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Wayfair, Inc. (W)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Wayfair Fourth Quarter 2020 Earnings Release and Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] As a reminder, today's conference call is being recorded. [Operator Instructions]

It's now my pleasure to hand the conference over to Head of Investor Relations and Special Projects, Jane Gelfand.

Jane Gelfand

Head of Investor Relations & Special Projects, Wayfair, Inc.

Good morning and thank you for joining us. Today, we will review our fourth quarter 2020 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co Chairman; Steven Conine, Co-Founder and Co-Chairman; and Michael Fleisher, Chief Financial Officer. We will all be available for Q&A following today's prepared remarks.

I would like to remind you that we will make forward-looking statements during this call regarding future events, and financial performance, including guidance for the first quarter of 2021. We cannot guarantee that any forward-looking statements will be accurate, although we believe we have been reasonable in our expectations and assumptions. Our 10-K for 2020 and our subsequent SEC filings identify certain factors that could cause the company's actual results to differ materially from those projected in any forward-looking statements made today. Except as required by law, we undertake no obligation to publicly update or revise any of these statements, whether as a result of any new information, future events or otherwise.

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Also, please note that during this call, we will discuss certain non-GAAP financial measures as we review the company's performance. These include measures such as adjusted EBITDA and free cash flow. These non-GAAP financial measures should not be considered replacements for and should be read together with GAAP results. Please refer to the Investor Relations section of our website to obtain a copy of our earnings release, which contains descriptions of our non-GAAP financial measures and reconciliations of non-GAAP measures to the nearest comparable GAAP measures. This call is being recorded and a webcast will be available for replay on our IR website.

I would now like to turn the call over to Niraj.

Niraj S. Shah

Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

Thanks, Jane, and good morning, everyone. We are pleased to report that Q4 marked another solid quarter of growth, profitability and free cash flow and that 2021 is off to a strong start. As the pandemic drags on, online shopping behavior is becoming increasingly entrenched and consumer demand for the home category remains elevated. Wayfair is capitalizing on these tailwinds by delivering a truly differentiated experience for both customers and suppliers. In the process, we are cementing our position as the leading platform in the space and reinforcing our brand to tens of millions of customers.

This is we do every year with the Q4 earnings: we published our annual letter to shareholders today, and we hope you find the time to read it. These letters afford us the opportunity to look back and think forward in a longer-term way. In this environment, it is so tempting to fixate on the latest news headline, web traffic update, credit card data refresh or the year ago quarterly comp. But there are bigger things happening at Wayfair. Perhaps the pandemic has accentuated some of them, but the opportunity in what we are building is so much greater than any single period. It seems more important than ever to think in years rather than quarters and that is exactly what we do in the letter and how I want to frame my remarks for you today.

In 2020, our revenue grew 55% year-over-year to $14 billion. To be sure, we are fortunate to have been well positioned during COVID, but the growth is not totally unprecedented. Since our IPO in 2014 and through 2019, pre-COVID, we experienced a nearly 50% revenue CAGR. We believe the runway for future growth is just as impressive. Let us first put the market in context. Across B2C and B2B, the North American and European home markets are about $840 billion in size today. They're also growing. By 2030, we estimate they will be well over $1 trillion. Like virtually all categories, shopping for the home is quickly and structurally moving online. We believe online penetration for US B2C is likely hovering just north of 20% these days with B2B and European B2C slightly lagging.

E-commerce for our category should easily come to represent more than 50% of all shopping. This means growth in the online channel should average in the double digits for many years to come. This is exciting because we are and should continue to take outsized share as category dollars move online. Wayfair's platform model is truly unique. We are neither a retailer nor a marketplace. Instead, we take the positives of both while minimizing the drawbacks associated with each. The clear advantage traditional retailers enjoy is holding the key to the customer relationship. If they deliver an exceptional experience, they build customer loyalty and, in the process, a strong brand. We embraced much of this first-party model or 1P, and our results show it. We have more than 31 million active customers today and are welcoming more new customers to Wayfair at a rapid clip. Repeat purchases represent more than 70% of our business, and customers are highly engaged with our platform even in between orders.

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In the US, Wayfair is very clearly a household name. We're the number one place consumers think to shop for their home online. We're well on our way to the same status in Europe, following a similar trajectory in timeline as we did in the US. Today, the Wayfair platform connects our tens of millions of customers with more than 16,000 suppliers. Given the nature of the category, most of these suppliers are small and unbranded, no supplier represents more than 2% of revenue on Wayfair, each supplier wants to control their own destiny. And so, we embrace the best aspects of an enhanced marketplace model to give them as much transparency as possible.

We also developed the tools our suppliers need to succeed, value-added solutions like end-to-end logistics, media, and merchandising. We enhanced this third-party or 3P approach with higher touch supplier partnerships that arm them with data, insights and assistance to help them make the best decisions to grow their business with Wayfair. Putting together the best elements of retailers and marketplaces allows us to unlock unlimited selection for our customers in an inventory-light way and deliver a top notch, reliable Wayfair branded shopping experience to them in every instance. This accelerates supplier participation on the platform and encourages them to use the applicable tools and services that we are continually creating to support them in growing their business on our platform. It's a virtuous cycle that enables the strong share capture we have experienced since our start in 2002 and also expect to see going forward.

