## 1HFY23 Results Conference Call Transcript

**Melbourne, Australia; 16 February 2023:** Redbubble Limited (ASX: RBL)

The transcript of the 1HFY23 Results conference call on 15 February 2023 is attached.

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**Authorised for release to the ASX by the Redbubble Limited Company Secretary.**

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**Title:** Redbubble 1HFY23 Results
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**Start of Transcript**

Operator: Thank you for standing by and welcome to the Redbubble 1HFY23 Results 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 one 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 Group 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 Announcements and Investor Presentation released to the market this morning.

I would 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. The 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, and welcome to everyone joining us. I'd like to start with an overview of our results. In January, we released our preliminary unaudited results. These have not changed. The Group delivered marketplace revenue of $289.3 million for the half which was in line with the prior corresponding period. We saw marketplace revenue accelerate over the half and particularly in the second quarter, with the second quarter 3% higher than the same quarter last year. This growth was driven by Teepublic which had its largest quarter to date, surpassing its previous high at the peak of the COVID-19 pandemic in late 2020.

We also saw continued strong demand for our largest product category, apparel, across both marketplaces. As we highlighted in January, customers appeared to be particularly value driven during the half which drove strong promotional intensity throughout the holiday season. In this environment, we adjusted our promotional activities to attract customers and deliver revenue growth. This included lifting our number of promotional days and experimenting with a number of new promotional offers. These initiatives enabled us to compete, to win the customer and help deliver revenue growth.

However, when combined, the impact to our margins of some of these initiatives was not commensurate with the total uplift generated, and as such, we are refining the use of these initiatives to better manage our margins going forward to ensure we are maximising our GPAPA dollars or our contribution dollars.

In January, we announced that we had begun to implement a cost reduction program to reduce our operating expenditure. This was primarily in response to what we saw ahead for the Group. We expect the consumer landscape to be challenging in calendar year '23 and we want to ensure our business has an appropriate cost position for this environment.

We have also refined our near term priorities to focus on what will have maximal impact on the key elements of our flywheel – content, customers and margin – in order to accelerate our return to cash flow positive, which we are aiming to achieve by the end of the calendar year.

Moving to slide 4. I wanted to start this section by touching on the macro tailwinds which we've discussed before and have contributed to the Group's growth. We believe that these trends will continue to benefit our business over the long-term and that the potential of the Group remains enormous. Over the past decade, we have seen a steady increase in the penetration of online shopping which was accelerated by the COVID-19 pandemic, with many individuals trying online shopping for the first time.

I, like many others, expected to see a plateau in online demand following this acceleration. Instead, in many categories we have seen a pull-back, and that impacted our ability to generate enough of a return from the investments we've made over the past two years. However, buying goods online has become a more accepted practice among a much broader cohort of society and we expect eCommerce penetration will normalise at a higher level than before the pandemic in the near future.

The Group is also a beneficiary of evolving consumer preferences. Today's customers are often looking for products which express their individuality, personality and passions. Rather than wanting mass-produced products, they are seeking out items which mean something to them. Across our marketplaces, individuals can choose from tens of millions of designs on more than 100 products to create something truly unique that expresses who they are.

Customers are also increasingly aware of the impact of their decisions on the planet and are wanting to make environmentally responsible choices. Since its inception, Redbubble has sought to deliver social good and maintain a small environmental footprint. Print-on-demand manufacturing has a relatively low environmental impact by limiting inputs and reducing waste and therefore is strongly aligned with the Gen Z and Gen Y purchasing preferences.

Moving to slide 5. The Group has benefited from these tailwinds since its inception 16 years ago. From humble beginnings in Melbourne, Australia, the Group has now grown to be a truly global business. This half, the Group shipped 5.8 million orders to customers in almost every country of the world. In 2018, we acquired Teepublic which really transformed the Group. The marketplaces are similar in their offerings but have some notable differences which has been a positive for the Group.

Teepublic's target consumer market is a bit different to Redbubble, primarily Gen Y who are 26 to 40 and their revenue is much more concentrated around apparel sales to US consumers. Redbubble's target market is Gen Z households, so 12 to 25 year olds and their parents. Revenue is spread across a range of products, including apparel, homewares and accessories and more than 50% of the Redbubble marketplace's revenue is generated outside the US.

Having the two marketplaces has proved beneficial for the Group in recent years in a changing consumer landscape as each marketplace has had a period where it has outperformed the other. During the COVID-19 pandemic, there was strong demand for homewares which benefited Redbubble. More recently, we've seen demand for apparel in the US remain strong, benefiting Teepublic. Their relative performance provides valuable insights for the Group and increasingly we're implementing successful initiatives from one marketplace on to the other.

On slide 6, both marketplaces operate as a flywheel where improving one element creates a positive impact on another. The content that artists sell attracts customers and as customers purchase, that enables the fulfilment network to scale, lowering costs and attracting additional customers. This increase in customers creates more artist revenue, encouraging new artists to the platform, they add more content and thus more customers and the cycle continues.

For many years, we've spoken about the benefit of the flywheel. We continue to believe that ensuring the flywheel is operating efficiently will enable us to deliver long-term growth. We have narrowed our focus for this calendar year on the areas we believe will have the most impact and generate a significant return in the short-term, so across content, customers and margin. More specifically, we are focused on (1) ensuring additive content is uploaded to the marketplaces and customers can find the very thing, (2) increasing the number of new customers and turning existing customers into repeat purchasers and (3) driving margin improvement to maximise gross profit after paid acquisition dollar generation, so that is our profit after COGS and paid marketing.

