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Wayfair, Inc. (W)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. My name is Rochelle and I will be your conference operator today. At this time, I would like to welcome everyone to the Wayfair Q2 2024 earnings release and conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I would now like to turn the call over to James Lamb, Head of Investor Relations and Treasury. Please go ahead.

James Lamb

Head-Investor Relations & Treasury, Wayfair, Inc.

Good morning, and thank you for joining us. Today, we will review our second quarter 2024 results. With me are Niraj Shah, Co-Founder, Chief Executive Officer and Co-Chairman; Steve Conine, Co-Founder and Co-Chairman; and Kate Gulliver, Chief Financial Officer and Chief Administrative Officer. We will all be available for Q&A following today's prepared remarks.

I would like to remind you that our call today will consist of forward-looking statements, including, but not limited to, those regarding our future prospects, business strategies, industry trends and our financial performance, including guidance for the third quarter of 2024. All forward-looking statements made on today's call are based on information available to us as of today's date. 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 2023, our 10-Q for this quarter 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 any of 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, including adjusted EBITDA, adjusted EBITDA margin and free cash flow. 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 and investor presentation, which contain 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.

I would now like to turn the call over to Niraj.

Niraj S. Shah

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

Thanks, James, and good morning, everyone. We're excited to discuss our second quarter results with you today.

Q2 was a dynamic quarter that resulted in another period of share gain and we continue to see efforts around cost optimization pay off with our best quarter of adjusted EBITDA and free cash flow in three years. This was all the more impactful because it was a quarter of continued macro headwinds that are pressuring the way customers shop the category.

Way Day was a tremendous success, with performance up in the double digits versus our event last spring. We saw notable engagement throughout all three days with broad-based strength across the catalog. The Way Day results are consistent with the pattern we've observed now for over a year, where promotions continue to drive customer engagement, but correspondingly, we see shoppers pulling back in the non-promo periods.

The performance spread between promo and non-promo remains wide, and our post-Way Day results came in below expectations. This was in part due to the increasing price elasticity we've been seeing in our customers as well as a decision to intentionally pare back on marketing spend following Way Day to remain disciplined on efficiency in periods where customer engagement is lighter.

We continued to take share in the second quarter as we proactively adjusted to the trends we were observing. A more moderate capture rate in May picked up as we got through June and entered July on the back of pricing actions in response to that changing elasticity, coupled with a normalization in marketing spend. Our market relative price index and internal measure of how Wayfair prices back up to competition returned to showing healthy year-over-year improvement following those actions, and correspondingly, we've seen our market share set further highs.

Q2 was a continuation of the macro trends we've been seeing for the last few years. Customers remain cautious in their spending on the home, and our credit card data suggests that the category was down by nearly 25% from the peak we saw in the fourth quarter of 2021. This mirrors the magnitude of the peak to trough correction the home furnishing space experienced during the great financial crisis, according to U.S. Census Bureau data.

Importantly, this calculation is on nominal dollars. Adjusting for inflation suggests we're now in the midst of a correction in excess of 35%, an unprecedented level of pullback in our sector.

We see three clear factors behind this correction: one, the malaise in the housing market; two, overspending in 2020 and 2021 that has warped the historic replacement cycle; and three, a slowing US economy. You're likely very aware of the evidence on the first factor. Over the first five months of 2024, new home sales are down by nearly 20% compared to the first five months of 2021, while existing home sales are down by more than 30%.

While you've seen many of our peers that are impacted by housing declined to an even greater degree than Wayfair, at the end of the day, with housing turnover levels that haven't been as depressed since the great financial crisis, the market fatigue weighs on everyone in the category, ourselves included.

On the second factor, like many of you, we spent time trying to tease apart the magnitude of the demand pull forward in 2020 and 2021 in an effort to gauge how far along we might be in this period of rationalization. Controlling for inflation, we measured actual spending from 2020 through the first half of 2024 against a hypothetical environment where the pandemic never happened. Using data from the Census Bureau, the analysis shows actual spend volume coming in below that hypothetical no-pandemic world.

I want to take a moment to let the magnitude of that sink in. Customers have more than compensated for the overspending during the pandemic and have now underspent in the category compared to historic patterns. This is in spite of the fact that the structural need for products in this category has not changed. As we've said many times in the past, people still need mattresses and tables and chairs. They still need desks and bathroom fixtures and kitchen equipment. And at some point, we expect a reversion to the mean.

While we've yet to see the housing recovery, replacement for pandemic spending, and broader economic upturn, we anticipate these drivers around the horizon. Given how deep we are into the cycle, it's fair to expect the turnaround to come soon, and Wayfair is well-positioned to benefit as it does. That brings us back to our own performance and how we are positioning Wayfair to drive both continued market share growth and profitability flow-through as the top line begins to inflect.

Back in February, I outlined three initiatives that we are working towards in 2024 to further build out our position in the market: our brand refresh in March, the opening of our first large-format Wayfair store in May, and the coming launch of our loyalty program later this year.

On our first quarter call, we spent some time unpacking the brand refresh and how excited we are about our new ways to speak to shoppers. Today, I want to dig deeper into the second initiative on the list, our physical stores.

Despite the massive shifts in the aftermath of the pandemic, we still see home as quite underpenetrated online at roughly a quarter of spending in the category. Even in a more mature state that approaches something closer to a 50/50 split, that still leaves hundreds of billions of dollars in addressable market opportunity on the physical side of the equation. We don't want to leave this opportunity untapped.

As we look at our own core competencies, we already have many of the pieces in place to address this segment of the market. We have a household brand across North America and parts of Europe with incredibly strong brand recognition and affinity. We have a nationwide, industry-leading fulfillment network and delivery capability. We have deep relationships with our more than 20,000 suppliers offering a broad range of product, style, and price points for our customers. And we have a customer file of more than 90 million shoppers.

