Q1 2017 Groupon Inc Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to Groupon's First Quarter 2017 Financial Results Conference Call. (Operator Instructions) Today's conference call is being recorded. For opening remarks, I would like to turn the call over to the Vice President of Investor Relations, Deb Schwartz. Please go ahead.

Deb Schwartz,

Good morning, and welcome to Groupon's First Quarter 2017 Financial Results Conference Call. On the call today are our CEO, Rich Williams; and CFO, Mike Randolfi.

The following discussion and responses to your questions reflect management's view as of today, May 3, 2017, only, and will include forward-looking statements. Actual results may differ materially from those expressed or implied in our forward-looking statements. Additional information about our risks and other factors that could potentially impact our financial results is included in today's press release and in our filings with the SEC, including our Form 10-K. We encourage investors to use our Investor Relations website as a way of easily finding information about the company. Groupon promptly makes available on this website the reports that the company files or furnishes with the SEC, corporate governance information and select press releases and social media postings.

On the call today, we will discuss the following non-GAAP financial measures: adjusted EBITDA, non-GAAP earnings per share, non-GAAP net income or loss attributable to common stockholders and free cash flow as well as FX-neutral results.

In our press release and our filings with the SEC, each of which is posted on our Investor Relations website, you'll find additional disclosures regarding our non-GAAP measures, including reconciliations of these measures with U.S. GAAP. Unless otherwise stated, all comparisons on this call will be against our results for the comparable period of 2016 and are excluding year-over-year changes in foreign exchange rates throughout the quarter.

And with that, I'm happy to turn the call over to Rich.

Rich Williams, Groupon, Inc. - CEO and Director

Thanks, Deb, and good morning. Earlier this year, I said we were on a multiyear journey to unlock the potential in Groupon and local. I highlighted 4 core strategic pillars that we believe are critical to our success. These are all foundational initiatives, and 2 are focused on growth. A core foundational pillar is to simplify and streamline our business to make what has historically been a complicated business both more efficient and simpler to operate and deliver value. Given our stage of development as a company, this is exceptionally important. We need to be able to focus our energy, run fast and lean and invest in our future and growth.

Next, it's foundational for us to focus on growing gross profit dollars over time. This may seem basic, but for us, it means placing a premium on gross profit growth and achieving our strategic goals even if it means lower revenue. Going forward, it also means explicitly favoring gross profit dollar growth over margin regardless of line of business. Executing on these pillars is central to keeping Groupon on a momentum-building and profitable growth track. Making our business faster and more efficient and getting more dollars flowing through the system makes it vastly easier to invest where we need it most in our growth pillars.

The growth pillar we're most familiar with at Groupon is growing customers. Over the years, we've demonstrated that customer acquisition is a core competency, and the scale advantages it has provided is a huge asset that should not be underestimated or taken for granted. We plan to continue to double down in this strength.

That said, the other critical pillar for growth, building a great customer experience and product, is where we're shifting our focus and need to develop. When we get this right, our customer scale can become a massive multiplier that should set us up for exciting levels of profitable growth. We're starting to build momentum on this initiative with tangible improvements to the existing Groupon product beginning to scale and more importantly, some exciting new experiences that are testing well. These 4 pillars are what our team is focused on, and our work in the first quarter builds on our now 6-quarter track record of delivery on our strategic initiatives.

We are moving forward and making progress.

For the first quarter, we delivered $45 million in adjusted EBITDA, a 42% increase year-on-year, reflecting our focus on improving SG&A as well as $309 million in gross profit. We also reported $1.36 billion in global billings and $674 million in global revenue. Our core North America business, where we've targeted the greatest percentage of our customer acquisition and product innovation efforts, continues to perform well and in line with our growth expectations, especially in light of what we believe were some macro retail headwinds that hit in the middle of the quarter.

Despite that short-term volatility and a seemingly cautious U.S. consumer, we saw solid demand overall, with North America local billings and units growing roughly 9% in the quarter. We also added another 0.5 million customers, bringing us to 31.6 million active customers in North America. Executing and remaining focused on our strategic initiatives continues to fuel our progress in North America. We expect that momentum to continue.

Our international business, however, continues to see the impact of the significant restructuring actions we took over the last 16 months. As you may recall, we undertook a broad examination of our global geographic footprint as well as our global operations to ensure we're making the right investments in the right countries and that we've built the necessary operational support to manage and grow those businesses over the long term. Ultimately, we undertook a rapid and broad restructuring, reducing our footprint from 47 to 15 countries while, in parallel, reorganizing and centralizing a multitude of key services and processes and scalable centers of excellence that now serve our global business more efficiently. We expected disruption as a result of the restructuring. I believe our team has done an amazing job on this so far, but it's simply not possible to undertake a project of that scale in that kind of time frame and expect business-as-usual operations. It is, however, proving to be a longer path to stability than we initially anticipated. It's important to keep in mind that these streamlining efforts weren't about short-term profitability or performance gains, but rather refocusing and taking the tough, necessary steps to support and build sustainable and profitable businesses. So while we have some short-term disruption to work through, we remain confident that we have an international footprint of attractive markets where we can grow profitably over time. Our team has a plan to work through these challenges and move on to growing our brand and businesses in international. They're heads-down executing against that plan, and we're confident we'll get the business on a stronger track over the course of this year.

