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CORPORATE PARTICIPANTS

Christopher Berry

Dominique Bourgault *Sonder Holdings Inc. - CFO*

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

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Sonder Holdings Second Quarter 2023 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, Chris Berry, Senior Vice President and Chief Accounting Officer. Please go ahead.

Christopher Berry

Thank you, operator. Good afternoon, everyone. Thanks for joining us today to discuss Sonder's Second Quarter 2023 financial results. We have Francis Davidson, Co-Founder and CEO; and Dom Bourgault, Chief Financial Officer, on the call with me this afternoon. Today, Sonder reported $157 million in revenue for the second quarter and a negative 27% operating margin, a 29-point improvement over the second quarter of 2022. Our free cash flow was a negative $27 million, or a 40% improvement over Q2 of 2022 and another step closer to our goal of sustainable positive free cash flow. Full details of our second quarter results are available in our shareholder letter, which can be found on the Investor Relations section of our website, at investors.sonder.com.

Our prepared remarks and Q&A session at the end of this call contain forward-looking statements, including, but not limited to, Sonder's strategies, market opportunities and estimated future financial and operating results. Our business involves risks and uncertainties that may cause actual results to differ materially from those discussed today and in our shareholder letter. 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 our SEC filings. The forward-looking statements and discussion of risks today are based on current expectations. Sonder assumes no obligation to update or revise them, whether as a result of new developments or otherwise, except as required by law.

Also, our remarks contain certain non-GAAP financial measures. For a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measure, refer to our shareholder letter posted to our Investor Relations website.

With that, I will 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, Chris. Good afternoon, everyone, and thank you for joining us today. First of all, I want to acknowledge and thank all of our Sonder employees, our guests and our partners for their efforts and their business as we strive to fulfill our mission to revolutionize hospitality through design and technology, making a world of better stays open to all. To provide a few highlights from the quarter that illustrate the remarkable progress we've had at Sonder, revenue grew 30% year-over-year, driven by a 32% increase in bookable nights on a 32% increase in overall live units, all while maintaining an occupancy rate of 82% and ADR relatively stable at $200. We also produced all of this growth with a 19% improvement in total overhead costs and a 6% improvement in total property level expenses per occupied night. These accomplishments resulted in a 40% improvement in our free cash flow compared to last year. I'm proud of the progress that we've made, but we still have much to do to reach our goal of sustainable positive free cash flow.

We're committed to delivering on this objective, and we'll pull every lever we can to get there as quickly as possible. Dom will share more details with you in a few minutes about some of the cost drivers we're focused on. But first, I'll dive a bit deeper into our revenue and total portfolio growth. Across all of our Sonder properties, RevPAR declined 2% compared to the second quarter of 2022. We did see a moderate pressure on ADRs for our apartment products during the quarter, yet the opposite is true for hotels where ADRs increased year-over-year. Our live units comprises roughly 60% of apartment style units and 40% hotel units.

Over the last year, our mix has shifted 8 points from apartments to hotels, lessening the impact of pricing pressure from the short-term rental apartment market in Q2. Year-over-year, RevPARs for our hotel properties were up mid-single-digit percentage points, while RevPARs for our apartment style properties were down a similar amount, highlighting this issue. This is notable, as just 5 years ago, Sonder did not operate any hotels. This diversification of property types is improving our overall economics, offering our guests a wider variety of stays and increasing our brand recognition.

Breaking it down by geography, our North America properties experienced a 4.5% decline in RevPARs, while our properties in EMEA saw a 7% improvement in RevPAR year-over-year. Notably, according to AAA travel data, 8% more Americans traveled internationally, while 20% fewer international visitors arrived in the U.S., and that's in May compared to May of 2019. I recently returned from visiting several of our Sonder markets in Europe, and it's clear that the demand for leisure travel is still very strong, and our properties there are performing very well.

In addition to some of these more macro factors, corporate sales grew slower than expected due to some turnover on our sales team, and we have experienced slow starts in a few of our recent North America property openings, particularly for properties that relied heavily on B2B demand before we took over their operations. It typically takes some time for new properties to ramp to system-wide average economics, but even so, a few of our newer, larger properties have not met our expectations. Our operations, real estate, revenue, sales and finance teams are working together to address these challenges and come up with solutions to quickly improve the financial performance of these assets.

