morgans

Redbubble

Solid performance

ADD (no change)

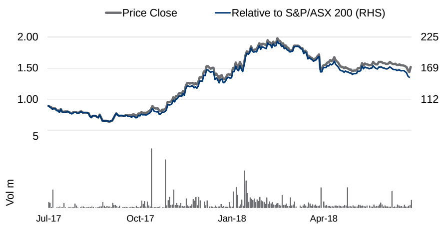
Current price:	A$1.52
Target price: ▲	A$1.91
Previous target:	A$1.66
Up/downside:	25.5%
Reuters:	RBL.AX
Bloomberg:	RBL AU
Market cap:	US$239.1m
	A$323.7m
Average daily turnover:	US$0.19m
	A$0.26m
Current shares o/s	212.9m
Free float:	70.0%

Key changes in this note

FY19F EPS down by 637%.

FY20F EPS down by 85%.

FY21F EPS down by 21%.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-5	3.1	70.8
Relative (%)	-5	-2.1	61.3

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Analyst(s) own shares in the following stock(s) mentioned in this report:

– Redbubble

- RBL reported preliminary summary financial for FY18, showing strong growth in revenues and gross profits.
- Despite worries of further margin erosion due to rising marketing costs, RBL produced a significant gain in gross profit after marketing costs in the fourth quarter.
- While our forecasts have been downgraded, our price target lifts to A$1.91 per share, mostly due to the roll forward to a new starting year.
- The business remains on track for another year of ~30% growth.
- We maintain an ADD recommendation.

Strong margin performance in fourth quarter

RBL delivered a solid FY18 operating performance, outlined in preliminary revenue and profit disclosures attached to its full-year cash flow statement. Revenue growth and underlying EBITDA were in line with market expectations and the fourth quarter gross profit after customer acquisition costs (GPAPA) was the best reported in a long time. GPAPA margin lifted to 27.6% in the fourth quarter, a major improvement on the 25.7% margin reported in the third quarter. The margin uplift was in line with management predictions and shows that the company's efforts to lift the level of organic (unpaid) traffic are bearing fruit

Lift in valuation, price target

We downgraded our profit forecast but are now close to market consensus. Until this report our price target was set by a weighted average of our DCF valuation and multiples of revenues and gross profit. From this report onwards our price target will be set by our DCF valuation alone. Our price target increases to A$1.91 per share, up from A$1.66 per share.

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; 4) further increases in mobile customer acquisition costs; and 5) irrational competitor behavior. 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 therefore High Risk, although risks will diminish greatly if the company hits FY19 guidance. Successful implementation of the current strategy would deliver substantial returns commensurate with this risk. As the stock trades below our price target, we maintain an ADD recommendation.

Financial Summary	Jun-17A	Jun-18A	Jun-19F	Jun-20F	Jun-21F
Revenue (A$m)	141.0	182.8	245.0	321.2	408.7
Operating EBITDA (A$m)	-8.07	-7.29	0.15	11.18	24.38
Net Profit (A$m)	-7.36	-13.79	-7.77	1.76	13.42
Normalised EPS (A$)	(0.069)	(0.065)	(0.036)	0.008	0.063
Normalised EPS Growth	(35%)	(5%)	(44%)		662%
FD Normalised P/E (x)	NA	NA	NA	183.9	24.1
DPS (A$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	NA	2,041	27	11
P/FCFE (x)	NA	NA	NA	84.34	19.57
Net Gearing	(83%)	(85%)	(89%)	(99%)	(106%)
P/BV (x)	9.42	13.01	15.75	12.27	7.21
ROE	(35.5%)	(47.1%)	(34.2%)	7.5%	37.7%
% Change In Normalised EPS Estimates			(637%)	(85%)	(21%)
Normalised EPS/consensus EPS (x)			7.30	0.30	0.79

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

ASX Code	RBL	Share Price	A$	1.52
Issued shares (m)	208.4	Recommendation:		ADD
Market Capital (A$m)	317	Blended Valuation:		1.91
		Price Target:		1.91
		TSR:		25.5%