The one piece of the puzzle we didn't have were the physical stores themselves. And so we launched our first mall-based pop-ups in 2018 and followed up with a store in the Natick Mall just outside of Boston back in 2019. This was a very small format experiment, and we quickly realized that we needed something larger to showcase the Wayfair brand and its true depth.

2022 marked the next stage in our physical retail journey with the launch of our specialty retail stores under the all-modern and [indiscernible] (00:10:06) banners. We launched three stores over the course of the year and then followed up with two more in 2023. These stores average between 10,000 and 15,000 square feet in high-traffic retail centers, typically close to other specialty furniture retailers.

Every element of the customer experience was thoughtfully designed with three key goals in mind: one, capturing incremental share of wallet as we broaden customer awareness to the true depth of our catalog; two, reaching a new segment of customers that have been reticent to shop for the category online; and three, building brand awareness and driving customer affinity, especially across our specialty brands. Our physical retail operating model mirrors the approach we take online. Inventories owned by our suppliers and our take rate on top of the suppliers' wholesale price drives our gross margins.

We've been pleased with the results across our slate of specialty stores, which, with the addition of several Birch Lane locations earlier this year, now sits at a total of nine. Our stores have been averaging thousands of shoppers per month with healthy growth in sales per square foot in tandem with considerable margin expansion as we fine tune the operating model and selection.

A core part of our strategy is building a bridge to help shoppers make the leap from the physical store experience to our online platform. This has been a major point of success and we're seeing that nearly a third of in-store sales are for products that aren't actually on display. That comes in tandem with a healthy halo effect where we are seeing substantial lift in online sales within the surrounding area of our stores.

Our specialty stores were years in the making before we opened their doors and we expect even longer preparing for the launch of our Wayfair branded store this past spring in Wilmette, Illinois. If you haven't had the chance to visit the store, I'd encourage you to do so the next time you find yourself in the Chicago area. We've been thrilled with the very strong initial response from the hundreds of thousands of customers who have visited the store and love how we are showcasing the Wayfair brand in its full breadth.

Part of what differentiates Wayfair is the scale and sophistication of our offering. We have unparalleled breadth of assortment across styles, price points, categories and brands, satisfying customer demand across a wide spectrum of budgets and purchase occasions.

Our technology and category expertise enable us to personalize the customer journey, combining customer insights and merchant intuition to curate and recommend the perfect looks for each shopper. We complement this with services that solves some of the biggest problems that could otherwise deter home purchases, such as design, financing, assembly and installation. And we have a supply chain that excels at carefully and quickly moving big and bulky items with reliably high service levels. We've deployed all of this in our new store, creating a shopping experience that's quintessentially Wayfair.

The store spans roughly 150,000 square feet with 17 departments and 2 dedicated spaces for design services. We have more than 10,000 items on display from hundreds of suppliers, many of which are available for customers to purchase and take home right from the store.

Large parts of the store are designed to be experiential, such as our functional shower studio and kitchen faucets or the office chair test lab. We've handcrafted the shopping journey in each segment of the store, such as our Find Your Fit mattress section that helps shoppers evaluate all the important attributes of their next bed, such as size, firmness and materials. Customers are loving the thought and care we've put into every corner of the store.

While it's only been a handful of months since opening, the early read on the store has been very encouraging. The majority of shoppers coming through are entirely new to Wayfair. We're seeing diversity in basket composition as well, with shoppers leaning heavily into cash-and-carry items that we feature in the mix.

As I mentioned a moment ago, that's been one of our core goals of physical retail, broadening customer awareness to the true scope of our catalog and earning more of their shopping occasions for higher-frequency items. What we've been most excited to see are the early impacts on the surrounding area. Our preliminary data on the Wayfair store shows a halo effect uplift that is multiples larger than we've seen at our specialty locations.

We're already working on opening our next Wayfair store to help test the model and gain a perspective across different geographies. Based on the performance of these stores and as they hit certain internal thresholds, we are excited about the full potential of physical retail over the next decade.

We're also planning to bring another store concept to life with our first physical location for Perigold next year. Just as we did with our specialty stores and the Wayfair store, the Perigold shopping experience will be uniquely curated to pay homage to all the reasons shoppers love our luxury brand. We can't wait for you to see what that looks like.

As we described at our Investor Day just a year ago, we see physical stores as one of the core growth drivers for Wayfair over the next decade and beyond. Our approach here will be measured and the intention is to have the stores justify their construction entirely on their own four-wall economics. You can rest assured that we have no plans to work through an investment cycle where we spend deeply at the expense of profitability to expand the store footprint in a rapid fashion.

Our approach here is very similar to how we scaled up the business in our early years, bootstrapping growth in our store portfolio on the back of the successes we've built up to that point. That back-to-basics mentality isn't just a description of our physical retail efforts, but it's been a core tenant of our entire operating philosophy these past few years. Every action we've taken, every goal we've prioritized and every dollar we've spent has been considered under the intense scrutiny of our high expectations for return on investment.

Even with the challenging macro, this was our best quarter of adjusted EBITDA and free cash flow generation in three years, clear evidence of our strict operating discipline. We are running the business with a goal of demonstrating substantial growth and profitability this year, even as the top line remains challenging. And that will be our mindset every year going forward as well.

Thank you. And with that, let me pass it over to Kate for a breakdown of our financials.

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Thanks, Niraj, and good morning, everyone. Let's dive into our second quarter financials before turning to our outlook for Q3. Top line results for the period came in slightly below our expectations, down 1.7% compared to the second quarter of last year. The decline was driven by a few factors.

