



Trading Update and FY23 Guidance Conference Call Transcript

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The transcript of the Trading Update and FY23 Guidance conference call on 18 January 2023 is attached.

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Authorised for release to the ASX by the Redbubble Limited Board Chair.

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Start of Transcript

Operator: Thank you for standing by and welcome to the Redbubble Limited conference call. All participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. If you wish to ask a question, you will need to press the star key followed by the number 1 on your telephone keypad.

I would now like to hand the conference over to Virginia Spring, Vice President, Investor Relations. Please go ahead.

Virginia Spring: Good morning to our Australian participants and good afternoon and evening for those joining us from the northern hemisphere. My name is Virginia Spring and I am responsible for investor relations at the Redbubble Group. With me today I have the Redbubble CEO Michael Ilczynski and Interim CFO Mark Hall. Michael will provide an overview shortly and we will then open up the lines for questions.

The key information for today's call is contained in the ASX announcement released to the market this morning. Please note that the preliminary financial results are from internal management reports and have not been subject to audit review. I would also like to call your attention to the safe harbour statement regarding forward-looking information in our ASX release. That safe harbour statement also applies to this investor call.

This session is being recorded and a transcript will be released to the ASX. I will now pass over to Michael.

Michael Ilczynski: Thank you, Virginia. Good morning or good afternoon to everyone. Thank you for taking the time to join us on short notice.

As Virginia mentioned, the Redbubble Group released an announcement to the market earlier today. We are now through the important holiday period and we felt it was necessary to provide an update on the Group's performance and outlook and our decision to reduce our cost base to accelerate our return to cash flow positive. We are still preparing our half-year results so this update is relatively short. We will provide a much more detailed overview in February with our full half-year release.

Starting with our financial performance. On a preliminary and unaudited basis, the Group delivered marketplace revenue of \$289.3 million for the half, which was in line with the prior corresponding period. Underlying marketplace revenue, which adjusts for delivery date revenue adjustments and market sales, for the half was \$290.4 million, up 2% versus PCP.

We were particularly pleased with Teepublic's performance during the half. This marketplace delivered double-digit revenue growth for the half and the second quarter was its largest quarter to date, surpassing even its previous high at the peak of the COVID-19 pandemic in late 2020. Across both Teepublic and Redbubble Marketplaces, apparel remained relatively resilient, up 11% in the first half for the Group. Overall, the Redbubble Marketplace did not perform as strongly as Teepublic and was negative year-on-year primarily due to weakness in some more discretionary categories like homewares and artworks, while on a regional basis the UK, which is Redbubble's second-largest market, was also significantly down on the PCP.

This holiday period, more so than in previous years, customers appeared to be particularly value-driven which drove strong promotional intensity to win the customer. The magnitude of the discounts offered by a range of other retailers were deeper than in previous years and the timing commenced much earlier. We responded by increasing our own promotional activities to attract customers and deliver revenue growth.

Pleasingly, our increased promotional activities drove revenue growth of 3% for the Group in the second quarter and 5% growth on an underlying basis. However, these promotional activities came at a cost with the Group's GPAPA margin decreasing to 17.9% for the half. This lower margin flowed through the P&L so while our operating costs were slightly below our expectations, operating EBITDA was negatively impacted by the lower GPAPA margin. Operating EBITDA for the half was negative \$18 million, down from positive \$10.5 million in the PCP.

Looking ahead, firstly, I want to make clear that we are not stepping away from our medium-term aspirations. We still see tremendous potential for the Group and expect that as we continue to improve the customer and artist experience on our marketplaces and as the consumer landscape improves, we will deliver significant sustainable growth. However, we expect macroeconomic conditions and therefore consumer demand to remain challenging in the near term. Accordingly, we have decided it is prudent to reduce our cost base. The Group is focused on improving its EBITDA margin and aiming to be sustainably cash flow positive by the end of calendar year 2023.

To be clear, this means we are aiming on a month-by-month basis to be cash flow positive in early calendar year 2024.

