Peloton Interactive Inc, Q1 2022, Earnings Call 2021-11-04

Presentation

Operator

Thank you for standing by, and welcome to Peloton's Fiscal First Quarter 2022 Earnings Conference Call. Please be advised that today's conference may be recorded.

I would now like to hand the conference over to your host, Head of Investor Relations, Peter Stabler. Please go ahead.

Peter Coleman Stabler

Good afternoon, and welcome to Peloton's fiscal first quarter conference call. Joining today's call are John Foley, our Co-Founder and CEO; President, William Lynch; and CFO, Jill Woodworth. Our comments and responses to your questions reflect management's views as of today only and will include statements related to our business that are forward-looking statements under federal securities law. Actual results may differ materially from those contained in or implied by these forward-looking statements due to risks and uncertainties associated with our business.

For a discussion of the material risks and other important factors that could impact our actual results, please refer to our SEC filings and today's shareholder letter, both of which can be found on our Investor Relations website. During this call, we will discuss both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP financial measures is provided in today's shareholder letter.

And with that, I'll turn the call over to John.

John Paul Foley

Thank you, Peter. Good afternoon, everyone. Thanks for joining us today. Before we recap the quarter and discuss our forecast, I want to spend a moment providing some context for our updated outlook. As you all well know, stay at home and work from home orders, coupled with commercial gym closures, drove massive awareness gains for Connected Fitness, accelerating an adoption curve that was already well underway. Given the unprecedented circumstances presented by the global pandemic, we said last quarter that modeling the exit from COVID and the massive growth we saw in fiscal 2021 would be a challenging task, and that has certainly proven to be true. With reduced backlogs, our visibility into our future performance has become more limited. From forecasting consumer demand to accurately predicting logistics costs, our teams have never seen a more complex operating environment in which to guide our expected results this year.

As noted in our shareholder letter, we are reducing our guidance for fiscal year '22. We have returned to presenting ranges given the uncertainty. The swift timing of these changes since giving our initial guidance in August, is not lost on us. As we prepared our previous guidance, we had to make assumptions about consumer behavior coming out of COVID, the impact of our original bike price reduction and the cost structure within our Connected Fitness segment, all against the backdrop of a global supply chain crisis.

While we have had to manage carefully around many issues such as component shortages, elevated freight costs and increased transportation costs, I'm proud of our team who has moved mountains to ensure that we have ample inventory across our portfolio ahead of the holiday season. While we continue to see a nearly 100% 2-year growth CAGR in both traffic and unit sales in Q1 and into Q2, we've seen a greater-than-anticipated taper of our website traffic levels over the past 2 months and a slower-than-expected pickup in retail showroom traffic, both of which are important inputs into our forward-looking demand model.

This reduction in traffic has added increased near-term uncertainty into our forecast. As expected, our original bike price reduction created a step shift in demand, helping to broaden our demographic mix and expand our market opportunity. The price move did significantly improve our e-commerce conversion rate, in fact, greater than we expected, but not enough to offset the year-over-year declines we have seen in overall traffic. We saw a positive and sustained reception to the price moves in our international markets. This was anticipated as our international consumers have proven to be more price-sensitive.

To maintain a premium end-to-end member experience, we made significant investments over the past year to scale manufacturing, logistics and operations. Overall, we believe we met the challenge, but there's no doubt that in some cases, we overcorrected. That, combined with the reduction to our demand picture and higher-than-expected costs across product, transportation and delivery are causing a near-term compression of our hardware margins. However, we are taking significant corrective actions to improve our profitability outlook, which will impact the back half of fiscal year '22 and into fiscal year '23.

While it's important for us to optimize fixed cost across the company, we won't compromise our Net Promoter Score position in the process. We remain committed to our goal of winning Connected Fitness, and our long-term thesis of fitness moving into the home is unchanged. We track our estimated market share closely. And while sales are currently not meeting our previous forecast, third-party data suggests that we continue to build on our leading share of the Connected Fitness market. We firmly believe at-home fitness customers will want one subscription for a comprehensive home fitness platform, and we are determined to be that one subscription.

Moving on to thoughts on the quarter. On August 30, we officially launched our new lower price Tread in the U.S. and resumed sales in the U.K. and Canada. On September 28, we launched sales in Germany, and we look forward to bringing Tread to Australia in the not-too-distant future. We have high expectations for our Tread. Our Tread platform provides members with both running and full body workouts taught by a great roster of instructors. We have reimagined the Tread experience in the same way we fundamentally improved the stationary bike experience with the launch of our original Peloton Bike.

Since its introduction, we have brought millions of people into home fitness through a dynamic ever-changing fitness platform, and our all-new Tread provides that same immersive experience. But it will take some time to educate consumers. That's okay. We're committed to the platform and gained confidence from the high marks the product is receiving from both consumers and the press. Since the launch of our media support in late September, we've seen steady progress in building Tread sales.

Our Tread Net Promoter Scores are very encouraging, with an initial NPS in the U.S. of 89 points. And with our planned investments in content and software, our already great Tread experience will continue to improve. Ask any bike member who joined the platform 3 years ago to compare the experience today versus when they purchased their bike, there's no comparison. And from an investment perspective, as we've said previously, we expect the tread market to be foundational to our long-term growth.

