

# REVOLVE

## REVOLVE GROUP INC. (NYSE: RVLV) Q2 2022 CONFERENCE CALL PREPARED REMARKS ON AUGUST 3, 2022

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

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

Before we begin, I would like to mention that we have posted a presentation containing Q2 financial highlights to our Investor Relations website located at [investors.revolve.com](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 current expectations regarding the continued impact of the COVID-19 pandemic on our business, operations and financial results, including on our near-term sales in Greater China; our growth, including growth in active customers, and market opportunities and related macro and industry trends; the expected impact on delivery times from opening our first east coast fulfillment center; our marketing and technology investments and marketing events; the launch of our Remi Bader collaboration; the extension of our Brand Ambassador program to include FWRD; our freight costs; 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](http://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.

We delivered strong results in the second quarter, highlighted by record net sales that increased 27% year-over-year, gross margin expansion to record levels for a second quarter, and continued strong growth in active customers. We delivered these results despite macroeconomic conditions that became more challenging as the quarter progressed, creating cost pressures that impacted profitability, and also contributed to a moderating year-over-year growth trend in net sales in June that has continued into the third quarter.

### **With that as an introduction, I'll briefly recap our results.**

In the second quarter of 2022, our **net sales** were \$290 million, a 27% increase year-over-year.

We added 124,000 **active customers** during the quarter, the highest-ever for a second quarter, and representing 39% growth year-over-year. Impressively, growth in active customers in the first half of 2022 has already exceeded our total growth in active customers for the full year in 2019.

**Gross margin** expanded approximately 30 basis points year-over-year to 55.9%, an all-time high for a second quarter, despite inbound freight costs remaining elevated.

However, below the gross margin line we faced increasing pressure on **operating expenses** that contributed to softer-than-expected profitability measures in the second quarter.

Our second quarter **net income** of \$16 million and **Adjusted EBITDA** of \$27 million declined 48% and 24% year-over-year, respectively, against a difficult prior-year comparison when our net income had increased more than 100% year-over-year. Importantly, net income and Adjusted EBITDA were 28% and 42% higher than pre-pandemic levels in the second quarter of 2019, respectively, further illustrating our continued focus on profitable growth.

The increased cost pressures were mainly within **selling and distribution**, and more specifically, customer shipping expenses. There are two main reasons why these costs came in higher than expected.

**First**, we incur **fuel surcharges** on every package that we ship to our customers and on return packages. Our fuel surcharges in the second quarter were more than 4X what they were in the prior-year, and had a material impact on the selling and distribution line item for the second quarter. While our premium price points enable us to absorb these costs more effectively than if we were operating at lower price points and we do expect some moderation in costs from the peak, these surcharges continue to create real cost pressure in the near term.

**Second**, is our **return rate**. We had anticipated that our return rates would increase year-over-year as our product mix of net sales continued to normalize. However, our return rate has trended even higher than pre-COVID levels in the first half of the year. Historically, the main factors that influence return rates include the mix of sales by category, by geography, by segment, and the mix of full price and markdown sales.

One of the primary drivers of the higher return rate compared to pre-COVID levels is a fast-growing percentage of our international net sales coming from countries like Canada where we offer hassle-free returns, a major growth catalyst that has resulted in Canada net sales quadrupling in just the past six quarters. Our return rate in Canada has approximately doubled since late 2020 when we launched hassle-free returns for Canadian customers, yet it is a tradeoff we'll make all day long considering the exceptional growth of our localization efforts in the markets. Another factor was our mix of full price sales, which have a higher return rate. The mix of full price sales was higher than we anticipated for the second quarter and was significantly higher than in 2019. And finally, on a normalized basis, we did experience an overall increase in the return rate this quarter due to what we believe is a shift in customer behavior that is likely driven by the challenged macro environment's effect on consumer sentiment.

**Shifting gears to net sales performance by geography**, our U.S. net sales increased 30% year-over-year, outpacing international net sales growth of 14% from a year ago. Our international trends reflect continued strong growth in the western regions like Canada and the U.K., where we have made excellent progress with our localization initiatives, partially offset by foreign currency headwinds resulting from the stronger U.S. dollar and temporary headwinds in China due to COVID-19 preventative measures.

