Upwork’s Q3’24 Prepared Remarks

SAMUEL MEEHAN, Vice President, Investor Relations
Thank you. Welcome to Upwork’s discussion of its third quarter 2024 financial results. Joining me today are Hayden Brown, Upwork’s President and Chief Executive Officer, and Erica Gessert, Upwork’s Chief Financial Officer. Following management’s prepared remarks, they will be happy to take your questions. But first, I'll review the safe harbor statement.

Safe Harbor Statement
During this call we may make statements related to our business that are forward-looking statements under federal securities laws. Forward-looking statements include all statements other than statements of historical fact. These statements are not guarantees of future performance, but rather are subject to a variety of risks, uncertainties, and assumptions. Our actual results could differ materially from expectations reflected in any forward-looking statements.

For a discussion of the material risks and other important factors that could affect our actual results, please refer to our SEC filings available on the SEC website and on our Investor Relations website, as well as the risks and other important factors discussed in today's earnings press release. Additional information will also be set forth in our Quarterly Report on Form 10-Q for the three months ended September 30, 2024.

In addition, reference will be made to certain non-GAAP financial measures. Information regarding non-GAAP financial measures, including reconciliations to their most directly comparable GAAP financial measures, can be found in the press release that was issued this afternoon on our Investor Relations website at investors.upwork.com.

Unless otherwise noted, reported figures are rounded and comparisons of the third quarter of 2024 are to the third quarter of 2023. Adjusted EBITDA, adjusted EBITDA margin, and free cash flow are non-GAAP financial measures, and all other financial measures are GAAP unless cited as non-GAAP.

Now, I'll turn the call over to Hayden.

HAYDEN BROWN, President & CEO
Welcome everyone to Upwork's third quarter 2024 earnings call.

Upwork continues to deliver durable, profitable growth as we execute our long-term strategy to drive revenue and margin expansion, even amid a challenging and dynamic macro environment. Third quarter revenue grew 10% year-over-year to $193.8 million, as we saw slight top-of-funnel improvements, momentum in Managed Services, an all-time high in take rate, and continued growth from our ads & monetization products. Our third quarter net income of $27.8 million and adjusted EBITDA of $43.2 million — both record highs — demonstrate our steadfast commitment to enhancing profitability. Simultaneously, we are rapidly innovating, especially in AI, and activating our levers to catalyze GSV and revenue growth. Together, all of these initiatives ultimately deliver greater shareholder value.

The organizational changes announced on October 23rd are part of our ongoing efficiency efforts, allowing us to execute more effectively while generating an expected $60 million in annualized cost savings. These changes enable us to continue leaning into our strengths, move more nimbly, and further innovate to deliver for our customers. We're assembling smaller, more streamlined teams that can move faster toward our goals. We're focused on a narrower portfolio of high-ROI and high-potential R&D investments. And we're implementing more automation and third-party vendor solutions across the business so our own teams can put all of their energy into excelling at what we do best.

In Enterprise, we used learnings from the last few quarters to sharpen our strategy. We've positioned a leaner, more effective sales and support team against our largest, highest-ROI clients, immediately improving profitability in this business unit while still enabling our smaller Enterprise clients to succeed with a lighter-touch approach.

The launch of Upwork Business Plus on October 16th lets us serve larger clients with a plan that meets their needs by being more fully-featured than our Marketplace offering, but with a higher take rate. At the same time, acquisition costs and cost to serve are significantly lower than with our Enterprise offering. Business Plus enables clients to grow and expand share of wallet with Upwork through a smoother glidepath that further closes the gap between our current Marketplace and Enterprise offerings. We are already achieving solid traction via Business Plus, with hundreds of clients organically enrolling in the new plan since its launch.

In the third quarter, we signed 42 Enterprise deals through a combination of our traditional Enterprise plans and a continuation of the testing from last quarter. We welcomed Hunter Douglas, Bill.com, Berlitz, and Guess as new Enterprise clients. Based on the success of our testing, we recently shifted our land sales team's focus to selling Business Plus and Managed Services. We are confident that this refreshed go-to-market strategy and our right-sized investment to deliver higher ROI for customers and shareholders will allow us to more effectively capitalize on the Enterprise opportunity.