Several of the RevPAR initiatives we've discussed in earlier calls continue to ramp and are contributing to our overall improving cash contribution margins. In the second quarter, we added another 18% of our total live units to our elevated visual merchandising platform, with reimagined art direction and photography. We now have 1/3 of our live units merchandised under this new program, and we've seen an uplift in conversion of over 10%. We expect over 50% live unit coverage by the end of the year.

Our ancillary revenue initiatives rollout continues to progress well. In particular, rolling out our paid parking options has added an incremental 26 basis points to RevPAR in the second quarter. Although not significant on an individual basis, our team is pushing through several of these ancillary revenue programs, each of which is improving our overall property financial performance. On the supply side, our overall live units grew 32% year-over-year, driven by strong conversion from our contracted units to live units. Our total portfolio of live units plus contracted units did decline 7% however, year-over-year, as development cost uncertainty and persistent high interest rates remain a significant issue for developers and landlords. We felt it was prudent to exclude an additional number of contracted units with financing contingencies, which drove the decline. Even after excluding these units, we continue to have a notable backlog of contracted units, representing a strong growth pipeline of nearly 60% of our live units count.

This quarter, we also publicly launched our new Powered by Sonder product. This is a collection of uniquely designed boutique hotels powered by Sonder's technology and operational expertise. These hotels are infused with local flair and have their own distinctive aesthetic. With our proprietary technology and our efficient operating model, we're able to provide compelling value to hotel owners. And in many cases, buildings in this product segment allow us to onboard and get to market more quickly. We have 23 Sonder hotels across 13 markets in this segment, with new properties coming on board.

Before turning it over to Dom, I want to highlight the accolades we received from our guests. We recently announced that over 1/3 of our properties, 87 in total, received TripAdvisor's Travelers' Choice Awards in 2023, and this is a threefold increase from last year. We're very grateful for this recognition. Two of our properties, the Maisonneuve in Montreal and Do Placa Reial in Barcelona, received the Best of the Best award, representing the top 1% of all TripAdvisor accommodations. So a huge shout out to our teams in these award-winning properties. Thank you for taking great care of our guests.

And with that, I'll turn over the call to our Chief Financial Officer, Dom Bourgault. Dom?

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

Thank you, Francis, and hello, everyone. After 5 months with Sonder, I continue to be impressed by the energy of the Sonder team and how dedicated they are to reaching our financial and operational goals. The team is united in our focus of achieving sustainable positive free cash flow in the near term and industry-leading unit economics over the long term. This quarter's results move us another step closer to achieving that goal. We still have a lot of work to do, but I'm pleased that our results demonstrate consistent progress on our path to becoming cash flow positive.

With that said, I will provide a brief overview of our second quarter financial results and then take you through guidance. We'll then open the call to questions. In the second quarter, we generated $157 million of revenue, representing a 30% increase compared to Q2 of 2022. As Francis mentioned, key top line performance metrics improved year-over-year, including live units, bookable nights, occupied nights, while we experienced a slight decline in RevPar. We ended the quarter with approximately 11,100 live units, representing 32% growth year-on-year, and we have over 957,000 bookable nights, also an increase of 32%, driven by the live unit growth. Occupancy remained strong at 82% in the second quarter, stable with Q2 of 2022 on the back of significant growth in bookable nights.

In the second quarter, free cash flow before onetime restructuring costs totaled negative $27 million, compared to negative $41 million in the first quarter of this year and negative $45 million in the second quarter of 2022. Free cash flow margin also improved year-over-year, reaching negative 17% compared to negative 37% in the second quarter of 2022. Sonder continues to show consistent improvement in free cash flow, and we expect this trajectory to continue. Our pipeline of live unit growth, combined with strong operating leverage in our cost base, will lay the path to sustainable free cash flow that will strengthen as we scale, and result in significant long-term value to our shareholders. Since Francis provided the details of our revenue performance, I'll now focus my remarks on the cost side. For Q2 2023, total cost and operating expenses increased by 6% year-over-year to $199 million, which is inclusive of $8 million of stock-based compensation plans. The 6% increase in total costs on the back of a revenue increase of 30% illustrates the strong improvements we've been driving in our operating leverage. Property level costs grew by 24%, and our non-property level operating expenses were lower by 19% compared to prior year.

Our commitment to positive free cash flow and cost leverage is driving fiscal discipline in our organization, and the results are encouraging. That said, there are several areas of opportunities for further cost reduction that we are going to address over in the next several months. I'd like to touch on a few of these today.

