

Redbubble

Outrunning the monster

ADD (no change)

Current price:	A\$0.79
Target price:	A\$1.27
Previous target:	A\$1.27
Up/downside:	60.9%
Reuters:	RBL.AX
Bloomberg:	RBL AU
Market cap:	US\$128.1m
	A\$164.7m
Average daily turnover:	US\$0.05m
	A\$0.06m
Current shares o/s	198.4m
Free float:	70.0%

- Redbubble continues to outrun competitors in the global fashion-on-demand market.
- Q1 revenue growth and most other metrics were as expected or slightly better.
- While discounting in t-shirts remains a challenge, Redbubble continues to grow volumes and gross profit at a rapid clip through clever marketing, product range and delivery.
- There are no changes to forecasts, valuation or price target (A\$1.27/share).
- We retain an ADD recommendation (high risk).

Result summary

Global art marketplace operator Redbubble overcame ongoing strong competition in the t-shirt market in the September quarter, with financial results falling broadly in line with market expectations. While global online retailer Amazon continued to apply pressure on all online clothing retailers in the t-shirt category, Redbubble was able to grow audience and transaction volumes fast enough to offset the damage caused by t-shirt discounting. Redbubble felt sufficiently confident about its performance in the first quarter to reiterate guidance that the company will be operating at EBITDA break-even level by the closing months of FY18.

Changes to forecasts

We have not changed our forecasts, valuation or price target. While some items in the Q1 result were at variance with our full-year assumptions, in the main the Q1 performance was in line with our former forecasts. Our DCF valuation is unchanged at A\$1.19/share. Our 12-month price target is unchanged at A\$1.27/share.

Risks and catalysts

Risks to Redbubble 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

Redbubble 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.



Price performance	1M	3M	12M
Absolute (%)	22.5	-10.2	-20.2
Relative (%)	18.6	-13.3	-28.7

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Financial Summary	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Revenue (A\$m)	114.6	141.0	178.5	219.1	270.5
Operating EBITDA (A\$m)	-8.97	-8.27	-1.90	6.94	18.09
Net Profit (A\$m)	-20.10	-7.56	-8.46	-1.23	8.27
Normalised EPS (A\$)	-0.11	-0.07	-0.04	-0.01	0.04
Normalised EPS Growth	143%	(34%)	(42%)	(85%)	
FD Normalised P/E (x)	NA	NA	NA	NA	19.92
DPS (A\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	NA	NA	20.51	7.19
P/FCFE (x)	NA	NA	NA	NA	18.26
Net Gearing	(108%)	(83%)	(83%)	(85%)	(92%)
P/BV (x)	4.02	4.89	6.81	6.28	4.37
ROE	(94.7%)	(39.2%)	(29.2%)	(4.9%)	25.9%
% Change In Normalised EPS Estimates			0%	0%	0%
Normalised EPS/consensus EPS (x)			1.31	1.97	1.17

SOURCE: MORGANS, COMPANY REPORTS

Figure 1: Financial summary

ASX Code	RBL	Share Price	A\$	0.79
Issued shares (m)	205.6	Recommendation:		ADD
Market Capital (A\$m)	162	Blended Valuation:		1.27
		Price Target:		1.27
		TSR:		60.9%

Key Financials		2016	2017	2018E	2019F	2020F
Reported NPAT	A\$m	-20	-8	-8	-1	8
Normalised NPAT	A\$m	-18	-14	-8	-1	8
EPS - reported	¢	-11.7	-3.7	-4.1	-0.6	4.0
EPS - normalised	¢	-10.5	-6.9	-4.1	-0.6	4.0
EPS Growth	(%)		35%	41%	85%	-772%
EPS - diluted		-10.6	-7.0	-4.1	-0.6	4.0
Dividend per share		-	-	-	-	-
Payout Ratio		-	-	-	-	-
Franking		-	-	-	-	-

Pricing Multiples		2016	2017	2018	2019	2020
Normalised PER		-6	-20	-19	-129	19
Diluted PER		-6	-20	-19	-129	19
Market PER (*)		20	19	18	17	16
PER Relative						
EV/Ebitda		-10	-15	-73	20	7
EV/EBIT						
Price/CF		-16	-25	175	15	7
Yield						

Key Ratios		2016	2017	2018	2019	2020
Growth						
Revenue Growth		61%	23%	27%	23%	23%
Ebitda Growth		26%	8%	77%	-	100%
EBIT Growth		42%	14%	41%	84%	100%
Margins						
Ebitda/Sales		-8%	-6%	-1%	3%	7%
EBIT/Sales		-11%	-10%	-5%	-1%	3%
Pre-Tax/Sales		-13%	-10%	-5%	-1%	3%
Efficiency						
ROE						
ROA						
ROIC						
Leverage						
Net Debt/debt+equity		-108%	-83%	-83%	-85%	-92%
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)		%	8%
DCF Valuation		\$m	273
Value Per Share		\$/shr	1.19

