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PTON.OQ - Q4 2021 Peloton Interactive Inc Earnings Call

EVENT DATE/TIME: AUGUST 26, 2021 / 9:00PM GMT

OVERVIEW:

Co. reported FY21 total revenue of $4.02b. Reported 4Q21 total revenue of $937m and net loss of $313.2m or $1.05 per basic and diluted share. Expects FY22 total revenue to be $5.4b and 1Q22 revenue to be $800m.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Peloton's Fourth Quarter Fiscal Year 2021 Earnings Call. (Operator Instructions) Please be advised that today's conference may be recorded. (Operator Instructions)

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

Peter Coleman Stabler - *Peloton Interactive, Inc. - SVP of IR*

Good afternoon, and welcome to Peloton's fiscal fourth 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.

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

John Paul Foley - *Peloton Interactive, Inc. - Co-Founder, Chairman & CEO*

Thank you, Peter. Good afternoon, everyone, and thanks for joining us today.

Our fourth quarter brought a remarkable year to a close. We finished the year with $4.02 billion of revenue, up 120% year-on-year and up 340% versus fiscal 2019. We added over 1.2 million Connected Fitness subscribers in fiscal 2021, and Digital subscriptions ended the year up 176% versus a year ago.

We introduced new products and software features, greatly expanded and enhanced our content library, and launched in Australia, which was no small feat given COVID pandemic complexities. We invested aggressively in supply chain and logistics, allowing us to bring product wait times back to prepandemic levels. Even with the significant investments we made in manufacturing capacity and expedited shipping, this level of growth drove far more EBITDA profitability than we had anticipated or intended to achieve at this point in our growth cycle.

We recognize, of course, that there is a great debate about the growth prospects of our industry post COVID. Therefore, I think it's worthwhile to spend a minute reflecting on the year and our path forward before we review the quarter and our outlook for fiscal 2022.

Over the past 2 years, you've heard us speak regularly about the Connected Fitness opportunity we see for Peloton, how the combination of our world-class fitness hardware and software and streaming media is fundamentally disrupting an industry that has seen little in terms of true innovation in the past 40 years, how our highly engaging, motivating and entertaining world-class fitness content is consumed in the comfort of your home, creating an unparalleled workout experience at an exceptional value, how the magic of network software and streaming media enables a near constant innovation cycle where your experience on Peloton platform is incrementally better every time you use it.

What happens when we put member engagement at the center of our business strategy and adopt a Members-first mindset across every part of our operation, the benefits that come with high subscriber retention and the advantage of industry-leading Net Promoter Scores, and the power of the Peloton community that motivates and encourages millions of people in their pursuit of physical and mental wellness. We believe that we are still in the first inning of Connected Fitness industry growth, and we have the opportunity to extend our leadership as the pioneer of this category.

Our strategy remains constant. We will continue to invest aggressively behind new hardware products, software experiences and content offerings for both cardio and strength training, the 2 pillars of physical fitness. We will continue to prioritize subscription growth over near-term profitability as it's still very early days in the consumer migration to Connected Fitness in the home. We will continue to expand our geographic footprint while leveraging additional distribution channels like commercial and corporate wellness. And we will continue to drive supply chain efficiencies via a focused hardware portfolio.

From our beginnings, we have also consistently sought to make our products and content more accessible, lowering a key barrier to purchase. In 2017, we began offering a 0% financing option. In 2019, we introduced our no risk 30-day home trial. Last year, with the introduction of Bike+, we lowered the price of our original Bike. Earlier this year, we reduced the price of our digital app for frontline health care workers, active military, first responders and full-time students. And just a few weeks ago, we introduced Peloton Corporate Wellness, further increasing the accessibility of our products through subsidy, relationships with corporate partners and health care providers.

Today, we announced our latest step on the journey to broaden the accessibility of our products. We are lowering the price of our original Bike by $400 to $1,495. Applying our 39-month 0% APR financing option, this equates to a hardware cost of just $39 per month. Adding our all access membership comes to just $78 per month, a monthly spend that scales across an entire household, creating an incredible value versus almost any other fitness offering. For a 2-person household inclusive of the All-Access Membership, that's under $40 per person per month during the finance period and less than $20 per person per month thereafter.

Today, we are also introducing revised financing options for our Bike+ and Tread products, extending our 39-month option to 43 months option, equating to a monthly payment of approximately $59 per month during the finance period. As before, we will continue to offer 12-month and 24-month options as well.

Democratizing access to our platform has always been our goal for our team. With our supply constraints largely solved now, we're seizing this opportunity today to continue to deliver against one of our key strategic priorities.

Now turning to some highlights for the quarter. Our community has now passed 5.9 million members globally, up 93% year-on-year and over 320% from the year ending fiscal 2019. Total platform workouts in the quarter reached 154.5 million, up 86% year-on-year and reflecting roughly 8x the number of workouts completed in Q4 of fiscal 2019.

In Q4, we averaged 19.9 monthly workouts per Connected Fitness subscription versus 24.7 in the year ago period. As expected, engagement levels were lower sequentially and on a year-over-year basis as typical seasonal trends associated with improved weather and consumer mobility have reemerged.

Last year's engagement benefited significantly from lockdown orders, work-from-home mandates and gym closures. On a 2-year basis, monthly workouts per Connected Fitness subscription increased 66% from 12.0% in Q4 of fiscal 2019, validating our significant software and content investments.

