REVOLVE

REVOLVE GROUP INC. (NYSE: RVLV) Q2 2023 CONFERENCE CALL

PREPARED REMARKS ON AUGUST 2, 2023

ERIK RANDERSON, VP INVESTOR RELATIONS

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

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; market opportunities; macroeconomic and industry trends; business, operations and marketing initiatives and investments; international expansion; our stock repurchase program; growth in active customers; 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'll begin with a recap of our second quarter results. And then I'll conclude by highlighting key operating priorities, investments and growth initiatives we are very excited about.

Net sales decreased 6% year-over-year to $274 million in the second quarter, a slight improvement from the 7% year-over-year decline in April 2023 discussed on last quarter's conference call.

As you have heard from many companies, the U.S. remains very challenging for consumer discretionary spending, particularly for our younger customer demographic. **Net sales in the U.S.** decreased 7% year-over-year, partially offset by **international net sales** increasing 4% year-over-year – highlighted by exceptional growth in Mexico, which has become one of our most important international markets.

Our **gross margin** was 54.0%, a meaningful sequential improvement compared to the first quarter's 49.8%, yet as expected, gross margin remained lower compared to the second quarter of 2022 when our mix of net sales at full price was exceptionally high.

Net income for the second quarter was $7 million, or $0.10 per diluted share, and **Adjusted EBITDA** was $10 million, or 3.8% of net sales. Our profitability was significantly lower than last year's second quarter, primarily due to the decline in net sales, the lower gross profit year-over-year and continued pressure on operating expenses, in large part due to a higher return rate.

We view the current macro environment as a near-term headwind on our path towards resuming attractive growth rates and margins over longer term horizons as we have demonstrated with our long-term historic track record of attractive growth and profitability.

And importantly, challenging operating environments create opportunities for financially strong and cash generative companies like REVOLVE to further separate from the pack by continuing to prudently invest through the cycle while some industry peers have no choice but to play defense.

With that in mind, I'll now recap several important growth and efficiency initiatives that we believe will further strengthen our foundation for profitable growth over the long term.

- **We are currently extremely focused on driving cost efficiencies within our global shipping and logistics operations** to help offset cost pressures resulting from a higher return rate year-over-year. As an update on this important initiative, this week we plan to launch a new process that we expect will drive meaningful efficiency gains for future periods by consolidating all return shipments coming back from Canada to the United States. And, separately, in the United Kingdom, we also just began to hold certain product returns in the UK for local re-fulfillment to UK customers without shipping the products all the way back to the U.S. as we historically have done. This initiative both reduces shipping costs and provides even faster service for our valued customers in the region. These are significant wins in two large international markets that demonstrate great execution and results in a short period of time as we have focused on leveraging our scale to drive efficiencies and continued improvement in our best-in-class customer service. Most importantly, our team is aggressively pursuing a long list of initiatives that we are confident will help us gain significant further efficiencies in the coming quarters. I look forward to sharing our progress in this area as we move forward.

- **We continue to expand the use of AI and machine learning across several key areas of our operations to drive growth and efficiencies.** During the second quarter, we launched a new type of AI-powered merchandising that leverages image recognition to recommend visually similar items to customers. To illustrate an impactful use case, when consumers are looking at a product on REVOLVE that is currently out of stock, our AI technology engages with the customer to recommend visually similar items. This enhancement demonstrated a notable conversion lift in our A/B testing conducted prior to launch. Separately, we are continuing to advance efforts to integrate AI into our owned brand design, which we view as an exciting opportunity to enhance creativity and accelerate the product development cycle.

- **We are also actively leveraging technology in evaluating solutions to optimize our return rate.** Consistent with our customer first focus, our efforts to reduce return rates over time will not detract from the customer experience. In the third quarter, we will be experimenting with several new initiatives including a virtual try on and size comparison feature tool that went live last month and we are testing a wide range of tools and visuals to better communicate product fit – such as enhanced fit rating customer reviews, detailed product fit guides, and video content within product detail pages.

- **Shifting to international expansion…** We recently appointed our first-ever head of **Greater China** to further strengthen the foundation for future expansion in the region. We plan to further build out our local team on the ground in China to expand key relationships and brand awareness, which is important since the marketing and social media channels in China are different than in all other markets we operate. Considering the size and importance of the China ecommerce market, we believe now is the right time for us to invest in a more meaningful way. To illustrate our growth potential in China, I'm excited to share that REVOLVE was the #6 ranked fashion brand on the **Tmall Global marketplace** during the month of June. This recognition and success contributed to our continued growth in China in the second quarter, and illustrates the level of interest in REVOLVE in this very large market.

