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Wayfair, Inc. (W)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the Wayfair Fourth Quarter 2021 Earnings Release and Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Landry Ngambia, Director of Investor Relations, you may begin your conference.

Landry Ngambia
Director of Investor Relations, Wayfair, Inc.

Good morning, and thanks for joining us. Today, we will review our fourth quarter 2021 results. With me are Niraj Shah, co-Founder, Chief Executive Officer and co-Chairman; Steve 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 during this call, we will make forward-looking statements regarding future events and financial performance, including guidance for the first quarter of 2022. We cannot guarantee that any forward-looking statements will be accurate, although we believe that we've been reasonable in our expectations and assumptions.

Our 10-K for 2021 and our subsequent 8-K 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.

Also, please note that as we review the company's performance during this call, we will discuss certain non-GAAP financial measures, including adjusted EBITDA, adjusted EBITDA margin 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 and our investor presentation, which contain 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 Investor Relations website.

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

Niraj S. Shah

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

Thank you, Landry, and good morning, everyone. It's great to reconnect with you today to share the details of Wayfair's fourth quarter 2021 results. 2022 marks the 20th anniversary since Steve and I started the business. In our annual shareholder letter, also published today, we talk about what we're doing to set ourselves up for the next 20 years.

When we launched Wayfair, we used the tagline, a zillion things home. Today, we have embraced Everything home – for a space that's all you. Even as taglines change, one thing has remained consistent for Wayfair throughout, and that is our focus on the customer and building a shopping destination where everyone can find their own unique expression of home.

You've heard us talk at length about how we do this through our platform business model, bringing together tens of thousands of the industry suppliers and tens of millions of customers for the widest possible selection and choice.

You've heard us talk about the investments we have made across technology and end-to-end logistics to build a unique and purposeful online shopping experience, and offer Wayfair shoppers fast and reliable delivery. The customer experience is what continues to drive every decision we make as we work to optimize it for today, 5, 10 and 20 years from now.

Wayfair has grown from two entrepreneurs who saw a massive market opportunity to a world-class team with more than 16,000 employees globally. We all share the same vision and wake up every morning eager to serve our customer and supplier partners.

Most humbling is that, we recognize that we have only just scratched the surface. Taking stock of the more recent past, the last two years posed unusual challenges for us and the industry as a whole, but meeting those challenges came with opportunity.

The on-set of COVID, in 2020, redefined how focused customers are on their homes and shifted how much time they intend to spend there. Never ending to do lists grew, and online demand surged, which allowed Wayfair to demonstrate the true scalability and structural economics of our platform.

2021 began the normalization process, though the world is still working through the ripple effects of the pandemic. As countries around the world reopened at their own pace last year, home category growth remains largely resilient, but the pendulum swung back with outsized strength in physical stores as consumers sought to return to old habits.

Supply chain disruptions impacted economies everywhere, due in-part to repeated factory closures and port logjams around the world. These cascaded into global inventory shortages and widespread inflation.

Our teams reacted to support the needs of our suppliers and customers, as we navigated 2021 and we are now leaning in to capture the benefits of returning inventory normalization in 2022.

Throughout the pandemic, our core strategy did not waiver. The primary elements for success in our category have not changed. The home is and will remain top of mind, and secular trends favor a durable shift to e-commerce.

Serving our $800 billion plus total addressable market is only possible in the long-run, through richness of assortment, easy and enjoyable product discovery and fast, reliable, cost-efficient delivery.

We're orienting the business to win across each of these dimensions through a technology-first approach and investing accordingly, making sure that our platform is built to win irrespective of the ebbs and flows in the macro environment.

Let me take a moment here to walk you through what we are doing across these dimensions. When it comes to assortment, it all starts with our supplier partners. Our ability to offer industry-leading assortment is enabled by our supplier base, and last year, we onboarded more than 7,000 new suppliers.

Having a wide variety of suppliers on the platform, is important, not just in maximizing selection, but also driving the kind of healthy competitive tension that leads to more innovation and even better pricing for our customers.

In 2021, we resumed in-person engagement with our suppliers including through our summit events. Through these interactions and also through enhanced supplier-facing communications and survey work, we are gathering valuable feedback that we are then putting into action.

A core part of this is building user-friendly technology solutions to improve the supplier experience and enable them to succeed as effortlessly as possible on the Wayfair platform.

Finding success on Wayfair, embolden suppliers to lean in with their whole catalogs, including by offering items on Wayfair that are not available on other mass platforms. In 2021, our selection grew by more than 11 million products.

Within our flagship House brand portfolio in the US, a meaningful share of goods is extended to Wayfair with a degree of exclusivity. And we have strong momentum in following the same playbook in our international markets.

As our assortment grows, finding exactly the right product among millions of items is not a trivial exercise. Our customers look at dozens of items before settling on the perfect choice for their home.

Among our most important assets is a deep and growing data-driven understanding of customer behavior.

Through data science and machine learning, we are building an increasingly personalized shopping experience for each customer and are starting to develop stronger content to appeal to unique customer profiles.

You will also have seen our announcements about upcoming physical store launches in 2022 and beyond across our portfolio of brands. Our specialty retail brand concepts will debut later this year and will be 10,000 to 15,000 square feet in size.

While the Wayfair store format will be substantially larger and is slated to first open in 2023. These spaces will allow us to tap into the store-based portion of our TAM and will be valuable avenues for discovery, visualization and marketing, complementing all that we are doing in e-commerce.

