

Q2 2020 Prepared Remarks

Denise Garcia, Investor Relations

Welcome to Upwork's discussion of its second quarter 2020 financial results. Leading the discussion today are Hayden Brown, Upwork's President and Chief Executive Officer and Brian Kinion, Upwork's departing Chief Financial Officer and current Advisor to the CEO. Also on the line is Jeff McCombs, Upwork's incoming 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. In addition, any statements regarding the current and future impacts of the COVID-19 pandemic on our business and current and future impacts of actions we have taken in response to the COVID-19 pandemic are forward-looking statements and related to matters beyond our control and are changing rapidly. 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 press release. Additional information will also be set forth in our Quarterly Report on Form 10-Q for the three months ended June 30, 2020 when filed. 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 at investors.upwork.com.

As always, reported figures are rounded; unless otherwise noted, comparisons of the second quarter of 2020 are to the second quarter of 2019. All measures are GAAP unless cited as non-GAAP.

The prepared remarks corresponding to the information reviewed on today's conference call will also be available on our Investor Relations website, shortly after the call has concluded.

Now I'll turn the call over to Hayden.

Hayden Brown, President and CEO

Thanks, Denise, and thank you all for dialing in today.

I want to start by commending our team for thriving in a fully remote work environment while continuing to put our customers at the center of everything we do. Overnight, knowledge workers everywhere have adopted a remote working model that is testing companies and individuals in new ways, and I'm incredibly proud of the work our team has been doing to bring our own 20 years of remote work experience to bear in supporting companies large and small in navigating the remote work landscape.

The seismic trends towards remote work and more flexible working models continue to move in our favor, and this was illustrated by numerous data points from our [Fourth Annual Future Workforce report](#) released in June. Our study found that 45% of hiring managers have frozen full time hiring, and yet 72% are continuing or increasing their usage of independent professionals—underscoring the focus companies have today on cost management and workforce flexibility. The breakthroughs companies are making in

the adoption of remote work and their focus on creating a more agile workforce is increasing the appeal of our online freelance talent solution.

Against this backdrop, I'm pleased to report second quarter revenue of \$87.5 million, representing 19% year-over-year growth and exceeding the high end of our guidance range. Spend from new clients was a larger contributor than usual this quarter, as we onboarded and activated a record number of new clients. We benefited from the structural shift in favor of remote work and labor flexibility and drove performance through our continued investments in brand, performance marketing, and use-case specific content and marketing outreach. The other key driver of our revenue was spend from retained clients. A predictable and meaningful spend level from retained clients is a critical differentiator of our business model, and we are proud of the degree to which our customers have continued to rely on Upwork freelance talent as an essential part of their own operations through the economic downturn - as evidenced by the addition of more than four thousand additional clients to our core client roster this quarter. And while some of our clients pulled back spending due to macroeconomic factors with the onset of the pandemic and deepening recession in April, retention spend trended upward thereafter, bringing client spend retention to 100% for the quarter.

Now I'd like to share more about the progress we made in the second quarter as well as the plans we are executing against with respect to our three strategic growth pillars in the third quarter.

First, on our strategic priority to **get more, bigger clients**.

In Q2 we saw significant traction with business customers from the launch of more than 50 new solution-focused pages demonstrating the specific ways that businesses can leverage freelancers on Upwork for immediate needs. We are also continuing to build the drumbeat of awareness with larger customers via our [Work Together Talent Grants](#) program, in which we are seeding a freelance talent showcase that demonstrates the applicability of Upwork freelance talent to some of the most pressing challenges being addressed by organizations today. For example, one grant recipient, Buoy Health, based in Boston, is an AI-powered healthcare navigation platform that is using Upwork freelancer content creators and designers to help consumers navigate COVID-19 and other healthcare journeys. Another recipient, Zindi, based in Cape Town, Johannesburg, and Accra, is enlisting user interface and user experience designers found on Upwork to enable machine learning experts in locations around the world to participate in virtual hackathons to solve COVID-19 challenges. In Q3, we are excited to be leveraging the powerful stories from these and other Talent Grant recipients to build awareness of Upwork, using a multichannel messaging and advertising campaign that just launched. This campaign targets both SMB and enterprise buyers, with an emphasis on business publications, podcasts and television.

