

THANKSGIVING SALES RESULTS AND INVESTOR UPDATE - TRANSCRIPT OF CONFERENCE CALL

28 November 2018

Start of Transcript

Paul Gordon: Hello, this is Paul Gordon, Company Secretary for Redbubble. Welcome to this teleconference following our earlier announcement of sales results for the Thanksgiving weekend including Black Friday and Cyber Monday. With me I have Redbubble's CEO, Barry Newstead and CFO, Chris Nunn. Barry will provide some commentary on our ASX release before we open up for questions. Please note that this conference call is being recorded. I would also like to call to your attention the safe harbour statement regarding forward-looking information in our ASX release. That safe harbour statement also applies to this call and Q&A. Over to you, Barry.

Barry Newstead: Good morning and welcome to Redbubble's investor conference call. I will make a few remarks and then we will open up for questions. Today we are providing an update to the market on Thanksgiving performance as we have done in prior years. The key information is in the ASX release we sent out earlier. My main focus will be on the Redbubble marketplace. The TeePublic business continues to perform strongly. In particular, I want to provide an update on the progress of the organic search sales issue related to the Google algorithm change that we shared in our 4C quarterly market release on 22 October.

Let me start by saying that Thanksgiving has seen an improvement in the business performance, providing a preliminary indication that Redbubble's efforts to address the Google algorithm issue and return to prior growth rates may be taking hold. Thursday and Friday were weak year-on-year due to one-off promotion factors, but Saturday through Cyber Monday Redbubble saw a return to stronger underlying growth with daily product and shipping revenue growth of 30%, 23% and 30% respectively on a constant currency basis.

From the beginning of October through Friday, 23 November, the business saw a slower than previous product and shipping revenue growth of 18%. This was due to a drop in organic visits and corresponding sales from Google organic search. It is clear that the cause of the drop was a Google algorithm change on 3 October, with the impact starting on 4 October. Looking back, the impact of the top line sales was due to the visit shift on that one day and visits have largely followed prior year seasonal patterns since.

As noted previously, the Redbubble team identified the drop quickly, analysing and prioritising actions to address the issue, despite having no reliable information about the specific reasons that might have contributed to the drop. It is important to note that this was not a targeted action against Redbubble, but a broader change by Google that would have affected a lot of websites. Over the years, Redbubble has experienced changes like this and we use our prior experience to quickly take action. In addition to the internal team, three external advisors provided recommendations.

The changes we implemented focused on five areas. Technical search engine optimisation changes that help Google's computers index Redbubble effectively. Secondly, user experience improvements that help users more easily navigate the site that's sending targeted signals to Google about the quality of Redbubble. Third, we



focused on removal of external links and/or user-generated content that might have sent negative signals to Google about Redbubble's reputation. Fourth, we took action to improve mobile site speed, an area we have focused on previously, but where additional opportunities were prioritised. Finally, we took some precaution action to roll back select releases from September.

In total, the team deployed over 30 changes, most of which were quickly but carefully deployed in October, with an aim of having Google re-index the site in time for Thanksgiving. Work continued through Thanksgiving to enhance the site. It was important for us to act quickly as the timing of the response from Google was uncertain. If there was and is an opportunity to protect most of the Q2 sales, as 63% of the quarter's sales last year were from Thanksgiving weekends onwards, it is worth underscoring, 63% of our Q2 sales start or were post-Thanksgiving and we believe that will be the same case this year.

It would have been ideal for improvements to have come through earlier, but it is a positive sign that organic search sales have improved markedly since Saturday and have helped boost revenue growth to levels we saw in early September. We would like to see further continuation of this trend and remain focused on delivering further improvements. That said, we are happy with the result we saw on Cyber Monday, one of the most important competitive shopping days globally. It was a record day from Redbubble, with 30% year-on-year constant currency growth at the revenue level. We saw a clear demonstration of the strength of the Redbubble customer value proposition, with over 925,000 items purchased on the day.

I'll also note that we are pleased with the performance of the iOS app which performed well over the weekend, as well as repeat customer sales growth which was strong and mobile continues to take share, with mobile conversion improving. Importantly, TeePublic is now a part of the Redbubble Group and their November and December results will form part of Redbubble's first half earnings. TeePublic continued their strong growth with 42% year-on-year revenue growth over the Thanksgiving weekend. This partnership is off to a good start.

