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Wayfair, Inc. (W)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Wayfair Third Quarter 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] And finally, I would like to advise all participants that this call is being recorded. Thank you.

I'd now like to welcome James Lamb, Head of Investor Relations, to begin the conference. James, over to you.

James Lamb

Head-Investor Relations, Wayfair, Inc.

Good morning and thank you for joining us. Today, we will review our third 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 fourth 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 any 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. I'm excited to share our third quarter results with you today. Q3 marked another proof point of resilience for Wayfair, with further market share capture in the face of sustained challenges in the category. Once again, we navigated a dynamic consumer environment while driving further discipline on costs to achieve a mid-single-digit adjusted EBITDA margin for the second quarter in a row, but that's just one piece of the picture. As I've mentioned many times before, our North Star is driving adjusted EBITDA in excess of equity-based compensation and CapEx and we're pleased to be making noteworthy improvements across each one of these, totaling almost \$100 million year-over-year in Q3.

The third quarter exhibited a continuation of choppy macro trends we've seen across 2024. Consumers remain trepidatious in their spending patterns and are demonstrating more price elasticity than we saw in the early months of the year. While we were pleased with the response we saw over Way Day at the start of the quarter, which we ran as an extended event for the first time this fall, it had become clear, even as we exited September, that we were seeing a broader pullback by shoppers in the lead-up to the election. Attention is focused away from the home right now and when customers are in the market is increasingly for lower investment, lower consideration purchases versus larger-ticket items that represent our traditional area of strength.

We remain optimistic that pieces are coming together to support a category recovery in the quarters to come. While it will take some time to play out, this improvement is poised to provide some relief in what has become a historic slowdown in the housing market. Redfin published an analysis at the end of Q3, noting that just 25 of every 1,000 US homes changed hands in the first eight months of the year, the lowest level they saw in their study running back to 2012, and more than 30% below the turnover levels back in 2019.

Now, as we've said for many quarters, we are not running the business with the expectation of a recovery in any specific timeframe. For more than two years, we've done two things simultaneously, driving cost efficiency and spending discipline to run the business profitably in a recessionary environment and setting ourselves up to be a considerable beneficiary when the category does return to growth. You've seen the former quite clearly with what is now nine sequential quarters of compression in our fixed costs and a third quarter result that is the lowest SOTG&A we've had since 2021.

The latter, you've seen us demonstrate across several vectors. For much of 2023, our mantra focused on the core recipe, bringing the best combination of competitive pricing, fast delivery and broad availability, together into an offering that wins customer orders day in and day out. Across 2024, we went a step further by concentrating on strategies to drive mindshare and frequency, including the three major initiatives we've spoken to several times. Even if customers aren't shopping for their homes at the moment, when that time does come, we want to make sure Wayfair is their first destination.

These efforts include many things, such as our brand refresh back in March and the launch of our first large format Wayfair-branded store over Memorial Day weekend. Our newer initiative is our loyalty offering, which just began rolling out last week. For \$29 per year Wayfair Rewards, customers will unlock exceptional value and experiences, with benefits including 5% back on purchases, free shipping on all orders, access to exclusive shopping events, special offers and a dedicated members-only support line. We know how much investors love math, so let me walk you through the business model of Wayfair Rewards at a high level.

Our average customer typically shops on Wayfair about twice a year, spending around \$300 per order. Priced at \$29 per year, the 5% back benefit would be roughly breakeven for our average shopper. Our goal is to push customers out of that two orders per year bucket into the three orders per year bucket or even higher. While we have more than 20 million active customers who have placed at least a single order over the past 12 months, about a tenth of those are shoppers that have made four or more orders in the same timeframe. We see an important opportunity to grow that figure, given shoppers typically purchase in the category six to eight times per year.

There's a flywheel we see from customers that grow their shopping occasions on Wayfair, as they increasingly spend more time on the site, browse a broader selection of the catalog and are more likely to shop through our app. These behaviors are self-reinforcing and we see that the path for a shopper to move from three to four orders per year is even quicker than the path from two to three. Customers who shop four or more times on Wayfair in any 12-month period, not only spend more but also nearly a third more likely to come to us via free traffic. So growing that cohort is highly beneficial to margins.

With the benefits of Wayfair Rewards, if that average customer now makes an incremental third order on Wayfair versus a competitor, we've grown our share of wallet by 50%. Those three orders at \$300 a piece are worth \$900 of total revenue, 45% of which goes back to the customer thanks to the program.

Accounting for the annual fee, we've now nicely grown revenue per customer per year profitably. That doesn't even include the efficiency on advertising, as Wayfair Rewards customers are that much more likely to return on a direct basis. There's tremendous potential here to drive more frequency amongst our existing as well as new shoppers.

We're excited about all the different ways customers will be able to interact with the new program, from deal hunting in our member-exclusive sales to saving up rewards over time for big aspirational upgrades. One of the areas we're excited to stimulate is in the frequency portion of our catalog, like kitchenware, tabletop, decor and bedding, where the benefit value really stands out. We plan to lean into the treat yourself angle of the program and encourage customers to use their rewards for all those upgrades and finishing touches they've been dreaming of but may not have had the budget for.

We're also eager to bring the program to new movers and project shoppers, like renovators or remodelers. These are customers with high category needs who can draw a lot of value from the program. We've been focusing on

these audiences for some time across our marketing and sales organizations. And we're excited to incorporate the value proposition of Wayfair Rewards in those outreaches to better attract their full business.

You've likely seen some of this marketing outreach since the launch of our brand refresh. As we discussed right after the debut in the spring, this was years in the making and we've been extremely pleased at the results we've seen in the months since. Much of our work has been focused higher in the customer acquisition funnel as we've increased our investment in television, social media and streaming audio and video.

