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Chewy, Inc. (CHWY) Q1 2026 Earnings Call Transcript

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Q1: 2026-06-10 Earnings Summary

Insights

EPS of $0.43 beats by $0.00 | Revenue of $3.36B (7.74% Y/Y) beats by $7.07M

Chewy, Inc. (CHWY) Q1 2026 Earnings Call June 10, 2026 8:00 AM EDT

Company Participants

Lee Horowitz
Sumit Singh - CEO & Director
Chris Deppe - Chief Financial Officer

Conference Call Participants

Nathaniel Feather - Morgan Stanley, Research Division
Eric Sheridan - Goldman Sachs Group, Inc., Research Division
Douglas Anmuth - JPMorgan Chase & Co, Research Division
Shweta Khajuria - Wolfe Research, LLC
Michael Morton - MoffettNathanson LLC
Anna Andreeva - Piper Sandler & Co., Research Division
Mark Stephen Mahaney - Evercore ISI Institutional Equities, Research Division
Michael McGovern - BofA Securities, Research Division

Presentation

Operator

Hello, everyone. Thank you for joining us, and welcome to the Chewy's First Quarter 2026 Earnings Call. [Operator Instructions].

I will now hand the conference over to Lee Horowitz, Head of Investor Relations and Strategic Finance. Lee, please go ahead.

Lee Horowitz

Thank you for joining us on the call today to discuss our first quarter results for fiscal year-end 2026. Joining me today are Chewy's CEO, Sumit Singh; and CFO, Chris Deppe. Our earnings release, which was filed with the SEC earlier today, has been posted to the Investor Relations section of our website. In addition to the earnings release, a presentation summarizing our results is also available on our website at investor.chewy.com.

On our call today, we will be making forward-looking statements, including statements concerning Chewy's financial results and performance, industry trends, strategic initiatives, share repurchase program and the environment in which we operate. Such statements are considered forward-looking statements under the Private Securities Litigation Reform Act of 1995. These statements involve certain risks, uncertainties and other factors that could cause actual results to differ materially from our forward-looking statements. We encourage you to review our SEC filings, including the section titled Risk Factors in our most recent Form 10-K for a discussion of these risks.

Reported results should not be considered an indication of future performance. Also note that the forward-looking statements on this call are based on information available to us as of today's date. We assume no obligation to update any forward-looking statements, except as required by law. Also, during this call, we will discuss certain non-GAAP financial measures. Reconciliations of these non-GAAP items to the most directly comparable GAAP financial measures are provided on our Investor Relations website and in our earnings release. These non-GAAP measures are not intended as a substitute for GAAP results. Additionally, unless otherwise stated, all comparisons discussed on today's call will be against the comparable period of fiscal year 2025.

Finally, this call in its entirety is being webcast on our Investor Relations website. A replay of the audio webcast will also be available on our Investor Relations website shortly.

And with that, I'd like to turn the call over to Sumit.

Sumit Singh
CEO & Director

Thank you, Lee, and good morning, everyone. Chewy delivered solid results in Q1, continuing to outperform the broader pet category while further expanding profitability and free cash flow. Our results demonstrate the durability of our business model and the structural advantages embedded across the Chewy platform. Despite the consumer environment that weakened in the latter parts of the quarter, we delivered nearly 200,000 net customer additions, achieved solid top line growth and record profitability generated strong free cash flow and maintained consistent category share capture, all while continuing to advance strategic initiatives that we believe will deepen Chewy's competitive moats, drive meaningful free cash flow dollars and deliver long-term shareholder value creation.

Q1 net sales grew 7.7% year-over-year to approximately $3.36 billion. We ended the quarter with 21.5 million active customers, up 3.6% year-over-year, while net sales per active customer or “NSPAC” increased to $597. Autoship customer sales once again outpaced overall company growth increasing over 10% year-over-year and reaching 84.4% of total net sales in the quarter further reinforcing the predictability, durability and recurring nature of our revenue base. Importantly, our performance continues to validate what we have consistently said about the pet category and about Chewy specifically. Pet remains a resilient category, driven by recurring nondiscretionary needs and strong emotional attachment. At the same time, consumers are growing more discerning, driven in part by elevated fuel prices and broader macroeconomic pressures. However, even against this more challenged backdrop, Chewy continues to steadily gain share.

Our value proposition remains exceptionally strong, industry-leading convenience, highly competitive pricing, trusted service, deep assortment and a recurring Autoship ecosystem that customers increasingly rely upon. We believe these advantages become even more relevant in periods where consumers prioritize value, reliability and trusted relationships. Importantly, our ability to continue expanding earnings and free cash flow in this environment further reinforces our confidence in the structural durability of the model.

Now let me spend a few minutes on margins and the underlying drivers supporting our profitability trajectory. Q1 adjusted EBITDA margin reached 7.5%, representing approximately 130 basis points of year-over-year expansion on the back of exceptionally healthy EBITDA flow-through of greater than 25%. This level of profitability at our scale reflects continued strength across multiple areas of the business, including sponsored ads, category mix, supply chain efficiencies, marketing productivity, OpEx discipline and improving operating leverage across our network.

