Is the ‘Code Red’ Recession Indicator Simply a False Alarm?: Term Sheet

By Polina Marinova  September 10, 2019

WHEN WILL THE NEXT RECESSION HIT?
My colleague Lucinda spoke with Campbell Harvey, the academic who discovered the correlation between an inverted yield curve and the subsequent downturn. He stands by its predictive power.

"I have gone on the record to issue a recession code red," said Harvey, a professor of finance at the Fuqua School of Business at Duke University. "Growth will slow according to my model."

From Lucinda’s story:

*Indeed the spread between the 10-year and the 3-month has sustained its inversion almost perfectly for exactly a quarter—minus one singular bright spot in late July when the yields of the two treasuries dallied at around the same levels. One of the initial curves that Harvey examined, the 5-year to the 3-month, has been inverted since February. And in what seems like confirmation of the fact, the 10-year and 2 year, which has also predicted past recessions, also has turned red in August.*

*Harvey notes that indicators such as GDP, unemployment rates, and the stock market are all lagging indicators—they give a snapshot of what is happening over the past quarter or now, for example. Instead, he points to a recent Chief Financial Officer survey conducted by Duke, in which 67% of CFOs said they expect a recession in late 2020. These surveys, says Harvey, can indicate how key decision makers plan to spend their money in the future.*
addition, pulling out will significantly reduce We leadership credibility. After IPO, re-position to higher-margin product mix, increase prices, and beat estimates for 2 quarters and the stock will do just fine. Better to do that now than 2020!

**Rahm:** They are screwed anyway now. The best possible option is go public at $10B, which would dilute the heck out of current investors, use the war chest to navigate through the recession...

**Nadine:** I say go ahead with the IPO. Their best action going forward is to focus on the outcomes they can control. They can't control the economy or VC funding but they can control many aspects of how they run the business. If they focus on running the business, VC funding and the economy are not the decision drivers. Go for the IPO and stay laser focused.

**Owen:** This WeWork IPO and headline valuation is a classic example of the devil being in the details because their anchor investors have prefs. It is misleading to read: ‘SoftBank invested at $47B’ because they have a ratchet that will make them whole even if they manage to pass this camel through the eye of a needle at $20-25B range. This changes incentives and alignment of your investor base.

Ratchets are mentioned in passing here and there, but a detailed analysis of their impact on We common holders would be an interesting idea for an article. If I were a We employee I would be very interested in knowing the valuation in which my options were actually in/out of the money due to impact of VC prefs.

**Minh:** WeWork has to go public. Institutional investors are getting anxious to cash out before a recession hits. WeWork is currently a cash-burning machine burning through billions of dollars, so
I think WeWork will proceed with the IPO at a much-reduced value for the following reasons:

- I don’t think they have any option but to proceed given their ongoing need for capital.

- I don’t think SoftBank can invest further at anything less than a <$20bn valuation as otherwise all of Softbank’s LPs will question Softbank’s sanity so, at that point, it makes sense for SoftBank to let others provide the funding as they nurse their massive paper loss.

- The WeWork business model is not going to change materially so any concerns investors have now are not going to be mitigated by delaying. If anything, the concerns will increase as WeWork add more lease assets / liabilities and may also need to show financial performance during a recession.

- I think there is a chance that WeWork could tweak their share classes to enable it to be included in various indexes to help with demand.

- I expect Adam Neumann to step down as CEO within 12 months of listing too.

Scott: I have been calling the fact that a recession will significantly maim, if not kill, WeWork’s "business."

All of this said, Softbank is on the biggest hook here and can’t afford to put up a zero or not have a positive return on the combo of Uber and We, as they make up more than 10% of the Vision Fund. Forget their threat of pulling back the $6bn credit facility. They can’t afford to take this business public without a strong and sustainable business model and therefore will have to lower their valuation to make this possible.

those businesses to continue as a going concern, so that revenue stream is also seriously at risk.

- They have been significantly increasing their headcount on Q over Q basis since 2017, reducing their operating leverage and increasing their fixed costs, making their model even more vulnerable to a recession.
- They have become "too big to fail" in markets like NYC where they are the largest leaseholder in the city. I smell bailout for the commercial real estate market in the future...

My prediction: they pull the IPO, Softbank funds the credit facility, they go into cost-cutting measures to show progress towards profitability, they reign in their growth spending and they try to weather the expected recession as a private company. They might also go the Uber route and start divesting high-growth but high-investment business units to focus on the core and try to expand their gross margins and find some operating leverage. If they do go forward with the IPO, Masayoshi Son will be signaling to the market that he is intent on losing 98% of his wealth for the second time!

**VENTURE DEALS**

- **QuintoAndar**, a Brazil-based real estate technology developer, raised $250 million in Series D funding at a valuation of more than $1 billion. **SoftBank** led the round, and was joined by investors including **Dragoneer**, **General Atlantic** and **Kaszek**.

- **Nextdoor, Inc**, a San Francisco-based neighborhood social network, raised $170 million in funding. Investors include **Bond**, **Riverwood Capital**, **Benchmark**, **Tiger Global Management** and **Kleiner Perkins**.

