Sonder Holdings Inc. Second Quarter 2022 Earnings Transcript

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

I'd now like to hand the conference over to your speaker today, Jon Charbonneau, VP, Head of Investor Relations.

Jon Charbonneau; VP, Head of Investor Relations
Thank you, operator. Good afternoon, ladies and gentlemen. Thank you for joining us to discuss Sonder's second quarter 2022 financial results. Joining me on the call today are Francis Davidson, Co-Founder and CEO; and Sanjay Banker, President and CFO. Full details of our results and additional management commentary are available in our second 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 contains 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 statement can be found in Sonder's periodic and other SEC filings.

The forward-looking statements and discussion of risks in this conference call, including responses to your questions, are based on current expectations as of today. Sonder assumes no obligation to update or revise them, whether as a result of new developments or otherwise, except as required by law. Also, the following discussion contains non-GAAP financial measures. For a reconciliation of these non-GAAP financial measures to the most directly comparable financial measure calculated and presented in accordance with GAAP, please see our shareholder letter posted to our Investor Relations website.

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

Francis Davidson ***Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board***
Thanks, Jon. Good afternoon, everyone, and thank you for joining us today. I'm very pleased to be reporting on our strong second quarter 2022 results. Our remarks today will cover 2 areas. First, I'll provide a quick overview of our financial performance for the second quarter, and then I'll provide an update on our cash flow positive plan announced on June 9.

We're excited to report strong second quarter results, highlighted by improving free cash flow, achieving negative $45 million for onetime restructuring costs compared to free cash flow of negative $62 million last quarter and negative $60 million a year ago. This also yielded significant improvements in our free cash flow margin, which improved to negative 37% versus negative 77% last quarter and negative 127% a year ago. In addition, cash contribution margin, excluding restructuring costs, which is an important metric to look at since it isolates property-level performance, improved to 18% versus 13% in Q1.

On a year-over-year basis, our RevPAR grew by 67% and revenue grew by 157% to $121 million, driven by a strong snapback in travel demand during the quarter. Sanjay will provide additional detail on our second quarter financial performance a little later on the call.

In June, we announced our cash flow positive plan, which shifted our focus from hyper growth to steady growth with a strong emphasis on rapidly achieving sustainable, positive free cash flow. To be clear, this shift was not due to lack of growth opportunities. Instead, broader market conditions had materially changed, and therefore, we believe it was prudent to shift our strategy to adapt to the changing macro environment. We firmly believe that this was the right decision and are fully committed to achieving positive quarterly free cash flow within 2023. Successfully executing our plan will enable us to more rapidly achieve positive free cash flow without additional fundraising and while preserving a robust cash cushion.

We focused on 4 key levers for our cash flow positive plan, including cutting cash costs, reducing planned signings pace, raising the bar on incremental lease signings and focusing on rapid payback RevPAR initiatives. The first lever is to reduce the cash costs by approximately $85 million on an annualized basis before onetime restructuring costs. More specifically, in June, we executed a restructuring plan, which will result in nearly $55 million in annualized cost savings versus Q1 2022 costs.

Separately, we also expect $30 million in annualized cash cost savings from reduced preopening costs and net CapEx associated with incremental units going live, given our focus on finding 100% capital-light units going forward.

The second lever is proactively reducing our planned signings pace. This enables us to lower head count across the board, lowering preopening costs and net CapEx, cut back on planned geographic expansion and simplify the business. We will continue to scale our live units by opening already contracted units as well as signing incremental deals that meet our high bar for signings. As a result, our existing contracted unit portfolio will be cash accretive as they come live given the upfront costs to originate and sign these deals were already incurred and the majority of these deals are capital light.

This brings me to our third lever, which is increasing our already high threshold for incremental unit signings. Prior to announcing our cash flow positive plan, our leases commonly included upfront rent abatements to help offset the costs and revenue ramp-up period associated with onboarding live units.

In addition, in the vast majority of leases, we have been successful in negotiating upfront allowances paid for by the landlord to help us offset the capital invested to prepare and furnish the building as well as individual units. And now, we have further raised the bar aiming to only sign units that are 100% capital light. This will set us up so new deals signed after our cash flow positive plan won't consume cash as they come live.

We're excited about our healthy late-stage pipeline of deals that fit this even more stringent profile. Further, we're also only focusing on countries where we already have operations or contracted units in order to leverage fixed costs more effectively.

Our fourth lever and final lever is focusing efforts on improving free cash flow through rapid payback RevPAR initiatives. Given our fixed landlord payments, a small increase in RevPAR translates to a much larger increase in cash contribution margin. As such, we're focusing on several rapid payback RevPAR initiatives, including our higher occupancy strategy, which was implemented in Q1 and includes, among other things, marketing bookings further in advance. This helped drive a significant increase in occupancy rate to 82% in Q2 versus 68% a year ago, enabling us to take advantage of demand elasticity to drive higher RevPARs.

