Operator Introduction

Good morning and welcome to the Blue Apron Holdings' second quarter 2021 earnings conference call and webcast. At this time, all participants are in a listen-only mode. As a reminder, this call is being recorded today, Tuesday, August 3, 2021, for replay purposes. A slide presentation has been created to accompany today's remarks and can be accessed on the Blue Apron Investor Relations website. Should you need assistance, please signal a Conference Specialist by pressing the star key followed by zero.

On this morning's call, we have Linda Findley Kozlowski, President and Chief Executive Officer of Blue Apron, and Randy Greben, Chief Financial Officer.

Before handing the call over to the Company, we will review the Safe Harbor statement. Various statements that the company makes during today's call about its future expectations, plans, and prospects constitute forward-looking statements for the purpose of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995.

Actual results may differ materially from those indicated by those forward-looking statements as a result of risks and other factors, including those described in the company's earnings release issued this morning and the Company's SEC filings.

In addition, any forward-looking statements represent the company's views only as of today, and should not be relied upon as representing its views as of any subsequent date. The company specifically disclaims any obligation to update these statements.

During this call, the Company will be referring to non-GAAP measures, which are not prepared in accordance with generally-accepted accounting principles. You are encouraged to refer to the earnings release and SEC filings, where it has defined these measures, and to review the reconciliation of these non-GAAP financial measures to the most directly comparable GAAP measures.

In addition, reconciliations of certain forward-looking non-GAAP measures referred to during this call are included in our earnings release which is available on the company's investor relations website located at investors.blueapron.com under "Events and Presentations."

With that, I would now like to turn the call over to Linda Findley Kozlowski, Blue Apron's CEO.

Linda?

Linda Findley Kozlowski (CEO)

Thank you Betsy. Good morning, everyone, and thank you for joining us today.

Our second quarter results once again highlight the sustained effectiveness of our growth initiatives, in particular our focus on attracting and retaining high-value customers through ongoing product innovation. Adding variety, flexibility and choice has allowed us to offer more ways to bring Blue Apron into kitchens each week. This has resulted in consistent growth of our customer value as demonstrated by our key metrics, including the third consecutive quarter of record Average Order Value. In addition, second quarter Adjusted EBITDA exceeded our guidance. Net loss also exceeded guidance, after adjusting for a non-cash charge associated with the financing agreement amendment in May which Randy will discuss further. Net revenue was in line with our expectations, even without the benefit of the approximately $2.0 million of recovered customer credits relating to a supplier recall in 2020.

Turning now to some second quarter highlights. The continued progress we have seen with our growth strategy is reflected in the sustained levels of heightened customer value, even as more people are being vaccinated and travel is increasing. Orders per Customer were in line with the strong quarterly levels we've recently been delivering, and Average Order Value increased both year-over-year and from Q1 to Q2, reaching a record level. As a result, Average Revenue per Customer was above $310 for the fifth consecutive quarter, the only quarters in which we have achieved that milestone since 2015. Given the return of seasonality we typically experience between Q1 and Q2 and that Q2 2020 benefitted the most from the spike in demand due to the pandemic, we saw total customers decline year-over-year and on a quarterly sequential basis. However, this decline was at levels within our expectations.

Our solid second quarter results reflect a return to a more normalized environment. Throughout the pandemic, we have tracked customer behavior by geographic region to understand the impact on our business as restrictions ease. With more of the country open, we continue to analyze these same geographic data points. The order rates are encouraging, even in places that previously had more stringent restrictions.

This internal data indicates that while the pandemic accelerated and heightened consumer awareness and interest in meal kits, as well as cooking more at home, it's a trend we expect to carry on for some time. Our goal is to continue to implement initiatives that help differentiate Blue Apron from our peer set and grow the value we derive among our targeted consumer group. This consumer segment places a lot of value on high-quality, unique ingredients, and easy to cook, delicious recipes. We are achieving this goal as illustrated by our Average Revenue per Customer, which is up 25%, or approximately $65, to $330, compared to the second quarter of 2019.

