstrated that the prior coverage and consensus of experts had been badly wrong, the media simply doubled down, quoting the same experts making the same narrative claims, with no attempt to consider alternate views, or to undertake new analysis of what had changed.

The vast majority of pre-IPO press coverage gave readers the sense that market observers believed that Uber and Lyft were very valuable companies, and that the IPOs would succeed. Dozens of stories in the mainstream press uncritically repeated Uber/Lyft talking points. A few reporters appeared dubious, and filed stories highlighting that neither company was profitable and noting the risk factors mentioned in the S-1s. But neither these (nor any other stories) ever raised the possibility that the IPOs might fall short of expectations. Other stories not only took success as a given, but described the spectacular returns existing investors would make, and how all the newly minted millionaires would affect the San Francisco housing market.

The "companies highly valuable/everyone expecting IPO to succeed" emphasis in the mainstream business and tech industry press was amplified by even more positive stories on cable TV channels and websites dedicated to promoting stock sales, where journalism standards are especially low. These articles highlighted the optimistic views of "analysts" who worked for firms that actively promoted IPOs, without ever presenting any contrary views or disclosing the financial interests of the analysts. CNBC's Jim Cramer told his audience "you want as much Lyft as you can get" and predicted that a post-IPO Lyft surge would bring huge numbers of investors back into the market.[12]

Outside the mainstream one could find numerous articles critical of Uber/Lyft claims and their lack of business fundamentals. These included observers who thought that there was a huge, dangerous "tech bubble", or who thought that years of private control had eliminated most future appreciation potential, or who thought Silicon Valley venture capital had become totally unhinged from reality, or who thought that years of artificially low interest rates had destroyed the market's ability to evaluate business risk, or who had actually discovered how vacuous Uber and Lyft's S-1 claims were. These minority views were available to investors doing very diligent research, but these observers were never quoted in the New York Times or the Wall Street Journal, much less CNN or CNBC.

The press reported the actual IPO results accurately. But it has largely ignored the obvious questions these results would raise with readers, and continued to ignore anything related to underlying economics. Just as pre-IPO coverage had ignored basic valuation questions (what was the basis for investors' expectations of future profits and equity appreciation?), the post-IPO

coverage refused to examine why the expert conventional wisdom the press had described was so badly wrong, and why the gap between the company/banker valuation and the market's valuation had been so large. Instead these media outlets published a slew of new articles relying on the same narrative and the same experts, suggesting they were in a state of denial about the actual results.

One category of article includes little but rah-rah cheerleading ("Uber's Best Days Are Ahead" and "Uber Is In It For the Long Haul, NYSE President Says" (both at Bloomberg)) or unexplained assertions that initial results are just noise, and markets will quickly readjust to the conventional wisdom ("Uber's Terrible First Day Might Not Matter At All" (Vox) "Lyft's IPO Failure Has Been Greatly Exaggerated (Motley Fool) "Sorry Bears, Uber's Bad IPO has Nothing to do With The Company's Future Success" (Market Watch)). Many of these emphasize that Facebook's IPO also stumbled out of the gate, while ignoring the fact that Uber and Lyft have none of characteristics that allowed Facebook's value to quickly recover.

Another category mindlessly repeated prior PR claims without any attempt to explain why the people actually investing in these stocks were too stupid to believe them ("Lyft's IPO: Disruption is Coming and the Investors Are Prepared to Wait" (Forbes) "Why Uber May Still Be Worth $100 Billion Even After Its Embarrassing IPO" (Yahoo Finance) "Uber Eats Could Fuel a Post-IPO Stock Rebound"(Fortune) "Uber Will Become profitable by 2024 Analyst Mogharabi Says" (Bloomberg)). Readers of this series may recall that Mogharabi was the Morningstar analyst who published willfully dishonest Uber valuation claims based entirely on arbitrary multi-billion dollar spreadsheet P&L plugs.[13]

Some tried to assure readers Uber really did have a path to profitability ("Uber Isn't Screwed, There Are Tons of Ways it Could Become a Profitable Monster" (Business Insider), "Uber's Three Paths to Becoming Profitable" (The Information)). but all of the paths involved pie-in-the-sky prospects (sell data or advertising) the author knew nothing about, or ideas (raise prices, cut service, cut driver wages) that would directly reduce growth and customer support, or proposals for an Uber-Lyft merger that are clearly financially (and probably politically) infeasible. Absolutely no one considered the possibility that Uber didn't have a path to profitability.

Numerous articles recognized the gap between expectations and reality but emphasized excuses designed to exonerate management. One ("Uber IPO Stalled Out, Caught in Perfect Storm" (Axios)) focused on unforeseeable bad luck the day of the IPO. The article actually suggested that Donald Trump might have deliberately timed announcements about Chinese tariffs just to hurt the Uber IPO, and that events in Venezuela and North Korea had seriously suppressed demand for ridesharing stocks. Even though none of those events hurt the overall stock market, which was up at the end of the day.

