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PTON.OQ - Q3 2021 Peloton Interactive Inc Earnings Call

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OVERVIEW:

Co. reported 3Q21 total revenue of $1.262b and net loss of negative $8.6m or $0.03 per basic and diluted shares. Expects 4Q21 revenue to be $915m, and full year 2021 total revenue to be $4b.

REFINITIV

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PRESENTATION

Operator

Greetings, and welcome to the Peloton Interactive Third Quarter 2021 Earnings Call. (Operator Instructions) This conference is being recorded Thursday, May 6, 2021. And now I'd like to turn the conference over to Peter Stabler, Head of Investor Relations. Please go ahead.

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

Thanks, Scott. Good afternoon, and welcome to Peloton's Fiscal Third Quarter Conference Call. Joining today's call are John Foley, our Co-Founder and CEO; President, William Lynch; and CFO, Jill Woodworth.

Our comments and responses to your questions reflect management's views as of today only and will include statements related to our business that are forward-looking statements under federal securities law. Actual results may differ materially from those contained in or implied by these forward-looking statements due to risks and uncertainties associated with our business. As a reminder, our question-and-answer session during today's call is for our covering analysts only. For a discussion of the material risks and other important factors that could impact our actual results, please refer to our SEC filings and today's shareholder letter, both of which can be found on our Investor Relations website.

During this call, we will discuss both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP financial measures is provided in today's shareholder letter.

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

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

Thank you, Peter. Good afternoon, everyone. Thank you for joining us today. I want to start by giving you an update on recent events regarding our treadmill products. As a company, we believe strongly in the future of at-home connected fitness, and we know we have a responsibility to be an industry leader in product safety. We are a Members First organization, and that means for all of us at Peloton, the safety of our Member Community comes first.

I want to be clear, though, Peloton made a mistake in our initial response to Consumer Product Safety Commission's request that we recall our Tread+ product. We should have been more open to a productive dialogue with them from the outset. As a Members First organization, promptly stopping the sales of our products while we cooperated more closely with the CPSC was something we should have considered sooner. For that, I apologize.

Given our goal of being the largest and safest home fitness brand in the world, yesterday, we took an important step initiating voluntary recalls and stop use directives for our Tread+ and Tread products in collaboration with the CPSC, the Consumer Product Safety Commission. That was the right decision at this time. We are working to build and introduce even more safety measures and to help set new industry safety standards for all treadmills. We want to provide a safe, world-class fitness experience for our members, people who want the convenience and value of being able to work out from home. Specifically, our voluntary recall involves immediately stopping sales of both products in all markets where they were available. We will also postpone the launch of Tread in the U.S., which was previously scheduled for May 27.

With regard to the Tread+, our work with the CPSC involves building an extra layer of safety features for that product. This will include a digital pass code that will further protect against unauthorized use, a feature that we expect to deploy via an over-the-air software update in the coming days. We will be working hard in the coming weeks and months to develop additional physical hardware to further enhance the safety of Tread+. We will, of course, share details as we develop a plan and a timeline for these additional safety features, but bear in mind that hardware features take time to develop, test and manufacture, and in this case, the CPSC will need to approve our proposed enhancements.

With regard to the Tread, which is our new lower-priced treadmill product that features a low profile traditional belt design, we are also temporarily stopping sales. As a reminder, this product was only available in Canada and the U.K. and as we have stated previously, we have been pleased with the reception and reviews. In addition, a small number of Tread units were made available to select U.S. members over the past few months in a controlled rollout to gain additional insights and feedback on the product ahead of launch.

While the new Tread has been well received, there have been some minor quality issues related to how the tablet console is attached to the Tread. The console or touchscreen attaches to the Tread with screws. In a handful of cases, we have had reports of the screws loosening, causing the console to detach from the unit. We notified the CPSC and the safety regulators in the U.K. and Canada last week about this issue and we'll be working with them to review our proposed solution. We expect to offer the Tread for sale as soon as the CPSC's full review of the product is completed. While this process typically takes 6 to 8 weeks, it could take longer, so we can't offer an on sale or revised launch date at this time. In the meantime, we will continue to produce the Tread -- we will -- sorry, we will continue to produce Tread content in anticipation of our Tread launch as well as to support our nearly 900,000 Digital subscribers. The pass code we are developing for the Tread+ will also be released on the Tread by the end of the fourth quarter of fiscal 2021.

As the largest home connected fitness brand in the world, we want to be leaders in safety. Our goal is to have the best safety features for treadmill products on the market, the most engaging content from our roster of world-class fitness instructors and the most innovative software that unites our community. While there will be a short-term financial impact due to the steps we're taking, we are putting and will continue to put our members first. In a moment, Jill will review how these actions are expected to impact our financial outlook for Q4.

