

Redbubble

Currency continues to weigh

ADD (no change)

Current price:	A\$0.89
Target price:	A\$1.21
Previous target:	A\$1.29
Up/downside:	36.2%
Reuters:	RBL.AX
Bloomberg:	RBL AU
Market cap:	US\$147.0m
	A\$185.5m
Average daily turnover:	US\$0.19m
	A\$0.26m
Current shares o/s	198.4m
Free float:	70.0%

- Global art marketplace Redbubble yesterday reported that it hit its revised full-year guidance for FY17, but despite strong operating performance the company is battling currency headwinds and discounting from Amazon.
- The company delivered full-year GTV, revenue, Gross Profit and EBITDA numbers that were in line with guidance. However most of the benefits of strong operating performance (strong traffic and transaction growth) were eaten by currency and competitor discounting.
- As the Australian dollar has continued to strengthen, we have downgraded our forecasts to reflect lower average order values in A\$ terms. Our valuation and price target declined to A\$1.21 per share (from A\$1.29).
- RBL continues to grow at rates that far exceed those of competitors and displays positive operating leverage despite the tough environment. We retain an ADD recommendation.

Guidance targets hit

RBL reported FY17 gross transaction volumes of A\$175m, compared to the guidance range of A\$175m-A\$180m. Revenue came in at A\$141m, compared to guidance of A\$140m-A\$148m, and Gross Profit came in at A\$50.1m, compared to guidance of A\$49m-A\$51.8m. The company closed the year with A\$27.8m in cash, compared to Morgans' estimate of A\$28m. The results were achieved despite unfavourable currency movements (a 7% drag on A\$ revenues) and discounting of tee-shirts by Amazon.

Currency still a problem

RBL earns 94% of its revenues in international markets and the strength of the A\$ continues to hurt. Changes to our currency forecasts have reduced our projections for average order value, reducing our earnings forecasts and valuation from FY18. Our valuation and price target drop to A\$1.21 (from A\$1.29).

Risks and catalysts

Risks to RBL's earnings and share price in the near-term include: 1) failure to grow GTV and revenue at the expected rate; 2) initiatives to increase patronage and mobile conversion rates produce lower growth than expected; 3) deterioration of foreign exchange rates; and 4) irrational competitor behaviour. Potential near-term catalysts include: 1) better GTV and gross margin growth rates than we have assumed; 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.

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 could deliver substantial returns commensurate with this risk. As the stock trades well below our valuation and price target, we maintain an ADD recommendation.



Price performance	1M	3M	12M
Absolute (%)	12.7	32.8	-22.6
Relative (%)	13.2	35.9	-26.1

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Financial Summary

	Jun-15A	Jun-16A	Jun-17F	Jun-18F	Jun-19F
Revenue (A\$m)	71.1	114.6	141.0	177.3	224.7
Operating EBITDA (A\$m)	-7.13	-8.97	-5.21	2.43	11.85
Net Profit (A\$m)	-6.27	-20.10	-10.57	-4.93	2.96
Normalised EPS (A\$)	-0.04	-0.11	-0.05	-0.02	0.01
Normalised EPS Growth	(634%)	143%	(50%)	(54%)	
FD Normalised P/E (x)	NA	NA	NA	NA	61.84
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	NA	NA	63.61	12.56
P/FCFE (x)	NA	NA	NA	NA	71.94
Net Gearing	(156%)	(108%)	(100%)	(101%)	(102%)
P/BV (x)	NA	4.53	6.16	6.48	5.47
ROE	(332%)	(95%)	(31%)	(17%)	10%
% Change In Normalised EPS Estimates			16.4%	27.1%	(37.0%)
Normalised EPS/consensus EPS (x)			0.89	0.89	1.60

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

ASX Code	RBL	Share Price	A\$	0.89
Issued shares (m)	205.6	Recommendation:		ADD
Market Capital (A\$m)	183	Blended Valuation:		1.21
		Price Target:		1.21
		TSR:		36.2%

Key Financials		2016	2017F	2018E	2019F	2020F
Reported NPAT	A\$m	-20	-12	-5	3	8
Normalised NPAT	A\$m	-18	-12	-5	3	8
EPS - reported	¢	-11.7	-5.7	-2.4	1.4	4.1
EPS - normalised	¢	-10.5	-5.7	-2.4	1.4	4.1
EPS Growth	(%)		46%	58%	160%	181%
EPS - diluted		-10.6	-5.2	-2.4	1.4	4.1
Dividend per share		-	-	-	-	-
Payout Ratio		-	-	-	-	-
Franking		-	-	-	-	-