A major story in the New York Times [14] documents the original Khosrowshahi/Morgan Stanley agreement on a $120 billion valuation objective, but then absurdly claims that neither could have foreseen at that time the problems that caused the value to collapse. Softbank and Didi have been aggressively expanding for years, but the article claims that no one could have predicted they might invest in Asian and Latin America markets Uber might have been interested in. The IPO revealed that all of the investment houses interested in ridesharing had already

invested, and none wanted to make new investments at higher prices; the article suggests that neither Uber nor the investment bank responsible for drumming up IPO interest could have possibly been aware that years of private funding rounds might reduce the demand for a public placement. The article includes the China tariff excuse and even cites Uber's huge losses, slowing market growth, and Lyft's ongoing losses as things that no one involved with the IPO could have imagined affecting its ability to achieve a $120 billion valuation.

This IPO coverage also illustrates the widespread media tendency to tell what readers what they ought to think, instead of laying out competing evidence or opinions that might allow readers to reach their own conclusions. Instead of laying out factors that might cause the IPO to do well or do poorly, most reports cherry-picked quotes that consistent with their pre-established conclusions. Reporters who believe they know what the right answer is will tend to only present one side of the story, fail to disclose the financial interests of quoted experts and will present opinions as if they were factual evidence.

In the past, Uber had proactively driven most of its favorable news coverage, but the pro-Uber slant of IPO coverage seems to have been almost entirely an expression of the views of the media outlets themselves. Throughout the IPO process what has surprised me most is that Uber's powerful PR machinery seemed to be missing in action. Given the huge importance of the IPO to Uber's owners, I expected to see a flood of messages targeted at different classes of investors or different parts of the financial press, and a range of articles written by outside experts explaining the company's great outlook and why its stock would be a great investment opportunity. Instead, Uber's public communication seemed to be limited to Khosrowshahi's rare public appearances. Nobody at Uber could apparently come up with any arguments for the stock except becoming the Amazon of Transportation and only reaching 1% of our market potential so far, which appear targeted at the most gullible, unsophisticated people in the market. Public enthusiasm for these IPOs depended almost exclusively on the residual power of narratives developed many years ago.

The media's refusal to ever revise or correct narrative claims makes them impervious to new, contrary evidence

As the IPO coverage illustrates, once the media has embraced a given narrative it will systematically ignore contrary evidence and steadfastly refuse to acknowledge that past reporting may have been incomplete or wrong. After reporting that Uber's growth was driven by its cutting-edge technology, abundant evidence might emerge that Uber's growth was actually driven by massive subsidies, regulatory arbitrage and other factors, and that the cited technology had no material impact on productivity or cost efficiency. But mainstream publications will almost never retract the original claim, or publish a new piece emphasizing the new evidence. Since readers see that the original narrative claims haven't changed they get locked into conventional wisdom and become largely impervious to new evidence.

The mainstream press' report of pre-IPO expectations was not the result of a serious survey of investors who had evaluated company data against valuation criteria. It simply reflected what most of the reporters (and their editors) personally expected. When actual IPO results were totally different from what they had told readers to expect, no stories even acknowledged the

discrepancy. Instead there was an abundance of stories doubling down on the previous claims. The narrative we reported can't be wrong; there must be a problem with reality. Admitting that prior reporting might have been wrong also requires admitting that they might have been played by sources that were being paid to manipulate media coverage.

The willful denial of new evidence is usually driven by the unwillingness to reconsider underlying beliefs or to avoid the implications of larger, more controversial issues. If a tech industry reporter's coverage over the years has been based on the belief that Uber (despite flaws) is a great company that has used technology to hugely improve urban transportation, they may have difficulty recognizing that investors' concerns about billions in cash burn might be a more important issue, or revising long held beliefs based on that evidence. Reporters who concentrate on Silicon Valley or IPO markets may find career options limited if their reports openly suggest that these fields include much that is wasteful and destructive.

It is unclear what might lead the media to abandon its embrace of the "Uber successful, efficient and highly valuable" narrative. $14 billion in losses in the last four years, pathetic S-1 prospectus claims and a "train wreck" IPO do not seem to have had much impact.

The conventional wisdom embodied in media-endorsed narratives can sometimes change quickly, but only if the change doesn't threaten those deeper, underlying beliefs. Susan Fowler's blog describing systemic sexual harassment at Uber triggered some of the most negative press coverage any company has ever experienced, and reversed the media narrative about Travis Kalanick overnight. But the media narrative that Uber was a successful, efficient and highly valuable company remained sacrosanct. None of the reporters suddenly focused on lawbreaking and misogyny at Uber were willing to even consider the possibility that Kalanick's culture was an integral part of Uber's horribly money losing, monomaniacal grow-at-all-costs business model. And there are abundant examples of media refusals to abandon narratives in the political world in the face of far more overwhelming new evidence (e.g. weapons of mass destruction).

The path forward may depend more on media narratives than marketplace changes

From a financial valuation standpoint, the question going forward is very simple: either Uber and Lyft have huge profit improvement and stock appreciation potential or they don't. While there are many things the companies could do to make their P&Ls marginally less worse, I cannot imagine any near-term changes that would increase profitable growth enough to revive the stock price. If you review the hundreds of recent press articles, you will see that no one else has been able to come up with a remotely plausible path to sustainably profitable growth for these companies either.

