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Wayfair, Inc. (W)

Q4 2023 Earnings Call

CORPORATE PARTICIPANTS

James Lamb

Head-Investor Relations, Wayfair, Inc.

Niraj S. Shah

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

Kate S. Gulliver

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

OTHER PARTICIPANTS

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Alexandra Steiger

Analyst, Goldman Sachs Bank Europe SE (Germany)

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

Anna Andreeva

Analyst, Needham & Co. LLC

Colin Alan Sebastian

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

Christopher Horvers

Analyst, JPMorgan Securities LLC

Steven Forbes

Analyst, Guggenheim Securities LLC

Oliver Wintermantel

Analyst, Evercore Group LLC

Curtis Nagle

Analyst, BofA Securities, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to the Wayfair Fourth Quarter 2023 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.

James Lamb, Head of Investor Relations and Treasury, you may begin your conference.

James Lamb

Head-Investor Relations, Wayfair, Inc.

Good morning, and thank you for joining us. Today, we will review our fourth quarter 2023 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 first 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 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. We're excited to be with you today to discuss our fourth quarter results and recap 2023. Q4 was one more definitive step on our profitability journey as we generated a 3% adjusted EBITDA margin, even in a difficult macro environment. This was our third consecutive quarter of positive adjusted EBITDA and free cash flow and a reflection of the immense progress we achieved across the entire year. In fact, on a revenue base that largely mirrored 2022, our free cash flow in 2023 improved by over \$1 billion.

As we exited 2022, we anchored ourselves around three core initiatives: nailing the basics, driving customer and supplier loyalty and cost efficiency. Over the course of 2023, we systematically executed on all three fronts. Our efforts to nail the basics and drive customer and supplier loyalty led to a large improvement in our core recipe across availability, speed and price competitiveness.

The improvements across our offering were directly responsible for the step-up we saw in loyalty, which manifested in our robust share expansion over the last year and by the fourth quarter, a return to year-over-year growth in our active customer count. That engagement was driven in part by our progress on the third initiative, a meaningful evolution in our cost structure with savings spanning labor, operations and every other line of our P&L, which allowed us to reinvest in our customer experience.

We've consistently shared that those same core initiatives would carry forward into 2024, and you've already seen the results of that play out. If you haven't had the chance, I'd encourage you to take a look at our shareholder letter that was published alongside our earnings results earlier this morning. Last year, we saw our team unlock large productivity gains as focused execution against our top ideas, met reduced friction and less internal bureaucracy.

As we look at the evolution and composition of our teams throughout 2023, it became increasingly clear to us that there was more that could be done to increase productivity. We realized that many of our teams were still over-indexed to middle and upper level managers in proportion to the more execution-focused team members that are the foundation of each group.

Late last year, we started an exercise involving a number of our senior leaders to look at each team across the organization and answer some simple questions. How would we maximize the efficiency of this team? How many people would be on it? What would the appropriate leveling look like? Would we actually prioritize all of the activities the team does? And then we answered as if we were starting from a blank slate.

We took this work and used it in conjunction with the effort we started in the summer of 2022 to return to our lean and fit self by reorganizing a rounded ideal structure. While this is not the work anyone enjoys being lean is a key part of our culture, and partly why we think we've out-executed others over the last 20 years. The key here is that we are comfortable being frugal around head count.

We're excited to welcome a group of new college graduates this summer, and we'll allocate those hires to the key teams and efforts that will provide the biggest gains, all the while growing the foundational base of talent in the company who can rise through the ranks in the years to come. This enables us to move forward against an ambitious set of growth initiatives, while at the same time, see our team thrive in a workplace where they have fewer obstacles, fewer meetings and fewer boxes to tick off to bring these initiatives to fruition.

Many of you asked if the decision was made in reaction to what we're seeing from the macro and the answer is no. Our intent was to address the structure of our award in a way that will unlock productivity gains, not just for one or two quarters, but for years to come. However, as we shared in our press release from last month, our category does remain challenged with softness persisting through the start of the year.

I was recently at the furniture market in Las Vegas and had the opportunity to speak with many of our suppliers. We heard that January was weak, though a short bout of extreme weather was clearly one factor. While uncertainty remains around the timing of a recovery, we are well positioned to see meaningful upside as the spending climate around the home and housing rebounds. And we continue to see our own growth well outpacing the category.

It's important to call out that our success is not exclusively against smaller home focused competitors. We're also seeing share gains against some of the biggest retailers in the country. I mentioned earlier that we've been able to win through execution gains driven by a more nimble, focused team, and we've been encouraged to see that play out across the organization.

One area that I'd like to highlight today is our UK business, where we've seen a noteworthy inflection in share over the past year. The UK is a key market for us with an addressable market estimated to be in the \$60 billion range. While the competitive ecosystem has strong similarity to the US with a mix of a few multinationals, a number of large multi-category retailers, several homeware specialists and a long tail of smaller competitors in various niches within the category. The actual list of names looks almost entirely different.

The market fragmentation works to our advantage, as we are one of the few scale players that focuses exclusively on the home. Over the past year, we've driven healthy market share growth on the back of considerable availability improvements, double-digit percentage growth in small parcel speed badging and meaningfully more competitive prices. This was fueled by our operational efficiency initiatives that drove considerable savings dollars, some of which we were able to pass back to our customers.

Our aided awareness in the UK is nearly as high as the US and we've seen an encouraging increase in customer satisfaction scores since the same time last year. Just as we do in Canada and Germany, we take a country-specific approach to servicing customers in the United Kingdom. Our creative is specifically built to emphasize UK

tone of voice, along with using UK homes in our television ads, which you can view on our UK specific social channels.