Since Q1, we've seen nice improvements in Qualified Recall Rating, which measures how well customers recall seeing any advertising from Wayfair across any channel. This is an important high-level view of how our advertising is resonating with consumers and to what degree they recall key details, like our product message and identity. In fact, we are now ranked in the top 10 among major retailers.

When we launched the Wayborhood, we talked about driving creative content that could exist across our portfolio of advertising channels and serve as a foundation for many years of marketing campaigns to come. In fact, in the past few weeks, we've rolled out our first major update to the Wayborhood with our holiday chapter and are in active development on more content for 2025.

We've seen very healthy ROI on the first iteration of the campaign with strong results when it comes to brand linkage and awareness as customers are quickly coming to recognize the Wayborhood as a symbol of Wayfair. This has translated to positive movement in our core metrics, direct traffic, and even more importantly, revenue per direct visit.

Back in the spring, I noted how the launch of the campaign came alongside a refreshed view of our channel mix, as we step more holistically into parts of the advertising funnel where we had been lagging behind. It should come as no surprise that influencer marketing has grown to be an incredibly important way that customers are exposed to the category. Shoppers are now routinely looking towards creators across YouTube, Instagram Reels, TikTok and more for inspiration on their next home purchases.

Our reach in influencer marketing today is quite small relative to potential and we're excited to scale it. Based on feedback from the creator community, we've made significant investments in improving the terms and technology supporting our program. Creators are eager to work with Wayfair because we treat them with the same mindset we treat our suppliers. We succeed when they succeed. This plan is working. We have dramatically increased our monthly pieces of content produced by the nearly 4,000 and growing creators we've partnered with.

Over the summer, we've amplified our influencer content and are seeing promising return on ad spend for the dollars we've tested. In fact, we've seen payback windows that are on par with what we find on lower funnel social ads, all while attracting what we expect to be higher lifetime value customers. We have a dense product roadmap that will allow us to scale breadth and depth of activities with influencers in partnership with our suppliers across the major platforms.

This will open the door to working with an even wider field of creative talent as we get into 2025. The ROI here is clear to us, but we want to make it clear to you, we're still operating within our rigorous payback thresholds that extend up to one year, but are often much quicker.

As I mentioned at the outset, we remain laser-focused on driving healthy profitability, while setting ourselves up for success as the category rebounds. That has been the core goal across all three of our major initiatives in 2024 to foster customer loyalty and spur repeat business while driving economic value. By leaning into marketing

strategies that build brand affinity and introducing programs like Wayfair Rewards to enhance the customer experience, we're not just aiming for short-term gains, but building long-lasting relationships with our customers that will be accretive on both the top and bottom lines.

Thank you. We hope you all have a festive holiday season. And now, let me pass it to Kate to go through our financials.

Kate S. Gulliver

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

Thanks, Niraj, and good morning, everyone. Let's dive into our third quarter results, beginning with the top line. Net revenue was down 2% year-over-year in Q3 or down about 7.5% on a sequential basis, closely in line with the sequential pattern we saw in 2023. This is driven by orders down 6.1% versus the year-ago period, modestly offset by AOV, which was up 4.4% year-on-year and down 1% sequentially, again, in line with what we would typically expect to see in the seasonal cadence moving from the second to the third quarter of the 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 for the quarter was 30.3% of net revenue. Back in August, we talked at length about the changing dynamics we have seen in customer price sensitivity and the opportunity we identify to lean in on take rates to drive incremental order capture. We heard many questions from investors around how this differs from funding promotions. So let me take a moment to address that because the answer fundamentally comes down to magnitude.

For years now, we've seen robust interest by suppliers to participate in promotional events where you'll see headline items at prices that are 20%, 30% off or more. These discounts are aligned in partnership with our suppliers and are funded through a reduction in their wholesale price, which we then reflect by lowering retail, while our gross margin remains resilient throughout. That's part of the reason why we've been happy to ramp up the number of promotional events and grow existing events like we did with Way Day last month. Promotion remains a critical marketing tool to drive customer engagement at a moment in time when the focus is just not centered on the home, and supplier demand to participate in promotions remains quite high.

Now, when we talk about making our own investment into lower take rates, the scale is very different from the discounting you'll see from suppliers and promotion. The magnitude of the investment here is in the tens of basis points at the consolidated level, hence, targeting gross margin in the lower half of our 30% to 31% range.

Across our nearly 10 million orders per quarter, we're able to collect a tremendous amount of data on price elasticity and can, with a highly tuned degree of precision, determine exactly which classes and geographies we'd see an order lift from a very modest reduction in the take rate.

As we said for some time, it's considerably more valuable to multi-quarter gross profit and adjusted EBITDA dollars to have an incremental order come in at a gross margin in the low end of that range than miss out on that order because we were keeping our gross margins at the top end. We're pleased with the results we're seeing so far as we've made this price investment, and you should expect that this will continue as we exit this year and enter 2025.

Of course, the other question we hear from investors is why make this investment if you still are seeing orders and revenue contract year-over-year. Our response to that is to once more point to the share picture. As Niraj said earlier, our ability to outpace growth of the category while still driving a strong margin profile for the business allows us to capture share now and sets us up for significant strength when customers begin to shop for the home in a more robust fashion once more.

Now, moving further down the P&L, customer service and merchant fees were 3.7% of net revenue, while advertising was 12.3%. That was slightly higher than where our advertising margin had been in recent quarters as a result of the renewed investment opportunities Niraj outlined. We're excited for the major unlocks we are seeing across the advertising funnel, but are keeping a steady hand on the wheel as we ensure that each dollar is spent with strict adherence to our payback windows.

Our selling, operations, technology, general and administrative expenses totaled \$388 million in the third quarter, a more than \$70 million improvement versus the third quarter last year and \$274 million improvement on a trailing 12-month basis.

