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# Wayfair, Inc. (W)

Q4 2015 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, ladies and gentlemen. My name is Jonathan, and I will be your host operator on this call. At this time, I'd like to welcome everyone to the Wayfair Q4 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.

And at this time, I'd like to introduce Ms. 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 fourth quarter and full year 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 would like to remind you that we will make forward-looking statements during this call regarding future events and financial performance, including for the first quarter of 2016. 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, which we expect to file in the near future, and other reports that 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 would 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. Our business continued to significantly outperform. Q4 2015 taps off a year of accelerating revenue growth. We generated $740 million in net revenue in Q4, up 81% year-over-year. Our Direct Retail business, which is now 93% of our total net revenue, grew 98% year-over-year to $686 million in the fourth quarter. For fiscal year 2015, we generated $2.25 billion of total net revenue, up 71% year-over-year.

In addition to the phenomenal revenue growth, I'm excited to announce that we generated our first quarter of positive adjusted EBITDA as a public company, with adjusted EBITDA of $2.8 million. As a reminder, for the first nine years, Steve and I operated the business profitably and we financed the company's growth out of cash flow and we did not take on an outside investment until 2011, when we rebranded as wayfair.com. That's nine years after we started the company.

Running Wayfair profitably over time is central to our beliefs and our business philosophy, and frankly it's why Steve and I together own almost half of the business today and are committed to the long-term growth and profitability of the company.

Since our IPO, we have told you that we would be at breakeven adjusted EBITDA by the end of 2016. However, due to the exceptional growth of our business throughout 2015, we're able to achieve and exceed this goal much faster than previously anticipated. And importantly, this positive adjusted EBITDA was generated while we maintained our ongoing investment into the business.

We built brand awareness, now at 72%. We added more new customers than ever before, ending the quarter with 5.4 million active customers, up 67% from Q4 2014. And the lifetime value of our customers continued to improve with orders for active customer up to 1.71 million from 1.69 million in the prior quarter.

In the fourth quarter, some of this outsized growth and the resulting positive adjusted EBITDA was driven by a very successful holiday season. As we announced in December for the five-day period from Thanksgiving to Cyber Monday, Direct Retail gross sales, which is defined as order intake, increased 130% year-over-year. While this five-day period was clearly the peak of our growth rate, we saw strength throughout the holiday period.

We started our promotions earlier this holiday with the first events launching October 1. This allowed us to take advantage of early shopping that our customer does to prepare home for the holiday season and it allowed us time to refine our offering in response to customer demand as the quarter progressed.

In total, we featured approximately 68,000 items across the 115 different merchandising programs, which range from editorial content to functional solutions to curated seasonal décor. We started working with our suppliers last spring to both ensure that the product we featured would be at compelling price points, and to enable us to photograph and merchandise these products in an engaging and exciting format.

Our strong relationships with our suppliers and the learnings and success of our 2014 holiday season allowed us to source a more popular and deeper set of items this year. Successful products range from a leather recliner, the most popular items sold on Black Friday, to Christmas garlands used to decorate our customers home for the holiday. A combination of an earlier, broader and deeper promotional cadence helped drive new customer acquisition, repeat and sustained revenue acceleration that we've seen since the beginning of this year.

Now since this is the first call of 2016, I'd like to touch on our strategy for the coming year. 2015 by any measure was incredibly successful for the company. We grew total net revenue 71%. We added over 2 million net new customers. We grew orders from repeat customers 96% year-over-year, which increased our shift to repeat orders by 400 basis points. Revenue per active customer grew by 11% year-over-year. We strengthened our relationship with our suppliers, maintaining our balance sheet inventory position flat while growing our range of exclusive products, our private label offering and growing our business. And we continued to build out our industry leading logistics network offering more two-day delivery product than ever before and improving speed and efficiency across the network.

These improvements to our offering and customer experience allowed us to successfully take advantage of the secular shift to online, resulting in significant share gain. Everything combined resulted in outsized revenue growth, a much faster path to positive adjusted EBITDA than we previously thought and significant cash flow.

Our model is clearly working. To highlight this, I'd like to point out that in Q4 our total net revenue increased approximately $330 million over Q4 2014. Annualized, this means that we're taking $1.3 billion of share in what is approximately a $250 billion market. This success occurred in what is primarily today a U.S. business. In 2016, we want to broaden our reach and also focus on growth in our international markets, Canada and Western Europe.

We believe these markets represent a tremendous opportunity for us. Western Europe has a total addressable market size similar to that of the U.S. of nearly $250 billion. Canada, well much smaller, is highly fragmented and we believe underserved today. We've proven that our model works in the U.S. Some of our earlier stage international markets like the UK are showing the same strength and we're excited to fully go execute our models.

As we always do, we'll start with a very focused approach, in this case that means Canada, the UK and Germany. We think of our UK and Germany businesses as similar to our U.S. business in 2013. As with the U.S., before turning up the dial in marketing, we worked to establish our European supplier base and our core operations infrastructure in Europe. Over the past year, we have invested heavily in building out our team. As of December 31, approximately 12% of our workforce was in Europe, a business that is less than 5% of annual net revenues, that is approximately 450 people in Europe.

In late 2015, we started implementing the U.S. advertising [ph] Playbook (9:56) with a particular focus on the UK and results in that market are very promising. Year-to-date in 2016 the UK business is growing at a multiple to U.S. growth rate. As we've seen success in the UK, we started to execute the [ph] Playbook (10:14) in Germany.

