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A Deep Dive Into Regus

The Strategy and Goals of the Flex Space Giant

Overview

While the conversation surrounding the industry often circulates around WeWork, the number of flex space providers operating around the world has grown significantly over the decade. These companies serve space users, from individual freelancers, contractors and one-off remote employees looking for hot desking-style or a la carte workspaces, to corporate occupiers seeking a traditional space with the right lease terms.

These different use cases illustrate just one of the diversities of the flex space world. The companies that occupy this space provide real estate and business services to a huge number of occupiers of all sizes, from a tremendous range of industries, with a broad palate of tastes in terms of ambiance, programming and focus.

One of the companies that most clearly represents this diversity is IWG. Formerly Regus, IWG now includes both the Regus brand as well as a number of other business lines such as Spaces and HQ, each representing a different niche within the industry. This multitude of real

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estate brands with Regus at its core may look familiar, but IWG's growing focus on suburban markets and franchising operations are disruptive and nontraditional. In this report, we'll cover the performance and growth goals of IWG before exploring the overall strategy of the IWG brands.

Company

IWG was founded by Mark Dixon, an entrepreneur from Great Britain, in 1989. It began as Regus, a flexible office space provider operating in Brussels, Belgium. The company had a successful IPO in London in the year 2000 and hit 1,000 spaces in 2009. Regus introduced IWG plc as a holding company for the growing portfolio of businesses in the mix in 2016. In general, IWG's business model revolves around leasing space from landlords and then subleasing space out at a variety of terms and lease lengths.

Strategy

One of IWG's primary goals is to grow their global presence across more spaces. To that end, the company is pushing its franchising model, while also amassing a growth capital war chest of almost $400 million in mid-2020, according to Ian Hallett, group managing director for IWG. The following sections will explore the IWG strategy through a number of areas.

Performance through the outbreak

The COVID-19 outbreak has proven broadly damaging to flex space providers, and IWG is no exception. With 3,359 current locations, the IWG businesses have dedicated over $100 million to occupier support initiatives such as deferred rent. Such a high tenant support budget is testament to the lasting impact of COVID-19 on the modern workplace, an impact which IWG said is greater than they had expected. However at the same time, IWG has made substantial efforts toward cutting costs this year, another example of the trend we have noticed toward cost cutting in the face of pandemic-borne disruption. To that end, IWG appears to be on track for over $260 million in cost reductions by year end, thanks to the measures explored in the sidebar.

Additionally, IWG is currently experiencing strong sales activity. The company attributes this in part to the pandemic, or rather, to changing perspectives that the pandemic is encouraging. According to IWG, businesses are becoming more interested in flex space "as companies address how their employees will work in the future, the advent of further potential pandemics and the need to preserve liquidity by limiting capital and operating expense."

IWG Cost-Cutting Methods

(IWG Q3 Trading Statement)

- Board remuneration cut in half
- Capital expenses for both growth and maintenance reduced
- Suspension of a $132 million share repurchase plan
- Cancelled shareholder dividend
- Space closures

At the same time, IWG is experiencing hits in some of its most important measurable areas. Revenue is down by almost $130 million and occupancy is down about 4 percent using IWG's metric of facilities that have been open since 2018, which helps account for lease-up vacancy. Earlier, in August, IWG reported hitting a first-half operating loss of around $25 million. In response, the company has closed 66 locations over the course of the third quarter of 2020 alone, representing 3 percent of the total portfolio of spaces under IWG management. Many of these closures are located in dense urban centers, like Midtown Manhattan. The same is true outside of the U.S., as in Australia, where closures are also in urban locations (Wolf Street, 2020).

The urban focus of these closures highlights IWG's geographic strategy, which is increasingly swinging toward suburban markets. For instance, performance at IWG's downtown NYC locations are down 30 percent compared to pre-outbreak activity versus southern CT locations, which are up over 40 percent (The Real Deal, 2020). In investor documents, IWG also noted an emphasis on smaller office spaces as well as virtual offices.

For more on IWG's performance, consider the graph below, which compares the company's finances and cash flow before the outbreak and during it. Of particular note is the major debt payoff that took place between 2019 and 2020. Owned properties do not constitute a major portion of IWG's portfolio, and as the company continues to push toward a franchise model (described later), it is like that this debt figure will remain low.