Now turning to some other recent announcements. On April 1, we officially closed our purchase of Precor. The Precor team adds greatly to our already talented supply chain, manufacturing and R&D teams. In addition, we expect that Precor will help us significantly grow our commercial opportunity in hospitality, colleges and universities, corporate campuses, and multi-unit residential buildings. To our Precor teammates, a hearty welcome. We're thrilled to have you join us.

The integration process with Precor is advancing according to plan, and we look forward to offering you updates in the future as we refine our go-to-market strategy. And to be sure, we continue to expect to produce Peloton products, both bikes and treads here in the U.S. by the end of this calendar year.

We are also excited to share some great new features announced at our virtual homecoming celebration last weekend. As many of you know, homecoming is our annual member community event with this year's event bringing together over 200,000 Peloton members for a 3-day weekend featuring special live classes and community discussions. Newly announced features include a major expansion of Peloton programs, which are guided fitness programs designed to help members stay on track to achieve specific fitness goals with weekly progress reports. We also launched Strive Score, which is a personal noncompetitive metric based on your heart rate. Using a compatible heart rate monitor, Strive Score gives you credit for all the work you do with Peloton even when you're off the bike or off the tread engaged in floor-based exercises.

With many members taking scenic rides and runs, we are also very excited to announce a major upgrade to our scenic experiences.

And finally, we will be introducing a pause button for our on-demand classes, one of the most member-requested features for years. We know sometimes life's other duties intrude on your workouts. And while maintaining the integrity of the leaderboard, members will soon be able to pause the workout and seamlessly pick up where they left off.

Member reception of these announcements has been great, and we're hard at work building more features to motivate and delight our member community. In fact, from a hardware, software and content standpoint, we've never been more excited about our future road map. Fiscal year 2020 (sic) [2021] is going to be a year of major innovation for us.

Now I'll hand it over to Jill to review our financial results and updated outlook.

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

Thanks, John. I will start with a review of our third quarter results. In Q3, we generated total revenue of $1.262 billion, representing a 141% year-over-year growth, exceeding expectations across all geographies. The primary drivers leading to our revenue outperformance versus guidance were significantly higher deliveries than expected, particularly for Bike, meaningfully better-than-expected churn, lower-than-anticipated financing rates, and strong accessory sales.

Last quarter, in order to reduce wait times for our products, we announced substantial incremental investments in expedited shipping of our products from Taiwan. Today, we're pleased to report that we have made significant progress. Wait times for our original Bike are back to pre-pandemic levels of 1 to 3 weeks. Wait times for our Bike+ are also coming down and should get to the same place as Bike by the end of Q4.

We added a record 414,000 net connected fitness subscriptions in the quarter, bringing our end of quarter connected fitness membership base to 2.08 million, up 135% year-on-year. Our better-than-anticipated net adds were driven by our expedited shipping investments, which accelerated Bike and Bike+ deliveries. Net adds were also helped by our low average net monthly connected fitness churn of 0.31%, the best we've seen in 6 years. Our record low churn is due in large part due to the efforts that we all make at Peloton day in, day out to drive engagement.

In Q3, we averaged 26 monthly workouts per connected fitness subscription versus 17.7 in the year-ago period, an increase of 47% year-over-year. Our remarkable workout growth is being driven by our differentiated world-class instructors and content, the continued introduction of new modalities of fitness, and ongoing software enhancements such as sessions, stacked classes and most recently, the rollout of our class scheduling features.

As a reminder, prior to the COVID-19 pandemic, Q3 historically represented our highest engagement quarter of our fiscal year. So we expect typical seasonal patterns to reemerge as we come out of COVID and enter warmer summer months.

As with recent quarters, we saw particularly strong growth when it comes to our strength classes, which again posted the highest year-on-year engagement growth of any of our floor-based modalities. As of March 31, switching gears to Digital, we had 891,000 Digital subscribers at the end of Q3. We're thrilled with the growth of Peloton Digital. We can think of no better way to introduce fitness-minded consumers to the amazing quality, breadth and depth of our content offering.

During the past year, we've dedicated more resources to building a powerful Digital to connected fitness upgrade path, and we are currently driving the highest monthly upgrade rates we have ever achieved. Trends suggest our new Digital cohorts will likely upgrade to connected fitness membership at a significantly higher rate than the 10% figure we've discussed in the past. As a testament to this progress, we're now seeing over 20% of our Digital subscribers ultimately upgrade to connected fitness, and that number continues to increase. As our Digital membership base grows, we expect our improving upgrade rates to become an increasingly large driver of our connected fitness sales.

Moving to gross margin. Gross margin for the quarter was 35.2%, in line with guidance. Connected fitness product gross margin was 28.4%. The biggest driver of our margin compression over the last -- over last year was the outsized onetime shipping investments we discussed last quarter to reduce our order to delivery time frame. In addition, we had margin compression due to our September 2020 price reduction of our original Bike and a modest impact from mix shift of sales to our treadmill products.