As I mentioned earlier, customer activity continues to be a bright spot. **Our active customers are becoming more productive**, illustrating our success in capturing a greater share of wallet. For the trailing 12-month period, net sales per active customer were \$488, an increase of 9% year-over-year. This stat is quite encouraging considering that new customer growth has been really healthy for the past several quarters, and that revenue per customer tends to increase significantly over time. Consider that in 2021, customers who had purchased from REVOLVE in a previous year represented 49% of our total Active Customers for the year, yet these more tenured customers generated **77%** of total net sales for the year.

I would also like to highlight that the significant majority of our newly acquired customers in recent quarters have purchased from us at full price, since our full-price customers consistently generate a higher lifetime value than customers acquired through markdowns.

Our consistently strong and profitable financial results also reflect our long-term focus on building trust with our customer. Core to building this trust is **operational excellence** and exceptional **service levels**.

I am excited to share that we have begun operating our first east coast fulfillment center, which we expect will raise the bar on our ability to delight customers with even faster delivery times for key east coast geographies. We have seen first-hand how much our west coast customers appreciate and value our one-day delivery timeframes available for many regions surrounding our Los Angeles fulfillment center. The power and stickiness of compelling service levels is also clearly evident in performance within our international markets. Almost universally, in international markets where we have invested to elevate service levels, our growth has accelerated in the months that follow.

**To wrap up**, we believe our results for the past several quarters demonstrate that we are gaining meaningful market share. And more importantly than just outpacing the competition, we are uniquely doing that while generating significant profitability and cash flow year after year. Our ability to self-fund the strengthening of our balance sheet year after year affords us a great deal of financial flexibility to invest where we see opportunities to drive shareholder value.

It's particularly important in an uncertain market environment like we are operating in today where inflation is at a 40-year high and U.S. consumer sentiment was at the lowest reading on record in June. I am extremely proud of how well our team has navigated through this increasingly challenging macro environment.

Michael and I have seen multiple economic cycles over nearly 20 years, and we have complete confidence in our team's ability to execute through even the most challenging environments, as we demonstrated in profitably navigating through uncertainty in the early stages of the pandemic.

Our team and technology are battle tested and have emerged stronger through this volatile period, and we are primed and ready for what lies ahead.

Now, over to Michael.

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

Thanks, Mike. Before I get into the details of the quarter, I want to pause and highlight that with today's results, we have now crossed the **billion dollar in net sales milestone** for our trailing 12-month period. This is a huge accomplishment for not only me and Mike, but also the many employees that joined us along the way when we were doing \$10 million, \$100 million or even \$500 million just a few years ago leading up to the IPO. Thanks to all of you. It has been fun, challenging and rewarding, and even more exciting is that we still have so much opportunity ahead.

Now, as we think about the quarter, we were able to deliver strong double-digit growth in an environment that became increasingly challenging as the quarter progressed.

Taking it a level deeper, our **product category trends** for the second quarter confirm that our core REVOLVE customer was getting out again in force, driving incredible growth in dresses with particular strength in special event styling. She is traveling, going to weddings and living her life to the fullest again. For these truly special occasions in her life, REVOLVE serves as her trusted source for inspiration and her go-to fashion destination.

The reopening this year has been most evident in the **REVOLVE Segment**, where net sales increased 30% year-over-year in the second quarter, despite international headwinds.

To capitalize on the return of an active social lifestyle and travel this summer, we kicked off the second quarter with the exciting revival of **REVOLVE Festival** after a two year-hiatus. REVOLVE Festival in 2022 was more impactful than ever on many levels. Event highlights featured our incredible lineup of performers, including Post Malone, Jack Harlow and Willow, and an unbelievable caliber of A-list attendees. We also hosted hundreds more influencers than ever before, with a strategic focus on a new network of content creators to further expand our reach and diversity into powerful new social media channels.

I am pleased to share that we have made great progress in connecting with our consumers these newer social media channels. I'm especially encouraged by the increased engagement with our compelling video content on **TikTok** and **Instagram Reels**. In the second quarter, new views of our TikTok content more than doubled sequentially compared to the first quarter of 2022, and nearly tripled year-over-year.