First, as Niraj shared, we observed a weakening overall macro in the back half of the quarter, consistent with the trends that many other consumer companies are experiencing. Second, our Way Day results were quite strong, but we saw less momentum in June when we were not running promotional events and subsequently pulled back on advertising, and this weighed on our revenue performance.

Consumers have remained cautious in the category for years and we've continued to see a pronounced spread in performance between promotional and non-promo days. There's an important caveat to add here, one that we've said before. Outperformance on promo days does not mean that sales strength is driven exclusively by discounted items. Less than a third of our sales during promotional events come from featured items and that has been quite consistent over the past year. What this means is that consumers are willing to spend in the category once they are engaged in shopping. Promotions have been for some time and are now even more so the most potent tool to drive that engagement.

One of Wayfair's core competitive advantages is the rich data-driven insight we have on customer behavior and our ability to regularly run pricing experiments, toggling prices up and down by small percentages on a portion of the catalog in order to develop a real-time view of customer spending behavior.

Our data science teams spend a tremendous amount of time studying the resulting demand curves and their work has painted a picture of a customer environment where we can both take further share as well as maximize profit dollars by leaning in on pricing.

The results from our price testing, in combination with the bifurcation we see in promo versus non-promo periods, present a clear opportunity to optimize gross profit dollars by investing in price over a multi-quarter period. This follows the construct we laid out several quarters ago. Based on what we see today, we believe targeting a gross margin closer to 30% gives us the ability to drive higher order capture than a similar investment would have yielded a year ago. Through this strategy, we are maximizing gross profit dollars and driving order capture even if at a slightly lower gross margin.

Absolute revenue growth will still be somewhat a function of the category at large, but our ability to take share dollars is very powerful right now. And that's something we aim to capitalize on. We are comfortable leaning into this construct as we pair this margin investment with the considerable success we've had driving fixed cost efficiency in the business, which we intend to sustain going forward. With the shifting consumer backdrop over the past several months, we actually began to lean into the price investment as we exited the second quarter and believe it makes sense to continue to do so in the back half of this year.

Let me now continue to walk down the P&L. As I do, please note that the remaining financials include depreciation and amortization, but exclude equity-based compensation, related taxes and other adjustments. I will use the same basis when discussing our outlook as well.

Gross margin was 30.3% in the quarter. It's important to note that there are several moving pieces within this, including supplier advertising, which has continued to be a real highlight. We've seen advertising penetration climb above the 1% of net revenue mark we hit a year ago, with Q2 showing a healthy sequential step up. This is offset by the renewed price investments I detailed a moment ago as well as the natural deleverage from our logistics network during this period where volumes remained under pressure for the category and for Wayfair.

Customer service and merchant fees were 3.7% of net revenue, showing ongoing progress from our cost efforts, while advertising was 11.7%, a further reflection of our own efforts to drive efficiency across our pay channel mix, particularly during the software demand environment we saw in June.

Our selling, operations, technology, general and administrative expense came in at \$399 million in the period. This was the eighth consecutive quarter of sequential SOTG&A compression and our sweeping effort to rebase the cost structure across our organization, and the ongoing efficiency opportunities here continue to be a strong lever for us.

Altogether, we reported the strongest quarter of adjusted EBITDA dollars in three years at \$163 million or 5.2% of net revenue. We've now checked the second box on the path to profitability that we laid out early last year, getting to a mid-single digits adjusted EBITDA margin, a stepping stone on the way to our next goal of 10% plus.

We ended the second quarter with \$1.3 billion of cash and equivalents and \$1.9 billion of total liquidity when including our undrawn revolving credit facility. Net cash from operations was \$245 million, while capital expenditures were \$62 million, lower than we had originally anticipated due to further efficiency on site and software development costs as well as some timing of physical retail costs. The net of these was also the best free cash flow generation in three years at \$183 million, even in the quarter with greater top line pressure than anticipated.

While not directly impacting free cash flow or adjusted EBITDA, it's also worth highlighting the progress we made on stock-based compensation and related taxes, which came in at \$98 million in the quarter. This was down by more than 40% year-over-year and the lowest level we've seen stock comp expense since 2021, as the accounting treatment catches up to the benefit of the cost actions we've taken over the past two years.

Now let's turn to third quarter guidance. Our quarter-to-date performance is warped by the new Black Friday in July event that just wrapped up earlier this week. So I'll move to the full quarter revenue outlook, which we expect to be down in the low single-digits year-over-year. This contemplates seasonality consistent with what we saw in the same period last year.

Moving on to gross margin, as I discussed earlier, we are continuing to operate in the range of 30% to 31% of net revenue, but we'll be targeting the lower half of that range in Q3 and Q4. We see a valuable opportunity to drive order capture by leaning in with competitive take rates to augment the promotional activity we're seeing in the space. Customer service and merchant fees should be just below 4% of net revenue and advertising should be between 11.5% and 12.5% once again.

Finally, SOTG&A should fall within a range of \$400 million to \$410 million for the quarter. You're once again seeing us bring down this range as we continue to execute on cost efficiency initiatives throughout the business.

Following this guidance down to adjusted EBITDA suggest a margin in the mid-single-digit range, a bit below our results from the second quarter due to the typical seasonal sequential revenue compression. While 2024 has not been a year of strong macro and top-line recovery as many had hoped, we're extremely proud of the work we've done across our cost structure to drive considerable profitability growth regardless of the headwinds. That work has put us in a place to drive more than 50% year-over-year growth in adjusted EBITDA dollars, all while taking considerable share amid a record-setting category correction.

We would hazard to say, there are a few examples in history of companies that have undertaken such considerable change while simultaneously protecting their major growth initiatives and the potential for massive profitability flow-through when top-line growth does return.