Like we did with the U.S. in 2014, over the course of this year, we plan to significantly ramp both advertising spend and the continued buildout of our team in Europe.

Our opportunity in Canada is smaller but also exciting. Until January, we served the Canadian market from our U.S. website. Customers had to purchase in U.S. dollars. There was no free shipping. The site was in no way tailored to the Canadian customer. Although, it is extremely early in Canada, our .ca site only launched on January 4. We are already seeing a significant ramp in Canadian orders from simply tailoring the site to the local market. We now price items in Canadian dollars. We have parts of the site in French. We offer free shipping on orders that are over C$75. Because of the proximity of the Canadian market to the United States, we can utilize our U.S. supplier network and logistics infrastructure to serve this market and over the next year, we're going to rollout more direct Canadian suppliers and some of our own proprietary logistics network in Canada. Additionally, like in the UK and Germany, we will invest in brand building and customer acquisition and retention through our advertiser spend.

In aggregate, these markets represent a compelling opportunity to unlock an incremental wave of growth for the business. Obviously, the investments we intend to make in these markets are significant. As you will hear from Michael, we will be investing our growing profitability back into these markets.

As with our investments in the U.S. in 2014 and 2015, we believe this is the right long-term strategy for the business and we will closely monitor our advertising spend to ensure that we are getting the appropriate paybacks and efficiency.

We have a unique opportunity to continue gaining share in the United States and to win in several specifically identified new markets. We are excited that the business is growing rapidly that we generated positive adjusted EBITDA and that we are free cash flow positive and that we are continuing to increase our leadership position in a very large market.

I'll now turn the call over to Steve who will speak to how the technology we developed in the U.S. is helping us execute in these markets.

## Steven K. Conine
*Co-Chairman and Co-Founder*

Thanks, Niraj, and good morning, everyone. We've spent the last 14 years custom developing technology to meet the unique needs of the home market. From front-end innovations like personalization, search, mobile web and apps to our supplier interface, to our advertising stack, to our logistics network. Our systems are largely home grown and developed utilizing our scale and proprietary data to build the best tools to serve our suppliers and customers.

One of the many reasons we believe we will be successful in Canada, the UK and Germany is our ability to leverage our existing single technology platform. With some local market tailoring, we are utilizing this core infrastructure for our non-U.S. operations. For example, you may have recently seen the press release regarding the launch of our proprietary search engine marketing platform, Athena in Europe. Athena, like the rest of our advertising technology, uses our knowledge of the industry, products, customer and advertising market combined with the vast amount of data we collect to improve the efficiency and effectiveness of our ads spend. We spent several years refining our advertising technology stack in the U.S. market and are excited to be able to leverage this investment for Europe.

Selection is of course a critical part of our differentiating customer offering. Our 7 million item product catalog is now increasingly globalized, meaning we can launch a single SKU in any currency language and market we work in. For example, in the UK and Germany, two countries that share our supplier base, we can launch a SKU onetime and have it appear in English and German pounds and euros. This allows us to fully utilize the supplier network we've built in North America and Europe to quickly upload new product as it is sourced.

Per our press release a few weeks ago, mobile technology is another area where we've utilized our engineering work in the U.S. to make the shopping experience better and faster for our international customers. We initially designed and developed our apps for the U.S. market. After a strong success in the U.S. with some local modifications, we have launched the app in Canada, Germany and UK. These are just three examples of how our engineers are able to leverage our scale, infrastructure and existing platform to launch products and features faster and more efficiently. I'm incredibly excited about the potential our business has in Europe and Canada. Our core engineering team, along with some in-region personnel and dedicated infrastructure is well positioned to help us rollout the U.S. playbook in our less developed markets.

I'll now, turn the call over to Michael, who will walk through the financials.

## Michael D. Fleisher
*Chief Financial Officer*

Thanks, Steve, and good morning everyone. As always, I will highlight some of the key financial information for this quarter and full year 2015 with more detailed information available in our earnings release, which can be found on our IR website. We had an absolutely fantastic quarter and year. In Q4, our total net revenue increased 81% year-over-year to $739.8 million.

As Niraj described, this growth was driven by our Direct Retail business, which increased 97.8% over Q4 last year to $685.6 million. Our Other business, which includes revenue from our small media business and from our retail partners declined as expected 12.5% over Q4 2014 to $54.2 million.

The continued acceleration of the Direct Retail business was driven in large part by the success of our holiday event. As we disclosed in an earlier press release, gross revenue defined as dollars of order intake for the five-day period from Thanksgiving to Cyber Monday grew 130% year-over-year. Adjusting for this growth, the quarter would have grown at a similar rate to Q3 2015.

Our gross profit for the quarter, which is net of all product costs, delivery and fulfillment expenses, was $175.7 million or 23.8% of total net revenue, and is within our near-term target range of mid 23% to 24%. This is compared to 24.1% in the same quarter last year and 23.8% in Q3.

The remaining financials I'll share on a non-GAAP basis. Excluding the impact of equity-based compensation and related taxes, which totaled $9.7 million in Q4 2015 and $57.7 million in Q4 2014. As a reminder, the large equity-based compensation recognized in Q4 2014 included the catch-up equity based comp and related taxes for the time vested equity that was triggered at the time of the IPO. For a reconciliation of GAAP to non-GAAP reporting, please refer to our earnings release on our IR website.

