REFINITIV STREETEVENTS

EDITED TRANSCRIPT

PTON.OQ - Peloton Interactive Inc at Barclays Global Technology, Media and Telecommunications Conference (Virtual)

EVENT DATE/TIME: DECEMBER 10, 2020 / 2:30PM GMT

CORPORATE PARTICIPANTS

Jill Woodworth *Peloton Interactive, Inc. - CFO*

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

CONFERENCE CALL PARTICIPANTS

Deepak Mathivanan *Barclays Bank PLC, Research Division - Research Analyst*

PRESENTATION

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Great. Good morning, everybody. Thanks for joining us. My name is Deepak Mathivanan. I cover SMID-cap Internet here at Barclays. We're super excited to have Jill Woodworth, CFO of Peloton; and Peter Stabler, Head of IR, joining us today. So we have about 25 minutes. I'll go through a list of questions. Jill and Peter, thanks for joining us.

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

Thanks for having us. We were just thinking it was very different last year, but obviously virtually good to be with everybody this year.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Yes, yes. No, this is a different year in every possible way.

QUESTIONS AND ANSWERS

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

All right. So great. So this is a question. I'll kick it off with a question, which we've been asking every company trying to make ourselves smaller and understand potentially about 2021. So I'll throw that question out to you as well.

Obviously, demand was really strong in 2020. There's still plenty of uncertainties about 2021. But how are you thinking about some of the demand trends for 2021 as you plan your business for various levels of investments and product initiatives that you have in the pipeline for next year?

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

So I know that everybody knows that COVID was obviously a nice tailwind for our business in 2020. But I think the key to 2021 is understanding the way we view COVID's impact on our business, and that was really more of an acceleration of a trend that we believe was already going to happen, which was the transference of fitness from the gym into the home because the home is the most convenient place to exercise, and we have developed a product that people use, which is really the key to fitness.

And so from our standpoint, we want the pandemic to end as much as anyone. The big challenge for us, as you know, is COVID created a much more unpredictable demand curve. And so I personally am very excited to get back to more predictability, right? We're scaling our supply chain. But I do believe, when we actually are at the controls with respect to the way we can drive our marketing and media spend to then drive traffic and drive demand for our products, it's going to create a much more predictable growth algorithm for us.

And I think what I'm really excited about in 2021 is our lower-priced Tread. So we continue to believe that we're going to see tremendous growth even beyond COVID. And I think that part -- an important part of that algorithm certainly will be the lower-priced Tread, again, which, I think we've said a lot, is likely to be 2 or 3x as big as we believe the bike opportunity to be.

So we're excited for it all to end and excited to get back to marketing and building our brand and product awareness in the way we've done it in the past.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. I mean obviously, the penetration into your SAM is still relatively low despite all the strong demand during 2020. Maybe talk about the supply chain side of the business. Clearly, you ramped with the new facility now. Is the facility fully operational? As you think about some of the supply chain constraints, should we expect it to get relaxed over the next few months and then potentially into 2021? Where do we stand on that currently?

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

So there's obviously the immediacy of getting our supply chain as ramped as possible. And just to give you a little bit of context on what we've already done. If you look back to the first quarter in 2019, we generated $112 million of revenue. Last quarter, fast forward 24 months, we posted $758 million of revenue. So we've already scaled several fold over the last several months.

So really, what we're trying to now think through is the 5-year plan, the 7-year plan, right? We know, in order to have millions of subscribers, you need to sell millions of products. In order to sell millions of products, you need to be able to produce millions of products. And so we've had a full 360 evaluation over the last 9 months of how we're going to get there, right?

And I think it's a combination of further leverage off of our existing third-party manufacturers. Certainly, our acquisition of Tonic, in some ways, was very fortuitous 14 months ago, because it allowed us to break ground on Shin Ji and put a lot of investment into building out our supply chain.

Shin Ji is on track. That is really more of a medium to long-term solution for us because it is going to take some time to ramp up the production of both bike and treads at Shin Ji. But we're on track. We're excited. We're getting everything ready to start building out our lines of production there. So super excited there.

And then we're also trying to figure out other long-term solutions, whether that's stateside production and assembly, whether that's more third-party manufacturers that we need to bring to the table to really help us flexibly manage that supply capacity over time. So -- and even looking at another factory on the Tonic campus.

