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# Wayfair, Inc. (W)

Q3 2015 Earnings Call


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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, ladies and gentlemen. My name is Sean, I'll be your host operator on this call. At this time, I'd like to welcome everyone to the Wayfair Q3 2015 Earnings Release and Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

At this time, I'd like to introduce Kate Gulliver, Head of Investor Relations at Wayfair. Please go ahead.

## Kate S. Gulliver

*Head-Investor Relations*

Good morning, and thank you for joining us. Today, we will review our third quarter 2015 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co-Chairman; Steve Conine, Co-Founder and Co-Chairman; and Michael Fleisher, Chief Financial Officer. We will all be available for Q&A following today's prepared remarks.

I'd like to remind you that we will make forward-looking statements during this call regarding future events and financial performance, including guidance for the fourth quarter of 2015. These statements are only predictions based on assumptions that are believed to be reasonable at the time they are made and are subject to significant risks and uncertainties. You should not rely on these forward-looking statements as representing our views in the future. Except as required by law, we undertake no obligation to publicly update or revise these statements.

Our actual results may differ materially and adversely from any forward-looking statements discussed on this call. For a discussion of factors that could affect our future performance, results and business, please refer to our annual report or Form 10-K, our quarterly report or Form 10-Q, which we expect to file in the near future, and other reports we have on file from time to time with the SEC.

Also, please note that during the course of this conference call, we may discuss certain non-GAAP financial measures as we review the company's performance. Please refer to the Investor Relations section of our website to obtain a copy of our earnings release, which contains descriptions of our non-GAAP financial measures and reconciliations of non-GAAP measures to the nearest comparable GAAP measures. This call is being recorded, and a webcast is available for replay on our IR website.

Now I'd like to turn the call over to Niraj.

## Niraj S. Shah

*Chief Executive Officer, Co-Chairman & Co-Founder*

Thanks, Kate, and thank you all for joining this morning. We're excited to announce that the business continue to experience accelerating revenue growth this quarter with the total business up 76.7% year-over-year to $594 million in revenue. Our Direct Retail business grew 90.9% year-over-year to $545 million. This is the fastest year-over-year growth rate for the Direct Retail business since Q4 of 2013, and represents three quarters in a row of accelerating growth.

As a reminder, our Direct Retail business consists primarily of sales from the websites and apps of our five brands, Wayfair.com, Joss & Main, AllModern, Birch Lane, and DwellStudio. Wayfair.com is by far our largest brand and its trajectory is the primary driver behind the Direct Retail growth rate.


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Many factors contributed to this phenomenal growth rate including the day-to-day improvements we make to our site, and our ongoing efforts to provide best-in-class customer experience from product selection to delivery, and also the improving strength of our brand.

This quarter, our Aided Brand Awareness reached 67%. This is compared to 52% in the same quarter a year ago. Our multi-channel advertising efforts including television, display and social are driving the steady increase. And while we are pleased with the improvement, we believe there is still significant opportunity to further grow our awareness.

We ended the quarter with 4.6 million active customers, an increase of 60.6% from Q3 2014, and a net increase of approximately 547,000 active customers from the prior quarter. This is almost 100,000 more net new active customers than were added last quarter. Orders from repeat customers represented 55.2% of total orders, and annual orders per active customer increased to 1.69 from 1.67 in the prior quarter.

Our history of driving new customer growth and repeat customer growth is continuing its phenomenal trajectory, as seen on the updated charts we posted to our IR website. This quarter, we added a new chart to more clearly show the breakout between orders from new and orders from repeat customers. In Q3, orders from repeat customers grew an incremental 173,000 over the prior quarter.

As we said since before our IPO, our investment strategy is simple. On one hand, we are investing in advertising to acquire high-quality new customers. And concurrently, on the other, we are investing in the site experience, merchandising and operations to grow repeat orders. Combined, this creates the flywheel that drives our strong revenue growth and the long-term leverage in the business.

As just described, there are multiple ways we work to improve customer satisfaction, and in turn, drive repeat business. One specific lever is our loyalty program. Historically, this program was largely based on Rewards Dollars that customers could apply to future purchases. We knew we could offer a more comprehensive loyalty program to our shopper that is better tailored to her needs and desires. In October, we took the first step in revamping this program with the launch of our private-label credit card, which provides benefits such as Rewards Dollars and financing on purchases.

We're particularly excited to be able to offer financing on large purchases. In our category, customers are frequently shopping high-ticket items. And it's been customary for years in retail to offer a financing option. Over time, we hope to roll out more specific benefits and personalized offerings to our cardholders. We've partnered with Alliance Data on the card, and as typical of these partnerships, Alliance qualifies the customers and takes all risk on payments. We think the private-label card is a strong start to an enhanced loyalty program, and we're excited about the launch.

Before handing the call over to Steve, I want to touch on our holiday plans. Last year, we expanded our holiday promotions with improvements across assortment, merchandising, visual imagery, product discounts, and marketing activities, allowing us to unlock a previously untapped seasonal sales lift.

Historically, we had not viewed our category as one that had large seasonal potential. Furniture and décor are not traditionally gift items. And we are very excited about the work our team did last year to capture the seasonal demand.


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We took the learnings from last holiday, and used them to refine our overall promotional calendar for 2015, by adding events, developing proprietary imagery and content and working with our suppliers to source the best products and prices for our customers.

Accordingly, we've seen strong revenue growth from these seasonal events throughout 2015. Most recently, in Q3, we had a highly successful Labor Day weekend event. But, of course, many of these seasonal promotions occur in the fourth quarter. And we're excited to build on the learnings from last year for this holiday season.

This year, we started holiday events in early October, a few weeks earlier than in 2014. And we'll be promoting a broader assortment of relevant offerings including decorative accents, seasonal décor and an extensive collection of housewares across a more in-depth and integrated marketing campaign that combines television, display, personalized e-mail and direct mail.

We're excited about how the season has started. And we believe we have a fantastic line-up. However, since most of the revenue from holiday is generated later in the quarter, it's too early to tell how this season will compare to last year. We look forward to sharing the results with you on our Q4 call.

I'd now like to hand the call over to Steve to update everyone on some exciting engineering and technology developments.

## Steven K. Conine

*Co-Chairman and Co-Founder*

Thanks, Niraj, and good morning, everyone. One of our goals at Wayfair is to offer the customer an easy and convenient shopping experience wherever she may be, at home, at work, running errands, watching TV. An easy-to-use and engaging mobile site and app for each of our brands is a key part of this approach, and our engineers regularly refine our mobile product and explore ways we can offer a unique experience to our customers on phones and tablets.