Our sales team experienced impressive top of the funnel activity but a slowdown in new deal close rates in Q2 as larger businesses were at various stages in managing their response to the current recession. However, we saw close rate improvements in June which have continued into the current period. Given the strong indicators we are seeing, with three consecutive months of all-time high sales accepted opportunities and improving deal close rate trends, we have confidence in where things are headed.

Next, with respect to our second strategic priority of **enabling more spend per client**, we successfully increased client hiring activity in our most valuable categories, including technical categories and customer support. As companies around the world adapted their tools and strategies to take advantage of digital systems and technologies in Q2, we found success driving adoption of Upwork for a range of needs served by freelancers in our Web, Mobile and Software Development category and IT and

Networking category. As companies large and small found themselves fielding an increased volume of customer contacts and in some cases struggled to pivot their onsite customer support teams to work in a distributed manner, we supported a number of clients such as Microsoft to successfully expand or launch new teams of multi-language customer support agents already adept at remote work. We are also excited to have partnered with Citrix to make it easy for clients to provision and deprovision Upwork freelancers and agencies onto their corporate tools using Citrix's virtual desktop solution.

We continued to advance our strategy of increasing spend per client by supporting clients to adopt Upwork for additional use cases. Our highest spending customers are those that use Upwork for payment and management of their own independent contractors, in addition to using Upwork for sourcing new flexible talent. This quarter, as more customers reevaluated their talent programs in a fully remote work environment, we were able to achieve significant adoption of our "Bring Your Own Talent" functionality, which allows clients to onboard pre-existing individual contractors and agencies onto our platform for global unified billing, enhanced visibility and reporting, strong spend controls, a worker classification option for peace of mind, and centralized team management. As another example of enabling broader use case adoption amongst clients, we entered into a partnership in Q2 with Business Talent Group, which offers access for our clients to their network of professional business consultants, while also enabling us to access BTG's additional client base which includes 50% of the Fortune 100.

In Q3, we are continuing to support customers adjusting to the remote work reality with further enhancements to our "Bring Your Own Talent" offering, in addition to making it even easier for our customers to scale their usage of Upwork for talent sourcing as well as remote team payments and management across their organizations. In light of the current environment and heightened customer interest in solutions that enable them to manage distributed teams centrally, we are expanding the availability of our employer-of-record offering to all our customers so they can convert their Upwork freelancers to be employees without leaving our platform, and so that they can easily onboard and pay their own distributed employees, not just freelancers, via the Upwork platform.

Our third strategic priority is to **make more high quality matches**, with a focus on our high value technical categories of work. We saw huge global demand in Q2 for technical talent to address critical business needs in a digital-first world, and we exceeded our goals for matching technical talent with exciting, high impact project and role-based work on our site. In Q2, we made significant enhancements to our semantic search and matching system, improving the relevance of search results and increasing client efficiency in search. We also released a new premium talent pool called "Upwork Expert-Vetted Talent", which builds on our deep expertise in vetting talent for our most selective enterprise clients. This solution makes available to our customers on a broader scale a pool of highly skilled talent identified via a unique combination of machine- and human-powered talent vetting and curation. In Q3, we will continue to expand our vetted talent pools as well as our core systems to offer a matching experience differentiated by the specificity, speed and quality of the talent matches we offer.

In addition to being laser-focused on our three strategic growth priorities, we are deeply committed to racial justice, and this commitment is integrated into many aspects of our work. We are building and scaling strategies and practices as an antiracist company with a particular focus on supporting our Black team members. We are holding ourselves accountable to a number of diversity, inclusion and belonging commitments, and have taken an open and transparent approach to discussing these efforts because we believe that this is an important way we can contribute to the larger, overdue national conversation about racism in America.

As part of this work and consistent with our mission to create economic opportunities so people have better lives, we remain dedicated to ensuring that Upwork is a platform where all people, regardless of skin color, gender or any protected characteristic, can compete on a level playing field and have opportunities to do incredible work. It is consistent with this that 60% of the Work Together talent grant recipients are organizations owned or led by members of underrepresented groups or are diversity-focused organizations, and 18% of the grantees are U.S. Black owned, led, or focused organizations. In Q3, we are continuing to invest in enhancements to our platform that better enable clients to use Upwork to achieve their own supplier diversity goals.

