

Redbubble

Back in the groove

ADD (no change)

Current price:	A\$1.05
Target price:	A\$1.33 ▲
Previous target:	A\$1.27
Up/downside:	26.9%
Reuters:	RBL.AX
Bloomberg:	RBL AU
Market cap:	US\$165.7m
	A\$218.9m
Average daily turnover:	US\$0.15m
	A\$0.19m
Current shares o/s	198.4m
Free float:	70.0%

Key changes in this note

FY18F EPS steady.

FY19F EPS up by 203%.

FY20F EPS up 71%.



Price performance	1M	3M	12M
Absolute (%)	34.6	34.6	20.3
Relative (%)	32.8	28.6	10.2

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- Redbubble reported strong Thanksgiving week sales, with Gross Transaction Value (GTV) up 42% yoy.
- Customer numbers grew 52% over the period, a positive indicator for the Christmas sales period.
- We have upgraded our forecasts to reflect the recent trends in consumer visits and average order value (AOV).
- Our price target – derived from a blend of valuation methods – has increased to A\$1.33 per share (up from A\$1.27/share).
- We maintain an ADD recommendation.

Growth momentum has returned

Redbubble reported its Thanksgiving week sales results, which show to us that the company has got its growth mojo back. In the five days leading to the Thanksgiving weekend, RBL reported that Gross Transaction Value (GTV) grew 42% year-on-year, the best growth rate the company has reported since listing. The rate of growth left competitors in a cloud of dust and has gone some way to restoring investor confidence.

Upgrade to forecasts

We have changed our forecasts to reflect the trends seen in the two most recent updates. Key changes are: 1) a faster rate of growth in consumer visits to Redbubble websites; and 2) a drop in the average order value to A\$40 by H2 FY18. In FY18 the net impact of these changes is immaterial. However, from FY19 onwards our assumption changes lead to stronger revenue and EBITDA outcomes.

Risks and catalysts

Risks to RBL include: 1) failure to grow GTV and revenue at the expected rate; 2) slower roll-out of performance improvement initiatives; 3) deterioration of foreign exchange rates; and 4) irrational competitor behaviour. Potential near-term catalysts include: 1) better GTV and gross margin growth rates; 2) a strong consumer response to the current growth initiatives, especially mobile user experience; and 3) competitors falling behind in terms of product range and user experience.

Investment view

RBL operates a fast-growing global marketplace in art inspired consumer goods. In our view the global market potential for its merchandise is highly attractive. The company has yet to reach cash-flow break even and is thus high risk. However, successful implementation of the current strategy would deliver substantial returns commensurate with this risk. As the stock trades well below our valuation and price target, we maintain an ADD recommendation.

Financial Summary	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Revenue (A\$m)	114.6	141.0	179.8	232.1	301.0
Operating EBITDA (A\$m)	-8.97	-8.27	-1.89	9.44	23.93
Net Profit (A\$m)	-20.10	-7.56	-8.45	1.27	14.10
Normalised EPS (A\$)	-0.11	-0.07	-0.04	0.01	0.07
Normalised EPS Growth	143%	(34%)	(42%)		1012%
FD Normalised P/E (x)	NA	NA	NA	172.5	15.5
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	NA	NA	20.46	7.23
P/FCFE (x)	NA	NA	NA	96.07	13.50
Net Gearing	(108%)	(83%)	(83%)	(90%)	(99%)
P/BV (x)	5.34	6.50	9.06	7.65	4.72
ROE	(94.7%)	(39.2%)	(29.2%)	4.8%	37.6%
% Change In Normalised EPS Estimates			0%	203%	71%
Normalised EPS/consensus EPS (x)			1.31	-3.04	1.99

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

ASX Code	RBL	Share Price	A\$	1.05
Issued shares (m)	205.6	Recommendation:		ADD
Market Capital (A\$m)	216	Blended Valuation:		1.33
		Price Target:		1.33
		TSR:		26.9%

