

# REVOLVE

## REVOLVE GROUP INC. (NYSE: RVLV) Q3 2022 CONFERENCE CALL PREPARED REMARKS ON NOVEMBER 2, 2022

### ***ERIK RANDERSON, VP INVESTOR RELATIONS***

Good afternoon, everyone, and thanks for joining us to discuss REVOLVE's third quarter 2022 results.

Before we begin, I would like to mention that we have posted a presentation containing Q3 financial highlights to our Investor Relations website located at [investors.revolve.com](https://investors.revolve.com).

I would also like to remind you that this conference call will include forward-looking statements, including statements related to economic conditions and their impact on consumer demand and our business, operating results and financial condition; our cost and inventory management; our growth, including growth in active customers, and market opportunities and related macroeconomic and industry trends; our partnership with Muus Collective; our plans to expand FWRD Renew and introduce the FWRD Brand Ambassador program; our future events; and our outlook for net sales, gross margin, operating expenses and effective tax rate.

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, 2021 and our subsequent Quarterly Reports on Form 10-Q, all of which can be found on our website at [investors.revolve.com](https://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 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**

Thanks Erik. Hello everyone.

We delivered another quarter of profitable, double-digit growth in the third quarter of 2022 that further distinguishes REVOLVE in the fashion e-commerce landscape, despite the increasingly challenged macro environment.

Before I get into the details of the third quarter, I want to provide a higher-level view of how Michael and I think about our strategy, as both operators and long-term owners of the business.

We have a founder led, investor first mindset that permeates throughout the organization. With this perspective, we are able to confidently make disciplined investments that we believe position us for continued success over the long term, even during periods of macro challenges. The recent time period is no exception where we continue to make key marketing investments and launch exciting new initiatives that further elevate our brand and build on the long-term opportunity to capture market share. We have a history of this while delivering growth, profitability, positive cash flow and a healthy increase in our active customer base. This mindset and focus on investing in the long-term opportunity, even through turbulent times, has been a key contributor to our track record of growth and profitability over the last two decades and we believe it will continue to drive our performance well into the future.

**Now, getting into the third quarter results.** In the face of many challenges, we grew our top line double digits and delivered meaningful profitability and cash flow. Our **net sales** increased 10% in the third quarter compared to the prior year period, on top of 62% growth in Q3 2021 compared to Q3 2020.

We delivered **Net Income** of \$12 million and **Adjusted EBITDA** of \$18 million in the third quarter. As expected, profitability was lower year-over-year due to reduced gross margins, higher return rates and other cost pressures discussed in detail on last quarter's conference call. Importantly, Net Income and Adjusted EBITDA increased 25% and 22%, respectively, compared to the third quarter of 2019, further illustrating our track record of profitable growth.

Even more important in such a turbulent environment is that we are generating meaningful cash flow, and further strengthening our balance sheet. We generated \$9 million of **free cash flow** in the third quarter – a triple digit increase year-over-year.

**Nearly 20 years of experience operating REVOLVE has shown us that companies capable of generating profitability and cash flow during periods of economic volatility can become even stronger relative to the competition.** We aim to be very disciplined in our cost and inventory management to maintain profitability, yet we are not over reactive. For instance, with the abrupt shift in consumer demand that we experienced in the second quarter of 2022, we took swift action to rebalance our inventory in a very strategic way to balance the moderation of our inventory levels with our focus on the customer experience and our long-term margin potential, while maintaining our very strong brand partnerships. There is still work to do, yet only a few months in, we are on track with our plan and very pleased with our progress as our inventory position grew only two percent during the third quarter when compared to the second quarter of 2022.

Successful execution of our marketing and merchandising investments led to growth of 84,000 **active customers** during the third quarter, expanding our active customer base to 2.2 million, an increase of 34% year-over-year. This is on top of the record growth in active customers we reported in our third quarter of 2021. We view our continued healthy growth in active customers as further validation of our large market potential.

