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Third Quarter Fiscal Year 2014 Earnings Conference Call
November 10, 2013

Operator:

Good afternoon ladies and gentlemen, my name is Mike and I will be your host Operator on this call. After the presentation we will conduct a question-and-answer session. Instructions will be provided at that time. If at any time during the conference you need to reach an Operator, please press the star followed by zero. Please note this call is being recorded today Monday, November 10, 2014 at 4:30 p.m. Eastern time. I would now like to turn the meeting over to your host for today's call Kate Gulliver, Director of Investor Relations at Wayfair. Please go ahead.

Kate Gulliver:

Good afternoon and thank you everyone for joining us on our first call as a public company. Today we will review our Third Quarter 2014 results. With me our Niraj Shah Co-Founder and Chief Executive Officer and Co-Chairman Steve Conine, Chief Technology Officer Co-Founder and Co-Chairman. And Michael Fleisher, Chief Financial Officer. We will all be available for Q&A following today's prepared remarks.

Before we begin I would like to remind you we will make forward-looking statements during this call regarding future events and financial performance including guidance for the fourth quarter of 2014. These statements are only predictions, based on assumptions that believed to be reasonable at the time that they are made and they are subject to significant risks and uncertainties. You should not rely on these forward-looking statements as representatives of 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 the call and for discussion of factors that could affect our future performance, results, and business, please refer to our IPO perspective, our quarterly report on form 10-Q which we expect to file and 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 reconciliation of non-GAAP measures to the nearest comparable GAAP measure. 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, Kate and thank you everyone for joining us today on our first earnings call as a public company. We are pleased to report strong Q3 results which we believe reflect the ongoing strength of our brands and business model.

Net revenue for the quarter was $336.2 million reflecting total growth of 41.7% over the prior year. Our direct retail business, consisting of sales generated primarily through the sites of our five brands include 57.1% versus last year with 2.9 million active customers as of the quarter end. As a reminder, our brand include Wayfair.com, Joss & Main, AllModern, DwellStudio, and Birch Lane. Michael will of course provide you with more detail and context as he walks you through the financials in just a few minutes.

Since this is our first call as a public company, I thought I would just take a few minutes to provide some background on the Company, our market opportunity and the key drivers of our growth. We designed Wayfair to transform the way that the mass-market customer shops for her home. Since our launch in 2002 we've built one of the largest online destinations for the home. Offering over 7 million products from 7,000 suppliers across a range of styles and price points.

We estimate that the total home biz market in the United States is over $230 billion. We believe that the mass-market, the largest piece of the market, and that it's underserved today. The home goods category is unique relative to other product categories because the purchase decision is very personal. Our homes are an expression of self and identity. Customers approach this market differently than others because they look for uniqueness and originality when selecting a bedside table or a chandelier and they need both vast selection and inspiring content to help guide their purchase decisions. Additionally brands don't really exist in this category making visual inspiration even more important to the customer.

Our online low inventory model provides several advantages relative to our competitors. Traditional brick and mortar retailers and other online players do not offer the selection or the engaging merchandising that the customer desires. Inventory based retailers are limited in their ability to offer a vast array of products due to structural and capital constraints on space and high inventory carrying costs. Traditional search based e-commerce sites that rely on direct brand search or product search don't work well in our category because there's little to know brand awareness for these products and these sites have a difficult time providing customers with the visually inspiring and a mode of browsing experiences they need to aid product discovery. A lot of it boils down to the fact that in this category a lot of customers will tell you that they don't really know what they are looking for until they see it.

To help illustrate the importance of broad selection and the challenges with inventory and merchandising home biz products, I wanted to highlight a couple of our product categories. In our decorative pillow category, for example, we currently offer thousands of pillows. The top 25 of these accounted for just 5% of revenue in the category in the nine month ending September 30th. In contrast, the category such a small kitchen appliances, one of the few categories we carry where purchases tend to be driven by brand, has much greater SKU concentration. For the small kitchen appliances in the nine months ended September 30 the top 25 SKUs represented 24% of the revenues in that category, nearly five times as much as in decorative pillows.

This makes sense when you realize many of us have the same KitchenAid stand mixer on our counter. At Wayfair, most categories are more akin to decorative pillows than kitchen appliances. Customers want unique products, they don't know the brand name and so this requires the retailers to offer both a vast selection of little known or unknown brands and an engaging visual way to explore the offering.

Ultimately we believe that Wayfair is uniquely positioned to win and grow in the mass-market for several reasons. First, our purpose filled technology designed specifically to serve the need of the home biz customer allows us to showcase millions of products in an intuitive and easy to use interface helping our customers find the perfect item for her home. Second, our long-standing partnerships with suppliers coupled with our proprietary logistics platform enabled the capital efficient low inventory business model with fast times to ship. Third, we believe that they're continues to be significant opportunity to build the Wayfair brand. First launched a little over three years ago in September of 2011. Over the past year we've been increasingly focused on driving brand awareness and improving our customer lifetime value by acquiring high-value customers who are more likely to make repeat purchases. We believe that these efforts, while requiring significant investment, are the right steps to drive long-term profitable growth in this business.