As I touched on last quarter, we are teaming up with content creator and Curve model, **Remi Bader**, to create a size inclusive owned brand collaboration that will launch next week. Remi has partnered with us on several marketing activations over the past year, and her follower engagement and personal brand momentum is truly impressive. What's especially exciting is that this is our first owned brand collaboration that truly expands our market potential into inclusive sizing. We have worked closely with Remi to ensure we provide the best product, and throughout the process Remi has been sharing key moments of the design and development process with her highly engaged community.

On the heels of REVOVLE Festival, we will continue to invest and actively create even further excitement for our brands with our impactful, in-person **marketing events**, building on our already strong connection with the next-generation consumer. The third quarter got off to an exciting start with our REVOLVE Summer activation in Puglia, Italy and our team just returned from a successful brand ambassador event in the Dominican Republic. We have several other events planned, highlighted by our return to New York for fashion week this September.



And across the business, we will continue to invest heavily in our **proprietary technology**, which we view as a significant competitive advantage. Mike's team is constantly building out internal technology to drive increased conversion rates and revenue, greater operating efficiencies, and an even better experience for our customers. For instance, within just the past few months, the technology and data science teams have developed proprietary internal applications that leverage machine learning and our rich data set to further optimize the customer experience and drive further operating efficiencies through enhanced fraud detection and package optimization. And on the site, we continue to elevate our personalization, product recommendations and search functionality, and recently launched an application that leverages machine learning algorithms to dynamically, and in real-time, recommend outfits for our customers to "complete the look." We are in the early innings of leveraging AI technology with some exciting projects in the pipeline that we believe will both drive revenue and operating efficiency in the months ahead.

**Shifting gears to FWRD**, our FWRD net sales for the second quarter increased 14% year-over-year against an incredibly difficult prior-year comparison when net sales increased over 150%. Importantly, over the last three years, our compound annual growth rate for FWRD net sales is 36%, meaningfully outpacing industry benchmarks.

And we are continuing to innovate and invest. An exciting development was our recent launch of **FWRD Buyback**, our proprietary resale program dedicated to circular luxury shopping. FWRD Buyback extends the life cycle of high-end designer handbags from coveted brands, allowing our customers to exchange their past purchases for credit to shop our full product offering. It enables us to expand our customer touch points and deepen our relationship with her, while further strengthening the value proposition for our loyalty program members – since, in addition to the credit, loyalty members earn up to 2,000 points for eligible handbags they exchange.

FWRD Buyback leverages our renowned customer experience and service capabilities to deliver an extensive assortment of pre-owned handbags from our top luxury brands at incredible value, including from the closet of FWRD Creative Director, Kendall Jenner.

The response has been very exciting, exceeding our expectations. Initial feedback from our luxury brand partners has been outstanding and within just the first couple of weeks, we drove more than 40% sell-through of our initial inventory.

We also continue to execute successful **cross marketing efforts** to introduce FWRD to our much larger base of REVOLVE customers, capitalizing on our strong customer loyalty and the highly complementary merchandising assortments between REVOLVE and FWRD. Ever since we launched the FWRD loyalty program last year, we have driven increased overlap between REVOLVE and FWRD active customers month after month. And yet we are still in the very early innings with a long runway for driving further cross shopping between REVOLVE and FWRD in the future.

In the coming months we plan to expand our successful REVOLVE **Brand Ambassador Program**, which launched last fall, to include FWRD. The FWRD expansion of the Brand Ambassador program will leverage the same proprietary technology as the REVOLVE program. Momentum of the REVOLVE Brand Ambassador Program has been nothing short of incredible, so we have high hopes for the potential of the FWRD Brand Ambassador Program as well, particularly since FWRD has historically been less active relative to REVOLVE in working with influencers. So, stay tuned for this exciting launch in the weeks ahead.

**To wrap up**, I am very proud of how well our team has navigated through the extreme cycles of ups and downs in the past few years. We believe we have demonstrated a unique track record for outperforming the competition in times of disruption and volatility, leveraging our strong team, operational excellence, and data-driven and customer centric approach to nearly everything we do at REVOLVE.

While there is considerable uncertainty ahead, I am extremely confident in the team and know that we are in a position of strength heading into whatever lies ahead with the economy. I'm excited about our future and believe we are well positioned to gain further market share, particularly from legacy retailers, in the months and years to come.

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

**JESSE TIMMERMANS, CFO**

Thanks, Michael, and hello everyone.