On slide 7, Teepublic's success since we acquired this marketplace in 2018 reinforces our conviction in the potential for the Group. As you can see on the slide, Teepublic has grown significantly over the last five years with a marketplace revenue compound annual growth rate of 39%. This half, it continued on its impressive top-line trajectory achieving double-digit marketplace revenue growth. In the current environment, there were not many other US eCommerce businesses that delivered that sort of growth and we're excited about what lies ahead for Teepublic.

As I mentioned, Teepublic's business is very concentrated. It is primarily t-shirts in the US. We see a huge opportunity for the business to grow its market share in other apparel categories and to other markets such as Canada and Australia. The Teepublic team have a strong focus on increasing customer attention through improvements to the on-site experience and the use of more targeted marketing campaigns. Further optimising search and discovery on-site and off-site will also drive growth.

Slide 8. Ensuring customers are able to find the content that appeals to them is vital for the flywheel to effectively operate. This is an area where Teepublic is currently outperforming the Redbubble marketplace with higher search to sale conversion. So we've been focused on the differences between the content experience on the marketplaces in order to improve each business and Redbubble in particular. Historically, we have spoken about how Redbubble's growing content library was a key competitive element for the marketplace.

A core advantage of the content library is having something that can appeal to the most niche tastes and historically we've seen a strong, positive correlation between more content and revenue growth. However, around 18 months ago this relationship started to break down as we had a surge in the volume of new content uploaded to the Redbubble marketplace. Unfortunately, a lot of this content was non-additive, it wasn't particularly unique or creative. Given the volume and the way it was described by the artists, it impacted the perceived quality of search results and the overall customer experience.

Often page 2 had better search results than page 1, which is not ideal for a search driven experience. As a result, we have seen a drop in on-site conversions as potential customers, people who have never visited the site before, decreased in their engagement and add to cart rates. This problem was initially marked by the surge in demand during the pandemic as well as by other improvements we'd made that nullified our ability to see this impact for some of this time.

During the same period, as you can see on the slide, uploads to Teepublic's content library have stayed relatively stable, thanks to differences in artist acquisition and review processes, and as we just discussed, their business has continued to grow. To address this issue on Redbubble, we have taken a number of actions. We've added much more friction when artists are uploading content to the Redbubble marketplace to promote the uploading of additive content only.

We've also introduced new technology as well as changed processes within our Group artist team. That team is built out of Teepublic's artist acquisition team and is now taking a lead role in artist acquisition across both marketplaces. Overall, this approach is working. From October '22 to January this year, we've seen a 35% drop in new content being added to the Redbubble marketplace while upload in sales from more established artists on Redbubble has increased.

On slide 9, further on content, while we're pleased with the improvement in reducing non-additive uploads, we are most excited about the opportunity to step-change our understanding of artists' content through the use of AI. This will enable improvement in search and discovery across both marketplaces, both on- and off-site and solve a core longstanding challenge of how to build an objective, accurate understanding of each piece of content available in the marketplace so we can place the right design in front of the right consumer every time.

To explain this further and why this is so important on the Redbubble marketplace, our search functionality is reliant on data provided by the artist – the title, the description and the tags. This means that up until now, understanding of each piece of content has been dependent on the data the artist provides. Unfortunately, this data is not always accurate, sometimes accidentally and sometimes deliberately. This can mean that irrelevant designs appear when a potential customer searches.

As there are currently millions of designs on the marketplace, solving this problem at scale has been an ongoing challenge for Redbubble. It is just not possible to human review more than 60 million different individual designs and every piece of information an artist has provided about each one of them. However, the advances in AI in the last 12 months hold the key to addressing this issue, where we will be able to remove our sole reliance on artist-supplied information as we can use AI to objectively enrich the data on every piece of content.

AI has provided accurate text information for content on the site. This will significantly increase the relevancy of search results. AI can also provide an alternate search engine in terms of surfacing relevant images for a given search and it can detect highly similar content that evades our current duplicate detection. The image on the right of this slide is Redbubble's search results generated using AI. If you do the same search of spring and sunset on Redbubble, the results are noticeably less relevant.

There are other potential benefits of this technology which will ultimately also help us to surface relevant content to customers. We are really excited about the potential of this technology, and saying it could revolutionise search and discovery on the Redbubble marketplace is not an overstatement, and this is not a pipedream. We have already tested this on several thousand designs and we have just recently produced AI generated data or tags across the entire Redbubble content library. Now it is all about testing and learning and then applying this at scale into the marketplace. This will take some time but we expect to be at scale, in production during this calendar year.

Moving to slide 10, in terms of customers, new customer acquisition has been a challenge this half, particularly for the Redbubble marketplace where we saw total unique customers decline versus last year, whereas for the Teepublic marketplace, total unique customers increased, up 7% this half. The previous slide where we highlighted using AI to help get the right content in front of customers, will help address both attraction and conversion of potential new customers.

Some positive aspects from a customer perspective – first, the proportion of revenue from repeat customers hit a first half high of 47%. Particularly pleasing was that we saw in absolute dollar terms, repeat marketplace revenue increase, driven by growth in reactivated customers. These are customers that made their previous purchase over 12 months ago. Marketplace revenue from reactivated customers was up 18% versus the PCP across the Group. The focus and investment we have put into this area is generating improvement.

