Wayfair Inc.
Q4 Earnings Release and Conference Call
March 4, 2015

Operator:

Good morning. My name is Lisa and I will be your conference Operator today. At this time, I would like to welcome everyone to the Wayfair Q4 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. If you would like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

Michael Fleischer, Chief Financial Officer at Wayfair, you may begin your conference.

Michael Fleischer:

Good morning and thank you for joining us. Today, we will review our fourth quarter 2014 and fiscal year 2014 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co-Chairman, and Steve Conine, Co-Founder, Chief Technology Officer and Co-Chairman. We will, of course, be available for Q&A following today's prepared remarks. Kate Gulliver is out for maternity leave, so I'm greatly looking forward to reminding you of the legal language around forward-looking statements.

I would like to remind you that we will make forward-looking statements during this call regarding future events and financial performance, including guidance for the first 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 IPO prospectus, our Annual Report on Form 10-K, 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 of 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 Shah:

Thanks, Michael, and thank you, everyone, for joining us today. We are pleased to report strong Q4 and full year 2014 results which we believe reflect the ongoing strength of our brands and business model.

Net revenue for the quarter was $408.6 million, reflecting total growth of 38.4% over the prior year. Our direct retail business, consisting of sales generated primarily through the sites of our five brands, grew 55.2% versus last year, with 3.2 million active customers as of the quarter end. As a reminder, our five home retail brands include Wayfair.com, Joss & Main, All Modern, Dwell Studio and Birch Lane. Though we experienced growth across all our brands, I'm very proud of the continued strong growth of Wayfair.com. As we've described before, Wayfair.com is our largest brand with the broadest selection and customer reach. It truly serves the large mass market segment and we believe its growth is reflective of the overall health of the business.

We're excited about the growth that Wayfair.com has continued to experience throughout 2014, and the fourth quarter in particular. Its ongoing strength has been the result of continued improvements across our platform in how we acquire customers; in the customer experience, including site merchandising, customer service and logistics; and in the growing awareness and increasing strength of the Wayfair brand. For this quarter in particular, the higher than forecasted growth in Wayfair.com and more broadly in our direct retail business was largely a result of a very successful holiday season. Historically, we have not put as much focus and energy into merchandising seasonal décor and promotions. I want to touch on some of the initiatives that we more aggressively executed this holiday period.

Our low inventory model, incredible supply chain execution and deep long-term relationships with our suppliers gives us two advantages over our competitors. We can be more responsive. An example of that was dealing with the recent Long Beach Port situation; and we can deliver more selection and value to our customers.

The planning for holiday actually began last spring and was a multi-team effort across the Company. This included our promotional merchandising and category management team, our site merchandising team, our creative team, our retail pricing team, our storefront, which is our product management team, and our engineering team. Starting last spring, our buyers use trends they saw in markets and data from prior holiday periods to better understand which products were most likely to be purchased during the holiday season for the home or as gifts. Our buyers and our category management team worked with our suppliers over the spring and summer to not only source deeper discounts on targeted projects, but to also ensure products would be in stock at our suppliers to meet fast holiday shipping expectations, and since we operate in general without inventory, this requires tight coordination with our supplier partners, which is a particular strength of our Company.

We sourced discounts in over 250,000 items, over a quarter million items, and more than 10,000 items were featured in 96 different holiday focused events. Other items were used as key items, and overall, our team sourced discounts that were on average 5% deeper than the prior year. The timing of the specific promotions was based on historical data of the peak buying time in the season for different product categories. For example, on November 9th, we ran a promotion for Thanksgiving kitchen and dining updates. That was designed to target our customer as she was planning out her Thanksgiving meal and hosting needs.

Across our brands, we consistently aim to provide our customer with exciting visual imagery and merchandising to enable our unique product discovery experience. For our holiday promotions, we curated and photographed at our in-house photo studio exclusive holiday décor imagery highlighting the promoted products, as well as a broad set of holiday decorating and gift ideas. These images, coupled with efforts on the part of our product development team and our site merchandising team, enabled us to bring our promotions and gift guide to life. The combination of these activities resulted in a highly successful holiday season, helping us to beat our prior revenue estimates. Michael will walk you through the full impact that the incremental holiday sales had on our quarter, but we're excited about our ability to unlock an increasing amount of seasonal sales potential for Wayfair.

Our Company has a unique blend of merchandising, marketing, operations and technology that we think is the right mix to maximize our success as the leading online home goods retailer. We think this unique blend is quite different than that, which is optimal for a store-based retailer who is constrained by square footage, inventory costs and fulfillment and delivery considerations.

Before turning the call over to Michael to go through the financial results, I'd like to just touch on a few other initiatives we're working on. Throughout the past year, we've been focused on growing and improving our mobile offering. Our customer increasingly spends her day on her phone and tablet, and through our branded apps and mobile optimized sites, we enable her to shop from anywhere at any time. Since launching the Wayfair.com app in March of this past year, we've seen significantly growing customer usage of mobile. In 2014, approximately 29% of our direct retail orders were placed via a mobile device. At Joss & Maine, where we launched our mobile app two years ago, over 43% of our orders were placed on a mobile device. What's interesting is that these stats are only capturing on what type of device the order was actually completed. When we look at traffic data, we see a much higher usage, suggesting that customers value the convenience of our mobile accessibility to help them browse our extensive offerings even if they ultimately place their order on a desktop. Our native IOS apps have now been downloaded more than 2.7 million times since we introduced them for Wayfair.com and Joss & Main.

Lastly, I'd like to speak to our ongoing investment in brand building and customer acquisitions. As you know, over the past year, we've increasingly focused on driving brand awareness and improving customer lifetime value by acquiring higher value customers who have a higher propensity to repeat. We've made significant progress on these goals throughout 2014. We launched the Wayfair brand in September of 2011, and in a little over three years, we've created a brand that, as of December, had 55% aided awareness. This represents a significant growth from our aided awareness of 36% just one year prior and is reflective of the investment in brand advertising that we've made on TV and online.

In addition to awareness, we continue to see strong trends in customer acquisition and repeat behavior. As of December 31st, 2014, we had 3.2 million active customers in our direct retail business. This is an increase of 53.8% over the prior year. We also saw a repeat rate of approximately 51% for 2014, up from 47% last year, despite the huge growth in new customers that would naturally depress this rate.