This approach is working. In Q3, 35.1% of the orders in our direct business were completed on a mobile device compared with 28.7% in Q3 2014. Although, we have mobile sites or apps for all our brands, much of this growth is due to the success of our Wayfair.com app. Our iOS app was originally released in March 2014. In July of this year, we hit 1 million downloads. In recent months, we've seen accelerating app interest and are now approaching 2 million total downloads. The app has become a key channel for repeat customer engagement and sales.

From a technical and customer experience perspective, we are constantly innovating and updating our apps. We've updated our iOS app 30 times since launch, including as recently as last week when we deployed a redesign that incorporates Apple Pay technology to further streamline the mobile shopping experience. Our Android Wayfair app, launched in May of this year, has already been updated 24 times.

Increasingly, we are looking to offer unique content and products on our app. Beginning this year, Wayfair.com app users will have access to exclusive products and early access to our Black Friday and Cyber Monday sales. Eventually, we believe, the app can offer the customer novel ways to engage with us, and enhance the shopping experience. We're able to maintain this pace of development and innovation across all our business because of the scale and growing team of over 400 engineers and data scientists.

I'll now turn the call back over to Niraj.


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## Niraj S. Shah

*Chief Executive Officer, Co-Chairman & Co-Founder*

Thanks, Steve. Our apps help to round out the customer experience and support the strong Direct Retail growth rate. Overall, our efforts in merchandising, marketing, site experience, customer service, supplier integration and logistics, all powered by technology, are combining to offer a world-class customer experience across multiple platforms and geographies.

I'll now hand the call over to Michael to walk through the financials.

## Michael D. Fleisher

*Chief Financial Officer*

Thanks, Niraj. And good morning, everyone. As always, I will highlight some of the key financial information for the quarter with more detailed information available in our earnings release, which can be found on our IR site.

In Q3, our total net revenue increased 76.7% year-over-year to $594 million. As Niraj described, this growth was driven by our Direct Retail business, which increased 90.9% over Q3 2014 to $545 million.

Our other business, which includes revenue from our small media business and from our retail partners declined as expected 3.3% over Q3 2014 to $49 million. Our gross profit for the quarter, which is net of all product costs, delivery and fulfillment expenses, was $141.4 million or 23.8% of total net revenue. This is compared to 23.5% in the same quarter last year and 24.6% in Q2 2015.

As we shared on the call last quarter, we believe gross margins should be between mid-23% to low-24% over the near-term, as it is the right, long-term strategy for the business to invest in the customer experience today, across price, delivery and service, to create even more loyal customers. Going forward, we expect margin to be similar to where it is this quarter.

The remaining financials, I'll share on a non-GAAP basis, excluding the impact of equity-based compensation and related taxes, which totaled $8 million in Q3 2015 and $0 in Q3 2014 as the IPO did not occur until early in the fourth quarter of 2014.

Post the IPO, we recognized equity-based compensation each quarter in all line items that have head count. For a reconciliation of GAAP to non-GAAP reporting, please refer to our earnings release on our Investor Relations site.

Customer service and merchant fees were 3.5% of sales compared to 3.7% in Q2. This cost is largely variable and should continue to run in the high 3%s to 4% of sales going forward. Advertising spend was 11.9% of revenue in the quarter or $70.7 million.

Year-over-year, advertising spend as a percentage of sales improved 290 basis points from Q3 2014 when it was 14.8% of revenue. This continues the trend we've seen throughout 2015 of year-over-year ad spend leverage each quarter, as we benefit from the investments we've made in advertising to build our brand and acquire new customers.

As you heard from Niraj, we added approximately 547,000 net new active customers this quarter, roughly 100,000 more than we added last quarter. We're excited about the success that we've seen with our marketing efforts to-date, and we'll continue to invest where we see appropriate paybacks, as we believe it's the right long-term strategy for the business.


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Overall, customer dynamics remain incredibly strong. LTM net revenue per active customer increased 8.5% to $371 annually, and LTM orders per active customer grew to 1.69 from 1.65 a year ago. Orders from repeat customers were 55.2% of total orders and up 173,000 orders sequentially.

As you can see in the updated cohort chart, we've posted to accompany this call, repeat dynamics across all our cohorts remain strong, with cohorts as old as 2011 and 2012 experiencing improving repeat dynamics due to the improvements in our site experience, merchandising, and customer experience.

Even after four years, we're seeing an increase in the monthly revenue per customer over the last year as they experience all the investments we continue to make in the site and customer experience.

Our merchandising, marketing, and sales spend on a non-GAAP basis was $23.7 million or 4% of net revenue compared to $13.4 million or 4% of net revenue in Q3 2014. Non-GAAP operations, technology, and G&A expense was $36.7 million for the quarter or 6.2% of net revenue compared to $25.2 million or 7.5% of net revenue in Q3 2014.

As we explained last quarter, these two line items are primarily head count, and the increase in spend both on a year-over-year basis and on a quarterly basis is due to the ongoing investment in our teams. As our expanded recruiting team has ramped up, we've been able to accelerate our hiring pace, adding over 390 net new employees in the third quarter. Even with this increase in hiring, we did see overhead leverage due to our significant revenue growth.

We expect our head count and operating expenses to continue to catch up some during the next quarter, as we have ramped up our hiring to meet the higher levels of growth of the last several quarters.

Adjusted EBITDA for the quarter was negative $1.4 million or negative 0.2% of net revenue compared to negative $18 million or negative 5.4% of net revenue in the same quarter a year ago. The year-over-year improvement in EBITDA margin was driven by the ongoing leverage in both advertising spend and operating expenses. As I stated on this call last quarter, I want to be clear that while we've seen greater flow through over the last few quarters, we plan to continue to invest in advertising and head count to effectively grow and manage the business.

For the second quarter in a row, non-GAAP free cash flow was positive at $35.3 million. This positive free cash flow was driven by net cash from operations of $51.5 million, primarily as a result of the favorable working capital dynamics in our business. This strong free cash flow was despite our $16.2 million investment in capital expenditures for the quarter.

Our inventory level with $22.6 million, only 1.2% of LTM sales roughly consistent with last quarter. It's important to note that while total net revenue increased over $250 million from last year, inventory only increased by $1.4 million. Non-GAAP diluted net loss per share was negative $0.13, $83.9 million weighted average common shares outstanding. As of September 30, 2015, we had approximately $400 million and cash, cash equivalents in short and long-term investments.

Overall, we're very excited with our third quarter results and continued strong revenue growth from both our new and repeating customers. Now, I'd like to discuss guidance for Q4 2015. The good news is, we have a business with extraordinary strong accelerating growth. The bad news is, this makes my job of giving guidance very difficult. We forecast Direct Retail revenue growth of $575 million to $610 million, a growth rate of approximately 66% to 76% year-over-year.