Now that we've talked about assortment and discovery, let's shift gears to delivery and logistics. Just a few minutes ago, I referenced the supply chain disruption our industry has faced for the last two years and how our team is planning to continue to tackle it over the course of 2022. Though we're not completely immune to global supply challenges, nowhere is it more apparent than in logistics how our philosophy of thinking and investing for the long-term can serve us.

Four years ago, we recognized that there was an opportunity to drive even more efficiency for our suppliers by becoming a digital freight forwarder. In doing so, we stood up a logistics solution to reliably and cost effectively get products from where they are manufactured to as close to the end customer as possible in North America and Europe, a solution we now call CastleGate Forwarding.

In 2021, as the industry watched ocean container prices spike, CastleGate Forwarding offered a safety net for many of our suppliers and moved more than 80,000 20-foot equivalent containers during the year. This was not a one-time fix, but instead the result of several years of forward thinking into solving an industry problem, albeit one that ended up getting quite acute last year and is likely to remain so in 2022. This year, we expect to roughly double CastleGate Forwarding volume, which makes us a significant player in this industry.

We didn't start CastleGate Forwarding specifically to solve the problems of 2021 or 2022, we did it to create value for our suppliers and our customers. The value of this solution will only grow as our scale increases and as we add services over time, such as our domestic break bulk facilities, which began to come online in the last quarter.

I want to zoom back in now because aggressive execution is what turns visions into reality, and that's exactly what we're aiming for this year. For almost two years now, suppliers have been selling product nearly as fast as it could be produced, and we're justifiably less focused on optimizing inventory positioning.

Lead times expanded and speed promises degraded. While shoppers temporarily accepted these circumstances, they did so begrudgingly. And our customer insights continue to show that availability and speed are still very important to them. Now that inventory levels are recovering, we are leaning in with our fulfillment network to once again deliver on those customer speed expectations and to reinforce the inherent benefits of our proprietary logistics infrastructure.

For 2022, we've created a tangible set of financial and operational incentives for our suppliers to drive even more product through our CastleGate network. And we expect penetration to return to and then exceed pre-pandemic highs. As this plays out, our customers will win through the plethora of choice and the convenience of fast delivery.

Participating suppliers will win because the cost and speed advantages translate into lower retail prices and conversion gains. These commercial benefits and cost efficiencies will also accrue to Wayfair, accelerating a self-reinforcing flywheel effect.

I'm just giving you a flavor of how we're building durable advantages across all aspects of the Wayfair platform by continuing to think and invest longer term. With this mindset and the backing of a solid balance sheet, we're navigating today's challenges while empowering thousands of Wayfairians to focus on our customer and the future.

When we began this journey, Steve and I had some ambitious goals for what Wayfair could be in two decades. We [ph] aspired (12:21) to think about the business in the long term, focused on years and not quarters. Wayfair has accomplished a lot already. And there is so much more opportunity ahead.

Wayfair has matured and reached the point where we can sustainably marry growth, profitability and continuous investment each year. At the same time, we remain comfortable with the quarterly volatility that inevitably results from disruptive thinking. Though there's a lot of macro noise to work through today, this is also how we think about 2022.

Before I hand it over to Steve, I want to touch on our upcoming CTO transition which we announced last month. As part of the long-standing succession plan, Jim Miller, our Chief Technology Officer, who is also a long-time board member prior to that, is retiring.

And Fiona Tan, our current Global Head of Customer and Supplier Technology, will step into the CTO role. Jim has been an invaluable partner and leader during a highly dynamic time, and has helped transform our technology organization for the better. He leaves it in very capable hands, and we have no doubt that Fiona will take a pivotal part of our business to an even higher height. Jim will stay on as an adviser until June, and we thank him for his many contributions and dedication to Wayfair.

As we typically do, now let's turn our attention to a specific business area within Wayfair. Steve is going to talk about the latest developments across consumer financing and how that reinforces customer loyalty.

Steven K. Conine

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

Thank you, Niraj, and good morning, everyone. The world of payments and financing is rapidly evolving as our customer expectations around how and when they choose to pay when they shop. Our goal in this arena is to make Wayfair financially accessible to as many households as possible, and to responsibly cater to their various needs. To do so, we offer a menu of compelling payment options with competitive underwriting and fee structures for both customers and for Wayfair. We're also incorporating loyalty benefits into our financing solutions to attract new customers, increase spend and increase purchase frequency.

Across our portfolio, we have four types of solutions in the financing space, the most recent of which is our offering for professionals. On the consumer side, we have credit cards, our Wayfair Financing platform and Buy Now Pay Later, all of which cover a wide range of customer use cases, profiles and project types. Each financing solution we offer is different, often coming with its own built-in brand affinity and customer networks that we can leverage. In many cases, we can customize financing options to drive Wayfair-specific deals and programming.

Let's talk about these, in-turn. First, you've heard us talk in the past about our exciting and already sizable B2B business. It continues to enjoy strong momentum, and a big part of the flywheel for professional customers is making sure they too have compelling loyalty and financing options. We're very excited to have partnered with Capital One Trade Credit to begin offering a Wayfair Professional credit card with rewards for business shoppers and a Wayfair Professional flex account with flexible payment terms, both of which we expect to roll out later this year.

[ph] Customers (00:15:31) will be able to apply with their business credentials to build credit. And we have built out a suite of business-specific features like tracking spend by customer or project and provisioning account access for multiple employees.

