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FIGS, Inc. (FIGS)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. Thank you for attending today's FIGS Fourth Quarter and Fiscal 2023 Year Earnings Conference Call. My name is Cole and I'll be the moderator for today's call. All lines will be muted during the presentation portion of the call, with an opportunity for questions and answers at the end. [Operator Instructions]

I'd now like to turn the conference over to our host, Jean Fontana. Please go ahead.

Jean Fontana
Senior Vice President-Investor Relations, FIGS, Inc.

Thank you. Good afternoon and thank you for joining today's call to discuss FIGS' fourth quarter and full year 2023 results, which we released this afternoon and can be found in our earnings press release and in the stockholder presentation posted to our Investor Relations website at ir.wearfigs.com. Presenting on today's call are Trina Spear, our Co-Founder and Chief Executive Officer; and Daniella Turenshine, our Chief Financial Officer.

As a reminder, remarks on this call that do not concern past events are forward-looking statements. These may include predictions, expectations or estimates, including about future financial performance, market opportunity or business plans. Forward-looking statements involve risks and uncertainties, and actual results could differ materially. These and other risks are discussed in our SEC filings, including the 10-K we filed today, which we encourage you to review, do not place undue reliance on forward-looking statements, which speak only as of today and which we undertake no obligation to update.

Finally, we will discuss certain non-GAAP metrics and key performance indicators which we believe are useful supplemental measures for understanding our business. Definitions and reconciliations of these non-GAAP measures to their most comparable GAAP measures are included in the stockholder presentation we issued today.

Now, I'd like to turn the call over to Trina Spear.

Trina Spear

Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

Thank you, Jean. Looking back at 2023, we outperformed our expectations, with net revenue growth of 8% and adjusted EBITDA margin of 15.8%. We reduced inventory by 33% and generated strong free cash flow of $85 million. Looking across the business, we grew our active customer base 13% versus last year. Additionally, we achieved 18% net revenue growth in non-scrubs, 42% growth in our international business, and nearly 50% growth in our TEAMS business. We also opened our first permanent retail location, our community hub in Los Angeles, with strong early reads in traffic and conversion.

Importantly, we continue to lay the groundwork to scale our business with investments in infrastructure and technology. While we are proud of these accomplishments, recent trends have become more challenging, which I will speak to in more detail shortly. But I want to share right upfront my fervent position that we are on the right course. During 2023, we took measures to rightsize our inventory levels, which are leading to some after effects. However, the work we have underway to create a more solid foundation from product to marketing to operations will set us up to succeed in the future. We remain the distant leader in healthcare apparel and have the scale and balance sheet to opportunistically invest across numerous growth levers.

Now, diving in a bit deeper to provide context on our 2024 net revenue outlook. With respect to the macro environment, we believe there are two factors that are impacting the healthcare apparel industry. First, we continue to see inflation weigh on consumers, including our healthcare community, two-thirds of whom make less than $100,000 a year. They have less spending power than they did two years ago and are being more intentional about how they spend every dollar.

Second, we believe that the sustained fatigue and stress amongst healthcare professionals post-COVID may be impacting behavior. The traumatic experience of COVID, followed by the sustained high demand for healthcare workers, is taking its toll on our community and maybe impacting their purchasing decisions.

Our Healthcare is Human roundtable discussion this past November shined a light on just how much pressure they're under, and we believe we may be seeing this reflected through lower engagement metrics. We are in the trenches with our community on these challenges and are diligently working to help solve them through our Awesome Humans Bill.

Despite these external challenges, we remain optimistic about the state of the healthcare workers long term, particularly given that healthcare and social assistant jobs are projected to be the fastest growing of any sector between 2022 and [ph] 2032 (04:39), and are estimated to create about 45% of all projected job gains over that period. This is according to the Bureau of Labor Statistics. In addition, a recent survey by the University of Maryland, Baltimore showed that 38% of Gen Z plans to pursue a career in healthcare.

Outside of these macro factors, we've also taken a step back to assess our own performance. In 2023, one of our top priorities was to reduce inventory levels back to approximately 25 weeks of supply by year end. We were successful in meeting our goal, with only a modest impact on our gross margin. We did this in part by bringing back a number of products from prior launches. For example, through our iconic FIGS10 campaign, we have relaunched 10 of our community's favorite colors in 10 weeks. At times, we also leveraged conversion-driven marketing, including promotional messaging, to move through our inventory. We believe this may have contributed to the lower frequency and active customer trends we're now seeing.

Looking back, we think we got away from the cohesive brand building strategy that ties our product launches to powerful storytelling campaigns. Our success has been based on brand excitement that ignites a word-of-mouth flywheel. This flywheel is what makes FIGS fundamentally different, and we're at our best when it's clicking.

In 2024, our focus will be leveling up in – on innovation and rebuilding our brand momentum through a number of initiatives. As discussed last quarter, we are evolving our supply chain through best-in-class partners across continents to deliver the most advanced products to healthcare professionals. In addition to innovation and quality and new product, we are enhancing important details like our waistbands, our trims, zippers, fabrications. We have also embarked on an initiative to improve fit consistency across our assortment, which we are excited to roll out over the next year, starting as early as Q2.