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As we did last quarter, I want to provide a little more color on this growth rate. Currently, Q4 quarter-to-date, we've experienced a similar retail growth rate as that in Q3. Of course, in the fourth quarter, revenue is more heavily-weighted towards the back half of the quarter for holiday shopping. Therefore, it's difficult to predict the full quarter at this stage.

As you heard from Niraj, we anticipate very strong holiday performance based on all the work the team has done. But we also had an extremely good holiday last year, and we'll be comping off that strength. As always, we're attempting to be thoughtful in setting our guidance based on what we've seen quarter-to-date, while also taking into account all the other factors of being a retailer where the customer has to show up every day.

We forecast other revenue to be between $50 million and $55 million for a total net revenue of $625 million to $665 million. We forecast EBITDA margin of negative 0.75% to negative 1.25%. As I've said before, we are catching up on our operating expenses as we've ramped hiring to meet the needs of the accelerating top line growth.

We anticipate that our expanded recruiting team will continue to catch-up during the fourth quarter, so we're guiding EBITDA margins taking that into account, as well as our continued investment in ad spend.

For modeling purposes for Q4 2015, please assume equity-based comp expense of $12 million, average weighted shares outstanding of 84.2 million, depreciation and amortization of approximately $10 million, and CapEx of approximately 3% to 4% of sales, roughly consistent with recent quarterly CapEx trends.

As a reminder, because we don't invest in physical stores or inventory, our capital requirements are very low, resulting in strong free cash flow and enabling investment in high ROI initiatives, like improvements in our site experience and the speed, quality and efficiency of our delivery process.

CapEx in the near-term is primarily related to the scaling of our supply chain infrastructure, including warehouses in our distribution network, and of course, our ongoing engineering investments.

Now, let me turn the call over to Niraj before we take your questions.

## Niraj S. Shah

*Chief Executive Officer, Co-Chairman & Co-Founder*

Thanks, Michael. This call is our fifth earnings call as a public company, following our IPO in October of last year. We're extremely pleased with the performance and trajectory of the business over these past five quarters.

The Direct Retail business has continued to accelerate with its fastest growth rate since Q4 of 2013. Our customer base gets stronger every day with increasing numbers of new customers trying our site for the first time, and existing customers engaging with greater frequency and increasing spend. All of this has occurred in the context of leveraging ad costs and improved profitability.

As excited as we are about the past five quarters, we're even more excited about the future. The home space represents an enormous market opportunity that we are just beginning to tap, and we believe that Wayfair can be the leading destination for all things home.

We'd be happy to now take your questions, so I'll turn the call over to the operator.


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# QUESTION AND ANSWER SECTION

**Operator**: Thank you. [Operator Instructions] Your first question comes from the line of Neely Tamminga from Piper Jaffray. Your line is open.

Neely J. N. Tamminga
*Piper Jaffray & Co (Broker)*

Q

Great. Good morning; and congratulations on a solid performance. I've a question and then a follow-up, if I may. On the first question Niraj, we flipped through the slides, and we saw the slide referring to the 2011, 2012 cohort spending back up.

It's really impressive. What we're trying to figure out, is she just like naturally gravitating back to the site? Is she clicking through e-mail? Kind of what is the customer cost of that re-acquisition or re-engagement, re-spending, I suppose is what we're trying to figure out. Then I'll have a follow-up, if I may.

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

A

Sure, Neely. Thanks for your question. Yeah. So, the way to think our business, obviously revenue is growing very nicely and you've seen revenue growth actually accelerate now for a few quarters in a row, obviously that acceleration cannot continue forever. But the reason we've been accelerating while ad cost has been coming down is actually because the repeat business actually runs at a very low ad cost relative to new business. So what happens over time is just that that mix shift is actually what drives down the ad cost as a percentage, even though we actually have more dollars in an absolute amount to acquire more new customers.

For the 2011 and 2012 cohorts there, those cohorts sort of predate the Wayfair brand being known. And it's important to note that those cohorts have a much smaller number of people in them than the 2013, which has less than the 2014, which has less than the 2015. So not only – those lines going up, not only does that represent cohorts that are more valuable on a per person basis, but actually, frankly, the more recent cohorts are much larger than the older ones. So, actually the momentum you see there is actually kind of multi-fold in terms of its value to us.

Michael D. Fleisher
*Chief Financial Officer*

A

And Neely, it's Michael. The only other thing I might add is, you've seen us over the last year continue to make a huge investment in the site experience. And even our most – our oldest cohorts of 2011 and 2012 customers, they're getting the benefit of that site experience, right? So, when they come back, the ease of shopping, how easy it is to find things, all of those other great things that we've invested in, that's paying off in terms of lifting their revenue as they sort of – it's easier to find something, make that purchase or sale.

Neely J. N. Tamminga
*Piper Jaffray & Co (Broker)*

Q

That's helpful. It's logical, but it's helpful, just to make sure we have that framed up there. And then just a follow-up here; look, there's been some noise in the press, as recently as I think last night related to a foreign vendor that I think your company and others carry. Could you comment on some of the – the overall situation as well as


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whatever potential impact there is in your business? I guess just a bigger, higher level question here is what is your general approach to vendors around safety and compliance type issues? Thanks.

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

A

Yeah. Sure, Neely, yeah. Thanks for the question. So, we carry a big selection, as you know, 7 million items. And I think some of the other folks mentioned, Walmart, Home Depot, these are all folks who carry a big assortment of items, along with Amazon. And so, our approach is actually to be very thorough in worrying about the safety of the products we sell. In order to do that, we do a few things. One is all our suppliers, we have supplier agreements with them, we have indemnification agreements with them, we have certificates of insurance from them, we have detailed product information. We specify it down to the various regulatory bodies, whether they be local, state or federal, what pieces they comply with or if items don't comply so that we can then take the appropriate steps in terms of whether we offer them or not. And that's how we're able to make sure that the products are of high quality and meet all the guidelines.

The other thing we do though, that not many people do, is that we do not source items directly from the factories that they're made overseas. So we're sourcing from folks who are the distributors and the actual product designers, who are generally American and European companies, who are then sourcing in Asia. And so, we have an additional layer of QA/QC that a lot of the other retailers, who are directly sourcing, may not have except through their own QC personnel who would be on site. So, that's our approach, it's been pretty thorough. It's worked quite well.