Before I hand the call over to Mike, let me provide an update on our strategic focus areas for the year, which we continue to believe are critical areas as our marketplace grows and evolves. First, on streamlining and simplifying our business. In the first quarter, as I mentioned briefly, we completed our footprint exercise as planned and on schedule. Beyond reducing our global footprint, we've seen other opportunities to drive efficiency across our operations, and we've continued to take actions to capture them. While those actions inevitably entail some disruption, they've also generated significant SG&A savings that will help us drive stronger bottom line performance over the long term while also giving us further flexibility to invest opportunistically.

Second, on growing customers and accelerating purchase frequency. We continue to see the benefits of our increased marketing investment. As mentioned earlier, we added 500,000 customers in North America as well as another 150,000 in international on a same-country basis. And we continue to see success by maintaining our 12- to 18-month payback window for this incremental marketing spend. Over the last 5 quarters, we've added 5.7 million customers in North America alone, and these ROI thresholds ensure that we continue to do so efficiently and with an eye toward long-term customer value.

Our international business can also benefit from additional focus on customer acquisition. Increasing our marketing investment in key European cities to extend the Groupon brand and further expand our customer base is part of our existing plan over the coming quarters. We also expect to continue to invest in off-line advertising, which we found to be a great channel for us in terms of customer acquisition, customer engagement and brand building, both in North America and abroad. Our new "Save Up to $100 a Week on What You Do Every Day" campaign launched in February and paints a precise and compelling picture of Groupon as a daily habit while underscoring our core messages of value and savings. These brand-building efforts, measured and held to the same ROI thresholds as the rest of our marketing spend, are a core piece of our marketing strategy at this point, and we continue to improve both our measurement and messaging.

Last, we continue to focus on improving the customer experience. This should be our most important and powerful strategic growth pillar. When we get this right, we have an opportunity to deliver outsized growth. The value creation potential and getting our average customer purchase frequency from 5 to 10 or 20 on a base of nearly 50 million customers is simply massive. A great product can fuel this kind of change. A few years ago, we didn't have great clarity on what that really meant. Now I believe we do, and we're excited and focused on delivering it for customers.

We believe a great customer experience on Groupon is really pretty basic. It's 2 things: First, we need to largely eliminate vouchers. Yes, that means Groupon without the physical coupons for the vast majority of situations. We sell billions of dollars worth of coupons every year. But let's be honest, not many people truly love the paper version. What people do love is saving both money and time, and we can do that for them without the paper. In order for Groupon to be seamless, we need to build on our strengths in mobile and take the next step to becoming voucher-less.

With voucherless redemption providing a new foundation, the second component of a great customer experience becomes both more apparent and addressable. We need amazing selection. With a voucherless, convenient experience, we expect customers to visit Groupon and search a lot more than they do today. Customers just need to be able to find what they're looking for on Groupon when they're hungry or bored or just need a car wash.

Great selection and inventory is a cornerstone of engagement in any scaled marketplace. As much as we scaled inventory over the years, our existing product doesn't give merchants flexibility to offer lower discounts and even market rate inventory in our mobile-first experience. We have to scale products that support that flexibility. Our card-linked offers product, which is live in a small number of markets today, is the tip of the spear for both voucherless and scaling inventory. This product highlights just how much better the local commerce experience can be with product innovation, modern tooling, strong partners and customer focus. It's early, but we love what we're seeing with that product so far. I'd say it's a true wow experience on our platform, and we're beginning to push hard on moving it to more markets and customers. Why? Because customers that have tried card-linked Groupons are using them much more frequently than traditional voucher-based Groupons, and our sales team is many times more efficient selling to merchants with a much wider range of discounts available and more flexible terms.

We plan to lean into our voucherless efforts heavily, first with card-linked offers, where we'll broaden our partnerships, harden its infrastructure for scaling and aggressively expand to additional markets this year and into 2018. We have plenty to learn through as we scale this improved customer experience, but we're excited for the journey.

With that, I'll hand it over to Mike to provide more detail about the quarter as well as an update on our full year outlook. Mike?

Michael O. Randolfi, Groupon, Inc. - CFO

Thanks, Rich. We made substantial progress during the quarter on critical initiatives that align with our strategy, which include reducing our go-forward international footprint, shifting our resources more heavily toward local, rationalizing our cost structure and working on new product introductions.

The first quarter was a slower start to the year than we expected, and we weren't pleased with our gross profit performance for the period. However, we saw a significant improvement in trends in North America local in March, and that has continued into the second quarter. With the enhancements we've made to the customer experience, coupled with increased efficiencies we have realized within our cost structure, we believe our strategy will enable us to unlock value over the long term.

We remain confident in our full year adjusted EBITDA outlook and continue to believe we are on a path to deliver multiyear adjusted EBITDA and free cash flow growth.

As I discuss our results for the first quarter, note that all comparisons, unless otherwise stated, refer to year-over-year growth and are FX-neutral. Additionally, during the quarter, we exited all remaining 11 countries not included in our go-forward country footprint and have presented the results for the businesses in those 11 countries as discontinued operations in our earnings tables for the current and prior periods. As a result of these dispositions, we have consolidated our EMEA and Rest of World segments into one international segment. We plan to file an 8-K over the coming weeks with our most recent 3 years of financials reflecting discontinued operations and our revised segment presentation. As a reminder, our business is now comprised of 15 countries, primarily in North America and EMEA, where we believe we have a long-term opportunity to win.

For the first quarter, gross profit was $309 million, and adjusted EBITDA was $45 million, up $13 million from $32 million in the year-ago period. Gross profit declined by 2% year-over-year, led by a 2% increase in North America and a decrease of 12% internationally. In North America, gross billings were up 3%, driven by local, up 9%. We added 500,000 active customers in North America in the quarter, bringing total customers to 31.6 million. While we continue to see strong returns on customer acquisition marketing, as expected, net customer growth was partially offset by attrition from LivingSocial customers.