Turning to our bike portfolio. The original bike price reduction accelerated sales, allowing us to convert more price-sensitive households. While we believe the wider price gap between Bike and Bike+ has resulted in some trade down impact. We're comfortable with that outcome. As we have said, growing household penetration remains our primary objective.

On the engagement front, we recently passed a significant milestone, over 1 billion classes taken by our members. We're honored to be playing such a positive role in our members' lives and look forward to many billions more. We finished the quarter with 2.49 million Connected Fitness subscriptions, up 87% versus the year-ago period. End of quarter digital subscriptions were 887,000, up 74% versus a year ago, and our global Peloton member community now stands at over 6.2 million. Engagement per Connected Fitness subscription totaled 16.6 workouts per month, declining modestly from Q4 and more significantly when compared to last year's COVID-impacted quarter. On a 2-year basis, engagement was up 42% over the first quarter of 2020.

As we have said, summer months have traditionally seen lower engagement levels, and we expect our first quarter to represent the trough quarter for engagement for the fiscal year, as it has in every non-COVID year in our history. In the quarter, we continued to aggressively invest behind content and new software features for our members. We produced over 2,500 new classes and launched features requested by our members. Examples include subtitles for live classes, redesigned class filters, a reimagined progress tracking feature and structured workout plans to help keep our members on track.

We also welcomed 8 terrific new instructors, bolstering both our New York and London-based teams. Our new instructors will be teaching in English, German and Spanish with a focus on running, Tread boot camp, strength, walking, outdoor and stretching.

Finally, this quarter featured the addition of 60 new running and cycling scenic classes, which were taken over 1 million times in the period. Looking ahead, we're about to enter our busiest time of the year. Our inventories are healthy and our logistics teams are well-equipped for the seasonally strong sales period. We have low expected OTDs across our portfolio as we know timely delivery is greatly appreciated during the holiday and New Year's resolution periods.

Now I'll hand it over to Jill to review our Q1 financial results and updated outlook.

Jill Woodworth

Thanks, John. I will start with a review of our first quarter results. In Q1, we generated total revenue of $805 million, representing 6% year-over-year growth and an 88% 2-year CAGR. In terms of revenue drivers, we had lower-than-expected financing penetration, better-than-expected Connected Fitness churn, partially offset by the $11 million adjustment to our return reserve for our Tread recalls. We added 161,000 net Connected Fitness subscriptions in the quarter, bringing our end of quarter Connected Fitness membership base to 2.492 million, up 87% year-on-year.

Average net monthly Connected Fitness churn was 0.82%. As a reminder, we disclosed last quarter that we will no longer be offering forward churn guidance but will continue to report this metric. We continue to expect low, industry-leading churn and high engagement, especially as we head into colder weather.

At the end of Q1, we had over 887,000 app subscribers, representing 74% year-over-year growth, slightly ahead of our internal expectations. For the quarter, we saw modestly better retention than expected, but we're also seeing some challenges related to acquisition efficiencies. As you likely know, there have been some significant changes made by Apple that are leading to some targeting headwinds. Like many other direct-to-consumer marketers, we're seeing some disruptive impact as our teams adjust to the new data landscape.

Looking ahead, we remain bullish on our app business and its role as an important lead generation tool for Connected Fitness. Our teams will continue to adjust to the new marketplace reality, and we expect our corporate wellness initiatives to begin to contribute more meaningfully to our app business as the year progresses.

Moving to gross margin. Gross margin for the quarter was 32.6%, which came in slightly below our expectations. This was entirely due to our Connected Fitness product segment, which had a gross margin of 12%, below our guidance of 15%. There were 2 primary drivers of our Connected Fitness gross margin shortfall, an increase in our return reserve for our recalled Tread products and some inefficiencies seen in freight out and logistics.

As we mentioned last quarter, forecasting Tread returns has proven to be very challenging. While we saw an easing of return activity through late summer, we believe the expiration of our subscription waivers motivated a higher-than-anticipated number of Tread+ owners to initiate returns. Consequently, in the quarter, we increased our reserve to account for this activity.

As a reminder, the impact of recall-related returns is added back to our adjusted EBITDA, but is fully reflected on the revenue and gross profit line. With this increase in our reserve, we are attempting to capture the entirety of expected returns from now until the end of the recall-related return window, which lasts for another 12 months. But there is the possibility that future adjustments will be needed.

Excluding the impact of the unexpected increase to our return reserve, our Connected Fitness margin in Q1 would have been 14% and overall gross margin would have been 33.6%. On the logistics front, we saw some additional inefficiencies associated with middle and last mile delivery costs and Precor-related freight-in expenses. These negative impacts were partially offset by lower-than-anticipated Bike financing rates and Bike-related reserve adjustments.

Subscription gross margin was 66.7% and subscription contribution margin was 69.6%, ahead of expectations as we continue to leverage fixed costs associated with content production. As a reminder, quarter-to-quarter, we continue to see some variability, but we now expect to reach our subscription contribution margin target of 70% by Q4 of this year.