We're taking what used to be a complex multidimensional process, and consolidating it into a single partnership with Wayfair. Turning to our B2C side, today, Wayfair shoppers in the US have two major credit card options that combine loyalty with financing. These are the co-branded Wayfair Mastercard and a private label Wayfair credit card through which we offer the choice of rewarding discounts or financing offers.

Card members across both can earn 5% back in Wayfair rewards for purchases on Wayfair sites, and Wayfair Mastercard members can also earn Wayfair rewards on purchases made everywhere else. Some of you might recall that we launched these options in the fall of 2020 in partnership with Citi, and that it represented a major improvement in customer benefits. Since the introduction, we have seen a strong response from shoppers with over 750,000 card members now spending hundreds of millions of dollars on Wayfair per year.

We've been adding tens of thousands of new card members every month. And during their first year as a card member on Wayfair, they spend 2.5 times more than our average customer.

For consumers who prefer other ways to pay, we have the Wayfair financing platform, which provides leasing and financing to meet the needs of each shopper. Customers apply just once in an accessible Wayfair native application and eligible applicants see a menu of options available to them.

Our model maximizes approved customers and minimizes their costs through a marketplace of providers. Once approved, customers are able to choose from a menu of offerings from more than half a dozen brand-name providers such as Citizens Pay and Katapult, letting shoppers choose which format fits them best.

Once again, this is a good example of how we are using a technology-first solution to introduce smart competitive dynamics to drive the best outcome for our customers. The Wayfair financing platform is an important new customer gateway for us. This past quarter, more than half of orders that used this platform came from new customers.

And over the last year, we've served more than 400,000 shoppers. Rounding out the set of payment solutions, eligible customers who want to pay over time without a credit application can leverage multiple Buy Now Pay Later options from leaders such as Klarna.

Consumers are enthusiastically embracing these programs, and you will see our Buy Now Pay Later offering grow availability and competitiveness during their success. Across the investments and partnerships we are building, our North Star is creating the most accessible shopping experience for our customers, while providing rewarding benefits.

That includes increasingly personalizing their experience even at checkout through payment solutions and extending loyalty benefits to wherever they prefer to shop, be it online or in future physical retail locations. We want to make sure we reward our customers for their loyalty as they come back again and again.

Thank you, and I'll now turn the call over to Michael for a review of our financials.

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

Thank you, Steve, and good morning, everyone. Let's take a look at the financial details for the fourth quarter before discussing the outlook. As you saw in our press release this morning, Q4 total net revenue was $3.3 billion, representing an 11.4% decline year-over-year.

Q4 largely played out in line with our quarter-to-date revenue commentary back in November. Even though we did begin the holiday promotional season earlier than normal in order to mitigate potential bottlenecks during the Cyber 5 period, supply chain challenges across the industry continued to persist throughout the quarter. On a segment basis, US net revenue declined 8.8% from Q4 last year, while international net revenue declined by 23% year-over-year and 24.4% on a constant currency basis.

It's difficult to precisely measure the performance of the online market in real time. However, we do believe our trends largely mirrored broader e-commerce softness in the period. As was the case back in Q3, Wayfair.com in the US outperformed the consolidated business for the full quarter, while the specialty retail brands in the US remained a drag.

As a reminder, we're in the process of more tightly curating these specialty retail catalogs and are therefore going through a period of large negative year-over-year declines. The international business faced difficult comps in Q4, due in-part to more stringent lockdowns that were in place last year.

Turning to Q4 KPIs at the consolidated level, in the trailing 12 months, we had more than 27 million active customers, 12.5% lower than last year. Order frequency over the last 12 months was 1.89, a slight decline year-over-year.

These are continuations of the same trend we've seen over the last couple of quarters, given the outsized year ago comparison. LTM net revenue per active customer grew about 11% year-over-year to $501 driven by higher AOV, but somewhat offset by a moderate decline in order frequency.

In times like these, when inflation is pervasive in the economy, we work with suppliers to hold down cost increases to the extent possible, and where necessary also pass some of these increases on to retail prices. This is what you're seeing put upward pressure on AOVs.

I'll now move further down the P&L. As I do, 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, related taxes and other adjustments. I'll use the same non-GAAP basis when discussing our outlook as well.

Q4 gross margin was 27.2%, in line with our guidance of 27% to 28%, and our comment that it would land towards the lower end of the range. Lower volumes year-over-year as well as inflation driven by supply chain bottlenecks and a tight labor market remain pressure points on the gross margin line.

Customer service and merchant fees were 4.4% of net revenue in the fourth quarter, just slightly above our guidance due to increased compensation costs. Advertising as a percent of net revenue was 10.6%.

While digital advertising markets are also seeing some price inflation, we are staying disciplined by adhering to our ROI framework across our various marketing channels. We also continue to innovate with new channels and are being very deliberate around where we invest across the marketing funnel to unlock the best efficiencies.

Our selling, operations, technology and G&A or OpEx expenses totaled $481 million, landing just on top of our outlook. As we previewed last quarter, the magnitude of the sequential step-up is a result of compensation adjustments starting to take effect in Q4.

Our team also made some progress against our hiring plan, and we continued our transition to the cloud, which essentially moved some of our legacy data center CapEx spend to OpEx. Putting this all together, Q4 adjusted EBITDA was negative $4 million.

This was in line with our guidance for a roughly breakeven result. In the US, adjusted EBITDA was $65 million or a 2.4% margin, while the International segment booked adjusted EBITDA of negative $69 million.