None of what I just said is new, though it is perhaps a clear articulation of the ecosystem we have built. What is evolving, however, is how effectively we can compete across the four verticals, two continents and the hundreds and hundreds of classes of home goods on which we focus. We're no longer small in any of these. You know the US B2C business well, but our North American Professional or B2B business is approaching $1.5 billion in net revenue. And the UK and Germany combined are north of $1 billion in net revenue. With the benefit of this scale, we are creating an ever-improving shopping experience for each type of customer, while unlocking cost efficiencies that benefit customers, suppliers and Wayfair.

The market is vast and under-served. It is going through a period of structural change and consolidation into fewer hands as it moves online. COVID accelerated some of this, and we believe these forces will not reverse. Wayfair already has a strong foundation in each area that is critical to delivering a great customer experience. And we have the drive, resources, and ingenuity to reinforce and compound our share gains.

In 2020, we proved out our path to profitability, and we have now firmly demonstrated our ability to grow strongly and profitably. In Q4, adjusted EBITDA totaled $263 million and a 7% margin. In 2020 as a whole, we generated about $950 million in adjusted EBITDA. Though the magnitude of margins will move some quarter-to-quarter, we are confident that our strong profitability will continue and will expand over time.

Many of you have asked whether it makes sense to refresh our long-term financial targets in light of the fact that we surpassed some of the original ones first established at our IPO. Frankly, we think it's much more interesting to think about the compounding potential of profitable growth, while paying attention to the initiatives in place that should over time add to margins. Each of the lines of the P&L interacts with the others. So, we have tried to take a different tack in our latest investor presentation to give you a sense of the long-term direction of travel from our original targets six years ago.

What you will see upon closer review is that we have confidence Wayfair's adjusted EBITDA margins will grow significantly over time versus our original target. Because we operate with a truly long-term view, we're now putting a time stamp on this as there's always volatility from period to period. Still, we see significant scope to drive gross margins and customer lifetime value higher over time. The drivers remain the same. One, the benefits of scale and unlocking better wholesale costs; two, logistics efficiencies; three, the growth of value-added supplier

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services; and four, merchandising and associated pricing gains. We will back these gains up with exceptional customer service, where we will continue to invest in line with sales growth.

Advertising remains ROI and payback driven and is a function of variable contribution margins. Variable contribution margins are now higher than our original model contemplated and should trend higher still, which means that we are comfortable should advertising remain near current levels as a percentage of net revenue in the near-term. Longer term, we expect to extract further efficiencies and leverage on the advertising line. This leaves us with SOTG&A or OpEx, which we expect to naturally lever over time as technology and productivity gains allow us to temper our hiring of OpEx people relative to the rate of revenue growth. These are just mechanics, the outcome of our platform positioning, our strategy and the sharp execution we expect of ourselves.

We will remain ambitious and aggressive while investing with a long-term view. And we believe we will do so while growing increasingly profitable over time. Put another way, growth via happy customers begets more growth, which then expands the profit margin.

I've deliberately taken this step back today to zoom out from the noise that surrounds the pandemic and its effects on Wayfair. Though 2020 was a volatile year, every year brings its own opportunities and challenges, and 2021 will be no exception. We think 2021 will be solid but are focused on the much larger opportunity. This is what I've laid out for you today, and this is what the entire Wayfair organization is rightly focused on. We hope you agree.

I'll now pass it over to Steve to dive deeper.

Steven K. Conine

Co-Chairman and Co-Founder, Wayfair, Inc.

Thanks, Niraj, and hello, everyone. Since you are all close students of Wayfair and the industry, I wanted to cover off on three topics that are likely top of mind as we close out 2020 and look ahead. These include our cohort performance, the evolution of certain marketing channels and the latest in terms of product availability as category demand remains elevated. First, we thought it was important to give you a sense of how the exceptional circumstances of 2020 affected our customer cohorts. While we do not intend to offer ongoing updates, we did include the latest snapshot of our annual cohorts in this quarter's investor presentation. Upon closer inspection, you will see very strong and increasing engagement across the board.

Recall, the denominator in these lines represents the total number of customers activated each year. Effectively, the area under the lines represents the lifetime value to-date of each annual cohort, capturing the respective customer spend on Wayfair since they began shopping on the site. The flattening out of each curve and eventual upward smile that we can see in these lines indicates a strong tale of repeat revenue and growing wallet share over time. Though the chart doesn't capture this, it is important to note that the profit value of the space under each curve is also growing.

After the onset of the pandemic, multiple cohorts inflected meaningfully. And now nearly 12 months hence, they appear to be flattening out, but at higher than previously achieved levels. One of the most interesting insights here is the cohort lines also showcase that the less active or even lapsed customers reengaged in 2020. In the process, they experienced the Wayfair platform renew. We got another opportunity at righting whatever reason behind why they didn't take to the platform initially, or just plainly convincing them that shopping online for the home does not have to come with trade-offs.