Customer service and merchant fees were 3.5%, the same as Q3 2015. Advertising spend was 11.9% of revenue in the quarter or $88 million. Year-over-year ad spend as a percentage of sales improved 150 basis points from Q4 2014 when it was 13.4% 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 in the U.S. and acquire new customers. We added approximately 769,000 net new active customers this quarter, over 200,000 more than we added last quarter, making it the largest quarter of net new customer acquisitions to-date.

Overall customer dynamics remain incredibly strong. LTM net revenue per active customer increased 11.4% to $381 annually and LTM orders per active customers grew to 1.71 from 1.63 a year ago. Orders from repeat customers were 54.3% of total orders and up 397,000 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. We are very encouraged by the underlying trends we see in customer behavior.

Our merchandising, marketing, and sales spend on a non-GAAP basis was $27.1 million or 3.7% of net revenue compared to $13.8 million or 3.4% of net revenue in Q4 2014. Non-GAAP operations, technology and G&A expense was $41.2 million for the quarter or 5.6% of net revenue compared to $28.3 million or 6.9% of net revenue in Q4 2014.

As we explained last quarter, these two line items are primarily head count and the increasing spend both on a year-over-year basis and on a quarterly basis is due to the ongoing investment in our team globally. As our expanded recruiting team has ramped up, we've been able to accelerate our hiring pace, adding over 550 net new employees in the fourth quarter for a total of 3,809 employees as of December 31. Even with this increase in hiring, we did see leverage on the [ph] OT G&A (20:38) line due to the significant revenue comp.

Adjusted EBITDA for the quarter was positive $2.8 million or 0.4% of net revenue, compared to negative $7.2 million or negative 1.8% of net revenue in the same quarter a year ago. This is the first quarter of positive adjusted EBITDA since we began the ramp in our ad spend two years ago in the U.S. Adjusted EBITDA steadily improved throughout 2015, and the significant revenue growth in Q4 resulted in additional ad spend and head count leverage driving to positive adjusted EBITDA. We're very excited about the strength in our business and the opportunities that this scale and profitability continue to create for us.

In addition to the positive adjusted EBITDA for the third quarter in a row, non-GAAP free cash flow was positive at $78 million. This positive free cash flow was driven by net cash provided by operations of $90.4 million, primarily as a result of the favorable working capital dynamics in our business and net of our $12.4 million investment in capital expenditures for the quarter.

Our inventory level was $19.9 million, 0.9% of LTM sales compared to 1.2% last quarter. It's important to note that while total net revenue in the quarter increased over $330 million from last year, inventory only increased $100,000. Non-GAAP diluted net loss per share was negative $0.07 on 84.2 million weighted average common shares outstanding.

We achieved similar results for fiscal year 2015. Total net revenue of $2.25 billion represented a 70.6% growth rate over 2014, with our Direct Retail business growing 85.2% to over $2 billion. Adjusted EBITDA for the full year was negative $15.9 million, up from negative $62.5 million for fiscal year 2014. Importantly, we were also free cash flow positive for the full year with $72.9 million of free cash flow. This resulted in approximately $466 million of cash, cash equivalents and short-term and long-term investments as of December 31, 2015. It means that the business is self-funding, as it was for the first nine years of the company's history.

We are extremely encouraged by the strength of our brand, customer base and business model. We have a rapidly growing business that is generating significant free cash flow, and achieved our adjusted EBITDA targets a full year in advance of the commitment we made at the time of our IPO. Given this context, we believe the right next step for Wayfair is to continue our growth and successful market share gain in the U.S. and to replicate our strategy in Canada, the UK and Germany, areas where, as Niraj previously laid out, we see significant market potential.

This means we will be investing more heavily in brand building and head count in those geographies in 2016, and we are not forecasting positive adjusted EBITDA, again, until the fourth quarter of 2016, as we originally committed to at the time of our IPO, but now including a substantial investment in new markets.

Specifically for Q1 2016, we forecast Direct Retail revenue of $630 million to $665 million, an increase of approximately $260 million to $295 million over the same quarter last year and a growth rate of approximately 70% to 80%.

The trends in our business have remained strong into the first quarter, and we anticipate ongoing revenue strength. I know in the recent past, our actual Direct Retail revenue has significantly beat our guidance. We're currently almost two months into the quarter and I want to share with you what we're seeing for revenue trends.

Quarter-to-date, the Direct Retail business is growing faster than the top end of our guidance. However, we are seeing lower comps in last quarter, which obviously included the holiday spike. Though we continue to see incredible levels of growth, we do not expect growth to inflect up again this quarter, in light of the exceptionally strong fourth quarter and the fact that as we enter 2016 we start to face more challenging comps against 2015. We forecast other revenue to be between $30 million and $35 million for a total net revenue of $660 million to $700 million for the quarter.

As Niraj described, we are making significant marketing and people investments in our international business. We have an opportunity to roll out our U.S. playbook in additional markets and to continue to efficiently invest in the U.S. As we have said since our IPO, we believe the right long-term strategy for the business is to invest in a very disciplined way and gain share today.

We will continue to spend on advertising, which we know is efficient and effective, and in head count across our geographies to unlock an additional phase of growth. Also, in the U.S. we are taking advantage of more efficient ad rates in the first quarter, as we do each year in Q1, to continue to spend on new customer acquisition and brand building.

We continue to be laser-focused on advertising payback. And while we see an opportunity and intend to ramp spend, we have not seen any changes in the current environment to historical payback targets and ROI.

