Porter & Co.

PARTNER PASS
EXCLUSIVE REPORT

DISTRESSED INVESTING
ISSUE #8 | NOVEMBER 08, 2023

Shopping for the Home… From the Home

- From Shipping to Branding – This Company Gets It Right
- Escaping the Dot-Com Bust With a Focus on Growth

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From Shipping to Branding – This Company Gets It Right

Escaping the Dot-Com Bust With a Focus on Growth

> *This merchandiser offers bargains,*
> *Abundant choice, and elegance,*
> *And maximizes profit margins*
> *With artificial intelligence.*
> *- Martin Fridson*

The Pukwudgies were not happy.

The knee-high, malevolent spirits – a part of centuries-old folklore of the Massachusetts Wampanoag tribe – don't appreciate it when white men build vacation homes on ancient tribal burial grounds.

But dot-com billionaire David Wetherell, who'd just laid the foundation for a pricey beach house on the Massachusetts island Martha's Vineyard, didn't care that he'd offended the spirits.

At the time, the stock market was happy with him. And that's all that mattered.

When he first broke ground on a 7,000-square-foot beach house in 1998, Wetherell, a venture capitalist who snapped up promising internet companies in order to take them public, was sometimes called the "Warren Buffett of the Web." His company, CMGI – a $41 billion market cap behemoth and the best-performing U.S. stock during the five years from 1995 to 1999 – was described by the *New York Times* in 2000 as "a new corporate creature somewhere between a conglomerate and a venture-capital fund."

It was the height of the dot-com bubble – and tacking the word "Internet" onto a company's name was enough to send share prices through the ozone layer. CMGI's portfolio of 70-plus investments included search engine Altavista, web-hosting service Geocities, and several early online retailers like MotherNature.com and Furniture.com.

In those days, David Wetherell was hailed as a "visionary." He was a cash-rich talent scout for hot internet companies, with the budget to throw lavish IPO launch parties and shell out $7.6 million a year to brand the New England Patriots' football stadium "CMGI Field."

But soon after Wetherell started building his vacation house on the Pukwudgies' land, strange things started to happen. The foundation sank, rooms flooded, heavy machinery tumbled off trucks, and contractors kept breaking equipment and running behind schedule. Staff whispered about a "jinx."

Then, the construction workers found bones. *Very* old bones.

The Massachusetts state archaeologist confirmed that Wetherell was building his house on top of a 30-by-40-foot ancient native burial ground. The Wampanoag Tribal Council contacted Wetherell and suggested that he build his house elsewhere on his 10-acre property.

He refused. And that's when things *really* started to go wrong...

One night in late 1999, Chip – a Wampanoag native who'd been hired as a watchman for the property – sat down with John, a young construction worker, and told him something that John never forgot. As John later explained in *Salon.com*:

> *"[Chip]* ***said*** *that the old ones, the Tribal Elders, had prophesied that the [Wetherell] family 'would not have one day of happiness in this house.'"*

Whether that was due to the vindictive Pukwudgies... or to David Wetherell's own hubris... the Elders didn't say. But, soon thereafter, the dot-com bubble burst, and the Nasdaq Composite Index dropped 77% during a two-year bear market. CMGI shares fell 93%, as the company's market cap shrank from $41 billion to $5 billion.

Despite his early successful stock runs in the 1990s, it turned out that David Wetherell had an almost supernatural talent for backing the wrong horse...

CMGI-funded search engines Altavista and Lycos ignored customers' preferences for a clean interface and cluttered up their homepages with countless links and ads – and users moved on. Bubble survivor Google – with a blank page and a single search bar – ultimately won out.

On the e-commerce front, Wetherell probably wished he'd snapped up Amazon or eBay in the mid-90s. But instead, he'd picked clunky auction site uBid, as well as online vitamin company MotherNature.com, which misleadingly claimed customers would get access to advice from health professionals, and went out of business just a year after its IPO.

Not to mention Furniture.com, the online furniture retailer with order-tracking software so bad that it took customers eight months to receive a single chair.

By 2002, CMGI could not afford to sponsor the Patriots' stadium anymore, and Gillette bought out the naming rights. (Stadium workers had just over a month to get rid of 2,000 "CMGI Field" signs before the start of the 2002 football season.) That year, Wetherell stepped down as CEO of the ravaged company, which limped along for a few more years before changing its name to ModusLink Global Solutions.

David Wetherell (and most of his fellow late-90s tech wunderkinds) fell victim to the belief that the word "internet" was a magic bullet – a bit like today's artificial-intelligence **("AI") frenzy**. In reality, the few internet companies that survived the dot-com bust were good companies first, and internet companies second. They had sustainable business models and knew how to satisfy customers.

And somehow, Wetherell never bet on those.

John, the young construction worker who'd worked on Wetherell's beach house, had his own theory about why the dot-com bubble burst.

"There are lots of explanations for why the new economy died," he **wrote** years later in an article for *Salon*. "It was a tulip bulb mania that had to end: That's what the pundits say. But I have another explanation. I think it burst because we built that house where we had no business building it."

