Upwork Annual Report 2020

Form 10-K (NASDAQ:UPWK)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2019

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-38678

UPWORK INC.

(Exact name of registrant as specified in its charter)

Delaware	**46-4337682**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2625 Augustine Drive, Suite 601	
Santa Clara, California	**95054**
(Address of principal executive offices)	**(Zip Code)**

(650) 316-7500

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Trading Symbol	Name of Each Exchange on Which Registered
Common Stock, $0.0001 par value per share	**UPWK**	**The Nasdaq Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No x

The aggregate market value of voting stock held by non-affiliates of the registrant, as of June 28, 2019, the last business day of the registrant's most recently completed second quarter, was $1,174,421,292 (based on the closing price for shares of the registrant's common stock as reported by The Nasdaq Global Select Market on that date). Shares of common stock held by each executive officer, director, and holder of 5% or more of the registrant's outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

As of February 28, 2020, there were 113,931,825 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its 2020 Annual Meeting of Stockholders, or Proxy Statement, to be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, are incorporated by reference in Part III. Except with respect to information specifically incorporated by reference in this Annual Report, the Proxy Statement shall not be deemed to be filed as part hereof.

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Unless otherwise expressly stated or the context otherwise requires, references in this Annual Report on Form 10-K (this “Annual Report” or “report”) to “Upwork,” “Company,” “our,” “us,” and “we” and similar references refer to Upwork Inc. and its wholly-owned subsidiaries.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements within the meaning of the federal securities laws. All statements contained in this Annual Report, other than statements of historical fact, including statements regarding our future operating results and financial position, our business strategy and plans, potential growth or growth prospects, client spend retention, core clients, future research and development, sales and marketing and general and administrative expenses, provision for transaction losses, and our objectives for future operations, are forward-looking statements. Words such as "believes," "may," "will," "estimates," "potential," "continues," "anticipates," "intends," "expects," "could," "would," "projects," "plans," "targets," and variations of such words and similar expressions are intended to identify forward-looking statements.

We have based these forward-looking statements largely on our current expectations and projections as of the date of this filing about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in Part I, Item 1A, "Risk Factors" in this Annual Report. Readers are urged to carefully review and consider the various disclosures made in this Annual Report and in other documents we file from time to time with the Securities and Exchange Commission (the "SEC") that disclose risks and uncertainties that may affect our business. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time. It is not possible for us to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the future events and circumstances discussed in this Annual Report may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. The events and circumstances reflected in the forward-looking statements may not be achieved or occur. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, performance, or achievements. In addition, the forward-looking statements in this Annual Report are made as of the date of this filing, and we do not undertake, and expressly disclaim any duty, to update such statements for any reason after the date of this Annual Report or to conform statements to actual results or revised expectations, except as required by law.

You should read this Annual Report and the documents that we reference herein and have filed with the SEC as exhibits to this Annual Report with the understanding that our actual future results, performance, and events and circumstances may be materially different from what we expect.

PART I

Item 1. Business.

Overview

We are changing the way work gets done by connecting businesses with great talent to work without limits.

We operate the largest online talent marketplace, as measured by gross services volume ("GSV"), [1] which enables businesses to find and work with highly-skilled independent professionals. Freelancers on our platform include independent professionals and agencies of varying sizes and are an increasingly sought-after, critical, and expanding segment of the global workforce. During the year ended December 31, 2019, our platform enabled $2.1 billion of GSV. We define freelancers as users of our platform that advertise and provide services to clients through our platform, and we define clients as users of our platform that work with freelancers through our platform.

For freelancers, we serve as a powerful marketing channel to find rewarding, engaging, and flexible work. Freelancers using our platform benefit from access to quality clients and secure and timely payments while enjoying the freedom to run their own businesses, create their own schedules, and work from their preferred locations. Moreover, freelancers have real-time visibility into opportunities that are in high demand, so that they can invest their time and focus on developing sought-after skills.

For clients, our platform provides fast, secure, and efficient access to high-quality talent with over 8,000 skills across over 70 categories, such as content marketing, customer service, data science and analytics, graphic design, mobile development, sales, and web development. We offer a direct-to-talent approach as an alternative to traditional intermediaries such as staffing firms, recruiters, and agencies by providing proven quality talent and features that help instill trust in remote work, including the ability to engage freelancers as either independent contractors or as employees of third-party staffing providers. Our platform also enables clients to streamline workflows, such as talent sourcing, outreach, and contracting. In addition, our platform provides access to essential functionality for remote engagements with freelancers, including communication and collaboration, time tracking, invoicing, and payment. The clients on our platform range in size from small businesses to Fortune 500 companies.

