



Welcome to Upwork's discussion of its first quarter 2019 financial results. Leading the discussion today are Stephane Kasriel, Upwork's President and Chief Executive Officer, and Brian Kinion, Upwork's Chief Financial Officer. Following management's prepared remarks, we will be happy to take your questions. But first, let me 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 the federal securities laws. 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's website and on our Investor Relations website, as well as the risks and other important factors discussed in today's press release. In addition, reference will be made to non-GAAP financial measures. Information regarding reconciliation of non-GAAP to GAAP measures can be found in the press release that was issued this afternoon on our Investor Relations website.

Please note that the prepared remarks corresponding to the information reviewed on today's conference call will also be available on our Investor Relations website at investors.upwork.com, shortly after the call has concluded. Now I'll turn the call over to Stephane.

Stephane Kasriel, CEO

Good afternoon and thank you for joining us to discuss our first quarter 2019 results. We had a solid start to the year, with continued GSV growth and margin expansion - and we are excited to share our detailed results with you.

What drives us day in and day out is our mission: to create economic opportunities so people have better lives. We continue to make progress in launching new products, features and enhancements to our online talent marketplace. We do this to improve the quality of our marketplace, to capture more of our large addressable market opportunity and to address the needs of our most important constituents: the freelancers and clients who work together on our platform.

On the product front, we now have four marketplace offerings to help better serve the needs of our different clients: Upwork Basic, Upwork Plus, Upwork Business and Upwork Enterprise. As background, historically we had two marketplace offerings: Upwork Standard and Upwork Enterprise. Upwork Standard was as a self-service offering targeted at sole proprietorships and small businesses, while Upwork Enterprise is sold by our sales team and targeted at mid-market and enterprise customers. It became evident over time that we needed to have additional offerings to better address the needs of our diverse client base. Therefore in late Q1, we renamed Upwork Standard to Upwork Basic, and launched Upwork Plus and Upwork Business.

I will now describe which clients each of these products is targeted at, from our most entry-level product to our most advanced product.

- **Upwork Basic** is targeted at very small businesses, giving them access to our marketplace to find, engage and collaborate with talent;
- **Upwork Plus** is targeted at small businesses that wish to engage freelancers in a self-service way, and need the tools to stand out from the crowd and easily collaborate with coworkers;



- **Upwork Business** is targeted at mid-market businesses looking for ongoing, flexible access to talent, that need consolidated billing and a team of advisors to help them set up their freelancer programs; and
- **Upwork Enterprise** is focused on the largest businesses, which need a more tailored product solution, enhanced access to premium talent on Upwork and compliance services.

The pricing of each product offering is as follows:

- Upwork Basic doesn't have a subscription fee, but does have a client payment processing and administration fee of 3% (up from 2.75% in the previous, "Upwork Standard" offering). The new 3% client fee applies to all new Upwork Basic clients.
- We have a tiered freelancer service fee schedule based on cumulative lifetime billings by the freelancer to each unique client relationship using Upwork Basic. Freelancers working with clients on Upwork Basic typically pay us 20% of the first \$500, 10% for the next \$9,500, and then 5% for any amount over \$10,000 they bill.
- The subscription fee for Upwork Plus is about \$50 per month. The freelancer fee is the same tiered fee as Upwork Basic. The client fee is 3%, but is waived if the client pays via ACH.
- The subscription fee for Upwork Business is about \$500 per month, with a client fee of 10% and a freelancer fee of 10%.
- Upwork Enterprise pricing remains unchanged with a subscription fee that varies based on the complexity of the engagement, a freelancer fee of 10% and a client fee of either 10% or 20% depending on whether the client is using our Compliance offering or not.
- For both Upwork Business and Upwork Enterprise, we also offer discounted pricing for what we call "Bring Your Own Freelancer", or "BYO", where the client brings their existing freelancers and agencies onto the Upwork platform. For freelancers brought in through BYO relationships with a client, the freelancer does not pay a fee.

