

Peloton Earnings Call Transcript from 10/31/24

As the co-founder and driving force behind Apple Fitness+, Peter led its growth to millions of members and is responsible for successfully scaling over a dozen other subscription services, ranging from Ford Blue Cruise to Apple iCloud to Time Warner Cable home security. Importantly, Peter has also been a passionate member of the Peloton community since 2016 and has a deep appreciation and respect for this business, this brand, and the impact that we have on millions of people around the world every day. I truly cannot wait to officially welcome him to Peloton at the start of the calendar year.

Turning to our financial results, I am extremely pleased to share that we are reiterating our fiscal 2025 financial goals today, which include first, aligning our cost structure to the current size of our business by delivering over \$200 million of run rate cost savings by the end of fiscal year 2025 from our cost restructuring plan announced in May 2024. Second, improving our unit economics across all products and sales channels in pursuit of delivering sustainable, profitable growth and meaningful free cash flow generation. And third, continuing to make strategic investments in innovation to enable Peloton to return to top line growth in the long term.

This includes product development in both software and hardware features, refining our marketing strategy to attract new audiences, as well as evolving our content offerings to deliver more diversified, engaging fitness experiences. We believe these efforts will delight our current members and attract new ones to our strong and loyal community. Our Q1 results were strong, exceeding our guidance on all key metrics, which Liz will discuss in greater detail.

Progress on cost reduction efforts are reflected in our profitability metrics. We are proud to report Q1 results, which include \$13 million of gas operating income, \$11 million of free cash flow, and \$116 million of adjusted EBITDA. Our results also highlight the continued strength of our category-leading connected fitness subscription business, which has over 6 million loyal members, 2.9 million connected fitness subscribers, 582,000 app subscribers, and over 1.7 billion of annualized subscription revenue with 68% growth margin.

I am thrilled to see our cost reduction efforts materialize in our financial performance to date, and I must say the team has done an incredible job not only to deliver, but to exceed our goals thus far in reducing costs. A key part of managing our business toward profitable growth involves ensuring all the subscribers we require are profitable and ensuring we have sustainable unit economics. We manage our business through a lens of LTV to CAC and have taken action to improve the areas that are in our immediate control on both the LTV and the CAC sides of the equation.

To enhance customer LTV, we are focused on expanding connected fitness products growth margin across all of our products, sales channels, and markets, leading us to make certain pricing changes and reduce promotional activity in Q1. We are investing in marketing, products, and content initiatives to drive engagement, which will improve subscriber growth and retention over the long term. We also launched the used equipment activation fee, which increases the LTV for new customers who join Peloton via the secondary market.

Chris will talk in more detail about what we're doing to reduce our customer acquisition costs as well. Some of the pricing changes I mentioned were specific to our international business, where we raised the price for all of our bike products in all international markets in the first quarter to expand connected fitness product growth margin. This was especially important in Germany, where we transitioned our operations to an entirely third-party retail and distribution model.

This means that while our first-party website will remain live to serve as a brand awareness and product education platform, we are now directing traffic to third-party retailers, namely Amazon and Fit Shop, for sales and fulfillment. Germany's sales have outperformed our internal expectations following the third-party transition. We are optimistic that this channel strategy could provide a more capital-efficient model to explore expansion into additional international markets over time.

Paid connected fitness subscribers in our international markets grew 8% in Q1.

(Transcript brief interruption)

...unit economics in our North American business as well. In Q1, we continued our efforts to close underperforming first-party retail stores. Next month, we will test a reimagined smaller store concept in Nashville, Tennessee to evaluate a more cost-efficient retail model.

We also expanded third-party and online retail capabilities ahead of the all-important holiday season. On our website, we launched an exciting partnership with TruMed in early October, which makes it easier for qualified U.S.-based customers to use pretest, HSA, or FSA dollars to purchase Peloton products. We are also pleased to announce that for the first time, the Peloton Bike Plus will be available at Costco this holiday season with special pricing across 300 U.S. locations and at Costco.com. All of these changes position us well to capture the seasonally strong holiday demand with healthier unit economics delivering stronger connected fitness growth margins and free cash flow.

There is so much great work being done to optimize our channel and go-to-market strategies, improve our unit economics and growth margins, and re-architect our cost structure. All of this has made Peloton a more sustainable and profitable business, one that is better equipped to serve our members and grow our business over the long term. I will now pass the call over to Chris, who will provide an update on our innovation efforts across marketing, products, and content, where we are making thoughtful investments to drive sustainable, profitable growth.

Thanks, Karen. As Karen mentioned, we're focused on improving the efficiency of our customer acquisition costs, and this requires us to be strategic with our marketing campaigns that generate demand from target growth audiences and to be disciplined with our marketing spend. In that way, we reduced total sales and marketing expense by \$64 million, or 44% year-over-year, in Q1, primarily driven by historically low media spend in the quarter.

In fact, our Q1 was the lowest quarter of media spend since fiscal 2020, over four years ago. We intentionally pulled back our media spend during Q1 because it is a seasonally low hardware sales period for us. As we look ahead to the holiday season, we are already ramping up media spend to support demand generation ahead of this important time for hardware sales and subscriber additions.

Our go-to-market strategy continues to evolve with a balanced approach that creates demand among new growth audiences, coupled with improved efficiency in our short-term conversion tactics. Today, two-thirds of our members are women, so we see an opportunity to attract more men to Peloton through targeting and messaging that highlights the robust value of a Peloton membership. Further, we see an opportunity to grow our tread business, given our estimates that show the at-home treadmill market is more than twice the size of the at-home stationary bike market.

