Wayfair Inc.
Q1 2015 Earnings Release and Conference Call
May 11, 2015

Operator:

Good morning. My name is Jonathan and I will be your conference Operator today. At this time, I would like to welcome everyone to the Wayfair Q1 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. 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.

Ms. Kate Gulliver, Director of Investor Relations, you may begin your conference.

Kate Gulliver:

Good morning and thank you for joining us. Today, we will review our first quarter 2015 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co-Chairman, Steve Conine, Co-Founder, Chief Technology Officer 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 guidance for the second quarter of 2015. These statements are only predictions based on assumptions that are believed to be reasonable at the time they are made and are subject to significant risks and uncertainties. You should not rely on these forward-looking statements as representing our views in the future. Except as required by law, we undertake no obligation to publicly update or revise these statements. Our actual results may differ materially and adversely from any forward-looking statements discussed on this call. For a discussion of factors that could affect our future performance, results and business, please refer to our Annual Report on Form 10-K, our quarterly report or from 10-Q which we expect to file in the near future and other reports we have on file from time to time with the SEC.

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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, and the slides accompanying this call 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 Shah:

Thanks Kate, and thank you, everyone, for joining us today. We are pleased to report strong Q1 2015 results.

Total net revenue for the quarter was $424.4 million spend leverage this quarter. We believe the growth rate this quarter underscores the size of the market opportunity, the rapidly changing and favorable dynamics of how customers purchase home goods and Wayfair's unique position in the market.

As we've said before, the market opportunity for Wayfair is very large. Euromonitor estimate spending in our category in 2018 will be $264 billion in the United States and $308 billion in Europe. As a combined $572 billion market opportunity in the geographies we serve. Of course, the online portion of the market is just a fraction of the total.

When we started rate Wayfair 13 years ago, people didn't think that customers could get comfortable buying furniture and decor online. But over the past decade, as consumers have acclimated to purchasing a wide variety of products online and as the advantages to the online shopping experience have become apparent, that is to say vast selection, inspiring merchandising and attractive prices all from the convenience of one's home, we have seen growing consumer comfort with purchasing furniture and decor online.

Within this favorable market context, our team continues to refine, expand, and promote the Wayfair offering as we work to become the online destination for all things home and our direct retail growth rate this quarter is reflective of all of that work. As of April Wayfair.com now enjoys 62% aided awareness. We believe this growth and brand recognition over such a short period is driven largely by the increased marketing efforts we've taken over the past year. As a result we ended the quarter with 3.6 million active customers, an increase of 49.3% from Q1 2014 and up 11.8% from Q4. While new customer growth has remained strong, our growth rate in Q1 was also driven by improving repeat customer behavior further underscoring the strength of our offering. Orders from repeat customers reached 53.9% in Q1, up over 300 basis points from Q1 2014.

A key driver of both our customer acquisition growth and repeat gain is the consumer experience on our site. A whole host of Teams including Engineering, Product, Merchandising, Design, Storefront all work together to help our customer discover the product she wants in an easy and engaging manner. This is not an easy task with over 7 million items for sale, and so to give you a little more color on how we think about the site and storefront and the improvements we've made and all the Teams that work on these initiatives I'd like to turn the call over to my co-filed founder, Steve Conine.

Steve Conine:

Thanks Niraj. And thank you all for joining us today. As Niraj described the way the consumer interacts with our site is critical to getting both that initial purchase in helping to drive loyalty. We believe our site experience, custom-built for the unique needs of the furniture and decor market is a key differentiator for Wayfair. There are hundreds of people at Wayfair from engineers to designers to merchants to data analysts who work everyday on refining the Wayfair shopping experience.

For example, our Wayfair.com site and product Teams comprised of over 200 merchandisers, designers, editors engineers product managers and business analysts track our customer behavior throughout her shopping experience to understand where and how she engages with this site and our products. The Teams use both technology enabled and hand curated design elements to help improve customer engagement. With over 7 million different items, we likely have what a customer is looking for, but the search criteria can’t easily be typed into a search bar. For example, bathroom vanity for small bathroom is highly subjective. Our site merchandisers aim to help you find that perfect end table, decorative pillow or tabletop accent in the most engaging exciting efficient way possible.

Recent examples of this work are in the new category landing pages. The page acustomer first clicks on when shopping a specific product group. Previously these were entirely computer-generated and only showed customer’s basic navigation options. From the more than 3 million customers we sell to today and the millions more who visit our site we've learned that to find that perfect item for your home, it takes a lot more than basic search and navigation. Our new category landing pages help the customer truly discover the right product by combining proprietary imagery from our photo studios, helpful content and buying guides, created by our editors, trend forecasting from our merchants and enhanced navigation and discovery from our engineers.

The result is a 25-35% reduction in exit rates in our revised landing pages in Q1 2015 compared to the same period a year ago. In the past nine months the site merchandising Team has updated over 600 of these pages and we expect to see continued improvement as we rollout this initiative across our family of brands. For example of the types of changes we've made with the category landing pages, please check out the slides accompanying this call on the Investor Relations website. Of course, the right technology infrastructure is critical in enabling a high quality customer experience. Our over 300 engineers are continually updating both our front end and backend infrastructure. Among the many initiatives they focused on recently was the complete overhaul and updating of our JavaScript update. We know that site speed impacts revenue and as our user experience gets more gets more dynamic we need to maintain and improve our speed.