Subscription gross margin was 64.6% and subscription contribution margin was 68.4%, ahead of expectations as we continue to leverage fixed costs associated with content production.

Please note that in Q3, we saw a onetime benefit of approximately 350 basis points associated with reserve adjustments and the reclassification of certain costs to operating expenses. Total operating expense, as a percent of revenue, was 36.3% compared to 58% in Q3 last year. Our strong sales growth drove significant operating expense leverage in the quarter, and we also benefited from a shift of some marketing investments into Q4.

Sales and marketing expense represented 16.5% of total revenue versus the prior year period of 29.5%. We resumed marketing in the second half of the quarter, and we continue to ramp in Q4, given our improved OTD position.

G&A expense was 14.3% of total revenue versus 24.2% in the prior year. We leveraged expenses even while continuing to make significant investments in our teams and systems.

R&D expense was 5.5% of total revenue versus 4.3% in the year ago period. We will continue to prioritize investments in R&D as we build best-in-class hardware and software teams, both organically and through acqui-hires.

With better-than-expected sales and operating expense leverage, our fiscal year '21, Q3 adjusted EBITDA was $63.2 million, representing an adjusted EBITDA margin of 5%.

As I will discuss in a moment, most of the outperformance relative to our $10 million adjusted EBITDA guidance for Q3 was due to the pull forward of deliveries that we had expected to make in Q4. Net loss for Q3 was negative $8.6 million or a loss of $0.03 per basic and diluted share.

Lastly, we ended the quarter with $2.7 billion of liquidity and have additional liquidity in the form of an untapped $285 million credit facility. As a reminder, our balance sheet benefited this quarter from approximately $900 million in net proceeds from our convertible note offering completed in February.

Now on to our outlook. With the recent developments John mentioned with the Tread line, it is more difficult than usual to predict our financial results. But based on what we know today, we are updating our Q4 outlook. Our revised revenue guidance for Q4 is $915 million. We estimate the revenue impact of the Tread and Tread+ recall will be approximately $165 million.

The breakout of this impact to revenue is as follows: 1, we currently estimate that ceasing Tread and Tread+ deliveries will negatively impact revenue in the quarter by approximately $105 million; 2, we are offering both Tread and Tread+ members the ability to return the product for a full refund. We currently estimate an increase to our return reserves for this in Q4 of about $50 million. And lastly, 3, we will continue to produce Tread content, as John mentioned, and in conjunction with the Stop Use Directive, we will be waiving monthly All-Access subscriptions for both Tread+ and Tread members for 3 months. We estimate that this will impact subscription revenue by approximately $10 million in Q4.

Here are a few additional drivers of revenue guidance for Q4. We mentioned previously that we reduced our delivery backlog more than expected in Q3. And as a result, we pulled forward approximately $125 million of revenue that we had expected to fall into Q4. And secondly, we closed Precor on April 1, and so Precor will be consolidated in our Q4 financials. Our Q4 revenue estimate includes $60 million of Precor revenues.

In the context of these events and also the continued reopening in the U.S., we thought it would be helpful to offer some overall commentary on our Bike sales outlook. As anticipated, Global Bike and Bike+ sales have been tapering from COVID highs, and we're expecting a gradual return to historical seasonal sales trends. However, our unit sales remain significantly higher than pre-COVID levels. We expect Global Bike and Bike+ unit sales in Q4 fiscal '21 to be over 3x higher than they were in Q4 of fiscal '19, 2 years prior. This continued robust growth of Bike sales is the result of the benefits of our better, best Bike portfolio strategy, including our Bike price reduction last fall.

Our international business is growing at a faster rate than the U.S. Our scales and member -- scale and growing member base driving continued strong word-of-mouth and, of course, the resumption of media spend. We believe all of this sets us up very well for continued strong Bike portfolio growth in fiscal '22.

We have ramped media investments in recent weeks, coinciding with our greatly improved order-to-delivery outlook. After a long period of little-to-no marketing activity, we are very eager to build on our connected fitness leadership position. And this is particularly important as our demographic profile of our membership base continues to broaden.

With our revised Q4 revenue outlook, we now expect full year fiscal '21 total revenue of $4 billion, inclusive of the contribution of $60 million from Precor. For fiscal year '21, expected ending connected fitness subscriptions is $2.275 million, consistent with our prior guidance, taking into account our estimates of returns for Treads and Tread+. For Q4, we expect average net monthly connected fitness churn under 0.85%. This is an increase from Q3 due to typical seasonality observed in the warmer months of the year. Please note that our churn estimate excludes the impact of expected churn from those members who return their Tread or Tread+ as well as the impact of the subscription waivers.

