REVOLVE

REVOLVE GROUP INC. (NYSE: RVLV) Q2 2020 CONFERENCE CALL

PREPARED REMARKS ON AUGUST 12, 2020

ERIK RANDERSON, VP INVESTOR RELATIONS

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

Before we begin, I would like to mention that we have posted a presentation containing Q2 2020 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 net sales, gross margin, operating expenses, diluted share count and capital expenditures for the second half of this year. 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 subsequent filings, 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, Free Cash Flow and Adjusted Diluted Earnings Per Share. We use non-GAAP measures in some of our financial discussions, as we believe they more accurately represent the true operational performance and underlying results of our 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 GAAP to non-GAAP measures, as well as the description, limitations and rationale for using each measure, 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-CEO’s, 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

Thanks, Erik. Good afternoon everyone, and thanks for joining us today.

We hope each of you and your families are in good health. I look forward to the day when we can see many of you in person again.

So much has changed in just the past three months. On our Q1 conference call, we discussed the negative impacts of the COVID-19 pandemic that led to a year-over-year decline in net sales of nearly 50% in the final weeks of March. Almost overnight, the shelter-in-place mandates put an abrupt pause on the special social occasions that often serve as a catalyst for customers to buy from REVOLVE.

We took swift and aggressive action to protect our people and to adjust our cost structure for what quickly became a highly uncertain demand environment. I am extremely proud of how well our team has executed against our priorities despite the continuing unprecedented headwinds brought on by COVID-19. As we prepared for the worst, the teams re-engineered our entire approach to brand marketing and merchandising to position REVOLVE for success amidst significant changes in consumer buying behavior.

There are three key highlights of our second quarter results that I hope each of you will take away from my remarks:

- **First,** we delivered record EPS of $0.20 per share and record Adjusted EBITDA of $21 million in the second quarter. Each of these measures grew double digits year-over-year during the worst economic climate in decades.
- **Second**, we delivered record free cash flow of $53 million in the second quarter alone. That’s more cash flow than we generated for the entire year of 2019.
- **Third**, a key contributor to the exceptional free cash flow generation was our meaningfully higher inventory turns in the second quarter. Inventory turns in our REVOLVE segment increased approximately 30% year-over-year, reaching our highest level in 6 years.

Impressive collaboration and agility by our team drove the strong financial and operational results. Despite the very difficult macro environment and with most of our teams continuing to work from home, we nonetheless realized efficiencies throughout the business while maintaining exceptional service levels for our customers.

With that, I'll continue with the discussion of our second quarter results.

Our monthly net sales in Q2 improved throughout the quarter. In fact, June was our first month of positive year-on-year growth in net sales since the pandemic began. We believe the net sales improvement in the past few months reflects a better overall consumer spending environment combined with our effective marketing and merchandising strategies to capitalize on at home categories like beauty, loungewear, intimates and accessories. That said, we did experience some pockets of softness late in the quarter as states re-opened and COVID cases increased, especially in those states with higher COVID numbers.

Shifting to the balance sheet and cash flows…. Recall that when we began to feel the severe impacts of COVID-19 in March, we immediately adjusted our inventory buys for a scenario that assumed no sales recovery in the remainder of 2020. As a result, our reduced inventory buys -- combined with the better-than-expected net sales -- led to a 37% decrease in our inventory balance year-over-year in the second quarter.

The significant decline in inventory coupled with a better-than-expected 12% decline in net sales translated to a significant increase in inventory turns year-over-year. Working through our inventory position and improving inventory turns has been a key goal we have outlined for the past several quarters, so we are very pleased with our progress.

The higher inventory turns had a very positive impact on our cash flows for the quarter. As mentioned, we generated $53 million in free cash flow during the second quarter, up from $2 million in the prior year. We now have $151 million in cash on the balance sheet, which we believe positions us to navigate through this uncertain time, re-invest in inventory to support future demand and further invest in the business to drive long-term growth.

The strong results and significantly improved cash position led us to quickly unwind many of the reductions to our cost structure that we discussed on last quarter's conference call. During the peak of COVID-19 uncertainty, we made the very difficult decision to adjust personnel costs, primarily through furloughs and reductions in salary, wages and hours, as well as layoffs. I am very pleased to report that we have now brought back the majority of furloughed employees, and that by the end of this week, substantially all active employees, including executives as well as our independent board members, will have their compensation back to the pre-COVID run rate. I again want to thank all of our employees for their sacrifice and agility during this difficult time.