Be that as it may... Wetherell and his wife eventually split up, and she got the Martha's Vineyard beach house in the divorce. It still sits on Squibnocket Point, the southernmost end of the island, a monument to a broken family and a burst bubble.

Somewhere, the Pukwudgies are laughing.

In this month's issue, we'll examine one of the few solid internet companies that escaped the dot-com carnage – not surprisingly, it's a company that David Wetherell did *not* buy. We'll take a look at the brilliant, customer-friendly (and capital efficient) model that allowed this company to weather the storms of the early 2000s... long after its rival, CMGI-owned Furniture.com, splintered into matchsticks.

Bond at a Glance

Wayfair (NYSE: W) is an online platform that sells everything related to the home. It lists furniture at every price level for every room. It offers appliances, decorative items, outdoor furniture, lighting, and more. The company provides over 40 million products from 20,000-plus suppliers. Its websites and mobile app were visited 3 billion times over the last year. With a market cap of $5.4 billion, Wayfair generated $12 billion in revenue in 2022.

We are recommending Wayfair's 1% Convertible Bond due 8/15/26 – convertible at $148.48/share, and CUSIP: 94419LAF8. We like Wayfair and its bond because...

- it is a market leader in an industry with many smaller competitors
- the bond matures in less than three years
- the company is receiving market-rate interest on its large cash balance and it's paying below-market interest on its low-coupon debt
- the company's two founders have $1.5 billion of their own wealth on the line

Way Back When

This story starts with two longtime pals – Steve Conine and Niraj Shah – who met in high school at math camp. Their friendship continued at Cornell, where they studied to become engineers. In their senior year, the two wrote a business plan as an assignment for a class in entrepreneurship.

The pair's idea was for a business that designed corporate websites – and they quickly got busy making it happen, calling it Spinners. It was 1995, and the internet was in its infancy. As the internet expanded, so did the need for websites. They grew and sold that company a few years later for $1 million in cash and $25 million in stock of the purchasing company. When the dot-com bubble burst in 2000, those shares became worthless.

Undaunted, in early 2001, the young entrepreneurs started an enterprise-software business called Simplify Mobile. The business suffered after 9/11, when many of their potential customers couldn't return to their offices. They closed Simplify Mobile and moved on to the next one.

It was 2002, after tech stocks lost most of their value. "Smart" people believed that e-commerce – selling things on the internet – was a flash in the pan. They doubted whether a company called Amazon.com could ever make money.

Conine and Shah thought otherwise. They believed that e-commerce was in its early stages and was going to grow explosively.

Creating An E-Commerce Business

Research showed that there were many single-item websites for sale. They had names like birdhouses.com and everygrandfatherclock.com – hundreds of small e-commerce businesses providing a wide assortment of just one specific item.

From their experience building websites, Conine and Shah knew the ins and outs of the internet. They could track down which categories of goods were searched for most often on Google – then only in its fourth year. They knew how to figure out which words on a website would attract the most clicks. This was a rare and valuable skill at the time. They combined their initials and named their business CSN Stores.

Next, they believed that all they needed was a website with a name that made it clear what they were selling. In September 2002, the pair launched racksandstands.com – selling stereo racks and TV stands. They reached out to potential suppliers, and many of them let CSN place their products in its online catalog.

Before keyword management was a standard practice, Conine and Shah worded their site so when a customer typed in “television stand” or “stereo rack,” racksandstands.com would show up at the top of the search list. Because they worked with multiple suppliers, the selection dwarfed what anyone could find at traditional stores. To make a purchase, a customer placed orders with a credit card – either online or by telephone.

Here’s the beautiful thing. The customers paid racksandstands.com – which arranged for the manufacturer to ship it directly to the buyer. CSN *then* would pay the manufacturer 30 to 45 days later. The suppliers stocked the inventory until they shipped it to the buyer – CSN never had to touch it. As a result, building CSN required little up-front cash. The business model was capital light from the start, since there was no need to buy inventory. It was a money machine.

CSN Stores plowed the money from racksandstands.com into a second business. This time it was televisionbrackets.com, offering brackets for hanging a television on the wall. This operation sold mostly to hotels and hospitals. It too did well.

Soon, Conine and Shah hired staff to run the day-to-day business of taking orders and arranging delivery – freeing them to research their next idea. As sales from the two websites increased, they launched new web stores. This was taking place just as the internet – and e-commerce – was taking off. Revenue skyrocketed.

The business grew to 250 websites – all funded with cash from current operations. By 2010, the websites collectively had 5 million customers and generated close to $400 million in revenue. Conine and Shah decided it was time to centralize all these individual operations into one CSN Stores online catalog.

In 2011, the pair took in outside money for the first time – raising $165 million from venture capitalists. The money would go to creating a brand consumers would remember. For the first time they turned to consultants for advice.

The branding experts suggested the name “Wayfair” – which combined two positive-sounding words. Conine and Shah liked that the name was not already in use, so they didn’t need to pay a premium to buy it.