Our goal is to build demand among core audiences and capture that demand during less frequent promotional moments. While we are still in early days, we're encouraged by the

signals that suggest these marketing strategies are working. In Q1, we saw a 9% year-over-year mixed shift in hardware sales towards men, with the highest shift in our tread portfolio.

All of these efforts will enable us to expand LTV-to-CAC year-over-year, while refining a marketing approach to better support sustainable and profitable demand growth in the long term. While our LTV-to-CAC ratio improved significantly in Q1 to 1.9x, it was still slightly below our target of greater than 2x during a period with historically low media spend, as our media spend and promotional activity increased in Q2 to drive demand creation and conversion during the holiday shopping season, it's worth noting that many of the customers acquired during Q2 will not activate their subscription until Q3. As a result, there will be some quarterly swings in LTV-to-CAC, similar to what we've seen in prior years.

We consistently evaluate the overall picture of LTV-to-CAC on a full-year basis to inform decisions about quarterly media investments. Now, beyond our marketing efforts, product development plays a key role in driving long-term growth as well. This includes both hardware and software innovation.

Recently, we launched a number of software updates that are designed to drive higher engagement from our members by offering alternative workouts, a greater level of personalization, and more social engagement on our platform. While we are encouraged by early results, all of these software updates are still in an early test phase, and we expect some of these software initiatives to be more effective than others. Our development approach prioritizes getting early versions to market sooner so that we can test how customers respond and iterate accordingly.

This allows us to be nimble, scaling investments up or down with the results we see. Strength is the second most popular modality on our platform, and it continues to take share. In September, we launched a public beta test for a new app offering called Strength+.

In order to deliver strength training programs that are designed for use in a gym setting. These are non-class-based workouts and customizable to address a member's specific goals. We've gathered more than 70,000 sign-ups to date of people who are interested in trying Strength+.

We are getting productive feedback from our test population of 5,000 that is informing our product iterations. Beyond expanded strength offerings, our members have shown considerable interest in game-inspired fitness experiences. In fact, over 10% of our active subscribers engaged with Lane Break in Q1, our first game-inspired fitness offering.

So we're currently testing our second game-inspired experience in a closed beta of 100 existing BytePlus members. We're building this to deliver an immersive social and competitive workout experience. We also believe a greater level of personalization will enhance the value of Peloton to our members.

Among a small population of our existing members, we are testing a new software feature called Personalized Plans, which provides a weekly workout plan both in our app and through our connected fitness hardware based on a member's individual fitness goals. Our goals for Personalized Plans include both improving retention for new members who may need help getting started on our platform, as well as driving higher engagement among our existing members to enhance the value Peloton brings to their workout routine. Now we know that there is extensive social engagement among our members happening off of our connected fitness platform, so we're making changes to enable our members to engage with one another.

We recently launched Private Teams, a new feature where existing members can share results and compete in challenges. Team creation and adoption is pacing well, and it's aligned with

our expectations. Early results show members who join teams are both increasing workouts taken and connecting other members via fine friends at a faster pace than prior to joining teams, demonstrating healthy signals of a growing network effect.

Okay, so beyond our exciting software initiatives, we're proud to continue delighting our members with our best-in-class instructor-led fitness content, which delivered strong engagement results in Q1 that were relatively stable year over year and well above pre-COVID level. Our annual All for One programming event included various popular musicians and a live performance from Keith Urban in-studio. These All for One classes generated over 26,000 live member workouts and over 900,000 workouts on demand in the first week available on the platform.

We also rolled out a number of new offerings to serve our members' diverse interests, including strength for soccer and new programs across bar, Pilates, yoga, and meditation. We expanded our treadmill modalities by launching walking boot camps, which are excellent lower-impact workout options for members, and the latest in a series of content options for walking and hiking. At the same time, we delivered more content for the performance athlete segment, adding more 75, 90, and 120-minute classes in response to member interest in those options.

I'm incredibly proud of the Peloton team for continuing to innovate across marketing, product, and content while we significantly reduce costs in the business. That operational excellence that we're seeing from the team has made all of this possible. And with that, I'd like to hand it over to Liz, who will take us through a review of our first quarter financial performance.

Thank you, Chris. First, I'd like to provide an update for how we are tracking against the cost restructuring plan we announced in May. As of the end of Q1, we have actioned all payroll-related changes that were assumed in the restructuring plan, which will deliver over \$100 million of annualized run rate savings.

We continue to make progress and benefit from all other non-payroll-related savings. Together with the payroll savings, we are still on track to deliver over \$200 million of run rate cost savings by the end of fiscal 2025. And we are realizing some of these savings faster than we anticipated.

Also, we're delivering additional cost efficiency through reductions to media spend that were not included in our \$200 million restructuring goal. Now, I'll spend a few minutes on our Q1 results. We ended the quarter with 2.9 million paid Connected Fitness subscribers, reflecting a net decrease of 81,000 in the quarter.

This exceeded the high end of our guidance range by 10,000 subscribers. The main driver of our subscriber outperformance was slightly favorable churn versus our expectations as a result of fewer subscription pauses. This favorability was partly offset by slightly softer gross additions than we expected.

