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Wayfair, Inc. (W)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the Wayfair Q3 2023 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]

I will now like to turn the conference over to James Lamb, Head of Investor Relations and Treasury. Please go ahead.

James Lamb

Head-Investor Relations, Wayfair, Inc.

Good morning, and thank you for joining us. Today, we will review our third quarter 2023 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co-Chairman; Steve Conine, Co-Founder and Co-Chairman; and Kate Gulliver, Chief Financial Officer and Chief Administrative Officer. We will all be available for Q&A following today's prepared remarks.

I would like to remind you that our call today will consist of forward-looking statements, including, but not limited to, those regarding our future prospects, business strategies, industry trends and our financial performance, including guidance for the fourth quarter of 2023.

All forward-looking statements made on today's call are based on information available to us as of today's date. We cannot guarantee that any forward-looking statements will be accurate, although we believe that we have been reasonable in our expectations and assumptions.

Our 10-K for 2022, 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. 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 IR website.

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

Niraj S. Shah

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

Thanks, James, and good morning, everyone. We're excited to reconnect with you today to cover our third quarter results. While we still have a couple of months left to go, I'm confident the overarching theme of 2023 will be execution.

Our team came into this year with a plan, a plan to see our core recipe return to form, to return our business to profitability and to continue pushing our major growth initiatives forward. Wayfair is now in a place where we can both drive profitability while simultaneously investing for growth.

Q3 is one more proof point of exactly that. Today, we're reporting positive adjusted EBITDA of \$100 million, a second consecutive quarter of positive free cash flow and nearly 4% year-over-year revenue growth driven by strength in orders.

We saw order momentum persist from the spring through the summer, up 14% in the third quarter versus 2022. You're seeing this lead to steady improvement in our active customer metric, which saw sequential growth strengthen to 2% and is well on its way to getting back to positive year-over-year growth.

2023 has been an eventful year for Wayfair as the plans we set in motion during 2022 have come to fruition. Our remarkable progress against the three core priorities we set back in the summer of last year, nailing the basics, driving customer and supplier loyalty and cost efficiency put us in a position to beat our own timetable to profitability.

One of the analyst reports summing up our second quarter results was titled, they did what they said they would do, and we can think of no better complement. We executed further in the third quarter to produce consistent profitability while still driving demonstrable market share growth, as evidenced by our gains on customers and orders.

One of our long-running focus areas is controlling the controllables. And you're seeing that we have and will continue to keep a tight grip on the reins even with a volatile macro environment around us. Our improving order trend has led us to a place where net revenue returned to positive growth this quarter, even as average order

values continue to normalize versus last year. With a considerable inflationary pressures across ocean freight and raw materials coming out of the system, there's been no surprise to see pricing levels continue to come back down to a more normal range for the category.

We've heard a lot of debate around AOV over the summer as investors try to piece together where levels will stabilize. Our conversations with suppliers suggest that prices should continue to rationalize in Q4, which we anticipate will represent the year-over-year trough. Lower AOVs, in tandem with strength in the core recipe, are contributing to our order growth and share capture. This is particularly encouraging when we think about the strong repeat behavior of our customers, with nearly 80% of orders in 2023 so far coming from returning shoppers.

Growing market share is a key focus area as our category demonstrates persistent weakness. We've seen the sector slow from the last time we spoke in August. A few weeks ago, I was in High Point and heard repeatedly from our suppliers that the market is getting tougher. In the US, the category is now tracking down in the mid- to high teens on dollars with continued order pressure industry-wide.

In spite of the distressed home goods environment, our share position has held up well. Third-party data shows that our share gains across 2023 are persistent and have come from a large collection of peers rather than from any specific displaced retailer, just as it has for most of our existence.

Every day, we see customers choosing Wayfair because of our unmatched combination of competitive pricing, with the widest selection in the industry, and speedy fulfillment on the items our customers love.

The success has been broad-based across our catalog, not focused on any specific classes within our assortment. In fact, we still frequently hear our customers and investors express surprise at the depth of our catalog.

So I wanted to take a moment to highlight a couple of categories you might not immediately associate with Wayfair, but are great examples of our strong share gains. Many shoppers think of Wayfair as a great place to buy their next bed. But we don't stop there. Our customers can also pick out their next mattress, sheet set and bed pillows at the same time.

We've seen our share in the mattress class outperform meaningfully over the past couple of quarters, with positive unit growth in the low double-digit range year-over-year, while market volumes have been down by a commensurate amount in the same timeframe. Mattresses are known for having a wide range of price points and on Wayfair, you can find a broad assortment of the highest end national brands all the way to our Wayfair Sleep essentials line.

Mattresses are the perfect example of the core recipe in action. This is a class where we win by having that wide assortment in tandem with competitive pricing. As we do with our entire catalog, we take a good, better, best approach to our selection ensuring that customers are finding the highest value at any budget level. We wrap it all together with fast delivery. Mattresses have one of the highest levels of speed badging across any of the classes we sell.

We also have the value-added services customers expect and a great shopping experience, be it financing, white glove set up or taking an old mattress away. Our scale enables us to compete successfully in a class that pushes the boundary of online penetration across our category with nearly 1/3 of mattress sales happening online.