Giving the recency of the early signs of a return to prior growth, we want to remain cautious about guidance. Due to the uncertainty regarding the timing of the recovery of the Redbubble marketplace organic search sales growth, there are some downside risks to the previous revenue growth and operating EBITDA guidance. We will update the market at the time of the Appendix 4C release in January 2019.

Before opening to questions, I'd like to cover two additional points briefly. Firstly, there have been media reports about legislation to expand site blocking laws that reference Redbubble amongst other sites as a member of DIGI, an industry alliance. While we would not ordinarily feel the need to comment, we have received legal advice that the proposed law would not affect Redbubble and that the explanatory memorandum to the legislation makes it clear that only websites that are, quote: deliberately and flagrantly infringing copyright will be captured. Redbubble most certainly does not come within those categories.

Second, I would like to emphasise that Redbubble remains focused on our vision on achieving market-leading scale that will provide customers, artists and partners with an unparalleled value proposition via our marketplaces. This scale will enable Redbubble to disrupt large segments of retail commerce over many years to come.



With that, I would like to open up to questions.

Operator: Ladies and gentlemen, we will now begin the question and answer session. To ask a question today, please press star/one on your telephone and wait for your name to be announced. If you wish to cancel your request at any time, please press the pound or hash key. Just a reminder ladies and gentlemen, if you do wish to ask a question today, please press star/one. Your first question today comes from the line of Charles Frumberg from Emancipation Capital. Please go ahead.

Charles Frumberg: (Emancipation Capital, Analyst) Hi guys. I'm not quite sure how to phrase this, so bear with me, but looking forward, excluding what just happened because of the noise, with Google, the last couple of days, if you will, with respect to guidance, is that the only anomaly that you would expect and therefore that's why you're cautious, because you're not sure you could make up what you lost, or is there something more than that?

Barry Newstead: Thanks Charlie. So the reason for caution is that if we are able to continue the performance we've seen in the last few days and as we surmise, as we see it, organic search sales have improved significantly back to the kind of levels we were seeing before, we would expect that our guidance would be solid in that regard, in that we've still got a lot of the financial year to go and as I said, we've still got a lot of even this quarter to go. So I think the caution is we don't want to be both overstating the effect of the algorithm, which is still on the ground, given there's a reasonable limited time period. We also don't want to be overstating the effect of three days of return. So hope that gives some clarity of why the caution. We don't want to be cautiously optimistic and we don't want to be cautiously pessimistic.

Charles Frumberg: (Emancipation Capital, Analyst) I mean what's gone is gone, right?

Barry Newstead: Correct.

Charles Frumberg: (Emancipation Capital, Analyst) I mean if you lost a sale that was a one and done or a cumulative number of one and done, you're not going to get those back and I think everybody gets that. But as you look at your business and the rhythm of the business and it's hard to sort of get micro focused on a day or a week, but is there any reason to believe that the normal cadence and the growth and the outlook should change, even as you look out into calendar 2019?

Barry Newstead: Look I think we think the fundamentals of Redbubble remain strong and we think that the specific issue which I talked obviously, we focused on the Google algorithm, is a temporary issue that we will recover from as we look over time. So I think that's as clear as I can be on it. It was the single issue that was holding the business back. We hope that it's starting to significantly correct itself. With that corrected, we got a lot of strength through the marketplace. I think it's actually really worth noting the improvements in membership, which I think is an important strategic priority, that we have going forward to further accelerate the success of the marketplace.



Charles Frumberg: (Emancipation Capital, Analyst) I mean all I'm suggesting to you is that it was an unfortunate event and you got sort of punched in the face, but you shouldn't have to flinch as if you're an abused child here every time you're asked the question. If the business sounds like it's okay, then say that, particularly based on the last couple of - since post-Saturday's results.

Barry Newstead: Yeah, I hope that that's what I'm been trying to convey. Yeah, even if we have been punched in the face, we're still very much in the fight for many, many rounds to come.

Charles Frumberg: (Emancipation Capital, Analyst) Yeah, you're saying it more clearly than the press release would indicate, that's all I really wanted to mention.

Barry Newstead: Fair enough. Well I'm glad I had the opportunity to clarify.

Charles Frumberg: (Emancipation Capital, Analyst) Thanks a lot.