We do forecast ongoing year-over-year ad spend leverage. However, this will be at a slower pace in 2016, due to our investments in Canada and Europe. Just to be clear, this means our ad cost as a percent of revenue will continue to decline even after investing significant dollars in these international markets. Because of this near-term investment, we forecast adjusted EBITDA margins of negative 3% to negative 3.5% for Q1 2016.

For modeling purposes for Q1, please assume equity-based comp expense of $11.5 million, average weighted shares outstanding of 84.4 million, depreciation and amortization of approximately $10 million, and CapEx of approximately of 3% to 4% of sales.

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. We're very excited about the performance in our business. Revenue growth has outperformed even our own expectations, driven by the significant growth in the repeat business. Our recent cohorts continue to outperform prior ones, as we strengthen our brand and customer experience. For the third quarter in a row, we generated significant free cash flow and we now have positive adjusted EBITDA.

I know some of our peers have spoken about consumer softening and an increasingly promotional environment. We frankly have not seen these trends. Our customer base remains incredibly strong. It is in fact because of this customer dynamic and the success of our business model that we believe the right approach for our business is to continue our investment in building the leading site for the home.

Unlike in the brick-and-mortar home goods market, where inventory constraints necessitated a high degree of fragmentation, we believe that the online market for home, like much of e-commerce, will be a winner-take-most industry. We believe home is one of the few segments of general merchandise that is both unbranded and where much of the share shift to online is still to come, creating a very compelling opportunity. Our vast selection, engaging product discovery and exceptional customer service, all powered by technology, has enabled us to take significant share. There remains a huge opportunity to capture increasing share as the consumer shifts her spend online.

We are excited about the opportunities for growth over the next several quarters. We remain committed to our near-term and long-term profitability targets, and we look forward to continuing to bring you more strong results.

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

# QUESTION AND ANSWER SECTION

**Operator**: [Operator Instructions] Your first quarter comes from the line of Neely Tamminga with Piper Jaffray. Please go ahead.

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

Q

Good morning and congratulations on a solid performance in the year. Niraj, can we dig a little bit more into this growth in Europe as well as Canada. It's really three-part question. We're looking to understand a little bit more in terms of the buckets of spending in terms of the financial impact. It sounds like obviously advertising will go higher. It also sounds like you've already pre-spent on some human capital. So, if you can kind of reframe that up a little bit in terms of the key buckets of investment for the year and/or maybe specifically to the quarter? That would be helpful.

And then just higher level strategic questions that we have about those markets. First is, if we think about the trade, interior design and decorator trade market as a great seed to the brand over here in the U.S. Do they have similar situations like that in the interior decorator market for Canada, UK and Germany? How does that part of the industry work? And then on the expansion side, does it help to expand now in terms of your volume pricing to your existing sourcing structure and supplier network now, both in the U.S. so ultimately your gross margins can go higher earlier too. We're just trying to understand that dynamic? Thank you.

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

A

Oh, great. All right. Thanks, Neely. And let me try to answer those questions. So, the first question having to do with the investments outside the United States, in Europe and Canada. So, kind of a few thoughts there. So, certainly to ramp the business there, now that we feel like particularly in the UK and Canada, we've got the offering to where we're seeing really good customer traction. There is an investment in advertising. I do want to highlight, with that investment in advertising internationally, we still foresee our year-over-year ad spend, as a percentage of net revenue total company, to be going down. So, embedded in the fact that it will still go down, we actually have a large amount of investment in these countries. So, that's clearly one area.

The human capital side is where you start your investment early on because you have to build the transportation network and enhance the supplier network, the product selection, you have to have those things in place before you can actually have something you want to market. So, that obviously is a leading investment and we mentioned we have roughly 450 people in Europe and that sort of gives you a feeling of – you think about 450 people and the amount of activity that they can be engaged in, what they can do, it's obviously significant.

And the other place where you "invest" is when you think about gross margin, obviously the gross margin you have when you're smaller is not as good as the gross margin you get when you're larger and you're buying much larger quantities from your suppliers, you're getting discounts, you're getting transportation cost efficiencies, and all the things that we increasingly keep getting in the United States. And so, the early days gross margin is going to be a lot lower than the later days gross margin. And then so embedded in our gross margin is obviously also what is an investment outside the United States. So I think you could think about it as investing in these different areas. We highlighted the human capital piece because obviously that's something we've already done and it just kind of gives you some context when you think of the international piece being 5% of revenue [indiscernible] (33:27) and you think the 450 will give 12% of head count, it just gives you some perspective.

And then just a little more color on the advertising piece. So, for example, in the U.S. last year, we spent $40 million in TV. When we think about what we're going to be doing this year in TV outside the U.S., we think of it is sort of like $10 million in TV. So it's not at obviously the same level but the business is not as large, but it's growing and that was only a fraction of our spend. Last year we spent $200 million plus in advertising in the U.S., $40 million was TV. So it's a portion of the spend. So advertising is the same kind of mix where you have TV, you've got the online, you've got sort of other things you're doing.

Your second question was about, do you believe that there is a designer or decorator trade business in Europe? Absolutely. I mean, it's the same dynamic. Most consumers in this category, the goods are non-branded in the U.S., they're non-branded in Europe. It's super fragmented in the U.S., it's super fragmented in Europe in terms of who the retailers are. What we bring by amassing the huge selection of affordable goods under one roof with the great service delivery promise that we do, basically lends itself to be in a great platform for designers and decorators and trade customers and that dynamic is exactly the same in Europe.