Just like mattresses, we frequently find our customers surprised and delighted at the breadth of furniture products they can find for their dogs, cats, birds, fish or reptiles on Wayfair. The pet furniture opportunity represents several billion dollars of our \$800 billion TAM, and we've seen strong double-digit growth here over the past 2 quarters, well outpacing the peer set. Our place in the field is unique as we tap into the emotional investment of the home, multiplied by the emotional connection our shoppers have to their pets.

We've built a promotional calendar around the major pet-focused events to speak to customers in this space. For example, we ran an app-focused event for National Dog Day this summer, which saw considerable double-digit boost to click-through rates, conversion and sales as shoppers celebrated the opportunity to make their homes a better place for their four-legged friends.

Before I turn things over to Kate, I would like to spend a few minutes touching on three of the biggest questions we've heard from investors in recent weeks. And the first of these is around promotion. A few of you have asked how promotions have impacted our order momentum and ability to take share. So it's important to frame up how the environment has evolved in the past year. Last fall, we saw promotional intensity spike as suppliers use discounts as a tool to clear out inventory. While our cadence mirrors the peer group, our focus is leveraging promotion as a tool for engagement.

Shoppers are staying on the sidelines until they spot a good deal. But once in the door, they're proving happy to shop around. As I noted last quarter, during promotional events, less than a third of our gross revenue is driven by featured items.

Moreover, our average supplier is marking down within a very reasonable range where they can achieve positive order economics for themselves even with a discount. This is due in part to the massive base of 22 million customers that our suppliers access by selling on Wayfair. Our customer file draws more selection onto the platform, which in turn brings in more customers and ultimately spins the flywheel of share capture. As the inventory environment normalizes and promotional intensity evens out, we can continue to be a share winner as our core recipe has proven for many years.

The second question is unsurprisingly one, about the housing cycle and our ability to succeed in an environment where people are staying put in their homes for longer. The answer to that question is quite straightforward. While we do have customers that will come to Wayfair for purchases geared around a move, this is far from our most common customer use case. You can see this in our own data on orders and revenue per customer.

The average Wayfair shopper places about a two orders per year, totaling about \$540. This isn't someone that is typically refitting an entire room or a house. This is a shopper that's going through their home item-by-item, project-by-project, making small updates on a much more frequent cadence. If our customers stay in their homes for longer, we're well positioned to be their retailer of choice the next time they decide that they'd like a new lamp for the living room or want a new set of chairs for their dining table.

As I wrap up, the last question I want to address is when we heard following our Investor Day in August. For those that were able to tune into the event, you'll remember the slide on our growth algorithm, which detailed our pathway to returning to a double-digit growth rate. We walked through our major focus areas, our specialty and luxury brands, international efforts, physical retail investments, Wayfair Professional offering and our supplier advertising solutions.

In the weeks since, one of the most frequent questions we've gotten is how to think about the timing across these initiatives. The way to think about these growth drivers is on a staggered basis of maturity. While even the most

mature efforts on this list, our higher-end brands and Wayfair Professional are still in early days compared to our US business. We see a strong trajectory for each.

As these businesses eventually ramp up to the middle of their S curves, we expect the next initiatives will be right in line to follow a similar pattern. In totality, we believe that this will give us the legs to drive considerable share outperformance in the years to come. And as the category returns to stable footing, push our aggregate growth rate comfortably back into the double digits.

This also means that we will be vigilant about tracking their performance against our investment thesis. As we operate the business over a multiyear period, we'll concentrate our focus on growth drivers, delivering well over 10% top line growth, with significant flow-through to EBITDA, and we won't hesitate to shift course if a driver is not delivering as we expected.

That goes back to where I began today, the concept of execution. We see this as the key theme of 2023, but not one that goes away as the calendar turns over. Even with a turbulent macro, we remain committed to being adjusted EBITDA profitable in good times and bad. We'll continue to drive peerless focus and execution into 2024 and beyond, as we push every day to be the number one shopping destination for the whole.

Thank you. And now let me turn it over to Kate.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

Thanks, Niraj, and good morning, everyone. The third quarter was an exciting continuation of our profitability journey we laid out on this call last year. So let's dive into the details. Net revenue for the third quarter came in at \$2.9 billion, up 3.7% year-over-year, with our US segment up by 5.4% in spite of the increased slowness in the category. Niraj spoke about the major moving pieces here as it pertains to our KPIs. Order momentum showed nice double-digit strength, up 14% versus 2022, while AOV came down by about 9% against the same period.

All in all, we see this as important progress as our business builds momentum. Orders today are the best indicator of orders in the future, and we're encouraged by the improvement as we see shoppers increasingly returning to Wayfair for their needs across the home.

I'll now move further down the P&L. As I do, please note that the remaining financials include depreciation and amortization, but exclude equity-based compensation, related taxes and other adjustments. I will use the same basis when discussing our outlook as well.

Gross margin had another quarter of standout strength, landing at 31.2% for the period. There are a few moving pieces to unpack here starting with our efforts at pulling costs out of the system. We've talked about our cost efficiency efforts at length, so I won't repeat all the details now. But the important piece to remember is that our operative goal is to maximize multi-quarter gross profit dollars. To that end, we did carefully redeploy some of the savings dollars into the customer experience, with the goal of driving results that would show up not just in Q3, but also Q4 and even into next year. This was augmented by better-than-expected performance across our merchandising efforts, including strong results from some higher margin classes in addition to benefits from the profit-aware sorts that Niraj spoke about in May.