As a result of our efforts to keep our members engaged, Connected Fitness retention rates remain very strong, with average Connected Fitness monthly churn of 0.73% in Q4 and 0.61% for fiscal year 2021.

Moving on to Tread. As we announced on Tuesday of this week, we are thrilled to commence U.S. sales and resume U.K. and Canada sales on August 30, finally bringing this incredible product to market in the U.S. ahead of the key holiday selling season. Similar to how we reimagined what a stationary bike workout can be, our new Tread experience brings game-changing full-body workouts into the home. The early consumer reception supports our enthusiasm with a Net Promoter Score for our all-new Tread of 85 in our initial U.K. and Canada launch markets, an incredible result for a brand-new product. And to be sure, the software and content is only getting better. As we have said, we believe the opportunity for our new Tread is 2 to 3x the size of the bike category.

Sales of our slat belt Tread+ product, which has only been available in the U.S., remain paused as we continue to work on a retrofittable hardware modification to further enhance Tread+'s safety profile. As the category leader, we see a clear opportunity and, frankly, responsibility to innovate on safety, and we are encouraged by the progress being made across our teams.

Now I'll hand it over to Jill to review our Q4 financial results and outlook for fiscal 2022.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Thanks, John. I will start with a review of our fourth quarter results.

In Q4, we generated total revenue of $937 million, representing 54% year-on-year growth. The primary drivers leading to our revenue outperformance versus guidance were higher-than-expected Bike deliveries and better-than-expected Connected Fitness churn. This was partially offset by a higher-than-anticipated Tread and Tread+ return rate.

We made significant progress on product wait times with Bike and Bike+ order-to-delivery windows at prepandemic levels for the past several weeks. We added 250,000 net Connected Fitness subscriptions in the quarter, bringing our end of quarter Connected Fitness membership base to 2.33 million, up 114% year-on-year. This was ahead of expectations, reflecting strong Bike and Bike+ demand as well as better-than-expected gross additions helped by secondary market sales.

Despite typical seasonality and increased consumer mobility, average net monthly Connected Fitness churn was also better than anticipated at 0.73%. As of June 30, we had over 874,000 Digital subscribers, representing 176% year-over-year growth. This was a modest sequential decline from the previous quarter, which mostly reflects the seasonality of our Digital business, which is more pronounced than for Connected Fitness.

In addition, our growth in Digital quarter-to-quarter is influenced by our marketing spend, with acquisition efficiency and LTV in mind. As we discussed last quarter, we see Digital as a healthy emerging business as well as an effective path for many to upgrade to Connected Fitness. Further, Peloton's Digital accessibility and compatibility with multiple operating systems is very attractive to potential corporate wellness partners. As a result, we expect continued growth in our Digital subscriber base in fiscal '22, albeit with some quarter-to-quarter growth rate variability.

Moving to gross margin. Gross margin for the quarter was 27.1%, which came below our expectations. This was entirely due to our Connected Fitness Product segment, which had a gross margin of 11.6%, below our 21% guidance.

As I mentioned a moment ago, initial Tread and Tread+ return rates were higher than our forecast as of the third quarter call. We are now recognizing a higher-than-anticipated expense associated with actual returns and have updated the return reserve rate accordingly. Please keep in mind that we always expected some uncertainty in modeling returns, and we do not believe the delta versus our expectations is meaningful.

The impact of recall-related returns is added back to our adjusted EBITDA, but is fully reflected on the revenue and gross profit line. The Tread recalls also have some carryover impact on our logistics and warehousing costs, which came in higher than anticipated, rounding out the balance of the shortfall in Connected Fitness margin versus expectations.

As we are now largely past these recall-related activities, we expect a rapid return to more normalized and predictable execution across our logistics platform.

Subscription gross margin was 63.3%, and subscription contribution margin was 69.3%, modestly ahead of expectations as we continue to leverage fixed costs associated with content production. As a reminder, quarter-to-quarter, we will continue to see some variability, but we have strong visibility to our goal of a subscription contribution margin target above 70%.

Turning to operating expenses. Total operating expense as a percent of revenue was 59.3% compared to 32.7% in Q4 last year. Operating expense deleverage was driven by our planned shift in marketing spend from Q3 to Q4, lower revenue due to recall impacts in the quarter and the impact of adding Precor to our financials. Sales and marketing expense was 24.5% of total revenue versus the prior year period of 13.9%. As planned, we ramped marketing in Q4 given our improved order-to-delivery windows, and we lapped a year ago period in which we paused the majority of our advertising spend. G&A expense was 24.8% of total revenue versus 14.2% in the prior year. As you know, our business grew significantly during fiscal '21.

We made substantial investments across member support, financial systems and other functions so that the organization can scale effectively with the growth of the business. With our member experience as our North Star, these investments will help us continue to improve our end-to-end member touch points. Also, we added Precor to our organization, which was a driver of some of the sequential increase in G&A, inclusive of legal and integration costs related to the acquisition of Precor in Q4.

R&D expense was 10% of total revenue versus 4.7% in the year ago period. Similar to recent quarters, we continue to invest in developing best-in-class hardware and software teams, both organically and through acqui-hires.

Fiscal '21 Q4 adjusted EBITDA was better than expected at a loss of $45 million, representing an adjusted EBITDA margin of negative 4.8%. Net loss for Q4 was $313.2 million or a loss of $1.05 per basic and diluted share.