In terms of that article, that refers to laminate wood flooring, and that's a category that's been featured prominently in the press, because of Lumber Liquidators, who I think had a fairly extensive problem of their own sourced product. And for us, it's important to note, laminate flooring is a really small category. So laminate flooring, it's 0.02% of our sales. So that's two one-hundredths of a percent of our sales, which is about – the number I have is just under $400,000 year-to-date in that whole category, and a lot of that product comes from large producers like Armstrong and Mohawk.

And so Ark, for example, which is the brand that that article mentioned, we've had 10 orders from Ark in total for this type of product. And similar to what we always do, we made sure that the product complied, and then there was a point in time where the manufacturer actually told us that they were discontinuing the product. So, we actually pulled it at that point, which was even before the New York Times got interested in the product. So, we like to be very thorough there, and that process which was set up and honed over the years we think has worked very well. We've had millions and millions of orders, and we've been able to really avoid problems.

Neely J. N. Tamminga
*Piper Jaffray & Co (Broker)*

Q

Thanks, Niraj. Best wishes to you guys with holiday. Thanks.

Michael D. Fleisher
*Chief Financial Officer*

A

Thanks, Neely.

**Operator**: The next question comes from the line of Matt Nemer from Wells Fargo. Your line is open.


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Matt Nemer
*Wells Fargo Securities LLC*

Q

Good morning, and congrats on a great quarter. My first question was – I wanted to talk about the potential residual impact of the unseasonably warm weather in the U.S. It doesn't seem like it's impacting you. But we are seeing a lot of promotional activity in terms of fall décor and decorative accessories. I'm just wondering if you think that that will impact the overall home furnishings complex this fall given that we're kind of breaking 50-year records on temperatures?

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

A

Yeah. Sure, Matt. Thanks for your question. Yeah. Kind of a few thoughts I'll give you on that. One is, obviously, we can be much more agile and nimble than most other retailers, because we do not take inventory positions. So in other words, if we take an inventory position and we're an inventory-based retailer, and we made a mistake where the weather trends don't support the right product mix, relative to what we thought, we then are stuck with that inventory. We have to put it front and center in our stores until we can get rid of it. And so, we may then be pushing the wrong goods.

We don't do that, right. So, we focus – and we actually assort on a personal basis for folks using our personalization technology, and we create a tremendous amount of content. And so, as a result, what happens is, we're always leaning forward on the right product for the customer regardless of what that may be, and regardless of how that may change.

But the bigger point I'll tell you is that, whether it's the weather seasonal patterns or whether it's housing getting stronger or slowing, none of that in our mind affects anyone in online. Everyone in online has the benefit of basically a market that's growing at a 15% growth rate versus a brick-and-mortar market that's growing in an average year at 2% and in a good year maybe at 3% or 3.5%. If you're growing at 2% or 3%, I mean, that rate is so low that you frankly get affected by those things.

But if the overall average is 15%, and online where there's folks who are going to take big share and folks who are not going to get that share, frankly, it's all about whether or not you're the person doing the best job for the customer. And so here where our direct business grew at 90%, which would be six times the online growth, right.

You're not going to really see swings affected very much by a seasonal weather pattern or by these very sort of micro-specific effects or even by the macroeconomic effects, because frankly, whether the market grows at 2% or 3%, that 15% is basically saying that people are stopping going to brick-and-mortar stores. And they're increasingly going online because of all the benefits. And so, we just can't – we just don't see trends like that. And we don't believe they affect us very much.

Matt Nemer
*Wells Fargo Securities LLC*

Q

Makes sense. It doesn't sound like an issue. And then secondly, I'm wondering how big of a hurdle to conversion financing has been historically as you survey your customers and what – how much of a benefit the new ADS program could be particularly in terms of larger orders.

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

A


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Sure. Yeah. So, it's always hard to know the answer on something like that. Basically, what we know is that financing, obviously, is an additive, right? So, for some folks, it doesn't matter to them. And for other folks, it does matter. And for the folks for whom it does matter, you're giving them another tool from which they can buy from you.

In terms of the size of that, we've done work to understand our customers' interest in financing. But I wouldn't say that we've been able to turn that into a size-type number that is precise at all. What we know is that, there's just things that increase the customer experience with us, that offer the customer more options and more benefits. This is one of them. And we know that our loyalty program in general, we have a pretty good roadmap of where we want to take it.

And we know that the version we had in the past is a pretty basic one, where we're simply offering straight-up rewards to everybody for buying from us. That's a relatively weak version on a relative basis to what we're now working on. So, we know the new program is a significant benefit. But I really don't have a sizing estimate for you.

Matt Nemer
*Wells Fargo Securities LLC*

Q

I guess, put another way, is it fair to say that in the month of October, since you launched that program, you've seen a benefit to conversion from it? Do you get offered the card at some point in the funnel?

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

A

Sure. So, we're now offering the card to folks. But just like anything new, its current effect is tiny, right. So, the effects of these things tend to grow over time. And so, today's effect is actually very, very small.

Matt Nemer
*Wells Fargo Securities LLC*

Q

Okay. Make sense. Good luck during the holiday.

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

A

Thank you.

Michael D. Fleisher
*Chief Financial Officer*

A

Thanks, Matt.

**Operator**: Your next question comes from the line of Seth Basham from Wedbush. Your line is open.

Seth M. Basham
*Wedbush Securities, Inc.*

Q

Thanks a lot and good morning. My first question is on your guidance. I just want to make sure I understand it. It looks like from a revenue standpoint, you're looking for higher revenues versus the third quarter. But from an EBITDA margin standpoint, a little bit lower. I understand that you're investing in people. I'm trying to understand where else there's a big delta between Q3 and Q4 on EBITDA margins?


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Michael D. Fleisher
*Chief Financial Officer*
A

I think the biggest delta, Seth, is in people as we continue to accelerate our pace of hiring. As we mentioned last quarter, we're adding – we added to our recruiting team and this past quarter in Q3, we added 390 net new people. So, you can sort of see that ramp growing as we try to sort of meet the needs of the accelerating growth rate of the business. So, I think piece number one is catch-up there.

And then the second thing is, we will continue to spend on the ad spend line, and we've talked about that before. We expect to continue to see a bridge there as we've noted before. But we think that the customers we're bringing in, and you can see that in the cohort work and the number of repeat orders, all the customers we're bringing in are doing exactly, if not even better, than we anticipated. And so, continuing to spend on the ad spend line in order to bring in more of those customers makes a lot of sense.

Seth M. Basham
*Wedbush Securities, Inc.*
Q

That's helpful. So, you're still on track for at least breakeven EBITDA in 2016?

Michael D. Fleisher
*Chief Financial Officer*
A

Yeah. I think what we've said in the past is, by the end of 2016, that's our goal.