Moving further down the income statement. Customer service and merchant fees came in at 4.4% of net revenue. Advertising came in at 11.4% of net revenue as we drove improved efficiency across our paid channels, in part supported by the learnings from the advertising holdback tests we performed in the second quarter.

Rounding out the cost line, our selling, operations, technology, general and administrative costs, or SOTG&A totaled \$459 million for the third quarter. As we discussed back in August, you were seeing steady improvement on this line as we push for continued spending discipline each quarter and our goal to drive further leverage.

In total, we delivered \$100 million of adjusted EBITDA for the third quarter for a 3.4% margin on net revenue. This was another strong quarter of profitability for Wayfair and a reflection of the work we've done to rebuild our cost structure across the business. To put the significant progress we've made here in perspective, this is over \$220 million more of adjusted EBITDA and nearly 800 basis points higher adjusted EBITDA margin than we reported in Q3 of 2022.

Our US segment generated \$123 million of adjusted EBITDA for a 4.8% margin, and our international segment adjusted EBITDA losses continued to show improvement at negative \$23 million for Q3. We ended the third quarter with \$1.3 billion of cash and equivalents and \$1.8 billion of total liquidity when adding in the capacity from our undrawn revolving credit facility. Net cash from operations was \$121 million, which was offset by \$79 million of capital expenditures. The net of these was \$42 million of free cash flow during the quarter.

Now let's turn to guidance for the fourth quarter. Starting with the top line, quarter-to-date, we are seeing gross revenue trending close to flat year-over-year, and we would expect to end the quarter in the flat to positive low single-digit range. We anticipate AOV to show further compression in the fourth quarter versus 2022. Though this should likely be the trough on a year-over-year percentage basis, we expect that AOV will continue to be offset by strong performance on orders as we expect to once again pace above the category on unit growth.

Moving now to gross margin. We will guide you to a 30% to 31% range. We are continuing to move our guided range higher as a reflection of the structural improvements in our gross margin that we've achieved through our operational cost savings efforts. Our customer service and merchant fees line should once again be in the range of 4% to 5% of net revenue and advertising should be in the 11.5% to 12.5% range again as well.

We forecast SOTG&A, excluding stock-based compensation and related taxes to come in between \$455 million and \$465 million, as we continue to run the business through the lens of cost efficiency. If you follow this guidance, we would expect adjusted EBITDA margins for the fourth quarter to be somewhere in the low single-digit range, making clear and steady progress to our goal of sustainable mid-single digits before turning to the subsequent goal of 10% plus margins that we detailed at our Investor Day.

Now let me touch on a few housekeeping items. Equity-based compensation and related taxes of roughly \$140 million to \$160 million, depreciation and amortization of approximately \$103 million to \$108 million, net interest expense of approximately \$4 million to \$5 million, weighted average shares outstanding of approximately 118 million, and CapEx in a \$100 million to \$110 million range, based on the timing as we get closer to the launch of our flagship Wayfair store.

Given our expectation for sequential revenue growth in the fourth quarter, we would also anticipate that working capital is a source of cash in the period. As such, we would expect another quarter of positive free cash flow to round out the year.

Before I wrap up, earlier, Niraj walked through a few of the biggest strategic questions on investors' minds. And I want to do the same with a couple of the financial questions we've been hearing. Coming off our Investor Day in August, we heard many of you ask about the timing of our margin drivers, especially as it pertains to the pathway we described as we journey from a mid-single digits adjusted EBITDA level to one north of 10%.

We broke this pathway down into five components on the slide in our presentation. And I'll start by talking about the first three, which are all contributors to gross margin. We largely think of these as independent of core revenue growth as the biggest driver here of supplier advertising will be achieved through scaling penetration within our existing sales base.

Logistics will be driven by further cost savings as we achieve new levels of efficiency in our supply chain, in tandem with increased adoption of our fulfillment solutions by our suppliers. The remaining 100 basis points to 200 basis points of gross margin potential comes from a combination of merchandising and mix, achieved in large part by expanding the mix of our sales coming from more margin accretive businesses like our higher end retail brands and our professional platforms.

Beyond gross margin drivers, we talked to two more pieces on the path to 10% plus. We expect to drive 100 basis points to 200 basis points of advertising leverage coming from a combination of our own efforts to push for higher efficiency in our paid channels, as well as the normalization of the mix between free and paid traffic to our category. Some of you have asked if this is the floor on advertising as a percentage of net revenue, and to that I would say no. We have framed this journey around a discreet set of goalposts and expect advertising to come down by 100 basis points to 200 basis points on the pathway to 10% adjusted EBITDA margins. However, our business certainly has the potential for margins well in excess of that, and you can expect that we will give more clarity around what the pathway to a higher margin looks like as we get closer to the 10% mark.

That leads SOTG&A, which is the one step of the path that is primarily driven by revenue leverage. You've heard us say it many times, but I'll repeat it once again. Going forward, you should expect us to take a very deliberate approach to the size of this line item in reflection to the growth of revenue. While we haven't given any guidance for 2024, the one anchoring item I can offer is that whatever you're modeling for revenue growth, you should be modeling SOTG&A growth less than that.

Finally, the one other big question we've gotten since the event has been around our capital structure. As I mentioned during the day, we're excited that our profitability milestones have opened a new set of doors for Wayfair from a financing perspective. Our upcoming maturity include the remaining \$117 million due on our 2024 convertible notes and the \$754 million that is left on our October 2025 notes. The 2024 notes have a strike price of \$116 per share, but we've said that even if those notes don't end up converting, we intend to pay them down with cash from our balance sheet.

