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SOND.OQ - Q3 2023 Sonder Holdings Inc Earnings Call

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PRESENTATION

Operator

Good day and welcome to the Sonder's Third Quarter 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, Ellie Ducommun, Senior Director of Strategic Finance, and Investor Relations. Please go ahead.

Ellie Ducommun - *Sonder Holdings Inc. - Senior Director of Strategic Finance & IR*

Thank you, operator. Good afternoon, everyone. Welcome, and thank you for joining us to discuss Sonder's Third Quarter 2023 financial results. Joining me on the call is Francis Davidson, Co-Founder and Chief Executive Officer, and Dom Bourgault, Chief Financial Officer.

Our third-quarter shareholder letter and Form 10-Q were issued today after the close of the market. These materials are available in the Investor Relations section of our website at investors.sonder.com.

We encourage you to reference the detailed information contained in those materials during our call. Before we begin, I would like to remind everyone that our prepared remarks and the Q&A session to follow contain forward-looking statements under Federal Securities Laws. These statements are subject to numerous risks and uncertainties as described in our SEC filings, which could cause future results to differ materially from those expressed in or implied by our remarks, comments, or material, including our shareholder letter.

Statements in our remarks comments and materials are effective today only and will not be updated as actual events unfold. You can find reconciliations of all non-GAAP financial measures referred to in our remarks within our shareholder letter in the Investor Relations section of our website.

With that, I will turn the call over to Francis.

Francis Davidson - *Sonder Holdings Inc. - Co-Founder and CEO*

Thanks, Ellie. Good afternoon, everyone, and thank you for joining us today. I would like to start by thanking all of our Sonder employees, our guests, and our partners for their support as we strive to fulfill our mission to revolutionize hospitality through design and technology, making world of better stays open to all.

To provide a few highlights from the third quarter, revenue grew 29% year-over-year, driven by a 33% increase in bookable nights on a 31% increase in overall live units. With a 2% decline in ADR to $185, coupled with a 1% decline in occupancy rates to 83%. We also produced all of this growth with a 14% improvement in total overhead costs and a 9% improvement in total property level expenses per occupied nights. These accomplishments resulted in a 60% improvement in our free cash flow compared to last year from negative $39 million to negative $16 million and a 21% improvement in free cash flow margin from negative 31% to negative 10%.

I'm incredibly proud of the progress we're making toward our goal of sustainable positive free cash flow. We're pulling every lever at our disposal to rapidly deliver on this objective, Dom will share more details about our results with you in a few minutes. But first, I'd like to dive a bit deeper into our revenue and supply growth as well as the portfolio optimization program we're undertaking to improve our current portfolio economics.

Across all of our center properties, RevPAR declined 3% year-over-year. Our comparable properties RevPAR, which is calculated in line with industry peers and looks at RevPARs for Sonder properties that were live prior to January 1, 2022, grew 3% year-over-year. Several factors came into play this quarter, including broader travel industry trends, product mix between hotel and apartment style properties, geographic mix, cohort mix, and the impact of our corporate sales and pricing strategies.

Starting with the product mix, we continued to see relative strength in our hotel product and moderate pricing pressure for our apartment product. On a comparable properties basis, our hotel product grew RevPAR by 8% year-over-year, while our apartment product RevPAR grew by 1%. This bifurcation is representative of the market trends with hotel RevPAR growing year on year, but alternative accommodation, RevPAR decreasing across our geographies, particularly in North America.

Hotels now make up 40% of total live units compared to approximately 30% a year ago. While our hotel RevPAR growth outpaced that of our apartment product RevPAR for our hotel properties tends to be slightly lower than our apartment style properties. All else equal, the shift towards hotel properties had a roughly 1% negative impact on our year-over-year RevPAR growth. From a profitability perspective, hotel properties also tend to have lower rent and property level expenses to offset the lower RevPAR.

