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SOND.OQ - Q3 2022 Sonder Holdings Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 09, 2022 / 10:00PM GMT

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PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to Sonder Holdings, Inc. Third Quarter 2022 Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Jon Charbonneau, Vice President of Investor Relations. You may begin.

Jon Charbonneau

Thank you, operator. Good afternoon, ladies and gentlemen. Thank you for joining us to discuss Sonder's third quarter 2022 financial results. Joining me on the call today are Francis Davidson, Co-Founder and CEO; and Sanjay Banker, President and CFO. Full details of our results and additional management commentary are available in our third quarter 2022 shareholder letter, which can be found on the Investor Relations section of our website at investors.sonder.com.

Before we start, I'd like to remind you that the following discussion and the Q&A session at the end of this call contain forward-looking statements, including, but not limited to, Sonder's strategies, market opportunities and future financial and operating results that involve risks and uncertainties that may cause actual results to differ materially from those discussed here.

Additional information about the factors that could cause our actual results to differ from those expressed or implied in any forward-looking statements can be found in Sonder's SEC filings. The forward-looking statements and discussion of risks in this conference call, including responses to your questions, are based on current expectations as of today. Sonder assumes no obligation to update or revise them, whether as a result of new developments or otherwise, except as required by law.

Also, the following discussion contains non-GAAP financial measures. For a reconciliation of these non-GAAP financial measures to the most directly comparable financial measure calculated and presented in accordance with GAAP, please see our shareholder letter posted to our Investor Relations website.

Now I'll turn the call over to Francis Davidson, Sonder's Co-Founder and CEO.

Francis Davidson - *Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board*

Thanks, Jon. Good afternoon, everyone, and thank you for joining us today. I'm happy to report on our strong third quarter 2022 results. Our remarks today will cover 3 areas. First, I'll provide a quick overview of our financial performance. Second, I'll provide an update on our cash flow positive plan announced on June 9. And third, I'll provide a couple of quick updates on our Board.

We're excited to report strong third quarter results, highlighted by sequential improvement in free cash flow before onetime restructuring costs to negative $39 million versus negative $45 million for the previous quarter. FCF margin also improved, reaching negative 31%, compared to negative 37% in the second quarter of 2022 and negative 66% in the third quarter of 2021.

The sequential improvement was driven by continued improvements in our cost base, somewhat muted by an expected sequential decline in RevPAR. On a year-over-year basis, our RevPAR grew by 25% to $158 and revenue grew by 85% to $125 million. Sanjay will provide additional detail on our third quarter financial performance a little later on in the call.

I'd like to provide an update on the progress of our cash flow positive plan, which includes 4 key levers. The first lever is reduce cash costs by approximately $85 million on an annualized basis before onetime restructuring costs. This includes a restructuring plan we began executing in June, which will result in nearly $55 million in annualized cost savings versus Q1 2022 costs.

We expect to largely see the run rate benefit of these cost savings in 2023. This also includes $30 million in expected annualized cash cost savings from reduced preopening costs and net CapEx associated with incremental units going live, given our focus on signing 100% capital-light units going forward.

So the second lever is proactively reducing our planned signings pace with growth in the near term primarily driven by opening previously contracted units. As a reminder, this enables us to lower head count growth across the board, lower preopening costs and net CapEx, cut back on planned geographic expansion and simplify the business. This will likely result in lower quarterly new signings versus what was planned prior to the cash flow positive plan as it did in the third quarter.

Additionally, we believe signings are impacted by continued macro uncertainty. This is impacting real estate developers given the substantial increase in interest rates this year, especially in the U.S., and development cost uncertainty. At the same time, even if we signed no additional units or saw no incremental RevPAR improvements, the embedded supply growth from our previously contracted units that are expected to go live over time implies an approximate doubling of revenue in the coming years.

This brings me to our third lever, which is increasing our already high threshold for incremental unit signings by only targeting 100% capital-light deals. We're pleased to report the vast majority of Q3 signed deals met this more stringent criteria, and the goal is to achieve 100% in the fourth quarter.