As we discussed previously, our long-term framework for margin expansion remains unchanged. We continue to believe Chewy has a unique and differentiated operating model, one that combines a leading recurring revenue engine with a highly scaled fulfillment and health platform and we remain on track to reach our 10% adjusted EBITDA margin target over time. Importantly, our model does not require outsized industry growth or significant pricing inflation to expand margins. The underlying drivers of profitability expansion remain structural in nature and continue to strengthen, including the expansion of sponsored ads, product mix shift into higher-margin categories, including health and operating expense leverage from automation and scale.

Turning now to Chewy Health and Chewy Vet Care. We continue to believe health represents one of the largest and most compelling long-term opportunities for Chewy. Today, pet health care represents approximately $54 billion of TAM, including over $40 billion associated with in-clinic products and veterinary services alone. Our Chewy Vet Care Clinics are delivering strong stand-alone economics while simultaneously acting as a powerful customer acquisition and retention engines for the broader Chewy ecosystem. Approximately 40% of CVC customers are new to Chewy, and these customers tend to reach a year 1 [NSPACs] of approximately $900. Furthermore, existing Chewy customers who engage with CVC increase share of wallet meaningfully faster than other cohorts following their first visit.

At the same time, our veterinary teams deliver industry-leading productivity metrics, supported by the technology-enabled workflows and AI-assisted tools we are embedding across the platform, resulting in vet retention and employee satisfaction that outperforms peers. In a world where veterinarians are in short supply, this last point affords Chewy a structural advantage relative to peers as we look to scale our Vet Clinic footprint. As part of this strategy, we are excited about the recently announced acquisition of Modern Animal, which closed shortly after quarter end.

Modern Animal adds a highly complementary and well-established footprint with above-industry unit economics, strong clinical expertise and an experience-led technology-enabled model that closely aligns with CVC. This transaction accelerates the expansion of CVC and unlocks multiple avenues to accelerate clinic growth, combining CVC's organic growth with Modern Animal's existing footprint and development pipeline. Combined, we expect to operate approximately 60 clinics exiting fiscal 2026 with embedded revenue contribution approaching approximately $290 million at a steady state. We believe CVC will be a meaningful driver of long-term shareholder value at Chewy and we look forward to updating you on our progress in the coming quarters.

Now turning to AI. We continue to believe AI represents a meaningful opportunity for Chewy, both from a customer experience perspective and from an operational efficiency standpoint. Over the last several quarters, we have continued to build the foundational infrastructure required to deploy AI broadly across the enterprise. Today, we are embedding AI across multiple layers of the business including customer service, pharmacy operations, fulfillment and marketing workflows. We continue to see meaningful opportunities to structurally lower cost to serve while simultaneously improving speed, efficiency and service quality. Based on our current road map and implementation progress, we continue to expect AI-driven efficiencies to contribute a low tens of millions of dollars benefit in fiscal 2026 with a more meaningful ramp expected into 2027 and beyond.

Now before I turn the call over to Chris, I would like to briefly address our outlook and how we are thinking about the balance of the year. While we remain confident in the long-term trajectory of the business and Chewy's share-gaining posture with an increasingly larger pet TAM available to us, we are also recognizing that the consumer pet environment has become incrementally more challenged since we initially established our fiscal 2026 outlook earlier this year. As a result, our updated guidance, which Chris will discuss in more detail shortly, now reflects a more appropriately conservative view of the consumer environment and broader category growth assumptions for the balance of the year.

For clarity's sake, we are seeing a modest level of incremental pressure on premiumization and product attach rates amongst our current customer base, resulting in what we view as a short-term NSPAC headwind. Conversely, our improved go-to-market initiatives including better CRM efforts, resulting in greater conversion, increased engagement via our mobile app, continued success in reactivating lapsed customers and ongoing success in driving down churn is supporting an ongoing healthy trajectory for customer net additions. That said, our confidence in the underlying strength of the business, our ability to continue gaining share and our long-term growth and profitability algorithm remains unchanged.

Pet remains a more resilient category relative to other parts of the consumer landscape and Chewy is increasingly building the capabilities and business lines to accrue a growing share of this incredibly attractive end market. Additionally, the strength of our customer acquisition funnel continues to support sustained share gains across macro environments while also positioning Chewy to return to more typical NSPAC compounding rates as consumer conditions normalize, all on top of a meaningfully larger customer base. Furthermore, we believe our strategic initiatives across health, AI, fulfillment and customer experience continue to strengthen the moat around the Chewy ecosystem.

In closing, I want to thank the entire Chewy team for another quarter of disciplined execution and innovation. We remain focused on delivering profitable growth, durable free cash flow generation and long-term shareholder value creation.

With that, I will turn the call over to Chris.

Chris Deppe
Chief Financial Officer

Thank you, Sumit, and thank you all for joining us today. Q1 results reflect continued disciplined execution across the business, highlighted by continued share gains, meaningful margin expansion and strong free cash flow generation despite a macro environment that softened as we move through the quarter. Q1 net sales reached approximately $3.36 billion, representing 7.7% year-over-year growth, reflecting the continued strength across our recurring revenue base, balanced contribution from both active customer growth and NSPAC expansion and ongoing market share gains within the pet category.

