New Constructs®

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DANGER ZONE

7/27/22

Competition Will Run This Company Off the Road

Even after falling 70% year-to-date (YTD), the expectations embedded in this rideshare operator's stock price are way too high. Facing bigger competition, mounting losses, and a slow recovery from a pandemic-related decline in demand, we're keeping Lyft (LYFT: $13/share) in the Danger Zone.

Learn more about the best fundamental research

We put Lyft in the Danger Zone in March 2019 and reiterated our opinion on the stock in May 2021. Since its opening IPO price, LYFT is down 85% compared to a 40% gain for the S&P 500. Even after 125% outperformance as a short, owning LYFT is extremely risky given the company's:

- lack of scale in a commoditized industry
- low switching costs for drivers and riders
- free cash flow (FCF) burn
- current valuation implies revenue will grow at a 21% CAGR through 2031 and Lyft will more than double its 2020 global market share by 2031

Market Share Gains Have Stalled

Key to the bull case on Lyft is an alleged ability to take market share. While Lyft has seen the number of riders and drivers on its platform grow, the company remains profitless and a distant second in the U.S. rideshare market. In fact, the company's share of the U.S. rideshare market fell from 29% in April 2019 to 28% in May 2022, while Uber's (UBER) share rose from 69% to 72% over the same time.

Figure 1: Lyft's Share of U.S. Rideshare Market

Sources: Bloomberg Second Measure

The sudden slowdown in demand in the rideshare market during the pandemic significantly impacted Lyft's top line as revenue fell from $3.6 billion in 2019 to $3.5 billion over the trailing-twelve-month (TTM) period. Uber, with its superior scale and more diversified business, fared better.

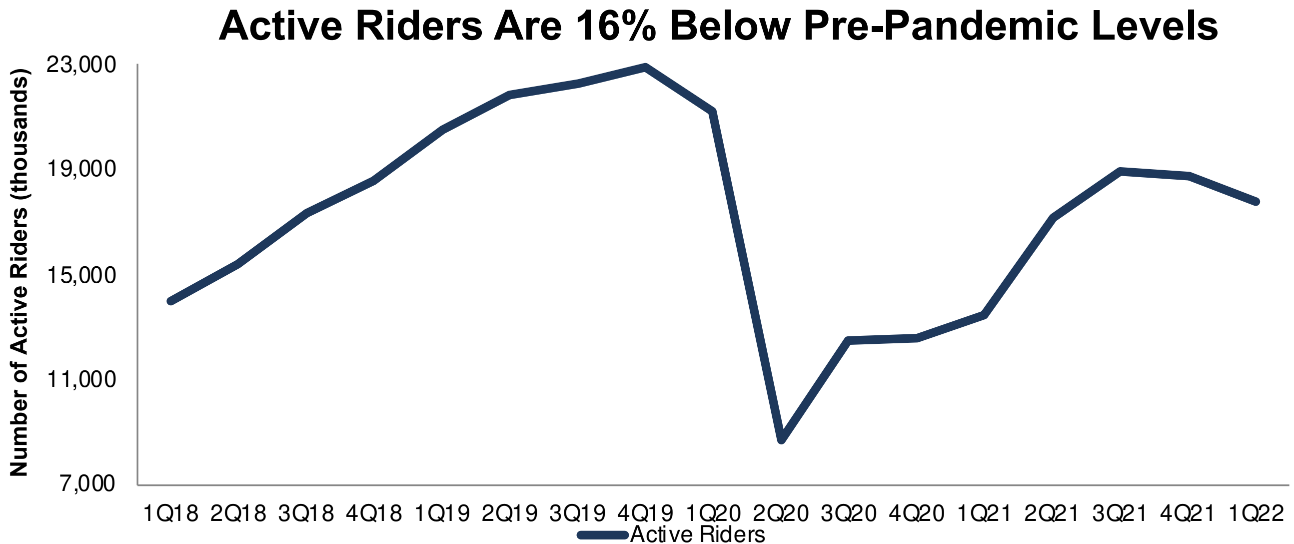
Important Disclosure Information is contained on the last page of this report.
The recipient of this report is directed to read these disclosures.

Lyft Struggles to Realize a Network Effect

Lyft may have strong name recognition and second position in the U.S. ridesharing market, but it operates in a very commoditized space. The only real switching costs for customers and drivers is the amount of time it takes to download the competing app. As more national and local ridesharing services enter the market, and taxis return to service as well, Lyft is likely to struggle to grow or even maintain its network.

Indeed, Lyft's active riders in 1Q22 are 16% below 1Q20, or pre-pandemic. More recently, Lyft's active riders have fallen 6% since 3Q21.

