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EDITED TRANSCRIPT

PTON.OQ - Q2 2022 Peloton Interactive Inc Earnings Call

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OVERVIEW:

Co. reported results with 2Q22 total revenue of $1.13b. Expects FY22 total revenues to be $3.7-3.8b and 3Q22 revenues to be $950m-1b.

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Thank you for standing by, and welcome to Peloton's Second Quarter Fiscal 2022 Conference Call. (Operator Instructions)

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

Peter Stabler

Good morning, and welcome to Peloton's Second Quarter Fiscal '22 Conference Call. Joining today's call are John Foley, our Co-Founder and CEO; and CFO, Jill Woodworth.

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

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

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

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

Thank you, Peter. Good morning, everyone, and thanks for joining us today on short notice. As you've probably seen by now, we made a number of important announcements this morning, all of which are intended to ensure Peloton is well positioned for sustainable profitable growth.

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I'd like to start by stating I love Peloton. I love the role we play in connecting the world through fitness. Our goal has always been to bring immersive and challenging workouts into people's lives in a more accessible, affordable and efficient way. We've done a great job of delivering on that vision, and our large and loyal member community is proof of that. But we also acknowledge that we have made missteps along the way. To meet market demand, we scaled our operations too rapidly, and we overinvested in certain areas of our business. We own this. I own this, and we are holding ourselves accountable. That starts today.

Early today, we announced several important leadership changes. I will be taking a new role as Executive Chair of the Board, and Barry McCarthy will be assuming the role of CEO. I couldn't think of a better person for that job as we transition to Peloton's next phase of leadership. Barry is a tremendously talented executive with deep experience in growing content-dependent digital subscription businesses and doing so profitably. And he has partnered successfully with 2 extraordinarily talented founders during this journey. Barry most recently led Spotify's global advertising business and also served as CFO overseeing their direct listing and helping to establish Spotify as the global brand it is today. Many of you may also know that Barry served as Netflix CFO for over 10 years. Plus, Barry is a longtime passionate Peloton member who shares our team's enthusiasm for our company's vision of improving lives through home fitness. I'll be partnering closely with him as we address the challenges facing our business and work to deliver on the value inherent in Peloton.

I'll now turn to our other announcements today, starting with an overview of the initiatives we're implementing to strengthen our business for the long term, beginning with today's restructuring program. Once fully implemented, we expect these initiatives to yield at least $800 million of annual run rate cost savings through operating expense efficiencies and material improvements in our Connected Fitness gross margin. Jill will speak to the financial implications of this program shortly. In addition, we currently expect to exit fiscal year 2022 with approximately $1.2 billion of cash and $500 million of additional revolver capacity.

Over the last several months, our executive management team has worked diligently to identify the areas in need of adjustment. The restructuring program we announced today includes a meaningful reduction in the size of our teams across nearly all of our business operations from corporate functions to manufacturing, to logistics and R&D and at nearly all levels. This was a very difficult decision for our management team who has had the privilege of working alongside many of these team members from the beginning, but it's a necessary one to get Peloton back on track. We greatly value the contributions of our impacted employees and will work hard to assist them in their transitions.

Beyond this, we are taking significant structural actions to align our business and build margin back into our hardware economics. This includes optimizing our logistics footprint by reducing our owned and operated warehousing and delivery network as well as generating efficiencies across procurement and manufacturing.

We've also made the decision to wind down the development of Peloton Output Park. While we still see strategic merit in diversifying our manufacturing footprint and developing North American capabilities over the long term, we believe Tonic and our third-party manufacturing partners can support our growth for the next few years.

Our objective is to best position Peloton for sustainable growth while establishing a clear path to consistent profitability and free cash flow as we pursue the significant connected fitness opportunity.

Our restructuring will allow us to streamline our teams and reporting structures and create clear lines of accountability for all aspects of our P&L. The net result will be better and faster decision-making and a more focused team to drive growth and profitability.

As we adjust our operations, 2 key priorities will not change. First, our member experience. Our roster of instructors is foundational to the Peloton user experience, and we will continue to invest in our content creators for the benefit of our growing member base. We will also continue to invest in our platforms through innovative hardware, software and content experiences, improving our offering for both current and prospective members.

Second, we remain committed to increasing accessibility, both in terms of overall cost and in terms of the value we bring to our members. This is critical in order for us to deliver on the long-term Connected Fitness growth opportunity.

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There's one more announcement we made this morning that, while not directly related to our restructuring, I'd like to address on this morning's call. In addition to Barry McCarthy joining our Board of Directors, we've appointed 2 new directors, Angel Mendez and Jonathan Mildenhall. Angel is a proven supply chain leader, and Jonathan is a globally recognized marketing and advertising executive. We are thrilled to welcome them to our Board, and we look forward to benefiting from their unique perspectives.