While Upwork Plus and Upwork Business are newly launched, we believe these additional products are one way in which we stabilize our take rate and support future revenue growth. We've seen good early traction from these launches, one such case study is New York-based Lady M Confections, a fast-growing international e-commerce and brick and mortar business with 38 cake boutiques around the world. The marketing team came to Upwork to tap into our global talent pool of high quality professionals. They selected Upwork Business because it was the best fit for their team in finding talent quickly and Upwork handles all of the onboarding. This allows their team to focus on work versus the administrative side of hiring freelancers. As Lady M is opening new boutiques, hosting pop up experiences in new markets, and growing its online community, their marketing team is tapping into freelancers in local markets, specifically for photography and social media needs. From Hawaii, Washington, Texas, to Asia, Upwork has helped them connect with freelancers quickly.

Upwork Product Offering

Basic	Plus	Business	Enterprise
The essentials to start hiring, today.	For teams looking to stand out to quality talent and scale hiring fast.	For businesses looking for a flexible talent solution that scales with them.	For companies looking for a solution that fits into their talent program.
<ul style="list-style-type: none"> ✓ Verified freelancer work history and reviews on Upwork ✓ Unlimited proposals from freelancers ✓ Built-in collaboration tools and easy payments 	<p>Everything in Basic, and:</p> <ul style="list-style-type: none"> ✓ Dedicated account managers to help you find and hire quality talent fast ✓ Project tracking and collaboration tools for teams ✓ Tailored search results featuring Top Rated and Rising Talent 	<p>Everything in Plus, and:</p> <ul style="list-style-type: none"> ✓ Consolidated billing and invoicing with net 30 pay ✓ Dedicated team of advisors to get you hiring faster and more successfully ✓ Detailed reporting with company insights and trends 	<p>Everything in Business, and:</p> <ul style="list-style-type: none"> ✓ Custom configurable contracting and onboarding process ✓ Worker classification compliance services ✓ Project-based or managed solutions, and dedicated account executive
<p>Client fee: 3% of freelancer billing to client</p> <p>Freelancer fee: 20% of the first \$500, 10% for the next \$9,500, and 5% for any amount over \$10,000 billed to client</p>	<p>Client fees: Approximately \$50 monthly subscription charge; plus 3% of freelancer billing to client (Fee waived if client pays via ACH)</p> <p>Freelancer fee: 20% of the first \$500, 10% for the next \$9,500, and 5% for any amount over \$10,000 billed to client</p>	<p>Client fees: Approximately \$500 monthly subscription charge; plus 10% of freelancer billing to client</p> <p>Freelancer fee: 10% of billing to client, waived if freelancer was brought to the platform by the client due to preexisting relationship ("BYO" program)</p>	<p>Client fees: Individualized monthly subscription change; plus 10% of freelancer billing to client (20% if client is not using Compliance offering)</p> <p>Freelancer fee: 10% of billing to client, waived if freelancer was brought to the platform by the client due to preexisting relationship ("BYO" program)</p>

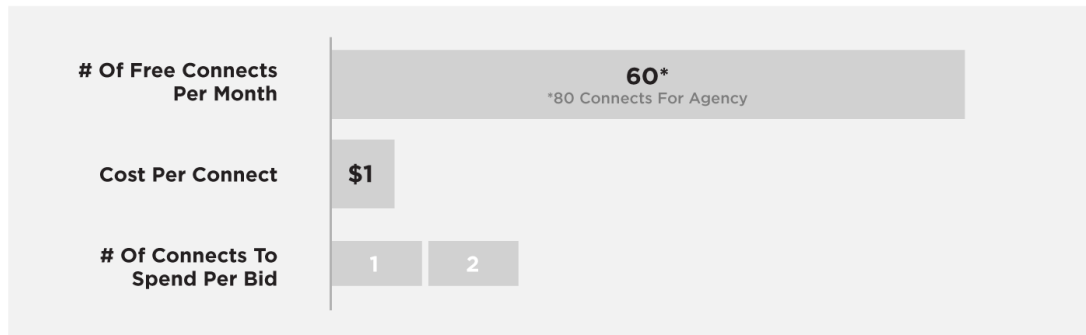
We are also focused on making our platform the most trusted on which to get projects done. We strive to ensure that it is professional, that customers are uniquely and accurately represented, and that the matching process results in good outcomes for both parties. Our Trust and Safety teams continue to excel in all key pillars of Identity, Trust, Marketplace Quality, Security, Fraud and Risk management. With regard to marketplace quality, in April, we announced plans to update Connects. These rolling updates have begun, and will continue through the end of June. Connects are virtual tokens within Upwork that allow freelancers to bid on jobs.

