APPENDIX 4C REPORT, FULL YEAR UPDATE - REDBUBBLE DELIVERS CONTINUED STRONG GROWTH IN REVENUE, GROSS PROFIT AND MARKETPLACE METRICS

24 July 2017

Start of Transcript

Paul Gordon: Welcome to Redbubble Limited's final-quarter update for FY17 ending 30 June. My name is Paul Gordon, the Company Secretary for Redbubble. I'm joined by Martin Hosking, CEO, and Chris Nunn, CFO, who will now provide an investor update and then open up the call to questions.

Martin Hosking: Thank you, Paul. Martin Hosking, Redbubble's CEO and co-founder here. I'm delighted to be here with Redbubble's CFO, Chris Nunn, when releasing Redbubble's 4C and announcing results for the fourth quarter of financial year 2017. We are also providing an unaudited P&L and some brief commentary on business performance and metrics for the quarter and for financial year 2017. Looking at the year as a whole, the Redbubble business is continuing to show the strong growth and defensible position that comes from developing a healthy and vibrant global marketplace. We are seeing the operating leverage that we had expected from previous investments and which are a consequence of the healthy marketplace dynamics. I'm pleased to say that Redbubble either met or exceeded the forecast provided in April of this year.

Taking the year as a whole, we saw strong growth in gross transaction value (GTV) and revenue and gross profit after paid acquisition in excess of 30% on a constant-currency basis, while operating expenses were up only 18%. The net impact of this is that our EBITDA loss narrowed and was $5.2 million for the year, at the better end of the forecast range. As we have previously indicated during the last two quarters, we have been undertaking longer-term projects that we expect to have impact over the next six to 12 months and beyond. Given this focus, we had anticipated the growth for the quarter, at 23.3% in constant currency, would be lower than the annualised growth rate. We anticipate that as these investments yield results, growth rates consistent with FY2017 as a whole can then be maintained into FY2018.

Confidence in future growth is underpinned by the changes we are seeing in global online retail environments. Consumers are increasingly embracing the possibilities of the distinctive and personally relevant. Major online retailers are thus seeing the potential for on-demand retail. Redbubble remains at the forefront of this disruptive change in consumer sentiment.

Over the previous 11 years, Redbubble has built a diverse global marketplace with a global fulfilment footprint, that gives us a distinctive competitive advantage versus both new and incumbent players. Our investments are designed to reinforce this advantage and to extend our leadership position. We will be providing more updates on these investments at the time of the Appendix 4E end-of-year results in August. As we have previously indicated, we consider the health and sheer scale of the marketplace to be our most important asset. Redbubble is now the largest global consumer internet company in Australia. Over 92% of sales are off-shore, providing unique exposure for Australian investors to the global opportunity embraced by Redbubble.

During the year, 2.9 million customers bought from the marketplace, up 33% from the previous financial year; 233,000 artists made sales during the year, up by 51%; and there were 188 million visits to the site during the year, up by 27%.

Our previous investments have borne strong results during the year. Mobile represented 53% of fourth quarter visits, and this is versus 47% in the 2016 quarter. Importantly, fourth quarter mobile sales grew by 40% year-on-year, with mobile devices delivering 36% of gross transaction value, this is versus 31% in the 2016 quarter.

We also saw strong growth from our European language websites. Germany is up 64% in the quarter, Spain by 110% and France by 35% in constant currency. The quarter and year as a whole demonstrated that the fundamentals of the business are strong, driven by the distinctive nature of the global marketplace. Notably, customer acquisition costs remained low, with 58% of GTV coming from unpaid sources during the quarter. This is consistent with the year as a whole. Artists continue to come exclusively from unpaid sources and there was a strong gross profit margin, 35.6% for the year, up from 34% last year.

Looking forward, our commitment is to extending our lead in the on-demand retail environment, and this is reflected in continued significant investment. Redbubble aims to be the marketplace synonymous with the idea that this is where anybody can find their thing, whatever that may be. These investments are designed to drive low customer-acquisition costs and increasing customer loyalty.

The four big themes are unchanged. Firstly, global acquisition, with a particular focus on increasing the leverage of the content viably into paid channels; ongoing improvements in organic acquisitions, particularly search and social channels; and continued investment in our European markets.

Secondly, relevant content and enriched consumer journeys through personalised content experiences, engaging content discovery and content partnerships. Thirdly, deeper relationships with our customers, particularly through the mobile app, which launched globally during the quarter and has a 4.5-star rating in the app store, and upgraded cost platform accounts. Fourthly, enhancing scalability with cost savings and a faster core platform.

