PARTICIPANTS

Corporate Participants

Joseph Patrick Wilson – Associate Director of Strategic Finance & Investor Relations, Wayfair, Inc.
Niraj S. Shah – Chief Executive Officer, Co-Chairman & Co-Founder, Wayfair, Inc.
Steven K. Conine – Co-Founder, Co-Chairman, Wayfair, Inc.
Michael D. Fleisher – Chief Financial Officer, Wayfair, Inc.

Other Participants

Peter Jacob Keith – Analyst, Piper Jaffray & Co.
John Blackledge – Analyst, Cowen & Co. LLC
Oliver Wintermantel – Analyst, MoffettNathanson LLC
Seth M. Basham – Analyst, Wedbush Securities, Inc.
Michael Graham – Managing Director & Senior Equity Analyst, Canaccord Genuity, Inc.
Brian Nagel – Analyst, Oppenheimer & Co., Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, my name is Lisa, and I will be your host operator today. At this time I would like to welcome everyone to the Wayfair first quarter earnings release and conference call. All lines have been placed on mute to prevent any background noise. After the speakers remark there will be a question and answer session. Please limit your questions to one question. [Operator Instructions]

At this time, I would like to introduce Joe Wilson, Associate Director of Strategic Finance and Investor Relations at Wayfair. Please go ahead.

Joseph Patrick Wilson, Associate Director of Strategic Finance & Investor Relations, Wayfair, Inc.

Good morning and thank you for joining us. Today, we will review our first quarter 2018 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co-Chairman, Steve Conine, Co-Founder and Co-Chairman, Michael Fleisher, Chief Financial Officer, and Julia Donnelly, Head of Corporate Finance. 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 2018. We cannot guarantee that any forward-looking statements will be accurate, although we believe that we have been reasonable in our expectations and assumptions. Our 10-K for 2017 and our subsequent SEC filings identify certain factors that could cause the company's actual results to differ materially from those projected in any forward-looking statements made today.

Except as required by law, we undertake no obligation to publicly update or revise these statements whether as a result of any new information, future events, or otherwise. Also, please note that during this call, we will discuss certain non-GAAP financial measures as we review the company's performance. These non-GAAP financial measures should not be considered replacements for and should be read together with GAAP results.

Please refer to the Investor Relations section of our website to obtain a copy of our earnings release which contains descriptions of our non-GAAP financial measures and reconciliations of non-GAAP measures to the nearest comparable GAAP measures.

This call is being recorded and a Webcast will be available for replay on our IR website. Now, I would like to turn the call over to Niraj.

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

Thanks, Joe and thank you all for joining us this morning. In Q1, Direct Retail revenue was up 48% year-over-year with total net revenue growing by 46% year-over-year. This represents year-over-year dollar growth of approximately $450 million in the Direct Retail business as we continue to capture a significant share of the dollars as they move online in home category.

We saw continued growth in both our U.S. and International businesses with U.S. Direct Retail revenue up approximately $350 million or 42% versus Q1 last year and International Direct Retail revenue up $100 million or 97% versus Q1 last year.

These strong results in Q1 follow the $460 million of Direct Retail revenue we added year-over-year in Q4 2017. As Michael will share with you later in the call, we're guiding to another high level of dollar growth for the second quarter. Needless to say, we are excited to see that our offering is resonating more and more with our customers and that they are rewarding us with their dollars, LTM orders per active customer and LTM net revenue per active customer both grew to new all-time highs this quarter.

This morning, I will provide brief updates across a few key areas of our business and then I'll turn the call over to Steve and Michael before we take your questions. We're taking a large number of steps across our business to bring customers the best possible offering in our category online and we're being rewarded with the outsized growth in market share that we're seeing in our business.

These investments span a variety of different areas across our business, but today I want to focus on three in particular to give you a sense of the great work that our teams are doing, namely, our Canadian expansion, our increasing penetration of the bathroom vanities category, and the launch of Way Day.

Our International business in Canada, UK and Germany continues to grow at a robust pace with Q1 net revenue of $203 million almost twice the level of net revenue in Q1 last year. We are very excited with the investments we're making internationally and the engagement we're seeing from customers in Canada, UK and Germany. Our continued strong growth in these markets and improvements in our International core KPIs give us increasing confidence in continuing the long-term investment cycle we're making there in the customer experience, advertising dollars and in our teams.

Today, I want to tell you more about Canada specifically. Our most developed region outside of the United States. As we've said previously, when we launched the Canadian site, it was able to leverage many of the supplier relationships and logistics capabilities we had previously built in the U.S. From that foundation the Canadian business has performed extremely well and even exceeded our aggressive internal expectations.

From the outset, we are aware that the Canadian consumer in the home category was underserved by brick-and-mortar companies and even more so online. Over the past two years, customers have been voting for us with their dollars, driving the high rate of growth we're seeing in Canada and we're continuing to invest behind this momentum.

As we entered our second year in Canada, we saw an attractive opportunity to grow our overall penetration by better serving the population in Québec, which represents over 20% of the Canadian population by, launching a French language site and developing French language advertising. This customization has proved fruitful with 15% of Canadian orders shipping to Québec in Q1 of this year up from 7% before the launch of the French language site, and we're seeing considerable opportunity to increase this penetration.

Logistics has been a key enabler of our growth today in Canada and we believe that the investments we are making to scale the proprietary infrastructure we have in Canada will be central to our continued gains in the region. Today products from U.S. suppliers account for approximately 80% of net revenue shipped to Canada with the products being routed to a U.S. CastleGate warehouse for consolidation before being shipped across the border. With the success of the Canadian business and the launch of CastleGate in Canada later this quarter, we're well-positioned to take our infrastructure in Canada to the next level. This new 800,000 square foot site will serve as a CastleGate facility and also as a cross-dock, a consolidation center, and a last-mile delivery agent.

