

Wayfair Inc.
Form 10-Q
August 08, 2017
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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 1934

For the quarterly period ended June 30, 2017

OR

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

For the transition period from _____ to _____

Commission File Number: 001-36666

Wayfair Inc.

(Exact name of registrant as specified in its charter)

Delaware 36-4791999
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) 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 No

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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Class

Outstanding at July 31, 2017

Class A Common Stock, \$0.001 par value per share 54,778,243

Class B Common Stock, \$0.001 par value per share 32,396,376

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For the Quarterly Period Ended June 30, 2017

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PART I

FINANCIAL INFORMATION

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.

Forward-looking statements are based on current expectations of future events. We cannot guarantee that any forward-looking statement will be accurate, although we believe that we have been reasonable in our expectations and assumptions. Investors should realize that if underlying assumptions prove inaccurate or that known or unknown risks or uncertainties materialize, actual results could vary materially from the Company's expectations and projections.

Investors are therefore cautioned not to place undue reliance on any forward-looking statements. These forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q and, 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.

Factors that could cause or contribute to differences in our future results include the cautionary statements herein and in our other filings with the Securities and Exchange Commission, including those set forth under Part I, Item 1A, Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. We qualify all of our forward-looking statements by these cautionary statements.

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

	June 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	\$203,810	\$279,840
Short-term investments	52,059	68,743
Accounts receivable, net of allowance of \$3,715 and \$3,115 at June 30, 2017 and December 31, 2016, respectively	23,890	19,113
Inventories	14,612	18,550
Prepaid expenses and other current assets	122,875	90,845
Total current assets	417,246	477,091
Property and equipment, net	295,368	239,354
Goodwill and intangible assets, net	3,668	4,230
Long-term investments	26,798	30,967
Other noncurrent assets	8,398	10,041
Total assets	\$751,478	\$761,683
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$371,407	\$379,493
Accrued expenses	89,051	67,807
Deferred revenue	89,138	65,892
Other current liabilities	48,951	44,028
Total current liabilities	598,547	557,220
Lease financing obligation	82,725	28,900
Other liabilities	58,266	96,179
Total liabilities	739,538	682,299
Commitments and contingencies (Note 6)		
Convertible preferred stock, \$0.001 par value per share: 10,000,000 shares authorized and none issued at June 30, 2017 and December 31, 2016	—	—
Stockholders' equity:		
Class A common stock, par value \$0.001 per share, 500,000,000 shares authorized, 54,306,006 and 49,945,202 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	54	50
Class B common stock, par value \$0.001 per share, 164,000,000 shares authorized, 32,724,614 and 35,885,692 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	33	36
Additional paid-in capital	446,966	409,225
Accumulated deficit	(434,066)	(329,940)
Accumulated other comprehensive (loss) gain	(1,047)	13
Total stockholders' equity	11,940	79,384
Total liabilities and stockholders' equity	\$751,478	\$761,683

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

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WAYFAIR INC.

CONSOLIDATED AND CONDENSED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three months ended		Six months ended June	
	June 30,		30,	
	2017	2016	2017	2016
Net revenue	\$1,122,856	\$786,928	\$2,083,681	\$1,534,276
Cost of goods sold	853,390	598,414	1,577,332	1,166,706
Gross profit	269,466	188,514	506,349	367,570
Operating expenses:				
Customer service and merchant fees	39,125	30,064	74,183	57,414
Advertising	124,241	94,426	242,506	192,103
Merchandising, marketing and sales	52,305	43,273	103,099	81,129
Operations, technology, general and administrative	91,347	69,481	180,319	127,763
Total operating expenses	307,018	237,244	600,107	458,409
Loss from operations	(37,552)	(48,730)	(93,758)	(90,839)
Interest (expense) income, net	(1,550)	531	(1,849)	1,083
Other income, net	451	246	627	915
Loss before income taxes	(38,651)	(47,953)	(94,980)	(88,841)
Provision for income taxes	224	321	434	638
Net loss	\$(38,875)	\$(48,274)	\$(95,414)	\$(89,479)
Net loss per share, basic and diluted	\$(0.45)	\$(0.57)	\$(1.10)	\$(1.06)
Weighted average number of common stock outstanding used in computing per share amounts, basic and diluted	86,714	84,786	86,374	84,615

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

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WAYFAIR INC.

CONSOLIDATED AND CONDENSED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net loss	\$(38,875)	\$(48,274)	\$(95,414)	\$(89,479)
Other comprehensive loss:				
Foreign currency translation adjustments	(822)	(302)	(1,103)	(635)
Net unrealized gain on available-for-sale investments	20	131	43	628
Comprehensive loss	\$(39,677)	\$(48,445)	\$(96,474)	\$(89,486)

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

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WAYFAIR INC.