As I talked about investing in gross margin and advertising earlier, those of you who have followed Wayfair for years may have had flashbacks to our history of investment cycles at the expense of profitability. What we've made clear over the past two years is that Wayfair is now fundamentally a different company than we were in the past. We are at a level of scale and maturity where we can both invest for growth and drive profitability at the same time.

So when I talk about compressing take rates or leaning into advertising due to their quick payback, you can see that we are funding these investments through further discipline as we manage our fixed cost base, a paradigm we will continue to uphold. Ultimately, we are focused on growing adjusted EBITDA, less CapEx and equity-based compensation measured in dollars. Our plans that are underway are progressing well. And this is part of why we are comfortable committing to 2025 adjusted EBITDA dollars being higher than 2024.

Altogether, we generated \$119 million of adjusted EBITDA in the third quarter for a margin of 4.1% of net revenue. As Niraj mentioned earlier, this was our second consecutive quarter of mid-single digits adjusted EBITDA margins, and we have now proven that we can operate at this level despite year-over-year revenue contraction.

We ended the quarter with \$1.3 billion of cash and equivalents and \$1.9 billion of total liquidity when factoring in our undrawn revolving credit facility. This was, of course, before we bolstered our cash balance further with the close of our inaugural high yield debt offering in early October. We saw investor demand many times larger than the \$800 million that we raised, which was a testament to the tremendous work we've done on driving profitability across the business.

With the rapid improvement in our financial profile and movement across rates and credit spreads, we saw this as an opportune time to de-risk the balance sheet by effectively prefunding our upcoming convertible maturities in 2025. As I've said from the beginning of the year, we are laser-focused on delevering the business over the years to come and we will use these proceeds in combination with our own free cash flow generation to handle our coming obligation.

Now, rounding out the cash flow statement, cash from operations was \$49 million in the third quarter, offset by capital expenditures of \$58 million. This CapEx was a bit lower than our guided range due to a combination of timing and further expense rigidity on our part. So while there will be some catch-up in Q4, the net will still be

lower than the run rate our Q3 guide implied. The end result was free cash flow of negative \$9 million in the third quarter.

Let's now turn to the fourth quarter guidance as we round out the year. Beginning with the top line, quarter-to-date, we are flat to down slightly year-over-year and expect to end the full quarter down in the low-single-digit range. This contemplates sequential seasonality in line with what we saw last year. While we're pleased with the strength we saw on Way Day and are excited for the holiday season ahead, we're also cognizant that the weakness in the category on top of all the distractions facing consumers right now create a challenging operating environment.

Turning to gross margins, we would guide you to the lower end of the 30% to 31% range once again, as we continue to lean in on take rates in the strategic areas where we see valuable payoffs in order capture. Customer service and merchant fees should be just below 4% again as well. Advertising should end up in a range of 12% to 13% of net revenue and likely toward the upper end of this range. This is higher than in the past few quarters as we see clear demonstrable evidence of high-value opportunities to lean in here to drive further share capture as we get into 2025. It's important to bear in mind that many of the dollars spent today are driving order capture in the next few quarters.

Finally, SOTG&A should fall in the \$400 million to \$410 million range. We saw some spending that had been planned for the third quarter shift to Q4. So there's a slight normalization here as you think about the sequential trend. Following this guidance down the P&L would lead to a fourth quarter adjusted EBITDA margin in the 2% to 4% range. Even with a challenging top line environment, this puts us right in line with the commitment we made to drive at least 50% growth in 2024 adjusted EBITDA dollars, which is a testament to our steadfast focus on cost efficiency.

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 \$90 million to \$95 million, net interest expense of approximately \$14 million, weighted average shares outstanding of approximately 125 million and CapEx in a \$60 million to \$70 million range. Layering this on top of the expectations for adjusted EBITDA and the working capital benefit with revenue up sequentially in the fourth quarter, we would expect healthy free cash flow generation to round out the year.

I want to make sure investors appreciate just how unique 2024 has been in the context of Wayfair's long history. We spent many years, post our IPO, focused primarily on growth, and then over the past several years, appropriately pivoted to prioritize profitability. 2024 has marked a return to the pre-IPO form of this business, balancing the dual mandate of driving progress on both the top and bottom line, and there's more to come in 2025.

As we close out the year, I want to draw back to Niraj and Steve's remarks from their Shareholder Letter from February. Our mission is to make Wayfair the best place to shop for the home over not just the next quarter or a year, but the next decade and beyond. We believe the best is yet to come and have never been more excited to execute against the tremendous opportunity in front of us.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. And we are now open for Q&A. [Operator Instructions] And your first question comes from the line of Ygal Arounian from Citi. Please go ahead.

Ygal Arounian

Analyst, Citigroup Global Markets, Inc.

Q

Hey. Good morning, guys. Maybe just first on the share gain that you're seeing, if you can, I don't know, quantify or qualify that a little bit more. Is it – do you see it all coming from the pricing that you can deliver? Are there other factors that you're seeing? And how do we think about that as the market gets better as you're positioning for that?

And then, on the 2025 EBITDA commentary, any more color we can get around that, the level of confidence? Niraj, you talked about the mid-teens incremental EBITDA margins. Just how do we think about that in a category that maybe doesn't improve as we work our way through the beginning of next year, at least? Thank you.

Niraj S. Shah

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

A

Yeah, Ygal, thanks for the questions. Let me run through them and then, Kate, if there's anything you want to add, Kate, you can jump in. So, on the first one around the share gain we're seeing. So, I would say, since the end of 2022, since fourth quarter of 2022, we've kind of consistently seen ourselves gaining market share every quarter, hitting all-time highs in the credit card panels that we get on market share.