Now before I turn the call over to Michael, I just want to touch briefly on some recent activities we undertook in the quarter to show a few of the many ways we are working to drive customer growth, increase repeat rates and improve lifetime value.

In the summer of 2013, we acquired DwellStudio now a key part of our more curated lifestyle brand offering that includes AllModern and Birch Lane. We were impressed by the design talent we found at DwellStudio and we wanted to work to bring the high-quality mid-century modern inspired product to a broader customer base. To do this we turn to Skyline Furniture, a longtime supplier partner of ours. Together the Skyline and DwellStudio team created a line of proprietary upholstered headboards, bed frames and children's furniture. The product is designed by DwellStudio consistent with the brands high quality standards and manufactured by Skyline exclusively under the

DwellStudio brand name. Through this partnership We've been able to offer the DwellStudio look and quality at more competitive prices with shorter lead times and with no inventory. Now we just introduced--the offering is already resonating with our customers was launched in September and we've seen a threefold improvement in every average monthly bed sales at DwellStudio. This is just one example of how we are able to leverage our deep supplier relationship to offer unique products and better values for customers.

We continue to believe that offering world-class customer service is a key part of the customer value proposition and one of our competitive advantages. Accordingly in August, we opened a new call center in Orem, Utah that we plan to staff with approximately 90 customer service agents by year-end and which has seating capacity for up to 400 agents. This facility is in addition to our existing customer service centers in Ogden Utah, Boston Massachusetts, Galway, Ireland and Sydney Australia where in total we have over 450 agents as of September 30th. The location in Orem allows us to expand our recruiting base for call-center talent to both north and south of Salt Lake City while leveraging the Management team and our facility in Ogden and enables us to better meet the needs of the business as it grows.

The last thing I would like to touch on is our continued efforts in expanding our brand presence in the market. Through our ongoing relationship with the (inaudible) network we partnered with HGTV on two of the networks top shows. Wayfair.com was featured on the popular competition series Brother versus Brother while Joss & Main was featured in Flipping the Block, one of the Network's new primetime series. HGTV highlighted our products on both shows with tie-ins on our site and on HGTV's website to enable viewers to shop and explore the products featured.

Now TV and online marketing is not the only branding work we do. If you live in the New York City area, for example, keep an eye out for our Wayfair branded delivery trucks that will launch this week. For those of you not in New York you can see some photos of the trucks on our IR website. Our density in New York allows us to run fully dedicated delivery trucks with our home delivery partner in the area crating some unique branded opportunities that can be rolled out to other geographies, all at no additional cost to us. But even more important is the opportunity to continue to provide a differentiated level of service to our customers. Having Wayfair dedicated trucks and drivers who are committed to our delivery experience standards is a big opportunity that comes from our continued growth, scale and density and is a direct result of the more than 20,000 orders on average we are delivering every day.

Going forward, we remain highly focused on driving growth by acquiring new customers and increasing our existing customers frequency of purchase at our site. As in the past we will do this by investing in our brands and the customer experience through improved site experiences, product offerings, and logistics. Overall, we are excited about the quarter's performance and the continued growth at Wayfair.

I would now like to turn the call over to Michael to walk through the quarterly financials in more detail.

Michael Fleisher:

Thank you, Niraj and thank you all for joining our call today. As a process note for this call and future earnings calls, I will highlight some financial key information each quarter, we will try to leave the maximum amount of time for your questions. More detailed information on the quarter is available in our quarterly press release, which can be found are in our investor website. Also as a reminder, the financial results we are reporting today are as of September 30 and therefore, represent pre-IPO results. We provided some financial information in the earnings release to show the impact of our IPO on a pro forma basis.

As you heard from Niraj our total net revenue was 336.2 million representing year-over-year growth of 41.7%. Our direct retail revenue consisting of sales generated primarily due to sites of our five brands was 285.5 million, a year-over-year growth rate of 57.1%. Net revenue from our other business, totaled 50.7 million, a decline as expected of 8.9%. Our other business includes revenue from our small media business and from retail partners, third parties who sell Wayfair products through their sites. As a reminder, we will focus primarily on growing our direct retail business where we own the customer relationship and can market to them on an ongoing basis.

Our gross profit for the quarter was 79 million compared to 58.6 million in the third quarter of 2013. Gross profit as a percentage of net revenue was 23.5% compared to 24.7% last year and 23.2% last quarter. Our gross profit is net of all product costs and delivery and fulfillment expenses. The changing gross margin this quarter was driven by changes in the mix of products sold, our pricing and promotions, and the year-over-year impact of an expansion of customer friendly policies like easier returns and more free shipping. We expect gross margin to remain relatively stable overtime as a percentage of net revenue, but some quarterly fluctuations are normal due to the wide variety of products we sell.