Seth M. Basham
*Wedbush Securities, Inc.*
Q

Got it. Okay, and then secondly, my follow-up is on shipping. There's been a lot of talk in the marketplace around FedEx and UPS raising shipping rates, particularly for companies that have a lot of people with third parties associated with shipping. Can you give us some insight into whether or not you think there's going to be a big effect on your business?

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

Sure. This is Niraj. Well, I'll tell you – so, we're obviously a large shipper. We're a large shipper of both small parcel items for which we use UPS and FedEx, and for large parcel items for which we have a different freight network. And as you would expect, at the scale that we ship at, we have deep relationships with these folks. We have very nuanced contracts. We have our own transportation operations, where we move product in advance of tendering into these carriers.

So, what I'll tell you is that, these types of developments that you're seeing, where they're changing rates, the effect that they would have on us is not something that we would tell you given there's any pause in the sense that, we tend to think about where these things are headed, well in advance, we understand them. And then, how we operate with these carriers is not the same kind of off-the-street rate structure that someone gets if they sign up for a new account.

Seth M. Basham
*Wedbush Securities, Inc.*
Q

Got it. That's helpful. Thanks a lot. And good luck in the fourth quarter.


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Michael D. Fleisher
*Chief Financial Officer*

A

Thanks, Seth.

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

Oliver Wintermantel
*Evercore ISI*

Q

Yeah. Good morning. I had a question on the average order value. It increased by about just over 8%. That was the fastest growth that we've seen so far. It was flat in the second quarter. Can you give us some more details on what drove that growth?

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

A

Yeah. Sure. So, what I'll tell you – so here's the thing. We don't really worry about the AOV. And by that, what I mean is that, we're doing a tremendous amount of things to be the customers' go-to for larger parcel items like sofas and bedroom sets and things that would drive up the AOV.

We're also doing a tremendous amount to really become a leader and be the go-to place in categories like basics and seasonal décor and decorative accents and housewares, and all of these things drive down the AOV.

So the number we're really interested is, if you look on like slide 20 on the in the slide deck we posted, and we've updated this every quarter, we drive this net revenue per active customer, annual net revenue per active customer. We're really looking to grow that. So we're looking to grow our share of the customer – of customers' wallet with us, and whether we do that by adding some incremental small purchases or by adding incremental large purchases, we're pretty agnostic, because we want to just be the customers' go-to in home.

So what I think has been driving up the AOV is that, the strength of the Wayfair brand and some of the things we've done on the merchandising side, on the delivery and logistic side have increasingly made us the go-to place for furniture and larger décor items.

At the same time, we're having really good success in these smaller items, and so these gains largely offset each other. They drive up this total net revenue per active customers, the green bars in the bottom of slide 20. And they cause the repeat, really metrics to look great, which is what accelerated growth in the Direct business to the 91% to 90.9%.

But the numbers we really care about is, we care about the customer spend with us, and the retention, the repeat characteristics. And as long as those keep going the right way, whether AOV goes up or down, we think doesn't matter.

Oliver Wintermantel
*Evercore ISI*

Q

Okay. Great. Thanks. And I just had one on the equity-based compensation. I mean, there was – the last two quarters was about the $3 million shy of what you guided to, and the third quarter it looks like there's a step up from your guidance. Can you maybe explain why the numbers were $3 million lower in the first quarter and second quarter? Thanks.


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Michael D. Fleisher
*Chief Financial Officer*

A

I think the equity-based comp pieces, we're trying to give a big round number for everybody for modeling purposes, and then the actual, obviously, is tied to all the movements, in and out of people.

There was a little bit of – with the Australia deal. We sold the Australia business in the second quarter, and then some into the third quarter – of some of that equity-based comp rolling in during that period, because we accelerated some of those people's equity. But otherwise, there's no other sort of unusual or anomalies there.

Oliver Wintermantel
*Evercore ISI*

Q

Thanks. Good luck.

**Operator**: Your next question comes from the line of Paul Bieber from Bank of America Merrill Lynch. Your line is open.

Paul Judd Bieber
*Bank of America Merrill Lynch*

Q

Good morning. Thanks for taking my questions and congratulations on a good quarter. I was hoping you can provide some color on accelerating growth of active customers? Are you finding efficient online marketing channels or do you think the TV advertising is contributing to the acceleration?

And then secondly, by my calculations, contribution margins improved year-over-year? Can you just provide some color and context on what's driving the improvement in contribution margins?

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

A

Sure. Let me answer the first part around accelerating revenue growth and the active customer number. So I think it's important to note, there are couple of things. So, one is – I wouldn't talk about TV per se, but I would talk about the brand awareness, right, which is the function, TV is one of the main drivers of that.

And the Aided Brand Awareness, we cited that during the call, and the 67% there, that's continued to climb over time. And we think, that obviously has very strong benefits for folks deciding to buy from us and folks thinking of us top of mind.

The other thing I'll point out is just the way that you kind of, think about active customers, right, you actually give credit when they first buy. But if you think about, from a marketing standpoint, the way it works is, at some point, they see our advertising, they become aware of us. They then may start visiting the site. Perhaps, they download the app or perhaps they sign up for the e-mail list or bookmark our site, and they start coming back. And eventually, they make that first purchase.

And so, the timeframe that they're engaged before they buy from us is a period of time that generally the quantitative metrics don't look at. And so, what I would point is just, as we're engaged with more and more people, and they're coming back to our site more and more often, the brand is getting stronger and stronger. It seems logical that more and more of them would tip towards buying from us, particularly as they more likely have a friend who's bought from us, who had a great experience and told them about it or whatnot.


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And then, obviously, if they have a good experience and they really enjoyed it, and then it's reinforced by what their friends are saying. It's reinforced by what they're seeing. They're obviously going to become more likely to come back. And if we're doing a good job at merchandising all these categories and improving the delivery experience, everything – it becomes more likely, they'll come back more and more often, right?

So, that whole continuum is the story and that beginning piece really starts before they first buy. And so I think that's sort of why it seems more stark when you just look at as a quarter standalone, because you're not thinking of kind of the accumulated benefit.

Michael D. Fleisher
*Chief Financial Officer*
A

Hey, Paul, it's Michael. On the contribution margin question, I think if you look year-over-year, gross margin this quarter, of 23.8%, we talked a lot about this last quarter. It is now kind of in the place we think it should be, right? I think we've been clear, sort of mid-23%s up to 24%, so I think we're right in that zone right now and feel good about that. Obviously, that's a little bit better performance than Q3 last year, which was 23.5%.