As indicated, we will provide more details on these themes at the end of the year announcement in August. As previously noted, we expect that growth through FY2018 will be reflective of the growth achieved overall during FY2017. It's thus worth noting that growth has not been and is unlikely to be linear. On a quarter-by-quarter basis, it will reflect changes in the environment overall and our investment activity. But the upward momentum is a constant, driven by the changes in consumer sentiment and Redbubble's global leadership position. I'll now hand over to Chris to go into more detail.

Chris Nunn: Thanks Martin. A bit of housekeeping. As has been our practice, we have included with our 4C release for the June quarter, a profit and loss for the quarter and the full year, down to the EBITDA level, and some key metrics. The profit and loss has not been subject to audit, as Martin said, at this stage. Our Appendix 4E release, scheduled for 24 August, will include fully audited financial information. I'll look firstly at the quarterly and the full year results referred to in our release, and then move briefly to the 4C, pointing out anything that should be highlighted to assist in understanding our past and projected cash flows.

GTV, gross transaction value, for the fourth quarter came in at $38.7 million, representing growth, versus the corresponding quarter last year, of 23.3% on a constant-currency basis. For the full year, GTV was $175.4 million, a growth rate of 30.3% on a constant-currency basis. This is at the lower end of the range indicated by our guidance in April, due largely to increased competition, particularly in the t-shirt category in the US in the last few months, but also to the persistently strong Australian dollar. We have responded to the competition in recent weeks by reviewing our pricing on a range of products, which is yielding promising sales results. As Martin has mentioned, we expect to see positive results of the longer-term investments, such as core site speed, in the coming quarters.

An excellent gross profit margin of 36.3% in the fourth quarter has taken the full-year margin to 35.6%. The underlying gross profit margin is well above 35% as we move into the new financial year. We continue to generate upside in the margin by negotiating better pricing from fulfillers and localising fulfilment. However, we can anticipate that pricing strategies in response to the emerging competition, whilst improving the top line, will be offset to some extent by reduced margin percentage. The extent of the margin reduction will depend upon subsequent negotiations with fulfillers if, as expected, volume increases materialise. Paid acquisition costs are growing faster than GTV presently, with a reported transition to mobile visits. However, we saw stabilisation in the ratio of unpaid to paid GTV as the second half of the year progressed. We expect growth in our paid marketing spend to increase broadly in line with the GTV going forward.

The cost to acquire each new customer was approximately $4.60 in the fourth quarter, $5.30 for the year as a whole, but the initial purchase of each new customer delivered on average a gross profit contribution of over $10. Whilst not evident in the fourth quarter in isolation, due partly to prior period paid acquisition cost being low, operating leverage is emerging with slowing operating expense growth. Fourth quarter and full year operating expenses came in significantly below guidance, aided only a little by the effect on our overseas costs of the strong Australian dollar.

Firming growth in operating expenses is evidenced by the fact that our current run-rate is only slightly above that incurred in the fourth quarter as a whole. EBITDA loss for the year at $5.2 million came in at the better end of the $5 million to $8 million we had forecast in our April guidance, as we offset slightly weak top-line numbers with improved gross margin and closely-managed paid marketing and operating expenses. The FX effect at the EBITDA level was minimal, less than $50,000.

Turning very briefly to the 4C, which shows our 30 June cash position at $27.8 million, operating investment largely capitalised development expenses and financing cash outflows for the fourth quarter and full year, and forecasting operating cash outflows for the first quarter of FY2018. The fourth quarter and the first of the new financial year are not unduly affected by the seasonality I have mentioned before.

Martin Hosking: Thank you very much, Chris. Operator, we are ready now to take questions.

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. To ask a telephone question it is star-1 and wait for your name to be announced. If you wish to cancel your request, you can press the pound or hash key. Once again, ladies and gentlemen, to ask a telephone question it is star-1. Thank you.

We have our first quarter from Ivor Ries from Morgans Financial. Please ask your question, Ivor.

Ivor Ries: (Morgans Financial) Yes, good afternoon Martin and Chris. If I might start by asking a question about the T-shirt competition, which of your competitors has taken their prices down and by roughly how much?

Martin Hosking: We've seen T-shirt prices overall come down. It's primarily in the United States. We have seen Amazon has moved as an increasingly competitive position so they have driven lower T-shirt prices across the category as a whole in the United States.

Ivor Ries: (Morgans Financial) How much - what's the average price of their T-shirt versus yours?

Martin Hosking: It's give-or-take 20% lower, Ivor.

Ivor Ries: (Morgans Financial) Right. The range of T-shirts that they have would be significantly less than yours, right?