Now, let me touch on a few housekeeping items. You should expect equity-based compensation and related taxes of roughly \$90 million to \$110 million, depreciation and amortization of approximately \$95 million to \$100 million, net interest expense of approximately \$6 million, weighted average shares outstanding of approximately 124 million, and CapEx in a \$70 million to \$80 million range. As mentioned, the third and fourth quarters will likely be slightly higher CapEx than the first and second. However, we should still see quite impressive leverage on this line for the full year of 2024.

As I wrap up, I want to underscore our steadfast commitment to driving profitability improvements regardless of the top-line circumstances. This quarter is clear evidence of our ability to deliver results, even as the macro backdrop of consumer behavior remain challenging. We have now demonstrated market share gains for seven consecutive quarters and have complete confidence that there are more ahead as customers choose Wayfair each and every day.

The broad macro headwinds, layered on top of home category weakness, require nimble execution in the near term, but it's important not to lose sight of the bigger picture. Our consistent ability to outperform the competition through our core recipe and the fundamental overhaul of our cost structure position Wayfair to benefit considerably when the category normalizes.

We have strong conviction in our strategy to successfully navigate the current environment while remaining laser-focused on the incredibly exciting longer-term opportunity.

Thank you. And now, Niraj, Steve, and I will be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of Christopher Horvers with JPMorgan. Your line is now open.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

Thanks. Good morning. So, my first question is going back to the comments on the consumer. So, it's basically that the troughs are getting deeper, and the consumer is becoming that much more sensitive to the promotional aspect of it. I guess, from your perspective, you have the toggling of further price investment that you're putting into the gross margin, but you're also dialing back the advertising. So, can you talk a little bit more about how are you going to navigate against this, what seems like a much tougher environment?

Niraj S. Shah

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

A

Yeah. Thanks, Chris. Thanks for the question. Yeah. So, I think here's the way to think about it. So, it's been a challenging environment for home goods for two years. The first piece of it was sort of kind of the COVID pattern of a binge on home goods, bust on home goods, which was – because the binge switched to travel, entertainment, leisure spend. And then what that's been rolled into is now, in the last six months, more likely you think of as a traditional recession economy, right, the economy slowing, consumers pulling back. You hear those comments from people like McDonald's, Starbucks, Pepsi, now talking about how the consumers pull back.

So, in that environment, and we've seen this before in great financial crisis, consumers sort of – because the category is not top of mind, it's out of favor, the everyday volume, the everyday business is slower, but promotions are still a marketing message that piques curiosity, causes traffic to come in, and customers then see something appealing and they buy it.

So, if you think about, we're still spending money on advertising, but we're sort of managing when we're spending to put more of the money towards the promo periods and a little less of the money towards non-promo, just to maximize our return based on what customers engage with. So that's more like a marketing message that works as promo. So then that's – we're putting that – more of the marketing spend there.

And so, that balance is a little bit of what we're talking about. And also, in this quarter, the way that played out with June is, June was more non-promo. We pulled back on advertising a little more. That made June a little softer. As we got into July, we're seeing our market share hitting all-time highs. We're seeing us continuing to succeed and take market share.

So, we're not really worried about how we can perform in this environment. We think that we can keep delivering the profitability, and we think we can keep taking market share. Obviously, in terms of really seeing the kind of growth we all want to see, that's not really going to be the kind of number you post when the market's negative 10%. But then, as the market kind of firms up and grows, I think you're going to see – the fact that we're continuing to invest in mid and long-term initiatives, will really pay off in the kind of growth numbers you'll see.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

There's a lot of – it does seem like, looking across the consumer, that July was a tough month, particularly the back half of the month. So, I guess from what you've been able to observe, because you're speaking to sort of down low single-digit for the quarter, given some timing shift, would suggest your worst quarter to-date. How much of that was actually a promotional shift versus some further consumer step back based on what you can observe, given the assassination attempt, the election, the Olympics and the consumer?

Niraj S. Shah

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

A

Yeah. So if you look sequentially, June to July, we actually see a better momentum in July than we saw in June. So, I would just say that the way we've been executing July, actually, the momentum increased.

So, I think it's going to be a challenging stretch while the economy is the way it is, but I don't know – there's always a lot going on. You mentioned the election, Olympics. There's always stuff going on. I actually think at the end of the day, while those things matter, I think what the truth is, is like we're going to be able to keep executing, taking market share. This is a big category. It is down probably 10-ish percent year-over-year, but everything's not equal. So, I think we can do far better than our competitors, which is what we've been doing for seven quarters now. And I think we'll be able to do it even with all these events.

I think the thing that's going to really cause the category to recover and gain momentum will be as housing picks up, and housing will pick up a little bit because of pent-up demand, but a little bit as interest rates get cut and the mortgage rate comes down. And so I think that's really the thing that you'd kind of look to. And that's the trend everyone expects, is that interest rates will come down, housing will pick up, but that's not going to be a light switch. That's going to play out over time. And so, in the meantime, you're going to see us keep taking market share, keep building our profitability, and that momentum will only increase as the market gets better.

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Yeah. And Chris, just to the Q3 specifically, since you mentioned that, really the Q3 guide speaks to the same seasonality that we saw last year, Q2 to Q3. So, I just – I wouldn't overly read into anything there. That's just consistent with where we've been operating.

Christopher Horvers

Analyst, JPMorgan Securities LLC

So, I guess, just one quick follow-up. So, from a market perspective, based on what you observed, do you think – your performance sounds better June to July, but do you think the market stepped down from June to July?

Niraj S. Shah

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

So, we get the credit card data just like others get and then we also get a lot of feedback from suppliers. I would say, I don't know if I can say it stepped down or it just remained weak. It's a little hard to be too granular and specific on that. I would say, certainly, we have – no one's seeing a market recovery. Okay? So that's definitely the case. But I don't know if I could confirm that it stepped down, because the credit card data, when you look at it just week to week, it's a little noisy. As you zoom out, the trends are very clear. So, we're seeing that we're clearly getting to all-time highs and the market's remaining weak is the way I would phrase it.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Got it. Thank you very much.