Normalised P&L	2016	2017	2018f	2019f	2020f
Group GTV	143	175	231	310	407
Artists/tax	-28	-34	-49	-65	-85
Revenue to RB	115	141	183	245	321
Fulfiller Costs	-76	-91	-119	-158	-207
Gross Margin to RB	39	50	64	87	114
Operating Costs	38	44	54	67	79
Normalised					
Group EBITDA	-9.0	-8.1	-7.3	0.1	11.2
D&A	-4.0	-6.5	-6.8	-8.2	-9.8
EBIT from operations	-13.0	-14.5	-14.1	-8.0	1.4
Finance/Other Income - net	0.1	0.5	0.3	0.3	0.3
Finance Costs - net	-1.8	0.0	0.0	0.0	0.0
Minorities	-	-	-	-	-
Associates	-	-	-	-	-
PBT	-14.7	-14.0	-13.8	-7.8	1.8
Tax	-3.4	0.0	0.0	0.0	0.0
NPAT - adj	**-18.1**	**-14.0**	**-13.8**	**-7.8**	**1.8**
Sig Items	-2.0	6.7			
NPAT - statutory	**-20.1**	**-7.4**	**-13.8**	**-7.8**	**1.8**

Key Financials		2016	2017	2018E	2019F	2020F
Reported NPAT	A$m	-20	-7	-14	-8	2
Normalised NPAT	A$m	-18	-14	-14	-8	2
EPS - reported	¢	-11.7	-3.6	-6.5	-3.6	0.8
EPS - normalised	¢	-10.5	-6.8	-6.5	-3.6	0.8
EPS Growth	(%)		36%	3%	44%	-123%
EPS - diluted		-10.6	-6.9	-6.5	-3.6	0.8
Dividend per share		-	-	-	-	-
Payout Ratio		-	-	-	-	-
Franking		-	-	-	-	-

Pricing Multiples	2016	2017	2018	2019	2020
Normalised PER	-12	-40	-22	-39	174
Diluted PER	-12	-40	-22	-39	174
Market PER (*)	20	19	18	17	16
PER Relative					
EV/Ebitda	-22	-33	-39	1920	25
EV/EBIT					
Price/CF	-30	-53	-55	68	18
Yield					

Balance Sheet	2016	2017	2018	2019	2020
Cash	48	28	21	18	26
Other ST Assets	2	3	4	5	6
PPE	1	2	2	2	2
Intangibles	7	9	12	14	17
Other LT Assets	3	10	10	10	10
Total Assets	62	51	49	50	62
Borrowings	0	0	0	0	0
Other Liabilities	17	18	24	29	35
Total Liabilities	17	18	24	29	35
Net Assets	46	34	25	21	26
Minorities	0	0	0	0	0

Key Ratios	2016	2017	2018	2019	2020
Growth					
Revenue Growth	61%	23%	30%	34%	31%
Ebitda Growth	27%	10%	10%	-	100%
EBIT Growth	43%	12%	3%	43%	100%
Margins					
Ebitda/Sales	-8%	-6%	-4%	0%	3%
EBIT/Sales	-11%	-10%	-8%	-3%	0%
Pre-Tax/Sales	-13%	-10%	-8%	-3%	1%
Efficiency					
ROE					
ROA					
ROIC					
Leverage					
Net Debt/debt+equity	-107%	-83%	-85%	-89%	-99%
Ebitda/interest cover					
Net Debt/Ebitda					

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

Cash Flows	2016	2017	2018	2019	2020
EBITDA	-9.0	-8.1	-7.3	0.1	11.2
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	0.1	0.2	0.0	0.0	0.0
WC change/Other	9.4	3.8	9.6	7.8	9.4
Net Operating Cash Flow	1.8	-4.4	2.3	7.9	20.6
Capex	-6.9	-8.9	-9.3	-10.9	-12.8
Other investing cash flow	0.0	0.0	0.0	0.0	0.0
Investing Cash Flow	-6.9	-8.9	-9.3	-10.9	-12.8
Financing Cash Flow	40.4	-0.1	1.1	0.0	0.0
Total Cash Flows	35.3	-13.4	-5.8	-2.9	7.9

** Includes some one-off finance costs

DCF Valuation		
Risk Free Rate	%	6.0%
Equity Risk Premium	%	6.0%
Beta		1.10
Cost of Equity	%	13.2%
Gearing Ratio	%	0%
Cost of Debt	%	5.5%
WACC	%	13.2%
Terminal Growth Rate (Y5)	%	7.5%
DCF Valuation	$m	448
Value Per Share	$/shr	1.91

Company Contacts		
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Level 3	Chief Executive	Mr Martin Hosking
271 Collins Street	CFO	Mr Chris Nunn
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SOURCE: MORGANS RESEARCH, COMPANY

Solid performance

Efforts to hold margins bear fruit

RBL delivered a solid FY18 operating performance, outlined in preliminary revenue and profit disclosures attached to its full-year cash flow statement. Revenue growth and underlying EBITDA were in line with market expectations and the fourth quarter gross profit after customer acquisition costs (GPAPA) was the best reported in a long time. Highlights from and comments on the result are:

- Full-year gross transaction value growth was 31.9%, in line with expectations, and fourth quarter revenue grew at a faster rate of 36.1%. GTV momentum continues to run well ahead of competitors, a key indicator of consumer response to improvements in the art marketplace made over the past 12 months.
- GPAPA margin lifted to 27.6% in the fourth quarter, a major improvement on the 25.7% margin reported in the third quarter. The margin uplift was in line with management predictions and shows that the company's efforts to lift the level of organic (unpaid) traffic are bearing fruit.
- EBITDA loss before non-cash items (mostly share plan amortisation) for the full year came in at A$3.7m, an improvement on the A$4.8m loss in the prior year. Operating cash flows for the year were positive at A$2.3m, a significant improvement on the A$4.6m outflow in the prior year.
- Management had provided guidance for ~30% revenue growth and underlying EBITDA generation (before share plan amortisation) in a range of A$2m to A$4m. The company also said that anticipated total cash burn over the coming year (after capex) was ~A$2m, indicating that the company's period of cash consumption is drawing to a close.
- Guidance was below Morgans' forecast. However, as the rest of the market had significantly lower forecasts, the outlook for FY19 was probably widely as expected.
- Mobile share of GTV continues to grow rapidly, placing pressures on margins. The company's ability to hold customer acquisition costs as a percentage of GVT, even as the mobile share of GTV grows, shows that RBL's initiatives to increase the share of non-paid traffic are working.
- RBL announced it was rolling out a new fulfiller platform that would allow a much larger group of fulfillers to supply customers. The company is aiming to broaden geographic and product range over the next 2-3 years.
- The company's download speed enhance program has finished its first phase and is now moving on to product pages and image density. We see these moves as critical for maintaining GTV momentum and customer satisfaction.

Figure 2: Redbubble FY18 performance relative to Morgans' forecasts

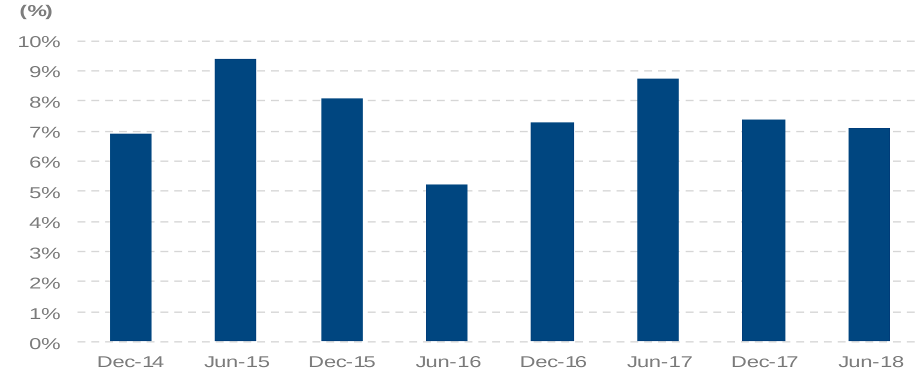
		Actual Hi FY18	Forecast H2 FY18	Actual H2 FY18	Actual FY17	Forecast FY18	Actual FY18	Actual Change	Actual V. Forecast
Visits	m	127.5	134.7	131.3	188.4	262.2	258.8	37%	-1%
Conversion rate	%	2.2%	1.7%	1.7%	2.0%	2.0%	2.0%	0%	0%
Orders Placed	m	2.8	2.3	2.2	3.7	5.1	5.1	37%	-1%
Average Order Value	A$	45.9	45.0	45.3	47.5	45.5	45.7	-4%	0%
Gross Transaction Value	A$m	129.8	104.3	101.5	175.4	234.1	231.3	32%	-1%
Revenues	A$m	102.3	82.4	80.5	141.0	184.6	182.8	30%	-1%
Fulfiller expenses	A$m	66.9	53.4	52.0	90.8	120.3	118.9	31%	-1%
Gross Profit	A$m	35.3	29.0	28.6	50.1	64.3	63.9	27%	-1%
Paid acquistion costs	A$m	9.6	7.0	7.2	13.9	16.6	16.8	21%	1%
GPAPA	A$m	25.7	22.0	21.4	36.2	47.7	47.1	30%	-1%
GPAPA margin	%	25.1%	26.7%	26.5%	25.7%	25.8%	25.8%	0%	0%
Operating Costs	A$m	23.1	26.7	27.7	44.5	51.4	50.8	14%	-1%
EBITDA - operating	A$m	1.1	-4.7	-4.8	-8.3	-3.7	-3.7	-55%	1%
Cash Balance	A$m	46.3	21.1	21.2	27.8	21.1	21.2	-24%	0%

SOURCES: MORGANS, COMPANY REPORTS

Customer acqusition costs

One major concern for RBL holders over the past two years has been the high cost of customer acquisition. As mobile traffic is much more expensive to purchase than desktop traffic, the rapid shift of consumers to mobile devices created fears that RBL's top-line growth would lead to shrinking margins. These concerns were substantially allayed in today's report, which showed that customer acquisition costs as a percentage of sales have trended down for the last 3 ½ years.