Incidentally, even with our investments in the new east coast fulfillment center we opened during the third quarter of 2022, we are still investing less than one percent of our annual net sales in capital expenditures. An important driver of our **capital efficiency and agility** is our ability to leverage our proprietary, internally developed technology instead of relying on capital outlays to purchase expensive and cumbersome technology systems from third-party vendors that is a common approach among e-commerce peers. Our approach is completely and fundamentally different. When we expand our fulfillment center infrastructure, we primarily leverage our internal engineering resources to evolve and customize our own existing proprietary technology systems to meet our specific needs and to support our best-in-class service levels for customers.

Shifting gears to **net sales performance by geography**, our **U.S. net sales** increased 10% and **international net sales** grew 12% year-over-year in the third quarter of 2022.

The international results are impressive considering the significant appreciation of the U.S. dollar during the third quarter, particularly against the British pound and the Euro. These currency movements present a headwind to demand considering that our pricing in local currencies is tied to the U.S. dollar. In other words, when the dollar strengthens against the British pound, our product becomes relatively more expensive for customers living in the UK.

And we can clearly see the negative impact on our monthly sales results in affected regions. Our net sales results in **Europe** and in the **UK** went from high single digit year-over-year growth during the month of July to negative year-over-year growth comparisons in net sales for the month of September, coinciding with currency exchange rates becoming much more challenging later in the third quarter.

That being said, It is also important to consider the broad macro challenges facing our European customers. To provide a framework, the UK and Europe on a combined basis represented a mid-single digit percentage of our total net sales for the first three quarters of 2022.

Importantly, by comparison, our year-over-year growth in net sales remained healthy in key international regions such as **Canada** and the **Middle East**, where the foreign currencies have been much more stable.

Finally, our track record of profitable growth also reflects **our long-term focus on building trust with our customer**. Core to building this trust is operational excellence and exceptional service levels.

During the third quarter we received gratifying recognition for our outstanding service levels in a key international market.

REVOLVE was recognized by and profiled in Singapore's largest English language daily newspaper, *The Straits Times*, for having the best customer service in the online women's apparel category. The publication highlighted REVOLVE's customer-first culture; use of technology in the buying process to stay on trend; fast and free express shipping; and hassle-free local returns in Singapore at no cost.

We are very proud of this recognition of our exceptional service levels that are a key competitive advantage and are a direct outcome of our growth strategy. Recall that in January of 2020, we announced service level enhancements in Singapore that were designed to further raise the bar on our international customer experience that led to our recognition.

Importantly, this example is part of a broader success we are achieving as an organization. Our **customer satisfaction score** in the third quarter was the highest level in at least 5 years, and we intend to continue to set the bar even higher.

**Like many others, we undoubtedly face challenges in the current environment and we have much more work to do.** We will continue with our swift action to rebalance our inventory growth in a very strategic way, we will continue to be very disciplined in our cost management and we will continue to make investments for the long term.

**All told,** I believe our third quarter results demonstrate that we are capably navigating through these uncertain times from a position of strength while continuing to prudently invest in our long-term growth opportunity.

Thanks again to the entire team for their dedication and invaluable contributions to our continuing success.

Now, over to Michael.

**MICHAEL MENTE, CO-FOUNDER AND CO-CEO**

Thanks, Mike.

I am very pleased with our ability to deliver double digit, profitable growth this quarter and I am very excited about the continued momentum of our brands, the strong relationship with our network of partners and customers, and the incredible performance by our team. We were very active in the third quarter as we continue to invest in our future growth opportunities, including key brand building events that generate returns over extended periods of time. We are very pleased with the early results of our activations and brand launches and, importantly, the positive feedback from our customers.

