

REVOLVE

REVOLVE GROUP INC. (NYSE: RVLV) Q2 2021 CONFERENCE CALL

PREPARED REMARKS ON AUGUST 4, 2021

ERIK RANDERSON, VP INVESTOR RELATIONS

Good afternoon, everyone, and thanks for joining us to discuss REVOLVE's second quarter 2021 results.

Before we begin, I would like to mention that we have posted a presentation containing Q2 financial highlights to our Investor Relations website located at investors.revolve.com.

I would also like to remind you that this conference call will include forward-looking statements. These statements include our current expectations regarding the continued impact of the COVID-19 pandemic on our business, operations and financial results, and our outlook for operating expenses for 2021. These statements are subject to various risks, uncertainties and assumptions that could cause our actual results to differ materially from these statements, including the risks mentioned in this afternoon's press release as well as other risks and uncertainties disclosed under the caption "Risk Factors" and elsewhere in our filings with the Securities and Exchange Commission, including, without limitation, our Annual Report on Form 10-K for the year ended December 31, 2020 and our subsequent Quarterly Reports on Form 10-Q, all of which can be found on our website at investors.revolve.com. We undertake no obligation to revise or update any forward-looking statements or information except as required by law.

During our call today, we will also reference certain non-GAAP financial information, including Adjusted EBITDA, Adjusted EBITDA margin, and Free Cash Flow. We use non-GAAP measures in some of our financial discussions, as we believe they provide valuable insights on our operational performance and underlying operating results. The presentation of this non-GAAP financial information is not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP, and our non-GAAP measures may be different from non-GAAP measures used by other companies. Reconciliations of non-GAAP measures to GAAP measures, as well as the definitions of each measure, their limitations and our rationale for using them, can be found in this afternoon's press release and in our SEC filings.

Joining me on the call today are our co-founders and co-CEOs, Mike Karanikolas and Michael Mente, as well as Jesse Timmermans, our CFO. Following our prepared remarks, we'll open the call for your questions.

With that, I'll turn it over to Mike.

MIKE KARANIKOLAS, CO-FOUNDER AND CO-CEO

Good afternoon everybody. We're excited to update you today on the momentum in our business that has been building since the last time we spoke.

There are three key takeaways that I want everyone to walk away with today.

First, we delivered record top and bottom-line results in the second quarter, with accelerating top-line growth compared to 2019. The very strong revenue growth trajectory discussed on our Q1 investor call last quarter improved in May and June and has continued strong through July. We also meaningfully outpaced the record profitability we had delivered in the second quarter of 2020, at a time when REVOLVE uniquely reported very profitable results during the depths of COVID. In fact, our net income and earnings per share more than doubled year over year on top of record Q2 performance from a year ago.

Second, a powerful driver of our exceptional top-line growth in Q2 was the further acceleration of growth within our FORWARD segment, which grew more than 120% on a two-year growth basis versus the second quarter of 2019. A clear and measurable catalyst at FORWARD was the launch of our FORWARD loyalty program early in the second quarter that is fully integrated with REVOLVE. The amount of FORWARD customers coming directly from our existing REVOLVE customer base accelerated almost overnight after we launched the FORWARD loyalty program, contributing strongly to our FORWARD segment growth in the second quarter. Michael will talk more about our cross-marketing efforts between the REVOLVE and FORWARD segments where the percentage of REVOLVE active customers who also shop on FORWARD is less than 5 percent.

Third, as the world has started to reopen, we see our core customer coming back to us in a powerful way. In the second quarter, we generated record growth in new customers and unprecedented numbers of reactivated customers who hadn't purchased from us in several quarters while social events were on pause. As a result, we delivered our strongest quarterly sequential growth in active customers in nearly two years.

With that as an introduction, I will provide an overview of our second quarter results and recent developments.

