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Will GM's Stake In Lyft Help Steer It Into The Passing Lane?

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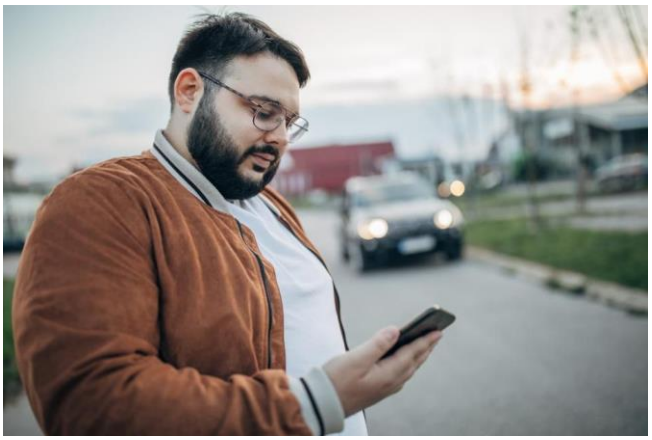
Since its 2009 bankruptcy and subsequent bailout by the federal government, General Motors (GM) has taken significant steps to remake itself as a leading automaker for the 21st century. In addition to focusing on its core brands—Chevrolet, Buick, Cadillac, and GMC—the company has invested heavily in hybrid (Chevrolet Malibu hybrid) and electric vehicles (Chevrolet Volt and Bolt EV) as well as autonomous vehicles (Cruise Automotive) and ride sharing.

That last point refers to GM's investment in Lyft which, after that firm's recent IPO, appears to have been a great investment. Its initial investment in early 2016 was $500 million and, after the IPO, GM ended up with about 7% of the stock, which at a price between $55 and $60/share puts the valuation at over $1 billion. GM's bet in Lyft looks to have been a wise one by any measure.



The ride-share space is still dominated by Uber, which is expected to announce its IPO in the coming weeks, but Lyft is its primary direct competitor. Sell-side analysts who cover Lyft expect the company to generate about $3.4 billion in revenue this year. Although Uber does about ten times the business of Lyft, they are otherwise very similar companies. They offer similar transportation services that users can reserve and pay for via an app on their mobile phones. In fact, many of their drivers also alternate between either of the companies as "free agents."

Another area where the business models of both firms align is that both classify their drivers as independent contractors rather than employees. That strategy drastically reduces ride-share firm overhead since the companies don't have to make heavy capital expenditures to purchase vehicles. Nor do they have to worry about healthcare, vacation pay, holidays, or other pesky human resources regulations like minimum wages or overtime pay. Obviously, their strategy turns the entire business model of legacy taxi operator's upside down and, therefore, many medallion companies have subsequently been forced into bankruptcy. The social impact on drivers from this industry disruption has been felt worldwide with subsequent strikes and airport blockades from California to France.

Currently, regulations in 25 U.S. states agree with the companies that their drivers don't qualify as employees, but that may be changing. Ride-share Drivers United recently organized a strike in Los Angeles for drivers from both companies, demanding a minimum $28/hour salary and a few days later a bill was introduced in the California legislature that would provide stronger protections and benefits for drivers and other gig workers. In Europe, several recent court rulings have held against Uber with regard to drivers' employment rights.

If these trends continue, they could change the profitability calculus for both firms, as Lyft noted in its IPO filing when it stated that classifying drivers as employees "may require us to significantly alter our existing business model." Uber took a similar position in its S-1 filing, saying that classifying drivers as employees would result in significant additional expenses. The filing did note, however, that in March of this year Uber agreed to pay $20 million to settle claims from drivers in California and Massachusetts over whether they should be classified as employees.

Although the outcome of continuing investigations by labor and tax authorities, as well as private lawsuits, will take time and remains uncertain, Uber used the IPO filing to make a case for why the status quo should remain in place: "We believe that Drivers are independent contractors because among other things, they can choose whether, when and where to provide services on our platform, are free to provide services on our competitors' platforms, and provide a vehicle to perform services on our platform." In the not too distant future, technological advances may eventually render human-drivers less relevant. In fact, many major companies (Apple, Waymo, Tesla, GM, Ford, and Uber just to name a few) are feverishly working towards commercial production of autonomously driven vehicles. What these changes mean in the long run for ride-share businesses remains to be seen.

One of the questions for GM's Lyft investment is whether that business can somehow help GM offer totally new technologically advanced products for its customers. Certainly, there's the potential for a partnership where Lyft drivers could be offered discounts for buying GM vehicles or offering Lyft services to GM customers. Or, possibly, Lyft could work with Cruise Automation, GM's autonomous driving division, to eventually have a network of ride-share vehicles that operate without drivers altogether. Another alternative for GM is to spin off its newly public Lyft stock to existing GM investors, who may then decide for themselves whether to keep the high-growth ride-share business or, instead, just sell it and remain focused on the high-cash-flowing legacy business.

In any event, GM's management and board are developing a strong track record of evolving with the latest technology trends despite their company's long history as an auto manufacturer. At a total market value of $21 billion, after netting out the values of Lyft, Cruise Automation, GM Financial, tax assets, and net debt, GM trades at an astoundingly cheap TEV/EBITDA multiple of only 1.3x. Meantime, GM stock pays a robust dividend of nearly 4% for those patient investors willing to wait to see how these exciting industry developments play out.