Leveraging our strength in logistics and our six UK Wayfair delivery terminals, we bring our UK customers a best-in-class fulfillment experience with services like scheduled delivery and white glove upgrades, while also opening up a wider selection from suppliers based in Continental Europe. We find that UK competitors frequently have much lower levels of selection, which makes our endless aisle even more compelling and positions Wayfair as an unparalleled option in the market.

Now before I hand it over to Kate, I want to take a few minutes to address three of the topics around which we've heard the most interest. Let me start first with the Red Sea and Ocean Cargo situation, which we've gotten many questions about over the past couple of months. Like many others, we've seen some supply chain disruption, especially for our product being shipped to Europe through the Suez Canal.

We've seen our carriers implement interim solutions, including routing shipments around the southern tip of Africa. It's important to keep in mind the minor scope of supply chain disruption this poses in contrast to the type of disruption we faced back in 2021. These new routes increased shipping time on a much more manageable basis than we faced in 2021, and availability across our catalog has seen no meaningful negative impact.

Container prices have risen, but nowhere near the order of magnitude the industry faced a few years ago when rates reached \$20,000 per container during the COVID crisis. So the net is that while rates have risen, it is something we're very capable of managing without issue, and we're already solving for that today.

The second topic we've received questions on has been average order values. We know this has been tracked quite closely in recent quarters as the inflationary pressures for many of those same supply chain challenges have now finally worked their way out of the inventory picture. Our AOV peaked in the second quarter of 2022 and by the end of that year, we began to see prices decline. We lapped those initial price drops this Q4 and saw that normalization process happening a bit more rapidly than we expected due in part to mix shift. We still anticipate seeing some modest negative year-over-year comparisons during the front half of this year as we approach a fully normalized pricing state mid-year.

The third topic we know investors are acutely focused on is a volatile macroeconomic backdrop as the category quickly approaches a new record for a peak to trough correction. As we've said consistently, our focus is squarely on controlling the controllables. You've seen the enormous progress we've made on our cost structure in the last 18 months. As part of our press release from January, we called out that we would expect to generate over \$600 million of adjusted EBITDA this year on a hypothetical flat revenue scenario, which would translate to a margin north of 5%, putting us in a position to check the box on step two of our profitability ramp.

And that only captures part of the substantial leverage we've unlocked in our model with our true earnings profile, further augmented by the reductions we've brought to bear on equity-based compensation and capital expenditures.

With all the work we've done to optimize our fixed cost base, we'll see even further benefits to the bottom-line, when the category recovers, as the high margin on flow-through of each incremental dollar of revenue will drive up the margin rate, quickly.

It's important to reiterate that our work on cost savings hasn't deterred our focus on delivering a best-in-class shopping experience.

For example, we recently launched free white glove delivery on certain large parcel items, which we combine with deluxing, where our delivery agents unbox an item, inspect it for any flaws before the final delivery and greatly enhance the customer experience to seamlessly set the item up in the customer's home and make sure it's immediately ready for use.

This is only possible to provide nationally with the scale and focus that Wayfair brings to the category. And it's one of the many factors behind a return to positive active customer year-over-year growth this quarter.

We're eagerly looking forward to demonstrating the growth potential of our business, as the category recovers. And I want to end by calling out some of the things I'm most excited for in 2024.

The first is the launch of our Wayfair branded store this May. We're delighted to showcase the breadth and depth of our catalog in an entirely new way and can't wait for you to see it.

The second is the launch of our new brand campaign, which will roll out in mid-March. We're bringing a vibrant refresh to the Wayfair brand with new merchandising, new marketing and new ways to connect with our shoppers.

And the third is our plan to launch a tender-neutral loyalty program this fall, a new opportunity to create a differentiated shopping experience for our customers to keep them coming back time-and-time again. We have a lot of exciting things underway to help us keep driving, compounding gains.

With that, let me turn it over to Kate, to walk you 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 fourth quarter results, beginning with revenue. Net revenue for the quarter came in at \$3.1 billion, up 0.4% from the same period last year. Orders grew by 2.7% year-over-year, and we saw active customer growth return positive, up 1.4% year-over-year in the period.

As Niraj discussed earlier, average order values came in higher than expected, down only 2.5% against the fourth quarter of last year as we saw boost from our performance in higher ticket classes during the holiday shopping season. I want to touch on the top line and macro context a bit before going further in the P&L.

As Niraj shared in his remarks, our category broadly remains under pressure. Within this context, we are very encouraged by our ongoing share gains and our continued ability to outpace the category. We started this year with the best share figures we've seen across all the data we have in our credit card panel back to 2018.

As we've shared previously, the share capture can be attributed to the return in strength of our core recipe in Q4 of 2022, as we improved availability, speed and price, driving a best-in-class customer experience. All of course, in the context of also aggressively managing our cost structure and driving profitability and free cash flow.

I'll now move further 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 profit came in at 30.4% of net revenue as we saw the typical effects of holiday seasonality play out in tandem with our own proactive reinvestment of some operational savings that we had achieved earlier in the year. Customer service and merchant fees were 4.2% of net revenue and

advertising was 12.2% of net revenue. Once again, there is a holiday effect here, which drove the sequential step-up in advertising dollars spent.

Finally, selling, operations, technology, general and administrative costs or SOTG&A came in at \$447 million for the fourth quarter. That was the impact of our work in 2022 and 2023 on driving fixed cost efficiency. We took SOTG&A down by over 13% in the full year 2023 versus 2022, and that doesn't even capture the progress we made on reducing capital expenditures and incremental dilution from equity-based compensation. Altogether, we had a third consecutive quarter of positive adjusted EBITDA at \$92 million for the period or a 3% margin on net revenue.