- Previously, a freelancer would receive 60 Connects and an agency would receive 80 Connects for free every month. Now, existing freelancers will no longer receive free Connects each month and newly admitted freelancers to the platform will continue to receive 20 Connects to get started.
- With the new Connects launch, freelancers will purchase Connects for \$0.15 each, which is a decrease from the prior \$1 per Connects price.
- To take into account the value of different projects, the number of Connects required to bid for a project will vary from zero to six connects depending on the size of the project (where previously every project required two Connects to bid). Bids submitted in response to invitations from clients will continue to be free.

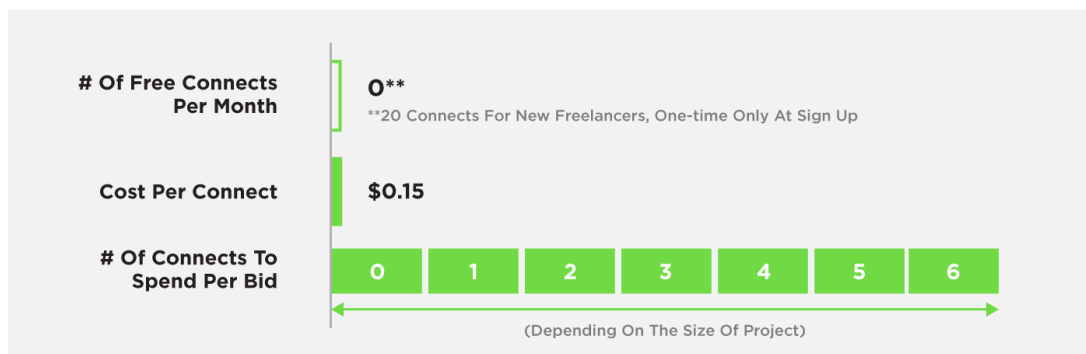
These changes in Connects are aimed at helping skilled professionals win more projects. We expect freelancers will submit fewer proposals, focusing on projects for which they are most qualified and most likely to win. As a result, clients will have a smaller selection of highly relevant proposals to review, making it easier for them to identify the best talent for their projects. We believe this change in Connects will be revenue neutral in the near-term as the main objective of this change is to encourage higher quality projects and client relationships on our marketplace.

Updated Connects

Before



After



During last quarter’s call I mentioned several of our priorities for 2019. I would like to provide a quick update on our progress against our Categories, Domestic and Enterprise initiatives.

In **Categories** we’ve done a lot to help freelancers differentiate themselves through their profiles. You can see this today in the visual nature of some of the design and creative profiles. Freelancers in those categories now have the option to showcase their portfolios in a more visual fashion. And in the second quarter, we will expand this enhanced visual functionality to include visual portfolio search for different project types as well, which allows freelancers to showcase their images in search results.

Also, as of March, all freelancers have access to specialized profiles. This is particularly pertinent to freelancers who are marketing multiple skills, which is the case for many freelancers. By allowing each freelancer’s account to house multiple profiles, the skills most relevant to the project at-hand are displayed first, making for a much cleaner, immediate match. Early indications for this feature are very positive. Our data shows show that freelancers who take advantage of specialized profiles are invited to a project over 30% more often than those that do not.

One [top-rated freelancer, Anton, a product designer](#) who also leads a development agency, shared with us that since specialized profiles launched, many clients have commented positively on the new format. Anton provided feedback that he can better showcase his deep understanding of two different skill sets. Before, Anton felt the prior profile titles were too long. By having multiple specialized profiles, now he can add specific information in each category that is directly related to what clients are looking for.



Indications make us confident that as additional freelancers adopt specialized profiles, project matching algorithms will continue to improve.

After Launches:

1 Portfolio Search Result

Melissa T.
Top-Notch Graphic Designer

\$65.00 / hr \$10k+ earned 100% Job Success United States

★ Specializes in Graphic Design

I am a top-rated Graphic Designer with 15 years of experience and excellent feedback from Upwork clients. My industry knowledge spans advertising for retail, food & beverage, pharmaceutical, healthcar ...