We closed our acquisition of SmartPak in the first quarter as planned and the revenue contribution from the business was in line with our previously communicated $80 million net sales expectation for the full year 2026. We continue to grow active customers ending the quarter with approximately $21.5 million increasing 3.6% year-over-year. Autoship customer sales reached approximately $2.83 billion in the quarter, increasing over 10% year-over-year and representing 84.4% of total net sales. Growth in Autoship continue to outpace overall company growth, reinforcing the durability and predictability of our recurring revenue model. NSPAC reached $597 in Q1, increasing approximately 4.6% year-over-year on a normalized basis when accounting for the extra week in the prior year comparable period, and reflects continued customer cohort maturation, growth in health and wellness penetration and increasing cross-category engagement across the platform.

Turning to profitability. We reported first quarter gross margin of 30.1%, representing approximately 50 basis points of year-over-year expansion, including a low single-digit million dollar impact from fuel surcharges passed on by our carrier partners. Gross margin performance was driven primarily by continued growth in sponsored ads, favorable category mix and continued operating discipline.

Moving to operating expenses. Please note that my discussion of SG&A excludes share-based compensation expense and related taxes as well as transaction and integration-related costs. First quarter non-GAAP SG&A was approximately $593 million or 17.7% of net sales. Now, Q1 non-GAAP SG&A excludes approximately $10 million of transaction-related costs associated primarily with acquisition and integration activities related to SmartPak and Modern Animal. As planned, we delivered approximately 90 basis points of year-over-year SG&A leverage, reflecting continued operating discipline, fulfillment productivity improvements driving down our variable costs and early benefits from technology and AI-enabled efficiencies across the organization.

We continue to lower our cost to serve as we scale. Advertising and marketing expense was approximately $206 million or 6.1% of net sales, reflecting modest leverage year-over-year. As we have consistently stated, our marketing strategy remains focused on profitable customer acquisition and long-term lifetime value generation, and we continue to see strong returns across both lower and upper funnel investments. Q1 adjusted net income was approximately $180 million, translating into adjusted diluted earnings per share of $0.43. Adjusted EBITDA reached approximately $253 million in the quarter representing a 7.5% adjusted EBITDA margin, up approximately 130 basis points year-over-year and reflects adjusted EBITDA flow-through of greater than 25%. This level of profitability expansion reflects the structural strengthening of Chewy's earnings model.

We are expanding earnings materially faster than revenue growth while continuing to invest behind strategic initiatives, including Chewy Health, Chewy Vet Care, AI infrastructure and fulfillment network optimization. The power of our underlying profitability profile allows us to both deliver consistent margin expansion while simultaneously investing into core strategic growth drivers that give us an increasing right to win a growing share of the pet parent wallet. Free cash flow for the quarter was approximately $71 million, increasing over 45% year-over-year. Q1 free cash flow reflected approximately $109 million of net cash provided by operating activities and approximately $38 million of capital expenditures. Our continued free cash flow stream reflects the durability of the Chewy model, the recurring nature of our revenue base and the structural expansion and profitability we continue to drive across the business.

During the quarter, we deployed capital across several strategic priorities, including the acquisition of SmartPak and approximately $200 million of share repurchases under our existing program. These actions reflect our continued confidence in the long-term opportunity ahead of us as well as our disciplined approach to capital allocation. We ended the quarter with approximately $520 million of cash, cash equivalents and marketable securities and over $1 billion of total available liquidity, inclusive of our revolving credit facility. Subsequent to quarter end, we completed the acquisition of Modern Animal further expanding our presence within the highly attractive and under penetrated pet health care market.

In addition, earlier today, we launched a $600 million Term Loan B transaction. Given the scale of our business, the durability of our earnings profile and our consistent free cash flow generation, we believe adding a modest amount of leverage is an appropriate evolution of Chewy's capital structure. We intend to maintain a conservative balance sheet and over time target net leverage below 2x adjusted EBITDA. Within that framework, the transaction enhances our financial flexibility and positions us to continue investing behind our strategic priorities, pursue attractive growth opportunities and return capital to shareholders while maintaining significant liquidity.

Now turning to our updated outlook. As Sumit mentioned earlier, while the pet category remains resilient overall, the consumer environment has become more challenged since we established our original fiscal 2026 outlook earlier this year. Most notably, we are seeing more pressure on discretionary attachment and premiumization behavior across portions of our customer base, resulting in slower NSPAC growth than we had originally anticipated. Against this backdrop, we are updating our full year fiscal 2026 net sales outlook to reflect both the softer consumer environment as well as a more conservative set of internal assumptions for the balance of the year. For fiscal 2026, we now expect net sales of between approximately $13.40 billion and $13.55 billion, representing approximately 6.3% to 7.5% year-over-year growth. Including within this range is an expected net sales contribution of approximately $80 million from SmartPak and approximately $70 million for Modern Animal for fiscal year 2026.

As we entered the year, we anticipated several company-specific initiatives which support improving growth trends through the back half of fiscal 2026, including expectations of the changes to our Autoship product flow would accelerate product line attachment rates and enhanced digital advertising bidding algorithms would drive faster levels of customer growth. While we remain confident in the long-term value of these initiatives and both products are delivering strong underlying gains, the impact of both products have been muted by the macro environment. We no longer believe it is prudent to embed a meaningful acceleration in consumer spending into our outlook given the current operating environment.