To support this, we're implementing three cost-reduction initiatives. First, we are suspending our investment in the Redbubble brand awareness project; second, we have decided to reduce the Redbubble Marketplace's workforce by approximately 20%. This represents 14% of the Group's total workforce. Thirdly, we are reducing our general expenditure to reflect our business priorities and scale. These initiatives are expected to reduce the Group's cost base by approximately \$20 million to \$25 million on an annualised basis. We will start to see the benefit of these initiatives during the second half of this financial year and we anticipate the full benefit will be realised from the beginning of FY24.

It is disappointing to not be able to continue with the level of investment we have been making and I am extremely sorry for the impact this will have on our people. We've worked hard to bring talented people into the Redbubble Marketplace over the past 18 months so the need to let some of them go today is extremely disappointing. However, as I have said over the past 12 months, our cost increases were investments made to improve and grow the Redbubble Marketplace and we said that if we were not able to generate a return then we would not persist with them. Given the performance in the first half and importantly, our expectations for the year ahead, we no longer believe that the current level of investment will generate an appropriate return in the near term and as such, we have done what we said we would and are reducing this investment.

Similarly, while the initial brand investment did generate increased awareness for Redbubble amongst the target audience, given the subdued consumer outlook we do not believe it is appropriate to continue with this program at this point in time. Our aim is to return the Group to a cash flow positive position on a sustainable and ongoing basis and the changes we are announcing today will help us with our aim of achieving this by the end of the calendar year '23.

Turning to our FY23 guidance. Given the Redbubble Marketplace's performance in the second quarter of financial year '23 as well as initial January trading, we now expect the Group's FY23 marketplace revenue to be broadly in line with FY22. We now expect our FY23 GPAPA margin to be higher than the first half of FY23 but below the full year FY22 GPAPA margin.

In August '22 we forecasted the Group's FY23 operating expenditure to be between \$135 million and \$145 million. We now expect FY23 operating expenditure to be between \$125 million and \$135 million. This does not include one-off costs of approximately \$2.1 million in the third quarter of this financial year related to the Group's cost reduction initiatives.

This wraps up my prepared remarks for today and thank you again for listening. I'll now be more than happy to take questions. However, as I stated earlier, we will provide a much more detailed overview of our performance and the cost reduction measures we are taking when we release our half-year results, so I may not be able to share all the details you would like today, particularly with regards to various operating metrics for the half that we will release in February.

Thank you, operator. We will now open for questions.

Operator: Thank you. If you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star 2. If you are on a speakerphone, please pick up the handset to ask your question. Your first question comes from Sophie Carran with Goldman Sachs. Please go ahead.

Sophie Carran: (Goldman Sachs, Analyst) Hi, Mike. Thanks for taking my questions. Just two from me, please, first on the GPAPA margin decline. Any colour that you can provide around how much of this was driven by the free shipping and the discounts versus what was investment in paid acquisition, and any commentary you can make around just that promotional intensity into January, and I guess the confidence you have in that GPAPA margin being above the first half on a full-year basis?

Michael Ilczynski: Yes. Thanks, Sophie. Appreciate the question. I won't give exact numbers; we will provide more detail in February but to give some colour, the primary drivers of the GPAPA margin reduction were (1) deeper discounts than we had provided previously, and secondly, the free shipping activities that we'd mentioned. It was less so an increase in paid acquisition. Paid acquisition was relatively in line with our expectations that we'd talked about previously, not substantially different environment to last year. The real change was above that at gross profit due to the combination of deeper discounts that were required to compete in the market and the free shipping combined.

In terms of our expecting moving forward, clearly the level of discounts that we provide and the free shipping, both the level and whether we offer it at all, are two things that are within our control and given that, we do have confidence that our GPAPA margin will improve in the second half from where it was in the first half.

Sophie Carran: (Goldman Sachs, Analyst) That's helpful. Thanks, Mike. Then just a second question if I can, just the change in thinking around the cost base and I guess your confidence in the revenue remaining flat this year as that cost base is cut. Then how do you think about then the medium-term revenue targets as you're pulling back on that incremental investment?