The development of our own infrastructure in Canada will improve our offering even further. The benefit to customers will be significant. First, products that are forward-positioned in our CastleGate warehouse will have lower aggregate duties relative to the products shipped directly to customers from the United States. Secondly, shipping costs will be reduced as we lower our reliance on third-parties and take greater control over the transportation of customer orders, optimizing the process to benefit suppliers, customers, and Wayfair. And finally, customers will experience faster delivery speeds and lower damage rates over time as an increasing proportion of orders ship from our CastleGate warehouse.

With the opening of this Toronto facility, we'll have coverage of just under 40% of our Canadian large parcel home deliveries, and over 50% of the Canadian population will be within our one-day delivery guarantee on small parcel items.

As the strength of our offering in Canada has increased, and the customer metrics we track have improved, we've also been increasing our investment in advertising in the Canadian market. We've seen strong results to-date with our level of aided brand awareness in Canada rising to 77% and Wayfair well on its way to becoming a household brand.

We're very pleased with the traction of our business in Canada and the return we are seeing from the investments that we have been making in the region. Our success underlines the potential of our businesses in UK and Germany where we have had to invest more heavily to build our foundations in those regions including new European supplier and transportation networks and with the U.S. business providing less of a head start than it did in Canada.

We're very pleased with the response we're seeing from customers in the UK and Germany and the momentum we are building with suppliers. We believe we are ideally positioned to scale at pace in these two markets as we invest for long-term growth. We're also excited to have opened our first CastleGate facility in Germany earlier this year and to launch brand marketing there in the second half of this year.

Now, for my second topic, I'd like to tell you more about the work we are doing to capture a higher share of wallet from our customer base. On previous earnings calls we've spoken about the steps we're taking to increase penetration of categories within our total addressable market where we've historically under-indexed, and to further strengthen the services we offer our shoppers to enhance our overall offering. Today, I wanted to talk in more detail about the steps we're taking to win in one of the many categories we're investing in, namely bathroom vanities, which we believe is a multibillion dollar market.

Our broader Wayfair customer proposition puts us in a great position to win with shoppers across categories. We offer customers huge selection and innovative shopping features such as Idea Boards, Search with Photo and 3D View in Room (sic) [View in Room 3D] (10:37), to help discover and visualize products we think they will love. We know that rich visual imagery plays an important part in the purchase process, particularly where products are unbranded and higher ticket prices may lead to higher consideration. These features of our offering are particularly relevant to customers shopping for bathroom vanities as the items typically are focal points of bathrooms with customers placing emphasis on the design and desiring uniqueness.

We have significantly enhanced the product discovery experience to shoppers in this category, with, for example, investment in our house brands program to help customers shop for a particular style and price point. We offer over 11,000 different vanities and customers have provided almost 50,000 product reviews across our catalog of vanities, including uploading more than 2,000 photos which we know gives shoppers added confidence as they make purchase decisions.

In addition to doing a great job of merchandising the vanities category in a rich and nuanced way, two added complexities are the importance of compatibility with the customers plumbing setup and the transportation of the product. We work closely with suppliers to provide detailed technical descriptions of the vanities we sell, equipping our customers with the knowledge to give them the confidence that the vanity they love will not only look good but will be straightforward to install.

Customers value the opportunity to speak with our customer service team when they may have specific questions on an item they are considering buying or have already bought. We've been scaling the number of people in our customer service team with specialist category knowledge to ensure that we can offer great service to our shoppers across all product categories. This is particularly important in vanities where customers may have questions on whether, for example, the vanity will fit in their space, if the opening in the back of the vanity will align with their waterline access point, or whether they can combine different items such as a vanity with an alternate backsplash.

We see this investment in people as a competitive differentiator in shopping the home category online. Transportation is also a challenge for the vanities category across our industry because of the risk of damage. In addition to vanities typically being large and heavy, they will often have product features that make them inherently at risk of damage in transit, such as stone countertops, China sinks and overhanging edges.

CastleGate is putting us in an advantageous position to overcome this and improve the overall customer experience. Suppliers can forward-position vanities in our warehouse, often with us receiving the product container-direct from the manufacturer. This coupled with our increasing control of the middle mile and last-mile of transportation reduces the number of touchpoints in transportation thereby over time improving the speed of delivery and reducing risk of damage.

We're continuing to enhance our vanities offering but are pleased with the response from customers with the category having an annualized run rate of over $100 million. Nearly double the size it was a year ago. We're hiring new people to join our teams across the business such as category management, marketing, merchandising, and operations to ensure we give customers a great experience in vanities as we drive for continued gains in share of wallet.

In our quarterly investor presentation, we give a brief overview of some of the other product categories and services we are scaling. We've been investing in these areas because of the results they are delivering for our customers and because we're increasingly bullish on the market opportunity we see ahead of us.

Finally, I want to briefly touch on our Way Day event which took place last Wednesday. Retail holidays have traditionally been anchored to public holidays as shoppers needed time off from work to visit stores, with the first half of the year seeing President's Day and Memorial Day as the major promotional date on the calendar. As online has grown, the importance of these shopping events has reduced as consumers can shop at any time from the convenience of their own home.

We saw Way Day as a great opportunity to bring customers a compelling promotional event at a time of year when home can be top-of-mind with, for example, outdoor spaces being refreshed and homes often being prepared for sale.

