

# Redbubble

## Trends look friendly

**ADD** (no change)

Current price:	A\$1.24
Target price:	A\$1.38 ▲
Previous target:	A\$1.33
Up/downside:	12.0%
Reuters:	RBL.AX
Bloomberg:	RBL AU
Market cap:	US\$197.3m
	A\$257.4m
Average daily turnover:	US\$0.19m
	A\$0.25m
Current shares o/s	198.4m
Free float:	70.0%

- Data from Google Trends suggests that Redbubble is having its best quarter for visitor growth since listing on the ASX.
- The 42% yoy visits growth reported by Google is comfortably ahead of Morgans' forecast growth rate.
- Although we have not upgraded forecasts, there is some risk that RBL will perform better than we currently forecast for FY18.
- Our price target has lifted slightly to A\$1.38 (from A\$1.33). Our ADD recommendation is maintained.

### Best quarterly growth rate since listing

Global online art marketplace operator Redbubble has notched up its best Christmas season in terms of customer visits, according to data derived from Google Trends. The Google data – which is based on the number of times consumers use the term “redbubble” in a search query – suggests that visits to the company’s desktop and mobile sites were up 42% in the December quarter to date. The growth rate implied by Google Trends is above the 38% forecast by Morgans.

### Upgrade to valuation, price target

We have not revised our FY18 forecasts for RBL. However on current trends there is some risk that RBL will do better than our forecasts for revenues of A\$179.8m, GPAPA of \$47.3m and an EBITDA loss of A\$1.9m. Our RBL valuation and price target – derived from a blend of DCF and multiple-based methods – has increased to A\$1.38 per share (up from A\$1.33 per share). The increase arises because we have increased the multiples applied under the EV/Sales valuation method to 1.6x to 1.7x sales (up from 1.5x to 1.6x sales) and the multiples we apply to the EV/Gross Margin method to 5.0x to 5.5x gross margin (up from 4.5 to 5.0x gross margin). The new multiples still represent deep discounts to peer group multiples.

### 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 below our valuation and price target, we maintain an ADD recommendation.



Price performance	1M	3M	12M
Absolute (%)	47	90	45.3
Relative (%)	45.6	84.4	36.2

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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	202.9	18.3
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	NA	NA	24.54	8.84
P/FCFE (x)	NA	NA	NA	113.0	15.9
Net Gearing	(108%)	(83%)	(83%)	(90%)	(99%)
P/BV (x)	6.29	7.65	10.65	9.00	5.55
ROE	(94.7%)	(39.2%)	(29.2%)	4.8%	37.6%
% Change In Normalised EPS Estimates			0%	0%	0%
Normalised EPS/consensus EPS (x)			1.40	1.01	1.50

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

ASX Code	RBL	Share Price	A\$	1.26
Issued shares (m)	205.6	Recommendation:		ADD
Market Capital (A\$m)	259	Blended Valuation:		1.38
		Price Target:		1.38
		TSR:		9.8%

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	-11	-33	-30	203	18
Diluted PER	-11	-33	-30	203	18
Market PER (*)	20	19	18	17	16
PER Relative					
EV/Ebitda	-19	-27	-126	25	9
EV/EBIT					
Price/CF	-26	-40	258	19	9
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
<b>Normalised</b>					
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
<b>NPAT - adj</b>	<b>-18.1</b>	<b>-14.2</b>	<b>-8.4</b>	<b>1.3</b>	<b>14.1</b>
Sig Items	-2.0	6.7			
<b>NPAT - statutory</b>	<b>-20.1</b>	<b>-7.6</b>	<b>-8.4</b>	<b>1.3</b>	<b>14.1</b>