CONSOLIDATED AND CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six months ended June 30,	
	2017	2016
Cash flows from operating activities		
Net loss	\$(95,414)	\$(89,479)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	39,675	23,065
Equity based compensation	28,462	20,462
Other non-cash adjustments	868	408
Changes in operating assets and liabilities:		
Accounts receivable	(4,723)	(4,218)
Inventories	3,949	2,508
Prepaid expenses and other current assets	(31,220)	(11,650)
Accounts payable and accrued expenses	(137)	9,748
Deferred revenue and other liabilities	30,660	22,862
Other assets	(117)	(7)
Net cash used in operating activities	(27,997)	(26,301)
Cash flows from investing activities		
Purchase of short-term and long-term investments	(25,334)	(69,055)
Sale and maturities of short-term investments	46,035	67,895
Purchase of property and equipment	(45,548)	(61,436)
Site and software development costs	(22,650)	(12,263)
Net cash used in investing activities	(47,497)	(74,859)
Cash flows from financing activities		
Taxes paid related to net share settlement of equity awards	(1,252)	(12,374)
Net proceeds from exercise of stock options	162	130
Net cash used in financing activities	(1,090)	(12,244)
Effect of exchange rate changes on cash and cash equivalents	554	(473)
Net decrease in cash and cash equivalents	(76,030)	(113,877)
Cash and cash equivalents		
Beginning of period	279,840	334,176
End of period	\$203,810	\$220,299
Supplemental disclosure of non-cash investing activities		
Purchase of property and equipment included in accounts payable and accrued expenses and in other liabilities	\$13,976	\$8,295
Construction costs capitalized under finance lease obligation and other leases	\$9,691	\$8,102

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

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(Unaudited)

1. Basis of Presentation

Wayfair Inc. (the “Company”) is one of the world's largest online destinations for the home. Through its e-commerce business model, the Company offers visually inspired browsing, compelling merchandising, easy product discovery and attractive prices for over eight million products from approximately 10,000 suppliers.

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, 2016 was derived from audited financial statements. The accompanying consolidated and condensed balance sheet as of June 30, 2017, the consolidated and condensed statements of operations, consolidated and condensed statements of comprehensive loss, and consolidated and condensed statements of cash flows for the periods ended June 30, 2017 and 2016 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 June 30, 2017 and statements of operations, comprehensive loss, and cash flows for the periods ended June 30, 2017 and 2016. 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 June 30, 2017 are not necessarily indicative of the results of operations and cash flows that may be expected for the year ending December 31, 2017, 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 six months ended June 30, 2017 to the items disclosed in Note 2, Summary of Significant Accounting Policies, 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, 2016.

3. Marketable Securities and Fair Value Measurements

Marketable Securities

As of June 30, 2017 and December 31, 2016, all of the Company’s marketable securities were classified as available-for-sale and their estimated fair values were \$78.9 million and \$99.7 million, respectively. The Company periodically reviews its available-for-sale securities for other-than-temporary impairment. The Company considers factors such as the duration, severity and the reason for the decline in value, the potential recovery period, and its intent to sell. As of June 30, 2017, the Company’s available-for-sale securities primarily consisted of corporate bonds and other government obligations that are priced at fair value. During the three and six months ended June 30, 2017 and 2016, the Company did not recognize any other-than-temporary impairment losses. The maturities of the Company’s long-term marketable securities generally range from one to three years. The cost basis of a marketable security sold is determined by the Company using the specific identification method. During the three and six months ended June 30, 2017 and 2016, we did not have any realized gains or losses.

The following tables present details of the Company’s marketable securities as of June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term:				
Investment securities	\$49,828	\$ 9	\$ (26)	\$ 49,811
Commercial paper	2,248	—	—	2,248
Long-term:				

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Investment securities	26,789	34	(25)	26,798
Total	\$78,865	\$ 43	\$ (51)	\$ 78,857

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	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term:				
Investment securities	\$63,135	\$ 7	\$ (39)	\$ 63,103
Commercial paper	5,641	1	(2)	5,640
Long-term:				
Investment securities	30,985	16	(34)	30,967
Total	\$99,761	\$ 24	\$ (75)	\$ 99,710

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. The following tables set forth the fair value of the Company's financial assets measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016 based on the three-tier value hierarchy (in thousands):

	June 30, 2017			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$11,403	\$—	\$	—\$11,403
Short-term investments:				
Investment securities	—	49,811	—	49,811
Commercial paper	—	2,248	—	2,248
Restricted cash:				
Certificate of deposit	5,000	—	—	5,000
Long-term:				
Investment securities	—	26,798	—	26,798
Total	\$16,403	\$78,857	\$	—\$95,260

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	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$200,867	\$—	\$	—\$200,867
Short-term investments:				
Investment securities	—	63,103	—	63,103
Commercial paper	—	5,640	—	5,640
Restricted cash:				
Certificate of deposit	5,000	—	—	5,000
Long-term:				
Investment securities	—	30,967	—	30,967
Total	\$205,867	\$99,710	\$	—\$305,577

4. Intangible Assets and Goodwill

The following table summarizes intangible assets as of June 30, 2017 and December 31, 2016 (in thousands):

	Weighted - Average Amortization Period (Years)	June 30, 2017		Net Book Value
		Gross Carrying Amount	Accumulated Amortization	
Trademarks	5	\$1,900	\$ (1,488)	\$ 412
Technology	3	1,453	(403)	1,050
Customer relationships	5	1,300	(1,018)	282
Total		\$4,653	\$ (2,909)	\$ 1,744

