Engine Capital Sends Letter to Upwork's Board of Directors Regarding Opportunities to Substantially Increase Shareholder Value

Believes Management's Lack of Strategic Clarity and Focus, Poor Execution, Excessive Spending, and Significant Turnover Have Led to Poor Performance

Underscores that Upwork's Current Trading Valuation of ~6.5x EBITDA Represents a Steep Discount to its Intrinsic Value and Other Online Marketplaces and Staffing Firms

Calls on Upwork to Refresh Board to Improve Marketplace Functionality, Grow Enterprise Opportunity, Repurchase Shares, and Optimize Costs to Capture Significant Upside Potential

NEW YORK--(BUSINESS WIRE)--Engine Capital LP, which owns approximately 3.5% of the outstanding shares of Upwork Inc. (Nasdaq: UPWK) ("Upwork" or the "Company"), today announced it sent the below letter to the Company's Board of Directors regarding actionable opportunities for enhancing shareholder value.

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September 13, 2024

Upwork Inc.
475 Brannan St., Suite 430
San Francisco, CA 94107
Attention: The Board of Directors (the "Board")

Members of the Board:
Engine Capital LP (together with its affiliates, "Engine" or "we") is a meaningful shareholder of Upwork Inc. (Nasdaq: UPWK) ("Upwork" or the "Company"), with ownership of approximately 3.5% of the Company's outstanding shares. We invested in Upwork because of its promising position as the world's largest work marketplace, its significant addressable market given the growing acceptance of remote work, its potential to meaningfully disrupt the workforce solutions industry, and our belief that the Company is deeply undervalued.

We are writing to you today because we believe the Company has a great deal of potential that is unfortunately not being realized. This is due to Upwork's lack of strategic clarity and focus, ineffective execution, poor capital allocation, and revolving management team under CEO Hayden Brown. We also question whether the Board is appropriately holding senior management accountable for its numerous missteps. In this letter, we outline our concerns with the Company's current trajectory and highlight the opportunities we see for the Board to turn around the business and significantly increase shareholder value.

Despite its leadership position and significant growth potential, Upwork has failed to create shareholder value over any relevant measurable period, as shown in the below table.[1] Upwork has also underperformed relevant indexes and its closest public peer, Fiverr International Ltd. (NYSE: FVRR) ("Fiverr"), as well as other staffing firms, which have faced the same macroeconomic headwinds as the Company. Furthermore,

[1] Total shareholder return calculated as of the close on September 11, 2024. Return since IPO calculated from the close of the first trading day. Staffing Peer Group includes Adecco, AMN Healthcare, ASGN Inc., Cross Country Healthcare, Hays, Heidrick & Struggles, Kelly Services, Kforce, Korn Ferry, ManpowerGroup, Randstad, Recruit Holdings Co., Robert Half, and Trueblue.

the stock trades at a deep discount to its intrinsic value and to relevant online marketplaces and staffing firms at an EV to 2025 EBITDA multiple of ~6.5x.[2]

Total shareholder returns overtime					
	Total shareholder return (YTD)	Total shareholder return (1- year)	Total shareholder return (3- year)	Total shareholder return (since Ms. Brown became CEO in January 2020)	Total shareholder return (since IPO in October 2018)
UPWK	-38.1%	-35.5%	-79.6%	-13.8%	-56.6%
Russell 2000	4.1%	13.3%	-5.7%	26.1%	25.9%
NASDAQ	14.4%	24.3%	24.4%	120.4%	152.0%
FVRR	-8.9%	-12.8%	-86.3%	5.6%	NA
Staffing Peer Group (Average)	-12.7%	0.1%	-21.6%	9.1%	17.9%
Staffing Peer Group (Median)	-14.2%	-5.9%	-26.3%	3.7%	9.4%
UPWK vs. Russell 2000	**-42.2%**	**-48.9%**	**-73.9%**	**-39.9%**	**-82.4%**
UPWK vs. NASDAQ	**-52.6%**	**-59.8%**	**-104.1%**	**-134.2%**	**-208.6%**
UPWK vs. FVRR	**-29.3%**	**-22.8%**	**6.6%**	**-19.4%**	**NA**
UPWK vs. Staffing Peer Group (Average)	**-25.5%**	**-35.7%**	**-58.1%**	**-22.9%**	**-74.5%**
UPWK vs. Staffing Peer Group (Median)	**-24.0%**	**-29.7%**	**-53.3%**	**-17.4%**	**-65.9%**

Former Employees Say Upwork's Issues Originate at the Top

To better understand Upwork's subpar performance, we spoke with more than 20 former senior employees. These discussions made clear that many of the Company's issues are self-inflicted and attributable to senior management. Below are the key issues the Company faces today, based on our extensive due diligence:

Lack of Strategic Clarity and Focus

Instead of pursuing a clear, consistent strategy and committing the necessary resources behind it, the Company appears unfocused and unable to prioritize initiatives. Former employees spoke about a scattershot approach to product development, with engineering resources spread too thin because too many projects are being pursued simultaneously.[3] New products are frequently introduced with great fanfare on earnings calls only to never be heard of again, a likely sign of insufficient traction.

