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PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to the Sonder's First Quarter 2023 Earnings Call. (Operator Instructions) And please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, John Charbonneau, VP Head of Investor Relations. Please go ahead.

Jonathan David Charbonneau - *Sonder Holdings Inc. - VP & Head of IR*

Thank you, operator. Good afternoon, ladies and gentlemen. Thank you for joining us to discuss Sonders First Quarter 2023 Financial Results. Joining me on the call today are Francis Davidson, Co-Founder and CEO; and Dom Bourgault, Chief Financial Officer. Full details of our results and additional management commentary are available in our first quarter 2023 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, Sonders strategies, market opportunities and future financial and operating results that involve risks and uncertainties that may cause actual results to differ materially versus 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 Sonders 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, John. Good afternoon, everyone, and thank you for joining us today. First off, I'd like to welcome our new CFO, Dom Bourgault to his first Sonder earnings call. I'm very excited to have Dom on board who brings over 2 decades of financial leadership experience, the vast majority of which was spent working at Expedia, and he has already made a great impact in his short time here at Sonder.

Before I comment on Q1 results, I want to share a few thoughts about our share price. While we understand the broader macroeconomic environment that's currently affecting capital markets, we're obviously not thrilled about the value at which shares have been trading. In our conversations with some of our shareholders, it's clear that we have the same desire to achieve cash flow positivity on a sustainable basis as soon as possible. The progress we've made since announcing our cash flow positive plan in June last year has been enormous. To communicate our actual results and their drivers more clearly, we've updated our investor presentation to better illustrate Sonder's free cash flow equation.

We believe this demonstrates the reasons why we have conviction that we're heading in the right direction and anticipate achieving sustainable free cash flow positivity without having to fund raise. The 4 drivers that have led to improvements to free cash flow are cash contribution margin improvement, live unit growth, overhead cost reductions and preopening cost reductions. We feel great about our capacity to keep pulling these levers to see free cash flow improve at a similar pace going forward.

Now on to first quarter results. Revenue grew by 50% year-over-year to $121 million in what is our seasonally slowest quarter of the year. As expected, January was a slow month, but we saw a steady month-over-month increase in RevPAR in both February and March. Additionally, free cash flow improved to negative $41 million versus negative $62 million in the first quarter of 2022, a $21 million year-over-year improvement. The free cash flow margin improved to negative 34% in the first quarter of 2023 versus negative 77% in the first quarter of 2022. This has been partially driven by our continued focus on reducing costs, such as overhead costs, which were down 20% year-over-year.

In fact, overhead costs have improved on an absolute dollar basis in every quarter since the first quarter of 2022, while revenue grew nearly 80% over that same time period. On direct costs, we've seen a roughly 10% reduction in property level operations and support expenses per occupied night on a like-for-like basis over the past year, primarily driven by improvements in housekeeping and customer service. This has helped drive a significant improvement in trailing 12-month cash contribution margin to 19% in the first quarter versus 4% a year ago. Dom will provide additional detail on our first quarter financial performance a little later on in the call.

Now I'd like to provide an update on a number of our RevPAR initiatives, which drive cash contribution margins. During the first quarter, we continued to expand our corporate business, including deepening our presence in existing verticals such as entertainment, while also expanding into several new verticals, including education, government and finance. We also signed new GDS partnerships and are working with many of the industry's leading travel management companies. We're very excited about our momentum within our corporate business and still anticipate another year of solid growth, which will further bolster weekday RevPARs, an area with immense opportunity.

Next, we're continually looking to improve our pricing optimization and have made considerable progress rolling out our improved pricing algorithms, allowing us to better capture demand throughout the booking window. More broadly, we believe that our revenue management technology is unique with a lot of innovative features, enabling us to maximize profit across the broad range of length of stays that Sonder attracts.

During the first quarter, we rolled out our new Flex cancellation policy on VRBO, and I've already seen a positive incremental benefit to RevPAR. At the same time, we tested a new commission model, which produced a notable uptick in both search and page views and therefore, we decide to implement it across all of VRBO.

Moving on, I believe our elevated merchandising strategy with the reimagined art direction and photography further showcases our design-led value proposition, one of our most important brand differentiators. This strategy has continued to result in an uplift in conversion of over 10% and was implemented in over 15% of total live units by the end of the first quarter. The FOUND in Santa Monica is a great example, and you can find it before and after within our shareholder letter. Throughout the second quarter, we anticipate upgrading our photography across an additional 15% of live units and expect over 50% live unit coverage by the end of the year.

Shifting to our total portfolio. In the first quarter, Live units grew by 35% year-over-year, driven by strong conversion from our contracted units to live units. This resulted in us surpassing 10,000 live units, a big milestone for the company. New signed units also more than doubled sequentially, which is encouraging after a slower second half of 2022, although many landlords and developers are still dealing with difficulty getting financing. That said, we still have a notable backlog of contracted but not live units, which we're expecting will continue to be the primary driver of unit growth over the next few quarters. I'd also point out that 100% of deals signed in the first quarter were capital-light.