Key Financials		2016	2017	2018E	2019F	2020F
Reported NPAT	A\$m	-20	-8	-8	1	14
Normalised NPAT	A\$m	-18	-14	-8	1	14
EPS - reported	¢	-11.7	-3.7	-4.1	0.6	6.8
EPS - normalised	¢	-10.5	-6.9	-4.1	0.6	6.8
EPS Growth	(%)		35%	41%	115%	1012%
EPS - diluted		-10.6	-7.0	-4.1	0.6	6.8
Dividend per share		-	-	-	-	-
Payout Ratio		-	-	-	-	-
Franking		-	-	-	-	-

Pricing Multiples	2016	2017	2018	2019	2020
Normalised PER	-9	-28	-26	173	16
Diluted PER	-9	-28	-26	173	16
Market PER (*)	20	19	18	17	16
PER Relative					
EV/Ebitda	-15	-22	-105	20	7
EV/EBIT					
Price/CF	-22	-34	219	16	7
Yield					

Key Ratios	2016	2017	2018	2019	2020
Growth					
Revenue Growth	61%	23%	28%	29%	30%
Ebitda Growth	26%	8%	77%	-	100%
EBIT Growth	42%	14%	41%	112%	100%
Margins					
Ebitda/Sales	-8%	-6%	-1%	4%	8%
EBIT/Sales	-11%	-10%	-5%	0%	5%
Pre-Tax/Sales	-13%	-10%	-5%	1%	5%
Efficiency					
ROE					
ROA					
ROIC					
Leverage					
Net Debt/debt+equity	-108%	-83%	-83%	-90%	-99%
Ebitda/interest cover					
Net Debt/Ebitda					

NB: Redbubble is debt free - negative net debt/equity implies net cash position.

DCF Valuation		
Risk Free Rate	%	6.0%
Equity Risk Premium	%	6.0%
Beta		1.20
Cost of Equity	%	14.4%
Gearing Ratio	%	0%
Cost of Debt	%	5.5%
WACC	%	14.4%
Terminal Growth Rate (Y5)	%	8%
DCF Valuation	\$m	312
Value Per Share	\$/shr	1.36

Normalised P&L	2016	2017	2018f	2019f	2020f
Group GTV	143	175	222	287	372
Artists/tax	-28	-34	-42	-54	-71
Revenue to RB	115	141	180	232	301
Fulfiller Costs	-76	-91	-115	-148	-192
Gross Margin to RB	39	50	65	84	109
Operating Costs	48	58	67	74	85
Normalised					
Group EBITDA	-9.0	-8.3	-1.9	9.4	23.9
D&A	-4.0	-6.5	-6.8	-8.4	-10.1
EBIT from operations	-13.0	-14.7	-8.7	1.1	13.9
Finance/Other Income - net	0.1	0.5	0.2	0.2	0.2
Finance Costs - net	-1.8	0.0	0.0	0.0	0.0
Minorities	-	-	-	-	-
Associates	-	-	-	-	-
PBT	-14.7	-14.2	-8.4	1.3	14.1
Tax	-3.4	0.0	0.0	0.0	0.0
NPAT - adj	-18.1	-14.2	-8.4	1.3	14.1
Sig Items	-2.0	6.7			
NPAT - statutory	-20.1	-7.6	-8.4	1.3	14.1

Balance Sheet	2016	2017	2018	2019	2020
Cash	42	28	20	26	46
Other ST Assets	2	3	4	5	6
PPE	1	2	2	2	3
Intangibles	7	9	12	14	17
Other LT Assets	3	10	10	10	10
Total Assets	56	51	48	58	82
Borrowings	0	0	0	0	0
Other Liabilities	17	18	24	29	35
Total Liabilities	17	18	24	29	35
Net Assets	39	34	24	29	46
Minorities	0	0	0	0	0

