NEW RISK ALERT: (WDAY)

Workday Pays Affiliate of Board Chairman $171 Million for Office Space

Latest 10-K raises serious concerns over SaaS firm's capital allocation as it spends big on real estate it may never use.

By Nick Winkler
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This alert compares the language used in the company's latest filing with the period before. Research suggests changes in language, particularly in the risk factor section, is a powerful indicator of future performance. Companies that change filing language, according to research, underperform those that don't by 30-50 basis points per month for the following year.

Workday Rents Office Space From Board Chair's Affiliate

Workday, an enterprise cloud SaaS firm, rents office space adjacent to its headquarters in Pleasanton, California owned by an affiliate of the company's Chairman, Dave Duffield. In the company's 2020 10-K, Workday disclosed it has paid the Duffield affiliate $40 million in rent over the last three years:

> *"The total rent expense under these agreements was $16 million, $13 million, and $11 million for fiscal 2021, 2020, and 2019, respectively."*

Our analysis reveals Workday has paid Duffield's affiliate $58 million in rent since 2015. The rent payments to Duffield, who is also Workday's co-founder, are disclosed each year in the company's annual report. However, new language in the most recent 10-K indicates that after renting for years, Workday now owns the space outright.

Workday Purchases Office From Board Chairman's Affiliate for $171 Million

During fiscal 2021, Workday paid $2 million for an option to purchase the aforementioned leased properties at a price based on third-party appraisals and negotiation between Workday and the affiliated party. On February 23, 2021 Workday exercised the option and purchased the properties:

> *"The purchase price is $173 million in cash, reduced by the $2 million fee paid for the Leased Property Purchase Option."*

In the footnotes, Workday explains why it made the purchase:

> *"This purchase provides long-term stability to our corporate headquarter footprint in Pleasanton, California."*

Workday paid more than the carrying value of the property. The company explains the accounting like this:

> *"The net carrying value of the properties purchased will be $159 million at the time of purchase, which is calculated as the net purchase price of $171 million, reduced by the difference between the carrying values of the right-of-use asset and lease liability of the leased properties immediately prior to the purchase of approximately $12 million."*

The Wisdom of Workday's Capital Allocation is Questioned

In the end, counting previous rent paid, Workday will have paid an affiliate of its Board chairman $229 million for property with a carrying value of $159 million. We're not accusing Duffield of wrongdoing. The transaction amounts to just 1.2% of Duffield's estimated net worth of $14 billion.

We raise the issue because Workday's employee headcount growth is slowing. Last year, headcount increased by just 300, the slowest rate of growth in nearly a decade. In the six years prior, Workday hired, on average, 1,600 new employees each year.

Likewise, the company closed most of its offices due to the pandemic. Most of the company's employees now work remotely. When discussing the pandemic's long-term effects on its office environment, Workday acknowledges increased risk to its real estate portfolio. Adding to the portfolio right now appears to accomplish anything but Workday's stated goal for the transaction, which is providing stability to its corporate footprint.

The transaction price may be immaterial to Duffield, but for Workday it's significant. The deal ($171 million) is approximately 62% of Workday's CapEx budget ($270 million) for FY22. By its own admission, Workday's future depends largely on product development. The decision to purchase real estate that may never be needed raises legitimate questions about the wisdom of Workday's capital allocation.