So we've got a lot of different balls in the air, but I think rest assured, we understand the importance to get to that millions of subscriber goal. Have to be able to make the product, and that's really been a huge area of focus over the last 9 months.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. Okay. I'll ask one more near- to medium-term questions, and then we'll talk about more interesting stuff. The ocean freight delays that's been reported, and there's been some chatter in the press about how there's been some customer dissatisfaction and cancellations associated with it. I mean, obviously, it seems like given the scale in which you're at, those will be isolated instances. But can you talk about how consumer behavior has been due to these -- some other near-term challenges?

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

Yes. So I would really separate the issues that we've had over the course of the last several months really into 2 buckets. We just talked about supply chain. And of course, that's something that is imminently solvable, right? We believe, over the next couple of quarters, we are going to get back to those normalized order to delivery for our products, and Bike+, in particular, where I think we talked about, we saw some pretty exciting demand for that product.

There's a separate issue which is the realities of operating in the COVID world, right? So like other e-commerce companies, there's obviously been a massive acceleration in the adoption of online and e-comm, right? I think the last I looked at was it was almost like 6 or 7 years of e-commerce growth boiled into a 9-month period. And so as you can imagine, that is creating a lot of the ocean freight delays, right? So COVID has sort of -- has created that.

The second thing is also -- and again, we're doing everything we can to be as efficient as possible. I know we talked about on our last earnings call, we even air shipped some bikes in order to bypass some of the congestion that we were seeing at the ports. But I believe that this is an issue that's going to be here for a while as we've just seen this incredibly rapid ramp of the adoption of people moving from buying in-store to online. And I think it's just -- I think it's is going to be a reality for a period of time. It's one of the reasons why, into the future, doing things more stateside could makes sense for us.

But the other issue is, we feel like we have let some of our customers down. And -- but the reality is it's generally been due to COVID closures of our warehouses. We've fought through natural disasters where we've had to close certain warehouses for periods of time, especially on the West Coast with the fire situation.

And so it has -- I think the real angst has really been more around the delivery reschedules, right? It's -- I think at this juncture, we've tried so hard to be transparent with our customers with that initial delivery date, right? It's on our hurricane banner. And we've been, I think, really upfront around the delivery time frames.

It's really been the minority of customers who through a port -- through port congestion, through a warehouse closure where we had to shift deliveries for the day, we're just fighting through the same COVID challenges that everybody else is. So hopefully, these are things that will be mitigated over the next couple of months. But certainly, this is very, very frustrating and painful for us to have to work through and see some of the commentary.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Yes. No, absolutely. Okay, switching gears here a little bit. One of the things like -- if you see companies like Apple have been able to do is to create an ecosystem where consumers kind of refresh their products at a more regular cadence. I mean, everybody buys new iPhone in 2 to 3 years. Now I think with Bike+ and the behavior that you've seen with Bike so far, what do you think is the opportunity for Peloton to create some sort of behavior like that?

Clearly, some of your initial Bike+ buyers were original Bike owners. So do you think there's opportunity to create some sort of like a subscription-esque behavior with your hardware offerings with multiple attritions over time? And do you think -- is there a right way to think about the cadence there?

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

I apologize. I did lose Internet for a very brief moment. I don't know if you noticed. I was potentially frozen in time. So I didn't make...

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

No worries, I can...

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

Maybe just do an abridged version of your question. I'll catch you and I apologize.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

No problem. I was saying that there are a few companies which are trying to replicate like subscription-esque behavior with the hardware by having product refreshes at a steady cadence, so people upgrade their devices. You've seen some of that with Bike+ currently, some of your early buyers. I was curious, with the data points that you have, do you think that behavior is possible for Peloton in the next several years?

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

Yes. And I'll be honest, I'm not sure -- if you're thinking about like are we trying to get into a regular hardware cadence, the answer is no. We -- albeit we really build our products to last for hopefully -- when you think about the Bike and the Bike frame, you think about our Tread, we really want our hardware to last 7 or 10 years.

Clearly, touch screens, as we've seen in the technology landscape, that has a much shorter lifespan, call it, 3 or 4 years. And we've already -- if you look at our first-generation tablets have actually already offered an at-cost exchange for our earliest cohorts of members. But we want the Bike hardware to last for years and years and years.