Operating expenses in the third quarter reflect our ongoing commitment to investing in and building the brand and improving our customer experience. Our sales and marketing spend in the third quarter was 77.4 million, or 23% of net revenue. This is up from 46.6 million or 19.6% of net revenue in the prior year. Sales and marketing expenses include labor related costs for our employees involved in sales and marketing and customer service activities, merchant processing fees, partner advertising fees and advertising for our direct retail business. As anticipated, advertising is an area where we continue to invest both online and on TV, spending a total of 49.8 million or 14.8% of revenue in the quarter. This is in line with our spend last quarter and as a percentage of sales, down from our peak in Q1 2014 of 15.9% of revenue. We believe our continued investment in brand building and customer acquisition is helping us acquire a significant number of high-value customers and we've already seen the benefit of this investment across a range of metrics.

First, the number of active customers in our direct retail business reached 2.9 million as of September 30, up 61% from September last year. Second, LTM net revenue for active customer increased to $342, up 8.6% from the same period a year ago and up 3% from Q2. And third, orders per customer measured as LTM orders divided by active customers improved to 1.65 from 1.55 in the same quarter last year. We believe these metrics highlight improving order frequency and are indicative of the higher customer lifetime value we see in our new customers.

In addition, to our brand building efforts, we are continually working to drive customer engagement by making our vast selection relevant for each individual user through increasingly personalized offerings. We currently send out over 1 million different permutations of our Wayfair.com daily sales e-mail. Helping each customer find the products that are right for her. This improved personalization has resulted in a 15% lift in e-mail open rates for these messages. You can see some examples of these e-mails on our IR website. To enable this kind of site and user experience improvement we've continued to invest in our team and infrastructure focused on both the customer front-end experience and our back-end logistics and supplier integrations.

This investment is reflected in our growth in G&A expense, which was 25.2 million for the quarter or 7.5% of net revenue compared to 15.5 million or 6.5% in the same quarter in 2013. The increase was primarily driven by growth in our engineering and operations teams, rent, and depreciation and amortization. Adjusted EBITDA for the quarter was negative 18.3 million or negative 5.4% of revenue compared to negative 0.2 million in Q3 2013. On a quarter-over-quarter basis, Adjusted EBITDA as a percentage of revenue improved by approximately 50 basis points from Q2. The reduction in our Adjusted EBITDA year-over-year reflects the strategic decision to continue investing in our brand and customer experience to attract more customers and improve lifetime value. Overtime we believe that this strategy will enable Wayfair to create substantial long-term shareholder value as the business continues to scale.

Non-GAAP free cash flow for the quarter was negative 22.4 million based on net cash provided by operating activities of negative 11.1 million less capital expenditures of 11.3 million. GAAP net loss per share was $0.71 which compares to a net loss per share of the $0.19 in the same period a year ago. As a reminder, this calculation is prior to the corporate reorganization that took place in conjunction with the IPO and is based on 40.5 million weighted average common units outstanding. Non-GAAP net loss per share was $0.29 on a pro forma basis after including the impact of the share issuances and share conversions as a result of the IPO and is based on 82.5 million weighted average shares outstanding.

Turning to the balance sheet, we close the quarter with 130.4 million of cash and investments, pro forma for the IPO, the quarter would have closed with 366.3 million of cash and investments. Despite our strong growth in sales we close the quarter with only 21.1 million of inventory or 1.8% of LTM sales, similar to inventory levels for the same date in the year prior. The low inventory level is consistent with our inventory light approach and capital efficient business model.

As a reminder even with this limited inventory level we were still able to ship to our customers in an average of 2.1 days due to our extensive supplier integrations and the proprietary delivery network we have built.

Finally, I would like to offer some guidance on Q4 2014. We expect to continue to see strong, but moderating net revenue growth as we comp off the rapid growth experience in Q4 2013. We anticipate total net revenue of 355 to 370 million consisting of direct retail net revenue of 295 to 305 million and other revenue of 60 to 65 million representing ongoing declines in the other business segment as we continue to focus on growing our direct retail business.

On the expense side, as previously described, we are continuing to focus on brand building through TV and other advertising and on improvements to the customer experience by investing in our site and back-end operations. These initiatives require ongoing investments in marketing and G&A, but we do anticipate starting to see some leverage. Accordingly we expect an improvement in EBITDA losses to a negative 4.5 to 5% of net revenue. We continue to believe that these are the right investments to make now to build our brand and grow our market share ultimately leading to continued growth and long-term profitability.

