Wayfair Inc.
Form 10-Q
May 09, 2016
Table of Contents

## UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

## QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF X 1934

For the quarterly period ended March 31, 2016
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF ${ }^{\circ} 1934$

For the transition period from to
Commission File Number: 001-36666

Wayfair Inc.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

36-4791999
(I.R.S. Employer

Identification Number)

4 Copley Place, 7th Floor, Boston, MA 02116
(Address of principal executive offices) (Zip Code)
(617) 532-6100
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T ( $\$ 232.405$ of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

## Edgar Filing: Wayfair Inc. - Form 10-Q

company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer x
Accelerated filer o
Non-accelerated filer o
(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Class
Outstanding at
Class A Common Stock, $\$ 0.001$ par value per share
Class B Common Stock, $\$ 0.001$ par value per share

April 30, 2016
47,291,156
37,423,591

## Table of Contents

WAYFAIR INC.
INDEX TO QUARTERLY REPORT ON FORM 10-Q
For the Quarterly Period Ended March 31, 2016
Page

## PART 1. FINANCIAL INFORMATION

Item 1. Unaudited Consolidated and Condensed Financial Statements
Consolidated and Condensed Balance Sheets as of March 31, 2016 and December 31, $2015 \underline{3}$
Consolidated and Condensed Statements of Operations for the Three Months Ended March 31. 2016
$\underline{\text { and } 2015}$
Consolidated and Condensed Statements of Comprehensive Loss for the Three Months Ended March
$\underline{\mathbf{3 1}} 2016$ and 2015
Consolidated and Condensed Statements of Cash Flows for the Three Months Ended March 31, $2016 \underline{6}$
$\underline{\text { and } 2015}$
Notes to the Unaudited Consolidated and Condensed Financial Statements $\quad 7$
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 17
Item 3. Quantitative and Qualitative Disclosures About Market Risk $\underline{27}$
Item 4. Controls and Procedures $\underline{8}$
PART 2. OTHER INFORMATION
Item 1. Legal Proceedings $\underline{29}$
Item 1A. Risk Factors $\underline{29}$
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds $\underline{29}$
Item 6. Exhibits $\underline{11}$
Signatures $\underline{32}$
1

## Table of Contents

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. All statements other than statements of historical fact contained in this Quarterly Report on Form 10-Q, including statements regarding our future results of operations and financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements.
In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "expects," "plans," "anticipates," "could," "intends," "target," "projects," "contemplates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other similar expressions. The forward-looking statements in this Quarterly Report on Form 10-Q are only predictions. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition and results of operations. These forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q and are subject to a number of risks, uncertainties and assumptions described in Part II, Item 1A, Risk Factors and elsewhere in this Quarterly Report on Form 10-Q. Because forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, you should not rely on these forward-looking statements as predictions of future events. The events and circumstances reflected in our forward-looking statements may not be achieved or occur and actual results could differ materially from those projected in the forward-looking statements. Except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements contained herein, whether as a result of any new information, future events or otherwise.

## Table of Contents

WAYFAIR INC.
CONSOLIDATED AND CONDENSED BALANCE SHEETS
(In thousands, except share and per share data)
(Unaudited)

|  | $\begin{aligned} & \text { March 31, } \\ & 2016 \end{aligned}$ | $\begin{aligned} & \text { December } \\ & 31, \\ & 2015 \end{aligned}$ |
| :---: | :---: | :---: |
| Assets |  |  |
| Current assets |  |  |
| Cash and cash equivalents | \$248,798 | \$334,176 |
| Short-term investments | 60,656 | 51,895 |
| Accounts receivable, net of allowance of \$3,091 and \$2,767 at March 31, 2016 and December 31,2015 , respectively | 11,854 | 9,906 |
| Inventories | 17,763 | 19,900 |
| Prepaid expenses and other current assets | 85,170 | 76,446 |
| Total current assets | 424,241 | 492,323 |
| Property and equipment, net | 162,594 | 112,325 |
| Goodwill and intangible assets, net | 3,505 | 3,702 |
| Long-term investments | 70,315 | 79,883 |
| Other noncurrent assets | 6,772 | 6,348 |
| Total assets | \$667,427 | \$694,581 |
| Liabilities and Stockholders' Equity |  |  |
| Current liabilities |  |  |
| Accounts payable | \$251,023 | \$270,913 |
| Accrued expenses | 60,600 | 51,560 |
| Deferred revenue | 48,691 | 50,884 |
| Other current liabilities | 27,813 | 23,669 |
| Total current liabilities | 388,127 | 397,026 |
| Other liabilities | 74,294 | 55,010 |
| Total liabilities | 462,421 | 452,036 |
| Commitments and contingencies (Note 6) |  |  |
| Convertible preferred stock, $\$ 0.001$ par value per share: $10,000,000$ shares authorized and none issued at March 31, 2016 and December 31, 2015 | - | - |
| Stockholders' equity: |  |  |
| Class A common stock, par value $\$ 0.001$ per share, $500,000,000$ shares authorized, $46,966,564$ and $45,814,237$ shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively | 47 | 46 |
| Class B common stock, par value $\$ 0.001$ per share, $164,000,000$ shares authorized, 37,664,049 and 38,496,562 shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively | 38 | 38 |
| Additional paid-in capital | 381,663 | 378,162 |
| Accumulated deficit | (176,770) | )(135,565 ) |
| Accumulated other comprehensive loss | 28 | (136 |
| Total stockholders' equity | 205,006 | 242,545 |
| Total liabilities and stockholders' equity | \$667,427 | \$694,581 |

The accompanying notes are an integral part of these Unaudited Consolidated and Condensed Financial Statements.

## Table of Contents

WAYFAIR INC.
CONSOLIDATED AND CONDENSED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)
$\left.\begin{array}{lll} & \begin{array}{l}\text { Three months ended } \\ \text { March } 31,\end{array} \\ & 2016 & 2015 \\ \text { Net revenue } & \$ 747,348 & \$ 424,371 \\ \text { Cost of goods sold } & 568,292 & 321,536 \\ \text { Gross profit } & 179,056 & 102,835 \\ \text { Operating expenses: } & 27,350 & 15,978 \\ \text { Customer service and merchant fees } & 97,677 & 57,999 \\ \text { Advertising } & 37,856 & 23,234 \\ \text { Merchandising, marketing and sales } & 58,282 & 32,870 \\ \text { Operations, technology, general and administrative } & 221,165 & 130,081 \\ \text { Total operating expenses } & (42,109 & (27,246) \\ \text { Loss from operations } & 552 & 264 \\ \text { Interest income, net } & 669 & (108 \\ \text { Other income (expense), net } & (40,888 & )(27,090 \\ \text { Loss before income taxes } & 317 & 46 \\ \text { Provision for income taxes } & \$(41,205) & \$(27,136) \\ \text { Net loss } & \$(0.49 & \$(0.33\end{array}\right)$

The accompanying notes are an integral part of these Unaudited Consolidated and Condensed Financial Statements.

4

## Table of Contents

WAYFAIR INC.
CONSOLIDATED AND CONDENSED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

Net loss
Three months ended
March 31,
20162015
Other comprehensive loss:
Foreign currency translation adjustments
(333 ) 144
Net unrealized gain on available-for-sale investments $497 \quad 46$
Comprehensive loss
$\$(41,041) \$(26,946)$
The accompanying notes are an integral part of these Unaudited Consolidated and Condensed Financial Statements.

5

## Table of Contents

WAYFAIR INC.
CONSOLIDATED AND CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)


Supplemental disclosure of non-cash investing activities
Purchase of property and equipment included in accounts payable and accrued expenses and in other liabilities
\$19,186 \$5,988
Construction costs capitalized under finance lease obligations
\$13,077 \$9,900
The accompanying notes are an integral part of these Unaudited Consolidated and Condensed Financial Statements.