**In September, we returned to New York during Fashion Week to host an impactful weeklong activation**, further elevating our brands with engaging experiences intended to delight and excite our community of influencers, customers and partners. The flagship event was our experiential, interactive and visually stunning **REVOLVE Gallery** that completely reimagines the traditional fashion week experience in a signature REVOLVE way and uniquely features a real-time shopping component. Back for a second year and bigger than ever, REVOLVE Gallery is an immersive, multi-brand installation featuring a curated assortment of emerging fashion designers, exclusive styles, and premier partners showcasing their brands in dedicated spaces.

We hosted 9,000 attendees at REVOLVE Gallery over four days, an increase of about 50% from our inaugural event in 2021. In addition, we hosted a much larger group of **high value customers** at our REVOLVE Gallery and other fashion week events, and more than 50% of these high value customers traveled from out of state to be a part of our 'money-can't buy' experience. It was incredible to interact with our customers, experience their loyalty to the brand and hear their glowing feedback on our level of service and their overall shopping experience.

We also attracted participation from hundreds more **influencers** than last year, who collectively amplified our elevated experience on social channels with dynamic and engaging content, particularly video. To further capitalize on the powerful industry wide shift to video content, for fashion week we diversified our influencer partners to increasingly focus on TikTok native influencers, who helped us to drive incredible growth in our TikTok metrics. Fueled by a very active month of September when we held several events during fashion week, our new TikTok views in the third quarter were more than 10 times higher than in the third quarter of 2021, meaningfully exceeding our expectations.

**Shifting to a discussion of owned brands**, during the third quarter we further expanded our market potential by introducing two new owned brand collections that rank among our most successful brand launches in our history.

Owned brands provide a powerful platform for us to internally develop products where we see opportunities in the market based on our data-driven approach to merchandising.

One area where we see opportunity for growth is in elevated owned brand products with premium price points. In September, we collaborated with supermodel **Elsa Hosk** to launch an elevated brand called Helsa, featuring an average unit retail price of around \$250, featured exclusively on both REVOLVE and FWRD. The collection was one of our best-ever performing owned brand launches, and was seen on a number of celebrities during New York Fashion Week. Created with sustainability in mind, Helsa is an elevated and creative expression of Elsa's own Swedish roots that Vogue described as being "minimalist heaven."

We also see opportunity in expanding our market potential into new customer demographics. As covered extensively in major press outlets such as Access Hollywood, Good Morning America, People, US Weekly, and InStyle, we have teamed up with content creator and Curve model, **Remi Bader**, to create a size inclusive owned brand collaboration exclusively available on REVOLVE. Demand for the collection's first drop in August resulted in many styles selling out right away and the second drop during Fashion Week also performed exceptionally well. The most exciting outcome is that our collaboration with Remi both resonates with our current customer and expands our owned brand market potential into extended sizes, enabling us to attract a new and incremental customer demographic. In fact, approximately one-third of all orders of the REMI X REVOLVE collection in the third quarter were new customers to REVOLVE.

**Now, I'll talk about a truly innovative new channel for our brand building investments** that I am very excited to talk about. Today we are announcing a strategic partnership that we believe has the potential to significantly and cost-effectively expand our audience reach and increase engagement with our community of customers, brands and influencers in exciting new ways.

**We are collaborating on the creation of a fashion-centered mobile gaming and eCommerce experience** – a game that is effectively an elevated fashion playground that will feature digital playable renderings of fashion and beauty items from REVOLVE and FWRD. The Web3 enabled platform will empower players to become their own tastemakers by providing tools for creative expression, enabling them to connect with their favorite REVOLVE brands and engage with trends through a gamified shopping and styling experience, collectible assets, and deep social interaction. We are particularly excited about this opportunity to expand our reach and engagement, considering that mobile gaming is the fastest-growing form of media on the planet and that 49% of mobile gamers worldwide are women, according to Google Play research.

**Our partner is entertainment studio Muus Collective**, which is backed by Griffin Gaming Partners -- one of the world's largest investment venture funds exclusively focused on gaming. Muus is led by Amber Bezahler, who has deep experience in leading platform, ecommerce and innovation initiatives for gaming brands. Muus co-founder and Chairwoman is Sarah Fuchs, formerly of Covet Fashion, a leading fashion mobile gaming platform that grew to more than three million active users and has been downloaded more than 78 million times, according to data.ai. Covet Fashion generated more than \$225 million in lifetime revenue before Electronic Arts acquired the franchise last year.