Our US segment drove \$131 million of adjusted EBITDA at a 4.8% margin on net revenue, while our International segment adjusted EBITDA loss of \$39 million was less than half the loss we had in the same quarter a year ago. We ended the year with \$1.4 billion of cash and equivalents and \$1.9 billion of total liquidity when adding the capacity from our undrawn revolving credit facility. Net cash from operations was \$158 million, which was offset by \$96 million of capital expenditures for free cash flow of \$62 million for the fourth quarter and our third quarter in a row of positive free cash flow.

Now let's turn to guidance for the first quarter. Beginning with the top line, quarter-to-date, we are trending down in the mid-single digits year-over-year and we would expect the full quarter to end in a similar place. We are continuing to win share among consumers but see the weight of a category correction now rivaling the great financial crisis dragging on top line growth.

To put this in perspective, our read of various data sources shows the category declining year-over-year now for nine consecutive quarters, with the last six quarters exhibiting double-digit contraction. Although the timing is inherently uncertain, when macro pressures on our categories and interest rates eventually ease, we are set up to benefit meaningfully on revenue growth and profitability flow-through.

Moving on to gross margins. We would continue to guide you to the 30% to 31% range as the appropriate place to model. As we've said for over a year now, we intend to be very tactical in our decisions around investing some of our gross margin back into the customer experience.

In light of the volatile start to the year for the category, we anticipate that we will continue to prioritize those investments. Customer service and merchant fees should be between 4% and 4.5% of net revenue, reflecting some of the cost takeout from the workforce realignment plan we enacted last month. We expect this to trend closer to the 4% mark as we run rate the full savings by Q2. Advertising should stay in an 11.5% to 12.5% range, and SOTG&A should be in a range of \$410 million to \$420 million.

Following this guidance through, we would expect adjusted EBITDA margins in the positive low-single digit range for Q1, which we would expect to be a low point, both on a dollars and margin basis for the full year. While we don't offer full year guidance, I want to refer back to remarks we made on our third quarter call.

It is critically important for us to deliver on our commitment of substantial adjusted EBITDA growth in 2024. We have multiple levers at our disposal to drive adjusted EBITDA independent of the top-line. Even if the macro environment remains challenged across 2024, we have line of sight to full year 2024 adjusted EBITDA growth, north of 50% year-over-year.

As you're modeling, it's worth bearing in mind that the first quarter is typically the period where we see an initial outflow of cash during the year, given our negative cash conversion cycle, which reverses as revenue builds in the spring.

Now, let me touch on a few housekeeping items. You should expect equity-based compensation and related taxes of roughly \$110 million to \$130 million, reflecting the healthy progress we made on cost takeouts. Depreciation and amortization of approximately \$103 million to \$108 million, net interest expense of approximately \$5 million, weighted average shares outstanding of approximately 120 million and CapEx in an \$80 million to \$90 million range.

As I wrap up, I want to spend a moment addressing the topic of capital structure planning as we look out at the maturities coming due over the next couple of years. The meaningful improvement in our financial profile over 2023 in combination with the cost action we took last month, had given us broad optionality in managing the convertible notes that come due in the fall of this year and 2025.

Looking out at the macro and our own cash flow profile, we are prioritizing prudence. Our goal, as always, is to maximize value to Wayfair's shareholders, and we are extensively evaluating the best timing and options to achieve this. Due to the hard work of the last year, we believe we've expanded our option set. For example, the improvements in our pro forma financial profile enable us to pay down the notes in cash and remain opportunistic around any potential refinancing activity.

Before moving into Q&A, I would like to return to what Niraj touched on earlier. 2023 truly was a year of meaningful progress for Wayfair. Our market share gains and a return to active customer growth clearly show that we are the premier shopping destination for the home. This foundation positions us incredibly well to reaccelerate towards the growth algorithm we laid out at Investor Day once the category stabilizes.

As importantly, we have made considerable improvements up and down the cost structure with a clearly demonstrated discipline that carries forward to 2024 and beyond. The combination of these elements, along with all of the exciting innovation we have in store, makes me more confident than ever about the bright future ahead for Wayfair. Thank you.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] . Your first question comes from the line of Simeon Gutman from Morgan Stanley. Your line is open.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good morning, everyone. I wanted to ask first about the spread of your share gains vis-à-vis the industry, if you can contextualize it all where, I don't know, e-com or total industry is trending? And then what gives you confidence that spread holds throughout the year or could even expand?

Niraj S. Shah

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

A

Thanks, Simeon. This is Niraj. Sure. Let me answer that. So first on market share, obviously, there's a lot of ways to calculate market share. I'd say our main two ways we do that or we have a credit card dataset we get, which has close to 100 competitors on it, and that gives us really good granular data at the competitor level and in total. The second is we talk to our suppliers literally, and they share how we're doing, and they'll share details relative to specific competitors. And while that's less of a quantitative read, that's a pretty dense detailed read. And so we use those two.

But if you zoom out, the easiest one is just to look at our revenue, right? And if you zoom way out, you see our revenue was up just under 0.5% in the quarter year-over-year. I think if you look at competitors, depending on the category you pick, you're going to see numbers negative 10%, negative 15%. You're going to basically see numbers even maybe higher than that some are going to be negative 20%, that's where the category was year-over-year.

