INVESTOR UPDATE

TRANSCRIPT OF CONFERENCE CALL

13 December 2019

Start of Transcript

Louise Lambeth: Good morning everyone, or afternoon for our US investors. This is Louise Lambeth, head of investor relations for Redbubble Group. Welcome to this teleconference following our most recent trading update, released to the market yesterday. With me, I have RB Group's CEO, Barry Newstead and CFO, Emma Clark. Emma and Barry will speak before we open up the call for questions. Please note that this call and Q and A session are being recorded. Before we start, I would like to draw your attention to the safe harbour statement regarding forward-looking information in our trading update. That safe harbour statement also applies to this call and the Q and A. Now, I will pass over to Emma.

Emma Clark: Thank you, Louise. Good morning, or afternoon to everyone and thank you all for taking the time to attend this session. As you are all aware, the Redbubble Group released a trading update to the market at this time yesterday morning. We've received feedback that it would be useful for us to hold an investor call to provide some context surrounding the information in the update. This has been valuable feedback, so thank you. Some of you questioned the need for an update at all, as we are still in the midst of the holiday training period. Fundamentally, our Board takes our continuous disclosure obligations very seriously and did a rigorous look at the gap between market expectation and top line growth, in order to make a decision.

To reiterate, what was shared in the trading update was as follows.

The Redbubble Group's consolidated quarter to date growth rate, from 1 October to 9 December, was 20% on a floating basis. At the marketplace level, TeePublic was 59%. However, Redbubble was 2%. We advised that we are still expecting to generate Operating EBITDA growth, on a like for like basis to last year and also achieve positive free cash flows for the financial year. Given we are still part way through a quarter, we will not be releasing additional operational data at this time, but would like to share context around the Group's current performance. We will provide more operational data, at our scheduled second quarter release, at the end of February next year. We focused the trading update on the sales performance, as that is the primary driver for the disclosure. Our margins are following their normal seasonal patterns and paid acquisition spend remains under control.

Operating expense discipline has been maintained, noting that as a growth business, we do expect operating expenses to increase gradually, over time. As is our current practice, we do not give formal guidance, but we hope this additional information is helpful for all of you. We remain committed to growing the Group to $1 billion plus in sales. I'll now pass over to Barry to go into further detail.

Barry Newstead: Thanks Emma. Good morning and good afternoon everyone. Clearly, we've seen a strong market reaction to yesterday's announcement and we want to take the opportunity to provide some context. We will explain why we see the update as less significant than the reaction might indicate and we want to provide investors an opportunity to clarify their understanding of our business. Redbubble went public with $140 million in revenue, three and a half years ago. Last year, we hit $308 million. We also became operating EBITDA and cash flow positive just a few months ago. It is hard to see this as a failure, or a company in crisis. We're in the early days of growth, with a market leading set of assets. The largest platform as it relates to content, artists, products and partnerships. It's early and our growth rates have, and will, vary.

We have a deeply talented group of engineers, designers, marketers and operations professionals, amongst others, to build the best class of products that serve a complex set of users. Our team of 58 engineers and data scientists are doing work that other bigger companies are spending huge sums on. Two good examples: our personalisation algorithms process every user click and generate highly relevant recommendations, that users engage with at high rates. This is the work of a team of less than 10 people. In addition, a team of three have built an image recognition capability that will allow us to protect content of Redbubble artists and partners, on our platform and off. This is powerful IP that our capital has been funding. We have many more examples of work that we have and are doing, that are about building a set of assets that enable us to win the war, even if we lose a few battles in the process.

It is the result of a strategic focus, from our board on down, to build a disruptive business, make good strategic decisions like buying TeePublic, and manage our way through the choppy waters of competing in a dynamic retail space. Now about the current choppy waters - we have identified two causes for Redbubble's lower growth rates and both were mentioned in the trading update. One is that our organic and paid traffic for apparel and specifically t-shirts in the US, did not improve as anticipated this quarter. Some of the weakness looks to be associated with our marketplace integrity work that is rebuffing low-quality or IP infringing designs from the platform. We continue to get better at removing content quickly and while we are adding great Fan Art content, it is still significantly smaller than the content we have removed.

We have also deterred serial infringers and low-quality uploaders, which is good for the marketplace over time in terms of building a powerful content moat, but it is costing us revenue right now. Finally, there has been increased competition in t-shirts, with small sites popping up, that in some cases, infringe on Redbubble's artist content. We are building tools to help Redbubble and TeePublic artists fight this and bring traffic back to us. It is worth noting that TeePublic did not have the same challenges Redbubble has with regards to serial infringers. We are confident in TeePublic's current and future trajectory. Whilst our organic rankings - referring here back to Redbubble again - have generally improved over the past six months, it has not yet generated significant traffic growth.