As we've discussed before, in 2014, we increased spend related to brand building and customer acquisition by marketing to customers earlier in the purchase cycle. If you used a very conservative framework and counted all ad spend as solely related to new customer acquisition, you would find for the full year, the CAC, or customer acquisition cost, which is the advertising spend related to acquiring new customers, was approximately $64 per new active customer. CAC varies some quarter to quarter from this average, but this CAC is not increasing. At 3.2 million active customers, we still only have a small portion of the 40 million plus households that make up the mass market in the United States.

As a reminder, this CAC calculation is based on a quarterly KPI that we have shared and assumes that all advertising spend in the period, including TV and brand building, is allocated to new customers who first purchase in that same period. It would be lower if we pulled out TV costs or the small amount we spend on driving retention for existing customers. For a detailed review of this calculation, please refer to the slide accompanying this call on our Investor Relations website. I just want to emphasize that this is truly just an average. We manage and track actual ad spend per customer and return on that ad spend by individual advertising channel and at the specific campaign level within that. With average net revenue per active customer of $342, you can see our contribution margin payback, on average, including all our TV spend, is just less than a year. We hope that by sharing the overall spend per customer, you can start to see that as customers repeat and as we generate increasing revenue from our existing customer base, we will continue to see improving leverage on this advertising investment. Very little of our ad spend is targeted at our existing customers since we reach them through TV, email, app (ph) content, partnerships and direct nav to our site.

We, of course, remain focused on new customer acquisition. The size of the market, which according to third party research estimates is $239 billion in the United States and $294 billion in Europe, shows the enormous potential for the online home goods sector and we remain very excited about Wayfair's ability to continue capturing and increasing share in the sector. We will achieve this through our marketing and brand investments, as well as ongoing improvement in our site experience, logistics infrastructure, customer experience and product offering. Overall, we're thrilled about the quarter and year's performance and the continued growth across all our brands.

I'd like to now turn the call over to Michael to walk through the quarterly financials in a bit more detail.

Michael Fleischer:

Thanks, Niraj, and thank you all for joining this morning. I will highlight some of the key financial information for this quarter and fiscal year 2014. There's more detailed information available in our earnings release, which can be found on our IR website. Before discussing the results, I want to review some changes that we made to the way our financials are presented.

Previously, we disclosed two lines of operating expense, sales and marketing, and G&A. Going forward, we are breaking out sales and marketing into three different line items: customer service and merchant fees; advertising; and merchandising, marketing and sales. Customer service and merchant fees includes the cost of our call center operations, as well as processing fees we pay for orders placed via credit cards. This line item has historically been variable and we expect it to continue to behave as such. Advertising is comprised of the advertising expense for our direct retail business, as well as fees paid to our retail partners, third parties who sell Wayfair products through their sites. Merchandising, marketing and sales is primarily comprised of our category managers, buyers, site merchandisers, merchants, marketers and the team who executes our advertising strategy.

Historically customer service and merchant fees, as well as advertising expenses, were broken out in the MD&A section of our financial results. We hope by putting them directly on the income statement, it will be easier to identify the broad spend categories of our business, the variable costs and the areas in which we anticipate seeing leverage, particularly the advertising line. Operations, technology and G&A is exactly as it reads and is primarily made up of the costs of our operations groups that lead our supply chain and logistics, our technology team building and supporting our sites and our corporate G&A.

For the fourth quarter of 2014, our total net revenue was $408.6 million, a year-over-year growth rate of 38.4%. This growth was driven by our direct retail business, which generated net revenue of 346.7 million, a 55.2% growth rate over Q4 2013. As anticipated, our other business, which includes revenue from our small media business and from our retail partners, experienced a decline in the fourth quarter to 62 million, down 13.9% over the same period a year ago. As we have shared previously, we're primarily focused on growing our direct retail business, where we directly own the customer relationship and can market to them on an ongoing basis.

As Niraj described, the higher than anticipated revenue growth is largely as a result of the activities we undertook for Q4 around the holiday season and our ongoing investment in acquiring high quality customers in 2014. Because the holiday activities were more successful than anticipated, the potential benefit from them was not included in our guidance and came at the end of the quarter; therefore, much of the incremental revenue did flow through to our bottom line. I will walk through this revenue impact in more detail as we discuss the operating expenses, but I want to emphasize that this impact was unique this quarter due to the upside success of the holiday sales period.

Our gross profit for the quarter was 98.4 million or 24.1% of revenue. This is compared to 23.9% in fourth quarter last year and 23.5% last quarter. Our gross profit is net of all product costs and delivery and fulfillment expenses. As stated previously, we do expect some quarterly fluctuations in gross margin due to the wide variety of products we sell, but over time, it will be relatively stable as a percentage of sales.

Before diving into our operating expense for the quarter, I want to touch on the equity-based comp expense that you will see in the GAAP presentation of these line items. As we've discussed, our equity vesting has two triggers, time and liquidity. Therefore, in the fourth quarter of 2014, we recognized an expense of 57.7 million, which includes the catch-up equity-based comp and related taxes for the time vested equity that was triggered at the IPO on October 2nd and the equity-based comp expense and related taxes for the quarter itself. This one-time catch-up expense is unique to the fourth quarter of 2014. Going forward, we will recognize equity-based comp each quarter as equity vest.

Note that there was no equity-based comp expense in the fourth quarter of 2013 or in the third quarter of 2014. The expenses recognized in all line items that have headcount, including customer service and merchant fees, merchandising marketing and sales, and operations, technology and G&A, as these are all mostly comprised of headcount-related costs. For purposes of comparison, we will review each of our expense line items on a non-GAAP basis, pro forma excluding the equity-based comp expense. For a reconciliation of GAAP to non-GAAP reporting, please refer to our earnings release. In our release, we've also included a version of the P&L on this non-GAAP pro forma for equity-based comp basis.

Customer service and merchant fees, when adjusted for equity-based comp expense, were 4% of sales, in line with the same period last year, and the total for the year was 4.1%. We believe these costs to be largely variable and will be relatively consistent as a percentage of sales over time. On the remainder of our operating expenses, we experienced higher than anticipated leverage, largely driven by the aforementioned outperformance in holiday sales. Advertising spend was 54.8 million or 13.4% of revenue in the quarter compared to 36.9 million or 12.5% of sales in the fourth quarter of 2013 and compared to 14.8% of sales in Q3. Overall investment and advertising has been core to our customer acquisition approach in 2014 as we focused on both growing our active customer base and increasing repeat frequency by targeting higher value customers.