As we continue to advance our technical capabilities, we also see opportunity to lean further into our layering system by becoming the category-defining brand across scrubwear, outerwear, footwear, underscrubs, compression socks, bags and so much more for healthcare professionals. Non-scrubs represented 23% of net revenue in the fourth quarter, reflecting strong performance in a number of these categories, and we see meaningful runway ahead of us. The recent launch of our On-Shift Sherpa Bomber Jacket was one of our biggest to date and is a great example of what we're able to bring to the market outside of core scrubs to address the needs of healthcare professionals on shift and off.

Lastly, as we take our product innovation to the next level, we are introducing Extremes. Extremes exemplifies how FIGS can serve even the most extraordinary needs of healthcare professionals. This year, we plan to introduce a series of innovative launches featuring technical products designed to solve problems for some of the most specialized fields within medicine. Last month, we launched our first Extremes collection, supported by an exciting marketing campaign featuring Dr. Luke Bennett, the Medical Performance Director for Hintsa, the medical team supporting Formula One.

Our large-scale storytelling campaigns will be designed to shine a spotlight not only on the extraordinary work that these healthcare professionals do every day, but also on just how extreme all healthcare professionals are. We have a series of exciting partnerships within sports medicine and other areas of healthcare as well, including search and rescue, large animal vets and EMT. These big brand moments will be augmented with a series of evergreen and smaller product launch campaigns throughout the year, as well as community events and activations that will enable us to engage healthcare professionals in person.

The success of our brand has not just been about great product innovation and powerful brand marketing, it's the seamless integration of both that generates excitement, leading healthcare professionals to share their FIGS experience with one another. We believe that our Extremes initiative is integral in rebuilding the powerful word-of-mouth dynamic that helped us to surpass $0.5 billion in 2022, just 10 years after our inception.

To lead our integrated marketing strategy, Bené Eaton has joined Figs as Chief Marketing Officer, bringing 15 years of experience, most recently as Nike's Head of Brand Marketing for New York City. In addition to Nike, her background includes Ralph Lauren and Under Armour. We look forward to having her lead our brand and digital marketing efforts as we work to get back the secret sauce that has driven our success for over the last decade.

While we're excited about our strategic initiatives to drive brand momentum, we know that building new and existing customer engagement in an environment of the headwinds facing our healthcare professionals will take time, which is reflected in our guidance. The healthcare industry is evolving and we're taking steps to evolve with it while also leveraging our multiple growth levers.

Starting with international, net revenue grew 42% in 2023 versus the same prior year period. The strong performance was driven by growth in our more established markets stemming from localization efforts and targeting initiatives, as well as traction we're gaining in the 10 markets we entered in 2023. Mexico and the Philippines remain our top new markets, and as you may recall, this came with minimal marketing investment. We plan to add new markets in 2024 as we continue to build our brand globally.

We are also excited to share that for the first time in our company's history, FIGS is partnering with medical teams behind sport, starting with Everton Football Club of the English Premier League, which is the most viewed sports league in the world. Our relationship with Everton's medical team demonstrates our commitment to celebrating healthcare professionals who have dedicated their lives to serving others, including athletes. Finally, in support of our growing international business, we plan to open a distribution center in Canada in 2025, which we believe will meaningfully improve our margin and enhance the customer experience with shorter shipping times.

Our TEAMS business grew net revenue by 66% as compared to the fourth quarter last year. We successfully launched our TEAMS app open access test, enabling businesses of any size to purchase scrubs through our platform, which contributed to strong growth in the quarter. We believe that our ability to serve businesses of any size through this platform meaningfully increases our addressable market.

In addition to serving these customers with premium product, we also offer personalization, including embroidery. During the holiday season, we created a customized experience for our largest TEAMS customer, a travel nurse agency, to offer a gifting experience to their employees. With healthcare evolving to become more specialized, personalized and localized, we see tremendous opportunity to grow this business through expanded assortment and exceptional online digital experience. The US concierge medicine market is expected to double to $13.4 billion by 2030. We see this reflected in record membership growth amongst concierge clinics and in the increased M&A activity within the primary care space. These trends validate our efforts to expand our TEAMS business.

Turning to retail, we are pleased with the early results of our first community hub since our opening in early November. We believe that consumers still want that in-person shopping experience, as evidenced by the fact that in 2023, e-commerce comprised only 15.6% of total retail sales in the United States. Our community hub is attracting new customers to the brand, while also enabling us to serve existing customers with an additional shopping channel. Since opening in Century City, we've received requests from numerous healthcare professionals to open a store in their market.