They decided that Wayfair would focus on the “home” category. As a large buyer, they would benefit from an industry with lots of small manufacturers and just a few large sellers. (Amazon and The Home Depot were and are competitors.) As engineers, Conine and Shah liked that the logistics – arranging to get everything to the right place and on time – are complicated. It provided a barrier to entry.

Making It Real: Wayfair's IPO

Wayfair went public in August 2014, selling 11 million shares at $29. This valued the company at $2.4 billion. The company received proceeds of roughly $300 million for operations. Conine, Shah, and the venture-capital investors held on to 87% of the company.

Today Wayfair sells decor at various price levels for the home. It offers appliances, rugs, outdoor furniture, lighting, and more. More than 3 billion visitors hopped on its website or mobile app in the last year. And as the graphic below shows, Wayfair has very high brand awareness at home, in Canada, and in Europe.

Household brand status in 3 of its 4 markets, as measured by aided brand awareness:

- **82% in the U.S.**
- **85% in Canada**
- **77% in the U.K.**
- **Germany tracking same trajectory as other markets, through at earlier stage**

Wayfair promises "convenience, value, and customer service." The typical customer is a woman, aged 25-54, with annual household income of $80,000.

Given its enormous selection of merchandise, Wayfair divides its product offerings into six curated websites and brand identities:

• Wayfair	"Everything home – for a space that's all you"
• Joss & Main	"The ultimate style edit for home"
• AllModern	"All of modern, made simple"
• Birch Lane	"A fresh take on the classics"
• Perigold	"An undiscovered world of luxury design"
• Wayfair Professional	"Just right for pros"

Much of the company's revenue comes from the main Wayfair site, which it also operates in Canada, the UK, Germany, and Ireland.

A Stealth Technology Company

One key to Wayfair's quick success was that its founders understood the potential of e-commerce at a time when most people did not. They were also early to embrace the vast potential presented by machine learning (ML) and AI. Both technologies perform best when used on large data sets. Wayfair's gargantuan customer database is therefore a gold mine.

AI technology evaluates vast quantities of information that far exceeds what the human brain can process. But like a human, it can engage in a conversation with a customer, answering specific questions about products.

ML technology analyzes a large universe of information while simultaneously performing a specified task. It identifies patterns in a database – those patterns are then fed back into the database. As this process repeats, the system's output becomes more accurate.

Wayfair uses AI and ML to improve operations at every step.

Wayfair Uses Machine Learning and AI in All Stages of the Business

Source: *Wayfair*

Marketing

Wayfair uses ML and AI to analyze customer behavior and predict customer choices. It feeds into the company's advertising activity on television and radio, in online videos, and through email, direct mail, search engines, and social media. (The company uses influencers, particularly on Pinterest and TikTok, and singer Kelly Clarkson provides celebrity endorsements. It has long-term partnerships with Google, Bing, and other major search engines.)

The company uses these AI and ML technologies to improve the efficiency of its marketing. These systems can evaluate all of Wayfair's transactions and all of its advertising spending. This enables the company to allocate advertising dollars to the outlets that bring in the most business. Wayfair also uses ML and AI in its bidding for advertising time on television or in choosing the best keywords to maximize its placement in customer searches – dramatically improving what Conine and Shah excelled at 30 years ago.

Merchandising and Pricing

Technology also plays a large role in Wayfair's merchandising.

The company divides everything it sells into three categories:

- **Branded goods:** names like KitchenAid, Kohler, and Sealy account for 25% of total revenue
- **Differentiated merchandise:** Wayfair generates 70% of its revenue from selling furniture from unbranded suppliers under its in-house brands like Birch Lane, AllModern, and Kelly Clarkson Home
- **Commodities:** Value-priced furniture and standard items like beds, sheets, and towels make up the last 5% of revenue

Wayfair uses AI to price its branded goods. AI searches the internet for the price of every item listed by the competition. Wayfair then matches the lowest price.

The profit margin that results – the difference between the item's selling price and its wholesale cost – varies from product to product. For search purposes, Wayfair's system ranks branded items according to profit margin. When a customer does a search, higher-margin items show up first.

Wayfair uses a different pricing system for its Differentiated and Commodities items. For these products, its advanced system calculates the price that maximizes profits. Again, utilizing the immense computing power of AI and ML, it takes into account expected sales levels, competitors' prices, shipping costs, and customer service costs. The markup percentage varies by product category.

For example, the company uses the same markup percentage for all floor lamps – which is likely a different markup on sofas or on armchairs. Management credits this strategy to allow Wayfair to have "the margin we want at the price we want."