It is obviously too early to make a definitive judgement as to why the market valued Uber and Lyft the way they did. My working hypothesis is that there was a large number of investors who thought their value was much lower than conventional expectations, and another large number who though ridesharing was a great investment opportunity. I would argue that both groups were strongly influenced by Uber's difficult-to-dislodge "successful, efficient and hugely valuable" narrative. The highly optimistic view is likely to erode as ongoing quarterly losses dash any hopes of a rapid stock price rebound. My guess is that negative investor opinion is primarily

driven by a growing sense that the Silicon Valley venture capital tendency to focus myopically on growth while ignoring profitability is a major, exploitable market imperfection, and that the private companies who have been living in the Enchanted Forest of The Unicorns have lost the ability to understand how public markets might value companies. But this doesn't seem to be based on analysis showing Uber and Lyft have no hope of sustainable future profits. It seems to reflect a sense that they are "successful, efficient and hugely valuable" but to the tune of perhaps $40-60 billion, not $80-100 billion value.

As peculiar as it seems, these companies—with a current combined value of $80 billion, who just raised $10 billion in fresh capital—might soon become zombie companies. Both have plenty of cash on hand, but neither has any path to sustainable profitability in their current form. Both are also caught between a valuation rock and hard place. Things they might do to boost the P&L (raise prices, eliminate weak markets, kill driverless car investments) would destroy any notion that they were "growth companies." If Uber actually made the investments needed to move towards becoming "the Amazon of Transportation", their profit and cash flow problems would get dramatically worse. Both management teams are undoubtedly highly focused on the need to everything possible to keep the stock prices from collapsing further, but it is hard to imagine what major steps could be taken in the near-term that would reverse the growing IPO was a "train wreck" perception. If Dara Khosrowshahi was unable to make substantive improvements in Uber profitability in the 18 months prior to the IPO, he is unlikely to be able to do much during the balance of this year.

Decline seems inevitable. What remains to be seen is whether it comes quickly or slowly, or whether it comes gradually or suddenly. The media is likely to cling tenaciously to successful/valuable narratives, which may help prop up the stock for a while. The chance that we will suddenly see a spate of mainstream stories suggesting there might have been some serious flaws in all the pro-Uber reports over the last nine years are between zero and nil. At the moment, economic/financial evidence is still badly losing the battle against artificially manufactured narratives.

The media's hand may be eventually forced by external factors that could place considerable downward pressure on these stock prices. There will be huge selling pressure after the six month lock-up periods end, given the unusually high percentage of pre-IPO shares, and investors and employees wanting to liquidate gains before prices fall further.

Another risk is the possible reemergence of the 2017 Uber Board civil war. Khosrowshahi's hiring in September 2017 quelled the previous Board rebellion because he promised Enchanted Forest caliber returns to both the 80% of shareholders who are now totally underwater and the 20% who invested prior to 2015 that are merely unhappy. He obviously failed to do this and there's little evidence that he took any of the major actions a stronger IPO would have required, such as developing compelling IPO sales pitches or strong 2018 P&L improvements that could be highlighted in the S-1 prospectus. One could argue that King Solomon would not have been able to accomplish those things either, but King Solomon would not have accepted a $45 million annual salary, plus huge payments for foregone Expedia bonuses plus the potential for bonuses up to $100 million unless he was willing to take bold action to produce the IPO results the Board was explicitly paying him to deliver.

Another external risk being closely monitored by investors is the potential for Jim Cramer's worst fear, that the larger "tech IPO bubble" bursts. The last major IPO (Snap) had done poorly, and Silicon Valley investors hoped that strong Lyft/Uber IPOs would boost demand for the many other planned 2019 IPOs, including Slack, Airbnb, Palantir, Postmates, Grab and WeWork. All follow some aspects of the Uber/Lyft model where money-losing companies that had been privately funded for many years finally go public. If Wall Street systematically rejects the idea that companies burning huge quantities of cash all have the potential to become the next Amazon or Facebook, and larger world of Silicon Valley IPOs collapses, Uber and Lyft will be quickly buried under the rubble. As with the future of ridesharing, that outcome will depend on the ongoing battle between economic/financial evidence and artificially manufactured narratives.

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[1] *Will the Growth of Uber Increase Economic Welfare? 44 Transp. L.J., 33-105 (2017)* available for download at SSRN*:* *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933177*

[2]Hubert Horan, "Uber's Path of Destruction" *American Affairs*, vol 3, no 2, Summer 2019, pp.108-133. https://americanaffairsjournal.org/2019/05/ubers-path-of-destruction/

[3] See Can Uber Ever Deliver? Part Seventeen: Uber's 2018 Results Still Show Huge Losses and Slowing Growth as IPO Approaches (February 16, 2019)

[4] Lyft's S-1 claims were discussed in detail in Can Uber Ever Deliver? Part Eighteen: Lyft's IPO Prospectus Tells Investors That It Has No Idea How Ridesharing Could Ever Be Profitable (March 5, 2019)

[5] Uber's S-1 claims were evaluated in Can Uber Ever Deliver? Part Nineteen: Uber's IPO Prospectus Overstates its 2018 Profit Improvement by $5 Billion (April 19, 2019)

[6] Len Sherman, "Uber Should Be Judged On Its Own Merits, Not Amazon's", *Forbes*, May 5, 2019. Uber's S-1 made no attempt to explain why it was losing billions on the tiny share of this market it was currently serving, much less explain how it could ever serve an increased share of this market profitably.

