REVOLVE

REVOLVE GROUP INC. (NYSE: RVLV) Q3 2021 CONFERENCE CALL

PREPARED REMARKS ON NOVEMBER 3, 2021

ERIK RANDERSON, VP INVESTOR RELATIONS

Good afternoon, everyone, and thanks for joining us to discuss REVOLVE's third quarter 2021 results.

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

I would also like to remind you that this conference call will include forward-looking statements. These statements include our current expectations regarding the continued impact of the COVID-19 pandemic on our business, operations and financial results, our growth and market opportunities, the impact of Kendall Jenner's appointment as FWRD's Creative Director, our ability to manage through supply chain challenges, our outlook for operating expenses for the fourth quarter of 2021 and gross margin for the full year 2021, and our 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 today'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, 2020 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

Good afternoon, everybody. We're excited to update you today on the strong momentum in our business that continued to build during what was an incredible third quarter.

There are three key points that I want everyone to walk away with today.

First, we delivered record top-line results in the third quarter, highlighted by 62% year-over-year growth and 58% growth on a two-year basis versus the third quarter of 2019. This is an acceleration of 17 points compared to the 41% two-year growth rate we reported for the second quarter of 2021. The strong revenue growth trajectory discussed on last quarter's earnings call improved throughout the quarter, and the positive revenue trends have continued through October.

What's gratifying is that the strength in our top-line is broad based with net sales in the REVOLVE segment further accelerating in the third quarter while our FWRD segment delivered nearly triple-digit growth year over year.

Second, our brands are extremely well positioned in the market and the momentum of our brands driven by our strong assortment and innovative marketing is generating increased customer engagement. Last quarter, I discussed our plan to invest heavily in marketing and brand building initiatives during the third quarter. While we expect these investments to provide long-term benefits, we are thrilled with the early returns. In true REVOLVE style, we stood out during New York Fashion Week, delivering impact and awareness, innovation, and re-defining marketing for the modern fashion brand.

I'm equally excited to see the clear signs of increased customer engagement. Traffic in the past few months has accelerated, to well above levels before COVID-19. And we are generating more revenue per traffic session, helped by our customer increasingly buying from us at full price as well as a shift in category mix to higher price points. You can see the increased engagement in our results with orders and net sales generated per Active Customer accelerating in the past two quarters.

Even more exciting is that our Active Customer growth itself accelerated in the third quarter, resulting in record levels of quarterly growth in Active Customers by a wide margin. It's also compelling to consider that the substantial majority of our newly added customers are buying from REVOLVE and FWRD at full price, which speaks to the longer-term opportunity. Our experience tells us that customers acquired at full-price generate a higher lifetime value.

Third, nowhere in our business is the brand momentum more evident than in our FWRD segment. Based on publicly reported data, FWRD has been growing well ahead of the luxury peers, and we believe we have just scratched the surface on what we view as a massive long-term opportunity to build a curated luxury platform for the next generation consumer.

Setting the stage to continue our strong growth trajectory is our recent announcement of Kendall Jenner as the Creative Director of FWRD. We are beyond excited to partner with Kendall, who is the epitome of luxury fashion. She brings incredible creativity and passion to the role that we believe will meaningfully extend the FWRD brand's reach and influence.

We are also very early in cross marketing our FWRD offerings to the much larger REVOLVE customer base. Our launch during the second quarter of a FWRD loyalty program that is fully integrated with our REVOLVE loyalty program once again provided a powerful contribution to FWRD's growth in the third quarter. I'm encouraged that month after month, we are driving increased overlap between REVOLVE and FWRD active customers. Yet, with a very low percentage of overlap today, we think we have a compelling growth opportunity resident in our existing customer base.

With that as an introduction, I will provide an overview of our third quarter results and recent developments.

Our record growth in Active Customers and our ability to authentically engage with her through our marketing and merchandising resulted in record net sales of $244 million in the third quarter, an increase of 62% year over year, and 58% on a two-year growth basis compared to the third quarter of 2019. This is 17 points higher than the 41% two-year growth we reported for the second quarter of 2021.

We also continued to deliver outstanding profitability in the third quarter, while at the same time making meaningful marketing investments that we believe will pay dividends over the long term. Net income in Q3 was $17 million, or $0.22 per diluted share, and while it was down year on year, as expected, due to our marketing investment, net income increased 74% on a two-year basis versus the third quarter of 2019. For the 9-month year-to-date period, net income more than doubled versus the 2019 comparable period on a two-year basis.