We are targeting a summer opening for our second community hub in Philadelphia. The 4,100-square foot location will enable us to deliver events and programming that align with our community pillars and advocacy efforts. The large store format will also enable us to better showcase our broader layering system, presenting an opportunity to drive higher AOV. To exceed $0.5 billion as a digital only brand is something we're very proud of, and we believe that we can deliver an exceptional shopping experience across multiple channels. Our community hub rollout strategy will remain: test, learn, apply and win. And finally, we are laying the foundation to scale. We are undergoing the transition of our fulfillment operation to a best-in-class, tech-enabled facility we will launch later this year, that will enable us to scale and provide a better customer experience.

In conclusion, we recognize that industry dynamics are creating some near-term pressure, but we have been and will continue to take steps to offset these headwinds and position ourselves for long-term growth. We are unwavering in our belief that building a brand the right way takes time, but is the most authentic and valuable way to do it. We are positioning our company to capitalize on the opportunities in front of us while taking important steps to make us a stronger, more resilient company in the future.

We remain bullish on our long-term opportunity for several reasons. We are the pinnacle brand in the healthcare apparel space. We've just hit 1 million followers on Instagram, showing how we have the most loved brand in the industry. We have ample market share opportunity across geographies, channels and professions. We have long-term healthcare industry tailwinds. We have a strong balance sheet with $250 million in cash and short-term investments, we have no debt and we continue to be a cash flow generative business. I remain confident that the strategies we have underway will lead to healthy, long-term, sustainable growth.

Now, I want to take a moment to acknowledge the announcement related to Daniella Turenshine decision to leave FIGS to assume a CFO role at another company. I am so grateful for her contributions over the last 5.5 years, as she helped us build the brand that serves those who serve others. Daniella has had the backs of our healthcare community and she has been an incredible leader and thought partner to me and the whole FIGS family. She has also built out the best-of-the-best finance team, leading us to over $0.5 billion in net revenue while also being profitable. We are fortunate to have Daniella with us through mid-April to ensure a smooth transition. Kevin Fosty, our Corporate Controller, has been part of the FIGS family for the last three years, and we have every confidence in his ability to serve as our Interim CFO.

With that, I will turn the call over to Daniella to provide details on our fourth quarter and full year results and our outlook for 2024.

Daniella Turenshine

Chief Financial Officer, FIGS, Inc.

Thank you, Trina. My time at FIGS has been an incredible experience, and I'm so grateful to have been part of this growth journey. I'm so proud of what we have accomplished over the last several years, and I truly believe that there is so much opportunity ahead. Our finance team is comprised of some of the best and the brightest, and I have every confidence that we will have a seamless transition under Kevin's leadership.

I will now turn my discussion to a review of our fourth quarter financial results, followed by our outlook for the first quarter and full year 2024. We were pleased to have exceeded our adjusted EBITDA margin expectations for 2023. As we consider our 2024 outlook, we are mindful of the current macro challenges and remain focused on leaning in to our brand DNA to drive improved and more consistent performance in the future. Importantly, we have a strong balance sheet to make sound investments in our business to drive long-term sustainable growth.

As noted in our press release, our fourth quarter reflects a $4.7 million net revenue reclassification from selling expense to a contra revenue account. This was associated with an accounting change for duty subsidies that we have been paying on behalf of our Canadian customers.

Now, turning to our results. Beginning with the top line, for the fourth quarter, net revenues were $144.9 million, flat to Q4 last year. The aforementioned duty reclassification negatively impacted net revenues by $4.7 million. This reclassification was not reflected in our Q4 net revenue guidance of low-single digit growth.

Active customers for the 12-month period increased 13% compared to a record quarter of new customer growth in last year's Q4. As a reminder, we anticipated that the strong performance of our sample sale would pull forward some demand into the third quarter. AOV increased 4.5% to $117 in the fourth quarter due to higher average unit retail or AUR driven by product mix. Trailing 12-month net revenues per active customer decreased 5% to $210.

Gross margin for Q4 was 67.5% compared to 68.2% in Q4 2022. The net revenues impact of the reclassification negatively impacted gross margin by 100 basis points. Gross margin benefited from lower airfreight utilization, improved ocean freight costs and a more favorable promotional mix, partially offset by product mix.

Selling expense for Q4 was $28.1 million, representing 19.4% of net revenues, compared to 26% in Q4 2022. The 660-basis point decrease was primarily due to lower warehouse storage and associated labor costs within fulfillment, as well as improved domestic shipping fees. As a reminder, selling expense no longer includes the $4.7 million in duty subsidies we've reclassified.

Marketing expense for Q4 was $20.1 million, representing 13.9% of net revenues, compared to 14.8% in Q4 2022. The decline in marketing expense as a percentage of sales is largely due to lower brand marketing, including out-of-home. We continue to drive marketing efficiencies and spend on both new customer acquisition and retention, maintaining first order profitability.

G&A expense for Q4 was $35.4 million, representing 24.5% of net revenues, compared to 25.2% in Q4 2022. The decrease in G&A as a percentage of sales was largely due to lower legal fees and insurance costs, partially offset by investments in people. Our fourth quarter net income was $10 million or diluted EPS of $0.05, as compared to net income of $3.4 million or $0.02 in diluted EPS in last year's fourth quarter. Finally, our adjusted EBITDA for Q4 remained strong, at $26.6 million, for an adjusted EBITDA margin of 18.4% compared to 13.6% in Q4 2022.