Operator: Your next question comes from the line of Grace Fulton from Goldman Sachs. Please go ahead.

Grace Fulton: (Goldman Sachs, Analyst) Hi guys, thanks for taking my question. I was just hoping that you could provide a couple of comments about how you approached your paid acquisition costs during the period where you had some softer organic growth and also just how paid acquisition expense, as a percentage of product and shipping revenue is looking year to date.

Barry Newstead: Okay, I'll cover the first part, I'm not sure we have the data available on the second part. I think on the first part, I would say that through this period we've saved disciplined period. So we've retained the efficiency targets for paid marketing through the quarter, in fact I think we probably tightened a lot of it from the end of the first quarter, as noted in the first quarter releases that it softened a little bit. So we stayed really focused on that. We continued to be focused on the gross profit after paid acquisition that we get from those channels and that's what we stuck to through this period. So there is no notable change there and we're far from trying to pump up growth.

Chris Nunn: We're not buying growth.

Barry Newstead: We're not buying growth recklessly at all.

Chris Nunn: Or through promotions.



Barry Newstead: Yeah. I guess we'll hold on the proportions. Clearly for that period of time, when you have slower relative growth, that would flow through for the per cent of total sales.

Chris Nunn: When that slower growth is inorganic of free channel, that flows through to the percentage, absolutely, of paid as a percentage of revenue.

Grace Fulton: (Goldman Sachs, Analyst) All right, thank you. Just one last question, just to clarify, was TeePublic impacted at all by the algorithm changes?

Barry Newstead: They had a bit of slowing, although their overall growth on organic continues to be strong, they did see the effect to an extent.

Grace Fulton: (Goldman Sachs, Analyst) Okay, thank you.

Barry Newstead: A lot of sites did, just to be really clear. I think this is very broad-based algorithm changes. So it would probably be more the exception than the rule, if you were talking e-commerce site or somebody who relies on Google, be the exception that they would say that they didn't feel some effects. Some would have felt positive, some would have felt negative.

Operator: Your next question comes from the line of Owen Humphries from Canaccord, please go ahead.

Owen Humphries: (Canaccord, Analyst) Hey, guys. Has there been an instance in the past where the business has been impacted like this from an algorithm change? Secondly, more of a question where, given you guys have, or have stated you have, the largest number of artists, content, SKUs, products and, thus, more relevance in terms of your content to Google, any reason why you guys were specifically hurt? Does it change - expand your moat over time? Was the loss to your business made up for by gain in someone else? Or was it just lost in translation through an algorithm if they were searching for a keyword on Google?

Barry Newstead: Okay, so I'm just going to capture your questions. So these issues have come up periodically over time. The Google algorithm changes on a regular basis and we've been - probably, over Redbubble's history, a net beneficiary of changes to the Google algorithm over time. So there's periods where we've got gains, there's periods where we've had some setbacks. The net effect has been that, in general, we've got significant gains. I think it's really important to say that, in the grander scheme of things, our relationship with Google has accrued significant benefits over time and we expect that to continue to be the case, which I think I'll get to in a minute with your second point. So, yes, we've had past issues. We've had issues where the effect was pretty short-lived and we've had issues where the effect was a little bit longer and took a little bit of time to get a response. But we've also had times, like including really the same time last year, where we had real take-offs on the back of it. So I think that's the state of play and that's the state of play with our business. Obviously, over time, we're looking to have other sources continue to grow so that becomes a more muted effect. Actually, recalling

earlier days, it would have been a much more significant effect because we wouldn't have had other channels to rely on.

In terms of the artist content relevance, I think the big picture on this as well is we absolutely believe and have seen through time, and I think even this last few days are proof of it, that we have amazing content on Redbubble. That as things shake themselves out over time, that content will continue to be the win for Redbubble and that will continue to be the win for us in Google organic search, and Google paid search, in direct traffic and in other sources. So I continue to think that is fundamental to our success. My expectations, when we look back over time, it's likely that the things that have gone on in a short time will probably accrue as benefits to us, even though it might not feel like that right now.

