Investor Briefing - Appendix 4C, Half Year Update and Revised Guidance

23 January 2017

Start of Transcript

Paul Gordon: Good morning all. Welcome to the Redbubble Limited investor call for the Appendix 4C relating to Q2 FY17. My name is Paul Gordon, Company Secretary. I'll now hand over to Martin Hosking, CEO, to talk first, then Chris Nunn, CFO and then we'll open up for questions.

Martin Hosking: Thank you Paul and good morning all. It's Martin Hosking here, the CEO of Redbubble. I'm pleased to be announcing Redbubble's results for the second quarter of financial year 2017, our 4C results, as well as our preliminary, unaudited results for the first half of 2017 year. The full 4D results, which is the audited half year results, will be released at the end of February.

Overall, I'm pleased with the results Redbubble's achieved since our IPO in May of last year. While clearly it was disappointing not to have achieved the forecast we provided at that time, it does not mean the business is not enjoying significant growth and emergent operating leverage. I want to highlight some of the constant currency numbers which I believe are most indicative and relative to Company.

GTV growth, that's gross transaction value growth, in the first half of the financial year was 31.3% and is indicative of the Company seizing a significant opportunity. Even more importantly, our growth in gross profit after paid acquisition of 44.6% shows that this is being achieved through below cost means that we have indicated underpins the Redbubble marketplace.

Our operating leverage is indicated by the modest growth in OpEx of only 12.4%, 115% improvement in EBITDA versus the same half year last year is the net loss as a result. As I say, I fully acknowledge that these results, while impressive, do not make the forecast prepared earlier in calendar year 2016. After Thanksgiving weekend last year, we had indicated that we're enjoying softer than forecast growth and this continued through the December shopping period.

Redbubble is unusually exposed among Australian technology companies to a global marketplace with 94% of sales coming from offshore. Redbubble is not alone in finding it challenging to forecast global events in 2016. Brexit, the rise of Donald Trump and the resilience of the Australian dollar are but three examples and each of these has in turn impacted the Redbubble business. Even more specifically, the transition to mobile and a resultant rise in paid spend has been more rapid than almost all forecasts.

Against this background, Redbubble is performing strongly. The fundamentals of the forecast we provided at IPO were that during Fy2017 Redbubble would enjoy strong GTV growth, show emergent operating leverage and be in a position to move into profitability during FY2018. Each of these things has been demonstrated.

As I said before, these financial measures reflect the fundamental strength of the global marketplace that is Redbubble. It is a marketplace that is both resilient and balanced. During the half year, customers grew by 33.8% and selling artists by 54%. The print-on-demand bubble, combined with outsourced fulfilment means that this growth is cash flow positive, seen particularly strongly during the quarter that has just passed, with low capital requirements.

As we briefly outline in the release today, there are a wide range of growth initiatives underway at Redbubble. We now have a development team of over 50 people, plus a strong marketing team in San Francisco and a new office in Berlin. All of these people are dedicated to scaling the marketplace.

To wrap up, before handing over to Christ, I want to reiterate that while the performance may not be entirely predictable, it is driven by sustainable factors. Firstly, Redbubble operates in a huge and growing global market, demanding more personalised and relevant products. This will drive long term sustainable growth. Secondly, there are strong network effects from more artists and consumers. This drives low customer acquisition costs, sustainable margins and represents a significant barrier to entry.

Thirdly, the vast content library can be repurposed for new products and new geographies and combined with unusual artist loyalty, the back library of increasing value. Finally, as a result of the outsource print on demand, we carry no inventory, with a positive cycle and require limited capital growth.

The net of all these factors is that GTV and revenue will continue to grow much more rapidly than operating expenditure, with strong margin and low customer acquisition costs. We expect to see this translate into a small cash EBITDA surplus for financial year 2018.

I'll now hand over to the CFO, Chris Nunn, who will go through the financials before taking questions. Thank you, Chris.