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

Niraj Shah:

Thanks, Michael. We are very pleased with the third quarter results and Wayfair's trajectory and we are excited about the Company's future. 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 are happy to take your questions now, so I will turn the call over to the Operator.

Operator:

At this time I would like to inform everyone in order to ask a question press star one on your telephone keypad. We will pause for a few moments to compile the Q&A roster.

Your first question is from Deb Schwartz with Goldman Sachs.

Deb Schwartz:

Great thanks, and congrats on the quarter. Two questions, first, Niraj the home category tends to be one with lower purchase frequency than the others. Can you talk about the initiatives that you have to drive repeat purchases from your customer base and then secondly on marketing, I think you said it was close to 50 million in the quarter, which was up, I believe, from the second quarter. Can you talk about how you are think about returns and pay back on that spend and what your expectation is for marketing specifically in Q4?

Niraj Shah:

Sure Deb thanks for the question. To answer a few questions. First the question about home with regards to what are we doing to drive frequency. You know, there I would say it is no one thing. It's actually a bunch of things and we think in aggregate we're happy with what we're seeing happen. So some of those things, for example, have to do with from merchandising standpoint, what we're doing with exclusive products that customers are starting to know that they can only get at Wayfair. Our loyalty program which has given us some nice traction, we're continuing to do things with that that we think will kind of further develop that. Third we're doing things around editorial content and inspirational imagery and tips and advice, things that allow customers to come back to us or encourage them to come back to us even when they are not thinking of making a purchase and the last thing I just mentioned, kind of on-the-fly right now, and by no means the least, obviously building up our brand, making our brand top of mind for customers as their go to place for the home. So I think there's actually a large number of things we're doing around frequency. I didn't not even touch on what we're doing on mobile just now. These things really add up, I think, in terms of driving that.

In terms of marketing spend, which clearly is an area we've been investing in. In terms of what we're thinking in Q4, why don't we just say, you know, in general the way we've been thinking about marketing spend and what we showed during the offering period there with the cohort example we put in the materials, is that we are investing in acquiring customers but we're investing in acquiring customers that we think really have a lifetime value that makes it very productive for us and at the rate of growth of those customers it's certainly causing us to operate at a loss, but the underlying economics are very appealing. And that philosophy has not changed. And then what we think is happening and will continue to happen is, obviously the base of our customers, is that base grows bigger and bigger and you're seeing, you know, the things around customers coming back more and more, that repeat base of revenue changes the mix of new verse existing and that affects what advertising costs and percentage of revenue looks like at a high level. So that philosophy is basically the same and so inQ4 I wouldn't expect necessarily to see any difference.

Deb Schwartz:

Great, thank you.

Operator:

Our next question is coming from Neely Tamminga with Piper Jaffray.

Neely Tamminga:

Great good afternoon. Let me add my congratulations as well. I do have just two different types of questions here. First for Niraj, could you talk a little bit more about what's going on for holiday? You guys have historically not really been a holiday destination per se, but we are noticing more holiday shops and I guess what we're trying to figure out here (inaudible) customer acquisition in goals (ph) in terms of bringing in a customer who is not normally a Wayfair customer, not yet one, or is it really expanding the overall performance for your existing Wayfair customers to purchase from you? And then I've a follow-up please. Thank you.

Niraj Shah:

Sure. So on that first part in terms of holiday, the holidays interesting for us. With the category we're in is not traditionally big holiday category, but that's said obviously the amount of spending during the holidays is very significant and as a result even home does have a holiday bump. I would just say that historically while we've done some things around holiday, nothing on the order of magnitude of what we're doing this year. If you look at the gift guides that for example lodged on Josh &Main last night, if you look at the Wayfair holiday sales, which are featured kind of throughout the season, they were actually featured yesterday also and they're accessible through the home page at Wayfair.com. I think you'll see a lot of what we're doing on the merchandising side, I think, is appealing to customers, will help drive both increased frequency from the base and could be appealing for new customers in terms of what they will make as their first purchase. So we think a lot of the merchandising initiatives we have fit well into some of these seasonal opportunities and that's an opportunity for us that we have historically not taken advantage of like we're focusing on this year.

Neely Tamminga:

Thanks, Niraj. And then for you or for Steve, could you talk a little bit more about mobile? So obviously the Wayfair app launched this year. How are you think about people purchasing via mobile either through forcing that traffic in or actually converting on that traffic and I guess more of a technical question for Steve, it looks like you guys are averaging may be up to two updates or an update every two weeks on the iOS app. Just wondering how you feel about that cadence and if there any major updates or functionalities on deck that we should be watching out for? Thanks.

