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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Peloton Interactive Fourth Quarter 2022 Earnings Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

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

Peter Stabler

Good morning, and welcome to Peloton's fiscal fourth quarter conference call. Joining today's call are CEO, Barry McCarthy; and CFO, Liz Coddington.

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.

I'll now turn the call over to our operator to take our first question. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from the line of Justin Post from Bank of America.

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

Great. A couple. First, when you said churn about 1.41%, and I think it would be lower if you adjust for Canada, is that what you're looking for in the first quarter? Or is the adjusted with Canada?

And then secondly, just thinking about the shape of the year, looking for flattish subs in the first quarter, how are you thinking about holiday seasonality going forward? And what needs to happen to get to break-even cash flow?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

You take the first two parts, and I'll do the cash flow.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

Sure. So the first question, I believe, if I understand correctly, was related to churn and what our expectations are for the first quarter. As we mentioned in our shareholder letter, we saw a modest increase in our monthly churn for Q4 and that was related to our All-Access subscription price increase that we had in June. I'm happy to say, though, that for July, we saw churn levels declined from June and declined from the Q4 average. So we expect our retention levels to remain attractive. Our engagement trends suggest that churn will continue to remain low in the first quarter and for the rest of the year.

With regard to the flat subs, seasonally, Q1 is a low growth quarter for Connected business product sales. We did increase prices on Bike+ and Tread and that took effect on 8/12. And while we do expect our Q1 churn to remain low, as I said before, our volume of Connected Fitness growth additions in Q1 is expected to be offset by churn due to the size of the sub base.

Now how does that play for seasonality going forward for the rest of the year? We're not providing any full year guidance on revenue or subscribers, but we do expect revenue for the year to most closely resemble the seasonality for fiscal '22 in terms of revenue per quarter. Hopefully, that's helpful.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

And then I think the third part of the question, Justin, was the cash flow, what do we have to do to get to breakeven cash flow. And the short answer is, not to be glib, we need to rightsize the spending of the business or the run rate of the business, whatever the run rate of the business turns out to be.

And then secondly, and I made this point when I first joined the company, both to employees and to investors, it's not enough to just cut expenses. We have to grow revenue. And we've taken a number of steps in order to accomplish that objective. We have substantially picked up the pace of innovation and testing and risk-taking in order to accomplish that objective.

Among the new initiatives are Fitness-as-a-Service, the sale of previously owned bikes, evolution of our digital app strategy, which we have more to say over the next several months. Among other initiatives like the introduction of the rower and the new pricing strategy.

So we happen to sit right smack in the middle of the pivot where we have made substantial progress addressing all of the infrastructure-related headwinds of the business. And now it's time to get back to the business of expanding the franchise. We do that principally by expanding the TAM. And we do that principally with a good, better, best strategy that targets not only the premium segment of the market, but the value segment of the market and the use case for Connected Fitness with competitive platforms.

Operator

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

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

You've had multiple product price changes over the past several months. Just trying to understand how comfortable you are now with the most recently revised pricing that creates this greater gap between entry level and premium products and then how you're going to communicate those options in your marketing.

And then, Barry, if you could perhaps also update us on Fitness-as-a-Service, how we should be thinking about kind of full rollout and how you'll increase awareness around the product going forward.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Doug, I have difficulty hearing. But I think the first part of the question is about pricing generally, and then loan to the market. And the second piece of the question is about FaaS, how do we think about it? And what are our plans for it.

Okay. Let me begin with FaaS, and then I think I'm going to ask Liz to jump in on top. So we've sort of gradually expanded the footprint for FaaS and our marketing initiatives around FaaS. We're selling, selling, renting at a pace of, in round numbers, 30,000 to 40,000 units on an annual basis. So it's a relatively small footprint, and we haven't really leaned into it yet.

We -- and it begs the question why because we've been at it for a while. And the answer is in order to know whether or not the value proposition works for consumers and works for Peloton, we need to understand what the retention behavior is and the implied churn rates so we can calculate lifetime value and figure out whether or not we've created a nuclear bomb or the path to the promised land. And I would say, so far, we're encouraged by the churn data that we've seen, recognizing that it's a growing but limited sample. So I'm guardedly optimistic.