Briefly touching on the full year, net revenues were $545.6 million, an increase of 7.9% year-over-year. Gross margin was 69.1%, a decrease of 100 basis points year-over-year due to product mix shift, and to a lesser extent, higher duties and a higher mix of promotional sales, partially offset by lower airfreight utilization and ocean freight rates. As a percentage of net revenues, operating expenses slightly increased to 62.8%, from 62.6% in the prior year, primarily due to higher general and administrative expenses, offset by lower marketing and selling expense. Adjusted EBITDA margin was 15.8% as compared to 17.2% in the same period last year.

Touching on our balance sheet, we finished the quarter with cash and cash equivalents and short-term investments of $246.7 million. Inventory decreased 33% to $119 million at the end of the fourth quarter, reaching our target of approximately 25 weeks of supply for year end. Overall, we are comfortable with the balance of core and limited edition inventory levels and believe we will be back to normalized weeks of supply in 2024. Capital expenditures for the year totaled $16.3 million, of which $12.2 million is associated with the fulfillment enhancement project.

Before turning to our guidance, I want to reiterate some of the comments Trina discussed in regards to factors impacting our business. First, we believe macro challenges such as inflation will continue to pressure healthcare professionals in the near term. We believe this could be exacerbated by the rising fatigue and stress among some workers in the industry.

Looking at our own business, during 2023, as we focus on getting down inventory to more normalized levels, we believe we may have shifted a bit too far away from our approach of tying product launches to brand storytelling campaigns. We believe that the strategic actions we are taking in product and marketing will ultimately drive improved performance, though we recognize that this will take time, which is reflected in our outlook.

Looking at profitability, we expect selling expense pressure associated with our fulfillment enhancement project and deleverage on G&A to pressure adjusted EBITDA margin in 2024. We are confident in the steps we are taking to drive improved performance, and therefore, we plan to continue to leverage our strong balance sheet and cash flow dynamics to make strategic investments that will position us to scale our business for future growth.

Now, moving to guidance for the full year 2024. As a result of the aforementioned factors, we expect net revenues to be flat to down mid-single digits as compared to the full year 2023, reflecting pressure and frequency trends and active customer growth. Looking at cadence, we expect the third quarter to be the most challenged of the year as we anniversary the strong volume generated by last year's sample sale, as we continued to work down inventory levels.

Turning to gross margin for the year, we expect to be roughly in line with our 2023 rate as we elevate products with new fabrications and trends and continue to see product mix shift. We expect this to be offset by a duty cost benefit later in 2024. Turning to selling expense, transitory costs associated with our fulfillment enhancement project are estimated to be approximately $14 million or about 250 basis points in 2024.

In terms of ongoing fulfillment-related costs, we expect that the costs associated with the new facility will offset the savings we gained on storage cost to house excess inventory last year. Therefore, 2023 represents a good baseline for what we expect selling expense to be as a percentage of sales following the completion of our transition to our new fulfillment center. Longer term, we expect to gain leverage as we scale.

In terms of cadence, we expect the majority of these transitory costs will be spread within the first three quarters, with the second quarter carrying the highest expense. The bulk of the project involves moving our fulfillment to a new facility in 2024, while simultaneously continuing operations in our current facility to ensure a smooth transition. The projected $14 million in transitory costs are largely associated with temporarily running the two concurrently.

The new facility will operate with state-of-the-art robotics and new technology that we expect to increase reliability, flexibility and efficiency, as well as improve order delivery times. In addition, we expect this new facility to have the capacity to support $1 billion in net revenues as we continue to scale our business.

G&A is expected to deleverage based on our net revenue outlook. We are taking a close look at our cost structure to identify savings opportunities, but will continue to invest in the areas of our business that drive growth. We expect D&A to increase commensurate with the increase capital expenditures.

As a result of these factors, adjusted EBITDA margin for full year 2024 is expected to be between 11% and 12%. This reflects approximately 250 basis points of cost headwind from the transitory portion of our fulfillment project.

In terms of our Q1 2024 outlook, we expect net revenues to decline in the low-single digits, reflecting pressure in active customer growth and continuation of slower frequency trends. We expect gross margin to be down versus Q1 last year due to investments in innovation and product mix shift.

Looking at operating expenses, for selling expense, we expect the transitory fulfillment project cost to impact Q1 by approximately 370 basis points. Offsetting this will be the benefit of the cost savings from non-recurring storage fees from last year, as well as the duty reclassification. Net-net, we expect selling expense to deleverage by approximately 70 basis points, which also takes into account higher ongoing fulfillment costs. As a result, we expect first quarter adjusted EBITDA margin to be approximately 7.5%. Capital expenditures for 2024 are expected to be between $18 million and $19 million, including $13 million to $14 million and fulfillment enhancement-related costs.