Average net monthly paid Connected Fitness subscription churn was 1.9%, slightly favorable versus expectations and in line with the prior quarter, and an increase of roughly 40 basis points year over year. As a reminder, our net churn performance from the year-ago period included a one-time benefit as a result of elevated subscription unpauses and exceeded the high end of our guidance range by 12,000 from both higher additions and better than expected average monthly paid app subscription churn, which was 7.1% in the quarter. In the first quarter, we've continued to scale back the amount of media spend dedicated to support growth in paid app subscriptions to maximize media efficiency.

As we continue evolving our app with software enhancements such as personalized plans and private teams and developing new app offerings like our StrengthsPlus beta, we may elect to invest more in app media if we see signals that suggest we can accelerate growth of app subscribers efficiently. Total revenue was \$586 million in the first quarter, comprising \$160 million of Connected Fitness products revenue and \$426 million of subscription revenue. Connected Fitness products revenue was down 12% year over year due to lower hardware demand and subscription revenue was up 3% year over year due to content licensing revenue from Lululemon and Google Fitbit.

Total revenue was above the high end of our \$560 million to \$580 million guidance range, primarily due to higher subscription revenue as a result of higher paid Connected Fitness and paid app subscribers than we expected, as well as slightly higher Connected Fitness products revenue. As a reminder, Q1 is a seasonally lower period for hardware sales, which is reflected in the revenue mix of 27% Connected Fitness and 73% subscription for the quarter. Total gross profit was \$304 million in the first quarter, an increase of \$18 million or 6% year over year.

Total gross margin was 51.8% and 180 basis points above guidance due to favorable Connected Fitness products segment gross margin and revenue mix shift towards our subscription segment. Connected Fitness products gross margin was 9.2% ahead of internal expectations and up 600 basis points year over year, primarily driven by product mix shifts toward higher margin pre-core and bike rental products, reduced personnel related expenses, and lower warehousing costs, partly offset by higher expenses associated with our standard warranty reserves. Subscription growth margin was 67.8% in line with internal expectations and up 40 basis points year over year.

Total operating expenses, including restructuring and impairment expenses, were \$291 million in the first quarter, a \$126 million or 30% reduction year over year, reflecting the progress we've made thus far toward rightsizing our cost structure. We are tracking ahead of our cost savings targets across all expense buckets. General and administrative expenses were \$120 million, a decrease of \$32 million or 21% year over year, primarily driven by lower payroll, stock-based compensation, and professional service fees.

We are pleased with the progress we've made on reducing G&A expense thus far, but we recognize the need to reduce G&A as a percentage of revenue over time and see opportunities to do so. Sales and marketing expenses were \$82 million, a decrease of \$64 million or 44% year over year, primarily from lower spending on media, payroll, and stock-based compensation. As Chris mentioned, we intentionally reduced Q1 media spend 57% year over year.

However, we have already begun ramping our media spending this quarter in preparation for the holiday season, and while we still expect media spend to be down year over year in Q2, we expect less of a reduction compared to Q1. Research and development expenses were \$59 million, a decrease of \$20 million or 26% year over year, primarily driven by reductions in payroll, stock-based compensation, and product development costs. This quarter, we recognized \$8 million of impairment and restructuring expense, of which \$5 million was non-cash.

The non-cash charges were primarily related to asset write-downs in relation to retail showroom exits. The cash charges consisted of \$3 million in exit and disposal costs and professional fees, offset by a \$0.5 million net benefit from lower severance and other personnel costs. We also recognized \$24 million of supplier settlements due to accruals in the first quarter related to settlement of a dispute with a third-party supplier.

Adjusted EBITDA was \$116 million in the first quarter, which was \$56 million above the high end of our guidance range, and a \$107 million improvement year over year. Our first quarter adjusted EBITDA outperformance included roughly \$15 million of timing savings within the fiscal year. We generated \$11 million of free cash flow in the quarter, outperforming internal expectations and delivering our third consecutive quarter of positive free cash flow.

We ended the quarter with \$722 million in unrestricted cash and cash equivalents. Overall, our first quarter performance reflects the progress we've made in re-architecting our cost structure while maintaining our leadership position within the connected fitness category and the strength of our highly retentive, high growth margin subscription business. Next, I'd like to provide context on our financial outlook for the second quarter and fiscal year of 2025.

Our guidance for Q2 FY25 ending paid connected fitness subscriptions of \$2.84 to \$2.86 million reflects a sequential decrease of 50,000 subscribers at the midpoint. We expect our average net monthly paid connected fitness churn rate to slightly improve sequentially in Q2. Our Q2 FY25 ending paid app subscription outlook of \$560,000 to \$580,000 reflects a sequential decrease of 12,000 subscribers at the midpoint as a result of a decision to limit app media spend.

Revenue guidance of \$640 million to \$660 million reflects a sequential increase of \$64 million at the midpoint as a result of these subscription trends combined with an expected seasonal increase in hardware sales. Total growth margin guidance of 46.5 percent reflects an expected sequential decline in growth margin of 534 basis points as a result of a seasonal mix shift toward our connected fitness product segment during the holiday sales period. Our second quarter adjusted EBITDA guidance of \$20 million to \$30 million reflects a sequential decline of \$91 million at the midpoint, mainly due to higher sales and marketing expenses as we increase media spend for the holiday season.

