

Wayfair Inc.  
Form 10-Q  
May 14, 2015  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**Form 10-Q**

---

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

**For the quarterly period ended March 31, 2015**

**OR**

**o 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**  
(State or other jurisdiction of  
incorporation or organization)

**36-4791999**  
(I.R.S. Employer  
Identification Number)

**4 Copley Place, 7th Floor, Boston, MA**  
(Address of principal executive offices)

**02116**  
(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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

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  No

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

Outstanding at April 30, 2015
42,403,967
41,126,255



Table of Contents

WAYFAIR INC.

INDEX TO QUARTERLY REPORT ON FORM 10-Q

For the Quarterly Period Ended March 31, 2015

	Page
<b>PART 1. FINANCIAL INFORMATION</b>	
<b>Item 1.</b>	<b>Unaudited Consolidated and Condensed Financial Statements</b>
	<b><u>Consolidated and Condensed Balance Sheets as of March 31, 2015 and December 31, 2014</u></b>
	<b>3</b>
	<b><u>Consolidated and Condensed Statements of Operations for the Three Months Ended March 31, 2015 and 2014</u></b>
	<b>4</b>
	<b><u>Consolidated and Condensed Statements of Comprehensive Loss for the Three Months Ended March 31, 2015 and 2014</u></b>
	<b>5</b>
	<b><u>Consolidated and Condensed Statements of Cash Flows for the Three Months Ended March 31, 2015 and 2014</u></b>
	<b>6</b>
	<b><u>Notes to the Unaudited Consolidated and Condensed Financial Statements</u></b>
	<b>7</b>
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>
	<b>17</b>
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>
	<b>28</b>
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>
	<b>29</b>
<b><u>PART 2. OTHER INFORMATION</u></b>	
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b>
	<b>30</b>
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>
	<b>30</b>
<b><u>Item 2.</u></b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>
	<b>50</b>
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b>
	<b>51</b>
<b><u>Signatures</u></b>	<b>52</b>

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, int projects, contemplates, believes, estimates, predicts, potential or continue or the negative of these terms or other similar expressions. T 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 the 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)

	March 31, 2015	December 31, 2014
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 206,082	\$ 355,859
Short-term investments	74,213	60,000
Accounts receivable, net of allowance of \$2,252 and \$2,545 at March 31, 2015 and December 31, 2014, respectively	7,958	5,949
Inventories	20,011	19,798
Prepaid expenses and other current assets	60,980	45,262
Total current assets	369,244	486,868
Property and equipment, net	74,983	60,639
Goodwill and intangible assets, net	6,115	6,478
Long-term investments	79,307	
Other noncurrent assets	1,559	1,538
Total assets	\$ 531,208	\$ 555,523
<b>Liabilities and Stockholders Equity</b>		
Current liabilities		
Accounts payable	\$ 123,336	\$ 147,873
Accrued expenses	47,727	42,335
Deferred revenue	31,899	26,784
Other current liabilities	17,247	15,600
Total current liabilities	220,209	232,592
Other liabilities	28,425	17,392
Total liabilities	248,634	249,984
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, 2015 and December 31, 2014		
Stockholders equity:		
Class A common stock, par value \$0.001 per share, 500,000,000 shares authorized, 40,736,828 and 37,002,874 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively	41	37
Class B common stock, par value \$0.001 per share, 164,000,000 shares authorized, 42,731,150 and 46,179,192 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively	42	46
Additional paid-in capital	367,925	363,944
Accumulated deficit	(85,258)	(58,122)
Accumulated other comprehensive loss	(176)	(366)
Total stockholders equity	282,574	305,539
Total liabilities and stockholders equity	\$ 531,208	\$ 555,523

Edgar Filing: Wayfair Inc. - Form 10-Q

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)

	Three months ended March 31,	
	2015	2014
Net revenue	\$ 424,371	\$ 278,707
Cost of goods sold	321,536	213,500
Gross profit	102,835	65,207
Operating expenses:		
Customer service and merchant fees	15,978	10,969
Advertising	57,999	44,204
Merchandising, marketing and sales	23,234	15,171
Operations, technology, general and administrative	32,620	22,769
Amortization of acquired intangible assets	250	249
Total operating expenses	130,081	93,362
Loss from operations	(27,246)	(28,155)
Interest income, net	264	56
Other (expense) income, net	(108)	88
Loss before income taxes	(27,090)	(28,011)
Provision for income taxes	46	15
Net loss	(27,136)	(28,026)
Accretion of convertible redeemable preferred units		(7,150)
Net loss attributable to common stockholders	\$ (27,136)	\$ (35,176)
Net loss attributable to common stockholders per share, basic and diluted	\$ (0.33)	\$ (0.85)
Weighted average common shares outstanding, basic and diluted	83,210	41,144

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 COMPREHENSIVE LOSS**

**(In thousands)**

**(Unaudited)**

	<b>Three months ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
Net loss	\$ (27,136)	\$ (28,026)
Other comprehensive loss:		
Foreign currency translation adjustments	144	(119)
Net unrealized gain on available-for-sale investments	46	
Comprehensive loss	\$ (26,946)	\$ (28,145)

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 CASH FLOWS

(In thousands)

(Unaudited)

	Three months ended March 31,	
	2015	2014
<b>Cash flows from operating activities</b>		
Net loss	\$ (27,136)	\$ (28,026)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	6,744	4,198
Equity based compensation	7,642	4,554
Other non-cash adjustments	231	75
Changes in operating assets and liabilities:		
Accounts receivable	(2,128)	1,741
Inventories	(240)	(630)
Prepaid expenses and other current assets	(15,327)	(9,591)
Accounts payable and accrued expenses	(16,800)	(6,478)
Deferred revenue and other liabilities	12,151	10,721
Other assets	(339)	(996)
Net cash used in operating activities	(35,202)	(24,432)
<b>Cash flows from investing activities</b>		
Purchase of short-term and long-term investments	(104,233)	(10,000)
Maturities of short-term investments	10,000	9,979
Purchase of property and equipment	(12,051)	(11,357)
Site and software development costs	(4,115)	(2,717)
Other investing activities, net	302	(3,407)
Net cash used in investing activities	(110,097)	(17,502)
<b>Cash flows from financing activities</b>		
Taxes paid related to net share settlement of equity awards	(4,251)	
Net proceeds from exercise of stock options	15	
Proceeds from issuance of Series B convertible redeemable preferred units		154,774
Repurchase of common units		(23,500)
Dividends paid to Series A convertible redeemable preferred		(15,000)
Repurchase of employee equity		(4,554)
Net cash (used in) provided by financing activities	(4,236)	111,720
Effect of exchange rate changes on cash and cash equivalents	(242)	20
Net (decrease) increase in cash and cash equivalents	(149,777)	69,806
<b>Cash and cash equivalents</b>		
Beginning of period	355,859	65,289
End of period	\$ 206,082	\$ 135,095
<b>Supplemental disclosure of non-cash investing activities</b>		
Purchase of property and equipment included in accounts payable and accrued expenses and in other liabilities	\$ 5,988	\$ 4,716
Construction costs capitalized under finance lease obligations	\$ 9,900	\$

Edgar Filing: Wayfair Inc. - Form 10-Q

**Supplemental disclosure of non-cash financing activities**

Accretion of preferred unit dividends	\$	\$	7,150
Purchase of employee equity included in accounts payable and accrued expenses	\$	\$	4,554

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 Company was incorporated as a Delaware corporation on August 8, 2014. Prior to the effectiveness of the Company's registration statement on Form S-1 related to its initial public offering (IPO) in October 2014, Wayfair LLC was the principal operating entity. In connection with the IPO of the Company, Wayfair LLC completed a corporate reorganization pursuant to which Wayfair LLC became a wholly-owned subsidiary of the Company, and the holders of equity interests in Wayfair LLC became stockholders of the Company. For additional information regarding the change in reporting entity, see Note 1, *Basis of Presentation*, in the Notes to 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, 2014.

The consolidated and condensed balance sheet data as of December 31, 2014 was derived from audited financial statements. The accompanying consolidated and condensed balance sheet as of March 31, 2015, the consolidated statements of operations, consolidated statements of comprehensive loss, and consolidated statements of cash flows for the three months ended March 31, 2015 and 2014 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, 2015 and results of operations and cash flows for the three months ended March 31, 2015 and 2014. The financial data and the other information disclosed in these notes to the consolidated and condensed financial statements related to these periods are unaudited.

Operating results for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2015, or for any other period. The consolidated and condensed results of operations and cash flows for the three months ended March 31, 2015 are not necessarily indicative of the results of operations and cash flows that may be expected for the year ending December 31, 2015.

**2. Summary of Significant Accounting Policies**

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

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, 2015 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, 2014 other than those noted below.

### *Marketable Securities*

The Company classifies its marketable securities as available-for-sale or trading securities.

Available-for-sale securities are classified as short term investments and long-term investments on the consolidated and condensed balance sheets and are carried at fair value. Unrealized gains and losses on available-for-sale securities that are considered temporary are recorded, net of taxes, in the Accumulated other comprehensive loss caption of the Company's consolidated and condensed balance sheets. Unrealized losses, excluding losses related to the credit rating of the security (credit losses), on available-for-sale securities that are considered other-than-temporary but relate to securities that the Company (i) does not intend to sell and (ii) will not be required to sell below cost are also recorded, net of taxes, in Accumulated other comprehensive loss. Further,

Table of Contents

the Company does not believe it will be required to sell such securities below cost. Therefore, the only other-than-temporary losses the Company records in Other income, net in its consolidated statements of operations are related to credit losses. As of March 31, 2015, the Company's available-for-sale securities consisted of investment securities. The maturities of the Company's long-term marketable securities generally range from one to three years.

### 3. Marketable Securities and Fair Value Measurements

#### *Marketable Securities*

As of March 31, 2015, all of the Company's marketable securities were classified as available-for-sale and their estimated fair values were \$88.5 million. The Company did not hold any available-for-sale securities at December 31, 2014.

The following table presents details of the Company's marketable securities as of March 31, 2015 (in thousands):

	March 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
<b>Short-term:</b>				
Investment securities	\$ 9,213	\$	\$ (1)	\$ 9,212
<b>Long-term:</b>				
Investment securities	79,260	86	(39)	79,307
<b>Total</b>	<b>\$ 88,473</b>	<b>\$ 86</b>	<b>\$ (40)</b>	<b>\$ 88,519</b>

#### *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

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

- 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

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, 2015 and December 31, 2014 based on the three-tier value hierarchy (in thousands):

Edgar Filing: Wayfair Inc. - Form 10-Q

Table of Contents

	March 31, 2015			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$ 152,635			\$ 152,635
Short-term investments:				
Certificates of deposit	65,000			65,000
Investment securities	9,213			9,213
Long-term:				
Investment securities	79,307			79,307
Total	\$ 306,155	\$	\$	\$ 306,155

	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$ 302,595			\$ 302,595
Short-term investments:				
Certificates of deposit	60,000			60,000
Restricted cash:				
Money market funds	302			302
Total	\$ 362,897	\$	\$	\$ 362,897

**4. Intangible Assets and Goodwill**

The following table summarizes intangible assets as of March 31, 2015 and December 31, 2014 (in thousands):

	Weighted-Average Amortization Period (Years)	Gross Carrying Amount	March 31, 2015 Accumulated Amortization	Net Book Value
Trademarks	5	\$ 1,996	\$ (702)	\$ 1,294
Customer relationships	5	1,300	(433)	867
Non-compete agreements	3 - 5	107	(61)	46
Technology	5	676	(485)	191
Other intangibles	3	373	(186)	187
Domain names	5	2,687	(2,683)	4
Total		\$ 7,139	\$ (4,550)	\$ 2,589

	Weighted-Average Amortization Period (Years)	Gross Carrying Amount	December 31, 2014 Accumulated Amortization	Net Book Value
Trademarks	5	\$ 2,001	\$ (604)	\$ 1,397
Customer relationships	5	1,300	(368)	932
Non-compete agreements	3 - 5	108	(52)	56
Technology	5	718	(467)	251
Other intangibles	3	373	(158)	215
Domain names	5	2,687	(2,684)	3
Total		\$ 7,187	\$ (4,333)	\$ 2,854



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

Amortization expense related to intangible assets was \$0.3 million and \$0.2 million for the three months ended March 31, 2015 and 2014, respectively.