So obviously, that delta is the share that we took because obviously, the revenue is customers voting with their dollars, that's the market share. So we are – the way to think about it for five quarters now since the fourth quarter of 2022, we've been taking away taking share, and that was basically on the back of availability and price starting to recover post COVID in December 2022.

By the fourth quarter of 2022, we had that recipe back intact. So we very quickly started picking up the share, the low-hanging fruit of the share. But then even though that got hard after that as we hit all-time highs, we've continued to take share. And so our all-time high – we keep hitting all-time highs in market share as the quarters go by. And so what we would expect to happen is that you're going to see the category for a period of time in the near term being challenged. So the year-over-year numbers for the total category will be not great. And you're going to see us outpacing them significantly, thereby picking up incremental share continuing to hit all-time highs.

So I don't know if that helps with the context of what we expect. But that's sort of the way we see it. And then the only other comment I would make is, obviously, we would expect the category to subsequently recover. It's a cyclical category. And it was interesting, I was reading a note someone put out about the Home Depot call the other day. And Home Depot is I'd say a well-run company, but obviously, it is in the home category as well, and they're talking about how certain segments are challenged right now, what have you.

But though – that no one talked about is, how from a cost and a revenue potential standpoint, they're really poised for huge gains once the category recovers. And what I will point out is like that's also how we feel we are. So in

other words, we're taking share while it's really hard to take share as the market is shrinking. It's a challenging time to take share as the competitors don't want to give up share. But we've taken up \$2 billion in cost, close to it. We've gotten ourselves where the unit economics are very strong. We've got customers really responding to what we're doing. You see that in the market share, you'll see that in the active customer count, which has picked up and so as the market turns and demand comes back, I think, you're going to see quite a nice acceleration in revenue and profits as well. So while the market is tough, you're going to see us continue to tick away just with the execution we're doing. And then you're only going to see that get a lot better as the market recovers.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

And to that point, and this will be the follow-up. As sales recover, what is the right way to think about incrementals for every point above zero? And then alternatively, if it stays negative for the medium term, is there a way to think about decrementals?

Niraj S. Shah

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

Yeah, sure. So I think the way to think about – so actually, one thing I'll just put a plug in for is that we, today, along with obviously the earnings call materials, one of the things we released on the investor website is our annual shareholder letter and as the title says annual, we only do that obviously once a year. So it's an opportunity to look out to the future and for us to share our thinking on a bunch of topics. And I really encourage everyone on the call to just take a few minutes to download that and read it. It's right on the IR website. Because there, we can really share some detailed thinking about what we're focused on, which is not so much the near-term focus as the call tends to be. But one of the things I do mention is how we think about how we're poised for future earnings. And I talk about how the next \$1 billion of revenue would flow through in the mid to high-teens on EBITDA. And that's basically the concept. We have fixed costs in the business, and we get to leverage those as we grow. So there's – that's hopefully your point on kind of how – what's the incremental potential look like?

Kate S. Gulliver

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

Yeah. And – hey, Simeon, it's Kate. Good morning. I guess what I would add to that too, you asked sort of going the other way. And in the prepared remarks, I referenced the comment that we made on the third quarter call around substantial EBITDA growth. And I said, somewhat irrespective of the top-line, we expect to see 15% EBITDA growth as really a floor. So even with ongoing challenging macro or in your scenario, a potential contraction ongoing, we would still expect pretty significant EBITDA growth in 2024 due to the cost actions that we've already taken.

Simeon Ari Gutman

Analyst, Morgan Stanley & Co. LLC

Thank you, both.

Operator: Your next question comes from the line of Alexandra Steiger from Goldman Sachs. Your line is open.

Alexandra Steiger

Analyst, Goldman Sachs Bank Europe SE (Germany)

Great. Thank you so much. So you've been very clear that reducing headcounts over the past few months have been a driver of efficiency and productivity within the organization. Where are we in that journey? Do you think

there is more room for efficiencies? And when do you think it's actually the right time to start rehiring, grow head count again? And then my second question for Kate. Could you just elaborate a little bit more on your Q1 revenue guide in terms of drivers behind the outlook and the factors that are inside versus outside your control? Thank you.

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

A

Why don't I answer the first part and then I then turn it over to Kate for your second part there. On productivity, efficiency gains, head count size, the way – I think the way to think about it is, we obviously did reduce head count over the last 18 months. But this last time, what we did is we did it with first and foremost an eye to what we thought a very efficient organizational model would be versus a cost savings target or something like that as the initial going-in goal.

And so we think we've set up what will be a very efficient organization. There is some head count we will add to that, but it's modest in the scheme of the head count we have and what it really does is, it lets us really reformulate teams including a lot of the more junior members of those teams, which during the COVID period, we hadn't hired. And so we didn't have as many of those folks on the team as would be make sense from a ratio standpoint. And so with the college hires who will join here, we'll have them there. But that's from like an incremental head count cost standpoint, that's not a big number.

And what we think is that there's a lot of productivity gains to come and that comes from a few different things. One, it comes from – with the organizational model we set up, we think it enables folks to move faster and get more done. We're already seeing early signs of that.

Second, we think then a lot of people are in new roles. So then as they get settled in as they're executing, we think there's compounding gains there. And then the last piece is we've spent a lot over the last couple years on technology transformation and re-platforming our core technology stack. And as we're nearing the later stages of that, we get a lot of gains from when we build feature function on the new technology. It's much faster to build and much more flexible. And those gains will come in the future, but we're nearing that point. So we're quite – we feel quite good about how productivity will continue to compound as we go forward.