Our new JavaScript framework is approximately three times as fast as our old framework for typical browser activities with less than half the code. Because there was no existing commercially available solution for our specific needs this work was done entirely in house starting this past November. The new framework allows our designers to use more exciting content on the site while improving the user experience through faster speeds and better customer interaction with the storefront. Our engineering talent and the technology that enables both the front end customer experience and our back end supplier management and fulfillment processes are key differentiators for us and therefore, we are update and refining our tech infrastructure in much the same way that we regularly evaluate and work to improve the way the customer experiences Wayfair. We believe the improvements made this quarter both in the underlying site architecture and the resulting user experience help to contribute to the direct retail growth rates and will continue to do so going forward.

I'd now like to turn the call back over to Niraj.

Niraj Shah:

Thanks Steve. Before handing the call over to Michael, I'd like to focus for minute on our advertising spend. It was a year ago in Q1 2014 that we began to aggressively ramp our advertising spend to both grow our brand awareness and improve customer lifetime value through the acquisition of customers who have a higher propensity to repeat. We've made significant progress on those goals throughout 2014 and into 2015 as awareness, customer growth and repeat behavior have all continued to improve. We are particularly excited that this quarter we are seeing these improvements while showing meaningful ad spend leverage. On this call last quarter I shared with you that advertising spend as a percentage of sales was expected to improve by 200 basis points year-over-year in Q1 2015. As a result of comping over the large step up in advertising in Q1 2014. Well we are excited to deliver on that forecast with 220 basis points of advertising spend leverage achieved year-over-year, while improving in our key metrics of customer acquisition and repeat behavior.

Throughout 2015 on a year-over-year basis we expect to see continued leverage on this line item as our somewhat fixed TV ad spend leverages and as we see ongoing repeat buying behavior from our previously acquired customers.

Overall we are very excited about the acceleration of the direct retail growth rate this quarter. We believe this growth is a clear result of the work that we've done to improve the customer experience, expand and improve our selection, refine our logistics infrastructure and grow our brand. And we are excited about the impact these efforts have had on revenue growth and advertising leverage.

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

Michael Fleischer:

Thanks, Niraj and good morning everyone. I'm going to highlight some of the key financial information for this quarter with more detailed information available in our earnings release and in the slides accompanying this call both of, which can be found on our Investor Relations website.

For the first quarter 2015, our total net revenue was $424.4 million, a year-over-year growth rate of 52.3%. As Niraj described, this growth was driven by our direct retail business which generated net revenue of $369.4 million, a 63.4% growth rate over Q1 2014. Our other business which includes revenue from our small medium business and our retail partners grew 4.3% to $55 million.

A little over a year ago we started the strategic de-emphasis of our retail partner program to focus more on the direct retail business where we own the customer relationship. As Niraj and Steve highlighted, we are particularly excited with the direct retail growth rate this quarter. As a reminder Q1 2015 is comping off a very strong Q1 2014, a quarter that had direct retail growth of 87.4%. The growth in 2015 was driven by success in all our sites, but in particular continued strength and momentum in our largest business, Wayfair.com.

Our gross profit for the quarter, which is net of all product costs, delivery and fulfillment expenses was $102.8 million or 24.2% of net revenue. This is compared to 23.4% in the same quarter last year and 24.1% in Q4. As a reminder, we do see some quarterly fluctuations in gross margin due to the wide variety of products we sell.

As with last quarter, I will present the operating expenses on a non-GAAP basis excluding the impact of equity based compensation and related taxes which totaled $8.2 million in Q1 2015 and $4.5 million in Q1 2014. As a reminder, the equity based compensation expenses recognized in all line items that have headcount. For reconciliation of GAAP to non-GAAP reporting, please refer to our earnings release in slides accompanying this call on our Investor Relations website, which include a version of the P&L on a non-GAAP basis excluding the impact of equity based comp and related taxes.

Customer service and merchant fees were 3.7% of sales compared to 3.9% in the same period last year. Advertising spend was $58 million or 13.7% of revenue in the quarter compared to $44.2 million or 15.9% of sales in Q1 2014. As Niraj spoke to a minute ago and as I described on our last call, the majority of the leverage in 2015 is expected to be from the ad spend line. Repeat buying behavior by previously acquired customers helped drive ad spend efficiency in Q1 as we need to spend far less on driving our existing customers to buy again.

Orders from repeat customers rose to 53.9% of total orders compared to 50.7% in Q1 2015. And remember this number is somewhat muted because the large number of new customers added in the quarter may not yet have had a chance to repeat. TV advertising provided additional leverage due to the somewhat fixed cost nature of our TV spend for Wayfair.com in the U.S. We expect this spend will continue to grow, but at a rate far lower than revenue helping to drive the leverage we see in ad spend.

Even with the leverage in ad spend, we are still seeing strong gains in customer acquisition adding 380,000 net new customers for 3.6 million total active customers. This compares favorably to the 318,000 net new customers gained in Q1 2014 and the 359,000 net new customers gained just last quarter. We believe this continued strength in new customer acquisition is the result of our increased highly efficient ad spend and the growing awareness and residence of the Wayfair brand. Our brand building effort began with the rebranding of the site in 2011 and accelerated last year with our increase in ad spend. This growth in new customers combined with the more favorable repeat dynamics contributed to our strong revenue growth this quarter.

On the remainder of our operating expenses we achieved higher than forecasted leverage which blows through to the EBITDA margin. These categories are largely headcount related and the leverage is somewhat due to slower than expected hiring. To continue to meet the needs of our business and grow, we had planned to expand Teams in merchandising, marketing, technology, and operations throughout 2015, but with a hiring emphasis in Q1. We believe the wide range of talent on our Team is truly what differentiates us from our competitors and for any position we will only higher when we find someone with the right fit and the right skill set. Individuals who are hard-working, intelligent, Team oriented and obsessive about data. While we continue to find talented people, we hired a net total of 191 people in Q1. The rate of hiring has been slower than forecasted. We expect to hire more people throughout the year, which will offset some of the leverage gained in Q1.