And in terms of how we're doing it, you mentioned pricing, and I'd say optimizing our pricing to maximize our profit dollars is certainly one thing. Again, we didn't really change pricing that much. I just want to quantify that, right? That's a low tens of basis points. But that's just the kind of an ongoing optimization we do on the demand elasticity to maximize our position there. But that's just one of many things.

So, we talked about pricing, but, for example, we could talk about improvements we've made in our logistics network. Like, for example, on our prior calls, we talked about consolidating delivery, which is right now live in Houston, Las Vegas. We're rolling that out nationally. Or we've done a whole series of kind of logistics features and functionality that increases speed, increases customer service levels. That grows the business.

So on our website, there are apps, what we call our storefront experience. That's a team that had spent a lot over the last couple years working on re-platforming big pieces of the technology, but as they've done that now, the developer velocity is much faster, the feature function we can roll out and optimize is back to a very high rate, and we're seeing gains from that. So, the way we can kind of take market share is actually through a long list of things we can do to improve the customer experience, drive up conversion, gain customer reach, optimize the outcomes we're getting.

And so when we look to 2025, we see a lot of ways to continue to grow our market share, regardless of whether the macro economy in this category is something that's getting better or not. So we're not counting on that. We know it's a cyclical category. We know that consumer discretionary durables are under a lot of pressure now. That is where we play. Despite that, we see a pretty good outlook for how we're going to grow on the back of taking market share.

And then, for the 2025 EBITDA, the way to think about the 2025 EBITDA is what we said is, we see 2025 EBITDA dollars being higher than 2024 EBITDA dollars, because the ongoing roadmap we have around what we can do around market share, as I just described, and kind of scale our business that way, while we also continue to have a good cost roadmap. And as you've seen on that SOTG&A line, for example, I don't know, if I forget the numbers, eight or nine quarters in a row, you've seen that come down in dollars. And that's just us being very smart about how we're spending money and continue to find ways to optimize that. But, Kate, let me just turn it over to you.

Kate S. Gulliver

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

A

Yeah. I just want to jump in to clarify. Obviously, we haven't given any 2025 guidance and we don't typically give annual guidance. But all we have said to 2025 is exactly as Niraj said, which is we are focused on growing adjusted EBITDA dollars. And that continues to be our focus and commitment. And we can do that through the combination of the cost discipline you've seen us execute on over the last few years and the investments that we're making now to grow revenue. And so that revenue growth, which we see come in on this multi-quarter basis, on a positive front from adjusted EBITDA dollars, will help us grow adjusted EBITDA dollars in combination with that cost discipline Niraj referenced how that's showing up on that SOTG&A line.

Ygal Arounian

Analyst, Citigroup Global Markets, Inc.

Q

All right. I appreciate it. Thank you.

Operator: Your next question comes from the line of Christopher Horvers with JPMorgan. Your line is open.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

Thanks. Good morning. So my first question is, you're – in the fourth quarter revenue guide, you're assuming some modest slowdown in revenue growth in the balance of the quarter, I'm parsing a little bit here, but flat to low single digits quarter-to-date versus down low single digits. You also mentioned pre-election deferrals. So can you bring that all together for us? Why wouldn't trends get better if consumers are slowing into election and pushing holiday sales later into the quarter?

Niraj S. Shah

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

A

Yeah, Chris, so I think on that, you've got the election coming up. That's something that may or may not really be determined in one day. That could take a little bit of time. We've got a calendar, the number of days that you're talking about kind of in the holiday season is a little shorter, and you have what's been a challenging macro. So you have a bunch of uncertainty.

So we feel very good about how we can continue to take share. But as you would – kind of looking forward to the quarter and you still have a lot of the revenue yet to come and you have some of these uncertainties, you're trying to like figure out where you think you're going to be.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

And I guess how significant has the – I mean, obviously, Way Day, you purposely extended that earlier. But do you think that – how significant is that slowdown ahead of the election versus maybe just timing shift around having a longer Way Day?

Niraj S. Shah

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

A

Yeah. I mean, I think Way Day, we – on hindsight, we're pretty happy with how we played that. We had planned for a three-day event. We built some flexibility in and how we did that. And then, as we saw the calendar playing out, we saw a bunch of other major retailers planning a two-day sales event right after Way Day. We decided to take advantage of the online shopping that was going to happen over that time. That certainly maximized how we did, but I don't know that that dramatically affects when you get a week or two out from – how demand is going.

I think it's just that – the macro, it just makes it harder to predict. I think that's basically the biggest thing I would just say when you look just the forthcoming holiday season. And you're like, hey, how is this going to exactly play out? You could come out with a range of possibilities that all seem plausible.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

Got it. That makes sense. And then, on the operating margin forecast for the fourth quarter. Kate, you talked about, we're hitting our goal of mid-single digits. You did 4.1% in the third quarter. But at the same time, the midpoint of the fourth quarter guide is not mid-single digits. So, I guess, to what extent does that sort of undermine the view of hitting that goal that you've sort of said you would get to and have said that you've achieved that? And then, is any of that just seasonality from a mix perspective versus timing of spending?

Kate S. Gulliver

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

A

Yeah. Chris, thanks for the question. I guess the way I'd look at it is, obviously, over the last two quarters, we've proven we can operate at that mid-single digits, right? And we've shown, I think, very nice discipline to get to that point. What you heard with the fourth quarter guide is a little bit of incremental investment on that marketing spend. And as a result, we stepped up that range a little bit. And then the net of that is that we think that that is going to drive incremental revenue and incremental adjusted EBITDA dollars over the next few quarters.

So I want to be clear that bottom of the funnel marketing spend is a place where we are quite disciplined, we have very good visibility and we feel confident in the ability of that to drive both the revenue and the adjusted EBITDA dollars. And that's really where we're driving towards.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

Thanks very much.