Kate S. Gulliver*Chief Financial Officer & Chief Administrative Officer, Wayfair, Inc.*

A

Yeah. So, Alexandra, on your revenue question, a few thoughts there. Obviously, the macro context is the macro context. We don't drive that. But we have been focused for the past 6 quarters on controlling what we can control. And as it pertains to revenue, a key piece of that is the recipe. So price, availability and speed. You've heard Niraj speak to that. That's been driving our share gains and we think we've done a really great job driving gains in what has been a challenging market. As it particularly pertains to this quarter, we're obviously, sitting on this call deep into the quarter at this point. And so I just point you to that as you think about our quarter-to-date number and referencing that is generally what you expect for the quarter.

Alexandra Steiger*Analyst, Goldman Sachs Bank Europe SE (Germany)*

Q

Great. Thank you.

Operator: Your next question comes from the line of Brian Nagel from Oppenheimer. Your line is open.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

Q

Hi, good morning. Thanks as always for all the details. So I have a couple of questions here. I know the first one is going to be a follow-up. Just with regard to that, the guidance – the top line guidance you've given here for Q1, should we interpret that to mean that if you're down mid-single digits, that the backdrop of Wayfair has actually gotten more difficult here. And I recognize there's a lot of seasonality and such. But as we've gone from Q3, Q4 and then into Q1, is it – has the backdrop actually gotten more difficult? And then my follow-up question, unrelated, Kate, thanks for all the details there with respect to the balance sheet. I guess maybe if you could help us understand better. You've obviously repositioned the business extraordinarily well. You have a better year and a better cash position, cash flow position, but how should we think about the timing of some of these actions on the balance sheet?

Niraj S. Shah

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

A

Okay. Great. Brian, why don't I – On your first part of your question, where you talk about is the backdrop getting more difficult. I think, what you're referring to there is, has the macroeconomic climate gotten tougher. I think that's kind of where you're going with that. And we would say, yes, we would say that the macroeconomic climate has gotten tougher. I think that is what – we just read comments from a lot of other retailers that have made public comments. That's what I think you're hearing broadly. We've seen that in the credit card data. And I was at the Vegas furniture market, which I referenced earlier, in January was particularly tough. Now, there was some bad weather in there that was temporal. So things have gotten a little better since. But the market is softer than you would have thought it would be if it was kind of like sequentially just kind of modestly seasonality adjusted flat.

So I'd say the macro has gotten tougher, but I will also point out the macro, the depth of the macro drawdown now is quite significant. So it's kind of like, again, someone – I forget who's note it was, but they referred to like demand bouncing along the bottom. And I'd say that's kind of like generally what we would think it roughly is, but you can't predict the macro. So that's why we focus more on the internal execution, on the recipe. We focus on the internal drivers that we know will let us take share, that will let us outcompete others and do well regardless of what the market size is. And we – just in this quarter, to date, so not the fourth quarter, but the first quarter our market share has continued to climb. So we're still hitting all-time highs. We're continuing – meaning we're climbing – we're hitting new all-time highs.

Kate S. Gulliver

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

A

Yeah. So thank you for the question on capital structure. As you pointed out, we've made significant changes in the profitability and the free cash flow nature of the business. And that broadly gives us optionality around capital structure. So as I said in the prepared remarks, one of those options actually is to pay the [ph] 2025s off (00:35:10) in cash and we think that is a good and viable option.

That said, we're very focused on what is most economically efficient for our shareholders and best for the business. And we intend to be prudent and thoughtful. And so we continue to vet a wide range of options from cash payments, to refinancing, to a combination. With regards to your question on timing, it's worth noting that each quarter that our financial profile continues to improve and our free cash flow generation improves, obviously, the cost of capital for us continues to come down, and so there is some benefit there to the timing as well.

Brian Nagel

Analyst, Oppenheimer & Co., Inc.

Q

Very helpful. I appreciate. Thank you.

Operator: Your next question comes from the line of Anna Andreeva from Needham. Your line is open.

Anna Andreeva

Analyst, Needham & Co. LLC

Apologies. Good morning, guys. Thanks so much.

Kate S. Gulliver

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

Good morning.

Anna Andreeva

Analyst, Needham & Co. LLC

Can you talk about if you're seeing anything different with demand across various household incomes, is it the lower-income consumer that's more pressure so far in 1Q? And also curious on performance of other high-margin brands in a portfolio outside of core Wayfair banner, headed to specialty retail and the Wayfair professional perform that's either in the fourth quarter or so far quarter-to-date? Thank you so much.

Niraj S. Shah

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

Thanks, Anna. So a few thoughts on that. So first, you do see demand get increasingly pressured as you move down the income levels. So, obviously, you would expect that, but we see that in our data, and we also see that in the macro data we get from – particularly some of the banks and credit card companies. So I'd say that trend is pretty clean and pretty obvious. And so I think there's nothing surprising to that though.

And then in terms of our brands, when you talk about our brand and specialty brands, which kind of play above mass and then the luxury platform Perigold, which plays above that, you're seeing that those higher-end ones are doing quite well. And Perigold, I mean the luxury market is much less competitive, but it's growing at very significant rates. And part of that is, it's smaller than Wayfair, but we have small market share everywhere. It's just – that's a relatively young brand for us. It's executing very well. And as we mentioned a minute ago, that higher end market is less pressured. So it's at a much better place, it's growing significant growth rates.

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

Colin Alan Sebastian

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

Thanks and good morning. I appreciate the opportunity. Maybe one quick follow-up on the last question around customer segmentation, I know there's a lot of curiosity around emerging competition in e-commerce from Asia, including expansion of the home category. Is that something that you foresee impacting prices or customer acquisition costs? Or is that more likely limited to the lower end consumer segment?