Michael Ilczynski: Thanks, Sophie. We remain confident that we still have the right level of capacity and capability within the Redbubble business to deliver on the initiatives that we have planned over the next six to 12 months. Obviously, our updated guidance reflects that. Yes, we've still got - obviously reduced capacity will impact us in the short term, but it doesn't impact our view of the opportunities for the business over the medium term, hence why there's no change to our medium-term aspirations.

Sophie Carran: (Goldman Sachs, Analyst) Great. Thanks, Mike.

Operator: Thank you. Your next question comes from Tim Piper with UBS. Please go ahead.

Tim Piper: (UBS, Analyst) Morning, Michael. Just a couple. Could I just clarify your comments around the cash flow there? In the release it says I think sustainably positive by end of calendar year '23. I think you then just said you're expecting that from the first couple of months of calendar year '24. Are we thinking about an exit run rate of the calendar year, i.e. the second quarter of the financial period of '24 being positive free cash flow?

Michael Ilczynski: Thanks, Tim, for the question. What we're trying to be really clear on is that when we're talking about cash flow positive we mean on a monthly basis, that the months will be clear. You will know from our numbers that November and December are positive cash months because they are large months, so they will naturally flow up in November and December. We would expect November and December to be cash flow positive and our real aim is then as we go into January, as we go into February, January is cash flow positive, February is cash flow positive, March is cash flow positive.

Tim Piper: (UBS, Analyst) Yes, I'm just trying to - because obviously your big cash outflows across January, February and half-on-half your working capital stream is in excess of \$30 million and a lot of the falls in those few months. If you're implying that the first few months of calendar year '24 are going to be cash flow positive, once you add back that working capital unwind, it implies that EBITDA will be very strongly positive in those early months of calendar year '24. Is that...

[Over speaking]

Michael Ilczynski: Yes, thanks for that. Thanks for the clarification. Obviously, adjusting for the big outflows that we have in January, so January is a big payment period. Thank you for clarifying that. Absolutely, we do have that big outflow from what comes in in November and December. So yes, we need to adjust for that. We're trying to be really clear that on a sustainable basis the GPAPA that we're earning, our contribution margin that we're earning each month needs to be more than our operating expenditure going out. We wanted to be really clear that our aim is to get that kind of month-to-month basis, obviously accounting for those large ins and outs and excluding those from the end of the calendar year. Thank you for that clarification.

Tim Piper: (UBS, Analyst) Okay, so basically talking about operating EBITDA?

Michael Ilczynski: Operating EBITDA is quite a close approximation for our cash, that's correct.

Tim Piper: (UBS, Analyst) Okay, got it. I just want to follow-up on maybe the previous question. Obviously, a lot of the OpEx investments flagged and you talked of that being largely revenue-generating. I'm just wondering with a 20% cut to the workforce, [you said] an immediate kind of impact to trading but do you not expect it to have a bit of an effect over the medium term in terms of the top line? I guess the follow-on to that is over the second quarter, revenue was better than expected but the economics of driving those sales are very, very weak. How do we get confidence that you can grow revenue at profitable economics over the next couple of years?

Michael Ilczynski: Tim, thanks for the question. That's correct. Our real focus is that we need to drive more contribution margin. That's both increasing our revenue and decreasing our costs above GPAPA, and that's what our teams are really focused on. Obviously, in going through this process and reducing our workforce, there's been a real, clear focusing-down on those initiatives in those areas that we think have the strongest potential to do that, not just in the next six months but over the next 12 to 18 months. We remain really confident in the growth opportunities that we have but we're also clear that we need to be focused and disciplined on those largest levers and we remain confident the people that we have can allow us to focus on those larger levers.

Tim Piper: (UBS, Analyst) Thanks. Sorry, that was a pretty broad question. I'm going to squeeze in one last one before I get back in the queue. Just again on the balance sheet, assuming normal seasonality and working capital and the rest, I'm just going to guess that maybe your cash is \$40 million to \$50 million by the time you get to June. You're still going to be heavily negative working capital on the balance sheet. How comfortable are you with that level of cash? Granted that the working capital cycle turns positive, particularly in the first half of the following period, but is \$40 million to \$50 million cash enough?