	Weighted - Average Amortization Period (Years)	December 31, 2016		Net Book Value
		Gross Carrying Amount	Accumulated Amortization	
Trademarks	5	\$ 1,900	\$ (1,298)	\$ 602
Technology	3	1,453	(161)	1,292
Customer relationship	5	1,300	(888)	412
Total		\$ 4,653	\$ (2,347)	\$ 2,306

Amortization expense related to intangible assets was \$0.3 million and \$0.2 million for the three months ended June 30, 2017 and 2016, respectively, and \$0.6 million and \$0.4 million for the six months ended June 30, 2017 and 2016, respectively.

Goodwill as of June 30, 2017 was \$1.9 million, unchanged from December 31, 2016.

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5. Property and Equipment, net

The following table summarizes property and equipment, net as of June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017	December 31, 2016
Furniture and computer equipment	\$ 169,449	\$ 133,297
Site and software development costs	97,667	77,429
Leasehold improvements	67,065	62,090
Construction in progress	21,133	47,013
Buildings (leased - Note 6)	83,681	29,856
	438,995	349,685
Less accumulated depreciation and amortization	(143,627)	(110,331)
Property and equipment, net	\$ 295,368	\$ 239,354

Property and equipment depreciation and amortization expense was \$19.0 million and \$12.4 million for the three months ended June 30, 2017 and 2016, respectively and \$39.1 million and \$22.7 million for the six months ended June 30, 2017 and 2016, 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 \$11.1 million and \$7.9 million in the three months ended June 30, 2017 and 2016, respectively and \$22.6 million and \$14.8 million in the six months ended June 30, 2017 and 2016, respectively. The Company has issued letters of credit for approximately \$11.4 million and \$10.6 million as security for these lease agreements as of June 30, 2017 and December 31, 2016, respectively. As of December 31, 2016, the future minimum rental commitments under non-cancelable leases with initial or remaining terms in excess of one year totaled \$568.7 million. Subsequent to December 31, 2016, the Company entered into additional non-cancelable leases in the United States ("U.S.") with initial or remaining terms in excess of one year with total future minimum lease commitments of \$59.4 million. Future lease payments have not been reduced by minimum sublease rentals of \$9.4 million due to the Company in the future under non-cancelable subleases through 2020.

The Company establishes assets and liabilities for the estimated construction costs incurred under lease arrangements where the Company is considered the owner for accounting purposes only, or build-to-suit leases, to the extent the Company is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease. Upon occupancy of facilities under build-to-suit leases, the Company assesses whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance. If the Company continues to be the deemed owner, the facilities are accounted for as financing leases.

The construction of one warehouse lease arrangement was completed during the three months ended June 30, 2016, and because the Company concluded it had a letter of credit of \$1.2 million, the Company did not meet the sale-leaseback criteria for derecognition of the building asset and liability. The construction of a second warehouse lease arrangement was completed in the three months ended March 31, 2017, and because the Company concluded it had a letter of credit of \$0.8 million, the Company did not meet the sale-leaseback criteria for derecognition of the building asset and liability. The construction of a third warehouse lease arrangement was completed in the three months ended June 30, 2017, and because the Company concluded it had a letter of credit of \$1.0 million, the Company did not meet the sale-leaseback criteria for derecognition of the building asset and liability. Accordingly, these leases were accounted for as financing obligations and \$28.9 million, \$12.6 million, and \$41.2 million was recorded in "Lease financing obligation" in the Company's unaudited consolidated and condensed balance sheets as of June 30, 2016, March 31, 2017, and June 30, 2017, respectively. The monthly rent payments made to the lessor under the lease agreement are recorded in the Company's financial statements as land lease expense and principal and interest

on the financing obligation. Interest expense on the lease financing obligation reflects the portion of the Company's monthly lease payments that is allocated to interest expense. For the three and six months ended June 30, 2017, land lease expense was \$0.2 million and \$0.5 million, respectively, and interest expense on lease financing obligations was \$2.0 million and \$2.9 million, respectively. As of June 30, 2017, future minimum commitments related to the financing obligations were \$5.9 million and \$39.2 million for principal and interest, respectively, through June 30, 2022.

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Collection of Sales or Other Similar Taxes

Based on the location of the Company's current operations, it collects and remits sales tax. 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 \$30.6 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 any losses that may arise from these assessments would be immaterial; however, no assurance can be given as to the outcome of these assessments.