In terms of geographic performance, we're continuing to see strong demand for our properties in Europe and the Middle East growing comparable properties RevPAR 14% year-over-year in those markets, while our North American comparable properties RevPAR remained flat. This trend is consistent with broader industry trends. According to the US Travel Association, Americans traveling abroad in July exceeded pre-pandemic levels by 10%, while inbound travel still lags pre-pandemic levels by roughly 20%.

Our RevPAR was also negatively impacted by some slower starts in a few of our recent North American property openings, properties that have been live for less than a year had average RevPAR approximately 30% lower than our mature units in Q3. It typically takes time for new properties to ramp up, but this is a larger drag than we've seen in the past, primarily due to a greater proportion of properties that rely heavily on B2B sales.

We've been investing in local sales teams in markets where the assets require them, and we're seeing early signs of success from this initiative. Additionally, we're seeing challenges in properties in Mexico City, which make up over 10% of the cohort of units that went live in the last year. We're planning to partner with property owners there to address these challenges of our portfolio optimization program, which we'll discuss in more detail shortly.

Our B2B sales efforts are regaining momentum. Our new VP of Sales joined us in Q3, and we're seeing an acceleration in our forward bookings, but we expect the impact on earned revenue to ramp over the next few quarters as corporate sales tend to have longer booking windows. Success in our corporate sales segment should enable us to bolster RevPAR in are primarily urban markets and in particular during weekdays.

And finally, this quarter, we leaned into a pricing strategy that focuses on building a better base of occupancy earlier in the booking window and enables us to have greater pricing power over the rest of the booking window. Overall, our experimentation and early results suggest this approach should yield higher ADR. We leaned into the strategy more aggressively in late July and expect to see more of its impact in the coming quarters.

We also continue to make progress on other RevPAR initiatives we've previously highlighted, including our elevated visual merchandising platform and ancillary revenue initiatives.

Moving on to the supply side, we're pleased to report. Our live units grew 31% year-over-year, driven by continued strong conversion from our contracted units to live units. However, our total portfolio of live units plus contracted units did decline 10% year-over-year and 2% sequentially. Similar to last quarter as development cost uncertainty and persistent high interest rates remain a significant issue for developers and landlords, we felt it was prudent to exclude a number of contracted units with financing contingencies, which drove a year-over-year and sequential declines.

Even after excluding these units, we continue to have a notable backlog of contracted units, representing a strong growth pipeline of nearly 50% of our live unit count. This is in line with our strategy set out in June 2022 to proactively reduce our planned funding space and focus primarily on growth driven by the conversion of our contracted units.

The strategy supports our goal to deliver sustainable positive free cash flow as soon as possible, given upfront costs to originate and sign our contracted deals have already been incurred. They're expected to be cash accretive as they come live due to their capital light structure and this narrowed focus enables us to prioritize improving the economics of our current portfolio.

As we strive to grow top line revenue we also continue to scrutinize future leasehold obligations, particularly on underperforming assets. While the majority of our properties are profitable and some of our properties do have negative margins. With that, we're collaborating with external advisors to implement a portfolio optimization program, working to understand how we can mitigate losses related to these underperforming properties, assessing our portfolio of rents relative to current operations and the existing market rents and exploring alternative solutions to minimize their drag on our bottom line.

We're engaging our landlords to work towards solutions at certain properties where both parties may benefit from revised commitments. We value the collaboration with our landlords as we'll seek mutually agreeable outcomes as part of the strategic initiative. It's never the intent for an operation to underperform, but in today's challenging marketplace, we must appreciate that a proactive approach to asset management is more important than ever.

Before turning it over to Dom, I want to highlight several new additions to the world-class team we're building at Sonder. First, I'm thrilled to welcome Tom Buoy and Simon Turner to our Board, Tom and Simon are among the most accomplished executives in the hospitality industry. They both bring deep expertise and experience in areas, including executive leadership operations, revenue generation and real estate.

I'm also pleased to announce we've been recently joined by Adam Bowen as Chief Accounting Officer, Katie Potter as General Counsel, and Chad Fletcher as Vice President of Sales. Each of these individuals brings experience and knowledge that will be valuable assets as we continue executing on our plan to achieve sustainable positive free cash flow as soon as possible.

