

REVOLVE

REVOLVE GROUP INC. (NYSE: RVLV) Q3 2023 CONFERENCE CALL

PREPARED REMARKS ON NOVEMBER 1, 2023

ERIK RANDERSON, VP INVESTOR RELATIONS

Good afternoon, everyone, and thanks for joining us to discuss REVOLVE's third quarter 2023 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.

I would also like to remind you that this conference call will include forward-looking statements, including statements related to our future growth and profitability and ability to generate cash flow; macroeconomic and industry trends; our competitive position; our business, operations and marketing initiatives and investments; average spending per active customer; category expansion; international expansion; our inventory balance and management; 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, 2022 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 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

Hello everyone and thanks for joining us today.

I will begin with a recap of our third quarter results, followed by updates on some key operating priorities and multi-year growth initiatives, consistent with our focus on investing for the long term to maximize shareholder value.

Net sales decreased 4% year-over-year to \$258 million in the third quarter, a slight improvement from the 6% decline in the second quarter of 2023.

We believe spending on discretionary products by our consumer demographic is being pressured by many factors, particularly in the U.S., including persistent inflation compounded by higher interest rates, reduced savings, and significant uncertainty in the macroeconomic and geopolitical climate.

Net sales in the U.S. decreased 5% year-over-year and **net sales in international markets** decreased 1% year-over-year. The relative outperformance in International was driven by exceptional growth in Mexico that was offset by declining sales in Australia and China, two regions impacted by economic challenges and currency headwinds.

By segment, **REVOLVE** net sales decreased 2% year-over-year, with going out styles like dresses detracting from growth against difficult comparisons. It is important to keep in mind that as previously shared, we have operated with new inventory buys down by a mid-teens percentage year-over-year through the first three quarters of 2023.

A highlight of the REVOLVE segment is our accelerated growth in beauty net sales that validates our long-term opportunity for category expansion. Michael will talk more about the exceptional execution of our beauty playbook in his remarks.

FWRD net sales decreased 14% year-over-year within a luxury sector that is recalibrating after two years of extraordinary growth coming out of COVID. Aspirational luxury consumers who were flush with cash 18 months ago just don't have the same capacity to spend in the current environment. **As a relevant benchmark**, Bank of America recently reported that its credit card data reflects a 16% year-over-year decrease in luxury fashion spending by U.S. consumers in the third quarter.

As we entered the year, a top priority was rebalancing our inventory. We achieved this objective in the third quarter, as the spread between our year-over-year inventory and sales trends was favorable in the third quarter for the first time in more than two years. This very important milestone was driven by the REVOLVE Segment, where the year-over-year decline in inventory was steeper than the year-over-year decline in net sales by several points.

Shifting to the FWRD segment... While I am thrilled with our successful effort to rebalance total company inventory – which has been beneficial to cash flows – the composition of our FWRD segment inventory is not yet optimal. As mentioned on previous calls, it will take longer to fully rebalance inventory at FWRD, considering the current challenges in the luxury industry as well as markdown restrictions from luxury brands that extend the timeframe for rebalancing our FWRD inventory.

Moving to key metrics... As a company passionate about serving our customers incredibly well, I am excited and proud that we crossed the 2.5 million **active customer** threshold in the third quarter. Notably, active customers increased by 52,000 in the third quarter, 53% higher than our growth in the second quarter of 2023. The improved results benefitted from year-over-year growth in new customers at an efficient cost of acquisition that declined year-over-year. Most gratifying is that our net promoter and customer satisfaction scores were higher than in any prior third quarter for at least five years. Not surprisingly, average spending per active customer has decreased year-over-year in the current environment, yet we hear loud and clear that our customers absolutely love Revolve. We view the lower average spending per active customer as a temporary dynamic that will normalize over time as the environment improves.

Shifting to profitability.... We are proud to be one of the only fashion ecommerce companies that generates consistent profitability and cash flow, a meaningful competitive advantage that allows us to invest through business cycles.

Net income was \$3 million, or \$0.04 per diluted share, a decline of 73% year-over-year that was negatively impacted by an accrual for a pending legal matter equivalent to \$0.07 per diluted share.

Adjusted EBITDA was \$9 million, a decline of 46% year over year, which reflects a lower gross margin and continued pressure on selling & distribution and fulfillment expenses primarily due to the higher return rate year-over-year, partially offset by increased marketing efficiency.