The low end of our guidance range assumes the current consumer backdrop worsens relative to the trends we are observing at this point, while the high end assumes spending patterns improve from current levels as we move through the second half. We continue to see healthy active customer trends, ongoing market share gains and continued strength in Autoship. That said, given the current environment, we now expect active customer additions to trend towards the lower end of our previously stated range of approximately 150,000 to 250,000 net adds per quarter. The Chewy customer funnel remains healthy with consistent churn gains during the quarter and extremely healthy reactivation rates, which are being somewhat offset by new to Chewy customer softness due to the challenged spending environment.

Now turning to profitability guidance. Given the continued strength we are seeing across the earnings profile of the business, we are maintaining our full year fiscal 2026 adjusted EBITDA margin guidance range at 6.6% to 6.8% or approximately 100 basis points of year-over-year expansion at the midpoint. That said, as we mentioned as part of the Modern Animal acquisition, while these clinics are highly profitable on a 4-wall mature basis, we expect the business to represent a modest margin rate drag in 2026. Thus, our stable total margin guidance speaks to the increasing durability of Chewy's earnings algorithm.

At the midpoint of our guidance ranges, this implies approximately $900 million of adjusted EBITDA for the year. Importantly, our updated profitability outlook continue to reflect ongoing investment across several strategic priorities, including Chewy Health, Chewy Vet Care, automation initiatives, AI-enabled productivity efforts and continued customer acquisition investments. Our confidence in earnings power of the business continues to strengthen, supported by structural improvements across gross margin, sponsored ads, fulfillment productivity, operating discipline and broader operating leverage throughout the organization.

Furthermore, as we look to continue to deliver robust profitability gains in spite of the more challenged consumer backdrop, we are able to act on certain efficiency gains that we originally had slated for the back half of 2026 earlier in the year supporting full year margin durability. As you think about the cadence of profitability through the balance of the year, there are several important items to keep in mind. First, as we discussed on our prior earnings call, we continue to expect quarterly gross margin cadence in fiscal 2026 to more closely resemble the patterns observed in fiscal 2023 and fiscal 2024. Specifically, we expect second quarter gross margin to contract modestly year-over-year, driven primarily by difficult comparisons associated with nonrecurring MAP pricing benefits realized during the second quarter of fiscal 2025. Despite this quarterly dynamic, we continue to expect gross margin expansion on a full year basis.

Second, we expect SG&A leverage to remain relatively consistent throughout the balance of the year as we continue investing behind strategic growth initiatives while also realizing ongoing operational efficiencies across the business. Taken together, these factors are expected to result in more muted adjusted EBITDA margin expansion during the second quarter relative to the first quarter with stronger year-over-year expansion expected across the back half of the year. Overall, while we are moderating our revenue expectations to reflect the current operating environment, our confidence in the long-term structural margin opportunity and free cash flow generation profile of the business continues to increase.

Now turning to second quarter guidance. For the second quarter of fiscal 2026, we expect net sales between approximately $3.30 billion and $3.33 billion, representing approximately 6% to 7% year-over-year growth. Our second quarter outlook assumes the current operating environment and consumer behavior trends remain generally stable with what we experienced exiting the first quarter. We continue to see healthy active customer engagement, Autoship program strength and continued market share gains, although we expect ongoing pressure on discretionary attachment and premiumization behavior to persist near term. Given the number of moving pieces impacting quarterly profitability cadence including the gross margin dynamics we discussed earlier and our desire to be more transparent and clear with quarterly profitability expectations, we are introducing quarterly adjusted EBITDA margin guidance.

For the second quarter, we expect adjusted EBITDA margin of between 6.3% and 6.4%, representing approximately 50 basis points of year-over-year expansion at the midpoint. As a reminder, second quarter profitability will be impacted by more difficult year-over-year gross margin comparisons associated with nonrecurring MAP pricing benefits realized in the prior year period as well as elevated fuel surcharge costs flowing through the quarter, which we expect to represent a roughly mid-single-digit million dollar headwind to the quarter. At the same time, we continue to expect ongoing SG&A discipline and operational efficiency improvements across the business.

Furthermore, our updated guidance for adjusted EBITDA margin in fiscal year 2026 contemplate similar levels of fuel cost headwinds for the balance of the year. Thus, while second quarter adjusted EBITDA margin expansion is expected to be more muted relative to the first quarter, we continue to expect stronger year-over-year profitability expansion across the back half of fiscal 2026 as reflected in our full year guide as we lap this onetime MAP item. We also expect adjusted diluted earnings per share for the second quarter to be approximately $0.36. And finally, for the full year 2026, we continue to expect share-based compensation expense, including related taxes, to remain broadly flat year-over-year. We are lowering our weighted average diluted shares outstanding by 5 million shares and now expect to end the year with approximately 420 million shares. Net interest expense of approximately $10 million to $15 million given the interest expense on our recently launched term loan and an effective tax rate in the range of approximately 24% to 26%.

