REFINITIV STREETEVENTS

EDITED TRANSCRIPT

SOND.OQ - Q4 2022 Sonder Holdings Inc Earnings Call

EVENT DATE/TIME: MARCH 01, 2023 / 10:00PM GMT

CORPORATE PARTICIPANTS

Christopher Michael Berry *Sonder Holdings Inc. - Senior VP, CAO & Interim Principal Financial Officer*

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

Jon Charbonneau

CONFERENCE CALL PARTICIPANTS

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

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

Ronald Victor Josey *Citigroup Inc., Research Division - MD*

PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to Sonder's Fourth Quarter 2022 Financial Results. (Operator Instructions) Also 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, Head of Investor Relations. Please go ahead.

Jon Charbonneau

Thank you, operator. Good afternoon, ladies and gentlemen. Thank you for joining us to discuss Sonder's fourth quarter 2022 financial results. Joining me on the call today are Francis Davidson, Co-Founder and CEO; and Chris Berry, Chief Accounting Officer. Full details of our results and additional management commentary are available in our fourth 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 in discussions 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*

Thank you, Jon. Good afternoon, everyone, and thank you for joining us today. My remarks will cover 2 areas. First, a quick overview of our financial performance in the fourth quarter and 2022. And second, a brief overview of our key focus areas for the year. I'm encouraged by what we accomplished in 2022, especially considering a material shift in company strategy midyear to focus on generating positive free cash flow. We continue to meaningfully scale the business and still have a robust portfolio of contracted but not live units to help drive growth in the near to midterm. At the same time, our cost structure improved through the year, and we expect further leverage on costs in 2023 and beyond. We also saw a meaningful improvement in property level performance, enabling us to cut free cash flow burn in half over the course of 2022. These results reaffirm my conviction in our business model, and I believe that we're on a path to generating positive free cash flow.

Now I'd like to provide more details on the fourth quarter and 2022. Our fourth quarter results were highlighted by the third quarter in a row of free cash flow improvement to negative $30 million versus negative $39 million in the previous quarter and negative $62 million in the first quarter of 2022. This helped drive the significant improvement in FCF margin throughout the year, reaching negative 22% in the fourth quarter versus negative 77% in the first quarter.

And cash contribution margin, which is a unit economic metric, we used to measure property level performance -- was 24% in the fourth quarter compared to 22% last quarter and 10% a year ago. In 2022, we saw a significant improvement in RevPAR, which is up over 30% year-over-year while we lowered our cost structure, including our property level cost drivers, which improved over the course of the year.

Together with high-quality and capital-light property openings, this drove a sequential improvement in cash contribution margin in every quarter of 2022, enabling us to cut cash burn and improve FCF margins. As you can see, we've meaningfully improved our unit economics versus a year ago and exited 2022 with a better overhead cost structure while continuing to strive for further improvements, including the ones that we'll speak about shortly. We believe this demonstrates that our business fundamentals will continue to improve and that we're executing against our cash flow positive plan. I'm also proud of our top line performance with 2022 revenue up approximately 100% year-over-year. Moreover, we generated $135 million in revenue in the fourth quarter, which is over $0.5 billion on an annualized run rate revenue basis, excluding 2022.

Now I'd like to provide a quick overview of our key focus areas for 2023, starting with our RevPAR initiatives. In 2022, we continued to expand our corporate business, which included, among other things, strengthening our position on GDS platforms and adding a significant amount of corporate travel accounts. This translated into approximately $70 million in booked to corporate sales in 2022, roughly 5x growth compared to 2021. This year, we plan to continue expanding into new industry segments and expect another year of strong growth within the corporate business, which will bolster weekday RevPAR in particular, an area with still a lot of upside.

We're also doubling down on our elevated merchandising strategy with a reimagined art direction and photography side which we have seen drive over 10% improvement in conversion rates across 10 pilot properties. We're excited to implement this in over 40 of our largest properties this year, which will represent over 50% of World Live Units.