In terms of our loss versus other's gain, well, I can say reasonably clearly that the number of people out searching isn't changing dramatically. So when they make an algorithm change, there are definitely beneficiaries. I would say that the beneficiary may be another company who we compete with, but it may also be Google. Let's just be really clear that when they make changes, they may make changes that actually push people, for example, to click on more Google ads or get into channels that are beneficial to Google. Obviously, we have no conclusive data about any of that, other than to say that Google seems to have shown the ability to continue to generate significant click growth in their paid area. So there's three parties at the table. There's often the other sites that are competing for search ranking and clicks, and Google is looking to turn as much of that into sales as possible. That's nothing new, but I think it's worth noting in an answer to that question.

Owen Humphries: (Canaccord, Analyst) Given the algorithm change, have you seen that shift to paid more prevalent, have the unit economics got better on paid mainly because of that change?

Barry Newstead: No, we haven't really seen it flow through in a big way. I mean I think that the paid business, as we just said earlier, has had solid growth. But we haven't sort of seen that direct follow on. But I just think it's important that that's part of a conversation about when Google's making changes, that the effects may affect Google's advertising business as well.

Owen Humphries: (Canaccord, Analyst) Okay, thanks.

Operator: Your next question comes from the line of Oliver Richner from Osmium Partners, please go ahead.

John Lewis: (Osmium Partners, Analyst) Hey, Barry, it's John. Thanks for the call today. I guess a couple of quick ones on the overall health of the marketplace in terms of growth opportunities. Without tipping your hand, how many new products do you see being released in 2019?

Barry Newstead: Without tipping my hand? Look, I think, as we said previously, we've spent some time, end of last year through to this year, on scaling up our ability to launch products. We're going to be, I think in the first half of next year, very much back in the business of launching new products in the marketplace. So prior years we



were doing in the order of 10 to 15 products a year. I'd like us to be in that general vicinity next year, if not a little bit better than that.

John Lewis: (Osmium Partners, Analyst) So for this year did you launch - for 2018, the calendar year, was there like two or three new products released?

Barry Newstead: Yes, I just want to - I mean the main product releases were really what you consider just kind of keep-up releases. So we obviously launched the new iPhones, for example. Those were the main releases this year. So, as I said earlier, I think we've been really quite quiet on the new product front, but we do not intend to remain quiet on that front.

John Lewis: (Osmium Partners, Analyst) Can you also give some colour - you had the new Cartoon Network licencing, and where you see that potentially going with other agreements in the licencing realm.

Barry Newstead: Yes, absolutely, we will plan more to talk about that in January. So we have announced, reasonably quietly I guess, a partnership with Cartoon Network and we now have officially licensed fan art around *Rick and Morty*, which is one of their top properties. In fact, I think it's their top property. For those who don't know, *Rick and Morty* is a television show on Cartoon Network, and a very popular one at that. So we've launched with them. We've seen some reasonably good early signs. I think it's still very early to do. We're launching additional properties within their portfolio as we speak. Then I think all I can really say, at this stage, is that we think that that's the beginning of - we continue to be in really fruitful conversations with other parties of a similar scale and importance in the licencing industry to Cartoon Network.

I think we see that really as a - we believe in it and we see it as a real colourful opportunity for growth. There's an incredible confluence between what customers are looking for, the content that these brands have, and the creative capabilities of artists, and then, fundamentally, the Redbubble platform which allows all this to come together in a manner that has the potential to generate real value. So we feel like the size of that around the Cartoon Network partnership is good. It's great to have a big partnership in place and to be learning as we go with that organisation, and it's great to see the momentum that that's generating in terms of business development.

John Lewis: (Osmium Partners, Analyst) The last question I had for you was, in terms of the artist dashboard, I know you put a number of - and process and have a couple of enhancements. But can you talk about what you hope to accomplish with some of the tools you're putting in on your artist dashboard?

Barry Newstead: Yes. So the artist dashboard work is - the core intent of that is to help artists sell more, at the simplest level. So what we're trying to do with the artist marketplace is give them insights into, for example, most importantly, what's selling of the work that they've already done. What are the themes around that work and what are the products around that work. So they just generate insights into the kind of areas that they could be creating new content for. So that's the current focus. Over time, we like that the evolve towards actually giving them insights into what areas of demand there is within Redbubble where there isn't sufficient supply. So that they have



the ability to actually fill markets that are already there that are not well supplied. So the real core there is about helping them sell more, and using the data and the insights from the marketplace to help them create better content, get their content on the best products. Ultimately, do things like price and market their products in a way that'll help them sell and obviously help the marketplace continue to drive.

