The " Sharing Economy": Good for Consumers, Bad for Investors

The Thinking Man's Approach

August 2015 | Series #32
Ignacio Pakciarz | CEO
Ilina Dutt | Research Analyst

In this month's Thinking Man, we focus on a new wave of companies that form the "Sharing Economy," and include our view on the main implications for investors. We start by describing what the "Sharing Economy" is, giving specific examples of companies and providing an overview of this diverse space. We go on to analyze the value these companies are providing – which is mainly more efficient and convenient services for consumers. Finally, we take a look valuations in the space, comparing them to more traditional players. We analyze whether these companies are capable of creating long term shareholder value, and conclude that at least at this stage, clients are better off being customers of these companies, rather than investors.

For more on how we are positioning our portfolios, please contact your investment advisor or email:

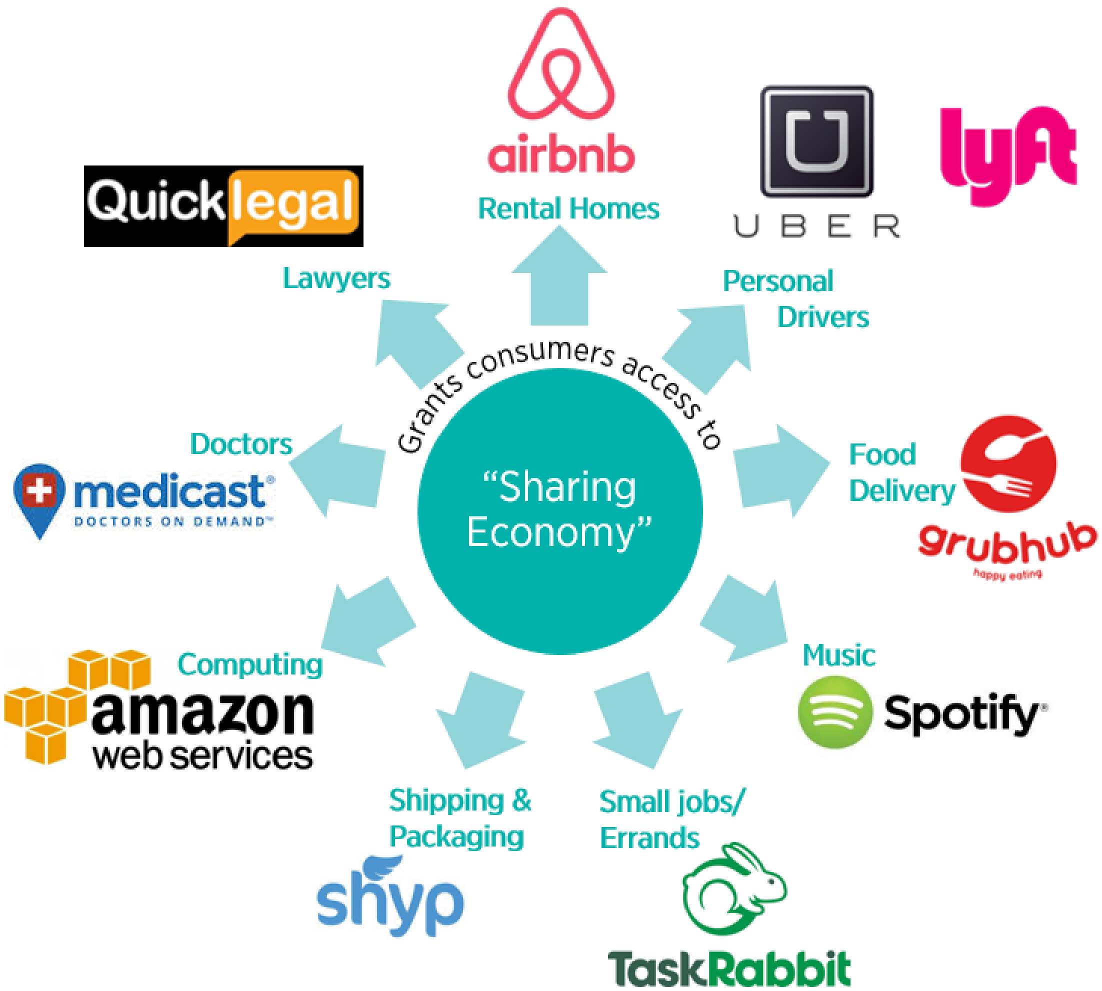
ideas@bigsurpartners.com

Over the past few years, we have seen the launch and rise of several new companies like Uber, Groupon, and AirBnB. These companies may have started in local markets with a mostly Millennial customer base, but they have now evolved into global enterprises used across generations, creating a viable alternative to traditional methods of transportation, lodging, computing, food delivery and even legal services. These companies are all part of a group known as the "Sharing Economy."