Table of Contents

The following table presents the changes in goodwill during the three months ended March 31, 2015 (in thousands):

	<b>Net Book Value</b>	
Goodwill as of December 31, 2014	\$	3,624
Foreign currency exchange rate effect		(98)
Goodwill as of March 31, 2015	\$	3,526

**5. Property and Equipment, net**

The following table summarizes property and equipment, net as of March 31, 2015 and December 31, 2014 (in thousands):

	<b>March 31,</b>		<b>December 31,</b>	
	<b>2015</b>		<b>2014</b>	
Furniture and computer equipment	\$	50,880	\$	48,399
Site and software development costs		40,015		36,294
Leasehold improvements		15,684		14,290
Construction in progress		15,107		4,800
		121,686		103,783
Less accumulated depreciation and amortization		(46,703)		(43,144)
Property and equipment, net	\$	74,983	\$	60,639

Property and equipment depreciation and amortization expense was \$6.5 million and \$3.9 million for the three months ended March 31, 2015 and 2014, respectively.

**6. Commitments and Contingencies***Leases*

The Company leases office space under non-cancelable leases. These leases expire at various dates through 2024 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 \$4.1 million and \$3.5 million in the three-months ended March 31, 2015 and 2014, respectively. The Company has issued letters of credit for approximately \$3.3 million as security for these lease agreements as of March 31, 2015 and December 31, 2014.

*Collection of Sales or Other Similar Taxes*

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

Based on the location of the Company's current operations, it collects and remits sales tax in Kentucky, Massachusetts, New York and Utah. 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 \$12.7 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.

### *Legal Matters*

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.

Table of Contents**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), deferred units, which currently represent Class A or Class B common stock of the Company.

In connection with the IPO and as described in Note 1, *Basis of Presentation*, the Company completed a corporate reorganization pursuant to which Wayfair LLC became a wholly-owned subsidiary of the Company, and the holders of equity interests in Wayfair LLC became stockholders of the Company. In addition, all of the outstanding common units and incentive units of Wayfair LLC were exchanged for shares of common stock or incentive units for common stock, and then were converted into shares of Class B common stock or incentive units for Class B common stock of the Company. Accordingly, common option units, restricted common units and deferred units were converted to stock options, restricted common stock and restricted stock units ( RSU ), respectively, and may be referred to as such in these notes to the consolidated financial statements. In connection with the IPO, the board of directors of the Company took over administration of the 2010 Plan and 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 419,552 shares had been issued as of March 31, 2015. Shares or RSUs forfeited, withheld for minimum statutory tax obligations, and unexercised stock option lapses from the 2010 Plan are available for grants of awards under the 2014 Plan.

All equity awards granted prior to the IPO were subject to two vesting triggers: a service period (typically five years) and a performance condition (a liquidity event in the form of either a change of control or an initial public offering, 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 will continue to vest over the remaining service period. Any future grants of awards are expected to vest over the service period.

In April 2014, the Company completed a tender offer to repurchase provisionally vested (defined as service period completed) stock options and restricted common stock from certain employees at a price of \$26.23 per share. A total of 202,757 shares of restricted common stock and 9,028 stock options were tendered for an aggregate of approximately \$5.5 million in net cash after adjusting for the exercise prices associated with the stock options. This tender offer was accounted for as a modification resulting in a \$5.5 million compensation charge when accepted by the employee. The Company recorded an expense of \$4.5 million and \$1.0 million in three month periods ended March 31, 2014 and June 30, 2014, respectively.

The following table presents activity relating to stock options under the 2010 Plan during the three months ended March 31, 2015:

Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual
--------	---------------------------------	--

Edgar Filing: Wayfair Inc. - Form 10-Q

			Term (Years)	
Outstanding at December 31, 2014	449,046	\$	2.98	6.5
Options exercised	(23,341)	\$	2.92	
Options forfeited/cancelled	(1,927)	\$	3.13	
Outstanding at March 31, 2015	423,778	\$	2.98	6.2
Exercisable at March 31, 2015	407,010	\$	2.97	6.2
Expected to vest as of March 31, 2015	10,832	\$	3.27	6.2

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

### Table of Contents

Intrinsic value of stock options exercised was \$0.5 million for the three months ended March 31, 2015. Aggregate intrinsic value of stock options outstanding and currently exercisable is \$12.3 million and \$11.9 million, respectively. 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 0.4 years as of March 31, 2015.

The following table presents activity relating to restricted common stock under the 2010 Plan during the three months ended March 31, 2015:

	Shares	Weighted-Average Grant Date Fair Value
Outstanding at December 31, 2014	161,476	\$ 4.75
Restricted stock vested	(139,841)	\$ 4.75
Unvested at March 31, 2015	21,635	\$ 4.75
Expected to vest as of March 31, 2015	14,021	\$ 4.75

The intrinsic value of restricted common stock vested was \$3.6 million for the three months ended March 31, 2015. Aggregate intrinsic value of restricted common stock outstanding is \$0.7 million as of March 31, 2015. Unrecognized equity based compensation expense related to restricted common stock expected to vest is less than \$0.1 million with a weighted average remaining vesting term of 0.3 years as of March 31, 2015.

The following table presents activity relating to RSUs under the 2010 and 2014 Plans during the three months ended March 31, 2015:

	Shares	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Contractual Term (Years)
Outstanding at December 31, 2014	4,542,231	\$ 17.67	5.6
RSUs granted	137,369	\$ 21.22	
RSUs vested	(419,552)	\$ 17.16	
RSUs forfeited/cancelled	(100,280)	\$ 21.43	
Outstanding at March 31, 2015	4,159,768	\$ 17.91	5.4
Expected to vest as of March 31, 2015	3,073,699	\$ 18.34	5.5

The intrinsic value of RSUs vested was \$10.7 million for the three months ended March 31, 2015. Aggregate intrinsic value of RSUs outstanding is \$133.6 million as of March 31, 2015. Unrecognized equity based compensation expense related to RSUs expected to vest is \$32.4 million with a weighted average remaining vesting term of 1.6 years as of March 31, 2015.

### 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

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

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.

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):

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

## Table of Contents

	Three months ended March 31,	
	2015	2014
<b>Net revenue</b>		
Direct Retail	\$ 369,396	\$ 226,000
Other	54,975	52,707
Net revenue	\$ 424,371	\$ 278,707

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	
	2015	2014
<b>Geographic net revenue:</b>		
United States	\$ 400,580	\$ 260,135
International	23,791	18,572
Total	\$ 424,371	\$ 278,707

	March 31,	December 31,
	2015	2014
<b>Geographic long-lived assets:</b>		
United States	\$ 72,812	\$ 59,013
International	2,171	1,626
Total	\$ 74,983	\$ 60,639

## 9. Income Taxes

For the three months ended March 31, 2015, income tax expense of less than \$0.1 million was recorded. The income tax expense recorded in the three months ended March 31, 2015 is primarily related to various foreign income tax assessments and to a lesser extent the amortization of goodwill for tax purposes for which there is no corresponding book deduction.

During the three months ended March 31, 2014, the Company was operating as a limited liability company and was taxed as a partnership under the Internal Revenue Code, and accordingly, no provision for federal or state and local income taxes was made on income since the members were individually liable for federal and state and local income taxes on their share of the Company's earnings. The Company recorded less than \$0.1 million in the three months ended March 31, 2014 associated with various foreign income tax assessments. 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 its corporate reorganization in 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.



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

The Company had gross unrecognized tax benefits of \$0.2 million as of March 31, 2015 which remains unchanged from December 31, 2014. The Company's policy is to recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense. The Company believes that it is reasonably possible that its remaining unrecognized tax benefits may be recognized by the end of 2015 as a result of a lapse of the statute of limitations.

Table of Contents

**10. Stockholders Equity**

*Corporate Reorganization*

On October 1, 2014, in anticipation of the IPO, the Company completed a corporate reorganization as described further in Note 1, *Basis of Presentation*. Pursuant to the corporate reorganization, Wayfair LLC became a wholly-owned subsidiary of the Company, and the holders of equity interests in Wayfair LLC became stockholders of the Company. The Company was incorporated as a Delaware corporation on August 8, 2014. In connection with this corporate reorganization, \$306.2 million of accumulated deficit from Wayfair LLC was transferred to additional paid in capital of the Company.

*Series A and Series B Convertible Redeemable Preferred Units of Wayfair LLC*

In connection with the corporate reorganization all of the outstanding Series A and Series B preferred units of Wayfair LLC were exchanged for shares of Series A and Series B convertible preferred stock of the Company. Immediately prior to the completion of the IPO, all of the outstanding shares of Series A and Series B convertible preferred stock converted into 27,546,934 shares of Class B common stock of the Company.

The Company recognized changes in the redemption value of the convertible redeemable preferred stock immediately as they occurred by adjusting the carrying amount of the redeemable security to what would be the redemption amount assuming the security was redeemable at the balance sheet date. Accordingly, the Company recorded accretion of the Series A convertible preferred stock of \$14.4 million credit, \$25.4 million, and \$12.2 million for the years ended December 31, 2014 and 2013 and 2012, respectively. At the time of the conversion of Series A and Series B redeemable convertible preferred stock an adjustment of \$14.8 million was recorded as a reduction of accretion expense when the carrying value of the convertible redeemable preferred units was reduced to its conversion value. The Company recorded accretion on the Series B redeemable convertible preferred stock of \$2.5 million for the year ended December 31, 2014.

Upon the issuance of Series B preferred units by Wayfair LLC in March 2014, the Company distributed \$15.0 million in accrued dividends to Series A convertible preferred stock holders and, upon the completion of the IPO in October 2014, distributed the remaining accrued dividends of \$24.5 million to Series A convertible preferred stock holders.

**Preferred Stock**

Upon the closing of the IPO in October 2014, the Company authorized 10,000,000 shares of undesignated preferred stock, \$0.001 par value per share, for future issuance. As of March 31, 2015, the Company had no shares of undesignated preferred stock issued or outstanding.

**Common Stock**

On October 7, 2014, the Company completed its IPO of 12,650,000 shares of its Class A common stock at a public offering price of \$29.00 per share, of which 10,500,000 shares were sold by the Company and 2,150,000 shares were sold by its selling stockholders, including 1,650,000 shares pursuant to the underwriters' option to purchase additional shares, resulting in net proceeds to the Company of approximately \$282.9 million, after deducting underwriting discounts and offering expenses. The Company did not receive any proceeds from the sale of shares by the selling stockholders.

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 40,736,828 and 37,002,874 shares of Class A common stock and 42,731,150 and 46,179,192 shares of Class B common stock were outstanding as of March 31, 2015 and December 31, 2014, 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. Each share of Class B common stock is entitled to ten votes per share and is convertible into one share of Class A common stock. The Class B common stock also has approval

Table of Contents

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 66 $\frac{2}{3}$ % 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 March 31, 2015, 27,824,101 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 a line of credit for up to \$25.0 million, with the committed amounts of \$10.0 million to be used for a revolving line of credit and to support letters of credit and \$15.0 million to be used to support the Company's credit card program. The Company is required to maintain certain covenants, including debt service coverage, tangible net worth, and unencumbered liquid assets. The Company did not borrow any amounts under the credit agreement during the three months ended March 31, 2015 and the year ended December 31, 2014. The credit agreement is renewable on an annual basis. The Company renewed this agreement on June 6, 2014 and it will mature on July 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 have been the only outstanding equity in the Company since the 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 as described in Note 10, *Stockholder's Equity*.

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 RSUs, 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 to common stockholders 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 share of Class A and Class B common stock are equivalent.

Even prior to the conversion of the Series A and Series B convertible preferred stock to Class B common stock, effective October 7, 2014, the Company applied the two class method for calculating and presenting earnings per share. Under the two class method, net loss attributable to

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

common stockholders is determined by allocating undistributed earnings between common stock and participating securities. Undistributed earnings are calculated as net loss less distributed earnings and accretion of Series A and Series B convertible preferred stock. As holders of Series A and Series B convertible preferred stock did not have a contractual obligation to share in the losses of the Company, the net loss attributable to common stockholders for each periods prior to the IPO was not allocated between common stock and participating securities. Accordingly, Series A and Series B convertible preferred stock are excluded from the calculation of basic and diluted net loss per share. The Company's basic and diluted net loss per share are the same because the Company has generated net loss to common stockholders and common stock equivalents are excluded from diluted net loss per share because they have an antidilutive impact.

Table of Contents

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

	<b>Three months ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
Net loss	\$ (27,136)	\$ (28,026)
Accretion of convertible redeemable preferred units		(7,150)
Net loss attributable to common stockholders	\$ (27,136)	\$ (35,176)
Weighted average common shares used for basic and diluted net loss per share computation	83,210	41,144
Net loss unit attributable to common stockholders per share:		
Basic and Diluted	\$ (0.33)	\$ (0.85)

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

	<b>Three months ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
Series A convertible redeemable preferred units		21,551,801
Series B convertible redeemable preferred units		5,995,133
Stock options	423,778	658,012
Restricted stock	21,635	3,474,273
Restricted stock units	4,159,768	5,292,793
Total	4,605,181	36,972,012

**13. Recent Accounting Pronouncements**

In August 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU 2014-15"), *Presentation of Financial Statements, Going Concern*. ASU 2014-15 will explicitly require management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosure in certain circumstances. The new standard will be effective for all entities in the first annual period ending after December 15, 2016 and earlier adoption is permitted. Management does not expect that the application of ASU 2014-15 will have an impact on the Company's financial condition, results of operations or cash flows.