Just two years after highlighting the tremendous opportunity to expand its Enterprise business at its 2021 Investor Day, the Company significantly downsized the Enterprise team in a strategic U-turn.[4] Enterprise's latest results are a fraction of the Company's initial expectations and nowhere near the $300 million sales target management introduced in February 2022.[5] We believe Enterprise represents a significant opportunity for the Company and could be a great differentiator to attract unique talent to its platform.

The Company's failure to maximize this opportunity is a direct result of its lack of focus combined with poor execution. Instead of fully committing to the Enterprise strategy, Upwork distracted itself with numerous other products and initiatives, including Project Catalog, which focused on the smallest gigs at the opposite end of the spectrum from Enterprise. After discussing Project Catalog for years, management has not mentioned it since the 1Q 2023 earnings call. While there will always be a new "shiny object" for senior management to pursue, we believe there are important foundational issues that need to be prioritized.

[2] 2025 consensus EBITDA.
[3] As an example, in a recent video, Ms. Brown boasted about more than **70** products and features in Upwork's 2024 Spring Update.
[4] Company's 2021 Investor Day transcript.
[5] Company's 4Q 2021 earnings call transcript.

Poor Execution

Despite spending north of $780 million since 2019 on research and development ("R&D") (~60% of the Company's current market capitalization), the platform continues to suffer from many functionality issues that prevent broader freelancer and client adoption.[6] It is confusing and difficult to navigate, freelancers and employers are not vetted thoroughly, talent is not mapped and categorized properly – making it difficult for great freelancers to get the jobs they deserve – and there are still too many scammers on the platform.

The Enterprise features don't provide enough differentiation and value to justify an upgrade from the Marketplace. Additionally, from an organizational point of view, the Enterprise and Marketplace divisions compete against each other and are not incentivized to cooperate, resulting in significant missed opportunities for the Enterprise division. Enterprise and Marketplace run on two different platforms with two different product heads, which leads to inefficiencies.

Poor Capital Allocation

Former employees spoke to us about a culture of waste and poor financial discipline under Ms. Brown. On the product development side, the Company has a long list of speculative projects which have questionable return on investment ("ROI") instead of focusing on a few high-conviction, high-ROI projects. This lack of discipline can be seen with the significant $100 million-plus brand marketing investment, which appears to have been made with little testing. While management may point to a slight increase in unaided awareness, former employees are highly skeptical that this large spend had a tangible impact on business performance. We challenge management and the Board to share the ROI of this brand marketing investment.

Significant Management Turnover

A lack of stability among the Company's senior management team raises additional questions regarding Ms. Brown's leadership. Ms. Brown is now effectively on her third management team in four years. This turnover has occurred in several crucial roles, including the CFO (Brian Kinion, followed by Jeff McCombs, and now Erica Gessert), the head of engineering (Matt McDonald, Saty Bahadur, and now Paul Black), the Chief Product Officer (Jessica Tiwari, Sam Bright, and now two heads: one for Enterprise and one for Marketplace), and the Chief Marketing Officer (Lars Asbjornsen and now Melissa Waters). Finally, Eric Gilpin – who was Chief Sales Officer and responsible for driving growth in the Enterprise business – was let go in 2023 and bizarrely not replaced.

The Board may be tempted to dismiss our assessment as the result of discussions with a few disgruntled employees. This would be wrong. Since Engine's founding 11 years ago, we have never heard such consistent frustration from so many employees regarding senior management, its inability to prioritize key strategic initiatives, and the many execution issues plaguing the Company. It's important to note that many of these former senior employees have remained shareholders of Upwork because they believe in the tremendous potential of the Company under the right strategy and leadership. They, like us, are rooting for Upwork to succeed.

We Believe Several Opportunities Exist for the Board to Right the Ship

Upwork is now at a crossroads. The Board needs to rapidly make important changes to give Upwork a chance at succeeding – or the platform risks becoming increasingly irrelevant. The 4Q 2024 forecasted double-digit negative growth in gross services volume should sound the alarm that time is of the essence. At this juncture, we believe the Board needs to prioritize the following to turn the business around:

[6] Represents cumulative R&D spend from 2019 through the estimated spend in 2024.