Figure 2: Lyft's Active Riders by Quarter: 1Q18 – 1Q22



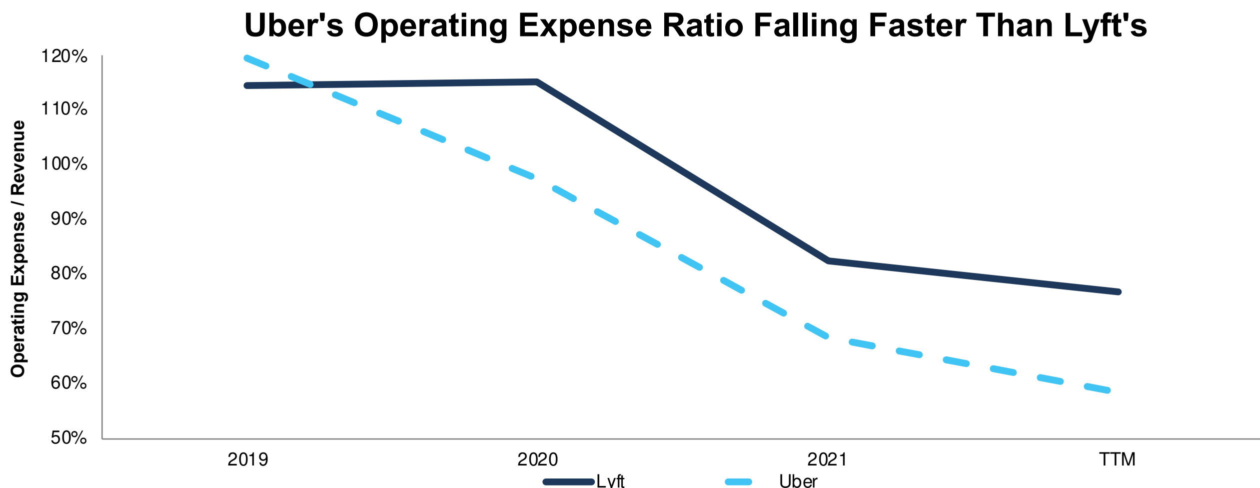
Sources: New Constructs, LLC and company filings

Falling Expense Ratio Is Unlikely to Stick

Since 2019, Lyft has focused on improving its profitability and has been successful in controlling costs. However, reduced expenses have also come alongside lower revenue and market share. Conversely, Uber's expense ratio has fallen faster while the company has grown revenue and improved its share of the rideshare market.

Per Figure 3, Lyft's expense ratio fell from 115% in 2019 to 77% over the TTM, while Uber's expense ratio fell from 120% to 59% over the same time.

Figure 3: Operating Expenses as % of Revenue: Uber & Lyft Since 2019

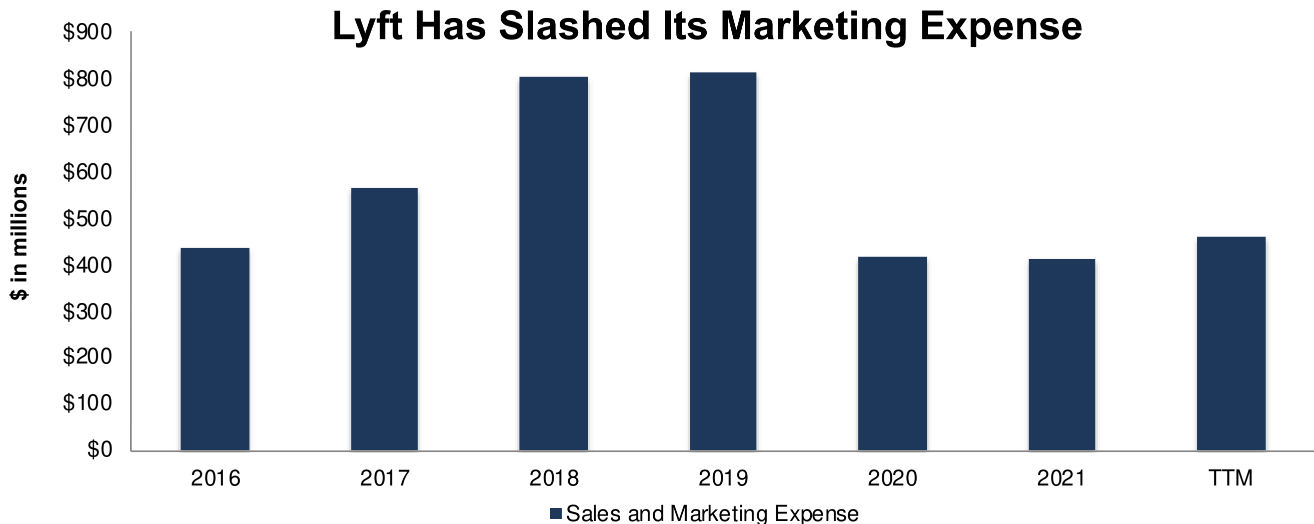


Sources: New Constructs, LLC and company filings

A large driver in Lyft's lower expense ratio is its reduced marketing and advertising spending. Per Figure 4, Lyft cut its sales and marketing budget by 43% from 2019 to the TTM period. Uber, on the other hand, increased its sales and marketing expense by 7% over the same time. Over the TTM, Uber's $4.9 billion sales and marketing expense was nearly 11 times Lyft's.

Looking ahead, Lyft is likely to increase its sales and marketing expense to better compete with Uber, which would likely send its expense ratio higher and push the possibility of profits farther away. In its 1Q22 earnings call, management noted that it wanted to "invest more in driver supply in Q2". Included in sales and marketing expense are driver incentives, which are likely to rise to aid the retention of drivers dealing with rising fuel costs.