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

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

Thank you, Francis. Hello, everyone, and thank you for your patience as we took a few more days to finalize or close process and release our results, we're pleased to report our best free cash flow quarter to date as a public company demonstrating continued progress on our path to achieving sustainable positive free cash flow in the near term and industry-leading unit economics over the long term.

I will first provide a brief overview of our third-quarter financial results and then take you through guidance before opening the call to questions. In the third quarter, free cash flow before onetime restructuring costs totaled negative $16 million compared to negative $27 million in the second quarter of this year and negative $39 million in the third quarter of 2022. Free cash flow margin also improved year-over-year, reaching negative 10% compared to negative 31% in the third quarter of 2022.

We generated $161 million of revenue, representing a 29% increase compared to Q3 of 2022. As Francis mentioned, key top line performance metrics improved year-over-year, including live units, bookable nights, and occupied nights while we experienced a slight decline in RevPAR. We ended the quarter with approximately 11,800 live units, representing 31% growth year-on-year, and we reached a milestone of over 1 million bookable nights in Q3 an increase of 33% year-over-year, driven by live unit growth. Occupancy remained strong at 83% in the third quarter, a slight decline from the 84% in Q3 of 2022, even as we saw significant growth in bookable nights.

Since Francis went into details on our revenue performance, I will now focus my remarks on the cost side. For Q3 2023, total costs and operating expenses increased by 17% year-over-year to $218 million, which is inclusive of $5 million of stock-based compensation expense, the 17% increase in total costs on the back of a revenue increase of 29% and bookable nights growth of 33% illustrates the strong improvements we've been driving in our operating leverage.

Property-level costs grew by 19%, while our non-property level operating expenses were lower by 14% compared to the prior year. This operating leverage improvement in turn drove our trailing 12-month cash contribution margin to 19% in the most recent quarter compared to 17% in Q3 of 2022. We remain focused on driving leverage across all cost categories to support our goal of achieving sustainable positive free cash flow as soon as possible.

Francis, already spoke of our efforts to right-size our largest expense item, the cost of our leases were a large scale initiatives currently underway aiming to improve our individual property economics to meet the targeted profitability levels, they were underwritten with. We remain relentlessly focused on driving efficiencies across our property-level costs, where we've outperformed our cost targets for the first three quarters of 2023 due to the success of multiple direct cost reduction initiatives.

We're also continuing to identify non-property level cost savings as illustrated by the 14% decrease in this category compared to the prior year. As a reminder, we have reduced our corporate workforce over 30% on a net basis since going public in early 2022 and continue to press on to reduce our non-headcount expenses as well. Driving consistent improvements in our cost structure is now integrated in our normal operating rhythm across the enterprise.

As discussed in our Q2 call in August, we evaluated the introduction of more common non-GAAP profitability metrics to make it easier to compare with our peers. As such, we plan to start using adjusted EBITDA and adjusted EBITDAR are in place of cash contribution margin beginning with our Q1 of 2024, earnings release.

Turning to the balance sheet, as of September 30, we had $207 million in cash, cash equivalents and restricted cash and $197 million in total debts. As you've seen in our 8-K last week, we've worked with our lenders to amend our credit agreements in the wake of the SVB Letters of Credit from earlier this year.

We're happy with the outcome, which allows us to regain some flexibility with the expansion of the banks we can use to issue letters of credit and the extension of the fixed feature on the term loan in exchange for a downpayment, reducing our gross debt level. We appreciate the partnership we have with our lenders.

Regarding guidance, known that the ranges we are providing for revenue and free cash flow for the fourth quarter of 2023 exclude any future impact of the portfolio optimization program that we discussed earlier on this call, which could be material. For the fourth quarter of 2023, we expect revenue between $165 million and $175 million, which at the midpoint represents a $148 million or 32% year-over-year improvement for full year 2023 and at $35 million or 26% improvement versus the fourth quarter of 2022.