I would say that I would think a win for us might be something like 125,000 to 150,000 bikes a year, renters, and the ability, which we have just brought online, to utilize our certified preowned inventory to fulfill demand under that program. So I would say net-net, that looks pretty encouraging.

Now there will be some substitution behavior, I think, between certified preowned and growth in Fitness-as-a-Service because they both target basically the same segment of the marketplace, which is the value-minded shopper. And it's pretty clear that we are bringing into the Peloton family a younger and slightly more female demo than we have historically, which is good news. I mean, those programs are expanding the TAM.

Now as it relates to CPO, we said we've seen substantially better performance. We -- off of very small numbers, so take it with a grain of salt. We outperformed our forecast by 3x. And we have a lot of bikes in inventory, used bikes, that we can recycle into that program. We've been talking about it for a year. We finally got it live. We're going to lean into it, remains to be seen how big that program can become. And as it scales, what the substitution behavior will be with the Fitness-as-a-Service. Okay. I probably talked too long about that, sorry.

As it relates to pricing, I want us to pursue a good, better, best strategy. So we believe and I think the net promoter scores for our various products support the notion that in the premium segment of the marketplace, the integrated hardware user experience from Peloton is the absolute best. And there are people who are willing to pay a premium for that. And we want to serve that marketplace well. But we also want -- if we're going to grow our revenues as fast as we would like, we're going to have to increase the TAM. And if we're going to increase the TAM, we're going to have to reach for new market segments, and that's where the good and better comes in. And that's where the FaaS and Fitness-as-a-Service and the digital app strategy comes into play.

And with respect to the digital app strategy, I had previously told investors that I wanted us to pursue a freemium strategy, we are going to implement that. There'll be various price points, and you'll have access to different kinds of content depending on how much you pay for the digital app. Roughly half of our paying customers today use our Connected Fitness-related content on the app. So it's quite clear they're using the app on somebody else's hardware, which is something we've always shied away from. And going forward, it's something we're going to lean into.

I would be delighted for you to use our content on somebody else's hardware if you already purchased it. That's a big installed base. And I think it's a big opportunity for monetization for us and we're going to lean into that segment of the market as well in order to grow TAM.

So we'll figure out the pricing as we go. I think it's -- if we have the luxury, like we do now because of our cash position and the changes we've made in the business, to price products in order to earn a reasonable return on hardware, we will. That wasn't the case earlier in the year. We absolutely needed to liquidate hardware to manage for cash, so we did, but we put that in the rearview mirror at the moment. Did I answer your question?

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

You did. Very helpful.

Operator

(Operator Instructions) Our next question is coming from the line of Ron Josey from Citi.

Ronald Victor Josey - *Citigroup Inc., Research Division - MD*

And I wanted to ask maybe a bigger picture on gross margins. And Barry, I know we talked about the focus being on free cash flow, but help us understand how you view gross margins maybe on the subscription side, given the pricing increase? And then on the product side, as you exit manufacturing and last mile and FaaS gaining share here. Just as we think bigger picture on the way towards free cash flow.

And maybe a second one just on that. Any insight or help us understand how you view inventory just continued coming down going forward.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

I'm going to ask Liz to take the gross margin subscription and bigger picture piece, and I'll just take that inventory liquidation.

I think there might be a perception that because we have a large inventory position that we will be liquidating during FY '23, we will have a large wind at our back from a free cash flow perspective that will help us achieve our objectives in FY '23, but we will not have the benefit of it in FY '24.

And I just want to burst that balloon and say, actually on a net basis, the benefit in FY '23 will be all of $6 million roughly. And the reason for that is we have the benefit, of course, of selling inventory we've already paid for, but we also -- in settlement of supply-related issues that we've dealt with in the past several quarters. We have quite a bit of money flowing out the door. So on a net basis, that's sort of a no harm, no foul.

And I think for the full year, if we're successful in managing to our current forecast, we'll end the year with about $1 billion in cash, which leaves us well capitalized for the run rate of the business.

Liz, do you want to address the gross margin piece of the question?