Chris Nunn: Thanks Martin. I'll look firstly at the half year financial highlights in a bit more detail than Martin did and then move on to the 4C, including an update for the remainder of FY17. I should point out, as Martin did, that whilst we do not expect there to be significant variances, all financial figures in the 4C and our presentation remain subject to half year audit review by EY.

As Martin said, Redbubble has grown strongly and consistently throughout the half year when compared to first half last year and has done so whilst improving gross margins and maintaining control of operating expenses. Revenue is up 26.3% and is 34.3% on a constant currency basis, eliminating the effect of the strong Australian dollar on the 93% of our revenue that is nominated in overseas currencies. However, it is still some way short of our prospectus forecast due to largely, we believe, to factors outside our control as Martin outlined.

Whilst our growth remains significantly higher than the rate of global online retail sales, the important second quarter was weaker in growth terms than the first quarter and significantly than we had anticipated. Performance on our European language site has been, however, a highlight with Spain and Germany created over 80% and 60% respectively, despite a near 5% FX headwind relative to the previous year.

Gross profit was lifted by 38.1%, 47.7% on a constant currency basis, with the margins increasing from 32.9% in the first half FY16 to 36% this half year, comfortably above the 34.1% forecast despite the negative FX effects. The main drivers of this have been sustainable factors of improved product pricing and mix, as well as the benefits of scale and negotiations with fillers and shippers.

We've introduced a new measure of gross profit after paid acquisition, which recognises that the increasing proportion of our sales are generated through paid marketing channels. The increase has been driven our hopes on what is a very profitable activity and also by the rapid transition to mobile referred to Martin and in our ASX release. Gross profit after paid acquisition, effectively unmet revenue, has grown 33.7% year-on-year, 44.6% on a constant currency basis.

Operating expenses have only grown 9.3% year-on-year this half year. Operating leverage demonstrated by this measure when compared with gross profit after paid acquisition was a major focus of the Company in the second half of this year and into FY18. Our first half EBITDA loss of just over $1 million is 55% better than the $4.2 million loss for the first half of FY16. However the lower GTV and revenue forecast is likely to delay our transition to mobile products profitability to late FY18, although we do expect, as Martin said, FY18 as a whole to deliver a small cash EBITDA surplus.

Looking at the 4C itself, it shows a strong, positive cash flow of $11.2 million for the quarter and $8.6 million for the half year. As we indicated in our release statement, Redbubble is a seasonal business, with the December quarter including the traditional strong Thanksgiving and Christmas online seasons. Much of the cost of fulfilment for items sold during December, which Redbubble has already received cash, is paid out in the following quarter. This can be seen in the forecast March quarter cash flows on the 4C.

I look forward to discussing our audited full year result - I should say, audit reviewed full year results in more detail on the release of the Appendix 4D half year report on 20 February.

Moving on to the updated guidance for FY17, with the weakening forecast growth in our top line numbers, we took the opportunity of a thorough review of operations and have provided the following update for FY17. In line with the first half of the year, we had projected the growth rates in GTV and revenue will continue in the range of 22% to 29% year-on-year, resulting in a top line GTV number between $175 million and $185 million, against the $215 million that was forecast in our prospectus. About 30% of this shortfall is due to the effects of the strong Australian dollar.

Revenue is expected to remain about 80% of GTV. We are very pleased with the work done by fiscal product and supply chain teams to deliver significantly improved gross profit. Whilst I would like to project a continued 36% in line with the remainder of FY17, we typically have a lower January margin with increased returns and re-dos from the holiday season. Nevertheless, we are comfortable that improved margins are sustainable. We are therefore forecasting a margin of 35% for the full year, against the 34.1% originally forecast.

Martin referred to the growing paid marketing or acquisition costs in response to the global and rapid shift in mobile. We're now forecasting our full year paid marketing expense to be around $13 million, which is 25% higher than IPO forecasts.