Moving on to the balance sheet and cash flow, we ended the quarter with $2.4 billion of cash and highly liquid investments. In Q4, net cash from operating activities was $89 million, and free cash flow was $15 million after factoring in $74 million of capital expenditures.

Before I turn to the details of our outlook, let me frame for you our latest thinking on the macro and how we're managing the business within that. The macro environment remains dynamic, and candidly, extremely difficult to read.

Although household savings remain robust, our customers are seeing widespread inflation impact their lives and pressure their wallets. They also have more choices around where to direct their dollars as pandemic restrictions ease.

Though we are watching the state of the consumer closely, at this point, we believe that interest and demand for our category and for Wayfair remain healthy. We just have to be patient for the pendulum of behavior that Niraj described earlier to reach its equilibrium and for structural e-commerce tailwinds to become more visible again later this year.

Let's now turn to Q1. On an orders placed basis quarter-to-date, our consolidated gross revenue is down in the low teens year-over-year. Besides the various macro cross wins which we are working through today, Q1 also presents a more difficult growth comparison than Q4, with the year ago period bolstered by stimulus early in the quarter and stringent lockdowns internationally.

Like you, we are tracking the implied CAGRs versus 2019. These are in the positive high teens quarter-to-date and are modestly better than what we saw towards the end of 2021. Anecdotal supplier feedback also suggests stronger relative performance recently for both e-commerce and Wayfair, all of which is encouraging.

As we move forward, we're planning for revenue trends that mirror pre-pandemic seasonal sequential curves, implying greater revenue dollars in Q2 versus Q1, a similar sized Q2 and Q3 and a larger Q4 due to holiday timing. Though it's early, this is what we're seeing play out so far in this quarter.

Turning now to Q1 gross margins. We continue to view 27% to 28% as a sustainable gross margin range for the time being, with clear plans in place to drive expansion above this range over the coming years. For now, however, the low end of this range continues to be most appropriate to target for Q1, particularly in light of the inflationary pressures the whole industry is dealing with.

Moving down the P&L, we forecast customer service and merchant fees as a percentage of net revenues at 4.5%, plus or minus. Advertising as a percent of net revenue will move around depending on the opportunities we see in the period and the resulting channel mix.

Based on what we're seeing thus far, the top end of our typical 10% to 11% range is reasonable to assume for Q1. SOTG&A or OpEx dollars excluding stock-based compensation-related taxes should be approximately $510 million to $520 million in Q1.

The main drivers here both year-over-year and quarter-over-quarter is compensation primarily for our existing team, but also for new employees as well. Net head count additions in the back half of 2021 were slower than planned due to economy-wide attrition trends, all part of the so-called great resignation. However, we now have good momentum in net hiring and expect a more steady pace from here.

Assuming the top-line trends we've seen quarter-to-date continue, this would translate to a negative low single-digit adjusted EBITDA margin for the quarter.

We are in great shape to handle any quarterly volatility and provided a normal seasonal revenue cadence to the year that I mentioned above, we expect for the full year to be modestly profitable on an adjusted EBITDA basis.

Touching now on a few housekeeping items, please assume the following for Q1. Equity-based compensation related tax expense of approximately $112 million to $116 million, depreciation and amortization of approximately $82 million to $87 million, interest expense of approximately $8 million to $9 million, weighted average shares outstanding equal to approximately 106 million shares.

Finally, we forecast CapEx in a $95 million to $105 million range in Q1. We do expect higher CapEx for the full year overall, as we build out the new retail store formats and continue to invest in our logistics footprint. Specifically, we expect to have two new US-based fulfilment centers opening in 2022. All in, Q1 will be a larger cash outflow period for us. This is typical and has to do with the timing of supplier payments post holiday and with net working capital dynamics, given Q1 is a seasonally smaller period relative to the holiday-enhanced Q4.

Over the last couple of years, we have clearly demonstrated the attractive inherent economics of our business. This should not be in question even as we consciously choose to accept some quarterly volatility on the bottom line. Just to put things in perspective, our full year 2021 net revenue was 50% greater than in 2019. And yet our head count is down slightly over that period of time. This is a tremendous achievement that speaks to the resiliency and talent of our organization, not to mention the scalability of the investments we have made over many years in technology, infrastructure and process.

From this point, we intend to add people to our team in a more ongoing and normalized way, to support both our near-term and long-term growth and profitability initiatives. Our goal is to onboard people at a reasonable pace in order to get them executing efficiently without putting undue stress on the organization. Put another way, we are deliberately continuing to pursue high ROI initiatives that we know will set us up for success over many years to come. Even as we do so, and if our top line assumptions play out, we expect 2022 to be a modestly profitable year for Wayfair in adjusted EBITDA terms. This is what Niraj described, when he referenced our ability to grow, be profitable and invest at the same time.

However, if revenue normalization in the form of a more typical seasonal build, quarter-over-quarter is slow to materialize, you should expect us to take a close look at our plans and course correct, if we think necessary.

Importantly, we have the benefit of a strong balance sheet to keep us focused on the long term and on striking the right balance for Wayfair whatever the macro environment may be.

Thank you all very much. Now Niraj, Steve and I will be happy to take your questions.