[7] Matt Levine, "The Three-Way Banana Split Was Bad" Bloomberg, May 16, 2019

[8] Most media coverage at the time ignored Board members interest in financial returns and incorrectly portrayed the rebellion as a response to the negative publicity from sexual harassment and other "cultural" issues. See Can Uber Ever Deliver? Part Ten: The Uber Death Watch Begins (June 15, 2017)

[9] Aggressively optimistic views of Uber's potential value did not originate with Dara Khosrowshahi or Morgan Stanley. During the IPO Susan Fowler (whose 2017 blog post brought Uber's systemic sexual harassment problem to national attention) quoted a Uber executive who told her " If we do not make it to a $200B valuation, I think most at Uber would feel as though

we failed." Sarah Lacy, "Who is really responsible for Uber's failed IPO? Uber". *Pando*, May 14th 2019

[10] While the discussion of the recent IPOs includes Lyft, the "narratives" about ridesharing were almost exclusively developed and promulgated by Uber, not Lyft. These Uber-created narratives probably had more to do with demand for Lyft shares than anything Lyft did.

[11] Detailed discussions of how Uber's narratives have always been directly based on propaganda techniques, the strategic importance of Uber's PR/propaganda programs, and Uber's success in getting its narratives uncritically endorsed in the mainstream media. can be found in Part IV the TLJ article and in Can Uber Ever Deliver? Part Nine: The 1990s Koch Funded Propaganda Program That is Uber's True Origin Story (March 15, 2017)

[12] 'You Want to Get as Much Lyft as You Can,' When It IPOs, Says Jim Cramer" The Street, March 4th, 2019; "Cramer: Lyft IPO likely to surge, drawing investors back to whole stock market", cnbc.com, March 28, 2019

[13] Can Uber Ever Deliver? Part Sixteen: Is Morningstar's Horrendously Bad Uber Analysis a Preview of Uber's IPO Prospectus? (13 August 2018). The comment earlier that press coverage had failed to ask basis valuation questions would be more accurately stated as the press only posed valuation questions to analysts willing to fabricate data about multi-billion dollar profit improvements.

[14] Mike Isaac, Michael J. de la Merced and Andrew Ross Sorkin, "How the Promise of a $120 Billion Uber I.P.O. Evaporated" *New York Times,*May 15, 2019

https://www.nakedcapitalism.com/2019/09/hubert-horan-can-uber-ever-deliver-part-twenty-one-mike-isaacs-book-ignores-economics-and-financial-results-and-gets-the-uber-story-almost-entirely-wrong.html

Hubert Horan: Can Uber Ever Deliver? Part Twenty-One: Mike Isaac's Book Ignores Economics and Financial Results and Gets the Uber Story Almost Entirely Wrong

Posted on September 16, 2019 by Yves Smith

By Hubert Horan, who has 40 years of experience in the management and regulation of transportation companies (primarily airlines). Horan has no financial links with any urban

car service industry competitors, investors or regulators, or any firms that work on behalf of industry participants

One of the recurring themes of this series has been the poor quality of Uber coverage in the mainstream business and tech press.

On September 3rd, Mike Isaac, who has been covering Uber for the New York Times since 2014, published *Super Pumped! The Battle For Uber*.[1]

Isaac's central argument is that Uber is a fundamentally successful company that was nearly undone by '[CEO Travis] Kalanick's boundary-pushing behavior, unabashed pugnacity, and eventually, the CEO's own personal decline." (p. xviii). "Uber was the unicorn to end all unicorns" (p. 6), with the potential to "drag the entire transportation industry out of the analog world and into the digital one" (p. 64). Uber represented the "best and worst of Silicon Valley" (p.xviii). It was "a company worth tens of billions of dollars that succeeded in changing the way we move through the world, yet nearly destroyed itself in a bonfire of bad behavior, ugly decisions, and greed" (p. xx) and provides a cautionary tale "about how blind worship of startup founders can go wildly wrong" and threaten the survival of "a multi-billion dollar empire." (p. xix). The misogyny and rest of the bonfire of bad behavior directly reflected Kalanick's personality, and became rampant because Kalanick prevented the Board from exercising normal discipline and control.

Isaac argues that Uber was brought back from the depths of its 2017 crises when key Board members realized "Uber didn't have an image problem, it had a *Travis* problem" (p.235) and began to assert their role as the adults in the room, initiating the "Battle for Uber". When an outside investigation led by former Attorney General Eric Holder produced damming findings, the Board forced Kalanick's resignation as CEO. Since his hiring, new CEO Dara Khosrowshahi has worked to "systematically undo nearly everything his predecessor had stood for." (p. 331)

Every component of Isaac's argument is wrong.

Uber is not a successful company. It has lost over $20 billion and does not have a plausible path to profitability. It took billions in unsustainable predatory subsidies and narratives manufactured by Uber's massive PR spending to create the appearance that it had disrupted the taxi industry. Uber actually has higher costs than the incumbents they disrupted and is incapable of producing taxi service at a cost the market would be willing to pay for. It is not the unicorn to end all unicorns. It has never had any sustainable competitive advantages and its valuation has never had any relationship to economic reality.