Our full year FY25 guidance reflects the expectation that hardware sales will decline year over year as well as an expectation that average net monthly paid connected fitness churn will continue to increase modestly year over year and follow a historical seasonal pattern. Our full year guidance range for paid connected fitness subscriptions of \$2.68 to \$2.75 million remains unchanged and reflects a broad range of outcomes. We will continue to our strategy to improve unit economics over the course of FY25, which may include additional changes in pricing, promotional strategy, or other levers available to achieve our financial target.

Any changes in these areas may affect our gross additions for paid connected fitness subscriptions across the fiscal year. Our full year guidance range for paid app subscriptions of \$550,000 to \$600,000, a \$20,000 reduction versus our prior guidance, reflects our decision to limit app media spend as we invest in product development to improve the member experience. Additionally, as we continue to improve our member experience, we see clear opportunities to improve engagement, which could result in favorability to churn for both connected fitness and apps.

While we are optimistic we can improve engagement through product and content innovation and evolving our marketing strategy, the timing of when we will start to see meaningful impact from these efforts is uncertain and therefore not reflected in our guidance. Our primary focus for FY25 is delivering our key financial results, which include total revenue, total growth margin, and adjusted EBITDA. We are prioritizing these metrics along with delivering free cash flow.

Our FY25 outlook for total revenue remains unchanged at \$2.4 billion to \$2.5 billion, as well as our outlook for total growth margin, which remains unchanged at 49.0%. We are raising our FY25 adjusted EBITDA guidance by \$40 million to \$240 million to \$290 million, which reflects our continued improvements in profitability, largely due to gross margin expansion, the

operating cost savings we expect to achieve related to our previously announced cost restructuring plan, and reduced media spend year over year. We are also raising our free cash flow target to at least \$125 million, an increase of \$50 million from our previous guidance, primarily from lower inventory production that we expect to create a greater working capital tailwind, as well as continued operating expense efficiencies. Following our Q1 free cash flow results of \$11 million, we do expect to achieve positive free cash flow in all four quarters of the fiscal year.

We expect to make meaningful progress in deleveraging our balance sheets throughout FY25 and beyond. And now I'd like to turn it back to Chris for some closing remarks. Thanks, Liz.

I want to take a moment to recognize the remarkable progress the entire Peloton team has made since I took on the role of interim co-CEO with Karen in May. In a relatively short time, I've seen us get smarter in many ways. We've made meaningful progress toward our goals of right-sizing our cost structure, improving unit economics, and innovating to drive long-term profitable growth.

And we are just getting started. So with today's announcement that Peter Stern will start as Peloton's next CEO and president in January, I will be stepping down as co-CEO effective tomorrow, November 1st. Karen has graciously agreed to continue as interim CEO of Peloton until Peter arrives.

It has been a great experience working with Karen, Liz, the lead team, and the many talented team members here at Peloton. I am very proud to be part of Peloton for the difference we make in millions of lives every day. And I look forward to staying very involved as a much smarter board director going forward.

Thank you for the time this morning. We can now open the line for Q&A. Thank you.

As a reminder, to ask a question, please press star 11 on your telephone and wait for your name to be announced. To withdraw your question, press star 11 again. Due to time restraints, we ask that you please limit yourself to one question and one follow-up question.

Please stand by while we compile the Q&A roster. And our first question will come from the line of Simeon Siegel with BMO Capital Markets. Your line is open.

Thanks. Good morning, everyone. Congrats on the ongoing progress and on the new announcement.

It's really great to see. So some really nice momentum here on the profitability trajectory. So Karen, recognizing I'm about to ask you something to speak on someone else's behalf, I guess I was hoping you could speak to how you think or expect Peter would approach the balance of growth and profitability.

I'm wondering, do you expect any actions that he takes will flow quickly once he starts? Do you think he's going to have a taking stock period? It seems like you've all done a really collective nice job on diagnosing the problem and you're already successfully affecting that plan to improve the free cash flow. So I'm just curious if we can assume that that continues or whether it's a wait and see and then we'll watch how Peter wants to approach the business anew. Thank you.

Thanks, Simeon. It's absolutely on our mind. It's absolutely the right question.

It's how we're going to balance profitability and growth. And it was frankly top of mind for the board as we were looking for the next CEO. Peter is the right CEO for this chapter.

He's a seasoned strategist. He's known for execution and he does have that strong track record of driving innovation and growth. I will pause and just say, I do think we've set the table for his rival.

Job one was refinancing the debt in May. We did that. We stabilized the balance sheet and it's put us in a much better position to manage our maturities.

And Liz has talked a lot about the progress on the executing, the restructuring, reducing inventory levels, focus on profitability to generate the cash flow to allow us to begin deleveraging. So we do feel like we now have that stable base upon which to grow. In the very near term, and I don't know how long this is going to last, but we have been managing an uncertain macro environment, an uncertain consumer backdrop.

There's been weather and hurricanes. We have a very intense focus on the election. So we've been focusing on what we can control.

I don't expect that to change under Peter's leadership. We've been very sure that we're not going to chase unprofitable sub growth and we've been much more disciplined with spend up and down the CNL. Our media and marketing investments have been much more thoughtful and we're optimizing our unit economics by product and by channel.

So those are the things that I do not expect to change where we're going to continue to monitor those and kind of see when it makes sense to turn back on some of the growth spending and more meaningful ways. But again, make no mistake that that's not kind of where the story ends. Innovation and growth are still very important to us.

It's an and, it's a both. We are making investments in content and product development, both software and hardware and marketing. Growth is important for this very important holiday period where we are unlocking marketing dollars.