Pricing Multiples	2016	2017	2018	2019	2020
Normalised PER	-8	-18	-40	66	23
Diluted PER	-8	-18	-40	66	23
Market PER (*)	15	14	14	13	12
PER Relative					
EV/Ebitda	-13	-31	69	14	7
EV/EBIT					
Price/CF	-20	-94	36	12	8
Yield					

Key Ratios	2016	2017	2018	2019	2020
Growth					
Revenue Growth	61%	23%	26%	27%	23%
Ebitda Growth	26%	42%	147%	388%	100%
EBIT Growth	42%	-3%	55%	135%	100%
Margins					
Ebitda/Sales	-8%	-4%	1%	5%	8%
EBIT/Sales	-11%	-9%	-3%	1%	4%
Pre-Tax/Sales	-13%	-9%	-3%	1%	4%
Efficiency					
ROE					
ROA					
ROIC					
Leverage					
Net Debt/debt+equity	-108%	-100%	-101%	-102%	-103%
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		1.23
Cost of Equity	%	14.7%
Gearing Ratio	%	0%
Cost of Debt	%	5.5%
WACC	%	14.7%
Terminal Growth Rate (Y5)	%	9%
DCF Valuation	\$m	237
Value Per Share	\$/shr	1.06

Normalised P&L	2016	2017f	2018f	2019f	2020f
Group GTV	143	175	222	282	348
Artists/tax	-28	-34	-45	-57	-70
Revenue to RB	115	141	177	225	278
Fulfiller Costs	-76	-91	-114	-144	-178
Gross Margin to RB	39	50	64	81	100
Operating Costs	48	55	61	69	77

Normalised	2016	2017f	2018f	2019f	2020f
Group EBITDA	-9.0	-5.2	2.4	11.9	22.4
D&A	-4.0	-7.3	-8.1	-9.9	-11.8
EBIT from operations	-13.0	-12.5	-5.6	2.0	10.6
Finance/Other Income - net	0.1	-0.3	0.7	1.0	1.3
Finance Costs - net	-1.8	0.0	0.0	0.0	0.0
Minorities	-	-	-	-	-
Associates	-	-	-	-	-
PBT	-14.7	-12.8	-4.9	3.0	11.9
Tax	-3.4	1.2	0.0	0.0	-3.6
NPAT - adj	-18.1	-11.7	-4.9	3.0	8.3
Sig Items	-2.0				
NPAT - statutory	-20.1	-11.7	-4.9	3.0	8.3

Balance Sheet	2016	2017	2018	2019	2020
Cash	42	30	28	34	45
Other ST Assets	2	4	4	5	5
PPE	1	2	2	2	3
Intangibles	7	11	14	17	21
Other LT Assets	3	3	3	3	3
Total Assets	56	49	52	61	77
Borrowings	0	0	0	0	0
Other Liabilities	17	20	23	28	33
Total Liabilities	17	20	23	28	33
Net Assets	39	30	28	33	44
Minorities	0	0	0	0	0

Cash Flows	2016	2017	2018	2019	2020
EBITDA	-9.0	-5.2	2.4	11.9	22.4
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	1.2	0.0	0.0	-3.6	-7.0
WC change/Other	3.9	5.2	5.8	3.5	-2.7
Net Operating Cash Flow	-4.7	0.0	8.3	19.0	26.7
Capex	-6.9	-13.0	-9.7	-13.3	-15.4
Other investing cash flow	0.0	0.8	0.0	0.0	0.0
Investing Cash Flow	-6.9	-12.2	-9.7	-13.3	-15.4
Financing Cash Flow	40.4	0.0	0.0	0.0	0.0
Total Cash Flows	28.8	-12.1	-1.4	5.7	11.3

** Includes some one-off finance costs

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SOURCE: MORGANS RESEARCH, COMPANY

Currency continues to weigh

Strong underlying operating performance

Global art marketplace Redbubble yesterday reported that it had delivered on full-year guidance for FY17, but despite a strong operating performance the company is battling currency headwinds and discounting from Amazon.

