

Q4 and Full Year 2019 Prepared Remarks

Palmira Gerlach, Director of Investor Relations

Welcome to Upwork's discussion of its fourth quarter and full year 2019 financial results. Leading the discussion today are Hayden Brown, 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 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 at investors.upwork.com.

As always, reported figures are rounded; unless otherwise noted, comparisons of the fourth quarter of 2019 are to the fourth quarter of 2018 and comparisons for the full year 2019 are to the full year 2018. All measures are GAAP unless cited as non-GAAP.

As we have disclosed previously, we adopted the new revenue recognition standard, Accounting Standards Codification Topic 606 ("ASC 606") on December 31, 2019 on a modified retrospective basis effective January 1, 2019. This primarily impacts our tiered pricing program for freelancer service fees, which results in a deferral of revenue. Financial results for the reporting periods during 2019 are presented in accordance with the new revenue recognition standard, although for purposes of comparison to our prior guidance and to our fiscal year 2018 results, we will also be discussing certain of our 2019 results under ASC 605. Our press release filed today includes for the first time the additional information to reconcile the impact of the adoption of this revenue standard on our financial results for reporting periods in 2019. Additionally, we have posted a presentation on the investor section of our Investor Relations website with details regarding the impact of the ASC 606 adoption on our reported financial results.

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, shortly after the call has concluded.

Now I'll turn the call over to Hayden.

Hayden Brown, President and CEO

Thanks, Palmira, and thanks everyone for dialing in today.

When I joined Upwork eight years ago it was clear to me that this company is positioned at the crossroads of four major secular trends: first, a planet blanketed by internet access, offering the potential to connect people across the globe like never before. Second, better and better collaboration tools, making remote work increasingly comparable to being face-to-face. Third, shifting sands in the labor force, in which people increasingly demand to work differently, seeking freedom from the traditional nine-to-five workplace, and greater autonomy in when and for whom they work. And fourth, an increasing war for talent, with companies running out of options for how to attract and retain the types of workers they need to be competitive. This company was founded on a transformational idea that today seems like an inevitability: high quality work and workers available on demand, at the touch of a button. While this is a future that we have envisioned for quite some time, the signals I see within our business today suggest we're close to reaching a tipping point.

While demand for our services from small businesses has always been and continues to be strong, today we are seeing the tides turn in larger company contexts. We've gained evangelists at midsize to Fortune 500 companies, one third of whom are our clients. This is igniting new conversations amongst executives in corporate America about how broken today's models are for sourcing and working with skilled talent. These companies increasingly recognize that the so-called "skills gap" can be bridged by leveraging talent from beyond their local regions and from sources outside of their traditional staffing vendors. These larger companies now realize that Upwork's on-demand talent solution is a critical pathway for them to not just achieve bottom-line objectives, but to exceed topline goals. This is because a dynamic workforce model that leverages Upwork can deliver sought-after innovation and the necessary talent to fuel the digital transformations that so many companies are grappling with.

Upwork's opportunity is immense. We're pursuing a \$560 billion dollar market of professional service jobs that can be performed remotely. We're driving a transformation in the labor market that will be as seismic as the impact of e-commerce on retail and as disruptive as the sharing economy has been on fixed asset industries. We're the largest online talent solution and our suite of product offerings is designed for all companies in need of professional talent. But, even though we have been building strong foundations over many years, I believe that we are just getting started. Our goal is to become the world's top provider of flexible talent solutions by attracting the best clients, with the best work opportunities, for the world's best talent. With that in mind, I believe Upwork can be a higher growth business, that we can grow into and sustain a 20% plus year-over-year growth rate for the long-term. My chief focus is to make that a reality.

Since becoming CEO on January 1, I have prioritized setting up our teams to execute a focused 2020 growth acceleration plan. Earlier this month, I made significant organizational changes to enable us to

streamline the delivery of our end-to-end customer experiences. Given our business model, in which each year's performance is significantly driven by recurring spend from past cohorts of clients, the results of this year's organizational changes and our strategic growth investments may not immediately appear. However, the important growth work we do this year will set us up for accelerating growth towards a 20% target in the years to come.