And again, this is going to be a big part of, Peter's going to be a big part of this equation. He has the relevant experience. He has the track record and a large portion of his compensation is going to be designed to balance those and drive both profitability and growth.

So his incentives are well aligned with those goals. I think of course he's going to have, one of the things I love about him is he absolutely has a growth mindset. So of course I think he's going to have a taking stock period.

I think we want him to come in and learn what has worked, what has not worked before he just kind of, you know, fires before he aims and learns. So I do think there'll be a taking stock period. But I'm really excited about his arrival.

He is, I believe, the guy who is going to come in and set the strategy that is going to return us to growth. He's very bullish. We all are very bullish on the health and wellness space, the share of wallet that is going to go to this category.

So again, he's going to spend time learning. We will spend time aligning on where to go, how quickly to invest. And again, I do believe he's the right leader to return us to growth.

And I do believe strongly that under his leadership, our brand is well positioned to be a long-term player and the absolute leader in this category. As you can tell from Karen's remarks

there, she and I have been very involved in this process and with Peter in particular. And so we're very excited.

He's really aligned. All those conversations have been so positive. So we know we've got the right leader that's going to bring the right balance and focus on growth.

I'm going to say the excitement is resonating. So that's great. So thanks guys.

And then if I could just follow up quickly on that, maybe for Liz, a quick one. It's not a lot, but I think this is the first quarter of sequential inventory growth in a long time. So any help on the composition of that inventory, any way to frame what type of equipment is making up that increase? And I guess I'm asking it not as much for the number.

I'm just wondering if we should be reading into that as a signal that maybe you do see some uptick in demand ahead, or maybe it's the build for the new distribution partners, or am I just way off and it's not an event and it's just a function of maybe the lighter growth sides you mentioned. So any help on that inventory vis-a-vis the growth comment would be helpful. Sure.

So the question I believe is around our sequential growth in inventory into the first quarter. As we said during, it's pretty modest. It's pretty modest.

And it's really related to our seasonal buildup of inventory ahead of the holiday season. And we do expect a significant inventory tailwind on the full year. We've done some great work.

Our supply chain team has done some excellent work in working with our manufacturing partners to reduce our production levels over the course of the year to enable us to be a lot more efficient with our inventory over time, and reduce our days of on-hand inventory, which is great. And that will create a cash tailwind for us over the course of the year. In Q1, it's very slightly, but that's in relation to just the seasonality of buying ahead of the holiday season.

And we expect our inventory balances to come down over the course of the year. But we are just, to be clear, producing inventory for all of our products. So because we do need that inventory over the course of the year, but we do see it as an overall tailwind for us on a four-year basis.

Sounds great. Thanks a lot, guys. Best of luck for holiday, and nice job.

Great. Thank you. Thank you.

One moment for our next question. And that will come from the line of Kurt Nagel with Bank of America. Your line is open.

Good morning, guys. Congratulations on the solid quarters. This is Camunto on for Kurt Nagel.

This quarter, churn came in line at a seasonally high period. What are we factoring for the rest of the year? Would that be a stable rate compared to the last year for the remaining quarters? Sure. So first, let's take a step back.

Our business continues to benefit from very strong subscriber retention and low churn overall. In Q1, our average net monthly churn was 1.9%, which was relatively in line with last quarter. It was up 40 basis points year-over-year. As we discussed during the last quarter earnings call, we expected Q1 net churn to be up year over year due to a few reasons, including the following. Slightly worse overall retention from our 1P and 3P subscriber base, which we've talked about.

Next shift towards secondary market subscribers, which do have a slightly lower retention than our first party subscribers. And then we also had the impact of a one-time benefit in Q1 of fiscal 24 related to higher subscription unpauses following elevated pauses in Q4 of fiscal 23 related to our original by seat post recall. And we did not repeat that benefit this year.

As we move forward and look at Q2, we do expect our churn to improve seasonally compared to Q1. We do expect that improvement will likely be a bit muted though compared to quarter over quarter improvement that we saw in fiscal 24. Again, because of those two headwinds that I mentioned about the slightly worse retention in our overall subscriber base and that mixed shift into secondary subscriptions, which do have that higher churn profile.

So overall, for the remainder of the fiscal year, we expect our churn to continue to be higher year over year because of the mix of subscribers from the secondary market continuing to grow. But we do expect churn to remain below 2% for the whole of fiscal 2025. I do want to point out though, and we've mentioned this before, that our guidance doesn't assume any potential upside to subscriber retention as a result of the software innovation initiatives that Chris talked about earlier, which we believe could positively impact member engagement and ultimately retention over time.

And the reason we haven't incorporated those is because the magnitude and timing of those benefits is uncertain at this point. Great. Thank you.

Thank you. Thank you. One moment for our next question.

And that will come from the line of Brian Nagel with Oppenheimer. Your line is open. Good morning.

I too would like to add my congratulations on the business and your CEO announcement. My questions. So the first question, I've got two, I'll ask them in order.

Just on the balance sheet, you talked in your prepared comments about 25 being a de-leveraged year. So I guess the question I have there is maybe you can go into a little more detail. Clearly the business now from the P&L standpoint is much more stable, you're generating cash flow, but are there any specific steps you can identify here to address the balance sheets in particular, the debt that remains on the balance sheet? Yeah, this is the, I'll take, I'll start that one off and then focus on that on top.