Our fourth and final lever is focusing efforts on improving free cash flow through rapid payback RevPAR initiatives. Given our fixed landlord payments, a small increase in RevPAR translates to a much larger increase in cash contribution margin. As a result, we remain focused on several rapid payback RevPAR initiatives, including growing our new corporate travel offering.

We ended Q3 with approximately 600 accounts versus 400 last quarter and 100 in Q4 of 2021. While we're still in the early stages of our corporate travel offering, we've gained traction each quarter since its launch, and we're incredibly excited about this as an opportunity to drive incremental RevPAR. We also remain focused on building out several ancillary revenue offerings, which we believe will further benefit RevPAR in 2023 and beyond.

To summarize, we remain committed to reaching positive quarterly free cash flow within 2023 without additional fundraising and while preserving a robust cash cushion.

Before turning the call over to Sanjay, I would like to highlight a few very exciting recent additions to our Board of Directors. A few weeks ago, we announced that Sean Aggarwal has joined the Board. Sean is currently the Chair of the Board of Directors at Lyft and brings a deep understanding of both the real estate and technology sectors.

In August, we also added Michelle Frymire to our Board. Michelle served as the CEO of CWT, one of the world's largest travel management platforms, providing business travel, meetings and event management for some of the world's biggest global companies. We believe Michelle's wealth of experience in the travel industry will bring strong contributions to our future development as a global hospitality leader.

And finally, we recently announced that Sanjay will transition from his role as President and CFO to join the Board at the beginning of next year. In his time as President and CFO over the past 4 years, Sanjay provided critical leadership for the company. He led us through multiple rounds of funding, helped stabilize and navigate the business through the COVID pandemic and also led a successful public listing earlier this year.

I believe his wealth of knowledge on our strategy and operations will make him a huge asset to the Board. I also couldn't be more excited about the level of talent, industry expertise and public company experience we have assembled on our Board.

Separately, we've launched a formal search process for the next CFO, and Sanjay will continue to remain in the role through the end of the year to ensure an orderly transition and support the recruitment of a new CFO.

In closing, our focus remains on the execution of our cash flow positive plan to drive sustainable, long-term value for all our shareholders and continue to revolutionize hospitality.

With that, I will turn over the call to President and CFO, Sanjay Banker, to provide you with further details on our recent financial performance and an update on our guidance. Sanjay?

Sanjay Banker - *Sonder Holdings Inc. - CFO & President*

Thank you, Francis, and hello, everyone. I'd like to start by saying what a great privilege it's been to serve as Sonder's President and CFO over the past 4 years. I have great confidence in the company, our plan and our team. I look forward to joining the Board and continuing to work with management in 2023 as a Senior Adviser to support the execution of the company's strategic plan.

With that said, I will first provide a brief overview of our third quarter financial results, and then we'll share our guidance for the remainder of 2022. We'll then open the call to questions. Unless otherwise specified, all of the Q3 growth figures cited in my remarks are year-over-year comparisons.

In the third quarter, we generated $125 million of revenue, representing an 85% increase compared to Q3 2021. Our Q3 revenue growth year-over-year was driven by our live portfolio growing 43% and RevPAR growing 25%. Again, this quarter, key performance metrics improved year-over-year, including live units, bookable nights, occupied nights and RevPAR. We ended the quarter with approximately 9,000 live units, representing 43% growth, driven by the conversion of contracted units into live units. This included the opening of Business Bay in Dubai, which will be our largest property ever at approximately 400 units.

In Q3, we had over 786,000 bookable nights, an increase of 47%, driven by this live unit growth. At quarter end, we had over 18,900 units in our total portfolio, representing 17% year-over-year growth. RevPAR in the third quarter was $158, up 25% year-over-year, and ADR grew 3% to $189, driven by continued market recovery. Our occupancy further increased to 84%, up 1,600 basis points year-over-year.