In addition, William Lynch has transitioned from President of Peloton to a full-time member of the Board. We also want to thank Erik Blachford for his many contributions to Peloton. Erik is stepping down from his role on the Board, and we wish him all the best as he turns his attention to other personal and professional endeavors.

Finally, I want to acknowledge that this has been a very humbling time for all of us at Peloton. Since we founded Peloton in 2012, we've transformed our company from a 5-person fitness group into a loyal community of nearly 6.7 million members worldwide. Throughout this period, our loyal member community and incredibly committed team have been a great source of strength to me personally. I want to sincerely thank all of you for your support.

With that, I'll hand it over to Jill.

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

Thanks, John. I will start with a review of our second quarter results. As you know, we prereleased our summary results on January 20. In the quarter, we generated total revenue of $1.13 billion, representing 6% year-over-year growth and an underlying 56% 2-year CAGR. Excluding Precor, which we acquired on April 1 of last year, core Peloton revenue was approximately flat year-over-year.

Relative to expectations, our revenue reflected lower-than-expected demand, largely offset by a favorable mix towards Bike+ and lower financing penetration rate. Engagement per Connected Fitness subscription totaled 15.5 workouts per month. On a 2-year basis, engagement was up 23% over the second quarter of 2020. As expected, we've seen significant month-over-month improvement in engagement from December to January, with sequential growth exceeding levels we've seen in previous non-COVID years. Overall, we believe our engagement levels are very healthy, particularly when viewed against fitness industry norms and are likely to remain higher than witnessed during comparable pre-COVID periods.

Our average net monthly Connected Fitness churn remained low at 0.79% in the quarter. We continue to be pleased with our overall platform retention as our 12-, 18- and 24-month retention rates continue to improve year-over-year.

At the end of Q2, we had 862,000 app subscribers, representing 38% year-over-year growth, slightly ahead of our internal expectations. App subscribers declined modestly on a sequential basis primarily due to the 60-day free trials offered in November.

Moving to gross margin. Gross margin for the quarter was 24.7%, slightly ahead of our expectations, primarily due to our subscription segment. Our Connected Fitness Product segment gross margin of 6.4% was modestly below our guidance. Relative to our expectations, our Connected Fitness margin reflects favorable timing of inventory receipts, a slightly lower-than-planned holiday promotion impact and a benefit from a modest mix shift to Bike+. These benefits were offset by significant logistics cost pressure and a modest increase in Tread+ return reserve. Subscription gross margin was 67.9%, and subscription contribution margin was 71.4%, ahead of expectations.

Turning to OpEx. Sales and marketing expense was 30.8% of total revenue, reflecting a return to typical holiday marketing this year. G&A expense was 21.9% of total revenue. We've made significant investments in teams, systems and member support, which accounted for this increased spending. G&A will be a significant focus for our restructuring, and you should expect dollar declines in this line item versus our first half run rate.

R&D expense was 8.8% of total revenue versus 4.5% in the year ago period. The year-over-year deleverage reflects the onboarding of several acqui-hires and the R&D team from Precor. We believe our investments in R&D drive new product features and functionality that create and sustain our strategic advantage.

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Rolling everything up, our Q2 adjusted EBITDA loss of $266.5 million was better than expected. We ended the quarter with $1.6 billion of cash and cash equivalents and have additional liquidity in the form of an untapped $500 million credit facility.

Before reviewing our outlook, I'd like to start by providing a bit more detail on the actions we're taking to address our cost structure. The restructuring we announced today will help accelerate decision-making, increase accountability, create a more efficient and flexible supply chain, reduce capital intensity and ensure we are optimizing our spend to support profitable growth. Although it will take time to fully implement, we have spent the past several months developing a detailed plan that provides line of sight to cost reductions that we expect to drive gross margin, EBITDA margin expansion and improve our unit economics.

We expect this program to generate at least $300 million run rate savings within Connected Fitness COGS by the end of fiscal '24. The majority of the savings will come from efficiencies in procurement, manufacturing and logistics. We will drive immediate benefits from the significant overhaul of our logistics network, which includes consolidating warehouses and shifting volume to variable cost third-party providers.

We still have further work to do in order to optimize delivery routes, inventory placement and staffing levels but expect these initiatives to meaningfully reduce our cost per delivery over the next several months.

Procurement and manufacturing efficiencies will take longer to fully materialize in our P&L as we sell through higher cost inventory.