In May 2014, the FASB issued ASU No. 2014-09 ("ASU 2014-09"), *Revenue from Contracts with Customers*. 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 is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. Accordingly, the Company will adopt this ASU on January 1, 2017. Management is currently evaluating which transition approach to use and the impact of the adoption of this ASU on the Company's financial condition, results of operations or cash flows.

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**

Wayfair is one of the world's largest online destinations for the home. 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.

The typical Wayfair customer is a 35 to 65 year old woman with an annual household income of \$60,000 to \$175,000, who we consider to be a mass market consumer and who we believe is underserved by traditional brick and mortar and other online retailers of home goods. Because each of our customers has a different taste, style, purchasing goal and budget when shopping for her home, we have built one of the largest online selections of furniture, home furnishings, décor and goods. We are able to offer this vast selection of products while holding minimal inventory because we typically ship products directly from our suppliers to our customers. This supplier direct fulfillment network is a key component of our custom-built technology and operational platform, which also includes extensive supplier integrations, a proprietary transportation delivery network and superior customer service.

We founded our company in May 2002 and have since delivered over 18 million orders. From 2002 through 2011, the Company was bootstrapped by our co-founders and operated as hundreds of niche websites, such as bedroomfurniture.com and allbarstools.com. In 2006, we launched AllModern. 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, home furnishings, décor and goods and to build brand awareness, drive customer loyalty and increase repeat purchasing.

Our co-founders are lifetime tech innovators who have worked together in the commercial internet sector since 1995 and have created a company culture deeply rooted in technology. Our technology and data focus facilitates critical e-commerce capabilities such as tailored shopping experiences across our five brands, consumer targeting and personalization, and anytime, anywhere shopping across our websites, mobile-optimized websites and mobile applications, which we collectively refer to as our sites.

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

In the three months ended March 31, 2015, we generated net revenue of \$424.4 million, up 52.3% over the same period in 2014. Our net revenue in the three months ended March 31, 2015 included \$369.4 million from Direct Retail, which we define as sales generated primarily through the sites of our five brands and \$55.0 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, 2015, we generated a net loss of \$27.1 million and Adjusted EBITDA of \$(12.3) million, decreases of \$0.9 million and \$7.1 million, respectively, over the same period in 2014. Our net loss and Adjusted EBITDA results were primarily due to a decrease in advertising as a percentage of net revenue in the three months ended March 31, 2015 compared to the same period in 2014, which were driven by increased leverage from our growing base of repeat customers, and television advertising expense not increasing at the same rate as revenue growth. 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):

	<b>Three months ended March 31,</b>		
	<b>2015</b>	<b>2014</b>	<b>% Change</b>
<b>Consolidated Financial Metrics</b>			
Net Revenue	\$ 424,371	\$ 278,707	52.3%
Adjusted EBITDA	\$ (12,340)	\$ (19,403)	
Free cash flow	\$ (51,368)	\$ (38,506)	
<b>Direct Retail Financial and Operating Metrics</b>			
Direct Retail Net Revenue	\$ 369,396	\$ 226,000	63.4%
Active Customers	3,597	2,409	49.3%
LTM Net Revenue per Active Customer	\$ 346	\$ 323	7.1%
Orders Delivered	1,797	1,138	57.9%
Average Order Value	\$ 206	\$ 199	3.5%

**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 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.

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

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 the compensation charge associated with a tender offer we completed in April 2014 and the equity based compensation and related taxes recorded in the first quarter of 2015 as described in Part 1, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, *Liquidity and Capital Resources*.
- Adjusted EBITDA does not reflect changes in our working capital;

Table of Contents

- 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) income and our other GAAP results.

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

	<b>Three months ended March 31,</b>	
	<b>2015</b>	<b>2014</b>
<b>Reconciliation of Adjusted EBITDA</b>		
Net loss	\$ (27,136)	\$ (28,026)
Depreciation and amortization	6,744	4,198
Equity based compensation and related taxes	8,162	4,554
Interest income, net	(264)	(56)
Other (expense) income, net	108	(88)
Provision for income taxes	46	15
<b>Adjusted EBITDA</b>	<b>\$ (12,340)</b>	<b>\$ (19,403)</b>

**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.

Edgar Filing: Wayfair Inc. - Form 10-Q

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):

	<b>Three months ended March 31,</b>			
	<b>2015</b>		<b>2014</b>	
Net cash used in operating activities	\$	(35,202)	\$	(24,432)
Purchase of property, equipment, and leasehold improvements		(12,051)		(11,357)
Site and software development costs		(4,115)		(2,717)
Free cash flow	\$	(51,368)	\$	(38,506)

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.

Table of Contents

**Revenue Growth through Mobile Platform**

Mobile is an increasingly important part of our business. We launched our mobile applications for Joss & Main in 2012 and Wayfair.com in 2014. 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.

**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. In 2013, we signed a lease to increase our office space, in 2014 we further increased the office space to accommodate the anticipated growth of our headcount in our corporate headquarters and in 2014 we also signed a lease to expand 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.

**Components of Our Results of Operations**

Certain prior period operating expense captions in the consolidated statements of operations have been expanded to provide greater detail and to conform to current period presentation.

**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, rewards 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.

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

We maintain a membership rewards program that allows enrolled customers to earn points which can be redeemed on future purchases. We defer the portion of our revenue associated with rewards which are expected to be redeemed prior to its expiration.

### **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 quarterly fluctuations are expected due to the wide variety of products we sell.



Table of Contents

**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. Increase 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.

**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.

**Amortization of Acquired Intangible Assets**

We have recorded identifiable intangible assets in conjunction with our acquisitions and are amortizing those assets over their estimated useful lives. We perform impairment testing of goodwill and intangibles with definite lives annually and whenever events or circumstances indicate that an impairment may have occurred.

**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 (Expense) Income, Net**

Other (expense) income, net consist primarily foreign currency gains (losses).

Table of Contents**Results of Consolidated Operations (in thousands)****Comparison of the three months ended March 31, 2015 and 2014****Net revenue**

	<b>Three months ended March 31,</b>		
	<b>2015</b>	<b>2014</b>	<b>% Change</b>
<b>Net revenue</b>			
Direct Retail	\$ 369,396	\$ 226,000	63.4%
Other	54,975	52,707	4.3%
Net revenue	\$ 424,371	\$ 278,707	52.3%

In the three months ended March 31, 2015, net revenue increased by \$145.7 million, or 52.3% compared to the same period in 2014, primarily as a result of an increase in Direct Retail net revenue. In the three months ended March 31, 2015, Direct Retail net revenue increased by \$143.4 million, or 63.4% compared to the same period in 2014, primarily due to sales to a larger customer base, as the number of active customers increased 49.3% in the three months ended March 31, 2015 compared to the same period in 2014. Additionally, LTM net revenue per active customer increased 7.1% in the three months ended March 31, 2015 compared with the same period in 2014. The \$2.3 million or 4.3% increase in other revenue in the three months ended March 31, 2015 as compared to the same period in 2014 was primarily due to increased sales through our retail partners.

**Cost of goods sold**

	<b>Three months ended March 31,</b>		
	<b>2015</b>	<b>2014</b>	<b>% Change</b>
<b>Cost of goods sold</b>			
Cost of goods sold	\$ 321,536	\$ 213,500	50.6%
<i>As a percentage of net revenue</i>	<i>75.8%</i>	<i>76.6%</i>	

In the three months ended March 31, 2015, costs of goods sold increased by \$108.0 million, or 50.6%, compared to the same period in 2014. Of the increase in cost of goods sold, \$88.5 million was due to the increase in products sold to our larger customer base. In addition, shipping and fulfillment costs increased \$19.5 million as a result of the increase in products sold during the period. Costs of goods sold as a percentage of net revenue decreased in the three months ended March 31, 2015 compared to the same period in 2014 as a result of changes in the mix of the products sold and shipping costs.

Table of Contents**Operating expenses**

	<b>Three months ended March 31,</b>		<b>% Change</b>
	<b>2015</b>	<b>2014</b>	
Customer service and merchant fees (1)	\$ 15,978	\$ 10,969	45.7%
Advertising	57,999	44,204	31.2%
Merchandising, marketing and sales (1)	23,234	15,171	53.1%
Operations, technology, general and administrative (1)	32,620	22,769	43.3%
Amortization of acquired intangible assets	250	249	0.4%
	\$ 130,081	\$ 93,362	39.3%
<i>As a percentage of net revenue</i>			
Customer service and merchant fees		3.8%	3.9%
Advertising		13.7%	15.9%
Merchandising, marketing and sales		5.4%	5.4%
Operations, technology, general and administrative		7.7%	8.2%
Amortization of acquired intangible assets		0.1%	0.1%
		30.7%	33.5%

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

Customer service and merchant fees	3.7%	3.9%
Merchandising, marketing and sales	4.6%	4.1%
Operations, technology, general and administrative	6.7%	7.9%

In the three months ended March 31, 2015, excluding the impact of equity based compensation and related taxes of \$0.2 million and less than \$0.1 million recorded in the three months ended March 31, 2015 and 2014, respectively, customer service costs and merchant processing fees increased by \$4.9 million, from \$10.9 million in the three months ended March 31, 2014 to \$15.8 million primarily due to the increase in sales during the three months ended March 31, 2015. Our advertising expenses increased by \$13.8 million from \$44.2 million in the three months ended March 31, 2014 to \$58.0 million in the same period 2015, 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, 2015 compared to the same period in 2014 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. Excluding the impact of equity based compensation and related taxes of \$3.9 million recorded in the three months ended March 31, 2015 and 2014, merchandising, marketing and sales expenses increased by \$8.1 million, from \$11.3 million in the three months ended March 31, 2014 to \$19.4 million in the same period of 2015. 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, 2015, excluding the impact of equity based compensation and related taxes of \$4.0 million and \$0.6 recorded in the three months ended March 31, 2015 and 2014, respectively, operations, technology, general and administrative expense increased by \$6.5 million from \$22.1 million in the three months ended March 31, 2014 to \$28.6 million in the same period of 2015. 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 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. In the three months ended March 31, 2015, amortization of purchased intangible assets increased by less than \$0.1 million compared to the same period of 2014.

Table of Contents**Liquidity and Capital Resources****Sources of Liquidity**

	March 31, 2015	(in thousands)	December 31, 2014
Cash and cash equivalents	\$ 206,082		\$ 355,859
Short-term investments	\$ 74,213		\$ 60,000
Long-term investments	\$ 79,307		\$
Accounts receivable, net	\$ 7,958		\$ 5,949
Working capital	\$ 149,035		\$ 254,276

**Historical Cash Flows**

	2015	Three months ended March 31, (in thousands)	2014
Net loss	\$ (27,136)		\$ (28,026)
Net cash used in operating activities	\$ (35,202)		\$ (24,432)
Net cash used in investing activities	\$ (110,097)		\$ (17,502)
Net cash (used in) provided by financing activities	\$ (4,236)		\$ 111,720

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, 2015, 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, proceeds from the IPO 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. 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 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 used in operating activities consisted of net loss adjusted for certain non-cash items including depreciation and amortization, and certain other non-cash expenses, as well as the effect of changes in working capital and other activities.

Table of Contents

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.

Cash used in operating activities in the three months ended March 31, 2014 was \$24.4 million and was driven by a net loss of \$28.0 million and cash used in operating assets and liabilities of \$5.2 million, partially offset by certain non-cash items including depreciation and amortization expense of \$4.2 million, equity based compensation of \$4.5 million, and other non-cash items of \$0.1 million.

**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 maturities of marketable securities, leasehold improvements for our facilities and acquisitions of businesses.

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.

Cash used in investing activities in the three months ended March 31, 2014 was \$17.5 million and was primarily driven by purchases of property and equipment of \$11.4 million, purchases of short-term investments of \$10.0 million, site and software development costs of \$2.7 million, and other net investing activities of \$3.4 million, partially offset by net increase in the maturity of short-term investments of \$10.0 million.

**Financing Activities**

Cash used in financing activities in the three months ended March 31, 2015 was \$4.2 million and was primarily due to \$4.3 million 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, 2014 was \$111.7 million and was primarily due to net proceeds from issuance of Series B convertible redeemable preferred units of \$154.8 million, partially offset by the repurchase of common units of \$23.5 million, the dividend distribution to our Series A preferred unit holders of \$15.0 million and the repurchase of our securities of \$4.6 million.

**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.



Table of Contents

**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 critical accounting policies and estimates as compared to the contractual obligations described in *Contractual Obligations* included 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, 2014.

**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, 2014 except those described in Note 1, *Basis of Presentation*, 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.