And then the third question with regards to our supplier base and sort of pricing leverage, frankly, as we keep growing, our suppliers are seeing us as their key way to take advantage of the Internet opportunity. They're very excited to grow with us. And as we've mentioned, the gross margin has significant opportunities to grow over time, ranging from private label to suppliers giving us better pricing as our quantity of volume goes up to transportation cost efficiencies we can unlock. And all three are happening, continue to happen and so the whole point about supplier pricing being one of the levers is absolutely true.

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

Thank you.

**Operator**: Your next question comes from Deb Schwartz with Goldman Sachs. Please go ahead.

Debra Robin Schwartz
*Goldman Sachs & Co.*

Q

Great. Thanks and congrats on the quarter. You're seeing great customer attraction this year. Was all the outperformance coming from the Wayfair brand or more broadly, can you give us a sense of how the different brands are doing, either on a relative growth basis or the contribution for the brands? And then one follow-up on Europe, can you just give us a sense of your view on the competitive landscape in the markets that you're going to drive toward this year?

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

A

Yeah. Sure. So, the first question about our different brands. I mean, the thing there – so it's a tricky question-answer, because the truth is the Wayfair brand is so much bigger than all of the other brands it really matters to a much lower degree how the other brands do. But we have some of our other brands that are smaller growing at a fantastically high growth rate.

But frankly, they're so small relative to Wayfair when you look at the aggregate numbers, you're really seeing the story of Wayfair.com. So, what I would say is we believe all our brands have a role and we're seeing really nice traction in terms of where we're investing. We're investing measuring paybacks not in aggregate but very granularly. But Wayfair is by far the biggest brand, I think that's important to keep in mind as you kind of think of how you model it because that's sort of the story of how the numbers work.

In terms of your second question about the competitive landscape in Europe, it's similar to the U.S. meaning that you have brick-and-mortar regional furniture folks, you have sort of the equivalent of national big box folks that focus on the other category for home and ancillary, you have some pure play Internet folks, but it's super fragmented. And so, in the U.S. you tend to have a perception that IKEA is a dominant furniture player in Europe. Well, IKEA is large in Europe. Well, IKEA is actually large in the U.S. and U.S. – if you just look at the furniture piece they may have 4% share. If you look at Europe they have 7% share. It's not that much more share. It's more share but it's still a super fragmented market. That's basically the case. As you go through in Europe through each country, they reflect sort of the similar kind of thing that you see in the U.S. as you go through each region. The dominant furniture players vary and part of it is that the styles vary.

When you look at kind of other goods, it's similar dynamic and again, these are generally unbranded items. So it's very similar. The retail landscape is very similar for basically the same reason.

Debra Robin Schwartz
*Goldman Sachs & Co.*

Q

That's helpful. Thank you.

**Operator**: Your next question comes from Seth Basham with Wedbush Securities. Please go ahead.

Seth M. Basham
*Wedbush Securities, Inc.*

Q

Good morning, and thanks for taking my question. I'd like to touch base first on the international expansion. Given that you guys only have about 1% market share in the U.S. and are very early in your growth as a result of that here in the U.S., could you just give us a little bit more perspective on why right now is the best time to spend a lot of your time and attention growing internationally?

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

A

Yeah. Sure. So, I mean, I think the truth is, Seth, we're very ambitious as a company but we're very pragmatic. So, on one hand, there is a lot we want to do. On the other hand, we try to stay to a realm of what we think we can do well. As you start your resources too thin, you end up getting – sort of you're doing a lot, but you're not actually making headway basically anywhere. So, the way we think about it is, in the U.S., we feel like we not just put in place sort of the key value prop that drives customers but we're pretty far along on building the brand; we're at 72% awareness and that continues to grow really nicely.

If you look at the repeat rate, our repeat orders were up 96% year-over-year in the U.S., new orders were up 67%. So you are seeing really good traction and new is cruising right along but repeat has been the reason growth is accelerated over the course of 2015. And I think if you look – we uploaded a presentation this morning, which is sort of our standard slides but with a couple of new things thrown in.

On slide 11, when you get a chance to look at it, we talk about the concept of the market share. And one of the things you look at, and this would understate the market share we're taking because it's lagging, it looks back at the whole year. And obviously, our growth accelerated through the year. So if you try to do it quarterly, you'd actually see some progress I think. But basically implies that we took a third of the dollar growth of the online home market, which would be primarily in the U.S. given that our business is primarily in the U.S. So, we feel very good about where we're in the U.S. We have a long list of things we're doing to further compound what we believe our advantages are in the U.S. and we believe past that, we do have the ability to do additional things but not necessarily endless amount of things. And so the markets we're focused on are Canada and Western Europe. We think we can do that well. And to be honest, that's where our focus is. We're not really looking at adding markets to that.

Seth M. Basham
*Wedbush Securities, Inc.*

Q

Okay. That's helpful perspective. Understanding that you expect significant investments in these areas but still expect to leverage advertising spend, should we also expect customer acquisition costs to remain flat or go down and payback periods to remain flat or go down in 2016?

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

A

Yeah. So, the way I've looked at that, obviously you have an imperfect view of it relative to the much more nuanced view have. So, I would think in aggregate, which is the view you have, I would say that over the last five quarters, six quarters, you've seen it be flat and I would say you're going to kind of continue to see that. So it bounces up or down a couple of buck range, and I think the answer is yes, you should fully expect to see that.