- **Lastly, and continuing on the international theme, we are also expanding our borders for talent acquisition.** After demonstrating during the pandemic that a distributed workforce can work very efficiently for many functions, we have begun expanding our hiring scope well beyond California into select overseas markets. In the past several months we have successfully attracted talent for technology, customer service and other functions in countries outside of the U.S. It's exciting because hiring engineers in a competitive U.S. market has historically been a real challenge for us due to our very high standards, and hiring outstanding talent overseas provides an added benefit of being able to efficiently work on development projects around the clock. While we expect this important initiative to result in some cost efficiencies, it is not our primary focus. What we are most excited about is meaningfully expanding the available talent pool to even further raise the bar on our exceptionally high standards, as demonstrated by our achievement of record net promoter scores every year for the past few years. We have recently opened our first office overseas to guide this important effort.

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.

Our long-term mindset and strong balance sheet, combined with our conviction in the strength of our business model and confidence in our team to execute through the short-term challenges and over the long-term, led our Board of Directors to authorize a **$100 million stock repurchase program**. 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.

We authorized the stock repurchase program with confidence that the nearly $270 million in cash and no debt on our balance sheet gives us financial flexibility to remain opportunistic to invest in the business across multiple dimensions in our efforts to drive shareholder value.

In summary, while we will certainly face more near-term challenges in the current environment, we will remain nimble and continue to focus on our hallmarks of technology innovation, operating efficiency and brand building to capture more share of the very large market. We remain squarely focused on investing in the long-term opportunity ahead of us, leveraging our 20 years of operating experience and our competitive advantages to guide us through these uncertain times.

Now, over to Michael.

MICHAEL MENTE, CO-FOUNDER AND CO-CEO

Thanks, Mike, and hello everyone.

Our headline numbers for the second quarter, during a very challenging macro environment, aren't reflective of what we believe is our long-term growth potential. Despite the short-term challenges, with our strong business model and focus on the long term, we have been able to deliver on important operating priorities that should prove to be beneficial in the years to come. I'm particularly pleased with our early momentum in driving efficiencies in our shipping and logistics operations and in our innovations to leverage AI to drive further operational efficiencies, optimize processes and enable deeper connections with next-generation consumers.

Speaking of connecting with customers, a highlight of the second quarter was the unveiling of **our first-ever physical experience for FWRD** here in Los Angeles. Inspired and curated by our Creative Director Kendall Jenner, the destination launched in early June and is an incredible showcase of the FWRD brand and our luxury brand partners. A private opening night reception hosted by Kendall Jenner and attended by many other A-Listers created meaningful buzz that has continued to gain strength as favorable word of mouth has spread. Many of our high value FWRD customers flew into Los Angeles for the opening night event, demonstrating the strong interest among our most loyal customers.

The brand elevating experience has enabled us to engage deeply with FWRD customers, connecting with them in ways we have never done before.

Traffic flow and customer interest have been great and customer feedback has been exceptional. We are learning a great deal and hearing on a consistent basis that customers love our selection and curation, more than long-established luxury destinations in the area. Many of our top FWRD customers based in Los Angeles have enjoyed the opportunity to pre-select items online to try on in person, and also conveniently return items they had previously purchased online from FWRD or REVOLVE. This has driven traffic flow and conversion, demonstrating synergies with our ecommerce operations that we'll consider as we continue to evaluate whether physical retail has a place in our growth strategy long term.

Another takeaway from the experience is that our luxury customers truly embrace the pre-owned vintage handbags in our new **FWRD Renew** offering discussed on prior investor calls. In fact, during a recent day at the FWRD Pop Up, we sold two pre-owned vintage handbags for more than $35,000 each. In a single day. The continuing success of the FWRD Renew offering further validates the demand for pre-owned handbags among our customers. As a result, later this quarter we plan to meaningfully expand our growth potential in luxury resale by offering Renew to the much larger set of customers on REVOLVE as well.

Finally, our FWRD brand partners have been incredibly supportive of our efforts to engage our community in a truly differentiated destination. We have hosted around 20 impactful events with revered luxury brands including Versace, Miu Miu, Blumarine and Anastasia Beverly Hills just to name a few --- with many events focused on our emerging Beauty category. Additionally, several of our luxury brands have created exclusive offerings for the FWRD experience that are not available anywhere else.