Two factors impacted North America local performance in the quarter. Following double-digit billings growth we experienced in January, traffic softened measurably in February, consistent with the results of many retailers during that month. In response, we were aggressive on pricing to stimulate demand and increased supply of high-quality national retailers that have lower margin but drive long-term engagement. As a result, North America local units accelerated to over 9% growth in the quarter, while gross margin declined 160 basis points. North America local billings growth accelerated in March, and that positive momentum carried forward into April.

In goods, North America billings declined 11% in the first quarter, and gross margins were up 160 basis points year-over-year as we optimized for gross profit. Additionally, we continue to increasingly shift our impression mix and marketing effort from goods toward local, where our supply and merchant base is truly differentiated. While this is having some negative impact on goods billings trends and reduces overall company revenue and cash flow in the near term as we trade first-party goods for third-party local and marketplace sales, we believe this mix best optimizes for overall gross profit generation over the long term.

In international, as Rich mentioned, we drove the team to complete our country exits by March 31 of this year such that we could move forward and focus on our go-forward footprint. We successfully completed those exits in that time frame, but it was not without some short-term disruption to the business and execution challenges. International gross profit declined 12% to $89 million for the first quarter, driven by a 6% decline in billings and a 160 basis point decline in gross margin.

We've made progress across several supply, marketing and product initiatives toward the end of Q1 and into Q2, and we believe these as well as other actions we are taking put us on track to stabilize gross profit internationally in the coming quarters.

Turning to SG&A. Our goal over time is to build a scalable and flexible model with processes, systems and an organization that is highly efficient and leverages the benefit of that scale.

We have made significant progress in early 2017 to better align our cost structure with our business needs and our growth objectives. We plan to reinvest some of our cost savings in marketing and product initiatives that are critical to growing customers and increasing frequency. Our SG&A for the quarter was $232 million, lower by $31 million. We ended Q1 with headcount of approximately 7,100, down roughly 700 from a year ago on a like-for-like country basis. And we took actions in April to further rationalize our cost structure, reducing headcount by approximately another 300 employees. Marketing was $86 million for the quarter, down 1% from the year-ago period. As Rich mentioned, we are excited about our new offline campaign and expect our marketing spend for this campaign to reflect a meaningful step-up in Q2 2017 versus Q1 2017 as well as versus the year-ago period.

Moving on to guidance. We are maintaining our previously provided range of $200 million to $240 million of adjusted EBITDA for 2017. However, with the improvements in international likely to take a few more quarters than originally expected to be fully realized and meaningfully show up in our results, we expect gross profit to come in closer to $1.3 billion for 2017. So still within our $1.3 billion to $1.35 billion range, but likely toward the low end.

Given all of the changes we're making, we want to provide some additional revenue insight. We expect to generate revenue of roughly $2.9 billion or possibly lower this year, which would produce the gross profit results in the range we just discussed. As Rich said, we are managing the business toward optimizing gross profit and are willing to tolerate near-term revenue fluctuations so long as the changes we're making drive improvements in the long-term gross profit performance. For example, in the second quarter, we expect revenue to be down approximately 10% on a year-over-year basis and gross profit dollars roughly in line with Q1 and to build as the year progresses. Put simply, we expect to see improved growth in North America local gross profit relative to Q1 and continued pressure in North America goods and international, all in line with our actions and focus on gross profit.

In addition, we're significantly stepping up our Q2 marketing with investments in our offline campaign. As this marketing investment is likely to exceed our sequential SG&A reduction, we expect that adjusted EBITDA in Q2 will be lower than Q1 and represent only a modest increase over last year's Q2 2016 adjusted EBITDA of $36 million.

Turning to free cash flow. Our free cash flow in the first quarter was negative $150 million, bringing our total free cash flow on a trailing 12-month basis to $5 million. As a reminder, our cash generation is seasonal as we typically consume cash in the first few quarters of the year and generate significant free cash flow in the fourth quarter.

Further, as we shift the business to local from goods, we have a less-favorable working capital benefit pressuring free cash flow in Q1 and possibly in Q2 as compared to the prior year. For the full year 2017, we still expect to generate meaningful positive free cash flow. We ended the quarter with $691 million in cash in addition to our $250 million revolver.

With regard to share repurchases in the first quarter, we repurchased $26 million, and we will continue to be opportunistic going forward.

In closing, as we look forward, we're excited about our initiatives to increase purchase frequency, remind customers of their ability to save money in their daily life, build great supply and develop an efficient, highly scalable organization. We believe this focus will not only give us the ability to continue to build a great company, but will also put us on a path to multiyear adjusted EBITDA and free cash flow growth.

Rich Williams, Groupon, Inc. - CEO and Director

Thanks, Mike. When we last spoke in February, after 5 quarters of strong financial and operational performance, I noted that our work was far from done. I've been clear all along that redesigning a business already operating at scale would take time, but we are making progress. We have a clear plan and believe we're on the right track strategically to unlock the potential in this business. Without question, it's an exciting time at Groupon. We are building what we believe can be one of the great mobile marketplaces, and we're excited to head toward sustained, profitable growth beginning this year and in line with our previous expectations.

With that, let's open it up for questions.

QUESTIONS AND ANSWERS

Answer – Operator: (Operator Instructions) And our first question comes from the line of Sam Kemp from Piper Jaffray.