Similarly, while total unique customers were down for the half, marketplace revenue for the half was flat, indicating that average order value per customer increased. Again, this has been a particular area of focus with initiatives such as increased bundles, product comparison upsells and free shipping thresholds contributing this, and our efforts in fan-art and licensing. So further on customers and expanding on that last point, an initiative that is assisting with customer retention, that is assisting in bringing consumers back to the site to purchase again is a new fan-art licensing agreement we have signed with Netflix during the half.

This is the largest licensing agreement we have signed to date. Already there are more than 20,000 fan-art designs on Redbubble inspired by 16 popular Netflix properties. It is early days for this partnership; however, we are seeing some interesting trends. These designs are over-indexing on repeat purchases so they are bringing existing customers back to the marketplace and when they do come back, the average order value is significantly higher. This reinforces the point I was making about Redbubble content and the use of AI. We know that when we put relevant, interesting designs in front of customers, they engage and the AI work will help us do this in a much better way.

This partnership with Netflix is a step change in our licensing agreements. I have talked previously about the human and technology investments we have made in content moderation over the past 18 months. This demonstrates that this investment to improve the site for all parties including rights holders is paying off and now creating positive business opportunities. We are really excited to continue to grow this side of our business.

Lastly on customers and moving to margin on slide 12. This half, we added significant promotional functionality and experimented heavily across them. On Redbubble, we added strike-through promotions. Historically on the Redbubble marketplace, customers were required to use a discount code during promotional periods to access the sale price whereas on Teepublic, they favoured strike-through pricing with great success, seeing a much higher uplift in days with this type of promotion compared to using a discount code.

The benefit of strike-through pricing is that customers are reminded as they travel around the site that a sale is happening and it is much more effective in off-site channels as well. Based on Teepublic's success, we invested in building this functionality on the Redbubble marketplace during the half and we were pleased with the results. The sales uplift compared to non-promotion days was much higher when offering strike-through pricing than when requiring the use of a code. For example, comparing two 30% off promotions we ran during the half, one strike-through, the other discount code, the uplift was 20% to 25% higher for strike-through.

We've also been experimenting with offering free shipping to encourage customers to increase their order value above a free shipping threshold. This experiment showed good initial uplifts, particularly in the UK. However, as the graph on the right highlights, the notable increase in the proportion of customers above the free shipping threshold was not as strong in the US as the UK. On the Redbubble marketplace, we experimented with offering these two promotional activities – strike-through discounts and free shipping at the same time during the half. We believed this would drive both increased conversion and higher average order value.

Unfortunately, this did not generate the extra uplift in marketplace revenue that we expected and as such there was a significant cost to Redbubble's GPAPA margin from running these offers concurrently. As such, we have adjusted our strategy and we are unlikely to offer these concurrently again. We will continue to experiment with free shipping. However our focus is on ensuring this is done in an accretive manner. This is the approach we had taken in December, and in January we have seen the expected rapid improvement to the Redbubble marketplace's GPAPA margin.

Onto slide 13, in addition to improving customers' onsite experience, another area of focus and investment has been working across the marketplaces' third-party fulfilment and logistics network, to ensure customers have a great post-purchase experience and ultimately love the product they receive. This is vital for increasing repeat purchase rate. One element of this is getting artists' products to customers sooner. We've made some great progress on this. On the Redbubble marketplace we've seen a 22% increase in a number of orders that are shipped within two days and a 26% reduction in the overall time it takes from when a customer pays for their product to when it is shipped.

As we have been able to consistently bring down these days, this gave us the ability to extend our Christmas last order by date. This is great for customers as they have longer to buy gifts and also for us, as a business, as these days leading into Christmas are some of our biggest during the year. The dates on the slide are averages, which show great improvement, even though we were negatively effectively in the UK by some Royal Mail challenges.

We have also been focusing on improving quality by reducing product defect rates. Again, this is an area we have invested in through an expanded quality team that works with the third-party fulfilment network. And these improvements not only positively impact customers they also help reduce costs of [made] goods for the marketplace.

And finally, before Mark takes you through the financials, I wanted to highlight some of the experienced leaders who have joined the Company over the past 18 months and are driving a number of the exciting initiatives we have discussed today. Despite the workforce reductions we had to make last month, we still have a great group of both leaders and team members across both marketplaces. The majority of the people on this slide were actively recruited by us, as we respected the marketplaces where they were working and we wanted to bring those skills across to our Group.

For example, Thilo Kaipert is ex-Uber and is leading the charge on improving the seller side of the Redbubble marketplace, encompassing the artist experience and content strategy. Stacey Wallace joined us from Amazon and is responsible for the improvements to the Redbubble supply chain, logistics and customer service. We've also included Rob Doyle on this slide. Rob will be joining the Group in March as our new Chief Financial Officer. Rob is currently CFO of Domain Group, an ASX200 Company, which operates a leading property marketplace in Australia.

And Vivek Kumar joined as CEO of TeePublic last year. He's done a great job onboarding into the role. And I also really want to acknowledge the whole TeePublic Executive Team, who have not missed a beat, and continue to deliver, despite a significant leadership change during this year. Unfortunately, we don't have time to talk about all the exceptional people on this slide, let alone the great team members we've left off. I'm confident that we've got the right team in place to deliver on both our near-term priorities and our medium-term aspirations.

I'll now hand over to Mark, our Interim CFO.