So first of all, Karen mentioned earlier that we de-risked our balance sheet with the refinancing in May, and that allows us to now be very focused on de-leveraging over time. And we're also very excited to be talking about the positive free cash flow and also raising our minimum free cash flow target. We are being disciplined with the level of investments that we're making and that goal, the goal there is to set us up for future growth that is sustainable and profitable.

And so as a result of generating that meaningful free cash flow, we do see the opportunity to meaningfully de-leverage going forward. That means we're going to continue to improve our adjusted EBITDA and then continue to generate that positive free cash flow. And when we do that, we will naturally de-leverage.

We also see over the course of time, real interest cost savings with rate step downs when our leverage ratio falls between below five. And then eventually there's also the potential conversion of our 2029 five and a half percent convertible notes. So our balance sheet is in a much better position than it's been in the past.

We've lowered risks, we've positioned ourselves well for sustainable and profitable growth now, and we also see the ability to strategically reduce our growth set over time. And we will be strategic about that, but we don't have anything to share regarding a definitive capital allocation framework for how we're going to execute that at this time. Did you have a follow-up question? I did.

Thank you for that. And my follow-up question is unrelated, but I guess somewhat bigger picture too. It may be a little, it's probably a better question as your new management team takes place.

But if you look at the business, I'm looking at the business, one of their positives has been the ability of Peloton to really maintain that core base. And you talked to us a few minutes ago about moments ago about you're, you're still very low churn, but as you're watching the business and if you stabilize the business, are you, are you finding, or is there anything you could help us with as like where you're finding those incremental pockets of new demand, those new customers that could come into the Peloton system? Yeah. And hi, this is Chris.

That's a great question. And I think it goes straight to the kind of discipline that we've been talking about in marketing. A key part of that is who are you reaching, you know, and what's the opportunity and what's the message and how are you doing that efficiently? And I think we've had some really great success just recently in focusing on men.

You know, in the preparatory market, we talk about two thirds of our current members are women. And so now we're, you know, we're targeting the male demographic in our advertising. We've done more buys during NFL games.

We featured the Watt brothers. But more importantly, the, the campaign and the work that we're doing is expanding our reach. And we're seeing in the data that there's a shift toward men in new hardware purchases and with the greatest shift within that in the TRED and TRED Plus products.

So we feel really good about that. And it's just an indicator of the way we're thinking about the marketplace now, which is targeting, as you said, targeting those discrete pockets and then being efficient and effective in the way that we're reaching them. I should point out that here in November, we're going to, we're going to be holding a lot of member gratitude events and messages.

And that's another core part of this, you know, activating that incredibly loyal base to refer and engage their friends and family to bring them into the Peloton experience. You're going to see us do a lot more of that. Very helpful.

I appreciate it. Thank you. Operator, next question, please.

One moment for our next question. And that will come from the line of Nathan Feather with Morgan Stanley. Your line is open.

Hey everyone, thanks for taking the question and really encouraging to see the progress on profitability. You know, as you think about how to drive sustainable, profitable growth, it's interesting to hear how you're thinking about where physical retail fits in as a component of go-to-market, especially given the Costco launch. Do you see some portion of the customer base who are more willing to convert in person than online? And then reflecting on the own stores, let's just say here where you see the potential to improve performance versus the prior format.

Thank you. Sure. This is Karen.

So on retail in general, I'd say we are still on the path to close some of the underperforming retail stores. That said, we will have them this holiday season. So the team has put together some really thoughtful activations in a subset of those stores to bring instructors and magic and excitement to them to make sure they're not, you know, they're still representing the brand well and we can, you know, engage with our members and new customers and have some excitement around those spaces.

We are testing to the point on how we might reimagine it. We're testing a smaller micro store concept in Nashville. So it's a way to do it in a lower capital, lower payroll, lower square footage, but still have a physical presence.

It's also the reason why we are exploring additional 3P locations like Costco. We're hoping that reaches an incremental audience. We have, we're so excited about, you know, a lot of people shop on Amazon.

We're happy to be there and trust Amazon with, you know, they're just, that's part of their daily routine. And then we still have the exporting goods. Internationally, 3P is important too.

And it's a much more capital efficient way for us to roll out. So retail, I would say is in the reimaged process. It's not going anywhere.

It's just, we're going to kind of optimize the mix between 3P and 1P and make sure that it makes economic sense and reaches as many new incremental buyers as possible. Great. That's helpful.

And then A, given the more flexible international model you talked about in Germany and Austria, interested to hear how you're thinking about potential further international expansion and is distribution the primary constraint to growth or is it more on the localized content side? Sure. So international is still another important part of the long-term growth strategy for us. It's just a matter of prioritization and sequencing.

I do think we've made some very important steps. Germany is the example where we are entirely 3P now. So in order to do that and do that profitably and effectively, we had to make some pricing changes.

We need to make sure there's sufficient margin for that third party to have some margin and it still makes economic sense for us to do so. So now we have a couple of different models and we can test and see which ones. We're still learning what makes sense and how much to invest as we roll it out.

But it's not, there's not one limiting factor. It's just how do we want to sequence and prioritize the various investments. But I would say we're really excited about the way the international model has taken shape.

Again, both with the way we've taken some of the investments on the people side and centralized those. And then also with the pricing, it's just a better go-to-market strategy. So we will expand over time.

We have no new plans to talk about markets right now. So that's something that as Peter gets onboarded, we'll evaluate additional investments in current markets and or new markets we want to go into over time. But it's still a very important part of the long-term strategy.