To that end, I've seized the unique opportunity I have right now as the new CEO to step back and take stock of our business relative to its potential. I spent my first two months immersed with our clients, our freelancers, our partners, our internal teams, investors and industry leaders, listening closely to their ideas and assessing all aspects of our business. I've set us up to execute on a strong growth plan, while also beginning to evaluate a number of opportunities that will enable Upwork to better fulfill its transformational potential. I'm taking my first 100 days to develop a fresh perspective, and I look forward to sharing specifics on opportunities and key decisions in our future earnings calls and investor updates.

Before I recap our 2019 performance and our outlook for 2020, I want to express my gratitude to Stephane Kasriel, who in December decided to step down from the President and CEO position he held for over four years. I had the pleasure of working with Stephane for seven years, and he was an excellent leader who ushered Upwork from being a small startup into being the largest online talent solution. I was honored to take the baton from Stephane as President and CEO of Upwork last month, and I couldn't be more excited about what's to come.

Within Upwork, I'm known for bold leadership, a long term strategic focus, and my deep passion for our mission and our business. I spent part of my childhood in Kathmandu, Nepal and have seen firsthand that talent is everywhere but opportunities are not. I'm incredibly proud of the work we do to achieve our mission- to create economic opportunities so people have better lives- and of our dedicated workforce, both our employees and the talented freelancers who work for us directly. Working together, we have a distinct advantage in our ability to sustainably accelerate Upwork's growth due to our uniquely talented teams, collaborative culture, market knowhow, large scale marketplace and our technology leadership.

2019 Recap

I would like to recap 2019, with a focus on fourth quarter performance. I'll also share my perspective on our 2020 expectations and the work already happening to move us to a higher growth trajectory in future years.

I'm pleased to report a strong fourth quarter with revenue at \$80.7 million, exceeding our previously provided guidance of \$79.0 to \$79.5 million. This brought our full year revenue to \$302.6 million, also exceeding our guidance of \$301.0 to \$301.5 million. Please note that these numbers are under the ASC 605 revenue recognition standards, which we'll discuss in more detail later.

Our fourth quarter and full year GSV was \$549 million and \$2.09 billion, respectively. Now let's dive into the drivers of topline performance in 2019.

GSV is driven by two factors: spend from our large retained client base and spend from our newly-acquired clients. Our client spend retention rate as of December 31, 2019 was 102%. This is lower than our all-time high of 108% as of December 31, 2018. We have found that the 108% retention rate was driven by the launch of our domestic marketplace in 2017, which led to an increase in hourly rates on the site that was most pronounced in 2018 and started to normalize in 2019. In addition, after the launch, a subset of U.S. clients engaged solely U.S. freelancers and have exhibited lower client spend retention than the rest of our clients. As this dynamic is stabilizing in our marketplace, we are seeing our client spend retention rate revert closer to our historical levels and we expect it to stabilize around 98-100%.

In terms of spend from newly-acquired clients, 2019 largely met our goals with respect to spend per client, but we saw some softness in our Q4 core client additions, adding approximately 4,000 core clients in the fourth quarter. Some of this is a byproduct of our emphasis on the addition of larger client companies and the expansion of our footprint within existing accounts, where we believe we have significant headroom.

Our overall take rate in Q4 was 14.6%, up from 14.3% one year prior. Our marketplace take rate improved to 13.4% in Q4 compared to 12.8% a year prior. We achieved this take rate improvement by making several changes last year:

1. We saw good adoption of our new paid client subscription plans, which have higher monetization characteristics both in the subscription fee and take rate.
2. We also changed both the cost of Connects—which are the virtual tokens used by freelancers when submitting proposals—and the number of Connects required to submit a proposal. This was part of an effort to improve proposal quality, but a byproduct of this was improving monetization in the back half of 2019.
3. Lastly, we increased our client payment fee for Upwork Basic and Plus from 2.75% to 3%.

Now, let's talk about our cost structure, where we saw continued improvement in the management of our cloud computing costs, which largely accounted for the improvement in our fourth quarter gross margin to 71% vs. 69% in the fourth quarter of 2018. Within operating expenses, we realized leverage in several areas, but namely R&D. Lastly, we achieved success in decreasing transaction losses via ongoing efforts in our trust and safety and our payments programs. As a result, these efforts drove larger-than-expected improvements in our adjusted EBITDA.