## Table of Contents

Notes to Consolidated and Condensed Financial Statements (Unaudited)

## 1. Basis of Presentation

Wayfair Inc. (the "Company") is an e-commerce business offering visually inspiring browsing, compelling merchandising, easy product discovery and attractive prices for over seven million products from over 7,000 suppliers across five distinct brands-Wayfair.com, Joss \& Main, AllModern, DwellStudio, and Birch Lane. In addition to generating net revenue through Direct Retail sales, which includes all sales generated primarily through the Company's websites, mobile optimized websites, and mobile applications ("sites"), net revenue is also generated through sites operated by third parties and through third party advertising distribution providers that pay the Company based on the number of advertisement related clicks, actions, or impressions for advertisements placed on the Company's sites.
The consolidated and condensed financial statements and other disclosures contained in this Quarterly Report on Form 10-Q are those of the Company. The consolidated and condensed balance sheet data as of December 31, 2015 was derived from audited financial statements. The accompanying consolidated and condensed balance sheet as of March 31, 2016, the consolidated statements of operations, consolidated statements of comprehensive loss, and consolidated statements of cash flows for the periods ended March 31, 2016 and 2015 are unaudited. The unaudited interim financial statements have been prepared on the same basis as the audited consolidated financial statements and in the opinion of management, reflect all adjustments, consisting of only normal recurring adjustments, necessary for the fair statement of the Company's financial position as of March 31, 2016 and statements of operations, comprehensive loss, and cash flows for the periods ended March 31, 2016 and 2015. The financial data and the other information disclosed in these notes to the consolidated and condensed financial statements related to these periods are unaudited.
The consolidated and condensed statements of operations, comprehensive loss, and cash flows for the period ended March 31, 2016 are not necessarily indicative of the results of operations and cash flows that may be expected for the year ending December 31, 2016, or for any other period.
2. Summary of Significant Accounting Policies

The Company has identified the significant accounting policies that are critical to understanding its business and results of operations. The Company believes that there have been no significant changes during the three months ended March 31, 2016 to the items disclosed in Note 2, Summary of Significant Accounting Policies, in the Notes to the Consolidated Financial Statements included in Part II, Item 8, Financial Statements and Supplementary Data, of the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

## 3. Marketable Securities and Fair Value Measurements

## Marketable Securities

As of March 31, 2016 and December 31, 2015, all of the Company's marketable securities were classified as available-for-sale and their estimated fair values were $\$ 96.0$ million and $\$ 96.8$ million, respectively. We periodically review our available-for-sale securities for other-than-temporary impairment. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and our intent to sell. During the three months ended March 31, 2016 and 2015, we did not recognize any other-than-temporary impairment loss. The maturities of the Company's long-term marketable securities generally range from one to three years.

## Table of Contents

The following tables present details of the Company's marketable securities as of March 31, 2016 and December 31, 2015 (in thousands):

March 31, 2016

|  | Gross | Gross | Estimated |
| :--- | :--- | :--- | :--- |
| Amortize |  |  |  |
| Cost | Unrealized | Unrealized | Esiair Value |

Short-term:
Investment securities $\$ 25,646$ \$ 15 (5 ) \$ 25,656
Long-term:
Investment securities 70,130 220 (35 ) 70,315
Total $\$ 95,776 \$ 235 \quad \$(40 \quad) \$ 95,971$
December 31, 2015
$\begin{array}{llll} & \text { Gross } & \text { Gross } & \text { Estimated } \\ \text { Amortize } \\ \text { Cost } & \text { Gnrealized } & \text { Unrealized } & \text { Esins } \\ & \text { Gains } & \text { Losses } & \end{array}$
Short-term:
Investment securities $\$ 16,908$ \$ $\quad$ (13 ) \$ 16,895
Long-term:
Investment securities 80,1722 (291 ) 79,883
Total $\$ 97,080 \$ 2$ \$ (304 ) \$ 96,778
Fair Value Measurements
The Company's financial assets and liabilities are measured at fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The three levels of inputs used to measure fair value are as follows:
Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities
Level 2-Unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable or can be corroborated by observable market data for substantially the full-term of the asset or liability Level 3-Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liability
This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. The Company measures its cash equivalents and short-term and long-term investments at fair value. The Company classifies its cash equivalents and restricted cash within Level 1 because the Company values these investments using quoted market prices. The fair value of the Company's Level 1 financial assets is based on quoted market prices of the identical underlying security. The Company classifies short-term and long-term investments within Level 2 because unadjusted quoted prices for identical or similar assets in markets are not active. The Company does not have any assets or liabilities classified as Level 3 financial assets.

## Table of Contents

The following tables set forth the fair value of the Company's financial assets measured at fair value on a recurring basis as of March 31, 2016 and December 31, 2015 based on the three-tier value hierarchy (in thousands):

March 31, 2016
Level 1 Level 2 Level 3 Total
Cash equivalents:
Money market funds $\quad \$ 165,476 \$-\quad \$ \quad \$ 165,476$
Short-term investments:
Certificates of deposit 35,000 - $\quad$ - 35,000
Investment securities - 25,656 - 25,656
Restricted cash:
Certificate of deposit 5,000 - - 5,000
Long-term:
Investment securities - 70,315 - 70,315
Total
\$205,476 \$95,971 \$ \$301,447
December 31, 2015
Level 1 Level 2 Level 3 Total
Cash equivalents:
Money market funds $\quad \$ 267,300 \$-\quad \$ \quad \$ 267,300$
Short-term investments:
Certificates of deposit $35,000 \quad-\quad$ - 35,000
Investment securities - 16,895 - 16,895
Restricted cash:
Certificate of deposit $5,000 \quad$ - $\quad$ - 5,000
Long-term:
Investment securities - 79,883 - 79,883
Total $\$ 307,300 \$ 96,778 \$ \$ 404,078$
4. Intangible Assets and Goodwill

The following table summarizes intangible assets as of March 31, 2016 and December 31, 2015 (in thousands):
Weighted - Average Amortization
Period (Years)

Trademarks 5
Customer relationships 5
Non-compete agreements 3-5
Other intangibles 3
Domain names 5
Total
March 31, 2016
Gross Catcyingulated
AmountAmortization Book Value
\$1,900 \$ (1,014 ) \$ 886
1,300 (693 ) 607
100 (89) 11
373 (298) 75
2,687 (2,685 ) 2
\$6,360 \$ (4,779 ) \$ 1,581

9

## Table of Contents

|  | Weighted-Average <br>  <br>  <br> Amortization | December 31, 2015 <br> Gross Catcyingulated |
| :--- | :--- | :--- | :--- | :--- |
|  | Period (Years) |  | Net Book Value | AmountAmortization |
| :--- |

Amortization expense related to intangible assets was $\$ 0.2$ million and $\$ 0.3$ million for the three months ended March 31, 2016 and 2015, respectively.
Goodwill as of March 31, 2016 was $\$ 1.9$ million, unchanged from December 31, 2015.
5. Property and Equipment, net

The following table summarizes property and equipment, net as of March 31, 2016 and December 31, 2015 (in thousands):
$\left.\begin{array}{lll} & \begin{array}{l}\text { March 31 }\end{array} & \begin{array}{l}\text { December } \\ 31, \\ \\ \text { Furniture and computer equipment }\end{array} \\ \hline \text { 2016 } & 2015 \\ \text { Site and software development costs } & \$ 78,617 & \$ 68,416 \\ \text { Leasehold improvements } & 55,311 & 50,907 \\ \text { Construction in progress } & 30,751 & 29,315 \\ & 70,646 & 27,563 \\ \text { Less accumulated depreciation and amortization } & 235,325 & 176,201 \\ \text { Property and equipment, net } & \$ 1621 & )(63,876\end{array}\right)$

Property and equipment depreciation and amortization expense was $\$ 10.3$ million and $\$ 6.5$ million for the three months ended March 31, 2016 and 2015, respectively.
6. Commitments and Contingencies

Leases
The Company leases office and warehouse spaces under non-cancelable leases. These leases expire at various dates through 2027 and include discounted rental periods and fixed escalation clauses, which are amortized straight-line over the terms of the lease. Rent expense under operating leases was $\$ 7.1$ million and $\$ 4.1$ million in the three months ended March 31, 2016 and 2015, respectively. The Company has issued letters of credit for approximately $\$ 7.0$ million and $\$ 5.9$ million as security for these lease agreements as of March 31, 2016 and December 31, 2015, respectively. The Company has entered into additional leases throughout the United States ("U.S.") and Europe subsequent to December 31, 2015, where the future minimum rental commitments under non-cancelable leases with initial or remaining terms in excess of one year are $\$ 216.7$ million in the aggregate.
Collection of Sales or Other Similar Taxes
Based on the location of the Company's current operations, it collects and remits sales tax in Kentucky, Massachusetts, New York, Utah, California, Illinois, and Texas, and subsequent to March 31, 2016, New Jersey. The Company does not currently collect sales or other similar taxes for the sale of goods in states where no obligation to collect these taxes is required under applicable law. Several states have presented the Company with assessments, alleging that it is required to collect and remit sales or other similar taxes. The aggregate amount of claims from these states, not including taxes allegedly owed for periods subsequent to such assessments or interest and penalties after the date the Company last received such assessments, is approximately $\$ 12.9$ million. The Company does not believe that it was obligated to collect and remit such taxes, and intends to vigorously defend its position. At this time, the Company believes a loss is not probable and therefore has not recorded a liability; however, no assurance can be given as to the outcome of these assessments.