We are steadfast in our commitment to serving the Enterprise market and believe Upwork has the right model to unlock the very large Enterprise TAM. Our account management teams will continue to support our existing installed base of hundreds of Enterprise customers, whose selection of Upwork is a result of our unique value proposition and product offerings. Execution of this strategy is being overseen by Ernesto Lamaina, our GM of Enterprise. Ernesto has already logged major successes over his past year at Upwork and brings deep experience building enterprise products and leading digitally enabled businesses within traditional staffing providers.

These operational changes support our strategic plan to create shareholder value, alongside our execution on key GSV and revenue growth levers that include:

> One: Making Upwork the preeminent destination for AI talent and work.
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> Two: Improving customer productivity and accelerating work outcomes with AI-powered features and experiences built on Uma™, Upwork's Mindful AI.
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> Three: Continued expansion into our Enterprise TAM, which we've already touched on today.
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> Four: Acquiring new clients cost-effectively and at scale through partnerships.
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> Five: Continuing to drive marketplace quality, efficiency and take rate expansion via our ads & monetization efforts.

Progress on these levers was notable in Q3, as showcased in our semiannual Upwork Updates product release on October 16th.

First, AI continues to be a tailwind for our business, with GSV from AI-related work growing 36% year-over-year in the third quarter, even as we lap quarters of very pronounced growth in this type of work. In parallel, the number of clients engaging in AI-related projects on the Upwork platform grew 30% year-over-year in the quarter.

Second, we're continuing to make rapid progress along our AI roadmap by infusing Uma, our mindful AI, with advanced features that improve our customers' productivity. We unveiled new capabilities for Uma as a powerful work companion that helps customers brainstorm work ideas and solutions, analyze problems, write content, code for projects, and more, all enhanced by rich historical signals from the Upwork platform. To improve speed and quality of matching between clients and talent, Uma can now create tailored proposal drafts for freelancers and evaluate candidates for clients based on how closely professionals' skills and experience fit their job post. These features are gaining popularity with customers and will amplify our matching performance, with our corresponding metrics like fill rate already being at an all-time high. Additionally, to expedite our progress in delivering on-demand work outcomes to larger clients, our Managed Services teams are now utilizing Uma as a competitive advantage.

A key accelerant to our AI strategy has been our successful acquisition and integration of Headroom, which enabled us to deepen our AI talent bench and increase velocity of our AI roadmap, including the launch and advancement of Uma. Today, we're thrilled to announce the next step on that AI roadmap as we've entered a definitive agreement to acquire Objective, an AI-native search-as-a-service company. Objective's multi-modal search technology will be another accelerant to our core search and match performance, as well as Uma's capabilities associated with images, videos, and audio content. The Objective team will provide further depth for the Upwork AI and machine learning group. These small, focused acquisitions are aimed at advancing our AI strategy, and we have a strong track record of integrating them to elevate our AI offerings and talent density. We anticipate the transaction will close in the coming weeks and are eager to welcome the Objective team to Upwork.

Next, we've continued pursuing our strategy to acquire new clients cost-effectively and at scale through partnerships. We've introduced the ability for third-party tech providers to offer fully-managed projects delivered by Upwork embedded directly within their own checkout or platform experiences. In early proof-of-concept partnerships, emergent tech providers like Lettuce and Ocoya are now offering project outcomes within their own customer workflows delivered through AI-powered Upwork Managed Services supported by proven talent from our platform. We also expanded our Upwork Partner Experts program so that clients can find the exact expertise they need more easily on Upwork, now partnering with Webflow, Smartsheet, Bubble and others to supply pre-vetted experts in their technologies.

Finally, we continue to drive marketplace quality, efficiency and take rate expansion via our ads & monetization products, which continue to be one of our fastest-growing revenue streams, increasing 35% year-over-year during the quarter. In Q3, we introduced a new ad product: Featured Jobs that are likely to be seen by more candidates and connect clients with the talent they need more efficiently. Other ads & monetization enhancements included expanding Boosted Profiles to appear more prominently in search results, giving high-intent freelancers a better likelihood of getting selected by clients for a project.