Graphic Design Deliverables • Packaging Design • Social Media • Poster • Brochure • 5 more

Graphic Design Software • Adobe Photoshop • Adobe Illustrator • Adobe InDesign • Sketch

1 more

2 Portfolio Search Result On Mobile

Melissa T.
Top-Notch Graphic Designer

\$65.00/hr \$10k+ earned 100% USA

★ Specializes in Graphic Design

I am a top-rated Graphic Designer with 15 years of experience and excellent feedback from Upwork clients. My industry ...

Graphic Design Deliverables • Packaging Design • 8 more

Graphic Design Software • Adobe Photoshop • 3 more

1 more

Before:

Melissa T.
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[*See full profile here](#)



Shifting to our **Domestic Marketplace** initiatives. Though on a smaller base, our domestic U.S.-to-U.S. marketplace continues to perform very well. We are seeing continued improvement in first-job-posts, fill rate and growth in overall project size in the U.S.-to-U.S. business. Our UK testing is ongoing, but we have no plans to expand that beta at this point.

There continues to be an exciting opportunity to also address more local needs using our Domestic Marketplace offering where we have existing liquidity in certain of our categories. For clients interested in finding freelancers within the same metropolitan area, our local freelancer search option test continues in the San Francisco Bay Area, Los Angeles, and New York - and has expanded to other cities, including Austin, Seattle, Washington D.C. and Chicago. Within these markets, about 50% of clients - and a portion of freelancers - are able to select the local search option. This exposure will expand further this year to additional clients and freelancers, as we amplify our efforts in select test markets.

In 2018, we made the decision to centralize our sales team in Chicago, strengthening our foundation for **Enterprise Sales**. Hiring is on-target, with our total sales team reaching 120 people at the end of Q1. We now have approximately 50 reps on a new business or growth quota, which is an increase from around 35 Reps in Q1 of last year. We've come out of the gate strong in Q1 exceeding our overall new business goals, as we've seen good early traction on the Upwork Business product since launch.

We look forward to continued momentum on all of these initiatives as we head through the year.

As the business grows we are also driving more high-level, influential conversations as part of our industry leadership. With that in mind, yesterday we announced our first Chief Economist. As our Chief Economist, Dr. Adam Ozimek will drive Upwork's growing body of research and public data releases. Our goal is to help businesses better understand hiring trends, help professionals spot emerging trends, and make our data more available to those of us working to create a more positive future of work. To the last point, I myself participate in the World Economic Forum, through my role as co-chair of the organization's working group on the future of work. My goal is to help guide constructive conversations that steer the world towards better future of work scenarios.

In addition, our Chief Business Affairs and Legal Officer, Brian Levey, was recently named to the SEC's newly formed Small Business Capital Formation Advisory Committee. The Committee provides a formal mechanism for the SEC to receive advice and recommendations on matters relating to small businesses. Through this appointment, Brian intends to further our efforts to enhance marketplace efficiencies and unlock economic opportunities for entrepreneurs across all regions of the United States.

And with that, I will turn the call to our CFO, Brian Kinion.

Brian Kinion, CFO

Thank you, Stephane, and good afternoon everyone.

I will start with a brief update on our key operating metrics. Then I will discuss both our financial results for the first quarter of 2019 and our guidance for the second quarter and full year 2019, which we included in our earnings release earlier today. Please note that numbers are rounded for the sake of convenience and unless noted otherwise, comparisons of the first quarter of 2019 are to the first quarter of 2018. I will be referring to GAAP measures unless explicitly cited as a non-GAAP measure.



We monitor and measure our business performance using the following key operating metrics: gross services volume (or GSV), core clients, and client spend retention. We believe these metrics are key indicators of our growth and the overall health of our business. GSV, which includes both client spend and additional fees we charge for other value-added services, increased by 21% in the first quarter to \$487 million. We continue to drive GSV with year over year increases in both core clients and client spend retention.

The number of core clients increased by 22% to approximately 111,000 as of March 31, 2019. Client spend retention was 107% on a trailing 12-month basis as of March 31, 2019, compared to 103% as of March 31, 2018. This is consistent with our expectation that client spend retention will stabilize in the 106 to 108% range for the near term. We continue to focus on increasing spend from our expanding base of clients on the platform.