We ended the quarter with $1.6 billion of cash and liquid assets and have additional liquidity in the form of an untapped $285 million credit facility. As a reminder, our balance sheet benefited in fiscal '21 from approximately $900 million in net proceeds from our convertible note offering completed in February.

Now on to our outlook. As you know, fiscal 2021 was a very unusual year in which both supply and demand shocks impacted our performance. We are now lapping those comparisons, which makes predicting our year-over-year performance more challenging than normal.

The Q1 and fiscal 2022 outlook we are sharing today reflects our best current estimates and includes the following assumptions. One, a return to normal seasonal patterns where Q2 and Q3 combined comprised roughly 60% of sales, with Q1 being our lowest sales and delivery volume quarter. As in the years prior to COVID, we expect fiscal '22 sales trends to be impacted by seasonal weather as well as holiday and New Year's resolutions purchases. We saw these trends going into fiscal '22. Two, strong demand for Bike and Bike+, with higher unit sales expected than in fiscal 2021. Three, strong acceptance of our lower-priced Tread, with our expectation that approximately 50% of Treads globally will go to existing Connected Fitness households, and therefore, those sales will not result in an incremental Connected Fitness subscription. Four, compelling net customer acquisition costs with rapid payback.

Five, continued high engagement and healthy retention across all cohorts, including those added during the pandemic, implying expected low churn of our Connected Fitness subscriptions. Sixth, operating expense growth ahead of revenue growth as we restore sales and marketing following pandemic-related cuts and recognize the annualized impact of recent G&A investments we've made to scale our organization for growth. And last, number seven, sequentially improved Connected Fitness gross margin and positive adjusted EBITDA in the second half of this year as we leverage our fixed investments in our supply chain and logistics platform and generate operating expense efficiencies.

Moving on to revenue. In Q1, we expect revenue of approximately $800 million, representing 6% year-over-year growth and an 87% 2-year CAGR. Please note that our Q1 revenue assumption contemplates a very small contribution from the upcoming launch of Tread in the U.S. and resumption of sales in the U.K. and Canada due to our anticipated order-to-delivery expectations of 3 to 4 weeks and the fact that we recognize revenue upon delivery, not sale. For fiscal 2022, we expect total revenue of $5.4 billion or 34% year-over-year growth and a 72% 2-year CAGR. Given our significant manufacturing capacity and logistics investments during the past year, we are entering fiscal 2022 with a normalized backlog for our Bike portfolio, and guidance reflects our expectation of continued strong demand.

Please note, we are assuming 15% of full year revenue will occur during Q1, which is below 19% in the COVID-affected fiscal '21, but modestly above the 13% contribution we saw in fiscal 2018 and 2019.

Moving to Connected Fitness subs. We expect to end Q1 with 2.47 million Connected Fitness subscriptions or 85% growth versus last year's Q1, implying 140,000 net adds. For Q1, we expect monthly average net churn for our Connected Fitness subscriptions of 0.85%. Please note that after this quarter, we will no longer guide monthly average net churn of our Connected Fitness subscriptions on a quarterly or annual basis.

As we have discussed in the past, this is a difficult metric to forecast with precision, and we, therefore, do not see the value in continuing to provide guidance. However, churn remains a very important metric to us, and we will continue to report our actual results each quarter. Everything we do at Peloton is designed to keep our members engaged and our churn rate low. And over time, we expect our churn and retention rates to remain relatively consistent.

For fiscal 2022, we forecast ending Connected Fitness subscriptions of 3.63 million, implying 56% growth year-over-year and 1.3 million net adds. Similar to revenue, our guidance assumes normalized seasonality, with Q1 net adds representing 11% of the full year total, down from 20% last year but similar to the 12% we saw in fiscal 2018 and 2019.

Moving on to margin. We expect total company gross margin of 33% in Q1 and 34% in fiscal 2022, which is based on a Connected Fitness product gross margin of 15% in Q1 and 23% for fiscal 2022. The year-over-year gross margin compression reflects the following factors: one, the impact of our price reduction on the original Bike that we announced this afternoon; two, the sales mix impact from launching Tread, which currently carries a lower margin than our Bike portfolio; and three, significantly elevated cost of certain commodities, including steel and semiconductors as well as freight rates multiple times higher than normal.

As we've mentioned previously, we manage our Connected Fitness Product segment to optimize for gross profit dollars rather than gross margin percentage. While introducing a more accessible price point for Bike and a higher sales mix of Tread will lower our gross margin percentage in the near term, these are strategic actions that expand our addressable market and will be highly accretive to gross profit dollars over time. We continue to expect Connected Fitness gross profit to largely offset our fully loaded CAC over time, and our fiscal year '22 guidance assumes a modestly positive net tax, which follows a significantly negative net CAC in fiscal year 2021.

While our current guidance reflects our best estimates of today for commodity costs and freight rates, it's possible we may see additional pressure on our Connected Fitness margin if costs are materially worse than we expect or if component shortages necessitate expedited shipping costs. We continue to see tightness in component supply, but we have and are taking steps to prepare for a strong holiday season and balance of fiscal year 2022 demand. Lead times for certain components continue to be abnormally long and were, therefore, utilizing longer-term commitments with our supplier base while expanding our supply chain partnerships in order to limit any disruption.