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Liz Coddington - *Peloton Interactive, Inc. - CFO*

Yes. So with regard to gross margin, the way I think about gross margin is just kind of two pieces, right? There's the revenue piece, which we increased the prices for Bike+ and Tread, and so that's going to obviously have a positive effect on gross margin overall. And then from a cost of goods perspective, we decided to fully outsource our last-mile delivery to 3PLs, we announced that. That will have a positive impact on our delivery costs.

We're also focusing on improving our delivery quality. That should also help reduce our warranty costs over time. And then kind of more of a longer-term opportunity on gross margin, this is related to the Connected Fitness side of it, is opportunities to reduce the cost of our hardware through how we design our products, but that's obviously like a longer-term opportunity.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Let me just jump in and mention related to that is redesign to enable self-install, which would dramatically change the logistics and the costs associated with last mile domestically and internationally.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

Yes. And I did want to reiterate that for Q1, we provided a guidance of around 35% gross margin, but we're not providing any further guidance for the year beyond that at this time.

You also had a question about kind of subscription gross margin. And obviously, that is -- that margin is higher than our product gross -- our Connected Fitness product gross margin. As our subscription base continues to grow and mature, that will naturally have some benefits to gross margin overall as well.

Operator

Our next question is off the line of Lauren Schenk from Morgan Stanley.

Lauren Elizabeth Cassel Schenk - *Morgan Stanley, Research Division - Equity Analyst*

Great. Just following up on that last one. How should we think about sort of the longer term or stabilized Connected Fitness gross margin?

And my second question, in terms of the self-install option, is that only going to be available on Amazon for the time being? Any color on the margin benefit from that? It looks like pricing is similar or the same as having the professional delivery. And then in terms of other potential third-party partners, what are you looking for in those new relationships?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Well, let me see. As it relates to long-term gross margin, I think increasingly, the business is driven by the growth in recurring subscription revenue. That has an inherently higher margin than the hardware side of the business. And so the long-term trend for margin is towards the software margin rather than the hardware margin.

The cost implications for self-install -- well, let me talk about the implications of self-install generally. One of the challenges related to the delivery of hardware is coordinating the delivery schedule with the availability of the members who purchased hardware. And if we could move to a drop ship model, we eliminate all or the majority of that friction, which would be a very good thing.

Secondly, if in the process of designing a self-install capability, we were able to decrease the weight of the unit, there's some last mile cost-related benefits that would flow through to us as well.

And then lastly, if we can get to a self-install, we think it significantly improves the opportunities for international growth, which we plan to lean into when we are able to absorb the incremental cost for that expansion.

And then there was a question generally about third-party retail partners. In my previous comments to investors, I had indicated this was a strategy that I hope we would lean into. It's early. We're learning. This is not a substitute for our own retail strategy. This is a recognition that we need to be where our customers are. Sometimes that's in the store, sometimes that's on our website.

We know from our own research that there are roughly 500,000 searches a day on Amazon for -- a month -- excuse me, a month for Peloton. And so there's an opportunity to sell there and in other retail formats as well. And it's important that we test and learn by broadening our distribution to see which of those could be cost-effective for us. And then we'll, over time, as we come to understand the margin implications, that would be great.

In time, it'd be terrific if we could broaden the distribution to other Peloton hardware platforms on Amazon. But at the moment, we need to be able to be drop shipped in order to be on their platform, and our Tread and our Bike+ doesn't lend itself to that solution yet, which is why it's not yet -- we have not yet offered it for sale on their platform. But in time, I hope that we are able to find a solution to that short-term roadblock.

Operator

The next question will come from the line of Edward Yruma from Piper Sandler.

Edward James Yruma - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

I want to just click down a little bit on engagement. I know you're going to stop reporting metrics on a quarterly basis. But how do you think about engagement holistically? Obviously, I know a lot of moving pieces post COVID and seasonality, but where do you see engagement going over time? And is there anything you can do to help drive that number higher?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

So let me jump in here. I said I wanted to lean in the software. It's important that we be creative both in hardware and software. But I think the primary growth opportunity for us is in exploiting our singularly unique competitive advantage, which is our content, right? It is -- it's the crown jewel, and it continued to perform spectacularly well.