Legal Matters

In September 2016, a putative class action complaint was filed against the Company in the Superior Court of the province of Quebec (Naomi Zouzout v. Wayfair LLC, Case No. PQ 500-06-000809-166) by an individual on behalf of herself and on behalf of all other similarly situated individuals alleging violations of various Canadian consumer protection statutes. Among other remedies, this lawsuit seeks compensatory and punitive money damages, costs, and various fees. In June 2017, the Company entered into a settlement of the litigation, subject to judicial approval. The parties will present their proposed settlement to the court for review and approval in September 2017. This settlement is not expected to have a material adverse effect on the Company's results of operation or financial condition. From time to time the Company is involved in claims that arise during the ordinary course of business. Although the results of litigation and claims cannot be predicted with certainty, the Company does not currently believe that the outcome of any of these other legal matters will have a material adverse effect on the Company's 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 the Company's overall operations. In addition, the Company may also find itself at greater risk to outside party claims as it increases its operations in jurisdictions where the laws with respect to the potential liability of online retailers are uncertain, unfavorable, or unclear.

7. Equity-Based Compensation

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, restricted stock units ("RSUs"), performance shares, stock payments, cash payments, dividend awards and other incentives. Prior to the adoption of the 2014 Plan, Wayfair LLC issued certain equity awards pursuant to the Wayfair LLC Amended and Restated Common Unit Plan (the "2010 Plan"), which was administered by the board of directors of Wayfair LLC. Awards issued under this plan that remain outstanding currently represent Class A or Class B common stock of the Company.

8,603,066 shares of Class A common stock were initially available for issuance under awards granted pursuant to the 2014 Plan. The 2014 Plan also contains an evergreen provision whereby the shares available for future grant are increased on the first day of each calendar year beginning January 1, 2016 and ending on and including January 1, 2024. As of January 1, 2017, 8,389,750 shares of Class A common stock were available for future grant under the 2014 Plan. 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. All equity awards granted prior to the initial public offering ("IPO") were subject to two vesting conditions: (i) a service period (typically five years) and (ii) a performance condition (a liquidity event in the form of either a change of control or an IPO, each as defined in the 2010 Plan). Employees were able to retain provisionally vested stock options and shares upon departure. The Company determined that a liquidity event was not probable until the closing of its IPO on October 7, 2014, and as such, no expense was recognized until that date. After the IPO, awards for employees still providing service continue to vest over the remaining service period. Any future grants of awards are expected to vest over the service period.

The Company adopted Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-09, "Compensation - Stock Compensation" ("ASU 2016-09") as of January 1, 2017. For additional information, refer to Note 13, Recent Accounting Pronouncements.

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The following table presents activity relating to stock options for the six months ended June 30, 2017:

	Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)
Outstanding at December 31, 2016	209,759	\$ 2.98	4.5
Options exercised	(54,656)	\$ 2.92	
Outstanding and exercisable at June 30, 2017	155,103	\$ 3.00	4.0

Intrinsic value of stock options exercised was \$2.8 million for the six months ended June 30, 2017. Aggregate intrinsic value of stock options outstanding and currently exercisable is \$11.5 million. All stock options were fully vested at June 30, 2017.

The following table presents activity relating to restricted common stock for the six months ended June 30, 2017:

	Shares	Weighted- Average Fair Value
Outstanding at December 31, 2016	60,000	\$ 35.05
Unvested at June 30, 2017	60,000	\$ 76.88

Aggregate intrinsic value of restricted common stock unvested is \$4.6 million as of June 30, 2017. Unrecognized equity based compensation expense related to unvested restricted common stock is \$3.4 million with a weighted average remaining vesting term of 1.5 years as of June 30, 2017.

The following table presents activity relating to RSUs for the six months ended June 30, 2017:

	Shares	Weighted- Average Grant Date Fair Value
Outstanding at December 31, 2016	6,986,776	\$ 34.21
RSUs granted	1,666,579	\$ 43.49
RSUs vested	(1,164,337)	\$ 31.15
RSUs forfeited/canceled	(692,201)	\$ 37.18
Outstanding at June 30, 2017	6,796,817	\$ 36.74

The intrinsic value of RSUs vested was \$53.8 million for the six months ended June 30, 2017. Aggregate intrinsic value of RSUs outstanding is \$522.5 million as of June 30, 2017. Unrecognized equity based compensation expense related to outstanding RSUs is \$217.7 million with a weighted average remaining vesting term of 1.8 years at June 30, 2017.

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.

Beginning the fourth quarter of 2016, the Company changed its operating and reportable segments to U.S. and International. These segments reflect changes in the way the CODM allocates resources and evaluates financial performance, which is based upon each segment's Adjusted EBITDA. Adjusted EBITDA is defined as loss before depreciation and amortization, equity-based compensation and related taxes, interest and other income and expense, provision for income taxes, and non-recurring items. These charges are excluded from evaluation of segment performance because it facilitates reportable segment performance comparisons on a period-to-period basis. Refer to Note 2, Summary of Significant Accounting Policies for the accounting policies of segments.

The Company allocates certain operating expenses to the operating and reportable segments, including "Customer service and merchant fees," "Merchandising, marketing and sales," and "Operations, technology, general and administrative" based on the usage and relative contribution provided to the segments. It excludes from the allocations certain operating expense lines, including "Depreciation and amortization," "Equity based compensation and related

taxes," "Interest (income), net," "Other

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(income) expense, net," and "Provision for income taxes." There are no revenue transactions between the Company's reportable segments.