During Way Day, customers in the U.S. and Canada were able to shop at Black Friday-level prices across tens of thousands of products with free shipping on everything. We ran a large number of initiatives to drive awareness of Way Day with shoppers including TV, direct mail, and PR, as we saw it as a great way to continue to market our proposition in a very relevant way when other retailers were not. The scale of our business is central to the effectiveness of Way Day. Wayfair enjoys high levels of brand awareness in both the U.S. and Canada today and is therefore attractively positioned to capitalize on Way Day, reaching a large number of customers and generating a high degree of participation from suppliers.

Our teams have been able to test and learn with promotional approaches and site features during the Cyber 5 period and other sales events enabling the business to give shoppers an overall experience that we think was highly engaging and brought them the best of Wayfair.

Way Day performed extremely well for us resulting in the biggest revenue day in our history and we expect that the event will grow further for us in future years.

On the earnings call last quarter, we highlighted the significant growth we've been seeing across our CastleGate network and the expansion planned in the U.S. and International. In Q1, our first CastleGate facility in Germany became operational and we believe this will further enhance our offering to suppliers and customers in the region.

As I mentioned earlier, we expect our CastleGate facility in Toronto to open later this quarter. In addition to our Toronto facility which is now operational as a WDN last-mile delivery site, we've opened two additional last-mile delivery facilities since our earnings call, one in Harrisburg, Pennsylvania, and the other in New Orleans, bringing the total to 22 facilities in the U.S.

We are pleased with the customer satisfaction results we are seeing in the markets where WDN last-mile facilities have been introduced and we expect to continue rolling out additional facilities in 2018.

Now I'll turn the call over to Steve to talk about our approach to data science.

Steven K. Conine, Co-Founder, Co-Chairman, Wayfair, Inc.

Thanks, Niraj. On previous earnings call, we've spoken about the data driven approach we take across our business and today I wanted to tell you more about how we are constantly using data to drive our business forward. Data science is a term that is often overused in e-commerce. At Wayfair, we believe we are at the forefront of using data to improve the decision-making of our employees and ultimately to enhance the experience of our customers and our suppliers.

Our investments in this area have been a core driver of our success to-date. Often, we talk about the overall investment we have made in building our team of almost 1,600 engineers and data scientists and today I wanted to give more color on our data science work specifically.

Over the last four years, we have built a sizable team of data scientists, hiring highly quantitative individuals from top academic research programs as well as experienced industry practitioners of machine learning and data science. We believe we offer driven people the chance to work on complex and rewarding problems in an environment where they develop quickly and drive impact across our business. We place great importance on our ability to develop algorithmic technology in-house at a fast pace, and we see this as a competitive advantage of our business. There are several aspects of our business that have enabled us to do this.

First, we have an integrated data infrastructure. Our long-term investment in business intelligence, technology infrastructure and custom software equips our data scientists with ready access to data across our business enabling them to act on real-time marketing, customer product and logistics data. We have been able to build multiple platforms in-house at a strong ROI as a result.

Second, is the deep level of collaboration between our data scientists and the functional teams across the business, which results in quick iteration, implementation and measurement. Data science and machine learning influence a wide variety of our business areas such as on-site personalization, dynamic pricing, algorithmic merchandising, demand forecasting and advertising technology, among many others. We have a culture that has always placed a high degree of importance on data which makes this type of teamwork much more natural than it would otherwise be, and results in a level of integration that is rare within the industry.

Finally, we collect rich customer and product data. We have a depth of data that is rare within the home category due to the scale of our customer base and product offering and the longevity of our business online. This data is what powers our data science team's work. On average, we capture and store four terabytes of data every day. And over the course of a year we track approximately 40 billion customer actions on our site, putting us in a great position to generate data-driven insight to improve the experience of our customers.

One of our unique advantages is that our data science team impacts the entire customer experience, even before a customer is familiar with the Wayfair brand, we have proprietary marketing measurement models that prioritize the type of ads and creative content that are likely to be most engaging to specific groups of potential customers across digital, direct mail and television marketing.

When customers reach our site, our algorithms consider aspects around product diversity, style, popularity and more to offer an engaging experience every visit. We offer unique features like search within photo that use deep learning to find Wayfair products that are visually similar to photos our users submit. Once the customer places an order, our models determine the most effective way to fulfill the order, taking into account our proprietary logistics network.

Deep analysis of data is central to how our business operates and to how we win with customers. This analytical focus is not limited to our data science team. Across our business, we hire people with an analytical approach to problem solving which continually strengthens the culture of data driven decision-making that has been a core part of our culture since Niraj and I started the business 16 years ago.

I will now turn the call over to Michael to discuss Q1 financials in more detail.

Michael D. Fleisher, Chief Financial Officer, Wayfair, Inc.

Thanks, Steve, and good morning, everyone. I will provide some highlights of the key financial information for the quarter with more detailed information available in our earnings release and in our investor presentation which, as we mentioned several quarters ago, we have refreshed this quarter with a new format and content.

In Q1, our Direct Retail business increased 48% year-over-year to $1.389 billion representing year-over-year dollar growth of approximately $450 million. Our total net revenue increased 46% year-over-year to $1.404 billion. Our KPIs which we report on a consolidated global basis continued at healthy levels in Q1, many reaching all-time highs. LTM active customers increased to 11.8 million customers up 33% year-over-year. Purchase frequency, as measured by LTM orders per active customer, continued the growth we saw in each quarter of last year to reach a new high of 1.79, and orders from repeat customers continues to grow more quickly than orders from new customers.

In the U.S., our Direct Retail business increased to $1.186 billion in Q1 up 42% year-over-year. This represents year-over-year dollar growth in the quarter of approximately $350 million in U.S. Direct Retail revenue. As Niraj highlighted earlier, internationally, Direct Retail revenue from our Canadian, UK and German businesses collectively reached $203 million, up $100 million versus Q1 last year. We're delighted with the response we're seeing from our International customers and the strategic progress we're making in building our business outside the U.S.