We have always maintained that we have the capability to manage our operating expenses in relation to slowing growth in the top line and we are prudently doing so without restricting our capacity to grow. We're now forecasting a 20% year-on-year growth in operating expenses in FY17, compared to 26.7% growth forecast at the IPO.

As I indicated, the slowdown in top line growth has delayed our transition to profitability on a month-to-month basis, which we now expect to occur late in FY18. Whilst we are forecasting FY18 as a whole, there was a small cash EBITDA surplus. Operator, we can now throw over to questions.

Operator: Certainly. Ladies and gentlemen, if you would like to ask a question, please press star/one on your telephone and wait for your name to be announced. Once again, to ask a question, please press star/one on your telephone. Our first question comes from the line of Conor O'Prey from Canaccord. Please go ahead.

Conor O'Prey: (Canaccord, Analyst) Good morning gentlemen, standing in for Owen, who is away. Just a question on currency if I may and perhaps if you could let us know what was in the forecast for the US dollar and GBP in the period and also the rates that were realised for you guys at the same time. Thanks.

Martin Hosking: Okay, Conor, I can certainly tell you what rates we forecast in the IPO, but I can also tell you what rates we're now forecasting for the rest of the year. I don't have exact rates currency-by-currency in front of me. I can certainly advise you of that later of what actually occurred. I'll just have to total difference.

The forecast rates in the IPO for the US dollar, $0.741. To the GBP, it's $0.51. For the euro, it's $0.667 and for the Canadian dollar, it was $1. For the second half of this year, we've left the US dollar unchanged at $0.741, brought the GBP down to $0.59, the euro $0.70 and the Canadian dollar at $1, so basically Canadian dollar unchanged.

Conor O'Prey: (Canaccord, Analyst) Were those IPO forecasts, were they for the full year or for the half?

Martin Hosking: No, they were for the full year.

Conor O'Prey: (Canaccord, Analyst) Yes, perfect, okay. Thank you very much.

Operator: The next question comes from the line of Ivor Ries, from Morgans Financial. Please go ahead.

Ivor Ries: (Morgans, Analyst) Good morning Chris, good morning gentlemen, just a question on the conversion rate. You managed to get the conversion rate up in that period, just notwithstanding the shift to mobile. Could you just give us a flavor of the movement in the conversion rate of desktop versus mobile over this half compared to the previous corresponding half? Thanks.

Martin Hosking: Well as the presentation said, conversion rate 10% higher for the first half compared to last half. It's probably slightly - the increase was fairly even across the two devices, probably started better on desktop than mobile and that's partly to do with the number of visits, Ivor. As we discussed, the more visits you get, that doesn't necessarily mean they always convert at the same rate as before and we're getting more mobile visits and mobile can be more transitory by nature. So yes, it converts slower, probably haven't delivered the same growth rate on conversion to mobile than desktop, but overall we had 10% improvement.

Ivor Ries: (Morgans, Analyst) Yeah, but I mean if I'm looking at that mobile as now the dominant source of traffic, so you had to get some sort of improvement in mobile in that period to get that.

Chris Nunn: We are seeing improvements in mobile conversion rates, but I think that the reality is consumers are getting increasingly tough or simply taking their transactions to mobile. Certainly, as we've said for over a year, we have a mobile development and mobile first strategy, so the place at which the website improves first is the mobile site, so we are expecting mobile conversion rates for the year to increase.

Martin Hosking: Yes, they are now increasing, I just want to clarify what I said, they're both increasing, I think desktop's increasing a little more, has increased a bit more. I should point out, Ivor, in terms of visits, they're still close to 50/50, so a little bit more in mobile now, but it's not like it's - it's been a revenue source, converting better, but it's not a bigger visit source. Clearly it will become so.

Ivor Ries: (Morgans, Analyst) Yes and average order value, that declined, there was currency obviously, but was there also some mobile impact there, there's a greater percentage of mobile orders and they tend to be lower in value?