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Thanks, Chris.

Operator: Your next question comes from the line of Peter Keith with Piper Sandler. Please go ahead.

Peter Jacob Keith

Analyst, Piper Sandler & Co.

Hey, thanks. Good morning. So maybe just a little bit of follow-up on there as it relates to market share. Did you feel like – it sounded like your market share maybe compressed a little bit, market share gains compressed in Q2 versus Q1. But then I thought you're saying you're back to your traditional sort of market share capture. Could you help us to unpack that a little bit? And maybe strategically, what you've changed to improve that trajectory?

Niraj S. Shah

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

Okay. Yeah. Thanks, Peter. Yeah. So I think what we're talking about is, really, it's kind of like – I think you talked about, like the rate of increasing market share. So what we're really discussing is the speed at which our market share is growing. And we're saying that for seven quarters, our market share has been growing. And when we zoom out, we'd say it's kind of been growing at a relatively steady pace.

I think if you zoom in on, that I was mentioning this in one of Chris's questions, when you zoom in on a week, it gets a little noisy, then a month, it's a little noisy. Quarter, it gets a little more stable. But you got to kind of zoom out pretty far. And we get data on close to 100 competitors. And when you look at their numbers, you see, again, this volatility in these numbers.

So, I'd be a little careful to worry too much about the numbers as you zoom in. And I would just zoom back out. And I'd say, what we're consistently doing to take market share, right? We're continuing to invest in the mid to long-term initiatives and those play out over time. We're making sure that we've got the selection, the price, the availability, and we're increasing the quality of the merchandising as we go. And then we're making sure, on the advertising, we're advertising in the ways that are productive, drive the traffic, get the customers into the site and sort of make sure that we can monetize that.

And so, I'd say that playbook of what we're doing, making sure we don't lose track of the mid to long-term, while just executing very well every day, is what's working. And that's continuing to work. And the reason I mentioned that July sequentially picked up momentum to June is that June was a softer month. And again, if you think promo, non-promo, June was really more of a non-promo period. And then the way we flexed the ad spend caused June marketing support that we provided to be less as well.

So that sort of kind of in our mind really clearly explains June and July is a little bit more back to the normal and we're seeing the numbers reflect that. So I guess that's kind of what I was trying to describe.

Peter Jacob Keith*Analyst, Piper Sandler & Co.*

Q

Okay. That's helpful. And then, Niraj, I'm bummed we didn't run into each other in Las Vegas this week. So, I know you were there. When you talk to any supplier at the Vegas conference, there's concern around factory direct product that's coming in from China and being sold on Wayfair. So, the message I'm getting is that US suppliers are pulling back on CastleGate. And I'm wondering just how are you guys handling this evolution in your supplier base? And is there a risk of CastleGate revenue maybe moderating a bit?

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

A

Yeah. So we have, obviously, a large number of suppliers. That number has kind of grown over the last few years. We did have a real big shoot up in the number of suppliers, kind of, in 2021 timeframe, which we then kind of pulled a little back on, but make sure we had quality suppliers. I will say a lot of those quality suppliers are US-based importers. We have some US-based manufacturers, but we also have some great Asian-based manufacturers and Asian-based importers.

So, we'll sort of work with everybody as long as it's a high-quality supplier, and that we care about the quality of product, the price of that product, the quality of their operations. We want to make sure customers are very satisfied. And so, we work with all these folks and we have different teams that support these folks and work with them. Those teams are spread all over the globe.

And I think from a supplier standpoint, so if you're in Las Vegas and you're talking to the US-based importer or manufacturers, what you're going to hear from them is the same thing you hear from the Asian suppliers, which is, obviously, it's a tough macro out there. And so in a tough macro, what do you hear from suppliers? Of course, no one wants competition. They'd rather have demand come to them, right?

And so, I think the fact that there are factories who are building cross-border programs is kind of competitively a challenge for some US-based importers. But at the same time, what we're seeing is that the US-based importers who lead with design and focus on really efficient operations, we have quite a few of them that are succeeding, that are doing well. And I met with dozens of suppliers over the last few days in Las Vegas. And this is what you hear from all of them is that generally, Wayfair is their best channel right now. They're seeing that outperformance. They know it's a competitive market. They're focused on then what matters for the – sort of how do they maximize their business today and then over the mid- to long run.

And then CastleGate is really something that we encourage them to use for their best sellers. So, it's something that – something's working where way you can really accelerate the sales on that item is making sure it's maximizing its speed of delivery, it's optimizing that forward positioning, which then also [ph] lets us get a lower (00:38:46) retail price because you minimize the outbound ship costs, which is a factor that drives the retail price.

And so, what I actually heard from a lot of suppliers is that that is something that they want to make sure they do. So, I actually – this market, I would say that the interest in using CastleGate is on an upswing, but [ph] it's got some (00:39:05) challenging macro, so people are being very careful to not have an overstock of inventory and want to be pretty lean on that. And so they're balancing all the different kinds of pressures and goals.

Peter Jacob Keith*Analyst, Piper Sandler & Co.*

Okay. Thank you. And I would agree that everyone seeing Wayfair as their best channel. So, thanks for that feedback.

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

Thanks.

Operator: Your next question comes from the line of Curtis Nagle with Bank of America. Please go ahead.

Curtis Nagle*Analyst, BofA Securities, Inc.*

Great. Thanks so much. So, two questions. One, just on the pricing actions, and maybe [indiscernible] (00:39:36) straight. But sounds like at the moment you're, I don't know, a little out of line where you wanted to be. From what I recall in the past few calls, I think the commentary was you were in a good spot. So, I guess if that's correct, kind of what changed? Are vendors sharing any of the burden? And I guess, is this in response to any of the share gains narrowing a bit, if that's the case?