With the better-than-expected sales trends, we have rapidly moved from a mode of trying to reduce inventory receipts at the beginning of the second quarter to now pursuing inventory opportunities to make sure we have the right mix and the right level of inventory in the second half of the year and as we enter 2021.

Aside from the strong Q2 financial results, I am encouraged by the innovation and positive impacts that are moving our business forward.

Our Operations team delivered phenomenal results, delivering their most efficient quarter in the past seven quarters as the efficiency gains from the investments we've made over the last 18 months continue to provide benefits. In early 2019, we invested in an expanded and consolidated distribution center and throughout 2019, we layered in incremental automation. During this past quarter, we automated another key process in the distribution center, which is already having a positive impact on our distribution process. And with capacity in our current facility for over four times our current unit levels, we have more room for improvement over the longer term.

Continuing on the topic of running the business as efficiently as possible... Our buying and planning team was able to pivot quickly from initially reducing our inventory commitments and then quickly shifting back into investment mode as demand picked up. We also moved very quickly to merchandise into categories that are more aligned with the sudden change in consumer preference. For example, within just days after the CDC recommended that consumers wear masks in public, we had masks available on the site for purchase. Today we have approximately 100 styles of masks across third-party brands and owned brands and it's grown into a low 7-digit net sales business at attractive margins.

Through leveraging our read and react strategy, technology and team of data analysts, the buying and planning team was able to drive our merchandise reorders to a record high in July, when expressed as a percentage of total net sales. Product reorders are very important because reorders improve inventory dynamics and reduce inventory risk since we only reorder those products that are selling well. In fact, often times the reordered product is already ordered by customers and reserved for them by the time the merchandise reaches our facility.

Arguably most important from my vantage point, we are keeping our customers very happy. Our customer satisfaction levels continue to surpass our high standards, with the warehouse operating safely and efficiently fulfilling orders with the same best-in-class service levels despite everything going on in the world around us. Customer inquiries are handled by customer service agents capably working from their homes, without missing a beat, continuing to drive brand loyalty for our valued customers. Making our customers happy is what personally brings me the most joy, since I firmly believe businesses exist to serve customers and that customer satisfaction is key to long-term success. Having co- founded the company with a customer centric mindset from day one, to this day I still read every single piece of customer feedback. Our very strong customer satisfaction metrics are a direct result of this organizational focus on the customer that is built into our DNA.

Now, shifting to the more recent trends in the third quarter to date… The positive year-over year net sales growth in June carried through to July and early August with the quarter-to-date period showing low-single digit growth on a year-over-year basis. It's important to note that our net sales growth rate remained in the same general range in the last several weeks of July and into August, averaging low single digit year-over-year growth and remaining in positive growth territory despite the recent resurgence of COVID-19 cases and the reversal of many cities and states re-opening. These COVID-19 setbacks led to a decline in U.S. consumer confidence in July that adds uncertainty to the slope and timing of a future recovery.

By geography, in July, international sales continued to remain stronger than net sales in the U.S. This aligns with the trend we have witnessed in the second quarter with international outperforming the U.S.

Michael will share a detailed breakdown of our net sales by product category in July, which demonstrates that customer shopping and purchasing behavior continues to be significantly influenced by the global pandemic. A positive outcome of the category mix shift is a reduction in the percentage of merchandise returned, which benefits net sales and reduces certain operational expenses such as shipping and fulfillment costs.

I am extremely pleased with our ability to navigate through these challenging times. Time and time again, we have asked a lot of our team and they have delivered.

So, thanks to all of our team members for your hard work and sacrifice, for staying nimble, and for your dedication to exceeding our customers' expectations. We're not out of this yet and there will be challenges ahead, but I'm confident that we have the team in place and the organizational discipline to manage our way through this and come out stronger on the other side.

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

MICHAEL MENTE, CO-FOUNDER AND CO-CEO

Thanks, Mike, and hello everyone.

We have experienced a lot in our 17 years of operating REVOLVE but the past few months have been by far the most challenging. We entered this period as a brand known for travel, music festivals and social gatherings, with an inventory position prepped for prime time starting with REVOLVE Festival that had been scheduled for April. And nearly overnight our customers couldn't travel, gather in large groups, and in many cases couldn't socialize and were locked down at home. But with the strength of our business, the power of our brand, and most importantly the sacrifice, commitment and execution of our team, we are able to deliver our most profitable quarter ever.