1. Improve the Basic Functionality of Upwork's Marketplace

Instead of developing dozens of new products and features, we believe Upwork needs to first fix the foundational issues that have been plaguing its platform for years. The Company needs to dedicate more resources to attract and retain higher quality freelancers, improve their vetting process, verify their skills, and allow them to demonstrate those skills in more efficient ways, such as through certifications. Toptal, one of Upwork's competitors which has been particularly successful in Enterprise, vets its freelancers through automated coding and language tests before conducting live interviews. This allows Toptal to attract high-quality talent and improve the caliber of its marketplace. There is no point going after the Enterprise market if Upwork doesn't have the highest quality talent on its platform.

The Company also needs to make its platform less confusing and more intuitive. Too many freelancers and employers leave the platform because they get frustrated by its complexity. Ironically, many former Upwork employees told us they find Fiverr's experience more intuitive and straightforward. Upwork also needs to vet jobs; too many jobs are posted without a credit card on file, indicating no expectation of payment. Finally, the Company needs to enhance its search functionality by improving how its talent is categorized.

While these efforts may be less exciting than announcing Uma, Upwork's mindful AI, this foundational work is critical to the Company's future success and needs to be done.

2. Focus on the Enterprise Opportunity

As noted above, there is a tremendous opportunity for the Company to grow its Enterprise business, with the right execution. We believe the Company should:

- **Offer more gated features to Enterprise clients.** There is currently not enough product differentiation for companies to become and stay Enterprise clients. Many larger corporations simply use the Marketplace offering or sign up for Enterprise but don't use it. For Enterprise to succeed, there needs to be a compelling value proposition that attracts and retains large employers.

- **Collapse the Enterprise and Marketplace divisions.** There are currently thousands of companies that use the Marketplace and could be nurtured to become Enterprise clients. However, under the current organizational structure, the Enterprise and Marketplace teams compete against each other, operate separately, have different product heads, and maintain separate profit and loss statements. Collapsing the two divisions would create cost efficiencies, as well as establish a unified product team that could look across divisions and create product differentiation for different pricing tiers. Such a structure would eliminate conflicts and better incentivize everyone to work together to maximize the lifetime value of each customer, from individuals to large corporations looking for freelancers.

- **Hire a sales force with experience selling to C-suite executives.** While Upwork has floundered, Toptal has achieved significant success in Enterprise by hiring experienced sales representatives. We believe Upwork can be successful by hiring fewer of these more experienced representatives, which would limit the expenses that typically come with investing in senior sales employees.

Given the current go-to-market strategy and product offering of the Enterprise division, it is no surprise it has been such a disappointment.

3. **Further Optimize the Company's Cost Structure and Reduce Dilution From Stock-Based Compensation**

Since 2019, Upwork's operating expenses have ballooned from ~$231 million to ~$530 million in 2023, with R&D spend and stock-based compensation having materially outpaced revenue growth during this period. We believe the Company's cost structure is still bloated, even after the recent restructurings. Our diligence suggests there are material opportunities to further reduce costs and improve margins while strengthening the platform and the Company's growth profile.

There are still too many layers of management and too many Vice Presidents making more than $1 million. We believe the Company can significantly improve its cost structure by focusing the organization and its R&D efforts on fewer initiatives, collapsing Enterprise and Marketplace, unifying the product teams, improving efficiency within sales and marketing, and reducing its general and administrative spending. As one former employee told us: if Upwork eliminates half of the Vice Presidents, guts advertisement (and only uses performance marketing), cuts Human Resources by 50%, and simplifies product development, it will end up with a healthier, faster growing, and more profitable organization.

Since Upwork's initial public offering, the number of common shares outstanding has grown 36%, from ~104 million to ~141 million, causing material dilution to the equity owners of the business. The Company needs to immediately and significantly reduce this dilution. This is achievable if the Company further streamlines the business, cuts costs, collapses divisions, and simplifies its product teams. Culturally, we also believe the Company should stop competing for talent with the world's largest technology companies as this is a war it cannot win. Upwork would be better served by hiring at least some senior executives from the staffing industry it is trying to disrupt.

4. **Utilize Upwork's Strong Capital Position to Aggressively Buy Back Undervalued Shares**

If the Company is willing to make the changes detailed in this letter, it can unleash Upwork's significant potential. In this scenario, we believe the shares are extremely undervalued and the Board should use Upwork's cash position (net of the convertible debt) as well as its future free cash flow to aggressively repurchase shares. We acknowledge the Board has repurchased $100 million of shares in the first and second quarters of this year. We were therefore disappointed when the Board did not authorize a new share repurchase, especially since the Company now has an opportunity to repurchase its shares at an even lower price. When asked about this, management mentioned that the Board was also considering potential M&A to further expand the Company's addressable market. This response is symptomatic of Upwork's inability to focus. Upwork's addressable market is already very large and should be the Company's primary focus at this juncture. Between the Company's current net cash position of ~$140 million and its significant free cash flow generation over the next three years, we estimate it will have more than ~$575 million of available capital to allocate during that period. This represents almost 50% of Upwork's current market capitalization. The way the Board allocates this capital will have a tremendous impact on the Company's share price performance. The Board should therefore immediately authorize and execute further share buybacks while the stock remains deeply undervalued.