Weak organic traffic looks to have added a flow-on effect to paid search for US t-shirts. We have a plan that we are working through. We have received some fresh ideas for search engine optimisation that we are implementing. We have good t-shirt line extensions to introduce in the new year and lifestyle previews that look to be a real conversion opportunity. We continue to see upside potential for Redbubble's US t-shirt Business - it's just taking longer than we had expected. The second issue is our sticker growth, in the US, has slowed. I underscore, has slowed. We're not talking about a decline. Stickers have been a strong source of year on year growth, for Redbubble, in the past - for the past few years and whilst we would have expected seasonal Q2 softness, their performance is lower than expectations. Historically, Redbubble has had a leading position in organic rank for stickers. However, in the past month, Amazon has gained the top position, in the US market, for some sticker related terms.

They also appear to be competing more, in Google Shopping, for popular terms. It appears that sellers on Amazon are offering bundles of stickers, of unknown quality, for as low as $6.99. Redbubble stickers generally sell for $12.50 for 10 high-quality stickers. This has hurt our conversion rates. Stickers are an important business for Redbubble - and the slowdown in sticker growth in the US has impacted the overall growth rate of the business, especially as 10% to 15% of sticker orders include other products. However, we have a formidable position in stickers. This is a slowing of growth from a high-point, not a decline. We aim to respond to the competitive challenge. Redbubble has a strong brand for quality and a very, very wide variety of designs, that go well beyond the popular topics associated with terms like VSCO, which is a fad.

Redbubble has a scope to adjust our offering, both in terms of price point and bundles are - bundling into packs, the main offering of Amazon sellers. Our brand positioning is highly differentiated from Amazon, for many customers. Finally, outside the US, the Redbubble sticker business is still taking off. It is important to note that there are areas of the RB Group that are performing at, or above, expectations. TeePublic is accelerating and this is increasingly meaningful to the overall Group, as we've sustained high growth rates and attractive economics. US t-shirts have accelerated for TeePublic and European t-shirts have been taking off. In addition, new products are doing really well. This is an important ballast in the t-shirt business for the Group and for the overall Business in total. Member acquisition on Redbubble continues to perform well and member conversion to purchase remains steady, off a much higher member base.

We still have work to do to lift the average purchase rate above 1.1x but current performance is in line with expectations.

Our growth in apps continues to be healthy, when controlling for the sticker issue and early signs for the Android app are good. Our Home and Wall Art categories are outperforming with solid growth in the US and excellent growth in Europe. A lot of this has come from our new product launches this year and we've also seen a strong jump from some changes we've made, in previews, that will be extended to other products. Fan Art is still small overall, but remains exceptionally high growth. More brand launches are planned for January. Authentic Sellers are where the growth is, so the challenge remains that Redbubble is still working through the transition towards high quality content and artists.

Growth in Europe, as I noted earlier, is excellent for both Redbubble and TeePublic. Paid marketing continues to be efficient and profitable for both businesses. That being said, we obviously need to take measures against the issues that we are seeing in the US market on Redbubble, although the Group position is solid. It is important to note that our core strategy of moving ourselves from a transactional business, to a branded loyalty-based business, remains as important as ever.

As such we need to continue to be focused on the strategic elements that we have been discussing with all of you for the past year and a half, namely

1. Building loyalty with members to drive more repeat buying
2. Continuing to build fan art and supporting authentic sellers to expand their business on Redbubble
3. Continuing to launch new products to broaden our reach, and
4. Improving new user acquisition through brand building

The RB Group continues to be a growing company, with upside potential. As ongoing work takes hold, we expect to grow Operating EBTIDA and achieve positive cash flows. Building a disruptive business is not linear. We remain steadfast in our view that we are building towards a big vision and a billion-dollar business. Before opening the floor to questions, I would like to take this opportunity to wish all of you a relaxing holiday season with family and friends and a healthy, happy and prosperous 2020. I'll now open the floor for your questions.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you are on a speaker phone, please pick up the handset to ask your question. The first question comes from Grace Fulton from Goldman Sachs. Please go ahead.

Grace Fulton: (Goldman Sachs, Analyst) Hi guys, thanks for taking my question. Perhaps if I could just start by looking at the sticker category and what's happened there in a bit more detail, with Redbubble. Could you give a bit more detail on just how far the sticker category has fallen as a result of the increased competition? Sort of the actions that you could take to combat it and just sort of the growth margin implication as well, because it was one of the higher margin categories?