Financial Results

With these key operational metrics in mind, I will now turn to our financial results. Total revenue increased by 16% to \$68.9 million in the first quarter. Marketplace revenue increased by 17% to \$60.9 million, representing 88% of our total revenue for the first quarter. Growth in marketplace revenue continues to be driven by an increase in the number of core clients and our client spend retention. This is evidenced by strength from our small business customers, our focus on customized experiences for categories through tailored features and functionalities, growth from our U.S. to U.S. domestic marketplace offering and an increase in spend from clients using our enterprise offering.

As a reminder, we have a long-standing client that uses our managed services offering, and we recognize the entire GSV of their projects as revenue. Managed services revenue increased by 10% to \$8.0 million in the first quarter, primarily due to an increase in the amount of freelancer services engaged by this client. Managed services has grown at a slower rate than our marketplace revenue and we anticipate this trend to continue.

Total revenue of \$68.9 million was at the high end of our guidance range of \$68 to \$69 million. As we noted on our Q4 earnings call in February, there are several factors to keep in mind with regard to our revenue growth in 2019:

- One, we are lapping the U.S.-to-U.S. domestic marketplace launch in our first and second quarters of 2019, which makes for a harder year-over-year comparison.
- Two, the number of Mondays in any given quarter impacts our sequential and year-over-year revenue growth rates as the most work in a given week is typically completed on a Monday, which is also the day we recognize our client payment processing and administration fee each week. The first quarter of 2019 had 12 Mondays, whereas the first quarter of 2018 had 13. And the fourth quarter of 2018 had 14.
- Third, we have currently elected to spread our marketing investment in acquisition spend and brand awareness more evenly throughout 2019, as compared to our past practice of spending disproportionately in the first quarter. While we feel this was the right decision to acquire customers at a lower cost, it will impact revenue growth in the short-term.

Our take rate, which we define as revenue divided by GSV, was 14.2% in the first quarter, roughly consistent with the fourth quarter of 2018. As noted on our previous calls, we expected a slight deceleration in take rate as a result of our long-term strategy to align our incentives with (1) freelancers



that have longer term client relationships and now bill at the 5% fee tier and (2) clients that continue to adopt ACH as a payment method which waives the payment processing and administration fee. As mentioned earlier, that fee will only be waived for paid subscribers of the newly-introduced Upwork Plus product. Long-term, we believe freelancers billing at the 5% tier reduces friction and clients adopting ACH encourages larger and longer projects.

As Stephane described, we launched additional value-added products to offset some of the take rate deceleration and to increase spend and revenue on our platform. We have many levers to increase take rate, and will use them, assuming it's beneficial for the health of the platform. The new product offerings of Upwork Plus and Upwork Business are examples of these types of levers.

Non-GAAP gross profit in the first quarter increased by 21% to \$47.9 million. We are focused on driving gross margin leverage. Non-GAAP gross margin was 70% for the first quarter, up from 67% in the first quarter of 2018. Gross margins are influenced by multiple factors but primarily by payment processing costs. While increased ACH adoption puts downward pressure on our take rate and revenue, it positively impacts our gross margin. Gross margin is also impacted by our spend on AWS which is driven by GSV. We continue to focus on growing revenue faster than our AWS costs in the near term and have been successful in achieving this for the last two quarters. Finally, our cost of revenue to provide managed services constitutes a drag on our gross margin, which becomes less meaningful as our marketplace revenue continues to grow faster than our managed services offering.

Turning to operating expenses, non-GAAP sales and marketing expenses increased by 3% to \$19.9 million in the first quarter, representing 29% of total revenue compared to 33% in the first quarter of 2018. We also plan to spend significantly more in marketing and advertising in 2019 as compared to 2018. We believe this will allow us to acquire customers at a lower cost, drive brand awareness and attract new users throughout the year. We intend to expand our sales team throughout the year in order to execute on our plans to land and expand across mid-market and enterprise customers.

Non-GAAP R&D expenses in the first quarter increased by 11% to \$14.4 million, representing 21% of total revenue compared to 22% in the first quarter of 2018. In 2019 we plan to continue focusing our efforts in developing new products and features such as those in categories for improved profiles and portfolios, as well as our continued mobile-first transformation. We believe continued investment in R&D is important to further our long-term strategic objectives.

Non-GAAP G&A expenses in the first quarter increased by 32% to \$12.6 million representing 18% of total revenue, compared to 16% in the first quarter of 2018. These increases were primarily due to our investments in finance, accounting and legal to support being a public company.