I'll conclude with an update on **FWRD**, our luxury destination where we continue to see a great deal of opportunity for continued growth. FWRD net sales for the third quarter increased 17% year-over-year, an encouraging result in the current environment and considering the prior-year comparison as well. To illustrate how well we are executing against the large opportunity in front of us in luxury, over the last three years, our compound annual growth rate for FWRD net sales is a robust 35% and the FWRD business is about two and a half times the size it was three years ago.

One nascent area of FWRD's growth that we view as an exciting new opportunity is **resale**. Last quarter I talked about our new **FWRD Buyback program**, our proprietary resale program dedicated to circular luxury shopping, where we are offering to repurchase handbags from FWRD customers in exchange for credit on our sites. This exciting repurchase initiative has opened up a brand-new opportunity in resale that, for the first time, enables us to attract and retain customers interested in purchasing pre-owned handbags within a new and dedicated section of our FWRD site called **FWRD Renew**. I'm thrilled to share that customer interest in pre-owned handbags in the early going has exceeded our expectations.

To build on our early success, we are investing to further expand the FWRD Renew program beyond supply from our own customers participating in the FWRD Buyback program. In the coming weeks, we will begin testing the resale of handbags sourced from third parties with access to pre-owned handbags, including from the world's most coveted luxury brands.

Our investments in FWRD include further elevating the brand through our partnership with **Kendall Jenner as FWRD's Creative Director**. In September, Kendall co-hosted an exclusive FWRD event in New York to celebrate the new FWRD fall campaign that Kendall herself directed, the first time she has stepped behind the camera in her role as FWRD's Creative Director. Co-hosted with GQ Global Editorial Director Will Welch, the event was attended by VIPs and tastemakers including Emily Ratajkowski, Iann Dior, Devin Booker and Jordan Clarkson.

Coupled with the soon-to-be-introduced FWRD Brand Ambassador program I touched on last quarter that will officially launch in the next few weeks, there are a lot of exciting growth initiatives at FWRD that have me confident in our future.

**To wrap up**, there is no denying that we are operating in a challenging environment, yet we are very much up to the challenge and see a great opportunity to further separate from our competitors. We have an outstanding leadership team, including many leaders who have been with Mike and I for 10 years or more, we have a strong balance sheet, and we have a business that has been profitable in 18 out of the 19 full years since we have founded the company. This gives us the confidence to focus on the long term and continue investing in exciting growth initiatives that we believe will maximize shareholder value over the long term. With our technology-driven DNA, operational excellence, strong brands and connection with the next-generation consumer, we believe we are well positioned to capture market share.

Now, I will turn it over to Jesse for a discussion of the financials.

**JESSE TIMMERMANS, CFO**

Thanks, Michael, and hello everyone.

We are pleased with our accomplishments in the third quarter, as well as our exciting progress building on our long-term growth initiatives, all delivered by the team within an extremely difficult economic climate.

**I'll start by recapping the third quarter results**, highlighted by double-digit top-line growth, continued profitability and healthy free cash flow generation that further strengthened our balance sheet.

**Net sales** were \$269 million, a year-over-year increase of 10%, and an increase of 20% on a three-year CAGR basis.

As a reminder, our net sales in the third quarter of 2021 had increased 62% compared to the third quarter of 2020, and had even grown sequentially from net sales in the second quarter of 2021 – which is not our typical seasonality – creating a very difficult year-over-year comparison.

**REVOLVE Segment** net sales increased 9% and **FWRD** net sales grew 17% year-over-year.

**By territory**, domestic net sales increased 10% year-over-year and international net sales increased 12%, despite the currency headwinds that became progressively more challenging throughout the third quarter.