Michael Ilczynski: Tim, we don't forecast cash so I'm not going to comment on the accuracy of those numbers. What I will say is that obviously Board and management, we are really focused and we continually review the capital needs of the Group. As we've announced today, we're actively reducing our cost base and we do believe that will help us with our aim of returning to business, to cash flow positive by the end of the calendar year.

Tim Piper: (UBS, Analyst) Okay, got it. Sorry, just one more quickly. Just January trading, given the second quarter [beat] revenue and the full year has been trimmed, is it fair to assume that January has obviously stayed pretty tough in terms of the broader thematic out there?

Michael Ilczynski: Yes. That's where we tried to be clear that the revised guidance and also our actions, we have taken our trading since both January - but really for us it's when we close off our last order by dates a few days before Christmas. That trading has been subdued and that is absolutely factored into our forecast.

Tim Piper: (UBS, Analyst) Great, thanks. I'll jump back in the queue. Thanks for taking the questions.

Operator: Thank you. Your next question comes from [Ayan Norazi] with Barrenjoey. Please go ahead.

Ayan Norazi: (Barrenjoey, Analyst) Hi, guys, hope you're well. Just a few quick maintenance questions, please. Just the guidance on the costs of \$125 million to \$135 million for FY23, what FX rate does that [hinge] because I think previously guidance was based on constant currency which was A\$0.74. Can you please just clarify what currency is that based off?

Mark Hall: Yes, Ayan. It's Mark Hall here. We're assuming the current FX rates that are in the market now. That's our - what the basis of our outlook is.

Ayan Norazi: (Barrenjoey, Analyst) Okay, so that applies for both...

Mark Hall: The spot rate now, effectively. Spot rates at this point in time.

Ayan Norazi: (Barrenjoey, Analyst) So, both cost of doing business and revenue guidance for FY23 is based on spot rates of roughly \$0.70, whatever it is today?

Mark Hall: Correct.

Ayan Norazi: (Barrenjoey, Analyst) Fantastic. Then the guidance, when you're saying the \$20 million to \$25 million annualised reduction in FY24, if I take FY23 cost base of \$125 million to \$135 million, it's incorrect to take off \$20 million off that number because second half already assumes a bit of cost-out? Can you just give us an idea around cost benefit is already factored into that \$125 million to \$135 million, please?

Michael Ilczynski: Yes, sure. You're correct. We won't go into the specifics of exactly how much but the program of work that takes the cost out is rolling in through Q3, Q4. The reason we're giving you the annualised number is to give you a sense of what that will be once it kicks in full run rate. We're not - I can't give you a number around exactly how much of that crystallises this year, that's not where we're at today, but we did try and be very transparent around what that is on an annualised basis.

Ayan Norazi: (Barrenjoey, Analyst) Perfect. Then just on the marketing side, marketing as a percentage - performance of marketing as a percentage of sales is about 16% in the first quarter. Given your comments around it being pretty similar to last year in terms of intensity, usually there's a step-up in marketing as a percentage of sales. Is it fair to assume that the second quarter, that typical seasonality has played out so the market per sales is more than 16% of sales, is that fair?

Michael Ilczynski: Yes, that's correct. That is the normal seasonality. We usually - the second quarter, so the October to December quarter has the largest paid acquisition to revenue ratio for the financial year. That is the normal seasonality that we expect, and then obviously that comes off a bit in Q3/Q4.

Ayan Norazi: (Barrenjoey, Analyst) Perfect. Then the operating cash - the free cash - sorry, the cash positive guidance, is that based on the free cash flow? In other words, does that include you guys paying capitalised expenditure as well, capitalised OpEx, or is that just operating cash flow?

Mark Hall: Operating EBITDA is a reasonable proxy, as Mike said, but below the line there is some capitalised development that occurs and some other minor working capital adjustments. Our primary focus is on the operating EBITDA and with the overall objective of getting the free cash month to month. As Mike pointed out earlier, there's some big movements in working capital we need to normalise out but we're just trying to be transparent on effectively ongoing basis.