Turning to operating expenses. Sales and marketing expense was 35.3% of total revenue versus the prior year period of 15.1%. As we explained last quarter, this deleverage was planned as we ramped marketing. Looking ahead, we expect to realize substantial sequential leverage against sales and marketing expense as the year progresses. G&A expense was 29.8%

of total revenue versus 14.3% in the year prior. We invested over the last 12 months to scale operations, including significant investments in team, systems and member support. While this led to a series of significant sequential step-up in G&A spending over the last year, nearly all of this investment is completed. Looking ahead, we expect a sequential increase in G&A spend in Q2, but anticipate our Q1 spending level to represent a reasonable approximation of quarterly spend for the second half of the year.

R&D expense was 12.1% of total revenue versus 4.8% in the year ago period. The year-over-year deleverage reflects the onboarding of several acqui-hires and the R&D team from Precor. As with G&A, we expect roughly flat quarterly spend for the remainder of the fiscal year.

Our Q1 adjusted EBITDA loss was better than expected at $233.7 million. Net loss for Q1 was $376 million or a loss of $1.25 per basic and diluted share. We ended the quarter with $924 million of cash and marketable securities and have additional liquidity in the form of an untapped $285 million credit facility.

Now on to our outlook. We are reintroducing ranges for our guidance. As John alluded to earlier, the overall consumer and logistics environments have been challenging to predict coming out of COVID, and we are providing guidance just a few weeks ahead of our busiest sales season. For fiscal '22, we are now forecasting ending Connected Fitness subscriptions of 3.35 million to 3.45 million, implying approximately 1.1 million net adds and representing 46% year-over-year growth and a 77% 2-year CAGR for ending subs at the midpoint. This equates to roughly a 6% reduction in our forecasted end of year Connected Fitness subscriptions at the midpoint. Our revised full year revenue forecast is $4.4 billion to $4.8 billion, representing 14% year-over-year growth and a 59% 2-year CAGR at the midpoint of the range.

For Q2, we expect ending Connected Fitness subscriptions of 2.80 million to 2.85 million, implying 333,000 net adds and representing 69% year-over-year growth and nearly 100% 2-

year CAGR for ending subs at the midpoint. For Q2, we expect revenue of $1.1 to $1.2 billion, representing 8% year-over-year growth and a 57% 2-year CAGR at the midpoint.

Our revised guidance reflects a reduction in our expected Bike portfolio sales and Tread sales versus our original forecast, given traffic trends over the past several weeks. It also contemplates a greater-than-expected mix of original Bike versus Bike+ since the price drop and, lastly, headwinds in our commercial or Precor business.

Traffic and conversion are the key inputs in our demand forecast. Many of the modeling assumptions that predict e-commerce traffic that we made in August were too optimistic. Our baseline traffic forecast reflected our unchanged view of the growing consumer interest in Connected Fitness, our growing market share in the category, our leading brand awareness and expected increased word-of-mouth. However, it is clear that we underestimated the reopening impact on our company and the overall industry.

Importantly, we also expected the price drop to further drive a traffic uplift and increased conversion. While the price drop led to conversion rates that exceeded our forecast, overall traffic has not met our initial expectations. We have also seen a richer than anticipated mix of Bike sales versus Bike+, further impacting both revenue and our gross margin expectations. As we've said previously, we are agnostic to which entry point members choose, given that the LTV of our Connected Fitness subscriptions remains highly attractive.

Moving on to Tread. We started selling our all-new Tread on August 30 and began our media support on September 27. We noted on our last earnings call that the rollout of Tread would be slow to start in order to ensure that our members are receiving a positive delivery experience, and we take the time to reposition inventory to match demand by region. Since launching media for Tread, we have seen a progressive increase in Tread sales and remain bullish on the category and our ability to grow from our currently low product awareness.

Our primary task today is educating the consumer about our all-new Tread and how it differs from other treadmills on the market. However, much like our Bike portfolio, our revised traffic estimates will also impact our Tread forecast for the balance of the year.

Lastly, we have reduced expectations for our commercial channel or legacy Precor business, given both supply and demand dynamics. While the commercial gym industry has made significant gains as the country reopened, overall visits remain below pre-COVID levels, leading operators across some commercial segments to delay capital investments in new equipment. However, more importantly, sourcing certain component parts has become materially more challenging since we gave our guidance in August. This has led to supply constraints in some Precor products, leaving us unable to fulfill some of our commercial demand.

Moving on to margin. The reduction to our demand outlook is creating margin compression in our Connected Fitness segment as we have a significant amount of fixed costs associated with our supply chain, particularly within middle and last mile logistics. Migrating from quarterly sequential growth during COVID, back to our pre-COVID seasonality has proven challenging. However, we plan to optimize the mix of our own delivery and third-party networks to help drive savings in the coming quarters.

On the variable cost side, hardware cost efficiencies and ocean savings that we expected in Q2 won't start to materialize until the second half of the year, given the lower-than-expected demand profile for Q2. On freight, specifically, we are locking in better long-dated rates.

