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Just call it the 'bizzle'

Undetected embezzlement is an unconventional kind of stimulus. For one thing, it's not government-directed (no carping just now about the Social Security "Trust" Fund). For another, it's a boomtime boost, not, as is usually the case with stimuli, a palliative for recessions. Until the victim discovers his loss, the stolen funds constitute a credit for the thief but no debit to the property owner. John Kenneth Galbraith, who first called this form of single-entry bookkeeping to the attention of the reading public, called it the "bezzle."

We write to introduce the bezzle's first cousin. The "bizzle," a concept from the fecund mind of investor Paul Isaac, is the stimulus thrown off by venture capitalists and private-equity titans during cyclical upswings. The financiers seed startups. The startups spend money on rent, office furniture, talent, customer acquisition, investment banking, legal services, etc. It's the bizzle booster.

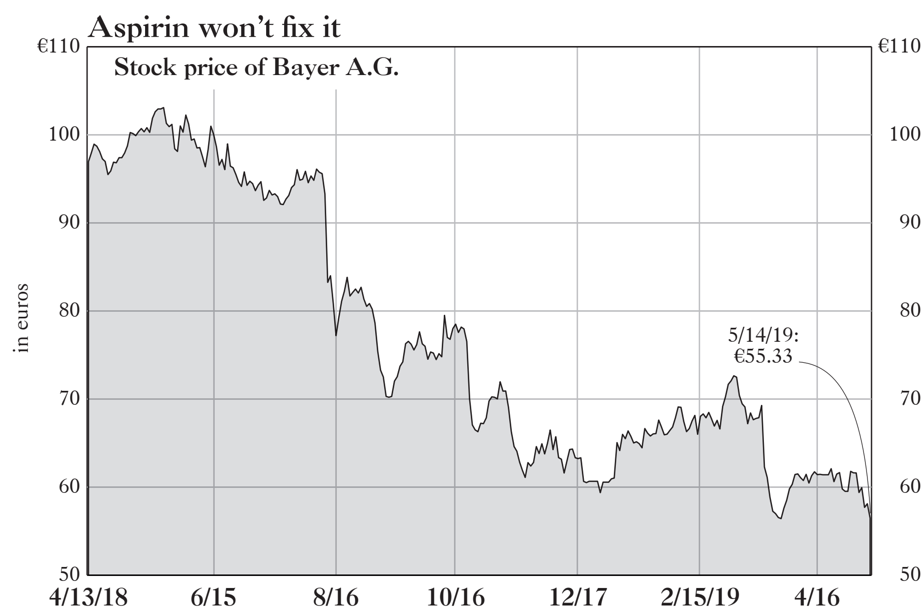
Of course, the financiers do not invest alone. The central bankers are their silent partners (and never so much as in the past 10 years). It's the low cost of capital that sets the minds of the investors at ease. They invest in hope of profits, and minuscule interest rates afford them the luxury of waiting for those anticipated earnings. Then, too, in a bull market, expected profits constitute a kind of scrip. In the high-end ZIP codes, it passes for near cash.

"The monetized equity appreciation and stock-based compensation they throw off fuel the renovation of Maui, Pacific Heights, Tribeca and the Hamptons," Isaac advises by email. "On a broader basis, we might also include the reduced savings or pension contributions on the part of investors who are comfortably relying on the higher projected returns of [venture-capital] activity in planning their financial affairs, as well as some broader multiplier effects on economic activity from the sum of the foregoing. Unlike the bezzle, the bizzle is not (necessarily) fraudulent, but it is a pronounced cyclical enhancement of aggregate economic activity and ebullience, and it is unusually concentrated in particular geographic areas. Hard to imagine what NYC would have looked like in the last five years without an appreciable bizzle effect for the local economy."

The bizzle can't grow indefinitely. What checks it in normal times are normal rates of interest. Today's abnormal rates, with attendant tight credit spreads, foster risk-taking, both well-considered and otherwise. And they afford the luxury of planning that stretches the limits of whatever used to define the concept "long-term."

It's a testament to easy money as much as it is to the vision of the entrepreneurs that WeWork Cos., Inc., after burning $2.3 billion in cash last year, is coolly planning an initial public offering later this year. It is likewise a sign of the times that Bernstein Research anticipates that the new-age landlord will need an additional $19.7 billion of cash before it breaks even—an event it says it is able to project for the year 2026.

History may remember these times as a golden age of invention and entrepreneurship, but those flattering



source: The Bloomberg

descriptors should come with an asterisk. The seemingly limitless patience of the backers of loss-making startups would surely be tested if Treasury bills fetched 5% rather than 2.4%.

To listen to the voices of the C-suite of Compass, Inc., founded in 2012, capital might as well be free. The would-be disruptor of the residential real-estate brokerage industry boasts a hypothetical valuation of $4.4 billion on the strength of a $400 million VC investment last September by SoftBank's Vision Fund and Qatar Investment Authority. For comparison, Realogy Holdings Corp., the largest American residential real-estate broker by sales volume, commands an equity market cap of just $940 million.

Compass is fast-growing, free-spending and unprofitable—characteristics not customarily found under the same corporate roof, at least not for very long. Around Labor Day last year, according to TheRealDeal.com, a real-estate news outlet, Compass "had 6,400 agents and 150-plus offices, up from just 2,100 agents and 42 offices nine months ago. In less than a year's time, the company has also quadrupled its non-agent count to 1,080 (from 265)."