And then maybe secondly, in the shareholder letter, I was intrigued by some of the comments on logistics around additional services that you're building on top of that infrastructure. And just curious for maybe a little more color on is that adding new revenue opportunity? Or is that more about creating additional efficiency. Obviously, in terms of competitive differentiation, there's some interesting stuff happening there. Thank you.

Niraj S. Shah

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

A

Thanks, Colin. So first on your first part of your question around the customer segmentation, and I think basically, your question is like the growth of Temu and Shein and TikTok shop. And so what role do you see them playing from a competitive standpoint for us.

What I would say is what we've really seen is where they compete is at the very low end of the market, both low-end quality wise and ticket size. And so that's where their volume is, that's what they're known for kind of with customers for. I think that's where you see Amazon obviously lowered their take rate at the low end of certain categories, I think, because it's kind of how the holiday competition there with those folks were. And I think some of the other folks who sell kind of smaller odds and ends, kind of, referencing.

We have not seen them really be a competitor. And we – obviously, we go focus into home. Many people have a home business, the question is what do they really sell in home? What are the subcategories and what tranches of them do they really play in, and that's where you start seeing the Venn Diagram overlaps end up not being necessarily a very large in certain places, and they are much larger in other places.

So we have not seen these folks to be competitors. Also, some of them are very large advertising spenders and we have not seen them really be a player when we look at the share and who our competitive set is in certain of the lower funnel advertising, things like Google PLAs and Google Search or some of these things that are highly targeted and high intent. We don't see them being players there.

And as you go upper funnel, things like display or things like television, these are vast markets where no one competitor or two competitors move that market and you're not necessarily competing with named specific competitors that those markets are more broad. So we haven't seen them be competitors.

Now we obviously watch all our competitors and what they're doing and how things are evolving. But we feel very good about what we've built for differentiation in home around the shopability, around the delivery and logistics, around the set of things that frankly or unless you'd focus in on these bigger bulkier items and the home goods, in particular, that are prone to damage, I don't think you can necessarily tackle those things very easily. So we feel very good about that.

And then to touch on the second part of your question on logistics, and you said, hey, and the shareholder letter talked about logistics for a little bit. And you talked about do these create revenue opportunities or these create cost efficiencies. Well, the answer is they can create both and just one example I'll highlight, which is kind of a service offering that makes a lot of sense for us to provide doesn't make a lot of sense if you don't focus on like our categories very deeply, would be something that's relatively new, but that we've been working on and we'll start to roll out, which is consolidated delivery.

So in consolidated delivery, it allows you, whether you're moving houses or you're doing a renovation or you're an interior designer doing a project for a client, or you want all the items for your bathroom remodel before your contractors show up at a given day or you're helping your son move into an apartment. And you can basically pick a – order of a set of large and small items, pick a date in the future that you want them all to be delivered and they can then be delivered at the same time on that date in the future.

So from a customer standpoint, you can see how in certain use cases, that's incredibly convenient. It would be very helpful for the customer for that to happen. And so you can imagine then the customer would be inclined to buy more of those items for that use case or that project from you, because it's going to be easier. They'll all come

together at the same time. And so maybe you wouldn't have bought that coffee maker from us, but if it's going to be one of the many items you want it delivered at the same time, you might as well just buy it from us instead of buying it somewhere else, even though it's more of a commodity item or what have you.

So you can see that growing revenue. But then from a cost efficiency standpoint, as you can imagine, delivering things one at a time is less efficient than delivering a lot of things all at once. And so when you have a logistics network where we have fulfillment centers, we're picking up from suppliers. We have over-the-road transportation, moving goods down the chain towards where they're going to be delivered from, we have the delivery terminals; given that we have that infrastructure, you can then with software, which you have to build, which is complicated. But as you have that, you can actually lower your cost of delivery, while improving the customer experience and growing revenue.

So you get these combination effects. I picked one that happens to just be the easier one to explain. There's a lot of other benefits in the various things we're doing. So we think the logistics runway is a real one. It's significant, and it still has a lot of room for us to build kind of good customer experiences there.

Colin Alan Sebastian

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

Great. Thanks, Niraj.

Q

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

Christopher Horvers

Analyst, JPMorgan Securities LLC

Thanks. Good morning everybody. So as you think about – a couple of questions. So first, as you think about the flat scenario and \$600 million plus of EBITDA, can you help us think about how that plays out down the P&L? Would you expect gross margin to expand in that scenario? If you go back to the Analyst Day, a lot of the long-term margin potential is in the gross margin line or is it simply more weighted to the lower cost on the SOTG&A line? Thanks.

Q

Kate S. Gulliver

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

Yeah. Hey Chris, good morning, it's Kate. I'll start with that. So it really is more of the cost takeout that we took out in January and seeing that flow through. So I would think about gross margin staying in that 30% to 31% range, which is where we've guided to and obviously where we averaged for 2023. Where you're going to see the cost savings from January on the P&L that was actually in two places. One is on the customer service and merchant fees. We said of the \$280 million total takeout, and again, that was net, so that included the hiring back. But of the \$280 million total takeout, \$150 million would hit down to the adjusted EBITDA line, of that \$25 million was in that customer service and merchant fee line. And so when I guided, I said that would come in a little bit more going forward and then \$125 million of that was on that SOTG&A line. You actually saw that in the guide. If you take the Q4 SOTG&A number and the midpoint of the guide, you'll see that \$125 million savings there. So really, where you see the pickups are on customer service and merchant fees and on SOTG&A, gross margin, [ph] AC&R (00:45:18) stay about where they average in 2023 for that hypothetical \$600 million on a flat revenue scenario.