This implies a slight decline from the previous revenue range for the second half of the year provided on our last quarter call due to the factors that Francis alluded to earlier. For free cash flow, we expect to between negative $39 million and negative $29 million in the fourth quarter. At the midpoint of the guidance range provided this translates to a $58 million or 33% year-over-year improvement in free cash flow for the full year of 2023.

This is in line with the bottom half of the implied Q4 range from our last quarter call, reflecting the lower revenue guidance in the additional $4.3 million in onetime prepayment interest penalties associated with our amended credit agreements, partially offset by continued progress on cost reduction initiatives.

Note that while Q1 2023 free cash flow sequentially worsen compared to Q4 of 2022. We do not expect this pattern to repeat itself going into 2024. As we continue to run our corporate sales and collection processes and better spread payments of certain annual contracts throughout the year, we do expect a sequential improvement in free cash flow from Q4 of 2023 to Q1 of 2024.

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 net. Our guidance framework also does not incorporate any future impact of our portfolio optimization program, which may be material given that we are in the early stages and there are still many unknowns about the magnitude and timing of the revenue and free cash flow impacts.

While we are optimistic about the final outcome of this process there is a high degree of uncertainty around how this will affect revenue and free cash flow in the short term as we strive to bring our entire portfolio up to positive unit economics.

With that we're now happy to take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Ron Josey, Citi.

Unidentified Participant

Hey guys, this is Robert on for Ron. Thanks for taking my question. Quick question on gross margin came in a little bit lower than expected in the quarter. Can you just talk to kind of some of the main drivers behind that miss? And then perhaps comment on how you see margins trending over the next quarters?

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

Hey, I'll take that question. This is Dom. In terms of the gross margins, I think this is mostly driven by the RevPAR, I mean just a little bit lower than where it was last year and up from what our expectations were as we saw the revenue results came in a bit towards the low end of the range.

In terms of the cost structure of the business we continue to see our EBITDA margin improving, our cost per unit coming down. So we're pleased with the success we've seen so far and the progress we've made on the cost side. But again, this remains in terms of GM percentage, subject to the volatility with RevPAR in any given period. So going forward, I think it's the same dynamic continues work from the cost side and work on improving our RevPAR just as the same gross margin.

Unidentified Participant

Understood. Thanks a lot.

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

Okay.

Operator

Nick Jones, JMP Securities. Your line is open.

Nicholas Jones - *JMP Securities LLC - Analyst*

Great, thanks for taking the questions. I guess two, one just as we think about the total portfolio versus to live units. I know that total portfolio is coming down, for kind of you're pulling some of the properties out of that. Is this kind of the right level to think about it going forward, another live units, you're kind of approaching 70%, a percentage of portfolio live. Do you kind of expect this number to stagnate for a little bit as you focus on free cash flow from here? And then I guess the second question is, how are you feeling about the balance sheet kind of given the macro environment and kind of of what you see ahead from here?

Thanks.

Francis Davidson - *Sonder Holdings Inc. - Co-Founder and CEO*

Yeah, thanks so much, Nick. Francis here, I'll take the first question. So yeah, as you pointed out, the core focus is really on driving the business to cash flow positivity, and we've been beating the same drum since June of 2022, that really the story there will be to convert our existing contracted properties into live properties. And so we're not seeking out to go and find a lot of new properties, we're just focused on making sure the ones that have been signed were expenses already been deployed to go and identify these assets and opened them that those are done successfully.

And of course, now also working on a portfolio optimization program and so our real estate team's effort is really focused on of ensuring that the portfolio economics as a whole are as strong as possible and that we work with our landlord partners to go and make these underperforming assets perform. I also want to point out that we've got still nearly 50% embedded growth, which we think is really exciting. Frankly, a lot of properties that we think are going to be really great assets for the brand for the guest experience and also add more dollars to on the contribution to the business are going to open in the next couple of years.

And so we think that this industry-leading growth is actually quite exciting and the growth rate is not an issue for the business at this point, we're growing quite rapidly. It's really just doing everything we can to go and accelerate the timeline to cash flow positivity.