Next, I'd like to drill down on our sales team, which is an important part of our long-term strategy. As I mentioned earlier, we are seeing a change in the enterprise market and we're positioning ourselves to take advantage of it. Just a few years ago, the most frequent question our sales team received from prospective clients was about "why" they should consider a solution like Upwork. Today, the top question we get is "how" they can use our solution—they recognize the need to evolve their talent strategy, and want to know how to get started. This is a major shift in mindsets, indicating a growing market readiness for our solution.

Our sales efforts are highly synergistic with our existing self-service marketplace business. One of the great benefits of our business is that we have a strong pipeline of accounts that start on our self-service offerings and are ready to upgrade to Upwork Business and Enterprise as they scale. In 2019 we created specialized roles for our sales reps, with some focusing on landing new accounts and others focused on expanding existing accounts. This specialization was successful, contributing to improved salesforce productivity. Given the traction we were seeing with both upgrading existing customers as well as landing new deals, and our healthy 18 to 24 month payback period on sales resources, a number we believe we can continue to improve, we substantially increased the size of our sales team over the course of 2019. We ended the year achieving our hiring plan of approximately 90 quota carrying sales reps, about half of whom were fully ramped. In general, it takes about six months for a new rep to ramp to full productivity. Overall, while still relatively small in their contribution to our total business, our sales team achieved strong growth and meaningful traction in 2019, and I see runway to continue investing in our sales model in future quarters. A strong sales team with excellent return economics will be essential to unlocking the giant portion of enterprise spend within the \$560 billion dollar market opportunity we are pursuing.

Looking forward

While 2019 was a solid year, I believe we can grow the business faster in future years. Immediately upon transitioning into this role, I reoriented the company to execute on a simplified strategy focused on three objectives that will set us up for growth acceleration in 2021 and beyond. These are:

1. Attract more, bigger clients
2. Enable more spend per client
3. Make more high quality matches, particularly in our technical categories of Web, Mobile, and Software Development

Attract more, bigger clients

Let me talk about our first priority, which is to attract more, bigger clients.

While prospective customers have increasingly heard of Upwork, they often underestimate the strategic advantages we offer. Too many of them think Upwork is simply a site for hiring freelancers for small gigs. In reality, over 85% of our more than \$2 billion dollar GSV in 2019 was derived from large engagements and complex projects, not small gig work. Our community of talented professionals receives an average project feedback rating above 90, and our clients rate Upwork with a net promoter score of above 60. By comparison, traditional staffing firms have an average NPS score of 4.

All of this data indicates that there is a major perception vs. reality gap about our business, and this year we're working aggressively to close this gap. Last month, we launched a new brand campaign which targets professional staffing buyers and showcases our platform's strengths for longer-term, high quality work with rated, reviewed talent. To ensure that we're attracting and converting the right clients, we are optimizing our lead funnel for Sales as well as innovating our self-service client onboarding experience.

I want to share an example of a client who is starting to tap into the full value we can provide. ElectrifiAI is one of the new Upwork Enterprise clients that we acquired in Q4. ElectrifiAI is a global AI and Machine Learning product company based in New Jersey. They're already experiencing 2-3 times increased productivity within their product teams by using Upwork. ElectrifiAI's product team is forecasting a 25% increase in the number of products they plan to develop and launch in 2020 versus 2019 because by using Upwork they are able to quickly find and work with experts that meet their exact business needs. We're focused on helping more companies like ElectrifiAI realize the tremendous potential that they have to achieve their business goals by using Upwork in more substantial ways.

Enable more spend per client

Next, I'd like to talk about our second priority, which is to enable more spend per client.

We're working on several initiatives to drive faster and broader adoption of Upwork within organizations that use our platform. Specifically, we're rolling out initiatives to help customers rapidly scale the number of active hiring managers in each account and to increase the size of contracts flowing through our platform.

To do this, we are investing in an extensive product roadmap, from business-friendly capabilities like single-sign on to improving our Upwork employer-of-record offering to more quickly scale payrolled relationships on our site. We are also investing in a more robust temp-to-hire offering for full-time work. These and other changes are aimed at enabling more clients to get longer-term, larger and more ongoing work done via our site.