Analyst: Samuel James Kemp, Piper Jaffray Companies, Research Division - VP and Senior Internet Research Analyst

Question – Samuel James Kemp: First one, Mike, can you call out the organic local billings growth for Q1, excluding LivingSocial? And then I feel like I remember you guys talking about expecting around 200,000 net churn at LivingSocial per quarter after you acquired it, and it looks there was about 100,000 net churn. Can you just talk about what's happening there? And then lastly, given the cadence through Q1 and into Q2, can you just call out, has local billings growth reaccelerated to double digits in March and April?

Answer – Michael O. Randolfi: Sure. So on LivingSocial, in terms of the billings impact in Q1, there was about a 300 basis point benefit of having LivingSocial this year and not having LivingSocial last year. With regards to net customer additions -- so I'll call out a few pieces there. The attrition from LivingSocial was pretty consistent with what we expected, roughly around 200,000 net attrited customers from LivingSocial, which was very much in line with what we expected in the quarter. That's about what we expect in the second quarter until they're on our platform. And then what I would just say is as you think about our net additions just in general is that this quarter on a same-country basis, net additions were approximately 600,000. But if you were to take into account LivingSocial, it'll actually be closer to 800,000, the LivingSocial attrition. So something just to keep in mind. With regard to just the general trends, so we ended the quarter with some strong growth in North America local in March. That strong growth continued into April. I wouldn't, at this stage, quantify what that was other than to say we ended the quarter on a strong note in North America local, and we've begun the new quarter on a strong note in North America local.

Answer – Operator: And our next question comes from the line of Paul Bieber from Credit Suisse.

Answer – Paul Judd Bieber: Can you provide an update on card-linked offers and Beauty Now? And when will those products be launched more broadly? I understand they're only in a couple cities. And will you support Beauty Now expansion with marketing dollars as well?

Answer – Rich Williams: Thanks for that, Paul. It's Rich. So we're -- we -- as I said earlier, we're really excited about both card-linked and Beauty Now. The products are great. If you've used them, experienced them, I think you'd agree that they're just a different way to experience Groupon and one that's really rewarding in a bunch of different ways than what we've had before. So our focus entirely on those products at this point is a combination of tuning the products and hardening the infrastructures for scale while we start to scale them up and launch them in additional markets. We're actively deploying those products in additional markets now. And that includes, of course, selling to merchants in additional markets and onboarding merchants onto those new products and moving them out. And I'd say, expect that to continue to happen over the course of the rest of this year and into 2018. But -- and we'll -- we expect acceleration on our rollouts throughout the course of the year as well. The -- with respect to marketing dollars and marketing support on Beauty Now, I'd actually say it goes to both products. When we're launching a new product, I think, historically, this hasn't been a strong suit of ours. We've just kind of thrown them out there and let them run on their own. These are so different for consumers. It's part of even why we're investing more in TV. We need to get a different kind of story told to customers and a different kind of message in the market. So we're not going to miss that opportunity as we roll these out. So you'll see broader-based marketing across additional channels in markets as we launch these, including our existing online channels as well as things like offline, out of home, et cetera. So keep your eyes peeled for that in additional markets.

Answer – Operator: And our next question comes from the line of Heath Terry with Goldman Sachs.

Answer – Heath P. Terry: Great. Just on the initiative to move to paperless, can you give us a sense of sort of what kind of technology investment that's going to require and where it fits in sort of your other major technology priorities? And then, given the inconsistency of demand that you saw in the first quarter, how do you get confident with the -- with maintaining your full year guidance?

Answer – Rich Williams: Great. Thanks for that, Heath. I'll jump on the first one, and then Mike can cover a little bit on the second as well. As far as the -- as we think about the initiative to move to paperless and voucherless, and it's slotting in our technical investments, technology investments, it -- here's what I told the team: They're unconstrained to make sure that they have everything they need to make sure those products are launched. But they're unconstrained within our current headcount, our current SG&A investment and R&D. So they have the resources they need to continue to move those products forward. Our investment levels in them from a technology perspective have been relatively stable over the course -- last, call it, 6 to 9 months as we've launched them up. So I don't expect any material increase in our SG&A relative to those products or investment. But it's -- if we find a need come down the road as we learn more about those products or see other opportunities to go voucherless that require moving in a new direction, we may shuffle things around. But that will always be our first look as to say how are we deploying our existing investments and our existing resources most effectively to meet those long-term needs. And if we find we can't do that, we've made all the moves we can make, then we'll, of course, consider additional investment in the team. But that -- I don't foresee that really being an issue at this point. And so I'll start off a little bit on confidence in general, and then Mike, please jump in. But part of what gives us confidence about the rest of the year is seeing how the business is responding to our inputs. And in particular, as Mike mentioned, how we -- how the business has responded in March and moving on into April as we continue to stay focused on our strategic initiatives on driving more high-quality inventory, on deploying more high-quality products. So all of those things build to give us more confidence in the trajectory overall of the business and the responsiveness of the business to the things that we're actively implementing day-to-day. So Mike, if you have additional color, please chime in.

Answer – Michael O. Randolfi: Yes, no. As Rich mentioned, if I one, I'd just simply look at the underlying trends. And particularly in the area of our business where we're most differentiated, which is on local, the underlying trends are really positive. So that's what I would say is number one. Number two, if I think about the kind of other 3 things that are going to kind of drive growth over time, it's having customers be aware of you and realizing your marketing message. Our marketing message has been really, really well received. We just see a lot of positive indicators in that. We continue to build out and have initiatives to build out great supply. That great supply is -- continues to be additive, over time, to our platform. And then third, from a product standpoint, we continue to innovate from a product standpoint. Obviously, there's some big things out there that we're very focused on such as our card-linked offers and Beauty Now. But also on a day-to-day, the team has just done a really great job of finding small changes that drive conversion improvement. So all of those collectively give us confidence in the outlook for the remainder of the year.