I'm quite pleased with our accomplishments in the second quarter, delivered by the team within an extremely difficult economic climate, that became even more challenging as the quarter progressed.

**I'll start by recapping the second quarter results**, highlighted by solid top-line growth, continued strong profitability and rapid expansion of our customer base. And we are doing it at scale. **Net sales** were \$290 million, a year-over-year increase of 27%, and an increase of 21% on a three-year CAGR basis.

**REVOLVE Segment** net sales increased 30% and **FWRD** net sales grew 14% year-over-year. Recall that FWRD faced an extremely difficult comparison in the year-ago period when FWRD net sales increased 151% year-over-year.

From a **merchandise standpoint**, the dresses category represented 32% of total net sales, an increase of 8 points year-over-year, and trended higher than peak levels in 2019 when dresses generated 30% of net sales.

**By territory**, domestic net sales increased 30% year-over-year, outpacing international growth of 14% that was impacted by currency headwinds that negatively impacted our international customers.

**Active customers** increased by 124,000 compared to the first quarter of 2022, our highest-ever growth for a second quarter. This growth expanded our active customer count to 2.2 million, an increase of 39% year-over-year.

Looking forward, we continue to expect moderation in the quarterly growth of active customers in the second half of the year as we cycle out of the COVID comparison periods for this trailing 12-month measure.

Our customers placed a record 2.2 million **orders** in the quarter, an increase of 27% year-over-year.

**Average order value**, or AOV, was \$303, an increase of 19% year-over-year that benefited from the exceptional year-over-year growth in dresses and a very strong full price sales mix.

**Shifting to gross profit...** Consolidated gross margin was 55.9%, our best-ever margin for a second quarter, and an increase of 29 basis points year-over-year.

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

**Fulfillment costs** deleveraged 40 basis points year-over-year, primarily due to a year-over-year increase in our return rate, as well as increased labor costs.

**Selling and distribution** costs were a significant headwind year-over-year, coming in higher as a percentage of net sales than we had expected due primarily to our return rate trending above 2019 levels and to a massive increase in fuel surcharges that are included in our shipping costs for customer shipments. To offer some context, our fuel surcharges increased nearly 60% on a sequential basis compared to just the first quarter of 2022.

**Marketing** deleveraged year-over-year, as expected, since we hosted our largest and most impactful brand marketing event of the year, REVOLVE Festival, for the first time in three years. Since the REVOLVE Festival investments were not in the prior-year comparable quarter, our brand marketing investments increased by a meaningful \$9 million year-over-year. We view these investments as important to building the strength of our brands over the long term.

**General and administrative costs** also deleveraged year-over-year, due entirely to a \$5.0 million accrual in connection with a pending legal matter. Adjusting for this non-routine accrual, we achieved G&A leverage, as our 27% net sales growth outpaced the growth in the remainder of the G&A expenses in the second quarter.

Our **effective tax rates** were very different for the year-over-year comparison. Our tax rate for the second quarter of 2022 was 23%, almost 20 points higher than the 3% tax rate in the second quarter of 2021 that included meaningfully higher tax benefits.

**Net income** was \$16.3 million, or 22 cents per diluted share, a decrease year-over-year that was impacted by the meaningful differences in our effective tax rate, the cost pressures referenced earlier, as well the non-routine accrual for the pending legal matter in G&A expense.

Please note that the legal accrual is reflected in net income, since net income is a GAAP measure, but was excluded as a non-routine item from Adjusted EBITDA, our non-GAAP profitability measure.

**Adjusted EBITDA** was \$26.9 million, a decrease of 24% year-over-year against a very difficult prior-year comparison as Adjusted EBITDA had increased 70% in the second quarter of 2021. Looking back to the pre-pandemic period as a benchmark, our Adjusted EBITDA for the second quarter was **42% higher** than the Adjusted EBITDA reported for the second quarter of 2019.

**Moving to the balance sheet and cash flow statement...** Lower net income year-over-year and working capital changes led to negative operating cash flow and free cash flow in the second quarter. These working capital changes primarily included continued investment in inventory, which increased \$29 million during the quarter. Our inventory investments are reflective of our efforts to keep pace with the robust consumer demand we had experienced over the past several quarters. However, with the demand trends shifting during the second quarter as discussed, our inventory balance ended the quarter in a place that is higher than we would like. While we feel good about the quality of inventory, the overall balance is elevated and we are working diligently to bring it back in balance. Also impacting our cash flow was significantly higher cash payments for income taxes, which increased by \$14 million year-on-year and sequentially compared to the first quarter.