Mark Hall: Thank you, Michael, and hello all. I'll start on slide 16, and I'll start with an overview of the Group's profit and loss statement for the first half, as well as the second quarter. Marketplace revenue was flat for the half, largely due to a softer performance in the first quarter. As Michael mentioned, we adjusted our promotional activities during the half in response to increased competition. As a result, we saw revenue accelerate.

Pleasingly, in the second quarter, revenue was 3% higher than the prior corresponding period. The increase in promotions did have an impact on our gross profit, which decreased 6% this half compared to the prior corresponding period. Our GPAPA result was also impacted by higher promotional activity, as well as an increase in paid marketing. Importantly, as Michael mentioned, we have refined our use of promotional activities to better protect our margins, even if this comes at the expense of revenue growth. Ultimately, we are very focused on GPAPA dollars to accelerate our return to cash flow sustainability. Our general results are encouraging in this regard.

In line with the Group's guidance provided in August, operating expenditure increased this half. However, since then market conditions have changed, and as a result, we have decided to significantly reduce our cost base. Once again, consistent with our aim of accelerating our return to cash-flow sustainability.

Moving to slide 17 and the product split, we provide a breakdown of gross transaction value by product category. Having a broad mix of categories enables artists to maximise their selling opportunities as key consumer preferences and needs have changed over the last two years. We are pleased to see double-digit growth in the Apparel category this half. This was the largest category for the Group and has grown over the last five years. This was offset by some weakness in more discretionary categories like Artwork and Homewares.

We have highlighted the Accessories category in this chart. This category includes facemasks which experienced a surge in demand during the COVID-19 pandemic. The benefit from these sales is now almost completely cycled and Accessories have returned to a more normalised level. Over the last few periods we have been breaking out contribution from facemasks to help investors understand the Group's underlying performance. We have provided this information in the appendix, but as facemasks are now fully cycled, we don't anticipate providing this breakdown again.

Moving onto market split, slide 18. We have provided an overview of revenue by market. North America remains our largest market, contributing 72% of gross transaction value. Pleasingly, this market remained resilient during the half, growing 4%.

Turning to slide 19, cost-reduction initiatives. In January, we announced that we were reducing our cost base by between $20 million to $25 million on an annualised basis. To achieve this, we have implemented three initiatives to accelerate our aim to return to cash flow sustainability. First, after taking a detailed review of our organisation, ensure we did not remove roles which would have a material impact on our ability to deliver our near-term priorities, we made the difficult decision to reduce the Redbubble marketplace's workforce by approximately 20%, or 54 roles. This represents around 14% of the Group's total workforce.

This did not take into account a number of vacant roles, which we had initially paused in the first half, and now cancelled. Combined, this represents approximately $12 million in savings compared to initial expectations in August. This restructure is now complete and the cost reductions locked in. Our Group headcount, as at 31 January, was 325 combined across both marketplaces.

Second, we suspended the Brand Awareness project. We are pleased with the initial results of this investment and we continue to think in the long-term investing in brand is an important course of action. However, we do not think that this project will generate commensurate return until the consumer landscape improves. Therefore, we could not justify our ongoing investment in this project in the near term. Again, investment has ceased and savings locked in.

Third, we are reducing our general expenditure, including travel, consultancy, software subscriptions, and other incidental overhead tied to the lower staff numbers. We are already seeing the benefit of our cost saving initiatives, and accordingly, we reduced our operating expenditure guidance by $10 million, to between $125 million and $135 million. The full benefit is expected to be realised from the beginning of FY24.

Moving to cash, slide 20. As I have said, we are very focused on accelerating our returns to sustainable free cash flow and will continue to implement a number of initiatives and levers to achieve this. At the end of the half, our closing cash balance was $97 million. Due to seasonality of cash flows associated with high holiday sales, the cash balance reduced over January to $44 million as we made payments to other marketplace participants.

As per our normal seasonal trends, and given our profit profile, we expect our cash balance to gradually decline until the first quarter of FY24 before stabilising. Our aim is to return the Group to cash flow positive by the end of this calendar year, and what we mean by this is that we aim to increase our operating EBITDA to a level to sustain our ongoing free cash flow.

Thank you, and I'll now hand back to Michael.

Michael Ilcyznski: Thanks Mark. Moving to slide 22, as Mark discussed, we've adjusted our priorities to accelerate our return to cash flow positive, with the aim to achieve this by the end of the calendar year. To do this, we needed to reduce our operational expenditure, and now increase marketplace revenue and improve the Group's GPAPA margin and absolute GPAPA dollars. As Mark highlighted, the initiatives we announced in January to reduce operating expenditure have largely been completed. Our focus now is continuing to maintain cost discipline while increasing revenue, and importantly, driving margin improvement across both businesses.

On slide 23, for calendar year 23 we are highly focused on a specific set of priorities that can increase marketplace revenue and improve our gross profit after paid acquisition. For TeePublic, we are looking to build on a strong performance during the first half. As I touched on earlier in my presentation, TeePublic's revenue is concentrated in t-shirt sales in the US, and we see real opportunity to diversify its revenue into other apparel categories. The marketplace is also focused on increasing repeat purchases and improving margins by optimising pricing and promotions.

Across both marketplaces, improving search and discovery as a focus, as getting relevant content in front of customers is so important to drive engagement and revenue growth. While using AI could have a huge positive impact on the Redbubble marketplace, we also see real benefits for TeePublic in applying this type of technology across their content library also.