IWG Performance (IWG, 2020)

Line item	H1 2020	H1 2019
Adjusted EBITDA	137.4	189.8
Working capital	177.3	80.2
Growth related partner contributions	(73.7)	(95.4)
Maintenance capital expenditure – Gross	(91.5)	(71.0)
Taxation & finance costs	(16.3)	(24.8)
Other items	(7.8)	4.6
Cash flow before net growth capital expenditure, share repurchases, dividends & adjusting items	125.4	83.4
Cash flow before growth capex per share (p)	14.0	9.3
Net growth capital expenditure	(116.2)	185.5)
Share issue proceeds	313.9	-
Master franchise proceeds	-	301.7
Dividends & share repurchases	(42.7)	(37.7)
Closing net debt	(15.9)	298.1)
Net debt : LTM EBITDA	0.0x	0.7x

Hub and spoke amidst COVID-19

In line with this push toward the suburbs, the final component of IWG's strategy is a push toward a hub and spoke model of office space. Under the hub and spoke strategy, companies keep a main headquarters office and then use satellite offices nearer to where employees live to provide a more flexible work balance. In an example of hub and spoke in action, the Oslo headquarters of accounting and business services firm EY recently announced moving to a Spaces hub in the city. According to Christin Bøsterud, EY's Norwegian CEO, "the agreement furthermore grants Oslo employees access to Spaces' coworking facilities both in Oslo and the rest of the world…" According to Mr. Hallett, there was a trend toward this type of work even before COVID-19. "Somebody will be in the hub for two days, maybe in a remote location for two days, maybe travelling on business for one day, in any given week."

This approach may have turned heads before the pandemic, but now that many big tech companies have announced permanent work from home policies, it is much more expected. With many workers hesitant to go into the office for safety reasons yet still desiring of the productivity and socialization that office spaces promote, and with numerous corporations dragging their feet to sign long-term leases, instead committing to short-term renewals, the idea of a hub and spoke style, flex space environment that is right-sized for modern workplace practices and eschews decade-long commitments seems like an attractive option.

Bankruptcy

Much media attention has recently gone to a wave of bankruptcy filings across almost 100 various IWG businesses over the last few months. Interestingly, the goal of these bankruptcies is not to address a challenging debt burden (refer to the small, and shrinking amount of debt held by IWG in the graph above) but rather to allow IWG to renegotiate its lease arrangements. The newest development is this story is IWG's threat to file for bankruptcy with its UK subsidiary, which is on the hook for over $1 billion in lease guarantees.

Since IWG is pursuing expansion in suburban markets, declaring or threatening to declare bankruptcy in urban markets appears to be a wise strategic game of chicken. If IWG's landlords cave in to the company's demands for rent breaks, IWG could pull out of bankruptcy with much more favorable lease terms. If the landlords refuse to budge, IWG could commit to the bankruptcy, closing down offices in non-target markets and consequently cutting costs automatically.

Franchising

Alongside the movement toward less dense markets, IWG has been increasingly pushing a franchise model to spread its brand and improve group revenue. This approach has become a benchmark of the company's overall strategy, with IWG referencing a "clear pivot to capital-light growth and franchising." Franchising flex space with partners capable of opening multiple spaces in a given market is a newer strategy for the company, introduced in 2019 with a deal in Japan. However, it now represents the thrust of IWG's growth activities through at least the next several years. For IWG, revenues from the franchise model stem from licensing fees and service revenue. In return, the company is positioned to assist franchisees with location decisions, supply chains, training, branding, and marketing, just as in any number of restaurant franchises.

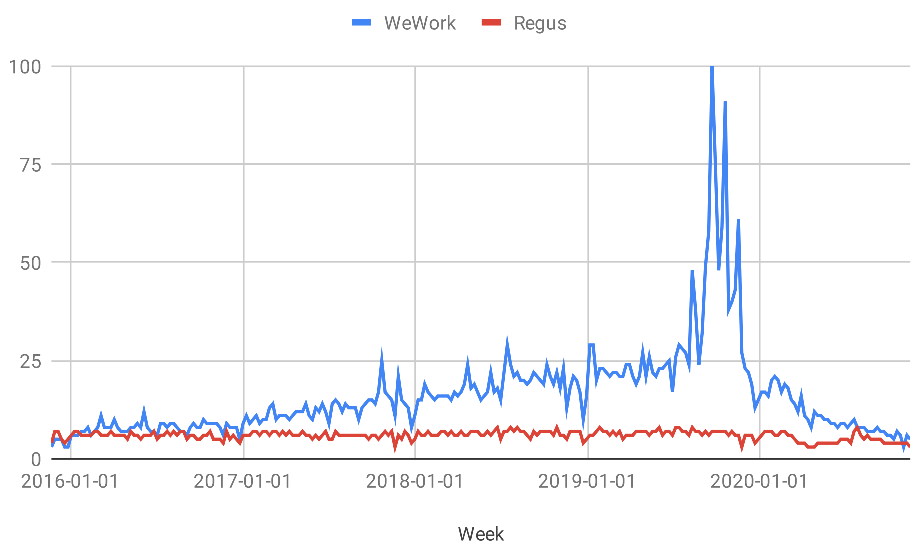
Franchising also allows IWG to avoid much of the risk associated with keeping billions of dollars of leases active at all times. If IWG's goal is to reduce the amount and the costs of leases active on the company's books, franchising represents an attractive method to move some of that risk onto the shoulders of the business partners. While the franchising model is new for IWG, it is not alone in the flex space world. A different flex office provider Knotel, which doesn't offer co-working space, instead focusing on corporate occupiers, also takes a disruptive approach in addition to standard leases: profit sharing. Under this model, Knotel avoids paying rent, instead passing some of its profits onto the landlords for its spaces.