And then on the customer service and merchant fees piece, obviously, also rolling in a contribution margin. I think last year Q3 was a bit of a high watermark. This quarter at 3.5%, as I noted in the top track, I think, is a little bit low, and I think we should, people should anticipate that, that will be sort of high 3%s to just under 4%, and that's sort of the normal range. It really is a variable cost, but it's somewhat tied to how many people you have onboard and how you're staffing your customer service operation in anticipation of upcoming holidays or additional staffing – and teams you want to put in place. And so, there's a little bit of lumpiness in that as well.

Paul Judd Bieber
*Bank of America Merrill Lynch*
Q

Okay. Thank you.

**Operator**: Your next question comes from the line of Aaron Kessler from Raymond James. Your line is open.

Aaron M. Kessler
*Raymond James & Associates, Inc.*
Q

Yes. Hi, guys. A couple of questions; first, can you just talk about, what percentage is proprietary product assortment today, and kind of where you view that going longer-term? And second, just maybe in terms of traffic sources, maybe direct versus indirect traffic, and how that's been changing over the last year? Thank you.

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

Sure, Aaron. This is Niraj, a couple of thoughts. So, on the proprietary product assortment, I think we've referenced that on prior calls. We didn't give a specific update on this call. But what we've said in the past is that, it's relatively small portion of total revenue, but growing it at a good speed, and that's from a – kind of a verbal. That's the same thing I would say today, is that's continuing to grow nicely. We're certainly very much believers that, that's a great opportunity for us.

I will highlight, we do it in a way that does not have us carry inventory, which we believe is very novel and unique and will accrue significant benefit to us. And we believe it's actually proving that it does. But we don't have specific number to update you on this call, but we will periodically give you updates on where that is quantitatively and very happy with how it's growing.


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On the traffic side, the Direct versus Indirect; again, I don't have specific numbers for you, but the thing I'll tell you is that, a lot of what you're seeing in the numbers is because it's being driven by the repeat. The repeat is driven by a low ad expense, as I mentioned, which is what drops ad expense.

Well, the reason it's driven by a low ad expense is because a lot of these folks are just proactive with coming back to our site, either because of downloading the app, they either go to it automatically, or they have app notifications or they're on the e-mail list, and they're getting e-mails, or we're just more top of mind, or they're engaging in our editorial content.

And so, it's just a combination of things basically causes the Direct to continue to grow. We obviously do advertise a fair bit. So that supports the Indirect, but, frankly, the Direct is taking share. You can almost think of it as kind of Direct being something of a proxy of repeat and Indirect being a proxy of new. That's not technically correct, but that's a similar philosophically to what's happening.

And if you look at slide 21, if you downloaded that presentation, which is a new slide we added, all we did there was chart the number of orders that are new versus the number of orders that are repeat by quarter, which technically would've been numbers that were available, but we never turned it into a chart.

And what you see there is, you do see the repeat line really break out on trajectory from the new line. The new line keeps the same trajectory it's had, but you see how repeat is really inflecting up. And I think that is – even though it's not the answer, it's almost the answer to your question about traffic sources.

Aaron M. Kessler
*Raymond James & Associates, Inc.*
Q

Okay. Great. And just finally, any product categories you would highlight in the quarter that were strong or is it kind of across-the-board strength in the quarter? Thank you.

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

I'd say it's across-the-board strength.

Aaron M. Kessler
*Raymond James & Associates, Inc.*
Q

Got it. Okay. Thanks. Good quarter.

Michael D. Fleisher
*Chief Financial Officer*
A

Thank you.

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

John Blackledge
*Cowen & Co. LLC*
Q

Great. Thanks. Just a couple of questions. So, just to clarify, in 4Q quarter-to-date, Direct Retail revenue was growing in line with 3Q growth, or around 91%. And also, do you think the increased focus around the holidays in


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integrated marketing campaign could perhaps drive accelerating top line growth from this point through quarter-end?

And then, just for the 4Q EBITDA guide, what are the biggest kind of swing factors for it to possibly be positive? Thank you.

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

So, John, I'm really excited to hear how Michael answers that question, so I'm going to turn it over to him.

Michael D. Fleisher
*Chief Financial Officer*
A

Hey, John. So, yes, that is what I said in my talk track about how Q4 is running quarter-to-date versus Q3's performance. I think the swing factor – well, look, I think on the holiday, the reality is, we don't know. We've done a ton of great work. The team has done an amazing job getting us ready for holiday. Obviously, early results in the quarter-to-date look fantastic. But as I noted in the talk track, we are comping off a really strong holiday last year when we really got focused on sort of holiday promotions. And so, it's just – it's too early to tell at this point exactly what the impact is going to be of that.

And then, look, I think on the EBITDA side, obviously, revenue upside has the potential to flow through at a higher rate to the EBITDA line. At the same time, we are – we continue to be very aggressive in terms of our hiring plans in order to make sure that we've got all the team staffed to continue to serve our customers in the way we're used to serving our customers. And continue to invest for the future as well, particularly on the ad spend line, right. As everyone is aware, the ad dollars we spend today aren't necessarily generating a customer instantaneously, right. We're introducing a customer to Wayfair who buys over time and then continues to buy in repeat. And so, there's that side of it.

And then the other side of it is continuing to invest in people on sort of the OpEx line, whether it's engineers who are building the next pieces to our product or new product additions or making the customer site experience even better and better. And those are people that we're going to add today that are really going to show up in repeat rate of customers a quarter from now, two quarters from now, three quarters from now. So that investment is going to continue. And so it's – that's really what you're seeing in the Q4 EBITDA guide.

John Blackledge
*Cowen & Co. LLC*
Q

Okay. Great. And maybe just one follow-up. Longer-term, given that the repeat customer rate – I think it accelerated from a growth perspective this quarter; like that's better maybe than what you thought a year ago. And so, longer-term, you guys have always said kind of like 8% to 9% EBITDA margin is the right number to think about. Is it perhaps better with – theoretically, better repeat customers than you guys thought a year ago or when you talked about that number? And then also just much higher top line. The top line trajectory in market share is much greater. Thank you.

Michael D. Fleisher
*Chief Financial Officer*
A

Yeah. So look, our long-term EBITDA margin target has been 8% to 10%. There's nothing we would see that would change our view that that's sort of where we're driving to over the long term. And I think, the repeat metrics we're seeing, how customers are coming come back, how they're sort of recognizing the great site experience, customer


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service experience, all of that is kind of as we anticipated, when we sort of put those together. And as Niraj mentioned earlier, there's obviously a much, much, much lower cost of advertising to get a customer to come back, because we know who they are. We have their e-mail. We can connect with them through the e-mail and the apps.