And then on the live unit growth side, we just posted in this third quarter at 31% year-over-year growth of live units. And so we're really happy with that pace and we'll keep on you're focusing the team on improving that free cash flow performance of the business in the near term.

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

And also the balance sheet question, so you saw we had a healthy cash position at the end of the quarter. You see also the sustained progress we've been making on the free cash flow front. That trajectory, I think when you look at the individual is very telling and it's up into the right and that we're working hard on our plan to keep that going role live units as Francis just talked about, there's a lot of embedded growth in the model that we feel good about the unit economics of reducing property level costs, including improving the brand profile of these properties and then controlling pre-opening costs and overhead as we have in the past. And that's the recipe for us to continue to improve free cash flow and when you contrast that with where we're at with the balance sheet, we see a trajectory we're comfortable with.

Nicholas Jones - *JMP Securities LLC - Analyst*

Great. Thank you both.

Operator

Jed Kelly, Oppenheimer.

Jed Kelly - *Oppenheimer & Co. Inc. - Analyst*

Hey great, thanks for taking my question. Could you just give us an update on how your RevPAR initiatives in the technology around revenue management is trending then I know it's relatively early and you don't want to guide the next year, but can you sort of give us what you're sort of looking for and what you think for '24 looks like? Thanks.

Francis Davidson - *Sonder Holdings Inc. - Co-Founder and CEO*

Thanks so much, Jed. I think that I'll start with the revenue management question. I think it's an incredibly important topic, it's a very important lever for the profitability of the business. And frankly, I think that we have we have room for improvement on our pricing strategy. One of the changes that we've recently initiated is to ensure that our pricing trajectories are more stable and by that, what I'm I mean that within 7 days or 14 days before target dates, we would go and reduce price to drive more occupancy and we actually think that's not the right approach and building a base of occupancy earlier into the booking window, but then holding price as we approach that date of arrival is actually on better strategy to drive stronger ADRs and stronger RevPARs.

So that's a major change that we're initiating. I think there are some dates where we've been selling out a little bit too early, and that's caused our capacity to yield optimally to be impaired, and so those are just a few tweaks that you can expect that we're going to we're going to put to work in the next few months and quarters. And all of that, of course, is powered by a lot of technology, we've built much of this technology in-house, and we're not afraid to also benchmark our technology versus third parties and to always explore whether our solutions are the most adequate. But really the biggest opportunity as we see it in the near term, as does is this price trajectory, the sellouts and ensuring that we can optimally drive RevPAR through higher ADR.

Dominique Bourgault - *Sonder Holdings Inc. - CFO*

And Jed, I'll take your question on '24, obviously, it's still too early for us to guide on '24 [quarterly], we're finalizing our '24 plans. As we speak, we still got a few more weeks to go to, button all of that. The other thing is the property optimization program -- the portfolio optimization program that Francis described earlier. This is very much in our, early innings. We feel confident it we'll improve the trajectory meaningfully, but for now, there's too many unknowns for us to embed any guidance based on that.

And then the last thing I'll say is similar to my answer to the prior question. I'll point you back to the trajectory, you see the trajectory of improvements. I illustrated earlier the ingredients behind that improvement and those we expect to continue to work hard and sustain going forward and right now, that's how we're framing '24 at a high level and a continued improvement in the trajectory and working on the key levers to deliver that. But no formal guidance at this point, more to come in the next month.

Jed Kelly - *Oppenheimer & Co. Inc. - Analyst*

Thank you.

Operator

Thank you. I'm showing no further questions in the queue at this time. I would now like to turn the call back over to Francis Davidson for any closing remarks.

Francis Davidson - *Sonder Holdings Inc. - Co-Founder and CEO*

Well, I just wanted to say thank you to all of our listeners and participants for joining the call today. We look forward to speaking with you in early 2024 and share our fourth quarter and full year 2022 results. So, thanks very much, everyone, for dialing in.

Operator

This concludes today's program. Thank you all for participating. You may now disconnect.