That said, I would remind everyone we are continually trying to strike the right balance between demand and rate. And therefore, we view occupancy as more of an output of this RevPAR optimization effort rather than a goal in and of itself.

Looking ahead, we expect our RevPAR to continue benefiting from the recovery of urban travel with third-party forecasters as of September 30 anticipating full market recovery back to 2019 levels in mid-2023.

Total costs and operating expenses increased by 51% to $186 million when comparing Q3 2022 to Q3 2021, inclusive of $6 million of stock-based compensation expense in the quarter. This increase in total costs and operating expenses were driven primarily by the expansion of our live units. As we noted in conjunction with the cash flow positive plan announcement in June, we are focused on free cash flow as a primary measure of financial performance. This metric aligns with how we view and manage our business internally.

In the third quarter, free cash flow before onetime restructuring costs totaled negative $39 million, compared to negative $45 million last quarter and negative $45 million a year ago. Free cash flow margin also improved, reaching negative 31% compared to negative 37% in the second quarter of 2022 and negative 66% in the third quarter of 2021. The sequential improvement was driven by continued improvement in our cost base, somewhat muted by an expected sequential decline in RevPAR.

Moving on, I would like to highlight cash contribution margin, which is a unit economic metric that measures property-level performance by excluding corporate and other non-property-level costs. This enables us to assess the cash performance of our live property portfolio, taking into account the benefit of upfront rent abatements, which is typical in the deals we signed.

In the third quarter, cash contribution margins were 22% versus 18% in the second quarter and 5% a year ago, demonstrating Sonder's unit economics equation is strong and improving. Our goals are to continue expanding these unit-level cash contribution margins as well as increasing the size of our live portfolio to cover nonunit costs and drive to overall profitability.

Free cash flow and cash contribution margin are the primary non-GAAP financial measures we will focus on publicly moving forward. As a result, we will not provide the reconciliations of property-level profit and adjusted EBITDA within our shareholder letter after reporting fourth quarter 2022 results.

Turning to the balance sheet. As of September 30, 2022, we had $318 million in cash and [$167 million] in total debt. Regarding guidance for 2022, we expect revenue of better than $455 million, representing more than 95% year-over-year growth and better than $129 million for the fourth quarter.

I would point out we are again facing notable FX headwinds in the fourth quarter relative to the exchange rates assumed when our previous 2022 annual revenue guidance of 100% to 110% year-over-year growth was first introduced 8 months ago.

At the same time, without overstating the magnitude of this, we have seen some incremental delay in contracted units being converted to live units, which has had some impact on our expectations for bookable nights in the fourth quarter relative to previous estimates.

For the second half of the year, Q3 and Q4 combined, we are reaffirming free cash flow of better than negative $70 million before restructuring costs, which implies better than negative $31 million in the fourth quarter. As Francis noted earlier, we remain focused on reaching positive quarterly free cash flow within 2023.

And as a reminder, the same as past quarters, our guidance is based on our best knowledge available from internal data and third-party forecasters and does not contemplate an extreme slowdown in demand. I would also like to call out that starting next quarter and for 2023 we will no longer be providing annual guidance, but we'll instead be providing revenue and free cash flow guidance for the following quarter.

I'll close our prepared remarks today by reiterating that our business fundamentals remain strong, and we believe our market opportunity is enormous. We are focused on driving sustainable, long-term value for all of our stakeholders via our cash flow positive plan and continuing to revolutionize hospitality for all.

While I will be transitioning out of my current role with Sonder at the end of the year, I want to reiterate the confidence I have in our business. I look forward to joining the Board in January and continuing to partner with management to make Sonder's vision of a better traveled world a reality.

We're now happy to take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Jed Kelly from Oppenheimer & Company.

Jed Kelly - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

Sanjay, good luck with everything with what you do in the future. First, my question is just on the guidance you called out. I guess, number one, are you seeing anything with the macro? Or is this -- is the RevPAR guide, I guess, sort of just all FX-related?