Our strategy to achieve this goal is founded on the consistent introduction of new products to create deeper connections with our customers. Compared to two years ago, we now offer significantly more choices and more variety. Our menu has grown to 43 weekly options compared to 17 in August 2019. As a result, every time a customer orders from Blue Apron today, they have more variety to choose from, including select customizable recipes, that allow them to personalize their order to meet their lifestyle. As we've discussed, this leads to increases in Average Order Value and Average Revenue per Customer, as well as customer retention and engagement. To this end, we saw a 26.7% improvement in Average Revenue per Customer for repeat customers compared to the second quarter of 2019.

As I highlighted, our new product initiatives are directly correlated to the increases we are generating in Average Order Value. In Q1, these products in total drove a 14% improvement in AOV, which increased to 16% in Q2. We expect this will continue to drive improvement to AOV in Q3 and again in Q4, even before the introduction of other new products currently on our 2021 roadmap.

The product that has and continues to drive the highest increase in AOV on a dollar basis is our Premium offering. It contributed approximately 68% of the year-over-year improvement in AOV in Q2. This offering features specialty proteins, advanced culinary techniques and unique flavors, which help drive repeat customers. On average, in Q2, 78% of Premium orders each week are repeat Premium customers.

The next key driver of customer engagement, retention and Average Order Value is Customization. We offer the option to swap, add, or upgrade an ingredient in select Two and Four-Serving recipes. In addition to paying more per box, customers who have tried these recipes tend to order at a higher frequency and churn at a lower rate, compared to similar ones who have not tried this option. We also continue to add more personalization to the menu and anticipate that in Q3 of this year, 50% of our Signature menus will be customizable.

In the second quarter, we introduced two new products that are also helping drive AOV - Add-ons and Craft Burger. Both were created, in part, in response to feedback and as we continue to look for ways to delight customers and meet their needs in the kitchen.

Add-ons, which are available on our Two and Four-Serving menus, are a simple way to add an appetizer, a side dish, and/or a dessert to a box each week. This offering allows customers to add more Blue Apron to their table, or can be used for different meal occasions, like a weekday lunch. Add-ons is off to a strong start. Almost 7% of our active customers have tried the offering at least once since it was launched in mid-May. We believe interest in this offering will continue to grow, especially as we look for ways to expand and promote it over time.

Building on the success we've had with our Premium offering, our culinary team is taking menu items that we know our customers love, and elevating the meal experience. Craft Burger is the first product we introduced under this new menu option and it has been proven to be popular so far. Since we've started shipping it to customers' homes in mid-June, Craft Burger has received high ratings and is responsible for 2% Q2 AOV improvement even though it was only available for the last two weeks of the quarter.

I'd also like to highlight the different ways we are expanding variety on our menu as a whole. We recently increased our Two-Serving menu to include 16 recipes, and our Four-Serving menu to 8 recipes. We also introduced the option to double the amount of the serving size on select Two-Serving recipes, which allows customers to have both Two and Four-Serving recipes in the same box for different needs during the week, or to enjoy leftovers. We expect both of these initiatives will help drive order frequency going forward.

Lastly, we are also working to continue to grow Blue Apron Wine. As the only meal kit company in the U.S. that offers a monthly wine subscription, expanding this offering will allow us to continue to give our customers more ways to bring Blue Apron into their homes. Under the leadership of our in-house wine team, we are continuing to expand and enhance our custom Blue Apron wine program. We are now offering select 750-ml bottles on our online Market, in addition to the 500-ml bottles we currently offer as part of a monthly subscription.

These are just some of the product innovations we've introduced which are helping to drive higher Average Order Value on a consistent basis. Similar to many successful e-commerce companies across industries, our objective is to provide our customers with a wide variety of products they can add to their existing box. We have planned for more coming down the pipeline as part of our 2021 product roadmap and believe these new additions will help drive further improvement in key customer metrics.

Shifting now to our marketing efforts, we continue to lean into partnerships with well-respected and recognized brands as a driver of customer engagement, retention and value.

Two weeks ago, we announced our collaboration with Partnership for a Healthier America to create Pass the Love boxes. These boxes were developed by our in-house culinary and nutrition experts, along with former White House Senior Nutrition Policy Advisor and Chef, Sam Kass. Inspired by episodes of the Netflix show, *Waffles + Mochi*, each box includes three easy-to-replicate recipes designed to get the whole family cooking together. These boxes are our most affordable yet, at $6 per serving, and will be available for a limited-time. We are very excited to partner with PHA to highlight the benefits of home-cooked, nutritious meals.