And so, I think that follows along and to us, in many ways starts prove out what we believe is the long-term thesis when we understand and dig in to what it cost to get the customer to come back. It really proves out the long-term thesis around being able to get to that 6% to 8% ad spend in the long-term model.

John Blackledge
*Cowen & Co. LLC*

Q

Thank you.

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

A

Thanks.

**Operator**: Your next question comes from the line of Debra Schwartz from Goldman Sachs. Your line is open.

Debra R. Schwartz
*Goldman Sachs & Co.*

Q

Hey, great. Thanks. And congrats on the quarter. Two quick questions, first on vendor services, can you talk a little bit about some of the initiatives that you have around fulfillment and vendor services? How far along are you; what you expect the impact to be on ship times and particularly into holiday? And then second question on free cash flow, Michael, you're now free cash flow positive. Any reason to think that you're not sustainably free cash positive from here? Thanks.

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

A

Hey, Deb. It's Niraj. I'll answer the first part and then turn it over to Michael. Yeah. So, on – your question was around vendor services, fulfillment, ship times and the like. We actually have a multi-year track record now of decreasing ship times. And I think when we went public, people were surprised that our lead time for something to leave a warehouse was already down to just over two days, and that was considered really good. In our mind, we wanted to get it down further and further over time, and we continue to march along that roadmap. And we also, obviously think about when it delivers, and we're working on really reducing that significantly.

And so, a lot of what we're doing on the operations side is around that delivery experience, which is basically a function of the time it takes for delivery; on large parcel it's a function of also how it's delivered and the customer experience associated with that. And on the small parcel side, obviously we use UPS and FedEx for that. And so, it's really being tightly integrated with them. And so, we keep making tremendous headway there.

Michael D. Fleisher
*Chief Financial Officer*

A

And Deb, on the free cash flow question. So, we're obviously, as we're running sort of right at or very close to breakeven at this point, the business is sort of comfortably free cash flow positive. The one thing I would note though is, we do have a working capital cycle and a seasonality to that, right, particularly in Q4, where we sell a lot towards the end of the quarter, and then end up paying out to suppliers in January. And so, there tends to be a larger positive free cash flow in – because of the working capital swings in Q4, and then a negative working capital


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outflow in Q1. But other than that, I think we're – based on where we're at from an EBITDA perspective, I think we feel pretty good about the positive free cash flow we're putting on the board.

Debra R. Schwartz
*Goldman Sachs & Co.*

Q

That's helpful. Thanks. And just a quick follow-up to the first question, Niraj, what I'm referring to a little bit more is some initiatives we've been hearing from vendors about storing inventory in your fulfillment centers. Can you talk about how much of a focus that is for you?

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

A

Yeah. Sure. So the way we think about the world is that, a lot of traditional retailers focus on just going directly to the factories and sourcing goods themselves. They orient around a narrow selection, they take inventory and that traditional model focuses on lowering their first costs as much as possible, and basically try to push the gross margin up as much as possible.

The thing about that is, that's predicated on a world where narrow selection is efficient. Our belief online is that, wide selection is much more beneficial. So our whole model is about being tightly integrated with suppliers, to where we can have a much wider selection. We can lean on the supplier to basically do a lot of product development, and do the sourcing, procurement, and do that into the supply chain.

And then the place where we meet is the domestic logistics, and then, obviously, we're doing all the marketing, merchandising, customer service and that end experience for the customer. And that partnership with these key supplier partners of ours, we think is a big piece of what's fueling our success, in terms of giving the customer such a good experience.

So to that end, one of the things we do is, we do provide a lot of the distribution and logistic services to basically provide that seamless end-to-end experience, because that's the integration point where we work with these suppliers, and so we have definitely have been ramping that up over time, and for really the suppliers we're tight with, we do focus on basically providing that operational capability to them in the same way that we don't want them doing customer service, we don't want them needing to do lot of merchandising work, we want to do that.

We similarly want to control this piece of the experience, and let them focus on what they're great at, which is really this product sourcing and product development piece. And so we have been growing that substantially.

Debra R. Schwartz
*Goldman Sachs & Co.*

Q

Great. Thank you.

Michael D. Fleisher
*Chief Financial Officer*

A

Thanks, Deb.

**Operator**: Your next question comes from the line of Michael Graham from Canaccord Genuity. Your line is open.


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Michael Graham
*Canaccord Genuity, Inc.*

Q

Hi. Thanks. Two questions, please. The first, just a bigger picture one on – on the addressable market. If you could just give us a quick refresher on, the $60,000 to $175,000 household, like, how many households do you think that is in the U.S., and how deeply do you think you can penetrate that? And maybe just, do you have any comfort that you're not about to hit an early adopter cliff, which I don't take you are, but some are saying that.

And then, second question is just, if I could ask on 2016, for any kind of preliminary content or comment, you're growing revenue in the 90% range, looks like consensus has you growing in the high 20%s next year, and I'm just wondering is there anything structural in the business that would make the growth rate slowdown that much? Thanks.

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

A

Sure, Mike. So, this is Niraj. On the addressable market question, let me just give you a couple of numbers. So, first, the wider definition we'd use the addressable market is $50,000 household income to $250,000. If you use that, it's 60 million households. If you narrow it in to what you mentioned, which is $60,000 to $175,000, you would narrow it into about 45 million households.

So, the way to think about it roughly is that 4.6 million active customers, and you then think about the U.S. households I mentioned, we really do not have very much penetration at all, particularly when you think about what we are, right?

Wayfair is an everyday store. The everyday store model is the primary commerce model that captures the bulk of the market. So, specialty models tend to play at the fringes, but they have a hard time scaling up.

So a lifestyle retail play like a Pottery Barn, a Restoration, they tend to get small pieces of the market. It's something like online, these private sale models. They tend to get small pieces of market. But then, if you look at, like the targets in the Home Depots and these mass retailers, they tend to get big chunks of the market. And it's because of the everyday store and nature of it.

And so we have a variety of models, but Wayfair is an everyday store, so we tend to think that it, based on its also ability to provide the selection, the merchandising and the experience can be the customers' go-to in home. So in other words, when we start thinking about the 60 million households, we think that, we can be the customers' go-to in the majority of those households. So 4.6 million, we think we're still pretty in the early days.

The other thing I'd point to that supports that is slide 18. If you look at the cohorts on slide 18, I agree with you that you always would worry about a diminishing return on your next customer, and at some point that, you know that you're saturating your TAM.