Cash Flows	2016	2017	2018	2019	2020
EBITDA	-9.0	-8.3	-1.9	9.4	23.9
Interest paid**	-1.8	0.0	0.0	0.0	0.0
Interest received	0.3	0.0	0.0	0.0	0.0
Tax Paid	0.0	0.0	0.0	0.0	-8.5
WC change/Other	2.8	4.1	6.0	7.5	0.8
Net Operating Cash Flow	-4.7	-4.2	4.1	16.9	33.2
Capex	-6.9	-13.0	-9.6	-11.3	-13.2
Other investing cash flow	0.0	0.8	0.0	0.0	0.0
Investing Cash Flow	-6.9	-12.2	-9.6	-11.3	-13.2
Financing Cash Flow	40.4	0.0	0.0	0.0	0.0
Total Cash Flows	28.8	-16.3	-5.5	5.7	20.0

** Includes some one-off finance costs

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SOURCE: MORGANS RESEARCH, COMPANY

Back in the groove

GTV growth rates back to pre-IPO levels

Redbubble reported its Thanksgiving week sales results, which show that the company has got its growth mojo back. In the five days leading to the Thanksgiving weekend, RBL reported that Gross Transaction Value (GTV) grew 42% year-on-year, the best growth rate that the company has reported since listing. The rate of growth left competitors in a cloud of dust and has gone some way to restoring investor confidence. Key facts and conclusions from the market update:

- Customer number growth grew 52% to 199,700 over the Thanksgiving weekend. As customer numbers grew faster than GTV, the trend to lower Average Order Value seen in Q1 is persisting.
- GTV and customer numbers are growing much faster than the web metrics we previously used as a guide for the company's underlying growth rate. Customer number growth was more than 10 percentage points higher than Google Trends traffic data suggested for that period.
- YTD revenue growth was 29.1% in A\$ terms and 30.8% in constant currency terms, showing that the heavy currency drag on revenues are abating after the heavy blow delivered the prior financial year.
- Constant currency revenue growth in Q2 is thus running faster than the 25.9% reported in Q1.
- A multitude of factors are driving the re-acceleration of growth trends. A wider range of artists, a wider range of product formats, constant improvements in the user experience and smarter marketing strategies are all contributing to the growth.
- The company re-iterated guidance that it expects similar constant currency top-line (GTV) growth rates in FY18 as in FY17 (30.1%) and that the company should be trading around EBITDA break even by the final weeks of FY18.
- The Australian dollar has weakened 3% on a trade-weighted basis relative the currencies in which it sells since the last quarter. If current exchange rate hold until 27 December, RBL will have a currency tailwind for the first quarter since listing.
- RBL has so far had limited benefit from its speed initiative, which aims to increase customer conversion rates by reducing page download speeds. In the period covered by RBL's update, few pages were on the new, faster download system.

Changes to forecasts

We have changed our forecasts to reflect the trends seen in the two most recent updates. Key changes have are: 1) a faster rate of growth in consumer visits to Redbubble websites; and 2) a drop in the average order value to A\$40 by H2 FY18. Our conversion rate assumptions have not changed. In FY18 the net impact of these changes is immaterial. However from FY19 onwards our assumption changes lead to stronger revenue and EBITDA outcomes. Changes to our forecasts are summarised in the following table:

Figure 2: Changes to forecasts

Revenues		FY18	FY19	FY20	FY21	FY22
Former	A\$m	178.5	219.1	270.5	333.1	379.1
Revised	A\$m	179.8	232.1	301.0	372.9	456.2
Gross Margin						
Former	A\$m	64.2	79.0	97.9	120.9	137.7
Revised	A\$m	64.7	83.8	108.9	135.3	166.0
EBITDA						
Former	A\$m	-1.9	6.9	18.1	32.1	42.1
Revised	A\$m	-1.9	9.4	23.9	39.6	58.0
NPAT - adj						
Former	A\$m	-8.5	-1.2	8.3	14.5	22.8
Revised	A\$m	-8.4	1.3	14.1	19.7	31.5
NPAT - reported						
Former	A\$m	-8.5	-1.2	8.3	14.5	22.8
Revised	A\$m	-8.4	1.3	14.1	19.7	31.5
EPS						
Former	¢	-4.1	-0.6	4.0	6.9	10.9
Revised	¢	-4.1	0.6	6.8	9.5	15.1

SOURCES: MORGANS ESTIMATES

Change to valuation

Due to the changes in our forecasts our DCF valuation – which uses a weighted average cost of capital of 14.7% – has increased to A\$1.36 per share (up from A\$1.19/share). Our choice of a very high WACC of 14.7% (normally 9.5%-10.5% for most industrial companies) reflects uncertainty around the time when RBL will become self-sustaining from a cash flow perspective. When RBL reaches cash-flow sustainability, the company will be de-risked significantly and our WACC will drop to more normal levels, resulting in a large increase in our valuation.