Answer – Operator: And our next question comes from the line of Mark Kelley with Citi.

Analyst: Mark Patrick Kelley, Citigroup Inc, Research Division - VP and Senior Analyst

Question – Mark Patrick Kelley: I just kind of want to follow up on the card-linked offers question from before. What -- is there a time line to add more partners beyond Visa? And I guess, how important is that in terms of your rollout plans? Do you think you need more partners before you really roll out more broadly?

Answer – Rich Williams: Thanks for that, Mark. Yes, we believe we can go pretty far with Visa as a partner. They're -- they've been a great partner so far, and the team there and our team here has been really tightly coupled and working closely together. But yes, as we really think about a full rollout to the total platform, we're working with additional partners and additional data sources to enable that. Over -- I'd say over the coming couple of quarters, expect to see some additional partnerships on that side that should help us accelerate it. But today, it's not a gating factor. If you think about Visa, Visa is covering 70-plus percent of cardholders, and I think that gives us a lot of runway to offer it to customers. And we control that offering, largely, recall. So if we recognize the user doesn't have a Visa card on file, we can, of course, prompt that user to bring up a Visa card on file. And we -- if they don't have a Visa card at all, we can suppress those offers to make sure that we're not putting irrelevant things in front of them. So we have a lot of control behind the scene. Not a massive gate at this point, but for sure, as we think really long term about voucherless, expanding our partnerships, expanding how we go voucherless is absolutely in our line of sight and something we'll be actively working on here on out.

Answer – Operator: And our next question comes from the line of Tom Champion from Cowen and Company.

Answer – Thomas Steven Champion: I'm just wondering if you could talk about some of your marketing programs intended to boost purchase frequency and kind of the early returns on the Save $100 a Week and if that's getting some of your active customers to engage on a daily basis.

Answer – Rich Williams: Sure. Thanks for that. I'll give you a high level, and then Mike can add a little bit of color as well. But -- it very much starts in this path with just changing the storytelling. Groupon is a well-known brand, but it hasn't been historically a well-understood brand relative to how we've changed the actual business and experience. So as we've built the marketplace version of Groupon, in many consumers' minds, we're still that daily deal email company. So really, our investment in offline starting late last year was really our first push to changing that story and changing that storyline. And in February, when we launched the Save up to $100 campaign, you can really see us leaning into that message hard to just reinforce that even before products like card-linked and Beauty Now, this is a product you can use every day or at least very frequently to save time and money, especially for our core customer. So we're going to continue to do that. Now early returns on it have been really, really pretty strong and -- which is why we've continued to lean into it. We've seen that not just on the financial side. As we measure it with a combination of both proprietary and third-party software and data analytical tools, we've been pleased with the economic outcomes and the ROI and where it's ranging relative to our other channels and specifically, some of our larger-scaled online channel. We've been really pleased with how it's been performing, with how it's changing customer perception of Groupon. And where -- we measure everything, of course, from brand recall and brand recognition. But more importantly, we're measuring brand understanding relative to the usability of Groupon every day to save money. And that was when we started in the 20-ish percent range, and we're now in the 50-ish percent range. So we've seen, in a very short period of time with relatively modest levels of investment, an ability to start changing how people are thinking of Groupon. And we're seeing good, solid traffic patterns and everything else as a result. And so we're going to continue along these lines, and Mike can give you a little bit of color on that front.

Answer – Michael O. Randolfi: Yes. As Rich mentioned and Rich talked about, the Save up to $100 a Week on What You Do Every Day, all the analytical indicators that we see and the financial return indicators indicate this message is really resonating well with consumers and ties very closely into the Groupon brand. And as a result, we are leaning quite heavily into the offline campaign. And when I talked about Q2, I talked about the idea that we're stepping up our offline campaign. Now let me just give you a little bit of quantification around that. If you look at -- in the second quarter, you should probably expect that we're going to spend about $15 million to $16 million more in marketing in Q2 on an absolute basis as compared to Q1. And the primary difference there is our support for that offline campaign. And it's based upon the feedback and the analytics that we're seeing that indicate this message resonates really well with consumers. And it ties very closely into the Groupon brand, and we're seeing it have a positive impact in our North America business where it's playing.

Answer – Operator: And our next question comes from the line of Brian Fitzgerald from Jefferies.

Analyst: Brian Patrick Fitzgerald, Jefferies LLC, Research Division - MD and Senior Equity Research Analyst

Question – Brian Patrick Fitzgerald: Maybe a couple questions, a follow-up to Heath's question on moving to voucherless. Is there a discovery in marketing that you can bring to bear? Also, how quickly can you bring that to bear? And then to what extent does growth supply -- or mix of supply in any way impact how fast you can move to a voucherless scenario? And then I have more follow-up.