Connected Fitness margin in Q1 will also be significantly impacted by last-mile delivery costs given the seasonality of our business. Peloton's last-mile logistics is an important aspect of our member experience. The fixed investments we have made in warehouses, vehicles and people in our delivery network are carried throughout the year. Therefore, we will experience higher fixed cost absorption during our smaller volume first quarter, but expect significant leverage of these expenses in the remaining quarters of fiscal 2022.

We expect a subscription contribution margin of 68% in Q1 and for the full year, with the improvement to last year reflecting continued fixed cost leverage.

Turning to operating expenses. As I alluded to earlier, we are planning fiscal 2022 as an investment year in marketing our products and optimizing operations after making significant investments to scale our organization. During fiscal 2021, we dramatically curtailed media spend due to supply constraints and were largely off air during important holiday and New Year's resolution selling periods, which created a synthetically low spend level that we will lap in the coming year. As we restore media investments in fiscal 2022, we expect material year-over-year deleverage in sales and marketing during Q1 and for the full year.

During fiscal '21, we also scaled our organization to support the higher-than-anticipated growth in our member base since the onset of the pandemic. Much of the needed investments are now largely in place, but the annual impact of a higher G&A base will drive year-over-year deleverage in fiscal 2022. As we expect more modest sequential G&A growth going forward, we expect to achieve healthy leverage on this expense base starting next fiscal year.

Finally, R&D will continue to increase as a result of both organic and acquisition-related spend on hardware and software development. Based on these factors, we expect adjusted EBITDA loss to be $285 million in Q1 and a loss of $325 million in fiscal '22 or a negative 6% adjusted EBITDA margin.

Keep in mind that in the absence of COVID, we would not have anticipated or intended to be profitable during fiscal '21. Although our profitability will step back in fiscal 2022 for the reasons I've outlined, we are very confident about the economic profile of our business model and expect to be adjusted EBITDA profitable again in fiscal 2023.

Lastly, we'd like to provide some thoughts on forward capital expenditures. As you know, we officially broke ground on Peloton Output Park a couple of weeks ago. We're glad to be underway with this project, and we're looking forward to building Peloton products here in the U.S.

As we outlined previously, we expect to invest approximately $400 million over the next 2 years on this plant, with much of that spend expected to occur in fiscal year 2022. In addition, we continue to make material investments in our supply chain, IT systems and our retail footprint, both domestically and internationally. These investments, which will position us for continued growth, will bring total capital spending to approximately $600 million in fiscal 2022. Looking out to fiscal 2023, we expect capital spend to taper.

Lastly, we continue to see a decline in customer deposits with the rollout of deferred payment capture. While this migration does not impact revenue recognition, it will continue to apply modest working capital pressure until fully deployed. We've completed the full rollout of deferred payment capture in the U.S. and expect a full global rollout in the coming quarters.

Operator, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Doug Anmuth of JPMorgan.

Douglas Till Anmuth - *JPMorgan Chase & Co, Research Division - MD*

One for John and one for Jill. John, we know there's seasonality. But just given the light 1Q guide, is the price -- is the Bike price gotten offensive or defensive? And how do you think about demand for Bike+ currently?

And then, Jill, hoping you can walk through a little bit more detail around the Tread gross margin structure perhaps relative to Bike or even Tread+ a couple of years ago when it first came out.

John Paul Foley - *Peloton Interactive, Inc. - Co-Founder, Chairman & CEO*

Thank you, Doug. So as Jill said in her opening remarks, we feel like the demand for Bike+ and Bike is robust, and we feel good about the entire year's forecast. The price drop with [B1] was absolutely offensive as we think about the competitive landscape and we think about democratizing the access to great fitness, which has, as you know, always been in our playbook. This is actually the first year since we founded the company that we had the opportunity to do this, and we're super excited that the investments we've made in our supply chain certainly over the last few years, but definitely in the last 12 months, are bearing enough fruit that we have the capacity to make what will become -- what will look like close to 2 million fitness units of hardware this year, which is just incredible considering, when we founded the company, we approached the biggest contract manufacturer we could find, and they said that they were confident that they could make up to 10,000 Bikes a year. That was only 8 years ago. So the scale of which we've seen and put in place and invested in across our entire supply chain with Bikes.

And now, obviously, it includes Treads. And the lower-priced Tread as well allowed us to consider lowering the price of B1 , and we think it's the right thing for our business, obviously, solving for net new sub adds, which was kind of our True North of getting more people into the tent and thinking about the LTV of those users, not just, Doug -- interestingly, not just as a subscriber for the $39 for a new Bike sub, which has always been kind of our True North and the golden goose of our business model, but think about selling those same people, the same households, future Treads and future products, apparel and all the other stuff that becomes a much broader LTV picture over time.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Doug, just -- sorry? Sorry. Did -- William, did you want to chime in?

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

No, I was just going to say on the price -- Jill, thanks. This is William. Just on the pricing, Doug, just underscoring the point about it being offensive and strategic, as Jill said, we've, as you might imagine, done extensive testing on elasticity for pricing on Bike, both in terms of in-market testing as well as qualitative and quantitative. And that testing gave us a lot of conviction that this price point will drive the kind of growth that's in the guidance, but also makes this price drop very strategic as we look at unit economics going forward. And so it's super consistent, as John noted, with our strategy around accessibility.