Our organizational changes for proactive cost discipline and our pace of innovation that fuels our GSV and revenue growth levers continue to fortify Upwork, illustrated by our ongoing market share gains and outperformance of industry peers. Thanks to our customers and team, even against a backdrop of undeniably challenging market conditions impacting small and large businesses alike, we grew revenue 17% year-over-year during the first half of 2024, whereas revenue declined an average of 8% year-over-year across the broader staffing industry.

We've made strong, steady progress along a clear path to durable, profitable growth and driven unrivaled scale while continuing to invest in a focused and impactful innovation agenda. As ever, we remain relentlessly committed to delivering for our customers and delivering shareholder value through increasing profitability and free cash flow alongside strategic capital allocation. The resiliency of this business and its enduring potential for value creation are proven. We look forward to continuing to unlock the immense potential of Upwork over the short, medium and long term for all of our stakeholders.

With that, I will turn it over to Erica to review our financials.

ERICA GESSERT, CFO
Thanks, Hayden.

The strength of our business is impressive in the current challenging macro environment. The third quarter was one of rapid execution at Upwork, in which we made strong progress across every area of our business. We continue to gain market share and generate increasing profitability and top-line growth. Margins reached all-time highs in the third quarter, with our gross margin increasing to 78% and our adjusted EBITDA margin to 22%. We are demonstrating continued progress toward our goal of 35% adjusted EBITDA margin in the next five years, while increasing our operating leverage every year along the way.

The organizational changes we announced on October 23rd will align our operating model with our ambitions for accelerated execution and margin expansion. These actions resulted in a company-wide 21% reduction in headcount and an expected $60 million in annualized cost savings.

Now, I'll review a few highlights from our third quarter results. Revenue grew 10% year-over-year to $193.8 million in the quarter, significantly above our previous guidance. This overperformance was driven by slight top-of-funnel improvements, momentum in Managed Services, and continued growth from our ads products. Marketplace revenue was $167.3 million, a 12% increase compared to $149.6 million in the third quarter last year. In our Enterprise business, total Enterprise revenue grew slightly at $26.4 million in Q3. We remain very confident in the huge opportunity in Enterprise. We will continue to report Enterprise revenue separately, even as we serve more of our Enterprise customers through our Business Plus plan, which will be recognized in the Marketplace revenue line going forward. Given changes to our approach, our traditional Enterprise plan deal number will decline as the year progresses and as we close out our existing pipeline, meaning our prior new Enterprise logo metric will be less relevant after Q4. Managed Services revenue showed strength in the third quarter, growing 5% on a year-over-year basis, reflecting steady demand for outcome-based delivery of work and our focus on expanding share of wallet among our largest Enterprise clients. We continue to grow our Managed Services land funnel and signed an increasing number of Managed Services MSAs in the third quarter.

Our overall active client base grew 2% year-over-year to 855,000, with both new acquisition and retention benefiting us. Our GSV per active client increased in the third quarter versus the second quarter, as our value proposition continues to resonate with customers, even in a period of tighter budgets. In Q3, we also saw average GSV per client increase over Q2 in all business segments, from enterprises to very small businesses.

Our Marketplace take rate continued to reach record highs at 18.3% in Q3, increasing 30 basis points from Q2, driven by continued growth in our ads & monetization business. While we have implemented significant pricing and monetization measures to optimize take rate over the past few years, in coming quarters we will take a more surgical approach, resulting in a more measured pace of take rate expansion. Introducing new and innovative ways to bring value to our customers catalyzes activity on our marketplace, and we expect these to be the drivers of take rate over the next few quarters, as opposed to wholesale pricing changes.

Non-GAAP gross margin continued to improve both on a year-over-year and sequential basis to 77.8%, as we executed disciplined cost management across every area of our business. Non-GAAP operating expense was $110.8 million, representing 57% of revenue in Q3 2024, compared to 59% of revenue in the prior year period. For the third quarter, non-GAAP R&D expense was $42.0 million. We expect non-GAAP R&D expense excluding one-time charges to decline by low single digits on a percentage basis sequentially in the fourth quarter. Non-GAAP Sales & Marketing expense of $42.9 million declined 3% year-over-year, and we expect spend to decline in the fourth quarter by an even greater magnitude on a percentage basis compared to the third quarter. Our provision for transaction losses remained low at $1.8 million for Q3, approximately 1% of total revenue.