Figure 4: Lyft's Sales & Marketing Spend: 2016 – TTM



Sources: New Constructs, LLC and company filings

Lyft Is Also Less Profitable Than Uber

Given the commoditized rideshare/transportation industry, Lyft faces an uphill battle toward profitability. Per Figure 5, Lyft's -35% return on invested capital (ROIC) and -26% net operating profit after-tax (NOPAT) margin over the TTM is far inferior to Uber's ROIC and NOPAT margin, which are also negative.

Notably, even with its large market share, Uber is still not profitable. Similarly, DiDi Global (DIDIY) (another Danger Zone pick), with 90% share of the China ridesharing market is also unprofitable. If market-dominant companies are unable to turn a profit in the ridesharing industry, it seems even more unlikely, that a smaller Lyft will generate positive NOPAT any time soon.

Figure 5: Lyft's Profitability Vs. Uber: TTM

Company	Ticker	NOPAT Margin	IC Turns	ROIC
Uber Technologies	UBER	-8%	0.7	-5%
DiDi Global	DIDIY	-24%	1.4	-35%
Lyft	**LYFT**	**-26%**	**1.2**	**-35%**

Sources: New Constructs, LLC and company filings

Food Delivery Will Also Pressure Margins

Lyft announced in December 2021 a partnership with food delivery provider Olo. Unlike popular food-delivery services, Uber Eats and DoorDash (DASH) (also a Danger Zone pick), Lyft will only provide last-mile delivery service on behalf of Olo. Lyft's B2B arrangement "is aimed at undercutting the prices of third-party platforms like Uber Eats, DoorDash, and Grubhub, which can charge restaurants as much as 30% per order." While B2B food delivery may drive more revenue for Lyft, the company will most likely offer its service at lower prices than its money-losing competition, which will make improving its NOPAT margin more difficult.

Cash Burning Strategy Can't Last Forever

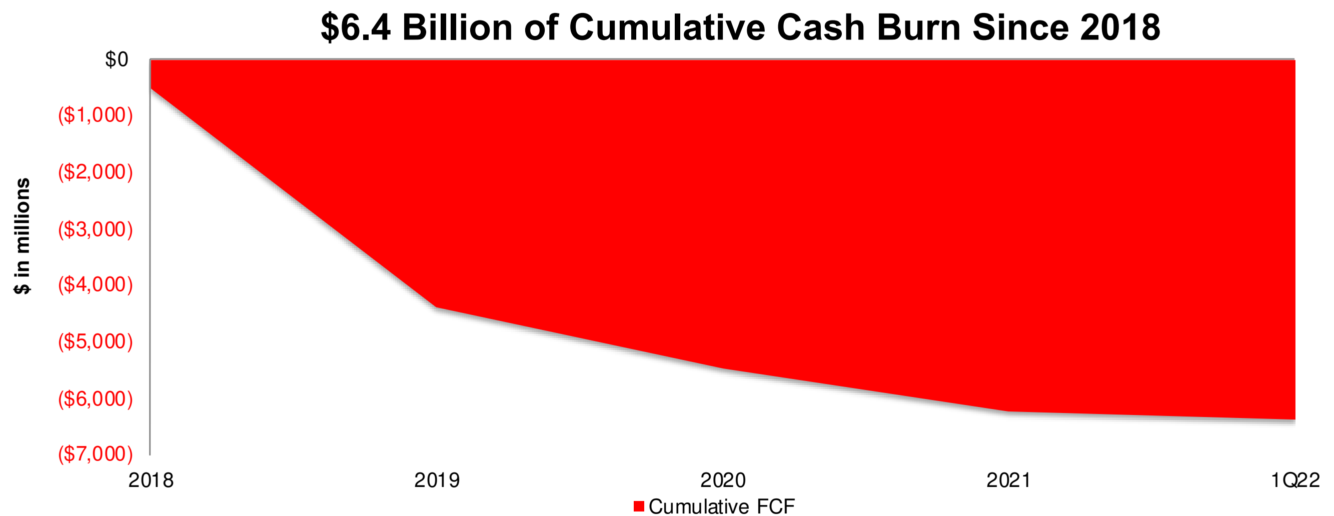
Lyft's unprofitable business means its burns through a significant amount of free cash flow (FCF). The company's FCF has been negative every year from 2018-2021. Over the TTM, the company burned through $770 million of FCF. The company's cumulative FCF since 2018 is -$6.4 billion (136% of market cap).

At the end of 1Q22, the company had $2.2 billion of cash on hand. If we assume a burn rate of $64 million per month (TTM FCF of $770 million / 12), Lyft has just under 32 months of cash on hand before needing to raise more capital.

Though Lyft has a longer lifeline of cash on hand than Snap (SNAP), Peloton (PTON), Freshpet (FRPT), and Carvana (CVNA), Lyft's large cash burn, negative interest coverage ratio, and overvalued stock price fits right in with those Zombie stocks. Nevertheless, 32 months is a long time so we're not calling LYFT a zombie stock yet.

Nevertheless, Lyft's cash burn is likely persist for more than 32 months especially if larger competitors enter the market. Potential rideshare entrants, Alphabet, Amazon, Apple, and General Motors generated a combined $285.5 billion in FCF from 2018 to 2021, or 1.4x the expected global rideshare market in 2030.