I'm so deeply proud of what the team has accomplished in this face of fierce adversity and dramatic uncertainty.

I will focus my remarks on the opportunities we have to deepen our customer relationships through merchandising, marketing and using the power and voice of our brand.

Starting with our merchandise… The dramatic shift towards a more stay-at-home lifestyle has allowed us to further deepen the relationship with our consumer by highlighting our offering of incredible fashion and design, in areas that were not focal in times past. Nascent categories such as beauty, intimates, activewear and loungewear have grown into key needs that our customer has begun to love coming to us for. It's clear that we have been able to nurture and expand what REVOLVE is all about. By enhancing our merchandising strategy, we believe we can expand our share of her wallet over the long term. It's incredibly important to us that whatever our customer needs, she can always come to REVOLVE as her trusted source of style.

For instance, in July we generated year-over-year growth rates in net sales of approximately 30% in denim, 80% in intimates and nearly 100% growth in accessories.

On the other hand, social distancing restrictions result in fewer opportunities to purchase outfits for special occasions outside the home, such as dresses, which is REVOLVE's largest product category. Importantly, net sales trends in dresses have improved in recent months, although year-over-year comparisons remain negative. To give you some guideposts, dresses decreased year-over-year as a percentage of REVOLVE segment net sales by about 6 percentage points in July. However, this year-over-year decrease in July is less than half of the year-over-year decrease in dresses as a percentage of REVOLVE Segment net sales that we experienced in the month of April 2020.

We are very excited about the opportunity in the beauty category. The demand for REVOLVE Beauty products has been phenomenal, with net sales increasing approximately 140% year-over-year in July. This is the fourth straight month that the Beauty category net sales have increased more than 100% year-over-year. Beauty is especially compelling because it is nearly all sold at full price with very little returns and is an incredible way to acquire new customers and expand our share of wallet with our existing customers.

With a base of over 5,000 of the most highly-coveted beauty products, we believe there is even more room for growth. Major beauty brands that had traditionally relied on department stores for distribution are increasingly seeking to sell their coveted merchandise through REVOLVE. These brands recognize the clear shift in consumer preference to buying online at a time when the number of mall-based department stores is expected to further decline by more than 50% by the end of 2021, according to published estimates.

Our brand marketing strategy has dramatically evolved this summer with the changing times. Despite being dealt a tough hand with an entire calendar of activations canceled, we've found powerful new ways to engage our customers on social media, adapting to her new lifestyle of spending more time at home. As shared last quarter, we shifted our entire brand marketing focus to creating engaging and inspirational live content shows featuring influencers, designers and celebrities. Since the pandemic began, we have now produced over 140 videos that have been viewed 11 million times on Instagram Live or IGTV.

The new content strategy has been highly efficient as demonstrated by our customer acquisition metrics in the second quarter. We drove exceptional increases in marketing efficiency during the quarter, as we nearly acquired the same number of new customers in the second quarter as we had in the prior-year period, despite our total marketing spend decreasing by 41% year on year. This marketing efficiency was a key driver of our strong profitability in the quarter.

I'm incredibly proud of how quickly and effectively the team responded by expanding our marketing playbook, enabling us to prove out an exciting new content strategy in creating video content on Instagram Live and IGTV. I look forward to once again hosting in-person brand marketing events when it is safe to do so and continuing with our powerful new digital content strategy that has proven to be both highly engaging and extremely cost effective. We believe this combination will be a powerful driver of growth over the long term.

The latest example of our marketing innovation is the virtual REVOLVE Summer, a three-week series of events that kicked off in mid-July. In years past, we have held REVOLVE Summer for weeks at a time in Bermuda, the Hamptons and Cuixmala, Mexico. This year brings a curated virtual REVOLVE Summer event that has allowed us to bring the REVOLVE community together and inspire customers with new looks – all from the comfort of their homes. 125 influencers from around the world have participated as brand ambassadors in these special events that include designers launching new collections exclusively available on REVOLVE.

