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Wayfair, Inc. (W)

Q1 2022 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 First Quarter 2022 Earnings 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.

Jane Gelfand, Head of Investor Relations, Treasury and Corporate Development. You may begin your conference.

Jane Gelfand

Head-Investor Relations, Corporate Development & Capital Markets, Wayfair, Inc.

Good morning and thank you for joining us. Today, we will review our first quarter 2022 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co-Chairman; Steve Conine, Co-Founder and Co-Chairman; Fiona Tan, Chief Technology Officer 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 second 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, our 10-Q for this quarter 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 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 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 & Co-Founder, Wayfair, Inc.

Thank you, Jane, and good morning, everyone. We're glad to reconnect with you today to share the details of Wayfair's first quarter results. More than two years ago, we made a swift transition to a remote working environment in the early days of the pandemic. Over the past several months, we welcomed back thousands of Wayfairiens to our corporate headquarters in Boston.

The energy and excitement has been palpable. As colleagues and friends reunited and many new faces made the jump from computer screens to desk mates. Being together in person a few times a week is a strong enabler of one of the most important drivers behind Wayfair's success, a collaborative culture.

Our talented, hard-working and low ego team is singularly focused on building the world's best destination for the home. Despite the rapid changes over the last two years, this goal has remained steadfast. And the response we continue to see from our customers speaks to the value Wayfair brings to their lives.

Even in this admittedly softer period, our active customer count was 25 million in Q1, and we delivered 10 million orders, generating nearly $3 billion of revenue. When we spoke in February, I noted we were seeing early signs of normalization in consumer behavior as the pendulum that pulled heavily towards e-commerce in 2020 and swung back to physical retail in 2021 had begun to even out. This is still the case, but in just the two months since a lot has transpired. With rising prices across the retail universe and amidst troubling geopolitical events, our mass customers in the US and internationally appear understandably more focused on where they are spending their next dollar, pound or euro.

Consumer spending is still climbing for retail overall. However, even with the relatively healthy individual balance sheet, shoppers are, nonetheless, devoting a larger share of their wallets to non-discretionary categories and reprioritizing experiences like travel. Reflecting these trends within our business, we are seeing more strength from luxury and professional customers vis-à-vis mass shoppers and stronger overall performance in the US relative to our international geographies.

Michael will get into the specifics, but for now, I'll just say that while the typical seasonal pattern of gradually building demand that we expected for the year is, in fact, playing out is happening in a more muted fashion than our normal seasonal curve. Factors like a slower start to spring weather make the exact curve hard to read, but we are seeing positive traction.

Last week, we had our most successful Way Day ever, a clear sign that customers remain very interested in the category. Notably, our Way Day event represented two of the four largest days in Wayfair's entire history. For

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context, the other two were during the pandemic. We also expect year-over-year revenue growth to progressively accelerate over the course of 2022, aided by improving product availability, speed of delivery and customer value, as well as normalizing year ago comparisons.

Given the volatility of the macro, this environment only reinforces the value of having a long-term focus, but also moving with agility and speed, features truly inherent to how Wayfair operates. Wayfair's core competencies have always included our ability to leverage data to have a real-time view of our customer and our strong partnership model with our suppliers. These enable us to identify actionable insights and to be nimble in our approach regardless of the environment.

Our P&L has natural variability, which adjusts in stronger and softer periods. And our platform empowers suppliers to fine-tune their offerings quickly to meet changing customer expectations. Suppliers know that they can lean on Wayfair to access a loyal and robust customer base. Internally, we are used to moving and pivoting quickly given the rate of change at Wayfair. These elements combined position us well in any environment to solve for the best long-term outcomes for our customers, suppliers and for Wayfair.

While rising energy prices are a headwind to shipping and fulfillment costs, some of the biggest pain points from last year are dissipating. Encouragingly, we are seeing a steady recovery in logistics globally since the low points of 2021 as areas of congestion continued to ease.

Product availability on the platform has improved by around 10 percentage points since the trough, while the delivery times have improved by more than 10% for small parcels, and more than 20% for large parcels from where they were this time last year.

While we've not yet returned to a fully normal supply chain environment, we are generally seeing the pace of improvement accelerate. Suppliers are thinking more strategically about inventory management than they have over the last two years, as the gap between supply and demand begins to close. And we believe this will accrue to Wayfair's benefit.

It is important to note that our business model excels when supply meets or exceeds demand as it does most of the time. However, 2021 represented the opposite. This resulted in poor availability, a significant degradation of delivery speed and cost pressures.

Seeing these factors reverse is responsible for the share taking that has started earlier in 2022 and had a long runway ahead. We are seeing strong interest in selling on Wayfair, due in large part to the value that suppliers can derive from CastleGate, all the way from Asia consolidation and ocean freight forwarding to storage and fulfillment, to last mile logistics.

We've nearly doubled the number of suppliers selling on the platform since 2019. So many of our newer suppliers are only now discovering the true value that CastleGate can add to their business and we expect increased uptake across all of our logistics services as the year goes on.