In conclusion, we believe we have identified areas of opportunity to reignite demand in our business, but also recognize that this will take time and we are still facing macro headwinds. We remain excited about the long-term prospects for our business. We are the distant leader in healthcare apparel with distinct competitive advantages in product innovation and brand love, coupled with the scale and balance sheet to invest in future growth.

With that, I will turn it over to the operator to kick off our Q&A session. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question is from Brian Nagel with Oppenheimer. Your line is now open.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Hi. Good afternoon. Thanks for taking my questions. So Daniella, I guess the first question I have, just to make sure we're clear on this, so the EBITDA guidance, EBITDA margin guidance for 2024 is 11% to 12%. You said that the 250 basis points reflects the transitory cost. Is that all [ph] that's best abnormal (28:56) in 2024 or are there other factors that are temporarily suppressing EBITDA margins next year – or this year?

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

Thanks for the question, Brian. So our 2024 EBITDA outlook of 11% to 12%, once you adjust for the 250 basis points of transitory selling expenses, gets you to 13.5% to 14.5%. I think the other thing that is impacting the outlook is the revenue guidance. So, we are expecting to see some short-term deleverage in G&A expenses. I think looking into the future, we believe that a high-teens adjusted EBITDA margin is still a really good target for our business. And I think we showed in 2023 at almost 16% that we're pretty close to that target as well. And so, yeah, super proud of the performance we delivered.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

Got it. Okay. Then my second question, just with respect to, I guess, the revenue guidance and what you're seeing with the consumer, so the more challenged backdrop that you and Trina articulated as well, is that – is it something you're seen here in – have you seen that more here as we started to progress into 2024?

And then, a second question I have with that is, recognizing that you are the leader out there in a very, very fragmented space, but are you seeing any indications and all that, for one reason or another, your target consumers are trading away from FIGS to something else or is it simply just weaker activity on the part of your core consumers?

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

Well, I'll take the first part in terms of what we're seeing in 2024. So I think, like we've said in the past, year-over-year, we have a different schedule for events, for launches. And so, it's very hard for us to compare apples-to-apples. However, the trends that we're speaking to in our outlook in terms of continued pressure on frequency rates, but also pressure on active customer growth, we are – we're utilizing the information that we have year-to-date to inform our outlook. And so, that's how we're encompassing that information.

And I'll pass it over to Trina to talk about your second question.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Yeah. Thanks, Brian. So, I think what we're seeing with the consumer more broadly is that the economic landscape has felt uncertain for the majority of our customer base since 2021, when COVID-19 was – has really slowed since then. So, inflation has really been impacting our base. Two-thirds of our customers make less than $100,000 a year and they have less spending power than they did two years ago and are being more intentional about how they spend every dollar.

The second impact that we've seen has more – it's more related to the healthcare community and the sustained high demand that is being really put on this community and taking a toll on them. There is a supply and demand imbalance, a staffing shortage where healthcare professionals are being asked to do much more than they have had to do in the past. Long term, healthcare is an incredibly strong segment and it's going to continue to grow, but that's what we're seeing.

And to your question around are they trading down, we really are not seeing that. A very large player in the less premium part of the healthcare apparel industry by the name of SPI just filed for bankruptcy. So, we really – this isn't really specific. We don't – we think this is being felt by the overall industry. And I do think that staying true to who we are, staying true to our authenticity, our product innovation, our brand storytelling and advocacy is what will help us win long term.

Brian Nagel
Analyst, Oppenheimer & Co., Inc.

Q

That's very helpful. So before I hand it over, Daniella, best of luck in your new – next endeavor. It's been a pleasure working with you.

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

...so much, Brian.

Operator: Our next question is from Edward Yruma with Piper Sandler. Your line is now open.

Edward Yruma
Analyst, Piper Sandler & Co.

Q

Hey. Good afternoon, guys. Thanks for taking the questions. I guess first, I know you listed a number of different use cases for some of your more specialized medical wear. But kind of curious to link back to the comments on pockets of incremental demand that you see. So is it these kind of more niche applications, is it the layering system? I guess kind of what gives you comfort in that medium-term view based on [ph] what it is in (33:58) the product offering today?

And then, second, would just love to kind of think through the promotional calendar. Now that you've got an inventory more aligned, has there – is the expectation that promotions should be broadly lower than they were in 2023? Thank you.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Sure. Thanks, Ed. So I think from a product perspective, in 2023, we had a number of launches, but we were also bringing back a number of different styles and colors from the past. And so, if you look at the cadence of the year, net-net, there was less newness, there was less innovation in terms of where we are now. And we're very proud of the ability of what we did in terms of bringing down our inventory from a peak of $190 million to $119 million in Q4.

And so, where are we now on product? We have a very healthy week of – weeks of supply. We feel really good about our ability to introduce innovation across new fabrications, product features and functionality in both scrubs and in non-scrubs. And this includes our outerwear business, footwear, underscrubs, lab coats, compression socks, really stepping up and leveling off on all of these categories, all with the needs of the healthcare professional in mind.