## Table of Contents

Legal Matters
On September 2, 2015, a putative class action complaint was filed against the Company in the U.S. District Court for the Southern District of New York (Dingee v. Wayfair Inc., et al., Case No. 1:15-cv-06941) by an individual on behalf of himself and on behalf of all other similarly situated individuals, (or collectively, the "Dingee Plaintiffs"), under sections 10(b) and 20(a) of the Exchange Act related to a drop in stock price that had followed a report issued by Citron Research. On September 3, 2015 a second putative class action complaint was filed, asserting nearly identical claims (Jenkins v. Wayfair Inc., et al., Case No. 1:15-cv-06985). On November 2, 2015, the plaintiff in the Dingee action moved to consolidate the two lawsuits, and to designate himself as lead plaintiff in the class action and his attorney as lead counsel for the class. On November 3, 2015 plaintiff in the Jenkins action voluntarily dismissed his complaint. As a result, only the Dingee action remains pending. On November 13, 2015, the Court appointed Dingee as lead plaintiff. On January 11, 2016, Dingee filed an amended complaint along with a second named plaintiff, Michael Lamp. The Dingee Plaintiff's complaint seeks class certification, damages in an unspecified amount, and attorney's fees and costs. We have moved to dismiss the case; briefing on the motion to dismiss was completed on April 1, 2016 and the parties are awaiting a decision. The Company believes a loss is not probable and intends to defend the lawsuit vigorously.
On February 2, 2016, a putative class action complaint was filed against the Company in the U.S. District Court for the Central District of California (Carson, et al., v. Wayfair Inc., Case No. 2:16-cv-00716) by two individuals on behalf of themselves and on behalf of all other similarly situated individuals (collectively, the "Carson Plaintiffs"). The complaint alleges that Wayfair engaged in a deceptive marketing campaign in which the Company advertised certain "original" or "regular" retail prices, which the Carson Plaintiffs allege were false. The Carson Plaintiffs' complaint seeks injunctive relief, attorney's fees, punitive damages and damages. The Company believes a loss is not probable and intends to defend the lawsuit vigorously.
The Company is subject to legal proceedings and claims in the ordinary course of business. However, the Company is not currently aware of any legal proceedings or claims that it believes will have, individually or in the aggregate, a material adverse effect on the Company's financial position, results of operations or cash flows.
7. Equity-Based Compensation

In 2010, the Company established an equity incentive plan and, in 2011, the plan was amended and restated as the Wayfair LLC Amended and Restated 2010 Common Unit Plan (the "2010 Plan"). The 2010 Plan was administered by the board of directors of Wayfair LLC and provided for the issuance of common option units, restricted common units (all common units), and deferred units, which currently represent Class A or Class B common stock of the Company. In connection with the IPO, the board of directors of the Company adopted the 2014 Incentive Award Plan ("2014 Plan") to grant cash and equity incentive awards to eligible service providers in order to attract, motivate and retain the talent for which the Company competes. The 2014 Plan is administered by the board of directors of the Company with respect to awards to non-employee directors and by the compensation committee with respect to other participants and provides for the issuance of stock options, SARs, restricted stock, RSUs, performance shares, stock payments, cash payments, dividend awards and other incentives. The 2014 Plan authorizes up to $8,603,066$ shares of Class A common stock to be issued, of which RSUs for 4,192,719 shares had been issued as of March 31, 2016. Shares or RSUs forfeited, withheld for minimum statutory tax obligations, and unexercised stock option lapses from the 2010 and 2014 Plans are available for grants of awards under the 2014 Plan. In addition, on the first day of each calendar year beginning January 1, 2016 and ending on and including January 1, 2024, the shares available for future grant are increased in accordance with the 2014 Plan.

## Table of Contents

The following table presents activity relating to stock options for the three months ended March 31, 2016:
Weighted-
Weighted- Average
Shares Average Exercise Remaining
Price Contractual
Term (Years)
Outstanding at December 31, 2015
Options exercised
Outstanding at March 31, 2016
Exercisable at March 31, 2016
Expected to vest as of March 31, $2016 \quad 133 \quad \$ \quad 3.42 \quad 5.2$
Intrinsic value of stock options exercised was $\$ 0.7$ million for the three months ended March 31, 2016. Aggregate intrinsic value of stock options outstanding and currently exercisable is $\$ 10.6$ million. Unrecognized equity based compensation expense related to stock options expected to vest is less than $\$ 0.1$ million with a weighted average remaining vesting term of 0.3 years as of March 31, 2016.
The following table presents activity relating to restricted common stock for the three months ended March 31, 2016:
Weighted-
Shares Average Grant
Date Fair Value
Outstanding at December 31, $2015 \quad 1,993 \quad \$ 4.75$
Restricted stock vested $(1,993) \$ 4.75$
Unvested at March 31, 2016 - \$ -
Expected to vest as of March 31, 2016 - \$ -
The intrinsic value of restricted common stock vested was less than $\$ 0.1$ million for the three months ended
March 31, 2016. All restricted common stock shares were fully vested at March 31, 2016.
The following table presents activity relating to RSUs for the three months ended March 31, 2016:
Weighted-
Shares Average Grant
Date Fair Value
Outstanding at December 31, 2015
RSUs granted
RSUs vested
RSUs forfeited/canceled
Outstanding at March 31, 2016
Expected to vest as of March 31, 2016 4,562,931 \$ 31.35
The intrinsic value of RSUs vested was $\$ 19.5$ million for the three months ended March 31, 2016. Aggregate intrinsic value of RSUs outstanding is $\$ 266.7$ million as of March 31, 2016. Unrecognized equity based compensation expense related to RSUs expected to vest is $\$ 115.3$ million with a weighted average remaining vesting term of 1.7 years as of March 31, 2016.
8. Segment and Geographic Information

Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated on a regular basis by the Chief Operating Decision Maker ("CODM") in deciding how to allocate resources to an individual segment and in assessing performance. The Company's CODM is its Chief Executive Officer.
The CODM reviews financial information presented on a consolidated basis for purposes of making operating decisions, allocating resources and evaluating financial performance. As a result, the Company identified that it has one operating and reportable segment.

## Table of Contents

The following table presents the activity related to the Company's net revenue from Direct Retail sales derived through the Company's sites and Other sales derived through sites operated by third parties and fees from third-party advertising distribution providers (in thousands):

Three months ended
March 31,
20162015
Net revenue
Direct Retail \$711,846 \$369,396
Other 35,502 54,975
Net revenue \$747,348 \$424,371
Revenue from external customers for each group of similar products and services are not reported to the CODM.
Separate identification of this information for purposes of segment disclosure is impractical, as it is not readily available and the cost to develop it would be excessive. No individual country outside of the United States provided greater than $10 \%$ of total revenue.
The following table presents revenue and long-lived assets by geographic area (in thousands):
Three months ended
March 31, 20162015
Geographic net revenue:
United States $\quad \$ 705,921 \$ 400,580$
International (1) $\quad 41,427 \quad 23,791$
Total $\quad \$ 747,348$ \$424,371
(1) In the three months ended March 31, 2015, international net revenue included $\$ 2.5$ million from our Australian business, which we sold in July 2015.

| March | December |
| :--- | :--- |
| 31, | 31, |
| 2016 | 2015 |

Geographic long-lived assets:
United States $\quad \$ 159,038 \$ 110,042$
International 3,556 2,283
Total
\$162,594 \$112,325
9. Income Taxes

For the three months ended March 31, 2016 and 2015, income tax expense of $\$ 0.3$ million and less than $\$ 0.1$ million was recorded, respectively. The income tax expense recorded in the three months ended March 31, 2016 and 2015 is primarily related to various foreign income tax assessments, state income taxes and to a lesser extent the amortization of goodwill for tax purposes for which there is no corresponding book deduction.
Deferred income taxes reflect the impact of temporary differences between the amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. The Company has deferred tax assets related to its net operating loss carryforwards accumulated since the fourth quarter of 2014 and related to net operating loss carryforwards of certain of its foreign subsidiaries. A valuation allowance against net deferred tax assets is required if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The Company reassesses the valuation allowance on a quarterly basis and has provided a valuation allowance for the full amount of its net deferred tax assets.
The Company had no unrecognized tax benefits as of March 31, 2016 and December 31, 2015. The Company's policy is to recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense.
10. Stockholders' Equity