Steven Conine:

Yes, thank, this is Steve Conine. We are definitely big believers that there is a continued opportunity in mobile to really create an offer that's great for our customer and that cadence your seeing with us sort of rapidly reiterating on our mobile app. I think you'll see us continue to do that. That's kind of our standard operating (inaudible) engineering group here at Wayfair. We definitely have always continually tried to improve and use iterations to continue to get better and better with the products we have in market. We definitely have a very strong sort of mobile first approach to development inside the entire sort of engineering group that delivers products to our customers today or that does the software that our customers use. So it's going to continue to be a serious area of focus.

Neely Tamminga:

Thank you. Best of luck.

Michael Fleisher:

Thanks Neely.

Operator:

Our next question is coming from Paul Bieber with Bank of America Merrill Lynch.

Paul Bieber:

Hi, guys. Paul for Justin. Congratulations on your first quarter. I was hoping you could provide some high-level commentary on Wayfair versus Joss & Main in the quarter and then how should we think about the contribution of the three other sites as we head into 2015?

Niraj Shah:

Sure Paul, this is Niraj. As you know, we don't really devolve the exact details of them, but the statements we've made in the past I'd say are definitely the same, Wayfair is by far our biggest brand and then you've got a big step down in size to Joss & Main which then from there you'd have a big step down in size. So in that sense when you look at the total results, the total results it would be impossible for them to not reflect to a very high degree what's happening at Wayfair.com. I don't know, Michael do you want to add anything to that?

Michael Fleisher:

In order to deliver the results we are delivering and the growth we are delivering Wayfair, not only does Wayfair need to be delivering, but that the business units really ned to be delivering strong growth.

Paul Bieber:

And a quick follow-up question, are you guys disclosing repeat orders and mobile orders moving (ph) forward?

Michael Fleisher:

We are disclosing four KPI metrics that we put in the press release and then some of the other metrics like mobile and repeat order we'll do on a more ad hoc basis going forward at sort of appropriate points of time during the year.

Niraj Shah:

What I would say though, and that is what we are doing from the disclosure standpoint, I would say though when you think about repeat and mobile—these are things we are very focused on and we are seeing really nice traction in the business and we would definitely update you on that in the future.

Paul Bieber:

Okay, thank you.

Michael Fleisher:

Thanks, Paul.

Operator:

Our next question is coming from Matt Memer with Wells Fargo Securities.

Matt Memer:

Afternoon everyone. Just a couple of questions. First on the gross margin percentage, it was a touch below what we were thinking, it was actually up sequentially though for the first time in a couple of years. You mentioned mix and pricing and I'm just wondering if you could provide more color on those, what in the mix may have driven that this quarter and then was there anything that you were doing in pricing that was either tactical or more of a response to the environment?

Michael Fleisher:

Thanks, Matt. I don't think there's anything really specific to point out. I think, as you know, we carry so many products and so many categories that just sort of say, it was this pricing or that promotion. There is no one driver of this. As I did note, we are continuing to see the year-over-year comps of offering, better returns and free shipping, some of those very customer friendly policies. But gross margin is going to move around a little bit quarter-to-quarter. It is sort of the nature of the way our business runs, but there is nothing particular or unique in sort of pricing or promotions that is driving anything this quarter.

Matt Memer:

Okay, fair enough. And then two, I guess a question about two external factors that are out there, the first is fuel prices are down, diesel prices are down and I'm wondering if we might see some benefit on that as your trucking partners, distribution partners pass some of those savings on to you? And then the second piece of that is, there's this issue on the West Coast with the ports. It's obviously more than a second derivative effect for you given that Wayfair has such an inventory light model, but I'm wondering if your vendors are on top of that or you could feel some effect of that if they don't bring enough inventory in in time.

Michael Fleisher:

On the fuel prices, I don't think we're anticipating any substantive (ph) changes near-term. I think we have good long-term rates with all of our partners and we did not particularly feel the pain when the costs were going up and I'm not sure we're going to sort of see a near-term benefit though it's something we obviously we monitor on our ongoing negotiations in renewals of deals with our big partners there in the supply chain.

Niraj Shah:

Matt, this is Niraj. On the point about ports. They’re—obviously we’re relying on our suppliers having inventory. That said we do work with our key suppliers to make sure that they know the amount of product we’re expecting to sell and in turn that they have available. What I will say is that that has been a topic of some concern for a while. We've been proactive in terms of trying to get ahead of any problems, but currently we do not foresee having problems with access to product.

Matt Memer:

Okay, great. Thank you, so much guys.

Operator:

Next question is from Michael Graham with Canaccord.

Michael Graham:

Hey, guys thanks very much. I just have a couple of quick ones. The first is about thinking about your Q4 guidance and I wanted to ask about revenue visibility and how you do your forecasting. Michael if you could just comment on relative to other businesses that you've managed, is this a high visibility business or not and what are some of the factors that might contribute to coming in at the lower-end or the higher-end of that range and then secondly I just want to get your philosophy about delivery and any upside to revenue to profit or reinvesting that upside in marketing to grow the customer base. Just generally what are your thoughts there? Thanks a lot.