And then number two, can you just kind of touch on where you are in the current supply ramp and said units are coming on slower than you initially thought? I mean, where do you think you are sort of in the unwinding of your supply where you start to get better visibility on that?

Sanjay Banker - *Sonder Holdings Inc. - CFO & President*

Yes. Thanks, Jed. First of all, thanks for your question, and thank you for the kind words. I'll take the first part of the question around the revenue guide, and I'll pass it to Francis for the question about the supply ramp. As you pointed out and as we said in the opening remarks, the drivers of the revenue guide are the FX commentary we provided around the fact that FX has just moved against us. We set the full year guide originally back in February, 100% to 110%, and then we reaffirmed it in August. But FX has been a headwind through most of the year, but especially in the period in the last few months.

And so as we step back and we look at the impact of FX overall for the year, it's a mid- to high single-digit millions of dollars revenue impact to us. So that is a big driver. It's not the only driver. We did mention that looking to Q4 there remains some incremental pressure on bookable nights. We discussed it previously. It's a timing issue in terms of the time line for confirmed, signed, known projects to be handed over.

And so bookable nights will be up sequentially for Q4, of course, but not as much as we had been expecting recently. So when put all that together, without giving explicit guidance around sort of the decomposition, that's what's informing our revenue guide. It's not, to be clear, a macro issue, but really about FX and new unit timing.

Francis Davidson - *Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board*

Yes. Let me jump in here for the second part of your question on live units. So -- just as a reminder, the focus really for the business, if you take anyone in the company, you ask them what is the thing that we should prioritize, it's really the cash flow positivity plan and seeing improvement in free cash flow. So live units at 9,000 is a 7% increase quarter-over-quarter, but a 43% increase year-over-year. And there's natural variability quarter-to-quarter, larger deals, full buildings. And so the focus for us remains on the year-over-year.

It's important also to note that there's a 110% embedded growth that will come from our contracted properties in that we have more properties that are contracted but not yet live than we have live units today. And so we think that the growth picture in several quarters to come remains exciting. But it's true that in the near term we're seeing, right, some supply chain, labor challenges on the part of our developer partners, right?

As a reminder, we don't, as Sonder, actually build those properties or are responsible for renovations, but rather lean on our partners in order to do that. And they're faced with, yes, some challenges on the labor side that are leading to some projects being delivered a little bit more slowly than the timetable that they provided us.

There's a series of measures, though that we do control on our side in order to accelerate the time line it takes to open these properties. For example, bulk orders having enough inventory on the balance sheet, applying pressure on our partners, hiring, training. Though there are many things that we also don't control given that our developer partners are responsible for construction.

So -- we're still finding it interesting -- a good number of properties, but with a higher bar, of course, with the cash flow positive plan, ensuring that those are 100% capital-light deals. And so the growth picture, especially given the quantity of properties that are already signed, remains really attractive in the several quarters to come.

Jed Kelly - *Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst*

And then a follow-up, just can you give us an update on your RevPAR initiative, how that's trending versus what you laid out in the past couple of calls?

Francis Davidson - *Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board*

Absolutely. So on the corporate travel side, which is an initiative that we launched in mid-2021, right, to help bolster our weekday RevPAR performance, this grew to 600 corporate accounts. That was up from 400 in Q2. So really exciting rapid growth on that front and still early, right, in our journey to generate increasing quantities of business, corporate customers. So that's one of the initiatives.

Another really exciting one has been our high-occupancy strategy, which we started implementing in Q1, right, after some really extensive elasticity testing that our data science team ran. And so occupancy clocked in Q3 at 84%, which is really, really attractive. And we managed to, of course, maintain attractive ADRs as well. And so the RevPAR numbers that ensued were -- drove the cash contribution margin and the improvements in the margin profile of the business and unit economics of the business that we were seeking.