Supply Chain

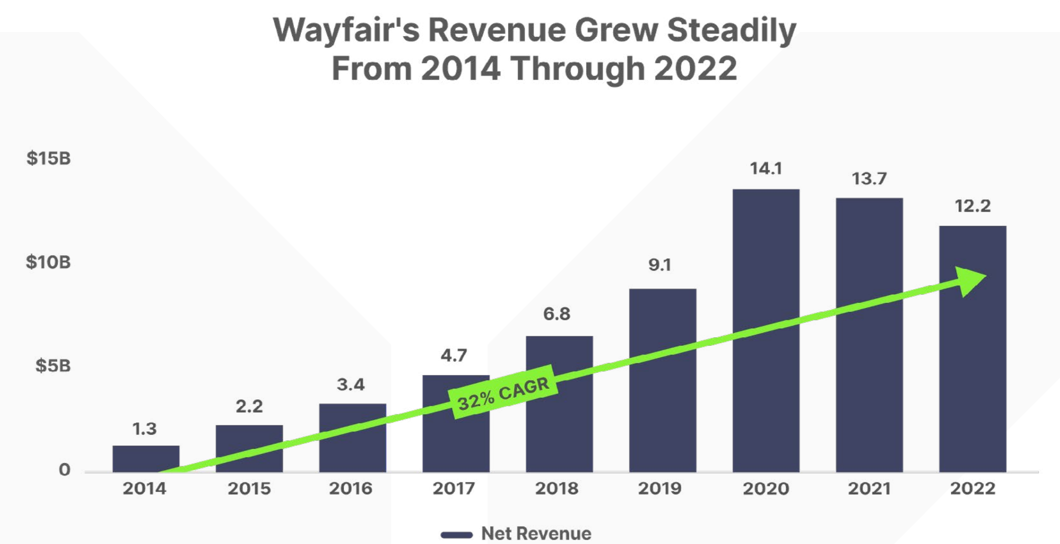
Maintaining the flow of thousands of items to millions of customers is Wayfair's life blood. Managing products with a wide variety of weights, shapes, and sizes calls for sophisticated operating software and tracking systems.

Wayfair created CastleGate – its own international logistics business that handles every link on the supply chain. It enables suppliers – which are often located in Asia – to focus on manufacturing products and to leave the logistics to CastleGate, which...

- arranges for pickup
- transports the merchandise to port
- transfers it into containers filled with merchandise destined for Wayfair warehouses across the U.S.
- contracts for ocean shipping and customs
- uses Wayfair's distribution centers and large-parcel delivery service

Suppliers have financial incentives to use CastleGate instead of their own logistics management. Wayfair's shipping volume is so high that it receives the largest volume discounts available. Its pre- and post-shipping operating systems are more efficient than any supplier's systems, producing additional cost savings. Reduced supply-chain costs lead to a virtuous cycle. Lower prices create greater demand which, in turn, enables manufacturers to lower prices...

Financials: 2014-2019



Source: Wayfair

Wayfair's management team deserves high marks for how it has grown the company since going public in 2014. From its IPO through 2019, as the chart above shows, revenue rose an average of 48% per year. Supporting this rapid growth required significant capital. Each year Wayfair dedicated its operating cash flow plus cash on hand to build the business so that it could handle large increases in sales. Most of this capital investment was used for:

- hiring more employees
- funding for new warehouses and purchasing computer equipment and delivery trucks
- developing its own software and operating systems

Management anticipated that these expenditures would hurt short-term results – but would help over the long term. Going from rackandstands.com producing $7 million a year to Wayfair's $12 billion in annual revenue in just 10 years makes it hard to quarrel with the strategy.

After many years of skyrocketing sales, in 2019 management got careless. The business lost roughly $200 million *before* these capital expenditures to increase the scale of the business – and almost $600 million after taking them into account.

COVID Boom and Bust

COVID arrived in early 2020. Like all businesses during the pandemic, Wayfair wrestled with a few large questions that would determine its profitability – and even threaten its existence.

What would happen to its 16,000 employees if Wayfair were deemed a "non-essential" business, having to close for an unknown period of time?

If it got labeled "essential," how could it operate safely – and at what cost?

Would the supply chain continue, or would there be a shortage of merchandise?

With all of this big-picture uncertainty, how much cash would Wayfair need to stockpile until things return to normal?

As a precaution, in 2020 the company issued bonds for $535 million – bringing its cash cushion to roughly $1.6 billion. This extra cash proved to be unnecessary. In March 2020, sales began to rise and rise and rise. In part because nobody could go out – to dinner, to movies, or live performances – household budgets were flush. An influx of government stimulus checks added even more to consumers' spending power.

Ultimately, Wayfair was ruled "essential" – meaning it was necessary for it to remain operating while "non-essential" businesses had to temporarily close. For safety purposes, it operated with as many people as possible working remotely. The supply chain of goods, largely from Asia, held up well. All of the money that management invested in growth paid off. The company was ready to handle the surge in orders that came during the pandemic. Wayfair became a profit machine.

A Boost From the Pandemic

Year	Revenues ($ Billions)	Operating Profit ($ Millions)	Cash Flow ($ Millions)
2019	$9.1	($497)	($598)
2020	$14.1	$947	$1,082
2021	$13.7	$614	$130

Pre-pandemic, Wayfair management spent money to create infrastructure to keep up with the company's rapid growth. From the quarter beginning April 1, 2020, through the end of the third quarter of 2021, the strategy of investing for growth worked. The company generated more than $1 billion in operating profits in 2020. However, demand started to weaken during the second half of 2021 – and the big-spending pandemic benefit was gone by the end of 2021.