Normalised P&L		2016	2017	2018f	2019f	2020f
Group GTV		143	175	220	270	334
Artists/tax		-28	-34	-42	-51	-63
Revenue to RB		115	141	178	219	270
Fulfiller Costs		-76	-91	-114	-140	-173
Gross Margin to RB		39	50	64	79	98
Operating Costs		48	58	66	72	80

Normalised		2016	2017	2018f	2019f	2020f
Group EBITDA		-9.0	-8.3	-1.9	6.9	18.1
D&A		-4.0	-6.5	-6.8	-8.4	-10.1
EBIT from operations		-13.0	-14.7	-8.7	-1.4	8.0
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	-8.5	-1.2	8.3
Tax		-3.4	0.0	0.0	0.0	0.0
NPAT - adj		-18.1	-14.2	-8.5	-1.2	8.3
Sig Items		-2.0	6.7			
NPAT - statutory		-20.1	-7.6	-8.5	-1.2	8.3

Balance Sheet		2016	2017	2018	2019	2020
Cash		42	28	20	22	35
Other ST Assets		2	3	4	5	5
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	54	70
Borrowings		0	0	0	0	0
Other Liabilities		17	18	24	27	32
Total Liabilities		17	18	24	27	32
Net Assets		39	34	24	26	38
Minorities		0	0	0	0	0

Cash Flows		2016	2017	2018	2019	2020
EBITDA		-9.0	-8.3	-1.9	6.9	18.1
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	-6.2
WC change/Other		2.8	4.1	5.9	6.7	1.2
Net Operating Cash Flow		-4.7	-4.2	4.0	13.6	25.5
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	-5.6	2.3	12.3

** Includes some one-off finance costs

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SOURCE: MORGANS RESEARCH, COMPANY

Outrunning the monster

Good financial outcome despite the Amazon effect

Global art marketplace operator Redbubble overcame ongoing strong competition in the t-shirt market in the September quarter, with financial results falling broadly in line with market expectations. While global online retailer Amazon continued to apply pressure on all online clothing retailers in the t-shirt category, Redbubble was able to grow audience and transaction volumes fast enough to offset the damage caused by t-shirt discounting. Key outcomes from the first quarter report:

- Redbubble felt sufficiently confident about its performance in the first quarter to reiterate guidance that the company will be operating at EBITDA break-even level by the closing months of FY18.
- Redbubble dropped a number of key category prices during the quarter, resulting in an average order value (AOV) 7.9% below the same time last year at A\$43.60. Most of the damage looks to have been done by t-shirts, which make up more than 60% of Redbubble sales. Morgans check of website pricing shows t-shirts today being offered at 10.8% below the same time a year ago in US\$ terms.
- The price impact on revenues was offset by higher-than-expected growth in visits (up 36%, 6% above our forecast). Visits growth is an outcome of smarter marketing, better product range and better fulfilment. The company seems confident of repeating this performance in Q2.
- Gross profit margin after paid customer acquisition (GAPA) dropped from 28.3% to 25.1%. The company said that GAPA was unusually high in the prior corresponding period and affected by delays in obtaining fulfiller discounts in Q1. The company said that it expected a normal GAPA of around 26% over the full year.
- Redbubble will embark on a number of key initiatives in the current quarter, one of which will be to move to another platform which will dramatically cut page download times. Download times have a significant bearing on conversion rates. The timing of the shift to the new platform could have a material impact on H2 performance.
- Operating expenses were well-controlled, with OPEX including paid acquisition rising just 18.5% in constant currency terms, which was 4.2 percentage points below growth in GP margin. Operating leverage is being demonstrated.
- The company ended Q1 with \$28.8m in cash in the bank, better than expected. The following table summarises the Q1 performance metrics.

Figure 2: First quarter performance summary

		Q1 FY17	Q1 FY18	Reported Growth Rate	Constant Currency Growth
Visits	(m)	42.0	57.2	36.2%	
Conversion Rate	(%)	1.81%	1.83%	1.1%	
Average Order Value	A\$	47.4	43.6	-8.0%	
GTV	A\$m	36.1	45.6	26.3%	30.5%
Revenues	A\$m	28.9	35.3	22.1%	25.9%
Gross Profit	A\$m	8.2	8.8	8.1%	10.7%
GP Margin	(%)	28.3%	25.1%	-11%	
EBITDA	A\$m	-2.3	-2.1	9.7%	10.1%
Cash from operations	A\$m	-2.66	3.19	220%	
Cash used in investing	A\$m	-3.2	-2.4	-24%	
Net cash consumed/produced	A\$m	-5.8	0.8	113%	
Closing cash balance	A\$m	36.0	28.8	-20%	

SOURCES: MORGANS, COMPANY REPORTS

No change to forecasts

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Risks and catalysts

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

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