REVOLVE

REVOLVE GROUP INC. (NYSE: RVLV) Q4 2020 CONFERENCE CALL

PREPARED REMARKS ON FEBRUARY 24, 2021

ERIK RANDERSON, VP INVESTOR RELATIONS

Good afternoon, everyone, and thanks for joining us to discuss REVOLVE's fourth quarter and Full Year 2020 results.

Before we begin, I would like to mention that we have posted a presentation containing Q4 and full year 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 and capital expenditures for the first quarter of 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, 2019 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 more closely represent the true operational performance and underlying results of the business. 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 the call over to Mike.

MIKE KARANIKOLAS, CO-FOUNDER AND CO-CEO

Good afternoon everyone, and thanks for joining us today. We delivered another quarter of outstanding results in what remains a challenging and volatile environment. Our results are highlighted by three points of gross margin expansion that helped drive a more than doubling of earnings per share and a 37% increase in Adjusted EBITDA year over year. The strong fourth quarter capped off a year unlike any in our 18-year history. I'm proud of our team for operating with agility, discipline and strength to deliver record profitability for both a fourth quarter and a full year.

There are three key themes I want to focus your attention on:

- **First, we are primed and ready for the reopening of the economy**. As millions of people are getting vaccinated against COVID every day across our markets, trends are already slightly better in the first quarter year-over-year. We see an exciting opportunity for REVOLVE in the months ahead as more people are finally able to get back to enjoying all of the social occasions they have been missing out on for the past year.

- **Second, in 2020, we delivered record profitability and free cash flow that significantly strengthened our balance sheet,** positioning us well to invest in future growth opportunities. Such strong performance during a downturn gives me even more confidence in our long-term potential when the wind is at our backs once again.

- **Third, we accelerated plans to expand into adjacent product categories, enabling us to serve more of our customer's needs and touch more aspects of her life.** In 2020, we significantly increased our sales penetration in emerging product categories like beauty, activewear and intimates. Our expanded marketing playbook enabled us to stay connected with our customer and helped drive our early success in the emerging product categories outside of our traditional offerings, which now allows us to target an expanded share of her wallet.

Given our focus on value creation over the long-term, **I'll take just a few minutes to review our performance for the full year 2020 before shifting the focus to our 2021 initiatives.**

We began 2020 with strong momentum, delivering better than 20% year-over-year net sales growth in January and February before our top line was negatively impacted by the escalation of the COVID-19 outbreak in the U.S.

I am most proud of how well our teams responded to the crisis. As a brand known for the discovery of on-trend merchandise centered around aspirational experiences and social interactions, the onset of COVID introduced extraordinary headwinds impacting both consumer demand and our impactful marketing events. Nonetheless, the team delivered impressive outcomes against what became new priorities brought on by the pandemic.

- **Amidst all the uncertainty, we delivered strong results on our priority of protecting our financial position and optimizing our cash flow**. We leveraged our technology platform, our experienced team and our leadership expertise to quickly and aggressively adjust our merchandise buying plans and focused our teams on driving operational efficiencies throughout the organization. These efforts enabled us to generate $71 million in free cash flow during 2020, an increase of 113%, while more than doubling our net cash position to $146 million at year end.

- **Significantly improved inventory health in 2020 was a key driver of our cash flow generation and balance sheet efficiency.** Inventory turns increased more than 25% year over year in our core REVOLVE segment.

- **Our healthy inventory position helped us achieve a high percentage of net sales at full price in 2020.** 77% of net sales came at full price, well ahead of retail industry benchmarks. Our full price selling was particularly strong in the third and fourth quarters, serving as a key contributor to our gross margin expansion in the second half of 2020.

- **We realized significant operating efficiencies in fulfillment during 2020**, even with COVID-19 headwinds and our incremental investment to ensure employee safety. Fulfillment cost per order decreased by 11% year over year, illustrating that the warehouse investments we made in technology automation in the past two years are driving long term, sustainable efficiencies.