We continued to see the benefits of this approach in Q4, where active customers reached 3.2 million, an increase of 53.8% over the prior year and the largest quarterly increase in total net customers in Wayfair history. Even with this rapid growth in new customers, most of whom would not have had an opportunity to repeat since their initial purchase, we saw stable repeat metrics with our most recent quarters and improvements versus the prior year. Orders per customer, measured as LTM orders divided by active customers, was 1.63, up from 1.58 in Q4 2013, and 50.3% of total orders delivered were from repeat customers compared to 46.8% in Q4 2013 and 49.8% in Q3 2014. We believe this consistency in repeat metrics, while growing the base so rapidly this quarter, highlights the ongoing improvements that we see in the repeat quality of the customers we're adding to our active customer base and the ongoing investments in our site experience and merchandising.

Our merchandising, marketing and sales spend on a non-GAAP basis was 13.8 million or 3.4% of sales compared to 10.4 million or 3.5% of sales in the fourth quarter 2013, and our new presentation format category is largely comprised of labor costs. The increase from the quarter in 2013 reflects the investments we've made in headcount across the business throughout 2014 to help us deliver our enhanced site merchandising, drive repeat of our existing customers and execute our advertising strategy to acquire new customers. Non-GAAP operations, technology and G&A expense was 28.3 million for the quarter or 6.9% of sales compared to 16.7 million or 5.7% of sales in the fourth quarter of 2013. The increase was primarily driven by growth in our engineering and operations teams, rent, and depreciation and amortization. We are, at our core, a technology company and today, have over 300 engineers and data scientists focused on making our site the perfect place for our customer to find whatever she needs for her home.

Adjusted EBITDA for the quarter was negative 7.2 million or negative 1.8% of revenue compared to negative 0.7 million in Q4 2013. The outperformance in EBITDA versus guidance was largely the impact of our holiday sales activity and is unique to this quarter, and though I've taken great pains to note that this quarter is unique because of our late in the quarter holiday success, it is worth noting that even with our increased investment in bringing on board new customers, we can show very strong flow through to profitability of incremental revenue. As we have said, we are on a path to deliver leverage on the ad spend line and on EBITDA over the next year, as our existing customers continue to repeat purchase and new customers continue to respond to our advertising and make their initial purchases.

Non-GAAP free cash flow for the quarter was 50.8 million based on net cash provided by operating activities of 62.5 million, less capital expenditures of 11.7 million. The fourth quarter is typically a very strong cash flow period based on the timing of sales, payments to suppliers and the attractive free cash flow characteristics of our business model. Non-GAAP net loss per share for Q4 was $0.18 based on 83 million shares outstanding. GAAP net loss per share was $0.73 cents. This includes the entirety of our equity-based comp and related taxes of 57.7 million and a reduction of the accretion expense of 14.4 million on our redeemable preferred units, since our IPO conversion amount was lower than the carrying amount of these units. Both figures also include a small impairment charge of 800,000 related to the goodwill of our operation in Australia.

We achieved similar strong results for fiscal year 2014. Total net revenue of 1.3 billion represented a 44% growth rate over 2013, and our direct retail business grew 64% year-over-year to 1.1 billion. Total Adjusted EBITDA for the year was negative 62.5 million or 4.7% of sales, reflective of our investment this year in building our brand and active customer base and continuing to improve the customer experience.

Turning to the balance sheet, we closed the year with 415.9 million of cash, cash equivalents and investments. Inventory was 19.8 million or just 1.5% of LTM sales, consistent with inventory levels from the same date in the prior year. As we have expanded and grown our business, we've been able to maintain our inventory light model while broadening our offering to consumers, expanding our proprietary and exclusive products and improving shipping times. In 2014, we averaged 2.2 days to ship compared to 2.5 days in 2013. We've consistently seen improvements in ship times through close work with our over 7,000 suppliers and the expansion and improvement of our proprietary delivery network.

Finally, I'd like to offer some high level guidance on Q1 2015. While revenue growth has remained strong as we comp over significant growth in Q1 2014, we expect slightly moderating net revenue growth rates, with total net revenue in the quarter of 375 to 390 million, comprised of direct retail net revenue of 330 to 340 million and other net revenue of 45 to 50 million. This split reflects the strength that we see in our direct retail brands and intentional ongoing declines in the other business as we continue our strategic shift to focus more on our direct retail business. We continue to expect the other revenue line to experience declines of this level.

For the first quarter of 2015, we anticipate ad spend and EBITDA leverage versus 2014, resulting in EBITDA margins of negative 3.5 to 4% compared to EBITDA margins of negative 7% of net revenue in Q1 2014. As we have said in the past, we anticipate seeing year-over-year leverage through 2015. We remain committed to the investments in brand building made in 2014, as well as ongoing improvements to the customer experience and, accordingly, believe the investments that we're making in Q1 2015 and throughout the year are the appropriate steps to help us capture share in the extremely large home goods market that will ultimately lead to continued strong growth and long-term profitability. We expect the majority of the leverage in Q1 and 2015 will come on the ad spend line as the new customers we've acquired in 2014 repeat. In addition, we will see leverage because of the somewhat fixed cost nature of our TV ad spend for Wayfair.com in the US, which is approximately $30 million per year that we expect will only grow at a rate far, far lower than our direct retail business.

It's worth noting that we give EBITDA guidance as a percent of revenue. I know most of you convert this in your models to a dollar amount and these nominal dollar amounts end up in the consensus numbers. If we overachieve on revenue, the nominal dollar losses, albeit at the guided or even better percentages, could yield a higher nominal dollar loss. At the risk of stating the obvious, we are driving our business on the percent of EBITDA loss basis and are making the ongoing investment decisions throughout each quarter to both deliver our results and because the right long-term strategy is to continue acquiring high-value customers. For modeling purposes for Q1 2015, please assume equity-based comp expense of 8.5 million. This will be similar to the ongoing quarterly expense we'll recognize, and average weighted shares of 83 million and depreciation and amortization of approximately $6 million.

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

Niraj Shah:

Thanks, Michael. We're very pleased with the fourth quarter and full year results and the Company's continued strong growth. We believe we're making the right investments today to drive long-term growth, and we remain committed to both creating the best site for the home and to delivering long-term value for investors. We're excited about 2015 and the long-term trajectory for the business, and thank you for listening to all the information we wanted to share with you.

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

Operator:

At this time, I would like to remind everyone, in order to ask a question, press star, then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Our first question comes from the line of Deb Schwartz from Goldman Sachs. Your line is open.