U.S.
The U.S. segment primarily consists of amounts earned through product sales through the Company's sites in the U.S. and through sites operated by third parties in the U.S.

International
The International segment primarily consists of amounts earned through product sales through the Company's international sites.

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 U.S. provided greater than 10% of total revenue.

The following tables present Direct Retail and Other net revenues and Adjusted EBITDA attributable to the Company's reportable segments for the periods presented (in thousands):

	Three months ended June 30,		Six months ended June 30,		
	2017	2016	2017	2016	
U.S. Direct Retail	\$976,673	\$702,408	\$1,814,229	\$1,375,108	
U.S. Other	20,395	30,265	40,868	63,486	
U.S. segment net revenue	997,068	732,673	1,855,097	1,438,594	
International Direct Retail	125,788	53,249	228,584	92,395	
International Other	—	1,006	—	3,287	
International segment net revenue	125,788	54,255	228,584	95,682	
Total net revenue	\$1,122,856	\$786,928	\$2,083,681	\$1,534,276	
			Three months ended June 30,	Six months ended June 30,	
			2017	2016	
Adjusted EBITDA					
U.S.		\$20,425	\$(2,920)	\$24,153	\$(3,959)
International		(22,671)	(21,937)	(47,295)	(41,858)
Total reportable segments Adjusted EBITDA		(2,246)	(24,857)	(23,142)	(45,817)
Less: reconciling items (1)		(36,629)	(23,417)	(72,272)	(43,662)
Net loss		\$(38,875)	\$(48,274)	\$(95,414)	\$(89,479)

(1) Adjustments are made to reconcile total reportable segments Adjusted EBITDA to consolidated net loss including the following (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Depreciation and amortization	\$19,323	\$12,578	\$39,675	\$23,065
Equity based compensation and related taxes	15,983	11,295	30,941	21,957
Interest expense (income), net	1,550	(531)	1,849	(1,083)
Other (income), net	(451)	(246)	(627)	(915)
Provision for income taxes	224	321	434	638
Total reconciling items	\$36,629	\$23,417	\$72,272	\$43,662

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):

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	Three months ended		Six months ended June	
	June 30,		30,	
	2017	2016	2017	2016
Net revenue				
Direct Retail	\$ 1,102,461	\$ 755,657	\$ 2,042,813	\$ 1,467,503
Other	20,395	31,271	40,868	66,773
Net revenue	\$ 1,122,856	\$ 786,928	\$ 2,083,681	\$ 1,534,276

The following table presents long-lived assets by segment (in thousands):

	June 30,	December
	2017	31,
		2016
Geographic long-lived assets		
U.S.	\$ 288,873	\$ 233,099
International	6,495	6,255
Total	\$ 295,368	\$ 239,354

9. Income Taxes

Income tax expense was \$0.2 million and \$0.3 million for the three months ended June 30, 2017 and 2016, respectively and \$0.4 million and \$0.6 million for the six months ended June 30, 2017 and 2016, respectively. The income tax expense recorded in the three and six months ended June 30, 2017 and 2016 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 June 30, 2017 and December 31, 2016. 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 (Deficit)

Preferred Stock

The Company authorized 10,000,000 shares of undesignated preferred stock, \$0.001 par value per share, for future issuance. As of June 30, 2017, 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 54,306,006 and 49,945,202 shares of Class A common stock and 32,724,614 and 35,885,692 shares of Class B common stock were outstanding as of June 30, 2017 and December 31, 2016, 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. 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 66 2/3% 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 June 30, 2017, 38,407,318 shares of Class B common stock were converted to Class A common stock.

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11. Credit Agreement

On February 22, 2017, the Company entered into a \$40 million credit card program and a credit agreement consisting of a \$100 million secured revolving credit facility (the "Revolver") with Citibank, N.A. ("Citibank"). The Citibank credit facility replaced the Company's existing credit facility with Bank of America, N.A. ("Bank of America"), which was terminated on February 22, 2017 as described below.

The Citibank Revolver has a \$40 million letter of credit sublimit and a \$10 million swing line sublimit, and a final maturity date of February 21, 2020. Wayfair LLC is the borrower (the "Borrower") under the Citibank credit agreement. Subject to certain conditions, the Borrower has the right to increase the Revolver by \$25 million. Borrowings under the Revolver will bear interest through maturity at a variable rate based upon, at the Borrower's option, either the Eurodollar rate or the base rate (which is the highest of (x) Citibank's prime rate, (y) one-half of 1.00% in excess of the federal funds effective rate, and (z) 1.00% in excess of the one-month Eurodollar rate), plus, in each case an applicable margin. From closing until September 30, 2019, the applicable margin for Eurodollar rate loans is 1.75% per annum and the applicable margin for base rate loans is 0.75% per annum. After September 30, 2019, the applicable margin is subject to specified changes depending on the applicable consolidated leverage ratio. Any amounts outstanding under the Revolver are due at maturity. In addition, subject to the terms and conditions set forth in the credit agreement, the Borrower is required to make certain mandatory prepayments prior to maturity.