Stepping back and looking at the long-term opportunity, there was already a seismic shift happening in the broader retail landscape even before COVID-19. Purchasing power has been shifting to the next- generation consumer and shopping is moving to the digital world with overall retail growth being driven purely by e-commerce. We believe that this shift, particularly the digital transformation, has been accelerated in the last several months and will continue to shift further post pandemic.

With our pure play digital strategy and focus on the next-generation consumer, we believe REVOLVE sits squarely at the intersection of these two powerful shifts. We believe this powerful shift, combined with our strong brand, deep connection with our customer and the strong foundation that we have built over the last 17 years, positions us well to capitalize on the opportunities ahead.

Now, I'll turn it over to Jesse for more detail on the financial results and trends.

JESSE TIMMERMANS, CFO

Thanks, Michael.

It's been a tough few months, but we're proud to have executed well against the key priorities we outlined last quarter of protecting our people and protecting our balance sheet.

Our significantly bolstered cash position further increases our confidence that we are well positioned and have the levers to manage through the current environment.

Now, starting with the second quarter results… Net sales were $143 million, a decrease of 12% year over year, but in this very fluid environment, it's important to look at the intra-quarter trends behind these quarterly figures. We were pleased that monthly net sales improved each month throughout the second quarter and our year-over-year growth turned positive in June.

Drilling into the top line…. By segment, the **REVOLVE Segment** and **FORWARD segment** net sales in Q2 each decreased 12% year-over-year. Similar to the overall net sales trends on a monthly basis, year-over-year net sales comparisons for each segment improved each month from April to June.

Active customers were 1.5 million, an increase of 13% year-over-year. Recall that since Active Customers is a trailing 12-month metric, performance on this metric is not directly comparable to traditional quarterly metrics like orders placed or average order value. As mentioned on previous calls, as we cycle through the high customer growth periods of late 2018 and early 2019 and layer on the impact of COVID, the active customer growth has and will continue to decrease sequentially until we cycle out of this period.

Orders placed were 1.2 million, a decrease of 10% year over year.

Average order value (AOV) was $204, a decrease of 26% from $275 in the prior year and consistent with the April AOV trends we discussed on the Q1 earnings call. The significant decline in average order value reflects a shift in net sales mix to "at home" product categories such as beauty, accessories and loungewear with lower average price points. On the other hand, the dresses category which carries the highest average selling price, decreased as a percentage of our net sales mix by 9 points year-over-year. This has a disproportionate impact since dresses is our largest category. Also, as we expected and communicated on our Q1 call, we experienced a lower mix of full-price sales and lower margin within our marked down product, both of which negatively impacted AOV.

As a reminder, orders placed and average order value are gross metrics, which means they are calculated prior to the effect of merchandise returns.

Speaking of returns, partially offsetting the lower number of orders year-over-year and the lower average order value was a meaningful decrease in the percentage of merchandise returned year over year. The reduction in return rates is due to a number of factors working in our favor. First, we do believe there may be a broader change in customer behavior in response to the uncertainty caused by COVID-19 as it relates to returns, with customers being more discerning in their purchase decision making process. This is evidenced by the fact that return rates, even at a category level, have decreased. Second, there is a positive impact to merchandise returns as a result of the changing merchandise mix. For instance, the return rate for the currently fast-growing beauty category is typically in the low single digits, and return rates for other currently fast-growing categories like intimates and accessories are also much lower than the overall average. Dresses, which has historically been our largest category by a wide margin, has a meaningfully higher return rate than the average. And finally, there is also a positive impact on returns from the higher mix of markdown sales, particularly final sale items.

International net sales increased 3% year-over-year, outperforming the 15% year-over-year decline in net sales in the U.S. By region, positive trends in Western Europe have been partially offset by headwinds in certain Asian markets such as Hong Kong.

Moving to gross profit…. Consolidated gross margin was 50.5% for the second quarter, a decrease of approximately 530 basis points over the prior year and directionally consistent with our commentary last quarter predicting gross margin headwinds for the balance of 2020.