As they reengaged, these customers discovered the collective benefits of the investments and upgrades Wayfair has made since their first interaction. It should have had a rich, positive and much improved experience. In the

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process, we effectively reset those relationships and got another chance to establish trust and loyalty with the set of customers. This is part of the reason why we are seeing several of the cohorts settling out at higher levels on the chart.

How we reach out to and engage with customers, new or repeat, is constantly evolving. In anticipating some of your questions, I'd like to quickly discuss some developments in the digital marketing landscape as well as physical retail.

You are likely aware of upcoming privacy related changes that stand to affect the way we interact with apps and some forms of social media. While the way we market to some of our customers may well have to change as a result, there are many puts and takes at play here. The end result is that we don't believe there will be a meaningful financial impact. Most importantly, our proprietary ad tech stack, close customer relationships and strong brand appeal will allow us to adjust more quickly and more effectively than other digital marketers out there.

While none of the potentially impacted channels is a significant portion of our spend, we are deploying our energy and skills to optimize within any new constraints and are ultimately focused on doing what's right for our customers. Change is constant. And over the last 20 years, we have seen many adjustments to the marketing landscape. The hallmark of our proprietary technology and world-class team is that we have always maneuvered into the changes and created opportunities from them. Separately, you may have heard that we closed our Natick, Massachusetts-based store last month. As a reminder, the Natick experiment was open for about 18 months. It was a very small format space that represented our first real retail test.

I deliberately called Natick an experiment, as we are looking to test into the right omni-channel strategy for Wayfair through iteration and ROI-based analysis, just like we do for all our emerging marketing channels. We believe that home has a long future runway for online penetration, but also see value and our customers interacting with our brands and products through other channels. What the format of our physical locations will look like, however, remains to be seen and will likely vary as we think about our different portfolio of brands and widespread geographic presence. Natick was a great testing ground for what was and what wasn't resonant with the Wayfair customer. You should expect to see those learnings recycle into future concepts.

Finally, I want to finish up with a quick update on product availability. As you know, the industry continues to operate with elevated out of stocks. While we are not immune to these circumstances, we do have more means to mitigate pain points given Wayfair's inventory-light platform model. The good news is that availability is sequentially improving, having reached maximum out of stock levels in mid-2020. Production has ramped, and carrier networks are expanding capacity, just as we have with our large parcel dedicated Wayfair Delivery Network.

Still, there are bottlenecks in the supply chain. For instance, we are currently dealing with the seasonal pattern of China shutting down production around Lunar New Year, which is somewhat exacerbated by COVID. There's also well documented pressure and lack of availability on ocean freight, which is amplifying the backlog of orders flowing to North America and Europe. These are transient issues. And at current levels of demand, we expect the industry to reach more normalized inventory levels by the summer of this year.

In the meantime, we are heavily leveraging our International Supply Chain, or ISC, services, to improve the bottleneck for our suppliers. Through ISC, we are helping suppliers unlock freight capacity at fair market prices, thanks to our scale and close partnership with leading ocean cargo companies. Though the situation is unfortunate because customers are having to remain patient when it comes to lead times on certain products, we

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do think this presents Wayfair with a unique opportunity to strengthen our partnership model and to drive greater adoption of our end-to-end logistics services, like ISC and CastleGate fulfillment. We are already seeing this play out. The number of participating suppliers in CastleGate grew at 60% year-over-year in 2020, and we expect the significant growth to continue across all of our value-added services.

I will stop there, and I'll now hand the call over to Michael.

Michael D. Fleisher

Chief Financial Officer, Wayfair, Inc.

Thank you, Steve, and good morning, everyone. Let's jump into the financial details of the fourth quarter, and then we'll turn to some forward-looking thoughts. As you saw in our press release and our new IR presentation, Q4 total net revenue was $3.7 billion. This represented 45% growth and more than $1.1 billion added year-over-year. The quarter played out largely as we expected, with the incremental lift from Cyber 5 and other holiday programming, somewhat muted versus a typical year, given demand has been elevated for some time now and holiday-themed marketing was spread out over a longer than typical timeframe.

We saw strong gains across both reporting segments, though with slightly different dynamics. Net revenue in the US grew 40% year-over-year. We believe this reflects some normalization of customer behavior as we all adjust to the persistent pandemic backdrop. Meanwhile, in our International segment, we saw sequential acceleration in growth to the tune of nearly 400 basis points, translating to net revenue up 71% year-over-year. Tighter COVID restrictions put in place during the quarter in the UK, in particular, did contribute somewhat though in both Canada and Germany, momentum was also quite strong.

In Q4, Wayfair's strong customer acquisition and retention trends continued. We surpassed 31 million LTM active customers, which grew 54% year-over-year. New orders grew 31%, while repeat orders were up 56% year-over-year. Repeat orders represented more than 72% of our total mix. LTM orders per active customer continued to edge up sequentially and were up 5% year-over-year. LTM revenue per active customer grew both year-over-year and quarter-over-quarter to $453.

I'll now move down to P&L. As I do so, please note that I'll be referencing the remaining financials on a non-GAAP basis, which includes depreciation and amortization, but excludes stock-based compensation and related taxes.

