Q2 2017 Groupon Inc Earnings Call

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PRESENTATION

Operator

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

The following discussions and responses to your questions reflect management's view as of today, August 2, 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 risk 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 also 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, everyone. The second quarter saw strong execution against all fronts of our strategy and continued steady progress toward our long-term mission. We're in the driver's seat and on our way to building the daily habit in local commerce.

Our decision to lean into some macroeconomic headwinds last quarter helped us regain some momentum and ultimately accelerate our local business as we move through Q2. In addition, our focus on running a streamlined global operation, our commitment to fueling gross profit growth and our initiatives to invest in the customer experience and increased engagement continue to gain traction and strengthen our business fundamentals. Once again, the team remained incredibly focused and delivered results while continuing to advance our long-term goals.

I'll cover some news on the longer-term initiatives momentarily, but I'll first take a moment to cover the headway we made in the second quarter. The second quarter saw additional steps on our path to sustained profitable growth. We delivered $53 million in adjusted EBITDA and $328 million in gross profit. Both were solid results, reflective of improved fundamentals in our local business and our decisions to steer more of our focus there, plus our continued efforts to grow our customer base and increase engagement.

North America, in particular, had another strong performance with local units growing more than 10% and gross profit increasing $20 million compared to the previous year. North America goods margins improved to 14.8% as we continue to tune that business for engagement and expanding overall customer lifetime value. Our success in North America local in the quarter was largely driven by the strength of our health, beauty and wellness and things-to-do categories, 2 areas where we have great inventory and increasingly differentiated offerings.

I'd say that we're just scratching the surface in both of these categories, but are already well positioned in each with strong partnerships with companies like Live Nation Entertainment, Viator, and Booker, that make them attractive to customers and merchants. In the second quarter alone, we seated over 1.5 million fans and sent over 2 million people to salons and spas. These are signs of a healthy and growing business, and we plan to build on our competitive and technological advantages in these areas in the second half of the year and beyond.

We're confident and proud of our progress, but our work isn't done. We still have real work to do to unlock the bigger opportunity in local and to improve the performance of our international business, where we continue to see some disruption, primarily as a result of our restructuring efforts. To be clear, we're not surprised by the challenges in international. They are consistent with our expectations and reflective of short-term impacts from market closures and large organizational movements. But we have a plan to turn it around, and we're making progress. Mike will cover more of the details.

But the focus for international is simple: Deliver on the fundamentals of inventory, customer growth and customer experience that have helped put our North American business on ever-stronger footing. In the first half of the year in international, we released a new mobile app, made improvements in search and relevance and began revising our merchant sales and onboarding processes. We ultimately believe the playbook we're following in North America on every critical front will translate to similar gains in international over time, which is why you should expect to see us continue investing there.

Before I turn the call over to Mike for a deeper look at our financial results, let me touch on a couple of our strategic focus areas. First is customer experience. As I said on our last call, the future of Groupon is voucherless. The friction and inconvenience of a traditional voucher or paper coupon in the mobile age from Groupon or anyone is simply something we have to move past. Our card-linked offers product, which we're calling Groupon+, is the chief way we're working to remove the voucher. Not only does it reduce friction for customers and merchants, it's a potential accelerant for scaling inventory in our marketplace by offering businesses more flexible discounting options, which, in turn, enables them to run more frequently on our platform.

Removing the voucher also makes Groupon easier to work with for merchants who no longer have to train their staff on accepting Groupons or create bespoke, potentially confusing deal arrangements. The customers benefit as well with card-linked. They simply pay the way they're accustomed to paying, yet still enjoy valuable Groupon discounts on their purchases.

We're building momentum on our rollout of Groupon+, going from hundreds of card-linked offers to over 1,000 by the time we exited the second quarter, and we doubled the number of available markets, including major cities like New York, San Francisco, Chicago and Los Angeles. We're still in earliest minutes of the first period with this rollout, and we expect to continue to ramp the product in terms of cities, merchants, offers, categories and technology throughout the rest of 2017.

On that last piece, our card-linked platform and technology, we continue to invest aggressively in the infrastructure necessary to further scale the product. This means adding more consumer and merchant features to make the product even easier to use, plus expanding payment options for customers. To that end, we just completed an agreement with MasterCard, which should enable us to offer Groupon+ to millions more existing and potential customers. We expect to have MasterCard live on the platform as a Groupon+ linking option later this quarter. All said, the combination of MasterCard and Visa should allow us to address over 80% of U.S. consumers.