To facilitate this, we are driving more education, simplifying the supplier onboarding process and bundling services to make it easier than ever for them to take advantage of CastleGate. Over time, this should unlock a wide range of benefits, like better delivery speed, higher conversion and improved cost efficiency as well as more reliable ocean and last mile capacity, all of which lead to a win for customers, suppliers and Wayfair.

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Over the past several months, we've met with thousands of our partners across a series of industry events, where we heard a consistent set of feedback. Suppliers are just as focused as we are on the state of the consumer and they're looking to double down on platforms where they know their interests are best aligned. They're excited to lean into Wayfair because of the partnership model we bring, offering them dedicated and live support, augmented by an increasingly sophisticated set of technology tools, all geared around helping them grow their business.

Suppliers have multiple ways to stand out on Wayfair, these include deeper CastleGate integration, participating in house brands in our B2B business, leaning into key promotional events and enhancing their presence through Wayfair media and merchandising solutions.

Wayfair stands out as the best place to sell online because of our ability to integrate services across the full spectrum of supplier needs. We're seeing growing interest across each of these dimensions.

Suppliers are excited about all the ways we can drive value for their business in the near term, while we simultaneously invest to bring new shoppers into the ecosystem over the long run. One example of this is what we're doing with physical retail, in just a few weeks, with the opening of our first all modern store. We're excited to begin to showcase our specialty retail brands in an entirely new set of formats. And our teams have put a lot of thought and creativity into optimizing the in-store shopping experience for customers. This is the next stage of Wayfair's omni-channel journey.

Our first Joss & Main store will launch later this year and we are especially excited to open the first store under the Wayfair banner next year. Our physical retail locations will be a gateway into the broader Wayfair ecosystem, building on and complementing the richness of the online shopping experience with our world-class logistics infrastructure underlying both, yet another example of us taking a decade-long view of the business.

Even with the uncertainty that we are seeing in the environment, we have conviction that Wayfair is uniquely positioned to command considerable share in the future because of the loyalty of our shoppers today, the runway of customers yet to capture and our differentiated set of capabilities.

We've always run this business thinking about what is best for our customers and our suppliers. That remains our focus today, as we maintain the delicate balance between being nimble and responsive to the environment and continuing to manage the business for the long run.

Switching gears, as you may have seen this morning, today, we are also sharing that Michael Fleisher will be retiring next January. And that Kate Gulliver is being named incoming Chief Financial Officer and Chief Administrative Officer. Many of you have been students of Wayfair from the IPO in 2014 and therefore know Michael well. He has been a trusted partner to me and Steve for the past eight years, having joined the company when we had less than $1 billion in revenue and overseen its growth to the industry leader that it is today.

Under Michael's watch, Wayfair's capabilities have grown exponentially more sophisticated. Our employee population has expanded from less than 2,000 to approximately 18,000 today. And together, we have weathered all sorts of dynamic environments, which have only made the company stronger.

What's perhaps less visible from the outside is the top-tier talent Michael has nurtured across all parts of the organization. At the top of that list is Kate Gulliver, who has worked alongside Michael for nearly his whole tenure. Kate has long been part of Michael's thoughtful succession planning and will transition into the CFO and CAO role in November as he looks forward to retirement early next year.

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She will lead all the areas that Michael currently oversees, which includes finance, legal, talent, real estate and corporate affairs. Some of you know Kate is Wayfair's first Investor Relations leader, after which she went on to build out our Talent organization as Chief People Officer. Prior to Wayfair, Kate was at Bain Capital and McKinsey.

While Michael will be very missed, Steve and I and the broader leadership team already view Kate as an invaluable partner and have tremendous confidence in her ability to elevate Wayfair even further in her new capacity in the years to come. Even as Michael remains fully engaged over the coming quarters, we're excited for you to spend more time with Kate as we get into the summer.

Turning now to our next speaker, I'm very happy to introduce Fiona Tan, who recently became Chief Technology Officer after a-year-and-a-half of working in tandem with her predecessor, Jim Miller. She's joining us today to discuss our Tech organization and what we're building to take Wayfair to the next level of scale.

Fiona Tan

Chief Technology Officer, Wayfair, Inc.

Thank you, Niraj, and good morning, everyone. I'm excited to join you today to discuss our Technology organization and how we are building the future of Wayfair. To give you a brief background on myself, I studied at MIT and Stanford and worked at Oracle, TIBCO Software, Ariba and most recently, Walmart, where I was the Head of Technology for their US division.

I joined Wayfair in the fall of 2020 as the Global Head of Customer and Supplier Technology under our prior CTO, Jim Miller, and spent the past year-and-a-half working hand-in-hand with Jim as we began setting Wayfair up to grow from a $10 billion to $100 billion platform.

I want to start by giving you an overview of the organization and how it's evolved in recent years and then talk specifically about some of the most important areas where we see tech as a driving competitive advantage for Wayfair.

Wayfair's Technology team consists of more than 3,000 software engineers, product managers, data scientists, user experience and user interface designers and a whole host of other roles that develop sustain and support the full stack technology in products that help run every function of Wayfair globally.

At the highest level, our mission is to create world-class experiences for all Wayfair shoppers, suppliers and employees. To do this, we build the underlying technology that enables us to deliver those experiences in a manner that is durable, scalable, resilient and consistent.