We also intend to shift towards in-sourced unit production at Tonic and evaluate other strategies that will benefit our cost structure in future quarters. Also, within our commercial business, we are seeing incremental pressure and additional sourcing constraints that will weigh on our margins for the remainder of the year.

In light of the current cost increases in units, freight and delivery, and while we expect some of this pressure to abate in the back half of the year, we are evaluating ways to improve our fixed cost efficiency and move to a more variable cost structure, in addition to other strategies to better balance growth, profitability and member experience. All in, we now expect a Connected Fitness product gross margin of 7% in Q2 and 16% for fiscal year 2022.

As we've said before, we are more focused on Connected Fitness gross profit dollars than margin percentage, with the goal of using those gross profit dollars to offset our sales and marketing expense. This is an extraordinary year where this goal is difficult to achieve, but we are committed to making material improvements to our cost structure that will help us get back towards being net CAC neutral in fiscal 2023.

For our subscription business, we expect a contribution margin of 69% in Q2 and 70% for the full year, with the improvement to last year, reflecting continued fixed cost leverage and some benefit from identified cost savings. Rolling up our segments, we now expect total company gross margin of 24% in Q2 and 32% for fiscal 2022.

Turning to opex. In response to our revised sales and margin outlook for fiscal 2022, we have identified material savings across our operating expenses, though some of these actions may take a quarter or 2 to show improvement. Some of these identified areas of savings include: making significant adjustments to our hiring plans across the company, optimizing marketing spend and limiting showroom development, identifying areas of efficiency, improvement and member support and streamlining our product development teams while maintaining a focus on new products and expanding software features.

Inclusive of the headwinds in COGS and planned cost efficiency initiatives, our current estimate of adjusted EBITDA loss for Q2 is between $325 million and $350 million. Our revised outlook for full year fiscal '22 is a loss of $425 million to $475 million on an adjusted EBITDA basis. Despite these near-term headwinds and our reduced revenue outlook, we continue to expect to be adjusted EBITDA profitable in the back half of fiscal 2022 and for the full fiscal year 2023.

We're making the necessary adjustments to keep us on our path to profitability, and our long-term view of our opportunity is unchanged. We have confidence in our Bike portfolio. We're seeing growing momentum behind our all-new lower-priced Tread, and we are optimistic regarding new products in our pipeline, the commercial and corporate wellness opportunities and continued international growth.

Turning to capex. We are evaluating ways to optimize our U.S. manufacturing expansion and costs, but continue to believe that this is the right long-term move, especially in light of the supply chain challenges we are facing today with freight and delivery costs, needed supply chain flexibility and the benefit that will come from stateside expertise in manufacturing. As we look to manage our costs, we now expect approximately $400 million of capex spend through the balance of fiscal 2022. While the next several months present a forecasting challenge in our business, we have many levers to control our costs and will implement the appropriate strategies to support our continued growth in our member base, revenue and path to profitability.

I will now hand it back to John.

John Paul Foley

Thanks, Jill. As you all know, we've been managing through an unprecedented 19 months since COVID began, going from extreme demand to extreme supply shocks. And coming out of

COVID, consumer behavior and supply chain inputs have been very challenging to predict in the short term, as clearly evidenced by our new outlook. But please note that the entire Peloton management team is focused on making the best decisions for the long-term health of our business despite the challenges we are currently facing.

We know the positive impact we are having on our members' lives. And while our growth is not what we had expected just a few short months ago, we are extending our lead in home fitness cardio and becoming a leader in strength. We make the best, most immersive and interactive home fitness products available, and we have more on the way in the coming weeks and months. We will come out of the other side of this uncertain operating environment a much stronger and more nimble company. We will be vigilant in managing our cost structure for both growth and profitability.

In conclusion, I want to let you know that managing this business is incredibly personal to me and the entire team here at Peloton. As one of the founders and the biggest individual shareholder, I can't tell you how much we care about Peloton, and we want every piece of it to be beautiful, including the financial model and performance. I am incredibly proud of the vision that we have laid out, and I'm energized by the clear path to get there. Nothing is in our way. We see exactly what needs to be done, and we are going to do it: continued growth, innovative new products, smart performance marketing, improved hardware margins, rightsized opex and a relentless focus on the value that our members receive from their Peloton membership. All of this is within our control. We are operators and leaders. We love what we do, and we have never been more excited about our future than we are today.
With that, I'll turn it over to the operator for questions.

Question and Answer

Operator

Our first question comes from the line of Doug Anmuth of JPMorgan.

Douglas Till Anmuth

I have 2. First, just hoping you could help us understand is how much of your reduced forecast is due to Bike versus Tread, if there's some more color that you can add there. And then second, I think just in terms of balance sheet and cash flow. You've burned about $650 million in cash in 1Q and obviously looking at further EBITDA losses ahead. So with $924 million in cash on the balance sheet, just curious how much cash you're comfortable operating the business with going forward.

Jill Woodworth

Yes. Doug, it's Jill. Thanks for your questions. I think I'll just answer your second question first, and I think that's a little bit of a shorter answer than the first. I think just cutting to the chase, we don't see the need for any additional capital raise based on our current outlook. As we mentioned, we're taking significant steps to adjust our expenses across COGS and opex with this revised revenue guidance, then we have a lot of levers to pull.