There is another layer to the franchise model in IWG's case, as well. As the company pushes harder into suburban markets, it is likely that some of these lower-density trade areas will turn out to offer less stable demand than the central business districts of big cities. By moving into a franchise-based, fee collecting business model, IWG is positioning itself to explore more of these less traditional, higher-risk locations without needing to be as closely tied to direct sales volume as a traditional flex space operator.

Regus and WeWork

Part of IWG's strong performance has been its gradual and organic expansion as opposed to the venture-funded, "growth above all else" model espoused by the likes of WeWork. This certainly allowed IWG to avoid the same fate of WeWork, as its IPO was scrapped due to an astronomical $47 billion valuation. However, Regus never had the kind of awareness that the WeWork brand continues to benefit from. This is visible across a range of metrics, such as Facebook, where WeWork has over 1.3 million likes versus Regus, with 200 thousand, as well as simple word of mouth (when WeWork attempted to IPO it had 604,000 desks versus IWG's total 602,535, despite Google search volumes that showed WeWork

Comparative U.S. Regus versus WeWork search volume (Google Trends, 2020)



dominated its competitor since 2016). Also, it is worth mentioning that WeWork refers to itself, speciously, as a tech company, while Regus has always been a real estate provider. That difference seems miniscule but it is important to understand the difference in conceptualization between these two brands.

A diversity of brands

Although IWG has grown mostly organically, recent years have seen an expansion of the company's M&A activity, perhaps meant to take a bite out of the trendy space occupied by the WeWorks of the world. An interesting marketing side note here is that this diversity of brands allows IWG's various subsidiaries each to cater specifically to a particular audience, versus the WeWork approach where hot deskers and corporate occupiers alike are approached with the same messaging.

This flexibility provides another benefit beyond the simple marketing strength we just discussed. As the flex space model evolved over the years, from the early days where Regus was the only game in town to the heights of WeWork to the current COVID-19-influenced landscape, the business has seen a shift from an emphasis on business clients to freelancers, contract workers and remote employees of bigger companies, and then back to corporate clients that can take down larger floor

IWG Flex Space Brands

Regus

Regus is the flagship brand of IWG as well as the largest global flex space provider.

SPACES.

Spaces has an emphasis on entrepreneurial and creative teams, and was acquired by Regus in 2015. This business is positioned as a WeWork competitor, and talk has circulated about a potential sale here.

Signature by Regus

This is a brand within the Regus business line, tailored toward more upscale work environments.

stop&work by Regus

A flex space service provider under the Regus brand, operating in France.

HQ

HQ is oriented toward providing frictionless space for work. It was acquired by Regus in 2004 at a time when it was one of the company's biggest competitors.

BASEPOINT business centres

Basepoint is focused on offering space to service providers and small businesses like workshops and studios. Basepoint was also purchased in 2017.

No18

This brand is focused on offering live/work spaces, not apartments, but rather lounges and social spaces as well as offices and meeting rooms. This company was acquired in 2017.

THE CLUBHOUSE

This brand takes a similar approach to No18, taking a loungelike approach to space for growing and large corporate businesses. The Clubhouse was acquired in 2018.

BizDojo

This New Zealand-based brand puts an emphasis on programs and community for workers and creatives. BizDojo was bought by IWG in 2018.

too THE OFFICE OPERATORS

This is a flex space provider operating solely in The Netherlands and Belgium, founded by ex-Regus employees. TOO is another recent IWG acquisition.

Openoffice

Openoffice is a flex space brand focused on the Asia Pacific market.

plans all at once. While WeWork attempted to serve both types of clients through the same brand, IWG can use different brands to fulfill different individual needs. Regus fits the needs of corporate occupiers, for instance, while BizDojo is better for individual workers. These flex space providers are in addition to several related companies under the IWG umbrella: Meetingo (meeting rooms), Easy Offices and Worka (flex space listing tools), Managed Office Solutions (traditional serviced offices), and Rovva (a virtual office provider.

Conclusion

IWG's brands present an interesting case study in flex space management for the post-WeWork landscape. Perhaps there is not a one-size-fits-all brand for freelancers and big businesses, small startups and large corporate occupiers, designers and accountants. IWG's solution is to acquire successful businesses with a range of identities, geographic locations and focus areas. For a company with aggressive growth goals that still include dense urban centers while putting a priority on suburbs and less populated markets, this multitude of brands and perspectives might be a winning approach.

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