5. **Strengthen the Board and Adhere to Best Corporate Governance Practices**

The Company maintains a staggered Board, which prevents the annual election of all directors and therefore insulates them. This is one of the key reasons why leading proxy advisory firms and academics view staggered boards as a problematic governance structure. We urge the Board to declassify itself to provide shareholders the opportunity to elect directors on an annual basis.

We also believe the Company would benefit from a significant Board refresh. While we have the utmost respect for the successful venture capital investors currently serving on the Board, their funds (Benchmark

Capital and Jackson Square Ventures) are no longer investors in Upwork and their representatives' lengthy tenures (20 years for Gregory Gretsch and 18 years for Kevin Harvey) go against best practices.[7] Chairman Thomas Layton has been a director of Upwork and its predecessor oDesk since 2006 (amounting to a tenure of 18 years), as well as Chairman since 2011.[8] It is also worth noting that Elizabeth Nelson has been a director since February 2015 and will be on the Board for 10 years at the next annual meeting. While Institutional Shareholder Services Inc. does not currently have a voting policy relating to director tenure, its views on the topic are clear through its QuickScore governance rating system, which states that "limiting director tenure allows new directors to the board to bring fresh perspectives. A tenure of more than nine years is considered to potentially compromise a director's independence and as such QuickScore will consider tenure > 9 years excessive."

We also note the numerous business relationships between various directors, which diminish their independence. Mr. Harvey is a founder and general partner at Benchmark Capital ("Benchmark"). Mr. Layton has served as an Entrepreneur-in-Residence at Benchmark since 2011 after serving as CEO of a number of Benchmark portfolio companies. From 2002 to 2022, Board member Gary Steele was CEO of Proofpoint, another Benchmark portfolio company. Messrs. Harvey and Steele served together on the board of Proofpoint for 19+ years. Ms. Nelson previously served on the board of Zendesk, another Benchmark portfolio company, alongside Peter Fenton, another general partner of Benchmark. We also note that Mr. Layton and Ms. Nelson have served together on the board of Ancestry. Finally, Board member Leela Srinivasan was an executive at OpenTable and overlapped with Mr. Layton, who was chairman.

We also note there is not a single director with relevant staffing industry experience and little relevant experience in enterprise sales, two backgrounds critical for Upwork's success. Given these dynamics, we believe the Board should be refreshed and strengthened by the addition of new independent directors with relevant experience as well as the appointment of a shareholder-designated director with a public investing background and relevant capital allocation expertise at mature companies.

6. Align Executive Compensation to Shareholder Value Creation

Management must be incentivized effectively. Prior to last year, Upwork operated a "growth at all costs" playbook, as evidenced by management's incentives being exclusively tied to revenue growth. This compensation structure encouraged poor behavior and is behind many of the inefficiencies that exist today. While the compensation framework was changed in 2024 to now incentivize both profitability and revenue, we believe the current structure still fails to align executive compensation with the most relevant levers of shareholder value creation. Management's annual bonus and long-term equity incentives are still tied to revenue, a poor metric to use as it does not necessarily correlate with value creation and can incentivize poor capital allocation decisions. Furthermore, the current structure fails to properly account for the significant shareholder dilution as a result of stock-based compensation. We strongly encourage the Board to de-emphasize revenue targets and instead compensate management primarily based on EBITDA and free cash flow per share targets going forward.

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[7] These tenures include time spent on the board of oDesk, Upwork's predecessor.
[8] Upwork was formed after oDesk & Elance merged in in December 2013.

Upwork has the capabilities to compete and disrupt the staffing industry with a unique value proposition: faster hiring, greater access to quality talent, and meaningful cost savings. We firmly believe a tremendous amount of shareholder value can be unlocked if the Board acts with urgency to make necessary changes. We request a meeting with members of the Board at your earliest convenience to discuss the matters and initiatives we have set forth in this letter. On behalf of Engine, we look forward to working with you to increase long-term shareholder value.

Sincerely,

Arnaud Ajdler
Managing Member

About Engine Capital

Engine Capital LP is a value-oriented special situations fund that invests both actively and passively in companies undergoing change.

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