Now for you to be able to enjoy it, you have to be able to discover it. And the way we improve engagement and lower churn and increase lifetime value and drive more organic growth from word of mouth is by making you more delighted with that content. And the way we do that is by helping you engage with it by understanding -- by personalizing it, by giving it a front end that understands what your likes and dislikes are and then serving you content that is consistent with your preferences.

This is what -- this is why Netflix beat Blockbuster. And this is among the reasons that Spotify has run the table with the world's largest streaming music service. And the more content you have, the more important it becomes that you'd be good, even great, at building that personalized user interface.

So it is currently a focus for us, and we will be relentless about it. And I would say we're still really in very early stages. I mean, there's a little bit of stuff we serve you. And if you use a Bike by web, example, there's a little bit of stuff on your screen when you log in that reflects -- maybe reflects some of the instructors you've taken classes from, but there's a ton of stuff that we continue to serve to you that you have never engaged with that reflects what we think you should be interested in, but what really matters is what you think you should be interested in. And so we need to close that gap.

Operator

Our next question will come from the line of Eric Sheridan from Goldman Sachs.

Eric James Sheridan - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Maybe just a two-parter. Barry, how are you thinking about the health of the brand today? You came out of the pandemic with a lot of awareness of the brand and a lot of halo effect. But sales and marketing has been more of an area of reduction in the last couple of quarters. So how do you think about sort of returning to sales and marketing as a channel, continuing to grow awareness of the brand and use sales and marketing as a tool to address sort of the better, best strategy you talked about in terms of amplifying the gross addition dynamic for the platform?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Thanks for the question, Eric. Fortunately, I think the health of the brand is exquisitely good. The health of the business has been challenged, but the brand remains beloved and the Net Promoter Scores remain extraordinary.

If you are what your track record says you are, we are a U.S.-based bike company, right? 96% of hardware -- of the hardware platforms and people's homes today are bikes.

But there's so much more opportunity available to us to drive growth. Not just Bike+, but the Tread, the Rower, the Guide and especially the digital app and coupled with the good, better, best strategy that opens up the segment of the TAM we haven't historically targeted. And the opportunity for us now is to invest in growing awareness.

By way of example, the Bike has a 53% unaided awareness, but the Tread is only 21%. The unaided awareness for the digital app is 4%. And so there's tremendous upside to be had, we can execute here. And in part, the principal message of my letter is, okay, we're pivoting now. There are a bunch of things we had to fix in order to put ourselves in this position, which didn't happen sooner, but it's happening now, and we're going to tackle head on this challenge related to marketing and growth.

And what I've tried to articulate is that the different initiatives that we're going to pursue in order to drive success. The important thing to recognize is that the path to success involves having more swings at the plate. And so you've seen us deploy a number of initiatives to accomplish that objective.

And we're going to connect with the ball. It's just a matter of time. And I know from my Netflix experience and my Spotify experience, I can't tell you exactly which one of those initiatives is going to get us where we want to go. But I am confident of the cumulative effect.

Operator

Our next question will come from the line of Shweta Khajuria from Evercore ISI.

Shweta R. Khajuria - *Evercore ISI Institutional Equities, Research Division - Analyst*

I have one on the next quarter guide. So I think this was somewhat asked earlier, but I just want to get a little bit more clarification. If you exclude the Canadian members in the guide, organically, does that imply net adds decline because 85% of members actually did take the action. So could you please clarify that?

Second is on gross margins, possible to get a little bit more color on the magnitude of impact from the price increases versus the cost-cutting actions that you took related to customer service and outsourcing third-party logistics?

And then the final question is, Barry, as you think about growth next year, possible to give a sense of how fast, if at all, the connected fitness market is expected to grow. And in terms of the magnitude of the impact of all these initiatives, whether it is FaaS or international, or digital subscription, app initiatives. Which ones do you think in order of magnitude will be most impactful next year?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Liz is deciding how she must answer the first two.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

I'm trying to make sure I understand your questions, Shweta. So the first question was about the Canadian subscribers. I think what you were asking is if that implies a negative net add as a result of the fact that the subscribers churn, but not...