While it's still early for Groupon+, we're encouraged by both the customer and merchant response. Our goal is for anyone with a Groupon account and a payment solution, whether that's a credit card or a digital wallet, to have access to seamless Groupon offers and discounts. We believe our approach with Groupon+ delivers an outstanding customer experience and the ability to work with even more local businesses over time.

Likewise, we're seeing exciting prospects in our beauty booking product, which we call Beauty Now. This is another voucherless and, importantly, cashless experience, where customers book their service, set a time and pay online in advance at their convenience, much as one might arrange for a car, flight or a hotel. Beauty Now was launched a few short months ago, and we've already expanded to 5 markets based on early results and customer feedback. It's nascent, but steadily attracting top-shelf spas and salons, taking advantage of Groupon's position as one of the top online health, beauty and wellness destinations in the U.S. What's exciting about this product right now is the traction we're seeing as a result of the combination of our partnerships and internal bookings technology. In just a few months, we've grown to literally thousands of bookable spas and salons running on Groupon, a dramatic change and clear sign of the needs and opportunity with merchants in this large, historically underserved space.

As we've invested in the customer experience, we've also focused on broad engagement through our marketing programs. As customers have a cleaner and richer Groupon experience, we're driving more of them to our marketplace and looking to bring them back more often. In the second quarter, we saw further traction in these programs.

Bottom line, our marketing efforts are paying dividends. Over the last 6 quarters, we've added more than 6 million new customers in North America alone. We added more than 300,000 customers in North America in the quarter and expect to continue to invest with a 12 to 18-month ROI window and an eye toward generating long-term customer value.

We're particularly pleased with our off-line campaign, which has done an excellent job of driving brand awareness and engagement with our platform. Since we launched off-line campaigns about 1 year ago, we've seen brand understanding more than double. As simple as it sounds, we can't take the importance of this for granted. Bringing our customers along on the journey is critical for our long-term success. We expect to keep investing here with increased focus on purchase frequency and reinforcing Groupon's brand and ability to help customers save money on what they do every day. In addition, we expect to target international customer acquisition more aggressively with our off-line campaigns, focusing on countries where our products and platforms closely resemble those in the U.S. Overall, our combined online and off-line campaigns are performing well, reflected by steadily increasing North America local unit growth, customer growth and gross profit growth.

Finally, our efforts to streamline and simplify the business have further bolstered our overall results. Our hard-earned SG&A improvements are giving us the room to invest in our future while delivering a stronger bottom line. We are leaner, faster and executing better where we believe we can win.

Underscoring that last point, Monday, we announced a long-term commercial deal with Grubhub to power food delivery through Groupon. We believe food delivery is a core local use case, and our own efforts in the area have shown us that it has a home on the Groupon platform. Along the way, we also learned that it's not something we have to directly operate. Restaurants are a large and important part of our business, and food delivery remains an exciting opportunity for them and us.

As we complete the integration with Grubhub expected to be later this year, we'll give customers yet another way to seamlessly enjoy the Groupon experience, including exclusive discounts on something they do multiple times per week, and it will be backed by the leading food delivery platform in the U.S. We believe this arrangement will ultimately allow Groupon and Grubhub to better capitalize on this fast-growing market and better serve restaurants and customers by combining Grubhub's more than 55,000 restaurant partners in 1,100 cities with Groupon's 32 million North American customers and top 25 mobile footprint.

Our partnership with Grubhub is a demonstration of our unrelenting devotion to our customers and merchants. Our marketplace is at its best when we bring customers the best answers to their needs. The power in our platform comes from making local easily transactable and readily available for tens of millions of customers looking to connect with great local businesses and amazing new experiences. We believe strong partnerships are an increasingly important component to unleashing the true potential of our local business. Expect more from us on this front as we build the daily habit.

With that, I'll turn it over to Mike for more color on our performance and outlook.

Michael O. Randolfi, Groupon, Inc. - CFO

Thanks, Rich. As I discuss our results for the second quarter, note that all comparisons, unless otherwise stated, refer to year-over-year growth and are FX-neutral.

We're seeing strong momentum in our North America business and are pleased North America local gross profit accelerated to double-digit growth in the second quarter. Our investments in the customer experience and marketing are paying off, and we continue to see improved EBITDA leverage. For the second quarter, total gross profit was $328 million, an increase of $13 million from a year ago; and adjusted EBITDA was $53 million, up $18 million. We expect this momentum to continue into the second half of the year. And with greater-than-expected progress in driving efficiencies in our cost structure, we are narrowing our adjusted EBITDA guidance range to $215 million to $240 million, raising the midpoint. On gross profit, as we work towards stabilization in our international business, we are maintaining our full year guidance range of $1.3 billion to $1.35 billion.