Kate S. Gulliver

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

A

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.



Thanks. Good morning, everyone. So just sticking on some of the advertising and election dynamics. So you highlighted the elevated ad spend from the stepped up influencer marketing, but we're also hearing that ad rates are very high right now around the election season. So how do you think about the ad spend going forward? Do you think the overall costs are going to come down as we get further into November, December and going forward?

Niraj S. Shah

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



Yeah. Thanks, Peter. So the way to think about it is, certain parts of the ad market will definitely have elevated rates pre-election. So think about this as like local television, think of this as some of the upper funnel channels, which you could use for any variety of messaging. And just to remind you, we're very quantitative in how we spend the money. So, in other words, we won't chase that spend. So if it's not economic, someone else can buy that media. And of course, if it becomes economic again and makes sense to us, we would buy that media.

And so that's sort of one thing. Think of that is like, whether you think about influencers or, separately, we're talking about some lower funnel fast payback channels, those are channels that are very narrow and specific to different types of advertising. And so those aren't ones where you'd find political ads. And so that's sort of a different segment of the advertising market.

But I think the main thing to just to kind of keep in mind is that we're just very quantitative in when we're talking about this ad spend. So we're not – we don't really participate in anything that's not economic. And yes, those channels, like local television, do get much cheaper after the election, but, yeah, we don't really do that much in local television, for example.

Peter Jacob Keith

Analyst, Piper Sandler & Co.



Okay. Helpful. And then, Niraj, just a separate question for you is just on Wayfair Rewards. So it's exciting you have a loyalty program out there. I am recalling, it was six or seven years ago, you did have a loyalty program called MyWay, which was ultimately disbanded. So maybe just talk about the learnings from MyWay and what's different this time that ultimately might make this new loyalty program stay?

Niraj S. Shah

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



Yeah. So I think our biggest learning from MyWay was that the kind of customer value proposition that we had associated with the program, it just wasn't that strong. Now, in contrast, if you think about what we're offering on Wayfair Rewards, what I talked about on the call already is, you think about that average customer, \$600 a year, they're getting 5% back. That tranche of customers would be basically breakeven on the program, right off the bat, off their annual spend. They pick up those other benefits, the members-only customer service line, early access to the sale events. But obviously, the way it works is if you're getting rewards dollars every time you make a purchase, you have a balance you could use against your next purchase. And that customer is already spending a few thousand dollars in home today spread across many, many retailers. So you think about that next \$2,000, \$3,000 that they're not spending with Wayfair, well, if they spend some of that with us, the program [ph] has some cost (00:36:19) for them and they're going to get rewards on that incremental spend.

And so it has some of the basic engineering you want in a program that makes it very obvious and easy for the customer to change kind of where they choose to drive their spend. And then there's a bunch of other benefits tied to the program that you say are not economic, but they could be exciting to consumers.

So I think we've got a very good setup. And I don't think, in hindsight, MyWay did not have as good a setup. And for that reason, we didn't see the traction we wanted with that. Wayfair Rewards, it's new, right, it's only been out there for a couple weeks, but we're happy with the start it's getting.

Kate S. Gulliver

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

A

Yeah. I would just add. You heard Niraj speak to on the call the value of loyal customers. And so we have a very good understanding of when someone is increasingly loyal with us, the overall ROI that that drives and customer lifetime value there. And so this program is really designed at driving incrementality from folks who we're getting a portion of their spend, but we know we're going to be getting that third and that fourth order. And we tested the concept with customers. We had good reaction. So we're really excited about both how the customer perceives this value prop and what it can do for us.

Peter Jacob Keith

Analyst, Piper Sandler & Co.

Q

Very good. Thank you so much.

Operator: Your next question is from the line of Simeon Gutman from Morgan Stanley. Your line is open.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning, everyone. Couple questions. First on the category, home furnishing. If turnover or housing turnover picks up, I think the category would rebound. If it doesn't, curious what you think about pent-up demand to drive – is that going to drive some life in the category? Where do you think we are in that continuum?

Niraj S. Shah

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

A

Yeah. So, I think kind of you're phrasing it well in the sense that, obviously, if housing demand, existing home sales picks up, that's obviously highly stimulative to the category. We are seeing signs that there is pent-up demand, but how much time needs to elapse before that becomes top of mind enough to be stimulative on its own is less clear, I would say. This is why, if you just think about our strategy we've had for two years, during which the market's gone down, what, 25%, but we've basically been able to take significant market share. And so we are doing far better than that.

I think our strategy is really not counting on a rebound in the category, but it's actually calling out the fact that, use rough numbers, the category was, whatever, a little over \$400 billion in North America and now it's, whatever, over \$300 billion in North America, it's still 300, whatever, plus billion dollars of spend that's out there. And we think that there's a lot of argument on why we can take share very nicely with all the things we're doing.

And if you kind of think about that, it being a long tail, very fragmented, and you're increasingly seeing players who are having a harder time being differentiated in the middle, sort of losing share or going away, and you've kind of seen that from major players where they're declining a lot or there have been a handful – most recently, what, Conn's, Badcock and More going out of business.

And so there's definitely things that are changing. And I think this is the real opportunity for us. And yes, of course, when the category turns, there's going to be tremendous amount of growth, too. But it's sort of like, timing that, I don't think is very easy to do and I don't think it's really pertinent with given the strategy we have.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Q

And then the follow-up on just the construct for 2025, which I know once you give a construct, we're going to ask all sorts of questions. There's obviously a lot of room where you say EBITDA dollars north of 2024. The question is, you could – let's say, that's up couple hundred million dollars, or are you going to lean in to market share to the point where you'll just drive a modest outcome? And I'm not looking at dollars and how much it'll be up year-over-year, but more on your posture of how much you want to lean in to take market share to just achieve that goal of growing them or actually taking market share in a more meaningful way, if that's the essence of the question.