Preferred Stock

## Table of Contents

The Company authorized $10,000,000$ shares of undesignated preferred stock, $\$ 0.001$ par value per share, for future issuance. As of March 31, 2016, the Company had no shares of undesignated preferred stock issued or outstanding. Common Stock
The Company authorized $500,000,000$ shares of Class A common stock, $\$ 0.001$ par value per share, and $164,000,000$ shares of Class B common stock, $\$ 0.001$ par value per share, of which $46,966,564$ and $45,814,237$ shares of Class A common stock and $37,664,049$ and $38,496,562$ shares of Class B common stock were outstanding as of March 31, 2016 and December 31, 2015, respectively. The rights of the holders of Class A common stock and Class B common stock are identical, except with respect to voting and conversion rights. Each share of Class A common stock is entitled to one vote per share and each share of Class B common stock is entitled to ten votes per share. The Class B common stock also has approval rights over certain corporate actions. Each share of Class B common stock may be converted into one share of Class A common stock at the option of its holder and will be automatically converted into one share of Class A common stock upon transfer thereof, subject to certain exceptions. In addition, upon the date on which the outstanding shares of Class B common stock represent less than $10 \%$ of the aggregate number of shares of the then outstanding Class A common stock and Class B common stock, or in the event of the affirmative vote or written consent of holders of at least $662 / 3 \%$ of the outstanding shares of Class B common stock, all outstanding shares of Class B common stock shall convert automatically into Class A common stock. Subject to preferences that may apply to any shares of preferred stock outstanding at the time, the holders of common stock are entitled to receive dividends out of funds legally available if the Board, in its discretion, determines to issue dividends and then only at the times and in the amounts that the Board may determine. Since the IPO through March 31, 2016, 32,974,871 shares of Class B common stock were converted to Class A common stock.

## 11. Credit Agreement

The Company has a credit agreement with Bank of America, which provides the Company with an unused line of credit and a credit card program with a maximum commitment of $\$ 35.0$ million, $\$ 45.0$ million and $\$ 35.0$ million for the periods of July 31, 2015 through September 30, 2015, October 1, 2015 through February 28, 2016 and March 1, 2016 through July 31, 2016, respectively, with the committed amounts of $\$ 10.0$ million to be used for a revolving line of credit and to support letters of credit and the remainder to be used to support the Company's credit card program. The credit agreement is renewable on an annual basis and, if not renewed, will expire on July 31, 2016. The Company is required to maintain certain covenants, including tangible net worth and unencumbered liquid assets, with which the Company was compliant at March 31, 2016 and December 31, 2015. The Company did not borrow any amounts under the credit agreement during the three months ended March 31, 2016 and the year ended December 31, 2015. 12. Net Loss per Share

Basic and diluted net loss per share is presented using the two class method required for participating securities. Class A and Class B common stock are the only outstanding equity in the Company since our IPO in October 2014. The rights of the holders of Class A and Class B common stock are identical, except with respect to voting and conversion. Each share of Class A common stock is entitled to one vote per share and each share of Class B common stock is entitled to ten votes per share. The Class B common stock also has approval rights over certain corporate actions. Each share of Class B common stock may be converted into one share of Class A common stock at any time at the option of the stockholder, and will be automatically converted into one share of Class A common stock upon a sale or transfer, subject to certain limited exceptions. In addition, upon the date on which the outstanding shares of Class B common stock represent less than $10 \%$ of the aggregate number of shares of the then outstanding Class A common stock and Class B common stock, or in the event of the affirmative vote or written consent of at least 66 $2 / 3 \%$ of the outstanding shares of Class B common stock, all outstanding shares of Class B common stock will automatically convert into Class A common stock.
Basic net loss per share is computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net income loss per share is computed using the weighted-average number of shares of common stock and, if dilutive, common stock equivalents outstanding during the period. The Company's common stock equivalents consist of shares issuable upon the release of restricted stock units, and to a lesser extent, the incremental shares of common stock issuable upon the exercise of stock options and unvested restricted stock. The dilutive effect of these common stock equivalents is reflected in diluted earnings per share by application of the

## Edgar Filing: Wayfair Inc. - Form 10-Q

treasury stock method. The Company's basic and diluted net loss per share are the same because the Company has generated net loss and common stock equivalents are excluded from diluted net loss per share because they have an antidilutive impact.
The Company allocates undistributed earnings between the classes on a one-to-one basis when computing net loss per share. As a result, basic and diluted net loss per Class A and Class B shares are equivalent.

14

## Table of Contents

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share data):

|  | Three months ended <br> March 31, |  |
| :--- | :--- | :--- |
| Net loss | 2016 | 2015 |

The following have been excluded from the computation of basic and diluted net loss per share as their effect would have been antidilutive:

Three months ended
March 31,
20162015
Stock options 262,819 423,778
Restricted stock - 21,635
Restricted stock units $6,170,8204,159,768$
Total 6,433,639 4,605,181
13. Recent Accounting Pronouncements

Stock Compensation
In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, "Compensation - Stock Compensation" ("ASU 2016-09"). This ASU revises the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and an option to recognized gross stock compensation expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. This ASU is effective for annual reporting periods beginning after December 15, 2016 and early adoption is permitted. Management is currently evaluating the impact of the adoption of this ASU on the Company's consolidated financial statements.
Leases
In February 2016, the FASB issued ASU No. 2016-02, "Leases" ("ASU 2016-02"). This ASU revises the accounting related to leases by requiring lessees to recognize a lease liability and a right-of-use asset for all leases. The new lease guidance also simplifies the accounting for sale and leaseback transactions. This ASU is effective for annual reporting periods beginning after December 15, 2018 and early adoption is permitted. Management is currently evaluating the impact of the adoption of this ASU on the Company's consolidated financial statements.

## Table of Contents

## Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. This ASU was originally effective for annual reporting periods beginning after December 15, 2016 and early adoption was not permitted.
In August 2015, the FASB issued ASU No. 2015-14, "Revenue from Contracts with Customers - Deferral of the Effective Date" (ASU-2015-14), which defers the effective date of ASU 2014-09 for one year and permits early adoption as early as the original effective date of ASU 2014-09. Accordingly, ASU 2014-09 is now effective for annual reporting periods beginning after December 15, 2017 and early adoption is permitted only as of annual reporting periods beginning after December 31, 2016, including interim reporting periods within that reporting year. In March 2016, the FASB issued ASU No. 2016-08, "Revenue from Contracts with Customers - Principal versus Agent Considerations" ("ASU 2016-08"). This ASU clarifies the implementation guidance for principal versus agent considerations in ASU 2014-09. This ASU is effective at the same period as ASU 2015-14 and ASU 2014-09. Management is currently evaluating when to adopt the revenue recognition accounting pronouncements, which transition approach to use, and the impact of the adoption of this ASU on the Company's consolidated financial statements.