The strong growth in new customers, the return of our existing customers and our ability to engage with her through our marketing and merchandising, resulted in record net sales of \$229 million in the second quarter, an increase of 60% year over year, and 41% on a two-year growth basis compared to the second quarter of 2019. This is 11 points higher than the 30% two-year growth we reported for the first quarter of 2021.

Our profitability and cash flow in the second quarter were also outstanding. Net income was a record \$32 million, or \$0.42 per diluted share, up more than 100% on a year-on-year basis versus our prior record Q2 results from a year ago. On a trailing 12-month basis, we have now generated more than \$100 million in Adjusted EBITDA during some really challenging times over the past four quarters. That's higher than the combined Adjusted EBITDA we generated in the four years leading up to our IPO in 2019. These results demonstrate how we have leveraged our scalable technology and operating platforms to drive higher margins over time.

And the profitability is converting to substantial cash flow. For the first six months of 2021, we generated \$65 million in free cash flow. This significantly strengthened our balance sheet and positions us to invest in future growth opportunities.

Turning to our people and operations.... With the very strong growth in net sales in the second quarter, we have shifted into aggressive hiring mode. We are bringing on talent, not only to support consumer demand and exciting growth opportunities, but also to ensure we continue to serve our customer incredibly well. I would like to acknowledge and express my sincere thanks to our customer facing teams, in areas such as fulfillment and customer service, for your dedication and perseverance in handling such a strong uptick in customer orders in recent months while we scaled up the teams to add capacity.

From a financial standpoint, it is gratifying to see evidence of scale efficiencies come through on the income statement resulting from the higher demand. For instance, we delivered leverage on fulfillment costs as a result of automation efficiencies as well as our increased scale, and on general and administrative expense, where the costs are more fixed in nature and are spread out across a much larger base of revenue. These operational efficiencies were achieved despite an increasing return rate year over year and were key contributors to our record profitability in the second quarter.

We also continued to manage our inventory very well. This is best illustrated by our gross margin expansion, aided by a record mix of net sales at full price and shallower markdowns in the second quarter. Our clean inventory position at quarter end with low markdown levels further illustrates the competitive advantages of our data-driven merchandising that helps us to quickly adjust our assortment to align with the fast-moving shifts in consumer preference.

We increased our activity on the marketing front this quarter and we are planning to significantly increase our activity in the coming quarters. We will be investing more than ever in what we believe are some truly exciting initiatives to be unveiled in the upcoming weeks. We believe this is the right time to invest and that these investments will help us to further capitalize on our current business momentum, drive incremental consumer awareness and customer activity, and further elevate the brand for the next phase of growth.

Shifting gears, our strong results have not come without challenge and there remains uncertainty in the macro environment.

We are closely monitoring the recent rise in COVID cases around the world and the varying levels of restrictions that are being reinstated, including here in Los Angeles recently. This serves as a reminder that we are not out of the woods yet.

Relatedly, the industry wide supply chain challenges had a progressively larger, albeit manageable, impact in the last few months. This came through in a decrease in the percentage of on-time deliveries from our suppliers and in an increase in our inbound shipping rates. And finally, the potential challenges presented by the recent Apple iOS changes that I mentioned last quarter started to become evident late in the quarter, so it's an area we'll continue to focus on with our advertising partners.

These headwinds are not unique to us and affect all companies. We believe REVOLVE is well positioned to continue to effectively navigate through the many challenges presented in this very dynamic environment.

I'll wrap up with a discussion of regional performance. I am excited by the strong growth in the U.S. market, which increased 59% year over year in the second quarter, and continues to be strong months after the most recent government stimulus payments.

Meanwhile, our international business continues to perform very well and represents an exciting opportunity for future growth. **International net sales grew 63%** in the second quarter of 2021 relative to the prior year, driven by strength in all major regions, and illustrating how well our brand is translating across cultures and geographies.