In North America, gross profit was $234 million, up 8% year-over-year, driven by local gross profit growth of $21 million or 13%. We continue to emphasize local within our marketplace, which not only optimizes the overall business for gross profit growth, but is enabling us to drive share in categories where we believe we have a more differentiated consumer and merchant value proposition. We're seeing customers respond as local unit growth accelerated to over 10%, and gross profit per customer was roughly flat at $30, despite significant growth in net new customers over the trailing 12 months, whose purchase behavior hasn't yet had time to fully mature. We expect this trajectory of double-digit North America local gross profit growth to continue through the third quarter based on strength we've seen through July. North America goods gross profit of $36 million was flat with Q1 and down $6 million year-over-year on strong gross margin performance, which partially offset lower volume. This is in line with our increasing focus on local.

In international, while gross profit of $94 million was roughly flat from a year ago as we worked to return that business to growth following our restructuring actions and country exits, billings and customer trends continue to be negative in the second quarter. Despite the first half performance, we continue to believe that international is a significant long-term opportunity as those markets represent an addressable population greater than North America while only generating a fraction of the gross profit. We believe in the coming years, there is potential to unlock that gross profit opportunity as we leverage the focus associated with our reduced footprint and narrow the gaps in brand, product and supply as compared to North America.

Globally, active customers were 48 million, flat from Q1, with growth in North America offset by declines internationally. In North America, we added 300,000 active customers in the quarter as activations were partially offset by continued attrition of LivingSocial customers. While we continue to see strong returns on customer acquisition marketing, we're increasingly focusing our marketing efforts on frequency and international. We expect, in the back half of this year, global net adds will improve as compared to the second quarter.

Our SG&A for the quarter was $230 million, lower by $29 million. We ended Q2 with headcount of approximately 6,700, down roughly 600 from 1 year ago and down 4,000 compared to 2 years ago before our country exits and divestitures. While we don't expect significant further headcount reductions going forward, given the progress we've made this quarter, we expect SG&A will be lower in the back half of this year as compared to the first half.

As discussed last quarter, we reinvested some of our cost savings into marketing, which was up $14 million sequentially to $101 million. We are seeing strong results from our off-line campaign with an improvement in brand awareness and North America local unit growth. For the third quarter, we expect marketing to increase sequentially by approximately $10 million. That means we expect to have greater year-over-year increases in marketing spending than the 13% year-over-year increase in Q2. As you'll recall, the back half of 2016 was a challenging media period due to the Olympics and election when we pulled back on marketing.

Moving on to guidance. While we are seeing strong gross profit growth in North America and have increased confidence, as we've previously indicated, we still expect improvements in international to take a few more quarters. Additionally, we will lose some gross profit from our decision to exit most of our food delivery operations as we believe it will take some time to replace that gross profit through our commercial agreement with Grubhub. Therefore, we continue to believe there is potential for 2017 gross profit to be toward the lower end of our $1.3 billion to $1.35 billion guidance range.

On adjusted EBITDA, given the progress we've made on our cost initiatives, we are narrowing the range and raising the floor to $215 million to $240 million, despite increased investments in Groupon+ and other purchase frequency initiatives. And keep in mind, while we've seen strength in July that we expect to continue through the third quarter, we anticipate gross profit performance will follow normal seasonal patterns. The third quarter is a seasonally lighter quarter than Q2 for our business. For example, in the third quarter of 2016, total gross profit declined 7% sequentially from the second quarter. In Q3, we expect similar seasonal patterns, and thus, we expect gross profit of around $310 million. This reflects our outlook for international and a continued shift from goods to local, which would lead to revenue below $650 million for the third quarter and $900 million for the fourth quarter.

For the year, as discussed last quarter, we expect revenue of $2.9 billion or lower. Our off-line marketing campaign remains a core part of our brand building and engagement strategy, and we expect this marketing investment is likely to offset our sequential SG&A reduction, which, taken together, would result in adjusted EBITDA for the third quarter of below $40 million.

Turning to free cash flow. It was negative $36 million in the second quarter, bringing our total free cash flow on a trailing 12-month basis to positive $36 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. On CapEx, we now expect it will be lower than 2016, closer to $60 million for 2017 as compared to the $68 million for 2016. For the full year 2017, we continue to expect to generate meaningful positive free cash flow. We ended the quarter with $619 million in cash in addition to our $250 million revolver.