Our merchandising, marketing and sales spend on a non-GAAP basis was $19.4 million or 4.6% of net revenue compared to $11.3 million or 4.1% of net revenue last year. This category is largely headcount and an increase in spend reflects our continued focus on improving the customer experience through the product offering in front end site as well as our brand building efforts. We regularly edit headcount to these groups to meet the growing needs of our business and will continue to hire for these Teams throughout the year.

Non-GAAP operations technology and G&A expense was $28.6 million for the quarter or 6.7% of net revenue compared to $22.1 million or 7.9% of net revenue in Q1 2014. Our engineering and operations Teams are the backbone of our organization, building the infrastructure necessary to provide our customers with a best in class experience from product discovery, two product delivery.

While we will see some leverage in these Teams in 2015, the 120 basis points of leverage this quarter was partially a result of delayed hiring. We do anticipate ongoing hiring in the next quarter's aswe build out our sites and logistics infrastructure for our expanding customer base.

Adjusted EBITDA for the quarter was negative $12.3 million or negative 2.9% of net revenue compared to negative $19.4 million or negative 7% of net revenue in Q1 2014. The year-over-year improvement in EBITDA margin was largely driven by leverage in our advertising spend, the remaining improvement was a result from the operating expense leverage I just noted.

Non-GAAP free cash flow for the quarter was negative $51.4 million based on net cash from operating activities of negative $35.2 million less capital expenditures of $16.2 million. While our low inventory model results in attractive working capital dynamics, due to the timing of supplier payments, post the strong holiday season, our first quarter typically has a large negative free cash flow. This year our high growth in Q4 means that we had a larger cash outflow for supplier payments in Q1.

Non-GAAP diluted net loss per share was negative $0.23 on 83.2 million weighted average common shares outstanding. As of March thirty-first we had $359.6 million of cash, cash equivalents and short and long-term investments. This quarter we moved some cash to instruments with slightly longer maturities, but under accounting rules are characterized as long-term but have maturities of only two or three years.

Our inventory level was 20 million or 1.4% of LPM sales. Our business model and our strong supplier relationships have allowed us to maintain very low inventory levels even as we have expanded selection, styles, and proprietary offerings.

Overall we are very excited with our first quarter results. I'd now like to offer guidance for Q2 2015.

We forecast direct retail revenue of $380 million to $390 million. Our direct retail revenue guidance and growth rates reflect the acceleration we saw in the business in Q1. We expect other revenue to be between $45 million and $50 million for total net revenue of $425 million to $440 million. We expect EBITDA margins of negative 3.5% to negative 3.75%.

Similar to Q1 2015, we expect year-over-year leverage on the ad spend line as we continue to see the benefits of our strategy to acquire more high-value customers. Though remember, the ad spend line shows leverage on sequential quarters last year and as such, the year-over-year ad spend leverage will be less than in Q1.

As I described last call, we give EBITDA guidance as a percent of revenue, this is how we manage the business within the quarter and make ongoing investment decisions. Therefore, if we overachieve on revenue, the nominal dollar losses albeit at the guided or even better percentages could yield a higher nominal dollar loss. For modeling purposes for Q2 2015, please assume equity based comp expense of approximately $10 million, average weighted shares outstanding of $83.5 million depreciation and amortization of approximately $7.5 million.

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

Niraj Shah:

Thanks Michael. We're pleased with the first quarter results, in particular the revenue strength and growth acceleration in our direct retail business. We believe the investments we made in 2014 and continue to make this year are creating an increasingly differentiated customer experience and are helping us create the leading site for the home. This in turn leads to higher growth, stronger customer loyalty, and allows us to deliver long-term value for our Investors. We remain excited about the incredible market opportunity here and we look forward to sharing more good news in 2015 with you. We would now be happy to take your question, so I will turn the call to the Operator.

Operator:

At this time I would like to remind everyone that in order to ask a question please press star then the number one on your telephone keypad. We will pause for just a moment to compile the Q&A roster. Our first question comes from the line of Neely Tamminga from Piper Jaffray.

Nelly Tamminga:

Great. Good morning and congratulations on some great results here. The first question here for Steve or Niraj, the all modern app launched in the quarter and we are just wondering—when you guys launch these apps on the new brands, do they tend to be good lead generators ot new customers or does it help with this sticky factor in keeping that customer to repeat purchase and then are there more apps on deck for some of your brands. That's the first question and I have a follow-up for Michael. Thank you.

Niraj Shah:

Thank you Neely and nice to hear from you. The answers actually what you said, the sticky factor. I'll let Steve comment on a little more how we think about it, but it's totally for our core base.

Steve Conine:

Yes, I mean, when we first launched these, we definitely—we do them for the loyal customers and then as we start improving the app we will definitely use more for acquisition. You will definitely see us roll out apps across our additional brands this year and in particularly internationally, which is exciting. And we just launched our Android app for Wayfair as well. So we now have a native Android app which we think is a nice improvement over the version we had out previously.

Neely Tamminga:

Great, thank you. Very much on that, and Michael question for you. Can we just step back a little bit? We've had a few quarters now underneath our belt, great results, revenues keep beating pretty meaningfully. Could you share with us a little bit more about your philosophy on guidance giving--the numbers that you've put out there, is it about where you think you are going to be or is it about where you are actually currently trending? Could you talk us through a little bit more on that. Thanks.