First, we must get into the right real estate deals to begin with, and hold our portfolio of live units to high standards of performance. Our total live units generated 18% in cash contribution margin over the past 12 months. While roughly 3/4 of our properties are positive contributors to this performance, some of our properties do have negative cash margins. For example, certain properties in markets such as Phoenix have struggled to perform. We are taking a deep dive onto these underperforming properties, looking at a set of improvement actions, including targeted marketing and corporate sales efforts, RevPAR initiatives and partnering with our landlords for creative ways to restructure the leases.

Rapidly improving the financial performance of these properties represents a sizable opportunity to solidify and accelerate the achievement of our sustainable free cash flow goal. Second, we must achieve better leverage on our property level costs. For example, our utility costs are approximately $30 million annually [in the world]. We're partnering with utility management companies to gather a complete data set for our utility providers and costs across our portfolio in order to better manage the rising cost of energy. We're also taking action to be more efficient in our buildings and reduce waste. These actions will both reduce costs and our overall carbon footprint, a win-win for all our stakeholders.

We're also addressing payment processing fees and commissions. We have been inefficient historically in how we flow funds, especially with cross-border transaction. Recently, we have partnered with our team and processors to more effectively process foreign currency transactions, and expect to save over $1 million in commissions on an annualized run rate basis from improvements made to date, with more opportunities ahead. And third, we can do more on nonproperty level operating costs. As a reminder, we have reduced our corporate workforce approximately 30% on a net basis since going public in early 2022, resulting in approximately $30 million of annualized savings, but we are not stopping there. For instance, we have been combing through all of our software contracts, aiming to eliminate duplicate solutions, renegotiate terms with vendors, and establish new processes to ensure we have solid ROI metrics before we enter into new contracts or renew existing ones.

These are only a few examples of the actions we are taking internally to drive cost reduction in our operating model and ultimately help us achieve positive free cash flow. Trailing 12-month cash contribution margin was 18% versus 13% at the end of Q2 of 2022. We know that cash contribution margin can make it difficult to compare us with our competitors. As the company matures and our unit economics become more comparable to the industry, we are looking to transition to more traditional earnings metrics like EBITDA or EBITDAR over the next year. EBITDAR in particular, is commonly used by other organizations in the industry that operate leased properties, as it allows management and investors to assess the financial performance of the business, excluding the costs of financing those properties.

Turning to the balance sheet. As of June 30, we had $220 million in cash, cash equivalents and restricted cash, and $187 million in total debt. Restricted cash increased sequentially in Q2 due to the dynamics stemming from the failure of SVB and from certain amendments to our financial covenant requirements, leading us to collateralize certain new letter of credit issuances under our facility with First Citizens. We are working with First Citizens and our other financial partners on solutions to provide the right form of financing that will allow for the issuance of uncollateralized letters of credit.

As a reminder, there are no financial covenants tied to our term loan, and we are not contractually obligated to pay cash interest until January of 2024. Looking ahead, for the third quarter of 2023 we expect revenue between $160 million and $170 million and free cash flow, excluding onetime restructuring costs, between negative $25 million and negative $15 million, which at the midpoint is a $19 million or nearly 50% improvement versus the third quarter of 2022. For the second half of 2023, based on our current projections of RevPAR and live unit growth, we expect revenue between $335 million and $355 million, which is a slight decline from the range of $345 million to $375 million from our last quarter call, due to the headwinds that Francis alluded to earlier.

For free cash flow, we expect between negative $55 million and negative $35 million in the second half of 2023, reflecting the lower revenue guide, partially offset by continued progress on cost reductions from initiatives such as the ones we mentioned earlier. At the midpoint of the guidance ranges provided, this translates to $63 million or 36% improvement in free cash flow for the full year of 2023. With that, we're now happy to take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

The first question comes from Ron Josey with Citi.

Unidentified Analyst

This is Jake on for Ron. So I just had 2 questions. First, this is really -- Powered by Sonder. That's really great to hear about this new initiative. Could you maybe speak a little bit more about the motivation behind it? And then also how the economics might differ from the business? And then just thinking out like 2, 3 years from now, like how would you see this evolving over time? And then second is really on RevPAR. Really great to get the color on this current quarter. And the breakdown, we found that really helpful. Could you speak to how you're thinking about as you look at the back half of the year, whether the various factors you highlighted in your prepared remarks, do you expect those to persist? Is that implied in your guidance?