We also expect a $500 million run rate reduction to annual operating expenses. Key areas of focus include reductions in workforce and marketing, changes in corporate real estate strategy, software expense cuts and reduced outside services spend. Every cost bucket is under scrutiny, and we expect to drive efficiencies across the board. While some of these expense reductions will take time to complete, we can capture most of the run rate savings in fiscal '23. In total, we expect this restructuring program to result in approximately $210 million in onetime charges, of which $80 million will be noncash.

In addition, as John mentioned, we have decided not to pursue North American manufacturing at this time. We believe Tonic and our third-party manufacturing partners can support our growth over the next few years.

Now on to our outlook. We are reducing our fiscal '22 outlook as we extrapolate trends that we have seen in the first half of the fiscal year continuing into the second, namely the continued reduction in traffic. We are reducing sales and marketing expense meaningfully in the back half of the year as we intend to use the seasonally slower months in late Q3 and Q4 to better understand our baseline post-COVID demand. These cuts will provide critical learning so that we can drive improved efficiencies in fiscal '23. Our goal is to support our brand with acquisition marketing but with laser focus on efficiencies and clearing return hurdles. Also, we anticipate a potential elasticity response to our January 31 delivery and setup surcharges.

Lastly, we cannot rule out the potential that our significant restructuring could have some temporary impact on demand generation as our organization adjusts to our new operating model.

Based on these factors, we now project $3.7 billion to $3.8 billion of revenue for full year fiscal '22. Our revenue guidance for fiscal '22 incorporates Peloton guide sales starting in April. We expect Peloton guide to represent a small contribution to revenue in Q4. We have decided to pursue a soft launch given the time of year and seasonality of our business, and therefore, the majority of our marketing spend in Q4 will be focused on our existing Connected Fitness products.

For Q3, we expect revenue of $950 million to $1 billion. For fiscal '22, we expect ending Connected Fitness subscriptions of approximately 3 million, implying 670,000 net adds and representing 29% year-over-year growth and a 66% 2-year CAGR for ending subs. For Q3, we expect ending Connected Fitness subscriptions of approximately 2.93 million, implying 160,000 net adds and representing 41% year-over-year growth and an 82% 2-year CAGR for ending subs.

For our Connected Fitness segment, we are presenting margin commentary, excluding restructuring charges that are added back in our adjusted EBITDA calculation. We believe this approach will offer more constructive modeling guidance.

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As we have outlined, our pricing changes and warehouse restructuring will have significant positive impact on our margin structure in Q4. The Q4 implied Connected Fitness margin is expected to be in the mid-teens and will provide a good starting point for us to achieve continued planned improvements in Connected Fitness margin in fiscal '23.

With the reduction of our demand plan, we now expect Q3 and full year fiscal '22 Connected Fitness margin of approximately 6% and 11%, respectively. For Q3 and fiscal '22, we expect a subscription contribution margin of 71%.

Rolling up our segments, we now expect total company gross margin up 23% in Q3 and 28% for fiscal year '22.

We now expect full year fiscal '22 adjusted EBITDA of negative $675 million to $625 million. We expect negative $140 million to $125 million of adjusted EBITDA in the third quarter, reflecting the revised demand forecast. As I discussed earlier, we will start to see the benefits of our restructuring efforts in the second half of fiscal '22, which include planned reductions in media spending and slight benefits to G&A and R&D. As a result, we expect our second half operating expense to be approximately $150 million lower than in the first half, inclusive of restructuring charges.

Moving on to capital expenditures. With the change in plans around Peloton Output Park, we now expect total CapEx spend for fiscal '22 of approximately $350 million, and that's relative to our initial expectation of $600 million. Coupled with the pause in further showroom expansion, we now expect approximately $100 million and $65 million of total CapEx spend in Q3 and Q4, respectively.

We intend to continue to build out a shell facility in Ohio. Our total spend on POP in fiscal '22 is expected to be in the range of $90 million to $100 million, including $60 million in the back half of the year. We plan to sell both the building and the land by the end of fiscal '23 and recover a majority of the spend upon sale. Beyond this year, you can expect a modest CapEx profile as we work towards a CapEx-light model moving forward.

Moving on to inventory. From a balance sheet perspective, we expect inventories to decrease sequentially in Q3 and further in Q4. We've slowed production to better match our current demand outlook. Our aim is to get back to a normalized inventory balance no later than the end of fiscal '23, driving a more efficient use of our balance sheet going forward.

Before closing, I'd like to provide a bit more context on how the announcements made today connect with our financial and strategic goals. There are 3 key objectives to highlight: reestablishing Peloton as a sustainable growth company, restoring our Connected Fitness hardware margins and generating consistent positive free cash flow to self-fund our business.