Martin Hosking: No, I don't think we've picked a particular trend on mobile as being particularly like that. There was a change of - first quarter, you may recall there was a product mix there and that's to do with the northern hemisphere, big proponents of sticker sales, which is lower value than normal, but this has actually come back. So you're right, the 8.2% AOV is almost with 0.2% all FX, it's a very minor part of it, if anything, to do with product mix or mobile or device.

Ivor Ries: (Morgans, Analyst) So what you're saying is that the mobile - that the average order value on the mobiles is holding up?

Martin Hosking: Yes, that's right. It's almost the same over - I think we've got - there are some sites which will be much more exposed that - particularly if you've got much higher AOV, that's where it tends to be - where the higher average AOV, that's where you get a differential between mobile and desktop. We don't see that.

Ivor Ries: (Morgans, Analyst) Right. If I may ask one more question before getting out of the queue, just on the planned increase in the marketing spend. Can you take us through the logic on that, why you felt it necessary to increase the online marketing spend?

Martin Hosking: I'll comment and then hand it over to Chris. We're increasing the spend where it's profitable, Ivor. It makes sense to spend as much as we can while it is profitable, and given we are performing strongly on mobile, we're increasing our spend there while it is profitable. So it is still profitable on first order and so we're expecting to be able to continue to do that, but that's how the numbers fall out.

Chris Nunn: The other side to remember is we really - we can see that the transition to mobile, yes, it might have been faster than we expected, and that transition to mobile naturally brings more click-on links that are paid, so it really drives us to spend more otherwise we'd go down in rankings.

Martin Hosking: Yes. I will say this is - we're aware of the sensitivity of this issue, which is why we're pulling out this gross profit after paid marketing spend so that we can highlight that in essence the paid marketing is a cost of acquiring a customer, so that's the number which should be continuing to grow strongly, that number we're focused on internally.

Ivor Ries: (Morgans, Analyst) Great, thanks.

Operator: Once again, if anyone would like to ask a question, please press star-1 on your telephone. The next question comes from the line of Nga Lucas from Mirrabooka. Please go ahead.

Nga Lucas: (Mirrabooka Investments, Analyst): Hi Martin, Hi Chris, it's Nga speaking.

Chris Nunn: Hello Nga.

Nga Lucas: (Mirrabooka Investments, Analyst): How are you going?

Chris Nunn: Good. How are you?

Nga Lucas (Mirrabooka Investments, Analyst): Good, thanks. Ivor's actually asked a couple of my questions, but do you have a sense for the contribution or the impact from the actual soft markets and economic conditions versus mobile shift?

Martin Hosking: I'm not sure. It's hard for us to extrapolate it completely Nga. The reality is that we've looked at the statistics across the different jurisdictions and we're growing at I think twice the rate of online retail sales, it's a bit over that. Clearly then we were caught in headwinds. We were - the reality of Thanksgiving was that it - since the rise of Trump and Brexit, we've had - those headwinds have been strong. The early part of Thanksgiving, the Black Friday sales were strong, but then as we indicated at that Thanksgiving release we then saw the trend reverse back to a rather subdued trading environment. That subdued trading environment then continued in retail through to the end of the Christmas period. We can't exactly extrapolate how much of that's been a factor versus other factors.

Chris Nunn: What we can see very clearly is this number has dropped away around about the end of October, at least a fortnight to three weeks and it just happened to partly coincide with the US election process. The campaign was going on there, which was clearly distracting people even in Australia, let alone directly in the US. It's a big part of our market - still 60% odd of our revenues come out.

Nga Lucas (Mirrabooka Investments, Analyst): And just a follow-up question on the paid marketing, and I guess your strategy to manage this shift to mobile, can you just talk about the key themes? Is it just managing conversion, a bit more paid marketing? How are you going to address this?