- **These operating efficiencies, combined with lower return rates, were a key driver of our record profitability**. Net income increased to $57 million, an increase of 59%, and Adjusted EBITDA grew to $69 million, an increase of 25% year over year, despite the modest decrease in net sales.

- **We accelerated plans to expand into adjacent product categories**, enabling us to serve more of our customer's needs and touch more aspects of her life. These efforts accelerated our growth in at home categories like beauty that offer exciting longer-term opportunities, and position us to expand our share of wallet over the longer term, particularly when demand recovers for our traditional categories like dresses.

- **We continued to raise the bar for the customer experience**, by staying laser focused on operations and exceeding our customers' expectations. In fact, we achieved record performance in our net promoter scores in 2020 and exceeded our very high target for customer satisfaction rankings. From day 1, we have been hyper focused on the customer experience, so it is gratifying to hear such positive feedback from our customers during what was the most challenging time in our history to deliver on our high standards.

- **And, finally, we accelerated our international expansion and further elevated service levels** to support our customers in key regions. International net sales increased 15% year over year, and international growth accelerated to 24% in the fourth quarter, as we realized the benefits of investments we have made to strengthen our value proposition.

All in all, I am very proud of how well we executed and I'm excited about the path forward.

Turning now to our priorities for 2021…. Our key focus is to ensure we are well positioned to capitalize on the reopening. We believe the world is on an exciting path to reopening, and our customer can't wait to get back out again and enjoy the active social lifestyle that she loves and has come to associate with REVOLVE. As a brand built and centered around this social lifestyle, REVOLVE is ideally positioned to benefit as the world reopens. Our leadership team is aligned on five key priorities to capitalize on the reopening opportunity and the much larger opportunity that we believe lies ahead:

- **First, we will accelerate our brand building investments to take full advantage of the pent-up demand we expect to see when people can socialize and celebrate in person again.** We are optimistic and excited for what we believe could be a robust recovery in 2021. When mobility returns, our customers are going to want to look and feel amazing with our latest fashion, so our stepped-up marketing investments should help us capitalize on the increased demand we expect.

- **We will further pursue expansion of our product categories into adjacent areas like beauty and activewear** to enable us to develop deeper relationships with our customers. Continued success of newer categories will provide us the opportunity to serve more of their needs, potentially capturing a greater share of their discretionary spending over the longer term.

- **We will invest in further strengthening our owned brands portfolio** through the launch of exciting new brands, collaborations and styles within our existing portfolio of brands.

- **We will build on our momentum in international markets.** We see great opportunities to further elevate the customer experience in international markets across both REVOLVE and FORWARD. We will continue to optimize the customer experience in Western markets where we have already made investments and we will further invest in newer regions such as China and the Middle East that have been performing very well for us and hold great potential.

- **Finally, we will continue to raise the bar on the user experience across all regions.** We will leverage technology to provide additional website personalization; introduce new payment methods; provide major feature upgrades to our mobile applications; and drive faster refunds for customer returns, among other things.

Before I turn it over to Michael, I will reiterate how grateful I am for all our dedicated employees who collectively made our 2020 achievements possible.

MICHAEL MENTE, CO-FOUNDER AND CO-CEO

Thanks, Mike. I'm very excited to be here today to share our thoughts on the business and the opportunities ahead. The competitive advantages that drove our success during the first 17 years of building REVOLVE carried through 2020 and enabled us to not just manage through the most challenging year in our history, but also put us in a position of strength as we enter 2021.

With this strong positioning, we are excited to play offense and start investing again as we look forward to re-opening.

It starts with great merchandise, an area where we started to re-invest already in the back half of 2020. Our strong team, centered around our data-driven approach and read-and-react strategy enabled us to react fast to align with the shift in consumer preferences induced by COVID. Our ability to adapt so quickly helped drive the strong financial results in 2020 and accelerated the diversification of our assortment to address more aspects of our customer's life.

The early success of new product categories opens up exciting opportunities to further expand our collection of styles across both third party and owned brands, capturing more share of her wallet over the long term.