In addition, what we're also going to do is reevaluate the cadence of some of the capital investments that we're making, inclusive of POP. And while we know that POP is a decades-long, right-term strategic move for us, there's definitely ways for us to find ways to make that a more economical spend over the next couple of years.

In terms of your first question. Certainly, I would say, as we think about the 3 or 4 contributors to the reduction of guide, I would say Bike portfolio is the largest. And that is obviously a decrease in the demand profile. But secondarily, as you know, with the mix shift, it is also more heavily weighted towards the original Bike, right, or the lower-priced Bikes than Bike+. And so that does have revenue implications and EBITDA implications and effectively, Connected Fitness gross margin implications relative to what we thought.

And just giving you a little bit more detail there. As you know, we're agnostic on entry point. But certainly, before we did the drop in original Bike, we were seeing about a 50-50 mix. That expanded a lot. After we dropped the price, it's come down a little bit, but call it, more like 3 quarters original Bikes. So that's also contributing. But again, just remember, we're agnostic to entry point, and that has no impact on sub growth.

And then Tread, we're still in very early days, but obviously, the traffic trends that we're seeing on Bike are the same for Tread. And so we have also taken down Tread. And then the last piece would be Precor or commercial business where we've moderated some of our expectations for the year given some of the headwinds we saw in Q1. So those are the -- that's the order.

Operator

Our next question comes from Edward Yruma of KeyBanc Capital Markets.

Edward James Yruma

John, just a bigger picture question on Tread. Obviously, you indicated that results have improved once you kind of deployed more marketing. But just kind of what are the initial consumer feedback on the device? Do you think that people understand that it's a total body fitness solution? Or are they comparing it to kind of conventional treadmills? And then as you look forward, are there other things you can do to help the consumer understand the attributes of the product?

John Paul Foley

Yes. I'm glad you asked. We were very excited about Tread. You heard in our prepared remarks that we have a fantastic 89 Net Promoter Score out of the gate, which is just, off the chart, incredible reception from our members. The press reviews have been coming in. I encourage you to read them. And Gadgets has had a great review this week. So the reception to the product has been fantastic.

You are pushing on a -- I think that it's a real dynamic that treadmill is being -- having been in the market for decades and decades, there's some -- there's -- we talked about last quarter, there's an asset and a liability with the awareness of what a tread is where you see it and you think it's something to run on. And certainly, it is. Ours is the best tread to run on. But to your point, it's also a portal to a full-body workout, as we call it.

And circuit workouts are so popular. If you think about Orangetheory and Bootcamp classes, and then even CrossFit, huge category, huge opportunity. So Tread on the hardware side is huge. And then the content from a circuit training perspective is a fantastic, huge opportunity, huge market and huge consumer demand. And so we do have some education to work through in the coming quarters and coming years.

It's the same education we went through with the Bike, where people would say, years ago, why do I need a $2,000 stationary bike? And it's like, well, it's not a stationary bike, it's a portal to a fantastic indoor cycling class with the community and the quantified itself and the instructors and the programming and the music and everything that the Peloton Bike brought.

Similarly, the Tread is so innovative that there is some education, and we're going through that. I will point out, we've only been, call it, 30 days on television, trying to start telling that story. And the trend of sales of Tread has been fantastic. So we're bullish on this year. We're bullish on the coming years. And it's going to be a huge new product line for us. So we're super excited.

William, I don't know whether you wanted to add anything on top of that.

William J. Lynch

No. I'll just add to Ed's question. As evidence of the awareness, John mentioned, we measure awareness of our various products in the brand and track empty measures. And our unaided awareness among the target is only at 11%. And you have to go back to close to 2000, late 2015 to find that kind of awareness on bikes. So we actually view that as a massive opportunity.

Our formula for growth that we've been able to hone on Bike and then as we roll out internationally, it starts with product experience. We deliver the best product experience in Connected Fitness and Tread within 89, as high as what we've seen on Bike. And so when we start from there is the core, we start to build awareness. We build the installed base, to John's point on momentum. We get people talking about it. And we have an expression that our members sell more bikes than we do. We're seeing that word-of-mouth with Tread just start.

And we feel like as we climb with these investments in marketing through the holiday, we're really excited about our holiday campaign, which we announced today. We feel very good that Tread is going to be everything we hope, short, mid, long term in terms of growth. We've actually said we think it could be a bigger category than Bike. Everything we're seeing early suggests that could be true, but it's all about getting the awareness up.

Operator

Our next question comes from Justin Post, Bank of America.

Justin Post

Great. I would like -- first, on the acquisition model. First, churn looks good. So part of the model was you acquired people at a gross profit on the equipment that covers your marketing costs. I know that's a little off right now. Do you see that getting back to covering your acquisition costs? Or has there been a change there on the front end? Obviously, the churn doesn't look different on the back end.

And then second, Jill, maybe you could talk about the sub guidance. It looks like it's about 300 to 350 in the December quarter adds and then 600 in the back half. Yes, how conservative -- or what kind of factors did you put into that guidance to make sure you really reset at a beatable or achievable bar?