Figure 6: Lyft's Cumulative Free Cash Flow: 2018 – 1Q22



Sources: New Constructs, LLC and company filings

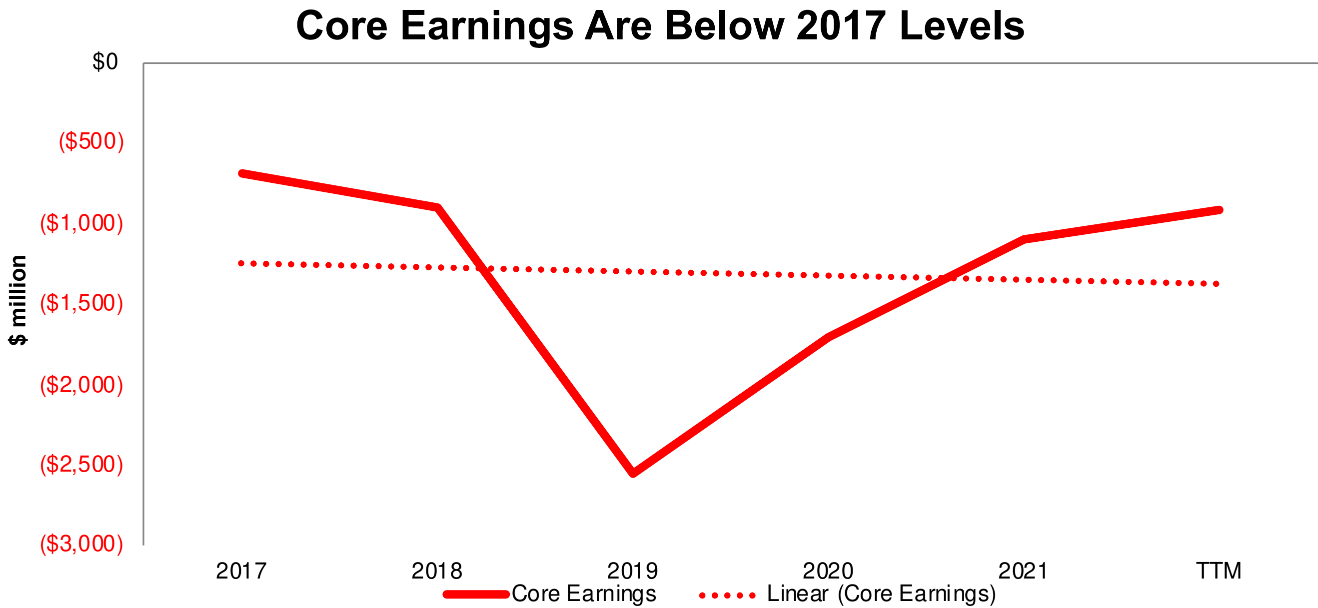
Lyft Unlikely to Produce Large Profits

Despite strong market growth numbers, ridesharing has yet to become profitable for any company. Should any company ever become significantly profitable, low barriers to entry and the lack of switching costs open the door for competition to replicate identical offerings, ensuring margins remain low for the foreseeable future.

Though airlines have more barriers to entry than rideshare providers, the rideshare market reminds us of the airline industry. Airlines serve as a prime example of people's willingness to switch between transportation providers based on cost in a commoditized industry. It is not surprising that the airline industry has a long history of losses and bankruptcies. We believe the ridesharing industry will follow a similar pattern, which is a major reason we have advised against owning shares in industry-leading Uber since before its IPO.

Poor profitability has certainly been Lyft's story up to this point. Lyft's Core Earnings are negative in each of the past five years and fell from -$688 million in 2017 to -$911 million TTM, per Figure 7. Given the commoditized nature of Lyft's industry, the threat of competition from better-capitalized companies, and Lyft's falling share of the rideshare market, continued losses seem more likely than not.