I'll share the remaining financials on a non-GAAP basis, excluding the impact of equity-based compensation and related taxes, which totaled $27 million in Q1 2018. For a reconciliation of GAAP to non-GAAP reporting, please refer to our earnings release on our IR site.

Our gross profit for the quarter which is net of all product costs, delivery and fulfillment expenses, was $324 million, or 23.1% of net revenue, consistent with our near-term expectation for gross margins in the 23% to 24% range.

On the Q4 call, I described the attractive opportunities we're seeing to invest ad dollars at ROIs within the approximately one-year payback threshold that is central to our business. In Q1, we continued to invest behind the healthy conversion and repeat rates our customers are demonstrating, with advertising spend of $162 million in the quarter, or 11.5% of net revenue. We're seeing continued strength in our ad spend investments, as demonstrated by the year-over-year leverage in Q1 spend.

In our new IR presentation, we've outlined the customer acquisition costs we saw across 2017 adjusting for the scale of our repeat customer base, which is an increasingly important driver of the effectiveness of our ad spend. If you run this simple calculation historically, it shows that new customer acquisition costs have remained within a similar range over the last few years, and we're continuing to see attractive opportunities to acquire new customers at these levels.

One other point to note is that the number of net new active customers grew by 33% in Q1 year-over-year. But as we've talked about on these calls many times before, this number is not tied to ad spend in any particular quarter.

Looking out to Q2, we expect to continue investing ad dollars in the high ROI opportunities we're seeing, and anticipate ad spend as a percentage of net revenue to fall sequentially from Q1 in line with seasonal trends, and to be flat or slightly above the 11.1% level of Q2 last year.

Our non-GAAP selling, operations, technology and G&A expenses are driven primarily by compensation costs and in Q1 totaled $186 million. As I've highlighted in our recent earnings calls, we're continuing to ramp up our hiring across the business as we invest further based on the results we're seeing in our three main investment areas of building out our International capabilities, developing our proprietary logistics network, and increasing our penetration of categories and services where we have historically under-indexed.

In the first quarter, we added 1,002 net new employees for a total of 8,753 employees as of March 31, 2018. We're excited to be adding great people to teams across our business as we continue to improve our customer offering in the U.S. and internationally and win outsized market share. Approximately 680 of the net new employees in Q1 were in OpEx areas, such as marketing, merchandising, operations and technology, compared with approximately 340 net new employees added in those areas in Q4. We expect to see similar levels of OpEx hiring in Q2 compared to Q1, as we continue to build out teams across our investment areas.

In light of the increase in OpEx hiring in Q1, I want to provide a further breakdown of the main areas of head count growth this quarter which have been broad-based across our business as a result of the cross-functional makeup of many of our teams. We are very bullish on the opportunities we are seeing to hire talented people in the key OpEx areas. These new hires are generally working on the many initiatives that will drive revenue growth in future periods, not near-term.

Like we did three years ago when we started investing in our logistics initiatives, CastleGate and WDN, we added the people and investment first in anticipation of driving clear customer benefits that then payback in higher NPS, repeat rates and lifetime value. The same is true where we are continuing to build teams across our three investment areas today.

We added approximately 100 net new people in merchandising and approximately 100 net new people in marketing, as we invest in dozens of product categories and services to fully penetrate our TAM. Operations head count grew by approximately 120 people as we expand our logistics networks and add new supplier services such as drayage and ocean freight. Our technology teams across engineering, business intelligence and product development increased collectively by approximately 250 net new people over the quarter as we invest in market-leading proprietary software to advance various initiatives across our business. We continue to be delighted with the caliber of talent we're adding to our teams, and we are keeping the talent bar high as we continue this elevated rate of hiring.

Turning to our logistics investment, as Niraj mentioned earlier, the build-out of our CastleGate and WDN facilities in the U.S. and International is progressing well, and customers are continuing to respond positively. This ongoing expansion puts us in a strong position for continued growth but does mean that unutilized rent continues to weigh on our P&L in the $5 million to $8 million range per quarter in OpEx.

Adjusted EBITDA for Q1 2018 was negative $50 million, or negative 3.6% of net revenue. Adjusted EBITDA for the U.S. business in Q1 was negative $8 million, and adjusted EBITDA for the International business was negative $42 million as we continue to invest in our three International regions.

Non-GAAP free cash flow for the quarter was negative $48 million based on net cash from operating activities of negative $13 million, in-line with seasonal trends, and Capital Expenditures of $35 million. CapEx spending was 2.5% of net revenue in Q1. For Q2 we expect CapEx to be approximately 4% of net revenue. As of March 31, 2018, we had approximately $593 million of cash, cash equivalents and short and long-term investments. Now, let me turn to guidance for Q2 2018.

We forecast Direct Retail revenue of $1.545 billion to $1.575 billion, a growth rate of approximately 40% to 43% year-over-year and representing year-over-year Direct Retail dollar growth of approximately $450 million. Within that, we expect U.S. Direct Retail year-over-year growth in the range of 35% to 37% and International Direct Retail year-over-year growth in the range of 80% to 90%.

As you heard from Niraj, Way Day was extremely successful and created a new high watermark as our largest revenue day ever. This is of course fantastic and speaks to the growing strength of our brand and business, but it also creates a challenge in setting guidance for the quarter as the day does not have a historic comp. Quarter-to-date excluding Way Day, Direct Retail gross revenue growth has been running consistently in the 40s as it has for some time, and needless to say it would be higher if we included Way Day.