The misogyny and rest of the bonfire of bad behavior was the direct, inevitable result of a "growth-at-all-costs" strategy that combined the massive spending on subsidies and PR narratives with a ruthless, monomaniacal culture designed to convince the world that Uber's industry domination was inevitable and any resistance was futile. The strategy also drove the rapid revenue and valuation growth Uber's investors wanted.

Uber's 2017 crisis was not triggered by the Board's sudden desire to reign in governance problems. Instead, it was a rebellion against Kalanick's refusal to rapidly move toward an IPO that would allow investors to realize cash gains on their investments. Kalanick's resignation was not triggered by the Board's sudden awareness of bad management behavior, or by unexpected disclosures in the Holder report, that bad behavior had been going on for years with the full knowledge of the Board. In the two years he has been CEO Khosrowshahi has not made a single significant change to Uber business model or growth strategy that had been in place under Kalanick.

Isaac's approach to the Uber Story is fatally flawed

Before addressing the many problems with *Super Pumped!* It is important to emphasize that the facts presented in the book (records of events, quotes) are entirely accurate. There is nothing in the book that even remotely suggests active bias or that Isaac had any kind of agenda.

Super Pumped! obviously includes a lot of material from his published New York Times stories, which have been regularly cited in this series. Isaac broke the "Greyball" story (the software Uber developed to obstruct local law enforcement efforts against it) and major stories about the Board rebellion against Kalanick. This book includes the previously unpublished story about how Uber used the entire proceeds from a "Safe Rides Fee" to improve its bottom line, rather than to finance the consumer safety protections as it had promised.

The book is highly readable, but the audience won't get an accurate understanding of Uber. It is understandable that Isaac's day-to-day reporting on Uber would focus narrowly on things like events and quotes. A full length book gave Isaac the opportunity to dig deeper into the story and to analyze broader issues that would have been difficult to address while working against deadlines, but he didn't. The book illustrates how one can string together factual points that clearly meet the Times' day-to-day reporting standards and still get the bigger-picture "story" badly wrong. [2]

Isaac's approach to Uber's history suffers from three fatal flaws.

<u>Isaac thinks the Uber story can be told without any reference to economic or financial data</u>. Normally one evaluates company performance in terms of things like profitability and investor returns. Isaac doesn't present any of the P&L results showing growing massive losses over ten years. Nor does he present any data on investment funding, cash flow, efficiency, productivity, pricing, cost competitiveness, or anything else. There are a couple passing mentions of Uber's valuation, but no explanation of where it came from, or what caused changes. Readers thus have no idea what Uber's current business situation or future outlook is, and have no way to understand Kalanick's impact of the company's performance.

<u>Isaac thinks Uber can be explained solely on the basis of personalities.</u> *Super Pumped!* focuses almost exclusively on the personalities of a handful of key Uber insiders (primarily Kalanick and Board member Bill Gurley of Benchmark Capital) and readers get no information about Uber other than descriptions of what that this particular handful of people say and do. Since Isaac excludes all economic and financial data, readers have no clue what business issues might be

driving those people's behavior and have no way to evaluate whether claims they make might be powerful insights or self-serving nonsense.

Isaac convincingly portrays Kalanick as an arrogant asshole, and many readers may have a negative visceral reaction to this portrayal. But managers with no offsetting abilities do not remain in place long, and readers they have no way to develop a balanced understanding of Kalanick's actual record. By discussing personal styles outside of the business context, Uber comes across as an adult version of a high school student council or college fraternity, where the social dynamics may be colorful but are inconsequential in the grand scheme of things.

This narrow framing means readers never see counter-arguments and cannot understand how Uber behavior compares to comparable companies. If, as Isaac suggests Kalanick's power and lack of accountability caused serious damage at Uber, why didn't similar governance problems cripple Google or Facebook? Wasn't Kalanick's "arrogant asshole" style common across the Silicon Valley? Uber is presented as an engine solely powered by Travis Kalanick's personality and drive, an engine that inexplicably failed in 2017.

Isaac appears totally oblivious to Uber's massive spending on PR narratives. As this series has documented at length, one of Uber's top priorities was always the creation of PR narratives [3] that provided simplistic explanations of Uber's amazing competitive strengths that would make its global domination of the taxi industry inevitable, tried to justify Uber's huge valuation, and diverted attention from Uber's terrible economics. [4] Isaac doesn't seem to understand the size and importance of these efforts, so his readers aren't shown how they established the widespread perception that Uber was a highly innovative, successful company despite billions in ongoing, growing losses.

More problematically, Isaac uncritically repeats many of these manufactured narrative claims which may mislead readers into thinking they are backed by objective evidence. His own efforts to portray Uber as a successful company (aside from misogyny and other bad behavior) suggests that he couldn't see through Uber's spin, and after five years on the Uber beat, never bothered to investigate whether the company's claims were honest. Since he doesn't understand the importance of these narratives, he doesn't understand why the public actions of the Board and both CEOs have always been tightly aligned with them, and given a choice between seemingly irrational marketplace actions and doing things consistent with the narrative, the narrative always won.

Isaac doesn't seem to understand Uber's business model, or its investors' strategy for earning outsized returns

Another major flaw is that Isaac never provides his readers with a coherent summary of Uber's business model or strategy, and it is not clear he would have been capable of doing this. Isaac's book purports to tell the story of what Kalanick did as CEO, and the conflict with the Board that led to his dismissal. But this focus ignores the question of what Kalanick and the Board thought management should be doing to eventually produce sustainable profitable growth and returns on the money invested in the company. It also overlooks whether the conflicts might have had

anything to do with performance against those strategic objectives, or changing views about what those objectives and priorities ought to be.