**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 are held primarily in cash deposits, certificates of deposit, money market funds, commercial paper, corporate bonds, and treasury securities. 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, Australian Dollar 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, 2015. 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, 2015, 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.**

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 have any pending litigation to which we are a party or to which our property is subject that we believe to be material. 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**

*Our operations and financial results are subject to various risks and uncertainties, including those described below. We caution you that the following important factors, among others, could cause our actual results to differ materially from those expressed in forward-looking statements made by us or on our behalf in filings with the SEC, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in the discussion below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may differ materially from those anticipated in forward-looking statements. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make in our reports filed with the SEC.*

**Risks Related to Our Business and Industry**

*Our recent growth rates may not be sustainable or indicative of our future growth.*

In late 2011, we closed and permanently redirected over 240 of our niche websites into Wayfair.com. Additionally, we launched Joss & Main. In 2013, we acquired DwellStudio, and in 2014, we launched Birch Lane. Because we launched most of our brands in recent years, we have a limited amount of information regarding the purchasing patterns of our customers on these websites. We depend heavily on this information to plan and forecast our business, including anticipated customer acquisition costs, net revenue per active customer and other key performance metrics. If our assumptions prove to be wrong, we may spend more than we anticipate acquiring and retaining customers or may generate less net revenue per active customer than anticipated, any of which could have a negative impact on our business and results of operations. In addition, our historical growth rates may not be sustainable or indicative of future growth.

We believe that our continued revenue growth will depend upon, among other factors, our ability to:

- build our brands and launch new brands;
- acquire more customers;
- develop new features to enhance the consumer experience on our websites, mobile-optimized websites and mobile applications, which we collectively refer to as our sites;
- increase the frequency with which new and repeat customers purchase products on our sites through merchandising, data, analytics and technology;

Table of Contents

- add new suppliers and deepen our relationships with our existing suppliers;
- enhance the systems our consumers use to interact with our sites and invest in our infrastructure platform;
- expand internationally; and
- pursue strategic acquisitions.

We cannot assure you we will be able to achieve any of the foregoing. Our customer base may not continue to grow or may decline as a result of increased competition and the maturation of our business. Failure to continue our revenue growth rates could have a material adverse effect on our financial condition and results of operations. You should not rely on our historical rate of revenue growth as an indication of our future performance.

*If we fail to manage our growth effectively, our business, financial condition and operating results could be harmed.*

To manage our growth effectively, we must continue to implement our operational plans and strategies, improve and expand our infrastructure of people and information systems and expand, train and manage our employee base. We have rapidly increased employee headcount since our inception to support the growth in our business. The number of our employees increased from 1,558 full-time equivalents as of December 31, 2013 to 2,353 full-time equivalents as of December 31, 2014. To support continued growth, we must effectively integrate, develop and motivate a large number of new employees. We face significant competition for personnel, particularly in the Boston, Massachusetts area where our headquarters are located. Failure to manage our hiring needs effectively or successfully integrate our new hires may have a material adverse effect on our business, financial condition and operating results.

Additionally, the growth of our business places significant demands on our management and other employees. For example, we typically launch hundreds of promotional events across thousands of products each month on Wayfair.com, in addition to hundreds of promotional events or Daily Events on Joss & Main in which we promote thousands of products via emails, push notifications and personalized displays. These events require us to produce updates of our sites and emails to our customers on a daily basis with different products, photos and text. The growth of our business may require significant additional resources to meet these daily requirements, which may not scale in a cost-effective manner or may negatively affect the quality of our sites and customer experience. We are also required to manage relationships with a growing number of suppliers, customers and other third parties. Our information technology systems and our internal controls and procedures may not be adequate to support future growth of our supplier base. If we are unable to manage the growth of our organization effectively, our business, financial condition and operating results may be materially adversely affected.

*If we fail to acquire new customers, or fail to do so in a cost-effective manner, we may not be able to increase net revenue per active customer or achieve profitability.*

Our success depends on our ability to acquire customers in a cost-effective manner. In order to expand our customer base, we must appeal to and acquire customers who have historically used other means of commerce to purchase home goods and may prefer alternatives to our offerings, such as traditional brick and mortar retailers, the websites of our competitors or our suppliers' own websites. We have made significant investments related to customer acquisition and expect to continue to spend significant amounts to acquire additional customers. For example,

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

we have continued to expand our national U.S. television branding and advertising campaigns. Such campaigns are expensive and may not result in the cost-effective acquisition of customers. We cannot assure you that the net profit from new customers we acquire will ultimately exceed the cost of acquiring those customers. If we fail to deliver a quality shopping experience, or if consumers do not perceive the products we offer to be of high value and quality, we may not be able to acquire new customers. If we are unable to acquire new customers who purchase products in numbers sufficient to grow our business, we may not be able to generate the scale necessary to drive beneficial network effects with our suppliers, our net revenue may decrease, and our business, financial condition and operating results may be materially adversely affected.

We believe that many of our new customers originate from word-of-mouth and other non-paid referrals from existing customers. Therefore we must ensure that our existing customers remain loyal to us in order to continue receiving those referrals. If our efforts to satisfy our existing customers are not successful, we may not be

Table of Contents

able to acquire new customers in sufficient numbers to continue to grow our business, or we may be required to incur significantly higher marketing expenses in order to acquire new customers.

We also utilize paid and non-paid advertising. Our paid advertising includes search engine marketing, display advertising, paid social media and television advertisements. Our non-paid advertising efforts include search engine optimization, non-paid social media, mobile push notifications and email. We obtain a significant amount of traffic via search engines and, therefore, rely on search engines such as Google, Bing and Yahoo!. Search engines frequently update and change the logic that determines the placement and display of results of a user's search, such that the purchased or algorithmic placement of links to our sites can be negatively affected. Moreover, a search engine could, for competitive or other purposes, alter its search algorithms or results, causing our sites to place lower in search query results. A major search engine could change its algorithms in a manner that negatively affects our paid or non-paid search ranking, and competitive dynamics could impact the effectiveness of search engine marketing or search engine optimization. We also obtain a significant amount of traffic via social networking websites or other channels used by our current and prospective customers. As e-commerce and social networking continue to rapidly evolve, we must continue to establish relationships with these channels and may be unable to develop or maintain these relationships on acceptable terms. If we are unable to cost-effectively drive traffic to our sites, our ability to acquire new customers and our financial condition would suffer.

***Our success depends in part on our ability to increase our net revenue per active customer. If our efforts to increase customer loyalty and repeat purchasing as well as maintain high levels of customer engagement and average order values of our customers are not successful, our growth prospects and revenue will be materially adversely affected.***

Our ability to grow our business depends on our ability to retain our existing customer base and generate increased revenue and repeat purchases from this customer base, and maintain high levels of customer engagement. To do this, we must continue to provide our customers and potential customers with a unified, convenient, efficient and differentiated shopping experience by:

- providing imagery, tools and technology that attract customers who historically would have bought elsewhere;
- maintaining a high-quality and diverse portfolio of products;
- managing over 7,000 suppliers to deliver products on time and without damage; and
- continuing to invest in our mobile platforms.

If we fail to increase net revenue per active customer, generate repeat purchases or maintain high levels of customer engagement and average order value, our growth prospects, operating results and financial condition could be materially adversely affected.

***Our business depends on our ability to build and maintain strong brands. We may not be able to maintain and enhance our existing brands if we receive unfavorable customer complaints, negative publicity or otherwise fail to live up to consumers' expectations, which could materially adversely affect our business, results of operations and growth prospects.***



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

We currently offer five distinct brands to our customers, but we have a limited operating history with most of these brands. Maintaining and enhancing these brands are critical to expanding our base of customers and suppliers. However, a significant portion of our customers' brand experience depends on third parties outside of our control, including suppliers and logistics providers such as FedEx, UPS and the U.S. Postal Service. If these third parties do not meet our or our customers' expectations, our brand may suffer irreparable damage. In addition, maintaining and enhancing these brands may require us to make substantial investments, and these investments may not be successful. If we fail to promote and maintain our brands, or if we incur excessive expenses in this effort, our business, operating results and financial condition may be materially adversely affected. We anticipate that, as our market becomes increasingly competitive, maintaining and enhancing our brands may become increasingly difficult and expensive. Maintaining and enhancing our brands will depend largely on our ability to provide high quality products to our customers and a reliable, trustworthy and profitable sales channel to our suppliers, which we may not do successfully.

Table of Contents

Customer complaints or negative publicity about our sites, products, product delivery times, customer data handling and security practices or customer support, especially on blogs, social media websites and our sites, could rapidly and severely diminish consumer use of our sites and consumer and supplier confidence in us and result in harm to our brands.

***Our efforts to launch new brands and expand our existing brand portfolio internationally may not be successful.***

Our business success depends to some extent on our ability to expand our customer offerings by launching new brands and expanding our existing brand portfolio into new geographies. For example, in 2014 we launched Birch Lane in the United States and Canada, and we launched our Joss & Main brand in the United Kingdom, France and Germany. Launching new brands or expanding our existing brand portfolio internationally requires significant upfront investments, including investments in marketing, information technology and additional personnel. Expanding our brands internationally is particularly challenging because it requires us to gain country-specific knowledge about consumers and regional competitors, construct home goods catalogs specific to the country, build local logistics capabilities and customize portions of our technology for local markets. We may not be able to generate satisfactory revenue from these efforts to offset these upfront costs. Any lack of market acceptance of our efforts to launch new brands or expand our existing brand portfolio could have a material adverse effect on our business, prospects, financial condition and results of operations.

***Expansion of our international operations will require management attention and resources, involves additional risks, and may be unsuccessful, which could harm our future business development and existing domestic operations.***

We believe international expansion represents a significant growth opportunity for us. Today, we deliver products to customers in a number of countries, and plan to expand into other international markets in order to grow our business, which will require significant management attention and resources. For example, we have made and will continue to make significant investments in information technology, logistics, supplier relationships, merchandising and marketing in the foreign jurisdictions in which we operate or plan to operate. We have limited experience in selling our products to conform to different local cultures, standards and regulations, and the products we offer may not appeal to customers in the same manner, if at all, in other geographies. We may have to compete with local companies which understand the local market better than we do and/or may have greater brand recognition than we do. In addition, to deliver satisfactory performance for customers in international locations, it may be necessary to locate physical facilities, such as consolidation centers, in foreign markets, and we may have to invest in these facilities before we can determine whether or not our foreign operations are successful. We have limited experience establishing such facilities internationally and therefore may decide not to continue with the expansion of operations. We may not be successful in expanding into additional international markets or in generating net revenue from foreign operations. Furthermore, different privacy, censorship, liability, intellectual property and other laws and regulations in foreign countries may cause our business, financial condition and operating results to be materially adversely affected.

Our future results could be materially adversely affected by a number of factors inherent in international operations, including:

- localization of our product offerings, including translation into foreign languages and adaptation for local practices;
- the need to vary our practices in ways with which we have limited or no experience or which are less profitable or carry more risk to us;
- unexpected changes in regulatory requirements, taxes, trade laws, tariffs, export quotas, custom duties or other trade restrictions;

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

- differing labor regulations where labor laws may be more advantageous to employees as compared to the United States;
- more stringent regulations relating to data privacy and security, including the use of commercial and personal information, particularly in the European Union;
- changes in a specific country's or region's political or economic conditions;
- the rising cost of labor in the foreign countries in which our suppliers operate, resulting in increases in our costs of doing business internationally;

Table of Contents

- challenges inherent in efficiently managing an increased number of employees over large geographic distances, including the need to implement appropriate systems, policies, benefits and compliance programs and maintain our corporate culture across geographies;
- risks resulting from changes in currency exchange rates;
- limitations on our ability to reinvest earnings from operations in one country to fund the capital needs of our operations in other countries;
- different or lesser intellectual property protection;
- exposure to liabilities under anti-corruption and anti-money laundering laws, including the U.S. Foreign Corrupt Practices Act and similar laws and regulations in other jurisdictions;
- import/export controls; and
- logistics and sourcing.

Operating internationally requires significant management attention and financial resources. We cannot be certain that the investment and additional resources required to establish and expand our international operations will produce desired levels of net revenue or profitability. If we invest substantial time and resources to establish and expand our international operations and are unable to do so successfully and in a timely manner, our business, financial condition and operating results may be materially adversely affected.