Seth M. Basham
*Wedbush Securities, Inc.*

Q

Great. Thank you very much and good luck.

**Operator**: Your next question comes from Oliver Wintermantel with Evercore ISI. Please go ahead.

**Oliver Wintermantel**
*Evercore ISI*

Q

Yeah. Good morning. Thank you. I had a question regarding the guidance – probably one for Michael. So, strong revenue growth, but then the EBITDA margin rate is certainly a little weaker than we all thought probably. Can you give us some details on how we get there, what the gross margin rate is, what the leverage is on SG&A. And then, to follow-up there, maybe also some details in the gross margin rate in the fourth quarter, what drove that? Thank you.

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**Michael D. Fleisher**
*Chief Financial Officer*

A

Yeah. Thanks, Oliver. I think the gross margin is coming in really exactly where we've been targeting it. I think as you heard from us, two, maybe three quarters ago now that we're targeting mid 23% to 24%, so coming in at 23.8% is I think right where we want it to be.

And I think when you look at the year-over-year guidance, I do think that gross margin at that mid 23% versus last year's Q1 of 24.2% that's obviously one of the places. And as we talked about that 24.2% and then Q1 and Q2 gross margin sort of got ahead of where we really wanted it to be. So that's when we brought everybody to the sort of mid 23% place. So I think that's – we're still targeting that. We feel confident about that. We think that's the right balance even as we sort of make investments in the international business, as Niraj just commented.

We will show ad spend leverage. As I noted in my earlier comments, the ad spend leverage year-over-year will be lower than it was last year. Last year was obviously extraordinary coming off the sort of high watermark of 14% but that will still show some ad spend leverage largely because we're getting really great ad spend leverage, right, in the U.S. business and, in fact, investing that back into the ad spend that we're ramping up in our international operations.

And then we'll continue to hire people. You saw this quarter a little bit of leverage on the [ph] OT G&A (43:02) line, the opposite on the merchandising, marketing and sales line. I think that's a little lumpier depending on just sort of how the hiring and recruiting efforts go. We have ramped that up nicely now. We've hired 550 net new people last quarter. But I would say those areas I think you'll probably see sort of similar levels on a percent of revenue basis. So I think that's how you can kind of model yourself to the compare of our guidance of negative 3% to 3.5% on the EBITDA line versus last year negative 2.8%.

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**Oliver Wintermantel**
*Evercore ISI*

Q

Okay. Great. And just, lastly, if you could maybe give us some economics about maybe the international markets that you go in not from a revenue growth, but just how you think about the economics of these markets compared to the early stages in the U.S.?

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**Michael D. Fleisher**
*Chief Financial Officer*

A

I think they looked very similar. If you look back to sort of our business in 2013 and then 2014 when we really ramped up ad spend I think that's sort of the place, as an example, the UK business would look like today. I think the difference is that in the U.S., at that time, we did have a sort of a big base of built existing customers from the sort of pre-Wayfair days. And so, you were spending on ads but you had some existing base of customers that's different in the international markets where they're sort of still at much earlier stage.

And so, I think the leverage point there is leveraging the success we've had in the U.S. to sort of now go and fund the investment and building out these international markets. But I think from a straight up economics perspective over time, we expect these businesses to look extraordinarily similar and I think that's true on what payback trends will look like, gross margin will look like, et cetera.

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Oliver Wintermantel
*Evercore ISI*

Q

Thanks very much.

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**Operator**: Your next question comes from Paul Bieber with Bank of America Merrill Lynch. Please go ahead.

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Paul Judd Bieber
*Bank of America Merrill Lynch*

Q

Good morning. Thank you for taking my questions. How should we think about the magnitude of positive EBITDA in 4Q later this year? And then secondly, from a high level, can you provide some color on the evolving category mix at Wayfair? Is the outsized growth being driven by category expansion as well as just the past customer, active customer, and repeat purchase behavior. Just some color on category mix would be really helpful? Thank you.

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Michael D. Fleisher
*Chief Financial Officer*

A

Thanks, Paul. It's Michael. I'm certainly not going to guide what Q4 EBITDA numbers are going to look like. But what I would say is this, at the time of the IPO, we were very clear that we sort of committed that we would be profitable by the fourth quarter of 2016, and we sort of stuck to that commitment. What we're saying now is right, we've gotten the whole business, in effect the U.S. business, right, because it represents 95% of the business. We've got the whole business profitability a year earlier and even with continuing to show ad spend leverage, et cetera, we're going to make some investments in the international business. So by the time we get to Q4 2016 you're going to end up with a business that meets our original expectations and commitments to everybody, but at the same time now has a substantial investment in what we believe, will be a growing and sort of next phase or additional phase of growth from some key international markets. So, too early to call sort of a number in Q4 but we're highly committed to that.

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

A

And this is Niraj. Let me just jump in on the category expansion, category mix question. So, there – I think the way I think about that Paul is just like we talked about international being an investment and as you pointed out, into the future there could be a very high return there both in terms of revenue and profits. Well, the new categories basically represent the very similar thinking to that in the sense that today they're very small so they could be growing at a very high rate but they are so small that the business is still really dominated by the categories you primarily think of us for, which is furniture, décor, the soft goods but it's less some of the categories we've talked about recently and some of the things are growing in home improvements, some of the things which we're growing in house wares. But those could be quite large for us in the future in the customer base that we have, since we're very engaged with it and that's a big opportunity for the future.