Figure 7 Lyft's Core Earnings Since 2017



Sources: New Constructs, LLC and company filings

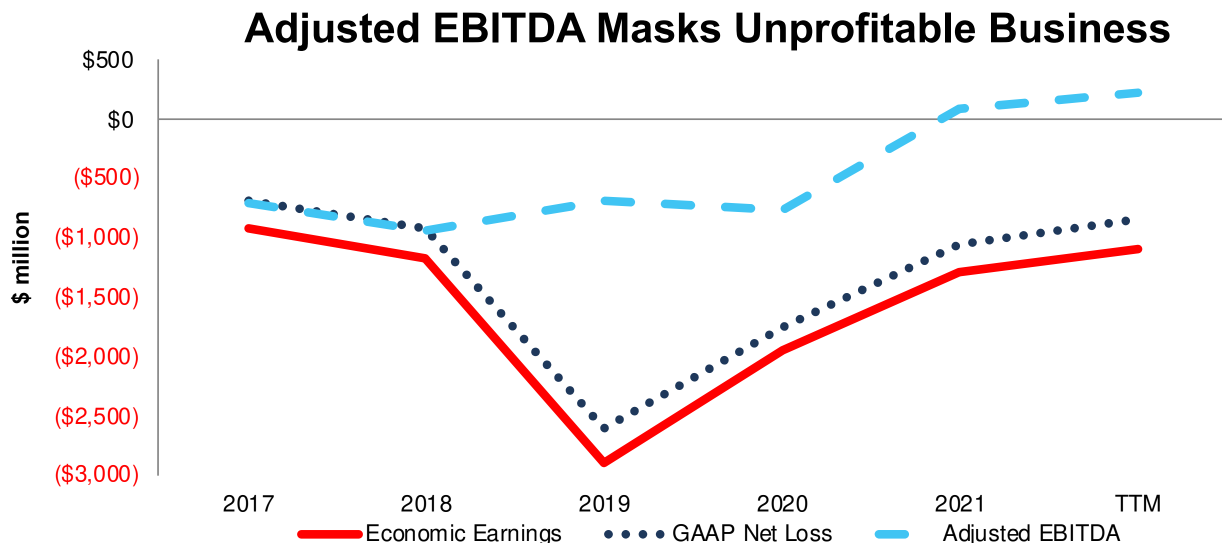
Adjusted EBITDA Masks Operating Losses

As with many unprofitable companies, Lyft uses flawed non-GAAP metrics such as Adjusted EBITDA, which paints a rosier picture of the company's operations. Adjusted EBITDA allows management significant leeway in removing actual costs of the business to present a more optimistic view.

Over the TTM, Lyft removed, among other items, $714 million (21% of revenue) in stock-based compensation, $137 million (4% of revenue) in depreciation and amortization, and $25 million (1% of revenue) in payroll tax expense related to stock-based compensation to calculate its Adjusted EBITDA.

After all of Lyft's adjustments, Adjusted EBITA over the TTM is $221 million, up from -$696 million in 2017. Economic earnings, which remove unusual gains/losses and changes to the balance sheet, are -$1.1 billion over the TTM and down from -$910 million in 2017. See Figure 8.

Figure 8: Lyft's Economic Vs. GAAP and Non-GAAP Earnings: 2017 – TTM



Sources: New Constructs, LLC and company filings

Autonomous Driving Invites More Competition

While the advent of autonomous driving promises to increase Lyft's take rate and reduce its driver-based costs, companies that own driverless technology could directly enter the rideshare market and create stiff competition. Indeed, Alphabet (GOOGL) and General Motors (GM) appear to be doing just that. Alphabet's Waymo is already operating Waymo One in Phoenix and General Motors' Cruise is serving San Francisco riders with self-driving vehicles.

Other driverless technology companies such as Amazon's (AMZN) Zoox or Apple (AAPL) could also enter the rideshare market that Uber and Lyft have spent years as their driverless technology matures.

Stock Price Requires Doubling Global Market Share

Given the high level of negative cash flow, Lyft's economic book value, or no growth value is -$37/share. The value of the cash on Lyft's books was $6.50/share at the end of 1Q22, but every day of money-losing operations means the cash per share value goes down.

To get a better handle on the true value of Lyft, we use our reverse discounted cash flow (DCF) model to analyze the future cash flow expectations baked into Lyft's stock price. We also provide an additional scenario to highlight the downside potential in shares if Lyft's revenue grows at more realistic rates.

DCF Scenario 1: to Justify the Current Stock Price.

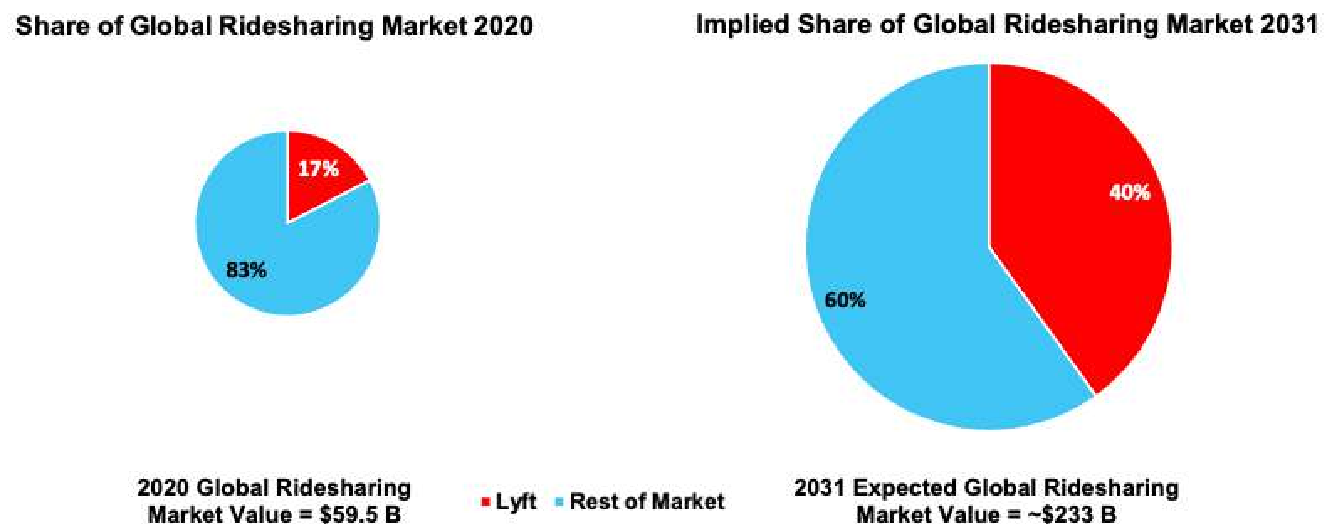
If we assume Lyft's:

- pre-tax margin rises to -4% (vs. -26% TTM) in 2022, 0% in 2023, +2% in 2024 and +4% (similar to airlines prior to consolidation) from 2025 – 2031,
- revenue grows 32% in 2022, 24% in 2023, and 20% in 2024 (equal to consensus estimates), and
- revenue grows at a 19% CAGR from 2025 – 2031, then

the stock would be worth $13/share today – equal to the current stock price.