We believe that a key differentiator and driver of our growth is our track record of creating trust and enabling freelancers and clients to successfully connect at scale on our platform. As the largest online talent solution that enables businesses to find and work with highly-skilled independent professionals, as measured by GSV, we benefit from network effects that drive growth in both the number of clients posting jobs and the number of highly-skilled independent professionals seeking work. The growth in our marketplace is driven by long-term and recurring use of our platform by freelancers and clients, which gives us increased revenue visibility. For example, for the year ended December 31, 2019, in addition to acquiring new clients, our client spend retention was 102%. For additional information related to how we calculate client spend retention, see the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations—Key Financial and Operational Metrics."

We generate a majority of our revenue from fees charged to freelancers. We also generate revenue through fees charged to clients for transacting payments through our platform, as well as foreign currency exchange fees, Upwork Payroll service fees, and fees for premium offerings. In addition, we provide a managed services offering where we engage freelancers to complete projects, directly invoice the client, and assume responsibility for work performed.

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[1] GSV represents the total amount that clients spend on both our marketplace offerings and our managed services offering as well as additional fees we charge to users for other services. For additional information related to how we calculate GSV, see the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations—Overview—Business" and "—Key Financial and Operational Metrics."

Our Platform and Marketplace

We operate the largest online talent solution that enables businesses to find and work with highly-skilled independent professionals, as measured by GSV. We believe the following core aspects of our platform provide us with a competitive advantage:

Trusted Platform for Freelancers and Clients

Our proprietary platform fosters trust and credibility among freelancers and clients, while reducing the friction associated with searching for, contracting and collaborating with, and paying highly-skilled independent professionals for short-term and longer-term projects. We use a combination of the latest technology, data science, product features, and our skilled team to position our platform as a trusted online marketplace to get work done. We build and use software to highlight relevant freelancers, facilitate security and identity verification for account ownership, and flag suspicious posts. We provide clients with tools to validate work performed by freelancers and to provide both public and private feedback once the work is completed. Our feedback system enables freelancers to build their business reputation by establishing long-term credibility with project review and verified client feedback. We provide escrow services to help ensure that clients on our platform only pay for work that has been completed and freelancers are paid by their clients in full and on time.

Proprietary Data Drives Increasing Efficiencies

We have built an expansive and unique repository of data on our platform. Our proprietary database maintains detailed and dynamic information, including skills provided by freelancers, feedback, and success indicators of freelancers and clients transacting on our platform. Using this data in our machine learning algorithms on our platform enables us to provide a trusted, convenient, and effective user experience for both new and existing freelancers and clients, and enables clients to better connect with available talent for their projects. Moreover, our machine learning algorithms leverage our closed-loop transaction data on millions of completed projects. The large volume of transactions on our marketplace positions us to improve the effectiveness of our search algorithms and product features.

Robust Platform Functionality

Our platform includes a proposal tracking system, search engine and collaboration functionality, artificial intelligence-driven talent matching and proposal ranking capabilities, time tracking and invoicing systems, and payments services. The robust functionality of our platform is designed to enable freelancers to more easily run their businesses and clients to find and work with high-quality talent globally.

Powerful Global Network Effects

We have heavily invested in building a robust platform with features and functionalities to connect freelancers and clients at scale. We believe our platform provides a strong value proposition for both sides of our marketplace and our scale creates powerful network effects that strengthen our competitive position. In turn, as more clients use and post projects on our platform, we are able to attract more freelancers. As a result, we have been able to scale our business and our global community of users efficiently and without the need for local physical presence.

Business Model with Strong Retention Metrics

The growth in our marketplace is driven by long-term and recurring use of our platform by freelancers and clients, which leads to increased revenue visibility for us. For example, for the year ended December 31, 2019, in addition to acquiring new clients, our client spend retention was 102%. For additional information related to how we calculate client spend retention, see the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Key Financial and Operational Metrics.” In addition, we believe the scale of our platform incentivizes freelancers to build their business reputations and continue to use our platform.

Our Products

We have marketplace offerings and a managed services offering. Our marketplace offerings include Upwork Basic, Upwork Plus, Upwork Business, Upwork Enterprise, and Upwork Payroll.

Upwork Basic

Our Upwork Basic offering provides clients with access to freelance talent with verified work history on our platform and client feedback, the ability to instantly match with the right freelancers, and built-in collaboration features.

Upwork Plus

Our Upwork Plus offering is designed for teams looking to stand out to quality talent and scale hiring fast. In addition to receiving all the product features of Upwork Basic, Upwork Plus clients can access personalized assistance, whether strategic or job-specific. They also receive perks such as a verified client badge and highlighted job posts, which stand out to top freelancers and help clients achieve results.

Upwork Business

Our Upwork Business offering is for mid-market clients looking for a flexible talent solution that scales with them. Upwork Business clients receive all the product features of Upwork Plus, in addition to consolidated billing and monthly invoicing, a dedicated team of advisors, and detailed reporting with company insights and trends to enable clients to hire faster and more successfully.