We are at a critical inflection point in our business. These are the early days of a significant transformation of our operating model to achieve a better balance of growth and efficiency. We are lowering our second half outlook to reflect the short-term headwinds that I discussed earlier as well as intentional actions to position our company for future success. We understand that this prompts questions about our future top line potential. To be clear, we believe we have significant growth potential ahead.

The paid fitness industry has a long-term track record of growth across cycles, and we continue to believe that Connected Fitness is the most attractive subsegment. The Connected Fitness category grew during calendar year '21 even against very difficult COVID comps. And in recent months, continues to maintain a significantly higher market share than in pre-COVID period. As work-from-home and hybrid remain prevalent themes that are likely to persist into the future, we expect Connected Fitness will take category share and drive growth of the overall fitness category.

Our own attitudinal research as well as others published recently has shown that openness to working out at home, and Connected Fitness in particular, is now at levels much higher than they were pre-COVID. And while traffic levels are reverting to pre-COVID norms, we have seen this improved product market fit for Peloton result in higher post-COVID conversion rates.

Importantly, we expect Peloton to remain the dominant category leader. Our engagement, retention and NPS scores demonstrate the continued effectiveness value and convenience of our platform. And although our recent performance has fallen short of expectations, we nonetheless grew our share within the Connected Fitness category over the past 12 months.

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Moving on to hardware margins. As I discussed earlier, we now expect an even more pronounced Connected Fitness gross margin contraction in fiscal '22, which primarily reflects fixed cost deleverage from lower volume. Currently, we are not generating nearly enough hardware profitability to achieve our goal of covering customer acquisition costs, which means it is critical for us to rebuild this margin structure.

On January 31, we took the first step by adding delivery and installation charges to Bike and Tread in North America and similar surcharges in our updated all-inclusive pricing in our international markets. This pricing change will positively impact Q4 Connected Fitness margin.

The restructuring program we announced today will provide further tailwind with our COGS savings primarily driven by efficiencies in logistics, procurement and manufacturing. We expect logistics savings from our warehouse restructuring to meaningfully reduce our delivery cost beginning in Q4. Our procurement and manufacturing savings will also be considerable but will primarily benefit fiscal '23 and '24. In total, these actions should have a material positive impact on our Connected Fitness gross margin and enable us to trend closer to net CAC neutrality over the next several quarters.

Going forward, we do not intend to rely on the capital markets to support our growth. Our use of cash in fiscal '22 has been abnormally high, and we are confident we will see meaningful improvement in fiscal '23 and consistent positive free cash flow in the near future.

There are a few factors underpinning our confidence. First, our EBITDA improvement opportunity. We expect our restructuring efforts to generate at least $800 million in run rate savings by fiscal '24. Supply chain savings will take more time to be fully realized, but we expect the majority of OpEx savings to benefit fiscal '23. Our recent pricing actions should also be a material tailwind to EBITDA.

Second, the improvement in operating cash flows going forward. Our much higher-than-normal inventory balances this year are obviously creating significant cash headwinds in fiscal '22. Given our current inventory is nonperishable and nonseasonal, we expect to sell it at full price. As we work down our inventory balance, we should see a considerable cash flow tailwind in fiscal '23. We are implementing stronger processes and greater discipline in our inventory management and intend to bring our days on hand down over time with the goal of a more neutral annual cash impact going forward.

Third, we have opportunities to lower capital expenditures. Within CapEx, our fiscal '22 outlook includes $90 million to $100 million in spend on POP as well as material spending on systems implementations, product development and other nonrecurring project-based investments.

Finally, the $130 million in restructuring-related P&L cash costs will be heavily concentrated in fiscal '22. Ultimately, we are comfortable with our balance sheet position, and we expect to end fiscal '22 with approximately $1.2 billion in cash and $500 million of additional revolver capacity and have a line of sight to improve cash flows next year.

I will now turn it back to John with some closing thoughts before we get to questions.

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

Thank you, Jill. We've announced a considerable number of changes today, changes in leadership and on our Board as well as the difficult but necessary steps we're taking to cut costs and better balance growth and profitability. These actions will make Peloton a stronger and more nimble organization than it is today, an organization that is better equipped to capitalize on our leadership position in Connected Fitness for the benefit of all stakeholders.

I'm proud of the company that we have built over the last 10 years. Under Barry McCarthy's leadership, the future has never been brighter for Peloton. As I transition out of the CEO role and into that of Executive Chair, I could not be more excited to partner closely with Barry. I look forward to speaking with you next quarter and updating you on our progress.