So for us, the real value is in that subscription, right, that $39 a month. So in my view, the longer it lasts, like we don't need -- we don't want to rely nor do we want to need to rely on people upgrading and replacing their products over time. Clearly, that doesn't mean that we're not going to innovate on our existing products, as you saw with our introduction of Bike+, which introduced a lot of features and functions that our members were asking for. But you won't see it on a quick cadence. It will be in the cadence that we've already delivered on vis-à-vis the Bike vertical. But that's really not going to be a strategy for us.

So -- and we also want a very prudent portfolio for us. It's going to be key to get economies of scale on these products in order to improve the margin profile of these products over time so that we can then make them more affordable like we did the original Bike to continue to grow our addressable market.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. Okay. On the subscription side, obviously, we added a ton of new content, expanded verticals. So you've also seen engagement go up really nicely during this period. But how are you thinking about the price elasticities there? I mean I think, clearly, you don't have the need to flex the price now. But the value prop that you have increased seems like has gone mostly as a kind of consume -- captured by the consumers. So how should we think about potentially pulling some of those pricing levers on that side?

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

So I would say that the $39 a month is kind of sacred to us, right? We know that for a consumer subscription, it is a higher price point, right, when you compare across Netflix or Spotify or other services. So for us, we love the $39 price point.

Clearly, based on the engagement levels and the value that we believe our members get from that subscription, we certainly believe we have some pricing power. But when you look at the economics, right, of our subscription model and you look at the gross profit margin of our subscription business and where we think that can go, we're really happy with that subscription contribution margin range of 70-plus percent, which is where we think we can get to over the next few years.

So from my perspective, we would rather continue to pile more and more value and more content and more software features, right, and more fitness verticals into that subscription than think about raising the price over time to be commensurate with the additional investments. We just want it to be an undeniable value for the consumer, and so really no plans at this juncture to raise the price.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. No, that makes sense. Okay. On the digital side, the growth has been phenomenal over the past few quarters. And clearly, you saw a pretty nice uptick from free to paid conversion and then also some stickiness around that. But from a product standpoint, what do you think are some of the areas that you need to tailor it more to kind of sustain growth and make it a product which is addressable for a large subscriber base?

Clearly, if you just think about less friction in terms of subscribing to it and the value prop associated with it, you would think the addressable market for digital is a lot bigger than the core subscription business. So do you think there's product tweaks needed or maybe content merchandising inside that, that should be different? What do you think that will take into a scale bigger than the core product?

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

So first of all, I would highlight that digital is a very nascent business for us, right? And there are very low barriers to entry for content-only fitness subscription and very low switching costs for the consumer. So it's a really different business model than the one that we've cultivated, right, with Connected Fitness, where there's a buy in, right? There's an initial investment. Even though financing has helped spread that investment over a period of time, the reality is it's -- there's a very different consumer behavior with digital.

And we are incredibly bullish on digital, but it's still very early days. When you look across the brand awareness of our products, right, Bike-aided brand awareness is pretty high, but we've got a lot of room to grow. Tread as a category for Peloton is very low, so is digital.

So we still have very low brand awareness. It's why things like the Chase partnership have been really interesting to us to increase the awareness of the product. We believe we have the best fitness app on the market, but again, with very low barriers to entry, higher churn relative to our Connected Fitness.

Today, we're treating it like an incredibly powerful sales funnel for Connected Fitness. And maybe over time, our -- maybe digital can be millions and millions and millions of subscribers. But I think, in my humble opinion, our focus right now is taking our digital members and helping them convert into Connected Fitness. Most of them tend to use a wide variety of programming. And the good news is, is that in order to get an indoor cardio workout on a Bike or Tread, you need a Bike or Tread. And so our view right now is let's widen the funnel as much as possible.

So let's -- obviously, within a cost-effective way, let's get as many members as possible into digital. But ultimately, the point is to drive value by getting them to convert to Connected Fitness over time. So I see it as a great sales channel as opposed to a great long-term business model just given all the challenges, competition, lower margin, higher churn. And to us, it's interesting, but for very different reasons. And thankfully, we have this great high-margin Connected Fitness business that we think is really the bread and butter of what we do.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. Okay. No, that makes sense. Can we talk about the geographic market expansion opportunity? I mean I think with the supply chain, particularly in terms of production capacity in place over the next few quarters, it seems like you will now have opportunity to kind of expand into a few other markets. Clearly, U.S. and U.K. are significant. But then there's also other markets where you -- feels like you can enter with very limited kind of incremental investments. How should we think about the milestones that you would like to see before you go and approach some of these international markets?