We introduced financing in October of '17. That was the first move, 30-day home trial. Jill talked about or app moves and accessibility around frontline workers and what we've done with the military and student rates. So we feel like this is just a continuation of that strategy and allows us to continue our lead in Connected Fitness as we add more and more households to the membership.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Great. And I might just add and then obviously answer your question around Tread gross margins is, for fiscal '22, we are expecting a slightly positive net customer acquisition cost, which we think is an incredible trade-off for the LTV of the sub that we get, which John mentioned. And so the economics for us were incredibly compelling, especially doing so in a position where we had order-to-delivery in a really good spot in manufacturing in a great spot.

As it relates to Tread gross margin, just a couple of pieces in the backdrop. Obviously, we noted that we are facing commodity cost and freight rate increases at the moment across all of our products. So as a starting point, and as you know, too, as a starting point, we've only just started producing Treads over the last several months. So we have a very long runway to get economies of scale there. So think about our margin profile in the low teens. But also, I would put in the back of your mind, think about what we did with Bike over the last 5 years. On an index level, let's say, 5 years ago, it cost us $1 to make a bike. It costs us $0.40 today, even with the commodity and freight rate increases. So I think given our very lean portfolio and our ability to build very few SKUs with great capacity will give us a tremendous margin power over the next few years.

And then I might just add, especially with Tread, as we think about moving production to the U.S., avoiding those shipping costs and freight costs is also going to be very margin-accretive going forward. So this is just the beginning. It's a little bit of a double whammy effect with Tread this year, right? You're going to have less efficient marketing as we build product awareness, and we're going to have lower gross margin, and both of those will become more efficient over time.

Operator

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

Justin Post - *BofA Securities, Research Division - MD*

Great. Maybe we could get on the Tread. Can you help us all understand -- I appreciate the 50% sub contribution per unit, but how you think about units this year and how you thought about the launches in Canada and U.K., what you learned there, and maybe the differences between the U.S. launch and the Canada U.K. launches?

John Paul Foley - *Peloton Interactive, Inc. - Co-Founder, Chairman & CEO*

Justin, this is John. Thank you for asking. We love the Tread category. We have said we are going to win the Tread category. And so I'm glad you're asking about it.

I'm going to back up a little bit further to your question about what we learned in Canada and the U.K. and tell you what we learned with the Tread+, which has been in the market for even longer. We've been learning a ton about the experiences and the programming with the software and the contents evolving significantly over the past 2 years since the Tread+ has been in the market. So we kind of -- you could think about it as a proof of concept with that platform so that when the lower-priced Tread hits the market here in the U.S. next week and back on sale in the U.K. and Canada as well and then very quickly in Germany, we kind of have a 2-year head start on ourselves of protecting that experience.

But specifically to your question about the reception in Canada and the U.K., I have to point out the 85% Net Promoter Score that we saw in those markets right away, which is just incredible for a new product, considering that the software and the content are going to continue to get better.

In the early days of selling bikes, I would talk to individual members who are on the fence, and I said, "Listen, buy the Bike. Trust me, every quarter, the software and the content is going to get better." And going back, if you talk to some [OG Pelotoners] who had their Bike for 6 or 7 years, that's absolutely what they've experienced. And so that same promise holds true with the Tread, and we're super excited about that category, not just for running, of course, and I think you know this, Justin, but for everyone on the call, it is also a strength platform of sorts.

When you think about the boot camp content and the circuit workouts that you get on and off the Tread with the Strive Scores and the tethering when you're off the Tread and your heart rate monitor is still helping you stay connected in the experience. So it's an incredible platform. We're super excited about it. We're super proud of it, and we're very pleased that it's going to be back on sale next week.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

And then just to chime in on the 50%, we wanted to give you all just a guidepost just so that you could better understand the contribution to Connected Fitness subscriptions with Tread and wanted to make sure that wasn't overstated in any way. I think as you think through the trends that we saw, of course, when you have very low brand awareness in a product, your existing member base are going to be the ones first raising their hands to buy the product, and that's what we saw in the U.K. That's also, to John's point, what we saw with Tread+ in the very early days. So that 50%, think about it like a blended average. But of course, as we get the word out and we ramp up our incredible marketing efforts around our all-new lower-priced Tread, I think what you're going to see is very high existing members buying the Tread, but that percentage coming down we get the word out and we launch our marketing campaigns around that and attract incremental subscribers to the platform.

Operator

Your next question comes from Ed Yruma of KeyBanc Capital.

Edward James Yruma - *KeyBanc Capital Markets Inc., Research Division - MD & Senior Research Analyst*

Jill, just first on the gross margin differential on [B1]. I know you gave some color there. But just try to really understand again, have the price reductions over time been funded by your manufacturing efficiencies? Kind of how much is still left? And kind of what's the timing in terms of getting the gross profit generated by one device to offset CAC? And then as a follow-up, lots of exciting stuff in corporate wellness. How should we think about the margin profile there?

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Great. So on the first one, obviously, what we've seen over the last several years, as I've said earlier, is that we've been able to get incredible costs of our Bike product over the last 5 to 6 years to the tune of about 70% to 80%, right, versus what we were paying for a bike 5 or 6 years ago. And as you look at our original Bike, it's our most mature supply chain. And -- but for us, we think at a $1,495 entry point, it is absolutely worth the ability for us to grow our addressable market and sacrifice gross profit margin percentage because we do think the gross profit dollars matter here more. And over time, even though we are going slightly net positive in CAC this year, we -- that will revert very quickly our market -- with marketing efficiencies and with the conversion uplift that we expect. So we think it's an absolutely right trade-off for that very valuable high margin long lifetime sub.