Michael Fleischer:

Thanks, Neely. We're guiding today really based on our most reasonable view of the performance from the quarter-to-date, right, so what we've seen so far in the quarter just as we did last quarter. And we are not trying to guide to some sort of outsized beat. But ultimately this is a consumer business and the customers have to show up. While the past performance is obviously an indicator, sometimes we're going to overachieve and sometimes we'll underachieve. This also gets magnified, I think when you look at the direct retail business growing north of 50% or you are at an inflection point in growth, and your growth rate, it just makes it harder to predict the balance of the quarter. Clearly last quarter we ended up with phenomenal performance towards the end of the quarter that resulted in the larger beat from our prior guidance, but we have to be prudent and try to give you guys a reasonable view of the performance based on what we know through today. That's sort of philosophically how we are thinking about it.

Nelly Tamminga:

Great, thank you so much, and best of luck out there you guys.

Niraj Shah:

Thank you Neely.

Operator:

Our next question is coming from the line of Matt Nemer from Wells Fargo.

Matt Nemer:

Good morning everyone. So first question actually is on the gross margin. I realize there is some mixed effects, which is somewhat out of your control, but I'm wondering if you could talk to how much of the improvement was driven by mix and how much might be attributable to core improvements and processes in distribution, et cetera. Thanks.

Niraj Shah:

Sure. Thanks Matt. It's Niraj. We've said for a long time that over time gross margin will go up albeit a moderate pace due to three things, private label, transportation efficiencies and greater skill getting us better economics with suppliers. And while those three are all true, I would say that what I said last year, which is just that gross margin—or last quarter, which is gross margin is going to bounce up or down in a band, which is not 10 basis points but tens of basis points and last quarter I said it was at the higher end of the band. This quarter I'll tell you the same thing, it's still at the higher end of that band. So in other words, if it was in the higher 23's that wouldn't really in my mind be it going down that much. Sort of had two quarters where it's been the higher end of the band. And those three things that will drive it up overtime are all in play, but the shift to private label, that plays out overtime, different transportation cost efficiencies we continue to get, but there is a lot of things in there that cause that to play out, not superfast and same with scale. So long story short, think of our normalized gross margin right now still in the high 23's with an incline expected overtime with this quarter sort of just being at the high end of that plus or minus band.

Matt Nemer:

Okay, great. That's super helpful. Then just secondly, I know you're not providing detail by brand, but I'm wondering if you could just comment on the Joss and Main performance given the churn that we're seeing on some other flash platforms. Thanks

Niraj Shah:

Yeah, sure. We think of Joss and Main as sort of being our brand for home enthusiasts and the way that brand is structured with the kind of the daily engagement, the ever changing offering, sort of makes it not a good fit for the bulk of the customers, but makes it a great fit for a small set of the customers. Now with our aspiration to be the preeminent online home retailer, the way we think about it is, we've got this big infrastructure that lets us handle sourcing millions of items, very efficient delivery into the home. Just all kinds of things that are fairly expensive to do and a scale you do well. So once you have that it makes sense for us, in addition to Wayfair, which can be a household brand name and a go to site, really large scale, and it makes sense to tackle sort of these nicheier (phon) offerings like the life style retail brands we have that give us a lot of private label like Birch Lane and Dwell Studio and the décor enthusiasts brand Joss and Main. That said, they all have different sizes (inaudible) these other brands outside of Wayfair are going to address a smaller pieces of the Tam (phon).

So we don't measure them necessarily as expecting them to grow at similar rate to one another or to get to similar size, but we have a profit profile in mind for all of them and we sort of focus on gaining outside share up until the point where they're kind of reaching maturity in their tam and then gliding into the profit profile, that's what we want. And all of which making sure that they ride on this infrastructure that we built so they don't create their own incremental fixed cost past that of the actual merchandising and marketing which they need to bear as part of the profit profile we want them to get to. That's how we think about it. There is no question of very large long-term opportunity from a scale standpoint as driven by the Wayfair brand and there's also no question that these other brands help us address the overall home market which we want to be the company on the online side that's the dominant guy.

Matt Nemer:

Got it. Great Thanks so much.

Niraj Shah:

Thanks, Matt.

Operator:

Our next question is coming from Heath Terry from Goldman Sachs.

Heath Terry:

Great thanks. I was wondering if you could give us a little bit of sense as to of what categories were particularly strong outperformers or to the extent that there were any that were underperformers this quarter especially as it relates to your marketing spend and the ROI that you target for those giving categories. And then to the extent that you are seeing this higher leverage or higher degree of leverage on your marketing spend, as you increase back to the normal ROI that you target in these given categories, is it reasonable or are you guys anticipating in the guidance that you are giving that we will see growth accelerate as you spend back down to that ROI or is there something else going on in that math that we should be paying attention to?