If you are in Los Angeles before August 13, please drop by and see us at 8804 Melrose Avenue in West Hollywood.

The second quarter was a very busy period of **investment for brand marketing,** anchored by the successful REVOLVE Festival in April that I talked about on last quarter's conference call, the FWRD physical experience, as well as a well-timed event to support our best performing international market.

In June, we hosted a weeklong brand activation with a series of **events in Mexico City** to showcase the REVOLVE brand and lifestyle, and spread the word about our outstanding service levels that have been integral to our growth and customer loyalty around the world. The events drove tens of millions of social media and press impressions, often emphasizing a consistent theme that going shopping in Mexico has never been so easy as with REVOLVE. Most exciting is that our impactful events served as a catalyst in driving a spike in new customer growth across Mexico --- which had already been in triple-digit year-over-year growth territory even before the event. Mexico is now a top 5 international market for us, demonstrating how we can leverage our brand and operational excellence to capture the very large international opportunity.

Our impactful marketing has also contributed to the success of recent **owned brand collaborations**. HELSA, our brand collaboration with Elsa Hosk that is exclusively available on REVOLVE and FWRD, continues to perform incredibly well. We just had our fifth HELSA drop and it was the most successful yet. We also launched an exclusive new collaboration with model and social media personality, Cindy Kimberly, that has resonated very well with our increasingly global customer base.

As mentioned on prior investor calls, the softening consumer demand in recent quarters combined with our elevated inventory position entering 2023 led us to be more conservative in planning owned brand inventory buys since owned brands require a deeper inventory commitment per style than third-party brands. Yet the success of our recent collaborations illustrates the power of our owned brand platform and serves as a positive indication of the owned brand potential longer term.

I'll close with an update on our continued successful journey to expand into **Beauty and Men's**, two areas that offer exciting growth potential**.** Both categories continued to grow at attractive rates in the second quarter, double-digit growth on a combined basis, benefiting from increased focus under our new leadership in these areas and continued improvement to our brand assortment. I continue to be confident that once we optimize the product assortment for these categories, the business will follow because these are very large market segments and considering that we have earned our customer's trust and attention by consistently exceeding their expectations.

We have several exciting brands in the queue to onboard in the third quarter, particularly in the Beauty category, which should help Beauty become an even more important source for acquiring new customers than it already is.

It's noteworthy that some of our recent Beauty best sellers have generated a significant portion of their recent sales volume through **our partnership with TikTok Shop.** It's still early days, yet it's exciting to see validation of the potential for TikTok as a new channel for growth.

In closing, the current environment is clearly impacting demand for many consumer discretionary items, particularly apparel in the U.S. But we take the long view. We remain on offense, energized and investing for growth and expansion for years to come.

I'm more excited than ever and my confidence in the long term is underscored by our recently announced **$100 million stock repurchase program**. Mike and I own nearly 45% of the outstanding common stock and we continue to see a significant runway for growth in the years to come.

I want to express my sincere thanks to the team for keeping us at the forefront of innovation and maintaining an unwavering focus on the customer.

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 second 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 second quarter results.

Net sales were $274 million, a year-over-year decrease of 6%. Linearity of our net sales comparisons year-over-year was fairly consistent throughout the quarter.

REVOLVE Segment net sales decreased 4% and **FWRD Segment net sales** decreased 15% year-over-year in the second quarter. The FWRD comparison reflects softening demand among our luxury customers, particularly in the U.S., consistent with commentary from several luxury retailers and brands in recent months.

By territory, domestic net sales decreased 7% and **international net sales** increased 4% year-over-year.

Active Customers, which is a trailing 12-month measure, increased by 34,000 customers during the second quarter. This growth expanded our active customer count to 2.5 million, an increase of 14% year-over-year. In the near term, we expect further moderation in the quarterly growth of active customers.

Our customers placed 2.3 million **orders** in the second quarter, an increase of 1% year-over-year.

Average order value was $301, a decrease of 1% year-over-year.

Shifting to gross profit… **Consolidated gross margin** was 54.0%, above the high end of our guidance range. The decrease of 198 basis points year-over-year primarily reflects a lower mix of net sales at full price compared to the second quarter of 2022.

Moving on to operating expenses….

Fulfillment costs were 3.4% of net sales, slightly higher than our guidance. The deleverage of 71 basis points year-over-year was primarily due to a year-over-year increase in our return rate, higher wages for our fulfillment center staff, and utilization not yet fully optimized in our recently expanded fulfillment network.