The 2025 notes have a strike price of \$417 per share. So while we remain optimistic about the potential for our stock, we are planning around how to handle them in the absence of conversion. This will involve some combination of paying down with cash from our balance sheet, as well as refinancing. With a wider suite of options available to us, we intend to be thoughtful around exploring options in the debt markets and are quite cognizant of the trade-offs between convertible and high-yield debt.

As I wrap up, I want to return to the discussion of execution that Niraj touched on earlier. Over the past 12 months, our relentless focus on cost control has enabled us to deliver consistently improving adjusted EBITDA. As we look ahead to 2024, I want to be clear that our operating mindset remains the same and we expect to deliver substantial adjusted EBITDA growth, even if the environment gets more complicated. We've demonstrated throughout 2023 that we know the right levers to pull to deliver profitability growth. As we shared at our Investor Day, ultimately, we are committed to delivering on mid-single digit margins and then eventually 10% plus. All with the goal to maximize free cash flow generation over time.

Thank you. And now Niraj, Steve and I will be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Chris Horvers with JPMorgan. Your line is open.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

Thanks and good morning. So one question, two parts. So first, on the fourth quarter, is there a reason why we wouldn't see some sequential improvement in the adjusted EBITDA rate? I know you talked about low single digit, but you continue to gain traction in the initiatives that you're referring to and some of the cost savings still have yet to flow through, I think, in the P&L.

And then as you think about next year, I think you made a comment earlier this year that at this current level of business, you should reach mid-single-digit adjusted EBITDA. So you think about an environment that's maybe a little bit tougher. If we just held these revenues, do you get to perhaps the lower end of that range?

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

A

Hey Chris, good morning. You have both Niraj and Kate here. Maybe I'll just start on speaking to the guidance for the fourth quarter. And then as we think into sort of how some of this flows through for next year. And then Niraj, I'll pass it off to you. On the fourth quarter, you started Chris with saying you've continued to achieve those cost savings. And certainly, we feel very good about the progress that we're making there. And you can see some of that in the guidance. We obviously continue to up the gross margin guidance range. We've continued to bring down the SOTG&A guidance range, and that's reflective of those initiatives panning out.

If you look at Q4 specifically, what we're reflecting there is, as we've spoken about in the past on the gross margin, we're really trying to maximize growing gross profit dollars on a multi-quarter basis. Q4 tends to be a great quarter for us to bring new customers in. It's a highly promotional quarter. It's a great time for us to get somebody on to the platform and then they come back and repeat and spend more dollars with us. And so, we're just balancing those pieces as we think about, in particular, that gross margin for the fourth quarter.

If you think about sort of 2024, obviously, we haven't guided to that, but perhaps I can provide reflecting on that thought model that we spoke about before, I can maybe sort of reference that and speak to how that might plan out in your sort of flat revenue example there. You're absolutely right that you should expect to continue to see ongoing improvement in EBITDA, and that's really driven by a few factors.

We started the year saying we were taking out about \$1 billion in cost. If you start on that gross margin line, we said we'd achieve over \$500 million taken out of that line in 2023. And you will see that by the end of this fourth quarter, where we'll reinvest some of that.

But let's say, for this example, you take the exit rate of the fourth quarter on gross margin and use that in 2024, that would be a nice step up from where we were in 2023. If you look at the next line item on CS&M, we spoke about taking some of the cost out of that in that January restructuring that you did. You've seen that moderate nicely throughout this year.

Again, you could take sort of where that's landing and assume some further improvement there in 2024 as those cost actions fully materialize and you've got the appropriate leverage there. Then if you move down to ad spend, that's one where we said in that over \$1 billion cost takeouts, we were pulling out some of the higher advertising spend as a percent of net revenue investments. And I think if you look at sort of the average of 2023, that place is reflective of the efficiency that we've been driving in that line. So again, in your model of flat revenue in 2024, you could probably use that.

And then if you go down to SOTG&A, you've seen some really big movement on that line throughout 2023, obviously, starting with those January restructurings and the full impact of that run rating through less the combination of the incremental movements that we've made on that line quarter-on-quarter. Obviously, you saw that materialize again this quarter with that \$459 million and the further efficiency we're driven there.

So again, if you look at full year 2024, you could take the exit rate of that in the Q4 of 2023 and apply that into full year of 2024, and you'd see really nice flow-through. And as I said in the prepared remarks, substantial EBITDA growth just from those cost savings fully run rating through. So I think you're thinking about it in a very productive way. Obviously, you'll make your own assumptions around where revenue goes. But I believe we've demonstrated this year, we're very committed to these levers and pulling the right levers to drive EBITDA growth.

Niraj S. Shah

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

A

Yes. Maybe I'll just jump in a little bit. This is Niraj and just to add a couple of more thoughts. Because as Kate said, we're definitely committed to strong adjusted EBITDA regardless of the macro. And I think we're well poised for that because if you think about – we talked a lot about the cost savings, Kate kind of recapped a lot of what we've done.

But just the operational cost savings wasn't a onetime thing. There's a – we just started working on our plan for next year, and there's a lot more to come. So, there's a lot of gains.