A

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

And is that because the long-term gross margin initiatives are more sales dependent versus an opportunity to continue to take cost out. And just as a quick second follow-up, the worst case, plus 50% EBITDA in 2024. Is that – does that assume that the current trend of the business that's down mid-single digit sticks to the rest of the year? Thank you.

Kate S. Gulliver

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

A

So let me answer the first part of your question first on the gross margin [ph] savings. (00:45:59) So first, we remain very confident in the gross margin opportunities. Obviously, we've talked about getting – in our Analyst Day, we talked about getting to 35 plus on gross margin. That, of course remains, what we were trying to provide in that \$600 million is the framework on that flat revenue scenario, just from the cost savings for this year, how you could see that flow through. We continue to see ongoing operating efficiency in that gross margin line. And we always make the trade-off of, do we pass that through to the customer or do we pocket that. And as we've spoken about in the past, that's an ongoing discussion around what is going to be optimal on a multi-quarter basis. And you obviously saw us reinvest some of that in the fourth quarter of this year. So, although an opportunity there, nothing has changed in our longer-term plan, and we expect to see that to continue to pan out.

On your question around the 50% adjusted EBITDA growth, I would think about that as a floor that we're trying to set. So the top line scenario, we're obviously not guiding to the top line, but we wanted to help folks see the opportunity that we have on adjusted EBITDA, somewhat irrespective of the macro conditions, based on all these cost efforts and the levers that we have at our disposal. You and I actually just talked about two of them. So one would be the hiring in the SOTG&A. That includes some hiring back throughout the year that can be metered as necessary depending on the macro and the other one on that gross margin line, we of course always have ongoing operating and cost efficiency there that we're pushing on, and we can choose to pass that through or to pocket that. And that gives us some optionality and it's why we feel comfortable saying that we can have that substantial adjusted EBITDA growth, irrespective of where the top line goes.

Christopher Horvers

Analyst, JPMorgan Securities LLC

Q

Thanks very much.

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

Steven Forbes

Analyst, Guggenheim Securities LLC

Q

Good morning. Niraj, I wanted to maybe expand on your curation comments in the letter, especially as we think about sort of how the assortment right, or the vendor base can change or house brand penetration can change over the coming years. And then maybe if you can sort of weave in how the curation strategy could or does sort of marry together with like any mitigation strategy around tariffs.

Niraj S. Shah

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

A

Great, Steven. So what I would say is the curation strategy, which is about really building up the – talk about the house brands and the specialty retail brands, but building up the selection in those with great items that we know customers will be thrilled with once they open the item and get it in their house and set it up and putting that kind of stamp of approval on it.

Obviously, make sure it's very well priced. The logistics are under optimized. We think we can keep building that up and adding that value to that curation. So we think what we've done so far is just the beginning of that. Now what I would say is, obviously, we then are very thoughtful about which suppliers we're working with for those items, like where are we taking these items from. So we're picking these from items who we know – from suppliers that we know are reliable and ones that we can work with well and who we have a tight relationship with.

Obviously, that then we could take many things into account. And obviously, like where items are produced due to the tariffs question really is about source of production. The category I would point to that's had a lot of tariff complexity over the last couple of years is mattresses. And there's been multiple rounds where mattress sort of different countries have been assigned, different kind of penalties associated with tariffs, which has really inhibited production in different places. And we've obviously been very cognizant to make sure that we have production that lets us have the quality items we want at the prices that make sense and making sure that we maintain availability that we're not out of stock and chasing it.

So that's the type of thing that we think about as we're building our assortment in mattresses, our assortment is under brands like Nora or Wayfair Sleep. And then obviously, we work with branded folks as well. So hopefully, that answers your question in terms of how we think about it in the kind of the context of geographic location and supplier selection is part of how we think about it.

Steven Forbes

Analyst, Guggenheim Securities LLC

Q

Thank you. And maybe just a quick follow-up for you, Kate. The comments around sort of your ability to pull back on maybe the reinvestment plans for the back half, anyway to help us contextualize the spread between gross and net? Should we look at the first quarter SOTG&A guidance compared to the fourth quarter and assume that's like two-thirds of the benefit? Or any help on sort of just framing where the second quarter SOTG&A number sort of troughs?

Kate S. Gulliver

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

A

Yeah. So I guess I would help you with this. On the SOTG&A, if you pick the midpoint of that guide for Q1 and compare that to where the fourth quarter landed, you see the \$125 million of net savings [indiscernible] (00:51:00), right? And so within that first quarter, you obviously had a month of comp for folks that exited in that quarter and not sort of offsetting what we said would be some of the hiring back. You actually end up at that net number in the first quarter, and that should stay based on the hiring plan, that should stay relatively constant throughout the year.

Now, as I said, sure, it's a lever for us if we had to pull and you could see us pull that lever dependent on the macro. But it's important to note that we think these hires made sense. It's part of rebuilding the pyramid structure that we think is appropriate for the ongoing growth and execution of the business.

Niraj referenced some of the campus hires and how those flow in and the benefit there. But generally, the Q1 guide, you think about that as a sort of good point on SOTG&A throughout the year based on the current hiring plan.

Steven Forbes

Analyst, Guggenheim Securities LLC

Q

Thank you.