***We have a history of losses and expect to have increasing operating losses and negative cash flow as we continue to expand our business.***

We have a history of losses, and we accumulated \$306.2 million in common members' deficit as Wayfair LLC and an additional \$85.3 million loss as Wayfair Inc. through March 31, 2015. We expect our operating losses and negative cash flow to continue in the near-term as we increase investment in our business. Because the market for purchasing home goods online is rapidly evolving and has not yet reached widespread adoption, it is difficult for us to predict our future operating results. As a result, our losses may be larger than anticipated, and we may never achieve profitability. We expect our operating expenses to increase over the next several years as we increase our advertising budget, hire additional personnel and continue to develop features on our sites. In particular, we intend to continue to invest substantial resources in marketing to acquire new customers. In addition, as we grow as a newly public company, we have and will continue to incur additional significant legal, accounting and other expenses that we did not previously incur as a private company. Furthermore, if our future growth and operating performance fail to meet investor or analyst expectations, or if we have future negative cash flow or losses resulting from our investment in acquiring new customers, our financial condition and stock price could be materially adversely affected.

***System interruptions that impair customer access to our sites or other performance failures in our technology infrastructure could damage our business, reputation and brand and substantially harm our business and results of operations.***

The satisfactory performance, reliability and availability of our sites, transaction processing systems and technology infrastructure are critical to our reputation and our ability to acquire and retain customers, as well as maintain adequate customer service levels.

We currently utilize three third-party data center hosting facilities. If one of our facilities fails or suffers an interruption or degradation of services, we could lose customer data and miss order fulfillment deadlines, which could harm our business. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunications failure, terrorist attacks, cyber-attacks, data loss, acts of war, break-ins, earthquake and similar events. In the event of a failure of a facility, the failover to its back-up facility could take substantial time, during which time our sites could be completely shut down. Our back-up facilities are designed to support transaction volumes at a level slightly above our average daily sales, but may not be adequate to support spikes in demand. Our back-up facilities may not process effectively during times of higher traffic to our sites and may process transactions more slowly and may not support all of our sites' functionality.

Table of Contents

We use complex proprietary software in our technology infrastructure, which we seek to continually update and improve. We may not always be successful in executing these upgrades and improvements, and the operation of our systems may be subject to failure. In particular, we have in the past and may in the future experience slowdowns or interruptions in some or all of our sites when we are updating them, and new technologies or infrastructures may not be fully integrated with existing systems on a timely basis, or at all. Additionally, if we expand our use of third-party services, including cloud-based services, our technology infrastructure may be subject to increased risk of slowdown or interruption as a result of integration with such services and/or failures by such third-parties, which are out of our control. Our net revenue depends on the number of visitors who shop on our sites and the volume of orders we can handle. Unavailability of our sites or reduced order fulfillment performance would reduce the volume of goods sold and could also materially adversely affect consumer perception of our brand. We may experience periodic system interruptions from time to time. In addition, continued growth in our transaction volume, as well as surges in online traffic and orders associated with promotional activities or seasonal trends in our business, place additional demands on our technology platform and could cause or exacerbate slowdowns or interruptions. If there is a substantial increase in the volume of traffic on our sites or the number of orders placed by customers, we will be required to further expand and upgrade our technology, transaction processing systems and network infrastructure. There can be no assurance that we will be able to accurately project the rate or timing of increases, if any, in the use of our sites or expand and upgrade our systems and infrastructure to accommodate such increases on a timely basis. In order to remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our sites, which is particularly challenging given the rapid rate at which new technologies, customer preferences and expectations and industry standards and practices are evolving in the e-commerce industry. Accordingly, we redesign and enhance various functions on our sites on a regular basis, and we may experience instability and performance issues as a result of these changes.

Any slowdown or failure of our sites and the underlying technology infrastructure could harm our business, reputation and our ability to acquire, retain and serve our customers, which could materially adversely affect our results of operations. Our disaster recovery plan may be inadequate, and our business interruption insurance may not be sufficient to compensate us for the losses that could occur.

***Our business is highly competitive. Competition presents an ongoing threat to the success of our business.***

Our business is rapidly evolving and intensely competitive, and we have many competitors in different industries. Our competition includes: furniture stores, big box retailers, department stores, specialty retailers, and online retailers and marketplaces, including:

- *Furniture Stores:* Ashley Furniture, Bob's Discount Furniture, Havertys, Raymour & Flanagan and Rooms To Go;
- *Big Box Retailers:* Bed, Bath & Beyond, Home Depot, IKEA, Lowe's, Target and Walmart;
- *Department Stores:* JCPenney and Macy's;
- *Specialty Retailers:* Crate and Barrel, Ethan Allen, HomeGoods, Pottery Barn and Restoration Hardware; and
- *Online Retailers and Online Marketplaces:* Amazon and eBay.

We expect competition in e-commerce generally to continue to increase. We believe that our ability to compete successfully depends upon many factors both within and beyond our control, including:

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

- the size and composition of our customer base;
- the number of suppliers and products we feature on our sites;
- our selling and marketing efforts;
- the quality, price and reliability of products offered either by us;
- the convenience of the shopping experience that we provide;
- our ability to distribute our products and manage our operations; and
- our reputation and brand strength.

Many of our current competitors have, and potential competitors may have, longer operating histories, greater brand recognition, larger fulfillment infrastructures, greater technical capabilities, faster and less costly

Table of Contents

shipping, significantly greater financial, marketing and other resources and larger customer bases than we do. These factors may allow our competitors to derive greater net revenue and profits from their existing customer base, acquire customers at lower costs or respond more quickly than we can to new or emerging technologies and changes in consumer habits. These competitors may engage in more extensive research and development efforts, undertake more far-reaching marketing campaigns and adopt more aggressive pricing policies, which may allow them to build larger customer bases or generate net revenue from their customer bases more effectively than we do.

***Purchasers of home goods may not choose to shop online, which would prevent us from growing our business.***

The online market for home goods in the United States is less developed than the online market for apparel, consumer electronics and other consumer products in the United States and, we believe, only accounts for a small portion of the market as a whole. If the online market for home goods does not gain acceptance, our business may suffer. Our success will depend, in part, on our ability to attract consumers who have historically purchased home goods through traditional retailers. Furthermore, we may have to incur significantly higher and more sustained advertising and promotional expenditures in order to attract additional online consumers to our sites and convert them into purchasing customers. Specific factors that could impact consumers' willingness to purchase home goods from us include:

- concerns about buying products, and in particular larger products, without a physical storefront, face-to-face interaction with sales personnel and the ability to physically examine products;
- delivery time associated with online orders;
- actual or perceived lack of security of online transactions and concerns regarding the privacy of personal information;
- delayed shipments or shipments of incorrect or damaged products;
- inconvenience associated with returning or exchanging items purchased online; and
- usability, functionality and features of our sites.

If the shopping experience we provide does not appeal to consumers or meet the expectations of existing customers, we may not acquire new customers at rates consistent with historical periods, and existing customers' buying patterns and levels may be less than historical rates.

***We may be subject to product liability claims if people or property are harmed by the products we sell.***

Some of the products we sell or have manufactured for us may expose us to product liability claims and litigation or regulatory action relating to personal injury, death or environmental or property damage. Some of our agreements with our suppliers and international manufacturers may not indemnify us from product liability for a particular supplier's or international manufacturer's products, or our suppliers or international manufacturers may not have sufficient resources or insurance to satisfy their indemnity and defense obligations. Although we maintain liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all.



*Risks associated with the suppliers from whom our products are sourced could materially adversely affect our financial performance as well as our reputation and brand.*

We depend on our ability to provide our customers with a wide range of products from qualified suppliers in a timely and efficient manner. Political and economic instability, the financial stability of suppliers, suppliers' ability to meet our standards, labor problems experienced by suppliers, the availability of raw materials, merchandise quality issues, currency exchange rates, transport availability and cost, transport security, inflation, and other factors relating to the suppliers are beyond our control.

Our agreements with most of our suppliers do not provide for the long-term availability of merchandise or the continuation of particular pricing practices, nor do they restrict such suppliers from selling products to other buyers. There can be no assurance that our current suppliers will continue to seek to sell us products on current terms or that we will be able to establish new or otherwise extend current supply relationships to ensure product acquisitions in a timely and efficient manner and on acceptable commercial terms. Our ability to develop and maintain relationships with reputable suppliers and offer high quality merchandise to our customers is critical to our

Table of Contents

success. If we are unable to develop and maintain relationships with suppliers that would allow us to offer a sufficient amount and variety of quality merchandise on acceptable commercial terms, our ability to satisfy our customers' needs, and therefore our long-term growth prospects, would be materially adversely affected.

We also are unable to predict whether any of the countries in which our suppliers' products are currently manufactured or may be manufactured in the future will be subject to trade restrictions imposed by the U.S. or foreign governments or the likelihood, type or effect of any such restrictions. Any event causing a disruption or delay of imports from suppliers with international manufacturing operations, including the imposition of additional import restrictions, restrictions on the transfer of funds or increased tariffs or quotas, could increase the cost or reduce the supply of merchandise available to our customers and materially adversely affect our financial performance as well as our reputation and brand. Furthermore, some or all of our suppliers' foreign operations may be adversely affected by political and financial instability, resulting in the disruption of trade from exporting countries, restrictions on the transfer of funds or other trade disruptions.

In addition, our business with foreign suppliers, particularly with respect to our international sites, may be affected by changes in the value of the U.S. dollar relative to other foreign currencies. For example, any movement by any other foreign currency against the U.S. dollar may result in higher costs to us for those goods. Declines in foreign currencies and currency exchange rates might negatively affect the profitability and business prospects of one or more of our foreign suppliers. This, in turn, might cause such foreign suppliers to demand higher prices for merchandise in their effort to offset any lost profits associated with any currency devaluation, delay merchandise shipments, or discontinue selling to us altogether, any of which could ultimately reduce our sales or increase our costs.

*We may be unable to source additional or strengthen our relationships with suppliers.*

As of December 31, 2014, we had relationships with over 7,000 suppliers. Our agreements with suppliers are generally terminable at will by either party upon short notice. If we do not maintain our existing relationships or build new relationships with suppliers on acceptable commercial terms, we may not be able to maintain a broad selection of merchandise, and our business and prospects would suffer severely.

In order to attract quality suppliers to our platform, we must:

- demonstrate our ability to help our suppliers increase their sales;
- offer suppliers a high quality, cost-effective fulfillment process; and
- continue to provide suppliers a dynamic and real-time view of our demand and inventory needs via powerful data and analytics capabilities.

If we are unable to provide our suppliers with a compelling return on investment and an ability to increase their sales, we may be unable to maintain and/or expand our supplier network, which would negatively impact our business.

*We depend on our suppliers to perform certain services regarding the products that we offer.*

As part of offering our suppliers' products for sale on our sites, these suppliers generally agree to conduct a number of traditional retail operations with respect to their respective products, including maintaining inventory and preparing merchandise for shipment to our customers. We may be unable to ensure that these suppliers will continue to perform these services to our or our customers' satisfaction in a manner that provides our customer with a unified brand experience or on commercially reasonable terms. If our customers become dissatisfied with the services provided by our suppliers, our business, reputation and brands could suffer.

*We depend on our relationships with other third parties, including our retail partners, and changes in our relationships with these parties could adversely impact our revenue and profits.*

In the years ending December 31, 2014 and 2013, approximately 16% and 26%, respectively, of our net revenue was generated from other operations, consisting primarily of revenue generated online by third parties, which we refer to as our retail partners. Our relationships with our retail partners allow consumers to purchase products offered by us through their websites and mobile applications. Because our agreements with our retail partners are generally terminable at will, we may be unable to maintain these relationships, and our results of

Table of Contents

operations could fluctuate significantly from period to period depending on the performance of our retail partners and their willingness to continue to offer and/or promote our products. Our agreements with our retail partners may also restrict our ability to market certain products, and not all of our suppliers may permit us to market through all of our retail partners' sites. Because some of our retail partners are competitors or potential competitors in the home goods market, some or all of our retail partners may in the future determine they no longer wish to do business with us or may decide to take other actions that could harm our business. We may also determine that we no longer want to do business with them. Because we do business with a small number of retail partners, if any one of our contracts with our retailer partners were to terminate, our revenue from our retail partners may decline and our relationships with our suppliers may be adversely affected.

Because we rely on FedEx, UPS and the U.S. Postal Service to deliver most of the small parcel products we offer on our sites, we are subject to shipping delays or disruptions caused by inclement weather, natural disasters, labor activism, health epidemics or bioterrorism. In addition, because we rely on national and regional major transportation companies for the delivery of some of our other products, we are also subject to risks of breakage or other damage during delivery by any of these third parties. We also use and rely on other services from third parties, such as our telecommunications services, and those services may be subject to outages and interruptions that are not within our control. For example, failures by our telecommunications providers have in the past and may in the future interrupt our ability to provide phone support to our customers. If these products are not delivered in a timely fashion or are damaged during the delivery process, or if we are not able to provide adequate customer support, our customers could become dissatisfied and cease buying products through our sites, which would adversely affect our operating results.