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

They're not a gross add.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

They're not a gross add. So they -- if they had not churned, it's just -- it wouldn't be an impact is the way that I sort of think about that. So not really -- they're not considered a gross add is effectively the way that we would think about that.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

So it shows up in the net, not the gross number.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

Correct, Correct. The gross margin question, I wasn't quite following what you were asking there. Is that...

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

How much of the gross margin -- just try to correct me if I'm wrong, how much of the gross margin improvement comes from last mile, member service reduction as opposed to price increase.

Shweta R. Khajuria - *Evercore ISI Institutional Equities, Research Division - Analyst*

That's right.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

While Liz is [noodling] on that, let me jump in on the connected fitness market next year. Honestly, I don't pretend to know what's going to happen to the marketplace as a result of different puts and calls in -- with the economy. I think the challenge for us regardless is to grow the TAM and to reach market segments that we don't currently reach in order to accomplish that objective.

So which leads me to answer to your question, where do I think will be the principal leverage points for the business. I'm going to put rower on the shelf for a moment in answering that question. Probably certified preowned, that just flew out the door, followed by -- in my nirvana, it would be followed by growth in the digital app because I think that is singularly important to us from a strategic perspective.

And if we're successful with that initiative, we will unlock access to the installed base of competitive hardware and use occasions that don't currently exist for our content, followed by Fitness-as-a-Service. And if Fitness-as-a-Service really takes off, then there's a whole capital strategy that we will need to figure out for that business. But I'm confident that we'll have access to the capital, if the margins are as attractive as we think and if it's really growing as fast as we think it might.

And then I said, I'd put rower on the shelf. We will have to see how that product does when it arrives. It's going to be expensive, but I think we're going to revolutionize the market, and we'll see how those two cross currents land. But we anticipate that it will be a significantly better user experience than anything currently available in the marketplace.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

Okay. For the gross margin question, I think you were asking like how should we think about the composition of the gross margin improvement and how much is coming from price and how much is coming from our 3PL logistics, moving to the 3PL outsourcing model for last-mile logistics.

In Q1, the vast majority is going to come from pricing because we just announced the move to outsource to third parties. And so that will take a bit of time. Over the course of the year, we still expect more of it, more than 50% ought to come from the pricing and -- but the logistics will be very impactful, and it will be meaningful over the course of the year. Does that help? Does that answer your question, Shweta?

Operator

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

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

Can you talk a little bit about the consumer and maybe the interaction between in-person studios and gyms and connected fitness? Obviously, the industry is down quite a bit, and there's a lot of macro effects, but can you maybe just talk about what you might be seeing in terms of the pendulum maybe swinging one direction to the other?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Let's see. I'm not sure that our experience translates to the experience of our competitors. I think it probably doesn't. In our uniquely different ecosystem where we've just opened up our studios, the amount of energy and -- amongst our passionate user base is, well, it's just something to behold. People lined up around the block for hours, classes oversold, crashing our reservation system. I mean it's just insane.

And that's not what the industry is experiencing generally. Now that back, notwithstanding the passion and enthusiasm among their rapid member base. As a percentage of total class is taken live, relatively small but it has an enormous halo effect and drives tremendous word of mouth, I think, all of which helps grow the brand. Is that helpful?

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

Yes, that helps. Would you consider expanding the in-person studios and such? Obviously, you have a lot of excitement so far, but it's fairly small.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

I think there's an opportunity -- I'll tell you how we are thinking about it. Jen Cotter, who runs that business for us spectacularly well, and I have spent time thinking about ways in which to create marketing and branding and PR opportunities on a local basis, using the celebrity power of our instructors in different geographic markets. So if we were to expand, I think that would be the sort of the kernel of an idea that we would try to leverage geographically rather than opening, say, incremental studios around the country just because the cost of doing that is so prohibitively high.

Operator

Our next question will come from the line of John Blackledge from Cowen.

John Ryan Blackledge - *Cowen and Company, LLC, Research Division - Head of Internet Research, MD & Senior Research Analyst*

Two questions. First, how should we think about the retail store footprint in fiscal '23 and beyond? And the second question, on cash flow breakeven. Is there any way to kind of think about the level of top line in second half '23 to get to that cash flow breakeven number?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

I'll let Liz take the second one. Let me do the retail footprint.