Barry Newstead: Yes, so - I'll probably just refer back to what I said earlier - as Emma said, we're not going to get into really detailed operational metrics. I will take the second part of your question directly, which is, the things that we are doing. First of all, Amazon's improvement is very, very recent. We need to make some adjustments to that. But I think we're confident that we can do so. I think that there's three things that are notable. One is just really making sure we're getting the right content surfaced on organic search. We've moved from the number one position, to the number two position. That's a competitive fight that we're up for, so we're working to ensure that we get back to the number one position.

I think over time, we think that as the fads change, we have the ability to move faster to those fads than Amazon has. It's just worth noting that we've had a really strong sticker business, for a long time. A certain part of the sticker business has become mainstream and become a bit of a fad, around what's called VSCO stickers. That's really where it's been picked up. But our business is much broader than that. I think that's the first thing. The second thing is, we're looking at our competition in Google shopping and how we compete there. I think it's been very much a secondary area for us, so we're working on how do we ensure that our position, in Google shopping, is strong. The third area is that we're looking at our price point. We've made some adjustments to our price point, which after a few days, already is really looking to be solid in terms of performance and in terms of GP. Finally, the competition we're seeing is around what are called packs, which are groups of stickers. Frankly, Redbubble has been - basically, sells bundles of stickers, where you're assembling individual stickers. We're working to put product out into the market that will pre-curate packs. But the way in which we intend to do that is to actually utilise the strength of our community to do so. We built a capability we call lists, which is the ability for our customer to generate a list. Say for example, my favourite 10 space designs on Redbubble. We're going to make those lists available for our customers to buy as packs in the coming period of time. That's our immediate response. Then I think finally- we have a very strong brand position in stickers and this is not the strongest time of the year for stickers. We intend, as we get back to the end of school period and then back to school, which are really periods we've shown to be really strong in this area, that our brand will come through with those kinds of buyers.

Emma Clark:

I'd just like to add just one clarifying point, Grace, and then I'll answer directly your margin question. So, with the Amazon competition, it's not Amazon Merch, it's not Amazon themselves selling these bundles, it's actually individual sellers. So, they themselves, we don't know how permanent a feature they will be in the landscape. In terms of margin, you are correct in the sense that stickers are one of our higher margin products, so if they are a lower percentage, that will impact margin slightly. However, there are lots of things going on in margin and if you take the flipside of the coin, which is TeePublic's growth being more than expectations, TeePublic is higher margin as well. So, that's why, effectively, as I said earlier, margins are tracking to their normal seasonal variations with the current trends that we see in place. We don't see any substantial changes to margins because various factors are all offsetting themselves within that overall Group margin.

Grace Fulton: (Goldman Sachs, Analyst) Okay. Also, just to clarify for TeePublic with the stickers. When you acquired it, you disclosed it was 12% of sales. Was there much of a hit for TeePublic in that category?

Barry Newstead: Well, we haven't really raised it, so it's not a notable point, positive or negative. I think I did note that TeePublic's non-T-shirt products, in particular new products, are doing really well. But not notably under the TeePublic business overall is doing better than expectations, as you can see in the numbers that we disclosed.

Grace Fulton: (Goldman Sachs, Analyst) Okay, so turning to the apparel category. You sort of called out the impact of the work you're doing in terms of IP infringing content. Just wondering why that's seemed to have impacted more in this quarter as you've been disclosing work you've been doing on that for the last two to three quarters?

Barry Newstead: I think we're just highlighting that as an important issue. I think that we also highlighted the competitive environment and the emergence of some of these small players that are in some cases, may be infringing on really strong Redbubble and TeePublic content. So, I think that there are a number of factors at play here, including the fact that we do not feel that we've got the level of gain in our organic rankings that we would have like to have seen to this point. So, I wouldn't hone in on the one point, I think there were a few points that I raised in the speaking notes that I would point back to.

Grace Fulton: (Goldman Sachs, Analyst) Okay, so all this work you've been doing on the infringing content, I believe it has had to do with preparing the business to have the partnership programs for being in partner with those brands. At some point, will you be looking to do a similar program for TeePublic? Like, removing the infringing work?

Barry Newstead: We already removed infringing work from TeePublic as well. I briefly made the note that TeePublic grew up in a slightly different era. There's only six years difference, but it took a slightly different approach. But the early days of Redbubble were much earlier days in the ability to manage IP and so, when TeePublic was created, it was created with some of the lessons from the early years of Redbubble in mind. We don't see it as being the same kind of challenge. We do apply consistent IP processes across both businesses, but I think it's really a strategic decision we've made. Obviously, by necessity, of wanting to be a company that is really in a position where we can manage IP effectively and then we can build a content moat that is built not on questionable IP but on really high quality IP that we're in a position to defend - defend for folks on our platform - and defend for partners, and as I said earlier, defend off platform.