Before turning it over to Dom, I want to thank our employees, partners and guests across the globe for choosing Sonder and for their continued belief and support in our mission to revolutionize hospitality. 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. I'm excited to be here with the team and working for a company that is revolutionizing hospitality through design and technology. Since joining Sonder 2 months ago, I have taken an in-depth look at the business and has reaffirmed the confidence I have in our overall strategy when first deciding to join the company. I believe we are on the right track, but there is still more work to be done in order to reach our goal of achieving sustainable positive free cash flow as soon as possible while preserving the company's attractive growth profile.

With that said, I will provide a brief overview of our first quarter financial results and then take you through guidance. We'll then open the call to questions. In the first quarter, we generated $121 million of revenue, representing a 50% increase compared to Q1 of 2022. Our first quarter revenue growth year-over-year was driven by an increase in bookable nights of 30% and RevPAR growth of 15%. Again, this quarter, key top line performance metrics improved year-over-year, including live units, bookable nights, occupied nights and RevPAR.

More specifically, we ended the quarter with approximately 10,400 live units, representing 35% growth driven by the conversion of contracted units into live units. In Q1, we had nearly 900,000 bookable nights, an increase of 30%, driven by this live unit growth.

RevPAR in the first quarter was $134, up 15% year-over-year, with the ADR component growing 4% to $167. As Francis mentioned, the first quarter is our seasonally weakest quarter of the year, and RevPAR saw some incremental impact from new units going live during the quarter. As a reminder, new units take a period of time to ramp up to normalized ADRs. Occupancy rate was 80% in the first quarter, up 700 basis points year-over-year but down 300 basis points sequentially. Q1 last year saw some residual impact from Comic Con while we began experimenting with our higher occupancy strategy during the same period was a full benefit to occupancy rate initially seen in the second quarter.

Total Q1 costs and operating expenses increased by 17% year-on-year to $205 million, inclusive of $12 million of stock-based compensation expense in the quarter, demonstrating strong operating leverage compared to our revenue increase of 50%. The increase in total costs and operating expenses were driven primarily by the overall growth in our live units. As it relates to the cost reduction actions we spoke about last quarter, we remain confident in achieving the $10 million in annualized cost savings related to headcount reductions, and we continue to look for additional savings across the rest of our cost structure on an ongoing basis.

In the first quarter, as Francis mentioned, free cash flow before onetime restructuring costs totaled negative $41 million compared to negative $30 million in the fourth quarter and negative $62 million in the first quarter of 2022. Free cash flow margin also improved year-over-year, reaching negative 34% compared to negative 7% in the first quarter of 2022. The free cash flow improvement year-over-year was due to ADR growth as well as an improvement in nonproperty level operating expenses. Given typical low ADR seasonality in Q1, we believe sequential performance is less relevant and would focus more on year-over-year comparisons.

Finally, cash contribution margin, which is a unit economic metric we use to provide visibility on property level performance was 12.5% versus 12.9% in Q1 of 2022. The slight decline primarily stems from the change in classification of certain costs starting in the first quarter of 2023, which was not adjusted for prior periods, impacting the metric by 200 basis points year-over-year.

Turning to the balance sheet. As of March 31, we had $246 million in cash, cash equivalents and restricted cash and $180 million in total debt. Note that while restricted cash declined sequentially in Q1, it is likely to increase in Q2 due to the dynamic spending from the failure of SVB, leading to us having to collateralize certain new lines of credit issuance under First Citizens ownership and due to certain amendments to our financial covenant requirements. We've been pleased with the partnership with First Citizens so far, and we'll be working with them to explore options to enhance our partnership going forward.

On the free cash flow front, since the beginning of 2022, Sonder has demonstrated a consistent improvement in free cash flow, and we expect to see this trajectory continue. Forward visibility into attractive growth in bookable nights, combined with strong operating leverage in our cost base, creates a clear path to a sustainable free cash flow formula, one that we aim to continue to strengthen as we scale, resulting in significant long-term value to our shareholders.

For the balance of 2023, we are expecting that our free cash flow vertical continued to trend significantly lower compared to the same period in 2022 and as such exit 2023 with a liquidity profile that should provide the runway needed to execute on our plan without needing to raise additional capital.

Looking ahead, we felt it prudent to lower our RevPAR assumptions for the balance of this year due to lower projected ADRs, given the uncertain macro conditions we are facing. While achieving a positive quarter of free cash flow this year is still a goal, we believe it is unlikely under this lower RevPAR scenario. Our primary focus is to put the business on a solid path to achieving sustainable positive free cash flow as soon as possible while preserving the business's attractive self-line growth rates and, again, doing so without having to raise additional capital.

With regards to guidance itself, we are aiming to provide you with more visibility into the trajectory of our business and by changing our approach to now provide revenue and free cash flow guidance for not only the upcoming quarter, but also the second half of this year.

For the second quarter of 2023, we expect revenue between $155 million and $165 million and free cash flow, excluding onetime restructuring costs between negative $30 million and negative $20 million, which at the midpoint is a $20 million improvement versus the second quarter of 2020. For the second half of 2023, we expect revenue between $345 million and $375 million, which at the midpoint of the guidance ranges provided, translates to approximately 40% year-over-year growth for the full year of 2023. For free cash flow, we expect between negative $5 million and negative $30 million in the second half of 2023. At the midpoint of the guidance ranges provided, this translates into a 40% year-on-year improvement for the full year of 2023 or a $70 million improvement.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Nick Jones of JMP Securities.