Answer – Rich Williams: Okay. I'll start with that, Brian. There are both pieces. You call out a couple of really key pieces on moving to voucherless. On the discovery side, I think -- and marketing both, they tie in that in just -- in the most basic way is just education. We have to get these products not just in front of users. We have to start talking about them more actively. In markets like Chicago, where often, where the product has been deployed, you've seen that dialogue already happening. You've seen investments from us in the local markets [heavying] up on that messaging. And we've seen adoption rates of the products moving in a nice, solid, steady line and moving up and to the right as we'd expect. We feel -- one of the reasons we haven't gone harder, faster on the products, it's not because we didn't see really great, interesting things like frequency increases early on. We did. It's more that we've been working to really square away how discovery works inside the Groupon ecosystem, inside our mobile apps, inside the website because a lot of our current card-linked offers are free-to-claim. So you have free-to-claim products that live right next to pay upfront vouchered products. So there's a lot of cognitive load for users there. And we've had to tune our relevance systems. We'd have to tune our messaging and tune our merchandising displays. So we've had a lot to work through there. We're feeling much better about where those sit, and that's what's giving us confidence to start rolling to more markets. So I think that's on both sides. But those discovery bits internally and the marketing pieces externally, they really need to work together, and you'll see us doing both of those pieces in parallel as we move to additional markets. Supply, there's -- it's really not a -- there's really not a gating factor at this point in supplier mix. Now we've chosen to launch first in the food and drink category and really for restaurants and bars. A couple of basic reasons for that. One is, in particular, that restaurants feel the pain of vouchers more than I think than probably any other category in our business because it's just so much more awkward, and it's not as clear when the voucher exchange is supposed to occur and on and on. And there's so much staff churn and staff training involved in the restaurant business. It alleviates a lot more pain there. It's not that it doesn't work in any other category. We've just decided to focus our efforts there because it is such a cure for some of that acute pain of the vouchered product. But we've seen that merchants, in general, adopt these products. And whether that's -- and I'm saying voucherless in general, whether it's card-linked or Beauty Now. They adopt them at a much, much higher rate. They're way easier for us to sell because they're just better products. So I'm not worried about mix or supply and specific items and supply. I'm really -- it's more our gate is about getting to market and having the conversations with both our existing merchants and new merchants or folks that we haven't been able to convert in the past and doing that at scale. So -- and that's just something we know how to do well. It's just something that does take a certain amount of time because we're talking about a product that we can sell to hundreds and hundreds and hundreds of thousands more merchants, at least we believe we can. And that's going to take a little bit of time over the next coming year and then in 2018 to get that into a place where we feel really good about it.

Answer – Operator: And our next question comes from the line of Tom Forte from the Maxim Group.

Analyst: Thomas Ferris Forte, Maxim Group LLC, Research Division - SVP, and Senior Consumer and Consumer Internet Analyst

Question – Thomas Ferris Forte: On the television advertising front and then marketing in general, to what extent is that having an impact on getting customers to return to Groupon? And what are your other initiatives not just to drive new customer acquisition growth, but to get old customers to come back to Groupon?

Answer – Rich Williams: Sure. Thanks for that, Tom. It's still early for us to have a real -- a great bead on its impact in total customer purchase frequency. That's a number that, as you know, there are multiple factors at play. There's us adding lots of new customers to the mix that have an inherently lower frequency that just haven't had time on our platform to fully engage. So there are some things there that make it hard to tease out. But I will say that we're -- what we have seen so far, as I said before, is really encouraging in how it's changing how people are thinking about Groupon and how it's even impacting traffic overall to the site and direct in our apps and to the website. So we're generally feeling very, very bullish about how TV and our other marketing efforts, in general, to drive more of that top of mind and repeat -- what we believe, at least, will be repeat behavior long term. The other initiatives on the marketing side, I mean, we -- I guess, really, there's 2 fronts. One is, of course, in the marketing side. We talked about we're going to continue to go deeper here. And not just in TV, but in more longer-format storytelling online marketing. So that's -- whether it's video on YouTube, the work that we're doing with other emerging platforms, whether it's Instagram and Snap, et cetera, like that's all a part of the mix here to get Groupon back in front of both existing users that maybe haven't worked with us in a while as well as new users. And that's -- so we'll continue to lean heavily in that. But really, the biggest things that we're working on related to purchase frequency are the products that we're making and the product initiatives we're rolling out. Because that's where we're seeing the clearest signal of significant changes to purchase frequency. As I've said before, I mean, it's -- people who are using these new products and adopting these new products are using them multiple times more frequently than they are using this -- the original Groupon voucher. So tuning our marketing to those products as we launch them in market will be probably the single biggest and most significant change outside of just the things we do normally and outside of TV to change that purchase frequency story over the longer horizon.

Answer – Operator: And our next question comes from the line of Mark Mahaney from RBC Capital Markets.

Answer – James Patrick Shaughnessy: This is Jim Shaughnessy stepping in for Mark. Just another -- to follow up on the card-linked offers. I appreciate the color around the purchase behavior differences. I was wondering if you could maybe give a little more detail around adoption usage from a cohort's perspective? Just some of your older, more frequently -- frequent Groupon customers adopting these products. Is it a mix of both or is it new? And then maybe a second question about how many markets you're in today and expectations for the end of the year in terms of number of markets.