So, our P&L today has investment in a whole number of areas that are not actually manifesting in today's return to P&L that you see, it has the cost but it doesn't have the upside. So, I would think of those as future upsides.

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Paul Judd Bieber
*Bank of America Merrill Lynch*

Q

Okay. Thank you.

**Operator**: Your next question comes from the Matt Nemer with Wells Fargo. Please go ahead.

Matt Nemer
*Wells Fargo Securities LLC*

Q

Thank you. Good morning, everyone. In the UK, I'm wondering if you can talk to where you've ramped advertising you started to rollout your U.S. [ph] Playbook (47:58). Could you talk to the customer acquisition cost and payback trends in that market? Are they similar to what you've seen in the U.S. and where would the, I guess, 2014 and 2015 UK cohorts fall relative to your cohort slide?

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

A

Sure, Matt. So, what I would tell you is if you want to think about where the UK is think of it as basically the equivalent of at the beginning of 2014 in the U.S. So it's more of early in that. We don't have the 2014 cohorts and 2015 cohorts yet, we have the 2013 cohorts. And so, what I would tell you is what we've seen is that we have customers that are very engaged. We feel like we have a selection that's working. We have a lot of metrics that are showing us that the customer engagement and all of the other follow-on metrics you would want to see repeat and so on, so forth, we're very happy with where they are and where they're trending. We're not going to get into really specific detail, breaking out the UK from the total in terms of the metrics. But I just want to make sure you frame it at the right timeframe is it's still pretty early. And what we're telling is that, we've been investing into getting the offering to where it makes sense to aggressively market it, and we feel like we've crossed that threshold and we're seeing the same things we were seeing at Wayfair in early 2014, in Wayfair.com in the U.S. And so, that's what gets us excited about it and also why it makes sense to push it forward from an advertising customer acquisition standpoint.

Matt Nemer
*Wells Fargo Securities LLC*

Q

Are there are any other major differences that we should be aware of in terms of order size or maybe the seasonality of that business in these markets?

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

A

Again, we're not going to break out a tremendous amount of detail. From a high level perspective, I think of them as generally similar. Seasonality is similar, customer behavior is similar and the category size pro portion to other category is similar, but we're not going to get into very specific guidance.

Matt Nemer
*Wells Fargo Securities LLC*

Q

Okay. And then just switching topics. You launched two pretty big categories in the home improvement arena. Just wondering if you could talk about the long-term opportunity in that market and if you have any sense for how incremental that could be to the $250 million (sic) [billion] (50:09) TAM that you talk about in the home furnishings business?

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

A

Yeah. I think the way to think about it is, when you look at furniture and décor, that's obviously a very big market in the U.S. I think if you look at what housewares represents, what the home improvement categories you just discussed represent, those represent a significant percentage of growth opportunity relative to furniture and décor. So, in that sense, there is a lot of upside there. It gets even bigger when you realize that, despite the fact that we have very little share in furniture and décor, the share we have is way, way, way more share than we have in these new categories. So, the kind of outsized potential there is even higher, but the $250 billion actually does include some of these categories in it. So, I just don't want you to double count.

Matt Nemer
*Wells Fargo Securities LLC*

Q

Got it. And is that a – I know it's early days, but does that look like it's bringing in a new kind of customer demographic for you, or do you think it's your existing customer that's a type of customer that's broadening out their spend into these categories with you?

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

A

It's really about our core customer. Our core customers in the United States we sort of define as the 50,000 to 250,000 household income range and from an income standpoint, it's typically the core shop where we had typically a women, the age range is really 35 to 65. When you look at that income range, you basically get 60 million households in the U.S. with 45 million below that, 7 million above that. Those 60 million in the middle there, where the bulk of the spend is concentrated, those are really the folks that we're catering to, and those are the folks that not only are buying the offering, you historically thought it was four, but those are the same customers who are interested in these categories that we're now discussing.

Matt Nemer
*Wells Fargo Securities LLC*

Q

Got it. Okay, great. Thanks for your comments. And good luck this year.

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

A

Thanks, Matt.

**Operator**: Your next question comes from the line of Aaron Kessler with Raymond James. Please go ahead.

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

Q

Yeah. So, hi guys. A couple of questions. First, on the gross margins. Can you just talk about the long-term leverage there? Your, I guess, long-term range is about 25% to 27% versus the 24% roughly today. Second, any plans to maybe breakout the international investments versus domestic profitability in 2016? And then finally, just maybe on CapEx as a percentage of revenue, any details there, maybe where that trend longer-term? Thank you.

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

A

Yeah. What we've been saying sort of repeatedly and it's absolutely I think the same answer right now, is that, there's three key levers to driving that gross margin up over time. One is as the private label offering, which we're rapidly scaling, becomes a bigger portion of the total, which allows us more pricing latitude. The second is as our volume grows with our suppliers, our ability to get better cost basis keeps increasing, because our suppliers tend to think about the world as profit dollars versus percentage margin. And the third is that there is dramatic opportunities on transportation cost efficiencies as we keep growing our volume. And that transportation cost is not an insignificant cost. So, those efficiencies are very significant and I'd point to that one also in the sense that, that's not something that needs to come out of our supplier or out of our consumer. That's something – that's just an embedded cost in the whole chain, that as we make it more efficient to reduce that cost, that actually doesn't take value and transfer it away from anybody. It accrues value to everyone.