Very important is our ability to continue to generate strong cash flows. **Cash generated from operations** and **free cash flow** were \$12 million and \$11 million in the third quarter, a year-over year increase of 25% and 33%, respectively.

Our strong **balance sheet** enabled us to confidently invest our free cash flow into our **\$100 million stock repurchase program** announced last quarter, without sacrificing investment in the business. We deployed \$12.6 million to repurchase approximately 907,000 shares of Class A common stock during the third quarter at an average cost of \$13.87 per share.

Since we view the current environment as a near-term headwind and remain confident in our longer-term opportunity to drive growth and profitability, we view stock repurchases as an attractive and accretive use of our capital.

Moreover, at a time when many fashion ecommerce peers have significantly reduced investment to limit their cash burn, our long-term mindset, strong balance sheet and consistent cash flow generation give us the confidence to continue to prudently invest throughout the cycle. Our long-term approach to investment decisions should allow us to emerge in an even stronger competitive position when the environment improves.

With that in mind, I will now offer updates on our important growth and efficiency initiatives that we believe will further strengthen our foundation for profitable growth over the long term.

- **We remain extremely committed to driving cost efficiencies within our global shipping and logistics operations.** The successful launch I discussed last quarter of consolidated customer return shipments from Canada to the U.S. and local re-fulfillment for certain product returns in the U.K. have reduced costs as intended, but were overshadowed in our financials by the higher return rate year-over-year. Building on our early success, in the coming months we plan to extend our local re-fulfillment of certain product returns to Europe. We expect this initiative to reduce shipping costs and provide even faster service for our valued European customers. I am also excited by our innovation in establishing alternative shipping arrangements in certain U.S. regions that have reduced our shipping costs in these regions and even further improved shipping timelines, particularly on the weekends. It is early days, yet we see great potential for our many initiatives to drive efficiency and even further improve on our exceptional service levels.

- **With the increase in return rate year-over-year being such a headwind on our financial results, I am spending a great deal of time and focus with the team on initiatives designed to reduce the return rate and make returns more efficient.** A recent survey on our product returns indicates that nearly two-thirds of returns relate to size and fit, validating our opportunity to move the needle over time as we believe we can leverage technology to do a much better job communicating the fit and sizing before the purchase. Some early results are promising. The virtual try on and size comparison feature tool launched last quarter on FWRD for handbags and accessories has shown excellent results in reducing return rates for customers who engage with it. We are planning to meaningfully expand the tool's availability and have recently launched it on the REVOLVE site as an A/B test. We have also recently launched product videos on the product detail page for several brands and very soon we will launch product fit guides to test additional efforts to reduce the sizing uncertainty. If these efforts prove successful, the financial benefits should be compelling. Consider that for every 1-point decrease in our return rate, we would expect to realize cost savings of approximately 30 to 50 basis points in reduced Selling & Distribution and Fulfillment costs. A reduced return rate would also drive higher net sales, due to a lower percentage of orders being returned.
- **We are also very focused on further expanding our capabilities and growth opportunities within Owned Brands.** As shared on recent earnings calls, the softening consumer demand in recent quarters has led us to be more conservative in planning our Owned Brand inventory buys since Owned Brands require a deeper inventory commitment per style than our third-party brands. And the lower mix of Owned Brands year-over-year is a driver of the gross margin decline I mentioned since Owned Brands have a much higher gross margin. Nonetheless, we are excited by and continue to invest in the long-term potential in Owned Brands, which offer huge potential for product differentiation and margin expansion. Consider that our REVOLVE segment gross margin of 55% reported today was in the same zone as the REVOLVE segment gross margin in the third quarter of 2019, even though the Owned Brands mix of the REVOLVE segment net sales in the third quarter of 2023 was roughly half of the Owned Brand mix in the third quarter of 2019. This comparison illustrates the opportunity to drive margin improvement from Owned Brand expansion in the coming years, if we can continue to raise the bar through our ongoing investments.

- **Lastly, we continue to expand the use of AI and machine learning across several key areas of our operations to drive growth and efficiency.** I am excited about a current application of AI technology that allows our customers to visually search for similar styles without any keywords. Currently in beta testing, the compelling user experience is especially relevant for driving discovery among the tens of thousands of styles on REVOLVE. We are also gearing up to launch a personalized recommendations landing page for returning customers, leveraging outstanding development work by our Data Science team to tap into our deep data insights. We believe the increasingly personalized site experience will provide a more engaging and rewarding shopping experience, and based on prior efforts, could lead to improved conversion rates.