Deb Schwartz:

Thanks. Congrats on the quarter. Couple of questions. First on advertising, you're seeing good returns on your advertising spend but you're spending a little bit more than probably previously stated, so when we think about 2015, can you talk about how you're thinking about advertising for 2015 and Q1 in particular?

Second question – you mentioned that you're seeing, or you're able to source more effective discounts from your vendors. Can you talk about your philosophy about passing that through to the customer versus letting it flow through on your gross margin line, and whether or not those vendor discounts were specific to the holiday season or we should expect that on a go-forward basis in 2015?

And third question, I know you don't really break out performance across the brands, but can you talk about new customer growth, repeat activity across some of the brands on a high level?

Niraj Shah:

Sure. Thanks, Deb. Let me take you through the answers. So on the first question with regards to advertising spend and how we think about what amount to spend and the economic return on it, you know, the answer there is we manage it the same way we sort of always described in the past, where it's actually managed very specifically at the campaign level within the different channels, and that's where we're looking for the cohort performance and the payback on that type of customer, and that's how we're able to make sure we get the economic return that you're seeing. In terms of the amount of money we're willing to spend on advertising, one of the things that's tricky with the way the business gets modeled is we think about the P&L as sort of a living, moving thing, where we think about certain lines as a percentage of revenue, and so in other words, if revenue is growing more and we think about where we want to advertise (inaudible) as a percentage of revenue, that'll obviously move the nominal dollar amount. So I think one of the things that's tricky is if you're just looking at a fixed dollar amount and you say, okay, you spent more or you spent less, but the revenue line has moved in the meantime, we may think about it as actually, it came in right where we want it to be because we think of it as that percentage of revenue.

So I would encourage you to look at it both ways, and if you look at it as a percentage of revenue, we're really expecting to continue to see a lot of leverage. You know, we stepped it up in Q1 of '14 and that model has served us really well. We have been seeing a general downward trend, meaning leverage as you look at the percentage of revenue sequentially since then, and with Q1 '15, you anniversary that step-up. So, you know, Michael mentioned, look, we're going to show a lot of leverage in Q1 '15, mainly from the advertising line, and I think the advertising line as a percentage of revenue will be down a couple of hundred basis points or something like that. So you're talking about really seeing that there is leverage coming because of the customers we're getting and the repeat they have, the loyalty they have, so on and so forth.

On the second question on the discounts from suppliers, the way to think about it there is in terms of holiday versus go forward, in general, as we continue to scale and we build these ongoing type partnerships with our suppliers, it lets us do things like, you know, get exclusive items, it lets us do things like get better pricing because of the volume we're moving. That said, the holiday period is a period of particular intense buying, right, and so the discounts that you source for holiday or, for that matter, if you're running a particular sale event like a—in Q1, you might have President's Day or you might have Memorial Day in Q2 and, you know, you're going to obviously source the steepest discounts on these very specific events and there's no bigger specific event than holiday. So in that sense, holiday has more but, in general, we do think one of the things that will drive gross margin up over time is suppliers giving us better pricing, but we've also mentioned transportation expense and we've mentioned private label as other drivers of gross margin.

In terms of whether we pass it through versus let it flow through to gross margin versus pass it through to the customer, what I'd say there is what we've always said, is our philosophy is to balance those two things, so it's neither one or the other. It's rather—there's an end, and so we generally keep some but we give some back, and that's on everything from the transportation savings to how we think about supplier discounts, so on and so forth.

Then on the last question about the performance of the brands, you know, kind of repeat, new customers, so on and so forth, as you mentioned, we don't break that out, but what we've always said is that Wayfair.com is by far our biggest brand, you know, by far our biggest brand. So, you know, what you see in the total performance has to be reflective of what you're seeing in Wayfair. We have some very small brands that we think are very exciting, you know, for example, Dwell Studio and Birch Lane, where effectively those are private label lifestyle retailers and we love what we're doing there, but you know, they're very small and they're relatively early. So you get that mix of everything is the total but the total's really driven by Wayfair.com.

Deb Schwartz:

Great. Thank you.

Michael Fleischer:

Thanks, Deb.

Operator:

Our next question comes from the line of Neely Tamminga from Piper Jaffray. Your line is open.

Neely Tamminga:

Thanks very much and congratulations to the whole team over there on a job well done. Two, really, questions from us. First is on holiday. So you saw a great success on holiday, it was very thoughtfully executed. You know, Easter, spring, outdoor, décor, I mean all of this just seems to be right in your wheelhouse as well though, Niraj, and so we're kind of wondering a little bit about how you're thinking about your opportunities in those key warmer weather sort of trigger point type décor categories in '15 versus '14. We think that outdoor was actually pretty weak for the industry last year, so we're kind of wondering, like, how did you perform last year and what are the opportunities this year?

Then related to that financially, with Easter being earlier and the way you guys cut up your quarter, does that actually reflect more of a stronger revenue number maybe in your Q1 guidance relative to how we should be thinking about it for Q2?

Then just a bigger picture landscape question from us, you know, there have definitely been some recent concerns out there around the flash sale and daily deal type online selling formats. Could you just recap for us how you're viewing that format of selling across the landscape and then your portfolio of brands, and do you think you've seen an evolution and how should—how are you thinking about it? Thank you.

Niraj Shah:

All right, thanks, Neely. To answer those questions, first on the sort of summer, you know, outdoor season or Easter or outdoor décor, you know, the launch of outdoor furniture for the season and all this, Q2 and Q1, late Q1 type of thing, here's the thing.

I—you know, what we think is—yes, there's clearly all kinds of seasonal events throughout the whole year and we generally—we play in quite a few of these. So what I would say though is, you know, the holiday season is still the biggest of all of those so in that sense, there's still more opportunity in Q4 than in Q1 and in Q2, Q3, but if you start thinking about us over time, you know, we've been really ramping what we're doing from a merchandising standpoint and a product standpoint around seasonal events and seasonal décor. So I think that is something that we can continue to gain a lot of ground in, and in particular on the outdoor side, those are categories we've been in for some time and I do think they're—we're doing some compelling things there.