Answer – Rich Williams: Thanks. So on cohort mix with new products, it's a mix of everything. But one -- the thing that we, of course, saw, and it's just how we roll them out, was that our older cohorts adopted them faster just because they're -- they really didn't have additional marketing when we first launched them. We just sort of threw them out into the ecosystem to see how they would gain traction. And of course, our oldest and most active cohorts started to adopt them first. But as we started to layer on marketing, the customer cohort mix is starting to become more broader, and they are starting to become an activation channel, especially as we focused on food and beauty. And those are 2 of our biggest activating channels, and we'd expect that to continue. I think the nuts and bolts of those products are just that they work for people better. And I think our -- I would expect every market we roll into, a similar pattern will play where our older cohorts will adopt first. And then as we layer on marketing and merchandising, new folks will move on. As far as markets that we're in, we're just in a handful of markets today. We're in -- and -- but we're selling in many more markets than that. So I'm not going to give specifics for a specific number of markets over the course of the year, at least not at this point. But we'll update you as we go. But I'd say, watch us to move into some major markets here over the course of the next couple of months, and those are markets that you're very familiar with at this point. And as they become live, we'll give you a heads up when those products are in market.

Answer – Operator: And our next question comes from the line of Sameet Sinha from B. Riley.

Analyst: Sameet Sinha, B. Riley & Co., LLC, Research Division - Senior Analyst

Question – Sameet Sinha: Actually, my question is more regarding international. Clearly, you've done a good job of reducing the number of markets. But with the complexity of the business and, especially domestically as we've seen over the last few quarters, extremely volatile. Can you talk to me about the merits of still being in international markets versus focusing your efforts on the domestic side trying to stabilize the business and getting all the new products out, improving the messaging and improving -- basically, educating the consumers more? The resources probably would be better utilized here.

Answer – Michael O. Randolfi: Sure. So no, I'll be glad to. And so let me just go back to when we originally assessed what markets we were going to remain in and have as part of our country footprint. We essentially looked at what was the opportunity in those markets over an extended period of time, and then what did we think was our potential over time to unlock that opportunity. And we viewed that in the course of years, not 1 or 2 quarters or 3 quarters, but literally over the course of years, but within a reasonable multiyear horizon. So call it a few years. And so from our perspective, we looked at the markets and said, these are markets that have the dynamics, the profile, the type of customers we like, the level of density, the amount of discretionary spending. Some head start in these markets, where we believe that potential ultimately exists over the longer term. And our view on that hasn't changed. And if anything, it's more solidified than at the time we determined our country footprint. If I think about what the potential of the opportunity is, I'd just point out, like if you look at this quarter and you look at our North America gross profit, this quarter, we had $221 million of gross profit in North America. In international, we had about $88 million of gross profit. Our international markets, roughly the same -- similar population size as the U.S. A lot of great cities just like the U.S. It's simply that international, when we were at 47 countries, we didn't have the ability to focus in terms of developing the brand, the supply and the product. So when we think about over the long term, today, you have $88 million of gross profit, and we think about what the potential is to be able to close that gap, at least partially over the course of years with North America, we think that potential exists over the course of the next several years. So we do think there's a really good opportunity to close that gap. And just to remind you, as you grow gross profit, with us having a strong focus on maintaining efficiency, a lot of that gross profit generation over an extended period of time should also flow down to EBITDA and support our goal and our belief that we'll generate multiyear adjusted EBITDA and free cash flow growth. So that's our thought process around international.

Answer – Operator: And our next question comes from the line of Brian Nowak from Morgan Stanley.

Analyst: Brian Thomas Nowak, Morgan Stanley, Research Division - Research Analyst

Question – Brian Thomas Nowak: I guess kind of bigger picture. A few months ago, you really talked about how gross profit is the key metric, and I understand turnarounds can be choppy and things. It sounds like it's been a bit more challenged. I guess I'd be curious to hear about more specifics on things that have surprised you year-to-date, both domestically and internationally, just kind of more detail on the international execution issues, in particular. And then what strategies did we really look for to kind of remedy the challenges you've seen year-to-date?

Answer – Rich Williams: Great. I'll start, Brian. Thanks for that. And Mike will add some color as well. It was a pretty big change for us to move -- to focus on gross profit. It's important to keep that in mind. And yes, as you said, rebuilding a business, turning around a business, it's -- these are not overnight exercises when you're talking about $6 billion top line businesses. But this is a business, putting that aside for a second, where if you take a step back and look back even to 2012, you've seen a business that's been increasing revenue since 2012. Lockstep, every year, revenue basically increasing, while gross profit has been on a negative trend over the same period of time. We don't think that's healthy. We don't think that's the right model at all. And I think in general, most people agreed with us as we made this move. But you're also -- put that in context. We're overcoming almost 5 years of momentum of focusing on revenue at the expense of gross profit. So within a quarter, it's kind of why we frankly don't guide to quarters because we expect some amount of volatility to occur. What surprised us, however, as we're changing all this other stuff, that is not a surprise. The stuff where we have our hands on the wheel changing things, those worked as we frankly expected them to work. What surprised us was more just the macro softness that we've seen in North America and that we weren't alone in seeing. I think you've probably seen the GDP numbers in Q1, not exciting. You go back to 2009 to see GDP growth in that zone relative to what it is. I think that was a surprise. So that -- yet, I'd say we still put our hands on the wheel on that one and steered into it and said, we're going to lean into that change. We are not going to be fazed by it, and we're going to be willing to keep customers engaged in the product. So we leaned in the promotional calendar. We had some amazing retail offers with big brands in the platform. We invested more in order discounts, which is a contra GP to the tune of about $11 million in NA in Q1. So I think in general, the transition from 5 years of revenue focus at the expense of GP to a focus on GP during a time with a lot of customer volatility, it's right in line with our expectations, and we'd say the business is very much on track. So it's not something that's lost on us, the volatility, and it's not something we like either. And as Mike said, we're not pleased with how things are. We believe, if not for February, we could have been in a much, much better position, and we can see that in March and April. But we are continuing to focus on the same things. Strategically, they've proven over the last now 6 quarters, that they have the right kind of impact on this business. We're going to continue to focus on growing our customer base. We're going to continue to focus on building amazing products that bring people back to our platform more frequently. We're going to continue to lean into our efforts to make the business simpler to operate and have it deliver more value. We're going to continue to be more efficient in how we operate the company. And I think those, over the longer horizon, will deliver the kind of results that we do expect and we will get excited about, and we're steadfast in that belief at this point.