Operator, please open the lines for questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question coming from the line of Doug Anmuth with JPMorgan.

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

John, I was hoping you could just update us a little bit in terms of the current product mix, just maybe talk a little bit more about what you're seeing across the One Bike and Bike+ and then also kind of early thoughts still on the Tread here. And how does the restructuring impact your product development plans going forward?

And then, Jill, you talked a lot about both the COGS and the OpEx savings. Can you help just frame those kind of collectively through fiscal '22, '23 and '24?

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

That was a lot baked in there, so you'll have to bear with us as we get through. I think there were embedded about 3 or 4 questions. I think your first question was really around mix. And I guess what I would say first off is that we've obviously learned a lot about mix over the course of the last several months, obviously, with the pricing changes that we made in August and then, obviously, with the promotional activity that we ran through the holiday. And so as you can imagine, our Bike+ does have the higher gross profit margin in the portfolio. And what we did see through promotional impact is that narrowing that gap between our original Bike and our Bike+ does positively skew mix to Bike+. And so obviously, we've had a lot of learnings there. And one of the reasons that helped underpin our confidence as we look to slightly increase and add the delivery surcharge back to Bike.

If you go -- I think you also asked a question around Tread so far. And so what I would say is we're incredibly pleased with the performance of Tread so far. We continue to believe that the Tread category is bigger than the Bike category. And our job is to educate the consumer on the product market fit, build product awareness that leads to purchase intent. So we know that our Tread has the highest NPS of any of our products. And so we've been excited to continue to build on that momentum. We also know that our awareness continues to build, and more than half of our sales are going to new members since launch. And lastly, I hope you've noticed we've received a lot of great accolades in the press and positive reviews on the product. So we're incredibly pleased with the results so far on Tread.

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

And Doug, with respect to restructuring impact on development and our product pipeline, one of the philosophies we entered the restructuring mindset or program with was don't eat the seed corn and don't touch what's sacrosanct and beautiful and important about our business. And product development, software content, the things that impact the member experience were largely untouched. So I think you're still going to be excited to see what comes out of Peloton in the coming quarters and years.

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

And Doug, just doubling back on the restructuring, I believe you asked about the COGS improvements that we expect to generate over the next couple of years. As we outlined, we see a line of sight of at least $300 million in run rate savings. The majority of those savings will come from efficiencies in procurement and manufacturing and logistics. And obviously, some of the actions that we took on the logistics front today are immediately realized in Q4. And that, plus our pricing action from our delivery surcharge implementation at the end of January will help us end the quarter, Q4, with a mid-teens Connected Fitness margin.

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I do want to make a note that just in terms of our own mix of deliveries versus third party, essentially, we're shifting from 60% in-house to around 40% in-house. So while this is a pretty dramatic move for us, we are keeping owned warehouses in our larger markets where we can drive efficiency throughout the year. So those are really our higher volume markets.

We certainly have a lot more work to do to optimize around delivery growth and inventory placement and staffing levels. But all of this, we think, will meaningfully improve. But again, I think we're going to start off with a much healthier base by the end of Q4 in the mid-teens.

The one -- and then the last point I would make, I know there's a lot here, is that what we will not change is our member focus and trying to create a great member experience. We realize through the outsourcing of our delivery that, that may be called into question. But our focus is as intent as it was, and we'll be working with our third-party providers to ensure that our delivery experience is consistent across the board. So hopefully, that helps answer your question.

Operator

And our next question coming from the line of Edward Yruma with KeyBanc.

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

I just want to kind of follow up on the last question but ask a broader question on demand. As you think about all the different things you've experimented with, right, tactical price reductions, new products, as we think about the longer-term growth algorithm, what do you think restores the business back to a growth trajectory? Is it some of these new products? Is it just kind of lapping some of these comps? And I know that you did make a comment about affordability and trying to reduce that. I wanted to know how that squared with the implementation delivery fees.

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

Thanks, Ed. I'm going to take this, and I think John might chime in. There's a lot here. Certainly, our second half demand is a softer demand picture. And so it obviously exemplifies the fact that it has been difficult for us to forecast and predict demand coming out of COVID. But I do want to highlight that there are 3 other factors that we believe are relatively short term in nature that are driving our revised outlook.

No doubt, we are going to see an elasticity response from the price increases on our original Bike and Tread. And those, as you know, are in the form of the delivery and installation surcharge. We also are intending to purposefully reduce our marketing spend in the back half of the year so that we better understand baseline of demand post-COVID.