In this scenario, Lyft would generate $21.6 billion in revenue in 2031 or 6x its TTM revenue and nearly equal to Uber's TTM revenue. Per Figure 9, at $21.6 billion, Lyft's share of the global ridesharing market[1] in 2031 would equal 40%[2], up from 17% in 2020.

Figure 9: Lyft's 2021 Market Share Vs. 2031 Implied Market Share



Sources: New Constructs, LLC and Allied Market Research

[1] Allied Market Research estimates the global ridesharing market in 2030 will be valued at $205.8 billion. To estimate the global rideshare market size in 2031, we increase 2030's value by 13%, the estimated ridesharing market CAGR from 2020 – 2030.
[2] Since Lyft does not disclose its total bookings, we use Uber's 1Q22 mobility take rate of 23% to estimate Lyft's bookings.

In this scenario, Lyft grow's revenue by 21% compounded annually from 2021 – 2031. Note that companies that grow revenue by 20%+ compounded annually for such a long period are "unbelievably rare". The cash flows expectations in Lyft's current share price are unrealistically high, which indicates downside risk is much larger than upside potential.

DCF Scenario 2: Shares Have 54%+ Downside at Consensus Growth

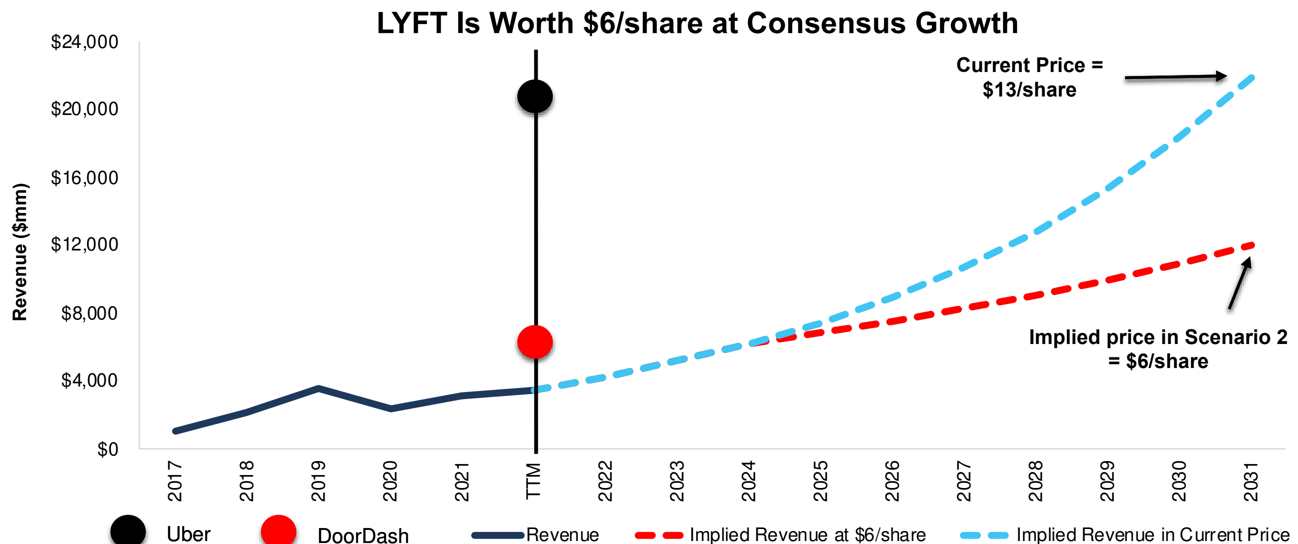
We perform a second DCF scenario to highlight the downside risk in owning LYFT. If we assume Lyft's:

- pre-tax margin rises to -4% in 2022, 0% in 2023, +2% in 2024 and +4% from 2025 – 2031,
- revenue grows at a 25% CAGR from 2022 – 2024 (equal to 2022 – 2024 consensus CAGR), and
- revenue grows at a 10% CAGR from 2025 – 2031, then

the stock would be worth $6/share today – or 54% below the current stock price. In this scenario, Lyft would generate $12.1 billion in revenue in 2031, or 2.5x its TTM revenue and more than double DoorDash's TTM revenue. In this scenario, Lyft would improve its share of the global ridesharing market from 17% in 2020 to 22% in 2031.

Figure 10 compares Lyft's historical revenue to its implied revenue in each of the above DCF scenarios. We also include Uber's and DoorDash's TTM revenues for comparison.