Moving on to profitability metrics in Q4. We expect Q4 gross margin of approximately 35%, comprised of a connected fitness product gross margin of approximately 21% and a subscription contribution margin of approximately 68%. We expect connected fitness gross margin in Q4 to be impacted by the following unusual items. As part of the recall, we will incur logistics costs to pick up returned Treads and Tread+. We have also offered our existing Tread+ owners the option to have us move the Tread+ to another room within their homes. These costs, combined with the increase in return reserve, are expected to reduce connected fitness product gross margin this quarter by approximately 900 basis points. A portion of these costs will also impact operating expenses.

The second item is expedited shipping. In the quarter, expedited shipping investments are driving year-on-year deleverage of our connected fitness product gross margin as well. The port congestion issues we have discussed on recent calls remain acute, and we are recently -- we have recently allocated an additional $15 million in expedited shipping expense to our Q4 plan, in part due to the Suez Canal blockage. Based on our current forecast, we do not anticipate meaningful expedited shipping expenses in fiscal '22.

Lastly, I'll note that connected fitness margins continue to be impacted by the September 2020 price reduction of our original Bike.

Moving on to subscription margin. We expect a subscription contribution margin of 68%. We continue to expect leverage against our fixed costs associated with content production, but the onetime tailwinds in Q3 that I previously discussed are not anticipated to return in Q4. Over the long term, we continue to expect our subscription contribution margin to exceed 70%.

Turning to operating expenses. Our planned sales and marketing spend in the back half of the fiscal year is now weighted to Q4. This is due to a shift in timing of media and production spend. For fiscal year '21, we continue to expect sales and marketing expense to be materially lower as a percent of revenue when compared to fiscal year 2020.

With regard to G&A, we've accelerated some of our systems and people investments, primarily in supply chain and member support functions. Given the lower revenue expectations in the quarter and the increased spend, we expect G&A to be greater than 20% of revenue, but continue to expect significant leverage in G&A in fiscal '22.

We also continue to invest heavily in R&D and have accelerated certain product development costs, including through engineering acqui-hires. With these investments in people and technologies, they will deleverage our R&D expense base, but they will accelerate the development of new products and features. The increased spend combined with the lower revenue this quarter will result in R&D reaching nearly 10% of revenue.

For adjusted EBITDA in Q4, we now expect negative $60 million, including Precor adjusted EBITDA of negative $5 million. Adjusted EBITDA will be negatively impacted by the loss of sales of Tread and Tread+ for the remainder of Q4 and the loss of revenue from subscription waivers. We estimate these items combined will negatively impact Q4 adjusted EBITDA by approximately $16 million. All other costs associated with the recall will be excluded from adjusted EBITDA, such as the increase to the return reserve, Tread inventory write-downs, the logistics costs associated with refunds and moves, and the subscription waiver cost of service.

This all represents a revised guide for adjusted EBITDA of approximately $240 million for fiscal year '21. We have done our best to provide our current estimate of the impact to Q4, but obviously these impacts are subject to change.

I will now turn it back to John for some closing comments.

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

In closing, I'd like to reiterate that the safety of our Member Community is our first priority. And through working with the CPSC and others, our aim is to have the safest products on the market while delivering the best experiences in value and fitness. We will be working diligently against these goals, and we remain optimistic about our business, strategy and team, short, mid and long term. The underlying growth of our scale Bike business is bringing thousands of new connected fitness members onto our platform daily, building a community million strong that is arguably our greatest asset.

We will continue to innovate for our Member Community, and we're particularly excited about our fiscal year '22 road map, when we plan to introduce new hardware, software features, languages and content, and all the goal of providing the most comprehensive connected fitness and Digital membership experiences in the world and driving ever-increasing engagement among our members.

Of note, there were 171 million total platform workouts during Q3, a 258% year-on-year increase. This engagement leads to industry-leading retention levels, and most importantly, a happier and healthier community, now numbering over 5.4 million global members.

I will now turn it over to the operator to take your questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Doug Anmuth with JPMorgan.

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

I have 2. First, John, just hoping you could talk about what impact the recalls may have on Bike and Bike+ sales and demand? I mean we have obviously the 4Q numbers, but as you look into fiscal '22 a bit as well. And then just secondly, if you could talk more about the process to get Tread to market in terms of repairing existing kind of built up Tread inventory, making the changes in manufacturing and then also getting approvals as well?

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

Doug, it's Jill. I'm going to take the first question on Bike. I think as we said on the prepared remarks that our guidance for Q4 certainly embeds our thoughts on the impact of the recall on Tread. And so we do -- we have baked in some modest impact to Bike and Bike+ sales, but we think that will be temporary, and we don't think there will be any long-lasting impact. And I think, as I outlined, we're still predicting unit sales in Q4 to be 3x what they were -- more than 3x what they were 2 years ago. So we -- obviously, last year was a big comp. It was the first few months of COVID. But that type of growth over a 2-year stack, we're pretty excited about, and we believe that, that can continue into fiscal '22.