Make more high quality matches, particularly in tech

Our third priority is to make more high-quality matches, particularly in our technical categories of Web, Mobile and Software Development. Technical categories of work account for a substantial portion of our total GSV, and yet these are not our fastest-growing categories today. We believe these categories can grow significantly faster given our talent supply and the ever-growing demand for quality technical talent in the labor market. To tap into this, we are deploying a similar playbook to the one we successfully built last year to accelerate the Design categories.

And now that I've discussed our three strategic pillars for the year—to attract more, bigger clients; to enable more spend per client; and to make more high-quality tech matches—I'd like to turn the call over to our CFO, Brian Kinion, for additional details on our financials. After he concludes, I'll wrap up our prepared remarks with some closing thoughts.

Brian Kinion, CFO

Thank you, Hayden, and good afternoon everyone.

My remarks today will start with the impact on our financial results from the adoption of two accounting standards we were required to adopt in 2019. Then I will discuss our financial results for the fourth quarter and full year 2019 and provide our revenue guidance for the first quarter and full year 2020, which we included in our earnings release filed earlier today.

Adoption of New Standards

We adopted ASC 842 which is the new leasing standard as of January 1, 2019 using the effective method. We recorded a right-of-use asset and corresponding lease liability in our consolidated balance sheet for approximately \$22 million. The impact to our consolidated statement of operations was immaterial.

As we previously disclosed, we were required to adopt ASC 606 which is the new revenue recognition accounting standard. We adopted 606 on December 31, 2019 on a modified retrospective basis effective January 1, 2019. The amount and timing of revenue recognized during 2019 remained largely unchanged across our offerings as a result of this adoption. However, the most notable impact relates to our tiered pricing program for freelancer service fees. For freelancers working with clients that are on our Upwork Basic and Plus offerings, we have a tiered freelancer service fee schedule based on cumulative lifetime billings by the freelancer to each client. Under the new standard, we will effectively defer a portion of the higher upfront fee and then recognize it ratably over the estimated time that we receive the lower fee. The impact on adoption was to record \$11.8 million of deferred revenue with a corresponding entry to accumulated deficit, which represents the net impact of our tiered freelancer services schedule from the inception of its implementation in 2016 to the end of 2018. The net impact on our 2019 marketplace revenue was approximately \$2.1 million less under 606 versus 605. We will be reporting revenue on a go-forward basis under 606 and we expect the impact of this adoption to impact marketplace revenue that would have been recorded under 605 by approximately \$750 thousand per quarter or approximately \$3.0 million for the full year 2020.