A good example of this and I mentioned it is our On-Shift Sherpa Bomber Jacket. It was one of our best outerwear launches since 2022. Our scrub legging launch was a huge success. So we're energized by what we've seen in Q1, but we know that building the level of engagement that we had will take time. But we are going to continue to bring healthcare professionals, new innovation that not only drives them to try to really engage with any particular launch, but also drives the core, and that's the flywheel that has made us so successful.

In terms of the promotional calendar, Daniella, do you want to take that one?

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

Yeah. So in terms of promotional cadence for 2024, I think it's important to note that in 2023, despite having an elevated inventory balance, we maintained discipline around our promotional events. And I think that's really apparent in the really strong gross margin rate that we delivered for the full year.

And so, looking into next year, our guidance assumes that we continue to maintain that same discipline around our promotional events. As you know, we don't do like-for-like events every quarter. And so, we think that's really important to ensure that our customer isn't waiting for the next event. I think we're going to continue to be really focused on protecting our brand, but we're also really mindful of the fact that we're in a challenging macro environment where, as Trina discussed, the consumer is under pressure. So, I think we're going to balance all of those things and expect to have a relatively similar promotional cadence in 2024.

Operator: Our next question is from Brooke Roach with Goldman Sachs. Your line is now open.

Brooke Roach
Analyst, Goldman Sachs & Co. LLC

Q

Good afternoon and thank you for taking the question. I was hoping we could talk a bit more about your marketing plans for the year. It looks like you have some efficiencies in the fourth quarter, but revenues are under pressure and the customer is engaging a little bit differently. Can you talk about what's changing in your advertising and marketing spends in 2024 on customer acquisition costs and the absolute percent of planned marketing costs as a percent of sales this year?

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Sure. Thanks, Brooke. So first off, I want to reiterate how excited we are about Bené Eaton joining us as our new CMO. I think we're currently making a shift to really tie our product, our merchandising and our marketing together with very intentional and cohesive brand campaigns and engaging our community at the top of the funnel. It is why our community loves FIGS. It is what has driven our success in having – having that lens is going to be super important over the long run. And so, that is how we think about it. And I think the strategy around launching new products, engaging our community, they're waiting up until midnight, seeing what we launched or engaging with that product and then replenishing the core, none of that is changing. That continues to be how we think about the merchandising behind that marketing.

In terms of the spend and CAC, we've been, as you know, incredibly efficient. It's been around 15% – marketing as a percent of net revenue has been around 15%, and that's been stable quarter after quarter after quarter. We look to remain and be disciplined, but are also evaluating certain parts of the business and opportunities where we can potentially push that more as we see across channels, across international, across TEAMS, ways in which we can drive that long-term LTV and long-term return on net investment, and that is where we're focused.

Brooke Roach
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks. And then, just one quick follow-up for Daniella, can you provide thoughts around what level of US versus international growth you're contemplating in the flat to down 5% revenue outlook for the year? Thank you.

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

I'm not breaking out in the specific buckets, I think similar to what we've seen in the past, international is in earlier stages and we are expecting the growth trajectory to be stronger than the US. But I think we're really focused on, as Trina mentioned, driving intentional product innovation and combining that with cohesive storytelling and brand campaigns across our portfolio, and that's going to ultimately drive both the US and the international business over time.

Operator: Our next question is from Dana Telsey with Telsey Advisory Group. Your line is now open.

Dana Lauren Telsey
Analyst, Telsey Advisory Group LLC

Q

Hi. Hi, Trina. And best of luck, Daniella. As you mentioned about product launches to better enhance – to focus more on the storytelling campaign part of it, too, as we go through 2024, with the new people also that you've brought in, Trina, how do you see the product telling story? What should we be looking for on the product cadence to drive excitement, given the consumer – more consumer challenges now? How do you think about the product offering both in scrubs and in non-scrubwear? Thank you.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Thank you, Dana. It's really exciting to be able to bring different stories around what healthcare professionals are doing in extreme environments. And so, our big campaign for the year is Extremes, and we feel as though showcasing, even someone like Dr. Luke Bennett, who's – he's a – the Medical Director behind Hintsa, which is basically leading the medical teams for Formula One racecar driving, which is super cool. And so, telling that story, tying in that to the racing suit that we launched, tying that to the entire collection that brought in different elements of that profession, bringing different elements and different innovation across scrubs, but also across outerwear. We've had a number of launches this quarter within outerwear that ties to the Extremes campaign. And so, this is a really exciting direction for us in launching pinnacle products that not just drive excitement for them and of themselves, but also drive our community to the core.

And so, that's what we're going to continue to do. There's a lot of opportunity within fabrication. We're right now developing two new fabrications within scrubwear that we believe are going to change the game. And then, outside of scrubwear, outerwear is a massive category. Healthcare professionals are still wearing jackets that are made to go hiking and rock climbing. And so, there's a lot of runway, I would say, in outerwear as it's kind of the second behind scrubs, and then across the layering system for sure. But tying these two pieces, and really three, it's product, it's merchandising and marketing, tying these three pieces together in a really intentional way is the direction and is where we're headed.