Drilling into some specifics, our Q2 results illustrate how our international investments can drive growth and customer satisfaction. For instance, Canada was again a standout contributor for the REVOLVE segment after our recent launch of all-inclusive pricing that further raised the bar on our Canadian customer experience. Building on this success, in June we introduced all-inclusive pricing on our FORWARD segment for Canadian customers. It's early, yet the improved service offering has driven a powerful improvement in the growth trajectory at FORWARD off of a small base. Next up, we plan to launch all-inclusive pricing on FORWARD in the UK, another of our largest international markets where we see a meaningful opportunity to expand our luxury offering.

Before I turn it over to Michael, I will just reiterate that while there is still some uncertainty out there, our results demonstrate that we are continuing to navigate the challenges very effectively. Moving forward, we are focused on actively investing in our growth opportunity and we are excited for the path that lies ahead.

MICHAEL MENTE, CO-FOUNDER AND CO-CEO

Thanks, Mike.

We are more excited than ever about the future of the REVOLVE and FORWARD brands and our ability to continue to capture consumer mind share and wallet share over the long term. Our ability to react to the extreme shifts in demand and consumer preferences over the past 18 months has shown how scalable our platform is and how agile we can be.

Last year, when travel and social activities were halted overnight, we were able to react very quickly with merchandise and marketing that connected with her new stay at home lifestyle. Our team and systems enabled us to manage through a very turbulent time, staying connected with our customer and delivering record profitability and cash flow in 2020. More recently, we were able to get ahead of the significant increase in demand and a shift in consumer preference as economies opened up. As our customer started traveling and socializing in person again, we quickly shifted our product mix and re-activated our powerful in-person brand marketing strategy. Outfits for going out on the town and special events are once again among the styles in highest demand. Dresses and skirts returned to outstanding year-over-year growth in the second quarter, even while we continue to drive growth in newer categories. As Mike mentioned, our loyal customers are coming back to us for these core offerings to look their best as they get out again.

Our ability to get ahead of the increased demand for going out categories and have the right product for our customer at the right time was a key driver of the REVOLVE segment's acceleration in net sales in the second quarter of 2021. Combined with our successful management of inventory, we achieved a record percentage of net sales at full price in the second quarter.

The strength in our operational execution, inventory management and merchandise selection were leveraged throughout the business and were very evident in the success of **FORWARD**, our luxury segment that delivered Q2 results that were nothing short of incredible. While momentum has been building at FORWARD for some time, the second quarter was a breakout moment. Net sales increased 151% year over year, and increased 122% on a two-year growth basis compared to the second quarter of 2019. FORWARD also delivered record gross margins in the second quarter.

The strong results underscore FORWARD's differentiated position in the market as a preferred destination for the next-generation consumer seeking curated luxury offerings. As another signal of our momentum, next week we are excited to launch yet another coveted luxury brand on the FORWARD site -- the women's collection from Tom Ford.

Even more compelling is the power of the combined REVOLVE and FORWARD brands.

From a customer and assortment perspective, the two brands are both synergistic and complementary. REVOLVE has historically been focused on the discovery of trend driven, ready-to-wear styles, while FORWARD has been more heavily weighted toward the statement pieces in her wardrobe - shoes and handbags - categories that we know the REVOLVE customer loves and spends on.

We have only recently started to invest to fully leverage our broader platform and customer base to cross market the REVOLVE and FORWARD offerings to maximize our long-term opportunity. Recall that on last quarter's investor call we had just introduced our FORWARD loyalty program that is fully integrated with our REVOLVE loyalty program. So, for the first time ever, we are now directly rewarding and incentivizing customers to cross shop on REVOLVE and FORWARD. The results have far exceeded our expectations in the early going.

We can see in the numbers that the launch of the FORWARD loyalty program was a meaningful contributor to the FORWARD segment growth in the second quarter. After launching the FORWARD loyalty program, we saw a significant increase in the percentage of REVOLVE loyalty shoppers who cross shopped FORWARD. Encouragingly, this rate of overlap continued to increase throughout the entire second quarter. We estimate that the increase versus baseline levels alone generated more than 10% of FORWARD net sales in the U.S. in the second quarter, and contributed more than 30 points to our year-over-year growth for the segment's U.S. results.