[Technical Difficulty] (00:31:21-00:31:52)

Thank you everyone for joining us this morning. We're having a couple of technical difficulties. But I also want to just take a second and say thank you for joining us in what is obviously a very difficult day for the world at large. The events in the Ukraine are on our minds and far outweigh what we're here to talk about this morning. But obviously, we're, of course, here and happy to take your questions. So, I'll ask the operator to compile the queue and get us to the first question. Thanks.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Peter Keith from Piper Sandler. Your line is open.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Hi. Thanks so much. Good morning, everyone. I wanted to just ask about some of the near-term performance, might be you guys talked about improving in the quarter to-date period to high-teens two-year sales CAGR. So, kind of a two-part question. Number one, you – at a high-teens rate, you're running below kind of your longer term goal to get to over $100 billion by 2030. So, A, why do you think you're running below that level here? And then secondarily, you are seeing some near-term improvements. So, could you elaborate on what's may be driving that sequential acceleration?

[Technical Difficulty] (00:33:20-00:33:43)

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

A

Hey, Peter. Sorry, it's Michael. We're still having some technical difficulties. And so Niraj is currently muted and we're trying to unmute him. So, apologies for that. Let me try and answer your question and then Niraj can jump in after me.

I think there's a couple things here. First, we are seeing – as I mentioned before, we're seeing sequential improvement and we are seeing ourselves on a normal sequential pattern now. I want to be clear, we're in a very murky environment, right? We're seeing that in January and February, we watch this on a weekly basis. And so we are seeing, coming out of Q4 into Q1, very much the more – or more normal pattern of how the sequential performance is going. And so, I would say that's piece number one.

In terms of the sort of the longer term, when you think about that sort of like 2030 goal, et cetera, we continue to be in a period between post-COVID, inflation, and everything else that's going on in the world right now, that just makes it hard to exactly understand how the consumer is going to perform. And so, I just think we're trying to be thoughtful and measured there.

I will say though that, to your point, if we're running in the high-teens CAGR on 2019 basis, we're pretty close to where we think – what you would need to believe in order to get to the long term, and that's in this sort of really murky, sort of, tough environment.

Maybe I'll pass it over to Niraj, if we've solved the tech problem.

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

A

Can you guys hear me now?

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

A

Yes.

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

A

Okay. Great. I'm not sure what the issue was. I think, Peter, one of the things – and I've missed part of Michael's answer, because of these technical problems, but basically, I think the macro is setting a lot of what the current growth rate is in some degree because of what traffic is there and what the channel mix on the traffic is.

When you talk about some of the improvements you're seeing, what I will say is that, on one hand, to see continued gains in growth rate when you look at how it's going to play out sequentially, you obviously need the macro to get back to kind of a stable place, which we think it's headed there. But frankly, there's a lot we are working on as well, that are very specific to things we are doing that drive the business forward.

One is, when you think about suppliers forward positioning goods through the CastleGate network, which drives up the speed badging on the site, it also drives lower retail prices because a lot of the last mile transportation cost comes out, which is the most expensive transportation leg.

That's a pretty big driver of conversion. That tips in new customers, drives the repeat flywheel. We're seeing that will progress nicely this year. And we have kind of a leading indicator on that because as you're aware, on ocean freight, our forwarding business has grown in scale.

That ocean year is mid – it runs midyear, so May through April a year. And as we talk to suppliers about what capacity they want. What we've seen is that the interest to flow goods in the network is very high. And we have a lot of flow plans that show that, that will be playing out.

And then there's, a lot of other things that we don't always talk about. But we've been investing in new classes. And so, as an example, large appliances is a category that is really a small number of players operated in somewhat of an oligopoly manner. And there's a huge opportunity to do a great job there with storytelling, helping customers find the right products.

There's a lot of technical complexity, delivery and logistics matters, service matters. And we're having great progress there. The red carpet merchandising with the flagship brands, those are really progressing very nicely, increasingly exclusive, increasingly taking share in our business.

The vertical focus of the B2B business, B2B business is a couple billion dollar business, well, as we've grown it, obviously, the account managers, what we've done with customers has worked very well.

We've increased the offering. But now the vertical experiences that we're building out, is a nice accelerant. Perigold in the luxury space, we're still a small player there. That's growing quite nicely. There's a huge amount of headway there.

The goods that we carry there from the few hundred brands that typically were only available through the designers and the interior design trade channels is really an incredible selection of goods, bringing those direct to customers and making them available online with the customization that's there with the breadth of selection that's there.

So, I'm going to stop rambling, but there's a lot of things that will continue to drive up the growth rate specific to us outside of the macro and then the macro, we think will also help.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay. That's helpful. And maybe I'll just pivot to margin, specifically, I would ask about CastleGate, which we think has a notable competitive advantage, yet the dollar volume through CastleGate has come down on a two-year basis.

Niraj, you talked about providing some financial and operational incentives to suppliers. So, in doing so, will that provide some margin dilution in the near-term in order to get suppliers to commit more inventory?

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

A

Here's the way to think about that. So, the way we historically approached it with suppliers is it was very clinical. And it was very technically correct, but it was complicated. By that, what do, I mean?

Well, the ocean freight cost-X, the drayage cost-Y. The brokerage fee is this, the cargo insurance is that, the induction charge depending on the location is this, the consolidation fees are that. So, it was very complicated to understand your costing.

What we did is we basically simplified it. We said, hey, look, move the goods into CastleGate upstream. Induct them into our consolidation operation. Here's what you're going to pay, and they think of it as covering that ocean freight drayage, that inbound cost that they would have otherwise paid someone else. And in today's world, it's even hard to access it, even if you're willing to pay and the rates that we offer are still pretty compelling. So, that's a very easy ask. And what we've done is we bundled in to one kind of price, the different fees to make it easy for them to understand what the opportunity is, but what we're doing is we're managing it on a total cost of ownership basis.