With two full months to go, no historic precedent for the impact of Way Day on the balance of the quarter, and our normal prudence in setting revenue guidance, we're guiding the quarter in a very similar fashion to last quarter. Overall, our guidance for Q2 points to another strong quarter of dollar and percentage growth and we continue to be pleased with the market share we are gaining.

We forecast other revenue to be between $13 million to $17 million for total net revenue of $1.558 billion to $1.592 billion for the second quarter. For consolidated adjusted EBITDA, we forecast margins of negative 2.1% to negative 2.4% for Q2 2018. We're continuing to make the long-term investments in our business that have driven our success to-date and that are being rewarded by customers increasingly shopping with us.

In the U.S. business we expect to deliver adjusted EBITDA between breakeven and positive 1%. We expect International adjusted EBITDA to be negative $40 million to negative $45 million in Q2 as we continue to add resources and ad spend in Canada, the UK and Germany. As I have pointed out in the past, we won't slow or attempt to time our investments to deliver a specific level of adjusted EBITDA in any particular quarter.

For modeling purposes for Q2 2018, please assume equity-based compensation and related tax expense of approximately $32 million to $34 million, average weighted shares outstanding of 89.2 million, and depreciation and amortization of approximately $29 million to $31 million. Q1 represented a great start to 2018 with approximately $450 million in Direct Retail year-over-year dollar growth. We're excited to see strengths across all our KPIs demonstrating that what we are delivering is appealing to customers and that our investments in our key strategic areas are yielding results.

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

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

Thanks, Michael. Steve and I are very excited about the momentum in our business and our ability to capture the opportunity we see ahead of us, both in the U.S. and internationally. We're extremely proud of the progress our company of over 8,000 people is making in transforming the experience of shopping for the home, from the home. Customers are rewarding us with their dollars as they increasingly benefit from the investments we've been making in our logistics and infrastructure, in deepening the products and services we offer them, and in strengthening our proposition and brand awareness internationally.

All of our efforts are focused on continuing to improve what we can offer shoppers so that we can capitalize on the secular tailwind from offline to online in our category and grow substantially in excess of the online market growth rate for the home category.

And with that, I'll now ask the operator to open up the lines so we can answer a few of your questions.

QUESTION AND ANSWER SECTION

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

<Q – Peter Keith – Piper Jaffray & Co.>: Hi. Thanks. Good morning, everyone. Congratulations on the continued strong revenue growth. In looking at the quarter, certainly the metrics were strong. It doesn't show much sign of competitive impact at this point, although the gross margins coming in at the lower end of your range, so I guess kind of a two-part question around gross margin. When you're in-line now with Q4 which is seasonally low, why wouldn't the gross margin start to be drifting up sequentially, particularly as you're getting some of the logistics benefits that should be helping that line? And the second part of the question, would gross margin see any negative impact in Q2 as a result of Way Day? Thank you.

<A – Niraj Shah – Wayfair, Inc.>: Thanks, Peter. Yeah, we're definitely excited with how the business is performing and you could see that in the metrics, right? You see advertising going down while you have very strong revenue growth. And so to your point, despite a lot of noise about competitors, the reality is we're not seeing in actuality. We're seeing customers actually coming back with a significant increased momentum, so we're very excited with how things are going.

On gross margin, let me just try to explain a couple different factors that drive that number because the mix of them is what's really the outcome here. And so, the range is basically a range we consistently – we think we're in great shape to deliver, you heard Michael address that, and so, yes, we're in the lower end of that in this last quarter. Part of that is there's a couple of dynamics there where you have mix shift in International, for example, runs at a lower gross margin, so as that takes share that's a little bit of downward pressure. And we talk a lot about these emerging categories and we talk a lot about the OpEx hiring. A lot of that drives the emerging categories.

And so when you take a look at our investor presentation, you'll see we refreshed it this quarter because it have been three, three-and-a-half years and on page 26 we talk a lot about some of the categories, some of the things we're doing to drive an increased customer experience and fully penetrate the TAM. When we really ramp a new category, it's effectively almost always at a significantly lower gross margin than our average and as it scales up it gets much higher, so that's one set of factors is this mix shift, International and categories.

The second is that and you'll see this in our Q, on the transportation logistics, there's definitely been some cost pressure there. However, we don't expect that to persist. In fact, we expect that to revert because of the logistics network we built. So we believe in the industry side there's going to be continued upward pressure and we've certainly seen a little bit of that. A lot of what we've been rolling out actually basically counters that, but the gains, we've gotten only a piece of the gains so far, so there's a lot more gains to come. So the combination of these things has gross margin a little lower but we don't foresee it staying there and that's why kind of we gave you the range and we say it'll stay there.

In terms of Way Day, I'll let Michael address it because that's effectively playing at guidance, but again, you heard our guide but, Michael?

<A – Michael Fleisher – Wayfair, Inc.>: Yeah. Look, Way Day was a very strong day. You heard the details and sort of our perspectives on it in terms of the guide. From a gross margin perspective, nothing in Way Day's performance would change our 23% to 24% guide for gross margin for Q2.

And remember, whenever we're doing promotional events, whether that be a Way Day, Cyber Monday, Black Friday, or any of the other seasonal promotional events, we work very closely well in advance with our supplier partners to make sure that we're getting the best deals from them and can pass the best deals on to our customers. And so there's always a mix in that, but generally, promotions though they run at lower margin, they're not markedly lower margin when you think about the concessions we're getting from our suppliers in order to have their products moved at those kinds of volumes.

<Q – Peter Keith – Piper Jaffray & Co.>: Okay. Very helpful. Thank you very much.

<A – Joe Wilson – Wayfair, Inc.>: Thanks Peter.