Martin Hosking: Oh yes, both the range of - the range of apparel products that they have and then the range of products overall that they have is less, and of course the range of content that they have is significantly less as well. So we remain the dominant market players across all the categories as a whole, and clearly also for the artists as the go-to place to get their work sold.

Chris Nunn: It's probably also worth mentioning, some of the more traditional competitors we might have referred to in the past have been more affected by Amazon than we have, in our view.

Martin Hosking: Yes. So I think it's correct to say now that we're less concerned by companies like Society6 which we have previously mentioned, and Amazon is more on our radar screen than they have been previously.

Ivor Ries: (Morgans Financial) Yes. If I may ask another couple of questions before I get out of your way. One is, what the main effect of exchange rates were for the last quarter, just the main currencies, US dollar, pound and Canadian dollar?

Chris Nunn: When you say the main effects?

Ivor Ries: (Morgans Financial) Sorry, the main - the rates that you use to convert in Australian dollars in the last quarter, US dollar, pound and Canadian dollar.

Chris Nunn: I don't have that off the top of my head. The numbers we've quoted are just matching the same currency, so whatever the Euro was this quarter compared to the previous corresponding quarter in Euros or US dollars or pound, that's what the constant currency measure is designed to show.

Ivor Ries: (Morgans Financial) Yes. It would be useful to know what rates you used for translation for the fourth quarter, so that enables us to see whether there's any - where the fourth quarter stood in average exchange rates versus where we are at the moment. And if I could ask a supplementary question on separate conversion rates for mobile and desktop?

Chris Nunn: Yes, I can give you those. For the quarter, the last quarter FY17, desktop 2.29, mobile 1.15 for the full year.

Ivor Ries: (Morgans Financial) You've had a number of initiatives underway to improve the mobile conversion rate; how is that going?

Martin Hosking: The mobile experience is continuing to get better. we'll have more details on the overall mobile experience at the time of the full year results, including on the app itself, Ivor, but we're continuing to see the results of the improved mobile experience on the mobile website.

Chris Nunn: Yes. There is a slightly-reduced, very small reduction in mobile conversion rates because of the last year, and that's a function mainly of the competition, I would suggest, and the increasing amount of mobile traffic those two together will give you a challenge when it comes to mobile, as we've always referred to.

Ivor Ries: (Morgans Financial) Yes, okay. Thanks.

Operator: Once again, ladies and gentlemen, it is star-1 to ask a telephone question. Thank you.

Our next question comes from Roland Jabbour from Jabbour Holdings. Please ask your question, Roland.

Roland Jabbour: (Jabbour Holdings) Thank you. Hi, everyone.

Martin Hosking: Hi, Roland.

Roland Jabbour: (Jabbour Holdings) My question is probably for Martin. Considering the positive indicators on the report, basically on all fronts, what do you feel would be - what information would be impacting the market in order for it to have that negative impact on the share price today, considering that the report indicators are all positive?

Martin Hosking: Roland, that is a very good question. The share price is obviously different between expectations and reality and how that moves at any given point, it's beyond me. If I could really answer you well, Roland, I'd be a lot better at predicting the direction of the share price. I think overall, Roland, what I might say though, was that quarter by quarter Redbubble will have different results and growth will be more or less fast or more or less slow and different things will be occurring that will impact the share price. That's the day-to-day considerations, but underlying all of it though is a fundamental reality that consumer sentiment is driving upward momentum for Redbubble.

We are the leading global marketplace and so we're best placed globally to take advantage of that. So the positive trend should over time be reflected in the share price. Whether or not they are reflected in the share price on a day-to-day basis, that's really very much out of my hands and depends upon a whole bunch of factors related to consumer sentiment, not only in relation to Redbubble but to the sector as a whole and to obviously investment priorities of investors at any given point in time.

Chris Nunn: If I could add, Roland, it's also important to look at the spread between bid and offer, and I think you'll note that the actual - the best offer price is the price the market opened at today. So it does - spread has been significant, it's $0.05 to $0.10 at times and that can cause some volatility.

Roland Jabbour: (Jabbour Holdings) Yes, thank you. I've noticed that the drop is something like 15% and then it drops about 6% or 7% in a few minutes, but it would just - it just sounds very - it seems very strange because if one would look at those numbers, what better numbers would the market have expected?

Chris Nunn: Well, I think the point is that markets do this. It's not uncommon for prices to move quickly and then move back to a more normal pattern in a very short time. I don't think there's anything unusual there at all.