And it's not really so much about barriers as it is about, as we're thoughtful about our priorities, we have to be thoughtful about making an experience that meets the bar. And so the content does have to be relevant and localized. And so you're going to see us be thoughtful about that.

And if we're expanding international markets, we're going to do it in a way that we're proud of. Great. Very helpful.

Thank you. Thank you. One moment for our next question.

And that will come from the line of Shweta Khajuria with Wolf Research. Your line is open. Hello.

Can you hear me? Yes, we can hear you. Okay. Thank you for taking my question.

I guess, could you please talk about how you came to the decision with Peter? As a CEO, it seems that he has phenomenal experience, especially as it relates to Apple Plus or fitness experience with Apple, which is translatable. But as you were going through different candidates, what specifically about Peter do you think will jump out as he comes on board? Thanks a ton. Sure.

Well, I couldn't be more excited. This is a fun one to talk about. Peter just really hits and checks a lot of the boxes that we were looking for.

As you mentioned, his experience, not just the Apple Fitness Plus, but really he has a ton of breadth of experience across hardware, software, and content businesses, across services. But he's also had a lot of experience driving growth through innovation. And that's where we are in our journey.

As we kind of talked about, we have the stable base. We now need to return to growth. And I also just really believe he's highly aligned with Telecom's core values.

He has been a member for eight years. He loves what we're doing. He loves health and wellness as part of his own routine and his own regimen.

So, I think he believes in the product. He believes in the space. He has this perfect skill set and experience set.

And I just think he's going to be a great fit. So, we're just really, really excited to get him started. Hard to add anything to that.

I will just say, on a personal level, he's thoughtful. He's considerate. He's going to definitely bring an approach to learning, which I think is excellent.

And he deeply appreciates what Peloton has done. And he's excited about helping to lead the next chapter. Thanks, Shreya.

Next question, please, operator. One moment for our next question. And that will come from the line of Andrew Boone with JMP Securities.

Your line is open. Thanks so much for taking my questions. I wanted to double-click on the reduction in marketing this quarter.

Can you guys talk about the learnings, as you guys did pull back there, and what may be incremental? And then, as we think about that 2 to 3x kind of LTV to CAC target, can you guys

talk about the path back into that framework? And then, for my second question, is I'd love to double-click in terms of connected fitness, gross profit margins. You guys have seen steady improvement there. Is that kind of the ceiling, or do you guys feel like there's more progress to go? How does that move into a step function that may be in the double digits? Thanks so much.

Yeah, I mean, I'll start. And then, Liz, you can chime in, I think. I would say the word at the top here, as it relates to marketing, is discipline.

And I talked about it in the Q&A, but effective audience targeting, being effective in the way that we're optimizing our investments, the way that we're focused on the entire marketing picture, including the retention and engagement of our existing members. These are kind of the key hallmarks of what Lauren Weinberg, our CMO, has brought in this last year to Peloton. We've gone from being promotion-heavy to a place where we're now balancing demand creation and desire with those moments where we can capture demand through conversion events and promotions and fusel opportunities like we have coming up in the holiday.

And then, you see it in the numbers. We significantly reduced our customer acquisition costs. We've become much more disciplined in our media spending and a lot more focused on where are those qualified growth audiences.

So, all of these areas, I'm really impressed with what Lauren and her team have done and the way they, I think, set up Peloton as part of this broader effort at the company to create a solid foundation of sustainable and profitable growth. So, yeah, you can expect that to continue. So, on the question around the LTV/CAC and the path back to getting to that 2 to 3x, so, you know, our goal is to get to that 2 to 3x range, ideally closer to 3. We do have some work to get there.

We're not quite there yet. And we have these near-term levers that we are focused on that are under our control. And then, as Chris was talking a lot about investing in future growth.

So, the pricing changes that we've made and the reduced promotional activity that you saw in Q1 are ways for us to improve our growth margins. So, we made progress on those in Q1. And as we go into Q2, we will still have promotions over the holidays.

But we will continue to make progress on our LTV by improving our growth margins over time. And ultimately, our goal is to get to where we have significant positive growth margins across all products, all channels, and all markets. The other piece is around our CAC, which, you know, Chris was talking about.

That's really about the discipline, not overspending to acquire unprofitable customers, and then also evolving our messaging to target those audiences in order to drive that efficiency. And then we also have, in addition to kind of the working media dollars that we invest in marketing, we're also focused on those non-media costs that do hit our sales and marketing and impact our CAC. And that includes things like exiting retail showrooms, which Karen talked a little bit about earlier, optimizing our brand and creative spend, and also optimizing our headcount.

So, we've been focused on all of those things. Now, I think the last part of your question was around connected fitness growth margin, and do we have the ability to make more progress? We certainly have the ability to make more progress over time. Again, we're really focused on the things that we can control, and you're seeing some of the progress there manifest.

And then, you know, we will do the right thing in terms of LTV to CAC, and if it does make sense to invest a bit more in the LTV side of the equation relative to the CAC side of the

equation, we will continue to make those tradeoffs as we go. But our goal is to continue to drive improvement in gross margin because that helps us fund our CAC and create a lot of that efficiency that we're looking for. You know, our holidays are an example, seasonally higher demand.

We will be spending on media in that quarter, and that will drive growth into the future quarters, and we will also be spending on promotions in that quarter. One other thing I want to mention is that pre-core does fit within our connected fitness segment, and it's accretive to our connected fitness gross margin overall. So, as the pre-core business grows, that will also drive higher connected fitness margins over time.