Ayan Norazi: (Barrenjoey, Analyst) Apologies, you cut off a bit there. Just to clarify, the cash comment is based on operating cash flow, not including the CapEx commitments, because CapEx is a pretty significant...

Mark Hall: Our objective is primarily on the operating EBITDA. That's a reasonable proxy for free cash flow. There is some capitalised development occurring below that line and some other minor working capital movements but primarily our focus is on the operating EBITDA that will get us to our overall objective.

Ayan Norazi: (Barrenjoey, Analyst) Perfect. Last one, just the brand awareness campaign that you've [shuttered] now, is that just the \$8 million to \$12 million of investment, now that goes to zero in FY24, is that correct?

Michael Ilczynski: Yes, that's correct. Yes.

Ayan Norazi: (Barrenjoey, Analyst) Perfect. Thanks, guys.

Operator: Thank you. Your next question comes from Wilson Wong with Jarden. Please go ahead.

Wilson Wong: (Jarden, Analyst) Hi, guys. I just want to get more clarity around the types of roles being cut, and then a 14% reduction at the Group level in the headcount, what does that equate to in terms of the percentage of the staff cost base?

Michael Ilczynski: Hi, Wilson. In terms of the types of roles, two things I think are important. Number 1, it's impacting the Redbubble Marketplace, not the Teepublic marketplace, not the Teepublic business. Those businesses do operate reasonably separately, hence the - the 20% number is from the Redbubble Marketplace and that represents 14% of Group. In terms of roles, it is across the organisation but it's focused on those areas where we don't believe that we can generate an appropriate return over the next 12 months. We're really focused on what roles do we need to deliver on what we need to deliver during this calendar year coming. It is across the business but it is concentrated in different teams. I think you had a second part of the question that I missed, Wilson.

Wilson Wong: (Jarden, Analyst) Yes, it's what does that represent in terms of the actual percentage of the total staff cost base?

Michael Ilczynski: The 14% and 20%, that's from a - it reflects the cost. Sorry, I should correct that. It's a headcount reduction; in terms of a dollar number, I can't give you that number exactly off the top of my head. It won't be too far off that though.

Wilson Wong: (Jarden, Analyst) Sure, okay. My last question is just around just given the extent of the cost reductions, any changes to the level of paid acquisition marketing investment you're planning for the next couple of years?

Michael Ilczynski: Thanks, Wilson. I think as we've talked about a few times, our paid acquisition in both of the businesses across both of the marketplaces, we have been and we continue to be focused on that first transaction profitable guideline of making sure that when we're acquiring new customers it's not on a negative cost basis. That philosophy will continue. Obviously, we've got to - it's critical that we make sure that what we're spending we spend profitably; that's been something that has served us well over time and it's something that we'll continue to focus on.

Wilson Wong: (Jarden, Analyst) Sure. Thanks, guys.

Operator: Thank you. Your next question comes from Owen Humphries with Canaccord. Please go ahead.

Owen Humphries: (Canaccord, Analyst) Morning, Mike and Mark. Thanks for taking the questions, tough decisions in a dynamic macro environment. Two quick ones. As we head into November, it sounds like the cash low point is going to be in November. Can you maybe provide - because obviously the share price is where it is not because of valuation because they're on the balance sheet. You've made that guidance statement that you'd be free cash flow positive from November. Can you just maybe provide some comfort around what is the cash low point for your business, given your expectation around your guidance?

Michael Ilczynski: Sorry, I don't quite understand the question. Would you maybe rephrase it a little bit?

Owen Humphries: (Canaccord, Analyst) What's the cash low point for the business up until November?

Michael Ilczynski: Sorry, Owen, you cut out a bit too. Was it low point or cash flow point?

Owen Humphries: (Canaccord, Analyst) The cash low point of the business at the time...

Michael Ilczynski: Oh right, got you. Thank you. As we've said, we don't forecast out or provide specific guidance on our exact cash position on a month-by-month basis. As I've said, we're very focused on that position and we're very focusing on returning the business to a cash flow positive position.