Niraj Shah:

Okay, thanks Heath. Let me try to answer your question. So first, you sort of said, are there some categories outperforming others and then how do you think about that relative to ad spend. The first thing I would just say is, we don't think of ad spend. Very little of our ad spend is tied to categories. The vast majority of our ad spend is really either around kind of building up the Wayfair brand proposition, which is if you think what we do about television or what we do with sort of some of the other online advertising we do that's broad-based, and then really the vast majority, that's a smaller piece relative to the second piece then the vast majority is about online customer, new customer acquisition. And online new customer acquisition again, is generally around the notion that Wayfair is the ultimate home store not with category led offering. So while there is some category product lead stuff like some search terms on Google or some of the PLA type advertising on Google, which is product lead, that is really not a terribly large portion of the total. So the way I would think about it is quantitatively we certainly measure any advertising we do for it to hit the ROI goals we have and so in that sense it's generally fairly equal. We don't try to invest in one category versus another from an advertising perspective. And then what we do from a merchandising standpoint, when we get a customer, we're obviously trying to put him in front of categories we think that are interesting to them. In the case of an emerging categories, for example we're doing a lot with seasonal decor and decorative accents right now. We certainly will feature them fairly broadly to see if we can get engagement with the base and the good news is we are, and then in that sense maybe it's a little more of a speculative bet, but it's unrelated to the advertising. That's more of merchandising decision of what you are leading with, say on the home page or in that seasonal promotion or what have you.

To talk a little bit about ad spend leverage, sort of unrelated to categories. The reason we are getting leverage right now is actually, it really has nothing to do with spending less or pulling—pulling down to a tighter ROI target. It's actually a totally different reason we're getting leverage. We're getting leverage simply because, the way to think about it is, the ad spend today—has been through all of '14, is comprised of television, which we've kind of said, is sort of a $38 odd million spend, which seems like a lot in absolute dollars, but relative to total ad budget, which is on the direct business, which call in the order of magnitude of 200, it's a relatively modest piece and think of it as somewhat fixed. And then you have a piece of the ad budget, which is for repeat business which runs at a pretty low single digit percentage of revenue cost relative to the revenue there. So the vast majority of the dollars are for new customer acquisition. What happens is you spend that money for new customer acquisitions, you get those people, they even buy necessarily in that period, but they buy in future periods and then they repeat in later periods and so what happens is as you're growing the revenue line, it's being driven by the fact that more and more people are repeating and people that you've gotten engaged with the brand in prior quarters become customers. So the math is you can actually keep spending a larger amount in absolute dollars and still be driving down the ad costs as a percentage of revenue significantly just by the nature of how TV is fixed and the nature of how inexpensive the repeat business is and you can see the repeat business is growing at a very good clip. So that is sort of the shape of it. Michael, do you have any thoughts on that?

Michael Fleisher:
The only other thing I would add, Heath, is when we gave guidance last quarter I think we were very clear about 200 basis points of leverage on the ad spend line and I tried to make clear in my comments earlier that people should not expect that level of leverage year-over-year because everyone needs to remember that from Q1to Q2 of last year we showed over 200 basis points of ad spend line sequentially, so we'll continue to have sequential on year-over-year leverage on the ad spend line, but it won't be as dramatic a number as it was in Q1.

Heath Terry:

Great. Just to follow-up, may be to simplify it a little bit, beside seasonal, which you mentioned, any other categories that did outperform or any that underperformed absent the piece about advertise--relative to advertising just relative to overall growth in the business?

Niraj Shah:

The way I would tell you to think about it is, I think for a broad base customer we are becoming increasingly their go to in furniture and decor and we have obviously have a range—you know we have furniture which is larger ticket. We have a lot of decor which we think of as middle ticket, so think of rugs and lighting and if you are renovating you can think of things like plumbing fixtures and things like that and then we have lower ticket things, decorative accents, seasonal decor or housewares, other categories like – you know it could even be entry price point bath mats and pillows, accent pillows and the like. And we're seeing pretty good strength across the board, we're all seeing good strength in customers who engage with one of these buckets starting to buy across a different bucket and we think that's a pretty big opportunity for us, but it's not really any one-way trend and you can kind of see that in the sense that our average order value, which is a little over $200 Two hundred dollars is sort of an odd number because nothing we seller is really $200. Most things you think of are either less then or more than $200 so it just shows you that mix and the fact it's not really moving is indicative of the fact that we're kind of half strength across the board.

Heath Terry:

Great. Thanks guys.

Niraj Shah:

Thank you Heath.

Operator:

Our next question is coming from Michael Graham from Canaccord.

Michael Graham:

Good morning guys and congrats. Just two questions. One is you talked a lot about the data that you gather on the shopping experience, I'm just wondering as you look forward where there are still (inaudible) conversion opportunities to convert potential customers into customers and to convert customers into repeat purchasers. And then just on the repeat customer [inaudible] you were just talking about. You're on a steady march upward, how high do you think it can go and the last two third quarter's it was down sequentially, I'm just wondering, is that a seasonal pattern that should repeat itself and what's going on there? Thanks.

Niraj Shah:

Thanks Mike. This is Niraj. I'll chime in and let Michael chime into. On the conversion side in terms of us converting, I couldn't quite hear whether you were converting folks to be active customers or whether it was just broad conversion on the site, but in either case there's a huge amount of opportunity because if you look at what we're doing with merchandising, which I sort of touched on some of with Heath's question a minute ago. As our merchandising gets stronger, as we become stronger and stronger in these various categories,the personalization technology, which Steve's talked about in the past becomes more and more robust which we are seeing very nice gains from. Alll of these things basically contribute to customers, sort of, their engagement with us going up, which can be measured by any number of things like frequency of visit, time on site and all these things. And in turn them coming back buying more and more often. And one thing I will say on repeat customers before I turn it over to Michael, remember that repeat customer metric too, it gets suppressed by the rate of growth of new customers so as we gain a lot of new customers, they are in turn making their first order, so that's going to hold down the number of repeat orders we could have and despite that we sort of have nice growth there. But Michael.