Next, on June 9, we announced our cash flow positive plans which shifted our focus from hyper growth to generating positive free cash flow more rapidly than previously planned. As a reminder, this shift in focus was not due to a lack of growth opportunities, but instead because market conditions have changed, and we thought it was prudent to shift our strategy to adapt to the changing macro environment. As you can see from our fourth quarter results, we've continued to make meaningful progress against this plan. I'll let Chris provide details on guidance, but we'll note that our focus remains on reaching our first quarter of positive free cash flow in 2023.

We've also continued to evaluate our cost structure, especially given ongoing macro uncertainty. As a result, we decided to reduce our overhead expense base, both across non-headcount and headcount spend, reducing approximately 100 corporate roles or 40% of our corporate workforce, which will lead to approximately $10 million in annualized cost savings. In addition to anticipated savings from non-headcount spend reductions. We've done our best to support our departing colleagues with care, dignity and compassion and are providing severance packages, including benefits continuation and other support to system transition.

Another component of cash flow positive plan has been to proactively reduce our planned [finding] pace with growth in the near term still being primarily driven by opening previously contracted units. And in the fourth quarter, live units grew by 28% year-over-year, driven by strong conversion from our contracted units to live units. At the same time, we continue to see development cost uncertainty and augmented risk around financing. As a result, we felt it was prudent to exclude a number of contracted units with financing contingencies, which drove the sequential decline within our total portfolio numbers. Importantly, the vast majority of contracted units we excluded weren't expected to go live until 2025 or beyond, and we expect limited impact to growth this year or even in 2024. Separately, we've made a lot of progress in the search for our next CFO and hope to have an update for you in the coming weeks.

In closing, our focus remains on the execution of our cash flow positive plan to drive sustainable long-term value for all shareholders. I want to thank our employees, partners and guests across the globe for choosing Sonder and for their continued belief and support of our mission to revolutionize hospitality.

With that, I'll turn the call over to our Chief Accounting Officer, Chris Berry, who will provide you with further details on a recent financial performance and an update to our guidance. Chris?

Christopher Michael Berry - *Sonder Holdings Inc. - Senior VP, CAO & Interim Principal Financial Officer*

Thank you, Francis, and hello, everyone. I will first provide a brief overview of our fourth quarter financial results. And then we'll share our guidance for the first quarter of 2023. We'll then open the call to questions. And unless otherwise specified, all of the Q4 growth figures cited in my remarks are year-over-year comparisons. In the fourth quarter, we generated $135 million of revenue, representing a 56% increase compared to Q4 of 2021. Our fourth quarter revenue growth year-over-year was driven by an increase in bookable nights of 39% and RevPAR growth of 11%. Again, this quarter, key performance metrics improved year-over-year including live units, bookable nights, occupied nights and RevPAR. We ended the quarter with over 9,700 live units, representing 28% growth driven by the conversion of contracted units into live units over the past year.

In Q4, we had approximately 852,000 bookable nights, an increase of 39% driven by this live unit growth. RevPAR in the fourth quarter was $158, up 11% year-over-year despite a 7% decline in ADR to $191. The decline in ADR was a result of our higher occupancy strategy we have talked about previously. To that point, our occupancy was 83% in the fourth quarter, up 1,400 basis points year-over-year. Our strategy hasn't changed in this respect. Our goal is to optimize revenue, and we are continually trying to strike the right balance between demand and rate. Occupancy rate is an output of this optimization effort rather than a goal in it of itself.

Total costs and operating expenses increased by 25% to $194 million, inclusive of $5 million of stock-based compensation expense in the quarter. All of this while revenue increased 56%. The increase in total costs and operating expenses were driven primarily by the overall growth in our live units.

We continue to focus on free cash flow as our primary measure of financial performance. We are building this muscle at Sonder. The trajectory and our free cash flow result is evidence of this, and we continue to look at our investments and our cost structure through the lens of our free cash flow metric. In the fourth quarter, as Francis mentioned, free cash flow before onetime restructuring costs totaled negative $30 million compared to negative $39 million in the third quarter and negative $53 million in the fourth quarter of 2021. Free cash flow margin also improved, reaching negative 22% compared to negative 31% in the third quarter of 2022 and negative 61% in the fourth quarter of 2021. The sequential improvement was primarily driven by continued efficiencies realized in our efforts to optimize our cost structure as we scale.