Jill Woodworth

Great. Thanks very much for the question. In terms of net CAC, you rightly point out what we've tried to solve for really is a net CAC neutrality, meaning that the gross profit dollars in the units that we sell offset the fully loaded. Remember, it's all fully loaded. It's showrooms, it's merchant fees, it's acquisition marketing, media fully loaded CAC. Certainly, this year, given the pressure we're seeing on COGS, and that is combined with the fact that we've returned to media spend in the near term, net CAC is positive. And so you can sort of think about a ballpark number for the year in the $300 to $400 range.

Certainly, as you know, with the high engagement and high retention we have, we continue to expect, as you alluded to, an incredibly attractive, even with those economic LTV to CAC. But also just keep in mind that we've just begun marketing Tread, right, about a month ago. So we saw a little bit of media spend in Q1. But obviously, we expect to continue to ramp to build product awareness of Tread. So as you know, for a more nascent product where you have lower volumes, you have to build that volume up over time to really get some CAC efficiency. That's also working against us.

And then, of course, we talked about in our prepared remarks some of the headwinds we're seeing on COGS, which we believe will get better throughout the year. So certainly a departure from previous years, but I think what you can expect is us to get back towards net CAC neutrality in fiscal '23.

And in terms of I think what you were asking really is the confidence level in the new guide. Yes, we are confident in the ranges that we've provided for both Q2 and full year. We certainly moderated expectations in the guide, reflecting the traffic trends we saw. And I think that includes across the company, that's like portfolio, that's Tread, that's commercial and also some of the mix shift elements that I had talked about earlier.

We've learned a lot, right? We've learned a lot since the price drop around what are the traffic trends, what do conversion trends look like. And so those 2 months were a great learning for us to obviously have a base off of which to give a guide. Going into Q2, as you know, the next 12 weeks, our critical holiday period as well as New Year's resolution.

We have a great campaign that launched today. We have inventories in great place, which -- in a great place, which means OTDs. Despite the volumes that we're projecting, we're going to be in a great place. And then, of course, we're looking at sales ramps from previous years, right? Last year is a tough year to use as a model. But we have previous years where we know what the seasonal spikes in our business looks like. And I think we've taken a good approach in looking at previous years combined with this current data since the price drop to arrive at our guide.

Operator

Your next question comes from Youssef Squali of Truist Securities.

Youssef Houssaini Squali

Great. Maybe one question for John and one for William, if I may. So John, engagement remains a key obviously to the Peloton story. This is the second quarter of the client engagement. I think in your prepared remarks, you spoke about Q1 being the trough. Maybe speak to what you're doing proactively to kind of fix that outside of the, basically, the reopening? Is it a content issue? Is it just something else altogether that maybe we didn't talk about?

And then, William, can you discuss the Precor integration? I think you guys mentioned that it's -- the performance is trailing a bit behind your own expectations, but I care more about the -- how is the integration going? And particularly as you look at their kind of richer product offering, how much of it do you think is susceptible to you guys offering as maybe part of that one subscription model that you, John, are envisioning for the model -- for the business going forward?

John Paul Foley

Yes, Youssef. Thank you. William, I'll take this one first to go in order. So yes, with respect to engagement, we always expected the engagement to come down slightly coming out of COVID. I mean it's just the idea that gyms are available, people can get out of their house now. They're not locked down. So we knew that we weren't going to see those crazy elevated COVID engagement numbers forever. But I will say that the 2-year CAGR in the prepared remarks, you might have heard there was over 40% quarter-to-quarter. But to answer your question, there are a whole host of things we're doing, and we are always innovating on content and software features and building.

Every time we launch a new content vertical or content category or a new instructor, we're not retiring other categories. We're just -- it just continues to get more selection, more music genres, more instructor styles. And so what you saw in Q1 is a seasonal impact that we've always had going back 6, 7 years in our business. So some of this you can't fight. I mean in the cold winter months, coming out of New Year's resolutions, people are working out on our platform more than they are in August. And that's just -- there's only so much we can do to shift that.

But I will say, we continue to be dramatically better -- to see dramatically better engagement than any gym or any other Connected Fitness product platform. So we feel good, and we're bullish about the coming quarters and how that's going to play out with engagement.

William J. Lynch

And then, Youssef, on Precor, just reminding everyone why we made that acquisition. First and foremost, it was about building the -- substantially the best Connected Fitness equipment manufacturer in the world. We feel like one of our objectives internally, and we've said this, is to build a structural advantage not only in scale and our ability to build Connected Fitness equipment. I'll remind everyone, this has been a very fragmented market where any one line making tens of thousands of things was remarkable or making millions of things. And that's been challenging to build that capability over time, especially with our growth. But we've done that and then also build a structural cost advantage and quality advantage while we build that scale advantage.

We feel like to win Connected Fitness, as John noted, you have to be best of breed in that. And Precor's talent, Rob Barker, Greg May, that team is remarkable. We thought it was the best team when combined with ours. And everything we've seen in terms of the integration, some of the work we've done out of the Whitsett -- with the North Carolina facility on domestic manufacturing staging for POP. It has been going remarkably well, and everything we believe and hoped in our diligence has been true there.