Owen Humphries: (Canaccord, Analyst) Okay. Then the second one is just given your guidance around that free cash flow positive by November/December and then into the first quarter of next calendar year, can you maybe just provide us comfort around what GPAPA margins you assume in that number?

Michael Ilczynski: Look, again, we've provided guidance on our GPAPA margin for the rest of this financial year. We haven't provided that level of detailed guidance out into FY24. That's something that we'll look at when appropriate into FY24. Clearly, we need to improve the economics of the business and the actions today are focused on reducing our OpEx and clearly the focus for the business internally now moves to how do we increase our contribution dollars. That's both how do we grow revenue but also how do we improve our gross profit and our GPAPA margin?

Owen Humphries: (Canaccord, Analyst) Okay, good one. I guess I'm assuming that if you go into FY24, the macro deteriorates further, that you're more fixated on the cash balance and there'll be obviously further cuts required to get the business to that point. Is that the hard-and-fast now for the business and the Board to get the free cash flow positive in FY24?

Michael Ilczynski: I'm not going to speculate on future actions, Owen. As we've said in the release, we're assuming subdued conditions continue. Our guidance does not assume a significant deterioration from here. If that happens obviously we'll adjust our plans as appropriate.

Owen Humphries: (Canaccord, Analyst) Thanks, good one. Thanks, guys.

Operator: Thank you. Your next question comes from Wei-Weng Chen with RBC Capital Markets. Please go ahead.

Wei-Weng Chen: (RBC Capital Markets, Analyst) Hi, guys. Just a couple of questions from me. Your guidance for flat NPR for the year, I'm just wondering what you've assumed with respect to promotional activity in that second half, and maybe how that might relate to the activity you saw in the first half.

Michael Ilczynski: Yes. Thanks, Wei-Weng. I'll only speak at a high level. At a high level we don't expect our overall promotional level to be as intense as what we've seen - as what we have particularly in the second quarter, and that will contribute in an increase in GPAPA margin over the half. We won't go further, because these are obviously levers that are in our control and there's also an element of competitive information in exactly what we're doing when. That second quarter, we don't expect to see the same level of combined activities that we had moving forward.

Wei-Weng Chen: (RBC Capital Markets, Analyst) Yes, okay. I guess push comes to shove, how would you look at it [comparing] - Would you sacrifice margins for growth or would you sacrifice growth but maintain your absolute GPAPA levels?

Michael Ilczynski: I think that what we're particularly focused on is that GPAPA, absolute GPAPA dollars, that's the number - that's obviously the contribution level that pays for our OpEx. They are the dollars that we need to increase as a business. That's what the team is focused on. Obviously, the two ways of doing that is either more revenue or better gross profit margin, and both of those areas are what we're focused on. That's the - the key question we keep - we will be asking ourselves is will it increase GPAPA dollars or not.

Wei-Weng Chen: (RBC Capital Markets, Analyst) Yes. No, that's perfect. Then just geographically I guess, were there regions that maybe out or underperformed in that first half? Were job cuts focused on those regions that underperformed?

Michael Ilczynski: Thanks, Wei-Weng. We will provide a much more detailed breakdown in February. At a high level, we did see a difference in regions. As I mentioned, particularly the UK for the Group and for the Redbubble business was particularly weak and particularly in the second quarter there was weakness there, plus the Royal Mail strike during December did not help things as well, but it was weak before that.

In terms of our job cuts, the business operates globally. We've got our three offices within the Redbubble Marketplace, the three offices in Melbourne, San Francisco, and Berlin. The changes from here are not reflective of the performance in the regions, they're more reflective of the roles that we're focused on moving forward.

Wei-Weng Chen: (RBC Capital Markets, Analyst) Yes. Thanks. That's all from me, thank you.

Operator: Thank you. That's all the time we have for our question-and-answer session. I'll now hand back to Michael for some closing remarks.

Michael Ilczynski: Thank you again for joining us on short notice, appreciate the questions and look forward to talking to more of you both follow-up to today and then when we release our full half-year results in mid-February. Thanks again.

Operator: That does conclude our conference for today. Thank you for participating. You may now disconnect.

End of Transcript