I would also like to provide an update on cash contribution margin, which is a unit economic metric we use to measure property level performance by excluding corporate and other non-property level costs. This enables us to assess the performance of our live property portfolio, taking into account the benefit of upfront rent abatement, which is typical in the deals we signed. In the fourth quarter, cash contribution margin was 24% versus 22% in the third quarter and more than double the 10% from Q4 of 2021. We are focused on continuing to improve this metric over time and I am pleased with the progress we are making in property level financial performance.

Turning to the balance sheet. As of December 31, we had $289 million in cash and restricted cash and $173 million in total debt. Note that restricted cash increased by $41 million sequentially due to temporary cash collateral requirements as we transition our letters of credit and deposit accounts to our new line of credit bank partner. $8 million of that restricted cash was already released in January, and we anticipate the majority of the remainder of this cash will be released by the end of this year. In conjunction with the change in bank partners, we were also able to increase our line of credit capacity from $50 million to $60 million to support our live unit growth as this line of credit supports letters of credit issued to our property owners.

Regarding guidance. For the first quarter of 2023, we expect revenue of better than $110 million representing 37% year-over-year growth. I want to remind everyone that Q1 has historically been our seasonally weakest quarter of the year, and we anticipate a similar pattern again this year. For Q1 2023, we expect free cash flow of better than negative $45 million before restructuring costs. Separately, 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 a significant slowdown in demand.

With that, we are now happy to take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we have a question from the line of Jed Kelly with Oppenheimer & Company.

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

Great. Just -- can we just talk about the outlook for 1Q and then just sort of how you're thinking of RevPAR. I think when we look at the overall hotel industry this year, it seems like you get a big jump in RevPAR in 1Q prior, call it, 25% to 30% that the year-over-year growth sort of dissipate. So do you expect your RevPAR to sort of follow a similar trend? So any thoughts on RevPAR would be great.

Christopher Michael Berry - *Sonder Holdings Inc. - Senior VP, CAO & Interim Principal Financial Officer*

Jed, this is Chris. I'll start this off. Yes. So the guidance today, we said -- we really guide toward revenue. We don't really differentiate or split out RevPAR versus bookable night. But we are guiding better than $110 million in Q1, which is an increase of about 37%, 38% versus Q1 of 2022. So we feel good about that trajectory right now. I mean just recognizing too that Q1 is typically our lowest quarter from a seasonality perspective as well. The other reminder too, is last year, during sort of really hard-hit COVID periods like Omicron in Q1, we performed better than our peers. So the comps going into Q1 for us are going to be a little bit tougher than the other comps from our peers. So just a recognition of that.

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

Got it. And then just with some of the headcount reduction should we expect the majority of that to come out of G&A? And then can you just give us an update, your positive cash contribution quarter. Are you expecting that to be in 3Q or 4Q? Just how should we be thinking about that?

Christopher Michael Berry - *Sonder Holdings Inc. - Senior VP, CAO & Interim Principal Financial Officer*

Yes, Jed, thanks again. In terms of the impact of the headcount reductions, the largest impact will be to G&A. These are largely corporate roles. So that's the answer for that one. In terms of the free cash flow timing, we're really focused on reaching positive free cash flow -- quarterly free cash flow here in 2023. We're not providing anything further at this point other than the guidance for Q1.

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

Got it. All right. And then just -- and then with the reduction of units, can you just talk about how we should be thinking about your portfolio approach going forward? And anything on like how we should be thinking about the supply ramp this year?

Christopher Michael Berry - *Sonder Holdings Inc. - Senior VP, CAO & Interim Principal Financial Officer*

Yes. For sure. This is Chris once again. Yes, each quarter, we take a fresh look at our portfolio based on what's going on current fact circumstances, macro environment. And what we've done is our best product. We exclude what we consider at risk units given the macro on financing environment challenges that we've seen over the past several months. And then how that impacts any financing contingencies that are built into some of these contracted properties. Just to be clear, some of the contracted properties are still -- they're still in our portfolio. We just have excluded them from our overall look to be more of a conservative, when given the uncertainty that's out there on these financing contingencies.