There has been quite a bit of buzz in the investment world about these companies, which often boast sky-high valuations. Many of these companies have the backing of important venture capital firms or titans of Silicon Valley. Clients have been asking us whether it makes sense to consider some of these companies as potential investments. It is our belief that while companies in the Sharing Economy have made things much more efficient by using technology, it remains uncertain that they will build a business of lasting value, or have a clear path to shareholder value creation. There are just not enough profits to share in the "Sharing Economy". Most of the benefits are for consumers – which is why we believe clients should be consumers and not investors in these companies.

What is the Sharing Economy?

The Sharing Economy encompasses a new wave of companies that use the Internet to attack inefficiencies in the supply of goods and services. These companies create attractive offerings for customers by making them highly convenient and cost efficient. Perhaps the most well- known is Uber, the on-demand personal car service that is typically cheaper than a taxi. Uber users request the service from an App on their smartphone, which instantly locates and summons the closest Uber driver in the area. Users are notified of their wait time and details on who their driver is - what type of car they drive, their name, and rating. The driver picks up the user from the user's current location, and is obligated to take the user to any location of their choice. Uber is now available in 58 countries, 300 cities worldwide and services more than 8 million users.



The Sharing Economy has taken off in the last few years, thanks to the use of mobile technology and popularity of smartphones (85% of 18-29 year olds and 79% of 30-49 year olds in America own smart phones).[1] Mobile technology allows consumers and producers to be instantly connected at any time and any place, removing barriers to supply and demand and creating more efficient markets.

Take TaskRabbit, a Sharing Economy company, as an example. TaskRabbit's mobile marketplace allows users to outsource small jobs and tasks – from assembling furniture, organizing closets, to doing yard work or waiting in line for concert tickets. TaskRabbit users describe what they would like done, and the price they are willing to pay for it. A network of pre-approved local contractors bid to complete the task at hand. This is a prime example of what many of these Sharing Economy companies do – make the local business marketplace more efficient, providing both customers and providers access to each other.

[1] PewResearchCenter, "U.S. Smartphone Use in 2015," April 1, 2015

Over the last few years, there has been a boom of Sharing Economy companies in all types of different markets, as demonstrated by the above graphic, which highlights some key players across the space.

You can see that these companies are not limited to providing personal goods and services – Amazon's Web Service, for example, allows corporate clients to obtain computer service infrastructure through its cloud computing services. Their customers do not have to own any servers or other large and expensive equipment that was required a few years ago.

Who does the Sharing Economy benefit?

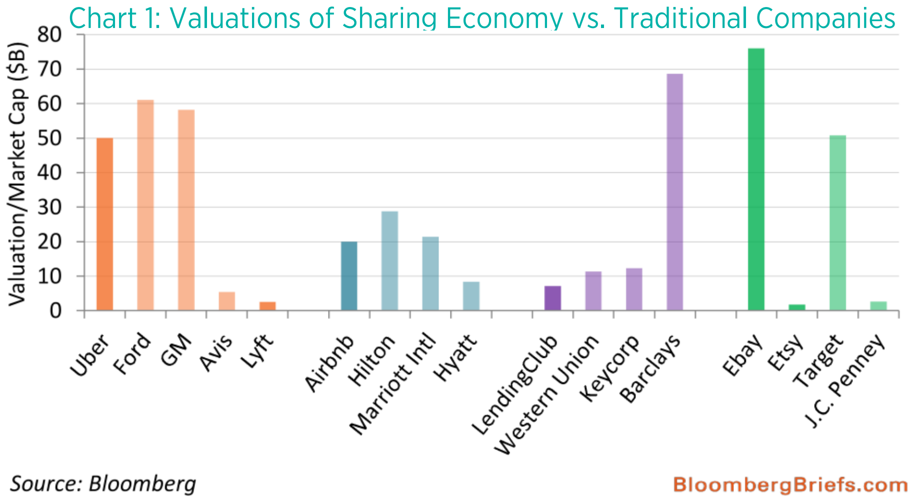
The Sharing Economy has opened up the marketplace for providers of goods and services, allowing many local businesses or individuals - who did not have the correct infrastructure - to compete. Now consumers have more to choose from – and these providers must differentiate themselves by offering more competitive pricing and more added value. When Uber first started in San Francisco in 2011, the minimum ride fee was $15, and prices were slightly higher than local taxis.[1] They quickly noticed that consumers were not willing to pay more and changed the pricing model to be lower than taxis, and also reduced the minimum to $5 – a model they have stuck with. A recent study by Harvard Business School found that he Sharing Economy companies which offer more access and convenience to consumers with lower prices have proved to be the most competitive and made the most gains in terms of market share.[2] The study points out that customers are using these companies not for any community building or social network effect (as some of these companies promote) but for the reason any capitalist consumer purchases a good or a service: because it gives them the most for the price.