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

Francis here, I'll get started on the first question, and I'll let Dom step in for the question on RevPAR -- or the RevPAR guide. So listen, we're really excited by Powered By Sonder. So thank you for calling out that really important initiative. The motivation for it, frankly, is multifold. It starts with just the mission of this business. I mean our mission starts with the words to revolutionize hospitality. And we've been very careful not to say to revolutionize short-term rentals or apartments. Hospitality is a broader category, and we hope to be successful across a variety of asset classes starting with apartments, but also with hotels and with a few bets that we have in resorts.

But over time, adding a plethora of accommodations categories, we think is the most appealing brand value proposition. So we want to do it for the customers. But there are several other reasons why we decided to launch Powered By. One is that it's really a good business in that often, we identify independent hotels. They're really, like, beloved by their guests. But they don't have the technology that we've built, maybe the operational wherewithal to really maximize the value of the asset. And so in conversations with these owners, it makes a lot of sense for Sonder to be the operator for these assets. Well, under our current brand construct, it's not possible for us to take on properties that have a different design aesthetic, or at least prior to the launch of Powered by Sonder. So Powered by Sonder allows us to operate these hotels, to bring in our technology, to bring in our operations. But without having to redesign the whole thing, if it already is really interesting and distinctive and beautiful and has its own identity. And so it's allowed us to really expand the range of supply that we can take on at really attractive economics.

Another one of the benefits is that those properties could become live quite rapidly. So when you're talking about a multifamily development project, you might be 2, 3 years out. And especially in the financing environment right now, it could take a while for these properties to actually deliver. There's some risk that they might not get financed at all. Whereas when we're talking about an independent hotel and a Powered by Sonder property, they can be turned over to us relatively rapidly and with minimal investment on our part or on the owner's part. And so we're talking about rapid payback periods and pretty rapid conversion of signed to live units.

So that hopefully answers the question a little bit on economics as well, in that those are capital-light deals. We used the same hurdles internally for these Powered By properties as we do for other deals that we sign, meaning that we pay attention to the cash contribution margin that the asset is expected to generate. We do a very robust underwriting. And so both on payback, on profitability, on minimum deal size, we're looking at similar variables now -- up until now and the performance has been very strong. So lastly, let me comment briefly on how we see it evolving over time over the next couple of years.

So we announced that we had 23 properties to launch this brand segment across, I believe, a dozen markets, and we've got more that are signed. So this is a relatively new initiative for us. We're just getting started here, but we see that there's a vast, vast opportunity, especially in markets with a deep supply of independent properties. I'm talking about Continental European capitals like Paris or Barcelona or New York City, with just a really deep supply of independent hotels that could be converted to Powered by Sonder. So I'll leave it here on the question of Powered By and let Dom step in for the second question.

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

Thanks, Francis. And Jake, to your question on the RevPAR dynamics we've seen and how we forecasted that. So essentially, just to reiterate what Francis touched on in terms of the trends we've seen in Q2. Strength in EMEA across the board, but offset by weakness in North America, in particular in alternative accommodation, and also slower corporate bookings. So what we do in our RevPAR forecast is we integrate those latest trends (technical difficulty) [now a] range around that. The range, of course, is meant to incorporate the [given] the inherent volatility of RevPAR in the market, given how dynamic it is. And the range is constructed to give us a little bit of room and absorb some of these movements. Yes, and again, just to reiterate, I think what you saw in Q2 is how we think about the rest of the year (technical difficulty) and try to incorporate that in the guidance.

Operator

The next question comes from Jed Kelly with Oppenheimer.

Unidentified Analyst

(technical difficulty) This is Josh calling for Jed. Just wondering if you could speak to about balancing occupancy in ADRs and talk about the progress around revenue management? Then I have a quick follow up.

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

Jed. I'm going to jump in, Francis here. What I understood here is the balance between occupancy and ADR. So the audio didn't come in super clearly, but let me maybe just provide a quick commentary on how we think about occupancy and balancing that with ADR. So one thing to note is just how strong Sonder's occupancy rate has been for the last several quarters. I think for 10 quarters in a row here, we've outperformed industry peers. So we're talking about low 80s occupancy rates. And it just speaks to the value proposition of the Sonder brand, right, which is to offer a really elevated accommodation, a really modern service experience, but doing so at a price point that's reasonably affordable. And so that translates into quite a lot of occupancy and ADR, which was last quarter around $200.