You can broadly think about our organization across each of these major stakeholders with teams in each functional area dedicated to solving for the unique needs of each group. In addition to the people we have working on all our internal enterprise technology, such as our proprietary marketing, tech stack, we have a diverse set of teams working on building a better customer experience.

These span what we call store front, search, customer service and more. At the same time, we have groups dedicated to making Wayfair the best possible platform for our supplier partners and focus on elements like merchandising, supply chain and self-service tools. As we thought about readying Wayfair to grow into $100 billion business, we set out to evolve our organization in several very specific ways to facilitate that growth.

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And I'm excited to say that we are nearly finished with our move to the cloud. We also continue to work on re-platforming from a legacy technology stack to cloud-native microservices. These will give us a clear path to scalability while preserving the ability to be nimble in how we build out the platform in the future.

Alongside the progression of our technology stack, we've also been taking our team to the next level. One of our big focus areas has been growing the seniority of the team and bringing on talent with domain expertise and experiencing building products at scale. We've brought in senior leaders from some of the most respected technology companies in the world which has deepened our expertise in critical functions and acts as a magnet for other talent.

As we started this evolution two years back, 60% of our team members had less than three years of professional experience. We've now flipped that ratio and that figure sits at less than 30% today. A driving force in our ability to track and retain top talent has been the opening of four new development centers. New office locations in some of the top markets for technology talent across North America. Since we announced these new centers, we have hired more than 400 team members to work across the San Francisco Bay Area, Austin, Seattle and Toronto.

I'd like to turn now to the underlying technology itself and how it influences the experiences that our customers and suppliers have as they buy and sell on Wayfair. In particular, we are deeply focused on the benefits of machine learning and automation as we think about driving scale in the business.

Let me walk you through a few examples of how these are applied across marketing, catalog and logistics. One of the biggest areas we leverage technology is in our marketing organization, which itself is made up of more than 200 quantitative marketers, engineers and data scientists. Our team drives billions of customer interactions every week with a big focus on automation.

As an example, we leverage machine learning in the creation of over 36 million search keywords across three languages as we drive search engine optimization. Beyond marketing, we use machine learning to curate the tens and millions of items across our catalog as well as to augment, enrich and ensure accurate and complete product information. This enables us to respond to customer needs through filters in search, making sure customers can shop with enhanced confidence and find products in the style and price points that are right for them.

One last area to highlight is how we are applying machine learning into our logistics network. We are dynamically curating customer search to show products that not only fit the parameters of their search but are also located in fulfillment centers closest to them.

Doing so, can significantly cut the distance products travel, lowering costs and prices, reducing damage and driving higher conversion. We also have strong teams thinking about what it will mean to shop for the home years from now. For instance, Wayfair Next is our R&D team specifically focused on exploring the future of the Internet and e-commerce. We have been experimenting in this space for a long time. And early on, saw an opportunity to scale the creation of lifestyle imagery, by digitizing photography through 3D modeling. We believe this 3D content will become a backbone for novel applications in the VR and AR space. And we've already made early steps in integrating these models into proprietary and third-party experiential features.

The future of the home is in the cloud, and it won't be long before many customers have a digital rendition of their home, which they can decorate in virtual space as a complement to how they decorate their home in the real world.

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Wayfair has long-led the industry in innovation around how customers shop for their homes. We are positioned to continue to do so and are very excited about what the future holds.

Thank you. And now, let me turn it over to Michael for a review of the financials.

Michael D. Fleisher

Chief Financial Officer, Wayfair, Inc.

Thank you, Fiona, and good morning, everyone. Before I dive in, I just want to thank Niraj for the kind words. Working with Niraj and Steve to build this tremendous company over the last eight-plus years, has been the privilege of a lifetime. While I'm not going anywhere over the coming quarters, I do want to say that this decision is purely the fulfillment of a personal commitment I made to myself and my family several years back.

I could not be more bullish on Wayfair's prospects and the talented team behind it, nor in Kate's future as CFO and CAO. Kate has been a constant sounding board and partner to me over the last several years and is a proven, capable and inspirational leader inside Wayfair. I am so excited to work with Kate to facilitate a very smooth transition over the coming quarters and to reintroduce her to all of you in the process.

Now let's take a look at the financial details for the first quarter, before I move on to the outlook. As you saw in our press release this morning, Q1 total net revenue was $3 billion, representing a 14% decline year-over-year.

Q1 revenue landed somewhat below our quarter-to-date revenue commentary back in February. We saw some encouraging trends as the quarter began, suggesting a return to more typical shopping behavior with a strong President's Day event.

While we knew that March would be a more difficult comparison with the added stimulus from last year, we also saw new macroeconomic headwinds develop, as geopolitical events served to exacerbate inflationary pressures and subdued some customer sentiment, particularly in Europe.

On a segment basis, US net revenue declined 10% from Q1 last year, while International net revenue declined 31% year-over-year. We once again saw Wayfair.com in the US outperformed the consolidated business for the full quarter, down in the high single-digits year-over-year.