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

<Q – John Blackledge – Cowen & Co. LLC>: Great. Thanks. Two questions. So the advertising costs were a bit lower than expected. I think it was about 11.5% of total revenue and the guide for 2Q ad spend also a bit lower. Just wondering if you're seeing leverage from the rising repeat rate which was much better than we thought? And then, the second question would be the top-line guide also a lot better than we expected against more difficult compare from 2Q 2017, so any further color on the top-line strength would be helpful. Thank you.

<A – Niraj Shah – Wayfair, Inc.>: Thanks, John. So a couple of things, so first on the ad spend. Yeah. I mean, I think that should hopefully help with some of the noise out there about this worry about ad spend, because you see the 80 basis points of year-over-year ad spend leverage going down to 11.5% despite the International mix shift. And what that is a function of is basically, you can see we're still getting a lot of new customers, 2.1 million new orders in the quarter, right? But the way it works is as the experience gets stronger and the brand gets stronger, what happens is that as customers get exposed to Wayfair, the odds that over time they'll buy increase.

And then, a whole separate factor is that the odds that they'll want to come back increase, right? So you see repeat is the primary driver of our growth, because repeat grows faster than new. But what happens is the same thing that's driving repeat which is the experience drives effectively the sub-function of the advertising turning into a new customer. So the reality is we have International and other things that put pressure on that number, but we have things that help us on that number, and you're seeing that that's playing out.

In terms of the top-line guide, the tricky thing about percentages, right, is when we're growing at this rate and you have a percentage, it matters what happened last year in the same quarter, and so we believe that that's not sort of the best number to focus on, obviously the percentage is really strong and that's great, but we believe that the dollar growth is actually a really interesting number.

And so when you see the year-over-year dollar growth in Direct Retail this quarter, it'll be $450 million. You heard in Michael's guide, he guided that again next quarter. If you think that – if it stayed there and it's actually been a rising number, but if it stayed there that's $1.8 billion a year of dollar growth. As you start thinking, well, how much share is that of the market growth and you start to see that that's a real nice momentum.

And so what's happening is you almost need to think about that as a sequential thing where you're getting more customers, you're investing in the experience, their odds of coming back are increasing, and that's just a compounding thing quarter after quarter after quarter. And by the time your four quarters past, what happened last year – what happened last year is less relevant than what actually happened last quarter and the quarter before.

And so all these OpEx folks that we've hired, they're effectively working on things that have no ramification on today's P&L. These are new things, and 6 to 12 months after they start you see an incredible ROI on the work that they're doing, and we tried to illustrate a whole laundry list of things they're working on in the presentation, and that's why the revenue growth is actually not that big a deal, because we're still – we're in such a huge market that there's tons of revenue growth opportunity, tons of customers, tons of share of wallet, and all you're seeing is that the experience – as simple as that sounds, the experience is sort of what the customers value, so they come back vis-à-vis compare it to what else is out there, there's a huge difference, and that's kind of the driver. So the tough compare, obviously, that matters on a percentage, but it's kind of overwhelmed by this other thing.

<Q – John Blackledge – Cowen & Co. LLC>: Thank you. Appreciate it.

<A – Joe Wilson – Wayfair, Inc.>: Thanks, John.

Operator: Our next question comes from the line of Oliver Wintermantel from MoffettNathanson. Your line is open.

<Q – Ollie Wintermantel – MoffettNathanson LLC>: Yeah, good morning, guys. I had a question regarding the top line growth, and I want to focus on the U.S. So if you look back a few quarters and think about what is driving it, is it more the driving new customers to your website or is it a better conversion rate? Because you're exceeding your guidance range so I just want to see what is driving it. Is it more traffic or more of a conversion?

<A – Niraj Shah – Wayfair, Inc.>: Yeah. So [ph] Ollie (44:00) first, just throw it out there. We've always exceeded our guidance range but anyways that's an aside, but what I would tell you, so if you look at the U.S., the year-over-year dollar growth is at $350 million, right? And if you look back, sort of that's a nice kind of a growth climb and there's that period in the beginning of 2016 where we had said we had hired a lot of people at the end of 2015 beginning of 2016 and onboarding them was a challenge so we've actually changed our rate of onboarding to basically both, on one hand, ramp people but digest them well.

But frankly, what you actually see happening right now is dollar growth is actually kind of growing because of what I just said a minute ago in terms of the experience, basically being rewarded with the repeat business and that's really the flywheel is the repeat. So traffic certainly grows but conversion is increasing so that gets leverage on the traffic. If you think about new traffic and the conversion increasing, it gives you leverage of getting new customers and you think about the experience getting better on the conversion on repeat but also the propensity of someone to come back that gets you leverage on repeat.

So repeat still grows faster than new and it's sustainable because of this cycle of continual improvement which is basically creating a larger moat. So if you think about conversion on a differential basis relative to our competitors getting stronger, that basically makes your advertising dollar go further because Google doesn't say it's $3 for this click. It says I want an effective CPM of Y dollars. Same with how you bid for display like what is it worth to me? Is it worth $0.04 or $0.03? Well, if you're a stronger converter because of the value of the experience and the value of the lifetime value or the one-year payback of a customer, well you could pay $0.04 instead of $0.03 instead of $0.02 and you can actually get a higher return on that than the guy who pays $0.02.

And so these different things fundamentally kind of make the whole math come out. So it's not – it's no one thing but it's kind of these things multiply against each other, I guess, is basically the answer.

<Q – Ollie Wintermantel – MoffettNathanson LLC>: Right. Thanks very much. Good luck.

<A – Joe Wilson – Wayfair, Inc.>: Thanks, Ollie.

<A – Niraj Shah – Wayfair, Inc.>: Thank you.