The Citibank credit agreement contains affirmative and negative covenants customarily applicable to senior secured credit facilities, including covenants that, among other things, will limit or restrict the ability of the Company and its subsidiaries, subject to negotiated exceptions, to incur additional indebtedness and additional liens on their assets, engage in mergers or acquisitions or dispose of assets, pay dividends or make other distributions, voluntarily prepay other indebtedness, enter into transactions with affiliated persons, make investments, and change the nature of their businesses. In addition, the Citibank credit agreement requires the Company to maintain certain financial ratios. As of June 30, 2017, the Company was in compliance with its covenants under the Revolver.

The Company previously had a credit agreement with Bank of America, which was replaced by the Citibank credit agreement on February 22, 2017. The Bank of America credit agreement provided the Company with a \$20.0 million revolving line of credit to support direct borrowings and letters of credit, provided that a maximum of \$5.0 million could be applied to direct borrowings under the revolving line of credit, plus an additional \$45.0 million credit card program (which the Company continued to utilize on a transitional basis as of June 30, 2017), for a maximum aggregate commitment of \$65.0 million. Subject to the terms and conditions of the Bank of America credit agreement, advances under the line of credit, if any, would bear interest at the LIBOR rate, plus 1.75%. The Bank of America credit agreement also required the Company to maintain certain covenants, including debt service coverage, tangible net worth and unencumbered liquid assets.

The Company did not borrow any amounts under the Revolver or the Bank of America credit agreement during the six months ended June 30, 2017 and the year ended December 31, 2016.

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. 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. 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 attributable to common stockholders is computed using the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share attributable to common stockholders 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 treasury stock method. The Company's basic and diluted net loss per share are the same because the Company has generated net loss attributable to common stockholders and common stock equivalents are excluded from diluted net loss per share because they have an antidilutive impact.

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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.

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

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net loss	\$(38,875)	\$(48,274)	\$(95,414)	\$(89,479)
Weighted average common shares used for basic and diluted net loss per share computation	86,714	84,786	86,374	84,615
Net loss per share:				
Basic and Diluted	\$(0.45)	\$(0.57)	\$(1.10)	\$(1.06)

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

	Three and six months ended June 30,	
	2017	2016
Stock options	155,103	235,721
Restricted stock	60,000	—
Restricted stock units	6,796,817	6,612,349
Total	7,011,920	6,848,070

13. Recent Accounting Pronouncements

Stock Compensation

In March 2016, the FASB issued 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 recognize 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, including interim reporting periods within that reporting year, and early adoption is permitted.

The Company adopted ASU 2016-09 as of January 1, 2017 using a modified retrospective approach with the option to recognize gross stock compensation expense with actual forfeitures recognized as they occur, with a cumulative-effect adjustment to retained earnings recognized as of January 1, 2017 of \$8.7 million. The adoption of ASU 2016-09 also requires all income tax adjustments to be recorded in the consolidated and condensed statements of operations.

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 15, 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.

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Management expects to adopt ASU 2014-09, ASU 2015-14, and ASU 2016-08 (collectively, the "Revenue Recognition Accounting Pronouncements") for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting year. While management is still in its assessment process, management generally expects to identify substantially similar performance obligations after adoption of the Revenue Recognition Accounting Pronouncements as compared with deliverables and separate units of accounting under previous revenue recognition guidance. Therefore, the Company generally does not expect the impact of the adoption of the Revenue Recognition Accounting Pronouncements to be significant to its consolidated financial statements, processes, or systems. As we continue to evaluate the impact of the Revenue Recognition Accounting Pronouncements, we have identified no material changes to our current revenue recognition accounting policy for product sales generated through the Company's sites, or Direct Retail, which we identified as our most significant revenue stream. Management expects to apply the Revenue Recognition Accounting Pronouncements retrospectively with the cumulative effect of initially applying the Revenue Recognition Accounting Pronouncements recognized at the date of initial application recorded as an adjustment to retained earnings, referred to as the "Modified Retrospective Approach."

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 expects to adopt ASU 2016-02 for annual reporting periods beginning after December 15, 2018. Management is currently evaluating the impact of the adoption of this ASU on the Company's consolidated financial statements, and expects it will have a material impact on our consolidated financial statements, primarily the consolidated balance sheets and related disclosures.

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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 and our audited consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2016. 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 I, Item 1A, Risk Factors, of our Annual Report on Form 10-K, our actual results may differ materially from those anticipated in these forward-looking statements.

The following discussion includes financial information prepared in accordance with generally accepted accounting principles ("GAAP"), as well as certain adjusted or non-GAAP financial measures such as Adjusted EBITDA, non-GAAP diluted net loss per share and free cash flow. Generally, a non-GAAP financial measure is a numerical measure of financial performance, financial position or cash flows that excludes (or includes) amounts that are included in (or excluded from) the most directly comparable measure calculated and presented in accordance with GAAP. Management believes the use of these non-GAAP measures on a consolidated and reportable segment basis assists investors in understanding the ongoing operating performance of our business by presenting comparable financial results between periods. For more information on these non-GAAP financial measures, including reconciliations to the most directly comparable GAAP financial measures, see "Non-GAAP Financial Measures" below.