What are the Implications for Investors?

Over twenty years ago, there was a company called Webvan, one of the first Sharing Economy companies, whose mission was to deliver fresh produce and high quality fish, meat and other groceries to user's homes. The company raised $800 million through venture capital firms, and in 1999 went public with a strong IPO. In 2001, after their service proved to be too costly, Webvan went bankrupt. This may serve as a cautionary tale for the current wave of Sharing Economy companies. Will we see a similar trend with companies offering services that may be too costly in the long run?

[1] Jenna Wortham, "With a Start-Up Company, a Ride is Just a Tap of an App Away," New York Times, May 3, 2011

[2] Giana M. Eckhardt and Fleura Bardhi, "The Sharing Economy Isn't About Sharing at All," Harvard Business Review, January 28, 2015



Uber, a company founded only 6 years ago (and only operating outside of San Francisco since 2011) is currently valued at $50 billion, similar to the market cap of Kraft Foods or Target. Avis, a global rental company, is worth 10x less than Uber's current valuation – Uber's valuation is more on par to global car manufacturer Ford. AirBnB, the home sharing company (which owns no properties), estimates its current valuation is $20 billion, similar to that of Marriott International, the leading global hotel brand, and double the size of the global brand Hyatt. Chart 1 from Bloomberg on the previous page shows valuations of a few Sharing Economy companies and other players in their market.

Are these valuations justified? Revenues and other key financial data of these companies are kept under close wraps as they are private companies, so it is hard for outsiders to understand exactly the base of these valuations. However, we encourage our investors to look at these companies with caution.

Very few people will argue that Sharing Economy companies have done wonders for consumers- making goods and services more convenience and cost effective. Their technology has make the old "brick and mortar" economy much more efficient. However, it is still unclear whether these companies are going to build lasting value for shareholders. Creating markets that are more efficient does not necessarily translate into creating output – or value.

Some analysts fear that companies will make profits in the short term – picking the "low hanging" fruit or profits that initially result from the market reaching a more natural equilibrium. Companies may use these profits as a base of unrealistic projections of future earning and valuations, which could be unsound as they may be based upon unsustainable initial success which may be difficult to replicate in the longer term.

The ease of setting up Sharing Economy businesses has also meant that there can be more than one Sharing Economy company competing in the same space. Take Lyft, for example, a similar personalized car service to Uber. Lyft is trying to carve out their own market share – and one way is through offering customers lower prices than Uber. In fact, this past week, Lyft has been offering all Miami users a 50% discount for all rides in the Miami area. GrubHub and Seamless Web both compete for local food delivery business and offer competitive weekly promotions to their customers – 10% off certain restaurants if you use one provider, or a free appetizer if you use another. Tiernan Ray, a Tech Analyst at Barron's points out that "there may end up being a lot of companies with their fingers in the same pie of local business."[1]

In conclusion, the Sharing Economy will likely continue to use technology in fascinating ways to make markets more efficient and bring more interesting options to consumers. We think it is much better for clients to thus use these companies as a customer, rather than an investor.