Owned brands continue to be core to our long-term strategy. Our owned brands are true brands in the eyes of the consumer. They drive traffic, attract new customers, generally have higher gross margin than comparative third-party products and add to the uniqueness of our merchandise offering. The combination of our owned brands and emerging third party brands establishes an assortment with very low overlap with other retailers. As we shared previously, we temporarily dialed back owned brands in 2020 after the onset of COVID-19, largely to allow us to make shallower inventory buys across a wider range of styles. We are encouraged by the performance of our owned brands in the fourth quarter across a narrower range of styles. We are excited to build upon this success in the coming quarters as we invest to drive further category expansion through a combination of new styles, brands and collections, including brands focused on sustainable fashion and collaborations with well-known personalities. The owned brand team and I have never been more excited about our future plans than we are right now.

Shifting to marketing, I am excited about the power of an expanded marketing playbook that combines our unparalleled in person events with the acceleration into content, livestreaming and emerging social channels.

Over the last year, we have stayed relevant to her lifestyle through meaningful content and livestreaming while, at the same time, accelerating our expansion into emerging social media platforms such as IGTV, TikTok and Instagram Reels, where we generated a combined 58 million views in the second half of 2020.

A significant headwind during the past year has been that we have not been able to host our marquee in-person events that are a powerful marketing lever, particularly for generating social media impact and building the brand long term. We are very excited to get back out there to do in-person events again in 2021 – starting this week actually, where we are hosting four in-person events in Australia – in Sydney, Brisbane and on the Gold Coast. The events are attended by Australia-based influencers. Australia has had a very effective COVID response, so it is further ahead on the reopening path than other parts of the world. Many Australians are making up for lost time, enjoying their current summer season like never before. Our net sales in Australia increased more than 30% year-over-year in the fourth quarter, a helpful indicator into how consumer behavior may evolve in other regions as the virus becomes more controlled.

Lastly, we are excited about the momentum and growth opportunities in our international business and the FORWARD segment, which generates a significant percentage of its sales outside of the U.S. International continues to represent a meaningful opportunity over the long term as we optimize our service levels and offerings in these regions. We also see opportunity to invest more aggressively into FORWARD than we have in years past. The luxury customer has been very resilient through the pandemic and with the global market for luxury fashion rapidly shifting to digital, we see great opportunity to increase the awareness of FORWARD's highly curated selection of iconic and emerging luxury brands. With a merchandise assortment that is very complementary to that of REVOLVE and with REVOLVE's large and powerful customer base, we are excited to expand our cross-promotion efforts between the two segments. The introduction of an integrated loyalty program that includes both REVOLVE and FORWARD on the same platform will further solidify our meaningful opportunity to cross pollinate the brands.

I am very proud about what we have been able to accomplish to date, but truly believe the best is yet to come.

With that, Jesse will close out with some additional detail on the financial results and trends.

JESSE TIMMERMANS, CFO

Thanks, Michael.

I'm truly encouraged by how well our teams executed throughout 2020, putting us in a position of strength as we look ahead to the post-COVID era.

Our fourth quarter results capped off record performance in 2020 for Net Income, Adjusted EBITDA and Free Cash Flow, significantly strengthening our balance sheet. We started to tap into our strong balance sheet in the fourth quarter to reinvest in inventory and marketing, shifting back into a mode of playing offense with the vaccine distribution moving forward. And we will continue to make investments in 2021.

Now, starting with the fourth quarter results… Note that all of the comparisons I will discuss will be on a year over year basis, unless otherwise stated. Net sales decreased 5%, an improvement from the October net sales results we shared on our Q3 investor conference call.

By territory, international net sales increased 24%, meaningfully outperforming the 10% decline in net sales in the U.S. The international strength was broad based with Australia, Canada, Greater China and the Middle East as key contributors.

Looking at consumer demand, very strong growth in at home categories like beauty, intimates and activewear continue to be offset by headwinds in occasion wear categories like dresses and skirts. We are optimistic about the opportunity for recovery in occasion wear trends as we anniversary the COVID outbreak in March and even more so, as consumers around the world are vaccinated in the coming months and start socializing in person again.