And I think it's just important as we move forward, we're making a lot of OpEx cuts. But to be clear, from a marketing perspective, that is an engine that we are not shutting off. Marketing will be critical to our success going forward. And so what you'll see is that what we want to do is, one, get to better marketing and media efficiency and also reduce a lot of the fixed costs within sales and marketing so that we can allocate more to that variable marketing spend. So that is something that we are not going to sacrifice on. We want to grow. We want to change more lives.

And then third, I think we would be, I think, naive if we didn't think that there could be some operational disruptions as we work through this restructuring. And so those are sort of the 3 short-term headwinds that we're seeing.

But stepping back, we believe that the opportunity is unchanged. We believe the fitness and wellness industry will continue to grow. It's grown for decades through many, many cycles. The Connected Fitness industry will take share. The Connected Fitness industry will also grow fitness participation. And we know that consumers coming out of COVID with work-from-home and hybrid models are more predisposed to want to work out at home today than they ever were pre-COVID.

And I just want to also take one other step back as it relates to our subscriber base. Keep in mind, we are projecting 3 million subs by the end of this year. When we entered COVID, which feels like a decade ago now for us at Peloton, 2 years ago, we had just over 700,000 subscribers. So while

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our growth in sales in our Connected Fitness has been nonlinear, we are emerging from all of this with a very large scale, growing member base with low churn. We're changing lives. We have a great product, high NPS, low churn and are the category leader. And that's what really makes us excited about the future, and it's the same playbook we've had before. It's growing our core Bike business, growing new products, growing our channels like corporate wellness and growing international.

Operator

And our next question coming from the line of John Blackledge with Cowen.

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

Two questions. First, are you seeing any difference in the demand for Tread on a market-by-market basis? And then secondly, Jill, you talked about changing the CapEx after this year. Could you provide perhaps a range on CapEx as a percent of sales after fiscal '22?

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

Thanks very much. The first question is on Tread by market. I mean we're still in the very nascent stages of building product awareness in all of our markets. There's really no discernible difference, although as you can imagine, right, our brand awareness is lower than it is in the U.S. in our international markets. So you'd expect to see a potentially slower ramp there. But again, when you look at Q3 and you think about the fact that we only launched this product just over 5 months ago, it's a significant percentage of our sales. And I'll just go back to what I said before with Doug that we absolutely are very pleased with the launch. And the most important metric for us is NPS, and it's got the highest NPS of any product.

From a CapEx perspective, with a lot of the changes today around the restructuring and management changes, I'm hesitant to provide you an exact dollar figure on CapEx. I would just reiterate the fact that we want to move to a CapEx-light model. We believe we can do that. And so I think what you can expect is a considerably lower CapEx spend than what we're spending in fiscal '22. Plus, also expect that we'll have the tailwind of any sale proceeds from the POP facility.

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

Real quick. John, I also want to weigh in on kind of dovetailing with Ed's question on growth and your question on Tread is that to Jill's point, in the early days of our Tread, we have an awareness opportunity, and we had this in the earliest days of the Bike of why do I need this stationary bike that in the earliest days felt expensive? And the answer is because it's a portal to a fantastic boutique fitness experience at home. We have a similar challenge or opportunity with the Tread now of, one, just the awareness that Peloton has a Tread. And two, why is our Tread dramatically different than the Treads you've known about for decades? Both of those are marketing opportunities that we're really excited to lean into.

And you should know that our marketing efficiency goes up with the awareness of the Tread product and why it's so special, why it brings these boutique -- boot camp, circuit workouts into your home where it's not just get on the treadmill for 45 minutes because a lot of people don't look forward to that. I think it's the variety of content -- the variety of class content, the on and off tread workouts that are so popular in the off-line world, in the boutique world, that our treadmill was the first Tread and the best Tread to bring those to your house and to your home in an efficient and affordable manner.

So as we grow awareness in the coming quarters and coming years, our marketing becomes more efficient, and that's going to lead to more profitable marketing and obviously, growth, as Jill pointed out, that we think that category is going to be even bigger than Bike. And it has been -- historically, treadmill market has been 2 to 3x bigger than the stationary bike market. So between those 2 things, we're super excited about the Tread product line.

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Operator

And our next question coming from the line of Eric Sheridan with Goldman Sachs.

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

Maybe just a 2-parter on the CEO change for you, John. Can you give us a little bit of a better sense of the process behind bringing Barry in, what you saw in Barry's sort of past on the media side and the subscription side that fits well with the role and maybe some of the elements of hardware and logistics and manufacturing that Barry has a little bit less experience with historically. That would be part one. And two, when would we expect to hear from Barry and the broader investment community? When is he starting in the role? Can you give us a little bit of an update there?