Upwork Enterprise

Our Upwork Enterprise offering is designed for larger clients. Upwork Enterprise clients receive all the product features of Upwork Business, plus access to additional product features, premium access to top talent, professional services, custom reporting, compliance services, and payment terms flexibility.

Upwork Payroll

Our Upwork Payroll service, one of our premium offerings, is available to clients when they choose to work with professionals they engage through Upwork as employees. With Upwork Payroll, clients have access to third-party staffing providers to employ their workers so that they can meet their talent needs through our talent solution.

Managed Services Offering

Through our managed services offering, we engage freelancers directly or as employees of third-party staffing providers to perform services for clients on our behalf, directly invoice the client, and assume responsibility for work performed.

Escrow Services

We are licensed as an internet escrow agent by the California Department of Business Oversight ("DBO"). Pursuant to the DBO's regulations, funds that we hold on behalf of clients and freelancers are held in our escrow account and are released only according to escrow instructions that have been agreed upon by freelancers and clients. For fixed-price contracts, the client deposits funds that are held in escrow, in whole or by milestone, before the freelancer starts to work. The escrow funds are then released to the freelancer upon completion of a project or a milestone. For hourly contracts, the client receives a weekly invoice on Sunday and has several days to review the invoice. Funds are released to the freelancer after the review period unless the client files a dispute. In the case of any dispute between freelancers and clients over funds held in escrow, we have a dedicated team focused on facilitating a resolution between them.

Our Culture and Employees

Our mission—to create economic opportunities so people have better lives—is integral to our culture, and how we hire, build products, and lead our industry. We practice a "work without limits" model that includes a distributed team of on-site and remote employees, and a hybrid team model in which we also engage freelancers all over the world for our own specialized projects. Our hybrid team, and its belief in our mission and values, is critical to our success. With the consistent investment in the development of our team and our commitment to diversity, inclusion, and belonging for all team members, we are creating an environment where people are able to be themselves at work and perform to the best of their abilities. Through this work, we believe we will continue to increase our engagement and drive greater impact.

Our values are:

- Inspire a boundless future of work;
- Put our community first;
- Have a bias toward action; and
- Build amazing teams.

As of December 31, 2019, we had approximately 570 employees, and in 2019, we engaged over 1,200 freelancers to provide services to us on a variety of internal projects. None of our employees are represented by a labor union or are covered by a

collective bargaining agreement. We believe the positive relationship between us and our employees and our unique, strong culture differentiates us and is a key driver of business success.

Sales and Marketing

Our sales and marketing organizations work closely together to increase awareness, generate client demand, build a strong sales pipeline, and grow account relationships across businesses of all sizes, from small businesses to Fortune 500 companies, to accelerate GSV and revenue growth.

Marketing

We have a holistic and integrated marketing strategy with the goal of attracting users to our platform and helping them select the right product offering based on their business needs. This starts with cost-effectively building awareness of our brand and the key benefits of hiring remote talent faster than traditional staffing models, including talent quality, flexibility, and cost effectiveness. We draw insights and trends from our platform and primary research studies to drive broad public relations coverage. We also help shape influential conversations around the future of work and the immediate strategic opportunities provided by flexible talent solutions through major media outlets to further drive brand awareness and cement our position as a thought leader.

Building upon our brand positioning, we address key client needs in all our marketing efforts and help point our clients to the right Upwork product based on those needs. We also enjoy the benefits of high Net Promoter Scores ("NPS") that generate significant word-of-mouth growth. While a majority of our new client registrations come through direct and non-paid channels, we also increase our new client pipeline with a variety of digital, direct mail, and event marketing programs. We deploy email and life cycle marketing initiatives to retain, cross-sell, and upsell existing clients. In an effort to increase brand awareness, we began offline advertising and radio advertising campaigns in a small number of metropolitan markets in 2018 and initiated TV advertising campaigns in the second quarter of 2019.

We have also increased our focus on enterprise organizations by adding focused account-based marketing programs targeting companies with existing adoption of our platform to drive account growth. Once prospects are identified, our enterprise sales team works to broaden adoption of our platform into wider-scale deployments.

Enterprise Sales

Our enterprise sales team consists of sales development representatives and quota-carrying account executives who are focused on acquiring new clients with more than 50 employees. Our client strategies focus on mid-market, large enterprise, and global account clients. Specifically, our sales development representatives are focused on upgrading Upwork Basic and Plus clients to our Upwork Business and Enterprise offerings, while our quota-carrying account executives are focused on selling our Upwork Business and Enterprise offerings to prospective new clients. Our quota-carrying account management and success teams help new and existing clients scale usage of our platform throughout their organization. We achieve this by executing awareness campaigns, persona-based workshops, webinars, and account-based marketing campaigns that drive additional client spend through our platform. We believe this land-and-expand strategy helps clients ramp their usage of our platform and drives more value, awareness, and adoption over time. In an effort to accelerate our acquisition of mid-market, large enterprise, and global account clients, we began increasing our investment in our enterprise sales organization starting in the fourth quarter of 2019.