Niraj S. Shah

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

A

Yeah. The only thing I'll say, and I'm going to turn it over to Kate, though, is that those are interrelated, meaning that the things you do to take market share, some of those do not have costs associated with it that's not already shrunk, meaning like, for example, when I talk about storefront experience, that's a team of people we have on payroll. They're doing hard work every day, rolling out a lot of features. That will have an outcome that will drive market share. There's no incremental cost, meaning the ongoing payroll is the cost there.

There's other things you would do. Like, if you talk about advertising, you have a cost associated with revenue, but what we're saying is we're going to do the cost associated with profit dollars that it generates. So those who have a very direct relationship, they're not unrelated. But let me turn it over to Kate for any clarification.

Kate S. Gulliver

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

A

Hey, Simeon. Yeah, I would just reiterate, we are very focused on driving both the top and the bottom line. And we believe that we can do these things in concert with each other, and we have a high degree of conviction around that. So, what you're hearing us say is there are select places where we have made investments and are making investments.

Obviously, last quarter, we started to talk about that in the gross margin line. You saw how that showed up this quarter. We talked a little bit about the marketing spend. We are doing these things because we think that they drive incremental order growth and revenue capture. And ultimately, that drives adjusted EBITDA dollars growth. And we can do that while continuing to be quite disciplined on the cost side. And you've seen that pan out over the last few years as well.

Niraj already mentioned that SOTG&A expense, we've taken that down nine quarters in a row. On an LTM basis, that's down over \$250 million. That's on top of the cost takeouts that we took out at the end of 2022 and throughout 2023.

So you're seeing really nice discipline there where we can manage the fixed costs. And you're seeing us say, hey, there are some places where we think there are pockets of opportunity to invest that will drive, on a multi-quarter basis, revenue, gross profit dollars and ultimately, adjusted EBITDA dollars.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC



Okay. Thank you. Good luck.

Operator: Your next question comes from the line of Brian Nagel from Oppenheimer. Please go ahead.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.



Hi. Good morning. So, I have a couple questions. My first question on market share. So I know this has been a big topic and you've highlighted consistently, the numbers show that, clearly, Wayfair in a tough environment is taking market share broadly. But the question I have is, if – as you look at that – the data you have maybe closer, is there any indication that some of these more mass merchant, more value-oriented retailers or sites that are performing well in this environment, were they actually – you're having a more difficult time taking market share there or are they potentially taking market share back from Wayfair?

Niraj S. Shah

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



Well, I guess just to clarify, what I would say, so it's a large and fragmented market. There's quite a few people losing share. But just to clarify, we're not the only one winning share. And so two other folks have highlighted, who I think have done a very good job also over the last few years. One is Amazon. Now, they play at the kind of opening price point commodity item, it's really where they specialize, but they've done a good job. Another one is HomeGoods, who's purely brick-and-mortar, and they really play in sort of the decorative accents, decor, textile space, lower-ticket items. But they've both been taking market share.

So there's a handful of folks who are doing well, much longer list of folks who are not doing well. And that's kind of the landscape. And so, I wouldn't say that we expect to be the only winner, but I think there's actually kind of only a handful of winners and quite a few folks who are on the other side.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.



That's helpful, Niraj. And then my second question, and, Kate, it's probably more for you, but, look, again, you've done a great job taking your cost infrastructure down, controlling costs, amid this top line weakness. But as we look into 2025, the top line there is still somewhat of a wild card, but I guess the question is, and you look at your cost infrastructure, how much incremental opportunity is there to take costs down further? And then, philosophically, if sales were to stay weaker, are you looking to take more cost down or you at that point start to prepare for the eventual recovery in sales and kind of keep the cost infrastructure in place?

Kate S. Gulliver

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



Yeah. Great question. So, first, let me just start with how we look at the cost efficiency and the cost opportunity. You've seen us focus sort of up and down the P&L on cost. Obviously, the place where you see that continuing to show up is on that OpEx expense, that SOTG&A, although you've also seen nice discipline, for example, on the CapEx expense. And as we're driving towards our sort of ultimate goal of growing adjusted EBITDA dollars, less the CapEx, less the equity-based compensation, where you've also seen nice gains from a cost control perspective, you're seeing that sort of combination of those three continuing to improve.

So as we look at it, we do see ongoing opportunity for efficiency. You've seen us do those restructurings in the past and then you've seen ongoing tightening on a quarterly basis on that SOTG&A line. And as a reminder, that line is not just labor, right? That's labor, but it's also T&E, it's R&O, it's some overhead, it's some software expense. And you're seeing us be really disciplined in all of these pockets, as well as CapEx, equity-based compensation, et cetera. So when we look at it, yes, we see ongoing places for tightening and places to be quite thoughtful.

And as we think about 2025, again, what I will say and reiterate is, we are very focused on growing those adjusted EBITDA dollars. So we intend to balance things appropriately to continue to drive that. And that in combination with CapEx, equity-based compensation, so that adjusted EBITDA, less CapEx, less equity-based compensation continues to improve.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

Q

That's very helpful. I appreciate it. Thank you.

Operator: Your next question is from the line of Curtis Nagle, Bank of America. Your line is open.

Curtis Nagle

Analyst, BofA Securities, Inc.

Q

Great. Thanks very much for taking the question. I guess the first one is just on the AOV, came in above expectations, but pointed to high price elasticity and press for small versus large-ticket items. So just curious what drove the better expected and higher AOV in 3Q.