John Lewis: (Osmium Partners, Analyst) Okay, thanks.

Operator: Your next question comes from the line Charles Frumberg from Emancipation Capital, please go ahead.

Charles Frumberg: (Emancipation Capital, Analyst) Just a quick follow up and a point of clarification. If I heard it right, your Cyber Monday business is up 30%, correct?

Barry Newstead: Yes.

Charles Frumberg: (Emancipation Capital, Analyst) How tough was that comparison?

Barry Newstead: How tough was that comparison?

Charles Frumberg: (Emancipation Capital, Analyst) How much was that previous year?

Barry Newstead: For the prior year it was up 41. We had a big day the prior year. So it was a tough day to do the numbers.

Charles Frumberg: (Emancipation Capital, Analyst) So you're up 30% against a very difficult comparison?

Barry Newstead: Yes.

Charles Frumberg: (Emancipation Capital, Analyst) Yes, okay. Thank you.

Operator: Just another reminder, ladies and gentlemen, if you wish to ask a question today please press star one, thank you. Your next question comes from the line of Tony Hansen from EGP Capital, please go ahead.

Tony Hansen: (EGP Capital, Analyst) Hello, Barry. I had a - earlier questions were already answered around where the traffic that you guys missed out on went. It sounds like Google might have captured some of that. So I



thought I'd ask about the 20.3% year-on-year, is that just the sum of Redbubble's Thanksgiving Day sales plus TeePublic's Thanksgiving Day sales from 2018 over the equivalent 2017 sales, is that right?

Barry Newstead: Yes, that's correct.

Tony Hansen: (EGP Capital, Analyst) Okay.

Barry Newstead: Just the Thanksgiving weekend, Tony.

Tony Hansen: (EGP Capital, Analyst) Yes, okay. So I guess my follow up to that would be, how did TeePublic manage to avoid the damage from the algorithm change? Are they capturing traffic in a different way? Is there anything you can learn from those guys in terms of that?

Barry Newstead: I think there are things we can learn from them. I think, first of all, just to be clear, whilst they're a great business, they're a much smaller target. They're a much smaller business than we are. So we have a lot more content, a lot more long-tail content relatively, by a significant margin. So I think the effects are not quite the same because of scale. That said, there are definitely things that we - we talked about this at the acquisition. There's definitely things that we are and will learn from them, and vice versa. I'll say that we picked up a couple of things that they were doing previously that we implemented as part of our changes. Including just small but notable - they use a countdown clock for their promotions they had a view that that was a real success. So we put the countdown clock on Redbubble's promotions on the weekend. It's hard to completely validate the whole effect, but we saw the end of the days have a little bit more juice behind them. So really great opportunities to learn. Some differences around scale that we have to work through. There are some things they do on the search engine optimisation front which are probably viable for us. There's other things that they do which really aren't viable at our scale, where they're still doing some manual work that's beneficial. They also are narrower - their focus of their business is still quite a bit narrower in terms of product breadth.

Tony Hansen: (EGP Capital, Analyst) Okay, and would you say that the 42.2% growth that TeePublic experienced was sort of in line with what they were hoping for? Or were they adversely affected at all by this change? Were they hoping for better?

Barry Newstead: In general, the performance of TeePublic in November as a whole, including on the weekend, is better than they forecast.

Tony Hansen: (EGP Capital, Analyst) Okay, thanks.

Barry Newstead: Because also they had some tough comparison days as well from prior years. So they are happy and we're happy with how it's going.



Tony Hansen: (EGP Capital, Analyst) Okay.

Operator: Just another reminder, ladies and gentlemen, if you wish to ask a question please press star one, thank you. There are no further questions at this time. I would like to turn today's call back over to the presenters, please continue.

Barry Newstead: Great, well, I appreciate you all joining us on relatively short notice for this call and thank you for the questions. We're obviously continuing to be focused on delivering and building a great marketplace that'll be around for many years to come, and great value for all of our stakeholders. So appreciate your engagement and we look forward to updating you at our Appendix 4c release in January. Happy holidays, everyone.

Operator: Ladies and gentlemen that does conclude our conference call for today. Thank you for participating. You may all disconnect.

End of Transcript