And the connected fitness margin. Okay, next question, please. One moment for our next question.

And that will come from the line of Douglas Anmuth with J.P. Morgan. Your line is open. Great.

Thanks. It's Brian Smiley for Doug. I guess just as you enter the holiday season, can you just talk about which go-to-market channels and initiatives are key to just driving improving seasonality and higher hardware sales? And then, I know we've talked about it in the past, too, but can you just provide an update where the industry is in the overall cadence of return to growth and rate of decline? Thanks.

I'll take the holiday question. Yeah, thanks for the question. I mean, we're entering the holiday season with cautious optimism.

I think we talked about macroeconomic factors that are out of our control, but we're focused on things that are within our control. And I'm just going to be a broken record. You can expect us to spend in a disciplined way.

We'll spend less on media this year. We'll be less promotional than we were in our holiday season last year. And we will continue to manage our LTV to CAC ratios in the right way.

But we're excited about, as I mentioned, ways of getting existing members engaged and involved through referrals, the way we're targeting pockets of growth, and about new third-party relationships like the one we just discussed today related to Costco. So when we can do things like have our Bike Plus available with special bundled pricing and extended warranty like we're doing at Costco, that's another great opportunity. So we have a strong plan, we're prepared, and I think we're going to focus well this holiday season.

I think the last question was a bit about the connected fitness industry overall. So we do track with third-party data, so market share data around connected fitness and market share trends. Our data suggests that the overall fitness markets declined around two percent year-over-year in Q1.

We're seeing that gyms are settling into a new normal, growing around three to four percent year-over-year in the last couple of quarters, compared to eight to nine percent year-over-year growth that they were experiencing in Q1 and Q2 of fiscal 24. For the connected fitness hardware sales piece, sales overall are continuing to decline year-over-year, so gyms are still taking a bit of share. However, we are such a large part of the connected fitness market that the decisions that we are making to prioritize profitability are certainly impacting this trend.

Some of the other things that we're seeing are, you know, there are macroeconomic factors like the impact of inflation, interest rates, and uncertainty around the upcoming presidential elections that could be playing into overall connected fitness hardware sales in general. And

then, you know, so just for us, you know, we're focused on the things that we can control, which is really focusing on sustainable and profitable growth and then ensuring that we create the best possible experience for new and existing members that join our Peloton community. Thank you.

Operator, maybe we have time for one last question. And that will come from the line of Eric Sheridan with Goldman Sachs. Your line is open.

Thanks so much for squeezing me in. Maybe just one question on content. You know, as you continue to sort of build learnings around the business and think about where the strategy is going to go over the medium to longer term, as Peter joins, how do you think about the right levels of investment in content, duration around content, and the role that content can play in continuing to drive sort of end demand on the user side and engagement and sort of conversion metrics over the medium to long term? Thanks so much.

Yeah, thanks. Well, I mean, content is absolutely at the very center of our experience. And our instructor-led content is, you know, the hallmark of what makes for a great Peloton experience.

So we're going to continue to invest there and to innovate. We've done some really interesting things just in the last quarter around bringing new hiking and walking experiences to the treadmill, walking boot camps. We're doing some programs around taking walks after meals, which will be relevant as we approach the Thanksgiving holiday.

So there's lots still happening in that space. We talked about All for One and the music partnerships that we did there. It has been and will continue to be an area that's, you know, incredibly important to us.

And yeah, and I think, you know, that will continue. Just going to add one more thing. We are also investing in non-class-based content, too.

So in our entertainment offerings, in our gaming-inspired fitness experiences, which we're leaning into. And so we're, you know, we're seeing the opportunity to expand beyond our core our incredible instructor-led workouts, which we have all these modalities. And Chris was talking about some of the new ones that we've added that we really think are going to be value-added, but also those non-class ones that we are seeing gain some interest and traction.

And we think we'll be able to drive engagement over time, which, again, if our subscribers are engaged, then they stick with us. And we've seen that time and time again, and we want that to continue. Thank you.

I would now like to turn the call back to Ms. Karen Boone for any closing remarks. Thank you, Operator. Before we end the call, I just wanted to thank Chris for all the leadership he has brought to the business over the last six months, driving our teams toward innovation and reinforcing a members-first mindset during this period that has been a lot of transition and a lot of change.

I've been really lucky to have him as my partner over the last six months in our interim co-CEO role, and we're very lucky to have him return to the board and benefit from his experience and insights going forward. I will continue the role of interim CEO through the end of the calendar year before handing the baton back to Peter in January. And Chris and I will both be actively involved in ensuring a smooth and successful transition.

I really couldn't be more excited to get Peter on board. In addition to the depth of experience he brings, he really has such a great respect for the many passionate team members who work

to bring amazing experiences to our members every single day. And I know he brings a growth mindset and curiosity to learn all about the business.

He's going to bring a fresh perspective as we continue on our path to deliver sustainable and profitable growth. And lastly, I'm so proud of the Peloton leadership team, the many passionate and purpose-driven team members who are devoted to Peloton success. All the hard work and progress has really set us up to continue to deliver on our goals as we enter the next phase of Peloton's journey under Peter's leadership.

And we truly can't wait to welcome him to the team. Thank you and happy holidays. This concludes today's program.

Thank you all for participating. You may now disconnect.