These results benefitted from healthy expansion of our gross margin in the past two years, as our effective merchandising and inventory management contributed to delivering strong net sales at full price and reduced markdown levels, more than offsetting the reduction in owned brand mix as percentage of net sales.

Shifting gears, our strong results have not come without challenge and there remains uncertainty in the macro environment. Our sales results in certain regions around the world have been temporarily impacted when lockdowns have been reimposed, serving as a reminder that we are not out of the woods yet.

Equally relevant, and very much in focus recently, are the industry wide supply chain challenges, which have had a progressively larger, albeit manageable, impact in the last several months. This came through in yet a further decrease in the percentage of on-time deliveries from our suppliers and in a further increase in our inbound shipping rates in the third quarter. Importantly, with a customer that shops at full price for our premium price point product and with our strong gross margin, we are well positioned to manage through the increased freight costs that could remain in effect for several quarters.

Despite the many industry-wide challenges facing us, our operations and merchandising teams have done an outstanding job effectively navigating through this very dynamic environment. Our merchandising and planning team has not only been able to secure sufficient inventory, but more importantly, on-trend product that the customer desires. And our fulfillment, customer service and support teams haven't skipped a beat, continuing to meet and exceed our very high standards that our customers have come to expect from REVOLVE.

As a company passionately focused on the customer experience, I am extremely proud that our net promoter scores have further increased this year -- even as the organization scaled up to manage through the incredible growth in customer demand.

I'll wrap up with a brief discussion of regional performance. I am excited by the strong **domestic growth**, which accelerated to 65% year over year in the third quarter, an increase of 55% on a two-year basis versus the third quarter of 2019.

Our international business also continues to perform very well and represents an exciting opportunity for future growth. **International net sales** grew 49% year-over-year, an increase of 75% on a two-year basis versus the third quarter of 2019. Every major region contributed to our international growth, illustrating how well our brands are resonating on a global basis.

Before I turn it over to Michael, I would like to thank our team for their incredible efforts day in and day out. I am proud of how well each and every one of you has taken great care of our customer during this exciting period of rapid growth.

We are positioned better than ever, and I couldn't be more proud of your efforts that have helped to put us in such a position of strength.

Before I turn it over to Michael, I will just reiterate that while there are still some uncertainties out there, we are very proud of our results, we are ready to invest and we are excited about what lies ahead.

MICHAEL MENTE, CO-FOUNDER AND CO-CEO

Thanks, Mike.

Thanks Mike. I'm really proud, and impressed with our performance during this past quarter. After successfully navigating a very challenging pandemic so far, we are gradually transitioning into a post-pandemic world and we are thriving! It is very clear to me that the same strengths we have demonstrated in the most recent quarter, are positioning us to thrive for continued success over the long term.

An important driver of our success is that our customers love us and deeply connect with the REVOLVE brand. As our customer resumes her socially active lifestyle, it's clear to me that her relationship with us is stronger than ever. She shopped with us when she was stuck at home, and she is shopping more than ever as she starts to go out and needs to refresh her wardrobe. She also has begun to buy her luxury goods from us in a very meaningful way. With the trust we have earned from the customer, we believe we can continue to expand our offering and broaden her range of shopping at REVOLVE. The opportunity continues to grow.

Our technology driven DNA, AI and proprietary algorithms continue to provide a clear competitive advantage. Integral to our success in this recent period of extreme turbulence was understanding our customers' evolving needs, and a key to understanding our customer is our data driven mentality and proprietary technology infrastructure. Leveraging our data-driven approach, we've thrived in this fluid environment -- by quickly identifying shifts in consumer demand, which has enabled us to continue to gain traction in the marketplace and deepen our relationship with the customer.

Our operational excellence and agility are key differentiators and are a critical long-term competitive advantage that is especially evident today. Despite the external challenges in the marketplace, we have been able to ensure that deliveries to our customers have remained at our very high standards during a time when shipping delays from retailers have become routine. Our customers remain as satisfied as ever, creating a strong foundation for this next stage of growth.

Most exciting, we are addressing a very large market opportunity that continues to shift in our direction. Legacy retailers have been continuing to cede market share, and yet they still represent tens of billions of dollars of market opportunity. We are primed and focused on a long-runway opportunity to gain market share, acquire new customers, expand our share of wallet, and drive outsized growth over the long term.