I am pleased with our team's execution on these important initiatives that are key building blocks for our continued long-term growth and profitability.

In summary, while we face a multitude of challenges in the current environment, we will remain on offense. We continue to focus on our competitive advantages of technology innovation, operating efficiency and brand building to guide us through these uncertain times as we invest in the long-term opportunity ahead of us.

Now, over to Michael.

MICHAEL MENTE, CO-FOUNDER AND CO-CEO

Thanks, Mike, and hello everyone.

It has been a challenging few quarters contending with the macro environment and cycling through comparisons against a period of pent-up consumer spending coming out of COVID. As a relevant benchmark, Consumer Sentiment in the U.S. is currently 64, which is well below the Consumer Sentiment during the depths of COVID.

Nonetheless, as CEOs of a growth company, Mike and I are not satisfied with our current results. Even within a current difficult macro environment, we expect to outperform the benchmarks as we have for most of the 20 years since we founded REVOLVE. We have some work to do, our team is up to the challenge and I feel great about our early progress on growth initiatives and strategies that we believe offer exciting potential for our future. Our long history operating the business has taught us that periods of macro challenge can often present opportunity for market disruption. With our strong financial position, our fast paced and nimble operating structure, and our innovative, entrepreneurial mindset, we believe we are well positioned to drive improved results.

So, I will provide an update on what has me excited about our future.

First, we have some impactful and innovative **brand marketing activations** in the works for the fourth quarter and into early 2024 that I am truly excited about. An important element of our brand building and event planning strategy is to stay nimble, be relevant, fresh and exciting. Our marketing plans for the fourth quarter and into early 2024 capture this strategy in our efforts to drive the greatest impact from our passionate community of consumers, influencers and brands.

One of our cornerstone brand building events in the fourth quarter will be in an international region where we see a great deal of opportunity for future growth in the years ahead. This follows on the heels of our highly successful activation in Mexico, where our third quarter sales and customer growth were again truly exceptional -- helped by further advances in service levels that drove another exceptional quarter of triple-digit growth in new customers. As we exit the fourth quarter and extending into early 2024, we have a number of activities planned featuring both Revolve and FWRD that we are very excited about. We will share more details on these plans at a later date.

We are also leveraging our core competencies in disruptive marketing and technology innovation to drive results and lay the foundation for future growth.....

Mike talked about how we are leveraging AI for personalization and visual search on our websites. Beyond this, it is important to understand that we are testing the use of AI broadly throughout the organization in an effort to drive growth and efficiency. In the coming weeks, we will also be experimenting with AI-designed images on our website and mobile apps, which if successful, could prove to be a real game changer. We see many more applications for leveraging AI in the marketing realm, building on the success of our innovative AI billboard campaign launched earlier this year. Finally, on Friday, we will launch styles on REVOLVE from three emerging designers featuring new collections that were created entirely using AI design. Produced by the three winners of the first-ever AI Fashion Week, the looks are incredible and will be exclusively available for sale on REVOLVE.

And as a company known for leading innovation on social channels, it is exciting to see our collaboration with **TikTok Shop** showing a great deal of promise in the early stages. Net sales generated from TikTok Shop increased meaningfully in the third quarter compared to the second quarter of 2023, even though we only made available a limited selection of products on TikTok Shop. A key contributor to our success is our proven ability to create compelling content for social channels and engage with influencers to drive awareness and impact, combined with the conversion driven nature of the TikTok platform. Looking forward, we see an exciting opportunity to further leverage our experience into the TikTok platform and expand the range of REVOLVE products and categories that will resonate with the large audience of Gen Z consumers and content creators on TikTok.

To capitalize on the exciting growth potential within this new channel, we recently launched a series of live streaming content videos intended to further engage the TikTok community with product insights, styling tips and exclusive offerings. We also recently launched a dedicated TikTok Beauty account with beauty specific content and that will also soon have a beauty focused store within TikTok Shop. Beauty is a great category fit considering that TikTok has a fanatical beauty community and that beauty is ideal for influencers to create compelling educational video content. For years, the viral nature of TikTok has been a powerful catalyst for the beauty category — and now with TikTok Shop, consumers can discover and purchase products in one place.

Speaking of Beauty, I will wrap up with commentary on our newer categories where we continue to see a lot of growth potential.

The Men's and Beauty categories achieved strong double-digit sales growth in the third quarter, further validating our opportunity for category expansion. Beauty was the standout performer, so I will focus my remarks here.