Compass is turning heads through the sheer volume of its spending, or what we now know to be bizzling. The outlays take the form of "hefty marketing budgets, slick technology and stock options as [management] dangles the prospect of an initial public offering," *The Wall Street Journal* reports. There's a bridge-loan program, too, to tide over a seller while waiting for a buyer, and heretofore unheard-of blandishments to attract prospective hires: "Some agents received all the sales commission, with nothing going to Compass, on as many as eight of their first deals, according to offer letters." An agent in Compass's Boston office tells the *Journal* she feels like she's "a realtor at the Ritz."

Robert Reffkin, a Compass co-founder, has run a marathon in each of the 50 states to raise money for charity. He was named to *Fortune*'s roster of "Forty under Forty" in 2014. He is a father of three who hired his mother, herself a real-estate broker, to work at Compass. He has also lured Leonard Steinberg, whom REAL Trends named as the most productive real-estate agent of 2016, away from Douglas Elliman.

Reffkin and his fellow co-founder, Ori Allon, an Australian computer scientist who sold a business to Twitter, Inc., have raised venture capital from Founders Fund, Wellington Management Co., Institutional Venture Partners, Fidelity Investments, Qatar Investment Authority and, as mentioned, SoftBank's Vision Fund.

In the afore-cited *Journal* story, Bess Freedman, chief executive of the New York brokerage firm of Brown Harris Stevens, LLC, offered a competitor's view of Compass's bizzling: "It doesn't make sense," she said. "Are you a charity or are you a real-estate company?"

On the subject of earning more than you spend, Reffkin was quoted as saying this: "Short-term profitability is something that many of the more modern companies are not as focused on." To which Chief Operating Officer Maëlle Gavet was quoted as adding: "We're not yet at a stage where I have a very clear monetization strategy because we haven't really talked about it."

The indulgent state of the debt markets may explain part of this expressed lack of urgency in making corporate ends meet. The yield famine of the past 10 years has loosened the customary strictures on borrowing. "Thus," observes colleague Fabiano Santin, "in the fourth quarter of 2007 leveraged-loan issuers in the primary market carried leverage of 4.7 times adjusted earnings before interest, tax, depreciation and amortization and generated enough funds to cover interest payments by 2.7 times, according to data from LCD.

"In a world of seemingly infinite liquidity," Santin goes on, "the decision to extend credit perhaps hinges on the thinly constructed perception of one's ability to refinance. Today, leveraged borrowers operate with debt of 5.4 times Ebitda and interest coverage of 3.1 times. Given that more Ebitda reaches the bottom line despite the higher debt load, this stronger interest cushion may lower the threshold for new investments. Of course, falling Ebitda or rising rates would make short work of that source of financial strength."

Vice Media, LLC, a global digital-media enterprise with offices in more than 30 countries, is another profitless bizzler. Vice has subsisted for a quarter-century on hundreds of millions of dollars in investments from the likes of 21st Century Fox, Disney and private-equity firm TPG. It achieved a reported $5.7 billion valuation in 2017, a sum representing more than nine times its revenues, not quite three times richer than the corresponding Disney valuation in the same year.

Now Vice is cutting staff and Disney is writing down its cumulative $510 million investment in Vice to zero. Even so, SoftBank's Fortress Investment Group, LLC and Soros Fund Management, LLC just saw fit to lend $250 million in order to "accelerate" the growth of Vice's miscellaneous portfolio of businesses. That portfolio includes a subscription-based print magazine, podcasts, video content for HBO, a cable channel called Viceland, a multi-feature website, a YouTube channel, an ad agency, a record label, a film studio, a London bar. There must be a corporate bizzling department, too.

How big is the macro bizzle? There's a hint in the quoted words of Chamath Palihapitiya, CEO and founder of Social Capital, L.P. and a former Facebook, Inc. vice president, in the March 8 issue of *Grant's*: "Startups spend almost 40 cents of every VC dollar on Google, Facebook and Amazon. . . . Advertising spend in tech has become an arms race: Fresh tactics go stale in months, and customer acquisition costs keep rising."

As ever, the kneebone is connected to the thighbone. It's the low cost of capital—the artificially low cost, say we—that's sustained the bizzle boom. Some cheer it. They defend the funds lavished on big-spending startups as the rational search for the next great business disruptor. Others bemoan the tendency of the same low rates to muddle decision-making and misdirect capital.

Count the shareholders of Bayer A.G. among the aggrieved. On April 26, at the annual company meeting, the owners voted a motion of no-confidence in the management that, in 2018, spent $66 billion to acquire the manufacturer of Roundup. Few then appreciated that Monsanto Company's best-selling weedkiller would prove a suspect in tens of thousands of American cancer cases (13,400 herbicide claims have been lodged in U.S. courts). S&P did not so much as mention Roundup or the threat of such litigation in its published rationale for conferring a triple-B rating on the bonds that Bayer issued to complete the transaction.

The European Central Bank supported that project. The corporate-bond portfolio of the ECB, in the grand total of €178 billion, holds portions of a half-dozen Bayer issues, with coupons ranging from five-eighths of 1% to $2^1/_8$% (the portions are undisclosed). One such security is the $2^1/_8$s of 2029, which changes hands at 102 to yield 1.9% to maturity. The Bayer debt has been impervious to the Roundup-induced collapse in Bayer's equity capitalization—down by 42% in the stock market, the venerable aspirin maker is today worth less than the $66 billion that it paid for Monsanto.

The sang-froid of the debt market is surely testament to something. Perhaps to the unflappability of the senior creditors in the face of a scandal that may not exact a significant financial toll on its manufacturer. Or perhaps—more likely, we think—to the heavy thumb of the ECB on the scales of interest rates.

Capital is cheap and the bizzle goes on—each subject to Mr. Market's own kind of disruption, of course.

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