In closing, I would like to thank all of our Chewy team members for their continued disciplined execution and focus on operational excellence. We believe the combination of our recurring revenue model growing health ecosystem, structural margin expansion opportunities and strong free cash flow generation position Chewy well to continue delivering long-term profitable growth and shareholder value creation.

With that, I will turn the call back over to Sumit for some closing remarks.

Sumit Singh
CEO & Director

Thanks, Chris. While the consumer environment has become modestly more challenged, our first quarter results reinforce that the power of the Chewy model remains durable and continues to strengthen. We are continuing to gain share with an increasingly larger pet TAM by leveraging the assets and initiatives we have built across Autoship, Health, Vet Care, AI, fulfillment and customer experience. These capabilities are deepening our competitive moats, expanding the durability of our earnings and free cash flow profile and strengthening our right to win a greater share of the pet parent wallet over time. As today's transitory headwinds subside, we believe Chewy will be even better positioned to compound those gains and deliver long-term shareholder value.

With that, I will turn the call over to the operator for questions.

Question-and-Answer Session

Operator

[Operator Instructions]. Your first question comes from the line of Nathan Feather with Morgan Stanley.

Nathaniel Feather
Morgan Stanley, Research Division

I appreciate the quarterly EBITDA guidance, that's really helpful. Can you give us sort of finer point on the puts and takes here that are leading to the sequential margin improvement in the back half of the year?

Chris Deppe
Chief Financial Officer

Yes. So thanks for the question, Nathan. And so Q2, I'll just emphasize, is really all about phasing. The SG&A expansion that we expect in Q2 remained broadly flat to what we saw in Q1 and what we'll see for most of the year. But if you look at our gross margin curve from last year, Q2 had a much higher and sort of outsized increase quarter-over-quarter, that's not our normal seasonal pattern that you can see in our fiscal 2023 and 2024. And so Q2 is really just a phasing of that gross margin where 2026 looks more stable quarter-over-quarter on gross margin rate.

So as you get to the back half of the year, we continue to think back half of the year looks like our full year where SG&A delivers slightly more the gross margin improvement. Gross margin will continue to expand year-on-year, but the seasonality of gross margin in the back half of the year, looks "more normal" versus what we experienced prior. And so again, Q2 is really all phasing. Structurally, SG&A continue to leverage with fulfillment costs. We continue to leverage corporate payroll costs, gross margin will continue to expand with sponsored ads, premiumization and a rational promotional environment.

Operator

Your next question comes from the line of Eric Sheridan with Goldman Sachs.

Eric Sheridan
Goldman Sachs Group, Inc., Research Division

Maybe one and a follow-up, if I could. With respect to the comments you made about the consumer, how should we be thinking about going one level lower on consumer behavior? And are you seeing any deviation in behavior relative to age of cohort or income levels that you want to call out in terms of consumer behavior on the platform?

Sumit Singh
CEO & Director

Eric, this is Sumit. Not really. Those are not data points that we collect on a periodic basis, more so on a twice a year basis. But I can tell you that underneath of it, when we look at cumulative reorder rates for customers, these type of trends are holding very positive. I'm also looking at -- and that's true for new customers as well as reactivated customers. When I look at Nasdaq by cohort for the customers that we acquired in the period 1 of this year that is now lapping sort of 2 periods or that has now been -- who've been with us for 2 periods now those cohort trends are positive.

So broadly speaking, this is -- as we've shared on the call, more so around the broad trends of premiumization and a modest impact on attach rates. But in terms of consumer demographic, those type of data, we don't collect on a periodic basis.

Eric Sheridan
Goldman Sachs Group, Inc., Research Division

Okay. And then just one follow-up, if I can. Against the macro environment you find yourself in now. When you think about some of the longer-term platform and product initiatives that you guys highlighted in your prepared remarks. How do you think about either maintaining or accelerating the investment cadence in the business to capitalize on your market share potential relative to the rest of the industry as you look out towards the remainder of this year?

Sumit Singh
CEO & Director

So ours -- so we're always taking the steps. So we plan twice a year for the long-range plan and then sort of break those plans down into what we would execute over the next 12 months or so. And so our focus is always investing in activities that allow us to grow our TAM and continue to gain incremental share of wallet from customers. So you've seen -- and then underneath the gross margin line, we're investing in activities like building up infrastructure capabilities to invest back in AI that are driving efficiency savings that we've obviously quantified last quarter, and we've again confirmed this quarter.

So if you take that framework, then at the most strategic level, we're investing behind initiatives like Chewy Health and underneath of that, it's Chewy Vet Care and clinic initiatives that opened up the TAM by incremental $40 billion and is the fastest compounder of NSPAC is a good way to look at it.

When you think about our product initiatives, they are much more so to drive NSPAC curves up whether this is investment in Autoship that drives repeat recurring purchase behavior, whether it's improvement in experience that drives incremental, so one of the projects that we mentioned on the script that we are now -- not underwriting as bullish of behavior as we'd initially concepted when we heavy tested it, is this kind of notion of attaching more lines to Autoship per se. And that, again, goes back to the way the consumer behavior is acting rather than the direct kind of loss of our belief that these products will continue to drive product attach rate.