## Table of Contents

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated and condensed financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains forward-looking statements that involve risks and uncertainties. As a result of many factors, such as those included in the Special Note Regarding Forward Looking Statements and Part II, Item 1A, Risk Factors, of this Quarterly Report on Form 10-Q, our actual results may differ materially from those anticipated in these forward-looking statements.
Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to "Wayfair," "the Company," "we," "us" or "our" refer to Wayfair Inc. and its consolidated subsidiaries.
Overview
Through our e-commerce business model, we offer visually inspiring browsing, compelling merchandising, easy product discovery and attractive prices for over seven million products from over 7,000 suppliers across five distinct brands-Wayfair.com, Joss \& Main, AllModern, DwellStudio and Birch Lane. We have built one of the largest online selections of furniture, décor, decorative accents, housewares, seasonal décor and other home goods.
We founded our company in May 2002 and have since delivered over 26 million orders. From 2003 to 2011, we grew our net revenue organically from $\$ 7.7$ million to $\$ 517.3$ million, representing a $69.2 \%$ CAGR. In late 2011, we made the strategic decision to close and permanently redirect over 240 of our niche websites into Wayfair.com to create a one-stop shop for furniture, décor, decorative accents, housewares, seasonal décor and other home goods and to build brand awareness, drive customer loyalty and increase repeat purchasing. We also changed our name from CSN Stores LLC to Wayfair LLC.
We plan to grow our customer base by attracting more unique visitors to our sites through two main
strategies-increasing brand awareness and expanding direct online marketing-and then converting those visitors to active customers. Our online efforts are focused on building brand awareness to drive visitor traffic via direct navigation, search engine optimization and email marketing campaigns. In addition, we have made significant investments to improve the consumer experience on our sites, such as creating highly engaging visual imagery and merchandising, as well as easy-to-use navigation tools and personalization features that enable better product discovery. We plan to continue investing in our infrastructure, including enhancing our merchandising, data, analytics, and technology platform, as well as developing additional logistics and transportation solutions, self-service tools for our suppliers, fulfillment offerings and enhancing our development, testing and deployment systems.
Until late 2012, we were primarily focused on growing our U.S. business. In 2012, we began laying the groundwork for expanding our international business by building our international infrastructure, developing deeper country-specific knowledge, building international supplier networks and establishing our brand presence in select international regions. We currently deliver products to customers in a number of countries, including the United States, the United Kingdom, Canada, and Germany. In the year ended December 31, 2015, we generated net revenue outside of the U.S. of $\$ 114.4$ million or $5.1 \%$ of our total net revenue.
In the three months ended March 31, 2016, we generated net revenue of $\$ 747.3$ million, an increase of $76.1 \%$, over the same period in 2015. Our net revenue in the three months ended March 31, 2016 included $\$ 711.8$ million from Direct Retail, which we define as sales generated primarily through the sites of our five brands. Our net revenue in the three months ended March 31, 2016 included $\$ 35.5$ million from Other, which we define as net revenue generated primarily online through third parties, which we refer to as our retail partners, and net revenue from third-party advertisers. In the three months ended March 31, 2016, we generated a net loss of $\$ 41.2$ million and Adjusted EBITDA of $\$(21.0)$ million, increases of $\$ 14.1$ million and $\$ 8.6$ million, respectively, over the same period in 2015. Our net loss and Adjusted EBITDA results were driven primarily by our increased investment in advertising, including in Europe and Canada. For additional information about Adjusted EBITDA, our use of this measure, the limitations of this measure as an analytical tool and the reconciliation of Adjusted EBITDA to net loss, the most directly comparable generally accepted accounting principle ("GAAP") financial measure, refer to Key Financial and Operating Metrics below.

## Table of Contents

Key Financial and Operating Metrics
We measure our business using both financial and operating metrics. Our net revenue, Adjusted EBITDA and free cash flow metrics are measured on a consolidated basis. All other key financial and operating metrics are derived and reported from our Direct Retail sales, which includes sales generated primarily through the sites of our five distinct brands. These metrics do not include net revenue derived from the sites operated by our retail partners. We do not have access to certain customer level information on net revenue derived through our retail partners and therefore cannot measure or disclose it.
We use the following metrics to assess the near-term and longer-term performance of our overall business (in thousands, except LTM Net Revenue per Active Customer and Average Order Value):

Three months ended

March 31,
20162015 \% Change

## Consolidated Financial Metrics

Net Revenue
Adjusted EBITDA
Free cash flow
Direct Retail Financial and Operating Metrics
Direct Retail Net Revenue
Active Customers
LTM Net Revenue per Active Customer
Orders Delivered
Average Order Value
\$747,348 \$424,371 $76.1 \quad \%$
$\$(20,960) \$(12,340)$
$\$(80,582)$ ) $(51,368)$
\$711,846 \$369,396 92.7 \%
6,074 3,597 68.9 \%
\$392 $\$ 346 \quad 13.3 \%$
2,996 1,797 66.7 \%
\$238 \$206 $15.5 \%$

## Non-GAAP Financial Measures

## Adjusted EBITDA

To provide investors with additional information regarding our financial results, we have disclosed here and elsewhere in this Quarterly Report on Form 10-Q Adjusted EBITDA, a non-GAAP financial measure that we calculate as earnings (loss) before depreciation and amortization, equity-based compensation and related taxes, interest and other income and expense and (benefit from) provision for income taxes. We have provided a reconciliation below of Adjusted EBITDA to net loss, the most directly comparable GAAP financial measure.
We have included Adjusted EBITDA in this Quarterly Report on Form 10-Q because it is a key measure used by our management and board of directors to evaluate our operating performance, generate future operating plans and make strategic decisions regarding the allocation of capital. In particular, the exclusion of certain expenses in calculating Adjusted EBITDA facilitates operating performance comparisons on a period-to-period basis. Accordingly, we believe that Adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and board of directors.
Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are:
Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect cash capital expenditure requirements for such replacements or for new capital expenditure requirements;
Adjusted EBITDA does not reflect equity based compensation and related taxes;
Adjusted EBITDA does not reflect changes in our working capital;
Adjusted EBITDA does not reflect income tax payments that may represent a reduction in cash available to us; and Other companies, including companies in our industry, may calculate Adjusted EBITDA differently, which reduces its usefulness as a comparative measure.
Because of these limitations, you should consider Adjusted EBITDA alongside other financial performance measures, including various cash flow metrics, net loss and our other GAAP results.

## Table of Contents

The following table reflects the reconciliation of net loss to Adjusted EBITDA for each of the periods indicated (in thousands):

Three months ended
March 31,
20162015
Reconciliation of Adjusted EBITDA
Net loss
Depreciation and amortization
$\$(41,205) \$(27,136)$
Equity based compensation and related taxes
Interest (income), net
10,487 6,744

Other (income) expense, net
8,162

Provision for income taxes
(669) 108

Adjusted EBITDA
31746

Free Cash Flow
To provide investors with additional information regarding our financial results, we have also disclosed here and elsewhere in this Quarterly Report on Form 10-Q free cash flow, a non-GAAP financial measure that we calculate as net cash (used in) provided by operating activities less net cash used to purchase property and equipment including leasehold improvements and site and software development costs. We have provided a reconciliation below of free cash flow to net cash (used in) provided by operating activities, the most directly comparable GAAP financial measure.
We have included free cash flow in this Quarterly Report on Form 10-Q because it is an important indicator of our business performance as it measures the amount of cash we generate. Accordingly, we believe that free cash flow provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management.
Free cash flow has limitations as an analytical tool, and you should not consider it in isolation or as a substitute for analysis of our results as reported under GAAP. There are limitations to using non-GAAP financial measures, including that other companies, including companies in our industry, may calculate free cash flow differently. Because of these limitations, you should consider free cash flow alongside other financial performance measures, including net cash (used in) provided by operating activities, capital expenditures and our other GAAP results. The following table presents a reconciliation of free cash flow to net cash provided by operating activities for each of the periods indicated (in thousands):

Net cash used in operating activities
Purchase of property, equipment, and leasehold improvements
Site and software development costs
Free cash flow
Three months ended
March 31,
$2016 \quad 2015$
$\$(51,204)$
$(23,927)(35,202)$
$(5,451 \quad)(4,051)$
$\$(80,582)$