We have a lot of data internally. We've run many tests on elasticity to kind of figure out what is profit maximizing for us. And it's clear that our customer demographic responds quite strongly to changes in price. And so this is the benefit in terms of our capacity to generate strong occupancy, but it also makes it a little bit harder for us to just increase ADRs while preserving that occupancy. So that partly motivates our strategy to invest more in B2B travel and our sales team so that we can get less price-sensitive customers to generate demand, during weekdays in particular. So that's generally how we think about occupancy and ADR, but we're very happy with the strong occupancy results we've seen to date.

Unidentified Analyst

(technical difficulty) [Francis and] could you maybe talk about the progress around your revenue management?

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

Yes. So on revenue management, there's a series of initiatives that our team has been working on. One of the very important metrics is the booking curve or the price trajectory, the so-called price trajectory. And so typically, it's preferable to increase price closer to the day of arrival because these customers tend to be more inelastic. And so there can -- yield stronger RevPARs by having lower prices initially and raising them. But those dynamics are very different depending on season, depending on markets. And so our data science team has been doing quite a lot of work to figure out what is the optimal booking trajectory by market, by season, by asset, by even room type, to try and figure out how we can maximize yield. So that's 1 thing that we've been working on and update in the back end.

Another one is our compacting algorithm. So this is something that our technology team has delivered in the past quarter that's quite exciting which allows us -- actually it's part of the answer I should have mentioned on occupancy rate, is this sort of Tetris game with the calendar, to ensure that we can maximize the quantity of bookings that could happen in a given property, especially given that we tend to have a pretty broad distribution of lengths of stay. So to take a simple example, if a guest wants to stay with us for 4 weeks. Of course, the average length of stay is 4 nights, but suppose that someone wants to stay for 4 weeks and they need a place starting on Friday, a couple of days from now. Well, if we're not careful about how we allocate the significant number of bookings that we already have on the books, we might have nothing available.

But by properly putting the right reservations in the right units, we can actually open up more availability. So there's a pretty complex math problem here that's applied, where our team has been able to update the algorithms and generate incremental compacting, incremental occupancy, which is particularly valuable for the high season and demand-constrained -- supply-constrained markets and properties.

So those are just a couple of examples. Maybe the last 1 I should mention is an update to our fixed pattern length of stay formula. So I alluded to this in a prior earnings call, but for those that weren't on, the fixed pattern length of stay implies basically making the price per night a function of the length of stay. And doing, though, in a continuous fashion. So a 3-night or a 4-night stay will actually have a different price per night that depends on the cost to serve that specific guest. So this is something that's quite innovative in the hospitality industry, to kind of have our cost to serve by length of stay, feed into our pricing model.

And so our teams have updated and improved those formulas in a way that's allowed us, we believe, to increase the contribution profit at the asset level by just optimizing this kind of discount curve.

Unidentified Analyst

Then just like a quick follow-up. 3Q guidance looks like it implies slight revenue acceleration.(technical difficulty) Was that being driven more by [yield count or RevPAR]?

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

Yes. Sorry, I think we lost the last part of that question. So you mentioned Q3 guidance, revenue acceleration, and then we lost the rest of that question.

Unidentified Analyst

3Q guidance implies [revenue acceleration]. Is that being driven more by unit count or RevPAR?

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

Okay. So the question as we understand it, was it more unit count or RevPAR that is driving the revenue increase in the guide for Q3. So Dom, we'll let you answer that.

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

Thanks, Francis. It's basically all RevPAR. We -- from a volume standpoint, our forecast has been very stable. So yes, most of it is from a slight reduction in RevPAR for the same drivers we mentioned earlier.

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

So Dom, I think maybe the question was misunderstood here. So I think let me just reiterate it. So from Q2 to Q3, we're seeing a step-up in our revenue guide, right? So revenue came in Q2, $157 million. We're guiding $160 million to $170 million here. Is it mostly RevPAR bookable nights? And obviously, it's a combination of both. And we don't break down specifically what is RevPAR versus what is bookable nights. But last quarter, we saw about 850 live units open, and we've got quite a lot of units that are set to open this quarter as well. So we should see an increase in bookable nights into Q3, but the exact split we haven't broken out. Like it seems like Dom's having a little bit of an issue with the audio. So I'm going to cover for him on this one, but hopefully, that answers the question.

Operator

(Operator Instructions)

I show no further questions at this time. This concludes today's conference call. Thank you for participating. You may now disconnect.