Chewy Plus is another investment for us, although I should be very clear in saying that from a margin investment point of view, it is neutral, not dilutive to 2026. But again, that's one of those initiatives that we essentially are very closely evaluating our product market fit for in pushing NSPAC curves between $300 and $800 up. Now when you go kind of below the gross margin line, then we've clearly talked about continuing to invest in automation, continuing to invest in AI, and that drives SG&A curve leverages while we maintain really strong corporate payroll discipline across the company. So we're evaluating every line of the income statement and ensuring that maximized profit converts into free cash flow on a moving basis.

And then the last capital allocation, which is not directly a capital allocation question, but is how do we efficiently return capital back to shareholders.

Operator

Your next question comes from the line of Doug Anmuth with JPMorgan.

Douglas Anmuth
JPMorgan Chase & Co, Research Division

Sumit, can you talk about just how you get the confidence that the weaker environment late 1Q and into 2Q is macro-driven? And just weighing on the broader category rather than anything market share specific to Chewy. And then when you think about the AI savings that you talked about the low tens of millions in fiscal '26, are you still expecting kind of what you had talked about previously, like $50 million plus in fiscal '27?

Sumit Singh
CEO & Director

The answer to the second question because it's such a direct question and it's yes. Now moving to the first question on how are we confident? What are we viewing et cetera?

So we're very clearly gaining share. Our data suggests that competitive data across the industry suggests that, and there are a few things underneath of it. So when you look at customer retraction towards Chewy, it remains solidly driven by both our efforts as well as when you look at branded searches towards Chewy or direct traffic that is migrating to Chewy, that traffic was stronger. That relative to underlying trends when we look at industry level trends, in Q1, we saw weakening trends within the overall pet food and supplies from an impressions index point of view, and that trend declined year-over-year, underscoring the cautious consumer. And despite this, when you look at Chewy's absolute clicks, they increased mid-single-digit percentages year-over-year, and that was true for pretty much every category that we play in.

Number three, when you look at spend cohort behavior, right, we are continuing to -- outside of the modest pressure that we've talked about in these attach rate, consumables and health care categories that are recurring in nature, fueled by the Autoship flywheel continue to be super strong. And then when we look at underneath the share kind of -- where the share dynamics lie today. We believe the primary source of share gain in the pet industry are still within large e-commerce players such as ourselves. And furthermore, when you look at our customer behavior, we continue to see lower churn, healthier reactivation rates as well as healthy yet modestly worse than expected new customer acquisition.

So all those are indicators in a world where the consumer behavior is changing less so than our proposition is diluting in any particular way. And that gives us the confidence that the pressures that we're seeing are primarily macro related. And then finally, when you look at the fact that e-commerce continues to take strength, we continue to hold on to our customers. We don't see indicators that suggest a meaningful change in the competitive environment. And so taken together, these are the trends that have given us the confidence that the pressure we are seeing today is primarily macro related, reflecting a more cautious consumer environment rather than a result of increased competition or share loss.

Operator

Your next question comes from the line of Shweta Khajuria with Wolfe.

Shweta Khajuria
Wolfe Research, LLC

Let me try 2, please. So when we think about your mid- to longer-term growth rate, in your view, does anything change in the growth algorithm should we be thinking about your growth as sort of 2x the overall industry growth rate driven by the initiatives that you were taking outside of macro environment?

And then the second is on CVC and the veterinarian efforts. Now that the acquisition is closed, could you please remind us what your goals are between now and year-end and how we should be thinking about your expansion efforts there?

Sumit Singh
CEO & Director

Sure. So I'll take the first one. Chris can take the second one and I'll add as required. So yes, the answer to the first question is we still expect us to continue to grow share and to grow 2x or more relative to the market. The value proposition of how we are going to market is only strengthening across from broader initiatives where we're expanding TAM to the precision and quality of execution within those initiatives underneath those TAM, whether that's on the food and supply side of the house or whether that's product -- experience-led products such as Autoship or Chewy Plus, et cetera, or whether that's consumer behavior that we continue to accrue on our platforms. All of those are strengthening.

We have clearly signaled our aspiration in continuing to play and gain meaningful share in the categories that are health related, and we are continuing to see that come true. So overall, none of the expectation nor aspiration has changed in our ability to accrue market share and drive outsized growth relative to the market.

Chris?

Chris Deppe
Chief Financial Officer

Yes. On CVC, Shweta, so clinics, we still believe are a compelling revenue and earnings growth driver for Chewy going forward. We closed the last fiscal year with 18 CVCs and now that we have Modern Animal closed. We've added 29 clinics from them, putting us at 47 clinics. We will continue with our plan as stated of 10 to 12 new openings in fiscal 2026 for Chewy Vet Care and focus on integrating Modern Animal into our operating and technology stacks and then evaluate the business going forward. We'll plan to attack it aggressively via expansion as we move forward and continue to evaluate all of our both organic and inorganic opportunities in the space. So 2026, we'll stay with our 10 to 12 clinic opening plan of record and go from there.

Sumit Singh
CEO & Director

So Shweta to summarize, we will exit '26 with -- we'll exit '26 with roughly 60 clinics. And then as Chris said, our focus is stabilization and integration alongside ensuring that the synergies that we saw both from Modern to Chewy and Chewy to Modern are essentially starting to get unlocked, so we can have a really healthy 2027 relative to those.