Michael Fleisher:

Thanks, Mike. So let me answer the second question first. I think on the notion of reinvesting in the quarter, this quarter our plans are pretty well set for our ads and our marketing spend as well as the investments we’re making on the infrastructure side, so I think over time as we watch our revenue performance play out, we will then take that into account in our ongoing marketing and advertising and investments. But there is not a sort of near-term lever per se that we would be pulling there. In terms of forecast ability, in the end of the day, this is a consumer retail business, the consumer needs to show up and buy what we are selling. I think as we sit here in November, we have good visibility into our quarter, but particularly in the holiday quarter and some of the new initiatives that Niraj talked about with the holiday shops and some of what we’re hoping for to come out of those. I wouldn’t say we have perfect visibility and obviously our goal in guidance setting is really to put something out there that everybody can sort of hang their hat on and look at. But at the same time, we’re trying to be thoughtful based on, particularly this year, comping off an extraordinary growth fourth quarter last year where the direct retail business grew 105% in Q4 ‘13. So we are cognizant of that and trying to be thoughtful.

Michael Graham:

Okay, make sense. Thanks a lot.

Michael Fleisher:

Thanks, Mike.

Operator:

Our next question is coming from John Blackledge with Cowen and Company.

John Blackledge:

Great thanks. Just a couple of questions. The revenue per active customer was better than we expected. Was that mostly driven by the higher order frequency or are there any other key drivers or callouts and then the customer account growth of over 60% was pretty much in line, great growth. Could you talk about the drivers again and then thoughts on customer growth in the fourth quarter and how we should think about a for 2015? Thank you.

Michael Fleisher:

So I'm sorry, could you repeat the first question?

John Blackledge:

(Cross talking)

Michael Fleisher:

Revenue per active customer continues to look good. Look, this is a—there’s a combination of factors, right, we’re continuing to see good repeat. You can see that in the number of orders per customer, now at 1.65 and I think as we've discussed in the past, (inaudible) we will move around a little bit, revenue per active customer will move around a little bit. We are very focused on driving new customers and more repeat of our existing customer base and less focused on that sort of heavy outputs of AOB and revenue per active customer.

John Blackledge:

And Then (inaudible) customer count growth.

Niraj Shah:

I'm Niraj. I'm just going to chime in a little bit. We talked a lot about frequency, our goal is to build a large base of customers that we believe are very loyal to us, we're doing a lot to drive that and so as Michael said you have some of the detailed metrics that are being output of the strategies we put in place that we're excited about. Like some of the merchandising things I've mentioned. In terms of customer account growth what we think about that, obviously we're investing a lot in marketing to drive customer counts and we are trying to drive it though with (inaudible) customers, not just—kind of quality over quality, but obviously we're looking for a large quantity of high quality and we are seeing good success with that. Marketing is obviously the big investment line and we're happy with how the results are coming.

John Blackledge:

Great, thank you. Niraj could I just ask one follow up on how you think about competitive positioning as you enter 2015 given kind of the brand building that the Company has done over the last couple of years. Thoughts on competitive positioning and kind of market share gains 15 and out. Thank you.

Niraj Shah:

Sure. So one of the things we talk a lot about, obviously the home market is really, really large. The online piece of it is a good sized but it's actually growing at a nice clip and we think there is an opportunity to be one of folks tot really take shares that happen. We believe we were putting forth the right offerings to do that. The competitive landscape and the categories is tricky because every sells home goods, right, but there's no shortage of competitors, but what I would say is that, I think if you really take it from a customer standpoint, what the customer would desire in terms of being able to find just the perfect item at a price you can afford.   Hopefully accompanied by beautiful merchandising and great service and fast delivery.   this whole laundry list of things in home, which is where everyone else wants to own different items and you can't inventory at all and still provide it. I think we've got something particularly unique. So we tend to not focus on executing strategies against competitors. We'd rather focus on doing things that we believe will drive against what our customer wants and we feel like the mass-market customer's historically been underserved because of limitations of the business model with the other competitors and we are focused on provide her with something much more profitable for her.

John Blackledge:

That's great. Thank you.

Operator:

Our next question is coming from Aaron Kessler with Raymond James.

Aaron Kessler:

Hi, guys. Good quarter. A couple of questions. First on the partner channel, a little above our expectations. Anything you would call out there in terms of maybe driving some up performance on the partner channel. Secondly from an accounting perspective, the membership rewards. Should we think about it as sales and marketing or have contra revenues and third just in terms of maybe the checkout process, I know you have PayPal, anybody else you'd consider adding to further reduce friction on the checkout process, if that's an issue. Thank you.