In terms of channel, as Jill noted, there's softness there. The operators on the key verticals within those channels have been slow, whether it's hospitality or gyms to reopen, and certainly not at the rate that we'd expected. And so, hence, the take down in the guide. But it doesn't daunt us for what's going forward. We think we'll have the best catalog to offer. We do today when we combine Precor grade equipment with ours. And then also, that channel not only is a good business for us as it reemerges, it's also an incredible lead generation channel. Just an example of that is in hospitality, when we have a Peloton bike in a hotel for a year. It sells on average 7 bikes into the home, and that talks to the quality of the experience that it offers.

When a traveler goes into a Westin and gets on their Peloton in the morning and tries it using our trial, we get that lead capture. And we know, given the strength of the experience, they come home and they buy Peloton. And so it's not only a business that we think has a lot of, financially, has a lot of upside going forward given the catalog. Not only have they been helpful on the manufacturing side, it's very strategic for our at-home business as a trial channel, certainly in hospitality, but also when you think about universities and other verticals.

Operator

Our next question comes from Eric Sheridan of Goldman Sachs.

Eric James Sheridan

Maybe I'll ask a 2-parter, if I can. In terms of stimulating demand, what do you see now as sort of the key levers to pull in the business, whether it's mining existing digital subscriptions or how we should think about demand within your control versus demand without of your control?

And along those lines, it seems like what you were saying there with the variable cost structure is we should be almost rethinking about maybe margins longer term. Just want to make sure I heard that messaging clear and what the takeaways were in terms of a more variable mix of cost in the model.

Jill Woodworth

Sure. I might just change the order of your question very quickly, just to address what I meant. When you think about during COVID, right, we had several quarters of sequential growth. And what I'm specifically thinking through is we've obviously built a warehouse footprint. We've obviously invested in a lot of field operations, which has been great for our business. It's been great for our members. But I do think going forward, as we think about our growth, right, we're now going to have a more seasonal business again, right?

And -- so I do think as we think about future growth layered on top of those fixed costs, right, I think we have to get more creative in thinking through how to strategically use 3PLs, right? So -- it's not like we're going to just keep building out our warehouse footprint, we're just going to have to think about. And I think it's -- in addition to that, there's also some opportunity within our member support model.

So I just think as we have a seasonal business, right? I think one of the ways in which we can gain advantage is looking for ways to have fixed cost leverage and also improve variable cost structure. So I think it's just more to think about coming out of COVID, right, how do we rightsize our business model for the demand that we see in our business and the seasonality in making us have the most robust profitability.

William J. Lynch

And this is William. On the demand side, in terms of leverage, you sort of need to think about it by product. And I'll just start with Tread. We -- I think we've all made the point about how excited and bullish we are on Tread, and it's really about -- it's so unique to start with, a product at 89 NPS, and it's to the credit of our product team led by Tom Cortese and Jen Cotter. We've got the best product and content team on the planet. And it's a market or stream to be able to get the word out, and that's what we have to do.

11% awareness, 30 days in. It's just about scaling awareness, getting more people buying that product, them doing the work for us on word-of-mouth. We know that formula very well, and we -- Jill mentioned the new campaign that started today, really pushing the Tread, educating people, to John's point, about it's not just running, it's this incredible full body experience. We've got the best instructors in the world. So that's going to be a foundational growth engine for us going forward that has us very excited.

On Bike, had we not been comping the massive Bike growth in COVID in isolation, the Bike units this year would look incredibly exciting. Jill talked about the net sub adds, largely coming from the sale of Bike this year, that's a lot of volume. And so we have to keep penetrating the huge opportunity in SAM. We've said it's early days, both in SAM and TAM. We dropped the price on Bike just recently, and it's getting the word out. It's also our messaging and creative. We do a lot of consumer insights work on how do we get people over the fence and coming into Peloton on the Bike, and we feel great about that. It's new channels we're opening up. We referenced corporate wellness and others, huge partnership with UnitedHealthcare that's just getting off the ground. So we like our headroom on Bike. We like international markets. We added Australia.

Australia sold just 3x within the first month in terms of an international launch, 3x the number of units that we've sold in U.K., Canada or Germany, any other new international markets. So we've got amazing growth prospects in front of us, and it's just about being focused, being disciplined, getting over this COVID comp and also getting more efficient with our marketing, but we know how to do all that.

Operator

Our next question comes from Laurent Vasilescu of Exane BNP Paribas.

Laurent Andre Vasilescu

Two-part question here. During last year's Investor Day, you provided a lot of great stats about the income brackets of the consumer, the demographics. Embedded in your full year guidance for this year, like who is your target consumer, considering the price cut on the Bike?

And then secondly, more of a modeling question, but I think you mentioned there was a new digital marketing landscape now with Apple. Sales and marketing was 35% of sales. How do we think about those metrics for the second quarter and the full year?

Jill Woodworth

Great. In terms of -- I might just take your -- the second question first yet again because I think it's an easier question to tackle. Are you just asking what percentage we believe the leverage we're going to see in the sales and marketing line versus leverage? Certainly, versus Q1, we expect our sales and marketing to come down fairly dramatically throughout the year.