Within Redbubble, we are also focused on improving the onsite experience to increase transactions, which means we will make the purchasing experience easier and more engaging. And importantly, we are very focused on introducing new monetisation opportunities to Redbubble that better balance the incentives and distribution of value between artists, the customers and the marketplace. This is an area of significant opportunity and we will have much more to say about this in the coming months.

Finally, before opening up to questions, our guidance for this financial year. In January 2023, the Group revised its FY23 guidance, given the Redbubble marketplace's performance in the second quarter of FY23, as well as initial January trading. In this environment, we have remained focused on optimising our price, promotional activity, and paid marketing to maximise GPAPA, and our GPAPA margin improved significantly in January as a result. Going forward, we will continue to focus on maximising GPAPA. Due to this approach, in addition to continued softness in demand, particularly in our largest markets, the US and UK, we now expect the Group's FY23 marketplace revenue to be slightly below FY22.

Our FY23 GPAPA guidance is unchanged and we continue to expect the Group's FY23 GPAPA margin to be higher than the first half of FY23, but below FY22 GPAPA margin.

In August 2022, we forecasted the Group's FY23 operating expenditure to be between $135 million and $145 million. Due to the cost-reduction initiatives announced in January, which are now largely implemented, we expect FY23 operating expenditure to be between $125 million and $135 million. This does not include one-off restructuring costs of approximately $2.1 million,in the third quarter of FY23, related to these initiatives.

Thanks very much. Now happy to open up the lines for 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're on a speaker phone, 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 and Mark, thanks for taking my questions. Just first, just on that guidance and the change to the guidance for this year; can you give a little bit more colour around what you've seen since the last update that's seen that top line guidance revised down. Then, I guess, reconciling that with your comments around the second quarter being a bit of a step up versus the first quarter please?

Michael Ilcyznski: Yes, thanks Sophie, Michael here. Look two things on the change in guidance. Number one that's really important to emphasise is that the focus now for the Group has really been – is really on maximising our gross profit after paid acquisition dollars. So what that means is we have adjusted our promotional strategy, adjusting our paid marketing, to make sure that we are absolutely maximising gross profit after paid acquisition which can come at a bit of a cost of revenue.

As we talked about in the first half, we're very focused on making sure that we would win the customer and sometimes that meant that your paid marketing and your promotional initiatives moved past the point of profit maximisation. We've adjusted that, and so with our focus over the last five weeks, with that new focus implemented, that has meant that as we're focusing on our GPAPA, it has some impact to our actual top line result, but we think that's absolutely the right call. And in addition though, we've had an extra four weeks of trading, just to be able to see that softness that we alluded to in the market coming out of holidays, particularly in our largest markets of the US and the UK. So when we combine those two factors, that's really – they're the two things that are driving that change in guidance.

Sophie Carran: (Goldman Sachs, Analyst) Okay, thanks for that colour. Then, I guess, on the outlook slide and just on the calendar 23 priorities, was that – in that context, I mean how do you reconcile the marketplace revenue growth with also then the cost cuts, and then that focus on GPAPA margin? And then I guess your thinking around sort of a more medium-term pathway to scaling the business with this new cost base?

Michael Ilcyznski: Yes, thanks, Sophie. Look, as I said, our focus across both businesses is on maximising those GPAPA dollars. And the two ways is we can grow marketplace revenue and/or grow the margin that we're achieving that revenue at. The initiatives that we've got across both businesses are split and focused on doing those two things. So we do have some specific initiatives that are absolutely focused on how do we grow that top-line marketplace revenue? And then secondly, we have a number of initiatives focused on how do we do that at an improved margin?

So when we talk about our guidance moving forward, it's a combination of, we have one the focus on absolute GPAPA dollars, two, the impact that we think that we're going to get from those initiatives. But then third, putting that into the context of the consumer environment that we're in together. So when we combine those things, that gets us to our guidance and our forecast for the rest of the financial year.

Sophie Carran: (Goldman Sachs, Analyst) Great, thank you. Then just one final question from me around the return to cash flow positive. Can you talk around what you're assuming on the top line, and the demand environment that are required to return to that cash flow positive position? And then, what other levers do you have to pull with if you see a further deterioration in trading conditions?

Michael Ilcyznski: Yes, thanks Sophie. Look we're not going to talk about exact sort of financial year '24 forecasts. Obviously we've made that aim that we've got within the current environment that we're seeing. So we're not assuming a massive increase in consumer demand over the 12 months ahead. But importantly, we're also not assuming a significant deterioration from what we're currently seeing. So I think that's important – first, context is that we're assuming a relatively consistent level of demand from what we're seeing at this point.

And then secondly, though, it's the right question, we do have a number of levers in our hands if we need to. We've talked about, and we've shown, an ability to move on costs if we need to. We've also shown an ability to adjust our pricing and our promotional mix, et cetera, to adjust on revenue or margin. So we believe that we've got a number of levers at our disposal if need be.

Sophie Carran: (Goldman Sachs, Analyst) Great, thanks for that.

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

Wilson Wong: (Jarden, Analyst) Hi, Michael, thanks for taking my question. Can you just provide more details just around what's driving the reduced demand in the US and UK?