In closing, the investments we're making in customer experience, supply and marketing are translating into improved North America local unit growth; total North America gross profit growth; and laying the groundwork for future international growth, which leads us to believe we're on a path toward multiyear adjusted EBITDA and free cash flow growth.

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

Rich Williams, Groupon, Inc. - CEO and Director

Thanks, Mike. After another quarter of focused execution, we continue to see the benefits of our strategy and the development of an unparalleled local mobile marketplace. We have scale, a great brand and are well positioned to continue to make progress toward our vision and build an amazing company. We continue to invest in the things that helped get us here: customer experience, customer engagement and operational excellence. We believe these are fundamental to building a thriving ecosystem for local businesses. We also believe it's time to start playing more offense and for innovation to take a front row seat at Groupon.

Our network of merchants and partners in local, from world-class restaurants, tickets for great events and activities, to amazing health and beauty services is a tremendous advantage. We have nearly 50 million customers and a brand that runs with the world's best when it comes to satisfaction, and we have genuine wow-level experiences on our platform. Unleashing our innovation engine on this foundation over the next few years should be very exciting.

Now let's take some questions.

QUESTIONS AND ANSWERS

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

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

Question – Samuel James Kemp: Looks like ex LivingSocial, you added about 500,000 net customers during the quarter, which is down just a smidge from Q1. Can you talk about what we should expect going forward in the second half, especially as you shift more of that ad budget towards frequency driving marketing? And then if you look out to the next kind of 12 to 18 months, is the benefit of the Grubhub deal more about outsourcing that operational component? Or is it more about expectations that you have around volume benefits?

Answer – Rich Williams: So thanks for that, Sam. I'll hand it over to Mike to cover the -- just the outlook on the marketing side, and then I'll pick up after that on the Grubhub deal to give you a little bit more flavor on it.

Answer – Michael O. Randolfi: So yes, Sam, on the customer additions, first, I would just highlight that as we go to the back part of the year in general, I think you'll look at Q2 and see that is being relatively a low point on customer adds. So I would expect in the back part of the year, our customer adds for both North America and international will be -- will trend up from what you saw in Q2. So -- and that's while we're still having a frequency message. So I think what you saw in Q2, you're about right, around 500,000 net adds when you adjust for LivingSocial. And within that, we had a strong focus on net additions that had a good quality, really high-quality lifetime value. And so that was part of our 500,000 net adds for North America. But I would expect, both in North America and international in the back part of the year, for those to trend up from the second quarter level.

Answer – Rich Williams: Great. And on the question on Grubhub, you really -- you posed 2 pieces of it. Is it about reducing operational load? Or is it really about growth if we're looking 12 to 18 months out? To take a step back from the deal, really, the 2 things that we've learned -- at least the 2 big things that we learned while operating the business ourselves was that, one, food delivery has a home on the Groupon platform. Our customers understand it, and when we offer it, our customers buy it. The second piece we learned was we don't have to be the ones that really run the back-end and logistics component, the delivery piece and restaurant integrations, frankly, with that product. So when we stepped back from those learnings and we said, well, how do we offer this product to as many of our customers as possible as fast as possible, partnerships started to make the most sense. We could've continued to invest on it as a standalone, but that didn't make as much sense when we had the opportunity to partner with what we believe at this point is the strongest delivery platform for food in the U.S. So we look at it in both ways. We absolutely look at it as a way to reduce operational load over the next 12 to 18 months, especially relative to trying to scale to hundreds of markets on our own. And we also see it as an opportunity for engagement growth and unit growth and frequency growth in the platform over the longer term by being able to offer it to more customers and easier. So we look at it both ways. And right now, our focus with the deal is on getting the integration done. We just signed it, but our goal is very much to make it a core part of the Groupon experience for restaurants and to make it just as seamless as the rest of Groupon will be over time.

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

Answer – Paul Judd Bieber: Just a quick follow-up on the Grubhub line of questioning. Can you walk us through what the consumer experience will be for food ordering of Groupon going forward? Will Grubhub get branding in that experience? And is there any impact of the partnership on the outlook? And then just separately, what was the LivingSocial contribution to billings in 2Q?