***If our internal control over financial reporting or our disclosure controls and procedures are not effective, we may not be able to accurately report our financial results, prevent fraud or file our periodic reports in a timely manner, which may cause investors to lose confidence in our reported financial information and may lead to a decline in our stock price.***

We were a private company for 12 years prior to our IPO in October 2014 and, as such, have not historically had the internal control and financial reporting requirements that are required of a publicly-traded company. Commencing in 2015 we are required to comply with the requirements of The Sarbanes-Oxley Act of 2002, which requires that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, we must perform system and process evaluation, document our controls and perform testing of our key control over financial reporting to allow management and our independent public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent public accounting firm, may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses. If we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock would likely decline and we could be subject to lawsuits, sanctions or investigations by regulatory authorities, which would require additional financial and management resources.

We continue to invest in more robust technology and in more resources in order to manage those reporting requirements. Implementing the appropriate changes to our internal controls may distract our officers and employees, result in substantial costs if we implement new processes or modify our existing processes and require significant time to complete. Any difficulties or delays in implementing these controls could impact our ability to timely report our financial results. In addition, we currently rely on a manual process in some areas which increases our exposure to human error or intervention in reporting our financial results. For these reasons, we may encounter difficulties in the timely and accurate reporting of our financial results, which would impact our ability to provide our investors with information in a timely manner. As a result, our investors could lose confidence in our reported financial information, and our stock price could decline.

In addition, any such changes do not guarantee that we will be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy could prevent us from accurately reporting our financial results.



Table of Contents

***We may be unable to accurately forecast net revenue and appropriately plan our expenses in the future.***

Net revenue and operating results are difficult to forecast because they generally depend on the volume, timing and type of the orders we receive, all of which are uncertain. We base our expense levels and investment plans on our estimates of total net revenue and gross margins and have not historically relied on a formalized forecasting and budgeting process. In addition, we have been operating as five distinct brands for a short period of time, and we cannot be sure the same growth rates, trends and other key performance metrics are meaningful predictors of future growth. Our business is affected by general economic and business conditions in the United States, and we anticipate that it will be increasingly affected by conditions in international markets. In addition, we experience seasonal trends in our business, and our mix of product offerings is highly variable from day-to-day and quarter-to-quarter. This variability makes it difficult to predict sales and could result in significant fluctuations in our net revenue from period-to-period. A significant portion of our expenses is fixed, and as a result, we may be unable to adjust our spending in a timely manner to compensate for any unexpected shortfall in net revenue. Any failure to accurately predict net revenue or gross margins could cause our operating results to be lower than expected, which could materially adversely affect our financial condition and stock price.

***Our ability to raise capital in the future may be limited, and our failure to raise capital when needed could prevent us from growing.***

In the future, we could be required to raise capital through public or private financing or other arrangements. Such financing may not be available on acceptable terms, or at all, and our failure to raise capital when needed could harm our business. We may sell Class A common stock, convertible securities and other equity securities in one or more transactions at prices and in a manner as we may determine from time to time. If we sell any such securities in subsequent transactions, investors may be materially diluted. New investors in such subsequent transactions could gain rights, preferences and privileges senior to those of holders of our Class A common stock. Debt financing, if available, may involve restrictive covenants and could reduce our operational flexibility or profitability. If we cannot raise funds on acceptable terms, we may not be able to grow our business or respond to competitive pressures.

***Our business may be adversely affected if we are unable to provide our customers a cost-effective shopping platform that is able to respond and adapt to rapid changes in technology.***

The number of people who access the Internet through devices other than personal computers, including mobile phones, smartphones, handheld computers such as notebooks and tablets, video game consoles, and television set-top devices, has increased dramatically in the past few years. The smaller screen size, functionality, and memory associated with some alternative devices may make the use of our sites and purchasing our products more difficult. The versions of our sites developed for these devices may not be compelling to consumers. In addition, it is time consuming and costly to keep pace with rapidly changing and continuously evolving technology. We launched our mobile applications for Joss & Main in 2012, Wayfair.com in 2014 and AllModern in 2015. In addition, all of our sites in North America and a majority of our international sites are mobile-optimized. Because we have only recently launched a majority of our mobile-optimized sites and mobile applications, we cannot be certain that they will be successful.

As new mobile devices and platforms are released, it is difficult to predict the problems we may encounter in developing applications for alternative devices and platforms, and we may need to devote significant resources to the creation, support and maintenance of such applications. If we are unable to attract consumers to our websites through these devices or are slow to develop a version of our websites that is more compatible with alternative devices or a mobile application, we may fail to capture a significant share of consumers in the home goods market, which could adversely affect our business.

Further, we continually upgrade existing technologies and business applications, and we may be required to implement new technologies or business applications in the future. The implementation of upgrades and changes requires significant investments. Our results of operations may be affected by the timing, effectiveness and costs associated with the successful implementation of any upgrades or changes to our systems and infrastructure. In the event that it is more difficult for our customers to buy products from us on their mobile devices, or if our customers choose not to buy products from us on their mobile devices or to use mobile products that do not offer access to our websites, our customer growth could be harmed and our business, financial condition and operating results may be materially adversely affected.

Table of Contents

***Significant merchandise returns could harm our business.***

We allow our customers to return products, subject to our return policy. If merchandise returns are significant, our business, prospects, financial condition and results of operations could be harmed. Further, we modify our policies relating to returns from time to time, which may result in customer dissatisfaction or an increase in the number of product returns. Many of our products are large and require special handling and delivery. From time to time our products are damaged in transit, which can increase return rates and harm our brand.

***Uncertainties in global economic conditions and their impact on consumer spending patterns, particularly in the home goods segment, could adversely impact our operating results.***

Consumers may view a substantial portion of the products we offer as discretionary items rather than necessities. As a result, our results of operations are sensitive to changes in macro-economic conditions that impact consumer spending, including discretionary spending. Some of the factors adversely affecting consumer spending include levels of unemployment, consumer debt levels, changes in net worth based on market changes and uncertainty, home foreclosures and changes in home values, fluctuating interest rates, credit availability, government actions, fluctuating fuel and other energy costs, which in recent months have been particularly volatile, fluctuating commodity prices and general uncertainty regarding the overall future economic environment.. Adverse economic changes in any of the regions in which we sell our products could reduce consumer confidence and could negatively affect net revenue and have a material adverse effect on our operating results.

***Our business relies heavily on email and other messaging services, and any restrictions on the sending of emails or messages or an inability to timely deliver such communications could materially adversely affect our net revenue and business.***

Our business is highly dependent upon email and other messaging services for promoting our sites and products. Daily promotions offered through emails and other messages sent by us, or on our behalf by our vendors, generate a significant portion of our revenue. We provide daily emails and push communications to customers and other visitors informing them of what is available for purchase on our sites that day, and we believe these messages are an important part of our customer experience and help generate a substantial portion of our net revenue. If we are unable to successfully deliver emails or other messages to our subscribers, or if subscribers decline to open our emails or other messages, our net revenue and profitability would be materially adversely affected. Changes in how webmail applications organize and prioritize email may reduce the number of subscribers opening our emails. For example, in 2013 Google Inc. s Gmail service a feature that organizes incoming emails into categories (for example, primary, social and promotions). Such categorization or similar inbox organizational features may result in our emails being delivered in a less prominent location in a subscriber s inbox or viewed as spam by our subscribers and may reduce the likelihood of that subscriber opening our emails. Actions by third parties to block, impose restrictions on or charge for the delivery of emails or other messages could also adversely impact our business. From time to time, Internet service providers or other third parties may block bulk email transmissions or otherwise experience technical difficulties that result in our inability to successfully deliver emails or other messages to third parties. Changes in the laws or regulations that limit our ability to send such communications or impose additional requirements upon us in connection with sending such communications would also materially adversely impact our business. Our use of email and other messaging services to send communications about our sites or other matters may also result in legal claims against us, which may cause us increased expenses, and if successful might result in fines and orders with costly reporting and compliance obligations or might limit or prohibit our ability to send emails or other messages. We also rely on social networking messaging services to send communications and to encourage customers to send communications. Changes to the terms of these social networking services to limit promotional communications, any restrictions that would limit our ability or our customers ability to send communications through their services, disruptions or downtime experienced by these social networking services or decline in the use of or engagement with social networking services by customers and potential customers could materially adversely affect our business, financial condition and operating results.



*We are subject to risks related to online payment methods.*

We accept payments using a variety of methods, including credit card, debit card, PayPal and gift cards. As we offer new payment options to consumers, we may be subject to additional regulations, compliance requirements and fraud. For certain payment methods, including credit and debit cards, we pay interchange and other fees, which

Table of Contents

may increase over time and raise our operating costs and lower profitability. We are also subject to payment card association operating rules and certification requirements, including the Payment Card Industry Data Security Standard and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. As our business changes, we may also be subject to different rules under existing standards, which may require new assessments that involve costs above what we currently pay for compliance. If we fail to comply with the rules or requirements of any provider of a payment method we accept, if the volume of fraud in our transactions limits or terminates our rights to use payment methods we currently accept, or if a data breach occurs relating to our payment systems, we may, among other things, be subject to fines or higher transaction fees and may lose, or face restrictions placed upon, our ability to accept credit card and debit card payments from consumers or facilitate other types of online payments. If any of these events were to occur, our business, financial condition and operating results could be materially adversely affected.

We occasionally receive orders placed with fraudulent credit card data. We may suffer losses as a result of orders placed with fraudulent credit card data even if the associated financial institution approved payment of the orders. Under current credit card practices, we may be liable for fraudulent credit card transactions. If we are unable to detect or control credit card fraud, our liability for these transactions could harm our business, financial condition and results of operations.

***Government regulation of the Internet and e-commerce is evolving, and unfavorable changes or failure by us to comply with these regulations could substantially harm our business and results of operations.***

We are subject to general business regulations and laws as well as regulations and laws specifically governing the Internet and e-commerce. Existing and future regulations and laws could impede the growth of the Internet, e-commerce or mobile commerce. These regulations and laws may involve taxes, tariffs, privacy and data security, anti-spam, content protection, electronic contracts and communications, consumer protection, Internet neutrality and gift cards. It is not clear how existing laws governing issues such as property ownership, sales and other taxes and consumer privacy apply to the Internet as the vast majority of these laws were adopted prior to the advent of the Internet and do not contemplate or address the unique issues raised by the Internet or e-commerce. It is possible that general business regulations and laws, or those specifically governing the Internet or e-commerce, may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other rules or our practices. We cannot be sure that our practices have complied, comply or will comply fully with all such laws and regulations. Any failure, or perceived failure, by us to comply with any of these laws or regulations could result in damage to our reputation, a loss in business and proceedings or actions against us by governmental entities or others. Any such proceeding or action could hurt our reputation, force us to spend significant amounts in defense of these proceedings, distract our management, increase our costs of doing business, decrease the use of our sites by consumers and suppliers and may result in the imposition of monetary liability. We may also be contractually liable to indemnify and hold harmless third parties from the costs or consequences of non-compliance with any such laws or regulations. In addition, it is possible that governments of one or more countries may seek to censor content available on our sites or may even attempt to completely block access to our sites. Adverse legal or regulatory developments could substantially harm our business. In particular, in the event that we are restricted, in whole or in part, from operating in one or more countries, our ability to retain or increase our customer base may be adversely affected, and we may not be able to maintain or grow our net revenue and expand our business as anticipated.

***Failure to comply with federal, state and international laws and regulations relating to privacy, data protection and consumer protection, or the expansion of current or the enactment of new laws or regulations relating to privacy, data protection and consumer protection, could adversely affect our business and our financial condition.***

A variety of federal, state and international laws and regulations govern the collection, use, retention, sharing and security of consumer data. Laws and regulations relating to privacy, data protection and consumer protection are evolving and subject to potentially differing interpretations. These requirements may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another or may conflict with other rules or our practices. As a result, our practices may not have complied or may not comply in the future with all such laws,

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

regulations, requirements and obligations. Any failure, or perceived failure, by us to comply with our posted privacy policies or with any federal, state or international privacy or consumer protection- related laws, regulations, industry self-regulatory principles, industry standards or codes of conduct, regulatory guidance, orders to which we may be

Table of Contents

subject or other legal obligations relating to privacy or consumer protection could adversely affect our reputation, brand and business, and may result in claims, proceedings or actions against us by governmental entities or others or other liabilities or require us to change our operations and/or cease using certain data sets. Any such claim, proceeding or action could hurt our reputation, brand and business, force us to incur significant expenses in defense of such proceedings, distract our management, increase our costs of doing business, result in a loss of customers and suppliers and may result in the imposition of monetary penalties. We may also be contractually required to indemnify and hold harmless third parties from the costs or consequences of non-compliance with any laws, regulations or other legal obligations relating to privacy or consumer protection or any inadvertent or unauthorized use or disclosure of data that we store or handle as part of operating our business.