The International segment once again faced difficult comps, as we lapped over 80% year-over-year growth in Q1 of 2021. We also saw European customer sentiment drop towards the back of the quarter, as the war between Ukraine and Russia unfolded.

Q1 KPIs broadly reflected the macro trends that Niraj outlined earlier. For the trailing 12-months, we had more than 25 million active customers, which was 23% lower year-over-year. Order frequency over the last 12 months was 1.87, a decline year-over-year, but in line with levels we saw right before the onset of the pandemic. LTM net revenue per active customer grew about 13% year-over-year to $520, driven by higher 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 will use the same non-GAAP basis when discussing our outlook as well.

Q1 gross margin was 26.9%, this was largely in line with our guidance for the lower end of 27% to 28%. As we mentioned in February, inflation is weighing on our cost of sales, particularly on shipping and fulfillment as well as

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labor expenses. We saw higher energy cost take hold, particularly in the back part of the quarter, which is something we will have to deal with and offset over the coming periods.

Customer service and merchant fees were 4.8% of net revenue in the first quarter, a bit higher quarter-over-quarter due to increased compensation costs and a lower revenue base year-over-year. Advertising as a percent of net revenue was 11.2%. We're seeing smart opportunities with good ROI in top of funnel and brand-based advertising. In taking advantage of these, we're leveraging Wayfair's household brand status and driving higher awareness across the wide array of classes of home that we sell in order to penetrate wallet share.

Our selling, operations, technology and G&A or OpEx expenses totaled $525 million. The increase quarter-over-quarter is a combination of compensation adjustments for existing employees, and net head count growth.

I want to provide some context for the magnitude of the total head count jump this quarter, growing to approximately 18,000 by the end of Q1. The lion's share of this came from additions to our supply chain and customer service teams, which get accounted for in the cost of goods and customer service and merchant fees lines.

While our OpEx employee count is also growing to support the business, our intent is to increase these ranks at a more measured pace as we have previously described. Putting this all together, Q1 adjusted EBITDA was negative $113 million or negative 3.8% of net revenue. In the US, adjusted EBITDA was negative $30 million or a negative 1.2% margin, while the International segment booked adjusted EBITDA of negative $83 million for a negative 18.4% margin.

Moving on to the balance sheet and cash flow, we ended the quarter with $2 billion of cash and highly liquid investments. In Q1, net cash from operating activities was negative $226 million and free cash flow was negative $331 million, after factoring in $105 million of capital expenditures.

As a reminder, the net working capital swing in our business is typically at its most negative from Q4 to Q1 and tends to turn positive as revenue builds quarter-over-quarter as the year progresses.

Let's now turn to the outlook. As Niraj mentioned earlier, there are a lot of moving parts influencing consumer behavior and sentiment these days. War and widespread inflation should weigh on consumer spending, but we still see the consumer in a relatively healthy place today. As pandemic restrictions ease, there is also shifting between e-commerce and brick-and-mortar and experiences and things.

We believe the pendulum will swing progressively towards equilibrium here over the course of 2022. Said simply, we are still expecting revenue growth year-over-year to accelerate as the year goes on, though we are watching this very carefully. It is also encouraging that we are driving share capture in the US thus far in 2022 and expect that to continue.

All this said, it's very difficult to pinpoint when exactly things will truly normalize. We monitor the business very closely and in a data-based way and will remain nimble in adjusting to changing conditions as necessary. We have appropriate plans in place to properly balance our long-term focus on the massive market opportunity and the shorter-term realities of the environment in which we are operating.

As we have over the last few quarters, we will not provide formal top line guidance and will opt instead for transparency on what we are seeing thus far in Q2. On a quarter-to-date basis, our gross revenue is down in the mid-to-high teens year-over-year. Once again, the US and particularly wayfair.com is trending more strongly than

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our International segment. Comps do start to normalize from here and we are also seeing improving supply chain conditions and product availability.

For gross margin, as we have for the last five quarters, we continue to target a 27% to 28% range for Q2. Similar to last quarter, we believe the low-end of our range is most likely with the current state of cost inflation in transportation, energy and labor. We remain focused on passing through these higher costs where appropriate, while managing the remainder within our own cost structure.

For now, please model customer service and merchant fees as a percentage of net revenue within a 4.5% to 5% range. This is an example of a line item where we are choosing not to overreact to short-term top line volatility and keep a high bar on customer experience.

Advertising as a percentage of net revenue should once again land in a 10% to 11% range. We remain disciplined in our ROI-based approach. So where we end up in this range will depend on the opportunities we see in the period and the resulting channel mix.

SOTG&A or OpEx dollars, excluding stock-based compensation and related taxes, should equal approximately $555 million to $565 million in the second quarter. As with the last quarter, the main driver here will continue to be compensation for our existing team and new employees joining Wayfair. We remain extremely mindful of the delicate balance between hiring too quickly and resourcing our long-term opportunities and continue to monitor and actively manage this closely.

Q2 adjusted EBITDA will ultimately depend on how the top line progresses. However, I will note that assuming the top line trends we've seen quarter-to-date continue, this would translate to a Q2 adjusted EBITDA margin that is similar to Q1 levels.