The company delivered full-year GTV, revenue, Gross Profit and EBITDA numbers that were in line with guidance. However most of the benefits of strong operating performance (strong traffic and transaction growth) were eaten by currency and competitor discounting. As the Australian dollar has continued to strengthen, we have downgraded our forecasts to reflect lower average order values in A\$ terms. Key highlights of the result were:

- RBL reported FY17 gross transaction volumes of A\$175m, compared to the guidance range of A\$175m-A\$180m, up 22.8% in A\$ terms and 30.3% in local currency terms. Strong growth in consumer visits to the site (up 27.4% YOY) delivered most of the top line growth.
- Revenue came in at A\$141m, compared to guidance of A\$140m to A\$148m, and Gross Profit came in at A\$50.1m, compared to guidance of A\$49m to A\$51.8m. Revenue was undermined by the strength in the A\$, which resulted in the average order value falling 7.5% to A\$44.25. Virtually the entire AOV decline was due to currency.
- The company closed the year with A\$27.8m in cash, compared to Morgans' estimate of A\$28m. The results were achieved despite unfavourable currency movements (a 7% drag on A\$ revenues) and discounting of tee-shirts by Amazon.
- Amazon began a campaign of severe discounting of tee-shirts during the June quarter, with a typical shirt selling around 20% below the average RBL selling price. While Amazon does not have the art-driven content that is available on the Redbubble site, the company's aggressive campaign eroded demand at the margin. RBL shaved some prices during the quarter but gross profit margin held up tolerably well.
- Management re-iterated its view that it is confident of repeating the growth rates seen in FY17 through FY18. The confidence is underwritten by the continuing increase in the number of selling artists (up 37.8% in Q4) and continuous improvements in the user experience.
- The overall performance of the group in FY17 is summarised in the following table.

Figure 2: Redbubble performance summary

		FY16	FY17	(change)
Visits	(m)	147.8	188.4	27%
Conversion Rate	(%)	1.87%	1.65%	-12%
Average Order Value	(A\$)	51.3	48.1	-6%
Gross Transaction Value	(A\$m)	142.9	175.4	23%
Revenue to RBL	(A\$m)	114.6	141	23%
Gross Margin	(A\$m)	39.0	50.1	28%
EBITDA (underlying)	(A\$m)	-6.0	-5.2	13%

* Numbers in this table may not reconcile with Morgans financials due to different accounting classifications.

SOURCES: MORGANS, COMPANY REPORTS

Downgrade to forecasts

RBL earns 94% of its revenues in international markets and the strength of the A\$ continues to hurt. Changes to our currency forecasts for FY18 and beyond have reduced our projections for average order value, reducing our earnings forecasts and valuation. Changes to our forecasts are shown in the following table. As the company's operating performance (especially growth in traffic) has been better than anticipated, our FY18 and beyond forecasts would have been upgraded but for the unfavourable currency movements.

Figure 3: Changes to earnings forecasts

		FY17	FY18	FY19	FY20	FY21
Revenues						
Former	A\$m	143.3	174.5	234.5	296.0	373.7
Revised	A\$m	141.0	177.3	224.7	277.5	341.8
Gross Margin						
Former	A\$m	51.4	62.6	84.4	106.6	134.5
Revised	A\$m	50.1	63.6	80.9	99.9	123.0
EBITDA						
Former	A\$m	-7.3	0.6	13.6	25.9	41.6
Revised	A\$m	-5.2	2.4	11.9	22.4	35.3
NPAT - adj						
Former	A\$m	-12.6	-6.8	4.7	10.8	20.7
Revised	A\$m	-11.7	-4.9	3.0	8.3	16.3
NPAT - reported						
Former	A\$m	-12.6	-6.8	4.7	10.8	20.7
Revised	A\$m	-11.7	-4.9	3.0	8.3	16.3
EPS						
Former	¢	-6.3	-3.3	2.3	5.3	10.0
Revised	¢	-5.2	2.4	1.4	4.1	7.9

SOURCES: MORGANS, COMPANY REPORTS

Change to valuation and price target

Our valuation and price target are set using a range of different valuation tools, including DCF and multiples of revenues and gross profits. This composite valuation delivers an average valuation (and price target) of A\$1.21 per share (down from A\$1.29). The outcome of our valuation approach is summarised in the following table. The risks to our valuation and price target 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	237	249
EV/sales	282	310
EV/GM	251	301
Average	256	287
Shares Out	224	224
Value/share	1.14	1.28
Mid Point Value	1.21	

SOURCES: MORGANS, COMPANY REPORTS

Risks and catalysts

Risks to RBL's earnings and share price in the near-term include: 1) failure to grow GTV and revenue at the expected rate; 2) initiatives to increase patronage and mobile conversion rates produce lower growth than expected; 3) deterioration of foreign exchange rates; and 4) irrational competitor behaviour. Potential near-term catalysts include: 1) better GTV and gross margin growth rates than we have assumed; 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.

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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