Narij Shah:

I'm just going to jump in, this is Niraj and just talk about the partners and then Michael can try and answer your other detailed questions. But on partners, what I would say, that is a business where we certainly are primarily focused on growing our direct retail business. Those are our owned and operated sites, those are our brands where customers are coming to us directly, where we build that direct customer relationship and then frankly, we can kind of grow with them overtime without constantly reacquiring them or paying a marketing fee, what have you. So the partner business—we have some great partners in that business , but there's choices we make in that business in the sense that it's not our primary focus. It's our secondary focus. So as a result the revenue in that business I wouldn't say is necessarily optimized around doing any last (ph) thing we can do to grow. We make choices on who our partners are so on and so forth and that's not our primary focus. It's going to result in results that maybe that, you know, are a little more volatile there.

Michael Fleisher:

Aaron on the question how we do the accounting on the membership, it's effectively a contra revenues, so we basically deduct from the revenue we're taking the sort of expected future benefit of that reward and then account for it that way. So it's sort of, we take it right up front effectively. There's no long-term impact. And then on the question around PayPal and payments and stuff.   I think generally what we are focused on with now 2.9 million customers, what we're really looking for is if there are payment methods that a big chunk of our customers in a very popular way want to use, we will certainly work to make those available for them. We want to make it as easy as possible for them to check out, but I don't think you should be looking to be sort of at the leading edge of sort of new technologies on checkout until we really start seeing (ph) consumer adoption and really making sense for our customers.

Aaron Kessler:

Great, thank you.

Operator:

Our next question is coming from Chad Bartley with Pacific Crest.

Chad Bartley:

Hi, thanks. Relative to our expectations it looks like you were we able to invest most of the revenue upside in the quarter. So curious what types of advertising and marketing you deployed those dollars, strictly later in the quarter and then one follow up. Thanks.

Niraj Shah:

Sure Chad, it's Niraj. The way our marketing spend is heavily online, so we have a very meaningful TV program for brand building but then the vast majority of the dollars really, you can think of it as online and really focused on customer—new customer acquisition of right type of customers. So the spend strategically stayed on the same track that it's been on where we run TV at a certain level, we continue to do that to build up our brand and then we really are primarily acquiring customers through online advertising.

Chad Bartley:

Okay, and then just looking at Q4 guidance specifically for the direct revenue line I think it implies 24 to 30% sequential growth, that's a little bit better than we saw last year so curious if there's anything you'd highlight in terms of what's different either internally or maybe externally that you guys are taking into account. Thanks.

Michael Fleisher:

I don't think it's—I don't think there's any sort of particular difference. As Niraj said a minute ago, we are very thoughtful about that group of partners at this point, and I think we have pretty good insight into what they can drive in the fourth quarter and so that's how we sort of built up that plan. But, I don't think—it's not like there is some substantive difference. Obviously the one thing that has changed strategically year-over-year, right, is that we're more focused on driving our direct retail business as opposed to the partner business, so I think going forward we will continue to look a little different than it did in the past.

Chad Bartley:

Michael, sorry, I was actually asking about direct revenue which seems to imply maybe stronger sequential growth in terms of your guidance and I was just curious if there's anything that you guys would highlight whether something you are focused on in terms of different initiatives or the external environment.

Michael Fleisher:

Yes, I don't think—again, wouldn't point to anything specific there. I think the guidance is at this point, our best look at revenue for the quarter and again we take it obviously into much more detailed build up to get to that number. I would continue to point out that we are comping off a pretty extraordinary 2013 as sort of the moment that the transition from the micro sites to Wayfair really took hold.

Operator:

And the next question is from Shawn Milne with Janney Capital Markets

Shawn Milne:

I apologize for the background noise. I wonder if you could go back to your advertising spend a bit and someone asked about the fourth quarter, but I don't know if you could add may be a little bit more color on how you see the breakout in terms of brand spend over the next few quarters versus more sort of online and then I think there were some comments coming out of the road show that the brand number would begin to level off, Could you add more detail on that and that I have one follow-up. Thanks.

Narij Shah:

Yes, I think the way I would describe it is that the Wayfair brand in the United States, we feel like we run television at a level that is a good level to build a national brand at, so we don't actually think that's going to go up all in line with revenue or anything of the sort, we think it would go up at a moderate pace so that that television number, has grown to be a pretty big number in a relatively short period of time. We feel like—think about that is leveling off or going up at a modest pace, that would be that. Whereas we think of the online spend, the vast majority of the spend as being much more for direct customer acquisition, right, and there we're trying to attract new customers that have a certain kind of lifetime value and behavior and there we're spending X amounts of dollars to get Y amount of customers, so on and so forth and that is where the bulk of the dollars is. So I think that's the way to think about the two parts differently.

Shawn Milne:

And in terms of the just the online component, it would be great if you could add more color in where you are seeing signs of strength in customer acquisition and how you're selecting some of the online inflation costs, which are pretty typical, but certainly more pronounced in the social side of the business.