Let me touch now on a few housekeeping items. Please assume the following for Q2. Equity-based compensation and related tax expense of approximately $136 million to $140 million; depreciation and amortization of approximately $85 million to $90 million; interest expense of approximately $9 million; weighted average shares outstanding equal to approximately 105 million shares. Finally, we forecast CapEx in a $130 million to $140 million range for Q2.

We remain focused on both our long-term opportunity and running our business profitably. However, the macro environment is so murky right now that it is difficult to know how 2022 will play out with the consumer and our top line.

As such, we cannot commit to the business being adjusted EBITDA profitable for the full year, but we will be responsive based on what we are seeing, as we remain very focused on returning the business to adjusted EBITDA profitability.

Needless to say, how our top-line plays out over the balance of the year and how we choose to manage our expenses in response to that will drive the exact timing. We fully intend to manage Wayfair to strike the right balance between growth, profitability and smart long-term investment, and we have the balance sheet to allow us to strike this balance in a thoughtful way.

Zooming out, we also have complete confidence in the structural profit economics of our business and the key drivers that should propel them higher, recognizing that the investments we have made over multiple years are already mostly in place to do so.

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I now want to wrap up by going back to where I began. I have no doubt that Wayfair's best years lie ahead, because I've seen firsthand what our talented team is capable of and the scale of untapped potential in our market. The past two years have been some of the most challenging and rewarding, not just in my nearly decade-long tenure here at Wayfair, but my entire career.

They have reinforced the importance of coming in every day with a balanced perspective, bringing creativity and resourcefulness to solve today's consumer and supplier problems, while always keeping sight of what will serve them best longer term. This is how Niraj and Steve have long run this business and how Wayfair will continue to operate, both under my stewardship as well as Kate's.

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

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. Good morning. Thanks so much. Michael, congratulations, it has been great working with you and getting to know you. So, wish you nothing but the best. Just to dig into a question, maybe I'll just turn it to Niraj.

You had mentioned in the script that your business model excels when supply exceeds demand. Do you believe that inventory is shooting up with a number of suppliers and retailers? So I think we're entering that environment very quickly.

So could you unpack that a little bit for us and how your model benefits from improved supply? And what are the risks that the promotional environment might get a bit more competitive, as people try to clear out this excess inventory?

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

A

Hi. Sure, Peter. Well, thanks for your questions. So, first, let me clarify. It's not that our model sells when supply sees demand. It actually excels when supply is roughly equal to demand or supply exceeds demand, it's just that our model is very disadvantaged when supply is scarce relative to demand.

But to be honest, in a capitalist environment, supply is almost never scarce, but it was last year. And it was during World War II. So there's times where it is, it's just super rare. And why does it get hurt then? We're the only major retailer who doesn't write checks for inventory. So when supply is scarce, as you can imagine, if you're a producer, you can't produce anywhere near enough relative to demand, you're going to sell all of it to people who are writing checks. And so, our models, it just gets hurt a lot.

And it's not even just that we don't have the best items, but a sub-function of that has been, of course, we then take that inventory before we position it, then we get the speed of delivery. That then takes out costing, which then drives the retail price. So it's kind of like a – it has a knock-on series of effects.

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Well, now all of a sudden, what's so good about now, what's different than the back half of last year where we lost share because of this. Well, what's happening now is, as you mentioned, inventory is recovering. Not only is it recovering, it's starting to recover aggressively, because demand has actually fallen some in a macro perspective.

Well, we were already benefiting just as availability was getting better. Now availability is getting better at a very fast rate. Our speed of delivery has started to get better at a fast rate. Those manifest with sharper retail, we see customers respond.

Then, as you mentioned, some suppliers are having an excessive amount of inventory relative to what they want. What happens is, our competitive retailers, what they've done is they've bought their inventory for the next few months already, and they bought it at a certain price. They've locked in that price. They're now loath to discount, because they could put them in a bad cost position on retail relative to cost.

Well, on our platform, the supplier is setting their price every day. That price is then driving the retail price every day. And for a supplier, if you have extra inventory, you just want to turn it into cash, you're less focused on the exact profit margin on those items.

And so what we see happen and the first place they do this is with promotional events, by the way. So we saw this happen on Presidents' Day. We're seeing this – we saw this happen on Way Day. We're seeing this happen with the lead up to Memorial Day. These are obviously US holidays. Same thing is true in the other countries, which is, suppliers are leaning in aggressively. They're leaning in aggressively to get share. That's, obviously, a great customer value proposition. We do our role in bringing that promise to customers.

They're then curious, they come in and they check it out. And this is why we had our best Way Day ever. We had our best Way Day, because we have a large base of people who find Wayfair interesting. We put in front of them a great value proposition, they then obviously reacted. We had two of our best four days. And actually, if you look at Wayfair.com, we had our two best days ever.

And what do we think is going to happen in the near term? Well, we think, frankly, our speed of delivery, it's set to continue to get better at an aggressive pace, even though it's already gotten better by a good amount. Our availability is set to get better at an aggressive pace, even though it's already gotten better.