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

I guess just as we think about adding units to the portfolio and then live units, is -- should we kind of expect live units to outpace kind of net adds in the total portfolio through the rest of the year? And then could you maybe touch on how you feel about your cost structure as you try to reach free cash flow positivity in the face of kind of macro environment?

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

Yes. Thanks so much, Nick, Francis here. Thank you for kicking things off. I'm going to start with the first point on the live unit versus total portfolio growth. And so as we mentioned, we expect the majority of the live unit growth to come from our significant book of contracted units. And so you've seen in the last few quarters that while live units have grown quite a bit, the growth on total portfolio has been a little bit slower.

There's a couple of reasons for that, one of which has been the fact that we've cleaned up a lot of the deals that were in our contracted book that we didn't feel high conviction would convert to live units. And the biggest reason for this adjustment has been the capital markets environment, specifically on commercial real estate financing conditions. Even though we have a contract with these developers, we thought it was more prudent to say, you know what, we think it's less likely if there's a financing contingency, we're going to remove that from our contracted book if we don't think that the financing would actually come through.

So we've done a lot of that cleanup. We saw total portfolio actually increased in Q1 in addition to obviously live units. And so it's difficult to predict exactly how things will shape out. We haven't given specific guidance on that front. But really, the thing that we're most focused on internally is this continued live unit growth. This is really what's at the heart of the cash flow positive plan.

It's opening new properties that have very strong unit economics that have very rapid payback periods that very quickly start adding to the cash contribution dollars that are really fueling this improvement in free cash flow. So live unit growth is really the core focus of the team. We have a large book of contracted units, and we're focusing on making sure that these signed deals actually deliver live units as a core priority.

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

And Nick, this is Dom. So I'll take the second question on the cost structure. So first, nice meeting you. I'm happy to be here on the call and start speaking with investors going forward. So in terms of the cost structure, you'll see us continue to improve our cash contribution margin going forward. That's a key part of getting to free cash flow positive. Francis just spoke about portfolio expansion. That's another key component for sure, driving top line going forward.

And in terms of cost themselves, you've seen our overhead cost decline. We're going to continue to leverage overhead cost significantly. There was very strong leverage in Q1, and that's a goal of ours to continue to operate with a very tight overhead cost going forward. Preopening costs have also come down, and that's another one we'll continue to control. And then the last thing is on a direct cost standpoint. We're turning every rock optimizing every direct cost spend trying to decouple that growth from the growth of the top line. So a lot of progress has been made. You can see it in the numbers. There's still a lot of opportunity for us going forward to continue to expand margins.

Operator

All right. And then our next question comes from the line of Jed Kelly of Oppenheimer.

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

Could you maybe speak to how we should be thinking about your RevPAR throughout the rest of the year? And then on cash levels, could you give us a sense on how we should be thinking about trough cash level?

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

Yes. Maybe I'll start here for the question on RevPAR for the rest of the year. So like we mentioned earlier on the call, we've seen some nice momentum in the first quarter from month to month. And I'll just remind you that we've got really good visibility 30 to 45 days out on bookings just because of the booking curve or the percentage of bookings that are on the books gives us really high conviction about 1.5 months in advance. And so that really informed our Q2 guidance. But for the rest of 2023, we really take a look at macroeconomic analysis to try to understand what are the demand supply dynamics that are expected in each of the markets in which we're currently situated. And then we kind of roll those into our own forecast.

And like Dom mentioned earlier on in the call, we want to take a more balanced approach and cautious approach given the uncertainties that exist in the macro economy right now when it comes to how that particular very sensitive variable will evolve over time. And most importantly, we're planning the rest of the business, the cost structure and the decisions that we're making internally not assuming really ambitious heroic levels of RevPAR growth like we've seen in the last few years, given where we're at in the cycle.

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

Jed, this is Dom, so I'll take the question on the cash trough. So we're not going to comment explicitly on the cash trough. I think I'll point you back to the guidance. I think you might have seen also the materials we've updated on our investor page. We're going to continue to reduce cash burn through this year. You see the range there we have for the forecast burn. We can easily translate that into a ending cash balance at the end of this year, which we believe is going to be a good cushion for us to finalize the execution of our free cash flow positive plan and not having to raise capital again to get there.

And if you actually look at the trajectory of the burn and extrapolate that, you can get a sense of how close we're going to be and how much margin we'll have to maneuver. Again, we haven't done our '24 planning. It's too far out. We will update guidance later this year or very early next year once we have more data and we get closer to it. But again, I'll just point you to the trajectory of what business has delivered and what we forecast to be able to deliver for the rest of this year and that's kind of the construct there for how we think about our liquidity position.

Operator

Thank you so much. And presenters, there are no further questions at this time. This concludes today's conference call. Thank you for participating, and you may now disconnect. Have a good day.