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

Oliver Wintermantel

Analyst, Evercore Group LLC

Yes, hi guys. I had a question, Niraj, you mentioned three things that you're excited about in 2024. One was the new campaign in March and then the loyalty program. Maybe if you could spend a couple minutes on explaining what that entails?

Niraj S. Shah

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

Sure. Yes, so yeah, I mentioned three things I was excited about. One was the launch of the first Wayfair retail store and which opens in May, just north of Chicago in Wilmette. Another one was the new marketing campaign for Wayfair, which debuts in mid-March. So, that that's a campaign that obviously the most notable place you'll see it on is in television, but it's really carried through all the different channels. We're really excited about it. You'll see it very shortly.

But the whole goal is to continue to build brand loyalty for Wayfair and tell the story to make sure customers really understand the breadth and depth of what we offer and why Wayfair should be the place to go to for all things home. And so we think that this campaign can further that depth of understanding and continue to kind of build a real understanding and ultimately preference for what we offer.

And the third one, which you're asking about is the tender-neutral loyalty program. And the tender-neutral loyalty program, the way to think about it today, what we have for a loyalty program, all the benefits of the loyalty program are associated with having a Wayfair credit card.

So, you have to get a Wayfair credit card, either the Mastercard that's co-branded with Citibank or just the Wayfair-specific store-based credit card. And then there's different rewards benefits that are associated with that.

But we don't have a broad-based loyalty program that works regardless of how you choose to pay. And we think that there's a real opportunity for that, which could also help us not just provide customers with enhanced benefits, but help make us the more top of mind place for all things home. It creates significant incremental revenue and drive significant profit.

So, we're going to launch that later this year. We've internally figured out the framework of what that is, but we need to build the technology to support it and the marketing plans for it and to roll it out. So that's coming.

But the reason I referred to it is we know that customers love us and we think; A, there's an opportunity to deepen their understanding of what we do. That's where the marketing campaign comes in. And we also think there's a lot of things we can do to just cause them to come to us far more often. And that's where the tender-neutral loyalty program plays a big role.

Oliver Wintermantel

Analyst, Evercore Group LLC

Got it. Thanks very much. Good luck.

Niraj S. Shah

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

Thank you.

A

Operator: Your final question comes from the line of Curtis Nagle from Bank of America. Your line is open.

Curtis Nagle

Analyst, BofA Securities, Inc.

Good morning. Thanks for taking the question. Kate, just if you go back to 1Q and the guidance, just curious if you would go through kind of the range of outcomes within the mid-single – sorry, the low single-digit EBITDA, how much is that based on the ranging of the gross margin? How much of that is revenue, right? I think anticipation is it continues into low singles. So – mid-single, so if that got better, what would that mean? But just walking through kind of the most important or the biggest things that could drive variability within that low single would be really helpful.

Q

Kate S. Gulliver

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

Yeah. So, Curtis, obviously, we're somewhat unique about the first quarter. We're guiding somewhat seven weeks into the quarter. We said the trend on revenue is quarter-to-date that negative mid-singles. Obviously, if trend on revenue improves, certainly, you see more flow through, right? And that could be a variability on the bottom line. But generally speaking, that's what we've seen so far quarter-to-date. We've maintained that 30% to 31% guidance range on gross margin.

A

You've seen that hit – us hit that very consistently over the last several quarters. And then obviously, on the [ph] AC&R (00:55:58) and the ad spend, that'd be another line that you've seen us bring that into that 11.5%, 12.5% very consistently over the last several quarters, those being two of the more somewhat variable pieces there. Certainly, if revenue were to accelerate from here, would you see more flow through to that low single-digit number? Absolutely. But I'd again point you to the fact that we're in the third week of February, we're into the quarter and we see negative mid-singles at this current time.

Curtis Nagle

Analyst, BofA Securities, Inc.

Okay. Make sense. And then just a quick follow-up on the AOV. It sounds like it was impacted and certainly more than you expected from, I think, you said mix. But could we just dig a little bit more into what changed – drove the radical change? Was it anything you did or anything like as a customer perspective?

Q

Niraj S. Shah

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

Yes. So I think the thing about AOV, I think what I was trying to describe is actually the real phenomenon AOV over the last 1.5 years has actually been that all the ocean freight inflation then reversed and have come back out. And as that's come back out, you've seen AOV drop. That's been the primary driver of AOV, but then as you start anniversary-ing where it drops.

A

So in other words, it started dropping in the fourth quarter of 2022, the subsequent drop to the following year is not going to be as high because a lot of the drop had already happened, right? And so we're just in the latter

stages of anniversary-ing that deflation coming out. So over the next couple quarters, that – all that deflation will come out a year ago, and so that AOV will not really be moving for that reason anymore.

And what I was trying to say is that AOV can move for many reasons, right? It can move for mix of our brands. It can move for category mix. It can move for mix due to seasonality. And those are primarily the things that move AOV. It's just that the phenomenon over the last year where it's come down a lot, is due to the deflation and we're nearing the end of that. And so you should expect AOV to not necessarily drop as much because we're now finishing the anniversary-ing of that AOV. So that was more just kind of the question I was trying to answer earlier.

Curtis Nagle

Analyst, BofA Securities, Inc.

Okay. Got it. Thanks very much.

Niraj S. Shah

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

Thanks. And so I just want to thank everybody for joining on the call. One more plug, just to encourage you to read our shareholder letter, which is on our Investor Relations website, which we think you'll enjoy. And obviously, we think we're poised for really great things both in the tough macro, while we can take share. And then as things recover, obviously, significant EBITDA gains to come this year regardless of the environment. And we're seeing great customer success. So thank you very much for your interest in Wayfair.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect.

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