Additionally, we remain focused on growing our new corporate travel offering and ended Q2 with nearly 400 active accounts versus 250 last quarter and 100 in Q4 of 2021. While we're still in the early stages of our corporate travel offering, we have continued to gain traction each quarter since its launch, and we're incredibly excited about this as an opportunity to drive incremental RevPAR.

Lastly, we're also focused on building out several ancillary revenue offerings during the second half of the year, which should further benefit RevPAR, especially in 2023 and beyond.

Beyond our focus on these 4 key levers, we're continuing to deliver our signature tech-enabled design forward experience to our guests around the world and look to attracting a growing share of travelers across both business and leisure segments.

Separately, I'd also like to briefly discuss another 8-K we filed today after market close, which outlines our intention to launch an option exchange program for our current employees. This will provide employees a voluntary onetime opportunity to exchange existing underwater stock options for new stock options with the same terms at a strike price equal to fair market value. We strongly believe our team members are our most valuable asset, and this is a critical onetime event to properly incentivize and retain them.

To finish, I'd like to reiterate that we remain laser-focused on the execution of our cash flow positive plan to drive sustainable, long-term value for all our shareholders and continue to revolutionize hospitality for all. I'd like to thank our employees across the world for their tireless work and express my gratitude to our partners and investors for their ongoing support.

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

Sanjay Banker *Sonder Holdings Inc. - CFO & President*
Thank you, Francis, and hello, everyone. This afternoon, I will provide a brief overview of our second quarter financial results and share our outlook for the remainder of 2022. We'll then open the call to questions. Unless otherwise specified, all of the Q2 growth figures cited in my remarks are year-over-year comparisons.

In the second quarter, we generated $121 million of revenue, representing a 157% increase compared to Q2

2021. This was the highest quarterly revenue in company history by a wide margin, and the first time we eclipsed $100 million in a single quarter. Our Q2 revenue growth year-over-year was fueled by 67% RevPAR growth and the expansion of our live portfolio, which grew 53%.

Our key performance metrics improved year-over-year, including live units, bookable nights, occupied nights and RevPAR. We ended the quarter with approximately 8,400 live units, representing 53% growth driven by the strong conversion of contracted units into live units by opening 14 new properties worldwide in Q2. 3 of these properties are in New York City, where we just surpassed 1,000 live units in the market.

Not only is this an exciting milestone, it's a meaningful one from both a RevPAR and profitability standpoint. Greater Sonder density within the market improves our RevPAR and unit economics as we benefit from better sales conversion, reduced risk and additional operating efficiencies. Moreover, growth in New York City provides substantial opportunity to capitalize on both our core leisure offering as well as our new corporate travel offering. At quarter end, we had approximately 18,700 units in our total portfolio, representing 26% year-over-year growth.

During Q2, we proactively slowed our deal signings ahead of our June finalization of the cash flow positive plan. As Francis noted earlier, this plan includes higher hurdle rates, targeting 100% capital-light deals moving forward. In addition, to be conservative, we exited certain contracted units that did not align with the objectives of our cash flow positive plan and excluded from the total portfolio account certain contracted units with substantial contingencies.

In Q2, we had approximately 725,000 bookable nights, an increase of 53%, driven by our live unit growth. Combined with our strategic focus on increasing occupancy rates, it also drove 86% growth in our occupied nights. As a result, our occupancy rate increased 1,400 basis points to 82%.

As noted, a strong snapback in travel demand during Q2 drove year-over-year RevPAR growth of 67% to a record $167, an ADR growth of 38% to $203. Looking ahead, we expect to continue benefiting from the recovery of urban travel, which third-party forecasters anticipate will continue to recover through 2023, as well as additional upside from the rapid payback RevPAR initiatives Francis spoke about earlier.

Total costs and expenses increased by 68% to $189 million in Q2, inclusive of $5 million of stock-based compensation expense in the quarter. Total costs and expenses were driven primarily by the expansion of our live units.

As we noted in conjunction with the cash flow positive plan announcement in June, we're focused on free cash flow as our main measure of profitability. This metric aligns with how we assess profitability internally. I am pleased with the notable improvement in free cash flow in the second quarter, which totaled negative $45 million before onetime restructuring costs compared to negative $62 million in the first quarter and negative $60 million 1 year ago.

Given our strong revenue growth, free cash flow margin also showed significant improvement, reaching negative 37% compared to negative 77% in the first quarter of 2022 and negative 127% in the second quarter of last year.