Sales started to decline in 2022 – though they remained well above 2019's levels. Wayfair – which hired rapidly and increased spending on capital expenditures – became unprofitable. Operating losses in the first half of 2022 snapped the founders into action.

Taking an Ax to Expenses

"In hindsight, similar to our technology peers," said co-founder Shah, "we scaled our spend too quickly over the last few years." That's why in August 2022 – during a conference call discussing the weak numbers for the recently ended quarter – management announced that it would cut expenses significantly. It did not disclose a specific savings target.

Five months later, in January 2023, management disclosed its cost-savings target – $1.4 billion per year – and how it planned to achieve it.

- $750 million from laying off 1,750 employees – roughly 10% of headcount
- $500 million from a variety of operational expense cuts to be achieved by the end of 2023
- $150 million from cuts to advertising, capital expenditures, and administrative costs – about a 30% reduction

The table below shows quarterly operating profits from the beginning of 2019 through September 30, 2023. The table highlights the pandemic's effect (boosting profits), the declines that followed, and a return to profitability after management announced the above cost cuts.

Operating Profits Are Back In Black

($ Millions)

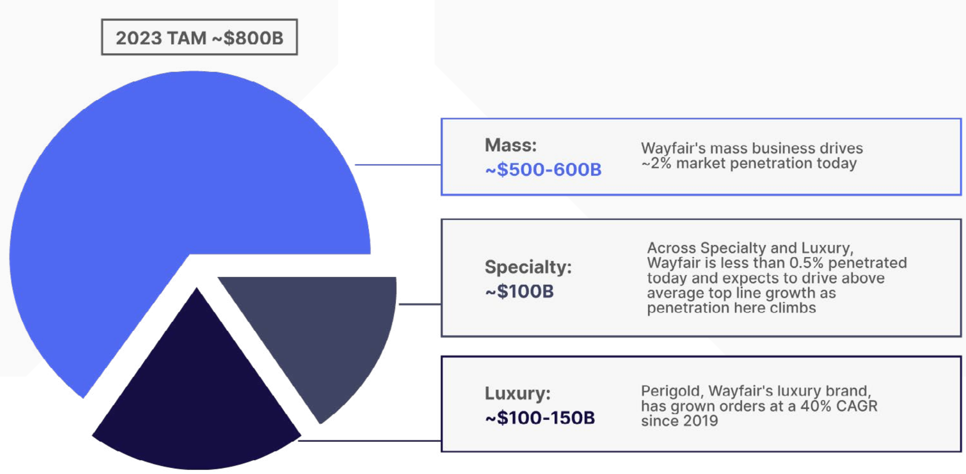
	2019	2020	2021	2022	2023
Q1	($102)	($127)	$206	($113)	($14)
Q2	($70)	$440	$311	($108)	$128
Q3	($144)	$371	$101	($124)	$100
Q4	($180)	$263	($4)	($71)	

Wayfair's Growth Potential

While profits sank following the pandemic because of elevated spending, Wayfair's revenue in 2022 and through nine months of 2023 is significantly above 2019. In fact, they rose 4% in the quarter that ended September 30.

The company's founders remain its largest shareholders because they believe Wayfair's revenue can continue to rise sharply over time – from the current rate of $12 billion to $13 billion per year. The company estimates the total addressable market ("TAM") of "home goods" will continue to grow from around $700 billion, exceeding $800 billion per year by the end of 2023.

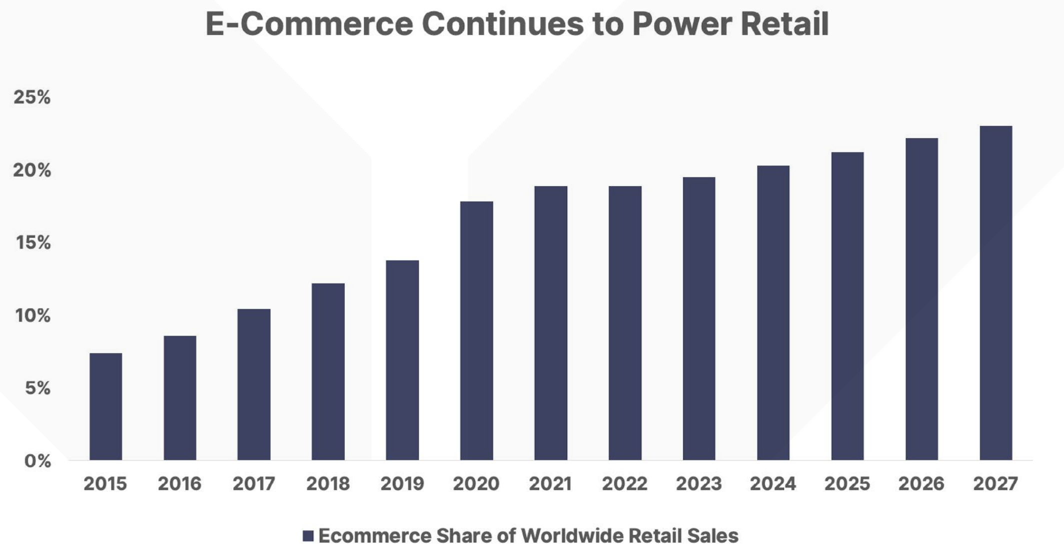
Wayfair's Specialty Brands and Perigold



Source: Wayfair

Using statistics from the Census Bureau, the Bureau of Labor Statistics, and European market-research firm Euromonitor, Wayfair projects TAM will expand to $1 trillion by 2030.