As you can imagine, in sales and marketing, right, obviously, in Q1, we began ramping our Bike media to talk about the price drop. And of course, that was our seasonal level of revenue. So sales and marketing as a percentage of revenue was obviously at a seasonal high for us.

As we move through the year, Q2 will be also a big key sales season for us. Essentially, you can expect through the year to probably end in the low to mid-20s on overall sales and marketing as a percentage. So it does come down almost sequentially through the year. So that is -- and then, did you have a question, I think, embedded on digital marketing?

Laurent Andre Vasilescu

That was the part of the question because of the new landscape, like how much is marketing as a percentage of your sales going forward for this year? But yes, that's in the first part of the question...

Jill Woodworth

Yes. Digital marketing -- yes, if you're talking about more of the media spend aspect of it, obviously, our full sales and marketing line does have obviously our -- it's all of our fully loaded showroom costs and merchant fees and, of course, everybody on the team. So are you asking specifically what breakout is variable media spend?

Laurent Andre Vasilescu

Yes, that would be great. And also, just overall, guidance on sales and marketing total as a percentage of sales for the year, which I think you just gave.

Jill Woodworth

Yes. And I will say on this point, as you know, TV has always been an incredible medium for us to convey the Peloton value proposition. And so I would generally say we're more heavily weighted there. So I don't think the changes that we talked about in the digital landscape are going to impact us much.

I do think from a variable media spend, we are a little bit more weighted, and there's a lot of other channels like OTT, but certainly, TV is a big category for us. So we're not concerned with the media landscape, but certainly, it does have some impact.

And then I think, William, you're going to take the demo question?

William J. Lynch

Sure, I can. We don't want to go too much into kind of our secret sauce, but we have customer segments that we used to buy media against. You're asking specifically about demographics. I think the general push there that I can talk about is we want to continue to penetrate younger and less household income. And we've been successful doing that.

Part of the thesis strategically on the price drop was we wanted to bring this amazing experience to more and more people. And obviously, we want to do that against the mission John talked about in his closing remarks, it's also good for business. It allows us to really penetrate the TAM and SAM given the size of that segment. And it's the fastest growing meaning, meaning the under 35,000 and 50,000 and under. It's been our fastest-growing segment for -- I think it's been the last year, we think -- I'm almost sure that's the case.

And so as we think about the opportunity, we talk a lot about Connected Fitness and our leadership there, but we really see it much more expansively. If you look at the price of fitness, which is a massive global market, it's really about -- there are 181 million people globally, gym memberships globally, and you look at the 6.2 million members that John referenced, and you think about our experience and the convenience of home and the value that we offer and engagement, and it's why we're so confident this -- if we do our job, continue to do our jobs, it comes to us. So that's -- we think about a broad segment. We have members that are 80-plus, and we have 20-year-old members. And so it's really a wide demographic.

Operator

Our next question comes from John Blackledge of Cowen.

James McGee Kopelman

This is James, on for John. In light of the traffic trends you mentioned, how are you thinking about the role of retail showrooms to drive conversion of the treadmill and bike? Prior to the pandemic, I think you said somewhere around half of treadmill conversions were due to first-hand experience, i.e., customers trying out treadmills on a showroom . Is that still the right way to think about conversions for the lower cost treadmill?

And then a second question on the product portfolio. In light of the supply chain issues and inflationary pressures, does that potentially impact product release cadence as we get through fiscal 2022?

John Paul Foley

Yes, James, I'll jump in on the first one. I'm glad you asked because as you know, we have over 100 fantastic store -- retail stores worldwide. And we are -- whenever we launch a new product, those stores become an even more important strategic asset. And we will see that when we watch our daily sales throughout the week and how much better the Tread does on Saturday and Sunday as those stores are full. And so for a more mature product, you might feel comfortable buying it online, like a Bike because you've ridden before, whether it was a hotel or your friend or whatever. And so you have a familiarity with that product.

Obviously, with the Tread, the new Tread being 2 months new in some markets, and even newer in other markets, going to those stores and getting on and having an experience and more and more going to the back and actually doing a workout in some of these stores is a huge asset. And while a lot of people are shutting down stores, we love our retail stores for just this reason. We think it's a really critical strategic asset when we bring new products to market. And we talked about the Tread is new, and we're going to have other new products in the coming quarters that we're excited about, and they also benefit from the retail footprint.

I'll take another product cadence question. Sorry about that. We did say this year is going to be a big year for product launches. We stand by that. We're excited if you caught in my prepared remarks, I alluded to the coming weeks and months of some new announcements, one that I'm very excited about. And then potentially another one next year, hopefully in H2. And we're pushing -- we've had a lot of fantastic R&D in the hopper for years at this point, and we are super excited to bring it to our members and to expand our opportunity. That's all I can say right now. But we are a technology and innovation company, and we're going to show what that means in the coming quarters.

Operator

At this time, I'd like to turn the call over to John Foley for closing remarks.

John Paul Foley

I guess that's it. Thanks, everybody. We'll talk to you next time.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.