Michael Fleischer:

The other thing I pointed to is the presentation—our Investor presentation on the Investor website, you really can see on page 20 there the seasonal pattern to that. So there has typically been a step up in Q1 and Q2 and then it sort of flattens out for the balance of Q3 and Q4 and then steps back up again. Nothing has changed in the business that would lead us to believe that pattern will change in any meaningful way.

Matt Graham.

That’s great. Thank you very much.

Michael Fleischer:

Thanks, Mike.
Operator:

Our next question comes from the line of Sean Milne with capital markets.

Sean Milne:

Thanks and good morning. Michael let me just start. It seems like in the numbers that you did what you said you were going to do in the first quarter and by that it seems like you exited the quarter with a lot of strength and momentum in the business and reinvested back into the business. Is that a fair characterization exiting the quarter and just a follow-up to—there’s a question about what was stronger in the quarter and it seems like Presidents' Day overall online was very good in this category and maybe if you could talk Niraj about any other sort of seasonal activities you have going on in the second quarter and I have one follow-up. Thanks.

Michael Fleischer:

Thanks Sean. I thin that is right and as we continue to try and let everyone know. We are trying very hard to watch the performance of our business within every quarter and the spend ad spend dollars as we can. Within that, within the quarter in order to get to the maximum—our maximum investment ability on the ad spend line. Obviously the people side of that is a bit lumpier. Hiring is lumpier and not as sort of fluid a lever for the business, which is why you saw a little bit of outsized leverage in some of the P&L lines that are more people oriented.

Niraj Shah:

To answer the question—this is Niraj. To answer the question around President’s Day, seems like it was solid as there (phon) anything in Q2. Two things, one is—President’s Day—certain holidays certainly retail holidays and they can be strong, to be honest in the context of that quarter they can end up being some of the bigger days, but the truth is they don't really swing quarters, in general, and that said there's a bunch in Q2 like for example, our outdoor category is very strong in the second quarter every year. This year we are really pleased with how it's doing, but there is something every quarter. So it doesn’t really--again I think you’ve got to be consistently strong across the board on what you're doing for holidays in the seasonal categories and all these things, but no one thing can kind of swing the story and I guess that’s particularly true when we’re growing at the rate we are growing at because the thing is the rate we are growing at requires you to be sort of growing across the board and if you are not, you know, a promotion or a product highlight or a strong category merchandising story would not make up for it.

Sean Milne:

And just follow-up, you've hit on some of the points, but really the order frequency, I think there were some that misunderstood that it was sort of a one and done in furniture and that continues to improve year-over-year. Maybe a little bit more color on some of the things that you're trying to do to drive order frequency. I know you talked a little bit about personalization and Steve gave some interesting numbers around new category or new landing pages, like to hear little bit more about that. Thanks a lot.

Niraj Shah:

Let me talk quickly about categories and let Steve talk about some of what we're doing on the merchandising side of it. The one thing I just said in categories, just to kind of clarify a little bit. I think we're known for furniture because of two things. One it's where we got started in our business when we got started 13 years ago and second we've sort of become the preeminent dominant guy in furniture, so in that sense it's easy to sort of highlight it as something we are known for, but the truth is we talk about furniture and décor and that goes broadly and if you think about things like bedding sets and towels and soft goods or things like housewares and seasonal decor and decorative accents and even the smaller decor items like lamps or rugs. There are a lot of things that are bought with much higher frequencies. You've got brick and mortar retailers that just sort of hang around those categories and can't even get a store based model to work in those categories and that is with the challenges of limited selection and so on and so forth. So if you think about where we play. We cover all of that, we cover all the way up through furniture and we cover these categories that are particularly important when you are renovating or modeling. Things like plumbing fixtures and lighting fixtures and flooring. So we have a much broader breath then would be fairly covered by (inaudible) furniture adding (phon) and that's part of why the opportunity is so large, but Steve can touch on some of the things we are doing to unlock this too.

Steve Conine:

Yes, I mentioned on the call, we obviously have focused a lot on some tools to improve performance of our site and a lot of that is driven because we are trying to deliver a much more dynamic and kind of exciting experience to our customers. This past quarter we've made some dramatic improvements on our tools that let our merchandising Team curate and merchandise really exciting deals and seasonally relevant products for customers and really trying to pay a lot of attention to how do you put things in front of people that are exciting and that can drive them to come back and purchase requently throughout the year. And it's sort of a combination of using smart merchandising with smart programming and being able to analyze trends and look at the data and figure out programmatically how you want to present things to customers but then also coupling that with smart (inaudible) maturation and we really, I think, added the talent or we've added some great talent on our Team and the ability to merchandise and curate products and create things that are exciting and on point and seasonally right.

Sean Milne:

Great, thank you.

Operator:

Our next question is coming from Seth Basham from Wedbush Securities.

Seth Basham:

Thanks a lot and good morning. My first question is around some of the metrics that you talked about regarding the 25% reduction exit from the landing pages. May be if you could you take a step Steve, and tell us what kind of improvement you've see in conversion?

Steve Conine:

In general, I mean conversion has been increasing—it's, we always have the debate internally in terms of performance and speed and how much that can directly impact performance and I think our point of view would be that speed is always better and it certainly creates an experience that customers are going to shop on and going to enjoy more. It's tricky to correlate that perfectly with conversions, there's just so many factors that lay into how consumers going to make an ultimate purchase decision. I think what we're doing is sort of across the board with site performance, smart curation, problematic personalization to really try to put things in front of you that are exciting. (inaudible) are also the factors that are helping to drive and improve metrics with our customer.