**Active customers** increased by a healthy 84,000 compared to the second quarter of 2022. This growth expanded our active customer count to 2.2 million, an increase of 34% year-over-year. Through the first three quarters of the year, we have already added more active customers in 2022 than in any prior full year in our history.

Looking forward, we continue to expect moderation in the quarterly growth of active customers in the fourth quarter of 2022 and especially in the first quarter of 2023 for this trailing 12-month metric. The reason the first quarter of 2023 will be a particularly challenging comparison is that we achieved exceptionally strong record growth in new customers in the first quarter of 2022.

Our customers placed 2.0 million **orders** in the third quarter, an increase of 7% year-over-year.

**Average order value**, or AOV, was a very healthy \$320, an increase of 16% year-over-year.

**Shifting to gross profit...** Consolidated gross margin was 53%, a decrease of 211 basis points, primarily due to a lower mix of net sales at full price year-over-year. The decrease in gross margin is directionally consistent with our commentary on last quarter's conference call, but did come in slightly lower than implied by our guidance range for the quarter.

**Moving on to operating expenses....**

**Fulfillment costs** deleveraged 64 basis points year-over-year, primarily due to a year-over-year increase in our return rate and the resulting mix of units processed, as well as increased labor costs and costs related to the expansion of our fulfillment network.

**Selling and distribution costs** deleveraged 158 basis points year-over-year and remained a significant headwind, yet importantly came in at a lower percentage of net sales on a sequential basis than in the second quarter of 2022. Costs for shipping packages to customers represent the majority of this line item, and these costs remain elevated year-over-year due to a higher return rate in 2022 and significant year-over-year growth in variable fuel surcharges included in every package shipped through our carrier partners.

**Marketing** leveraged by 265 basis points year-over-year, better performance than implied by our outlook commentary last quarter, primarily due to lower, but still significant, brand marketing investment year-over-year highlighted by the very successful events held in September during Fashion Week that Michael talked about.

**General and administrative costs** were \$28.5 million, and also came in lower than the outlook we provided on last quarter's conference call.

All in, despite some incremental fulfillment cost pressure, our cost structure came out better than expected, reflective of our disciplined approach to cost management.

Our **effective tax rates** were again very different for the year-over-year comparison. Our tax rate for the third quarter of 2022 was 26%, 12 points higher than the 14% tax rate in the third quarter of 2021 that included meaningfully higher tax benefits.

**Net income** was \$12.0 million, or 16 cents per diluted share, a decrease year-over-year that was impacted by the meaningful differences in our effective tax rate, the lower gross margin, and growth in operating expenses that slightly outpaced our net sales growth year-over-year.

**Adjusted EBITDA** was \$17.7 million, a decrease of 18% year-over-year.

Looking back to the pre-pandemic period as a benchmark, our Net Income and Adjusted EBITDA for the third quarter were 25% higher and 22% higher than the Net Income and Adjusted EBITDA reported for the third quarter of 2019.

**Moving to the balance sheet and cash flow statement...** Operating cash flow and free cash flow increased significantly – more than 400% year-over-year – and was helped by our team taking swift action to moderate inventory growth in the current environment.

For the nine-month year-to-date period, net cash provided by operating activities was \$34 million and free cash flow was \$31 million, with both measures down significantly year-over-year from the exceptional cash flow generation in the prior-year period. The decreases in both measures year-over-year primarily reflect lower net income, which included much higher tax rates and cash payments for income taxes that increased by \$14 million in 2022, as well as the increased investments in inventory during the first half of the year.

With the demand trends shifting lower in the current macroeconomic environment beginning in the second quarter, we moved quickly and decisively to bring inventory back in balance. While it has only been one quarter, we are pleased with our performance thus far and we are continuing to make further adjustments.

**The strong cash flow generation has further strengthened our balance sheet and liquidity.** Our balance sheet remains debt free and cash and cash equivalents as of September 30, 2022 were \$244 million, an increase of \$22 million, or 10%, from September 30, 2021 and an increase of \$6 million, or 3%, from just last quarter.