Selling and distribution costs were 18.6% of net sales, slightly better than our guidance. The increase of 68 basis points year-over-year reflects higher costs for customer shipments, primarily due to the higher return rate year-over-year. We are aggressively pursuing initiatives both to reduce our shipping and logistics costs and to address the increasing return rate.

Our Marketing investment represented 18.8% of net sales, an increase of 91 basis points year-over-year, reflecting increased investment in brand building during a very active quarter for our impactful marketing events, including REVOLVE Festival and the many events at the FWRD Pop Up.

General and administrative costs were $28.6 million, or 10.4% of net sales, slightly lower than our outlook we provided last quarter. The year-over-year decline in G&A costs primarily reflects a $5 million accrual for a legal matter in the second quarter of 2022.

Our **effective tax rate** was 25% and **Net income** was $7 million, or 10 cents per diluted share, a decrease of 55% year-over-year that was impacted by the net sales decline, a year-over-year decrease in gross profit, and continued pressure on operating expenses.

Adjusted EBITDA was $10 million, a decrease of 61% year-over-year.

Moving to the balance sheet and cash flow statement…

Inventory at June 30, 2023 was $205 million, a decrease of 2% year over year – very close to the 6% year-over-year decrease in net sales. It was the fourth consecutive quarter when we have narrowed the spread between our year-over-year inventory growth and year-over-year net sales growth.

Net cash used by operating activities and free cash flow in the second quarter were negatively impacted by a $15 million increase in inventory when compared to the first quarter of 2023, in part due to the continued pressure on net sales.

For the six months ended June 30, 2023, **net cash provided by operating activities** was $35 million and **free cash flow** was $33 million, an increase of 42% and 49% year-over-year, respectively.

Cash and cash equivalents as of June 30, 2023 were $269 million, an increase of $31 million, or 13%, year-over-year, yet was $14 million lower on a sequential basis compared to the first quarter of 2023. Our balance sheet as of June 30, 2023 remains debt free.

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…. The top line pressure we experienced in the second quarter has continued, with net sales for the month of July 2023 down a mid-single digit percentage year-over-year. We believe the uncertain macroenvironment continues to weigh on our customer's purchasing behavior and consistent with the second quarter results, during July, year-over-year net sales comparisons in the REVOLVE Segment continued to outperform the FWRD segment, and year-over-year net sales comparisons for our international business continued to outperform our domestic business.

Shifting to gross margin… We expect gross margin in the third quarter of 2023 of between 52.0% and 52.3%, implying a much smaller year-over-over decrease than in recent quarters – only 85 basis points at the midpoint of the range compared to a nearly 2-point year-over-year decline in the second quarter and an almost five-point year-over-year decline in the first quarter of 2023. For the full year, we are narrowing our gross margin expectations to a range of 52% to 52.5%.

Fulfillment: The continued top-line uncertainty and higher-than-expected return rate are leading us to take a slightly more conservative view of fulfillment efficiency for the full year 2023. We expect fulfillment as a percentage of net sales to be around 3.3% for the third quarter of 2023 and now expect fulfillment to represent 3.3% of net sales for the full year 2023.

Selling and Distribution: We expect Selling and Distribution cost efficiency to improve on a sequential basis and represent around 18.3% of net sales for the third quarter of 2023 and 18.3% of net sales for the full year 2023. The slight increase from our previous full-year guidance primarily reflects a higher-than-expected return rate.

The full year 2023 outlook for Selling and Distribution costs includes our assumption that we will generate increasing cost efficiencies in the second half of 2023 resulting from a variety of shipping and logistics efficiency measures we are pursuing. These benefits will partially offset the negative impact of the expected higher return rate year-over-year.

Marketing: We expect our marketing investment in the third quarter of 2023 to represent approximately 15.8% of net sales, a 3-point sequential decrease from the second quarter and an 80-basis point decrease year-over-year compared to the third quarter of 2022. For the full year 2023, we expect marketing to be within the range previously communicated, of 16.0% to 16.5% of net sales.

General and Administrative: We expect G&A expense of approximately $29 million in the third quarter of 2023 and $115 million for the full year 2023, at the high end of our prior full year outlook range.

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

To recap, while we view the current environment as quite challenging for consumer discretionary spending, we are focused on delivering shareholder value over the long term. Our team is investing significant time and energy into a broad range of exciting initiatives that we believe can extend our competitive advantages and benefit REVOLVE for years to come, particularly as the broader macro-economic environment improves.

Now we'll open it up for your questions.