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

We are one of the world's largest online destinations for the home. Through our e-commerce business model, we offer visually inspired browsing, compelling merchandising, easy product discovery and attractive prices for over eight million products from approximately 10,000 suppliers. Because of the large market opportunity we see in front of us, we are currently investing across our business, including investments to expand our international business, to build our proprietary logistics network and to continue developing various product categories.

Beginning in the fourth quarter of 2016, we changed our operating and reportable segments from one segment to two operating and reportable segments, U.S. and International. The following table presents Direct Retail and Other net revenues attributable to the Company's reportable segments for the periods presented (in thousands):

	Three months ended		Six months ended June	
	June 30,		30,	
	2017	2016	2017	2016
U.S. Direct Retail	\$976,673	\$702,408	\$1,814,229	\$1,375,108
U.S. Other	20,395	30,265	40,868	63,486
U.S. segment net revenue	997,068	732,673	1,855,097	1,438,594
International Direct Retail	125,788	53,249	228,584	92,395
International Other	—	1,006	—	3,287
International segment net revenue	125,788	54,255	228,584	95,682
Total net revenue	\$1,122,856	\$786,928	\$2,083,681	\$1,534,276

For more information on our segments, see Note 8, Segment and Geographic Information, included in Part I, Item 1, Unaudited Consolidated and Condensed Financial Statements, of this Quarterly Report on Form 10-Q.

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Key Financial and Operating Metrics

We measure our business using both financial and operating metrics. Our free cash flow metric is measured on a consolidated basis. Our net revenue and Adjusted EBITDA metrics are measured on a consolidated and segment basis. See Note 8, Segment and Geographic Information, included in Part I, Item 1, Unaudited Consolidated and Condensed Financial Statements, of this Quarterly Report on Form 10-Q. All other key financial and operating metrics are derived and reported from our Direct Retail sales, which includes sales generated primarily through our sites. 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			
	June 30,			
	2017	2016	% Change	
Consolidated Financial Metrics				
Net Revenue	\$ 1,122,856	\$ 786,928	42.7	%
Adjusted EBITDA	\$(2,246)	\$(24,857)		
Free cash flow	\$(27,225)	\$(19,418)		
Direct Retail Financial and Operating Metrics				
Direct Retail Net Revenue	\$ 1,102,461	\$ 755,657	45.9	%
Active Customers	9,547	6,672	43.1	%
LTM Net Revenue per Active Customer	\$402	\$404	(0.5)	%
Orders Delivered	4,278	2,930	46.0	%
Average Order Value	\$258	\$258	—	%
	Six months ended June			
	30,			
	2017	2016	% Change	
Consolidated Financial Metrics				
Net Revenue	\$ 2,083,681	\$ 1,534,276	35.8	%
Adjusted EBITDA	\$(23,142)	\$(45,817)		
Free cash flow	\$(96,195)	\$(100,000)		
Direct Retail Financial and Operating Metrics				
Direct Retail Net Revenue	\$ 2,042,813	\$ 1,467,503	39.2	%
Active Customers	9,547	6,672	43.1	%
LTM Net Revenue per Active Customer	\$402	\$404	(0.5)	%
Orders Delivered	8,490	5,926	43.3	%
Average Order Value	\$241	\$248	(2.8)	%

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 loss before depreciation and amortization, equity-based compensation and related taxes, interest and other income and expense, provision for income taxes, and non-recurring items. 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

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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;

Adjusted EBITDA does not reflect depreciation and interest expenses associated with the lease financing obligations; 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.

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Reconciliation of Adjusted EBITDA				
Net loss	\$(38,875)	\$(48,274)	\$(95,414)	\$(89,479)
Depreciation and amortization	19,323	12,578	39,675	23,065
Equity based compensation and related taxes	15,983	11,295	30,941	21,957
Interest expense (income), net	1,550	(531)	1,849	(1,083)
Other (income), net	(451)	(246)	(627)	(915)
Provision for income taxes	224	321	434	638
Adjusted EBITDA	\$(2,246)	\$(24,857)	\$(23,142)	\$(45,817)
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 provided by (used in) operating activities less net cash used to purchase property and equipment and site and software development costs. We have provided a reconciliation below of free cash flow to net cash provided by (used in) 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 because it omits certain components of the cash flow statement and does not represent the residual cash flow available for discretionary expenditures. Further, other companies, including companies in our industry, may calculate free cash flow differently. Accordingly, you should not consider free cash flow in isolation or as a substitute for analysis of our results as reported under GAAP. Because of these limitations, you should consider free cash flow alongside other financial performance measures, including net cash provided by (used in) operating activities, capital expenditures and our other GAAP results.

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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):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net cash provided by (used in) operating activities	\$18,101	\$24,903	\$(27,997)	\$(26,301)
Purchase of property and equipment	(33,596)	(37,509)	(45,548)	(61,436)
Site and software development costs	(11,730)	(6,812)	(22,650)	(12,263)
Free cash flow	\$(27,225)	\$(19,418)	\$(96,195)	\$(100,000)

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 set forth under Part I, Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2016.