Beauty net sales increased 44% year-over-year, and expanded to 4% of net sales from 3% in last year's third quarter, helping to offset the current softness in our apparel categories.

Our team has done an incredible job executing, improving all aspects of the beauty business, and bringing on impactful new beauty brands that helped drive the 36-point improvement in our year-over-year growth rate compared to the second quarter of 2023. Most exciting is our momentum in attracting impactful new beauty brands, which is even stronger entering the fourth quarter.

In October, we added a full range of products from one of the most coveted beauty brands, Laura Mercier, to both REVOLVE and FWRD. This is a huge win that we believe may help build momentum in attracting other top beauty brands. Also, earlier this month, we extended our top selling beauty brand on REVOLVE, Charlotte Tilbury, to list on FWRD as well. And right away, in the first week, Charlotte Tilbury became our top selling beauty brand on FWRD. We expect several more impactful beauty brands to launch in the coming weeks, just in time for the holidays.

Our goal is to become the preferred beauty destination for our customers. A big part of achieving this goal is having the right selection. We believe that as we continue to optimize our beauty assortment, our loyal customers will buy more and more beauty from us because we have earned their trust through our brand, curation, and best-in-class customer experience. We are off to a great start with the brand additions I mentioned, and a healthy pipeline of brands interested in partnering with us in 2024.

In closing, while we continue to face challenges in the near term, our team is energized by the opportunity to drive improved results across a wide range of longer-term initiatives that leverage the core competencies that have served us well for the past 20 years.

I want to express a heartfelt thanks to our talented team for their incredible efforts and persistence, particularly in the past few years.

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

JESSE TIMMERMANS, CFO

Thanks, Michael, and hello everyone.

I'll start by recapping our third quarter results and then close with updates on recent trends in the business and commentary on our cost structure as we look ahead.

Starting with the third quarter results.

Net sales were \$258 million, a year-over-year decrease of 4%, within an environment for consumer discretionary spending that remains quite challenging.

REVOLVE Segment net sales decreased 2% and **FWRD Segment net sales** decreased 14% year-over-year in the third quarter.

By territory, domestic net sales decreased 5% and **international net sales** decreased 1% year-over-year.

Active Customers, which is a trailing 12-month measure, increased by 52,000 customers during the third quarter. Our active customers crossed the 2.5 million customer milestone for the first time, an increase of 12% year-over-year.

Our customers placed 2.1 million **orders** in the third quarter, an increase of 9% year-over-year.

The increase in orders placed was offset by a decrease in **average order value**, or **AOV**, and a year-over-year increase in the return rate. AOV was \$299, a decrease of 7% year-over-year, against an elevated AOV comparison of \$320 in the third quarter of 2022 that was the highest we have ever reported.

Shifting to gross profit... **Consolidated gross margin** was 51.7%, slightly below our guidance range. The decrease of 127 basis points year-over-year primarily reflects a lower mix of net sales at full price and a lower mix of Owned Brand net sales within our REVOLVE Segment compared to the third quarter of 2022.

As you can see from our **segment gross profit** disclosures, the year-over-year comparison for segment gross margin is more favorable at REVOLVE than FWRD, which reflects the great progress we have made rebalancing the REVOLVE Segment inventory. As Mike alluded to, while we have made progress with rebalancing FWRD, we still have some work to do to fully optimize the FWRD segment inventory.

Moving on to operating expenses....

The quick summary is that better-than-expected marketing efficiency in the third quarter was offset by our fulfillment expense and selling and distribution expense as a percentage of net sales coming in slightly higher than our outlook.

Fulfillment costs were 3.6% of net sales. The increase of 56 basis points year-over-year was primarily due to a year-over-year increase in our return rate, a year-over-year decrease in AOV, increased rent expense, and other costs of operating our recently expanded fulfillment network, and higher wages for our fulfillment center staff. We expect to realize efficiencies on fulfillment expense as a percentage of sales in the coming years as we grow into and optimize our increased fulfillment center capacity.

Selling and distribution costs were 19.0% of net sales. The increase of 170 basis points year-over-year is primarily due to the higher return rate and lower AOV. We are aggressively pursuing initiatives both to reduce our shipping and logistics costs and to address the increasing return rate.

Our Marketing investment represented 15.4% of net sales, a decrease of 123 basis points year-over-year, reflecting a reduction in brand marketing investment and events in the third quarter of this year as compared to last year, as well as year-over-year efficiency in performance marketing investment as a percentage of net sales. The reduced brand marketing investment year-over-year is largely due to a shift in timing, from the third quarter to the fourth quarter, with a very active calendar of brand building events in the fourth quarter this year, heading into 2024.