During Q2, we paid out $2.4 million in cash restructuring costs and anticipate the remaining $1.7 million to occur in the second half of this year.

Turning to the balance sheet. As of June 30, 2022, we had $361 million in cash and $161 million in total debt.

Finally, regarding our outlook. In the third quarter of 2022, we anticipate revenue of better than $120 million, representing more than 78% year-over-year growth versus $67 million in the third quarter of 2021. This is primarily due to anticipated continued growth in bookable nights and live units, offset by a lower RevPAR.

Q3 RevPAR faces headwinds from FX and the impact of onboarding our largest ever building in the quarter. The 401 unit building in Dubai is expected to experience a typical short-term ramping effect that all of our new properties experience as well as the seasonality impacts associated with the region's summer low season.

Additionally, while we don't spend much on performance marketing, we reduced our spend by approximately 70% month-over-month in June as we focused on the cash flow positive plan. Given the time lag between our performance marketing spend and revenue impact, we expect the temporary Q2 reduction in marketing spend to have a negative impact on Q3 RevPAR. However, we ramped spend back up to historical levels in July, which we expect to provide a modest RevPAR uplift in the fourth quarter relative to the third quarter.

We continue to expect to grow full year revenue by between 100% to 110% as compared to full year 2021. We expect free cash flow in Q3 of approximately negative $45 million before onetime restructuring costs. For the second half of the year, Q3 and Q4 combined, we are reaffirming free cash flow of better than negative $70 million before onetime restructuring costs.

We'll drive these results by pulling the 4 key levers of our cash flow positive plan, which Francis detailed earlier, cutting cash costs, reducing planned signings pace, raising the bar on incremental signings and focusing on rapid payback RevPAR initiatives.

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

I'd like to thank all of our Sonder teammates for a great quarter and thank all of our investors and partners for your continued support. We're now happy to take your questions. Operator?

QUESTIONS AND ANSWERS

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

Jed Kelly ***Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst***
Great. Jon, good to hear your voice and welcome aboard. First couple of questions. You talked about this cash capital-light supply strategy and that's immediately cash accretive. Can you kind of dig in more to that? And in terms of like your competitors for supply, are you starting to see your competitors act more rationally?

And then my second question is just on the RevPAR offerings. Can you dive into ways you can increase RevPAR or plan to increase RevPAR in 2023, especially if we're under a more difficult macro environment?

Sanjay Banker ***Sonder Holdings Inc. - CFO & President***
For sure. So I'll start with the capital light supply strategy and some of the supply themes that we're seeing. And then I'll have Francis -- ask Francis to address the corporate travel and the RevPAR offering.

So on the capital light side, that has been a broad theme that we've been pursuing for several quarters now, increasing the fraction of our deals that are capital light. For us, we view capital light as a deal that is cash accretive within 6 months. And so that can happen through a variety of ways. The principal one is the landlord/developer is providing upfront funding for the FF&E that goes into a property. It also comes through the form of upfront abatement. So every single deal has its own composite of how we're getting -- generating the economics that we're generating.

But our stated path is to get to 100% capital-light, i.e., deals that are cash accretive within 6 months or less. In many cases, there are other deals that are cash accretive in month 1 or month 2. And so we are well on the way to reaching that.

We do see competitors, and it varies from deal to deal. But there's no single competitor or a segment of competitors that we see across the properties we look at, and that's partly because we have the advantage of pursuing deals in over 40 markets in a dozen plus countries. It's because we look at both multifamily deals, hotel deals, office conversion deals. And so we don't really see any competitor of size consistently across those different segments of real estate supply that we pursue.

Francis Davidson ***Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board***
Yes, Francis here. Let me jump in to address the question on 2023 RevPAR. So there's a lot of things -- a lot of levers that we're pulling to improve RevPAR. Like we mentioned in our cash flow positive plan, it's 1 of our 4 core levers that we're pulling in order to improve free cash flow.

So I'll just go through a couple of examples. The first is ancillary revenue streams. And so there's a series of things that we've tested out over the last several months that give us conviction that there's a big opportunity there to improve the revenue that we generate outside of just the room rate. So examples of that that we're exploring further are parking; breakfast trays, particularly in EMEA; pets; workstations.

So there's a variety of use cases where we think we can both enhance the experience and have an offering for a guest that otherwise might not even book with us. So there's kind of the double benefit there of incremental demand in addition to fees generated for these ancillary revenue streams. So for 2023, that's one of the components that we think is going to help bolster RevPAR.

Another really big one that we've been discussing for now a few quarters is corporate travel, right? This is a program that we launched in -- I believe it was mid-2021. And we've seen fast growth of corporate accounts. The latest figure for Q2 is 400 corporate accounts. That's up from 250 in Q1. So this is really (technical difficulty) in pursuing this new demand stream. And there's going to be a lot more of that in 2023.