By segment, REVOLVE Segment net sales decreased 5% and FORWARD Segment net sales decreased 2% in the fourth quarter.

Active customers were 1.5 million, a decrease of 1%, consistent with our commentary last quarter to expect further deceleration in active customers in the near term. Keep in mind that since this is a trailing 12-month measure, the Q4 active customer metric captures a larger number of quarterly periods impacted by COVID.

We had 1.0 million orders placed in the quarter, a decrease of 6%.

Average order value was $256, an increase from $232 in the third quarter of 2020, but remained 9% lower year-on-year. The year-over-year decline in AOV was primarily driven by a shift in net sales mix to “at home” product categories, such as beauty and intimates with lower average price points, and a reduction in average units per order. These AOV headwinds were partially offset by a higher mix of full price sales, our highest full price sales for a fourth quarter in over ten years.

Partially offsetting the lower number of orders and the lower Average Order Value was a meaningful decrease in merchandise returned for the third consecutive quarter. We attribute the lower return rate to a combination of more deliberate purchasing behavior by consumers during the COVID-19 pandemic, as well as a COVID-19 driven shift in mix to product categories with lower price points. The lower return rate also reflects a higher mix of international sales, where return rates have historically been lower than in the U.S.

Moving to gross profit… Consolidated gross margin was 56.0%, the highest ever gross margin reported for any quarter, an increase of 305 basis points. This performance was stronger than we anticipated, and is reflective of our healthy inventory across both segments.

Within the REVOLVE Segment, we delivered gross margin of 57.8%, up approximately 270 basis points. The REVOLVE Segment gross margin benefited from meaningfully improved inventory dynamics that contributed to a healthy inventory balance, leading to an increase in the percentage of REVOLVE Segment net sales at full-price, and a 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.

Within the FORWARD Segment, we delivered gross margin of 46.2%, an increase of approximately 520 basis points. The increase is reflective of the health of our inventory and a significantly higher mix of full price sales, resulting from a temporary inventory dynamic that resulted in a limited amount of markdown inventory available for sale in the fourth quarter. While we are very pleased with this gross margin performance, we caution investors not to model this level of Forward gross margin into the future.

And now moving to the cost structure….

Starting with fulfillment, fulfillment costs were 2.9% of net sales, an improvement of approximately 20 basis points. We continued to realize benefits from the lower return rate, as well as lower labor costs as a result of automation and efficiencies coming out of the investments we have made in our fulfillment processes over the last two years.

Selling and distribution costs were 13.4% of net sales, an improvement of approximately 80 basis points, and lower than we had budgeted. I'll call out two factors that helped the comparison relative to expectations.

- **First,** our Operations team did great work in optimizing our logistics, strategically directing packages to our shipping partners to avoid the shipping surcharges and shipping delays that impacted many other companies this holiday season.
- **Second,** our return rate in Q4 came in lower than we had anticipated. As a result, our cost structure benefited more than expected from reduced shipping, packaging and other costs associated with significantly lower merchandise returns year-over-year.

Marketing costs were 14.8% of net sales, an increase of approximately 20 basis points. This is consistent with our commentary shared last quarter regarding increased marketing investment and the competitive market for digital advertising.

General and administrative costs were lower year on year, as expected, declining approximately 70 basis points.

With our strong gross margin and well managed cost structure, we achieved net income of $19 million, or $0.26 per diluted share for the quarter, more than doubling the $0.12 of diluted EPS in the prior year. In addition to our strong operating results, our EPS comparison included tax benefits realized as a result of stock option exercises. Even when excluding these discrete tax benefits, our net income and diluted EPS would have each increased approximately 50%.

We also reported Adjusted EBITDA of $18.7 million, an increase of 37% and a margin of 13.3%, higher than the prior year by 407 basis points, in large part due to the gross margin expansion.

Moving to the balance sheet and cash flow statement… During the fourth quarter, we started to invest back into inventory to position our assortment to support the anticipated recovery and increase in demand in 2021. This investment resulted in a $22 million sequential increase in inventory, or 29%, compared to the third quarter. We ended 2020 with $95 million in inventory, a decrease of 9% year-over-year. This compares favorably to the 3% decrease in net sales for 2020 -- illustrating our higher inventory turns year-on-year and improved inventory health.