You know, on the specifics of Easter, Easter's actually at the very beginning of April and so I don't know if—well, it's kind of two different things there. One, I don't know if it moves a lot because really, our revenue is recognized when we deliver an item, you know, and so, yes, if you bought items for Easter and they delivered prior to Easter, so on and so forth, Easter's not a super big holiday for us and I guess the bigger point than that is when you look at our overall growth rate, I don't know that these—you know, if we were growing at, like, a 2 or 3 or 4 or 5, 6% year-over-year, you know, some low comp, then these things can shift some revenue, but when you're growing at a significantly faster rate than that, these things, like moving a little bit tend to get overshadowed by your overall growth rate, and so I think that's sort of the bigger thing that makes it sort of not matter as much.

But on your second question around, you know, sort of the portfolio brands and the various formats, here's the way we think about it. We have a big competitive advantage in the supply chain we've built, meaning 7,000 suppliers, access to seven million items, able to do that without any inventory risk, fulfillment and delivery, last (inaudible) delivery into the home, really fast shipping, you know, Michael talked about how for the year, we're down over last year. I think for the quarter, you know, the quarter has more small parcels but I think it was, like, 1.9 days was our time from an order to something shipping, which is, if you think about it, really fast considering there's seven million items. So what we do is we've got that supply chain which is really humming and we keep making it better and better. Well, on top of it, if you then think about the customer and merchandising to the customer, the real formats for home we basically participate in all of them.

You know, for Wayfair, we've got the everyday store with the huge selection, by far the biggest addressable market there where we really can take care of any customer every day. Then we've got the private sale format, you know, with Joss & Main. Now, that's a nichey format, only really relevant for the customers who are highly engaged, who really like—you know, they're kind of fanatical about—they're home décor enthusiasts, you know, and for them, it's great but that's going to be a small amount of the total market, right? Then we've got the lifestyle retail format. If you think about, you know, the catalogers you know or the specialty retailers you may love, well that's what Dwell

Studio, that's what Birch Lane are, right? So what we're doing is we're able to tackle more of the addressable market because of the fact that we have these brands that allow us to participate in sort of every merchandising format, and that's why we think all these brands are additive, and then if you think about what Dwell Studio and Birch Lane also are is they're basically private label as well, so that gives us a lot of room to grow.

Neely Tamminga

Really helpful, thank you. Best of luck.

Michael Fleischer:

Thanks, Neely.

Operator:

Our next question comes from the line of Matt Nemer from Wells Fargo Securities. Your line is open.

Matt Nemer:

Thanks so much. Good morning, everyone, and congrats. So my first question is around AOV. I realize that it's primarily a function of mix, but I would think that in the holiday, those incremental holiday sales would put downward pressure on that given that there's probably more giftables than large furniture items. So can we tie the AOV strength to repeat customers that potentially are spending more?

Michael Fleischer:

I think it's a mix, Matt, as you point out. So AOV was up year-over-year but it was down a little bit sequentially, so I think it does take into account that sort of—the smaller, more giftable side of holiday. I think on the repeat purchase side, look, it remained very strong. Obviously in Q4, we added a huge number of new customers and even with that giant new customer adds showing up in the denominator without those people having an opportunity to repeat, we really maintained very solid repeat rates, you know, 50.3% of the orders coming from repeat customers in the quarter.

Matt Nemer:

Okay, and then also, the gross margin came in stronger than we expected. It's usually down sequentially for obvious reasons, and you may have talked to this and I potentially missed it, but is that primarily merch margins, or are there kind of freight or other considerations that drove the strength?

Niraj Shah:

Well, you know, one of the things we mentioned—hey, Matt, it's Niraj. One of the things we mentioned was, you know, we did have a very concerted effort of planning the items that we were going to feature and sourcing significant discounts on them from our supplier partners and planning for that inventory to be available and so on and so forth, and obviously, that can have a benefit in terms of merch margins. On the transportation side, we're always looking to unlock value on the transportation side, so that's kind of an ongoing thing and there are occasional times where you get a little step-up and so on and so forth. But I would think of gross margin, you know, look, it's going to have some volatility in it, it's going to go up and down so I would be really careful. Now, I said—you know, when it went down, I said this, I said, hey, you know, I don't think of kind of 20, 30 basis points is a big swing down. Well, here, it went up I'll tell you though the same thing, right? So, you know, it's going to have some volatility but the general trend on gross margin over time is going to be flat to up, it's going to have a little bit of volatility, we are seeing the success though in unlocking discounts from suppliers, transportation savings and private label, so we have confidence it'll be flat to up over time but I wouldn't read too much into, like, you know, 10 basis point swings.

Matt Nemer:

Okay, that's fair. Then just lastly, on the Birch Lane shipping charge—change that you recently made, should we read that as an effort to sort of, you know, add some more growth to the brand, or the brand's doing great and you're, you know, hitting the gas—you know, is it…

Niraj Shah:

Yes, yes.

Matt Nemer:

(Cross talking).

Niraj Shah:

Here's the thing. Yes, but here's the thing. By the way, the brand's doing great and we're hitting the gas, would be the short answer to your question. But a slightly longer answer is, you know, we do a lot of consume survey work, qualitative and quantitative, and there's no question customers are not interested in paying for shipping. There's also no question that shipping is a real cost in the world, but you know, so is the QA guys you have in Asia who look over the product but you don't have a QA for product cost as a separate line item when someone buys something, right, and you don't have import duty as a separate line item, you don't have ocean freight as a separate line item. So our philosophy is, you know, the customer wants it simple and they want to find an item they love and, you know, message to them, hey, so we offer free shipping over $49, it makes their life easy, it's not our job to make their life harder and so I think a lot of the retailers who try to break it all out to find a way to get a few extra dollars is not as customer aligned as it could be, and so that's our philosophy, is to try to very customer aligned.

Matt Nemer:

Excellent. Thanks so much.

Michael Fleischer:

Thanks, Matt.

Operator:

Our next question comes from the line of Michael Graham from Canaccord. Your line is open.

Michael Graham:

Thanks. Just wondering if you could give us an update on, specifically within customer acquisition there, you mentioned that customer acquisition cost was not going up, which I think is really positive. Any comment on, you know, where in the funnel you're seeing strength or weakness? Like, is the top of the funnel doing really well, or are you having really good success with retention? Any comment you can make specifically about the social media channel and whether the pressures are going up there for you or not and how you're sort of mixing against that?

Then lastly, can you give us an update on how you're thinking about customer lifecycle? A lot of investors are wondering, you know, is—if the long-term payback for customer acquisition is there because, you know, you—there's a finite period at a time where you're sort of occupying a home for the first time where you're buying things for it and just wondering what your updated experience is around customer lifecycle. Thanks.