More importantly, we believe we are just getting started. The percentage of REVOLVE active customers who also shop on FORWARD remains below 5%, despite the highly complementary merchandise I described. And we have yet to introduce any loyalty programs outside of the U.S., which is an exciting future opportunity. We see the global ecommerce market for luxury as offering significant growth potential, and we are excited to continue our investment in FORWARD to capture this opportunity.

We are also increasing the investment in our powerful brand marketing initiatives. The brand marketing team has been agile and responsive in this very dynamic environment, delivering the right inspiration to our customers at the right time. This increased level of activity and the aspirational content reflective of her current lifestyle, further supported by the appropriate merchandising mix, was a key driver in the record new customer additions and the reactivation of our strong existing customer base that lapsed during the depths of the COVID pandemic last year.

When it became clear that our customer was ready to travel again, we captured her attention by hosting exciting events in aspirational locations such as Bermuda, Tulum, and the Amalfi Coast. These events stimulated her desire for vacation items through our impactful social media content, contributing to the high level of customer engagement with our online shop for vacation items in Q2.

Continuing the momentum on the increased level of investment in the second quarter to successfully capture consumer demand, we are aggressively gearing up for a much larger marketing playbook in the third quarter that will be headlined by some major brand marketing investments. I am very excited about what's in store for us in the coming weeks with events and campaigns that will be unlike anything we have ever done. So, stay tuned.

I'll wrap up with an update on owned brands, another contributor to our strong results for the quarter.

Recall that we are now a few quarters into our reinvestment in owned brands after a reset in early 2020 following the onset of COVID-19.

The early results of our rebuild efforts are very encouraging. Strong consumer demand for our owned brand styles led to a high percentage of sales at full price and exceptional gross margins for owned brands in the second quarter. Also exciting is that the core style-based metrics within owned brands were near record levels in the second quarter. If we continue to execute well and deliver on these core metrics as we scale up the number of styles we offer, the owned brands business has the potential to deliver significant upside to our consolidated gross margin over the long term, especially given the recent strength in our overall gross margin profile on a much lower mix of owned brands when compared to historical periods.

In addition to the strong owned brand metrics and margin profile, we are very excited about the continued expansion of our owned brand capabilities and assortment. In the very near term, we plan to unveil an exciting collection that brings us into an entirely new zone for our offerings. We will continue to invest in our owned brands throughout 2021 and beyond to maximize our long-term opportunity for these exclusive brands that remain core to our strategy.

All told, the recent momentum across the business has been incredible. With our position in the market as a trusted premium lifestyle brand and our deep connection with today's consumer, combined with our strong team centered on data-driven decision making, we have been able to deliver strong results during even the most challenging times. We are primed and ready to drive the next phase of growth.

I'll turn it over to Jesse for a review of the financials.

JESSE TIMMERMANS, CFO

Thanks Michael and hello everyone.

We are very pleased with our results for the second quarter and first half of the year. We believe we are well positioned to capitalize on this reopening opportunity, but more importantly, for continued strong growth over the long term. With that, I'll start by recapping the second quarter.

Net sales were \$229 million, a year-over-year increase of 60%, and reflect a two-year growth rate of 41% compared to the second quarter of 2019. This two-year growth rate is eleven points higher than the 30% two-year growth rate that we reported for the first quarter of 2021.

By territory, both the U.S. and international markets contributed to the strong top-line results with domestic and international net sales growth of 59% and 63% year-over-year, respectively.

By segment, REVOLVE Segment net sales increased 49% and FORWARD Segment net sales increased by an incredible 151% year-over-year in the second quarter.

A highlight of Q2 was accelerating growth in **Active Customers**, which turned positive year-over-year, increasing to 1,554,000. This is a 5% increase from just the first quarter of 2021.