Q4 gross margin was 29.1%, showing about 620 basis points of year-over-year leverage. This was about 90 basis points lower than in Q3. The year-over-year expansion continues to be supported by multiple drivers, including merchandising gains, strength in higher mix supplier services, and efficiencies in logistics. However, as we expected, the magnitude of logistics-related benefits was somewhat lower quarter-over-quarter. In Q4, customer service and merchant fees largely held steady relative to Q3 at 3.6% of net revenue. We do still expect to work our way back towards a more normalized approximate 4% of net revenue on this line. Consistent with our expectations, advertising came in at 10.2% of net revenue or about 210 basis points lower year-over-year.

Our selling, operations, technology and G&A or OpEx expenses came in at $376 million, which was modestly below our forecast. This is mostly due to the timing of net hiring and will reverse somewhat in the first half of 2021. Also embedded in OpEx were higher cloud-related costs, which were offset by lower unutilized rent as volume in our network increased. All-in, adjusted EBITDA for the quarter was $263 million or 7.2% of net revenue. In the US, adjusted EBITDA was $275 million or 9.2% of revenue, while the International segment posted slightly negative adjusted EBITDA at negative $12.2 million or negative 1.8% of revenue.

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We ended the year with $2.6 billion of cash and highly liquid investments on our balance sheet. And free cash flow for the quarter was $128 million. This is the third consecutive quarter of positive free cash flow generation. As a reminder, Q1 is typically a larger cash outflow period for us, given the timing of supplier payments post holiday. So, I would advise you to be aware of our seasonality and sequential flows as you model free cash flow quarter-to-quarter.

Turning now to our outlook, we are not going to provide traditional detailed guidance. Instead, we will share a view into the gross revenue momentum thus far into the quarter, along with some qualitative color. Quarter-to-date, our gross revenue growth is trending roughly in the mid-50s percent year-over-year. Though as we look ahead to March, we will almost certainly comp lower as we will start to comp over a very complex moment, particularly the initial COVID period last year, when there was an incredible spike in demand from existing and many, many new Wayfair customers.

Obviously, we successfully fulfilled those customer needs and continue to do so and have created ongoing lasting brand relationships. But how the back half of March and frankly, a good part of Q2 performs versus 2020 is very difficult to forecast. We're clearly entering this period with a very strong tailwind and strong revenue performance, both in terms of dollars sequentially and growth rate year-over-year. We will obviously fill in more details for you as we go. And in particular, we'll be back together with you in 10 weeks with Q1 actuals and greater visibility in the April's actual performance.

Our P&L thoughts below revenue for this quarter, largely mirror what I said last quarter. We expect gross margins in a 26% to 28% range. We expect to return to 4% of net revenue for customer service and merchant fees. Advertising as a percent of net revenue will move around depending on the opportunities we see in market in any given period. But generally, we think a 10% to 11% range is appropriate at this point as we continue to see strong ROI.

Finally, the largest driver behind SOTG&A dollars will be the pace of net hiring we undertake. In 2020, we significantly slowed our OpEx hiring and let our newer team members mature in their roles. We held steady despite the demand growth that came our way and saw productivity really accelerate despite being work-from-home. This coming year, we do expect OpEx net hiring to pick back up somewhat, albeit to what we think is a more measured and moderate pace. By moderate, we mean a pace of scaling that should continue to translate to operating leverage over time. To orient you as to how we plan to start the year, we would expect Q1 OpEx to be modestly below $400 million. All in, we fully expect that the first quarter will mark our fourth consecutive quarter of positive adjusted EBITDA at a total company level.

To help with a few housekeeping items, please assume equity-based compensation and related tax expense of approximately $89 million to $91 million, and depreciation and amortization of approximately $75 million to $80 million. We expect CapEx in a $68 million to $78 million range, subject to expected timing. Lastly, we expect basic weighted average shares outstanding to equal approximately 103 million. Though our fully diluted weighted average shares outstanding will ultimately be driven by the net income result in Q1 and the result of applying the if-converted method to our converts.

When the 10-K is filed later today, you will notice that we used approximately $100 million during Q4 to repurchase some of our stock. We will repurchase shares from time to time under our previously approved buyback authorization. Though, I would not model that as an ongoing activity as it will be opportunistic and episodic with the longer-term goal of reducing potential dilution from our outstanding converts.

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Turning briefly to the long-term margin outlook that Niraj shared earlier. We now believe we can clearly exceed our original 8% to 10% EBITDA margin target range as laid out at the time of Wayfair's IPO. Back in 2014, as a brand-new public company, operating in investment mode, we needed to illustrate where we were headed through highly specific P&L line-item targets. Now that we've executed and delivered on many of those goals, we're providing you with a framework for how we view the next level of opportunity. To be clear, we're not changing our guidance philosophy. And as we have always done, we will continue sharing ongoing updates around our various initiatives and the drivers of increased profitability over time.

As I wrap up, I want to echo some of what Niraj started with. It's easy for all of us to get distracted by the ups and downs related to year-ago comps, but these will not tell the whole story, which is far more positive. The reality is that we are going through a remarkable period of customer acquisition and retention, and a similarly remarkable period of strengthening our supplier relationships and the tools and services with which we equip them.