Answer – Michael O. Randolfi: Yes. I think the only couple things I would add there is, first, if you think about from the time Rich became CEO -- and just as a company in North America, we just started focusing on much healthier growth as a company. If you look last year, we had North America gross profit up 10.5%, right? So it's clearly a very healthy trend. And this year, we expect to build upon that. And then so from a North America standpoint, we continue to expect to see healthy North America growth, particularly in the local area of our business. The other thing I would just mention is we challenged the team this quarter to complete the exits of the additional 11 countries. And that entailed transitioning people and selling businesses, and that's a significant disruption. Now we think it was the right thing to do. We think it was the right thing to do to get it behind us because we think it's really important to focus on unlocking the value, the full value over time, of the 15 countries we're in. So those were conscious decisions. Those were actions we took, and we believe it's just the right focus over time.

Answer – Operator: And our next question comes from the line of Deepak Mathivanan from Barclays.

Analyst: Akshit Aggarwal, Barclays PLC, Research Division - Research Analyst

Question – Akshit Aggarwal: This is Aki on for Deepak. I guess 2 questions, if I may, first question being, I was wondering if you could talk about any trends you're seeing in the repeat purchase and spend behavior of the cohorts, new users, that you guys brought on board in fiscal '16 maybe in absolute terms. If not, maybe relatively your core customer. So that's number one. Then number two, wondering if you could give any more color on sort of your marketing mix between your different channels that you use and where you think sort of the most [efficiencies] in acquiring new customers today.

Answer – Michael O. Randolfi: Sure. So I'd give you a little bit of context. So as we stepped up our marketing in the last year, as we added customers, the cohorts have performed very much in line with our expectations. So our expectations were that they have a payback of 12 to 18 months, and we're seeing them perform well within those ROI thresholds. And what I would highlight there is if you look at just the history of Groupon, we have -- in North America, over an extended period of time, we have, at some point, acquired over 50 million customers. And today, we have over 31 million customers. So what you see is, is beyond the 12- to 18-month payback horizon is generally, our customer base is pretty sticky and tends to really stick around a long time. So even though we have a 12- to 18-month payback horizon, the lifetime value of those customers tends to be much greater than that over an extended period of time. So we've been very pleased with our customer acquisition efforts, and we continue to expect we'll see benefits from that going forward. With regard to our marketing mix, obviously, as we talked about today, we will be spending more money on offline. We're really please with our offline campaign. It's -- we look at that on a market-by-market basis and have a lot of attribution analysis around it, and it gives us a good degree of confidence that that's a really strong investment. Also seeing good progress and strong returns on the SEM side. We scaled back a little bit on the display side. But overall, we're pleased with our marketing efforts overall. What I would tell you in general, as we think about marketing, our goal over time is to invest within our 12- to 18-month payback thresholds, and that's what we're doing.

Answer – Operator: And our last question for today comes from the line of Doug Anmuth from JPMorgan.

Analyst: Lina Yurivna Rudashevski, JP Morgan Chase & Co, Research Division - Analyst

Question – Lina Yurivna Rudashevski: This is Lina on for Doug. Can you just provide some more color on how you're reengaging merchants? Beyond providing more flexible terms, are you looking to maybe lower your take rate in instances to grow quality merchants on the platform?

Answer – Rich Williams: Thanks for that, Lina. It's interesting. I mean, we -- it's not that we've ever stopped engaging merchants. There's definitely merchants out there that have worked with us in the past that -- and that have stopped for whatever reason that we're -- that we actively engage with. And there's lots of merchants we haven't worked with at all, and I think that's the bigger piece of the pie for us. If you look at even the last time we talked about our offers count, we're just a business that, in virtually every country we're in, is in the single digits of penetration into the merchant landscape. So we're -- we have a ton of headroom to go. So for us, it's less about purposeful reengagement and more about just how do we engage with the broader merchant space to bring them onto Groupon and to find ways that work for them on our platform. How that relates to take rates, we're -- we've been flexible with take rates on -- relative to quality for years, and we'll continue to do that. As we roll out different products, though, you're going to see different take rate mixes. And some of those take rates are going to, frankly, look higher just because of the way that the money flows through the P&L. So in some instances of card-linked, as an example, it's basically a commission-based product. So while our overall commission rate from a merchant might be lower, our commission dollars are relatively similar. Our take rate is going to look really high because it's really our commission is largely our gross profit ex some small processing fee. So you're going to see some changes in that space, but what I will say overall, though, is that take rate or our commission rate isn't a barrier to us moving into -- we're not -- it's not a self-imposed barrier to us increasing merchant scale. It's something that we want to make sure our platform is flexible for merchants and that brings great merchants on so that we can put great offers in front of customers. And the -- our focus on gross profit dollar generation is it provides us great freedom to be able to do that. And our history of now adding good solid gross profit growth for the first time in a long time over the last, call it the last 5 quarters, gives us confidence that it's the right call.

Answer – Operator: Thank you. Ladies and gentlemen, that concludes our conference call for today. We thank you for your participation, and you may now disconnect. Everyone, have a great day.