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

Great. Yes. I'll take the first one. He starts, in earnest, tomorrow morning. It's the first day of the job. And so he's drinking from a firehose right now, as you can imagine.

On your first question, the Board and I ran a thoughtful collaborative succession process over several months and determined that Barry is definitively the right CEO for Peloton for the next several chapters. We're super excited that he -- that we found him. We fell in love. We saw what he has to offer. And he also was similarly excited. So it was -- it moved fast once we established and got in contact with him.

The reason why he's so good, as you probably know, Erik, following successes over the last several decades, is he is a visionary, media, software, subscription business. He might be #1 in the world with understanding subscription businesses with his building -- helping rebuild Netflix and helping Daniel build Spotify. And so it's -- as I said to The Journal last night, he's kind of an embarrassment of riches as it relates to the Peloton story, and this is a third opportunity for him to help build one of the best global consumer products, media company brand.

I said in my preremarks that we were delighted that he and his wife are big Peloton members and users. And so they get the magic. They get what's special. So it's been a really exciting thing for me as one of the founders to get to know Barry, see his passion, already start to learn from him and his understanding to these businesses. And so we're excited.

With respect to hardware, he is as smart as anyone I've ever met. So we're not worried about his any perceived lightness on hardware. And again, I'm going over the Executive Chair role. We have a fantastic team. He's going to add value starting tomorrow morning, and we couldn't be more excited.

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

To your second part of the question, I think there's a lot of internal focus for Barry for the next couple -- several weeks or months. But obviously, at the appropriate time, I'm sure, well prior to our next earnings call, we'll get Barry introduced around. But I think, Erik, you'll be seeing a lot of familiar faces.

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

Erik, to your question as well with respect to supply chain and/or hardware, I do want to point out that we've added Angel Mendez to our Board who is a global supply chain leader and super experienced executive, and we plan to benefit from his strategic thoughts at the Board level. Barry is also joining the Board. So there's going to be a lot of collaboration. And we are stronger on the supply chain side today than we were yesterday, which is exciting.

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Operator

And our next question coming from the line of Jason Helfstein with Oppenheimer.

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

I guess two. I mean it seems a large part of what you're struggling with is we took a product that was potentially a long consideration product similar to a car that people might think about over 3, 6 months, and we shrunk it to literally an impulsive purchaser and COVID. And now we're going back to long consideration. And so maybe help us understand as you do your research like -- just how do we think about it, right? Because investors are trying to understand if they've miscalculated the TAM opportunity or really just going back to, again, a long consideration purchase.

And then just second, John, can you address your super voting stock? Now that you're joining the Board, does it still make sense for you to keep that super voting stock? And kind of how do you think about that in the best interest of shareholders?

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

So I'll take the first. I think the real question you're asking is, has our market opportunity shrunk. We don't think the opportunity or the strategy to attack that opportunity has changed. Our cost actions are all independent of the growth opportunity that exists for Connected Fitness and for Peloton.

I think we're simply acknowledging 2 points regarding fiscal '22. We accelerated our growth into the TAM more than we thought, and assessing demand coming out of COVID has been a significant challenge. And you're right, our #1 purchase barrier has always been price. And we -- there is a consideration period involved. But -- and certainly, during COVID, I'm sure that was somewhat truncated.

We did no marketing. We obviously saw very large increases in conversion. But even coming out of COVID, while traffic is down, right, we are still seeing sustained increases in conversion. And as you also think about COVID, you think about our price change in August, you think about promotional activity over the past several months, which is again very typical for us in that time of year, we have to work over the next 6 months to rebuild that lead database and that -- and we've had many events over the past couple of years, to your point, that have kind of somewhat drained the lead database.

So we have work to do, but I think we're going to study what our post-COVID demand is with going dark on marketing to better understand the baseline. And we're going to get back to efficient marketing next year. But again, we don't think the opportunities change. We believe our value proposition is commensurate with the pricing of our products. And we'll go back, I think, to the basics over the next several quarters, again, rebuilding the lead database and using marketing to drive awareness and purchase intent and convert more people. So I think we feel good about that.

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

And Jason, with respect to super voting stock, we have no changes planned at this time. But I will say, we have a very mature, seasoned, experienced Board of Directors and -- that operates in the best interest of all shareholders. And I think the announcement this morning that we're bringing in an incredible -- incredibly experienced and talented and proven CEO to strengthen our leadership team is just one of the many things that I would do to show my commitment that this is not about John Foley and/or my super voting shares or TCVs or anyone else's. This is about what's best for all shareholders, Peloton, of which I am one of them.

Operator

Our next question coming from the line of Shweta Khajuria with Evercore ISI.