As we look ahead, we see companies building enduring skills, capabilities and cultural norms that embrace remote work as part of their permanent status quo. This increases the comfort within businesses of all sizes to work with remote talent on Upwork. We also expect businesses to increasingly seek out solutions that enable them to more dynamically manage personnel and vendor costs through any economic climate, and believe we are uniquely positioned to meet these needs. With that in mind, we expect continued strength in new client acquisition in Q3. At the same time, we recognize that some of our existing customers may struggle further should the recession deepen and have anticipated this in our guidance. We remain confident in our growth strategy and excited about the runway ahead of us. The widespread cultural acceptance of remote work across the economy serves as a meaningful enabler for customers to adopt our solution at a larger scale and underscores the positive long-term trajectory of our business and its potential to achieve sustained revenue growth of 20% or more in the years to come.

As you may have seen, today we also shared the news that Jeff McCombs will join Upwork as Chief Financial Officer succeeding Brian Kinion. To help ensure a smooth transition, Brian will stay on as an advisor to the Company through October 2020. Jeff joins us from Doctor On Demand where he served as CFO. Jeff was also previously CFO at OpenTable, CFO at Flipboard, and Head of Global Business Operations at Facebook. His significant executive leadership experience will help expand Upwork's finance and operational capabilities and add tremendous value to our business—we're thrilled to welcome him to the team. I want to thank Brian for his significant contributions to Upwork throughout his tenure. We are so grateful for his leadership and dedication. Now I'll turn the call over to Brian, and then to Jeff to briefly introduce himself.

Brian Kinion, departing Chief Financial Officer and current Advisor to the CEO

Thank you for the kind words Hayden, and hello everyone. Before I get into our second quarter financial results, I'd like to share a few parting words. It has been an honor to work with such an amazing team over the years, and I'd like to thank everyone at Upwork for their partnership and support. Serving as CFO of Upwork has been a career highlight, and the Company is on a great path. I look forward to seeing Upwork succeed well into the future. I'd like to introduce Jeff, and then we'll turn to the second quarter results.

Jeff McCombs, incoming Chief Financial Officer

Thank you, Brian and Hayden, and hello everyone. I am very excited to join Upwork at such a transformational time for the Company. Now, more than ever before, the flexibility that Upwork provides is critical to businesses and freelancers alike. I look forward to working closely with Hayden and the rest of the leadership team to execute on Upwork's vision of connecting businesses with great talent. Now, back to Brian to wrap up with the second quarter results.