And we think those three actually amount to far more than the kind of 300 basis points from where we are now to what we're talking about in our long-term guidance. And then the reason it's far more and yet we only talk about the 300 points is that our general philosophy is that you're giving some back as you're keeping some. So, we actually don't view that long-term range of that 25% to 27% as particularly difficult to get to.

Michael D. Fleisher
*Chief Financial Officer*

A

Aaron, we do disclose our international revenue in our financials and so that will show up in the K. I don't anticipate that we'll do any additional disclosure around that near-term as we grow the business. I don't think we caught your third question, so could you repeat that again?

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

Q

Third is on CapEx and the revenues longer term?

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

A

Sorry, you broke up again.

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

Q

Yeah. On CapEx as a percentage of revenues long-term?

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

A

Yeah. So I think, as I said in my comments, we're sort of guiding CapEx at sort of 3% to 4% of revenues. We think that's the sort of right way to look at it. If you look at the full year last year, it was 2.8% of revenues. And as we continue to make some modest investments, I take the opportunity to remind everybody that this is not a particularly capital intensive business, right. We grew the business dramatically on basically flat inventory and with basically no inventory and no stores, our CapEx is really limited to sort of the capitalized software that we're building as well as sort of, what I would call, low capital intensity warehouse space, right, where we don't have a lot of automation and capital cost there, it's really just for racking.

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

Q

Got it. Great. Thank you.

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

A

Thank you.

**Operator**: Your next question comes from Mark May with Citi. Please go ahead.

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

Q

Okay. Thanks. I know you've answered a lot of questions about how the international markets differ or are the same as the U.S., but just one more. In terms of order fulfillment, could you just tell us if it will be radically different the way your network is set up in your supplier and logistics partner relationships work? And then, wondering if you could help us on a full year basis this year for the U.S. business when you kind of carve out the investments or incremental investments for international expansion. Do you expect the U.S. business to be operating income profitable on a full year basis this year, any color there would be helpful? Thanks.

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

A

Sure, Mark. So let me – just on the Europe question about the order fulfillment network and really just it's not going to be different, it's very analogous. So, in other words, we're working with suppliers across a wide range of product selection that gives us this kind of an uber selection. A lot of what we've been able to build is the logistics to actually move goods efficiently from one place to the other in a way in which we do consolidation, in the way in which we use different carriers. And in fact, some of the technology we built where we clear products from the U.S. and the Canada automatically in the border clearances and the transportation network, we've built, actually lend themselves well. The Europe, where you have different product selection originating in different countries, and as you move goods between countries, there is things you have to deal with around transportation, border security, VAT. And what we've been able to do by doing this is a massive selection that others don't have. Most folks work off a selection within country and each country start off as a discrete market. And while what will be available in that country will be some of the more popular styles, they will still have gaps for a lot of customers desires that frankly we can serve as well because we have this Uber catalog. So it's the same analogous model and it's set up really well.

On your next question about the U.S. operating income profit, I'm going to flip that back to Michael. But the only thing I'll say is what you did see in Q4 is that the total business was EBITDA positive, right with I mentioned 450 people in Europe and investments we are making. And so, obviously with the U.S. being so big and then having all those investments is still netting out a positive EBITDA number. So that bridge tells you something right there, but Michael maybe you – whatever you're want to [ph] add (57:52).

Michael D. Fleisher
*Chief Financial Officer*

A

Yeah. So just to add to that, let me try and answer your question Mark without giving guidance. I think as Niraj was just saying, look, 95% of the business is U.S. based today and obviously the business was profitable in Q4 on an EBITDA basis and as you've now heard from us, I think multiple times on the call, we expect to see continued leverage in that business right on the ad spend line, in particular. And so, I think if you sort of think that through, obviously that's going to continue to play out and it's that success in that part of the business that's really funding the investment in the other geographies.

**Operator**: And ladies and gentlemen, due to timing, we will only be able to take one more question. And your final question comes from the line of Michael Graham with Canaccord. Please go ahead.

Michael Graham
*Canaccord Genuity, Inc.*

Q

Thanks. Just wanted to ask about your customer growth. Can you give us a little color on what was going on with the funnel sort of underneath that metric, traffic conversion, retention, just where are you seeing strength in that whole equation? Thanks.

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

A

Sure. Mike, I think the thing you're seeing is that there's kind of strength along the whole chain, right. So, you start super high level [ph] radar (59:13) awareness [ph] continues to (59:14) grow. I think a number of folks have looked at our comScore traffic, our comScore traffic reports and we don't comment on traffic by comScore reports, strong numbers, both desktop and mobile, and we're certainly very happy with how we're seeing traffic grow.

We do a lot of survey work around customer awareness, but also customer preference data. We believe we're doing incredibly well there, which both shows the new order growth of 67% as I mentioned, but the repeat order growth was 96%. And if you think about a repeat customer and how that would tell you about new customer growth is that, you can market to someone and convince them to check you out. And if the offering is engaging and interesting enough, they'll buy, right? And that gets you the new customer, but really only if everything goes well and they're really pleased, those would get you the repeat. So when you see repeat growing faster than new, that to me is – repeat is a leading indicator for the future of new in the way I tend to think about it. But, I don't know if that helps you, but it's really strength everywhere.

Michael Graham
*Canaccord Genuity, Inc.*

Q

Yeah. Okay. Thanks a lot.

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

And so I think that wraps up the call. So, thank you everyone for taking the time to join us today. Sorry we couldn't take any more questions and we appreciate your interest in Wayfair.

**Operator**: And ladies and gentlemen, this concludes today's conference call. You may now disconnect.