Martin Hosking: I think, Roland, it probably is worth noting that I think Redbubble is a relatively unusual Company in Australia, as we have noted before, given how global we are. It is taking time for the investment community to really be comfortable with exactly what Redbubble is doing, and which is perhaps one of the reasons why we've seen a lot of buy-in recently over in the United States for Redbubble as well.

Roland Jabbour: (Jabbour Holdings) Thank you, gentlemen.

Operator: Once again, ladies and gentlemen, to ask a telephone question, it is star-1.

Our next question comes from Robert Bruce from Acorn. Please ask your question, Robert.

Robert Bruce: (Acorn) Good afternoon, Martin and Chris. Thanks for the update. Just two quick questions from me. One, just some commentary on success of the app, the Apple app that's been launched to date in partly beta mode and partly full mode I think now in Australia, and whether in the future that will help to reduce customer acquisition costs if the app is widely taken up. Then the other, second question I had was in the 4C it highlights that fulfiller costs in the next quarter are expected to be about $22 million. That's a reasonable pick-up on the $19 million odd in the 4C we've just had. Is that showing strong - we take from that strong revenue growth or we just read into it a seasonality with strong 1Q FY18 numbers?

Martin Hosking: I'll let Chris take the second question later. I'll take the first question in relation to the app. We have been pleased with the app's early days. We are iterating on the app quite significantly at the moment, so we're continuing to put a lot of work in. We are pleased with the fact it's got a 4.5 star rating in the App Store, that's from the consumer, so consumers are engaging with the app. We will be providing more details on the app in our overall mobile plan at the time of the 4E results in August. I'll hand over...

Chris Nunn: We should say it's also now a global app, in the English-speaking world, at least.

Martin Hosking: Yes.

Chris Nunn: Look, with the fulfilling, the answer to your question is yes, simply, Rob, in terms of the cash flows. But there's always timing differences on cash flows as against. So don't read too much into it, but I'm confident they're pointing in the right direction, otherwise I wouldn't have released them, forecast numbers.

Robert Bruce: (Acorn) Thank you.

Operator: The next question comes from Ivor Ries from Morgans Financial. Please ask your question.

Ivor Ries: (Morgans Financial) Chris, if I can ask you a question. You mentioned during the briefing that costs were well under control. I wonder if you could give a - and you suggested that cost growth is going to be restrained at similar levels in FY18. I just wonder if you could give us a little bit more colour around that?

Chris Nunn: Yes. I think growth at similar levels, not broad dollars at similar levels. Obviously, our operating expenses will increase. I was just trying to give a sense of a quarter in isolation never tells you very much so I was just trying to give a sense of the run-rate in my commentary.

Ivor Ries: (Morgans Financial) Yes. Should we expect the same to happen, that the operating expenses will rise at a slower percentage rate than gross margin over the next few quarters?

Chris Nunn: Yes.

Ivor Ries: (Morgans Financial) Yes. You also mentioned during the presentation fulfiller expenses are there. You're hoping that they might be able to get some benefits there. Could you share where you think those - the areas where you can get some benefits in gross margin from fulfillers?

Chris Nunn: Yes. Well look, we're always, as we've proven since I've been involved in the Company, we're always chipping away at that margin with fulfillers. It's a negotiation because of volume increases so economies of scale negotiations. It's probably significantly localising, so as soon as we localise it improves the shipping costs that we incur in getting the items delivered. Those are the two principal areas and they're across the board. There are some products which we haven't squeezed hard on and we'll squeeze a bit harder, and there's some we've been more active on, so there's always room to improve. But it's largely - in negotiations with the production fulfillers and with the shippers.

Ivor Ries: (Morgans Financial) Yes. When we look at the current half year, would you expect that there's any of your new fulfillers that have opened up, the local fulfillers opened up are now gaining scale, you get some benefits from that in the current half year versus the previous half?

Chris Nunn: Yes, we'll always - absolutely. While they're increasing the volumes then we're in a position to negotiate. We don't have the capital investment; they do. So as you know, they want to spread that capital investment over as many products as they can get. So we have a little bit of leverage in relation to growing volumes.

Ivor Ries: (Morgans Financial) Yes. In terms of your selling artists, you've done a great job in growing those numbers over the past year. Has most of that been organic, that is, you haven't had to spend too much money acquiring those artists?

Chris Nunn: Zero. I think Martin referred to that. They're entirely organic.

Martin Hosking: Entirely organic. Our presence with the artists' community comes from organic sources. We do spend on what might be thinking at a base level, or to drive that organic growth. We do have a blog which attracts artists. We have an artist-in-residence program, but we don't do any paid acquisition per se of artists.