Niraj S. Shah

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

A

Yeah. Curt, so I think the way to think about AOV, AOV is really an output metric, right? So if you think about our business, we're doing a lot, for example, to sell lower-ticket items. We talk about, like, the frequency agenda and what we're doing with housewares items, decorative accents. And one of the benefits of Wayfair Rewards, for example, is free shipping on every order. And so you say, oh, that'll decrease AOV. But then we have a luxury platform, Perigold, that's actually growing at a very nice rate. You say, oh, that's going to increase AOV.

And so we're doing a whole variety of things that our real goal is to grow the dollars per customer per year. So the way we think about getting market share is we think about market share is more customers and those customers each spending more with us. And an outcome of that is, obviously, a number of orders times AOV is the revenue. But, again, because our strategy is not around low-ticket orders or high-ticket orders, AOV is an outcome metric of the combination of things we do.

And so, I would say, AOV is kind of like a pertinent topic when you're talking about inflation of like-for-like items or deflation of like-for-like items, meaning your second quintile price for beds, is that moving? But that's not really what's happening right now. All of that inflation with COVID and the ocean freight rates, then there was a deep cycle of deflation of that coming back out, that's all behind us right now. And so this AOV is more – these moves are more an output metric of the seasonality and us executing the business on all the dimensions we talked about.

Curtis Nagle

Analyst, BofA Securities, Inc.

Q

Okay. Got it. Then just would love to ask a question on tariffs. Yeah. I mean, effectively, just kind of how we should think about the framework if we were to go to 50% or 60%. I think last you spoke, and it was a while ago, China exposure about 50%. So in terms of just kind of the implications on revenue and margins, how the industry reacts, right, I mean, pricing is probably harder to push and capacity to move, right, out of China might be lower, so just kind of piecing all that together, and maybe an update on what your exposure is at the moment would be incredibly helpful.

Steven K. Conine

Co-Chairman and Co-Founder, Wayfair, Inc.

A

Great. Niraj, let me give some thoughts on this and then I'll hand it over to you. This is Steve. So, yeah, tariffs are something we've certainly seen over the history of this business and we've seen antidumping and we've seen tariffs. And they certainly can have an impact.

I would say, on the one side, we're running a marketplace. And so we really have selection across a broad spectrum of suppliers and that allows our customers to see a lot of options for products they have and swap in different things. And so we're able to sort of move demand around in that regard.

We certainly have some practice now navigating tariffs. And so I think when we look out in the future, and certainly, it's uncertain exactly how that might play out, we feel much better about the playbook we will run and the approach we will take to help consumers buffer whatever price increases they may see selectively in certain imported products.

The other side of it is, our suppliers are obviously more directly impacted, even than we are. And so they've been working over the last year or two here to modify their businesses so that they don't have single source problem quite as much as they have in the past.

And so, I think the combination of all those, we think, will buffer this as best we can and should be very navigable.

Niraj S. Shah

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

A

Yeah. The only thing I would mention, though, too, so in the five years since, there's some anti-dumping things that happened in, like, wood – some specific categories of wood goods, certain factories from China, which happened years and years ago, but then, really, the notable things were the tariffs during the first Trump administration, where it got to 10% and then 25%. Well, ever since then – and that was for goods from China in our categories. Ever since then, what you've really seen happen is there's been a lot of suppliers who built manufacturing capabilities in Cambodia, in Vietnam, in Malaysia, Indonesia, other places so that they actually have more control over their future, should the tariff landscape change, et cetera.

So, I would say that the industry now is much more cognizant of that risk than they were five years ago. And so, I think we have kind of a couple benefits going for us. One is that the industry is definitely in a different position than it was five years ago. The second is, as Steve mentioned, we have 20,000-plus suppliers and we have domestic suppliers. We have import suppliers. We have suppliers who make goods in Brazil. We have suppliers who make goods in Eastern Europe. So we have suppliers that are quite different from one another. And so we have the benefit of how they compete on our platform for the customer.

So, yeah, I think it's – you never know quite what's going to happen, but I would say that that's certainly a topic that folks have been thinking about and doing things about.

Curtis Nagle

Analyst, BofA Securities, Inc.



Okay. Got it. Thank you.

Operator: Your next question is from the line of Colin Sebastian from Baird. Your line is open.

Colin Alan Sebastian

Analyst, Robert W. Baird & Co., Inc.



Thanks, guys. Good morning. So I know there's a lot of focus here on the category challenges and efforts in pricing and advertising. But, Niraj, if we sort of zoom out on broader e-commerce platform and technology trends, I mean, there's a lot of change happening around shopping tools and digital assistance and personalization within apps. And so, I wonder how important those initiatives are for Wayfair. And are you seeing any positive impacts perhaps in metrics like just time spent or discovery and browsing, even if those aren't converting yet to sales in this environment?

Steven K. Conine

Co-Chairman and Co-Founder, Wayfair, Inc.



Hey. Yeah. Thanks for the question. This is Steve again. Let me just kick this off. We have been doing a lot of things internally. Actually, just this morning, I sent out an internal sort of pre-earnings little video and I did it completely with AI. And I think part of this – we're all going through this learning curve together right now of how to best use these new tools. And so when you look out and say, if we don't adopt the best practices in the business, we're going to be in trouble. And so it's on us to really push our teams to make sure they're using these new tools and experimenting and trying new things, and pushing the cutting edge so that we can be a leader and not be kind of at risk of the market changing around us without us catching in.

So we have a number of initiatives internally that are – some are very tactical and some have very direct efficiency paybacks, where teams are using them to improve process flows that they have today. And then, some are much more experimental, where they're trying to go after things that could be disruptive in the future, that could be very exciting for our customers or could change the efficiency curves in different parts of our business.