Corporate wellness. William?

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

Jill, you want to...

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Yes. Did you want to take that? I mean we won't be offering just a breakout in terms of the economics of that business. It is very, very early days. I would say, we are still building a lot of the infrastructure, both from a sales and e-com flow perspective. So we have, I think, fairly conservative estimates in this year, although we think it's a massive multibillion-dollar market, which I think William can address further.

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

Sure. It's tens of billions of dollars annually now if you look at employers and what they invest in wellness for their employees. As Jill noted, it's early. John talked about us announcing it within the last few months. I will say that the initial sales rate through the partners we announced, the Accentures, Samsungs, Skies of the world has exceeded our expectation. But we feel great about that team, Cassidy Rouse and the team we put in place. We feel great about the business model.

Just the way we think about that, just to answer your question, is very similar to the way we think about our consumer business and getting to that net CAC equation. This is a super efficient channel for us to acquire customers. So we -- that relationship between gross profit on the hardware and how we acquire this customer is very similar to how we make decisions in our consumer business. And so -- it's an acorn, but we're emboldened by the early results and not a whole lot difference as we think about margin between those channels.

Operator

Our next question comes from Ron Josey of JMP Securities.

Ronald Victor Josey - *JMP Securities LLC, Research Division - MD & Equity Research Analyst*

Great. Just a quick one and a follow-up. John, you talked about new products being positioned for just additional product launches later this year. Is there any details you can share on the product, insights, type of workout, et cetera, would be really helpful, and any insights on the manufacturing capacity ahead of that. And then a follow-up on the lower-priced Bike. Can you just talk about the impact of what that means for CPO pricing?

John Paul Foley - *Peloton Interactive, Inc. - Co-Founder, Chairman & CEO*

Ron, new products, unfortunately, we can't talk too much about them, which is frustrating to me because I am super excited about a lot of these new platforms that I get to experience and see in the R&D pipeline. We have said that strength is a key priority for this year. There are some rumors of some other products that we might be working on. But I will say to Jill's earlier point about manufacturing scale, we're pretty focused. We don't have 50 new platforms in the R&D pipeline. We have a few that we're very excited about that we think are going to be staples in our portfolio. And several of them have been -- we've been working on for several years. So this should be a big year for our members and the new product pipeline, and we look forward to sharing information as it's available.

I think you also had a question on CPO.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Yes. I mean I can take that. Nothing really to update there. As we've talked about in the past, we just haven't had -- given our incredibly low return rate of our Bike and Bike+, we have just not had the inventory. So it's a little bit of a moot point for now. But obviously, if we ever are in an inventory position where we can launch CPO, it would certainly be priced below the new pricing for original Bike.

Operator

Our next question comes from Youssef Squali of Truist.

Youssef Houssaini Squali - *Truist Securities, Inc., Research Division - MD & Senior Analyst*

So 2 questions. John, can you maybe speak to the -- just the quarter to the trend in demand you're seeing. Obviously, the guidance implies a sequential decline, but maybe you can parse out the effect of the reopening relative to others like pull back and add spend, et cetera.

And then, Jill, I think you said something to the effect that you expect higher unit sales of bikes in '22 than you did in '21. If you just do a back of the envelope math, it looks like that would imply not a whole lot of sales for the new Tread. So I was just wondering if you can maybe provide a little more color on that.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Yes. Yes. I might take the second question first, and then we can double back on the first one. So I think what you're probably noticing is that this year, we're forecasting 1.3 million net adds. And last year, we added 1.24 million net adds. Is that correct?

Youssef Houssaini Squali - *Truist Securities, Inc., Research Division - MD & Senior Analyst*

Yes. Yes. Exactly.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Great. Well, it's a really great call out. But what I might note is that in fiscal '21, our net adds were boosted a lot by the backlog that we went into. If you remember when COVID hit in March, we went directly red line on manufacturing and went in with a pretty massive backlog going into fiscal '21 given the long OTD. So I would -- so first, I would say we have much better alignment in sales and delivery time frames in fiscal 2022.

And then -- so from my perspective, yes, we do forecast growth in our Bike portfolio this year on a year-over-year sales basis, but you have to take into consideration how big the backlog was that we went in. And I think you'll see that, that would then imply, even with the 50% of Tread buyers being existing members, that would imply a healthy first year of robust sales of Tread.

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

And Youssef, we can't comment too much on the quarter-to-date trends, as you can imagine. But I will say, and Jill alluded this in her opening remarks, is that we historically have been a very seasonal business where not only are people out running and riding their bikes in the summertime and getting outside. And this summer, I think, is exceptionally true in that sense coming out of last summer where people are on lockdown. But we obviously don't market aggressively, and I think Jill's opening comments talked about this in the Digital business. We couldn't be more excited about the Digital business. I think I've been one of the biggest champions for -- since day 1 in that business. And we think that it's an incredible lead-gen business as well as a stand-alone business on its own. And it's just not smart for us to market it aggressively in the summer vis-a-vis other times of the year.