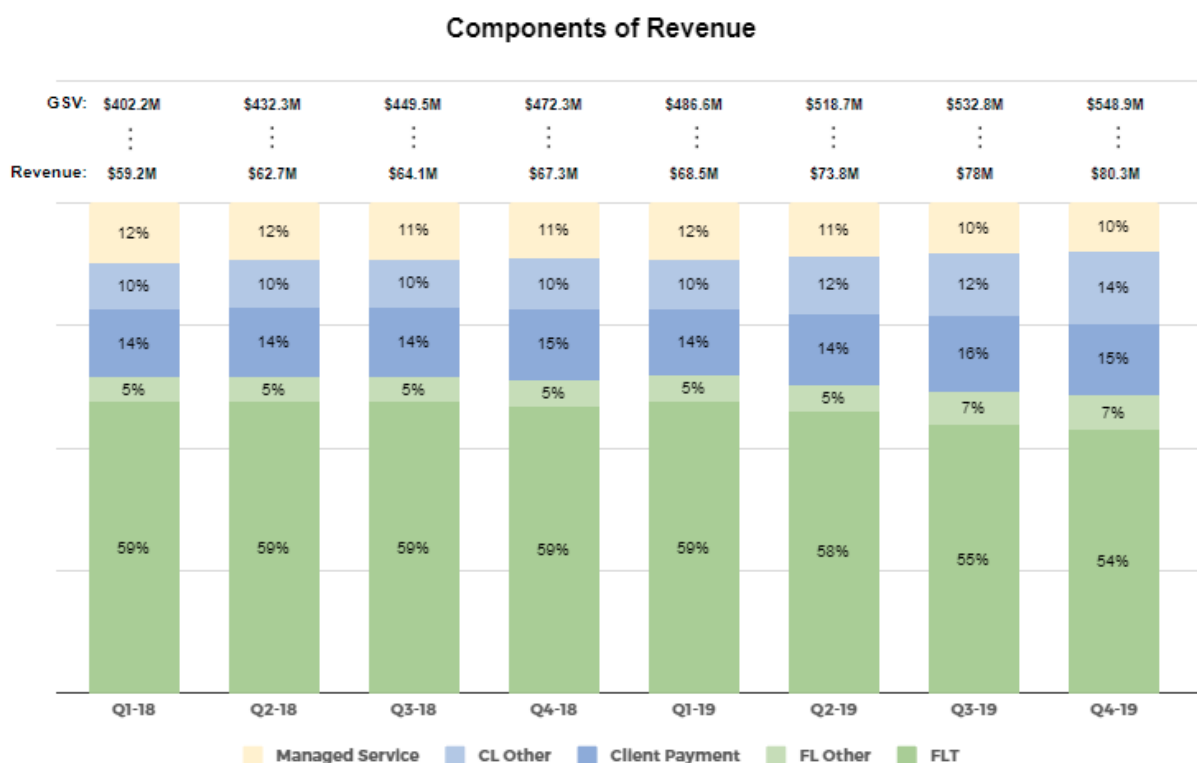
We have included additional information in the press release tables to reconcile the impacts of adopting both 606 and 842 on our financial results for reporting periods in 2019. Additionally, we have posted a presentation on the investor section of our website at investors.upwork.com with details regarding the impacts of adopting the new 606 revenue standard on our reported financial results.

As reported under 606, total revenue increased by 19% year-over-year to \$80.3 million in the fourth quarter and by 19% to \$300.6 million for the full year. Total revenue that would have been reported under 605 increased by 20% year-over-year to \$80.7 million in the fourth quarter and increased to \$302.6 million for the full year 2019.

Marketplace revenue, as reported under 606, increased by 21% year-over-year to \$72.2 million in the fourth quarter, representing 90% of our total revenue and increased by 20% year-over-year to \$268.3 million for the full year 2019. Marketplace revenue that would have been reported under 605 increased

by 22% year-over-year to \$72.6 million in the fourth quarter, representing 90% of our total revenue, and to \$270.4 million for the full year 2019, which was a 21% increase over the previous year.

Managed services revenue increased in the fourth quarter to \$8.1 million, and to \$32.3 million for the full year 2019. ASC 606 had no impact on managed services revenue.



2019 Revenue is under 606 and 2018 Revenue is under 605.

“Client Other” is the difference between client revenue and Client Payment Fees. “Freelancer Other” is the difference between freelancer revenue and Freelancer Service Fees.

Gross Profit

As reported under 606, non-GAAP gross profit increased in the fourth quarter of 2019 to \$57.5 million, representing 72% of revenue, compared with 69% in the fourth quarter of 2018. Non-GAAP gross profit under 606 increased in the full year of 2019 to \$212.9 million, representing 71% of revenue.

Operating Expenses

Non-GAAP sales and marketing expenses were \$24.8 million in the fourth quarter of 2019, representing 31% of revenue compared with 26% in the fourth quarter of 2018. Non-GAAP sales and marketing

expenses were \$93.3 million for full year 2019, representing 31% of revenue compared with 28% for full year 2018.

Non-GAAP R&D expenses were \$14.4 million in the fourth quarter of 2019, representing 18% of revenue compared with 20% in the fourth quarter of 2018. Non-GAAP R&D expenses were \$57.6 million for the full year 2019, representing 19% of revenue compared with 21% for the full year 2018.

Non-GAAP G&A expenses were \$15.0 million in the fourth quarter of 2019, representing 19% of revenue compared with 18% in the fourth quarter of 2018. Non-GAAP G&A expenses were \$54.7 million for the full year of 2019, representing 18% of revenue compared with 16% for the full year of 2018.