Now that will drive EBITDA, which is sort of what your question was about. But on top of that, I will encourage you to kind of just think about what's happening in the business because as you pointed out, there's nice momentum but what is that momentum like? If you look sequentially, order – you see orders are up year-over-year, 14%, you see sequential active customers from quarter-to-quarter up 2% that's poised to turn positive, right? We just had a great Way Day 2.0. You see the share we're taking is from a broad range of market participants. And so when you start adding up, okay, well, you're seeing this momentum in customers. You're seeing it manifest in order growth.

Order growth would be revenue growth if AOV were flat. AOV is at negative 9% this quarter, but that's almost through because basically, as you finish – going to finish the rest of the curve, you're basically down to all the inflation having been driven back out, which we're pretty far along on, so there's a lot of positive momentum. And I know you're [ph] pausing (00:31:09) to say, well, let's ignore that, let's say, revenue is flat. But I would just point to that momentum as well when you think about it. But I think, if you just say revenue is flat, then you can think about all the things we've been doing as well as all the savings that are yet to come, and then I think that's the answer.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

Thanks very much.

Operator: Your next question comes from the line of Maria Ripps with Canaccord. Your line is open.

Maria Ripps

Analyst, Canaccord Genuity LLC

Q

Great. Good morning. Thanks for taking my question. I just wanted to expand on your Q4 guide. I guess are you seeing any deceleration in consumer spending so far in Q4 versus Q3? Or I guess, what's driving this sort of modest deceleration in year-over-year growth rates? Is that largely coming from lower prices or sort of – I guess, are you seeing any maybe consumers trading down to lower-priced items or any weakness in large parcel purchases? If you can comment on that, that would be great.

Niraj S. Shah

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

A

Hi Maria, it's Niraj. Let me – so I mean, I think your question is basically the year-over-year revenue growth number Q3 to Q4. And what I would say, like, first if you take a step back and look at what we're guiding for Q4 compared to Q3. If you look at it sequentially, a normal holiday ramp, as you'd expect Q4 to be bigger than Q3 by 9%, 10%, something like that as a holiday step up. And what you'll see in our guide is we've stepped up revenue from Q3 to Q4 growing it by 7% or 8%, I think, in the guide.

And so we're actually guiding the holiday ramp. But maybe you say a little muted. But it's in the normal band. And so why a little muted? Well, we're in a promotional environment, and most of the revenue in the fourth quarter is always ahead of us. But in this case, when you do it on a promotional adjusted basis, it's virtually all ahead of us. We've had one promotion so far, which was Way Day 2.0, which performed very well, in fact, beat our internal forecast and expectations. So, we're seeing all the signs that say that, that will work. But we have that ahead of us. So we're guiding it slightly muted, but still with an eye to say we think we're going to do very well. There's a lot of growth there, and we're going to take share.

Now, year-over-year, your question is why does that compress then if you're guiding it positively? And the answer is, if you remember, when we got the recipe back intact and we started taking share and we were back to good form, that was at the end of summer, beginning of Q4 last year. So this Q4 will be the first year you're comping year-over-year on us being back to a strong position, the same way for 19 years, 17, 18 years before COVID, we grew the business from zero share to the \$9 billion we had in revenue pre-COVID.

Well, so we're back intact, and we're growing. So the way to think about it is, of course, you'd have a slight kind of a compression of the year-over-year rate before it would then expand again. And what you'd really care about is, hey, are you taking market share? What's the sequential customer number look like? Hey, where am I in this AOV annualizing? Because then the order growth is basically the revenue comp. And I think if you look at it that way and kind of analyze, okay, what's the momentum in the business, you obviously see the momentum is gaining.

If you look at it year-over-year, you then need to adjust for what happened in the third quarter last year, what happened in the fourth quarter last year. I think that's where the noise comes in. So, I'd encourage you to look at it both ways. And I think if you look at it sequentially, you'd say, oh, wow, these guys are really and then what's a tough market? These guys are really kind of moving along really well. They're well positioned for meaningful growth when the category recovers. And in the meantime, they're getting significant share gains. It's driven by the order strength. And on top of that, we talked about how we're committed to strong adjusted EBITDA regardless of the macro. So I think you're seeing it all come together there.

Maria Ripps

Analyst, Canaccord Genuity LLC

Q

Got it. That's very helpful. Thanks so much.

Operator: Your next question comes from the line of Ygal Arounian with Citigroup. Your line is open.

Ygal Arounian

Analyst, Citigroup Global Markets, Inc.

Q

Hey. Good morning guys. Maybe just digging in on the customers and AOV and the macro environment a little bit. As AOV normalizes here and you're seeing that kind of deflationary point, do you see that driving any of the incremental customer growth and order growth, meaning is prices normalizing driving a better environment, if you could just parse that out a little bit?

And then you guys did a good job kind of highlighting a lot of the questions you got from investors and one of the main ones that keeps coming up on our end from investors that you didn't address is just on international and continuing to see headwinds there and challenges related to that market, still not getting back to normal. Maybe if you could address your views there and if that's changed at all as we maybe get into a softer environment here? Thanks.

Niraj S. Shah

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

A

Sure. Let me start, and then, Kate, if you have anything, you can just jump in and add it. So let me do the first question first and then we'll do the international one second. So first, I think you have a question around AOV normalization and does that drive order growth? I think the way to think about it is, the AOV normalization, what that is showing you is that things are getting back to normal. What does normal mean? It means that no retailer has an advantage over the other on relative price, relative availability, relative delivery capability other than what they themselves are doing, okay?