Within the REVOLVE segment, we delivered gross margin of 52.2% in Q2, down approximately 530 basis points year-over-year. The REVOLVE segment margin was impacted primarily by a lower percentage of REVOLVE segment net sales at full price; deeper markdowns within the markdown product; and a lower mix of Owned Brands, as we have shifted a greater percentage of merchandise buys to third-party products with lower initial purchase quantities in order to maximize our flexibility in the pandemic. As we discussed in our Q4 2019 investor call, we started to recalibrate the Owned Brand platform to better refine the assortment. With that, we expected Owned Brand mix to compress. With the additional pressures felt as a result of COVID-19, we expected further Owned Brand mix compression in the short term. To give you some guide posts, the Owned Brand mix was down around 9 points year-over-year in the second quarter. As we comp the Owned Brand mix ramping in the prior year and as we cycle through the significant COVID-19 reductions we made in the second quarter of this year, we expect the mix of Owned Brands to decline by a greater magnitude on a year-over-year basis in the second half of 2020. Owned Brands are core to our long-term strategy and we have already started to ramp up design and reinvest in Owned Brand styles that will flow through to new inventory and subsequent sales.

Within the FORWARD segment, we delivered gross margin of 36.8%, a decrease of approximately 540 basis points year-over-year. The FORWARD segment operates within what has become a highly promotional environment in the luxury goods space. This led to a lower percentage of FORWARD segment net sales at full price as well as lower margin on the markdown product.

And now moving to the cost structure, starting with Fulfillment, which reflects the costs incurred to staff and operate our distribution center… Fulfillment costs totaled $3.8 million, or 2.7% of net sales, as compared to 3.3% in the second quarter of 2019.

This leverage was better than we expected, particularly since a lower average order value is typically a headwind for fulfillment costs as a percentage of net sales.

The team did an outstanding job driving efficiencies and balancing the scheduling of team members within a dynamic demand environment that, in the end, proved to be much better than our working assumptions. We also benefited from a reduced return rate and efficiencies gained from the automation investments we made last year. All the while, we have invested in maintaining our primary focus of ensuring worker safety and social distancing for all of our team members.

Selling and distribution costs, which consist primarily of shipping, merchant processing fees and customer service, were $19.1 million, or 13.3% of net sales, a decrease from 14.6% of net sales in the second quarter of 2019.

Once again, the efficiency was better than we planned for and benefitted from efficiencies in shipping costs due to lower returns and, to a lesser extent, efficiencies in payment processing and customer service costs. Great job to the team for delivering our best efficiency performance in more than two years.

Marketing costs were $14.6 million, or 10.3% of net sales, as compared to 15.4% of net sales in the second quarter of 2019.

As discussed on the Q1 investor call, the second quarter is typically the peak for brand marketing investments – driven by the REVOLVE Festival that in prior years we have invested millions of dollars to host. None of that was possible this year, so by necessity, we shifted into highly-effective digital brand marketing content at a much lower cost of production. As a result, our brand marketing spend decreased by $6.6 million year-over-year and performance marketing spend decreased by the remaining $3.7 million.

General and administrative costs, which primarily consist of salaries and wages, were $15.8 million, or 11% of net sales in the second quarter, as compared to 11.6% of net sales in the second quarter of 2019. The year-over-year reduction in G&A spend reflects the cost-reduction actions announced on last quarter's conference call.

Fortunately, net sales trends improved from the lows we experienced in late March and April and have, overall, been much better than initially feared, so we moved rather quickly to restore salaries and wages that had been temporarily reduced. We started making these adjustments in May and by the end of this week, substantially all full-time active employees, including executives, and our independent board members, will have their compensation back to the pre-COVID run rate.

For the second quarter of 2020, we achieved record net income of $14.2 million, or 20 cents per diluted share, an 11% increase compared to $0.18 in Adjusted diluted EPS in the prior year. Adjusted EBITDA was $20.9 million, an increase of 10% year over year, for a margin of 14.6%.

Moving to the cash flow statement, we had an incredibly powerful quarter for cash flow generation. The combination of increased net income and a $37 million decrease in our inventory balance enabled us to generate $53.8 million in cash flow from operations and $53 million in free cash flow for the second quarter of 2020.

In the 12 months since REVOLVE has been a public company, we have generated more than $80 million of free cash flow.

The strong cash flow generation significantly strengthened our balance sheet and liquidity. Cash and cash equivalents as of June 30, 2020 were $151 million, an increase of $47 million during the second quarter. As of the end of the Q2, $24 million remained drawn on our revolving credit line, a decrease from the $30 million balance as of March 31, 2020.