We have forward insight to that, by the way, partly because of our ocean forwarding business that we started four years ago. The new ocean year just kicked in starting May 1. We have doubled the capacity from last ocean year. This is a pretty good strategic advantage that actually lowers cost for our suppliers as well.

And so, a promotional environment, frankly, is a good environment for us, a normal environment, a very good environment for us. Promotional environment, why is that a good environment for us?

Well, suppliers lean in, they're competing with one another. That's great value for the customer. Customers find it compelling. They come in. This is why we did well also, by the way, during the financial crisis and the housing recession. So it's a very good setup. And I think honestly, a bunch of folks have noticed this in the year-to-date, share taking that we've done and the credit card data, all the third-party data is starting to show that we're taking significant share. And it's not on the back of buying the business, as you see from the gross margins holding steady. It's entirely because of this dynamic.

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Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay. That's helpful. Just sticking on the topic of the competitive environment. There is a broader view out there that the COVID backdrop the last two years forced some of the large mass retailers to get a lot better with e-com and specifically a lot better in the home furnishings category.

What are you seeing with the evolution of that competitive environment? And do you agree with that thesis that maybe your mass competitors have become a bit more sophisticated?

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

A

I mean, there's no question that the largest retailers all recognize e-commerce is important. So here we're talking about not just Amazon, who obviously is an e-commerce specialist, but we're talking about Walmart and Target and Home Depot, Lowe's. Again, I'm sticking with the US names, but each country has a kind of comparable set.

That said, they all focus on their core business. So when you think about Home Depot or Lowe's, they talk about the flatbed trucks and the delivery network, there's a lot of focus on building materials.

We talk about Walmart and Target, I'm talking about grocery, in-home grocery delivery. I'm talking about consumables, replenishment. Obviously, there, they're trying to protect their share, take share back from Amazon. So everyone is focused on their core business.

I would say that home is no different than every other category, which is that, for a general merchandiser, they want to be in every category. But they have the same challenges that Amazon has, which is, if you sell AA batteries and you sell nails, do you want the picture to be 1 inch square on a big screen monitor, or do you want to be 8 inch square, right?

The truth is, the nails at that size picture is not really compelling. And so, I think the key thing to think about is, we're a home specialist; that comes across in the selection and the merchandising. We don't do our business at just the opening price point, which is where those folks do their business in home.

We have a logistics network that's optimized for the types of deliveries that we do. It prevents damage, it lowers retail, it still drives speed of delivery in an exciting way that the others can't do for big bulky items. And our suppliers understand this.

So all the supplier technology we're building and all the things we're trying to provide them to optimize this are really valued by them, because our suppliers by and large, are not these very large multinationals where you're introducing three new models for the holiday and you're doing 200 containers of each.

These are small to mid-sized businesses, with a large diverse portfolio of products that the deep supply chain integration we do with them, the help we give them on the merchandising, these are very valuable services.

So I do think you're going to keep seeing us take share in a disproportionate way in home, because of our role in home, you'll see all those folks continue to do well in e-commerce broadly, but their share in home will be – they'll all share the kind of lower tranche of the market with us.

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And I think that's the dynamic we saw prior to COVID. That will be the dynamic we continue to see. I do think folks who are like more of the independents or the smaller players or the smaller specialized big box guys, they're going to continue to struggle on the e-commerce front, because it is a business that benefits those who have scale when you think about the logistics network, when you think about customer acquisition, these are not costs you can amortize on over a small base.

Peter Jacob Keith
Analyst, Piper Sandler & Co.

Q

Okay. Great. Thanks so much for the insight. I appreciate it and good luck.

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

A

Thanks, Peter and thank you for the nice comments.

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

John Blackledge
Analyst, Cowen and Company

Q

Great. Thanks for the question. And Michael, congrats on your excellent work over the years and also congrats to Kate on the new role. It will definitely be nice to work with her again.

So I have two questions on supply chain, Niraj, in your prepared remarks, you seem to suggest that supply chain issues are abating somewhat. Is that right? And just given conditions and recent COVID shutdowns in China, are they potentially new headwinds to supply chain? And then second question on gross margin, it was right around the low end of the range. How should we think about the puts and takes for gross margin in 2Q and the rest of the year? Thank you.

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

A

Sure. Thanks, John. So, yeah – and so, I would say our supply chain challenges – remember, supply chain for us is a combo, we talked about availability. Availability is not just a function of production, but a function of us getting access to the production to forward position it. And then the second is, obviously, the transportation flow.

I would say, those challenges are abating as demand has come off a little as our ocean freight capacity has grown, as we've gotten deeper in the planning cycle with our suppliers. Obviously, the shutdowns in China will create a new, kind of – it creates a low and then a burst of activity. But we think, generally, we're well positioned to manage it.

And again, a lot of what I'm describing is also on a relative basis to how it was before and a relative basis to our competition. And we feel like we're in a great position on both of those fronts, which is why we can take share in that environment.

I'm not suggesting that the supply chain is abating to the point where it's just business as usual from 2018, 2019. It's still complicated activity. But I think the fact that for six years, seven years, we've been building out our own proprietary network, ranging from ocean freight to proprietary last mile delivery, to deep integration with parcel carriers to a large fulfillment center network, over 20 million square feet of space deeply cubed out. These are the things that are making us able to manage this.