As we have focused on free cash flow this year, the signings that we've entered into this year, we've increased the hurdle rates, the contribution margin hurdle rates, lower payback periods, all of that as we really develop this muscle. And so we're pretty optimistic about further signings this year, but that's why you've seen some of the slowdown over the course of the past few months.

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

And just maybe 1 piece I could add here, Francis, stepping in on the question of the total portfolio is that these properties that have contingencies that we've decided to exclude as Chris just explained, have the vast majority of those are -- were not expected to go live before 2025, because we're talking predominantly of financing contingencies that would precede any sort of construction that would have to take place before those signed units can turn into converted units. And so the impact on live units and bookable nights for the next couple of years is minimal.

Operator

And it comes from the line of Nick Jones with JMP Securities.

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

I guess just one on 4Q with the Dubai location. I mean, any benefit from the World Cup in 4Q that we should note? And then I guess, if so, anything from the Super Bowl in 1Q?

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

Yes, Francis here. Happy to answer your question. The -- so we've got some significant events happening in across the world, across all of our markets many times a year. And so there's rarely an impact at the aggregate level that could be felt especially if you look at comparison periods, for 2021, where you had other things driving demand, especially in Dubai that were quite strong. So it's one of these markets that have very sharp recovery post COVID. So there's a lot of puts and takes there, but we don't think that the performance of the business or RevPAR was inflated as a result of onetime events?

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

Got it. And then, I guess, just to belabor the RevPAR piece. I think ADRs are you guys really kind of maintain price. It sounds like some of the commentary we've heard of that, that's going to be kind of resilient at least in the first half of this year. I mean, should we be considering any kind of mix shift as international travel comes back, maybe pressuring ADRs or any -- I guess, I'm trying to come at this question from a different angle of how we kind of can think about how resilient these can be as you progress to 2023.

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

Yes, certainly. So well, one thing I think that is important to keep in mind about our relative positioning of our price point, one of the major value propositions of staying at Sonder is that we remain with affordable option, especially for the quality of experience that we offer. And so when we look at our peer group, we typically come in with better occupancy, but slightly lower ADRs. And so we think that this value proposition could hold particularly well in a softer demand environment.

(technical difficulty) the other piece of that equation, which is what will the market be, well, I don't think we have any further differentiated insight than the market comments from economist on what the travel landscape looks like in urban markets. We have good visibility, 30 to 45 days out based on (technical difficulty) But beyond that, really, we look at what are -- what is kind of the consensus economic view and use that to plan our business. There is, I should say, despite a conservatism when it comes to the overall state of the economy, there is quite a lot of optimism for urban travel right now in the -- coming from these third-party forecasters because we're looking at a baseline of RevPAR that still isn't fully recovered until Q4 of 2022 across the urban markets in which we currently are versus 2019 levels.

And that's despite an economy that's inflated quite a bit overall since then. So we've only gotten back to RevPAR levels of 2019 as of Q4 2022. And so there's an expectation on the part of the market that we'll see strong ADR and RevPAR performance broadly in the markets in which we currently are. But of course, we don't have a crystal ball. I don't want to opine on to what exactly that will be.

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

Got it. And if I could ask a question on kind of live units. If I look back over the last 9 quarters, maybe with the exception of 4Q '21 and 1Q '22, it looks like somewhere between 500 and 700 units turn on sequentially. Is that the right way to think about the growth of live units?

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

So I think you're correct to point out that this has been kind of the pace of openings. We have a really substantial portfolio of sign not live properties, right, that's consisted in the majority of the growth of the business in the last several months since we announced our cash flow positive plan. It's about 1.8x growth in live units that we expect to generate as these signed units that are not yet live, become live. So we don't break out in our guidance the live units and certainly not several quarters forward, but we do have a really large books of signed deals that are expected to contribute to bookable nights over the coming years.

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

Got it. And I got 1 last question. Just how should we think about kind of corporate travel in 2023? Is that going to be kind of a big contributor? Or are there -- what's kind of low-hanging fruit there as you progress through '23?