I don't -- we don't know how many stores we're going to end up with when the dust settles. Our objective is to repurpose about $50 million worth of run rate spending to deploy it more productively from a marketing perspective when the dust has settled and we are done restructuring the retail footprint domestically and internationally. Liz, do you want to do the capital?

Liz Coddington - *Peloton Interactive, Inc. - CFO*

The cash flow question and thinking about revenue. As we mentioned, that we are pulling all these different levers on the business right now. And so there's a lot of uncertainty about how these levers will bear out. And so we're not providing any full year guidance on revenue. But we did expect it to follow the seasonality in terms of revenue per quarter for prior years.

Now that being said, from a cash flow perspective, we do have this north star goal that we are working to achieve, to achieve free cash flow breakeven by the end of the year, and we will be maintaining a cash balance of at least $1 billion. And what we have to do in order to do that is make sure that we continue to work hard to rightsize our cost, as Barry mentioned earlier, to align with the run rate of the business. So we will continue to do that in order to make sure that we achieve our goal of being breakeven free cash flow by the second half.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

I would say, by the way, related to the retail footprint savings, not expecting any savings in FY '23 for the cost of rationalizing that distribution chain will mostly consume whatever savings we would otherwise realize. So the savings, if there are any, would happen in '24. In my nirvana, there wouldn't be any savings. We'd take that $50 million and we'd redeploy it in marketing to drive some incremental growth. The question is, can we find ways to spend that cost effectively using our LTV to CAC framework.

Operator

Our next question will come from the line of Youssef Squali from Truist.

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

I have a couple maybe for Barry. On the Amazon partnership that you announced yesterday, arguably, you guys can do a lot more with Amazon. I wanted to understand just how you think about that partnership right now. It seems like based on the type of products you're allowing Amazon to sell or you're selling through Amazon, it's maybe at the lower end of your good, better, best strategy. Is that kind of the way to think about your retail strategy broadly speaking? Or is it versus DTC? Or is it that just as you try to learn more about that strategy since you've basically pivoted from DTC to a broader retail strategy.

And then maybe can you just talk about the status of Precor within the company? What is the strategic rationale of keeping it?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

I'll let Liz handle the Precor. With respect to Amazon, I'd love to sell all of our Connected Fitness platforms on Amazon good, better, best, but they need to be -- at the moment, they need to have the ability to -- for our consumers to opt in to self-install. And that's not possible with Bike+ or Tread. And so until and unless that constraint changes where we complete a redesign cycle, you won't see those other platforms on Amazon.

How important will it be? We don't know. And we have modest assumptions in our forecast related to the impact of that business. I hope that has tremendous upside. But we won't know until we know. So the point here is to begin the process of learning. And then based on the learning, make smart operating decisions about how to leverage the learning into a profitable opportunity both for them and for us. And so that's the journey we're on. And same thing with FaaS and same thing with certified preowned, and same thing with the various flavors of digital app that we're going to be rolling out.

So it's your intuition to figure out what to test and then use the data to inform you about how to react to the test results you're seeing and take risk and move fast and don't be afraid to break stuff.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

With regard to Precor, so there was a question there about Precor. We're continuing to assess our strategy for Precor. And it's been helpful for us as we've been building our Peloton commercial business. But with all the other things that we're working on, all of our supply chain work, the FaaS work that we've been doing, Precor hasn't -- the focus on Precor hasn't been our highest priority area. And we don't have much else to share at this point.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Yes, there have been other priorities that have consumed our focus and attention. I did say when I first joined, if it wasn't Connected Fitness related, it wasn't going to be part of our long-term strategy and strategy need to be about choice.

All those things are true, Liz pointed out, has been very helpful to us. That acquisition has been very helpful to us with our commercial business. Our commercial business growing at about 35% year-over-year in terms of revenue. I'd like to lean into that, I'd like to accelerate that growth, making that a priority to make that happen. And in the fullness of time, we'll have more to say about Precor, particularly now that we have more bandwidth to be able to think about the role it plays in our long-term strategy.