Operator

Your next question comes from the line of Michael Morton with MoffettNathanson.

Michael Morton
MoffettNathanson LLC

I just wanted some additional clarity on what you're seeing with the consumer and trying to connect some prior comments. So Sumit, in May when you were at an industry conference, you said you saw gross adds increasing and then churn improving quarter-over-quarter. But the guidance and the forward commentary talks about customer additions coming in at the low end of the net adds range per quarter. I would just love to get a better understanding maybe of some of the breakdown in consumer behavior over the last 30 to 60 days that seems to be driving such a reset. And then part of that is the question we get a lot is Amazon's push into same-day grocery is having an impact in the competitive environment at all?

Sumit Singh
CEO & Director

So on the first one, Mike, nothing has changed relative to how we had forecasted the curve of the year. If you recall our comments from last quarter and then again at Boston, we've essentially provided a range of active ads to be between 150,000 to 250,000 customers on a quarterly basis. And a further comment that we provided was that we will start out the year probably between the low to mid-end of that and then we had baked in an acceleration as we moved from the first half of the year to the back half of the year. Underneath of those 2 comments, if you recall, we have reiterated that we are not underwriting a rebound in how adoption or relinquishment trends are essentially changing. So we were not underwriting any kind of rebound relative to the industry.

So all of the progress that you're seeing is primarily driven by Chewy's efforts against a macro that was expected to normalize coming out of '25, but then we prudently observed that perhaps we should not underwrite that normalization. So all that has changed from that point until now is that we have seen, right, a further -- so instead of the back half getting stronger, we now maintain a point of view that we should be appropriately conservative given the trending that we have seen as we've played through the back half of Q1, which is a modest pressure on NSPAC driven by attach rate, particularly on the discretionary side as well as premiumization headwinds.

So that is what is leading us to update the guidance right? So you could call it, hey, it's majority on the macro, and there's a smaller amount based on our initiatives that we had underwritten or forecasted to provide us a tailwind as we had moved towards the back half of the year to consolidate NSPAC curves and therefore, drive the revenue. I would summarize it as the following, right? If you look at our long-term revenue guidance, it has consistently been high single-digit to low double-digit revenue growth. And the 2 inputs of that algorithm are active adds growing at low to mid-single digit and then NSPAC growing at mid- to high single digits, right? So Q4 performance or '25 performance was very much written with the high end of low single digit in terms of customer additions and then squarely mid-single digits for NSPAC.

And so our curve this year, right, is -- was also initially set for low to mid-single-digit customer additions, which we are now kind of forecasting to perhaps being in that low to mid-range of that 150,000 to 200,000 customers as indicated on our earnings call today. So very consistent with our commentary relative to last quarter coming into this quarter with the update being seen primarily on a slightly weaker macro.

And then second, Amazon's push into same-day grocery. No real comments. As I've mentioned, we're not seeing any change to competitive environment. We keep competitors in the rearview mirror. But clearly, we're focused on our proposition, our customers that continues to compound and we continue to sort of pull away an orbit, if you would, relative to the innovation that we are driving in pet, not only in plastic products that drive our Food and Supply segment, but also in net new categories such as health, equine, specialty animals, et cetera, et cetera. So overall, we feel very good about our positioning.

If you look at pricing or promotional intensity, which is generally a sign of a more competitive environment, I mean, we would say the broader retail environment is active from a promotional standpoint, but remains rational and consistent with what we've seen for quite some time now, right? And our approach continues to center on delivering a strong customer experience while maintaining the business well -- or managing the business with appropriate discipline. So there were times in Q1 when we leaned in on promotions for a discrete period of time because we saw the opportunity in the front half of the quarter. And as we moved into the back half of the quarter, we pulled back and are being deliberate about deploying these dollars to drive higher ROI when we see the opportunity.

Operator

Your next question comes from the line of Anna Andreeva with Piper Sandler.

Anna Andreeva

Piper Sandler & Co., Research Division

Sumit, we just wanted to follow up the pressure with premiumization on the NSPAC. And I think you mentioned that's more across discretionary. Can you remind us what's the penetration of what you guys consider discretionary on the platform? Are you seeing this more with new or existing customers? And just your thoughts on company-specific initiatives to accelerate that NSPAC. I think you mentioned promotional environment is pretty rational for the industry. But do you view higher promotional activity as a lever for Chewy to drive the business just as you go through this softer macro?

Sumit Singh

CEO & Director

Okay. Let's unpack those one by one. So on the first one, premiumization and discretionary, what is the penetration of discretionary strategy, et cetera? Okay. So if you look at our filing, it is clear that hard goods continues to perform well and remains an important contributor to customer engagement and NSPAC growth. So this is less specifically pointing towards hard goods softening, right? What we are referring to is not a decline in hard goods demand rather, the pace of discretionary attachment is running below our original expectations entering the year. And so as you would expect, we forecast down to the line item level on customers that we bring on to the platform, the spending behaviors of those customers, new existing customers and reactivated customers each have different type of cohorts curves that we build in. And within each of these, we're building an attach rate forecast.