Niraj S. Shah

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



Yeah. And what you've seen, like, so we've been a large adopter of machine learning data science for a very long time. It's how we price the catalog, how we do sort order, how we do a lot of personalization. But with the kind of more recent advent of GenAI, we've also been an aggressive adopter there where we have a lot of use cases where you can kind of do things and you see the return very quickly.

For example, we have a very large catalog, millions, millions, tens of millions of items. And so finding dimension inaccuracies and correcting them, auto tagging a lot of merchandising attributes, those are things that we've actually put into production. They're driving a lot of value at a very insignificant cost.

And then similarly, on how we empower our customer service agents to be able to take care of the customer and do a good job. We've been able to create tools there, or for our software development teams, and kind of the copilot type products out there for increasing productivity of coding. So there's been a bunch of things we've been an aggressive adopter on.

On the customer side, I think what you're also getting at is, it could change how customers shop. And there, I think we actually do have some kind of pilots and proof of concepts of things that we're trying that we do. We have one that we're setting a small amounts of traffic in and it actually shows really amazing customer engagement. It's still early. But we're basically – we're certainly – I think we're being prudent about how much we're investing, we're not overinvesting, but I think we're also not ignoring it. And I'd say we definitely are pretty happy with some of the progress we're making.

And we're in a good position, because it's a category, we're not selling commodity goods. And I think the biggest challenge with agents are if you're a seller of commodity items, now you can have an agent and say, hey, I want to reorder those Bounty paper towels, that dish soap, some more Dove soap bars. Well, that agent can basically figure out, hey, is it cheaper at Walmart, at Target, at Amazon, or does it make sense? So we're ordering enough from Walmart, automatically sign me up for Walmart+ or whatever, execute that order. I don't care whose kind of brown cardboard box shows up at my door, right?

But if you're selling items that are exclusive, there's a lot of consideration in how you pick the right item. There's a lot of fine distinction between different items. The agent role is going to be a little different. And I think there's things you can do to kind of enhance the customer experience in a way that's really engaging. But it's not – I think the real challenge is if you're more of a commodity provider.

Colin Alan Sebastian

Analyst, Robert W. Baird & Co., Inc.



Okay. Thanks, Niraj, and thanks, Steve.

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

Oliver Wintermantel

Analyst, Evercore ISI



Thanks, guys. Kate, I think you mentioned you're looking forward to a healthy free cash flow generation in the fourth quarter. Maybe can you confirm that free cash flow that you guys expect free cash flow to be positive this year? And then maybe the capital allocation into next year, maybe talk a little bit about how you want to invest in and what is driving CapEx next year?

Kate S. Gulliver

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



Yeah. So a few thoughts. So just, first, relative to the fourth quarter, we do typically see positive free cash flow in the fourth quarter. As a reminder, part of that's the working capital dynamic, right? So seasonally, the fourth quarter is typically a bigger revenue quarter than the third quarter. And that, in combination with our ongoing discipline around adjusted EBITDA growth and CapEx, should drive nice free cash flow in the fourth quarter.

Obviously, we haven't given any 2025 guidance, but as we think about CapEx, I'd sort of look at what we've done over the past year. And so what you've seen is ongoing discipline on that line as well. There are really two sort of components to CapEx that we break out here. One is the CapEx labor piece. And you've seen that continue to come in quite nicely, as we've been very thoughtful and disciplined on our team and our structuring.

And then the other is that PP&E line. And within that PP&E line is the investment in our logistics network and the investment in physical retail. And what we've spoken about there is, in the logistics network, we're very pleased

with where the network is today. So we're not in a growth mode on that network. There's some maintenance CapEx there, but it's really not about expansion. We have ample capacity for the growth that we intend to have.

And then on the physical retail side, what we've also said there is we're excited about that opportunity. We're obviously quite pleased with the results from that first large format store that opened in the spring, but we intend to be very disciplined about the rollout there. And so you should – overall, you've seen us throughout this year bringing CapEx nicely from last year as we maintain that expense discipline and rigor up and down the P&L.

Oliver Wintermantel

Analyst, Evercore ISI

Q

Got it. Thanks. Got it. And then maybe on international, looks like that had a nice improvement in EBITDA versus the first half of the year. On your comment about next year's EBITDA dollars to be positive versus 2024, how much of that is international improvement?

Niraj S. Shah

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

A

Yeah. So I'll just make a quick comment and then turn it over to Kate for the details. But I think what you're seeing over time is a lot of the work we did over two years of really kind of streamlining our cost structure, focusing on the key things for each business line that we think are important to drive them forward. And then as time plays out, we're seeing that the business – we're pretty happy with the progress we're making on the key drivers in each line of business that we want to see progress. I'm not really allowed to give guidance. I'll turn it over to Kate.

Kate S. Gulliver

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

A

I'm also not going to give guidance. But I'd reiterate what Niraj said, which is as we thought about the cost discipline and the selective areas where we invest, that's across the business, right? That's not just specific to the US. And what we said that as we started some of this cost restructuring is that that would be sort of global in nature in how we look at that. And as we sort of think about what we're driving for the business, we're really focused on the business overall and what that looks like across Wayfair Inc.

Operator: And in the interest of time, we will conclude our Q&A session here. I would like to hand back over to the Wayfair team for closing remarks.

Niraj S. Shah

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

Yeah. Thank you, everybody, for joining us today. As you can probably tell, we're pretty excited with where we are now with the business, the things that are rolling out and coming. And we're pretty – we really like the prospects we have as we're looking forward. Thanks for your interest in Wayfair. I hope you have a great holiday season.

Kate S. Gulliver

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

Thank you, all.

Steven K. Conine

Co-Chairman and Co-Founder, Wayfair, Inc.

Thanks.

Operator: This concludes today's conference call. Enjoy the rest of your day. You may now disconnect.

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