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

And Doug, let me break out the second question with respect to Tread to make sure that everyone on the call understands that there's 2 very distinct products, and it's the Tread+ and the Tread. The Tread+ is the more expensive Tread that we've been selling here in the States for a couple years. And that is the Tread that we are working with the CPSC to get a couple different fixes in. I talked about the software fix that's going to allow us to have a code that will help prevent misuse. People, who -- call it, kids who shouldn't be on the Tread, won't know your pin, won't be able to start the Tread. So that's the first -- that's the start that should -- that fix should go out in the next couple of days to all Tread+. But we won't get that product back in the market, and we won't take the suggested stop use off until we get what we're calling a hardware fix, something more robust that would go to, call it, the back of the Tread that would physically keep objects from getting under the Tread. I don't want to talk too much about it. There's a lot of different R&D as we look at it. And then we have -- once we get a plan and propose solutions, we have to work through the CPSC to make sure that they're okay with it. So that could take months, and it's going to take some time.

The Tread, which is the low profile, lower priced product that we've been selling in the U.K. and Canada with great reception and great Net Promoter Score, great reviews, is something that we think could be on a -- hopefully, a more accelerated time line with potentially just improving the screws and/or locking washers or we have a couple of different solutions to make sure that the screws don't come out of the console and that, that is a -- the product quality is improved. We're already in people's homes in the U.K. and Canada, securing their screen, so that they don't -- so that they're more -- the stronger attachment.

And here in the States, we're excited. Hopefully, I alluded to in my pre remarks, but if you think about the CPSC potentially turning around a solution that we would present to them within, call it, 6 to 8 weeks, we're optimistic that -- or we're hopeful that in early Q1 of next year, we'll be able to bring the Tread to market -- the lower-priced Tread to market here in the States with their approval.

So I just want to make sure everyone understands, there's 2 separate products, 2 separate issues. I think the Tread will be coming back to market much sooner than the Tread+.

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

And sorry, just to clarify, when you say early 1Q, because you're obviously on a different fiscal, you mean your fiscal second quarter. Is that what you're saying?

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

That's right. That's right. It would be -- early Q1 would be hopefully July.

Operator

Our next question is from the line of Ron Josey with JMP Securities.

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

Just maybe following up on Doug's question real quick and very helpful, John, with the additional commentary. Any changes to your manufacturing process that you're thinking of when you add maybe that additional hardware to the back of the Tread that just might take a little time, as you think about it -- as we think about just the newer manufacturing processes that Peloton has done this past year? And then -- that's question number one.

And then maybe the second question, Jill, you talked about improving free trial conversion on Digital, but then also Digital being a bigger part of the overall sort of newer subscribers to connected fitness going forward. Can you talk a little bit more just about that strategy and what that might mean for overall marketing going forward?

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

Yes, Ron, for the Tread+, to the extent that there is a hardware fix, as we're calling it broadly, there will be a manufacturing change. We'll have to probably tool a part and then work with our contract manufacturer to get that into the manufacturing flow. So that could take months.

Again, the Tread, which is the lower priced, lower profile belt treadmill that was doing well in the U.K. and Canada, we hope to quickly soon bring to market in the U.S., pending the CPSC's approval of our screw system. We believe that, that won't be meaningfully a change to manufacturing. It would be just a change to potentially just the screw itself, but we're working through some solutions. So we're -- yes, to Tread+, there will probably be a change in the manufacturing, but we're optimistic that the Tread, which will probably be the higher volume product for next year, we won't have to change our manufacturing process.

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

Great. And on the second question on Digital, it's obviously something we're really excited about. As you know, the way we've thought about Digital is as a sales funnel to connected fitness. And 2 ways to obviously drive that is to drive the total number of Digital subscribers as high as we can, and we're really proud that we're nearing nearly 900,000 Digital subscribers, which is pretty staggering growth to have achieved over the last, call it, 18 months. So first of all, we have a much bigger lead pool in Digital.

And then the second thing, which was something that we've only really done in earnest over the past year, which is really how do we get them on a more robust upgrade path to connected fitness. So we're so excited by both of those things growing in tandem with one another, but I think it is a testament. We've said in the past, we run that business at breakeven. To an extent, right, we're not trying to lose a lot of money going after Digital subscribers. But we are marketing that product, and it is something we evaluate from time to time. How do we allocate potentially more marketing dollars to Digital, knowing it will ultimately end up as a connected fitness sale? So that is something in real-time that we're constantly looking at, how do we allocate marketing dollars between connected fitness and Digital. And certainly, with the success of Digital, that might be something that we do more of in the future. But it's pretty fluid. And again, we do try to operate it on a relatively breakeven basis. But I think a lot of it -- is also a testament to the fact that our content and platform just gets better and better, so the Digital value is just going through the roof.