So what we are referring to is not a decline in hard goods, rather the pace of discretionary attachment is running below. And so customers are still purchasing discretionary categories but are somewhat being a little more deliberate in their spending decisions than they were several quarters ago. So when we take a step back, our product expansion with hard goods assortment remains healthy, and is continuing to support growth. The distinction is simply that what we consider -- because you could consider treats or we consider treats also as a discretionary item. If you look at the way pet parents are experimental with creeks and average pet parent can try up to 12 different treat brands a year.

And those brands, depending upon the willingness to pay rather than affordability kind of characteristics of the consumer can really lead to high-end premium treats being attached and driving the overall basket. So the whole thing for us kind of moves together in our ability to drive stronger attach. Our Autoship business has continued to grow strongly, and is a premium driver of attach for us. At the same time, some of these other non-sysgen-driven behaviors including some customers adding line items to Autoship that one of our products were supposed to drive. Those are some of the things that we're sort of going staring at and saying, okay, I might have been a bit more bullish on our forecasting.

And then your second is promotions and levers to accelerate?

We don't view -- so we view investment in the business broadly across the spectrum. We don't consider promotions. So when we are investing behind initiatives, right? We're essentially first interested in ensuring that our TAM and profitability expand on a sustainable basis. So we are less interested in chasing dilutive growth. We are also careful about not just over pouring dollars into marketing with the outcome being us picking up lower quality customers.

Anna, you may remember 2023, when we essentially ran sort of cash acquisition offers. And these type of offers just don't have high ROI and generally produce hit and run customers. So is promo lever, I would say demand elasticity is a very proven dynamic in the economics of a business. At the same time, LTV to CAC is a highly disciplined lever that we keep in front of us. And so the ROI of the investment is also very important to us.

Operator

Your next question comes from the line of Mark Mahaney with Evercore.

Mark Stephen Mahaney
Evercore ISI Institutional Equities, Research Division

I just wanted to ask about sponsored ads. And if you could provide a little bit more of an update on this. I know you've been citing it for a while as a driver of gross margin expansion? If you could be more specific about that. And then if there's anything new in terms of the types of advertisers that you've been able to bring on to the platform? Any color there would be great.

Sumit Singh
CEO & Director

Mark, I can start. Chris can add as he sees fit. So sponsored ads, we continue to be bullish, optimistic and pleased with the progress of this particular initiative. If you recall, we exited last year at roughly -- '25, we exited roughly at midpoint of our growth curve, overall expectation of 1% to 3%. And we've leaned in with on-site ads as the primary growth driver of margin contribution in 2024 and '25. As the program continues to grow, we will continue to mix into off-site ads. So broadly speaking, at our entitlement, which we are currently underwriting as 3%, right, we expect overall contribution to be at 2/3 or 70% of that to be converted in to move to the bottom line.

The quarter, we were pleased with, given our efforts to accelerate a product launch that we call Cmax, which allows advertisers to collaborate with us even faster, our ability to solve cold start challenges with new or smaller brands with more efficacy. And so we saw roughly 40% of our advertisers try out the product and give us really high marks for what we've taken to market. And essentially, part of sponsored ads is helping us offset some part of the fuel pressures that we are now citing and are persistently loaded into our P&L.

So broadly speaking, it remains a product that has high customer reception, receives strong scores from our advertisers. We have a healthy level of demand and we continue to focus on optimizing supply and ramping up offsite ads.

Operator

We have time for one more question, which will come from the line of Michael McGovern with Bank of America.

Michael McGovern
BofA Securities, Research Division

Given CVC customers are about $900 in year 1 NSPAC. Can you speak to the customer acquisition cost of a clinic acquired customer versus your primary digital channels. And then second question, just more broadly, can you kind of talk about the EBITDA margin headwind from Modern Animal in the Q2 guidance? Anything along the lines of just how much of the quarter-on-quarter margin headwind is a self-directed investment there?

Sumit Singh
CEO & Director

I'll take the first one. Chris will take the second. So Mike, in terms of customer acquisition costs relative to digital, this has been a pleasant surprise for us. What we've seen is the halo of the Chewy brand when a box is dropped in a particular MSA attracts with very little local activation, attracts high-quality set of customers to CVC, therefore, making our overall acquisition costs also highly efficient.

So as you recall, 40% of customers -- 4 out of 10 customers that are walking into CVC are net new to Chewy. And we expect this -- we've essentially seen this behavior or this particular trend stay true for every box that we have dropped so far in the last 18 boxes that have been dropped. And so at this point, after having operated the infrastructure for roughly 2, 2.5 years, we have some good data points from our original cohorts as well as our newer cohorts. So we're quite pleased with what it's costing us to acquire these customers. The Chewy brand awareness is helping a lot.

Chris Deppe

Chief Financial Officer

Yes, Mike, on the Modern Animal EBITDA margin headwind, as we shared when we announced the transaction, we expect Modern Animal to be generally adjusted EBITDA dollar neutral in 2026. So we shared there's a $70 million revenue or net sales impact for the year, roughly $1 neutral EBITDA, so that provides a modest margin rate drag for the year. From a timing and curve perspective, perhaps that drag is a little higher in Q2 and wanes through the year. But that's the overall view for Modern Animal.

Operator

Thank you for all your questions. This concludes today's call. You may now disconnect.

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