Because there's charges that suppliers never pay that we pay like the outbound shipping. And so, what we do is we look at the total cost, we manage the complexity. The suppliers are paying us for the logistic services, but in a simple manner. And by bundling it this way, we're actually making it a lot easier for suppliers to lean in, but not in a way that's margin dilutive.

What we're doing is we're basically making sure that the end-to-end benefits and the end-to-end costs are reflected versus what we're getting. And that's suppliers basically paying us, as I mentioned, for the logistics cost.

And obviously, we then are taking some of our own costs out. So don't think of it as being margin dilutive more than trying to simplify the offering.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay. That's very helpful. Thanks so much and good luck.

Operator: Your next question comes from the line of Brian Nagel from Oppenheimer & Company. Your line is open.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Hi. Good morning.

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

A

Good morning, Brian.

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

A

Hi, Brian.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Couple questions. I'm going to merge them together, but the prepared comments you talked about just the shifting backdrop post-COVID, consumers going back, I think, Niraj you may have made the comment, going back to their pre-pandemic ways, I mean to a certain extent, shopping more physical stores. So, the question I have is as you look at the Wayfair model and all the tools at your disposal, are there levers you could – you are pulling or you could pull here in the near term, to sort of say, drive even better recognition on the part of consumer as this potential normalization is happening?

And then second, we've talked in time to time about Wayfair testing physical stores. I know that within the context of the Wayfair business model, that's still a very, very small item. But is that – are you looking more at that now? Is there something more underway as you see consumers once again gravitating towards some type of physical presence?

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

A

Yeah. Sure, thanks, Brian. So, on your first question, when you talk about customers sort of reverting to pre-pandemic behavior and – we think of it as a pendulum, beginning of COVID it swung very, very strongly to online and on our way out of COVID it's swinging the other way. We think it's now coming back towards the middle.

I don't know that there are levers we can pull specifically that move it back to the middle any quicker. But I will just remind you in our business, over 75% of the business is repeat. So, we have a very large base of customers. They made 4 billion visits last year. They're very engaged. We have a direct way to communicate with them,

whether that's e-mail or through the app. They're very interested in what we're doing. And so, we are able to drive our business.

Obviously, the pendulum getting back to the middle is very helpful as well. And we have different segments. The B2B business at Perigold, those are growing quite nicely. The Wayfair business is mass business. It's doing well, it's resilient, it's going to be more affected by this pendulum swing than the high end right now with some of what you're seeing with inflation and the like. But it's doing pretty well. And Wayfair.com is down mid-single digits in Q4. So, we're seeing momentum building there.

The specialty retail brands, we are moving those to very tightly curated catalogs. We're seeing really nice progress where we've finished that curation though, obviously, in a time where availability is low and where, frankly, you're taking out some well-performing SKUs to really get to a tighter assortment that's all specialty quality. That – the comp is already negative, but that's part of the plan because we're nearing the end of the repositioning where then you'll see really fast growth.

And then the international geographies, they have that same pendulum swing. So, you have a mixed set of things that are kind of buffeting it around. And so, I don't know if there are levers we could do to kind of get to the end faster. I would just say, we're – I think, we're headed there anyways fairly quickly.

You talked about physical stores. I just want to highlight on physical stores. This is something we've been working on for years. So, the pandemic really does not have a role to play in how we think about that.

About five years ago, we tested pop-ups for a couple of years, then we had a 5,000 square foot store in the Natick Mall outside of Boston. And we really saw a very good performance there. And we learned a lot from that.

We then decided to embark on an effort to really build, what we think were the optimal stores for each of our concepts. And so, to that end, we've got some of the stores opening for our specialty retail brands this year.

We have a much larger format we're excited about for Wayfair that will open up next year. But the work for that started 1.5 years ago, started a long time ago. And so, the way to think about that is this is just the next step in creating an omnichannel experience that takes advantage of everything we have.

We have a distribution network. We have a delivery network that can deliver goods very quickly. We have a great offering. We have the inventory for that sitting in the supply chain. We've got a very large customer list that we can communicate with.

So, if you think about building a physical stores network, we basically have everything you need other than the stores themselves. So, as we build the stores, it's just another way to engage with our customers.

Some of the things we provide, whether it be design services or just customers having a tactile experience with products or some were more complex categories, it's just a great thing to add, as another way customers can engage with us.

And so, we're pretty excited about how it will play out. It's just it will be something kind of like our logistics network. It can be a big deal, but it plays out slowly over time, because there's time to open them and then optimize them before you really build more. But it's another exciting thing we have underway, in addition to lots of other things, as I mentioned earlier. So, we're excited about where we're headed.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Thanks, Niraj. I appreciate all the color.

Operator: Our next question comes from the line of John Blackledge from Cowen. Your line is open.

John Blackledge
Analyst, Cowen and Company

Q

Great. Thank you. Two questions, first, on the competitive environment. Aside from the lingering COVID comps, could you discuss the current competitive landscape? And as we hopefully emerge from the pandemic, do you think that competitors have gained some ground over the past few years on Wayfair?

And then second, on the – on CastleGate, Michael mentioned that Wayfair will add two more CastleGate facilities in the US in 2022. Could you just discuss timing of opening and where those facilities are? Thank you.

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

A

Yeah. Sure, John. Thanks for the questions. On the competitive front, what I would say is, I think during the last couple years, we've been able to even more firmly advance our position as the leader in home, and I think kind of customers have known us for that, we've built a household brand going into the pandemic. We already had it there. But I would say that all that happened during the time period, has accelerated it.