Michael Ilcyznski: Thanks, Wilson. What we've been saying, it's very – it's consistent with what we saw coming out of Christmas, but it's really maintained – where having those extra four weeks has allowed us to see those trends a little bit more. What I'd say is there's an overall – a bit lower in terms of search volume and the ability for customers. It's really consistent again with the product categories that we've seen. So it's nothing – I mean it's hard to put into specifics – there's no one thing that's particularly changed. It's just an overall slightly lower macroenvironment that we're experiencing, and it is different across markets.

For example, we're seeing Australia actually perform pretty well. Through January, countries like Germany actually performed pretty well also. But the US and UK combined are our two largest markets.

Wilson Wong: (Jarden, Analyst) Sure. My next question is just around the GPAPA margin in January. Any indication you can provide so where it sits, whether it's the lower or upper end of that 18%, 22% guidance range?

Michael Ilcyznski: We don't want to talk to specifics, but we did think it was important to highlight that the focus of our strategy on maximising our GPAPA dollars and improving our GPAPA margin, particularly with adjustment to our paid marketing mix and our promotional activities, had a significant impact on our GPAPA margin in January across the Group, but particularly in Redbubble. So that's probably as much as we want to say on that.

Wilson Wong: (Jarden, Analyst) Sure. And just on the longer-term marketplace revenue target, previously pointed out, where does this now sit just with the updated guidance?

Michael Ilcyznski: Thanks, Wilson. We still believe in the medium-term aspirations that we put forward. We believe that the market size is there, the opportunity for the business, and importantly, the ability to scale and produce the sort of margin profile that we put forward in our medium-term aspirations. We absolutely remain committed to them as our aspiration that we want to achieve over the medium term.

Wilson Wong: (Jarden, Analyst) Sure. Just my last question, perhaps for Mark, just around liquidity. With the $44 million net cash currently in the balance sheet, how much runway and how much of a buffer, if you could say over the next sort of 12 months or so?

Mark Hall: Look, I won't go into specifics about buffers, but a couple of comments I will make. One is our working capital cycle is quite favourable. So when we look at the month-to-month working capital, we get a cash upfront basically and the outgoings follow a month or two after that. So that's an observation, that we have a natural positive cash flow cycle. Also, if you look at our liabilities where the immediate cash flows are coming out, there's about a net $15 million of those that aren't payable in the foreseeable future – they extent out beyond time. So we feel our liquidity is sound because of that. And also, we've got our focus on cost. So we've made some pretty substantial steps on that front to address that.

Wilson Wong: (Jarden, Analyst) Thanks Mark, and thank Michael.

Operator: Thank you. Your next question comes from Aryan Norozi with Barrenjoey. Please go ahead.

Aryan Norozi: (Barrenjoey, Analyst) Hi guys. Just a few questions from me. First one, can you just please reconfirm what you mean by cash flow positive? So is it EBITDA less – is it operating cash flow less CapEx? Is it post or pre-CapEx? Can you just give us a like-for-like number relative to what you've reported in the first half so we just know what you're exactly referring to please?

Mark Hall: Maybe I can address that one. As I said in my section, we clearly iron out working capital movements. We have massive working capital movements during the holiday season, post-holiday season, and we certainly have seasonality in our yearly cycle of sales. So the way we're looking at it is we need to get our operating EBITDA down to a level that will sustain free cash flow going forward. So operating EBITDA is our focus.

Clearly, when we look at the bigger picture, we need to, beyond that, address to capitalise development, et cetera. But an easier way to portray that is it's the operating EBITDA. So we've got our eyes firmly on the levers we need to pull to get that down to a level that will sustain our free cash flow going forward. And the aim is to achieve that by the end of this calendar year.

Aryan Norozi: (Barrenjoey, Analyst) Okay, so there's $16.9 million of annualised capitalised costs; when you're saying free positive cash flow, you're not including those costs, you're just looking at operating [unclear]?

Mark Hall: No, no, we include all elements. We need to get a – generate an operating EBITDA sufficient to cover our capitalised development. We look at all levers to achieve that.

Aryan Norozi: (Barrenjoey, Analyst) Sorry, just to confirm, what you're referring to as free cash positive is after EBITDA minus your capitalised costs which are annualising $16 million. So after you've paid all that, you'll be free cash breakeven or positive, is that right?

Mark Hall: That's correct. But don't assume it will be $16.9 million going forward. We've addressed all elements of our cash flow in the P&L.

Aryan Norozi: (Barrenjoey, Analyst) Yes, another part of that question, the capitalised costs, how do we think about the number moving forward? Is it – I think, historically it's been a percentage of the fixed cost base which has been sort of 12%, 13% of your cost [to run] business, how do we think about that number please?

Michael Ilcyznski: Yes, thanks, Aryan. So we don't want to give an exact percentage, especially forward into the next financial year. We haven't done – we haven't given any specific forecasts. What I would say is obviously the major element of our capitalisation is the capitalisation of product development, which is driven by the size of our product development teams across the two businesses. As we've talked about we've made some pretty significant workforce changes over the past month, which will therefore have a pretty significant impact on that number.

Aryan Norozi: (Barrenjoey, Analyst) Perfect. And just around the revised guidance. So you've downgraded the revenue guidance to reflect partly the macro but also because you're focusing on optimisation of profit or GPAPA, but the range that you've given has been the same, it hasn't changed. So should we read into that as since January you last updated us that your GPAPA margin is actually tracking better than what you thought back then? So what I'm basically trying to get at is what we can see from the outside is basically you've cut revenue guidance by 2%, but has anything changed around the GPAPA margin since Jan, as well? So maybe you're tracking towards the higher end of that range or can you just give us some colour on that, please?