Operator: Our next question is from John Kernan with TD Cowen. Your line is now open.

John Kernan
Analyst, TD Cowen

Q

Hey. Thanks for taking my questions. Just wanted to take a look at the selling expenses and the outlook for selling beyond fiscal 2024, Daniella. As top line growth returns, what do you think a normalized selling margin is for the business, and what type of top line growth will you need to see that rate decline as a percent of sales?

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

Thanks for the question, John. So as we discussed, just to reiterate, we have about $14 million in non-recurring selling costs associate with our fulfillment enhancement project through the third quarter of 2024. This compares to kind of the original $16 million to $18 million that we cited previously. That is transitory. So looking beyond this transition year, those will roll off.

There are also going to be higher costs associated with the facility, but these are investments to drive better efficiency, flexibility, speed and accuracy, really to enable us to better serve our customers and really setting the foundation for us to expand our distribution network in the future.

Looking at ongoing costs, as we said in the script, we do believe that 2023 is a pretty good baseline level to use going forward, as these higher costs do offset the savings that we would have gained by no longer using the excess storage facilities to house inventory. Over time, there's a lot of opportunity to leverage this line item as we scale and also as we expand our distribution network and our serving our international customers closer to them, lower shipping fees and the like. And so, I think as we mentioned, we do plan to open a Canada DC in early 2025. So, that's going to be a really important driver of revenue and profitability on the horizon.

John Kernan
Analyst, TD Cowen

Q

That's helpful. Thanks. And then, when we look at the adjusted EBITDA margin, you've been in the mid to high teens recently. And with gross margin hovering around 69%, 70%, what is the long-term path? How does it look back to that higher levels of adjusted EBITDA margin you've been in the past and how should we think about the underlying drivers of that?

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

So yeah, I think, well, depending on our sales growth, we do believe that we can return to high-teens EBITDA margin fairly quickly. Super proud to have delivered almost 16% adjusted EBITDA margin in the past year. I think looking at the P&L buckets, you spoke about gross margin or continuing to maintain a really healthy rate there, while also driving more innovation, investments in quality and consistency. And I think into the future, we have the opportunity to really optimize in our supplier base and continue to drive better costing as we scale our core business and then continuing to invest some of those gains back into growth.

Selling expense, we just chatted through kind of the puts and takes there. I think as Trina has discussed, we're going to continue to remain efficient in marketing spend, but also have the ability to flex up or down, depending on what we're seeing in the environment. And over time, right, as we return to growth, we believe we can leverage G&A, but we're not going to make short-term sacrifices. We're going to continue to invest in growth in the near term. I think 2023 shows that our core business, it's high margin, it's replenishment-driven, it's highly profitable. I think there is some short-term impacts that are creating some pressure in 2024, but fundamentals of our business remain really strong.

Operator: Our next question is from Rick Patel with Raymond James. Your line is now open.

Josh Reiss
Analyst, Raymond James & Associates, Inc.

Q

Hey. This is Josh Reiss filling in for Rick here. I was hoping you could dig a little bit deeper on the active customer growth in 4Q. Any context on how many – how much of that growth came from the US versus international markets? And how should we think about new customer potential in 2024 compared to what you achieved in 2023?

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

We don't provide more break-out on active customer mix between the US and international. I think similar to the growth rates that we're seeing between the two, international is stronger driver of growth, but I think in both cases, we are underpenetrated and we have a lot of opportunity to continue to add more customers into the FIGS family.

Looking into 2024, as we've been speaking about, we are comping a really strong period of growth customer adds in 2023. As a reminder, over the last several years, we've actually doubled our active customer base. And so, we're comping some really big numbers here. And I think over time, as Trina was speaking to, we have an opportunity to really marry this intentional product innovation with our brand storytelling. I think the top-of-funnel marketing that we're doing is going to be a large customer acquisition driver, but these strategies will take time. And as a result, we are speaking to some pressure and active customer growth looking into 2024.

Operator: Our next question is from Matt Koranda with ROTH MKM. Your line is now open.

Matt Koranda
Analyst, ROTH MKM

Q

Hey, everyone. Just wanted to clarify what you said in terms of the quarter that should be sort of the lowest growth quarter in 2024. And then, maybe just if you could talk about the phasing of growth across the year, just given the overall sort of low-single digit negative outlook for revenue at the midpoint. And then, just factors that swing you towards sort of the bottom end of the guide and top end. Is it more product launches? Is it more successful promotions? Is it an improved macro that's on the high end of the guide? Like what are the puts and takes there?

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

So looking at the cadence of growth throughout the year, we are expecting Q3 to be the most challenged because we are comping a very successful sample sale in the third quarter of last year that we spoke to, where we did have just a larger inventory position to drive that event.