And the other thing that I think has happened is it's become very clear the role that logistics plays in providing an optimal e-commerce experience. And what you hear companies talk about advanced logistics, the only companies that you really hear talk about it a lot are Walmart, Target, Home Depot, Amazon and us. And I think that, that's kind of a key point, because without advanced logistics, it's very hard to provide that optimal experience. And frankly, it's very hard to control one of the major cost inputs.

And so, I think when you start talking about customer expectations to kind of one-day delivery, same-day delivery at competitive costs with great reverse logistics, and a great experience, convenient scheduled delivery, and in our case, you're talking about a lot of two-person deliveries and assembly and putting things in the backyard or putting them in a bedroom or what have you. That matters a lot. So, I would say, competitively, we feel very good about where we are. And we think actually the – as the results play out, you're going to see that our ability to kind of keep it up, being an outsized winner in the category is going to be very strong.

On your CastleGate question about the two fulfillment centers, the answer on locations, one is in Baltimore – or just outside of these cities, I guess. One is just outside of Baltimore and one is just outside of Chicago. And the one in Baltimore has just recently opened and the one in Chicago will open later in the year. So, I think that was sort of the specific question you had.

And then the thing you didn't ask, but I just want to comment on this, where we are in the development and evolution of building out the CastleGate fulfillment center footprint is that, at this point, we do not need to build it out for locations. So, we're building it out at this point for capacity. So, we're – we have an estimate of how much capacity we need and we're building them out in order to handle that capacity. So, one of the things that will play out over time is you should see the amount – percentage utilization in our network should actually grow despite the fact that we're going to open more facilities over time.

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

A

Just let me add on that point, Niraj. The one thing I don't think we've sort of said clearly is we do expect to have increasing penetration of goods flowing through our CastleGate network. So, we're opening incremental warehouses because of the volume that is flowing Niraj mentioned. We have forward visibility on that with ocean freight. And so obviously, as we run more – as CastleGate penetration grows, we run more through, that's part of what gives us the confidence in our 27% to 28% gross margin targets over time and sort of how we're building the business going forward.

John Blackledge
Analyst, Cowen and Company

Q

Thanks.

Operator: Your next question comes from the line of Steven Forbes from Guggenheim. Your line is open.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

Good morning. Niraj, you mentioned Wayfair.com, I think, was down mid-single digits in the fourth quarter. So, can you provide more specific color on Wayfair.com during, I guess, quarter-to-date in the first quarter? And then just provide sort of specifics on when the business will cycle the catalog changes within the specialty banners.

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

A

Sure, Steven, let me try to add a little color. So, kind of what I described B2B and Perigold growing nicely, Wayfair.com doing better than the total and then the drags being international and SRBs. Those statements are still true in the first quarter. So, I don't want to provide exact specific numbers for each of those, but those statements are all true.

And the SRBs, they're a relatively small share of the total business, but because of the repositioning and the changes we're making, they're down substantially. But what will happen is as you get into the back half of this year, you're actually going to see that flip. And then as they grow, you'll see them actually be comping up very positively. That's one of the things that makes comps right now really difficult is actually the shape of the year last year where you have COVID tailwinds in the first half and you had normalization happening in the second half, they make the comps this year look unusual.

And I think Michael has said, hey, if you roll forward just a normal seasonal pattern, don't even account for all of the things that we're specifically doing that should drive outsized performance, you actually get to very nice positive comps in the second half of this year. And so, one of the things that you have when you talk about the first quarter is, you're anniversarying these steep COVID comps from last year to rounds of stimulus, et cetera. But we're not that many months away from where that all is behind us.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

Thank you. And just a follow-up, as you think about inflationary pressures and inflation challenges among your customer cohort groups and so forth, any sort of color on how you're sort of thinking about managing and

mitigating these inflationary pressures, are you seeing price elasticity demand coming back into any of the categories? Or how are you sort of planning for the challenges that may come along with inflationary pressures?

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

A

Yeah, that's a great question. So, what has happened so far is inflation has been acute enough, the magnitude's large enough that suppliers have passed it on to us. And we in turn have passed it on to customers. You would expect inflation of that magnitude to dent demand to some degree.

To be honest, we have not seen that happen. Conversion has held up. And so, what do we think is driving that? The only thing we can come up with is like in America, for example, if you look at it, folks have $2 trillion more in their savings accounts now than they did pre-pandemic. So that sheer amount of money, we believe, is causing this amount of inflation to be digestible.

When we look out into the future – and one of the things we have on our platform is we do have the benefit of having a lot of different suppliers and so there is a competitive tension between them. So, they're not looking to take advantage of the inflation. In fact, they're loath to pass it through. They don't want to lose their position.

When we start thinking about how this will play out over time, I think, we're in an advantaged position relative to some. We've talked a lot about ocean freight and the opportunity there. Not only can we reliably move goods at a competitive cost but, frankly, we take out a lot of other expense when we talk about that last mile transportation leg. And so that actually drives lower retail. So that's going to be an advantage, we're going to be able to pass through to customers.

And as we talked about a few times, we expect the CastleGate penetration to ramp nicely through this year. We have forward visibility on that. And that's going to actually be a nice boon for customers when you talk about fighting inflation. So, we think that's pretty exciting.