Answer – Rich Williams: Great. Thanks for that, Paul. I'll start out on the Grubhub piece. And if Mike has anything to add on LivingSocial after that, I'll turn it over to him. The number one thing to think about with the Grubhub deal, as far as customer experience is concerned, is that our goal is, again, to make it a deeply integrated experience. And what I would say is look at our Groupon To Go experience that we've been running in markets like Chicago and St. Louis and Denver as a bellwether for what to expect in that overall delivery experience. And remember, we largely integrated the OrderUp experience deeply into the Groupon stack, and so it looks and feels exactly like Groupon when you're checking out and on and on. So that's our ultimate goal for the product, is to make it feel as comfortable as the rest of Groupon feels and is integrated as the rest of Groupon feels. We're still working out the specific details of that with Grubhub. But one thing you should absolutely expect is when somebody shows up with food and a Grubhub delivery person is delivering it, they're probably going to be looking -- they're probably very much going to look like a Grubhub delivery person. So there's going to be Grubhub brand. It's going to be present in the delivery experience for Groupon without question. And Mike, I don't know if you have a perspective you want to share on impact and outlook?

Answer – Michael O. Randolfi: Sure. I'll just talk about the outlook in general. I'd first just start by saying, as we've come into Q3, particularly for North America local gross profit, the same trends that we saw in the second quarter, where we saw strong double-digit growth, are the same trends that we've seen continue into Q3. And then in terms of the LivingSocial component to that, it's roughly -- from a billings standpoint, roughly 350 basis points from a billings standpoint, roughly similar take rates to our overall business. And what I would just say about LivingSocial is that we completed our technology integration in the month of June. They're on our platform. We think, over time, that will be additive over time. With regards to our commercial agreement with

Grubhub and the sale of some of the assets associated with our food delivery operations, what I would just say is, in the back part of the year, with the sale of certain of those assets, there were some GP that we'll no longer generate during this year. That's baked into our guidance. Over time, we expect the commercial agreement to ramp up, but that's going to take a little bit of time. So we don't necessarily expect that GP to be replaced this year. So net-net, it's actually a little lower GP in the short term. We obviously are very optimistic about the overall agreement and think it's a great opportunity for both companies.

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

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

Question – Sameet Sinha: A couple of questions here. Can you talk to us about domestic marketing spend? And I know you put that number out in the Q, but if you can give that out on the call, that'd be helpful. And secondly, can you talk about international business? Seems to have stabilized versus Q1. Should we expect this kind of level to continue? Or what are some of the puts and takes there?

Answer – Michael O. Randolfi: Sure. What I would say is, if you look at our marketing spends, both the year-over-year increase that you saw, the $12 million, and I think we're up $14 million compared to Q1, that sequential increase was steered almost entirely at this stage towards North America. Now what I would say is going forward, on marketing, you should expect that as we continue to lean into marketing, you'll see us add more and invest more internationally. We think there's markets there that as we build out the product, as we build out the brand and as we continue to build supply internationally, it will be -- we'll support that with marketing. And we're actually seeing some early -- some good early reads in certain markets. With regards to international, what I would say with regards to international, we definitely are -- it's definitely in a more stable place in the second quarter than it was in the first quarter. However, what I would say is, you still saw us where we had net customer reductions, and we still had some gross profit, GP, small GP decline in the second quarter. I would expect, over time, those trends to improve. However, I would also say we've -- there's been a lot of work that the team has taken on as we've reduced our country footprint. So as we think about this year, we still are, I'd say, somewhat cautious in the short term, but very -- with regards to international, but very optimistic with regards to the long-term opportunity. On international, I mean, we looked at it and -- consistent with my prepared remarks, I mean, the addressable market in those countries exceeds, in a material way, that of North America, yet today, we generate 1/3 of the gross profit. So we think that lends itself to a big opportunity. And with that, we are focusing on those various markets. In the last quarter, we had some significant product improvements, we built out supply. And we think, over time, those types of investments will bear fruit.

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: First one's on card-linked offers. I know it's kind of early in terms of the rollout in places like New York, but your early data suggests you have similar adoption trends relative to some of the test markets. And is the goal to get your payback time either to the low end of the 12 to 18 months target or maybe an improvement there? And then second, you gave out a lot of good color about the marketing plans for the rest of the year. Just curious how it relates to card-linked offers, specifically in terms of how you're planning to allocate your resources there?