During COVID, people had weird advantages depending on how they were set up, were the brick and mortar or were they online? Do they happen to buy inventory and carry four months of inventory, three months or six months normally versus that? And those odd advantages because of the scarcity of goods have really abated. So, everyone is in a great position now. Everyone is in a great position on price. Everyone is in a great position on availability. Everyone is in a great position on delivery. The question is what can they do with it? So now what you're seeing is retailers are competing with each other, the same way, in our case, they would have from 2002 to 2019 on the strength of what they're offering customers.

And so now what you're seeing are the results that basically show up based on everyone competing with each other and so who can put forward the best offer for the customer. And it's not to say that online beats offline because in our data, we tracked about 90 folks, we only see 3 if you look back to the 2019 period through now, having taken share. You see us taking significant share, you see Amazon taking share, and you see HomeGoods taking share.

HomeGoods is really a brick-and-mortar retailer. In fact, they pulled out of online recently, but I think it was kind of a de minimis piece of their business, but they're the ones they outcompeted Bed Bath. And as Bed Bath went out of business, they took that share. So there are different ways to get share. And that's what you see playing out.

So the way I'd encourage you to think about it, we're in a tough recession environment, that's 2 out of every 10 years. The market's down mid to high teens in dollars. There's that deflation that everyone has, so orders are not down by quite that much. But if you think there's 10 points of deflation, orders might be down 5% or something, maybe 7%, maybe deflation is 12 points. There's some mix in there. But you see our orders up 14%. So you see

us kind of gaining ground in the market. You see sequentially customers up 2%. So you're seeing them increasingly picking us. You're seeing that in the market share data. So think of it as we're in a normal environment, and we have been for approximately a year. And what you're now seeing is which retailers can take share in that environment.

And if you track dozens and dozens of them and listen to their strategies, you can see then in the results, how that's playing out. And I think that's going to continue to play out, both in this recession environment, but also as the category recovers, you're going to say, who's well positioned for meaningful growth. That's where you're going to see that we're very well poised for that. And so that's what you're going to see happen.

But in the meantime, we're going to keep taking share. And that's why you say why are we committed to strong adjusted EBITDA regardless of the macro? The answer is, well, we're gaining momentum and share in a tough market, and we have more cost savings coming. So we can do well now. But all that does is position you better for when things turn around and things really rip. And it's all getting – the share gain driven by order strength is really the thing to keep coming back to. Kate, anything on that before we go to that second part?

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

A

Yes. No, I would echo everything that you've said. I think you're absolutely right that AOV normalization certainly has driven order growth and customers. You've seen that sequential improvement in customers in the LTM active customer number. And you've, of course, seen that order growth number continue to grow.

I'd just point out on the last point Niraj was making on, on market share and where the category is, we're obviously up 4% in the quarter with the category down mid- to high teens. If you assume at some point when the category returns to growth and normalizes that gives you very significant growth for us up in the high teens. And as we've spoken about before, that flows very nicely through to EBITDA, and we're poised for that momentum. I think you had another question on the international segment.

Niraj S. Shah

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

A

Yes. Exactly. So on that, let me – again, I'll start Kate, and you can jump in. That segment is like 10% to 15% of our revenue or thereabouts. Those are – that's kind of the businesses outside the United States. And we mentioned how getting back to form on our recipe is the predecessor activity for taking share, gaining ground. And again, you'll see the share gain is driven by order strength and you'd see all the positioning that you'd want to see in terms of how we're doing.

Well, on that, what I would say is that each of the countries is a different state and the recipe fully being back intact. But as we've been getting it back intact, we're seeing the momentum we want. And so, what I would point out is that the KPIs that we would use to measure the success of those businesses are not necessarily evident to you. And honestly, we're very focused on making sure that every dollar we spend goes really far.

And so we're not interested in continuing to invest in something that we don't think is going to give us a gain, and we've done a good job of stripping out a lot of those costs, and we'll continue to do that. But we are pretty excited about our smaller businesses, whether it'd be Perigold, which is in the luxury space, small but it continues to take share at a nice pace. What we've done with specialty retail brands, which compete in the specialty segment. Wayfair Professional is one of the bigger of the smaller businesses that's clipping along nicely and then the international countries. And so we believe that the same model works there. There's a bit of a lag in timing. But

again, you see losses compressing. And what I think is, I would say that folks are focused on that segment. It's a little bit of missing the forest for the trees is kind of my view on it.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

Yes, I think that's right. I would just add that there's nothing that we structurally see about the international market that suggests it should operate over time in any way that's different than the nice EBITDA that you're seeing in the US market, and we'll continue to invest for growth there, of course. But we also were mindful of the cost structure there. And as we spoke about in general, we took out these costs. Those impacted us globally, not just in the US.

Ygal Arounian

Analyst, Citigroup Global Markets, Inc.

Great. Thanks guys. Appreciate it.

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

Anna Andreeva

Analyst, Needham & Co. LLC

Great. Thanks so much and good morning. Thank you for all the color guys.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

Good morning.

Anna Andreeva

Analyst, Needham & Co. LLC

Two questions from us. You mentioned some of the category callouts with mattresses and also pets. Just curious in aggregate, how did big ticket versus smaller, more decor type of items perform during the quarter? And is the decel you're seeing quarter-to-date driven by slower big-ticket purchasing, just given the macro?