Adjusted EBITDA was $43.2 million in the third quarter, representing adjusted EBITDA margin of 22.3%. Our profitable business model generated our highest quarter of GAAP net income ever and continues to generate GAAP earnings per share growth, which includes the impact of stock-based compensation. For the third quarter of 2024, GAAP net income was $27.8 million and fully diluted GAAP earnings per share was $0.20 cents. Free cash flow for the third quarter was $98 million, which benefited from the weekly timing of payments to customer accounts. Excluding this favorable timing impact, we estimate our free cash flow in the quarter would have been approximately $52 million, which is a 58% year-over-year increase. Cash, cash equivalents and marketable securities were approximately $601 million at the end of the third quarter.

Following the completion of our previous $100 million share repurchase program earlier this year, we are pleased to announce a new $100 million share repurchase authorization. We remain committed to executing our long-term strategy and will utilize our healthy balance sheet and strong cash generation to deliver shareholder value, including making the right investments in our growth levers, evaluating accretive M&A, and opportunistically deploying capital to repurchase shares.

Turning to guidance. We are increasing our fourth quarter revenue and adjusted EBITDA outlook based on a continuation of trends we saw in the third quarter. For the fourth quarter of 2024, we expect to produce revenue in the range of $178 to $183 million. For adjusted EBITDA in the fourth quarter, we are guiding to a range of $38 to $42 million, which represents an adjusted EBITDA margin of 22% at the midpoint. We expect the majority of the cost benefits driven by our recently announced organizational changes to materialize in 2025.

For the full year 2024, we anticipate revenue between $756 and $761 million, representing 10% year-over-year growth at the midpoint. We expect our take rate for the rest of the year to be down slightly from what we saw in Q3. As a result of our ongoing cost discipline and the strength of our business model, we are increasing our adjusted EBITDA margin outlook and now expect our full-year adjusted EBITDA will be in the range of $155 to $159 million. As a reminder, GSV and revenue growth, and consequently adjusted EBITDA margin, are affected in the fourth quarter of this year by the fact that there are fewer Sundays in the quarter this year versus last year. Because of the timing each week when our clients are billed, the number of Sundays in any set period affects our revenue and GSV recognition in that period. Excluding this structural impact, we estimate our GSV and revenue growth rates for the fourth quarter would be approximately four percentage points higher year-over-year. We expect full-year 2024 non-GAAP diluted EPS to be between $1.00 dollar and one dollar and two cents, up from our guidance last quarter of $0.90 to $0.94 cents. For the full year, we expect weighted average shares outstanding between 139 to 141 million. We are also providing an update to our stock-based compensation expense guidance for the year. Our prior guidance was that SBC expense would average a little under $20 million per quarter in 2024. We are tracking below that guidance both in our projection for Q4, due to our long-term strategy regarding team structure and operating approach that balances stock-based compensation with cash-based compensation. We expect stock-based compensation to continue to trend down into 2025. These efforts, along with our ongoing cost discipline and active capital return, reflect our clear and unrelenting focus on building shareholder value over the near and long term.

Finally, as we have discussed for some time now, the macro environment continues to be challenging. New tech jobs continue to hover at a nearly 3-year low, and inflationary and interest rate pressures continue to affect corporate spending across all business segments. We expect that it will take some time for these broader macro factors to improve and spending behavior to shift. Our ability to deliver strong growth over a multi-year period of volatility and suppressed demand is a testament to our focus on operational excellence and our highly attractive value proposition. However, we are not immune to the environment we operate in, and as we expect macro pressures to continue as we enter 2025, we are cautious about top-line growth over the next few quarters. Within this environment, we will continue our focus on durable, profitable growth, our investment in new growth vectors like the advancement of AI on our platform, and our commitment to driving shareholder value through capital return as we expand our margins and free cash flow.

As always, I want to close by thanking our incredible team at Upwork for their contributions this quarter and their unparalleled creativity, focus and pace of execution.

With that, we would be happy to take your questions.