Explaining the business model and strategy would require economic data (where will competitive advantages come from? what will drive growth and productivity improvements?) and industry comparisons (does Uber have lower costs than traditional taxis?). Isaac's story clearly underscores Uber's focus on rapid growth, but every other Silicon Valley funded company had the same priority.

Instead Isaac uncritically repeats bits of Uber's PR narrative—Uber is based on highly innovative technology that is changing the world, and is following a tech industry strategy directly based on Amazon's ("More than any other company, Amazon embodied the company [Kalanick] wanted Uber to become" p.11). Again, Isaac doesn't understand that much of the PR narrative was in fact PR—designed to distract attention from Uber's terrible economics, and nothing that an outsider should take at face value.

While it will never be realized, Kalanick and Uber's investors were always fully aligned around a highly innovative strategy for achieving outsized returns. Uber never intended to follow the difficult and risky parts of Amazon's strategy, such as developing major new product and efficiency breakthroughs that would give it huge, sustainable advantage over incumbent retailers and constantly plowing its strong positive cash flow into expansion opportunities where there were huge synergies with its core business. Uber's strategy was to skip all of the hard parts of corporate business development and to use billions in predatory subsidies to bulldoze their way to global industry dominance. Which is why Uber required 2300 times more pre-IPO funding than Amazon.

As noted, the monomaniacal "growth-at-all-costs" culture and the PR narratives provided critical support to this subsidy-driven strategy. The first accelerated progress towards the hoped-for industry dominance, and the latter created the false impression that Uber's "success" was based on the triumph of its superior products and efficiency in competitive markets, and the false impression that since Uber had the same economics as tech companies like Amazon and Facebook, it would quickly become robustly profitable and enjoy many years of huge equity appreciation.

Uber's investors did hope to replicate the second part of Amazon's strategy, where its dominance and platform ubiquity would create the anti-competitive market power needed to vastly improve margins in its core business and to profitably expand to many new businesses where it had no natural competitive strengths. This has not happened because Uber has not achieved the level of dominance needed to exercise anti-competitive market power.

The strategic use of enormous predatory subsidies and manufactured PR narratives was totally unprecedented, but it was a coherent, rational strategy. Kalanick and the Board totally understood and agreed on the strategy. Kalanick's ruthless, monomaniacal style was not a problem, but was exactly what the Board was looking for. As noted, the bad behavior that eventually produced systemic sexual harassment had been present at Uber from day 1, was

integral to "growth-at-all-costs" and until Susan Fowler's blog went viral, the Board never had any problem with it.

Isaac ignores every significant Uber question his readers might have

Why has Uber lost over $20 billion? Isaac completely ignores this question and there is nothing in the book that helps readers answer it. The book ignores the fact that Uber actually is higher cost and less efficient than the operators it has driven out of business, ignores that Uber has none of the growth economics that allowed other Silicon Valley-funded startups to "grow into profitability" and skips over the fact that taxis and other urban transport services have always been marginal, and that Uber's business model did not transform industry economics or solve longstanding structural cost and demand problems.

Did Uber ever build a sustainable core business? Obviously not, given its inability after ten years to generate positive cash flow, its lack of cost competitiveness and the absence of any other powerful, sustainable competitive advantages. Instead of providing readers with a clear answer to this question, Isaac simply cites vague narrative claims ("harnessing the power of the internet"). He mentions "innovations" but never mentions any evidence showing they had a significant impact on cost efficiency or productivity. If Uber's smartphone app was so powerful why hasn't any other company in any other industry been able to overwhelm competition and produce tens of billions in corporate value from a smartphone app?

Does Uber have any path to profitability? None is apparent, and nobody inside or outside of Uber has been able to articulate a half-way plausible theory of how Uber could achieve sustainable profitability. Isaac completely ignores this question and there is nothing in the book that helps readers answer it. Price increases cannot cover more than a trivial portion of the current profit gap. The market is simply unwilling to support prices that would cover Uber's actual costs. Price increases and service cutbacks would also throttle Uber's already rapidly declining growth rates, which would help kill any remaining perceptions that Uber is a high-growth company.

Uber's only major source of margin improvement has come from cutting driver compensation, to (and below) minimum wage levels, so there is no potential for further driver cuts. All of the new businesses Uber has expanded into (food delivery, scooters) appear to have even worse profit margins than car service, and their sole purpose appears to be to boost revenue growth rates, and mislead naïve investors that Uber has Amazon-like potential for profitable long-term growth and can become the "Amazon of Transportation." Normally startups do not undertake major expansion without a core business producing strong positive cash flow, and major synergies between the businesses; Uber has neither. Cutting back those businesses, or spending on speculative future businesses (self-driving and flying cars, trucking) would not get Uber anywhere near breakeven, but would also help kill the "high-growth" narrative that Uber believes is critical to its equity value.