Niraj Shah:

All right. Sure, Michael. It's Niraj. Thanks for the questions. Okay, so on customer acquisition costs, you know, I think the way to think about that is the whole strategy we shifted to starting in early '14 was a much bigger focus on the top of funnel. So we've always been in the bottom of funnel but you could almost think of it as we were always maxing out the bottom of funnel. What we really added in the mix though was a big concerted effort to become very significant at the top of funnel, which gets much more brand loyal customers who then get to know the Wayfair brand, use us their go-to. That shift of mix to higher value customers and that's been very positive for us, that's not brand new though. That's been going for—you know, tested in '13, going all through '14 and you're starting to see that the leverage is coming through in the advertising cost because of that, right? So in terms of more of those customers and they're coming back more and more often, that means that this quarter what we spent on advertising for those customers is really nominal relative to their revenue, right, so all of a sudden we're getting a lot of leverage because that drags down the effective ad cost as a percentage of revenue. Also things like television which is kind of like a fixed cost now as we get bigger and bigger is leveraged, drags down that ad cost—you know, the (inaudible) ad cost as a percentage of revenue. So that's working really well.

In terms of the social media channels, you know, I think a lot of people talked about that and here's the way we look at it. Any channel eventually gets inefficient or meaning the price premium gets tired than it's warranted. So we built the Company in the initial, initial days, you know, 2002 to 2007, off the back of Google ad words, and Google ad words was cheap back then. I don't think you'd find anybody who says that it's inexpensively priced today, and so what happens is you can't be relying on any one product. The product last year that a lot of people relied on very heavily was the ad unit Facebook offered in the news feed, which was an incredibly good ad unit. We used that fairly heavily too. Well, that unit started to get very, very expensive and so if you were overly reliant on that unit, you would then have a problem because you would have to either chase it or you'd lose a lot of volume.

Our attitude has been to never be reliant on any given ad unit, on any given partner, and so we have a tight relationship with Google, we have a tight relationship with Facebook, we have a tight relationship with quite a few different folks on the media side and we're always putting a disproportionate amount of effort into what's new. So for Google, today, that might be trying to figure out mobile and figure out YouTube, and for Facebook, it might be some of the new ad units that are focusing on mobile, and if you do that, you figure out breakthroughs, you then can buy that inventory while it's priced very well and if it gets more and more expensive, you may buy less of that inventory but hopefully you're working on new ways to reach your customer. So that's why we're not—you know, because of the way we approach it, we're just not at the mercy of any one ad units particular price in our market.

On the second question you had, customer lifecycle, you know, it is—you know, how do you think about, like basically frequency, right, because it just spikes up when they're moving or buying a home or what have you. Here's the answer to that. We—even after the success we've had, our annual spend per customer (inaudible) number is, like,

$342, right? That's just not that much when you think about who our customer is, right, so you know, our—the middle of the bell curve, right, it's a 45-year-old woman, family of four, household income $90,000, right, and so think about everything she's buying, not just furniture but the pillows and the bedding, you know, and towels for the guest room and the bathmat and the doormat and the cookware set. If you add up all of the potential spend that we could address, you actually get a fairly high frequency and a fairly good sized amount. So that $200 average order size on 340 a year doesn't reflect the person who's buying a new home. The person who's buying a new home is spending way more than that, right, but it does reflect an overall bend where we're just trying to be the go-to shop for someone for home products every day, and we can actually still take a lot of share of wallet on that and have that number rise without sort of having this problem because, you know, we've sort of saturated the movers. So I still think there's still a lot of room.

Michael Graham:

Okay. All right, that's great. Thank you very much.

Operator:

Our next question comes from the line of Justin Post from Bank of America. Your line is open.

Paul Beaver:

Hey, guys. This is Paul Beaver for Justin. Congratulations on a strong quarter. Couple of questions. As you invest in advertising and acquire new customers, can you give us some color on how the new customers are performing relative to the older customers? Then secondly, you briefly touched on some private label comments. Can you just give us an update on how your private label initiatives are going on Wayfair.com?

Niraj Shah:

Sure, Paul. So on the first question, kind of performance of old versus new customers, the easiest way for me to tell you about the new customers would be to have the conversation a year from now when they're not quite as you, but the truth is we do measure everything from, you know, three-day to seven-day to 14-day and 21—you know, we track them very tightly. Here's the thing. We are seeing great results from new customers. The number one reason though is at 3.2 million active customers, which, you know, folks say, “oh wow, that's really good and you've grown it a lot,” that's a small amount relative to the addressable market. Because of the format of Wayfair being an everyday store and because of the size of the market, in the US alone, you're talking about over 40 million households in our target market, and we would address even more than that when you get outside of just the core target of 60 to 175,000 household income. You know, what you end up with is lots and lots of running room before you'd hit diminishing returns. So we know—quantitatively, we're seeing great performance from new customers, and also, just from a—if you take a step back and you look at the forest instead of the trees, it makes all the sense in the world to us that we would have a lot of running room.

Michael Fleischer:

Yes, and one other thing I'd add, Paul, is if you—we put a new slide in our investor presentation. It's available on the IR website, maybe a month or two ago that shows the revenue curves of the 2011, '12, '13, '14 customers, and so you can really see how each year's group of customers is sort of outperforming on an ongoing revenue basis the year prior.

Niraj Shah:

I guess, one last thing I'd just mention there, we put—posted some slides on the website which talk you through sort of a way you could estimate looking at CAC, and CAC is like (inaudible) and it's going to move around a little bit from period to period, but in general, it'll give you a feel of how you could look at that trend over time and that'll also, I think, give you a lot of comfort that we're nowhere near saturation.

On the second question about private label, to be honest, this is kind of the same thing we've been saying, which is just it's still early. You know, it's growing really well, but it's still a small portion of our total, but we're seeing really nice performance there and we're investing a lot into scaling it up, and we—you know, the vast, vast, vast, vast majority of the gains are ahead of us instead of behind us and it's still a small portion still of the business today, albeit on a nice growth curve.

Paul Beaver:

Okay, thank you.

Operator:

Our next question comes from the line of Mark Miller from William Blair. Your line is open.

Mark Miller:

Hi, good morning, everyone. Just the Company's gotten significantly greater scale. I guess we've talked about many of the things, but I'd like to hear your summarization of what you think the largest network effects right now are for Wayfair. I mean, obviously TV spend gets leveraged, but as we think about the growth then through 2015, we're talking a year from now, what are the new capabilities you think you're getting that are most important with this rapid growth? Thanks.