We ended the quarter with $65 million in inventory, a decrease of 37% year over year. By comparison, our net sales decreased year-over-year by only 12%, which highlights that inventory turns improved significantly year-over-year. As Mike mentioned, inventory turns improved approximately 30% year-over-year in our core REVOLVE segment. While the cost of carrying inventory is low for us and we have the ability to hold merchandise for multiple seasons, we also targeted lower inventory and higher turns as we entered 2020. This initiative became even more important as we navigated through the impacts of COVID-19.

With sales performance that has been better than we initially expected, we actively shifted our efforts to reinvest more aggressively into inventory purchases to support the improved trends in consumer demand. These investments are over indexed on third-party inventory and are very focused on the categories that have performed well during the COVID-19 period and those categories we expect will drive sales in the back half of the year.

Now, let me talk about business trends since the second quarter ended on June 30th…. As Mike mentioned and consistent with the month of June, net sales in July and August to date are in positive territory on a year-over-year basis. Average order value in July was slightly higher than the second quarter, reflecting the improvement in the dress category, but was still well below prior-year levels. The return rate is still well below the pre-COVID level, but has increased from the low point earlier in the second quarter as we are seeing a slight mix shift back to full price and as the dress category has performed sequentially better.

We believe we are in a much better place than we were just three months ago -- as illustrated by our return to growth, significantly stronger balance sheet and improved inventory dynamics. Nonetheless, the duration and extent of the pandemic remains highly uncertain and the economic impact could last much longer.

So given the fluid environment, we're still not comfortable offering traditional guidance. However, I will provide some additional information to help in your modeling.

Net sales: As we mentioned, we are operating in a very fluid and uncertain time with a number of factors at play that can impact consumer demand and our top line results. While net sales improved sequentially on a monthly basis through Q2, it is important to note that the last several weeks of July and into August have been in the same general zone with low-single digit positive growth year-over-year. As such, and based only on what we know today, I would not expect significant improvement from our current levels in the near term.

Gross margin: The Q2 performance was better than our initial expectations, but we continue to believe gross margin will be challenged through the balance of the year and lower on a year-over-year basis. While gross margins have improved from the peak of the COVID-19 uncertainty earlier in the second quarter and we do expect promotional pressure to abate, we are still operating in an uncertain environment and historically our gross margins in the back half of each year are typically lower than the first half.

For our Selling and Distribution and Fulfillment cost line items… As pleased as I am with our fulfillment and selling and distribution cost efficiency in Q2, for modeling purposes, I would not guide anyone to expect this very high level of efficiency on these line items going forward. These variable cost line items will largely fluctuate with net sales in the near term. We do expect continued efficiency gains over the next several years, particularly in the fulfillment line item as we grow into our capacity and continue to realize the benefits of automation, but we also continue to face ongoing external headwinds and will be exposed to additional cost pressures as the product mix and return rates continue to evolve in these uncertain times.

Marketing: We will continue to manage our marketing investment efficiently. Without the opportunity to activate large scale in person events as we have done in prior years, we expect marketing as a percentage of net sales to continue to be lower year-over-year in the second half of 2020. Note that the magnitude of the year-over-year decline in marketing spend in the second half will be much smaller than it was in the second quarter because historically, Q2 has the highest amount of brand marketing investment by a wide margin.

General and Administrative: As mentioned, we realized leverage on this line item in the second quarter with the aggressive cost reductions we made. As we unwound most of those cost reductions over the course of June, July and August, we would expect to see a sequential increase in G&A for the third and fourth quarters when compared to the second quarter. Note that we don't expect to return to the pre-COVID run rate in the current year as we did have a number of layoffs and made other non-headcount cost reductions that will continue to benefit the cost structure in the current year.

Finally, we don't expect significant movement in our diluted share count or capital expenditures from what we communicated last quarter.

Now, I'll turn it back over to Michael to close out our prepared remarks.

MICHAEL MENTE, CO-FOUNDER AND CO-CEO

Thanks Jesse.

COVID-19 has brought incredible challenges, but true to our resiliency and entrepreneurial spirit, our team responded very quickly by protecting our employees and our balance sheet while, at the same time, launching innovative new ways to engage with the consumer and deepen customer relationships.

Seeing our team execute so well while further expanding our growth potential at a time when many industry companies are just trying to survive makes me more even confident in our future. We believe our agile team, strong brand, differentiated technology and deep customer connection, coupled with our balance sheet strength and flexible business model, positions us to thrive over the long term.

With that, I'll turn it over to the operator for your questions.