Operator

Our next question is from Ed Yruma with KeyBanc Capital Markets.

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

2 for me. I guess first on pricing with Bike, now that you've gotten OTD times kind of in line. Thoughts on kind of pricing. I know you did run a Mother's Day promo that was non comp. So should we expect to see more of those? And then second, John, kind of a broader question, right? You've had lots of highs and lows this year. You've kept people healthy during COVID, but you also had delivery delays and now Tread. How would you assess brand health? And kind of how do you get back to the perception that Peloton once had?

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

Yes. The first one, Ed, I will say, the awareness of our $49 Bike is still pretty low. We weren't able to lean into marketing that. So it feels like the understanding that for $49 a month, you get the -- the award-winning original Peloton Bike now in a week's time. It feels like we have a lot of runway with that. So we're not looking at a price drop anytime soon.

And the second question around brand health. It's obviously something we care deeply about. And yes, I think it's ebbed and flowed over the last 2 years, going back to adgate. We've had moments and months where we were -- our stars shined bright and situations like right now that we feel like we have some work to do to get back on the right side of the line with trust and safety, and let people know what we stand for.

I think yesterday was a big day in mending trust and telling the market and our consumers and our members that we're going to prioritize safety, and we plan to have an industry-leading brand, one of the special brands, one of the most trusted brands over the next couple decades. And it started yesterday with our recall to say we're going to take some short-term financial pain to be able to invest in building something that's built to last for decades where our brand is pristine. And so I think that's what we saw yesterday and something we're obviously committed to.

Operator

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

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

Jill, I think you're suggesting about 200 net adds in Q4. Could you clarify what the Tread impact is and what the Bike impact is? And then as you think about next year, interesting Bikes to grow. So can you talk about -- as you look back, how much supply was a limitation or the long order to delivery times versus the stay-at-home being a positive driver? How do you think about those 2 factors as we get into '22?

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

Great. So I want to try to be the most helpful to answer your question on sub adds. You're correct, it is roughly 200,000 adds. And as you know, we stopped delivering Tread and Tread+. So obviously, that had some impact on our guide for connected fitness subs. The other thing to take into account is that, that $2.275 million guide or the 200 -- roughly 200,000 net adds also takes into account the returns that we expect. Right? So for Tread and Tread+, and we talked about the fact that we have a $50 million increase in our return reserve for both Tread and Tread+ returns. So that is also net of Tread. So you can pretty much think at least on a net add perspective that the majority of those net adds are due to Bike, Bike and Bike+ globally. Does that make sense?

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

Yes, that makes sense. And then on '22?

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

For '22 net adds?

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

Yes. You mentioned you think Bikes can grow. I just want to make sure is that versus this year? And how do you think about the drivers?

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

Yes. So I think what -- I think in the context of everything, right, we obviously have the Tread news. We have the economy reopening with us finally getting out from under the pandemic. Right? And then you go back to history with Peloton and you look at the seasonality of our sales, right? We typically see more heavy sales, call it, 60% to 65% of sales in Q2 and Q3 -- our Q2 and Q3, which is September through March versus the warmer summer months. So there's a few things going on there, which is why I thought it was helpful to give the context that even with all of that backdrop, we're still looking at a Bike comp 2-year stack, right. Going from '19 to '21 in Q4, we're still talking about more than 3x in unit sales, right? We typically talk in deliveries, because that's what translates into revenue. But we feel very good about the health of the Bike and Bike+ business.

What I talked about was the portfolio, the fact that we have a better, best strategy, the fact that we have a long runway to market that lower priced Bike. The fact that international is actually positively comping last year, which is crazy given the type of volumes that we saw in the first few months that COVID hit us all. So international is firing on all cylinders, and we've ramped media investment. So there's just -- and the word-of-mouth with the scaled member base that we now have with over 5 million people. So I think it was just to give a little bit of optimism around the fact that we feel really good that we're going to have a very strong growth in our Bike and Bike+ business going forward. And I feel excited in August to give you some updated, more specific numbers on where we will land for fiscal '22. But we're excited and -- about everything that we have, especially now that we can be back on air telling our story.

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

It's William Lynch. Just to build on Jill's point. Also notably, it was in your question. OTDs will be in a lot better shape on Bike and Bike+ to Jill's point about our portfolio. As we look at last year versus getting into fiscal year '22, meaningful that order to delivery and overall supply will be in a lot better shape just as another point.

Operator

And we have a question from Youssef Squali with Truist Securities.

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

I have 2 quick questions. First, Jill, the $50 million in returns that -- in refunds that you've mentioned, if I'm doing my math right, that assumes about maybe 10% or 15% of the installed base for both Tread and Tread+. Is that the right way of thinking about it? And is there a risk of seeing maybe more refunds extended into early next year? And then John, on -- I guess on Precor, just how quickly can you launch new connected devices leveraging Precor just beyond the Tread, beyond the Bike and the Bike+?