These dynamics will drive long-lasting and compounding benefits to the Wayfair platform. We're steady in our desire and ability to innovate ambitiously and scale quickly when the ROI proves compelling. We're also stronger operationally and financially than we have ever been, but we will remain prudent and realistic as we think and plan forward. As a team we have no doubt that these attributes should translate to continued share gains and strong profitable growth in a very large and underserved market over many years to come.

Now we'll go back to Niraj for some closing remarks before we take your questions.

Niraj S. Shah

Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

Thanks, Michael. As we look ahead to the rest of 2021, I want to take this opportunity to thank our more than 16,000 employees. 2020 was a year that brought out the best across Wayfair, and we are incredibly proud of how our team stepped up for our customers, our communities and for each other.

Now Steve, Michael and I will be happy to take your questions. Thank you.

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QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instruction] Our first question will come from the line of Peter Keith with Piper Sandler.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Hi. Thanks for great details in the prepared remarks.

Steven K. Conine
Co-Chairman and Co-Founder, Wayfair, Inc.

A

Hey operator, I think we lost Peter.

Operator: Peter, please go ahead with your question.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

I focus on [Technical Difficulty] (32:13) bad connection. Can you hear me okay?

Steven K. Conine
Co-Chairman and Co-Founder, Wayfair, Inc.

A

You cut out, Peter. Could you start over again?

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Yeah, I'll try to be brief [Technical Difficulty] (32:27) percent level. So are you seeing suppliers lean more into your [Technical Difficulty] (32:37) logistics offer that you have out there?

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

I can try. To be honest, the question broke up some. So let me state what I think the question was and answer it because I'm not – I wasn't able to hear everything Peter said. But Peter, I think what you were asking was around gross margin. I think you referred to kind of the current level of gross margin around 29%. And I think you were asking about drivers. And I think I heard you ask are suppliers leaning more into the advertising products we have and are they embracing more of the logistics offerings we have.

And so the answer to that would be – so we've talked for multiple years now, about the 1,000 basis point runway we have on gross margin. And we referred to those four key levers, four key buckets, where supplier service is absolutely one; logistics efficiency absolutely one; the merchandising approaches we were taking was one; and then the benefits of scale with suppliers was one. And what we've talked about is, if you go back to when we went public, that we didn't even have some of those things like the logistics network didn't even exist yet. And so where we are now is you're seeing that we've been unlocking some of these gains, and they are in fact, flowing into the gross margin. And despite that, there's a lot more to flow in over time.

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And so that's why when you look at the new long-term model slide, we provide a directional indication that the gross margin expansion into the future is still quite strong because that opportunity is still in front of us, and we're going to continue to unlock these gains. But some of what's happened so far in terms of why are we at this 29% level certainly does have to do with logistics gains. And yes, suppliers are leaning into advertising, but I would point out that the supplier services is still very early stage and so the relative impact of it is small and very small if you consider it compared to potential.

Operator: Thank you. And our next question is going to come from the line of Kunal Madhukar with Deutsche Bank.

Kunal Madhukar
Analyst, Deutsche Bank Securities, Inc.

Q

Hi. Thanks for taking the question. Wanted to understand, from the seller perspective, in terms of what their options are, when they are looking at selling in their – whatever goods that they have in the US, whether it has been Amazon or Walmart or Target or whoever else is they're kind of selling into? And how do you compete with that? And what kind of economic impact or economic models do the competitors have where you come out stronger versus everybody else? Thank you.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Yes. So as you know, we have a large network of suppliers, right? So we – this is not dozens, but this is well in excess of 10,000 suppliers. And what a number of them have been doing is just they continue to build their business on our platform because, again, these are suppliers that focus on the home categories where we have the disproportionate volume and we're growing very quickly. And we're giving them more and more tools that are bespoke for home.

So if you look at some of the logistics tools that we give them around ocean freight or you look at some of what we're doing around integration for sortation and delivery or some of the merchandising tools we're giving them very much speaks to their products and their categories. So the economic model they work with us on is, obviously, they sell to us at wholesale, we sell it, retail, we add our margin in there.

But then we also do other things to impact the cost of goods that the items can hit sharp retails and they can benefit from volume and the logistics offerings that I referred to would be a great example. And so, while our suppliers obviously do sell to other folks, whether it's regional furniture stores or it's a generalist e-commerce platform like an Amazon or whether it's The Home Improvement Guys or Home Depot, Lowe's or Walmart, Target or more specialty, the reality is the volume and the volume gains [ph] they can have in the way (36:42) can compound on our platform is very attractive to them. And that's why we're seeing suppliers continue to lean in during this period of time where they have scarce supply. We're seeing them focused on making sure that they have supply available on Wayfair.

Michael D. Fleisher
Chief Financial Officer, Wayfair, Inc.

A

Yeah. I think the other thing I'd add, Kunal, on this one is, and we – the executive team spent a lot of time with our supplier partners. One of the things that's been really clear in this sort of unique time when they have more limited inventory is how much they want to be on our platform, largely because they recognize that the way our platform is built, having the right reviews, having the right customer ratings, having the right merchandising and having the

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product in stock continuously is a very important part of how they manage the Wayfair platform long term to their rate of success.