So when you think about a basket of advertising dollars against your businesses, summer is generally one of the least efficient. So we're trying to run a little bit more disciplined business, certainly on Digital, and you could extrapolate that more broadly. But I will say, even in the face of light marketing, sales have been robust across our Bike business. And I guess I'm not supposed to tell you, but how incredibly strong leads have been for our Tread business. So we are excited about how many leads are in the hopper for people wanting Treads, and we're excited about the demand that we've consistently seen this quarter and, frankly, since COVID hit, as you know.

Operator

Our next question comes from Jason Helfstein of Oppenheimer.

Jason Stuart Helfstein - *Oppenheimer & Co. Inc., Research Division - MD & Senior Internet Analyst*

So is there anything the data that suggest the kind of the longer pending Tread launch, meaning just it's been talked about obviously for a long time and all the issues that could have weighed on Bike sales, meaning you have some consumers who would only buy one device and they were kind of waiting and so that kept people potentially on the fence to decide what they wanted.

And the second question on the supply chain, we can see the inventory numbers up pretty dramatically quarter-to-quarter on the balance sheet. Outside of the cost headwinds that you talked about for supply chain, are you worried at all about actually getting product to the consumer over the next -- basically through the holiday season?

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

Well, I can take the second question first. This is William. In terms of the guidance that Jill provided, we feel like we've built -- and the investments that John and Jill talked about, we built the infrastructure to support our holiday plans. As Jill noted, we feel like fiscal year '22 is going to be a return to more seasonality. So a large part of our business is in Q2, Q3. And certainly, that's true of deliveries. And so everything in the supply chain from inventory that you're noting, the accumulation up on the balance sheet to warehousing and how we've expanded our warehouse footprint to our delivery infrastructures, people, vans, our last-mile facilities, all that we're staging for what will be our biggest holiday ever.

We're very excited both in terms of the Bike growth that Jill noted and then the launch of Tread, which we expect to be very large over time. And so there's -- a lot of companies aren't in that position or reading in automotive, some of the shortages on chips and semis. So we're very proud of our team. We think our partners, [TI], others who have helped us get in that position. So inventory is up. We are building inventory.

As you know, the lead times with ocean freight and freight in general have extended. And so we've been diligent about learning from the past and feel like we're in a really good position to execute this plan this year.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

And just to answer the first question around Tread potentially having an impact on Bike sales, I mean, it's hard to know for sure. But I think based on our data, I think when you look at the leads that we have for Tread, there's a lot of existing members. There's a lot of new people. We think it's a pretty massive category, but there's still very low awareness for us in the Tread category. So I personally don't think it influenced -- has influenced Bike sales over the last few months.

Operator

Our next question comes from Jonathan Komp of Baird.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes. Jill, can I follow up on your comments about the first half and the second half adjusted EBITDA outlook? And any more color on the factors that you're expecting to drive the inflection to positive adjusted EBITDA in the second half.

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Yes. And so I would say, first off, the Connected Fitness margin is really one of the main drivers of adjusted EBITDA profitability and that variability throughout the year. So if you look at Q1, the Connected Fitness margin is fairly depressed, largely due to delivery cost inefficiencies given that we're having lower volumes in the quarter. And of course, what that will do is reverse in Q3 -- sorry, Q2, Q3 and Q4 where we will leverage a lot of those fixed cost investments in our field operations with warehouses and people and vans. So that's going to get us a lot of leverage as we move through.

And of course, on OpEx, we will get substantial leverage here, too, as we move through the year and have higher revenue quarters. And as I said, 60% of our revenue is going to be generated in Q2 and Q3. And really, Q1, I will say, is just a little bit of an anomaly, right? We've built up a cost structure to support and scale our business. We've grown member support. We've grown manufacturing 9x over the last 16 months. And so it will take us a couple of quarters to really see that leverage back into the system, but we expect it in the back half of the year.

Jonathan Robert Komp - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. That's really helpful. And then one other follow-up. I think, John, you mentioned at one point, unit capacity close to 2 million fitness units of hardware, I think, for this year. How should we think about the horizon to which you're building out the capacity? And just any other context to how you see the hardware business scaling over the next few years relative to that 2 million-unit comment?

John Paul Foley - *Peloton Interactive, Inc. - Co-Founder, Chairman & CEO*

Yes. I mean that's something we spend a lot of time on. I'll extrapolate it also in the context of a business that's growing -- adding subs at 56% this year, and we'll continue to be a high or hyper growth company for years and years to come. I'll extrapolate into the idea as well with real estate in the context of our headquarters and our field ops and member experiences. You have to try and walk the line of seeing where you're going 5 to 10 years out, but not getting over your skis with fixed cost and overhead, and that's kind of the balance that we've had to strike over the last 6 or 8 years as we've grown the company.

And to answer your question, we're excited about our investments in Ohio and stateside manufacturing. We're excited about our continued relationship with Rexon, which is a big manufacturing partner of ours, and Tonic, which we brought in-house a couple of years ago, and continued the contract manufacturing relationships in-house. We have obviously partners on the tablet side as well, which has great scale, and we will probably always use contract manufacturers for that. But yes, you do have to think about how do you make millions of treadmills a year -- 3 or 4 years from now. And our team is planning that and getting ready for it, again, trying not to get over our skis with the OpEx or the CapEx way too far in advance, but you've got to make some bets. And as always, we're going to bet on success, not bet on failure because they kind of become self-fulfilling.