Looking back further, our cash position at quarter end was nearly five times higher than the cash on our balance sheet three years ago as of September 30, 2019. And this cash generation was operational without any kind of major financing event, providing a clear and powerful indicator of our operating strength and ability to generate cash through business cycles.

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

**Starting from the top.** As you know, it's a very uncertain time for consumer spending globally, with persistent inflation weighing on consumer confidence, macro pressures on consumers in key markets like Europe, the UK and China, and increasing foreign currency headwinds that became even more pronounced as the third quarter progressed.

**Looking at our net sales trends early in the fourth quarter through the month of October,** net sales increased approximately 3% year-over-year, against a more difficult year-over-year comparison than we have faced in the first 9 months of the year.

Trends in October were better domestically than in international markets, as net sales in regions where we face significant currency headwinds, such as the U.K. and Europe, have trended lower in recent months.

Given the uncertain macro environment and considering that our year-over-year comparisons are even more difficult for the balance of the fourth quarter, we encourage investors to model further moderation in our year-over-year net sales comparisons for the balance of the fourth quarter from the approximately 3% year-over-year growth in October. As a basis of comparison, recall that our net sales in the fourth quarter of 2021 a year ago increased 70% year-over-year.

While we are on the topic of year-over-year top line comparisons, **looking ahead to 2023,** for modeling purposes, based on what we know today, the first quarter of 2023 will be, by far, our most challenging comparison for net sales in 2023 since we had such an incredible first quarter of 2022. We expect net sales comparisons in 2023 to become progressively easier thereafter following the first quarter of 2023.

**Shifting to gross margin...** Consistent with the commentary on last quarter's conference call, we expect our gross margin for the fourth quarter of 2022 to be sequentially lower than the third quarter of 2022, primarily due to our expectation for a lower mix of full price sales on a sequential basis versus the third quarter of 2022. As a result, for the fourth quarter, we expect gross margin of between 52.5% and 53%. This implies a decrease of approximately 2 points year-over-year at the midpoint, about the same year-over-year decline as the third quarter. Looking beyond the fourth quarter, we expect continued pressure on gross margin in the first half of 2023 as we continue to work through our inventory position.

**Fulfillment:** We expect fulfillment expense of around 3.0% of net sales for the fourth quarter of 2022, consistent with our performance for the third quarter.

**Selling and Distribution:** We expect selling and distribution costs as a percentage of net sales in the fourth quarter to be relatively consistent with the 17.3% in the third quarter, and slightly lower than our outlook provided last quarter.

**Marketing:** We will continue to invest in building our brands and even further strengthening our brand connection with our loyal customers. We expect our marketing investment to be between 16% and 16.5% of net sales in the fourth quarter, higher year-over-year but lower sequentially versus the third quarter of 2022 and also lower than our prior outlook. Of note, in the third quarter we saw some early signs of advertising prices decreasing, likely due to marketers reducing investment in the current economic environment.

**General and Administrative:** We expect G&A expense of approximately \$29 million for the fourth quarter.

The expected increase in G&A costs year-over-year reflects investments in our team we have made this year to support our continued growth and expansion. We believe we operate very efficiently, illustrated by the nearly two points of G&A leverage we have achieved in just the past three years. And, directionally speaking, we expect the rate of year-over-year growth in G&A expenses to moderate in 2023.

**Lastly, let me touch on our tax rate.** Absent tax benefits in future quarters, we continue to expect our effective tax rate to be around 24% to 26%.

We continue to anticipate a very challenging macro environment in the months ahead and we will remain disciplined in our cost management while prudently investing in key initiatives and keeping an unwavering focus on the very attractive market opportunity ahead of us over the long-term. We are confident that with our strong brand, healthy balance sheet and operational excellence, we can navigate through these short-term challenges and continue to gain market share.

**With that, we'll open it up for your questions.**