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

<Q – Seth Basham – Wedbush Securities, Inc.>: Thanks a lot, and good morning. My question is around ad spend. In your presentation, you talked about 7% of Direct Retail ad spend on repeat revenue. Can you comment as to whether or not that was specific to Q1 2017 and what the trend has been over the last three years?

<A – Niraj Shah – Wayfair, Inc.>: Yeah, sure. Thanks, Seth. Yeah. So one of the things we found that's been confusing for folks is just that when you talk about ad spend as a total percentage it sort of doesn't help you understand repeat versus new. And we've always said that the reason the number came down from Q1 of 2014 of being like 16% down to where it is today is because the repeat runs so efficiently and we talk about the long-term model being at 6% to 8%. What that has in that is we already see how repeat runs at low rates. And to be a little bit technical for a minute, your second order versus your third order versus fourth order, the percentage cost keeps decreasing over time so as customers become increasingly loyal, their actual ad spend keeps dropping.

So we use 7% because it's the midpoint of 6% to 8% so it was really just a simplification for the purpose of modeling to give a way to breakout repeat versus new because the old model where we said repeat is free and new carries everything, well, we sort of explained that that's false but that's super conservative so why don't you think about it that way? But it created some confusion so we created a model that's still somewhat simplified, but it gives you a way to break apart repeat versus new.

What you find in actuality on repeat is, in fact, your second order is a certain percentage, your third order is at a lower percentage, your fourth order is at a lower percentage and so the repeat in total averages down over time as people continue to climb up that ladder. And so I guess for the purposes of modeling right now, we'd encourage you to use something like a 7% number because that gets you to an outcome that sort of explains to you how we look at it, but that number actually decreases over time.

<A – Michael Fleisher – Wayfair, Inc.>: And Seth, just to be clear, the $46 number that you quote in the presentation is for all of 2017. It happens to be the same number if you ran the calculation for the first quarter of 2018. It's also $46. And I think what you'll find is if you run that quarterly going back in time using the 7% cost for repeat that the cost, the ad cost to CAC has sort of remained in a very consistent band, plus or minus $45 going back the last three years.

<Q – Seth Basham – Wedbush Securities, Inc.>: Got it. Just to be clear. So that 7% number is the appropriate number to use going back 2016, 2015, and 2014?

<A – Michael Fleisher – Wayfair, Inc.>: Yeah, I don't think that – I think the cost to get a repeat customer and the cost to get a new customer remained extremely consistent over the last few years. That's what we're saying.

<Q – Seth Basham – Wedbush Securities, Inc.>: Thank you.

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

<Q – Mike Graham – Canaccord Genuity, Inc.>: Thanks. Good morning and thanks for the presentation. Can you just give us a reminder, Niraj, on the competitive front? In the presentation, you basically say that you're getting sort of 25% of the market growth. And can you just give us your thoughts on where you think the other 75% of that market growth in the U.S. is going, and what's the opportunity against that competitive set? And then just a real quick one, Michael, can you just remind us on the factors that drive the margin seasonality? Like Q2 last year was up a lot in the U.S. and you just guided for a good margin in Q2 in the U.S. this quarter. So just a quick thought on what drives that seasonality. Thanks.

<A – Niraj Shah – Wayfair, Inc.>: Thanks, Mike. Let me answer the competitive piece and then Michael can answer the second piece. So what we did there, as we showed in 2017 how many dollars we grew in the U.S. and what the total online market growth was with that 15% number, right, and we just showed what portion of it we would have. If you look at where we are now, we're actually at a dollar growth rate higher than that, right, so the percentage share we'd be taking would be increasing.

But what that is that's all the dollar growth online, so in other words, if walmart.com grows their online business and sells some in the category or an Amazon or Williams Sonoma, if they don't decline, if they grow 5%, even though the 5% or the 10% might be below the 15%, that's still part of the growth. Then you have some folks who might be growing 15%, 20%, 25%. That's some of the growth. And, obviously you see us whatever we're growing, whatever it was in the 40s, right? In low-40s in the U.S. this quarter.

So what happens is it's not that we're taking all the growth and others are shrinking; it's that we're taking a disproportionate – an increasing portion of the pie as it's moving online. But others have different businesses where they have pieces, particularly at the opening price point commodity goods. So when you add up all those folks, Home Depot, and all that growth is making up that other piece, and we don't believe that other piece is really dominated in any particular place and we believe we also have it more concentrated in the more commoditized products as well.

<A – Michael Fleisher – Wayfair, Inc.>: Mike, on the question on gross margin and seasonality, there's, obviously, some Q4 seasonality. But beyond that, I would say the real drivers of gross margin are what Niraj covered earlier, right? Today, it's really the impact of the International business weighing, as it sort of continues to grow and gain scale, and we've been very clear, runs it at a lower gross margin as we get that business going – as we continue to sort of do – the categories where we're working hard to penetrate the TAM further those start out at lower gross margins. So those are the weights.

And then, as we've always talked about, as we roll out CastleGate and WDN, those operations don't operate day one at full peak efficiency. We'll work our way into the efficiency of those over the course of the next 12 to 18 months, and we'll start to see the gains from that. But we've always said on the logistics side that as we roll that out, the costs are actually going to rise a little before they fall back to their original level and then down to lower levels, and we're starting to see that in the operations that have been running for the longest now. We're well into that, and we feel extremely good about the trajectory of our delivery cost and the logistics networks we've invested in.

<Q – Mike Graham – Canaccord Genuity, Inc.>: Okay. Thank you.

Operator: Our final question today will come from the line of Brian Nagel from Oppenheimer. Your line is open.