Figure 10: Lyft's Historical and Implied Revenue: DCF Valuation Scenarios



Sources: New Constructs, LLC and company filings

Each of the above scenarios also assumes Lyft grows revenue, NOPAT, and FCF while increasing invested capital by just 7% compounded annually through 2031. This assumption is highly unlikely but allows us to create best-case scenarios that demonstrate the expectations embedded in the current valuation. For reference, Lyft's invested capital grew 14% compounded annually before the pandemic from 2017 to 2019.

Though Lyft's invested capital fell from $3.4 billion in 2019 to $2.4 billion TTM, the company also experienced a decline in revenue from $3.6 billion to $3.5 billion over the same time. It is likely the company would need to increase its invested capital to drive the revenue growth assumed in the above scenarios. If we assume Lyft grows invested capital in line with pre-pandemic levels, then the downside risk is even larger.

Acquisition Would Be a Destruction of Capital

Often the largest risk to any bear thesis is what we call "stupid money risk", which means an acquirer comes in and buys Lyft at the current, or higher, share price despite the stock being overvalued. Given our analysis above, one of the only plausible justifications for LYFT trading at such a high price is the expectation that another company will buy it. With Lyft's shares already down 72% YTD, stupid money risk is higher than at the start of the year.

For this analysis, we think DoorDash (DASH) could be interested in buying Lyft at its current depressed valuation. The combined company would compete with Uber's rideshare and food delivery business, and likely avoid some of the anti-trust concerns an Uber acquisition would create. However, DoorDash would still be paying way too much for Lyft at its current valuation. Below, quantify how high the acquisition hopes priced into the stock are.

Walking Through the Acquisition Math

First, investors need to know that Lyft has liabilities that make it more expensive than the accounting numbers would initially suggest:

- $1.1 billion in total debt (23% of market cap)
- $10 million in outstanding employee stock options (<1% of market cap).

After adjusting for all liabilities, we can model multiple purchase price scenarios. For this analysis, we chose DoorDash as a potential acquirer of Lyft, but readers can use just about any company to do the same analysis. The key variables are the weighted average cost of capital (WACC) and ROIC for assessing value creation at different hurdle rates.

There are limits on how much DoorDash should pay for Lyft to earn a proper return, given the NOPAT or free cash flows being acquired. Figures 11 and 12 show what we think DoorDash should pay for Lyft to ensure it does not destroy shareholder value. Even in the most optimistic of acquisition scenarios, Lyft is worth less than its current share price.

Each implied price is based on a 'goal ROIC' and different levels of revenue growth. In Scenario 1, we use 20% in years one through five, which is 1.5x the forecasted ridesharing industry CAGR from 2020 – 2031. In the second scenario, we use 32% revenue growth in Year 1 and 24% in Year 2, which equal consensus estimates. In the second scenario, we extend the 2023 consensus estimate of 24% to years three through five. We use the higher estimates in Scenario 2 to illustrate a best-case scenario that assumes Lyft grows revenue faster for longer while being integrated within DoorDash's existing business.

We optimistically assume Lyft achieves a 4% NOPAT margin, which is above its TTM margin of -26%, and well above DoorDash's TTM margin of -10%. We also optimistically assume that DoorDash can grow Lyft's revenue and NOPAT without spending any working capital or fixed assets beyond the original purchase price, which is unlikely but creates a best-case scenario, nonetheless.

Figure 11: Implied Acquisition Prices for Value-Neutral Deal – Scenario 1

To Earn 11% ROIC on Acquisition		
Revenue Growth Scenario	LYFT's Implied Stock Value	% Discount to Current Price
20% CAGR for 5 years	$6	55%
26% CAGR for 5 years	$8	37%

Sources: New Constructs, LLC and company filings

Figure 11 shows the implied values for Lyft assuming DoorDash wants to achieve an ROIC on the acquisition that equals its WACC of 10.7%. This scenario represents the maximum price that can be paid to avoid value destruction. Even if Lyft can grow revenue by 26% compounded annually for five years and achieve a 4% NOPAT margin, the company is worth just $8/share. It's worth noting that any deal that only achieves an 11% ROIC would not be accretive to value, as the return on the deal would equal DoorDash's WACC.

Figure 12: Implied Acquisition Prices to Create Value – Scenario 2

To Earn 15% ROIC on Acquisition		
Revenue Growth Scenario	LYFT's Implied Stock Value	% Discount to Current Price
20% CAGR for 5 years	$3	75%
26% CAGR for 5 years	$5	62%

Sources: New Constructs, LLC and company filings

Figure 12 shows the implied values for Lyft assuming Lyft wants to achieve an ROIC on the acquisition that equals 15% (equal to Southwest Airlines' pre-pandemic ROIC in 2019). Acquisitions completed at these prices would be accretive to DoorDash's shareholders. In this best-case growth scenario, the implied value is far below Lyft's current price. Without significant increases in the margin and/or revenue growth assumed in this scenario, an acquisition of Lyft at its current price destroys significant shareholder value.

Earnings Miss or New Competition Could Send Shares Lower

Lyft has beaten earnings expectations in 10 of the past 12 quarters. However, Lyft earns a Miss Earnings Distortion Score which indicates the company is at risk of missing 2Q22 earnings based on overstated earnings in the TTM period. Over the TTM, GAAP earnings of -$832 million overstate Core Earnings by $80 million, or $0.23/share. Should the company miss upcoming earnings, shares could fall even more.