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

## Trends look friendly

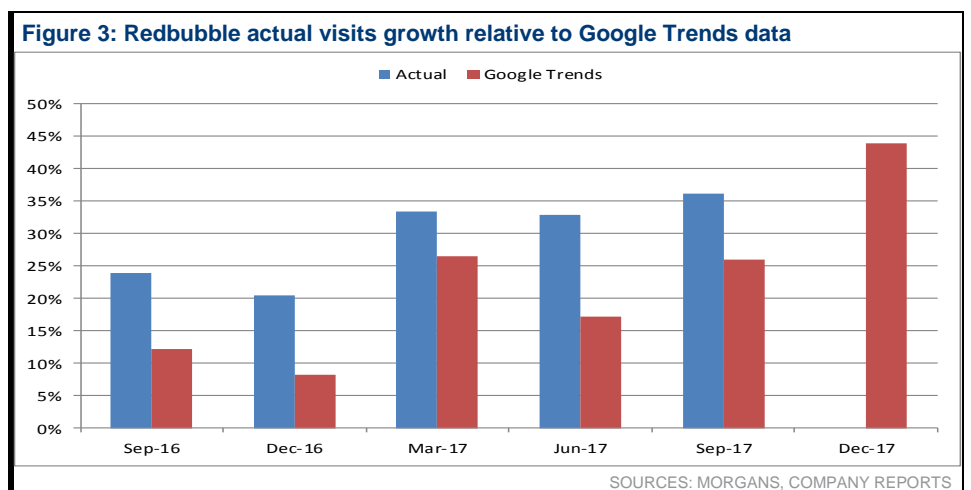
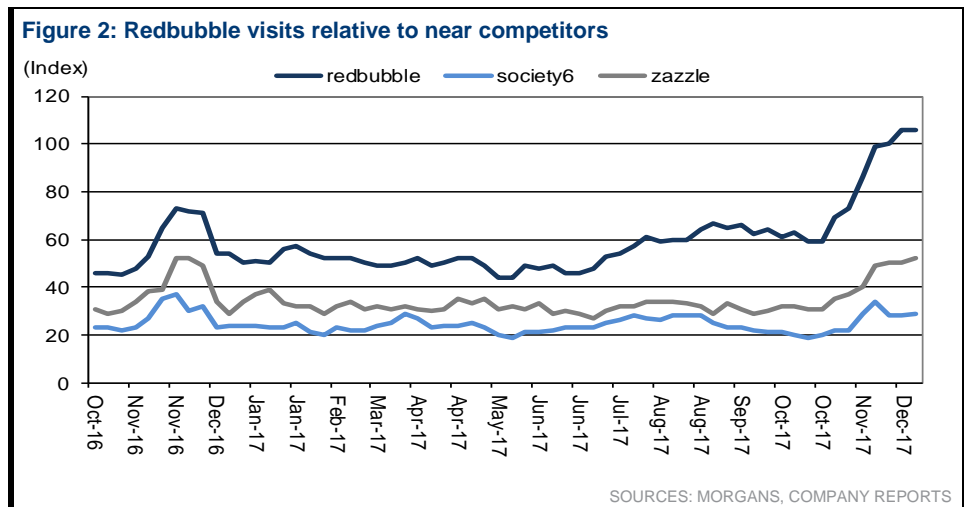
### Best quarterly growth rate since listing

Global online art marketplace operator Redbubble has notched up its best Christmas season in terms of customer visits, according to data derived from Google Trends. The Google data – which is based on the number of times consumers use the term “redbubble” in a search query – suggests that visits to the company’s desktop and mobile sites were up 42% in the December quarter to date.

Redbubble’s actual consumer visits could be better than the Google data suggests. Since listing on the ASX, actual consumer visits to the ecommerce site have consistently beaten the rate of growth suggested by the Google data. In the five quarters since listing, actual visits to Redbubble have exceeded the Google Trends data for the quarter by 11 percentage points on average.

The following two charts show:

- Redbubble continues to grow customer visits at a much faster rate than any of its nearest competitors. We have used Society6 and Zazzle – both offering art-driven consumer products – as comparison sites.
- Redbubble’s actual rate of visitation growth has consistently exceeded the rate reported by Google Trends since listing on the ASX. We suspect that RBL’s outperformance reflects a growing use by RBL of other sites – such as Facebook, Pinterest and Instagram – for paid advertising.



## Earnings impact

The key drivers of revenue and earnings for RBL are: 1) the number of visits; 2) the conversion rate of visitors to purchasers; and 3) average order value. Assuming no change to conversion rates and average order value, we estimate that each one percentage improvement in site visits will result in an increase of revenues of \$1.3m and Gross Profit After Paid Acquisition costs (GPAPA) of A\$0.5m.

We have not revised our FY18 forecasts for RBL. However on current trends there is some risk that RBL will do better than our forecasts for revenues of A\$179.8m, GPAPA of \$47.3m and an EBITDA loss of A\$1.9m.

Conversion rates and average order value (AOV) are the wild cards of FY18.

RBL's average conversion rate was 2.55% in the December quarter of 2016. If RBL can achieve a conversion rate close to this number in the current quarter, it will exceed our forecasts by a comfortable margin.

RBL's average order value has declined steeply in recent times, partly due to currency, partly to a shift towards consumers buying lower-priced items, and partly due to competitor pricing forcing down the price of key items such as t-shirts. In the most recent September quarter AOV was A\$43.60, down from A\$48.40 in the pcp.

As traffic volumes are now travelling well above our forecast rate of growth (38%), AOV would have to fall significantly below the September AOV for the company to fall short of our forecasts.

## Valuation and price target

Our RBL valuation and price target – derived from a blend of DCF and multiple-based methods – has increased to A\$1.38 per share (up from A\$1.33 per share). The increase arises because we have increased the multiples we believe are applicable to the EV/Sales method to 1.6x to 1.7x sales (up from 1.5x to 1.6x sales) and the multiples we believe are applicable to the EV/Gross Margin method to 5.0x to 5.5x gross margin (up from 4.5 to 5.0x gross margin). The new multiples still represent deep discounts to global peer group multiples, reflecting the fact that RBL has yet to reach cash-flow break-even. The calculation of our revised valuation and price target is shown in the following table. Risks to our revised price target being achieved are set out in the risks and catalysts section below.

**Figure 4: RBL valuation and price target**

		Low Value A\$m	High Value A\$m
DCF	WACC @14.7%	312	330
EV/sales	(1.6x - 1.7x)	288	306
EV/GM	(5.0x - 5.5x)	324	301
Average		308	312
Shares Out		224	224
Value/share		1.37	1.39
Mid Point Value		1.38	

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.

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### **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 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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