Risks to our valuation being achieved are set out in the risks and catalysts section below. The line “Other adjustments” in our valuation reflects non-cash share-based payments. The dilutionary impact of share-based payments is included in our model by assuming that 100% of current employee and executive options on issue are vested.

Figure 3: RedBubble discounted cash flow valuation

Year ended 30 June	2018	2019	2020	2021	2022	Modelling Assumptions	
A\$m						Risk Free Rate	6.0%
EBIT	(9)	1	14	28	28	Equity Risk Premium	6.0%
D&A	7	8	10	12	13	Company Beta	1.20
Ebitda	(2)	9	24	40	41	Cost of Equity	14.4%
Capex	-10	-11	-13	-15	-16	Debt %	0%
WC Change	0	0	0	0	0	Cost of Debt	5.5%
Interest						Tax Rate	30%
Tax	0	0	0	0	0	WACC	14.4%
Free Cash Flow	(12)	(2)	11	25	25	Long Term growth rate	7.5%
Other adjustments	3.1	3	4	4	5	Implied TV Multiple	14
Free Cash Flow	(8)	2	15	29	30	Discounted Terminal Value	233
						NPV \$	282
Discount Factor	1.00	0.86	0.73	0.63	0.54		
NPV of Free Cash Flow	-8.4	1.3	10.6	18.4	16.1		
NPV of Terminal Value					233		
NPV					282		
Cash/other					20		
Option premiums payable					10		
Total Present Value					312		
FD Shares Out					229		
NPV/Share					1.36		

SOURCES: MORGANS ESTIMATES

Change to price target

Our 12-month price target has increased to A\$1.33/share, up from A\$1.27/share. Our price target is set by a blend of DCF valuation, EV/Revenues and EV/Gross margin. As RBL is not yet profitable the EV/Revenue and EV/Gross margin multiples we deploy are at deep discounts to peer group averages. For example, for our EV/Sales valuation we use a multiple range of 1.5x to 1.6x sales, whereas global peers trade on 4.7x revenues. For our EV/Gross margin valuation, we use a multiple range of 4.5x to 5.0x gross margin, whereas global peers currently trade on 7.3x. Risks to our valuation being achieved are set out in the risks and catalysts section below.

Figure 4: RBL valuation and price target

		Low Value	High Value
		A\$m	A\$m
DCF	WACC @14.7%	312	330
EV/sales	(1.5x - 1.6x)	270	288
EV/GM	(4.5x - 5.0x)	291	301
Average		291	306
Shares Out		224	224
Value/share		1.30	1.37
Mid Point Value		1.33	

SOURCES: MORGANS ESTIMATES

Risks and catalysts

Risks to RBL include: 1) failure to grow GTV and revenue at the expected rate; 2) slower roll-out of performance improvement initiatives; 3) deterioration of foreign exchange rates; and 4) irrational competitor behaviour. Potential near term catalysts include: 1) better GTV and gross margin growth rates; 2) a strong consumer response to the current growth initiatives, especially mobile user experience; and 3) competitors falling behind in terms of product range and user experience.

Investment view

RBL operates a fast-growing global marketplace in art inspired consumer goods. In our view the global market potential for its merchandise is highly attractive. The company has yet to reach cash-flow break even and is thus high risk. However successful implementation of the current strategy would deliver substantial returns commensurate with this risk. As the stock trades well below our valuation and price target, we maintain an ADD recommendation.

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Analyst owns shares in the following mentioned company(ies): Redbubble

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