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

Great. So of course, as you can imagine, estimating the number of Tread and Tread+ that we will get back is a very difficult thing to do. This is our best estimate using all the data that we have available to us at this time. And I think your math is reasonably correct. It represents roughly 10% of Tread and Tread+ out there. So hopefully, we'll be able to give a much more robust update at the end of Q4 in August, when we report. And you're correct, the customers for Tread and Tread+ have been offered the ability to return their product all the way through November 2022. So this will be something that we'll be adjusting for over time. But we imagine that there will -- we'll see a sort of a bigger spike initially, and that should subside over the next several months.

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

And then Youssef, it's William Lynch. I'll take the Precor question. So we had to close the transaction, and we're pleased, as John noted, to have closed it on time. And the stated goal of that acquisition was to build the best R&D and supply chain team in all of fitness. We feel like that's -- as we look to the future, that is an important strategic moat and also given our growth to just, as a practical matter, be able to meet the demand that we think we're going to have looking forward across our best-in-class portfolio. So John mentioned in his opening script, we're on track. We stated that we'd be manufacturing in the U.S., notably for the first time, in the back half of the calendar year, first half of our fiscal. And we mentioned that we would be focusing on the Bike line.

The good news there is we are on track for that. We're actually early. Rob Barker, who is our -- is now CEO of Peloton Commercial, President of Precor. Rob led the Precor business and is a big part of the acquisition. He is -- he's done great work. And so we're tracking ahead. And notably, we -- given that our view on the Tread product line, as John said, the lower cost Tread, we've decided to also ramp up manufacturing out of that same North Carolina facility in the fall on Tread. So that's a new development. And is a testament to our conviction in that product line and also underscores just how strategic that acquisition was for us.

Operator

We have a question from John Blackledge with Cowen.

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

2 questions. How were the unit sales for the lower priced Treads in the U.K. and Canada in 3Q versus your internal expectations? And then, John, you mentioned pretty positive customer reviews on the lower-priced Tread. Just any color on what they liked about it? And then just on the sales and marketing ramp into 4Q. Is that broad-based across geos? And I'm assuming key focus will be on Bike and Bike+, but is there anything else there?

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

Great. So the first question is -- obviously, prior to the news over the last couple of days, Tread was performing very well against expectations. We had very strong launches in both the U.K. and Canada and had been anticipating a very strong launch in the U.S. as well, based on the member feedback from our controlled rollout here as well. So reviews have been great. Reception has been great.

And I think -- the second question, I think I might pass it to John and possibly William to chime in.

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

Yes. So good question, John. We are very proud of the Tread product line, recall notwithstanding. That's kind of why we did the recall, because we're so excited about it. We wanted to take a pause and make sure the CPSC felt great about it and that we added some additional safety features and took care of the quality or the screw situation on the console. But when we bring them back to market, we expect them to be the best products by far in the market and the safest products in the market. So we're very excited about them.

To answer your question, when you think about our original Bike product that had a, obviously, industry-leading and one of the highest Net Promoter Scores in the world in any category, to learn last month that our Tread product had an 85 Net Promoter Score was just kind of staggering, and it really spoke to how great the product and experience is.

And to your question, what people like about it. The boot camp classes are particularly popular where you're on and off the Tread. So you don't have the monotony of staying on a Tread for 45 minutes. You get on this gorgeous device. You have a fantastic instructor, a great community. And then you get off and you get a full-body workout on a Tread product in your home. And so when you think about getting the best cardio and the best strength in 1 workout, it's just so efficient and so fun and so motivating. And it's one of the things that's driving the Net Promoter Score.

I will add, I alluded to this earlier in my opening remarks, is the Strive Score. The Strive Score is a really cool feature that once you step off the Tread, of course, you get the metrics of the speed and the resistance and the incline and all that and all of the metrics and quantitative self that you would expect from Peloton. But when you stepped off the Tread, prior to Strive Score, you weren't connected to the leader board or being tracked and make sure that you're working hard enough and doing the weight training with all of the other people in the class. And now with Strive Score, it's even more immersive. So we're very excited. It was a fantastic product, and it's getting better. We also announced target metrics, which now it will tell you what incline you should be at. Of course, the instructor tells you, but now the software and the interface also tells you how fast you should be going, what your pace should be, what the incline should be. So it's an incredible software content, hardware platform. And when we bring it back to the market, it's going to be 10 out of 10 from an experience perspective and one of the safest treadmills or -- if not, the safest treadmills in the world. So we're very excited.