Our customers placed 1.8 million Orders in the quarter, an increase of 52% year-over-year, the highest growth rate in more than 5 years. Importantly, the strong increase in orders was driven by a quarterly record number of new customers, and equally exciting, the reactivation of tens of thousands of customers who had been inactive throughout 2020, during the depths of COVID-19.

Average Order Value, or AOV, was \$255, an increase of 25% year-over-year and essentially flat with the first quarter. Key drivers of the growth in AOV include a higher mix of net sales at full price and shallower markdowns; a shift in mix back to higher price point merchandise such as dresses; and a higher mix of FORWARD net sales. These tailwinds to AOV, which is a gross revenue measure prior to any product returns, were partially offset by a decrease in average units per order year over year.

Moving to gross profit... Consolidated gross margin was 55.6%, an increase of 517 basis points year over year. The strong margin expansion reflects healthy inventory and consumer demand dynamics across both of our segments, that led to a record percentage of net sales at full-price in the second quarter, and a significant decrease in the depth of markdowns.

These positive contributors to gross margin were partially offset by a decrease in the mix of owned brands as a percentage of REVOLVE Segment net sales, consistent with the outlook we shared on recent investor conference calls.

Moving on to operating expenses.... Consistent with our prior commentary, marketing expense as a percentage of net sales increased to above our historical trend line in the second quarter, as we began to invest in the exciting reopening opportunity. We intend to even more aggressively ramp our marketing investment for the balance of the year for both REVOLVE and FORWARD to capitalize on this opportune moment in time for our brands.

Selling and distribution as a percentage of net sales increased year-over-year and on a sequential basis, consistent with our prior commentary to expect deleverage with a normalizing product mix leading to a year-over-year increase in return rate in the second quarter of 2021.

The other two line items, fulfillment and G&A expense, leveraged year-over-year, resulting from automation efficiencies in our fulfillment center, as well as capacity utilization and scale efficiencies resulting from our 60% growth in net sales during the quarter.

The strong top-line results, gross margin expansion and our operating discipline resulted in record **net income** of \$32 million, or \$0.42 per diluted share for the quarter, more than doubling the \$0.20 of diluted EPS in the prior year. Adjusting for a lower-than-expected tax rate in 2021, our EPS would have increased 65% year-over-year.

We reported **Adjusted EBITDA** of \$35 million, a record high and a year-over-year increase of 70%. **Adjusted EBITDA margin** expanded to 15.5% from 14.6% a year ago, an increase of 86 basis points.

Moving to the balance sheet and cash flow statement... During the second quarter, we continued to invest in inventory to position our assortment to support very strong consumer demand. As a result, inventory increased by \$18 million during the quarter, to \$119 million.

Our average inventory balance for the second quarter of 2021 increased 32% year-over-year, well below the 60% year-over-year increase in net sales, illustrating our increased inventory efficiency.

Even with the investment in inventory, we generated \$33 million in **free cash flow** in the second quarter and \$65 million for the first six months of 2021, an increase of 8% year over year for the six-month period, despite a very strong comparison in the prior year.

Cash and cash equivalents, net of borrowings, at June 30th were \$220 million, an increase of \$93 million, or 73%, from \$127 million as of June 30, 2020. And our balance sheet remains debt free.

Now looking ahead.... We remain very cautious as there is still a level of uncertainty out there. With the recent increase in positive COVID cases, varying levels of restrictions and supply chain issues, we are not yet fully through the challenges presented by COVID-19. And while we have successfully managed through similar challenges in the past, we are not immune to these macro headwinds.

That said, with the very strong trends that began in March and April, further accelerating in the second quarter leading to 41% year-over-year sales growth in the first half of 2021, our net sales growth for the full year 2021 will very likely land well north of our historical target range of 20% growth.

Looking beyond 2021, we remain confident that we can continue to deliver net sales growth in excess of our long-term growth target of 20% -- just as we were prior to the onset of COVID-19.