- **Volocopter**, a Germany-based air taxi firm, raised 50 million euros ($55 million) in funding. **Geely**
Capital; Schterra, L.L.C.; Altitude Investment Management, JW Asset Management and a multinational beer company from Asia.

- **Vim**, a San Francisco-based healthcare technology company, raised $24 million in Series B funding. **Optum Ventures** and **Premera Blue Cross** co-led the round, and were joined by investors including **Great Point Ventures**, **Sequoia Capital** and **Leverage Health Solutions**.

- **Volta**, a San Francisco-based developer of electric vehicle charging networks, today raised $20 million in follow-on to its Series C funding round, bringing the total Series C round to $100 million.

- **Strong Roots**, an Ireland-based frozen food business, raised $18.3 million in Series A funding. **Goode Partners** led the round.

- **YASA**, a U.K.-based manufacturer of axial-flux electric motors and controllers for hybrid and pure electric vehicles, raised £18 million ($22 million) in funding. Investors include **Parkwalk Advisors**, **Universal Partners Oxford Sciences Innovation**, and **Inovia Capital**.

- **Earnest Research**, a New York-based provider of data analytics products for measuring the consumer economy, raised $15 million in Series B funding. **Pivot Investment Partners** led the round, and was joined by investors including **Greycroft**, **Osage** and **Bonfire Ventures**.

- **Numerated**, a Boston-based bank technology company, raised $15 million in Series B funding. **Patriot Financial Partners** led the round, and was joined by investors including **Venrock**, **FINTOP Capital**, and **Hyperplane**.
joined by investors including AREA Rodriguez, Leroy Hipple, Buphen Capital and DavenTech Capital.

- **ClearAccessIP**, a Palo Alto, Calif.-based developer of IP management solutions, raised $3.7 million in funding. Investors include **Alpana Ventures, Plug and Play Ventures, Founder’s X** and **Bill Tai**.

- **Cyware Labs**, a New York City-based threat intelligence sharing and cyber fusion product-based security company, raised $3 million in seed funding. Investors include **Emerald Development Managers**.

- **RHYTHM AI Ltd**, a U.K.-based company focused on the treatment of Atrial Fibrillation, raised £2.15 million ($2.6 million) in seed funding. **Rinkelberg Capital** led the round.

- **Kenmei Technologies**, a Spain-based specialized company working on mobile network intelligence and automation, raised 1 million euros ($1.1 million) in seed funding. Investors include **GoHub Ventures** and **R2 Seed Investments**.

**HEALTH & LIFE SCIENCES DEALS**

- **Platelet BioGenesis Inc**, a Cambridge, Mass.-based biotechnology company, raised more than $26 million in a Series A funding. **Ziff Capital Partners** and **Qiming Venture Partners USA** co-led the round, and were joined by investors including **Nest.Bio Ventures** and **eCoast Angels**.

**PRIVATE EQUITY DEALS**

IPOs

– iQ Student Accommodation, a London-based student housing firm, is reportedly close to hiring bankers for an IPO. Read more.

– PropertyGuru Group, a Singaporean online realtor backed by TPG Capital and KKR, is planning an Australian IPO that could raise up to A$400 million ($275 million) this year, Reuters reports, citing sources. Read more.

– Home Co., an Australian retail property owner, is seeking to raise $300 million in an initial public offering in Australia. Read more.

– 10x Genomics, a Pleasanton, Calif.-based maker of instruments for analyzing biological information, plans to raise up to $333 million in an initial public offering of 9 million shares priced between $36 to $38 apiece. It posted revenue of $146.3 million and loss of $112.5 million in 2018. Foresite Capital, Venrock, Paladin Capital, and Fidelity back the firm. It plans to list on the Nasdaq as “TXG.” Read more.

– BioNTech, a German-based firm focused on cancer therapies, filed to raise $100 million in an IPO. It posted a revenue of 127.6 million euros ($140.8 million), and posted losses of $47.7 million ($52.6 million) in 2018. The Strüngmann family (50%) backs the firm. It plans to list on the Nasdaq as
Advent International agreed to acquire a majority interest in Bimbo Foods Ltd, an India-based provider of packaged snack foods. Sellers include WestBridge Capital.

- The Riverside Company sold RE Panels S.A, the parent company of EPCO and TECSEDO, to THI Investments. Financial terms weren’t disclosed.

- GED Capital sold Nekicesa, a Spain-based converter of folding cartons supplying the pharmaceutical end-market, to Essentra. Financial terms weren’t disclosed.

- RDX, which is backed by Madison Dearborn Partners LLC, acquired Navisite LLC, an Andover, Mass.-based provider of managed cloud services, from Charter Communications. Financial terms weren’t disclosed.

**FIRMS + FUNDS**

- Lovell Minnick Partners, a Radnor, Penn.-based private equity firm raised $1.28 billion for its fifth fund, Partners V LP.

- Foundation Capital, a Menlo Park, Calif.-based venture capital firm, raised $350 million for its ninth fund.

- Link Ventures, a Cambridge-based venture capital firm, raised more than $100 million for its Link Ventures 2 fund.

- 4BIO Capital, a London-based private equity and venture capital firm, raised more than $50 million
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