With that, I'm now excited to share with you some of the highlights of the quarter...

We resumed our brand marketing activities with a bang! After several quarters of patiently waiting, we significantly invested into our brand in Q3 with great success.

For the first time ever, we participated in New York Fashion Week and stole the show, very successfully competing against the incumbent heavyweights of the fashion world. We hosted a weeklong brand marketing experience for both REVOLVE and FWRD, and we did it our way, bringing innovation and excitement to our community of brand partners, influencers, and customers.

A highlight was our immersive and elevated REVOLVE Gallery exhibition that reimagined the "front row" experience of fashion week while engaging with consumers in a new and exciting way. The visually stunning and interactive event brought together a curated and exclusive assortment of styles from emerging brands and our owned brands, and uniquely featured a real-time shopping component.

While New York Fashion Week events are typically exclusive affairs, we broke the mold by hosting 6,000 people over three days at REVOLVE Gallery – bringing together brands, partners, influencers, customers and journalists in a first-of-its kind event. In fact, it may have been one of the largest events ever held at New York Fashion Week. To protect our community, we adhered to appropriate safety precautions for the event which was ironically held at the former site of a luxury department store that closed in bankruptcy proceedings.

It was great to host some of the analysts and investors on the call today at our opening night reception that was attended by an a-list crowd including Kylie Jenner, Emily Ratajkowski, Megan Fox, Paris Hilton, and Camila Coelho, just to name a few. Not surprisingly, the event generated massive impact on social media with dynamic and engaging content across social channels. The social media post with the highest estimated media value for the entire New York Fashion Week came from the private reception at our REVOLVE Gallery event, further illustrating the impact of our events.

The incredibly deep connection we have established with the next-generation consumer is evident in the high-profile sponsors of the REVOLVE Gallery event, such as Afterpay. Many top brands and personalities seek to partner with REVOLVE because they realize being associated with our brand *c*an further elevate their brands in the eyes of the coveted and powerful Millennial and Gen Z consumer.

Another major highlight of New York Fashion Week was hosting our first-ever fashion show to introduce our new owned brand collaboration with revered luxury designer Peter Dundas. The highly-anticipated collection, Dundas X Revolve, is a key milestone for our owned brands, where momentum continues and net sales returned to year-over-year growth in the third quarter.

Importantly, initial drops for the collaboration, the first of many to come, earned high praise in reviews from the influential fashion outlets attending our event. According to WWD, our Dundas X Revolve runway event was ranked as the second most talked about fashion show of all of New York Fashion Week, based on social media and press impressions and estimated media value.

As a further sign of our brand momentum, we capped off the week by participating in the Met Gala, an uber exclusive and incredibly high-profile event that is the Oscars of the fashion industry, bringing more fantastic exposure for our brand. REVOLVE being included in the Met Gala for the first time is significant and demonstrates the level of admiration we have gained from the broader fashion community.

I'll wrap up with a discussion on FWRD and why we continue to be excited about the long-term growth opportunity here. FWRD's financial results for the third quarter were exceptional, with net sales increasing 95% year over year, and 112% on a two-year growth basis compared to the third quarter of 2019. FWRD also delivered a nearly 6-point increase in gross margins year-over-year in the third quarter.

Even more exciting is having Kendall Jenner as part of the team as Creative Director for FWRD, extending our reach and appeal to a broader audience of next generation luxury consumers than ever before. We have always had an extreme admiration for Kendall's style, creativity, and overall exquisite taste. We believe her multifaceted experience in the fashion industry and the vision she has outlined for FWRD has the potential to transform our business.

Only a few months into the role, Kendall has already been extremely active. She hosted and participated in several New York Fashion Week events, including an exclusive FWRD dinner and visits to emerging luxury designers she recommended including one new brand that we are already in the process of bringing onto the FWRD site. You may have also noticed her curation of Kendall's edits of her favorite styles on the FWRD site. She also led the redesign of our FWRD logo, further elevating the look to connect with the next generation consumer. And Kendall has created a compelling range of video and social content including a Vogue feature that followed her around New York for a day in her new role as FWRD's Creative Director. The video has been viewed more than 5 million times.