Wayfair should also benefit as e-commerce globally becomes a bigger percentage of retail sales overall.



Source: Statista

Specific Growth Initiatives

In addition, Wayfair is taking specific steps to rev up the company's growth.

It's building up its Wayfair Professional business, which caters to developers, contractors, and designers. On average, these professionals spend more than $20,000 per year on the company's business-to-business website. They now account for $2 billion in sales – or 16% of total revenue. Wayfair offers these customers a variety of benefits like bulk pricing, flexible payment terms, and in-house designers and project managers.

The company is expanding its operating systems and infrastructure by building more warehouses and purchasing additional trucks in Canada, the UK, Ireland, and Germany – markets still in early stages of development for Wayfair. These markets now generate less than $2 billion in sales. Management believes they will become profitable as they get larger – just as the U.S. business did. The potential market in these countries is $350 billion to $400 billion annually.

Wayfair is taking steps toward increasing supplier advertising on its website and mobile app as well. The company's technology enables it to tailor a supplier's advertising to a specific target market. Revenue from suppliers' paid advertising has tripled over the last four years and accounted for 1% of revenues last year. The company believes it has the potential to grow to 3% to 4% of revenue – an additional $400 million to $500 million to the top line.

Management is also working to increase the percentage of sales coming from its higher-priced and higher-margin specialty brands – AllModern, Birch Lane, and Joss & Main. It is also building up Perigold – Wayfair's luxury brand, which has grown 40% annually u since 2019.

As a test of a new revenue stream, Wayfair is building a small number of retail stores. The majority of furniture sales (75% to 80%) industry-wide still take place in person, and the company's stores will benefit from its strong brand recognition, highly developed marketing capabilities, and well-oiled supply chain. Currently, Wayfair has three stores – one AllModern and two Joss & Main. The company is building a Wayfair branded store scheduled to open in the Chicago area next year.

Valuation and Cash

Wayfair's business is improving. The company is generating operating profits for the first time since the end of 2021 – $224 million in the six months that ended September 30. Since only about half of Wayfair's announced cost reductions are reflected in these results, we expect to see additional benefits in coming quarters. With Wayfair's market growing and its expenses falling, we expect the company will become more profitable going forward.

In its Investor Day presentation this past August, management said it expects operating profit of roughly 4% of revenues in the near term. Assuming revenues of $12 billion, this equates to $480 million of operating profit. If we annualize the results from the last six months, the company is already at $448 million. We believe that Wayfair will reach its target sometime in 2024. This represents a $1.6 billion improvement over the $1.1 billion in operating loss in 2022.

Management's longer-term target is to generate operating profit equal to 10%. This would translate to $1.2 billion.

Wayfair has $3.2 billion in debt – 6.7x its $480 million in operating profit, a modest level for a growing technology company. If management hits its longer-term targets, this multiple would fall to 2.7x within a few years.

The stock market typically looks a year or two into the future. At the current trading price of $46.32, Wayfair stock and debt together are valued at $8.2 billion. This business valuation equates to over 17x the $480 million estimated operating profit for 2024 and 6.6x the company's operating-profit projection for a few years from now.

In short, the market is valuing business at more than twice its debt. In addition, as of September 30, Wayfair had $1.28 billion in cash. Between now and the maturity of our bonds in 2026, Wayfair has $117 million in bonds maturing in 2024 and $783 million in 2025.

Aging Debt

Year	Amount of Debt Maturing ($ Millions)
2024	$117
2025	$783
2026	$949
2027	$690
2028	$690

Management has a number of levers it can pull to pay off these bond issues as they come due.

In addition to the $1.28 billion in cash, CFO Kate Gulliver recently noted that the company could issue new bonds to pay off current ones as they mature. The improving results over the last three quarters support this belief.

Wayfair can also borrow up to $600 million from its banks. (We don't believe the company will need to do this.)