Speaking to kind of outperformance to our outlook, I'll pass it over to Trina.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Oh, okay. In terms of the outperformance to our outlook, I think there's a number of things that we'll be able to drive that rate. We saw success with our scrub legging. This is a completely new category that didn't exist in healthcare. And so, being able to bring that to this community and have it be successful, there are a number of different innovations that we're bringing forth throughout the year, and there is a lot – there is ability to outperform our expectations. And also the core, there's a number of things that we're doing from an evergreen marketing perspective to not only bring excitement around launches, but bring excitement around the replenishment aspect of needing to replenish your Catarina top and your Zamora pant and how often are you coming back throughout the year to do that.

Matt Koranda
Analyst, ROTH MKM

Q

Okay. Helpful. And then, just on the fulfillment project, just curious what changed on the numbers. It's not a huge difference, but I think it used to be about $18 million in terms of total project costs, and now, it's $14 million, and just what came out of that. Maybe help us understand a little bit about the change there.

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

Yeah. As we've gone throughout the year and gotten closer to this transition taking place, it's really just updates to our project plan and timing of the duration that we will need to be running both facilities in tandem has helped to bring the cost down. So, looking to optimize that and glad to see that those transitory expenses have come down with our most recent expectations.

Matt Koranda
Analyst, ROTH MKM

Q

Okay. Thanks. I'll turn it over.

Operator: Our next question is from Angus Kelleher with Barclays. Your line is now open.

Angus Kelleher-Ferguson
Analyst, Barclays Capital, Inc.

Q

Hi. This is Angus on for Adrienne. Thanks for taking my question. And Daniella, wishing you well on your next venture. As you look ahead to...

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

Thank you.

Angus Kelleher-Ferguson
Analyst, Barclays Capital, Inc.

Q

...2024 for selling expense, how do you think about the timing of the benefit from recapturing warehousing costs? And how many quarters do you expect to get that benefit along with the degree to which it will offset the fulfillment enhancement project beyond 1Q? And as a follow-up, curious about your new store, given it's now been open for a few months. So, any new learnings or early wins you could share there? Thank you.

Daniella Turenshine
Chief Financial Officer, FIGS, Inc.

A

So as it relates to our outlook for selling expense, we did discuss that we are expecting to see transitory costs as it relates to the transition. Those will be largest in the second quarter, but will take place in Q1 through Q3. And as we look at some of the transitory costs that we had previously to house excess inventory that we pulled forward, we are expecting that the ongoing costs of our new facility will offset the gains that we're getting from those costs looking into 2024. So looking past those transitory expenses, we think that 2023 represents a pretty good baseline for where we expect selling expense to be in the future.

And I'll turn it over to Trina to talk about our store.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Yes. As it relates to our community hub in Century City, we've seen really early success and have really been pleased with the traffic. There are a number of days where we've had lines outside, all down, all the way to the grocery store. We've had lines for our fitting room. And I think what we've realized – there's been a number of learnings. The store is about 1,000 square feet. We're really excited to open Philly this summer. It is a bigger format. And so, we're excited to have that location and that format to see what that does.

But some of the some of the exciting dynamics, over 40% of our customers are new to FIGS, just showing how we can continue to build the brand with people that may not know about FIGS. And so, having that retail presence, having that community hub element where we're having events and we're showing up and doing different – really engaging our community in-person is so important and we really think that's going to unlock a lot of what we're doing digitally. And so, I think we mentioned on the call, only 15.6% of consumers shop online. So having stores, having community hubs as part of our strategy is really important, and it's only going to further the brand love and the community engagement that FIGS has. So, very excited about what's to come.

Operator: Our last question is from Bob Drbul with Guggenheim Partners. Your line is now open.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Hi. Two questions, quick questions. The first one is on the retail store, just following-up from the prior question. Is New York City an area where you're contemplating a store from like a branding perspective?

And the second question is, as you think about sort of a slower environment, is there a SKU rationalization opportunity that you are considering? Just trying to understand sort of how you're approaching this slower environment. Thanks.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Thanks, Bob. Yes, we're very excited about New York City. It has been one of our key markets, one of our largest markets. It's amazing healthcare facilities, amazing hospitals in New York. And so, we'll get there, we're lining it all up, but very excited about New York City.

In terms of SKU rationalization, I think we are one of the – one of the things makes FIGS so special and such a great business model is having a very high volume with relatively low SKU count. And so, having this level of SKU productivity is something unique to being a uniform company. It's something unique to being a replenishment-driven company. And so, continuing to drive more people to the same products is a strategy that we will continue to follow. But feel very good about where we are from an inventory position and where we are from a SKU count position.

Robert Drbul
Analyst, Guggenheim Securities LLC

Q

Okay. Thank you.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

A

Thank you.

Trina Spear
Chief Executive Officer, Co-Founder & Director, FIGS, Inc.

Thank you, all, for joining our Q4 and 2023 full year conference call. We'll see you soon.

Operator: That concludes today's call. Thank you, all, for your participation. You may now disconnect your line.