Michael Ilcyznski: Yes, sure. Look I don't want to add to the guidance that we've given. I think what we would say is, as we did say, I should say – as we did say, is that we saw our GPAPA margin, particularly in the Redbubble business, improve significantly in January. Then secondly, the changes that we've made in optimising towards GPAPA dollars as opposed to pure top line, while that does have an impact on our top line number, we don't believe that has a significant impact on our absolute level of GPAPA, and therefore our absolute level of EBITDA, otherwise it wouldn't be the right decision to make. So I think you're reading into it the correct way, but I don't want to add any more specificity to the guidance that we gave.

Aryan Norozi: (Barrenjoey, Analyst) Okay, so basically, because you might have cut your revenue guidance, but given the strategy you're employing, the aim is that it would be sort of indifferent from a GPAPA dollar perspective at least?

Michael Ilcyznski: That's absolutely the aim. But I would just caution that we haven't provided any – we've provided consistent GPAPA margin guidance.

Aryan Norozi: (Barrenjoey, Analyst) Okay, so I'm sorry to hog the questions, just a very last one. Just to confirm, because it is an important point; if you spend hypothetically $15 million of capitalised intangibles in the next year, in FY24, so your guidance basically implies then operating EBITDA of $14 million as well, so that same number. Is that a fair comment, hypothetically [or not]?

Michael Ilcyznski: Well, one, I don't want to comment on the hypothetical numbers. But what I do think is really important to focus on is that we have not said, just being crystal clear – we have not said that we're going to be cash flow positive over the entire next calendar year – sorry, over the entire financial year. What we've said is that we aim to be sustainably cash flow positive by the end of this calendar year moving into calendar year '24. So I just want to be really clear on what our timing is. Our timing is as we move through November, December, January, February, March, when we normalise for our working capital movements, we want those months and then moving forward, month-on-month, to be at a cash flow positive – a cash flow positive position.

That's where we're aiming for, as Mark talked about. First step is to get our operating EBITDA to a position where it's enough to sustain our free cash flow position. And we're aiming to do that on – there's normalised, there's working capital movements that happen a lot over that period, but that's what we're aiming for.

Aryan Norozi: (Barrenjoey, Analyst) But given your CapEx spend is so large, on an annualised basis, even if it's cut, it still implies a pretty large positive EBITDA number to just get you there without working capital movements. Just operating EBITDA with less CapEx to be breakeven, it needs to be a pretty – relatively larger sort of swing in terms of positive EBITDA. I'm just wondering if I'm missing anything or am I misinterpreting your comment? Because basically my understanding is your guidance is operating EBITDA minus CapEx is cash flow breakeven. So is that – am I missing something?

Michael Ilcyznski: No, no, that's correct. As I said I would just caution that we're talking about that on a month-on-month basis moving into next calendar year, as opposed to looking towards all of FY24 – we haven't given FY24 guidance. We're talking about what our aim is, and our aim is to make sure that, as a Group, we're in a sustainable cash flow position from the end of this year moving forward.

Aryan Norozi: (Barrenjoey, Analyst) Perfect, thanks guys.

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

Owen Humphries: (Canaccord, Analyst) Morning guys. Just a quick question, just following on from the softness in revenue in Jan; have you guys thought about new revenue initiatives to the Group? Like in the past you've talked about leveraging the fulfilment network to third parties, you've also talked about, or potentially you thought about monetising the supply side of the marketplace [of] the artist. Just talking through other ways that you could drive gross profit growth?

Michael Ilcyznski: Thanks, Owen, for the question. What I'd point to is the last point on the slide where we talked about our focus in CY23. So in addition to the initiatives that we've got underway to drive what I would consider our current marketplace revenue in GPAPA, we are also focused on new monetisation opportunities for the marketplaces. So that's very much focused on how can we add additional monetisation options to the marketplace that, one, provide better incentives to all the participants, but also potentially provide a better distribution of value across the participants.

So we're not – I'm not going to flag exactly what we're doing there – it's too early for us to say these are the exact initiatives and these are what's coming out. But what I would point to is, when you look at a number of other similar marketplaces to us, you would see that those marketplaces generally have an additional set of monetisation opportunities. So things like listing fees, things like participation in on- and offsite marketing, things like premium placements for artists, et cetera. We don't have any of those on our marketplace and there are obviously things that we're looking at which we think would better balance incentives but also provide monetisation opportunities. They are things that we're [unclear] into and listing fees, as an example, both marketplaces have had very much a zero cost, zero risk strategy for artists, which has been fantastic for driving scale. It's exactly what you should do when you need to reach scale.

But now that we're at scale, particularly on Redbubble, most marketplaces would then look to focus on only having additional content that's really of high value. And using something like listing fees, which encourages artists to only upload content that is really additive, is a normal mechanism – it's something that we don't have. So you can imagine that that's an example of the things that we're looking at, without saying that that's something that we're going to be launching. But there's a number of those sort of opportunities that you can look to other marketplaces that the time is probably right, particularly on the Redbubble marketplace, to be pushing hard on some of those opportunities during this calendar year.

Owen Humphries: (Canaccord, Analyst) Good one. And I guess, last question is obviously you're talking about implementing some of the AI technology into the platform. I know the history here, well for myself anyway, is we get lost in the content on the platform, better tagging measures will improve the ability to find the relevant content to certain people. Can you just talk through some of the testing, whether conversion rates or anything that we can put a hat on around how this could impact the marketplace?