19

## Table of Contents

## Key Operating Metrics (Direct Retail)

## Active Customers

As of the last date of each reported period, we determine our number of active customers by counting the total number of individual customers who have purchased at least once directly from our sites during the preceding twelve-month period. The change in active customers in a reported period captures both the inflow of new customers as well as the outflow of existing customers who have not made a purchase in the last twelve months. We view the number of active customers as a key indicator of our growth.
LTM Net Revenue Per Active Customer
We define LTM net revenue per active customer as our total net revenue derived from Direct Retail sales in the last twelve months divided by our total number of active customers for the same preceding twelve-month period. We view LTM net revenue per active customer as a key indicator of our customers' purchasing patterns, including their initial and repeat purchase behavior.
Orders Delivered
We define orders delivered as the total Direct Retail orders delivered in any period, inclusive of orders that may eventually be returned. As we ship a large volume of packages through multiple carriers, actual delivery dates may not always be available, and as such we estimate delivery dates based on historical data. We recognize net revenue when an order is delivered and therefore orders delivered, together with average order value, is an indicator of the net revenue we expect to recognize in a given period. We view orders delivered as a key indicator of our growth. Average Order Value
We define average order value as total Direct Retail net revenue in a given period divided by the orders delivered in that period. We view average order value as a key indicator of the mix of products on our sites, the mix of offers and promotions and the purchasing behavior of our customers.
Factors Affecting our Performance
We believe that our performance and future success depend on a number of factors that present significant opportunities for us but also pose risks and challenges, including those discussed in Part II, Item 1A, Risk Factors, of this Quarterly Report on Form 10-Q.
Growth in Brand Awareness and Visitors to our Sites
We intend to continue investing in our brand awareness strategy and direct online marketing efforts. In late 2011, we made a strategic decision to close and permanently redirect over 240 of our niche websites into Wayfair.com. Since late 2011, we have marketed our brands, in particular Wayfair.com, through TV advertising, display advertising, paid search advertising, social media advertising and direct mail, catalog and print advertising. We believe that attracting new visitors to our sites and converting them into customers is key to driving our net revenue growth and operating results.
Growth in Customer Acquisition and Customer Retention
Our goal is to convert visitors into active customers and then encourage repeat purchases because it increases our operating leverage since it costs more to acquire a customer than to retain one. Our continued investments in infrastructure, including enhancing our merchandising, data, analytics, and technology platform, allow us to deliver increasingly tailored and personalized shopping experiences for customers across our sites. We believe our focus on a personalized shopping experience drives sales from new customers as well as repeat customers.
Revenue Growth Through Mobile Platform
Mobile is an increasingly important part of our business. We launched our mobile applications for Joss \& Main in 2012, Wayfair.com in 2014, and AllModern in 2015, and all of our sites are mobile-optimized. Due to the relative newness of smartphones, tablets, and mobile shopping in general, we do not know if this increase in mobile use will continue.

## Table of Contents

## Investment in Growth

We have aggressively invested in the growth of our business and this investment will continue. We anticipate that our operating expenses will increase substantially as we continue to increase our advertising spending, hire additional personnel primarily in merchandising, technology, operations, customer service and general and administrative functions and continue to develop features on our sites. We have continued to increase our office space to accommodate the anticipated growth of our headcount in our corporate headquarters and have expanded our warehouse space. These investments are expected to continue to generate losses near term and yield returns in the long term, but there is no guarantee that we will be able to realize the return on our investments.
Net Revenue
Net revenue consists primarily of sales of product from our sites and through the sites of our online retail partners and includes related shipping fees. We deduct cash discounts, allowances and estimated returns from gross revenue to determine net revenue. We recognize product revenue upon delivery to our customers. Net revenue is primarily driven by growth of new and active customers and the frequency with which customers purchase. The products offered on our sites are primarily fulfilled with product we ship to our customers directly from our suppliers and, to a lesser extent, from our fulfillment centers. We also generate net revenue through third-party advertisers that pay us based on the number of advertisement related clicks, actions, or impressions for advertisements placed on our sites. Net revenue earned under these arrangements is included in net revenue and is recognized in the period in which the click, action or impression occurs. This revenue has not been material to date.
Cost of Goods Sold
Cost of goods sold consists of the cost of product sold to customers, shipping and handling costs and shipping supplies and fulfillment costs. Fulfillment costs include costs incurred in operating and staffing the fulfillment centers, such as costs attributed to receiving, inspecting, picking, packaging and preparing customer orders for shipment. Cost of goods sold also includes direct and indirect labor costs including equity-based compensation for fulfillment center oversight, including payroll and related benefit costs. The increase in cost of goods sold is primarily driven by growth in orders delivered, the mix of the product available for sale on our sites and transportation costs related to delivering orders to our customers. We earn rebates on our incentive programs with our suppliers. These rebates are earned upon shipment of goods. Amounts due from suppliers as a result of these rebate programs are included as a receivable and are reflected as a reduction of cost of goods sold on the consolidated statements of operations. We expect cost of goods sold expenses to remain relatively stable as a percentage of net revenue but some fluctuations are expected due to the wide variety of products we sell.
Customer Service and Merchant Fees
Customer service and merchant fees consist of labor-related costs including equity-based compensation of our employees involved in customer service activities and merchant processing fees associated with customer payments made by credit cards. Increases in our customer service and merchant fees are driven by the growth in our revenue and are expected to remain relatively consistent as a percentage of revenue.

## Advertising

Advertising consists of direct response performance marketing costs, such as television advertising, display advertising, paid search advertising, social media advertising, search engine optimization, comparison shopping engine advertising, direct mail, catalog and print advertising. We expect advertising expense to continue to increase but decrease as a percentage of net revenue over time due to our increasing mix of orders from repeat customers. Merchandising, Marketing and Sales
Merchandising, marketing and sales expenses include labor-related costs including equity-based compensation for our category managers, buyers, site merchandisers, merchants, marketers and the team who executes our advertising strategy. Sales, marketing and merchandising expenses are primarily driven by investments to grow and retain our customer base. We expect merchandising, marketing and sales expenses to continue to increase as we grow our net revenue.

## Table of Contents

Operations, Technology and General and Administrative
Operations, technology, general and administrative expenses primarily include labor-related costs including equity-based compensation of our operations group that lead our supply chain and logistics, our technology team, building and supporting our sites, and our corporate general and administrative, which includes human resources, finance and accounting personnel. Also included are administrative and professional service fees including audit and legal fees, insurance and other corporate expenses, including depreciation and rent. We anticipate that we will incur additional personnel expenses, professional service fees, including audit and legal, investor relations, costs of compliance with securities laws and regulations, and higher director and officer insurance costs related to operating as a public company. We expect operations, technology, general and administrative expenses will continue to increase as we grow our net revenue and operations.
Interest Income, Net
Interest income, net consists primarily of interest earned on cash, cash equivalents and short-term and long-term investments held by us.
Other Income (Expense), Net
Other income (expense), net consists primarily of foreign currency gains (losses).
Results of Consolidated Operations (in thousands)
Comparison of the three months ended March 31, 2016 and 2015
Net revenue
Three months ended
March 31,
$2016 \quad 2015 \quad$ \% Change

Net revenue
Direct Retail \$711,846 \$369,396 92.7 \%
Other 35,502 54,975 (35.4)\%
Net revenue $\$ 747,348$ \$424,371 76.1 \%
In the three months ended March 31, 2016, net revenue increased by $\$ 323.0$ million, or $76.1 \%$ compared to the same period in 2015, primarily as a result of an increase in Direct Retail net revenue. In the three months ended March 31, 2016, Direct Retail net revenue increased by $\$ 342.5$ million, or $92.7 \%$ compared to the same period in 2015, primarily due to sales to a larger customer base, as the number of active customers increased $68.9 \%$ in the three months ended March 31, 2016 compared to the same period in 2015. Additionally, LTM net revenue per active customer increased $13.3 \%$ in the three months ended March 31, 2016 compared with the same period in 2015. The $\$ 19.5$ million or $35.4 \%$ decrease in other revenue in the three months ended March 31, 2016 as compared to the same period in 2015 was primarily due to decreased sales through our retail partners.

## Table of Contents

Cost of goods sold

Cost of goods sold
Cost of goods sold $\quad \$ 568,292 \quad \$ 321,536 \quad 76.7 \quad \%$
As a percentage of net revenue 76.0 \% 75.8 \%
In the three months ended March 31, 2016, cost of goods sold increased by $\$ 246.8$ million, or $76.7 \%$, compared to the same period in 2015. Of the increase in cost of goods sold, $\$ 199.1$ million was due to the increase in products sold to our larger customer base. In addition, shipping and fulfillment costs increased $\$ 47.7$ million as a result of the increase in products sold during the period. Cost of goods sold as a percentage of net revenue increased in the three months ended March 31, 2016 compared to the same period in 2015 as a result of changes in the mix of the products sold and shipping costs.
Operating expenses
Customer service and merchant fees (1)
Advertising
Merchandising, marketing and sales (1)
Operations, technology, general and administrative (1)

As a percentage of net revenue
Customer service and merchant fees
Advertising
Merchandising, marketing and sales
Operations, technology, general and administrative

| Three months ended <br> March 31, |  |  |  |
| :--- | :--- | :--- | :--- |
|  |  |  |  |
| 2016 | 2015 | $\%$ Change |  |
| $\$ 27,350$ | $\$ 15,978$ | 71.2 | $\%$ |
| 97,677 | 57,999 | 68.4 | $\%$ |
| 37,856 | 23,234 | 62.9 | $\%$ |
| 58,282 | 32,870 | 77.3 | $\%$ |
| $\$ 221,165$ | $\$ 130,081$ | 70.0 | $\%$ |

(1) Excluding equity-based compensation and related taxes as follows:

Customer service and merchant fees $\quad 3.6 \% 3.7 \%$
Merchandising, marketing and sales 4.4\% 4.6\%

Operations, technology, general and administrative $7.1 \% ~ 6.7 \%$
In the three months ended March 31, 2016, excluding the impact of equity based compensation and related taxes of $\$ 0.3$ million and $\$ 0.2$ million recorded in the three months ended March 31, 2016 and 2015, respectively, customer service costs and merchant processing fees increased by $\$ 11.2$ million, from $\$ 15.8$ million in the three months ended March 31, 2015 to $\$ 27.0$ million primarily due to the increase in net revenue during the three months ended March 31, 2016. Our advertising expenses increased by $\$ 39.7$ million from $\$ 58.0$ million in the three months ended March 31, 2015 to $\$ 97.7$ million in the same period 2016, primarily as a result of an increase in online and television advertising. Advertising decreased as a percentage of net revenue in the three months ended March 31, 2016 compared to the same period in 2015 primarily due to increased leverage from our growing base of repeat customers, and television advertising expense not increasing at the same rate as revenue growth in the U.S., partially offset by advertising investments in Europe and Canada.
Excluding the impact of equity based compensation and related taxes of $\$ 5.1$ million and $\$ 3.9$ million recorded in the three months ended March 31, 2016 and 2015, respectively, merchandising, marketing and sales expenses increased by $\$ 13.4$ million, from $\$ 19.4$ million in the three months ended March 31 , 2015 to $\$ 32.8$ million in the same period of 2016. The increase in merchandising, marketing and sales expenses was due to an increase in headcount primarily to grow and retain our customer base. In the three months ended March 31, 2016, excluding the impact of equity based compensation and related taxes of $\$ 5.2$ million and $\$ 4.0$ million recorded in the three months ended March 31, 2016 and 2015, respectively, operations, technology, general and administrative expense increased by $\$ 24.2$ million from
$\$ 28.9$ million in the three months ended

## Table of Contents

March 31, 2015 to $\$ 53.1$ million in the same period of 2016. As our revenue continues to grow, we have invested in headcount in both operations and technology to continue to deliver a great experience for our customers. The increase in operations, technology, general and administrative expense was primarily attributable to personnel costs, rent, information technology, depreciation and amortization and costs related to operating as a public company. Liquidity and Capital Resources
Sources of Liquidity
March 31, December 31,
20162015
(in thousands)
Cash and cash equivalents $\$ 248,798 \$ 334,176$
Short-term investments $\$ 60,656$ \$ 51,895
Accounts receivable, net $\$ 11,854 \quad \$ 9,906$
Long-term investments $\$ 70,315$ \$79,883
Working capital $\quad \$ 36,114 \quad \$ 95,297$
Historical Cash Flows

Net loss
Net cash used in operating activities
Other investing activities, net
Three months ended
March 31,
20162015
(in thousands)

Net cash used in financing activities
Since our inception, we have financed our operations, capital expenditures and acquisitions primarily through cash flows generated by operations and, since 2011, also through private sales of convertible redeemable preferred stock and sales of common stock in connection with our IPO. Since inception through March 31, 2016, we have raised a total of approximately $\$ 646.0$ million from the sale of preferred stock and common stock, net of costs and expenses associated with such financings, or approximately $\$ 453.8$ million, net of repurchases of our securities and dividends paid to Series A redeemable convertible preferred stockholders.
On October 7, 2014, we completed our IPO of 12,650,000 shares of our Class A common stock at a public offering price of $\$ 29.00$ per share, of which $10,500,000$ shares were sold by us and $2,150,000$ shares were sold by selling stockholders, including $1,650,000$ shares pursuant to the underwriters' option to purchase additional shares, resulting in net proceeds to us of approximately $\$ 282.9$ million, after deducting underwriting discounts and offering expenses. We did not receive any proceeds from the sale of shares by the selling stockholders. We used these proceeds to distribute $\$ 24.5$ million of cash to our Series A redeemable convertible preferred stockholders and pay $\$ 22.6$ million in minimum tax withholding obligations on the vesting of our restricted stock units upon the closing of our initial public offering.
We believe that our existing cash and cash equivalents, together with cash generated from operations, will be sufficient to meet our anticipated cash needs for at least the foreseeable future. However, our liquidity assumptions may prove to be incorrect, and we could exhaust our available financial resources sooner than we currently expect. In addition, we may elect to raise additional funds at any time through equity, equity linked or debt financing arrangements. Capital expenditures were $2.8 \%$ of net revenue for the year ended December 31, 2015, and related primarily to additional capacity to support our supply chain infrastructure, including warehouses and our distribution network, investments in our technology and operational platform, including our mobile platform, and additional resources required to establish and expand our international operations. Capital expenditures were $3.9 \%$ of net revenue for the three months ended March 31, 2016, and related primarily to ongoing investments in our technology infrastructure and equipment purchases and improvements for leased warehouses within our expanding supply chain network. While we expect capital expenditures to be approximately $4.0 \%$ of net revenues throughout 2016, we expect capital expenditures for the three months ended June 30, 2016 to be approximately $6.0 \%$ as we put a new data center
online, on top of the continued roll out of our supply chain infrastructure. Our future capital requirements and the adequacy of available funds will depend on many factors, including those described in Part II, Item 1A, Risk Factors, of this

24

## Table of Contents

Quarterly Report on Form 10-Q. We may not be able to secure additional financing to meet our operating requirements on acceptable terms, or at all.
Operating Activities
Cash provided by operating activities consisted of net loss adjusted for certain non-cash items including depreciation and amortization, equity-based compensation, and certain other non-cash expenses, as well as the effect of changes in working capital and other activities.
Cash used in operating activities in the three months ended March 31, 2016 was $\$ 51.2$ million and was driven primarily net loss of $\$ 41.2$ million, cash used in operating assets and liabilities of $\$ 30.0$ million, and other non-cash items of $\$ 0.2$ million, partially offset by certain non-cash items including depreciation and amortization expense of $\$ 10.5$ million and equity based compensation of $\$ 9.7$ million. Operating cash flows can be volatile and are sensitive to many factors, including changes in working capital and our net loss.
Cash used in operating activities in the three months ended March 31, 2015 was $\$ 35.2$ million and was driven primarily by net loss of $\$ 27.1$ million and cash used in operating assets and liabilities of $\$ 22.7$ million, partially offset by certain non-cash items including equity based compensation of $\$ 7.6$ million, depreciation and amortization expense of $\$ 6.7$ million, and other non-cash items of $\$ 0.3$ million. Operating cash flows can be volatile and are sensitive to many factors, including changes in working capital and our net loss.

## Investing Activities

Our primary investing activities consisted of purchases of property and equipment, particularly purchases of servers and networking equipment, investment in our sites and software development, purchases and disposal of short-term and long-term investments, and leasehold improvements for our facilities.
Cash used in investing activities in the three months ended March 31, 2016 was $\$ 28.2$ million and was primarily driven by purchases of property and equipment of $\$ 23.9$ million, purchases of short-term and long-term investments of $\$ 28.5$ million, and site and software development costs of $\$ 5.5$ million, partially offset by net increase in the maturity of short-term investments of $\$ 29.6$ million.
Cash used in investing activities in the three months ended March 31, 2015 was $\$ 110.1$ million and was primarily driven by purchases of short-term and long-term investments of $\$ 104.2$ million, purchases of property and equipment of $\$ 12.1$ million, and site and software development costs of $\$ 4.1$ million, partially offset by net increase in the maturity of short-term investments of $\$ 10.0$ million and other net investing activities of $\$ 0.3$ million.
Financing Activities
Cash used in financing activities in the three months ended March 31, 2016 was $\$ 6.6$ million and was primarily due to $\$ 6.6$ million statutory minimum taxes paid related to net share settlements of equity awards, partially offset by less than $\$ 0.1$ million net proceeds from exercise of stock options.
Cash provided by financing activities in the three months ended March 31, 2015 was $\$ 4.2$ million and was primarily due to $\$ 4.3$ million statutory minimum taxes paid related to net share settlements of equity awards, partially offset by less than $\$ 0.1$ million net proceeds from exercise of stock options.
Credit Agreement
For information regarding our credit agreement, see Note 11, Credit Agreement, in the Notes to the Unaudited Consolidated and Condensed Financial Statements included in Part I, Item 1, Unaudited Consolidated and Condensed Financial Statements, of this Quarterly Report on Form 10-Q.
Off-Balance Sheet Arrangements
We do not engage in any off-balance sheet activities. We do not have any off-balance sheet interest in variable interest entities, which include special purpose entities and other structured finance entities.
Contractual Obligations
For information regarding our contractual obligations, see Note 6, Commitments and Contingencies, in the Notes to the Unaudited Consolidated and Condensed Financial Statements included in Part I, Item 1, Unaudited Consolidated and Condensed Financial Statements, of this Quarterly Report on Form 10-Q. There have been no material changes to our contractual obligations and estimates as compared to the contractual obligations described in Contractual Obligations included