So, we made this strategic decision to build them this way, to invest in the technologies to manage this and we feel like it's unfortunately pain that we're taking, vis-a-vis, our short-term revenue growth, but it positions us extremely well for the world in which we are and are entering. As you said, I think it has helped us in our ability to start to build partnerships with rightsholders that, even though they're still small, they're growing in a really strong way. So, again, it's part of a strategic direction in which we're taking the business with a view towards 2025, 2030.

Grace Fulton: (Goldman Sachs, Analyst) Okay. I'll just ask one more question then I'll jump back into the queue. With the Redbubble revenue growth being 2%, can you give any indication of how your opex has trended during the quarter?

Emma Clark: No. So that would fall under the category of operational metrics I won't be releasing until the quarter's over - sorry, Grace. Obviously, if I go back to what I said at the start of the call, our operating expenditure remains under control, we remain quite disciplined, and we expect that to continue.

Operator: Thank you. Once again, if you wish to ask a question, please press Star One on your telephone and wait for your name to be announced. I will now give you a moment to register your questions. Your next question comes from Tim Piper from Royal Bank of Canada. Please go ahead.

Timothy Piper: (Royal Bank of Canada, Analyst) Morning, team, Tim Piper here. Just wanted to talk about the SEO strategies of TeePublic versus Redbubble platforms. So, obviously the TeePublic is performing very strongly, great SEO processes and strategies in place there. Can you just talk about maybe some of the learnings you can take from that platform across to Redbubble to potentially improve that?

Barry Newstead: Yes, there are some learnings we have been working through. There's no question that we've – look, as we've gone through 2019 – I'm already onto 2020 in my mind - what we've seen is that some of the things that the TeePublic team has implemented, because as we mentioned earlier in the year, they were a bit soft the first half of the year, have really worked extremely well, particularly as the year has gone on. So, we've taken lessons off by that, we've got a new SEO Advisor, who happens to have worked with TeePublic, who hadn't really been all that available to Redbubble earlier in the year. We've got a couple of new opportunities that we are very actively working to deploy, quickly.

So, again, with SEO, there are no guarantees, but we feel good about the potential to take the lessons from what Adam Schwartz has been able to do on TeePublic, and test in the Redbubble environment. So, I think that's the main element. I will say that, as I said earlier, I think some of the things that we worked through on

Redbubble in the last year have actually been quite successful under the covers, just not in the T-shirt business as of yet. So, as I said, we've had some gains in the T-shirt business in rank that hasn't flowed through to traffic, but actually there's been other products like posters in particular, where our rank has gone up significantly and it's helped the business grow. So, it hasn't been a complete failure through the year, it's just really about us continuing to stay focused on this area and take the new insights and deploy them.

Timothy Piper: (Royal Bank of Canada, Analyst) Sure. Just given that the life stage of TeePublic versus Redbubble and its size and the pace at which it's growing, does that SEO efficiency in processes over time become diluted, to some degree, as it grows bigger?

Barry Newstead: I think that would be speculation– clearly it becomes more complex, there's no question, and we are living proof of that in the Redbubble business. I think there's one of the things we've talked about since the beginning of this process is, we're learning a lot about what it looks like to be running a business with a lot of products and a lot of geographies with a huge amount of content. Our intent is to utilise that knowledge to ensure that TeePublic doesn't have to go through the same learning. So, indeed, it'll be more complex, I think we've now got a group where we can share learnings in a manner that our expectation is TeePublic does not have to go through the same road. Even some of the things that we talked about earlier with IP, some of the capabilities we're building, whether it be image recognition or personalisation, those are going to accrue to the TeePublic business at the appropriate moment.

Timothy Piper: (Royal Bank of Canada, Analyst) Great, thanks for that.

Barry Newstead: Thanks, Tim. Oh, and just worth noting, since you are from the Royal Bank of Canada, I didn't mention it, but Canada has been a stellar country for us, for Redbubble, this Christmas season, so I don't know whether it has to do with it being the home country of the CEO, or not, but certainly appreciate the support.

Timothy Piper: (Royal Bank of Canada, Analyst) Good to hear.

Barry Newstead: Thank you, all of you, for taking the time this morning to speak with us. I hope that we have provided some clarity and context around where we are and I hope we've shared with you the confidence we continue to have in this business and what we are really building towards. I also will just reiterate that I wish you all a very happy holidays and all the best for 2020. We are excited for what's coming. Thank you, and good morning and good afternoon.

End of Transcript