What actually drove Uber's meteoric growth? Isaac suggests this is totally explained by Kalanick's personality and his monomaniacal focus on "growth at all costs." But since he did not understand the investors' strategy, Isaac never mentions the tens of billions in predatory

investor subsidies that allowed Uber to provide much more service at much lower prices than could be economically justified. [5] Traditional taxis could not compete with Silicon Valley billionaires willing to funds years of multi-billion dollar losses.

Did Uber benefit drivers? Isaac tells readers that "Everyone in the company knew…driving for Uber was miserable" (p.190) but since he hasn't looked at financial data can't tell them why, and can't explain the responses of Uber management. Since Uber entered the market driver take home pay has fallen over 40%, and in many cities is now below minimum wage levels. To recruit drivers, Uber willfully lied about pay, and can terminate drivers (who are locked into expensive vehicle obligations) or change their compensation at will. Almost all of Uber's margin improvements in recent years came from these unilateral driver pay cuts. Instead of telling readers about driver pay and conditions, Isaac describes Uber executives who think morale problems can be solved with better communication programs. When Kalanick undermines these programs with further pay cuts, Isaac attributes this to Kalanick's nasty personality, ignoring the P&L problem he is actually struggling with.

Did Uber create sustainable benefits for cities and taxi users? Isaac completely bypasses these issues and there is nothing in the book that helps readers answer them. The simple answer is obviously not, since Uber has not and cannot provide its existing service on a sustainably profitable basis. The more complete answer is also no, since there is no evidence that a quasi-monopoly Uber, controlled by Silicon Valley investors totally free of any legal or regulatory oversight would produce more car service at lower prices than the (admittedly not very good) taxi companies they had driven out of business. Cities could not possibly come out ahead unless Uber could sustainably produce service at much lower cost, and had huge incentive to pass on many of those savings to consumers. Isaac fails to consider this question, and instead repeats a series of egregious falsehoods from Uber's narrative about all traditional taxi service problems being caused by corrupt regulators desperate to block innovation and job creation in order to protect The Evil Taxi Medallion Cartel. [6]

Was Uber's lawbreaking justified? Isaac documents a lot of this lawbreaking, including the willful refusal to obey laws governing entry, pricing, licensing, insurance and safety, deliberate obstruction of local police enforcement of these laws, competitor sabotage and so forth. But Isaac never answers this question which would require economic evidence showing that the laws materially reduced industry efficiency and that the lawbreaking produced sustainable consumer benefits. Instead of telling readers that none of this evidence exists, Isaac confuses them by quoting vague and totally unsubstantiated claims from Uber's PR narrative. Uber's "principled confrontation" with legal authority was fine because "it came from a place of principle" (p.13) Similarly, Isaac tells readers that Uber's refusal to obey laws requiring driver background checks was a matter of "principle." But those "principles" were nothing more than the ideological assertion that the since all local governments are inherently corrupt, companies owned by Silicon Valley billionaires should not have to obey any laws they don't like. Isaac reports Uber's claim that it was fighting for the principle of "a pure free market, untouched by the corrupt hand of big government and Big Taxi" (p.114) but doesn't point out Uber's complete disregard of this principle, spending massive sums to lobby those corrupt governments to artificially rig those markets in its favor, ensuring it was freed from rules that Yellow Cab would still be required to obey.

Was Uber's misogynist "bro" culture an incidental, fixable problem? Isaac is clearly disgusted by sexual harassment and misogynistic behavior. But he can't properly explain the importance of these issues because he hasn't tried to understand Uber's core business model issues. He recognizes that Kalanick established a monomaniacal "growth at all costs" culture, but doesn't recognize the problems this creates in a company that doesn't have competitive economics. Managers who can produce "growth at all costs" in this environment can hit on female staff whenever they want. Sexual harassment at Uber was never the problem of a "few bad apples" and was not going to be solved by increased sensitivity training. It was the absolutely inevitable result of investors demanding "growth at all costs" in a company with totally uncompetitive economics.

Why did Uber fail miserably in China? In the U.S., Uber—a company with limitless cash and the freedom to use it to fund billions in predatory subsidies—easily overwhelmed tiny, fragmented, undercapitalized incumbents. That formula does not work in a market like China, where the competition had even greater funding than Uber, and an even greater determination to achieve market dominance. [7] Isaac blames this debacle on Kalanick's irrational egotistical desire to achieve a China victory that had eluded every other large US company and valorizes Bill Gurley for getting the Board to reverse Kalanick's terrible error.

Since Isaac doesn't understand the importance of Uber's manufactured narratives, he fails to see that they had locked Uber into the failed China expansion. Uber's narratives claimed Uber's growth was due to incredibly powerful technological advantages that could overwhelm incumbents anywhere in the world, and that Uber's huge valuation was justified by the many years of profitable expansion it could pursue.

Expansion to China and other international markets had the Board's full support, and failing to do so would have been an explicit admission that the claims about powerful competitive advantages and limitless growth opportunities were complete nonsense. Perhaps Kalanick and the Board had blinded themselves to obvious risks after consuming too much of the narrative Kool-Aid, but given a choice between acting in accordance with the narrative or setting cash on fire, Uber management has consistently defended their narrative.

Why is Uber investing in autonomous cars? As with China, Isaac explains this in terms of Kalanick's irrational egotism. Enraged when he discovered in 2014 that Google (an Uber investor) had secretly mounted a major AV investment program, Kalanick began an Uber program to outdo (the incredibly better financed) Google effort. Kalanick also argued that AVs would allow Uber eliminate the cost of drivers.