Martin Hosking: I'll first of all introduce a theme which is important. The way in which paid placement on the mobile screen is when you go to a mobile screen now almost all of the links which you will see there are paid placement because Google and the other shopping engines have done a very good job of ensuring that everything is clicked on, because they have a relatively smaller number of links than you do on a desktop. So if you're clicking through mobile, whether it's on Google or indeed on Facebook, it's very likely to be a paid placement. Our strategy there is to continue to leverage our content diversity, so we've invested very heavily in making sure that were driving deep links into the site and very highly-targeted content. That had been the strategy in the unpaid world and also in the paid world. So that means we are working very closely with the two biggest players in our world, which is Facebook and Google, but that also - Pinterest is also a part of that, as indeed is Instagram - making sure that we're driving deep links both in search and also in social, and those are the words and the content which we can apply cheaply, because other people aren't - don't have the same content which we have. And so the strategy is to continue to invest here. It's overwhelming a data science and data mining job now.

Nga Lucas: (Mirrabooka Investments, Analyst): Okay. Thanks, guys.

Chris Nunn: The other thing to point out of course is that organic, i.e. unpaid still is a profitable source for us. The other focus for us is to ensure a very big area of growth, not just in the email marketing, which is a free source. That's grown by north of 60% in the half year, year-on-year. That will be a focus, personalising the way we get our products or a range of products in front of people is very important part to counter the national shift to paid.

Operator: The next question comes from the line of Ivor Ries from Morgan Financial. Please go ahead.

Ivor Ries: (Morgans, Analyst) Sorry to halt proceedings but if can just ask a follow-up question. Just in terms of selling, there's been a 54% increase in selling out of 264,000 in that period, quite a significant increase. Can you give us a flavour on what contributed to that?

Martin Hosking: It has been for - I'm not sure I can give it any specific flavour because it's not an area of significant investment. What we recognise is that by driving the marketplace and getting more customers, more artists come. The artist side of the equation has always been much more resilient and much more reliant on organic growth, it's the nature of the marketplace itself. So we're certainly not doing any paid acquisition for artists. We did have a team working through the six months on the artist strategy and they were doing some work around making sure that the artists on-boarding process was smooth - and making sure the image uploading process was smooth. It hasn't been beyond that; it's been entirely through the organic process which are a factor of the marketplace itself. The thing is, as I indicated, that underpins the strength of the marketplace model itself. Without those artists and without that new content, we don't actually have the capacity to do the paid marketing at the level of detail which we need to do it, but it also drives the new organic customers as well.

Ivor Ries: (Morgans, Analyst) So there was no hype or publicity about you in the artist world during that half or anything that - in customer numbers, increasing in selling artists just came about through just word of mouth amongst the artistic community, is that right?

Martin Hosking: Yes, there was nothing unusual or exceptional during that period. Artists remain very happy with Redbubble as a platform and we're continuing to be the number one place where artists choose to put their work on the internet under the print-on-demand model.

Ivor Ries: (Morgans, Analyst) Yes. Your 22% increase in visits, half-on-half, do you have any sense how you are travelling in visit volume versus your major competitors?

Martin Hosking: No, we don't really, Ivor. You have access to exactly the same sort of data sources as we do, - and that's primarily Google Trends. You can see we've outperformed on that, but they haven't released any numbers yet. So on the Google Trends you can see it's gaining share but that's the only public source of data we have.

Ivor Ries: (Morgans, Analyst) Great. Thanks very much.

Operator: Just a final call, if you would like to ask your question, please press star-1 on your telephone. Gentlemen, there appears to be no further questions so I'll hand it back to you if you have any closing comments.

Martin Hosking: No closing comments, really, other than to thank everybody for participating on the call. And just to remind everybody that Redbubble's 10th anniversary is on 2 February, so the site launched 10 years ago in 2007. So it's great to have enjoyed this journey with you. Thank you.

Chris Nunn: Thank you.

Operator: Thank you very much. Thank you, ladies and gentlemen, that does conclude our conference for today. Thank you so much for your attendance; you may all disconnect.

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