And then, the last thing, I would just say, which is not specific to inflation, but on this call for years, we talked a lot about – and we did this back when our gross margin was in the 24% to 25% range – those four pillars that could unlock a lot of gross margin benefits, and we talked about 1,000-plus basis point runway from that 24% to 25%. And the four big pillars, one was logistics savings and other was basically wholesale economics as suppliers benefit from volume.

The third was merchandising gains that we can make with our red carpet merchandising and the flagship brands. And the fourth was growing our supplier services, which is the logistics services and the advertising, the merchandising services that we sell to suppliers.

Well, there's still a long runway on those things ahead of us as well. And what we said is as we unlock those gross margin gains, our plan is to keep some. So, you see gross margin rise and give some back. And what gives some back means is that customers would see lower prices, or we would offer value-added services included. And so that's the other thing that's going to play out over time. And we're seeing good momentum on that as well.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

Thank you.

Operator: Your next question comes from the line of Anna Andreeva from Needham. Your line is open.

Anna Andreeva
Analyst, Needham & Co. LLC

Q

Great. Thanks. Good morning, everyone. Thanks for all the color. We have two quick questions. So, the number of active customers took a pretty big step down in the fourth quarter. How do you think about new customer growth in 2022?

And what are you seeing from your 2020 cohorts in terms of retention and buying behavior. And as a follow-up on gross margins, you mentioned the low-end of the 27%, 28% range appropriate for the first quarter, what's implied for gross margin in your guidance for the year for the adjusted EBITDA slightly profitable? Thank you so much.

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

A

Let me start, Anna, thanks for the question. Let me start with answers and then maybe, I'll let Michael jump in with any additional thoughts he has. On the active customer count, I just want to clarify that the active customer count would be any customers who placed an order within the last 12 months.

So, when we talk about the four billion visits, they're coming from a large, large number of customers that's in excess of the active customer number. But if they haven't made a purchase in that period, they drop out of that number even if they're very engaged. And so, the active customer number, you're still seeing the normalization happening from the peak of COVID. So that 27 million number, what you're noting is it's down from 29 million in the quarter before.

I'll just remind you, in Q1 of 2020, as we entered COVID, we had 21 million. So, it's up it's up 30%, it's up 6 million from then. And then again, the number that are engaged is a far larger number. That's the number that made the 4 billion visits in total. So, we feel pretty good about the trajectory.

The next thing I would just say is when you talk about growing the active customer count, that customer count, there's far more customers to get than we have already. And we know that. We do survey work regularly to understand their awareness of us and their preference for us.

And one of the things that the Annual Shareholder Letter, which we just released today as well, if you read that, one of the things I just talked about is the awareness amongst people who purchase from us, and then that resulting in their likelihood to come back is incredibly high. That awareness from those who don't – have not yet purchased from us is very, very different.

And so, in CPG, people talk a lot about trial. There's a new type of cookie and so pre-COVID, right, they have someone on the street corner handing out little sample packets, because they want you to try it. Because if you try it, you might decide you like it. And if you like it, you'll then go back and buy it over and over again.

And this is the opportunity we have where as folks try us, so they visit the site, they find something they like, they buy it. They get that item. That really, really create, that's the beginning of that flywheel, where then they're coming back over and over again. And there's just so much runway on the repeat side. And as you know, repeat is over three-quarters of the business, and it's the reason we grow so quickly.

So, we think there's just a lot of room with all the enhancements we're making that the conversion will keep rising. And as people are visiting the site as macro traffic grows. We're just going to keep getting new customers. And so, we don't think that, that is at all risky. We think that just keeps playing out over time.

Now the second part, which you asked a quick question about gross margin and guide for the first quarter, it was – we had the same range we've had for a while, 27% to 28%. And as I highlighted, that rate will go up over time. And that rate is up from the 24% to 25%, we're at for quite some time.

Your question was, what is it for the year? I'm going to let Michael field what is it for the year because we generally don't give a lot of this guidance. So, what I will say is, what it is over time is it's going to actually keep rising quite nicely. But where we are right now is what we were highlighting, and that has to do with the fact that even though we pass on inflation, what we don't do is pass on transitory costs that we think will correct. And so, in times where we absorb some of that for a short period of time, that can hit that number a little bit, which is why this quarter, we sit at the low end of that range. But Michael, do you want to chime in on the year?

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

A

Yeah. Thanks, Niraj, and thanks, Anna, for the question. Just to be clear, we only guide to the current quarter, and that's with the 27% to 28% range and the low end of that range, which I think is appropriate. And we've already answered that question. In terms of as we think about it throughout the year, what we're trying to do is give people some perspective that we're comfortable with the 27% to 28% range throughout this year.

I do think as you – obviously, it's all revenue dependent, right? It's highly tied to sort of what's going to happen on the top line and we've already described one that it's murky, but two that we've got a lot of confidence based on what we've been seeing. But I do think that if that plays out the way we anticipate, I do think we'll be towards the – we'll work our way towards the upper end of our 27% to 28% range towards the back half of the year. And that's certainly how we think the year will play out. But we're way far away from sort of giving any specific guidance about the year or the long or anything of that nature.

Anna Andreeva
Analyst, Needham & Co. LLC

Q

Okay. That's fair. Thank you so much and best of luck.

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

A

Thanks, Anna.

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

A

Thank you.

Operator: And we have reached the end of our question-and-answer session. I turn the call back over to the Wayfair team for some closing remarks.

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

Well, I just want to just say thank you to everyone, for your interest in Wayfair. And we're excited to continue this journey with you. And there's just such a large opportunity. We're excited to be telling you about everything we're doing to tackle it. Thank you very much.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.