Now, let me update you on some recent trends in the business since the second quarter ended and provide some direction on our cost structure for the balance of the year to help in your modeling of the business for 2021.

Starting from the top, the strong top-line trends we experienced throughout the second quarter continued through to the month of July, with growth of more than 40% on both a year-over-year and two-year basis compared to July of 2019.

We are very excited about the recent top line trends, but again, we need to acknowledge the uncertain environment related to COVID-19 variants potentially resulting in increased restrictions like we have experienced in Los Angeles, supply chain challenges, and other potential headwinds.

Shifting to gross margin... We are extremely pleased with our gross margin performance, driven by the record mix of net sales at full price in the second quarter. As we rebuild our inventory, however, we continue to expect the full price mix to begin to move closer to historical norms over time.

Nonetheless, given the strong first half results we now expect gross margin to come around 54% for the full year of 2021 – which is at the high end of the prior gross margin outlook of 53.5% to 54% provided last quarter. This implies a gross margin expansion of 140 basis points versus 2020, and expansion of 40 basis points versus 2019, despite owned brand penetration being significantly lower today than it was in 2019. This speaks to the longer-term opportunity for gross margin as the owned brand mix returns to year-over-year growth in 2022 and beyond.

Fulfillment: With the very efficient fulfillment performance in the second quarter, we now expect fulfillment costs to be approximately 2.5% of net sales for the full year – which is 40 basis points lower than our previous outlook and 70 basis points lower than fulfillment representing 3.2% of net sales in 2019. Really great work by the team in continuing to deliver efficiencies in this area.

For the full year of 2021, we now expect **Selling and Distribution Costs** to be slightly higher than the 14.6% of net sales we achieved for the full year 2019. This implies a sequential increase in the third quarter driven by increased return rates year-over-year as our product mix normalizes, and continued pressure on shipping costs.

Moving on to Marketing: With our customer coming back stronger than ever to refresh her wardrobe, we are excited to step up our investment in marketing to include new initiatives that we believe offer compelling returns over the long term. We will significantly increase our marketing investment in the second half of the year, and as a result, we continue to expect marketing expense as a percentage of net sales for the full year 2021 to be at least 15.8% of net sales, a full point higher than we reported for the full year in 2019. To be clear, with marketing for the first half of the year at 15.0% of net sales, in order to achieve the full-year target of at least 15.8% of net sales, you should expect a significant increase in the level of marketing investment during this second half of the year, and in particular, the third quarter. During the third quarter, we expect to deliver on the very exciting brand building activities Mike and Michael mentioned, which we expect will increase our marketing as a percent of net sales to more than 18% in Q3, before coming back down to the 15% level in the fourth quarter. The bulk of this investment will be in brand marketing activities, which have some level of short-term benefit, but are most impactful and important for the long-term building of the brand.

General and Administrative: In 2021, we are re-investing in our owned brand platform and other functions to support our next phase of growth and expansion. The quarterly run rate for general and administrative costs has increased by \$3.5 million in the first half of 2021, measured by comparing G&A expense in the fourth quarter of 2020 to G&A expense in the second quarter of 2021. We expect a similar sequential growth trajectory in the second half of this year as we continue to add talent to support our growth.

Lastly, let me touch on our tax rate. Our effective tax rate in the second quarter of 2021 reflects tax benefits realized as a result of the exercise of non-qualified stock options. Absent such tax benefits in future quarters, we expect our effective tax rate to be around 24% to 26%.

To recap, we are incredibly excited about our recent results, delivering yet another quarter of record net sales, record net income and exceptional free cash flow. And the strong growth is coming from all dimensions of the business, including the U.S. and International markets, REVOLVE, and FORWARD. While mindful of continuing uncertainties and potential headwinds in the current environment, we are focused on the long-term and investing in the business to capitalize on the incredible growth opportunity ahead.

Now, we'll open it up for your questions.