Should Alphabet, Amazon, Apple, or another well-capitalized company announce more interest in the rideshare market, investors may reconsider Lyft's long-term prospects and send shares lower as well.

What Noise Traders Miss With LYFT

These days, fewer investors pay attention to fundamentals and the red flags buried in financial filings. Instead, due to the proliferation of noise traders, the focus tends toward technical trading trends while high-quality fundamental research is overlooked. Here's a quick summary for noise traders when analyzing Lyft:

- loss of market share
- low switching costs for drivers and riders
- cash-burning operation
- valuation implies the company will gain 40% of the global rideshare market by 2031

Executive Compensation Could Be Improved

Lyft's executives receive annual equity awards that are not tied to any performance measure. Lyft's founders receive performance share units (PSUs) linked to a target stock price. While we commend Lyft for not compensating executives based on faulty non-GAAP metrics such as the above-mentioned Adjusted EBITDA, the sole use of stock price as a performance metric is not much better.

Lyft should link executive compensation with improving ROIC, which is directly correlated with creating shareholder value, so shareholders' interests are properly aligned with executives' interests.

Without tying executive compensation to ROIC, it is no surprise that executives have destroyed shareholder value since its IPO. Economic earnings, the true cash flows of the business, have never been positive and have fallen from -$910 million in 2017 to -$1.1 billion TTM.

Don't Buy What Insiders Are Selling

Over the past 12 months, insiders have not purchased any shares and sold 143 thousand shares. If insiders are not buying after the stock's large YTD decline, why should investors?

More than just insiders are selling this stock, too. There are currently 33.2 million shares sold short, which equates to 10% of shares outstanding and just under three days to cover. The number of shares sold short has increased 12% since last month.

Critical Details Found in Financial Filings by Our Robo-Analyst Technology

Fact: we provide more reliable fundamental data and earnings models – unrivaled in the world.
Proof: Core Earnings: New Data & Evidence, forthcoming in The Journal of Financial Economics.

Below are specifics on the adjustments we make based on Robo-Analyst findings in Lyft's 10-K and 10-Qs:

Income Statement: we made $249 million of adjustments, with a net effect of removing $24 million in non-operating income (8% of revenue). Clients can see all adjustments made to Lyft's income statement on the GAAP Reconciliation tab on the Ratings page on our website.

Balance Sheet: we made $310 million of adjustments to calculate invested capital all of which increase invested capital. One of the largest adjustments was $57 million in asset write-downs. This adjustment represented 3% of reported net assets. Clients can see all adjustments made to Lyft's balance sheet on the GAAP Reconciliation tab on the Ratings page on our website.

Valuation: we made $1.1 billion of adjustments to shareholder value all of which decreased shareholder value. Apart from total debt, one of the most notable adjustments to shareholder value was $10 million in outstanding employee stock options (ESO). This adjustment represents <1% of Lyft's market cap. Clients can see all adjustments to Lyft's valuation on the GAAP Reconciliation tab on the Ratings page on our website.

Unattractive Funds That Hold LYFT

The following funds receive our Unattractive-or-worse rating and allocate significantly to LYFT:

1. Spyglass Growth Fund (SPYGX) – 5.0% allocation and Very Unattractive rating
2. BNY Mellon Small/Mid Cap Growth Fund (DBMAX, DBMZX, DBMYX, DBMCX, SDSCX) – 2.8% allocation and Unattractive rating

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Disclosure: David Trainer, Kyle Guske II, Matt Shuler, and Brian Pellegrini receive no compensation to write about any specific stock, style, or theme.

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It's Official: We Offer the Best Fundamental Data in the World

Many firms claim their research is superior, but none of them can prove it with independent studies from highly-respected institutions as we can. Three different papers from both the public and private sectors show:

1. Legacy fundamental datasets suffer from significant inaccuracies, omissions and biases.
2. Only our "novel database" enables investors to overcome these flaws and apply reliable fundamental data in their research.
3. Our proprietary measures of Core Earnings and Earnings Distortion materially improve stock picking and forecasting of profits.

Best Fundamental Data in the World

Forthcoming in The Journal of Financial Economics, a top peer-reviewed journal, Core Earnings: New Data & Evidence proves our Robo-Analyst technology overcomes material shortcomings in legacy firms' data collection processes to provide superior fundamental data, earnings models, and research. More details.

Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

A top accounting firm features the superiority of our ROIC, NOPAT and Invested Capital research to Capital IQ & Bloomberg's in Getting ROIC Right. See the Appendix for direct comparison details.

Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

Superior Stock Ratings

Robo-Analysts' stock ratings outperform those from human analysts as shown in this paper from Indiana's Kelley School of Business. Bloomberg features the paper here.

Key quotes from the paper:

- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

Our mission is to provide the best fundamental analysis of public and private businesses in the world and make it affordable for all investors, not just Wall Street insiders.

We believe every investor deserves to know the whole truth about the profitability and valuation of any company they consider for investment. More details on our cutting-edge technology and how we use it are here.

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