What slide 18 shows that I think is really interesting is that, despite the size, the $2.4 billion run rate we're now at as of this last quarter, if you look at that slide, you'll see that the newer cohorts are far more productive than the older cohorts. And that's kind of been sustainably proven over a period of time. That chart now runs out, right at about – just under five years of history.

And so, what I think you're seeing is that, we're still in the early part of that adoption curve, and there's still far more households to get before we reach any sort of diminishing return problem which would imply that saturation is a real thing.


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On 2016, I'll let Michael answer it more fulsome. But I think to be honest, the biggest thing is, while revenue growth can't keep accelerating, I don't think most of the folks who cover us have updated their models for 2016.

Michael D. Fleisher
*Chief Financial Officer*
A

Yeah. Mike, I think the key thing is, I guess I'm hopeful that with the Q3 numbers now done, and Q4 guidance out there that everyone will start to really look at their 2016 number, there's nothing to your question, there's nothing structural that would cause – I think cause a lower, that low a rate in 2016.

And I think, what you really have is, a situation where most of those model haven't been updated in quite some time. But hopefully, now, everybody has got a sort of clear picture of what 2015 looks like, and then can start to figure out what they want to put out there for 2016.

Michael Graham
*Canaccord Genuity, Inc.*
Q

Okay. Thank you, guys, and congrats.

Michael D. Fleisher
*Chief Financial Officer*
A

Thanks.

**Operator**: Your next question comes from the line of Mark May from Citi. Your line is open.

Mark A. May
*Citigroup Global Markets, Inc. (Broker)*
Q

Hey, guys. Thanks for letting me ask a question. Just – I think most of them have been addressed, but just a couple. On the non-Wayfair brands, can you talk about the level of investment, and kind of what the trend has been in terms of profitability or improvements, or expansion in investment, or losses in those brands?

And then, I think there were some changes in the quarter related to Google and the search algorithm. I wonder if you could talk a little bit about any benefit that you may have derived from that in the quarter. And then how an improved ranking in the Google search engine could impact growth and profitability in Q4 and into 2016? Thanks.

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

Sure, Mark. Thanks for your questions. So the first question on the non-Wayfair brands, the other four brands, Joss & Main, Birch Lane, AllModern, DwellStudio, so as you know, we don't break out the numbers for all of them, but the way I would describe them is, I referenced a minute ago actually, different merchandising models versus the everyday store, and what I'd point out, the two that are everyday stores are Wayfair and AllModern, but AllModern is cut by a very specific style, so right there, it become specialty in a way.

And then you have two that are lifestyle retailers in Birch Lane and DwellStudio, and you have one that operates as a lifestyle retailer with that kind of very heavy engagement merchandising model, which is Joss & Main.

And so the way we think about these specialty brands, we sort of know they will all have different market sizes that are all much smaller than the Wayfair opportunity. So the way we tend to think about them is that, they either


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need be growing well with good unit economics in a productive way, that means that every dollar invested is getting us the economic return we want, meaning that quick payback, good lifetime value, good profits on the long-term value of the customer. Or as the growth is coming off, they need to be glide pathing into the profitability we want them to have long-term.

And what I'll say about each of them is that, they're all run that way. And so, while they are in different stages, each one is in a different stage of its evolution that is a consistent story kind of across all five of our brands. Now what you see in total, because Wayfair is so big, relative to the rest, you really see the profile of Wayfair.com coming through in the total. But that philosophy that we described for Wayfair.com, you can take as applying to all five, which is why we think the overall business is stronger by having all of them.

On the second question, about Google changes in the quarter, our general experience, and this is a multi-year comment, is that Google continues to make changes to their algorithm, making their algorithm more and more reflective of what customers actually show interest in. So where are customers most excited to see, what sites do they want to go to, where are they happiest, where are they most likely to purchase, where are they most likely to repeat visit, so on and so forth.

And as they've kept enhancing that; I'll tell you that we've continued, in general, to be a beneficiary along the way, where we see ourselves benefiting from a competitive standpoint in garnering that traffic. But despite that, what I'll tell you is that, natural search traffic, while it's a nice piece of traffic in the sense that it's free and it's incremental, it's actually a pretty modest portion of the total. So it's not that big.

So we obviously want to keep gaining in search results, but we believe the way we do that is because we're making the experience better and better, and we just think Google is frankly getting better and better at measuring that. And what's happening is, we're getting favored, but because it's not that big a source of traffic, even though we are getting favored, it doesn't help you, it doesn't move you up that fast in terms of your total business.

So it's a nice thing to have, and we think we'll keep benefiting, but it's not going to be a primary driver.

Mark A. May
*Citigroup Global Markets, Inc. (Broker)*

Q

Thanks.

**Operator**: Your next question comes from the line of Jason Helfstein from Oppenheimer. Your line is open.

Jason S. Helfstein
*Oppenheimer & Co., Inc. (Broker)*

Q

Thanks. Could you just dig a little, Michael, into your comments around next year and profitability? I mean you commented that you expect to be positive EBITDA by the end of the year. I mean, it would seem that you could be profitable in the first half of the year, if you don't, it's because you choose not to be?

So maybe kind of help us understand, are those more investments around – continued investments around marketing, is that more of the other engineering-driven investments? Just maybe talk about kind of how your decision-making around that kind of profit pivot? Thanks.

Michael D. Fleisher
*Chief Financial Officer*

A


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Yeah. Thanks, Jason. Look, I think to your point, we could profitable and more profitable now if we wanted to be, and we are making a very conscious set of decisions. I think we've been clear about this from the time of our IPO, and I think maybe more importantly, everybody is now seeing the benefit of those investment decisions in the accelerating growth rate, and the incredible repeat that we're seeing with our customers, including the old cohorts.

And so, I think there's real clarity now for everyone that the investments are worthwhile and have great ROI. And so for us, it's a matter of managing that, but also managing our commitment to getting the profitability by the end of the year.

And so, we're working those too off of against each other, but there's a very long list of places where we think there's a huge opportunity on the engineering side, adding engineering talent and other head count talent that can really sort of build the business, and deliver great new experiences for customers. And we continue to see great results on the ad spend.

And so, I think you'll continue to see us leaning on both of those again as we go into 2016, but making sure that we're doing that in a sort of thoughtful and measured way.

Jason S. Helfstein
*Oppenheimer & Co., Inc. (Broker)*

Q

Thank you.

Michael D. Fleisher
*Chief Financial Officer*

A

Thanks, Jason.

**Operator**: That concludes today's questions. I would now like to turn the call back to Niraj Shah. Please go ahead.

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

Thanks, everyone, for calling in. We hope you guys have a great holiday season, and we look forward to talking to you next quarter.

**Operator**: This concludes today's conference call. You may now disconnect.


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