28 February 2024

1HFY24 results webcast transcript

Articore Group Limited released its financial results for the half year ended 31 December 2023 (1HFY24) on 27 February 2024. The 1HFY24 results webcast transcript is attached.

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About Articore Group

Articore owns and operates the leading global online marketplaces, Redbubble.com and TeePublic.com. The Group's community of passionate creatives sell uncommon designs on high-quality, everyday products such as apparel, stationery, housewares, bags and wall art. Through the Redbubble and TeePublic marketplaces, independent artists are able to profit from their creativity and reach a new universe of adoring fans. For the artists' customers, it's the ultimate in self-expression. A simple but meaningful way to show the world who they are and what they care about.

Founded in 2006, Articore Group (ASX: ATG) was previously known as Redbubble Limited (ASX:RBL).

This announcement was authorised for release by Articore Group Limited Board Chair.

TRANSCRIPTION

Company: **Articore**

Date: **27 February 2024**

Time: **9:30 AEDT**

[START OF TRANSCRIPT]

Operator: Thank you for standing by and welcome to the Articore 1HFY24 results. All participants are in a listen only mode. There'll 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 Articore. With me today I have the Articore Group CEO and Managing Director Martin Hosking and Group CFO, Rob Doyle. Martin and Rob will provide an overview of our first half FY24 results shortly and we will then open up the line for questions.

The key information for today's call is contained in the ASX announcement and investor presentation released to the market this morning. I would like to call your attention to the safe harbour statement in our ASX release regarding forward looking information. 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 Martin.

Martin Hosking: Thank you, Virginia. First, I would like to thank everyone for their patience and understanding over the last week. We decided to push our results back a few days to enable me to travel to the UK to attend a close friend's funeral. I'm grateful that I was able to do this and appreciate the sentiments received from a number of investors. Before we get into results, I want to highlight that this is our first results announcement since we changed the Group's name to Articore late last year.

We made this change to reflect our new operating structure which clearly defines the two marketplaces, Redbubble and TeePublic and the Group. This has been an immensely positive change which has cleared up any confusion internally about how the different functions operate and interact. We now have greater insight into how that each marketplace is performing and are increasingly sharing knowledge and expertise across the two businesses.

Reflecting this change, we've moved to segment reporting and are providing more information on the individual performance of Redbubble and TeePublic which you can see throughout the materials we released today. First, let's start by looking at the Group's overall performance. The Group has delivered a remarkable turnaround this half. The last 12 months we've been focused on driving profitability and you can see that in our results today.

Gross profit increased 7% to $108.4 million in the first half of the financial year and our gross profit margin increased 660 basis points to 41.6%. This uplift was driven by a number of recently implemented initiatives focused on maximizing unit economics. We expect the benefit of these initiatives will be sustained going forward. Gross profit after paid acquisition, or GPAPA, increased 24% and the Group's GPAPA margin increased 670 basis points.

This improvement was driven by the uplift in gross profit as well as more efficient paid marketing spend. We realised the full benefit of the cost reduction initiatives we implemented in FY23 and maintained our strong cost discipline during the half. As a result, gross profit, GPAPA and operating EBITDA were all significantly above the Group's pre-COVID results, delivering $8.8 million of underlying cash flow up $36.4 million on our H1 2023 results.

While we are happy with our results today, there is no shying away from the fact that there is still work to do. We need to return the Group to a profitable revenue growth. Solid unit economics provides the foundation but is only the starting point. Delivering this for each marketplace utilising our existing resources is our primary objective going forward. On the next slide, we have provided a snapshot of each marketplace's performance during the half.

Both marketplaces have contributed to the Group's significant improvement in profitability and delivering positive underlying cash flow. The turnaround has been particularly significant for Redbubble. In first half FY23, the marketplace operating EBITDA was negative $13 million. This half, its operating EBITDA increased nearly $25 million to $11.8 million. The primary difference in the two marketplaces' performance relates to the top line. TeePublic has been able to drive margin expansion while also improving marketplace revenue.

However, Redbubble's marketplace revenue declined by 18%. This divergence is highly correlated to each marketplace's paid marketing activities. Both Redbubble and TeePublic set their paid marketing to be first order profitable. So we want paid marketing to be as high as possible, as every seller contributes to the bottom line. During the half, TeePublic was able to find more opportunities to do this, scaling their paid marketing expense in line with revenue.

Optimising paid marketing activities is a key focus area for Redbubble in the second half and a good example of where we can leverage the skills and expertise from one marketplace to the other to address an identified issue. Turning to the individual marketplace performance. On slide 5 we've provided a summary of Redbubble's key strategic achievements this half. Our intention is to share this dashboard with a consistent set of metrics for each marketplace every six months going forward.

We've selected three operational metrics as they provide a good indication of marketplace health. If selling artists, customers and designs sold are all going up and the flywheel is operating efficiently it should translate into solid financial returns for the marketplace. The number of ascending artists on the Redbubble marketplace increased during the half to more than half a million independent artists. This is a positive sign and reflects our recent focus on improving artist experience particularly for pro and premium artists.

Total artists' earnings decreased this half, reflecting the introduction of fees for standard account and overall marketplace revenue decline. Pleasingly, the amount taken home by pro and premium artists was largely flat. The number of customers and designs sold during the half were down which explains the decrease in marketplace revenue. The declining customers is primarily caused by a decrease in the number of new customers coming to the site.