Narij Shah:

I'll just chime in here. One of the things I believe Steve is getting at, internally when we operate, while conversion is certainly something that we track, we actually look at some other metrics and the truth is, our goal is really to be the customer's go to at home, whether they are intending to make a purchase or not and so we frankly would rather have the customer come back every week with just any thoughts they have, even if they're not going to buy on it as frequent—as a percentage basis if they only came when they actually need to buy something. So a lot of things we work on are just to be their go to, so that as result we'll capture more and more of their purchases, but that conversion percentage number is impacted sort of negatively if you are successful of that and then positively by things like the exit rate improvements and other things. I think what Steve is getting at, our core metrics are really all about—we want to be the place where they are engaged in and we want to reduce friction and sort of the exit rate was an example of friction removal.

Seth Basham:

That's helpful and that's a good segue into my second question. I know you don't report customer churn metrics, but Paul Tavely, can you speak to the trend we're seeing sequentially in year-over-year?

Paul Tavely:

Yes, I think if you use the—we don't give you guys quite enough data to really sort of dig into churn, just the gross metrics. I think churn, if you look at over the last eight quarters has remained in a relatively consistent band. It bounces up and down a little bit each quarter, but whether it's quarterly churn or last 12 months or however, you want to look at it, that bands been relatively tight for the last eight quarters so nothing new or unusual going on there. Even as we add larger and larger groups of new customers.

Seth Basham:

As you strive to acquire higher LTV customers who come back more frequently, purchase more frequently, would you expect turn to go down over time?

Paul Tavely:

I don't know that I would expectthe churn level to go down. I think what we're doing is we have an amazing Team of people in the marketing group who are super efficient in how they spend that money and sort of bring folks in who are those most likely high Life Time Value customers and what we want to do is when we find the folks within that group, right as the funnel narrow who are those folks, that's the place where we sort of direct our and our energy but I would expect there's always going to be some reasonable set of churn out of the folks who are not the right long-term customers.

Niraj Shah:

This is Niraj. Just to chime in a little bit on that. The other thing I would just say is if you look at absolute numbers we ended the quarter with roughly 3.6 million active customers and just that order of magnitude, while that's grown a lot, that's still we think a very small relative, to even in the United States alone, the audience for whom we are the best place for them for home. So if you look at that we think there's basically, depending on how you want to count 45million and 60 million households we would be I think, be the best home option for them and we think closer to that 60. I get that we won't get them all but 3.6 is still very much the early days so a lot of answers are sort of predicated on what we are seeing and the reason there is no diminishing return, in fact there's improving return, is there is so much ground to cover ahead of us before you get to the days where you will see some of these things change, which would sort of like the business more hitting more maturity type levels which we are nowhere close to.

Seth Basham:
Got it. Thank you very much, and good luck.

Michael Fleischer:

Thanks.

Operator:

Our next question is coming from John Blackledge from Cowen and company.

John Blackledge:

Great. Thanks. Two questions. First one for Niraj. With the brand awareness rising in the strong customer growth improving repeat customer count, can you talk about how you think Wayfair's position completively now versus a year or two ago as the Company does drive towards kind of big share gains in this huge market. And then second would be just talk about the overall health of the supplier relationships, maybe update us on the number of suppliers, opportunity for growth and potential growth and selection or SKUs. Thank you.

Niraj Shah:

Great John. So to answer those questions. The first question in how are we positioned competitively. I guess what I would say to that is on one hand home is a very crowded field and it will remain that way. On the other hand, I think our offerings actually fairly differentiated and becomes increasingly so over time. So if you actually take that, which is sort of due to a combination of what we are doing merchandising, marketing, operations, how we're using technology through the whole offering, we are making it more differentiated and the brand is getting stronger and stronger. I think those things, that multiplies out frankly, to us becoming stronger on a competitive basis and that said we still think there's a lot more we can do. So I do think we are—the easiest way to look at that frankly, is that the category is probably growing depending on whose numbers you believe, 15% year online year-over-year or 12 may be as a low number, you might see somewhere as 18 the high number. I think most of the numbers I see are 15-18 for home. So if you think about that and then you look at the growth of our direct retail business of a multiple, meaningful multiple to that, that share taking, I think particularly as you see a driven by repeat and sort of those types of things accelerating in the face of marketing, decelerating. I think that sort of tells you we are becoming stronger competitively because customers are voting with their dollars and short of buying that business, which you can see we are not, that's really the only conclusion you can draw that they are preferring to shop and spend with us.

On your second question, the health of the supplier relationships, I think in the industry we are known for having incredibly strong supplier relationships. I think if you were to query a couple of hundred of the supplier out there and if you could do it in a way that they would give you their unvarnished feedback, what you would get is that I think we are one of the folks they actually would state by name as significantly preferring because frankly, we try to create a situation that's very successful for them and very successful for us and as a result we are both doing very well. So I think you would hear that from them and that creates a lot of opportunities to grow. I mean from a selection standpoint we are not trying to bulk up SKUs in terms of an absolute amount. We are trying to fill in what we think our gaps oropportunity areas in our catalog. That's still a fair number of SKUs we are adding every month but I think it's actually more nuances than it's ever been and as a result it's more successful than it's ever been. In terms of numbers of suppliers, the last number we stated was over 7,000 and we have not kind of issued another official number, so I will just say over 7,000. I don't think that number whether be slightly different than that, 8,000, 7500 or whatever it is, actually matters. It could be 7,000, it could be 6,000, the key is that you are really able to have that biggest catalog that's broadest that covers all the styles, all the bases, all the price points and that's where I think we win and that's what we are continuing to flush out.