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

Transaction losses decreased to \$1.2 million in the fourth quarter of 2019, and were \$3.9 million for full year 2019, representing approximately 1% of revenue; our typical range has been between 1 and 2%.

Under 606, non-GAAP net income was \$3.4 million in the fourth quarter of 2019, compared with non-GAAP net income of \$2.7 million in the fourth quarter of 2018. Our basic and diluted non-GAAP net income per share under 606 was \$0.03 in each of the fourth quarters of 2019 and 2018.

Under 606, adjusted EBITDA was \$3.5 million in the fourth quarter compared with adjusted EBITDA of \$3.6 million in the fourth quarter of 2018.

2020 Guidance

Now, I'd like to share our forward-looking guidance for 2020, which is on a 606 basis.

For the first quarter of 2020, we expect revenue in the range of \$81.5 million to \$82.5 million. For the full year 2020, we expect revenue in the range of \$340.0 million to \$345.0 million.

Our revenue growth rates always vary from period-to-period due to a variety of factors. Specific factors influencing the shape of year-over-year performance this year include:

Q1 is expected to be stronger on a year-over-year basis in part because of the number of Mondays since that is the day we recognize our client payment processing and administration fee for the week. The first quarter of 2019 had 12 Mondays, whereas the first quarter of 2020 has 13 Mondays.

In Q2, we are anticipating further adjustments to how Connects are used on our site to drive high-quality matches, and we expect that to put some downward pressure on revenue. Last year, we adjusted the number of Connects required to submit a proposal. As we continue to optimize this to drive quality proposals and increase fill rates for jobs on our platform, we expect to see some negative revenue impact this year.

In Q3 and Q4, we are not expecting monetization improvements similar to the pricing changes that impacted us in the second half of 2019, which results in some year-over-year comparison headwind. In addition Q3 of 2019 had 14 Mondays, whereas Q3 of 2020 has 13 Mondays.

Lastly, we expect our managed services revenue to grow slower in 2020, as our primary focus is on increasing client usage of and spend on our marketplace offerings.

All of that said, I would like to emphasize that we are expecting fairly consistent sequential quarterly growth over the course of 2020.

As Hayden mentioned earlier, we are confident this business can have strong profitability economics over the long term. This year, however, our focus is on investing for growth in order to capture our large market opportunity. We will manage costs with discipline but have not prioritized achieving a particular EBITDA margin, and as such, we are not guiding to an EBITDA range this year.

Before turning the call back to Hayden, I would like to say that we are committed to providing regular investor updates as we've done in the past, and look forward to more face-to-face meetings as the year progresses. Now I'll turn it over to Hayden to share some concluding remarks.

Hayden Brown: Closing

Thanks Brian.

Above all else, I want the takeaway of this call to be that Upwork is incredibly well positioned to capture a huge opportunity, executing on a focused strategy that will deliver 20% growth and increasing profitability over time. We see critical secular trends converging and we are ready to take advantage of the changing landscape of how we work. We have a unique leadership position and knowhow in digital and remote work, a technology platform with incredible scale, a data asset including millions of users and trillions of unique matching data points, which together enable us to deliver better quality talent, faster, more effectively and at higher scale than any other solution that exists. We're well positioned to own a significant share of the large and growing market for contingent professionals, with early success and growing penetration of both the self-service market as well as the large enterprise space.

My number one priority is to make our potential as a market leader and a higher growth business a reality. While 2020 will be a transition year as we lay the foundation for the future, I'm confident that our efforts to strengthen our core self-service business and expand the impact of our Sales team will yield results. I appreciate the continued confidence of our investors, who share our vision and who I believe will be rewarded.

One of the best things about my job is that I get to see and hear from our customers every day, both those at giant corporations and those at small mom and pop shops. In recent conversations, Upwork clients and freelancers used words like 'superhuman' and 'Batman' to describe how they feel when using our product. Our customers speak with awe about how our company has truly changed what they thought was possible

for themselves and their businesses. Our tremendous opportunity to be a generation-defining company that changes people's lives for the better motivates me and all of us at Upwork every single day. We are confident in the future and excited about the opportunities ahead.

Questions

We look forward to answering your questions about our results and our outlook. Operator, we are ready for questions.