Answer – Rich Williams: Yes. Thanks, Mark. So yes, we're really happy with the data that we're seeing off the CLO, and we're seeing very, very consistent performance of -- with CLO rollouts city to city. Customers who adopt it really like it, and we're very excited about that. On the payback side of it, with respect to marketing, we treat it like the rest of the marketing program that we have. And when we apply our 12- to 18-month payback threshold, it's -- there's not really a goal to get it to the bottom end of that at this point. Actually, in that product, the goal is to push it as hard as we can within that 12- to 18-month payback. So if we find pockets of efficiency, we're going to try to scale those efficiency pockets up to generate more volume at either a solid efficiency or push it up to the high end of the range, at least for now. So I would expect us to not be focusing on hitting a low marker or anything else on that. I'd actually be thinking about how do we get as many customers as possible on it as fast as possible to make it even more attractive to merchants. So on the -- with respect to the actual marketing program around CLO, with the onboarding of MasterCard that you're going to see a little bit later this quarter, you should expect to start seeing in market more specific Groupon+ marketing campaigns, and that's going to be broad-based. You're going to see some out of home. You're going to hear about it in our off-line channels. You're going to see more of it in our online channels. And that'll be a market-by-market approach as we get to the place where we feel that the offer volume and content is really great. But for the rest of the year, really, part of our marketing budget will be allocated to just rolling out those products market by market, and you should see that really start to hit a little bit later this quarter.

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

Answer – Heath P. Terry: Just wondering if you can give us a little bit of sense of what you're seeing on the deal side from a category perspective. I know you called out spa and beauty. Any other categories that you're seeing particular growth or contraction in? And overall, how would you measure the level of deal quality that you're seeing on the platform compared to where it's been in the past? And then just quickly on the goods business. Is there a level where we should expect it to stabilize? Or does it, in time, fall into the category that restaurant delivery did for you and you potentially -- to yourself, partnering with someone else or exiting that business altogether?

Answer – Rich Williams: Great. Thanks for that, Heath. I'll start, and then Mike if you have any color, feel free. On the category side, yes, we mentioned some strength in health, beauty and wellness and our things-to-do category. Those are 2 of our largest categories in local. So seeing strength in those is generally a great thing for us, largely driven by both quality of merchant and offerings on our platform as well as our continued focus on shifting more and more attention on to the local business overall. So just a good combination of both strategic execution there and day-to-day inputs management in the business. I'd also say we're actually seeing great development in our home and auto category. It continues to expand for us, another fast-growing category. But overall, local is performing really well. And you brought up how we think about the level of deal quality, and I think you can -- you could -- hopefully, you can see that as a consumer or a customer on the platform. Even just -- right know, if you're going on the platform, you're seeing amazing brands. You're seeing Costco running on our platform right now. It's one of the best brands in the U.S. So overall, in every category, we're seeing significant improvements in overall quality, and that relates directly to the focus of our teams internally on amping up what we would call kind of the -- our Silver+ merchants. And that's really -- we have kind of a metal segmentation here that we apply, but our focus is very much on bringing that high-quality inventory to the platform, especially through our existing vouchers business. As we roll out card-linked offers and some of our other beauty booking and more convenience-based utility-oriented use cases on the platform, you'd actually start to see just more merchant volume, where it's --

quality means a lot of things in the high utility case, and sometimes, quality is just about proximity and availability. So as long as it's, obviously, a reputable merchant and one that's nearby, that can be something more important to our customer than a big-name brand. So I think you'll continue to see us, particularly in our voucher business, push on outright quality. But as you see more and more of our voucherless business coming up, it's going to be about coverage, so expect that over time. On the goods business, just hitting on a couple of pieces of that. You're going to see that business continue to move around a little bit, and a piece of that is we're going to move to where our customers really want to go. So we don't have a specific units level stabilization measure there. It's ultimately more about doing the best thing for the long-term lifetime value of a customer, and that's going to change throughout the year. So obviously, in the back half in Q4, customers naturally gravitate more towards products, and you're going to see a natural gravitation likely to that kind of mix, where goods will be favored a little bit more, just from natural market trends. So we're, at this point, focused on continuing to drive more health in that business, improve its gross profit profile and have it be a great contributor to engagement on our platform and lifetime value of our customers. I don't know if you have anything else to add, Mike.

Answer – Michael O. Randolfi: No, on the verticals, the one thing I would just highlight is on all the verticals where our consumers are purchasing in the local category from us, home and auto, things-to-do, our health, beauty and wellness and food and drink, all of them had meaningful growth in the second quarter. So I'd just highlight that. The other thing is, to Rich's point, as we think about goods, what I would think about just overall is we're focused on maximizing gross profit over the overall platform over an extended period of time. And so to us, goods plays a part of that. It's an important engagement driver for our consumers. But obviously, you're going to see us continue to emphasize our more differentiated local product. What I've highlighted is a couple of things on goods just to expect is -- I would still expect, as we move forward, the revenue trends in goods to be down year-over-year, and I'll just throw out a little bit of color on that. On the other hand, I would expect, from a gross profit standpoint, it's going to get closer to flattish as I look towards the back part of this year. And there's really 3 things going on there. First is you're going to continue to see us have a bias for our local category. It's higher margin and more differentiated. Second, within goods, you will see us manage goods to generate and extract more gross profit from goods itself. And the third thing that I would just highlight is, within goods, you're also going to see us emphasize more of a marketplace model, where we continue to bring third party supply in. Now keep in mind, that third-party supply may be very accretive from a gross profit standpoint, but it has a different revenue dynamic because you don't recognize the grossed up value of the revenue. You simply recognize the commission. So that's going to weigh on revenue, but be additive from gross profit. So as I look from a gross profit standpoint though, I do think it probably starts to look flatter as you get to the back part of the year than you saw in the second quarter.