[1] Tiernan Ray, "Not Enough Profits to Share in the Sharing Economy," Barron's, August 3, 2015

Important Disclosures

This material is distributed for informational purposes only. The discussions and opinions in this article are for general information only, and are not intended to provide investment advice. While taken from sources deemed to be accurate, BigSur Wealth Management, LLC ("BigSur" or the "Adviser") makes no representations about the accuracy of the information in the article or its appropriateness for any given situation. Certain information included in this article was based on third-party sources and, although believed to be reliable, it has not been independently verified and its accuracy or completeness cannot be guaranteed. Any statements regarding future events constitute only subjective views or beliefs, are not guarantees or projections of performance, should not be relied on, are subject to change due to a variety of factors, including fluctuating market conditions, and involve inherent risks and uncertainties, both general and specific, many of which cannot be predicted or quantified and are beyond our control. Future results could differ materially and no assurance is given that these statements are now or will prove to be accurate or complete in any way. This article may include forward-looking statements. All statements other than statements of historical fact are forward-looking statements (including words such as "believe," "estimate," "anticipate," "may," "will," "should," and "expect"). Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Various factors could cause actual results or performance to differ materially from those discussed in such forward-looking statements. BigSur shall not be responsible for the consequences of reliance upon any opinion or statements contained herein, and expressly disclaim any liability, including incidental or consequential damages, arising from any errors or omissions.

The companies discussed herein, are for illustrative purposes only and do not represent past or current recommendations by BigSur. This article is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific investor. Views regarding the economy, securities markets or other specialized areas, like all predictors of future events, cannot be guaranteed to be accurate and may result in economic loss to the investor. Any securities or products referenced BigSur believes may present opportunities for appreciation over the subsequent time periods. BigSur closely monitors securities discussed and client portfolios and may make changes when warranted as a result of evolving market conditions. There can be no assurance that the securities and performance included or referenced in the article will remain the same and investment strategies, philosophies and allocation are subject to change without prior notice. Specific securities or companies identified and described may or may not be held in portfolios managed by the Adviser and do not represent all of the securities purchased, sold, or recommended for advisory clients. The reader should not assume that investments in the securities identified and discussed were or will be profitable. BigSur may change its views on these securities at any time. There is no guarantee that, should market conditions repeat, these securities will perform in the same way in the future. Any referenced securities and their respective returns reflect the reinvestment of income and dividends, but do not take into account trading costs, management fees, and any other applicable fees, expenses, and various factors including account restrictions, guidelines, the timing of investments, and cash flows that may affect the investor's actual return and performance. Please refer to Part 2A of BigSur's Form ADV for a complete description of fees and expenses. Hypothetical performance results may have inherent limitations.

The returns and references to the S&P 500 index are provided for informational purposes only. The S&P 500 Index is a market-capitalization weighted index containing the 500 most widely held companies chosen with respect to market size, liquidity, and industry. The index is calculated on a total return basis with dividends reinvested. In addition, the volatility and securities of the index may be materially different from an investor's. The S&P 500 Index was selected and is referenced to allow for comparison of the performance of any referenced securities or overall market to that of a well-known and widely recognized index. Comparisons to indexes in this material have limitations because indexes have volatility and other material characteristics that may differ from the referenced strategy or security. Therefore, actual performance may differ substantially from the performance of any referenced index). Investors should be aware that the referenced benchmark funds may have a different composition, volatility, risk, investment philosophy, holding times, and/or other investment-related factors that may affect the benchmark funds' ultimate performance results. Due to these differences, indexes should not be relied upon as an accurate measure of comparison and are for informational purposes only. Unless noted otherwise, all index returns are denominated in U.S. dollars.

Target exposures included in this article may differ between clients based upon their investment objectives, financial situations and risk tolerances. Investments in general involve numerous risks, including, among others, market risk, default risk and liquidity risk. No security or financial instrument is suitable for all investors. Securities and other financial instruments discussed in this article, are not insured by the Federal Deposit Insurance Corporation ("FDIC"). The income and market values of the securities stated on this article may fluctuate and, in some cases, investors may lose their entire principal investment. Past performance is not indicative of future results.

This information is highly confidential and intended for review by the recipient only. The information should not be disseminated or be made available for public use or to any other source without the express written authorization of BigSur. Such distribution is prohibited in any jurisdiction dissemination may be unlawful. Please contact your investment adviser for advice appropriate to your specific situation.