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

Just a question on your growth initiatives, following up on one of the prior questions. Will there be any initiatives in the near term that you may have to hold or sort of pull back on whether it is international market expansion or some of the new products that were in the pipeline around corporate wellness, anything around that, that you can comment on?

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

Thank you. So the question centers around how we -- as we look at our restructuring, what does it mean and what does it not mean. And I think, again, it's about preserving member experience. It's about creating great products. It's about changing more lives. This is not a call for a slowing of growth or product development. This is all about rightsizing our cost structure, variabilizing our cost structure so that we can operate in any environment and not have demand dictate the bottom line. So we went through a very meticulous process with our entire senior leadership team to ensure that as we were making these cuts across our organization, we're doing so without preserving the acorns of growth that we have ahead of us. So it still is prioritizing product innovation, software innovation, new hardware products, corporate wellness and channels. So no impact to all of the various growth initiatives.

Now that doesn't mean to say that we're not going to take a harder look as we go into international markets or as we look at our showroom footprint to make sure that we're operating in the most efficient way, but all of this was done with the fact that we want to remain a growth company. That's our priority, along with profitability, and we're not cutting in the places that would hurt that growth.

Operator

Our next question coming from the line of Bernie McTernan with Needham & Company.

Bernard Jerome McTernan - *Needham & Company, LLC, Research Division - Research Analyst*

Jill, you mentioned a net investment and customer acquisition costs over the next few quarters. As we think about '24 and beyond, what's the right way to think about net customer acquisition costs, whether it's going to be neutral, positive or negative? And then just -- I wasn't sure if you would be willing to share, given these restructuring -- implementation of this restructuring, any reasonable target range to think about EBITDA margins going forward?

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

Sure. So it is our priority to get back to net CAC neutral. For those of you not familiar with our terminology, essentially, what was great about our unit economic model was that our customer acquisition costs were largely, if not fully offset by the gross profit margin in our hardware. So to get back to that place, we really have to attack it from both sides. And so it's going to take time as we work through our restructuring plan. We talked about some of the immediate benefits for getting to margin through logistics restructuring and through our pricing increase that gets us to a mid-teens Connected Fitness margin, but there's more work to do there. So obviously, we know that some other longer lead items such as the manufacturing and procurement efficiencies that we hope to achieve will take much longer than the next 6 months. So we obviously have the goal to get back to net CAC 0.

And then on the flip side of the equation, what I had said earlier, it's attacking that fixed cost infrastructure in sales and marketing and then looking at our variable cost structure and marketing and how we can be more efficient. So we're attacking it at both ends. Net CAC 0 or neutrality is certainly a goal of ours or to potentially do better than that. And we're also -- again, it's not just about unit economic model. We're also very, very hard -- looking at the efficiency of our complete OpEx picture, not just net CAC.

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And then in terms of the target Connected Fitness margin, I would actually just reframe it to be what I just said, which is our goal is to get back to net CAC neutrality. We're not prepared today to offer a margin target in Connected Fitness. But as I said, to get back there, we know we need to progress from where we're going to end this year. We have a line of sight to do it, and we're attacking it from sales and marketing.

Operator

Our next question coming from the line of Jonathan Komp with Baird.

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

First question, just high-level of thinking into 2023, the comments about expecting to work through inventory at full price. I mean that implies you're still planning some level of growth, some level of Connected Fitness Product sales, some level of subscription growth. So can you just shed any more light on sort of the near-term growth trajectory just to sort of level set our expectations?

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

Yes. I think the first thing to note is, obviously, our inventory won't be static, right, in terms of incoming inventory over the next 18 months. So we obviously wanted to put a guidepost out there that we felt comfortable with knowing that we'll continue to work with third-party providers. We'll continue to have a minimum amount of production out of our Tonic facility. And so it's not a static question. It's not like we're starting from a certain inventory level and just working that down over time. And therefore, you can imply a demand forecast based on working down that inventory.

It is -- so you can't kind of read too much into that. But of course, we know the importance of getting that inventory down. And I guess what I would say is I expect it to be a good cash tailwind in fiscal '23. And we're making all the right moves in order to bring down our production to a minimum level to allow us to do this in the most effective way possible while keeping this really important infrastructure that we built in manufacturing intact and keeping our supplier relationships very much intact, which are very critical to us. So this is just something that I didn't want to commit to a much shorter time frame, knowing that we will be taking on some more inventory. But I will reiterate in Q3 and Q4, our inventory levels are expected to come down.

Peter Stabler

And as we're approaching market open, we'll have to wrap the call here. Thank you, everyone.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.

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