And so I think you've seen a lot of our suppliers, if anything, double down during this time on Wayfair because they're recognizing the long-term potential of what it is and how our customers are shopping. And therefore, it's really important for them to be sort of be there and be in stock and do that on a continuous basis.

Kunal Madhukar
Analyst, Deutsche Bank Securities, Inc.

Q

Great. And as a quick follow-up, given the increase or the sharp increase in price – shipping prices and the bottlenecks that we are seeing there, how does that change – especially given all your China to US shipping initiatives and what have you, how does that kind of compound on your competitive advantage that you have versus everybody else?

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Yep. That's a great question actually. So we've referred to our ISC offering, which is effectively our freight brokerage offering, which is ocean freight and drayage. And it's for goods, particularly coming in from Asia, from China, from Vietnam. And what we've done there, we started that a few years back. And the whole focus was how do we build deep relationships with the top-tier carriers, so that we can get competitive pricing from high-quality carriers who honor their commitments even during times where the spot market spikes.

On that offering last year, we carried just under [ph] 50,000 TEUs (38:53). This coming year, we expect that to grow dramatically 50% to 100% growth on the container quantity. And what we're finding is that, that has offered price stability as well as access to capacity to our suppliers during a period of time where the spot market has spiked significantly. And the problem with the spot market spiking significantly is not even just a cost one, it's actually that even if you're willing to pay the cost, getting capacity is hard. And we have been able to continue to secure capacity and the pricing we have is far below the current spot market. And our suppliers who are then using that offering are benefiting because they have had that price stability, and they can continue to move goods.

So I think a lot of what we're doing benefits us, but it also benefits our suppliers and the predictability of it is one of the high-value drivers, and this is where the long-term orientation we have around building these offerings, even though they will take years to get to scale, this is an example, one that we started a few years ago, and it's paying off well right now.

Kunal Madhukar
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: Thank you. And our next question will come from the line of Heath Terry with Goldman Sachs.

Heath P. Terry
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you very much. Two kind of questions here. I guess one longer term, just in the decision to raise your longer-term EBITDA guidance, but maybe even more relevant to the outperformance that we're seeing currently. How are you thinking about the level of investment relative to the kind of growth that you can get out of that investment? You guys have obviously been incredibly successful over the years in terms of reinvesting in the

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business to drive faster growth. Where are your thoughts now on the level of investment or level of growth that investment can return? And then just kind of more of a short term question. Obviously, the port issues have affected a lot of companies. Is there a way to quantify what you believe the longer shipping time, fulfillment times have had on – have had on – or had during the quarter?

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Sure. Let me start with your first question. So the concept of investment and the P&L and how EBITDA plays out, it's actually a really important one, I think, for folks to understand. Because what's interesting now is the EBITDA you're currently seeing is while we're investing literally with thousands of people on new efforts as well as in marketing to scale new businesses like Germany and Perigold and the like. And what happens, they then end up being bigger businesses, they end up increasingly profitable. And so while you're then scaling a new set of things, what you're going to see happen is that margin expansion will happen while we are basically maximizing investments. So we're big enough now that we're effectively doing – going to be doing both in parallel. But you'll see margin expansion play out, while you'll see growth remain high because we're continuing to invest ambitiously with a long-term orientation and quantitatively. So you're going to actually see those two things be mutually consistent, which I think is part of what's so exciting.

And then when I talk – to your point about the port issues and trying to quantify the impact, what I would say is the biggest impact is, frankly, it's just delaying the timeframe to get back to the availability levels that everyone would like, meaning the quantity of items in stock for immediate shipment across the number of SKUs that they would like to have in stock, et cetera. So a lot of suppliers have item finished goods that have already been produced and sitting in Asia, that they have not been able to move, or factories are not able to produce goods because they're still storing other finished goods. And it's just delaying. I would quantify that as without the ocean freight congestion, maybe getting back to those in-stock levels in the next month or two, and instead, I think it will take an extra quarter to a few months to really get to the high in-stock levels.

For us, we actually benefit more than most because, again, we have such a broad selection available on the platform from so many suppliers. The substitution effect for a customer so that customer is still able to choose amongst many coffee tables, and they don't feel like their selection has been curtailed despite the fact that perhaps the number of coffee tables that we'd like to have available are not. And so that's where the aggregate selection we have is a huge benefit for us.

Heath P. Terry
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you very much, Niraj.

Operator: And our next question will come from the line of Steven Forbes with Guggenheim Securities.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

Good morning. And Niraj, after reading the letter this morning, I know you guys talked about the cohorts, and I appreciate that update. But really just wondering if you could provide some qualitative comments on how you believe the investments that you've made over the years here has changed the first experience for the customer. And then sort of what you think that means for your stability or less churn in the active customer base in 2021 and beyond?

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Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Yes. Sure, Steve. So what I would say there is if you think about the improvements we've made, the improvements we've made are really across the board, meaning fast delivery. It's convenient delivery, high-quality merchandising, better product discovery. There's kind of like – we've been making improvements in every area of the experience. Where we see it manifest then is, we see it manifest in customer repeat rates. And so you can see how the repeat order growth continues to grow at a rate faster than the total business. And that's just a function of – last quarter, repeat orders grew 55%, new orders grew 30%, which is customers basically value the experience, and so they come back. And so we're up to like 72% of orders are from repeat customers.