Our partnership with Chef Sam Kass will continue into the coming months. He also developed special recipes that will be available on our menu starting August 9.

In addition, we recently announced new sustainable packaging goals. By the end of 2025, we expect the packaging in our meal kits to be 100% recyclable, reusable or compostable, and to have 75% post-consumer recycled content, by weight.

The Pass the Love boxes and our new packaging sustainability goals are part of our Aprons For All initiative. Through Aprons For All, we're dedicated to managing the environmental and social impacts of our business to support an ethical, resilient food system.

In summary, we continue to make consistent progress across our business to build on Blue Apron's strong foundation and generate sustainable top-line growth and achieve positive Adjusted EBITDA on an annual basis starting next year. We are proud of the success of our revenue building and product initiatives, partnerships and marketing efforts, all of which are contributing to growth in our key customer metrics. We initially launched our growth strategies two years ago and are thrilled to see the results they continue delivering.

As always, we appreciate our long-standing customers as well as those who have recently turned to Blue Apron. We take seriously our commitment to provide every customer that invites us into their homes with a quality meal experience and world-class service. Looking at the growth of our key customer metrics, it's clear that those who invited us into their kitchens see the value Blue Apron offers and continue to order from us. We're striving each and every day to further improve so that we can retain our current customers, grow the value we derive from them, and attract new ones.

I will now turn it over to Randy to talk about our financials in more detail.

Randy Greben (CFO)

Thank you and good morning, everyone.

As highlighted in this morning's release, our second quarter revenue of $124 million was in line with the guidance we provided in May. Net Loss, when adjusting for a one-time non-cash charge of $4.1 million associated with the amendment of our financing agreement was also well ahead of guidance, as was Adjusted EBITDA. Net revenue, Net Loss, and Adjusted EBITDA all included the recognition of the recovery of approximately $2 million of customer credits that we issued in the 2020 third quarter, related to a voluntary recall of onions.

Second quarter KPI performance was again driven by our more expansive menu offerings, the continuation of our successful partnerships, and the rollout of new products such as Add-ons and Craft Burger. Product innovation continues to deliver as a critical component of our growth strategy and we expect to launch additional new products over the balance of this year to provide additional options for our customers to add to their meal-kits, resulting in higher Average Order Value and Average Revenue per Customer.

As previously stated, we plan to support these expansions with higher marketing spend compared to last year. Second quarter marketing spend was $16.3 million, or 13.2% of net revenue, compared to $11.6 million, or 8.8% of net revenue, in the second quarter of 2020. Q2 2020 had low marketing investment as we were focused on meeting the heightened demand brought on by the pandemic. Marketing investment in the first half of 2021 was approximately 14.3% of total net revenue, and we expect to continue to spend above last year's levels in the second half of 2021.

Turning now to a review of our key customer metrics, which continue to reflect the benefit from our focus on customer engagement and retention. We had 375,000 customers in the second quarter of 2021 reflecting a return to normal seasonality, down from 396,000 in last year's second quarter at the height of the pandemic. Orders per Customer of 5.3 continues to track right around our highest levels reported, Average Order Value was a record $63, and Average Revenue per Customer was $330. It's notable that Average Revenue per Customer was more than $310 for the fifth consecutive quarter, the only quarters in which we have achieved that milestone since prior to 2015.

On the cost side, COGS, excluding depreciation and amortization, as a percentage of net revenue, increased year over year by 320 basis points to 62.6%. The increase is primarily due to increases in in-bound freight and outbound logistics costs, as well as increases in food costs. The increases in food costs are primarily attributable to investments made in premium ingredients and seasonal produce, which are components of the enhanced product offerings, choice, and variety that we are providing to our customers. Our variable margin of 37.4% was below what we typically target, largely due to the impact of higher logistics costs which have been well publicized over the last several months, and was also impacted by inflationary pressure on our food costs. We continue to look for ways to address these issues, including working closely with our vendors to negotiate better rates. We expect variable margin will normalize towards historical levels through the back half of the year as we implement strategies to offset the higher logistics and food costs.