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On the gross margin question, what I would say there is, the way to think about it is that range, the 27% to 28% we gave you is the range you should think about. Now the gross margin has moved around in that range. And the reason it's moved around is – what we've always said is we take our cost structure of an item, the wholesale, the transportation costs, the other costs associated with the item, we apply the margin for that item and all the pure items, same margin, and that's the retail. And so, cost structure generally drives the retail.

Now that said, if there's a transitory change in a piece of the cost structure that we manage, which – the easiest one to think of, basically the main one is transportation, if we think that's going to abate or change again soon, we're not necessarily going to pass it through to only raise the price of the item a little bit to then drop it a little bit shortly thereafter.

And so, there has been a lot more movement on transportation, as you would imagine, over this period. So, there've been periods of time where we've sort of been on one side or the other side of that trade, but we've not wanted to just move retails around anymore than they've been moving.

And they've been moving a lot, because there has been a lot of wholesale price changes, both up and down, inflation broadly driving it up and then as you're mentioning, the supply is getting more available, we're seeing suppliers leaning in on promotional periods. Obviously, that drives it down. So that's kind of why you're seeing it move around a little more than you maybe normally expect. But I think, as you zoom out, you shouldn't expect a change.

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

The only thing I'd add, John, on that is I do think that we're in a period of sort of greater volatility around all of those costs. Product margin has remained very consistent, but obviously, there's a lot of movement, both on the wholesale there, as Niraj pointed out, and then also all of the delivery cost.

And so, the reason we're guiding everybody to the low end of that is because there is going to be some volatility in it and we're obviously trying to manage it the best we can not only for our business, for our customers, right? There's like – there's a balancing act there.

John Blackledge
Analyst, Cowen and Company
Q

Thank you.

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

Thanks, John.

Operator: Your next question comes from the line of Chuck Grom from Gordon Haskett. Your line is open.

Chuck Grom
Analyst, Gordon Haskett Research Advisors
Q

Hey, thanks. Good morning and also congrats, Michael, on your retirement. You called out success with Way Day last week. Can you share with us any additional insights, perhaps category performance and how that may help you plan your top line performance over the next few quarters?

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And then, my second question, you talked about a return to positive EBITDA territory, how do we think about the building blocks within the P&L? And I guess which ones do you think you expect to see inflect sooner rather than later?

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

Sure. Thanks, Chuck. On your first question, Way Day, I would say what was exciting about Way Day is we saw sort of broad-based activity. So, it was not concentrated in any particular category. And in fact, we mentioned outdoor had a slower start to season partially perhaps due to weather.

What's interesting is if you compare it to the pre-COVID kind of curves, 2018, 2019, 2017, those seasonal curves, it looks a lot like that, whereas 2021 in particular had a stronger pull-forward. And what was interesting on Way Day, outdoor did very well. We saw the broad-based performance that we would expect including the seasonality sort of spikes that we would expect. So, we thought that was pretty compelling.

On your question about returning to EBITDA profitability and the trajectory and how do we think about that, what I would say there is we feel very good about that. That's why we put it in the prepared remarks and we're trying to highlight it for a few reasons.

The first of which is, as we've discussed, we're holding gross margins. Our unit economics are intact. So what happens is revenue grows, obviously the flow-through is substantial, that ultimately is a very big driver of getting to EBITDA profitability.

And what's interesting is what – I was in Europe last week, I was in the UK for the major UK furniture trade shows in Germany and visited with quite a few folks. I was at High Point in the hardware show in the US just a few weeks ago.

What we are hearing in March and in April, we've heard folks have seen their business significantly step down. And particularly different retailer pockets, we're hearing about warehouses being full, retailers really having trouble on sell-through, different things. We've [ph] got a whole lot of (48:06) numbers.

And so, what we've seen with our business, we've seen demand hold up quite strongly. And you can even just hear it from Michael's numbers about what we're seeing quarter-to-date, we're seeing sequential growth. We're seeing a sequential pattern. We mentioned it's more muted than perhaps total pattern we normally see, but it's still very positive, sequential pattern and we've seen that play out.

So, how do we think about profitability? Well, we believe we're going to keep taking share. So we think revenue will grow. Even though we're adding OpEx head count, we're adding it in a moderate rate, so the OpEx as a percentage of revenue, which has risen as revenue normalized post-COVID, that percentage will go down as revenue rises.

And then, frankly, it is an uncertain environment. So, obviously, we have a variety of plans intact, in place to decide what to do depending on how the macro happens, so that we get to that EBITDA profitability. But we feel pretty good about how things are playing out. And so far, what's happening week-by-week is playing out, frankly, in a very positive way.

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And I think what's interesting is we tried to call this out last quarter and I mentioned the degree to which we think the availability of the key items in the back half of 2021 hurt us and we talked about how [indiscernible] (49:17) purchasing some other things were painful, that we didn't have and we didn't have the key items and so on and so forth.

Well, what's interesting is we've worked hard to recover from that, as we're seeing the recovery, we're seeing it be fairly substantial on the share taking. And so, even in what's going to be a choppy macro, we feel pretty good about how that will play out. And obviously, if the macro gets choppier than we're underwriting, we have a variety of things we can do to drive the EBITDA.