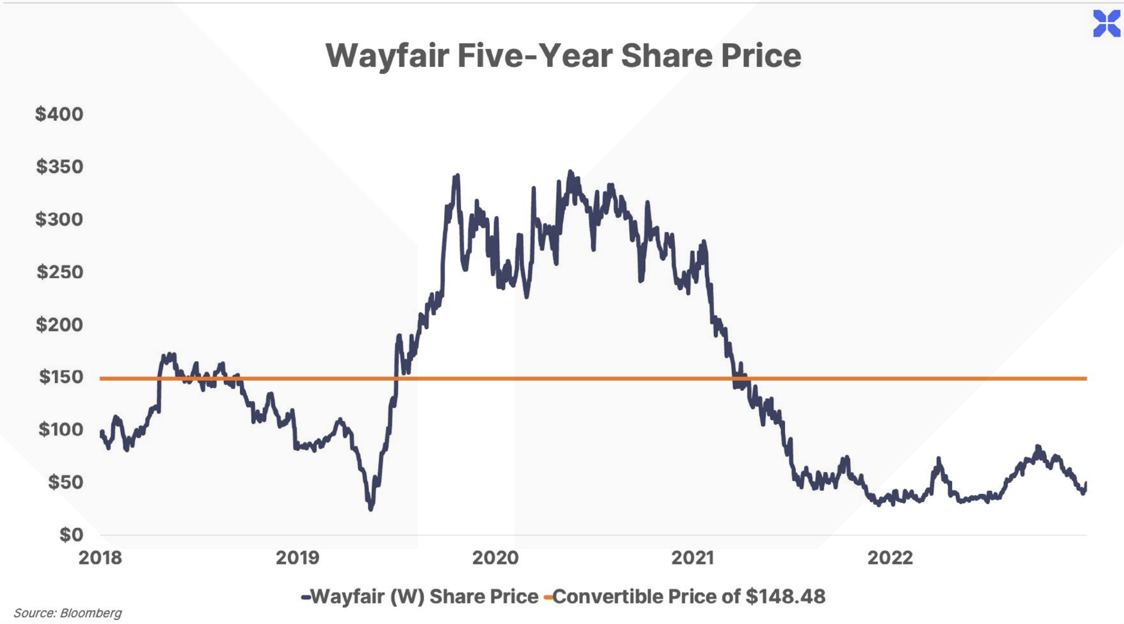
The business is now generating free cash flow. Operating income has exceeded capital expenditure for the last two quarters. This free cash flow – $170 million over the last two quarters alone – will increase the company's cash cushion.

One More Thing...

We're recommending these bonds because we expect they will be paid off in full when they mature in 33 months. We like them without considering the potential (but very unlikely) upside from converting the bonds into stock.

In August 2026, these bonds will receive the *higher* of their $1,000 face value or the value of 6.7 shares of Wayfair's stock. If the stock goes above $148.48 per share by August 2026, holders of these bonds will end up receiving more than $1,000 per bond. Admittedly, we think this is a very long shot, since the stock is currently trading at $46.32 per share.

Here is the Wayfair stock-price chart over the last five years:



If the stock price does go above $148.48 before the bonds mature in August 2026, bond holders can convert them into stock that will be worth more than the $1,000 face value. Your broker will know how to do this. (Before maturity, the market price of this bond is likely to reflect that value – so you can sell it to someone else.)

Converting Bonds to Stocks

Wayfair (W) Share Price	Corresponding Value of Wayfair 1% Convertible Bond
$148.48 or lower	$1,000
$150	$1,010
$160	$1,077
$170	$1,145
$180	$1,212
$190	$1,280
$200	$1,347

As mentioned, the value of Wayfair's stock ($5.2 billion) and bonds (adjusted for cash) together is $8.2 billion. At the conversion price of $148.48 per share, the company's stock itself would need to be valued at roughly $17 billion – or over 3x the $5.2 billion the stock alone is worth now. Wayfair's stock has rarely traded above this level – and that was only briefly in 2019 and during the 2020-21 pandemic-related boom.

Risks

While we believe Wayfair's results will continue to improve, we note three particular risks that the company faces.

Wayfair has *a lot* of competition. It's up against furniture stores (like Bob's Discount Furniture), big box retailers (like IKEA), department stores (like Macy's), and specialty retailers (like Ethan Allen). The company also competes online against Amazon and Overstock.com. While few, if any, of these competitors offer Wayfair's breadth of supply, together they provide significant competition.

As with any retailer, Wayfair's results are sensitive to the condition of the economy. Sales typically fall during recessions. We have seen how declining revenue can reduce the company's profits or lead to losses.

While Wayfair is a maturing business with a large and capable management team, its founders have set its strategy and steered its course. If Steve Conine and Niraj Shah were to leave the company, it could have a negative impact on the company's long-term performance. (There is no reason to believe this is going to happen.)

Discussion of Bond Terms

This bond is "senior unsecured." This means that in the event of bankruptcy – which we certainly do *not* see taking place – bondholders would get paid along with all other unsecured debt. The bonds would get paid *after* secured bonds and bank loans are satisfied. (Right now, there is no debt of that kind.) All of the company's $3.2 billion in bonds would get paid next – and ahead of all stockholders. In other words, these bonds would get paid fully before any of the founders – who now own $1.5 billion in shares between them – would get a penny.

Recommendation

Wayfair reported strong results for its third quarter that ended September 30 on November 1. These strong results caused the price of its stock and bonds to rise. The stock has risen from $42.61 on October 31 to $46.32 on November 7. The 1% Convertible Bonds maturing August 15, 2026, which had been priced to yield more than 11% annually, have risen roughly seven points. This has brought the yield on these Wayfair bonds down to 8.7%.