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

Yeah. So, I'd say the way we price is, we have a relatively sophisticated data science model that's measuring elasticity and really figuring out what margin rates we should be taking on each tranche of the catalog so that we maximize profit dollars. So that's the way I think of it.

So, what happens is, when you think about profit dollars, over a period of time, not going out too far out in the future, but not worry about just today, we do want to maximize that dollars number. And so we're going to then – the system is meant to optimize around that.

Again, on the pricing actions you're talking about, remember, we're talking about something in the low 10s of basis points. So we're really not talking about a – if you think about – you talk about, oh, are you lowering price to really get [indiscernible] (00:40:39) about lowering price 5%, 10%, 20%, meaningful changes, we're talking about 10s of basis points. So, it's really, think about this optimization, something that makes sense to maximize profit.

And I'll just point out that, this quarter, you look at our EBITDA, 5.2%, \$163 million, free cash flow, \$183 million, best quarter since 2021. And so you can say, okay, well, you've taking a lot of market share while driving profitability in what's clearly a tough macroeconomic environment. And thanks Peter for that shout out, but – and the suppliers are noticing, we're the best performing out there. So, I'd say those are the goals we want to hit and I think we're hitting.

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

A

Yeah. Curt, you asked specifically are suppliers sharing any of the burden and we continue to see suppliers leaning in with us quite nicely. That's how we're able to offer these incredible promo events and actually still maintain gross margin nicely north of 30%, right?

So, I think what we're talking about here, [indiscernible] (00:41:34) is it's a nuance on making sure that we're at the right and optimal point of the pricing curve based on where we see the consumer today. And frankly, we're excited that we can lean into that and deliver that for the customer. We're able to do that because of the significant cost efficiency that we've driven over the past few years.

Curtis Nagle

Analyst, BofA Securities, Inc.

Q

Got it. Okay. And then just turning to the store, great to hear it's off to such a great start and have some great potential. I guess, Niraj, could you talk a little bit more about kind of, sort of the potential ramp? Also, great to hear we're not entering an investment cycle. But kind of what the footprint can look like? What kind of productivity per box you're seeing? Margins, sounds like they're really good. Any more detail there would be great.

Niraj S. Shah

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

A

Yeah, great. So, what I would say is, obviously, the store has only been open for a little over two months. So, this is kind of the way we think about it. Like, we're going to be really prudent and pragmatic in how we grow the store. So, we've got Wilmette open. It's off to a great start. We've got a long list of things that we think can even improve its performance, but it's started off incredibly strong. And so we're pretty excited about that.

We're working on opening a second store. Targeting later next year for that second store. And so the idea is we're going to keep moving forward, but in a very methodical, pragmatic way so that we can make sure that we're optimizing performance and taking all those learnings and using them in what we do next, and that we do this in a way so that, a long time from now, when we look back, we've really built this out in a very successful way.

And so that's kind of the way we think about it. And it's probably a little too early to share super detailed financial metrics given that's only been open a couple months, but I would say, we're pretty thrilled with how it's performing.

Operator: Your next question comes from the line of Simeon Gutman with Morgan Stanley. Please ask your question.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Q

Hey, good morning, everyone. I wanted to follow up in the prepared remarks you talked about the elasticity getting a little better when you maximize gross profit dollars in the latter part of the quarter. Can you talk about any magnitude or quantification?

And then, if you're going to manage gross margin to the lower end of that 30% to 31% range, is the back half or even the third quarter run rate of sales reflective of that pickup, or is it not reflected in that negative low single-digit, I guess, quarter guide?

Niraj S. Shah

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

A

Yeah. So, I'll say a couple things and then I'm going to turn it over to Kate to really try to help with the – I guess, clarify the guidance maybe is kind of one of the questions there. What we're seeing, and this is kind of what I've mentioned, our momentum from June into July moved in a positive direction. So, we're happy with building momentum. We're seeing that in the market share and we're seeing it in our performance.

Again, there's this nuance of promo and non-promo periods that can make them – any given – these zoom-in periods are harder to compare. So you also take that into account. But that's what we're saying we're seeing. We're seeing that what we're doing is working. Kate, do you want to try to provide something...

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

A

Yeah. I think, Simeon, what you're asking is, does the guide take into account the gross margin investment, yes, it does. And what we're really doing there is, in an ongoing very challenging top line, the sort of double-digit macro decline, that's how we're able to stay negative low single-digits and continue to gain share.

We spoke in the prepared remarks on the call that what we see as a result of investments like this is improved order capture. Right now, that's in a down market, right. So, we're seeing that improved order capture on a down market. That leads to those all-time share highs and that is contemplated in what we've shared. And frankly, we're able to do that because of our ongoing success on the fixed cost base. So, the improvements that you saw in SOTG&A and some of the cost take-out, frankly, on CS&M, allow us to still do that, make that investment, deliver for the customer, take share capture, and still drive to that mid-single-digit adjusted EBITDA.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Q

Makes sense. The follow-up is back to the, I guess, full year EBITDA, and I know you're not guiding full year, but if we take the first half, I think there was \$238 million of adjusted with revenues down about 2%. So, if we end up doing revenues down, let's say, 2% for the rest of the year, is it as simple? Can we double the EBITDA and that's \$480 million, or is the imputed run rate in the back half on other cost items actually gets better, such that you can do better than that \$480 million?

Niraj S. Shah

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

A

Kate [indiscernible] (00:46:16)...

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Niraj is going to pass it off to me and I appreciate...

A

Niraj S. Shah

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

Well, I thought you said I'm not allowed to give guidance.