As with China, this move is better understood in terms of Kalanick understanding the need to defend the narratives supporting its long-term growth and valuation claims at any cost. Uber's valuation would have been seriously threatened if (realistically or unrealistically) the perception that AVs would eventually wipe out human-driven taxi business became widespread. Announcing a Uber AV program also supported the valuation narrative by creating the appearance that Uber was already making investments needed (realistically or unrealistically) to sustain growth over many decades.

Five years later, claims that Level 5 AVs will soon be commercially operated on public roads are no longer taken seriously. It is also clear that if commercial AVs ever became feasible, they would make Uber's economics worse. Commercial AVs would be more expensive than cars with drivers for many years, and would require staggering levels of risky capital investment that Uber currently avoids. Khosrowshahi has continued this seemingly irrational spending on AVs because of the same need to protect narrative claims that Kalanick faced. Even though Uber's losses are much more visible, and the prospects of AVs much more remote, Khosrowshahi knows he needs to have a "long-term growth" narrative to prop up the stock price. .

What caused the 2017 Uber Board rebellion? Isaac describes this as the inevitable reaction to Kalanick's hubris, egotism, arrogance and demand for absolute control finally pushing the Board to a breaking point. Kalanick and the Board had worked together productively for years but Kalanick's personality dramatically changed, and all hell broke loose.

Once again, Isaac disregards simple corporate economics. The investors, had spent years telling everyone that their investment in Uber was one of the most spectacularly profitable moves in Silicon Valley history, but after 8 years had not seen a penny of actual return. The private valuation of Uber had reached $68 billion because of Silicon Valley's myopic focus on rapid revenue growth (while ignoring profitability) and Kalanick's great skill [8] in attracting new investors at continually higher prices. This created irresolvable tension between investors who wanted an IPO as soon as possible and Kalanick, who was smart enough to realize that an IPO would begin to expose Uber's terrible underlying economics.

The run of terrible 2017 publicity that Uber experienced was not the cause of the Board rebellion, but merely the excuse to force the company on a direct path to an IPO. The Board had totally supported Kalanick's "growth at all cost" approach, and prior to 2017 had never uttered a word of complaint about the bad behavior (lawbreaking, competitor sabotage, journalist harassment, etc.) it produced. Khosrowshahi was hired because he promised an IPO, and the Board provided him with massive financial incentives to complete the IPO at the valuation they were seeking within 18 months.

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[1] WW Norton (2019)

[2] It is also important to emphasize that Isaac's book is far superior to many of mainstream media reports this series has taken pains to criticize. The worst Uber reporting fails basic tests of intellectual integrity—pieces purporting to be independent journalism or academic analysis that uncritically present Uber's PR narrative claims written by authors have obvious financial or ideological incentives to present a biased, one-sided pro-Uber position. See, Can Uber Ever Deliver? Part Six: Latest Data Confirms Bleak P&L Performance While Stephen Levitt Makes Indefensible Consumer Welfare Claims, *Naked Capitalism*(2 Jan 2017), Can Uber Ever Deliver? Part Eight: Brad Stone's Uber Book "The Upstarts"– PR/Propaganda Masquerading as Journalism, *Naked Capitalism*(16 Feb 2017) and Can Uber Ever Deliver? Part Fourteen: The New Yorker Lays Out the Template for Pro-Uber Propaganda, *Naked Capitalism*(15 Mar 2017)

[3] Readers who are not familiar with this series' extensive analysis of Uber's PR/propaganda narrative programs should see Section IV of my Transportation Law Journal article; *Will the Growth of Uber Increase Economic Welfare? 44 Transp. L.J., 33-105 (2017)* available for download at SSRN*:* *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933177*or pp.115-117 and pp.122-128 of my more recent "Uber's Path of Destruction" *American Affairs*, vol 3, no 2, Summer 2019, pp.108-133. https://americanaffairsjournal.org/2019/05/ubers-path-of-destruction/

[4] Among the many examples: there are radical differences between the economics of ridesharing and traditional taxis; the awesome power of Uber's technology could overwhelm competitors anywhere in the world; Uber will soon be able to produce "transportation as reliable as running water" and eventually displace car ownership; Uber is not actually a transportation company—it is strictly a software company selling to independent "driver-entrepreneurs"; Uber will have vehicles capable of Level 5 autonomy on the road by 2018; Uber will soon become the "Amazon of Transportation."

[5] Isaac does mention subsidies for incentive programs used to initially attract drivers (a small part of overall subsidies), but failed to explain the connection between reduced driver incentives and much higher driver turnover.

[6] Uber's nonsensical claims about the Evil Taxi Medallion Cartel and their corrupt regulatory defenders are addressed in the Transportation Law Journal article at pp. 61-63 and 71-86.

[7] Isaac correctly notes that the Chinese government would have never allowed a foreign company like Uber to achieve dominance, but this political support was unnecessary given Didi Chuxing's superior funding and clear commitment to market dominance.

[8] Isaac notes Kalanick's money raising skill, (p.188) and also notes growing division on the Board between early investors and what I would call the "dumb money" (post 2015 investments), but still treats IPO issues as much less important than Kalanick personality issues