There's also other improvements that we've seen when it comes to our revenue management, a series of initiatives on ancillary revenue that we're rolling out. So the things that we've been discussing all year kind of starting to land and generate meaningful results that are helping us bolster our demand.

Operator

And our next question comes from Nick Jones from JMP Securities.

Nicholas Freeman Jones - *JMP Securities LLC, Research Division - Director & Equity Research Analyst*

I guess on RevPARs and then, I guess, as it ties to your free cash flow goals for next year, I think, there's kind of increasing fears that ADRs and RevPARs may come under pressure next year as macro worsens. How does that impact kind of the free cash flow goal? And how are you thinking about kind of ADRs and RevPARs heading into next year? And I guess kind of where Sonder's positioned to kind of still hit the goals kind of -- regardless of the kind of outcomes next year? Or are there scenarios where it could kind of delay the free cash flow goal?

Sanjay Banker - *Sonder Holdings Inc. - CFO & President*

Yes. I'll start, and Francis could jump in if I miss something. The way we think about -- just as a level-set and as a reminder, Nick, and for those listening, the way we build our forecast is to leverage the best available third-party information that we have. So we rely on third-party forecasters, STR, CBRE and the macroeconomic work they do to develop RevPAR forecast on a city-by-city basis, and we then roll that up based on our unit mix and our property mix, our portfolio mix, our anticipated mix in order to come up with a macro view against which we then overlay our own RevPAR improvement initiatives, et cetera. And so that's how we come up with a forecast.

As of now, those forecasts do not contemplate an extreme slowdown in consumer demand. And so from our perspective, we build a base-case forecast around that, leveraging that third-party input. Of course, if there is a major macro event, that is one of the scenarios that we have to test. We test all manner of scenarios and sensitize our forecast to make sure that no matter what happens in the macro that we have ample cash and liquidity to get to our free cash flow goal over time with no incremental fundraising needs.

And so just to reiterate, our entire plan is built around the idea that we can be self-reliant and have no need for incremental funding, even if there's a macro downturn in order to be able to get to free cash flow over time. So of course, we'll be affected by whatever the macro is, but our base case view today is that, that is not taking into account any slowdown in demand.

Nicholas Freeman Jones - *JMP Securities LLC, Research Division - Director & Equity Research Analyst*

Got it. And...

Sanjay Banker - *Sonder Holdings Inc. - CFO & President*

Sorry. Go ahead, Nick.

Nicholas Freeman Jones - *JMP Securities LLC, Research Division - Director & Equity Research Analyst*

Okay. That was great. And then I know corporate travel has kind of been a focus. We keep seeing more and more announcements around layoffs, the reductions in force. I mean, is there -- is that showing up? Is that becoming a little more difficult to kind of get corporate travel as, I guess, corporates are scrutinizing their T&E expenses?

Francis Davidson - *Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board*

The -- it's Francis here. Let's answer the question. So there is a very low baseline, right, in Sonder's P&L of business travel mix. Like I mentioned earlier on, the corporate travel program was launched in mid-2021. And in Q1, we had -- I think we closed Q1 with 250 accounts. We had 100 in Q4, shortly after the launch of 2021. So the baseline is really low. And so to us, as we're adding these kind of corporate accounts, hopefully, a much more rapid speed than there would be any contraction of overall demand, that could be kind of a net gain for us. So this is how we see the opportunity is that there's enormous white space for our business to generate corporate travel.

And we're really just getting started here. We're also taking a multiyear view when it comes to the returns on these initiatives and that there's kind of a land-and-expand strategy. We have all these corporate accounts that are signed, but then getting an increasing share of wallet is also an important initiative. So our teams are working diligently to kind of make sure that we capture as much of that demand as possible and it's increasing as a mix shift of our revenue as they're landing more corporate accounts and getting a greater share of their spend.

Operator

And I'm showing no further questions. And this concludes today's conference call. Thank you for participating. You may now disconnect.