And so what we've been able to see is we have early indicators to that, right, which is whether people stay engaged with us. Are they downloading the app, are they visiting the site. And what we're finding is that we're continuing to be able to drive that up. And in truth, we still have a relatively low share of wallet. So there's a lot of opportunity with the existing base.

If you look at our average revenue per customer, it's something like $450. So it's relatively low compared to their annual spend, and so as we merchandise each category more, as we keep adding value propositions for the customer, as our brand gets better understood as not just being furniture and décor, but it really spans all of home, so it covers the 50% of home improvement that are the finished items, it covers housewares, it covers large appliances, these are big opportunities for customers to keep diverting more and more spend to us. And that's effectively the engine that powers the growth. And so these are the things we continue to invest in.

When we talk about thousands of people working for things for the future, it's these types of things and these types of things keep unlocking gains. And so we're basically creating a better and better experience for our suppliers, and a better and better experience for our customers, and that's what drives the flywheel.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

And then just as a quick follow-up, Niraj. I think it was about a year ago, at a conference, you spoke to sort of $0.20 of every dollar of revenue being spent on logistics. So curious if you can sort of update us on how that expense ratio, right, or overall logistic costs have evolved throughout 2020 and how we should think about what the sustained scaling of the business has done to that expense ratio. Any sort of comment would be – or quantitative comment would be helpful.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Sure. So if you go back into some comments a year and two years ago, when we talked about that 1,000 basis point runway in gross margin, when we refer to each bucket, one of the things we did say is that the delta between where we were at the time and what was in the long-term model slide at the time, which was kind of a few hundred basis point delta, we said that each of these buckets could cover that off alone. And one of those buckets was logistics.

And so if you think about that $0.20 of every dollar, what we were saying was that a few of those cents we can unlock through efficiency. Efficiency is everything from – I referred to ocean freight a few minutes ago to forward positioning goods so the last mile delivery leg is less expensive, to enhanced sortation which then let's you even skip terminals, to route density, which lowers our cost of delivery and we run our own transportation operations for the larger items. And so you're seeing this starting to play out.

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In terms of where we are in the journey, when you look at our annual filings, you'll see that we had 100 basis points of leverage in 2020 from fulfillment efficiencies. And so it's a complicated number to read because some of those savings accrue to suppliers to the way they buy services from us. And so there's some accounting around when suppliers are buying things from us. It's contra COGS and then some of the money comes out of their wholesale because we're now doing ocean freight which otherwise would be embedded in their wholesale and the like. But the point being, we are getting gains from that $0.20, but there's still a long way to go too.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

Thank you.

Operator: And our next question will come from the line of Oliver Wintermantel with Evercore ISI.

Oliver Wintermantel
Analyst, Evercore Group LLC

Q

Yeah. Hi. Good morning, guys.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Hi.

Oliver Wintermantel
Analyst, Evercore Group LLC

Q

I had a question also regarding investments. If you look at some very relative competitors to you, like Amazon, Walmart, but then also Home Depot, Lowe's, the last few days, they said how massively they're going to increase CapEx spend and square footage growth. I just wanted to see how you guys are viewing your build-out of CastleGate, the delivery network, where you are in the build-out and if you think that CapEx for you guys has to increase over the next few years and what the capacity is there.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Sure. Let me first touch on CastleGate and then answer your question a little bit and then turn it over to Michael for him to chime in as well. So what I would start with is on CastleGate, we – I think we described a number of times, we've built a footprint that covered the geographies we wanted to cover, albeit at low utilization, and we'd gotten to a point where we had the footprint. So now we're only adding buildings for capacity reasons.

And so what that means is that the costing for new buildings is significantly diminished because we don't have this unutilization effect, rather we add a building for capacity and it will ramp fairly quickly.

The next building coming online will be one this summer which is in Germany. And so today, we have a small warehouse in Germany that is full. And we will be moving to a 1 million square-foot building that will then afford us opportunity to continue to scale in Germany where there's significant demand for CastleGate, for example.

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We recently signed a lease for a building in Chicago, large warehouse that will come online next year. The reason for that is again, not footprint, but it's simply because we actually, in that geography, need additional capacity at that point in time. And so it will ramp quickly.

And so if you look at square footage build and you roll over the next few years, yes, we'll continue building significant square footage. But if you look at CapEx, and you start thinking of it as a percentage of revenue, you're actually – you're not going to see an increase in cost. So the question is, are you looking at absolute dollars, or you looking at percentages and do we get leverage? And in fact you can see the financials play out quite nicely. But let me turn it over to Michael for any specifics.

Michael D. Fleisher
Chief Financial Officer, Wayfair, Inc.
A

Yeah, just confirming that, Niraj. I think the – if you think about CapEx spend last year at sort of 2% to 3% of revenues, and I think you can think about that as sort of for the near-term forward, the same levels. So there's obviously still a substantive investment that we're making there as we sort of build-out for growth. But I don't think that we see a need to sort of dramatically step that up in any meaningful way beyond what we've been doing already.