We believe that Wayfair will make all payments of interest and principal on time and in full. Because of the sharp increase in these bond prices recently, we suggest that this is a bond to acquire on market weakness – but not now. We recommend these convertible bonds at or below $785 plus accrued interest, which would equate to a yield of roughly 10%. It's currently above that price, so we have placed it on the watchlist. Taxation of deep discount bonds like this one can be complicated. It's best to put them in an IRA or other **tax-deferred** account.

Action to Take: Place on the watchlist to buy the 1% Convertible Bonds maturing August 15, 2026 (CUSIP#94419LAF8), at or below $785 plus accrued interest.

Martin Fridson

Porter & Co.

Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team – all of whom are real humans, and many of whom have X accounts – you can get acquainted with us **here**.

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Wayfair Inc. 1% Convertible Bonds Maturing 8/15/2026 at $785 CUSIP#94419LAF8		
Summary		
November 8, 2023	Amount Invested	$787.36
	Total Interest and Principal	$1,030
	Current Yield	1.3%
	Total Return	10.14%
	Term	Under 3 years
	Issue Size	$949 million
	Credit Rating	NR
	Callable	No
Details		
November 8, 2023: Purchase the bond	Accrued interest*	$2.36 per bond
	Total Cost	$787.36 per bond
February 15, 2024	Receive interest payment	$5 per bond
August 15, 2024	Receive interest payment	$5 per bond
February 15, 2025	Receive interest payment	$5 per bond
August 15, 2025	Receive interest payment	$5 per bond
February 15, 2026	Receive interest payment	$5 per bond
August 15, 2026	Receive interest payment	$1,005 per bond

* The accrued interest from August 15, 2023, until November 8, 2023. This amount is received by the seller on the settlement date and is added to the price of the bond. The first interest payment you receive on February 15, 2024, is $5.

How to Buy This Bond With a Live Broker

If you are putting in a phone call to your broker, here's a quick breakdown of the steps you'll go through.

1. **Tell your broker the number of bonds you'd like to acquire.**
2. **Provide the name of the borrower, the coupon, and date of maturity.**
3. **Provide the CUSIP number.**

CUSIP stands for "Committee on Uniform Securities Identification Procedures" and is a unique series of numbers and letters assigned to every traded security. Providing the CUSIP will ensure that you're buying the right security. The CUSIP of the bond we recommend in this issue is 94419LAF8.

Specific Instructions for Buying Wayfair's 8/15/2026 Convertible Bond

Now, the bond we are recommending today is not always tradeable online, so instead you will need to place your trade by phone. We've confirmed that the Wayfair 8/15/2026 convertible bond is available through Schwab, Fidelity (only for qualifying orders i.e., over $50,000), and at full-service brokerage firms.

> Recall that the bond market is much less popular (and there's much less trading volume) compared to the stock market, so don't be surprised if you are dealing with a broker who knows little about the bond market.
>
> This is part of the reason why, in the bond market, there are fewer market participants and less overall interest, so it's easier to scoop up bargains when opportunities arise.

The instructions for placing an order are usually standard across the brokerage platforms mentioned above.

Here's an example of how the conversation with your broker might go:

Investor: "Hello. I am interested in buying Wayfair 8/15/2026 convertible bonds. Can you get me the bond quote so I can decide whether or not I want to buy?"

Broker: "Yes, can you confirm with me the CUSIP?"

Investor: "The CUSIP is 94419LAF8."

Broker: "We don't have these bonds in our inventory. However, we can place open market orders which allows for this bond to be traded and sold through an alternative trading system (ATS). We can get you a quote. How many of these Wayfair convertible bonds are you looking to purchase?"

Investor: "I'd like to purchase 25 of the Wayfair 8/15/2026 convertible bonds."

Broker: "Okay, I will get you a quote and call you back. Bye."

This is where the first conversation with the broker will come to an end... but within the next 24 to 48 hours of the next trading day, the broker should return your call and will give you the quote (the price) of the bond. This call is when you will place and confirm your order.

After your initial call to receive the quote, the broker will call you back in most cases and after he confirms he's speaking to the correct person, he can go ahead and place your order.

Here's how the second call might go:

Broker: "Hello, this is John Doe, the fixed-income specialist you spoke to earlier. I am calling to give you a quote for the 25 Wayfair 8/15/2026 convertible bond bonds you inquired about earlier today. The price for the size of your request to buy 25 bonds is $78.50. Would you like to go ahead and place the trade?"

Note: The $78.50 price he quoted is really $785.00 for the cost of each bond. When quoting bonds, brokers will most likely drop the last zero, so $78.50 becomes $785.00. Now, if the investor decides to purchase 25 bonds, his total will be $19,625 ($785.00 × 25 =$19,625) in addition to the commission or service fee.

Investor: "Yes. The total comes out to $19,625 plus the service fee. Is that correct?"

Broker: "Yes, it is correct. I will go ahead and make the transaction. You will get an email confirmation over the next 24 hours. Have a great day!"

As always, if you have questions, please call Lance, your personal Porter & Co. Concierge at (888) 610-8895, or internationally at +1 (443) 815-4447. We do not endorse any specific brokerage and are offering this guide for informational purposes only.