And just as a reminder, we're a business that operates in urban settings primarily, where business travel is a really important component, specifically of generating weekday RevPAR, where we have a gap of performance versus comps. So we have conviction in our capacity to go and close that gap by building out the corporate travel segment further.

And then there's other ideas outside of that revenue management: improving our technology to yield better fixed pattern length of stay, improvements -- there's a series of other -- a very extensive road map of things that -- ideas that we'll keep pursuing to help improve RevPAR in the coming years.

Jed Kelly ***Oppenheimer & Co. Inc., Research Division - Director & Senior Analyst***
Great. And then just on the options exchange you announced after the close, is there any impact on share price or anything? Or how should we be thinking about that in our models?

Francis Davidson ***Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board***
Yes, absolutely. The -- happy to address that question. So the philosophy at the heart of this option exchange program is that we believe that our team members are our most important asset to go and achieve our cash flow positive plan. We've got some really talented people at Sonder. Very proud of the -- not just the management team, but all the way down to our individual contributors. We're very thorough in how we assess talent and bring them in and train and develop our people. And so it's absolutely critical that we have -- that we retain our top employees.

So we don't have additional details to share at this time, but we thought that initiating this option exchange program would be an actual -- crucial lever to ensure that our team is competitively compensated.

Operator
(Operator Instructions) And our next question comes from Ron Josey from Citi.

Ronald Victor Josey ***Citigroup Inc., Research Division - MD***
Francis and Sanjay, I'm hoping you can help us understand. I mean, clearly, very strong occupancy and RevPAR results here in the quarter. So maybe help us understand how July trends were coming along? Just broader steps -- broader strokes if whether June saw -- July saw continued patterns from June, particularly as it relates to those 2 metrics? And then understood that guidance calling for lower RevPAR because of launching of newer properties, and I think you mentioned the one in Dubai. But just talk to us maybe bigger picture how you plan to balance occupancy rates with RevPAR given the 2023 plans to accelerate revenue streams going forward?

Francis Davidson ***Sonder Holdings Inc. - Co-Founder, CEO & Chairman of the Board***
Yes, certainly. I'll take this one here on -- and I'll start with the -- how to balance the occupancy with the rate. Our view is that it's all about mathematics and figuring out what will generate the strongest RevPAR. And so we ran a series of elasticity tests that demonstrates that by fluctuating the price lever, especially as we're seeing a comeback of demand post-COVID, that, that can yield substantially higher RevPAR at an occupancy rate that's in and around high 70s, low 80s that we've been seeing, 82% in the case of Q2, which is a 1,400 basis point improvement year-over-year. So very happy about the outcomes of the strategy, which led to this $167 RevPAR quarter that we just announced.

So I think we're seeing that this higher occupancy rate strategy is one that -- our test was showing it could yield some really interesting results, and now we're seeing it across the board for our entire portfolio deliver meaningful value for the business.

And as per your question on how we see July and Q3. Listen, we're not providing detail on RevPAR at this time. And -- but we are -- the guidance that we put out here for Q3 is $120 million of revenue, which we described as being an increase in bookable nights. So more properties will be opened. But this will be offset by a slightly lower RevPAR rather in Q3.

And so -- the dynamics that you alluded to as well when it comes to Dubai is a really important one. So we've got the biggest property in our portfolio -- in the -- that we've ever signed that's coming online. Just over 400 units that are coming online or are expected to come online in Dubai in Q3. This is a large building that we'll be ramping up during the low season in Dubai. So that's one of the reasons why the RevPAR for Q3 will be impacted. But I think, Sanjay, you wanted to...

Sanjay Banker ***Sonder Holdings Inc. - CFO & President***
Yes, just a supplement. I mean, obviously, Ron, we don't speak to individual months. But it's not lost on anybody that Q2 had a robust travel dynamic, not just for Sonder but for everybody in the travel category. And so we don't assume that same level of demand in the fall and winter, of course. That's partly typical seasonality. That's partly the unusual patterns of how this year is unfolding.

I think it's important that from a bigger picture perspective to keep in mind, though, that in our view, we are nowhere near full recovery to travel, even in Q2, relative to where we were pre-pandemic. And so while Q2 may have had a level of heavy travel patterns just given everything that's going on in the world, and we don't necessarily see that looking identical in Q3 and Q4, we do believe that looking into 2023, there's a meaningful headroom from a market recovery standpoint. We do believe that looking into 2023, there's a meaningful headroom from a market recovery standpoint, even relative to Q2 2022. And on top of that, we, at Sonder, specifically have a lot of our own levers, as Francis just outlined in detail (inaudible).

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