Oliver Wintermantel
Analyst, Evercore Group LLC
Q

Got it.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.
A

And the last comment I'll make also is like part of it's also historically in CapEx. We have technology spend there, and we're increasingly using Cloud, Google Cloud. And so that's actually moved to OpEx. And so CapEx, if anything we're going to show on a percentage basis benefits over time I think.

Oliver Wintermantel
Analyst, Evercore Group LLC
Q

Got it. Thanks very much and good luck.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.
A

Thanks, Oli.

Operator: And we have time for one final question. Our last question is going to come from the line of Jonathan Matuszewski with Jefferies.

Jonathan Matuszewski
Analyst, Jefferies LLC
Q

Hey guys, yeah, thanks for taking my question. First one I had is on the B2B business. I appreciate the color there on sizing that. Do you have a medium or long-term goal there you'd be willing to share relative to the $1.5 billion today? And relatedly among the six verticals you're focused on there, where are you most concentrated today? That's my first question. Thanks.

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Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Sure. Yeah, Jon. So the B2B business, I think we highlighted its current size is $1.5 billion, but we talk – and that's in North America. When we look at the TAM in North America, I think we highlighted that's around about $100 billion. So we're relatively small compared to the TAM. And frankly, we have a pretty bright runway for growth. So we don't have specific milestone guidance numbers for size. But I think as you've seen, as we build the foundation and we add value, in this case, it's around delivery logistics, access to selection, all the same value drivers we provide on the consumer side, the business can mushroom over time.

And on the B2B side, if anything, that repeat flywheel is even stronger because the annual spend per customer, the potential annual spend per customer is much higher than it is on the consumer side. So, when you get a customer and they're very happy, their frequency of purchase and the annual spend is a much bigger upside opportunity.

And then when you look at our verticals, obviously, we picked the six verticals to highlight the ones that we're focused on. And hopefully, they each make sense to you. And we haven't said anything publicly about sizing them, that's something we can address in the future. But they're clearly the ones we're focused on and you can see how they dovetail into the rest of our business. And so hopefully, that makes sense as to why those are the six.

Jonathan Matuszewski
Analyst, Jefferies LLC

Q

Got you. Yeah, that's helpful. And then just my second question, it looks like – you mentioned the quarter-to-date trend in the mid-50s, I believe, 4Q was 45%. Any thoughts in terms of the acceleration you're seeing? Any thoughts on kind of contribution from stimulus spend or any factors playing a role in the sequential acceleration through late February would be helpful. Thanks.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

A

Yeah. So I mean, we're seeing continued strong demand. Stimulus obviously always helps, but frankly, we're seeing the effect of stimulus be a lot less than the first stimulus was last April. And I think you're seeing some of the reports of how the money is increasingly being saved and used to paying debt and the like. And I think that would dovetail to our numbers as well.

And the last comment I would make is, since the start of COVID, we've seen spending demand levels just remain consistently high and less spending concentrated around holiday period. And so, I think one of the things you heard from a lot of retailers last holiday season is that demand started – the holiday demand started earlier and was more steady versus being more acutely around kind of Cyber 5 and peak periods.

And so I think that's just the trend that is kind of tied to the current timeframe where people are – they're at home, they have more – their life is following a more regular cadence versus the normal cadence, the one that we had before COVID and the one we'll return to in the future. And so I think there's some of that. But demand is remaining quite high, and there's nothing acute that I would draw you to that sort of caused a desell and a resell.

Jonathan Matuszewski
Analyst, Jefferies LLC

Q

Great. Thank you.

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Michael D. Fleisher
Chief Financial Officer, Wayfair, Inc.

A

The only thing I'd add, Jonathan, is that, look, the business is obviously performing extremely well. As I noted in my comments, right, we started to hit the sort of spiky COVID period in the back half of March. And then the other thing I just want to comment on is that we give these statistics to you as a gross revenue quarter-to-date number. That's often different than the net revenue tied to sort of shipping delays and things of that nature.

And so you've seen for the last couple of quarters that gross revenue quarter-to-date has been higher than sort of actual net revenues at the end of the quarter. And I just – we'll keep pointing that out to everybody, so everyone understands that there's a difference between those two figures. But obviously, we've seen early great strength in the business quarter-to-date and in many ways, I feel like the business is now operating at sort of a new level, a new baseline. And I think that's going to continue. And I think there's a ton of opportunity from here. But obviously, we're going to go compare against these very spiky periods in 2021 – and from 2020.

Jonathan Matuszewski
Analyst, Jefferies LLC

Q

Helpful. Thank you.

Operator: Thank you. I'd now like to turn the conference over to Mr. Shah for closing comments.

Niraj S. Shah
Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.

Well, thank you, everybody, for joining us this morning, and we appreciate your time. We're excited for 2021. We think we've got some pretty exciting things to come, and we look forward to spending more time with you in the future. Thank you.

Operator: Once again, we'd like to thank you for participating in today's Wayfair fourth quarter 2020 earnings release conference call. You may now disconnect.

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