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

Certainly. So I mean, we announced some really positive news today on corporate travel, right, $70 million of book-to-corporate sales, which was a 5x growth from 2021. So really extraordinary progress there from the team, really proud of the work that they've done to go and drive especially weekday demand and help bolster RevPARs during weekdays, where we've traditionally been not as strong as our comps, but we're making a lot of progress there, and there's more to come in 2023. Of course, there's the question mark on how strong will be business travel demand, which we don't have, again, differentiated insight into beyond what prognosticators forecasters have already laid out. But we feel very good about our capacity to get a disproportionate share as we have in 2022.

Operator

And it comes from the line of Ron Josey with Citi.

Ronald Victor Josey - *Citigroup Inc., Research Division - MD*

Two, please. One to follow up on Nick's questions here around corporate. And Francis, I think I heard you say in the prepared remarks just the integration with the GDSs helped to drive a lot of the growth there. Talk to us about just the plan to raise awareness, working with corporates being part of the overall travel, call it, booking of process flow amongst corporate travel, how that's -- how you're doing there and how that's driving overall growth? And then Chris, I think I heard you say that maybe tougher comps coming up due to COVID, but you cannot talk about summer travel and -- would love to hear your thoughts on what you're seeing in terms of current trends, thoughts in the summer travel, insights on booking windows, things along those lines.

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

Thank you. So let me kick it off with the first one, Ron. So yes, we've added more GDSs. There's a whole distribution landscape for business travel that our team has been working hard to add to our demand channels. And so those efforts are starting to pay off. And in addition to, of course, the technology kind of distribution angle, it's really important to have boots on the ground and folks that are there to advocate and sell the Sonder value proposition to corporate customers. We've been included in a lot more RFPs during RFP season (technical difficulty) as a result of some of these efforts. We've got many verticals that are just working quite well for us that we're leaning into, like entertainments, sports, corporate housing, relocations, internships.

So we're really kind of finding use cases that work really well for our offering and lean into these segments and these businesses in order to grow our corporate booking volume. So we're very happy with all the effort that it's taken to get there. It's by no means easy to pull off, but we've hired some folks that come from industry and know how to get it done and that have really delivered something quite strong over the last couple of years.

I'll let Chris jump into the summer travel question.

Christopher Michael Berry - *Sonder Holdings Inc. - Senior VP, CAO & Interim Principal Financial Officer*

Yes. I will really just restate what we've said in the past is we only have visibility internally to the next 30 to 45 days, and that goes into our Q1 forecast. When it comes to longer term, we're really relying on same sort of information that you probably have, Ron, in terms of the travel research out there. If you look at Q1 last year, when I see difficult comps, it's really that we performed better than our peers in Q1 last year during the Omicron wave that came through. And so that's why Q1 is a little bit tougher comp when looking at other peers. And then there was a -- last year, there was a little bit of a hockey stick recovery as we went from Q1 into Q2 and Q3. But right now, we don't have any really insight into what the next several months look like other than Q1, which is the guidance we provided today.

Ronald Victor Josey - *Citigroup Inc., Research Division - MD*

Got it. That's helpful. Maybe, Francis, as a quick follow-up, if I may. Just on corporate travel, the $70 million, if my math is right, it's around 15% of revenue. Hard to think about like where that goes longer term, but any reason to believe that corporate travel would be any different than, call it, more traditional lodging contribution, more traditional lodging players out there? Or do you think that maybe Sonder might be uniquely positioned just given the portfolio, given the comfort and all the different services that are offered there?

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

Thanks, Ron. I think that's a really thoughtful question. And we've been having some of the easy debates internally to try and figure out what is the steady state amount of demand that will be driven by a corporate program versus other sources of demand of demand and we're also very fortunate to be extremely strong at leisure. And so -- and we've managed to generate very attractive RevPARs and occupancies on weekends and in leisure strong markets. And so the goal wouldn't be to replace that demand with demand that would come potentially at lower RevPARs or ADRs from other segments. So it's really an optimization game and there's a different answer for each building and for each market (technical difficulty) see from first principles a reason to believe that we would be any weaker or particularly strong versus the global hospitality brands, but something that we're going to find out over the coming years.

Operator

And ladies and gentlemen, with that, I will conclude the Q&A session and today's conference. Thank you all for participating, and you may now disconnect. Good day.