And then secondly, as a follow-up to Chris' earlier question. So should we think if revenues are flat in 2024 year-over-year, you could be at the low end of that mid-single-digit margin goal that you guys talk about? Thank you.

Niraj S. Shah

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

Yes. Let me start with some of your questions on big ticket versus small ticket and then maybe Kate can answer the guidance question. When I say on big ticket versus small ticket, you can see this – well, I guess, maybe you can't see this in AOV because again, you see the overall effect of the deceleration – not deceleration, the normalization of AOV with the inflation turning into deflation and coming back out.

Basically, no, there's no real mix effect there. So we're seeing strength across the board. Part of that is the price elasticity. When that big item, which typically is bulkier and has a high ocean-freight factor gets hit with those costs, it really drives up the price of that item a lot. When that comes back out, that item becomes more price attractive that basically helps that item take share. So we've basically done well across the board. There's no real mix there.

And then you mentioned a deceleration in Q4. I just want to comment again. If you look at it sequentially, you see a strong holiday ramp into Q4. So I think the deceleration is based on assuming the year-over-year comps in Q3 and Q4 were both normal flat comps, and they're quite different from each other because, again, Q4 last year is when we started taking share as a much stronger comp. So as you would expect, even if we have strong comps continuing, that compresses before it expands again. That's where the 2% sequential customer count, the strong order growth, but all these other numbers kind of point to what I think is really happening.

So just keep that in mind. I would model it sequentially. You can also model it top down. But if you model sequentially and then impute year-over-year, I think you see a better trend of what's happening, and it sort of explains what I think otherwise may not. And then so I'll let Kate comment on that, and then Kate can also comment because you had a question about in 2024, what level could EBITDA be given revenue at the low end. I think that's probably because as we mentioned, there's a lot of cost savings still to come. And so I don't know if you want to guide that or not.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

A

Yeah. And as you know, we don't guide to 2024. I would point you to following Chris' question, I think we talked through some of the puts and takes on that thought model. And really seeing in 2024, obviously, the full impact of that over \$1 billion of cost savings up and down the P&L and work with that sort of from gross margin on down and the benefit of that should certainly drive substantial EBITDA growth beyond that, we haven't commented on 2024 guidance.

Operator: Your next question comes from the line of Simeon Gutman with Morgan Stanley. Your line is open.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Q

Hey thanks, good morning everyone. I want to ask a question about – little bit about the fourth quarter and then second about your posture around, I guess, promotion and ad spend versus sales. So first, the fourth quarter the chances of it getting more promotional, curious how you think about that? And then given your posture around margins, I guess, preserving margin over sales here, it sounds like you wouldn't dip your toe into that, but can you give us a sense how vendors are approaching it? Would you share some promotion versus them? And then in terms of advertising, are you inclined to ramp that up if you saw that market share was getting worse for some reason because of the promotional backdrop?

Niraj S. Shah

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

A

Yes. Thanks, Simeon. So what I would say is that we are expecting Q4 to be promotional. And that's part of why our guide on the sequential ramp of that 7% to 8% instead of 10% is a little more conservative is obviously it's hard with the promotional season really ahead of us other than Way Day 2.0. Way Day 2.0 beat forecast, did very well. So that was a positive sign.

That said, you have the whole kind of holiday season more or less ahead of you. And there's – the macro, it's hard to read the headlines and say, oh, this is a boisterous time where everyone's jubilant, right? So, I would say, we are expecting to be promotional. Our merchandising calendar, everything we've worked out with suppliers, our merchandising plans reflect what we expect to be a very promotional season. If you pull up the home page of any of our sites, you can get that feeling right now, pull up any of the apps. So you can see that we're leaning in on that and we're set up for that. All the guidance already accounts for that.

Now could it be more promotional than we're expecting? It's possible, although we feel like we have a good feel of what's happening in the markets. If it is more promotional, do we think that would hurt us? Well, who knows? I think we've got a very good posture, and this is why we've taken share over the last year to gain back anything we lost and then a lot more than that, right? We're at all-time high. So, I think we're set up really well.

Ad spend, we do not think of as something you just use as a dial to make yourself feel good on revenue. So we've really scrubbed ad spend to make sure every dollar works really hard for us. So we would spend dollars if we would think that the return we would get would be at that higher threshold that we've now established. But we're not going to – it's not – the outcome is not measured in market share.

Market share is something you then end up getting if you did it well. And so ad spend is yet another cost line that we expect to work really hard for us. And then as you can tell, we've reduced it. So obviously, revenue growth would be even far higher than it is now if we didn't reduce it. But we think it was the right move to make – expect every dollar to work harder. We're going to keep that expectation. We're seeing good results from that expectation. So that's the way we think about that.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

A

I just – I'll add one thought on the promotion piece because I do want to point out that even if the market does get more promotional, our gross margin is resilient. So unlike other retailers where you're taking inventory and you're discounting that that you've already acquired, in our case, typically our suppliers are reducing wholesale and we're passing on that benefit to customers. But you've seen throughout the year that our gross margin has actually grown even in the face of that because it's not coming from us dropping that price. And so I just – that is a bit of a nuance to our model, and I think one of our benefits, frankly, in our structure.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Q

Thanks guys. Good luck.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

A

Thank you.