So other than that, I don't have much color for you other than we have incredible people who are planning it and continue to land the planes like they did last year and we plan to do this year.

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

And maybe just to add to that, just the $400 million investment in POP, the Peloton Output Park. That is a decade-long -- we view that as a decade-long plus investment to support that capacity growth that John is referencing. And so we -- our goal -- we feel like we're there. But our goal is to continue to provide -- be the capacity leader -- cost, quality and safety leader in fitness. And there are very few companies in this fragmented market and very few factories that are producing at the kinds of volumes that we produce. So these moves, including POP, are all laid out. And to John's point, we look at things 10 years out to support robust growth that we're expecting in the future.

Operator

Our last question comes from the line of Kaumil Gajrawala of Credit Suisse.

Kaumil S. Gajrawala - *Crédit Suisse AG, Research Division - MD & Research Analyst*

A couple of years ago at your Analyst Day, you talked about the TAM and the SAM. And the SAM given the pricing at the time being around 15 million potential members. With the new lower price, for the new $1,500 price point, do you have an idea on how those numbers -- what those numbers may look like now?

Jill Woodworth - *Peloton Interactive, Inc. - CFO*

Yes. So I think you're talking about last September 2020. So it was about a year ago where we talked about a household SAM. And again, that's existing products and product verticals at existing prices. We said an addressable household of 15 million, and that represented 20 million in Connected Fitness unit sales, obviously, given the overlap that some households will own multiple products. And that had increased 43% from the last time we had done that analysis.

Of course, we have not rerun that analysis. But as you can imagine, with the observed data that William discussed in terms of the elasticity and the research that we have done, we believe that $1,495 significantly, significantly expands our addressable market. And so we're really excited about it. It was one of the key reasons why we did this was to continue to make our products more accessible and, of course, expand that addressable market. And then there are other things that will factor into increasing SAM like the extended financing terms that we announced on Bike+ and Tread and then, of course, just the building of awareness, which frankly has been the biggest needle mover for us over the course of the last several years as we looked at addressable market. When you -- and Tread, just as a reminder, and Digital still have very, very low awareness relative to our Bike portfolio. So I think there are tremendous gains that we're going to see over the next year now that we finally are bringing that product to the U.S.

Kaumil S. Gajrawala - *Crédit Suisse AG, Research Division - MD & Research Analyst*

Got it. And quickly on innovation is with the kind of timing delays with what's going on with Tread and Tread+, does that change the cascading of some of the other products you may have planned to roll out or whatever the calendar may have looked like where you'd prefer to have them spaced out? Or are any original plans for new products still running on whatever the time line might have been before the recalls?

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

Yes. I...

John Paul Foley - *Peloton Interactive, Inc. - Co-Founder, Chairman & CEO*

Sorry. Go ahead.

William J. Lynch - *Peloton Interactive, Inc. - President & Director*

Well, I was just going to say that we think Tread and being able to execute this Tread launch in the U.S., this is -- arguably, as John has noted, our research, and if you look at industry research, Tread is just a much bigger category than even Bike. And if you look at the amount of runners, boot camp, the amount of boutiques that offer this type of workout, circuit, boot camp, vis-a-vis spin, by every metric, Tread has the real possibility of being our biggest product. And so we're definitely focused on this opportunity. We think it's an incredible product, as John noted.

Having said that, if you look at our R&D spend that Jill noted, we've never been this prolific in terms of investment in exciting new products. And so we do think about the marketing and sales calendar. We do think about how to make sure we execute and drive the awareness that we need to in each product, and we're not mixing messages in the marketplace. And Tread with low awareness right now, we see as a massive opportunity. Having said that, as John noted, we're not done. And we're investing heavily. We -- the strength category has definitely been something we've been thinking about and investing in for a long time. And so we'll -- as John noted, nothing to announce here, but definitely something we're looking towards in the near future.

Operator

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

John Paul Foley - *Peloton Interactive, Inc. - Co-Founder, Chairman & CEO*

Thank you. Before we wrap up, I want to share a bit of nonfinancial but interesting and important news, nonetheless. In recent surveys conducted by comparably, Peloton earned the #1 position in a ranked list of 100 top global brands, and again, the #1 position for Best Place to Work in New York, besting a who's who of established brands and household names. For me, this is particularly gratifying recognition as these rankings point to both our member experience and the internal culture we've been building at Peloton since day 1.

By definition, powerful brands are recognized for their extraordinary product and service experiences. By always putting members first and obsessing over their experience, we're building the most powerful brand in fitness and potentially one of the most powerful brands in any category. It explains why we're so focused on Net Promoter Scores, by the way. And when we couple our dedication to member experiences with a commitment to expanding accessibility, we see an opportunity to extend our leadership position for years and years to come.

Peloton being named the Best Place to Work in New York is personally rewarding as a leader and a co-founder, but it's also a big strategic advantage as you can imagine. Recruiting and retaining the best talent is the foundation of every great technology business and separates the truly great companies from the good ones.

Lastly, and most importantly, I want to thank the entire Peloton team around the world for their hard work in a tough year of rapidly scaling while managing through a global pandemic. I also want to thank our members for allowing us to play a significant role in their health and wellness journeys. As you know, we don't take this opportunity nor responsibility lightly. We care deeply about every one of you.

And with that, we're going to sign off for the night. Thank you all for joining. We'll speak to you next quarter.

Operator

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