Michael, anything you want to add on that?

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

No, I actually think – I think you covered it really well. I would say the one thing that – the only thing I'd add, I guess, is that all of the sort of structural opportunities for increased gross margin over time, because of the investments we've made in the supply chain as well as across the supplier services, all of those still exist.

And so, as the business returns to a more normal growth pattern, I think you're going to start to see those flow through as well. And I think that's an important driver, not just near term but certainly in the midterm and long term.

Chuck Grom
Analyst, Gordon Haskett Research Advisors
Q

Great. Thank you.

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 and, Michael, also congrats on the planned retirement. Niraj, would love to just hear your thoughts on OpEx labor productivity and really why the recent ramp in SOTG&A and expenses doesn't change the longer-term margin walk and margin target for that respective line item.

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

Sure. Happy to answer that. So I think the biggest thing to keep in mind is that, so the head count – non-OpEx head count, like if you're talking about customer service or the fulfillment head count, they're very much tied to today's order volume, today's order flow, the number of orders going through our transportation network, the number of phone calls we're getting tied to today's orders.

And so, that you can say, well, how does that leverage over time? There's some leverage there with technology on things, but by and large, those are, to some degree, tied to the order flow, will get a little better, but tied to the order flow.

When you look at OpEx, it's really not tied to today's order flow. So if you look at the technology we're building, whether it be storefront technology around visualization or different ways for product navigation or whether you

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talk about the ocean freight, the forwarding business and how we're going to add a lot more automation to that or you're talking about things we're doing, a great example will be physical retail.

Physical retail will take a long time before it's substantial, and yet there's a very substantial sized team working on it today, because you need the team to build the offering and you need that in order to have one store. But one store doesn't move our P&L. But then one day, decades from now you have many, many stores that could be meaningful, right?

So the way to think about OpEx is, OpEx labor productivity is not relative to today's revenue, is relative to the revenue x years from now. And you cannot ramp OpEx fast and get it to work, because the people need to get ramped up, and that takes a meaningful period of time.

And we found that if, too high a percentage of people are new and don't have the historical knowledge, actually, it's counterproductive, you hurt yourselves. And meaning, we've said that we're never going to – we don't want to have more than 50% of the people with less than one year of tenure. And with turnover and with growth, you can hit that. And we've hit that in the past, and we've had problems.

And so, last year with a great resignation, we didn't really grow OpEx for a number of quarters. We started to at the end of the year. We've now added some folks there. Our plan on adding to OpEx is a very moderate ramp, so that we can actually make sure that we ramp people up. We've actually had a burst of new people here, so we need to make sure we ramp them up. So we're not going to pile on, pile on, pile on and create the problem we've had in the past.

And so, the way to think about it is, it's a moderate ramp that lets you do things that really stimulate revenue in the future. And so, the percentage cost of OpEx as a percentage of revenue goes down because if, in fact, you're building high ROI initiatives, they stimulate revenue in a way that's substantial. And you've done that work years before, right?

And so, that's why you can't link it in the current time, but this is why we really think about it this way. And as I mentioned, we have a variety of plans in place, meaning there's no one ramp plan we're 100% committed to. We moderate what we're going to do based on a combination of things and the macro is obviously a very, very, very large driver of that as well.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

And then maybe just a quick follow-up on that, I'm not sure if it's possible, Michael or Niraj, so just help us maybe separate, right, or segment the SOTG&A and expenses into different classifications, right, sort of in the event that the macro were to deteriorate pretty significantly, how much flexibility is there, right, for you guys to really control the overall expense structure of the business, just given the current free cash flow profile?

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

A

Let me let Michael answer that for you.

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

A

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Yeah. Thanks, Steve, and thanks for the comment upfront, too. Look, I think, I don't want to get into sort of trying to parcel all these things into different pieces. As Niraj mentioned, the thing, it's worth noting is, there's a substantive piece of expense in that line that is future focused. And obviously, you've got more flexibility on the stuff that's future focused than you do on the stuff that's supporting the customers and sort of running the business day-to-day.

And so, I do think there's a pretty high degree of flexibility there. At the same time, you want to be really careful and thoughtful when you're thinking about the trade-off between the sort of short term and sort of what the long-term opportunity is. And obviously, all the people we have working on future stuff are working against, what we believe, are really, really important, big long-term unlocks to sort of future growth.

But I think there's a balancing act here. One of the reasons you have a strong balance sheet is, so you can sort of be thoughtful about that balancing act in tougher times. We're trying to do that. But just to reiterate what Niraj said, we also have some – we have plans in place to make sure that if the macro world doesn't play out the way we think it's going to, that we know the actions we'll take.

Steven Forbes
Analyst, Guggenheim Securities LLC

Q

Thank you. Best of luck.

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

A

Thanks, Steve.

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 & Co-Founder, Wayfair, Inc.

Well, everyone, thank you for joining for the conference call. We appreciate your interest, as always.

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

And look forward to talking to you in the next quarter.

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

Thanks a lot.

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

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