A

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Yes. I appreciate your attempt to get a full year guidance, Simeon, but I'm just going to refer you back to the remarks that we made on the call. And what we said was we feel very confident in that earlier construct of being able to grow adjusted EBITDA more than 50%, irrespective of where the top line is. And that is because of that expense control management that you've seen from us. And you're seeing that play out nicely this quarter with revenue down, but we were able to hit that mid-single-digit adjusted EBITDA, and you'll continue to see that throughout the rest of the year.

A

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Fair enough. Thank you. Good luck.

Q

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Thanks.

A

Operator: Your next question comes from the line of Maria Ripps with Canaccord. Please go ahead.

Maria Ripps

Analyst, Canaccord Genuity LLC

Great. Good morning, and thanks for taking my questions. First, could you maybe talk about your motivation for conducting the Black Friday sale in July? Was it mostly an opportunistic decision or more so to reflect the more promotional environment? And then any color sort of on the effectiveness of this event on the heels of your Way Day in Q2? And then quickly, sort of stronger July trends that you mentioned, is that taking into account sort of Black Friday?

Q

Niraj S. Shah

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

Thanks, Maria. So, the Black Friday and July sale, it was successful. What I would say is, in kind of recession periods, which is kind of like what we have now, we definitely run a promotional cadence that's kind of the higher end of our range of promotions we would run per time. And in a normal time, you're at the lower end of that range.

A

So, we're running, I guess, promotions in line with sort of the playbook we have in the tougher economic environment. And again, it goes back to the fact that that's the marketing message that causes customers to actually get engaged with the category and come in. And so, it's really – I think the promotion is the right type of

marketing event that is successful that breaks through the noise in this type of environment. And so, yeah, we're happy with it.

Over the years, we did track different types of events in this timeframe. In prior years, we tried the anniversary sale concept. We tried doing a financing event. I'd say the Black Friday in July that this sale was more successful than those other formats we tried over the years. That might be a combination of the creative, the way we positioned the event, the way we marketed it, but also it could reflect the macro environment. Kate, anything you want to add?

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Yeah. No, I think that's fair. I'd just encourage us not to – we don't typically give out sort of monthly and – sort of monthly guidance there and I'd anchor you to the overall guidance that we gave for Q3.

Maria Ripps

Analyst, Canaccord Genuity LLC

Got it. That makes sense. And then secondly, just following up on margins, maybe a little bit of a follow-up on the prior question and sort of you being able to deliver on your target margin despite softer top line. So, I guess, now that you have sort of reengineered your cost structure, can you maybe talk about your ability to flex your expenses outside of marketing, flex your expenses up or down sort of in the short term to reflect the volatile top-line trends?

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Yeah, I think perhaps you're maybe speaking to the SOTG&A line, Maria, and what we've done there. That's where we've seen, obviously, very consistent reduction for eight quarters in a row now. That line is primarily – or we said the majority of that line is labor, although there's a number of other expenses in there, like software costs, R&O, T&E, et cetera. And we've been quite diligent and focused on reducing costs across the bucket of costs in there.

We've always said, or we said for the last few quarters, that the labor piece does remain an ongoing lever there. And you saw that play out a bit this quarter. And we continue to think that the diligent and the expense management there allow us to do things like make this investment when we know that's the right thing to do for the customer at this moment. So, that's sort of how those lines play off of each other and how we're able to think about investing in some areas, like price, where we're able to take cost out of other areas.

Niraj S. Shah

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

The one thing I would add is, like when you think about the efforts we've had on cost and the ongoing things we're doing to optimize the profitability, I mentioned best quarter of EBITDA, free cash flow since 2021. The other thing I'll point out though, is you actually see that we got to breakeven on owner's earnings. So that's EBITDA, less CapEx, less stock-based compensation.

So if you look at the stock-based compensation line, you see that that's actually improved significantly. That, of course, doesn't show up in EBITDA, but in the owner's earnings, that does show up. And so I just want to point that out as well.

Maria Ripps

Analyst, Canaccord Genuity LLC

Got it. That's very helpful. Thank you, both.

Q

Operator: Your next question comes from the line of Steven Forbes with Guggenheim. Your line is now open.

Steven Forbes

Analyst, Guggenheim Securities LLC

Good morning, Niraj, Kate.

Q

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Morning, Steve.

A

Steven Forbes

Analyst, Guggenheim Securities LLC

Niraj, the comment you made about sort of the performance of the business between promotional and non-promotional days, I was hoping maybe we could revisit that and maybe just contextualize, like how you would summarize the health of your consumer today. Like, how big is that spread? I don't know if you can quantify it for us and/or just compare it to sort of historic spreads that you've seen maybe in the pre-COVID eras. And then, what does that tell you sort of about just the state of the industry and how you're sort of thinking about how long this malaise can last for, right, or in essence, the path back to growth, right, how long it could take to get there?

Q

Niraj S. Shah

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

Yeah. So I think that I don't want to be overly dramatic because it's a spread. Again, it widens, but it's not like – it's not a light switch goes from like this way to that way. It's just like increasingly promotional versus non-promotional periods. And part of that, again, is because that's the marketing message that causes people to shop versus the category being a little more top of mind and then just proactively shopping every day.

A

The thing about kind of how does the category get back to growth, when does it get back to growth, I'd just get you – if you think about existing home sales, if you look at existing home sales and you just kind of look at that a long period chart of that, you can see how existing home sales has really dropped down. And there's a bunch of other people who do various sentiment-type indexes. And you can – what you can see is that there's a lot of pent-up enthusiasm and desire to move, but right now, the market is a little more frozen. You have a 30-year mortgage rate that's a little over 7%. And there's like some studies that showed like every percentage point move in the interest rate, lowers demand by like 16% or 18%, something like that, for every percentage point move. And it kind of makes intuit sense.