For the six-month year-to-date period, net cash provided by operating activities was \$24 million and free cash flow was \$22 million, with both measures down significantly year-over-year from the record cash flow generation in the prior-year period.

**Our balance sheet** remains debt free and cash and cash equivalents as of June 30, 2022 were \$238 million, an increase of \$18 million from June 30, 2021, yet lower than the first quarter of 2022. While there has understandably been quarter-to-quarter fluctuation, consider our cash generation over the three years that we have been public. The cash position on our balance sheet at quarter end was **more than five times higher** than our cash position three years ago -- on June 30, 2019, just after we completed the IPO. And this cash generation was purely operational, without external financing. A clear and powerful indicator of our operating strength and scale.

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

**Starting from the top.** As Mike mentioned, there is a great deal weighing on the consumer today with inflation at a 40-year high and U.S. consumer sentiment reaching a record low point in June. It's also important to recognize that our customer is younger and earlier in her career and income progression, often spending a disproportionate share of her wallet on discretionary apparel. The weak stock market could also have a dampening influence on consumer discretionary spending for the higher income luxury consumer. These pressures mounted as the quarter progressed, negatively impacting consumer demand and our top line, particularly in June and continuing into the third quarter, with net sales growth of approximately 10% year-over-year for the month of July.

Given the uncertain macro environment and considering that our comparisons are more difficult in the second half, we encourage investors to model further moderation in our year-over-year net sales comparisons for the balance of the third quarter from the approximately 10% growth in July. And since our net sales growth rate accelerated throughout 2021 and with the economy looking uncertain at best, we continue to expect the fourth quarter to be the most difficult comparison of the year.

**Shifting to gross margin...** We are very pleased with our gross margin performance that exceeded our second quarter outlook provided just last quarter, despite continuing headwinds on inbound freight costs.

A key driver of our strong gross margin performance for the past two quarters has been full price selling at record levels. However, consistent with the outlook we shared coming into the year, and particularly with greater inflationary pressures and very low consumer confidence, we continue to expect our mix of full price sales to moderate in 2022. We expect this moderation to begin in the third quarter and further moderate in the fourth quarter on a sequential basis, while still remaining higher than pre-pandemic levels for the full year 2022.

As a result, for the third quarter, we expect gross margin of between 53.5% and 54%. And we expect the fourth quarter gross margin to be sequentially lower than the third quarter.

**Fulfillment:** We now expect fulfillment expense of around 2.7% of net sales for the full year 2022, consistent with our performance for the first half of the year. We continue to view our fulfillment operations as extremely efficient from a cost and performance standpoint within the context of the broader industry, particularly in the current environment.

**Selling and Distribution:** We now expect selling and distribution costs as a percentage of net sales to remain around the 18% range for the rest of 2022, relatively consistent with the second quarter's 17.9% of net sales. This higher run rate than our previous outlook is due to our return rate trending higher than 2019 pre-pandemic levels and to the exponential increase in fuel surcharges that I talked about earlier.

**Marketing:** Late in the second quarter, we began to feel the effects of the weaker consumer in our marketing efficiency measures. With many consumers cutting back in the current environment, we are simply seeing a less responsive consumer. We now expect our marketing investment to be in a range of approximately 17% to 17.5% of net sales in 2022, up from our prior outlook of 15.8% of net sales as we assume that marketing efficiency will remain challenged in the near term. For the third quarter, we expect marketing to represent approximately 18% of net sales, down from the 19% in the third quarter of 2021.

**General and Administrative:** We now expect G&A expense of approximately \$115 million for the full year, with the increase from our prior estimate entirely due to the \$5 million accrual I mentioned earlier related to a pending legal matter. For the third quarter, we expect G&A expense of approximately \$29.5 million.

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%.

While we anticipate a very challenging macro environment in the months ahead, we are confident that with our strong brand and operational excellence, we can navigate through these short-term challenges and continue to gain market share. And, we believe we remain well positioned to deliver on our long-term profitability targets over time.

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