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

Yes. I mean first off, the global opportunity is massive. But I think at Peloton, we're constantly challenged by the fact that there are so many ways we can grow our business and how do we optimize and prioritize all of the various things we want to do. To date, going into international markets has taken a tremendous amount of effort, right? We are in 4 of the largest fitness markets in the world today that cover half of the world's population that belonged to a gym. So it was important for us in those markets, to your point, to have a fully vertical stack, right, logistics, showrooms, national media spend in order to really drive adoption and accelerate our growth in those markets well beyond what we were doing in the U.S. at the same time.

After Germany, the market opportunities in some of these regions really dropped off. And so what we have to do is reimagine how to deliver the Peloton experience in the best way possible without the building blocks of all the different components of our vertically integrated model that's been so successful, right? And do you have a direct-to-ship model, for example, versus your own logistics platform? Do you leverage third-party logistics? What do you do for servicing?

So we are certainly excited about continuing to expand internationally. But right now, I think it's probably going to be a couple markets every couple of years. It's not -- we're not going to be -- we're going to be very judicious as we go to make sure that the investment is rightsized for the opportunity.

And then as we look into markets, we also might evaluate partnerships, right, or ways in which we can get in at a more rapid clip. So we're super excited about the opportunity, but we're going to probably take it a bit slowly, 1 to 2 markets every couple of years and again think through how to make sure that, that investment is right for the opportunity.

What's going to be interesting, though, is I do think you may see us do more foreign language programming ahead of our expansion into international markets. So that's something that could be exciting for us. And I've always thought, too, as digital is a great way to sort of start to see the market internationally, so there's a lot of great ideas that we're thinking about as we think about that -- the international growth. But again, I think the important thing is just to be cautious as we go.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. Okay. And then on the margin side, during the IPO, you kind of laid out 10% plus EBITDA margins. Clearly, the business has taken a phenomenally different trajectory right now. And obviously, you have a pretty good leverage in the fixed cost side, and the subscription business has also shown pretty good improvement. And the brand of Peloton has become a lot more powerful under COVID.

How are you -- can you provide some updated thoughts on that 10% margin level? It seems like we could be achieving levels there at a fairly quicker pace and also potential areas of the business could provide additional leverage to reach above that margin target?

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

So I think philosophically, we believe that we are so in the early stages of our growth and the adoption of Connected Fitness in the home that there is no way that we can't be 100% focused right now on growth. Obviously, I think what we've been able to witness over the last several months is that with scale and therefore, leverage of fixed costs, that our model proves out, right?

And that's something we've always said. We've always talked about our unit economic model, right? How the marketing spend pays -- is paid for by the gross profit margin earned on the Connected Fitness unit. And thereafter, if we focus on engagement and have low churn, we have massive upside as it relates to the LTV of our Connected Fitness subscriber. So nothing has really changed there.

The fact is we've just pulled in, right, our growth, right, by a couple of years, which has then allowed us to see the leverage of our fixed costs in the model. So there -- we don't really then have a target. I think what we've been able to, again, to show is what we could look like in a more mature state, right, which I think is a fairly attractive margin, if you look at our margin profile in Q4 last year as well as Q1 of this year when you see a lot of leverage of those sales and marketing expenses.

And we still have 105 showrooms. We still have some fixed costs there, too. So it kind of gives you a sense of where we could go. But to me, it would be way too premature to sort of give timing guidance on adjusted EBITDA because, again, for us, it's all about driving the top line. It's not to say we're not disciplined as we spend. But for us, it's -- we want to keep our first-mover advantage, right?

We know that a lot of people and competitors have seen the attractiveness of this category. And to us, defending with our moat of vertical integration and continuing to invest to be the best is what we need to do right now. So unfortunately, it means I don't really have a bogey or a time frame for a certain level of profitability by a certain time frame. But hopefully, most of our investors are looking at the growth potential. And the fact that we are the market leader in Connected Fitness, to us, it's most important for us to defend that.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Got it. No, that makes sense, and that's fair. Yes, I'll ask again next year. But thank you so much for the time, and we'll wrap it up there.

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

All right. Well, it's great to see you. And again, hope everybody has a better '21. And we're excited to have this pandemic end. And thanks so much for having us. And hopefully, we can be there in person next year.

Deepak Mathivanan - *Barclays Bank PLC, Research Division - Research Analyst*

Great. Yes. All right. Have a great holiday.

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

Thank you. Have a great day.

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

Thanks, Deepak.