Our brands, customers and fans could not be more excited. Immediately following the news, traffic to the FWRD website and mobile app increased significantly, and several weeks later traffic has remained at higher levels than before the announcement. Downloads of the FWRD App more than doubled year-over-year in the month of September, and growth in FWRD followers increased by more than 10X versus the prior monthly run rate.

Another key driver of the success in the quarter and a huge long-term opportunity for FWRD is the continued expansion of cross shopping by REVOLVE loyalty members on FWRD, as more of our REVOLVE customers become aware of the incredible offering and benefits of shopping on FWRD. We have only recently started to invest to fully leverage our broader platform and customer base to cross market the REVOLVE and FWRD offerings to maximize our long-term opportunity. The early results of our efforts are very encouraging, highlighted by spend on FWRD by REVOLVE Loyalty Club members continuing to increase sequentially and a steady increase in the percentage of REVOLVE customers who also shop on FWRD every single month since we launched the FWRD loyalty program.

You can't talk about fashion without talking about REVOLVE and FWRD. We believe we have what it takes to be the destination for the next-generation consumer seeking curated premium and luxury product, and we are just getting started.

The competitive differentiators I outlined earlier give me great confidence in our opportunity for growth in the global ecommerce market for years to come. We are clearly taking market and wallet share from the legacy players, and with our scale and brand built over the past 18 years, we are also well positioned against newer entrants. We couldn't be more excited about the next phase of growth ahead of us.

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

JESSE TIMMERMANS, CFO

Thanks, Michael, and hello everyone.

We are very pleased with our third quarter results, highlighted by accelerating top-line growth, incredible brand momentum and strong customer engagement. We believe our results for the past few quarters demonstrate that not only have we navigated the pandemic challenges with agility, we are well positioned for our exciting next phase of growth in the new retail landscape.

With that, I'll start by recapping the third quarter.

Net sales were $244 million, a year-over-year increase of 62%, and reflect a two-year growth rate of 58% compared to the third quarter of 2019. This two-year growth rate is **17 points higher** than the 41% two-year growth rate that we reported for the second quarter of 2021.

By territory, both domestic and international markets contributed to the strong top-line results with domestic and international net sales growth of 65% and 49% year-over-year, respectively.

By segment, REVOLVE Segment net sales increased 56% and FWRD Segment net sales were again exceptional, increasing by 95% year-over-year in the third quarter.

A highlight of Q3 was **Active Customers** increasing by 124,000 compared to the second quarter of this year, our highest-ever sequential quarterly increase by a wide margin. This expanded our Active Customer count to 1.7 million, an increase of 12% year-over-year.

Our customers placed a record 1.8 million **Orders** in the quarter, an increase of 60% year-over-year.

Average Order Value, or AOV, was $276, an increase of 19% year-over-year and an increase of 8% sequentially from just the second quarter. A key driver of the growth in AOV year-over-year, and sequentially, was a further shift in mix back to higher price point merchandise such as dresses, handbags and shoes, as well as the continued strength coming from the FWRD segment.

Shifting to gross profit… Consolidated gross margin was 55.1%, a decrease of just 16 basis points against a very strong prior-year comparison, yet gross margin increased 148 basis points on a two-year basis, compared to the third quarter of 2019. Importantly, our gross margin was ahead of the gross margin outlook we provided last quarter as healthy inventory and consumer demand dynamics across both segments led to another strong percentage of net sales at full price in the third quarter, and a year-over-year decrease in the depth of markdowns.

These positive contributors to gross margin were partially offset by a decrease in the mix of owned brands as a percentage of REVOLVE segment net sales, consistent with the outlook we shared on recent investor conference calls.

Moving on to operating expenses….

Consistent with the outlook we shared last quarter, **marketing expense** as a percentage of net sales came in at 19.2% of net sales in the third quarter, well above our historical trend line. I couldn't be more excited about the early results of our investments in brand marketing that pay dividends over the long term. The level of marketing investment has since returned to historical levels in the current, fourth quarter.

Selling and distribution as a percentage of net sales increased year-over-year and on a sequential basis, consistent with our prior commentary to expect deleverage with a normalizing product mix leading to a further increase in return rate in the third quarter of 2021.

The other two line items, **fulfillment and G&A expense**, leveraged year-over-year, resulting in part from automation efficiencies in our fulfillment center. In fact, we have lower fulfillment headcount today than we did two years ago. During the quarter, we also realized benefits from capacity utilization and scale efficiencies resulting from our robust 62% growth in net sales during the quarter.