So then you say, okay, well, do you believe at some point here, you're going to start seeing rates come down and that will take some pressure off the economy. But one of the specific things that we'll do is that 30-year mortgage rate will start to drop and it'll drop at a pretty decent rate. That will start causing existing home sales to move up. The year someone moves, they spend a significant multiple of what they do in a regular year. And then it actually catalyzes the broader market because our customer, maybe they're moving, or maybe they're not moving, but they see their sister's new house. And they're talking about what the sister is doing in her house and then that

causes our customer – the other customer to maybe do something to freshen up their house. So it basically stimulates the category, and I think we're getting close to that period, but we're not quite there yet.

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

A

Steve, just on the promo point, another thought I'd add there is, we are cognizant of ensuring that we're not overly training the customer to shop exclusively on discounts. And so we're mindful of what promotions we offer, the types of those promotions and the cadence of those as well as we think about sort of long-term customer growth.

Steven Forbes

Analyst, Guggenheim Securities LLC

Q

That's helpful. And then, Kate, given the change here, I mean, it's great to see the free cash flow performance, I mean, obviously, I think all of us are probably thinking about the debt maturity schedule and revisiting Niraj's comment that he made at the – within the 2023 Shareholder Letter, right, about sort of being in a solid financial position to settle debts with cash as they come due. Any chance you guys can just revisit that statement for us and maybe just give us a sense of reassurance as we sort of rejigger or revise our free cash flow assumptions here?

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

A

Yeah. So thank you for mentioning the free cash flow this quarter. We're quite pleased with where we landed, our highest free cash flow quarter since 2021. And I think that shows, again, the underlying strength of the cost takeouts and the efficiency there and our management on other areas, like CapEx, as well.

What we've said about the capital structure for the last few quarters is, we're trying to drive optionality and I think you've seen that play out again this quarter, right? So optionality comes in the form of improving our financial profile and our free cash flow such that cash becomes an opportunity to use to pay down debt.

The other way that optionality plays out, and we've said this before, too, is that that opens up alternative venues of financing for us beyond the convertible market such as regular-way debt through an ongoing improvement in the maturity of the business and our adjusted EBITDA profile. And again, you saw that play out this quarter with our strongest adjusted EBITDA since 2021.

So we feel very good about the ongoing levers available to us on capital structure management. And we'll continue to be prudent and thoughtful and look at what makes sense in the market and what makes sense based on what we see internally as well.

Steven Forbes

Analyst, Guggenheim Securities LLC

Q

Thank you.

Operator: Your next question comes from the line of Oliver Wintermantel with Evercore ISI. Please ask your question.

Oliver Wintermantel

Analyst, Evercore ISI

Q

Yeah. Thanks. Good morning. Niraj, looking at the direct active customers that are up slightly, average order per active customer was up and then the repeat customers were up as well. So can you maybe talk a little bit about where the weakness in revenues comes from? Is that just basically new customers or other cohorts, that would be helpful? Thank you.

Niraj S. Shah

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

Yeah. Thanks, Oli. So I think those [indiscernible] (00:56:40)...

Kate S. Gulliver

Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.

Yeah. So, Oli, if we just – yeah, if we look at the KPIs, what we saw this quarter, remember, that active customer number, that's an LTM number that continued to be up a little bit, and obviously, that's been going in the right direction over the last few quarters. Disaggregating sort of orders in AOV though, you saw orders down, while AOV was slightly up. And the combo of those two things will lead you to that revenue softness, negative 2%, so – or negative 1.7%.

So that's really what you're seeing play out there. It's just a little bit of order softness, offset by some AOV. Again, it's – the AOV isn't anything unusual and Niraj spoke to that earlier on. We're back to a point of seeing normal movements in AOV. And obviously, what we're focused on is continuing to drive customer acquisition, order capture and pairing that with wherever the AOV is to help drive revenue overall.

Niraj S. Shah

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

And what I would say, because there's so much more granular repeat metrics we actually use to operate the business and so these higher level numbers aren't the ones I'm most familiar with. But what you actually see is that you see good customer engagement and the metrics that we track. But again, the category is out of favor, so the engagement is in the context of the environment. And so that's where you can see us outperform on market share. But that's in the context of the market, right, and the market is down.

So I think it's just us being down 1.7% in the context of a market that's down, we think, roughly 10% is us taking share, but, obviously, the total pie got a little smaller. And so I think that's really the punchline.

Oliver Wintermantel

Analyst, Evercore ISI

Got it. And as a follow-up, can you – how do you think about active customer accounts going into the third quarter and maybe by year-end? Thank you.

Niraj S. Shah

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

Yeah, sure. Again, so that number, the active customer account is a 12-month number. And so again, that's a little bit of a tricky number and again, not one that we managed to and the reason is like that number changes, not just by what you do in this quarter, but what happened a year ago in the quarter that falls out. And so I think that makes that number a challenge. But what you actually see in that number is that we're gaining momentum. And the way we're gaining momentum is we're taking market share to a degree that lets us offset the weakness of the market and stimulate our own business. And that's what's continuing to happen. So we feel pretty good about the momentum we have.

Oliver Wintermantel

Analyst, Evercore ISI

Got it. Thanks very much and good luck.

Q

Niraj S. Shah

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

Thank you.

A

Operator: I will now turn the conference back over to Wayfair team for the closing remarks.

Niraj S. Shah

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

Well, I just want to thank everybody for joining the call and we appreciate your time. We're excited about the position we're in and the things that we're doing and the way it'll play out. And so thanks for your interest in Wayfair.

Operator: Ladies and gentlemen, that concludes today's call. Thank you all for joining and you may now disconnect.

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