Michael Ilcyznski: Yes, thanks, Owen, and it is something that we're particularly excited about. It is a new technology – it's just come on in leaps and bounds in the ability for third parties like us to effectively tap into these open-source large models and apply them. We are particularly excited about the opportunity. Just to be crystal clear, we have not yet tested this on our platforms yet to out to consumers, so I'm not going to point you towards specific metric uplifts yet. That is the exact next step we're moving into literally over the next few weeks. What we have done though is we have applied this technology, not just to a small core but across the whole marketplace.

So we know it can be done, as we've done it. We've also human-reviewed samples of this to test for accuracy. We are very confident in the accuracy, and really what it can add, particularly in terms of increased relevancy and reduced irrelevancy which we know is a real bugbear for customers, for artists, et cetera. So we're very excited about it. I'm sorry that I can't point you to specific uplifts yet. That's the testing and the learning that we've got to do over the weeks and months ahead of us. But this isn't something that we throw out on a slide because it might be nice to do in Q4. This is something that we're already well, well into.

Owen Humphries: (Canaccord, Analyst) Thanks guys.

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

Tim Piper: (UBS, Analyst) Yes, hi, Michael. Just a couple of quick ones. Just on shipping, and I take the point around free shipping trials offers, et cetera, but you guys haven't increased your shipping charges in general I don't think. I mean Redbubble used to make a margin on shipping. What's it like now, do you effectively lose money on shipping, or is it that profit now just disappears netted out? Where does that kind of sit?

Michael Ilcyznski: Yes, thanks Tim. Sorry for the slightly long answer here. So we have been clear that we do – we have traditionally made a margin on shipping, and when we're not applying discounts we do make a margin on shipping. And we've talked about how, over time, we want to reduce that margin to make sure that our shipping is competitive for customers. By offering free shipping at a threshold, that substantially reduced our shipping margin. I think back in our Q1 update in October last year, we talked about the substantial reduction free shipping had had on our shipping margin. And then when we saw that play through in the second quarter, because we introduced free shipping into the US as well, it actually really ate into our shipping margin and really ate into our gross profit. And we didn't get the commensurate uplift at the top line to make that dollar, dollar accretive. So it really did have a substantial impact.

We've adjusted those settings since mid-December and that's been one of the things that have contributed to our rebound in GPAPA margin. So we still do make a margin on shipping and we believe we will make a margin on shipping moving forward. We've been clear in our intention to reduce that margin over time. We think that's the right way to compete and to make sure that we can complete to win customers in the environment we're in. However, we'll be taking a pretty steady incremental approach so that we don't have these big swings in margin that we experienced in the second quarter.

Tim Piper: (UBS, Analyst) Yes, I was just trying to understand outside of the free shipping offers – I mean you're indicating that you still do make a margin. I mean in the US in particular, like last-mile delivery, [unclear] and FedEx and all those kinds of players have been putting through pricing of, I think, at least in the high single digits per year over the last few years through COVID. I assume the margin must have just come down through like pricing increasing alone.

Michael Ilcyznski: Yes, no, look that's fair. We haven't passed on all of the increases in logistics charges that have come through the carriers. And so therefore you can imagine that one of our big areas of focus is really optimising both our relationships with the carriers, but also on our order routing. That's a big area where we've got focus moving forward on, which fulfiller an order gets manufactured by, to not only minimise the cost of manufacturing but also to minimise the ship cost, is a key area where both businesses are looking at how we apply technology to really focus on that. Because it is an area where you do see carrier charges go up, and it's a key consideration of what aspect of that we pass on to consumers.

Tim Piper: (UBS, Analyst) Got it. Just one last one. In this presso, there's obviously a lot going on at the moment through content, AI, operational, technology, so you're obviously very active. I'm just curious on the content side of things in that slide, and you're chatting about reducing that low-quality content. You sort of said that there's been steps put in place that makes the uploading process a bit – I can't remember the words you said – that are a bit harder effectively. I mean just looking through content and seller reviews of marketplace, it's obviously the uploading process is a key part of them being active on the platform. Are you confident that through these processes of cutting out bad content, that you're not going to impact effectively the activity of the good content creators?

Michael Ilcyznski: Yes, thanks for the question, Tim, but we have a really good engagement with some of our more established top-tier artists to make sure we're engaging with them and we understand their concerns. Absolutely it's a balance. But what I'd say at the moment, the Redbubble platform has over 60 million designs, right, and we know that we're not optimising the value that we're helping artists create from that very, very large content library. So right now the drive is not for more scale. Right now the drive is to make sure that we are absolutely optimising the return the artists are getting on their content, and we can get the right content in front of the right customers.

So if we're erring on any side, where we want to err on at the moment is optimising what is already by far the largest set of designs available for manufacturing on products in the world by far. So yes, absolutely it's a key area of balance. We think we're actually getting that balance right. We've had really positive feedback from a number of our more established artists about these changes. So yes, it's a key thing we're focused on, but right now, we've got a lot more value that we can help create on the library that we already have access to.

Tim Piper: (UBS, Analyst) That's great. Thanks for taking the questions.

Operator: Thank you. There are no further questions at this time. I'll now hand back to Mr Ilcyznski for closing remarks.

Michael Ilcyznski: Thanks very much. Really appreciate everyone listening in this morning, and thanks for the engagement, the questions, and we look forward to speaking to you all soon.

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

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