Net income and Adjusted EBITDA decreased year over year due to the increased brand marketing investment. However, Net Income and Adjusted EBITDA each increased meaningfully versus the pre-COVID levels in the third quarter of 2019. Also, looking at the 9-months year to date, Net Income and Adjusted EBITDA increased by 86% and 59% year over year, respectively.

Moving to the balance sheet and cash flow statement… During the third quarter, we continued to invest in inventory to position our assortment to support very strong consumer demand and to ensure we have adequate available inventory considering the current supply chain challenges. As a result, inventory increased by $23 million during the quarter, to $142 million.

Even with the investment in inventory, we generated $1 million in **free cash flow** in the third quarter and $67 million for the first nine months of 2021. The decrease of 10% year-over-year in free cash flow for the nine-month period reflects the much larger inventory investment this year compared to the first 9 months of 2020 when we significantly reduced inventory to preserve liquidity.

Cash and cash equivalents, net of borrowings, at September 30th were $222 million, an increase of $78 million, or 54%, from $144 million as of September 30, 2020. And our balance sheet remains debt free.

I'm especially proud of our incredible results considering the challenging and uncertain macro environment. It appears the supply chain issues are not going away any time soon, and right when we think we are turning the corner on COVID, new challenges emerge around the world. So, we feel very good about our ability to navigate the challenges as demonstrated by our exceptional results this year. Nonetheless, these headwinds are real risk factors that we have to deal with, day in and day out.

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

Starting from the top, the strong top-line trends we experienced in the third quarter continued through to the month of October, with a growth rate that is broadly in the range of our third quarter growth rate.

While we are very excited about the recent top line trends, we would not count on the same incredible growth rates that we've experienced in recent months to continue in the balance of the fourth quarter, during a time when the space is flooded with marketing and promotional activity.

Shifting to gross margin… We are extremely pleased with our gross margin performance with gross margin higher by approximately 350 basis points year to date versus the comparable period in 2020, and 120 basis points higher year to date on a two-year basis versus the comparable year-to-date period in 2019.

As a result, we are again raising the outlook for gross margin this year versus what we have shared previously. We now expect our full-year gross margin in 2021 to be approximately 54.5%, above the already upwardly-revised full year gross margin outlook of 54% I shared last quarter.

Fulfillment: With the very efficient fulfillment performance in recent quarters, we expect fulfillment costs to be approximately 2.5% of net sales for the fourth quarter – which is approximately 40 basis points lower year on year and showing even more efficiency when compared to 2019. The slight anticipated uptick compared to the third quarter of 2021 reflects normal seasonality, as Fulfillment costs have increased as a percentage of net sales on a sequential basis from the third quarter to the fourth quarter in four out of the last five years.

For the fourth quarter, we expect **Selling and Distribution Costs** to be around 16% of net sales, which is slightly higher than the 15.7% of net sales in the third quarter, and up significantly from 13.4% of net sales in the fourth quarter of 2020. You may recall that shipping costs comprise the majority of the Selling and Distribution line item and consistent with our prior commentary, we are seeing pressure on this line from increased return rates year-over-year as our product mix normalizes, and from continued cost pressures that are impacting the industry overall. We expect this pressure to continue through 2022, at rates similar to that of our expectation for Q4 2021.

Moving on to **Marketing**: After a very busy and exciting third quarter, we continue to expect marketing expense to revert to its historical level of approximately 15% of net sales in the fourth quarter, consistent with our commentary on last quarter's earnings call.

General and Administrative: We expect G&A expense to be around $26 million in the fourth quarter, nearly $2 million higher than in the third quarter of 2021 as we continue to invest in the team to support our rapid growth and expansion.

Lastly, let me touch on our **tax rate.** Our effective tax rate in the third quarters of 2021 and 2020 reflect tax benefits realized as a result of the exercise of non-qualified stock options. Absent such tax benefits in future quarters, we expect our effective tax rate to be around 24% to 26%.

To recap, we are incredibly excited about our recent results, with record growth in Active Customers and strength across all segments and major geographies in the third quarter. While mindful of continuing uncertainties and potential headwinds in the current environment, we are focused on the long-term and investing in the business to capitalize on the incredible growth opportunity ahead.

Now we'll open it up for your questions.