Answer – Operator: Our next question comes from the line of Justin Patterson with Raymond James.

Analyst: Justin Tyler Patterson, Raymond James & Associates, Inc., Research Division - Internet Analyst

Question – Justin Tyler Patterson: I wanted to revisit Beauty Now. It sounds like the expansion is going very well for that service. How should we think about the cadence of new markets and investment in this category over the course of the year? And then when you look at the customers engaging with that product, how does frequency and just purchasing behavior compare to the overall Groupon service?

Answer – Rich Williams: Sure. Thanks, Justin. So yes, well, Beauty Now is another exciting early progress story. The way to think about our expansion is that over the course of the last quarter or so, we've -- we doubled our markets, and that's a general trajectory that you should expect us to stay on. We're going to be aggressive on expanding markets and building inventory in the markets that we're launched in over the next couple of quarters and likely well into 2018. So there'll be a good pace there, and the team has done a -- got a good cadence, and we're running. The other thing to keep in mind as we push on Beauty Now is that we're also using that effort to expand the bookability on our platform overall. I think that's a very key component for us as we think about voucherless. It's -- booking and appointments, in general, is a doorway to voucherless. And as we onboard merchants onto Beauty Now, we're also onboarding voucher merchants onto the core booking technologies and platforms, so expect that to continue to scale at a pretty heady pace here over the next couple of quarters as well. As far as what we're seeing on the customer side, it's actually very similar to what we see in Groupon+, as we've talked about, the card-linked behavior that we're seeing from customers, where their purchase -- their purchase frequency takes a material step forward once they start to adopt these products. We're seeing the exact same things with purchase frequency about doubling for customers that start to adopt the product. So we're excited on that front, still early obviously, and we got a lot of work to do. But it's general pace, and the customer dynamics behind it are very, very encouraging.

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

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

Question – Brian Thomas Nowak: I have 2. The first one, you talked a lot about, over the past year, on increasing transaction velocity. Can you just talk about the transaction per customer trends you're seeing and how you think about growth between customer count and transactions per customer in the back half and into next year? And then the second one, just on the gross profit guide for the full year and the Grubhub arrangement. Can you just help us a little bit on how big that is from a gross profit perspective, Mike, to kind of -- to call it out as a headwind to gross profit for the year? And what was the EBITDA contribution?

Answer – Michael O. Randolfi: Thanks, Brian. So I'll take the first part -- I mean, the last part first. And with regards to Grub and the sale of certain of our assets from our food delivery business, what I would just say is, there's some impact on gross profit. And we've included that in our gross profit guidance from an adjusted EBITDA perspective. What I would say is it doesn't meaningfully impact our view on adjusted EBITDA in a material way. But -- and that's -- try not to get in too much more detail with regards to that, but I would just say, it's all included within our guidance. On our overall transaction velocity, what I would probably say on that is a couple things is, first, if you look at just our bias and our focus within the business, what you saw this quarter was, if you look at North America local, you saw units up double digits, and that was pretty closely in line with the increase in our customer count. So what you saw was definitely a high degree of engagement on the platform and what I would say is an increased level of engagement, particularly compared to what we have seen in the preceding quarters. It's not -- that's not something that -- that's not a metric that we're going to project going forward. But what I would say is, our focus is clearly on increasing engagement, increasing purchase frequency over time, generating more gross profit per customer, all the initiatives as a company that we're pursuing, whether it be Groupon+, Beauty Now. Our optimization between goods and local are all with that intention, so.