We continue to make progress with our initiatives to streamline operations. Since we began to implement these initiatives almost a year ago, we have generated improved efficiencies in several areas, including improvements in productivity and increased asset utilization which has allowed us to absorb the added complexity associated with our new product launches, without compromising on ingredient quality. In addition, we are working closely with our vendors to reduce on-site inventory, and we continue to find mutually beneficial opportunities to reduce operating costs, without creating supply chain risks. Along those lines, as we've managed capacity issues we believe we are able to address current and expected demand from our two fulfillment centers in New Jersey and California. We recently subleased our Arlington, TX facility, resulting in a quarterly cost savings of approximately $200K.

Product, technology, general and administrative (PTG&A) costs were $36.8 million in the second quarter of 2021, and included higher professional fees and investments made to support the company's growth plan and execution on key business initiatives.

The company recorded a one-time non-cash loss of extinguishment of debt of approximately $4.1 million in the second quarter of 2021, resulting from the amendment of the company's financing agreement in May 2021. This transaction was concluded to be an extinguishment of the existing debt, with the amended debt instrument then initially recorded at fair value in accordance with generally accepted accounting principles.

Other income in the second quarter of approximately $500K represented a non-cash fair value adjustment. This resulted from our obligation to issue warrants to our lenders as long as the debt remains outstanding. The warrant obligation is remeasured to fair value at each balance sheet date, with changes in fair value recorded in Other income (expense), net.

On the bottom line, we reported a net loss of $18.6 million and an Adjusted EBITDA loss of $3.5 million, which, as mentioned, when adjusting for the one-time charge related to our financing agreement, were both better than our guidance. Importantly, operating cash flow and free cash flow in the quarter were near breakeven levels, with both improving substantially as expected from the first quarter of this year. The improvement in cash utilization was driven by leveraging investments made early in the year related to the pre-positioning of inventory and other assets that we plan to use to drive our business through the balance of the year, in addition to the normalization of working capital timing. We expect to see an increase in cash used from operations in the third quarter which historically is a seasonally cash-intensive period, primarily related to fulfilling in the warmer summer months, coupled with lower seasonal revenue. Zooming back out, cash utilization over the second half of 2021 should be relatively consistent with cash used in the first half of the year, with the typical seasonality in our business resulting in most of this cash burn occurring in the third quarter.

For easy reference, a reconciliation table from net loss to adjusted EBITDA is included in our earnings release which has been posted on Blue Apron's investor relations website.

Following our equity offering in mid-June which added approximately $21.1 million of cash to our balance sheet, at June 30, 2021, we had net cash of $18.6 million. This includes cash and cash equivalents of $51.0 million, and $32.4 million in total outstanding borrowings under the financing agreement, of which $28.9 million was classified as long-term debt, and $3.5 million was classified as the current portion of long-term debt. We continue to evaluate opportunities to further strengthen our balance sheet.

Our guidance reflects certain assumptions regarding our business, including the execution of our strategic growth initiatives, planned investment increases in marketing initiatives, and ongoing operational improvements. The guidance also assumes that the company will not experience any unforeseen significant disruptions in its fulfillment operations or supply chain.

With respect to our financial outlook, we remain on track to achieve high single-digit to low double-digit net revenue growth this year compared to 2020, with the expectation that the second half of 2021 will return to growth over last year's second half after the narrow declines in Q2. And looking further ahead, we continue to expect to generate our first full year of positive annual Adjusted EBITDA beginning with full year 2022. This expectation reflects our confidence in our readiness to achieve further improvements in our key customer metrics which we expect to drive top-line growth while the business returns to what we believe should approximate our historical pre-pandemic seasonality and variable margin trends. With forecasted improving top-line, we expect sales and operating leverage, as well as continued marketing efficiencies and further cost containment progress in PTG&A expenses.

In summary, we continue to execute well against our growth strategy, and strengthen our relationships with our most valuable customers as we look towards achieving positive annual Adjusted EBITDA next year.

Linda and I will now take your questions.