Niraj Shah:

Yes, so the biggest way to think about that, and it's—in our business, there's not, like, a single network effect; there's a multiple set of things that you do that, in aggregate, create the network effect. So as you mentioned, the brand getting bigger obviously creates a network effect. The second is, you know, we talked about private label a second ago in terms of exclusive items. We've talked about the site merchandising effort we have and the product effort we have of what we're doing on the website, the 300 engineers and data scientists. Well, they're—as we make the site better and the mobile site experience better and better for product discovery across the seven million items which requires deploying a lot of technology and all the imagery we take out of the two photo studios we operate and all this, well that's all expenses but we can afford it because of the revenue base we have. Well, and if you think about that, that creates the customer experience to be highly differentiated and unique, which drives customers back and competitively creates a bigger moat, bigger defensibility in terms of what a competitor would need to do to try to address it, so on and so forth.

Then we do the same thing on the operations side, so the supply chain, the leverage we have with our suppliers, the amount of inventory we can move, the way in which we do the transportation network to take cost down, the way in which we do the logistics and delivery to the home to make the customer experience better and better, to take time out to deliver faster and faster. So this all, in aggregate, creates the network effect where by far and away, the best place for you to shop for your home ends up being on our brands, which then customers then are more inclined to try it and then they like it, so then they come back, and it just raises the bar of customer expectation on what can be had out there. The Birch Lane $49 shipping is an example, right. You can just tell the customer, hey, even in lifestyle retail, you shouldn't have to pay for shipping. Well, then the customer says, well, you're right, why should I have to pay for shipping there? I don't pay for shipping on any other ecommerce. Well then the customer realizes, well, it makes no sense to pay for ship—right, and so this all just adds up. Well, we can do that because of the transportation network, so it just all ties together.

Mark Miller:

Right, so I mean there's kind of a tipping point, I guess, for your internal capabilities but then—and then from an investor standpoint, where do we see that sort of tip for investors in terms of begin to see that Adjusted EBITDA margin percent begin to change, move aggressively to—towards positive or zero? Thanks.

Niraj Shah:

Yes, so the way I think investors should look at it, in the near term, the place you're going to see leverage is on the advertising expense as a percentage of net revenue line, right, so you're going to see that. That's the biggest line that we've had questions on, and that line's going to—you're going to start see—you're already seeing it, but you'll see it year-over-year in a really nice clean way, and that's sort of where the most questions are. Then over time, as I mentioned, gross margin and the op ex line, so you have the two headcount, major headcount lines below gross margin, well also are going to have leverage. Those'll plan over a longer period of time. There's less leverage to get there than there is on the ad cost line, but you're going to see it in all three, but in the near term, you get to see it on the biggest line and the one that, frankly, has had the most questions.

Mark Miller:

Excellent. Thank you very much.

Operator:

Our next question comes from the line of Shawn Milne from Janney Capital Markets. Your line is open.

Shawn Milne:

Thanks. A lot of questions have been answered. I just wanted to touch on a couple of things. First, just on the supply side, there hasn't been, I don't think, much of a change in the last quarter, so just in the vendor count. Maybe you just did a discussion on opportunities to continue to expand selection through '15. And then, you know, Michael, I know you mentioned a couple of times how unique the holiday was, and it's certainly early to understand sort of the repeat behavior of the customers that you got in the fourth quarter, but I get the sense that you're being a little bit cautious thinking that maybe this wasn't the same type of customer, or is it just too early to tell if that behavior—you know, if these customers you acquired in the fourth quarter will act similar? Thanks.

Michael Fleischer:

Yes, let me start with the second question before Niraj talks about the supply chain. These customers, everything looks like all the rest of our customers. I didn't mean in my comments to imply that the customers we acquired in the fourth quarter were any different. Really, what I wanted to make clear to everyone was, one, we acquired a lot of customers in the fourth quarter. This is the ongoing outcome of all the investment we've made in ad spend throughout the course of the year and our change strategy and investment there. Then secondly, obviously because it came at the—because the revenue from customers came late in the quarter at the holiday, it flowed through and we weren't adjusting our ad spend commensurately so it flowed throw to the EBITDA line.

Niraj Shah:

Then a quick answer on your first question, you know, I don't think we've released an updated supplier count number. We can add that in for next quarter. You know, we do add suppliers over time, and we rarely lose them, so—but at the same time, we work with quite a few folks. In terms of selection through '15, I'd say our big focus on selection is that, you know, there are some categories where we do feel like we need to onboard a fair amount of selection, which are very specific kind of subcategories that maybe we haven't been in as long and so on and so forth, but in general, the focus on selection is more nuanced. So other words, when we look at upholstery, it might be a specific price range and specific styles we're going after, and so we're really trying to be very aggressive building out selection in certain areas, but that's where the massive selection is, and then obviously, we have a big push on exclusivity and exclusive items and private label, which is a type of selection that we do have a lot of effort on. So those are the types of things we're really focused on right now.

Shawn Milne:

Great. Thank you.

Michael Fleischer:

Thanks, Shawn.

Operator:

Our next question comes from the line of Scott Devitt from Stifel. Your line is open.

Scott Devitt:

Hi, thanks. A different way of asking a prior question, but you've been public now such that you've been able to give guidance once at the end of 3Q as a public company and then you reported 4Q, and I know you mentioned the back-end loaded nature of the quarter and the strength and the customers acquired late in the quarter, but I was wondering if you can just talk a little bit about your approach to guidance, you know, so that we have an understanding as well how to think about the guidance that you put out, because I think you beat the midpoint by over 10 percentage points for the quarter so understanding that, you know, in terms of future guidance, including 1Q I think is important.

Then secondly, free cash flow, because of the inventory model that you have, it's highly cash generative. There were some unique items in '14. Could you just normalize that? Is '13 a more normal year in terms of the free cash flow dynamics of the business on a full year basis, and can you walk us through those dynamics in '14 on a full year basis?

Then finally, the other, or indirect revenue, Niraj, you mentioned, you know, assuming that continues to fade throughout time, I guess my question is, does that fade until it goes away? Is there a level at which you're comfortable with third party distribution or do you just think that that's not a relevant part of the model long term and so we should fade that towards zero over several years? Thanks.