Answer – Rich Williams: Yes. And only thing that I'll add there, Brian, is there's going to continue to be little noise in the units per customer measures as we do a couple of things. One is as overall rate of customer growth starts to stabilize over time, you're -- and those customers that we've acquired, and again, keep in mind, we've acquired 6 million customers over the last 6 quarters, as those folks start to mature and get into a place where their purchase frequency is more in line with previous cohorts, which starts to happen really in year 2 and beyond based on the curves that we've shown in the past, that'll start to be reflected there. But again, you got to keep in mind that, that big load of new customers that inherently hasn't had a time to mature is a bit of a weight to the overall, at least to the units per customer measure, as well as we're making some pretty big shifts between local and goods, and there's a lot of unit trading on that side. There's going to be a little bit of noise there as we get those to stabilize. And ultimately, long term, as we invest in voucherless, we invest in Groupon+ and Beauty Now and other voucherless capabilities that are really designed to add utility to the Groupon platform, we'd accept that -- so we'd expect that to start to overcome that noise. But we're a little bit a ways away from that.

Answer – Operator: Our next question comes from the line of Deepak Mathivanan with Barclays.

Analyst: Deepak Mathivanan, Barclays PLC, Research Division - Research Analyst

Question – Deepak Mathivanan: Two questions. First, Rich, beyond Grubhub, there are many vertical category leaders that have solid platforms with back-end integrations. Should we expect Groupon to pursue more initiatives like that? What are some of the areas that you think make sense? And then second, Mike, you called out SG&A savings in the back half in your remarks. Can you help us with the underlying drivers to achieve that? And long term, how should we think about the SG&A structure for Groupon?

Answer – Rich Williams: Thanks, Deepak. I'll just -- I'll cover the vertical piece. As I mentioned, you should expect this to be a bigger part and partnerships to be a bigger part of our story going forward. But it's not a new part. I want to clarify that. I mean, we've had now, going back 6 or 7 years, an amazing relationship with Live Nation Entertainment, as an example. We had a joint venture -- I have a joint venture with our GrouponLive business there, and that was bringing together the best of the content creators with the biggest local platform with over 30 million customers on it. We've had a great track record on that front. We just haven't done as much of it over the last couple of years. I would expect us to do more of it. Now as you mentioned, there are some great vertical players out there that look at Groupon and say, "Boy, I really want to have access to over 30 million customers in the U.S. or almost 50 million customers worldwide." And we look at them and say, "Hey, we really want access to that great inventory to keep our customers happy and engaged in the platform." So I think there's a lot of opportunity out there for us. Our teams are talking to a lot of folks. And it's just about finding the right combination of agreements, plus finding the right way to integrate those offerings into our platforms so that we leverage the best of Groupon and the trust in the Groupon brand, et cetera. So I'd just say, stay tuned, but expect more.

Answer – Michael O. Randolfi: On the SG&A front, what I would say is, if you look at over the last year, I mean, there's really 3 things that are driving the SG&A improvement: one is simply streamlining our operation and just running a much more focused business than we have in the past; second, moving several of our processes to shared service models; and the third thing is, throughout our business, working to adopt best practice-type practices from an administrative perspective. And all 3 of those have really helped us rationalize our SG&A and helped build a much more scalable model. In terms of what to expect, I would say based upon the actions we've taken thus far, I would expect, in the second half of this year, SG&A will be lower than the first half of this year. But I would say going beyond that, what I would say is, while you should always expect we'll have an eye for efficiency and continuing to improve how to run our business in a more improved way, what you should also expect is we're going to invest in our business. We're going to invest in our product. We're going to support Groupon+. We're going to support Beauty Now. We're going to work to have a good customer experience. We're going to invest in marketing. So my point there is, while over time, we expect to always work to gain efficiencies, you should also expect that we're going to be having offsetting investments as we lean into our business and work to drive growth in our business.

Answer – Operator: And our final question comes from the line of Akshay Bhatia with Bank of America.

Answer – Akshay Bhatia: So just a quick one on the EBITDA guidance. Versus what you guys are expecting for 2Q and where The Street was, it seems like you basically flowed through the beat into the guidance range. Why not take up the guidance to more than that, given what the trends you've seen so far through July?

Answer – Michael O. Randolfi: Yes. So just to highlight what was a source of our beat and what was different from our expectations, and essentially, it was just the strength that we saw in our North America local business, where it really just performed really well in the second quarter, and that's continued into the third quarter. And then what I would say within our guidance range, some of the things we thought about is particularly around international. As I mentioned earlier, we think that's a tremendous long-term opportunity, and we think there's a lot of potential to unlock value there. But we put that business through a lot in the last 6 months. And if you look at the second quarter, we still had declines in customers, small decline in gross profit, declines in billings. And so that was factored into our guidance range that we provided.

Answer – Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a wonderful day.