Operator

And our last question will come from the line of Arpine Kocharyan with UBS.

Arpine Kocharyan - *UBS Investment Bank, Research Division - Director and Analyst*

In terms of your previously announced $800 million of cost saves, and I appreciate that you're probably looking at many moving parts to that. But just if you could sort of bring it all together and outline what's the latest on some of the buckets that you're looking at and overall cost savings you should be targeting sort of more medium term? Just trying to understand, have you identified any areas where that initial expectation of how much you could -- could be much bigger than thought?

And then as a quick follow-up, now that you've done some testing of removing that upfront cost for the customer to have them pay higher subscription over time. Do you have a more kind of updated sense of what incremental demand opportunity that is for you, some numbers, if you could share, whatever you're looking at.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

So with regard to the cost savings, so it was a little bit hard to hear on the phone, but I believe you're referring to the restructuring plans that we laid out back in February, the $800 million, of which, $500 million is OpEx, $300 million is COGS. So we're actually tracking ahead of the $500 million OpEx target at this point. And we'll continue, like we said, to rightsize the cost structure of the business to align with the run rate of the business and whatever that requires.

Some of the things that we've announced, the 3PL strategy shift is part of that cost savings opportunity. On COGS -- sorry, actually, the 3PL shift is more related to the COGS side, excuse me. So on COGS, our savings is coming from that, for the most part, and also some headcount reductions. For that $300 million piece, we said that, that was going to take longer and it will in part because we have the -- it's very dependent on inventory. And so that will take more time as we move through the inventory that we already have to be able to realize some of those COGS savings.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

It's a function of the way we account for our inventory.

Liz Coddington - *Peloton Interactive, Inc. - CFO*

Yes.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

And then I'm pretty sure I didn't understand the second piece of the question related to upfront cost and subscription.

Arpine Kocharyan - *UBS Investment Bank, Research Division - Director and Analyst*

Now that you've done some testing of removing that upfront cost and have the customer pay higher subscription, do you have a -- because last time you shared some sort of helpful numbers, do you have a more updated view or sense of what incremental demand that unlocks for you over time?

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

I see. This is related to the rental program with FaaS, I think?

Arpine Kocharyan - *UBS Investment Bank, Research Division - Director and Analyst*

That's right. Yes.

W. Barry McCarthy - *Peloton Interactive, Inc. - CEO, President & Director*

Well, I think the -- what I said on the call earlier, I should reiterate here. We're currently at a run rate of about 40,000 units annually. And I think, a win for us would be something like 125,000, 150,000 a year. And so the opportunity and the challenge for us is to move it from where we are currently to that higher run rate. How big a challenge will that be? Well, we really haven't marketed it yet, and most people really don't know it exists. And when we do market it, it looks like it grows pretty fast.

And I'm hesitant to share any numbers because I really don't want it to be misleading. There are a couple of puts and calls, which make reading the data little dicey. We have changed price points. So the value prop is -- and so we detuned the value proposition for consumers, then we included Bike+, then we've removed Bike+, then we put -- now we're putting Bike+ back in. When we put Bike+ back in, we saw a 74% increase in volume over 8 weeks, week over week. But if we look back to the prior week, when we hadn't included Bike+ in the mix, it's only like a 35% increase over 9 weeks. Okay, but it's still a 35% increase over 9 weeks. And that's because we started to broaden the marketing of the FaaS program and create awareness for us. So really, the question is how high is the glass ceiling.

And I don't know how long it will take us to get there. My intuition is that we're on to something really important. The FaaS users, as I said, are younger, it skews slightly more female. And the biggest surprise for me, they're actually more engaged than our core users, which isn't what I expected since they had less of the financial investment in the product. Maybe that reflects the younger age demo, I'm not sure. And we'll have to see if that continues to scale as we broaden the market.

But it's quite clear that there's a big opportunity for us in the value conscious segment of the marketplace. And so we're going for it.

Peter Stabler

Thank you, everyone, for your time today. Hope you all have a good day.

Operator

You may now disconnect. Everyone, have a great day.