<Q – Brian Nagel – Oppenheimer & Co., Inc.>: Hi. Good morning. Thanks for all of the commentary, color. So, I had a couple of questions, I'll kind of form into one. First off, just on Way Day. Recognizing it's still early, but as you look at the sale spike you saw that day which you called out, was that – do you think that's more a function of people shopping that day? Or, I guess, what I'm trying to say is it incremental sales, or do people just move shopping around to focus on that one day? And then, what was the makeup? If you look at who was shopping, was it more skewed to new customers, existing customers, or consistent with the business? And then, I have a follow up.

<A – Niraj Shah – Wayfair, Inc.>: This is Niraj. Let me make a couple of comments and Michael can then chime in. So we saw great mix of new and repeat that day, so you see in the business, the majority is repeat, but we have a nice base of new customers. We were encouraged that day with seeing both types of customers turn out in significant proportion. I think it'll take a little more time to definitively say whether it cannibalized any other parts of the quarter. But we believe we did pick up significant incremental volume because of it, and so we're very excited about that. And time will prove that out definitively. But everything we've seen so far implies that actually the power of the Wayfair brand that we've built up, marketing the event and the quality of the event and the enjoyment associated with it actually let us take significant share through having it. So we believe it was very incremental. Michael, do you have anything you want to add?

<A – Michael Fleisher – Wayfair, Inc.>: I wouldn't add anything to it.

<Q – Brian Nagel – Oppenheimer & Co., Inc.>: Okay. Thank you. And then my follow-up. And again, we've talked a lot here about gross margins and you guys have given a lot of color too about just the trajectory there and how it's still very much within your stated range. So the question I have, I guess, is more for Michael. You mentioned that one of the factors weighing upon that gross margin rate is the outside sales growth in your International markets. Have you considered or could you give us some color on how that gross margin would look if you excluded the impact of International?

<A – Michael Fleisher – Wayfair, Inc.>: Yeah, I think at this point we're not going to break out further KPIs or financial metrics between the International and the U.S. business. I think we've put some color against it over time by noting that the gross margin in the International business runs substantially less than the U.S. business. And that's not surprising if you think about the early days. We are there and the supplier network that we need to build. And when you're building a new supplier network you're at a lower volume with those suppliers versus the U.S. suppliers where we've been working with them for a long time and have massive volume at this point.

But we've also pointed out that as the International business has grown, though it's gaining share and creating a weight on gross margin because it runs at a lower gross margin, its gross margins have been getting better. And so I think the trajectory of the International business is showing exactly what we want it to be showing for the investments we're making there. But, obviously, it's still running at a lower level. And as it gains share in the total mix, it weighs on the total gross margins to some extent.

<A – Niraj Shah – Wayfair, Inc.>: This is Niraj. I just want to maybe just add a thought, just as we're wrapping up the call here. But so one of the things I'd encourage you to think about, so I think there ends up being a lot of confusion about Wayfair, partially because we're very growth-oriented and we're investing into basically what will basically create huge long-term return. What I want to make sure there's kind of a good understanding of though is we are very, very quantitative in how we do that, and we're very focused on protecting the unit economics. And so I think if you start thinking about what we're doing, the unit economics, there's different types of unit economics. There's unit economics of revenue in terms of orders.

And so we don't want to buy revenue. So when you think about gross margin, one way to grow is to basically invest in pricing. And we try to be very diligent and deliberate about how we price items so that it's not that we're selling at a price that one day we need to raise. We're actually selling at prices that we can sustain forever.

Now when we enter a new category of gross margins lower than we want, we have a trajectory on how we'll get it where we want. In a new geography where we have it lower than we want, we have a trajectory on how we'll get it where we want. And a lot of that comes from scale and transportation and things that you just can't do without scale, but we know how we'll get there. So the unit economics around pricing we keep intact.

Another place is the unit economics around getting customers. So that's advertising. And that we've always kept these really tight payback frameworks so that we always know we won't be upside down when we're investing in getting a new cohort of customers. And we get paid back fairly quickly. And, obviously, as what you're seeing with the repeat is we're investing into the fundamental underpinnings of the experience so that actually we know that the lifetime value is increasing, not flat or decreasing. So if you're calculating the IRR at a three or five-year period for the ad spend outlay, it's actually an increasing number over time. And it's impossible to estimate today because you actually don't even know how much it'll increase by, but it's a positive moving number.

And then if you think about the P&L, you have gross margin which we just sort of talked about a little bit. You've got advertising which we just talked about a little bit and the other is the OpEx head count. And I think OpEx head count is the one that folks have the hardest time getting their head around when we talk about adding a thousand people. What are those thousand people doing? And if they're sitting around and they're just talking to each other, well, we'll never get our money back. And so is that a good use of money?

And the thing about it is while you see a thousand people, or we tell you it's a thousand people, we try to give you some flavor of all of the things they're working on. The truth is they're being added in groups of twos or threes or fives to these teams. And the teams are very much focused on the lever that drives an increasing customer experience and generally is actually something that improves our overall economic outcomes on a unit basis, in addition to, obviously, in aggregate in terms of driving up LTV and what not. So what happens is that we're in a world of opportunity.

Now you can't go after all of it at once, because if you go after all of it at once, you then have too many new people and they don't know, they lose the historical knowledge and they're working with other new people and there's no way to transfer the information. And so you can't do it all at once, but we're trying to kind of play that line of doing a lot, but being pragmatic, and that just gets us these outcomes. And that's why you're seeing the sustainable sort of growth rate and, again, I focus you back on the dollar instead of the percentage, but you're seeing this sustainable but very high growth rate, because it's a very differentiated experience, and customers are loving it, and that's why we're believing in continue, because we're in a TAM that's still large, and we're relatively small compared to the TAM that there's so much upside.

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

So, anyways, thank you for taking the time and all your interest and we'll talk to you all later.

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