Our Technology

We invest substantial resources in research and development to enhance our platform, develop new products and features, and improve our infrastructure. We utilize a flexible systems architecture to allow us to scale easily as our platform usage increases and to provide a consistent and robust user experience. We host our platform on Amazon Web Services ("AWS"). The core focus of our technology is on:

Reliability

Our infrastructure is designed to provide high reliability and robust platform performance. There are three components to our reliability strategy:

1. *Services-Oriented Architecture*. We have focused on building a services-oriented architecture that is designed to independently scale, or failover, as needed, leveraging the AWS platform. As a result, we believe we are more resilient to unexpected surges in traffic or to new code changes that we may introduce.
2. *Isolation as a Design Philosophy.* Leveraging the philosophy of domain-driven design, we have divided our platform into multiple sections to reduce the likelihood that a failure in any one section of our platform would negatively impact other sections of our platform.

3. *Self-Monitoring and Self-Healing.* Our platform is designed to continuously monitor its own health and act appropriately, particularly during our deployment of new code.

Security

Our platform is designed to help ensure the security of our data and systems, protect our users' personal information, and to meet the rigorous privacy and security requirements of our enterprise clients. To that end, we have obtained the following security and privacy certifications: SOC 2, Type 2 certification, PCI-DSS certification, and U.S.-EU and U.S.-Swiss Privacy Shield certifications. We are also TrustArc certified.

Our information security controls operate at multiple levels and are designed to detect, prevent, and mitigate cyber security threats that could impact the privacy and security of our data and our user's data. To operate at scale, we have automated several risk mitigation strategies. We have implemented comprehensive trust and safety processes to help prevent and detect suspicious behavior on our platform. Over the years of developing our platform, we have developed and refined specific pattern-matching algorithms to detect unusual behavior on our platform.

Another component of our security strategy is to leverage third parties who provide value-added user verification services. Augmenting our knowledge of user identity through these third-party services improves our ability to better detect and verify suspicious activity on our platform.

All access to our platform is encrypted using industry-standard transport layer security technology. When users enter sensitive information, such as tax identification numbers, we encrypt the transmission of that information using secure socket layer technology. We also use HTTP strict transport security to add an additional layer of protection for our users. For servers that store personally identifiable information, the data is encrypted. In order to make secure payments through our platform, we are also Payment Card Industry Data Security Standard certified, which means we have demonstrated compliance with the Payment Card Industry security standards required for businesses that complete credit card or debit card transactions.

Our users may elect to further secure their account credentials through two-factor authentication that requires them to authenticate on a second device.

Machine Learning Predictive Capabilities

We leverage historical data to create a continuously improving experience for freelancers and clients. Our platform contains a large repository of closed-loop data for the entire life cycle of work starting from when clients post projects, to when freelancers and clients match, how they communicate, how and when payment is transferred, and finally feedback.

Utilizing machine learning capabilities to predict future behavior based on many years of historical use cases, we are able to leverage this data analysis to create stronger user experiences.

During the search process, we leverage our proprietary data to help freelancers and clients efficiently connect. We leverage machine learning to balance supply and demand within the marketplace as well. Freelancers receive data on market rates based on similar jobs when submitting proposals. When clients post jobs, similar rate resources also appear within the system. Upon registration, our machine learning algorithms assess a freelancer's potential to be successful on our platform based on the current supply and demand in addition to the skills in the freelancer's profile.

Scalability

Our cloud-based platform has been designed to scale with increased usage and to support sudden traffic spikes by easily and cost-effectively bringing additional capacity online as required.

The Upwork Foundation Initiative

In April 2018, we established The Upwork Foundation initiative. The objective of The Upwork Foundation initiative is to further our mission of creating economic opportunities to make people's lives better by supporting:

- those who may not otherwise fully benefit from the changing nature of work, including through organizations focused on skill development in underserved communities;
- non-profit organizations to increase their social impact by using our platform; and
- our employees in volunteering in their local communities.

The initiative includes a donor-advised fund created through the Tides Foundation. We believe that building a sustainable program for charitable donations fosters employee morale, enhances our community presence, and strengthens our brand. In May 2018, we issued a warrant to purchase 500,000 shares of our common stock to the Tides Foundation at an exercise price of $0.01 per share. This warrant is exercisable for 1/10th of the shares on each anniversary of the effective date of our initial

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