John Blackledge:

Thank you, so much.

Operator:

Our next question comes from the line of Justin Post from Merrill Lynch.

Justin Post:

Great, thank you. I had two questions. First Michael, nice quarter versus guidance. Do you factor in some deceleration when you guide and kind of what drove the outperformance in March given it was a late guide. Just wondering if you put deceleration in your plan and then secondly, you are getting obviously scale, you' growing faster in that category. Are you seeing better positioning for your brands within search engines and other marketing channels as you scale? So is there a benefit from that. Thank you.

Michael Fleischer:

The question on the guidance, so we saw a real strength at the back end of last quarter. As I stated in my comments and tried to state earlier, we are trying to give sort of clearer guidance as we possible can when we go and build that. We're obviously taking into account the performance of the quarter to date and then we are looking at each piece of our business and how it's performing and how it's performed this past week versus the earlier weeks in the quarter and what we anticipate it's going to look like over the balance of the quarter. But at the end of the day it's a consumer business and those customers have to show up every day and make those purchases and so there's a balancing act on our part to sort of both look at the current run rates of the revenue and then also set a set of expectations that we feel confident enough to be out telling everybody about, but it's certainly not our goal to creating outside beats. It's our goal to be sort of putting out numbers out there that we think are the right ones.

What was the second question again?

Justin Post:

One follow-up to that, was there anything that was kind of new in the quarter that drove outperformance that could carry on to future quarters? I was just wondering, kind of pick out what drove the outperformance and the second one was in search marketing channels, is your skill starting to help you? Thanks.

Niraj Shah:

Great. This is Niraj. Let me chime in on the first one, Michael's kind of addressed that a little bit now. I think the outperformance frankly, I know this is probably an unsatisfying answer for you, but I think it's really just driven by the fact that we are in truth getting more and more customers and they in turn are coming back more and more often. And while you would like to nail it down to one marketing campaign or one particular product offering, it's really not that cut and dry and frankly, at the revenue level we are at there isn't really nothing we could potentially come up with short of giving away product that would do that. So it's the aggregate affect of all the things Steve was talking about. All the things that we're doing broadly in the Company. If you think about it we ended the quarter with a little over 2500 people and I think in roundabout numbers it's something like 1600/1700 of them something like that are in that fixed cost portion. So not in the customer service, in the warehouse, labor and all the stuff that's variable to the orders. So if you think about that out of the 1600/1700, maybe a hundred at most are kind of what you call over it and really almost all of them are merchants and marketers and technologists and operations guys are basically making the offering better every day and it's the aggregate effect of that that's really driving the experience as you first shop, as you first buy and repeat by. And that's what I think really the answer to your question.

The second part just to answer it quickly,. Search marketing is one of our channels. Again it is a portion of our total spend. It's really not any sort of dominant piece. And I think there what happens , Google, who is a major player there, their algorithms are becoming more and more acute at watching customer behavior to figure out what ads to show a not show effectively through the quality score. Otherwise you have to pay more to show a poor quality ad to be more and more relevant to the consumer, which is what they want right, because they want you to come back to them. So frankly, I think we benefit to that earlier question that someone asked about the Wayfair brand, is it strengthening and how are you doing competitively, as we do a better job for customers, you will see it in the year-over-year growth in the direct retail business and the repeat rate changes. Frankly Google will see it in terms of customer engagement with our site and they will in turn want to show us higher in free search. The quality score we have, which will improve, which will make search engine marketing better and better ROI and so on and so forth.

Justin Post:

Thank you.

Niraj Shah:

Operator I think we time for one more question.

Operator:

Certainly. Our last question comes from the line of Mark Miller with William Blair.

Mark Miller:

Hey, good morning. Thank you for that. Can you Michael maybe walk us through the flow of cash going through the year so first half and outflow, I think second quarter also had a use on the working capital but how does that look for the year working capital kind of if you could help us track the float (phon) relative to last year and what is your updated cap ex view for 2015?

Michael Fleischer:

Thanks Mark. No substantive changes to sort of how the cash flows in the year, so on a particular note this quarter, just so everyone sort of sees at the right way, I think if you combine Q4 and Q1 cash flows you will find that those kind of net each other off and the reason is pretty straightforward. We have a big large number of sales in the back end of Q4 related to holiday. We collect that cash from our customers, but don't pay our suppliers until into January and so then that cash flows out in Q1. The cash flow rates are sort of a more normalized around how they look versus EBITDA for the rest of the quarters for Q2 and Q3, so I don't think any changes year-over-year in terms of sort of the pattern to that and then cap ex, I think our cap ex will remain sort of similar to what it's been in the last year. Nothing substantively different from that and I would note we have some flow through in our cap ex both last year and this year from the office build out of the space in Boston. That is not real cash cost to us, but because of the accounting some of it flows through cap ex. We'll note that as it shows up in Q2 and Q3.

Mark Miller:

That's helpful. And then I guess just pulling that together it looks like free cash flow use would be similar plays to 2014 or just a little larger? Thanks.

Michael Fleischer:

Because we are only guiding for the current quarter, I'm not going to sort of extend out the cash flow notion but I don't think there's anything that's changed between sort of relationship between EBITDA and free cash flow in 2015 as it looked in 2014.

Mark Miller:

Okay, thanks. Nice performance. Great.

Niraj Shah:

Thanks Mark. So thanks everyone for joining the call and we appreciate all the interest in all the questions and we look forward to talking with you again next quarter.

Operator:

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

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