## Table of Contents

in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the Company's Annual Report on Form 10-K for the year ended December 31, 2015, except as disclosed in Note 6, Commitments and Contingencies, in the Notes to the Unaudited Consolidated and Condensed Financial Statements included in Part I, Item 1, Unaudited Consolidated and Condensed Financial Statements, of this Quarterly Report on Form 10-Q
Critical Accounting Policies
Our financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements and related disclosures requires us to make estimates, assumptions and judgments that affect the reported amount of assets, liabilities, net revenue, costs and expenses and related disclosures. We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements and, therefore, we consider these to be our critical accounting policies. Accordingly, we evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ from these estimates under different assumptions and conditions.
There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in Note 2, Summary of Significant Accounting Policies, in the Notes to the Consolidated Financial Statements included in Part II, Item 8, Financial Statements and Supplementary Data, of the Company's Annual Report on Form 10-K for the year ended December 31, 2015.
Recent Accounting Pronouncements
For information about recent accounting pronouncements, see Note 13, Recent Accounting Pronouncements, included in Part I, Item 1, Unaudited Consolidated and Condensed Financial Statements, of this Quarterly Report on Form 10-Q.

## Table of Contents

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have operations both within the United States and internationally, and we are exposed to market risks in the ordinary course of our business, including the effects of foreign currency fluctuations, interest rate changes and inflation. Information relating to quantitative and qualitative disclosures about these market risks is set forth below. Interest Rate Sensitivity
Cash and cash equivalents and short-term and long-term investments were held primarily in cash deposits, certificates of deposit, money market funds, and corporate debt. The fair value of our cash, cash equivalents and short-term and long-term investments would not be significantly affected by either an increase or decrease in interest rates due mainly to the short-term nature of these instruments. Interest on the revolving line of credit incurred pursuant to the credit agreement described above would accrue at a floating rate based on a formula tied to certain market rates at the time of incurrence; however, we do not expect that any change in prevailing interest rates will have a material impact on our results of operations.
Foreign Currency Risk
Most of our sales are denominated in U.S. dollars, and therefore, our revenue is not currently subject to significant foreign currency risk. Our operating expenses are denominated in the currencies of the countries in which our operations are located, and may be subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the British Pound, and Euro. Fluctuations in foreign currency exchange rates may cause us to recognize transaction gains and losses in our statement of operations. To date, foreign currency transaction gains and losses have not been material to our financial statements, and we have not engaged in any foreign currency hedging transactions.

## Inflation

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. We continue to monitor the impact of inflation in order to minimize its effects through pricing strategies, productivity improvements and cost reductions. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

## Table of Contents

## ITEM 4. CONTROLS AND PROCEDURES

## Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2016. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission, or SEC. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of March 31, 2016, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

## Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) or 15d-15(d) of the Exchange Act during the period covered by this Quarterly Report on Form 10-Q that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Table of Contents

## PART II

## OTHER INFORMATION

Item 1. Legal Proceedings.
On September 2, 2015, a putative class action complaint was filed against us in the U.S. District Court for the Southern District of New York (Dingee v. Wayfair Inc., et al., Case No. 1:15-cv-06941) by an individual on behalf of himself and on behalf of all other similarly situated individuals (collectively, the "Dingee Plaintiffs"), under sections 10(b) and 20(a) of the Exchange Act related to a drop in stock price that had followed a report issued by Citron Research. On September 3, a second putative class action complaint was filed, asserting nearly identical claims (Jenkins v. Wayfair Inc., et al., Case No. 1:15-cv-06985). On November 2, 2015, the plaintiff in the Dingee action moved to consolidate the two lawsuits, and to designate himself as lead plaintiff in the class action and his attorney as lead counsel for the class. On November 3, plaintiff in the Jenkins action voluntarily dismissed his complaint. As a result, only the Dingee action remains pending. On November 13, 2015, the court appointed Dingee as lead plaintiff. On January 11, 2016, Dingee filed an amended complaint along with a second named plaintiff, Michael Lamp. The Dingee Plaintiff's complaint seeks class certification, damages in an unspecified amount, and attorney's fees and costs. We have moved to dismiss the case; briefing on the motion to dismiss was completed on April 1, 2016 and the parties are awaiting a decision. Should the lawsuit proceed, we intend to defend it vigorously.
On February 2, 2016, a putative class action complaint was filed against us in the U.S. District Court for the Central District of California (Carson, et al., v. Wayfair Inc., Case No. 2:16-cv-00716) by two individuals on behalf of themselves and on behalf of all other similarly situated individuals (collectively, the "Carson Plaintiffs"). The complaint alleges that Wayfair engaged in a deceptive marketing campaign in which we advertised certain "original" or "regular" retail prices, which the Carson Plaintiffs allege were false. The Carson Plaintiffs' complaint seeks injunctive relief, attorney's fees, punitive damages and damages. We intend to defend the lawsuit vigorously.
From time to time we are involved in claims that arise during the ordinary course of business. Although the results of litigation and claims cannot be predicted with certainty, we do not currently believe that the outcome of any of these other legal matters will have a material adverse effect on our results of operation or financial condition. Regardless of the outcome, litigation can be costly and time consuming, as it can divert management's attention from important business matters and initiatives, negatively impacting our overall operations. In addition, we may also find ourselves at greater risk to outside party claims as we increase our operations in jurisdictions where the laws with respect to the potential liability of online retailers are uncertain, unfavorable, or unclear.
For information regarding our legal proceedings, see Note 6, Commitments and Contingencies, in the Notes to the Consolidated and Condensed Financial Statements included in Part I, Item 1, Unaudited Consolidated and Condensed Financial Statements, of this Quarterly Report on Form 10-Q.
Item 1A. Risk Factors.

## RISK FACTORS

We have identified the risk factors that could materially affect our business, financial condition or future results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. The Company believes that there have been no significant changes during the three months ended March 31, 2016 to the items disclosed in Part I, Item 1A, Risk Factors, of the Company's Annual Report on Form 10-K for the year ended December 31, 2015.
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
Sales of Unregistered Securities
During the three months ended March 31, 2016, we issued 303,343 shares of Class B common stock upon the vesting of outstanding restricted stock units, net of shares withheld to satisfy statutory minimum tax withholding obligations. The issuance of these securities were pursuant to written compensatory plans or arrangements with our employees, consultants, advisors and directors in reliance on the exemption provided by Rule 701 promulgated under the Securities Act, relative to transactions by an issuer not involving any public offering, to the extent an exemption from registration was required.

## Table of Contents

Use of Proceeds from Public Offering of Common Stock
On October 1, 2014 the SEC declared our Registration Statement on Form S-1 (File No. 333-198171), as amended, effective in connection with our IPO.
There have been no material changes in the planned use of proceeds from the offering as described in the Registration Statement and in our Annual Report on Form 10-K for the year ended December 31, 2015.

## Table of Contents

Item 6. Exhibits.
Exhibit
Number Description
31.1* Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2* Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1** Certification of Chief Executive Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
$32.2 * * \quad$ Certification of Chief Financial Officer pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS* XBRL Instance Document
101.SCH* XBRL Taxonomy Extension Schema Document
101.CAL* XBRL Taxonomy Calculation Linkbase Document
101.DEF* XBRL Taxonomy Definition Linkbase Document
101.LAB* XBRL Taxonomy Labels Linkbase Document
101.PRE* XBRL Taxonomy Presentation Linkbase Document

* Exhibits filed herewith.
** Exhibits furnished herewith.


## Table of Contents

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WAYFAIR INC.

Date: May 9, 2016 By:/s/ NIRAJ SHAH
Niraj Shah
President and Chief Executive Officer
(Principal Executive Officer)

Date: May 9, 2016 By:/s/ MICHAEL FLEISHER
Michael Fleisher
Chief Financial Officer
(Principal Financial Officer)