Ivor Ries: (Morgans Financial) Yes, okay. And customer acquisition, just a normal level of customer acquisition. Would you expect the spend on customer acquisition as a percentage of revenues to increase or remain about the same in the next couple of quarters?

Chris Nunn: I think to quote myself, we're broadly in line with my guidance on that one.

Martin Hosking: It's gone up marginally but the rate of change has been decreasing.

Ivor Ries: (Morgans Financial) Great. Thanks very much. Thanks.

Operator: Once again, ladies and gentlemen, it is star-1 to ask a telephone question. We have another question from Robert Bruce from Acorn. Please ask your question.

Robert Bruce: (Acorn) Yes, hi. Just some clarification just on the last answer, firstly. I think Chris, you said that customer acquisition cost was $4.60 in the fourth quarter but the full year was $5.30, in an earlier comment, but you've recently - just in that last answer to Ivor you said it was increasing. Have you got the comparators of where it was the year before so we can see what you mean? Because it looks like with the $4.60 in the fourth quarter less than the full year, that it has been coming down, or is it just purely seasonal?

Chris Nunn: Yes, it is largely seasonal. I don't think that trend is something you can just extrapolate, Rob. It depends. We have to be able to spend the money profitably to spend it, so we reach profit maximisation through certain channels at different stages during our year. So it's been pretty flat as an overall cost over the last 12 months, in total.

Robert Bruce: (Acorn) Right, okay. Just following on from my other question earlier, just on the app, assume - are you targeting a reasonable proportion to eventually come through the app, and what would that do to the paid search that you're currently incurring, and would that improve the potential margins if you can reduce that paid acquisition cost?

Martin Hosking: Yes, Rob, clearly, the app is designed to be a repeat customer experience, so it's for that proportion of our GTV which is currently repeat. Increasingly, those people, we would like them to be accessing Redbubble via the app. We'll always have a paid acquisition because that's likely to be where the new customer acquisition will be, but you're quite correct as well, that currently we are also paying four repeat customers, because the fact that they've come through from Google and they're repeat customer also doesn't mean they're free, it means we still have to pay for them. And so the app over time is designed to drive that customer loyalty, with the benefit therefore of reducing customer acquisition cost overall.

Chris Nunn: Just to be clear, Rob, that doesn't change; that affects the GPAPA, gross profit after paid acquisition margin, not the gross profit margin in case that was confusing.

Robert Bruce: (Acorn) No, no. that's quite clear, thanks. And Chris, I think you were going to give a few more numbers on those conversion rates earlier, but didn't get to finish. Could you finish that off, if that's all right, in terms of the split?

Chris Nunn: Yes. All I was going to add was the full year numbers as opposed to just that last quarter. The full year numbers of FY17 were 2.77 at desktop and 1.28 at mobile. An average full year is 1.96 across all three desktop, mobile and tablet, and the average across the whole quarter 4 across - was 1.65 across desktop, mobile and tablet.

Robert Bruce: (Acorn) Is the fall away in both conversion rates in the fourth quarter compared to the full year a seasonal aspect?

Chris Nunn: Yes.

Robert Bruce: (Acorn) Can you elaborate? Or is it that there's competition that's coming into the market?

Chris Nunn: No. The most significant reason for the drop away compared to a full year is seasonal, because we have a much better conversion rate in quarter 2 being the Thanksgiving and Christmas quarter. There will be - there is probably some effect; we don't know the exact amount of that - on competition. Basically, just pricing. You get to a stage where you're comparing pricing and then that's where you lose your conversion rate on that basis, but we're working on that, as we mentioned.

Robert Bruce: (Acorn) Right. The underlying fourth quarter numbers compared to the previous year for desktop and mobile are largely the same, it's just the increasing portion of mobile, is it, in terms of the move from 1.72 to 1.65?

Chris Nunn: Yes. The conversion rates, comparing the FY17 fourth quarter with the FY16 fourth quarter are pretty much the same, within one or two basis points.

Robert Bruce: (Acorn) Right, okay. The lower AIV, while we're on that back page, that is wholly to do with the FX movements or is there some impact of the T-shirt pricing coming through at that point?

Chris Nunn: No, it's really - no, we haven't - our work reacting to competition really didn't begin until the very end of the year. So the AIV variation is more than 75% FX and the rest will just be product mix.

Robert Bruce: (Acorn) Right, okay. Right-oh, thank you very much.

Operator: Once again, ladies and gentlemen, it's star-1. There are no more further questions at this time. I would like to hand the call back to the speakers for any closing remarks. Please continue.

Martin Hosking: Thank you very much, we appreciate it, and we appreciate the attendance and the questions. Thank you very much to everybody.

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