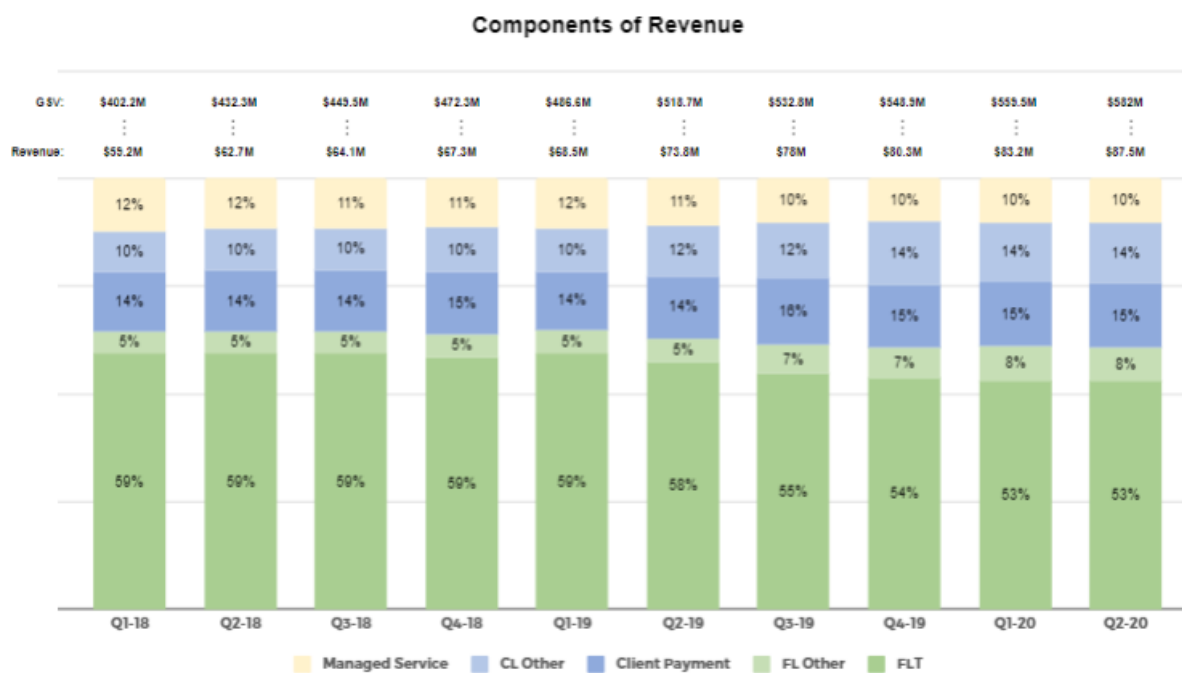
Brian Kinion

Thanks Jeff.

In the second quarter, our gross services volume was \$582.0 million and our revenue was \$87.5 million, reflecting a 19% year-over-year increase. Marketplace revenue was \$78.5 million, reflecting a year-over-year increase of 19%, while managed services revenue was \$9.1 million.

As we shared on our last call, we began to surpass pre-crisis levels on numerous top of the funnel client activity metrics such as client registrations and new job posts in early to mid-April. These new client relationships resulted in revenue at the higher tiers of our tiered freelancer service fee. Revenue was also boosted by client spend retention that improved over the course of the quarter. Lastly, our revenue performance was driven by better than expected usage of Connects, freelancers' virtual bidding tokens, and a COVID-related project under Managed Services.

Our core clients grew by approximately 4,000 to 133,300 at the end of the second quarter. And our client spend retention for the quarter was 100%. Our overall take rate in the second quarter was 15% and our marketplace take rate came in at 13.7%.



Non-GAAP gross profit was \$62.3 million, or 71% of revenue, which was consistent with the second quarter of 2019.

Non-GAAP sales and marketing expenses were \$33.1 million, representing 38% of total revenue as compared to 32% in the second quarter of 2019. The increase was driven by investments to drive brand awareness, performance marketing, and sales.

Non-GAAP R&D expenses were \$17.8 million, representing 20% of total revenue as compared to 19% in the second quarter of 2019. The increase was driven by our continued investment in product innovation.

Non-GAAP G&A expenses were \$13.4 million, representing 15% of total revenue as compared to 18% in the second quarter of 2019. We will continue to drive leverage in G&A as we scale for growth.

Transaction losses were \$1.0 million in the second quarter, representing approximately 1% of total revenue, at the low-end of our typical 1-2% range. An expected increase in transaction losses associated with the impact of the pandemic did not materialize in the second quarter.

We expect operating expenses will increase in absolute dollars but fluctuate as a percentage of revenue from period-to-period as we continue to invest for growth.

Non-GAAP net loss was \$3.0 million in the second quarter of 2020 compared to non-GAAP net income of \$1.0 million in the second quarter of 2019. Our basic and diluted non-GAAP net loss per share was \$0.03 in the second quarter of 2020 as compared to a non-GAAP net income per share of \$0.01 in the second quarter of 2019. Adjusted EBITDA loss was \$1.2 million in the second quarter compared to positive adjusted EBITDA of \$1.2 million in the second quarter of 2019.

Considering the macroeconomic uncertainty related to the pandemic and potential volatility in how this may impact our retained customer base, we are guiding third quarter revenue between \$89 million and \$91 million. Note that in Q3 we will be lapping monetization initiatives that will moderate year-over-year growth comparisons in the second half of 2020. We remain bullish on our business opportunities and will continue funding growth initiatives while closely monitoring our performance to achieve our ROI thresholds. We will continue to manage costs with discipline while preserving our cash and maintaining our strong balance sheet, which included cash and marketable securities of over \$146 million at the end of the second quarter.

Thank you; we will now take your questions.