Federal, state and international governmental authorities continue to evaluate the privacy implications inherent in the use of third-party cookies and other methods of online tracking for behavioral advertising and other purposes. U.S. and foreign governments have enacted, have considered or are considering legislation or regulations that could significantly restrict the ability of companies and individuals to engage in these activities, such as by regulating the level of consumer notice and consent required before a company can employ cookies or other electronic tracking tools or the use of data gathered with such tools. Additionally, some providers of consumer devices and web browsers have implemented, or announced plans to implement, means to make it easier for Internet users to prevent the placement of cookies or to block other tracking technologies, which could if widely adopted result in the use of third-party cookies and other methods of online tracking becoming significantly less effective. The regulation of the use of these cookies and other current online tracking and advertising practices or a loss in our ability to make effective use of services that employ such technologies could increase our costs of operations and limit our ability to acquire new customers on cost-effective terms and consequently, materially adversely affect our business, financial condition and operating results.

Foreign data protection, privacy and other laws and regulations are often more restrictive than those in the United States. The European Union, for example, traditionally has imposed stricter obligations under its laws and regulations relating to privacy, data protection and consumer protection than the United States. Individual EU member countries have discretion with respect to their interpretation and implementation of these laws and the penalties for breach and have their own regulators with differing attitudes towards enforcement, which results in varying privacy standards and enforcement risk from country to country. Legislation and regulation in the European Union and some EU member states require companies to give specific types of notice and in some cases seek consent from consumers before using their data for certain purposes, including some marketing activities. In the majority of EU member countries, consent must be obtained prior to setting cookies or other tracking technologies. Outside of the European Union, there are many countries with data protection laws, and new countries are adopting data protection legislation with increasing frequency. Many of these laws may require consent from consumers for the use of data for various purposes, including marketing, which may reduce our ability to market our products. There is no harmonized approach to these laws and regulations globally. Consequently, we increase our risk of non-compliance with applicable foreign data protection laws and regulations as we continue our international expansion. We may need to change and limit the way we use consumer information in operating our business and may have difficulty maintaining a single operating model that is compliant. Compliance with such laws and regulations will result in additional costs and may necessitate changes to our business practices and divergent operating models, which may adversely affect our business and financial condition.

In addition, various federal, state and foreign legislative and regulatory bodies, or self-regulatory organizations, may expand current laws or regulations, enact new laws or regulations or issue revised rules or guidance regarding privacy, data protection and consumer protection. For example, the European Union is considering revisions to its current privacy laws. Any such changes may force us to incur substantial costs or require us to change our business practices. This could compromise our ability to pursue our growth strategy effectively and may adversely affect our ability to acquire customers or otherwise harm our business, financial condition and operating results.

***Our failure or the failure of third-party service providers to protect our sites, networks and systems against security breaches, or otherwise to protect our confidential information, could damage our reputation and brand and substantially harm our business and operating results.***

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

We collect, maintain, transmit and store data about our customers, suppliers and others, including credit card information and personally identifiable information, as well as other confidential and proprietary information.

Table of Contents

We also employ third-party service providers that store, process and transmit proprietary, personal and confidential information on our behalf. We rely on encryption and authentication technology licensed from third parties in an effort to securely transmit confidential and sensitive information, including credit card numbers. Advances in computer capabilities, new technological discoveries or other developments may result in the whole or partial failure of this technology to protect transaction data or other confidential and sensitive information from being breached or compromised. Our security measures, and those of our third-party service providers, may not detect or prevent all attempts to hack our systems, denial-of-service attacks, viruses, malicious software, break-ins, phishing attacks, social engineering, security breaches or other attacks and similar disruptions that may jeopardize the security of information stored in or transmitted by our sites, networks and systems or that we or our third-party service providers otherwise maintain, including payment card systems which may subject us to fines or higher transaction fees or limit or terminate our access to certain payment methods. We and our service providers may not anticipate or prevent all types of attacks until after they have already been launched, and techniques used to obtain unauthorized access to or sabotage systems change frequently and may not be known until launched against us or our third-party service providers. In addition, security breaches can also occur as a result of non-technical issues, including intentional or inadvertent breaches by our employees or by persons with whom we have commercial relationships.

Breaches of our security measures or those of our third-party service providers or cyber security incidents could result in unauthorized access to our sites, networks and systems; unauthorized access to and misappropriation of consumer information, including consumers' personally identifiable information, or other confidential or proprietary information of ourselves or third parties; viruses, worms, spyware or other malware being served from our sites, networks or systems; deletion or modification of content or the display of unauthorized content on our sites; interruption, disruption or malfunction of operations; costs relating to breach remediation, deployment of additional personnel and protection technologies, response to governmental investigations and media inquiries and coverage; engagement of third party experts and consultants; litigation, regulatory action and other potential liabilities. If any of these breaches of security occur, our reputation and brand could be damaged, our business may suffer, we could be required to expend significant capital and other resources to alleviate problems caused by such breaches and we could be exposed to a risk of loss, litigation or regulatory action and possible liability. Actual or anticipated attacks may cause us to incur increasing costs, including costs to deploy additional personnel and protection technologies, train employees and engage third-party experts and consultants. In addition, any party who is able to illicitly obtain a subscriber's password could access the subscriber's transaction data or personal information. Any compromise or breach of our security measures, or those of our third-party service providers, could violate applicable privacy, data security and other laws, and cause significant legal and financial exposure, adverse publicity and a loss of confidence in our security measures, which could have a material adverse effect on our business, financial condition and operating results. Although we maintain privacy, data breach and network security liability insurance, we cannot be certain that our coverage will be adequate for liabilities actually incurred or that insurance will continue to be available to us on economically reasonable terms, or at all. We may need to devote significant resources to protect against security breaches or to address problems caused by breaches, diverting resources from the growth and expansion of our business.

***Changes in tax treatment of companies engaged in e-commerce may adversely affect the commercial use of our sites and our financial results.***

Due to the global nature of the Internet, it is possible that various states or foreign countries might attempt to impose additional or new regulation on our business or levy additional or new sales, income or other taxes relating to our activities. Tax authorities at the international, federal, state and local levels are currently reviewing the appropriate treatment of companies engaged in e-commerce. New or revised international, federal, state or local tax regulations may subject us or our customers to additional sales, income and other taxes. For example, Congress is considering legislation, the Marketplace Fairness Act, that would require companies engaged in e-commerce to collect sales tax taxes on Internet revenue. We cannot predict the effect of current attempts to impose sales, income or other taxes on e-commerce. New or revised taxes and, in particular, sales taxes, VAT and similar taxes would likely increase the cost of doing business online and decrease the attractiveness of selling products over the Internet. New taxes could also create significant increases in internal costs necessary to capture data and collect and remit taxes. Any of these events could have a material adverse effect on our business, financial condition and operating results.

Table of Contents

***Taxing authorities may successfully assert that we should have collected or in the future should collect sales and use, commercial activity, VAT or similar taxes, and we could be subject to liability with respect to past or future sales, which could adversely affect our operating results.***

We do not collect sales and use, commercial activity, VAT or similar taxes in all jurisdictions in which we have sales, based on our belief that such taxes are not applicable. Sales and use, VAT and similar tax laws and rates vary greatly by jurisdiction. Several states have presented us with tax assessments, alleging that we are 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 we last received such assessments, is approximately \$12.7 million. While we do not believe that we are obligated to collect and remit such taxes and intend to vigorously defend our position, we cannot be sure of the outcome of our discussions and/or appeals with these states. In the event of an adverse outcome, we could face assessments for additional time periods since the last assessments we received, plus any additional interest and penalties. We also expect additional jurisdictions may make similar assessments in the future. As a result, we may be required to collect such taxes in additional jurisdictions in the future. Such tax assessments, penalties and interest or future requirements may materially adversely affect our business, financial condition and operating results.

***We may expend substantial funds in connection with the tax liabilities that arise upon the settlement of restricted stock units.***

We may expend substantial funds to satisfy minimum statutory tax withholding and remittance obligations when we settle a portion of our restricted stock units, or RSUs, that were granted prior to our initial public offering. Our RSUs vest upon the satisfaction of both a service condition, which is typically satisfied over a period of five years, and an event condition, which was satisfied upon the closing of our IPO in October 2014. On the settlement dates for our RSUs, we currently plan to withhold shares and remit income taxes on behalf of the holders of our RSUs at the applicable minimum statutory rates based on the then current value of the underlying shares of our common stock, which we refer to as a net settlement. In connection with these net settlements, we will withhold and remit the tax liabilities on behalf of the RSU holders to the relevant tax authorities in cash. For example, from the closing of our IPO through March 31, 2015, our tax obligation was approximately \$32.2 million in the aggregate.

In order to fund the tax withholding and remittance obligations on behalf of our RSU holders, we expect to use a portion of our cash and cash equivalent balances. Alternatively, we may choose to borrow funds or use a combination of cash and borrowed funds to satisfy these obligations.

***We expect to pursue acquisitions, which could have a material adverse effect on our business, as could the integration of the businesses following acquisition.***

As part of our business strategy, we may acquire other companies or businesses. Since our inception, we have made two acquisitions, the remainder of the stake of our Australian joint venture in 2011 and DwellStudio in 2013. Acquisitions involve numerous risks, any of which could harm our business, including: difficulties in integrating the technologies, operations, existing contracts and personnel of an acquired company; difficulties in supporting and transitioning suppliers, if any, of an acquired company; diversion of financial and management resources from existing operations or alternative acquisition opportunities; failure to realize the anticipated benefits or synergies of a transaction; failure to identify all of the problems, liabilities or other shortcomings or challenges of an acquired company or technology, including issues related to intellectual property, regulatory compliance practices, revenue recognition or other accounting practices or employee or customer issues; risks of entering new markets in which we have limited or no experience; potential loss of key employees, customers and suppliers from either our current business or an acquired company's business; inability to generate sufficient net revenue to offset acquisition costs; additional costs or equity dilution associated with funding the acquisition; and possible write-offs or impairment charges relating to acquired businesses.

We may also pursue acquisitions in businesses that are complementary to our business but otherwise new to our organization. Pursuing complementary business opportunities would require significant time and resources that may divert management's attention from other business activities. In addition, any complementary businesses we acquire may expose us to additional laws, regulations and risks, including the risk that we may incur ongoing



Table of Contents

operating expenses in such businesses in excess of revenue, which could harm our results of operations and financial condition. The financial profile of any such new businesses may be different than our current financial profile, which could also materially adversely affect our financial condition.

***We rely on the performance of members of management and highly skilled personnel, and if we are unable to attract, develop, motivate and retain well-qualified employees, our business could be harmed.***

We believe our success has depended, and continues to depend, on the efforts and talents of Niraj Shah, one of our co-founders, co-chairman of the board of directors and our Chief Executive Officer, Steven Conine, one our co-founders, co-chairman of the board of directors and Chief Technology Officer, and other members of our management team. Our future success depends on our continuing ability to attract, develop, motivate and retain highly qualified and skilled employees, particularly mid-level managers, engineers and merchandising and technology personnel. The market for such positions in the Boston area and other cities in which we operate is competitive. Qualified individuals are in high demand, and we may incur significant costs to attract them. In addition, the loss of any of our senior management or key employees or our inability to recruit and develop mid-level managers could materially adversely affect our ability to execute our business plan, and we may not be able to find adequate replacements. All of our officers and other U.S. employees are at-will employees, meaning that they may terminate their employment relationship with us at any time, and their knowledge of our business and industry would be extremely difficult to replace. If we do not succeed in attracting well-qualified employees or retaining and motivating existing employees, our business, financial condition and operating results may be materially adversely affected.

***We may not be able to adequately protect our intellectual property rights.***

We regard our subscriber list, trademarks, domain names, copyrights, patent, trade dress, trade secrets, proprietary technology and similar intellectual property as critical to our success, and we rely on trademark, copyright and patent law, trade secret protection, agreements and other methods with our employees and others to protect our proprietary rights. We might not be able to obtain broad protection in the United States or internationally for all of our intellectual property, and we might not be able to obtain effective intellectual property protection in every country in which we sell products. The protection of our intellectual property rights may require the expenditure of significant financial, managerial and operational resources. Moreover, the steps we take to protect our intellectual property may not adequately protect our rights or prevent third parties from infringing or misappropriating our proprietary rights, and we may not be able to broadly enforce all of our trademarks. Any of our patents, marks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. Our patent and trademark applications may never be granted. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. Even if issued, there can be no assurance that these patents will adequately protect our intellectual property, as the legal standards relating to the validity, enforceability and scope of protection of patent and other intellectual property rights are uncertain. We also cannot be certain that others will not independently develop or otherwise acquire equivalent or superior technology or intellectual property rights.

We might be required to spend significant resources to monitor and protect our intellectual property rights. We may not be able to discover or determine the extent of any infringement, misappropriation or other violation of our intellectual property rights and other proprietary rights. We may initiate claims or litigation against others for infringement, misappropriation or violation of our intellectual property rights or proprietary rights or to establish the validity of such rights. Despite our efforts, we may be unable to prevent third parties from infringing upon, misappropriating or otherwise violating our intellectual property rights and other proprietary rights. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel, which may materially adversely affect our business, financial condition and operating results.