Our investment in inventory weighed on free cash flow for the fourth quarter. Nonetheless, for the full year of 2020, free cash flow was $71 million, an increase of 113%.

Cash and cash equivalents at year end were $146 million, an increase of $81 million, or 123%, from $65 million as of December 31, 2019. During the fourth quarter we repaid the remaining $15 million on our credit line, ending the year debt free.

Now, let me update you on some trends in the business since the fourth quarter ended on December 31st. Given the continued uncertainty in the macro environment, we'll again defer on offering any traditional guidance. Instead, we will share some recent trends and assumptions to help in your modeling of the business for 2021.

Starting from the top, the improved trends we experienced as we exited 2020 continued through to 2021 with net sales returning to positive territory with a low single digit percentage increase year over year through the first 7 weeks of the quarter, an improvement from the year-over-year decline in net sales reported for our fourth quarter 2020.

Growth in regions that are much further along in the COVID recovery, like Australia, China and the Middle East, have been much stronger than regions like the U.S. and the U.K. that are still in a stage of reduced mobility. We believe the recovery in these regions is an early indicator, speaking to the broader recovery opportunity that lies ahead of us.

Shifting to gross margin… From a seasonality standpoint, bear in mind that our first quarter has historically been the lowest quarter of the year for gross margin. In recent years our first quarter gross margin has declined by an average of more than three points on a sequential basis compared to the fourth quarter gross margin. We expect this sequential trend to continue for Q1 2021, while remaining higher than the gross margin of 49% reported in the first quarter of 2020.

Puts and takes driving the first quarter gross margin outlook compared to the prior year first quarter include continued strength in full price sales and shallower markdowns year over year, partially offset by a much lower mix of owned brand sales. To give you a frame of reference, owned brand mix of REVOLVE Segment net sales was down 15 points year-over-year in the fourth quarter. As we discussed on prior calls, we expect the mix of owned brands to continue to compress through at least the first half of the year, before starting to rebuild in the back half of 2021.

For Fulfillment costs, we expect the first quarter to be in the same range as the 2.8% of net sales we achieved for the full year of 2020. We should continue to benefit from the increased productivity supported by our automation technology and a lower return rate, partially offset by increased wages and benefits costs in 2021. Keep in mind that with the anticipated recovery, we do expect mix to shift back to our historically strong product categories related to going out. Dresses, for example, generally come with higher return rates, which will add sequential pressure to our fulfillment costs.

For our Selling and Distribution costs, we expect the first quarter to be in the same range as the 13.9% of net sales we achieved for the full year 2020.

Importantly, looking further out, as we anniversary the COVID-19 outbreak in the second quarter of 2020 we would expect Selling and Distribution costs to increase more meaningfully as a percentage of net sales in the second quarter and for the remainder of 2021. This assumes that we will see a higher return rate year on year beginning in the second quarter, which results in increased costs for shipping, handling, packaging and payment processing for returned items. Shipping and handling costs represent the lion's share of this line item and, as a result, we expect Selling and Distribution as a percentage of net sales for the full year 2021 to return to the 2019 levels of 14.6%, if not trend higher.

Marketing: As Michael mentioned, we are back to investment mode and we will keep the pedal down on marketing investments to capture the pent-up consumer demand upon reopening and beyond. We expect marketing to have the highest dollar increase of any of the expense line items, potentially exceeding historical levels at certain points during the year as we remain nimble, optimizing the timing of our investments with the anticipated timing of recovery in consumer demand and increase in social activities.

General and Administrative: On a year-over-basis, we are planning for G&A expense in dollar terms to increase in the first quarter and full year as we re-invest in our owned brand platform and other functions to support future growth.

To recap, we believe we have executed well during what has been, and is, a very challenging environment. With a strong balance sheet, a healthy base of inventory featuring an expanded assortment, and increased marketing investments we believe we are primed and ready for what lies ahead.

Now we'll open it up for your questions.