Niraj Shah:

This is Niraj. I'll answer the last question and let Michael answer the kind of guidance, free cash flow question you had. In terms of the other revenue, you know, I wouldn't necessarily fade that to zero. Here's the way I think about that. We have a handful of partners in the partner business, which is part of the other, and some of those may fade a fair amount and some of those I don't think will fade away. Some of those are—could be good long-term sustainable partners. So the reason we say that it'll kind of you should probably model it sort of down or flat to down is just that we are not focused there on growing that at any cost. Our primary goal is to grow our direct retail business, and then depending what our partners want to do there and what makes sense for us with our partners, there are things we do that grow that business with certain partners and there are things we do that don't. Given a retailer partner there may get a new head merchant or may change their technology platform in a way that could hurt our business with them or they may change it in a way that helps our business with them, so there's all these things there, so I wouldn't fade it to zero.

The other thing I'd point out though is in there is also our media business, and our media business is relatively small as a portion of the revenue in there, but it's very high from a gross margin and kind of profit contribution standpoint. That today sort of doesn't—it's not at the size where it's at all significant relative to the total amount there, but that is a shift that'll also happen over time, and that piece obviously, we're not planning on having go away. We're actually focused on really growing it, and it's actually—you know, we put out a release about what we're doing with Sherwin Williams and there's a lot we think we can do with different partners there and we're very excited about that.

Michael Fleischer:

Hey, Scott. To your guidance question, look, I think our approach is we're—in the end of the day, we're in a consumer business, right, and so the consumer has to show up. So as you know from our many discussions, we're highly oriented, we've got great systems, we sort of know exactly what's going on in our business minute by minute. That's one of the benefits of ecommerce, but at the same time, customers have to show up and sort of make purchases, and so there's a certain amount of conservatism that I think we have to build into how we think about what we're going to put out and tell you we're going to deliver upon on the top line. Then I think as we think about the EBITDA line, as I tried to make clear in my comments, we're managing, particularly on the ad spend line, and Niraj reiterated this in the Q&A here, we're managing how we put that spend into the market as we see how the revenue is coming in because we're targeting trying to deliver a certain spend level. So I think we intend to do that, deliver the EBITDA margins that we say we're going to deliver and—but again, with some built-in conservatism around the revenue side for obvious reasons, in that we just don't know exactly which consumers are going to show up and on what day.

On the free cash flow question, I don't think there were actually that many sort of particularly unique items in 2014. I think, in Q4, right, because we have a bunch of sales to customers where we clear cash in December but don't actually pay the suppliers until January, there's a clear pattern between Q4 and Q1 where Q4 is a big free cash flow quarter and then Q1 a big free cash outflow quarter, and that pattern has held. But I think, generally, if you look at—the way I think about it is if you look at our free cash flow compared to our EBITDA, whether it's for a particular over the course of the year, what you're going to find is free cash flow is better than EBITDA, and that's held true and that's that great cash flow characteristic of our business, right, which is that we're getting paid very quickly by our customers immediately on a sale and that cash is coming in the door right away and then we're paying the suppliers quickly, you know, within 30 days give or take after, but there's that sort of really nice free cash flow characteristic of our business, and with no inventory or very low inventory capital deployed and no stores, which we don't need to use that cash somewhere else.

Scott Devitt:

Thank you.

Operator:

Our next question comes from the line of Mark May from Citi. Your line is open.

Mark May:

Thanks. I think this was addressed earlier, but I just want to circle back on it. It looks like a decent amount of the upside on the revenue in the quarter came from AOV. Just wondering if you could maybe provide a little more color. Was there—in terms of details around product mix, if that was a driver of that or any changes in your discount or promotional activity, or maybe there's something else?

Then another question, just, you have a number of brands that you're investing in. If you were to back out some of the investment in your emerging brands like Joss & Main and others, what would the operating margin profile be at the Wayfair brand? Thanks.

Niraj Shah:

Sure, Mark, it's Niraj. I'll add a couple of comments and then Michael can chime in if he has more. I wouldn't think of AOV as being that big a driver. I mean, if you look at various quarters of the year year-over-year, you know, if you look at Q3, I think Q3 you're going to actually see potentially more AOV lift year-over-year than you see in Q4, but long story short, AOV is a small portion of what's changing. The biggest factor is actually the engagement of the base (ph) and the repeat and the activation of new customers, and you can do the math on new customer account growth and that, but those dwarf AOV as an impact, I think.

In terms of how you think of the various brands and their contribution, you know, that's—we're clearly investing across the board, right? Wayfair is by far our biggest brand, so in that sense, you know, it's obviously—when you think about the customer account growth and things like that, it's going to be the huge piece. But if you take a small P&L that's emerging, like Birch Lane, which is a little over a year old, it's doing great, but if you look at it on, like, a margin, percentage margin type thing, you know, something like that is going to not be performing very well, right? It's going to be disproportionately taking investment because it's so early. So it's all in how you look at it.

Michael Fleischer:

Right, but I think the emerging brands, also the dollar values are much smaller.

Niraj Shah:

Super small, yes.

Michael Fleischer:

I think maybe we have time for one more question.

Operator:

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

John Blackledge:

Great, thanks. Just one question. Niraj, maybe could you discuss how you think Wayfair is positioned competitively now, you know, with brand awareness rising, strong customer growth, the large supplier network, all the good things that are going on maybe relative to a year or two ago as the Company drives toward share gains of this really large addressable market? Thank you.

Niraj Shah:

Sure. I mean, look, I think the financial results are essentially a function of that, right, and so if you look at our rate of growth in the direct retail business and you look at the total category growth, there's no question we're growing at a multiple of that. Now, you could say, okay, well—but you're investing in advertising so you're getting the customer through advertising. Well, that's true, but then you look at the advertising leverage we're getting and how advertising cost as a percentage of revenue is coming down and the growth has remained very high; that's a function of getting a customer through advertising who's then coming back, who's very engaged. I think, well why are they doing that? It's basically, A, the brand is getting stronger; and B, everything we're doing on the customer experience, ranging from merchandising and the product discovery and the way in which we engage them with content and inventory to the delivery and logistics and how we take care of them on the service end is the reason they're coming back. So I think, competitively, if you're talking about building kind of the breakaway brands for home online, we like to think we are, and we think the customer behavior sort of shows that, and we are very excited because we think we can continue to actually build a lot on top of what was built, which will make it even better and better for the customer.

John Blackledge:

Thank you.

Operator:

At this time, I'd like to turn the call back over to the presenters for closing remarks.

Niraj Shah:

Thanks, everyone, for joining us for the call and we appreciate your time, and we look forward to chatting with you again soon.

Operator:

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