Narij Shah:

So you know, as you would surmise, we're very quantitative in our approach to how we do everything, including frankly, buying advertising. So I think certain markets you know, as they mature end up being prone to inflation in certain periods in the cycle, and we basically—you know, there is not very much in the way of advertising that we will do because we feel like we have to be there, so we try to be very savvy about where we invest efforts and we try to stay on sort of the early cutting-edge of different channels and technologies because there's usually greater opportunity there earlier rather than later. So I would say we try to avoid insulation to a high degree and say to a good degree we're very successful at that.

Shawn Milne:

Just lastly for me, you know, Michael you talked a little bit about gross margins moving around quarter- to-quarter based on mix and that makes sense, you know, I do believe though you were talking about some longer-term leverage in that line item. I don't know if it's the next several quarters, next few years.   Is that just leveraged over three PL providers in your network and may be a little bit of color on that. Thank you.

Michael Conine:

You know for the long-term gross margin the way we think about it is that there's obviously a whole mix of things that are in there but we think that there's an opportunity if we gain additional scale as our transportation delivery network becomes increasingly dense and then frankly as we continue to have success with a lot of the exclusive or private label products that we still offer on a basically very light or no inventory basis, but (inaudible) center margin. Those things, we think basically, factor in and will increase the percentage gross margin over time. That said, it's not a number where sort of is very focused on moving up as fast as possible. There's a balance, we do want to see it rise, but we also are making investments along the way.   So that we do think there's a good long-term gross margin story, but it's not kind of a cute near-term phenomenon.

Shawn Milne:

Okay, great. Thank you.

Operator:

Our next question is coming from Laura Champain (ph)with Canaccord.

Laura Champain:

Thanks. Niraj. Just to that point, what percentage of sales in Q3 were exclusive and private label products?

Niraj Shah:

Yes, sure, Laura we haven’t been disclosing a specific number on that but what I would say is it is still relatively small and historically even smaller than that. It's growing at a nice pace, but even today it's not a big percentage. We were optimistic about that growth and that growth is still ahead of us.

Laura Champain:

Got it. Thank you.

Michael Fleisher:

Thanks, Laura.

Operator:

Our next question is coming from Mark Miller with William Blair.

Mark Miller:

Hi, good afternoon everyone. You may not want to give the exact percent of orders from repeat customers, but could you give us some, I guess general sense. Is that something expect to climb in line with the trend you saw in the first half or how should we think about that kind of waiting between repeat and new customers?

Michael Fleisher:

I think, Mark, we continue to be very focused on repeat. The challenge in sort of giving you an exact answer is that it is obviously somewhat tied to how many new customers we're bringing on board. Right so as the efforts of our online advertising and TV continue to drive new customers, a couple hundred thousand this quarter in, obviously that increases the denominator making it harder to drive repeat up even though the existing customers are repeating more often. But, I think if you look at what transpired with repeat orders over the last year or so, I think we expect to see a continued march there, but it's going to have some quarter-to-quarter variability largely tied to how successful we'll be at in bringing in new customers.

Mark Miller:

Okay, great thanks. And then just some perspective on growth of daily deals or flash sales relative to the growth of items that are everyday assortment regular offering.

Narij Shah:

Sure, so I mentioned earlier we don't really bring up the sales of the different brands. Obviously Joss & Main really functions primarily as a flash sale type business model. Really the target audience there are home décor enthusiasts, so we believe the trend is more akin to using content and merchandising to drive revenue, but it uses that ever changing assortment concept, so that would be flash sales oriented. On the Wayfair brand, which you guys know, is our biggest brand by far, there we do have a program where we launch new features every day, some are curated events, some are kind of you know, kind of function based collections around, call it spring cleaning or whatever the topic might be obviously around seasonal topics as well, which is very pertinent right now. That said, the Wayfair business really trades off the fact that we have tremendous selection across all the home categories. And, so you could almost think about what we do every day is we give the customer a reason to want to think about us and a reason to check out what we are doing, but that keeps us top of mind but that's not necessarily what you may buy from us, right. If we're top of mine, it may occur to you that you're thinking about getting that area rug replaced that just got stained and you may come shop for it with us. Not necessarily because there's an event about rugs, right, more because we are top of mind. So I would just say that we're primarily focused on being more kind of evergreen go to destinations for home. That's really the strategy of where we see the revenue.

Michael Fleisher:

The only thing I would add Mark is, it's often times even when we are putting out a daily sale, it drives business in the everyday catalog. We can see those folks come in through the daily sale e-mail, but then go find something somewhere else in the everyday catalog and not purchase the daily sale, so it's about sort of staying top of mind and driving repeat for the everyday purchase.

Mark Miller:

Got it. Thank you.

Operator:

There are no further questions at this time. This concludes today's conference call. You may now disconnect.