Components of Our Results of Operations**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 fulfilled with product we ship to our customers directly from our suppliers and, increasingly, from our CastleGate warehouses.

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 net revenue through our third-party advertisers is recognized in the period in which the click, action or impression occurs. This revenue has not been material to date.

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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 and condensed statements of operations. We also perform logistics services for suppliers through our CastleGate solution, which are earned upon completion of preparing customer orders for shipment and are reflected as a reduction of cost of goods sold on the consolidated and condensed 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 and debit 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 display advertising, paid search advertising, social media advertising, search engine optimization, comparison shopping engine advertising, television 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 base of 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.

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 (Expense) Income, Net

Interest (expense) income, net consists primarily of interest earned on cash, cash equivalents and short-term and long-term investments held by us and partially offset by interest expense on the lease financing obligations.

Other Income, Net

Other income, net consists primarily of foreign currency gains (losses).

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Results of Consolidated Operations (in thousands)

Comparison of the three months ended June 30, 2017 and 2016

Net revenue

	Three months ended		
	June 30,		
	2017	2016	% Change
Direct Retail	\$ 1,102,461	\$ 755,657	45.9 %
Other	20,395	31,271	(34.8)%
Net revenue	\$ 1,122,856	\$ 786,928	42.7 %

In the three months ended June 30, 2017, net revenue increased by \$335.9 million, or 42.7% compared to the same period in 2016, primarily as a result of an increase in Direct Retail net revenue. In the three months ended June 30, 2017, Direct Retail net revenue increased by \$346.8 million, or 45.9% compared to the same period in 2016, primarily due to sales to a larger customer base, as the number of active customers increased 43.1% as of June 30, 2017 compared to June 30, 2016, partially offset by a decrease in LTM net revenue per active customer compared to June 30, 2016. The \$10.9 million or 34.8% decrease in Other revenue in the three months ended June 30, 2017 as compared to the same period in 2016 was primarily due to decreased sales through our retail partners, as we continue to focus more on our Direct Retail business over time.

Cost of goods sold

	Three months ended		
	June 30,		
	2017	2016	% Change
Cost of goods sold	\$ 853,390	\$ 598,414	42.6 %
As a percentage of net revenue	76.0	% 76.0	%

In the three months ended June 30, 2017, cost of goods sold increased by \$255.0 million, or 42.6%, compared to the same period in 2016. Of the increase in cost of goods sold, \$204.5 million was due to the increase in products sold to our larger customer base. In addition, shipping and fulfillment costs increased \$50.5 million as a result of the increase in products sold during the period. Cost of goods sold as a percentage of net revenue was consistent in the three months ended June 30, 2017 compared to the same period in 2016.

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Operating expenses

	Three months ended		
	June 30,		
	2017	2016	% Change
Customer service and merchant fees (1)	\$39,125	\$30,064	30.1 %
Advertising	124,241	94,426	31.6 %
Merchandising, marketing and sales (1)	52,305	43,273	20.9 %
Operations, technology, general and administrative (1)	91,347	69,481	31.5 %
	\$307,018	\$237,244	29.4 %
As a percentage of net revenue:			
Customer service and merchant fees (1)	3.5	% 3.8	%
Advertising	11.1	% 12.0	%
Merchandising, marketing and sales (1)	4.7	% 5.5	%
Operations, technology, general and administrative (1)	8.1	% 8.8	%
	27.4	% 30.1	%

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

	Three months ended June 30,	
	2017	2016
Customer service and merchant fees	\$586	\$528
Merchandising, marketing and sales	\$8,005	\$5,221
Operations, technology, general and administrative	\$7,187	\$5,459

The following table summarizes operating expenses as a percentage of net revenue, excluding equity-based compensation and related taxes:

	Three months ended June 30,	
	2017	2016
Customer service and merchant fees	3.4%	3.8%
Merchandising, marketing and sales	3.9%	4.8%
Operations, technology, general and administrative	7.5%	8.1%

Excluding the impact of equity based compensation and related taxes, customer service costs and merchant processing fees increased by \$9.0 million in the three months ended June 30, 2017 compared to the same period in 2016, primarily due to the increase in net revenue during the three months ended June 30, 2017.

Our advertising expenses increased by \$29.8 million in the three months ended June 30, 2017 compared to the same period in 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 June 30, 2017 compared to the same period in 2016, 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, merchandising, marketing and sales expenses increased by \$6.2 million in the three months ended June 30, 2017 compared to the same period in 2016, primarily due to the increase in headcount to grow and retain our customer base.

Excluding the impact of equity based compensation and related taxes, operations, technology, general and administrative expense increased by \$20.1 million in the three months ended June 30, 2017 compared to the same period in 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, and depreciation and amortization.

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Comparison of the six months ended June 30, 2017 and 2016

Net revenue

	Six months ended June		
	30,		
	2017	2016	% Change
Direct Retail	\$2,042,813	\$1,467,503	39.2 %
Other	40,868	66,773	(38.8)%
Net revenue	\$2,083,681	\$1,534,276	35.8