Figure 3: Customer acquisition costs as % of revenues



SOURCES: MORGANS, COMPANY REPORTS

Changes to forecasts

We have downgraded our forecasts to reflect company guidance for FY19 and guidance relating to the rate of cost growth going forward. Changes to our forecast are shown in Figure 4. Morgans' previous forecasts were well above consensus and therefore our large reductions in profit forecasts are merely bringing our numbers in line with the market.

Figure 4: Revisions to forecasts

		FY18	FY19	FY20	FY21	FY22
Revenues						
Former	A$m	184.6	247.7	322.3	412.8	520.9
Revised	A$m	182.8	245.0	321.2	408.7	515.3
Gross Margin						
Former	A$m	64.3	87.5	114.1	146.1	184.4
Revised	A$m	63.9	87.0	114.4	145.9	184.5
EBITDA						
Former	A$m	-3.7	9.3	21.0	34.8	55.9
Revised	A$m	-7.3	0.1	11.2	24.4	41.0
NPAT - adj						
Former	A$m	-10.2	1.4	11.6	16.7	30.5
Revised	A$m	-13.8	-7.8	1.8	13.4	20.1
NPAT - reported						
Former	A$m	-10.2	1.4	11.6	16.7	30.5
Revised	A$m	-13.8	-7.8	1.8	13.4	20.1
EPS						
Former	¢	-4.9	0.7	5.6	8.0	14.6
Revised	¢	-6.5	-3.6	0.8	6.3	9.4

SOURCES: MORGANS, COMPANY REPORTS

Changes to valuation, price target

Until this report our price target was set by a weighted average of our DCF valuation and multiples of revenues and gross profit. From this report onwards our price target will be set by our DCF valuation alone. Our price target increases to A$1.91 per share, up from A$1.66 per share.

Our DCF valuation has increased significantly, mostly due to the roll-forward of the base year of our valuation to FY19. Our DCF valuation has increased to A$1.91 per share from A$1.55 per share. Risks of our DCF valuation and price target being reached are shown in the risks and catalysts section below.

Figure 5: Discounted cash flow valuation

Year ended 30 June	2019	2020	2021	2022	2023	Modelling Assumptions	
A$m						Risk Free Rate	6.0%
EBIT	(8)	1	13	28	43	Equity Risk Premium	6.0%
D&A	*8*	*10*	*11*	*13*	*14*	Company Beta	1.10
Ebitda	0	11	24	41	57	Cost of Equity	13.2%
Capex	-11	-13	-14	-15	-17	Debt %	0%
WC Change	5	5	4	3	3	Cost of Debt	5.5%
Interest						Tax Rate	30%
Tax	0	0	0	-9	-13	WACC	13.2%
Free Cash Flow	(6)	3	14	20	30	Long Term growth rate	7.5%
Other adjustments	3.8	4.2	4.6	5.0	5.4	Implied TV Multiple	18
Free Cash Flow	(2)	8	19	25	35	Discounted Terminal Value	354
						NPV $	418
Discount Factor	1.00	0.87	0.75	0.65	0.57		
NPV of Free Cash Flow	-1.9	6.6	14.2	16.3	20.2		
NPV of Terminal Value					354		
NPV					418		
Cash/other					20		
Option premium paid					10		
Total Present Value					448		
FD Shares Out					235		
NPV/Share					1.91		

SOURCES: MORGANS, COMPANY REPORTS

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; 4) further increases in mobile customer acquisition costs; and 5) irrational competitor behavior. 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 therefore High Risk, although risks will diminish greatly if the company hits FY19 guidance. Successful implementation of the current strategy would deliver substantial returns commensurate with this risk. As the stock trades below our price target, we maintain an ADD recommendation.

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Regulatory disclosures

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

Recommendation structure

For a full explanation of the recommendation structure, refer to our website at http://www.morgans.com.au/research_disclaimer

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For analyst qualifications and experience, refer to our website at http://www.morgans.com.au/research-and-markets/our-research-team

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For an overview on the stock selection process, refer to our website at https://www.morgans.com.au/research-and-markets/company-analysis/Research-Coverage-Policy

Research independence statement

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