*We have been, and may again be, accused of infringing intellectual property rights of third parties.*

The e-commerce industry is characterized by vigorous protection and pursuit of intellectual property rights, which has resulted in protracted and expensive litigation for many companies. We are subject to claims and litigation by third parties that we infringe their intellectual property rights, and we expect additional claims and

Table of Contents

litigation with respect to infringement to occur in the future. The costs of supporting such litigation and disputes are considerable, and there can be no assurances that favorable outcomes will be obtained. As our business expands and the number of competitors in our market increases and overlaps occur, we expect that infringement claims may increase in number and significance. Any claims or proceedings against us, whether meritorious or not, could be time-consuming, result in considerable litigation costs, require significant amounts of management time or result in the diversion of significant operational resources, any of which could materially adversely affect our business, financial condition and operating results.

Legal claims regarding intellectual property rights are subject to inherent uncertainties due to the oftentimes complex issues involved, and we cannot be certain that we will be successful in defending ourselves against such claims. In addition, some of our larger competitors have extensive portfolios of issued patents. Many potential litigants, including patent holding companies, have the ability to dedicate substantially greater resources to enforce their intellectual property rights and to defend claims that may be brought against them. Furthermore, a successful claimant could secure a judgment that requires us to pay substantial damages or prevents us from conducting our business as we have historically done or may desire to do in the future. We might also be required to seek a license and pay royalties for the use of such intellectual property, which may not be available on commercially acceptable terms, or at all. Alternatively, we may be required to develop non-infringing technology or intellectual property, which could require significant effort and expense and may ultimately not be successful.

We have received in the past, and we may receive in the future, communications alleging that certain items posted on or sold through our sites violate third-party copyrights, designs, marks and trade names or other intellectual property rights or other proprietary rights. Brand and content owners and other proprietary rights owners have actively asserted their purported rights against online companies, including Wayfair. In addition to litigation from rights owners, we may be subject to regulatory, civil or criminal proceedings and penalties if governmental authorities believe we have aided and abetted in the sale of counterfeit or infringing products.

Such claims, whether or not meritorious, may result in the expenditure of significant financial, managerial and operational resources, injunctions against us or the payment of damages by us. We may need to obtain licenses from third parties who allege that we have violated their rights, but such licenses may not be available on terms acceptable to us, or at all. These risks have been amplified by the increase in third parties whose sole or primary business is to assert such claims.

***The inability to acquire, use or maintain our marks and domain names for our sites could substantially harm our business and operating results.***

We currently are the registrant of marks for our brands in numerous jurisdictions and are the registrant of the Internet domain name for the websites of Wayfair.com and our other sites, as well as various related domain names. However, we have not registered our marks or domain names in all major international jurisdictions. Domain names generally are regulated by Internet regulatory bodies. If we do not have or cannot obtain on reasonable terms the ability to use our marks in a particular country, or to use or register our domain name, we could be forced either to incur significant additional expenses to market our products within that country, including the development of a new brand and the creation of new promotional materials and packaging, or to elect not to sell products in that country. Either result could materially adversely affect our business, financial condition and operating results.

Furthermore, the regulations governing domain names and laws protecting marks and similar proprietary rights could change in ways that block or interfere with our ability to use relevant domains or our current brand. Also, we might not be able to prevent third parties from registering, using or retaining domain names that interfere with our consumer communications or infringe or otherwise decrease the value of our marks, domain names and other proprietary rights. Regulatory bodies also may establish additional generic or country-code top-level domains or may

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

allow modifications of the requirements for registering, holding or using domain names. As a result, we might not be able to register, use or maintain the domain names that utilize the name Wayfair or our other brands in all of the countries in which we currently or intend to conduct business.

*Our use of open source software may pose particular risks to our proprietary software and systems.*

We use open source software in our software and systems and will use open source software in the future. The licenses applicable to open source software may require that the source code subject to the license be made

Table of Contents

available to the public and that any modifications or derivative works to certain open source software continue to be licensed under open source licenses. From time to time, we may face claims from third parties claiming infringement of their intellectual property rights, or demanding the release or license of the open source software or derivative works that we developed using such software (which could include our proprietary source code) or otherwise seeking to enforce the terms of the applicable open source license. These claims could result in litigation and could require us to purchase a costly license, publicly release the affected portions of our source code, be limited in or cease using the implicated software unless and until we can re-engineer such software to avoid infringement or change the use of the implicated open source software. In addition to risks related to license requirements, use of certain open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties, indemnities or other contractual protections with respect to the software (for example, non-infringement or functionality). Our use of open source software may also present additional security risks because the source code for open source software is publicly available, which may make it easier for hackers and other third parties to determine how to breach our sites and systems that rely on open source software. Any of these risks could be difficult to eliminate or manage, and, if not addressed, could have a material adverse effect on our business, financial condition and operating results.

**Risks Related to Ownership of our Class A Common Stock**

*Although we do not rely on controlled company exemptions from certain corporate governance requirements under the New York Stock Exchange, or NYSE, rules, if we use these exemptions in the future, you will not have the same protections afforded to stockholders of companies that are subject to such requirements.*

Our co-founders control a majority of the voting power of our outstanding common stock. As a result, we qualify as a controlled company within the meaning of the corporate governance standards of the NYSE. Under these rules, a listed company of which more than 50% of the voting power is held by an individual, group or another company is a controlled company and may elect not to comply with certain corporate governance requirements, including:

- the requirement that a majority of the board of directors consist of independent directors as defined under the listing rules of the NYSE;
- the requirement that we have a nominating and corporate governance committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities;
- the requirement that we have a compensation committee that is composed entirely of independent directors with a written charter addressing the committee's purpose and responsibilities; and
- the requirement for an annual performance evaluation of the nominating and corporate governance and compensation committees.

To the extent we still qualify, we may choose to take advantage of any of these exemptions in the future. As a result, in the future, we may not have a majority of independent directors and we may not have independent director oversight of decisions regarding executive compensation and director nominations.

*The dual class structure of our common stock has the effect of concentrating voting control with our co-founders, which will limit your ability to influence corporate matters.*

Our Class B common stock has ten votes per share, and our Class A common stock, which is the stock that is publicly traded, has one vote per share. Following the IPO, our Class B common stock was held primarily by our co-founders, other executive officers, directors and their affiliates. Due to optional conversions of Class B common stock into Class A common stock following the IPO, our Class B common stock is currently held primarily by our co-founders and their affiliates. As of December 31, 2014, our co-founders and their affiliates own shares representing approximately 49.2% of the economic interest and 82.1% of the voting power of our outstanding capital stock. This concentrated control limits your ability to influence corporate matters for the foreseeable future. For example, these stockholders are able to control elections of directors, amendments of our certificate of incorporation or bylaws, increases to the number of shares available for issuance under our equity incentive plans or adoption of new equity incentive plans and approval of any merger or sale of assets for the foreseeable future. This control may materially adversely affect the market price of our Class A common stock. Additionally, holders of our Class B common stock may cause us to make strategic decisions or pursue acquisitions that could involve risks to

Table of Contents

you or may not be aligned with your interests. The holders of our Class B common stock are also entitled to a separate vote in the event we seek to amend our certificate of incorporation to increase or decrease the par value of a class of our common stock or in a manner that alters or changes the powers, preferences or special rights of the Class B common stock in a manner that affects its holders adversely.

Future transfers by holders of Class B common stock will generally result in those shares converting on a 1:1 basis to Class A common stock, which will have the effect, over time, of increasing the relative voting power of those holders of Class B common stock who retain their shares in the long-term, which may include our executive officers.

***Our stock price may be volatile or may decline regardless of our operating performance.***

The market price of our Class A common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our results of operations;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates or ratings by any securities analysts who follow our company or our failure to meet these estimates or the expectations of investors;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures, operating results or capital commitments;
- changes in operating performance and stock market valuations of other technology or retail companies generally, or those in our industry in particular;
- price and volume fluctuations in the overall stock market, including as a result of trends in the economy as a whole;
- changes in our board of directors or management;
- sales of large blocks of our Class A common stock, including sales by our executive officers, directors and significant stockholders;
- lawsuits threatened or filed against us;
- changes in laws or regulations applicable to our business;
- the expiration of contractual lock-up agreements;
- changes in our capital structure, such as future issuances of debt or equity securities;
- short sales, hedging and other derivative transactions involving our capital stock;

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

- general economic conditions in the United States and abroad;
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events; and
- the other factors described in the sections titled *Special Note Regarding Forward-Looking Statements* and Part II, Item 1A, *Risk Factors*, of this Quarterly Report on Form 10-Q.

In addition, stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies, including e-commerce companies. Stock prices of many technology companies, including e-commerce companies, have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and materially adversely affect our business, financial condition and operating results.

***Substantial sales of shares of our Class A common stock could cause the market price of our Class A common stock to decline.***

Sales of a substantial number of shares of our Class A common stock in the public market, or the perception that these sales might occur, could depress the market price of our Class A common stock and could



Table of Contents

impair our ability to raise capital through the sale of additional equity securities. We are unable to predict the effect that such sales may have on the prevailing market price of our Class A common stock.

***If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.***

The trading market for our Class A common stock depends in part on the research and reports that securities or industry analysts publish about us or our business, our market and our competitors. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

***Our management has broad discretion over our existing cash resources and might not use such funds in ways that increase the value of your investment.***

Our management generally has broad discretion over the use of our cash resources, and you will be relying on the judgment of our management regarding the application of these resources. Our management might not apply these resources in ways that increase the value of your investment.

***The requirements of being a public company may strain our resources, divert management's attention and affect our ability to attract and retain additional executive management and qualified board members.***

As a newly public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the listing requirements of the NYSE and other applicable securities rules and regulations. Compliance with these rules and regulations will continue to increase our legal and financial compliance costs, make some activities more difficult, time-consuming or costly and increase demand on our systems and resources, particularly since, after December 31, 2014, we are no longer an emerging growth company. The

Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and results of operations. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could materially adversely affect our business and results of operations. We will need to hire additional employees or engage outside consultants to comply with these requirements, which will increase our costs and expenses.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time-consuming. These laws, regulations and

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

standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us, and our business may be materially adversely affected.

As a result of disclosure of information required of a public company, our business and financial condition will become more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business and results of operations could be materially adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the

Table of Contents

time and resources necessary to resolve them, could divert the resources of our management and materially adversely affect our business, financial condition and operating results.

*Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of our company more difficult, limit attempts by our stockholders to replace or remove our current management and limit the market price of our Class A common stock.*

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. Our certificate of incorporation and bylaws include provisions that:

- permit the board of directors to establish the number of directors and fill any vacancies and newly created directorships;
- when the outstanding shares of our Class B common stock represent less than 10% of the then outstanding shares of Class A common stock and Class B common stock, provide that our board of directors will be classified into three classes with staggered, three year terms and that directors may only be removed for cause;
- require super-majority voting to amend some provisions in our certificate of incorporation and bylaws;
- authorize the issuance of blank check preferred stock that our board of directors could use to implement a stockholder rights plan;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- when the outstanding shares of our Class B common stock represent less than 10% of the then outstanding shares of Class A common stock and Class B common stock, prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our bylaws;
- restrict the forum for certain litigation against us to Delaware;
- reflect the dual class structure of our common stock, as discussed above; and
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with any holder of at least 15% of our capital stock for a period of three years following the date on which the stockholder became a 15% stockholder.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

*Sales of Unregistered Securities*

During the period between January 1, 2015 and March 31, 2015, we issued 271,633 shares of 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.

*Use of Proceeds from Public Offering of Common Stock*

In October 2014, we completed our IPO, pursuant to which we issued and sold 10,500,000 shares of Class A common stock and the selling stockholders sold 2,150,000 shares of Class A common stock, including 1,650,000 shares of Class A common stock pursuant to the exercise in full of the underwriters' option to purchase additional shares. The shares sold in the IPO were registered under the Securities Act of 1933, as amended, pursuant to a Registration Statement on Form S-1 (File No. 333-198171), which was declared effective on October 1, 2014.

Table of Contents

**Item 6. Exhibits.**

<b>Exhibit Number</b>	<b>Description</b>
10.1*	Wayfair International Assignment Agreement, dated April 1, 2015, between the Company and John Mulliken
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**	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.**

Dated: May 14, 2015

By: /s/ NIRAJ SHAH  
Niraj Shah  
*Chief Executive Officer*  
(Principal Executive Officer)

Dated: May 14, 2015

By: /s/ MICHAEL FLEISHER  
Michael Fleisher  
*Chief Financial Officer*  
(Principal Financial Officer)