We expect sales and marketing, R&D, and G&A expenses to increase in absolute dollars, although as a percentage of total revenue they may fluctuate from period to period.

We continue to see improvement from our provision for transaction losses. Transaction losses decreased by 50% to \$0.6 million in the first quarter, representing approximately 1% of total revenue. This is below our normal range of 2% to 3% of total revenue. We expect our reserves to return to our normal range and increase proportionally as our GSV grows.

Net loss was \$4.7 million in the first quarter of 2019 compared to a net loss of \$6.8 million in the first quarter of 2018. For the first quarter, our basic and diluted net loss per common shares outstanding was \$0.04 on 106.6 million shares.



Non-GAAP net income was \$0.5 million in the first quarter of 2019 compared to a non-GAAP net loss of \$3.9 million in the first quarter of 2018. Our basic and diluted non-GAAP net income per share in the first quarter of 2019 was breakeven compared to a net loss per share of \$0.11 in the first quarter of 2018.

Adjusted EBITDA, a key metric for us in operating the business, was \$1.2 million in the first quarter compared to negative adjusted EBITDA of \$3.1 million in the first quarter of 2018. We exceeded our adjusted EBITDA margin guidance primarily due to gross margin leverage and lower transaction losses. We continue to take a long-term view and balance investing in sustainable profitable growth, while building upon our leadership position of this very large and expanding addressable market opportunity.

Moving to the balance sheet and cash flows. We ended the quarter with \$121.2 million in cash, cash equivalents and marketable securities compared to \$129.1 million at December 31, 2018. As of December 31, 2018 and March 31, 2019, we had \$24 million in debt outstanding from our two term loans. We also temporarily drew down \$25 million from our revolving line of credit to provide working capital to fund our marketplace accounts receivable as of March 31, 2019 which was a Sunday. As a licensed escrow agent, we are required to fund the trust with our operating cash if there is ever a shortage due to the timing of cash receipts from clients for completed hourly billings. We repaid the \$25 million revolver on the first day of the second quarter. Please note that the quarter ending June 30, 2019 also ends on a Sunday and therefore, you should expect us to use the revolving line of credit in a similar fashion as we did this quarter and prior quarters that fell on a Sunday.

We used \$29.4 million in cash for operating activities in the first quarter, which was largely driven by the shift of operating cash to fund our escrow obligations related to the Sunday effect that I just mentioned. We used \$76.3 million in investing activities during the first quarter primarily related to the purchase of \$71.7 million of marketable securities and approximately \$1.6 million to start the build-out of our new Santa Clara headquarters. Cash provided by financing activities for the first quarter was \$25.8 million primarily due to the temporary draw down from our revolving credit line discussed previously. As a reminder, our first principal payment to pay down the term loans began in April 2019.

To note, we will be incurring additional one-time capital expenditures of approximately \$5.0 million and \$500,000 in the second and third quarter of 2019, respectively, to complete the buildout of the Santa Clara office due to our long-standing Mountain View lease expiring in the second quarter.

Before turning to guidance, as noted previously, we are lapping the launch of our domestic U.S.-to-U.S. marketplace during the first half of 2019 while also spreading our marketing spend evenly throughout 2019.

For the second quarter of 2019, we expect revenue in the range of \$72.5 to \$73.5 million. We expect adjusted EBITDA in the range of breakeven to positive 1% of revenue and weighted average common shares outstanding to be in the range of 109 to 111 million for the second quarter.

We are on track with our plans and expect revenue growth to accelerate across the third and fourth quarters and full year revenue in the range of \$299 to \$304 million, or 19% year-over-year growth at the midpoint of this range. We expect adjusted EBITDA in the range of breakeven to approximately 1% of revenue and weighted average common shares outstanding to be in the range of 109 to 114 million for the full year.

And now I'll turn it to Stephane for closing comments.



Final Closing from Stephane

Our first quarter performance puts us on a solid trajectory to achieve our plans for 2019 and beyond. We continue to lead both our business and our industry ahead as we fulfill our vision to connect businesses with great talent to work without limits. We are confident in the strategic initiatives we've set for long-term growth, and pleased with our progress against them.

And with that, we will now take your questions.