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

And then just on marketing spend briefly. Obviously, when we were in long OTDs and we announced we were spending $110 million to expedite largely Bikes, it made no sense to market when we were in that supply-constrained environment. The way we look, as Jill noted, in Q4, we'll be ramping up marketing spend, because OTDs are coming down, but also across all geos, as you mentioned, because we see opportunity. The way we're disciplined performance marketers, the way we look at that calculation is there's a CAC target, customer acquisition cost based on the LTV -- substantial LTV that we've got on our connected fitness products, both in terms largely contributed by hardware margins. And then our industry-leading membership revenue at the margins with the retention rates. And so we stick to that. We see opportunity to fuel growth, the growth that Jill mentioned on the core pipeline and those economics afford us the ability to market aggressively. So that's -- it's one of the many attractive things about our business. And now that we're in a better supply position, that's why you're seeing that marketing ramp on Bike across all geos.

Operator

Our next question is from Laurent Vasilescu with Exane BNP Paribas.

Laurent Andre Vasilescu - *Exane BNP Paribas, Research Division - Research Analyst*

I think it was called out that international is doing very well. I'm curious to know about the milestones you're setting for the Australian launch. And what does Australia mean for other potential country rollouts, especially since you recently added a Spanish-speaking instructor?

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

Well, Australia, if we look at market opportunities internationally on a couple of different ways. We actually have a matrix. One, it starts with an attractive TAM of what we're identifying as 3.3 million households. If you look at behavior, there's a huge universe of fitness fanatics. Boutique fitness, as an example, is growing 60% year -- boutique fitness is growing 60% year-on-year. Interestingly, as we looked at and did research on our purchase intent and awareness in Australia, Peloton actually, without any marketing in-country, has had both high awareness and purchase intent relatively. And Australians, we know, love global brands. That was another thing that came out of the research. So all those reasons made it super attractive. We'll launch both with Bike and Bike+ and Digital, we're actually doing something interesting. And this talks to the benefit of learning from each global launch. We're going to release the app first. And get -- feed the market with the app and that amazing Digital content that Jill referenced.

We'll have 3 retail share rooms at launch. Those are important early on. Retail's a great platform for demonstrating our amazing user experiences. And we've already got a 3PL in terms of logistics and delivery identified in the major metros. A lot of the population is concentrated, as I suspect you know, in Australia, so Melbourne, Sydney, Brisbane, we've got 3PLs ready to go. So Kevin Cornils and our international team are doing a great job. We have a country manager, Karen Lawson, in that country. So we feel very prepared. We're excited.

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

And I'll hop in with the -- thank you for noticing Mariana Fernández. And our Peloton Spanish -- Yoga en Español, as they were -- we are super excited about all the languages that we plan to offer. Spanish was a big one. Mariana is the first instructor, as you noted. We don't have any new countries to announce in that line right now. But you can imagine we have global ambitions and Spanish language is something that we're very excited about. Obviously, we have Mexico adjacency. Spain is a big market, and there's a lot of Spanish-speaking Americans, which is a third opportunity as we think about the Spanish -- the immediate Spanish opportunity. Again, we're not announcing any time lines there, but we do -- Spanish gets me excited, and Mariana is a great first addition in that vector.

Operator

And our last question for today is from Jason Helfstein with Oppenheimer.

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

Maybe I want to just ask what this all means now with the Tread just broader for the industry going forward? Mean your Tread+ wasn't enormously different than other flat treadmills on the market, but those tended to be in commercial locations. So are those companies now going to be restricted from selling those to home users? And just broader, how are you thinking about kind of what this means for the treadmill sales industry, given that it is the largest -- has the highest market share of all home fitness products?

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

Yes, it's a great question. Thank you for asking it, because you're right, it is the #1 selling piece of fitness equipment in homes globally from a units perspective. And we believe treadmills remain safe and effective exercise machines for the home when operated as instructed, and we know it is historically, like you said, the most popular fitness option in the home that we have. We know that millions and millions of Americans use treadmills safely in homes today. So we remain incredibly bullish about the opportunity. In order to run at home, you need a treadmill, in order to cycle at home, you need an stationary Bike. And we believe that they are going to be pillars for getting in shape at home. Again, especially when you think about treadmills of yesteryear being more for running and our treadmill is more of a multidisciplinary circuit training platform and a portal for experiences.

But clearly, to your question, we need to work with the CPSC to make sure that we not only emerge as the global leader in connected fitness, but also the leader in safety in the industry, and we believe that it is our opportunity and our responsibility, for that matter, to really be the industry leader in safety. We're obviously already the industry leader in innovation, and we're excited to work with the CPSC and keep you guys appraised of future announcements and future product developments that are going to make our Treads even safer.

Thanks, everybody.

Operator

There's no further questions at this time.

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

Thanks, everyone, for joining us today.

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

Thank you.

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

Have a great afternoon.

Operator

That concludes the call for today. We thank you for your participation and ask that you please disconnect your line.