Niraj S. Shah

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

A

Thank you. The other obvious point too is that obviously the inventory in the supply chain, the inventory we're selling is owned by our suppliers as well, which is a slightly different dynamic than most retailers. But I think that partnership with our suppliers is part of why we win as well.

Operator: Your next question comes from the line of Oliver Wintermantel with Evercore ISI. Your line is open.

Oliver Wintermantel

Analyst, Evercore ISI

Q

Yes, thanks. You guys did a great job in the repeat customer or from repeat customers growing again, but that would imply that the orders from new customers continues to decline year-over-year. Could you address that? Or when do you think that, that improves? And what can you actually do to improve that? Thank you.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

A

Yes. So I guess the overall point, and Niraj, feel free to jump in, is that sort of we are very excited to see repeat customers growing. I think that speaks to the strength in the model and the benefits that we're getting as – or the percentage of repeat growing. I think that speaks to the strength of the model and the benefits that we get as people experience the improved offering and come back and shop with us again. As far as what does that foretell for new customers? Certainly, we're not seeing any weakness there. And in fact, LTM active customers is actually growing sequentially. So our overall customer base is improving.

Niraj S. Shah

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

A

Let me just – sorry, Kate, let me just chime in a couple of things and then you keep going. But – so that repeat percentage, right, so 80% of orders are repeat orders, that is of all customers who bought ever, okay? And so obviously, we've been around for 20 years. We have a lot of customers. If you bought ever, you're in that number as a repeat order. The active customer number means you have to have bought within the last 12 months. So you could have people who bought in 2015. And if they buy again after being unengaged for eight years, it would still be a repeat order. But they would come into the active customer number after not being there.

Same thing if they weren't – if they didn't buy in 13 months, they would also come back into the active customer number. So you need to look at those two numbers in different ways. There's still a lot of new customers for us to get, and we're going to – we expect to get them over time. But there's a lot of people we've encountered over time. And so that active customer number is kind of this engaged base. They have to be bought within the last 12 months. Are they buying? And then obviously, if they buy again and they buy again, that's the flywheel that drives the business. That's where I mentioned, there's a 2% sequential growth in the active customer number. That number is poised to turn positive. And we are still, at this point, only getting \$550, I think it's \$540 per customer per year. So we still have a very low share of wallet. So, that's where there's a lot of juice.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

A

I agree with all of that. And Oli, just one thing I want to point out. I think you implied that new customers were weakening. But we don't – we give you the KPIs and then you have to do a little bit of math. And so recognizing that we've been on the call for 55 minutes, you probably haven't been able to do the math. But if you take the percentage of repeat and then back into what that implies for new orders, you'd actually see new orders growing quarter-on-quarter. So you would see – oh, sorry, growing year-over-year. So you'd see that nice improvement actually in new orders and new customers. And we continue to be excited about what that implies for the strength of the offering.

Niraj S. Shah

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

A

Right. So new orders is over – it's like 2-ish million. And so basically – ye, that's why I was trying to explain the definition of the active customer numbers separate from the repeat order stat because you could actually figure out a lot if you use them, but you have to understand how they're defined separately from each other. So we're

gaining a lot of new customers. But what I think is even more exciting than that is, frankly, that the customers we have are being engaged in coming back to that active customer number.

Oliver Wintermantel

Analyst, Evercore ISI

Got it. Thank you, very much and good luck.

Niraj S. Shah

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

Thank you.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

Thank you.

Operator: Your next question comes from the line of Jonathan Matuszewski with Jefferies. Your line is open.

Jonathan Matuszewski

Analyst, Jefferies LLC

Hey good morning and thanks for taking my question, it's on gross margin. So for three consecutive quarters, you've exceeded the high end of your guide on this line item by an average of around 90 bps. So just curious kind of what are your assumptions underpinning 30% versus 31%? And why should the 4Q result not top the high end of your guide considering the recent trend? Thanks so much.

Niraj S. Shah

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

Sure, Jon. Obviously, one thing you keep in mind, there's a different mix of goods that are sold each quarter, which creates some gross margin changes as well. But let me turn it over to Kate for the specific information on the guide.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

Yes. I think what you're seeing there is, again, nice flow-through of those cost savings that we laid out at the beginning of the year. We said in the second quarter that actually flowed through a bit faster than we had anticipated, and so we reinvested some of that in the third quarter. And we intend to be mindful of how we make that investment. We want to be maximizing gross profit dollars over a multi-quarter basis.

In the fourth quarter, as Niraj mentioned, seasonally, there's some impact there. It's also a great quarter to bring people onto the platform. We just had that discussion about new customers. It's a great quarter to bring new customers in and get the benefit of those customers over time. I will point out, you also, of course, saw us bring up the guidance range. So we remain confident in the direction that gross margin is going, and we're really excited about what we've been seeing there.

Jonathan Matuszewski

Analyst, Jefferies LLC

Thank you.

Operator: This does conclude the question-and-answer session. I will turn the call back to the Wayfair team.

Niraj S. Shah

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

I just want to say sort of thank you to all of you. We're obviously very excited for the holiday season. We're excited about the share gains we've had, the order strength, the momentum, the profitability growth, kind of the positioning we have for increased profits and everything. We thank you for your interest. And with that, we'll see you next quarter.

Kate S. Gulliver

Chief Financial Officer and Chief Administrative Officer, Wayfair, Inc.

Thank you.

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

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