General and administrative costs were \$35.2 million, including the \$6.6 million accrual for a pending legal matter. Excluding the legal accrual, our G&A costs came in slightly lower than our outlook for the third quarter.

Net income of \$3 million, or \$0.04 per diluted share, was impacted by the accrual for the pending legal matter equivalent to \$0.07 per diluted share. The 73% year-over-year decline in net income was also impacted by the net sales decline, a year-over-year decrease in gross profit, and continued pressure on certain operating expenses.

Adjusted EBITDA was \$9 million, a decrease of 46% year-over-year.

Moving to the balance sheet and cash flow statement...

Inventory at September 30, 2023 was \$203 million, a decrease of 5% year over year and down 1% sequentially from the second quarter of 2023. The year-over-year decline was one point steeper than our net sales decline, illustrating the progress we have made in rebalancing our inventory.

Net cash provided by operating activities and free cash flow in the third quarter increased by a strong double digit percentage year-over-year. For the nine months ended September 30, 2023, **net cash provided by operating activities** was \$47 million and **free cash flow** was \$44 million, an increase of 37% and 44% year-over-year, respectively.

We put our cash flow to work towards the new **\$100 million stock repurchase program** announced last quarter. We repurchased approximately 907,000 shares of Class A common stock during the third quarter, at an average cost of \$13.87 per share. Approximately \$87 million remained available under the repurchase program at quarter end.

As of September 30, 2023, **cash and cash equivalents** were \$267 million, an increase of \$23 million, or 9%, year-over-year, and we had no debt. Cash and cash equivalents decreased by \$2 million on a sequential basis versus the second quarter of 2023 as a result of our stock repurchases.

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.

Starting from the top.... The top line pressure we experienced in the third quarter has continued, with net sales for the month of October 2023 down a low single digit percentage year-over-year.

To assist in your modeling of our net sales in the fourth quarter of 2023, I want to highlight that our net sales comparisons are more difficult in the months of November and December - on both a one-year basis and on a multi-year basis -- when compared to the October comparison.

Consistent with the third quarter results, during October, year-over-year net sales comparisons in the REVOLVE Segment continued to outperform the FWRD segment. I would also like to highlight that our October net sales in the Middle East, which has been a growth driver for International, were impacted by the war in Israel. Our hearts go out to everyone affected at home and abroad suffering tragic loss and hardship surrounding the recent events in the Middle East.

Shifting to gross margin... We expect gross margin in the fourth quarter of 2023 between 51.7% and 52.0%, implying a year-over-over increase in gross margin compared to the fourth quarter of 2022. Taking into account our third quarter performance, we have fine-tuned our gross margin outlook for the full year 2023 to between 51.8% and 51.9%.

Fulfillment: We expect fulfillment as a percentage of net sales to be around 3.6% for the fourth quarter of 2023 and now expect fulfillment to represent 3.5% of net sales for the full year 2023.

Selling and Distribution: We expect Selling and Distribution costs for the fourth quarter of 2023 to be approximately 19.0%, consistent with the third quarter result, and 18.7% of net sales for the full year 2023. The slight increase from our previous full-year 2023 guidance primarily reflects a higher-than-expected return rate that has overshadowed early efficiency gains resulting from our shipping and logistics efficiency measures. Looking beyond the fourth quarter, in 2024 we believe we can begin to benefit from our concerted efforts to drive efficiency in our shipping and logistics operations globally.

Marketing: We expect our marketing investment in the fourth quarter of 2023 to represent between 17.0% and 17.2% of net sales. For the full year 2023, we have narrowed our expectation for marketing investment to represent between 16.2% to 16.3% of net sales, which is unchanged at the midpoint from our prior full-year range.

General and Administrative: We expect G&A expense of approximately \$29.6 million in the fourth quarter of 2023 and \$121.5 million for the full year 2023. The increase in our full year G&A outlook is entirely due to the \$6.6 million accrual for a pending legal matter recorded in the third quarter.

And lastly, we continue to expect our **effective tax rate** to be around 24% to 26%, consistent with the last several quarters.

To recap, we are laser focused on the large market opportunity ahead of us. Leveraging our strong financial position and consistent with our focus on the long-term, we will continue to prudently invest in a multitude of initiatives that we believe can extend our competitive advantages and maximize shareholder value in the years ahead.

Now we'll open it up for your questions.