The drop in new customers is correlated to the decline in paid marketing spend. For individuals who have never bought a product in the marketplace this is a primary entrance point. Fewer customers and a reduction in volume certainly contributed to less designs being sold. In addition, we believe the reduction in designs sold is a short term response to some of the measures we have taken to improve the content library on the marketplace.

We're confident that the long term benefits outweigh the cost. Having less content and improving the overall quality of the content library enables buyers to have a better experience on site and improves off site marketing. Returning the Redbubble marketplace to profitable revenue growth is our primary focus. To do this we are focused on optimising the marketplace's flywheel. Over the last 12 months we've made significant progress addressing issues that were inhibiting the flywheel.

We've dramatically improved the quality of content being uploaded to the marketplace pulling the surge of low quality content flooding the site as I have highlighted in previous calls. This clogged the engine making it difficult for customers to find designs that excited them leading to disengagement and in turn frustration from top artists that their work was not being discovered. We are now confident that we have fixed this issue. This is highlighted by the proportion of uploads from pro and premium artists increasing to 56% in December 2023 compared to 15% in December 2022 and also up in absolute terms.

We've also made progress in improving our margins. We launched dynamic order routing system in March last year. This half was the first holiday period that it was in use. Fulfillers now have greater awareness on how orders are routed and some have chosen to reduce their pricing to increase the amount of volume that our platform routes to their sites. We've also been able to reduce shipping costs across the Group. As a result of these initiatives COGS were down 8% in December 2023 compared to the prior comparative period.

The next part of the flywheel we're concentrating on is how to attract new customers to the marketplace and turn existing customers into repeat purchasers. As I've highlighted throughout this presentation, we're particularly focused on Redbubble's paid marketing strategy. Having strong offsite promotion also helps attract new customer and it also reminds customers who have previously bought a product about Redbubble and increases the likelihood of a repeat purchase.

In December 2023 paid marketing spend was down 22% compared to the PCP. This decline is fairly similar to the reduction in MPR which is not a coincidence. As I highlighted earlier, our paid marketing is profitable on first order which is why increase in spend in this area is a good thing. We've done a lot of work recently to better understand the profitability of individual products in different geographies which gives us confidence we can increase our spend without compromising our profitability.

TeePublic has delivered a strong set of results this half with profitable revenue growth. The metrics on this slide highlight that TeePublic's flywheel is operating more efficiently than Redbubble's with a number of selling artists and designs sold both increasing. Improving the artist experience has been a focus area for TeePublic. Last year we introduced two account categories on the site, artisan and apprentice. Artisan accounts are given more prominence on site in search results as well as in offsite marketing.

The amount they earn for each product sold is also higher. Introducing this distinction in artist account categories has been well received by the most valuable artists. There was a decline in arts earnings in the first half. This primarily reflects a decrease in arts earnings from apprentice accounts. The number of customers declined slightly during the half. This reflects a reduction in new customers in a tough economic environment. Pleasingly, we continue to see growth in repeat customers.

In 2020 repeat purchases represented just 32% of total MPR. In 2023 it was 47%. We further optimised the supply chain by increasing allocation of volume to lower cost third party fulfillers. We also adjusted order priority. Previously, third party fulfillers worked on a first in first out principle without taking into account how far the product needed to be shipped. We've now updated this logic so that third party fulfillers print products that have further to travel first, reducing the need to express ship to meet the promised delivery date.

A focus for TeePublic in the last half was enhancements to the website to improve customer experience. We know that historically visitors that search on the site have a much higher conversion rate than visitors that do not. So our upgrades will focus on introducing new experiences that allow visitors to browse content and expose them to the depth and breadth of the marketplace catalogue without relying on them to initiating a search.

The first enhancement was the introduction of categories, the buttons directly below the search bar. This feature is targeted at individuals who come to the site and don't know where to start. To determine the categories we use two different approaches. First we considered what historically are the most popular searches on the marketplace. We've also used AI to review the vast content library available to the marketplace and identify categories with the most relevant designs.

We are pleased with the impact of the introduction of categories had during the holiday period. The bounce rate on the homepage more than halved compared to the prior year highlighting the improvement to customer experience. This reduction also drives higher Google ranking for key searches, helping us reach new customers. We also launched a gifting module in October 2023. Often people find themselves on the site wanting to buy a gift for a friend or family member and this helps them to very quickly narrow down their search results by focusing on a particular product and design category.

For example, I want to buy a T shirt for a sports fan. From there I can further narrow down the search results to different types of sports and even further to finally, I'm looking at the marketplace with a broad range of retro football T shirts. For individuals who engaged with the gifting module, their conversion rate was 87% higher during the holiday period than individuals who did not. I'll now hand you over to Rob to take you through a more detailed review of the financial results.

Rob Doyle: Thank you, Martin. Turning to slide 10 and our profit and loss statement. As Martin highlighted, we've delivered a marked turnaround in performance this half. Our focus has been on increasing absolute GPAPA, maintaining strong cost discipline and ultimately returning the Group to positive underlying cash flow, all of which are evident in the numbers released today.

One thing I would like to call out is an adjustment that we've made to the results highlighted in our investor presentation and ASX announcement which means that gross profit, GPAPA, EBITDA, EBIT and net profit are $2.7 million lower in these materials than in our statutory financial statements. This non cash adjustment relates to the identification and correction of a reconciliation issue relating to artist expense accruals, specifically the treatment of cancelled orders.

This reconciliation issue resulted from a system change in 2020 which has now been remediated. In each historical period, the adjustment was below our materiality threshold but in total since 2020 amounted to $2.7 million which we've written back in full this period. As this is a one off item we've adjusted our results in the investor presentation and ASX release to enable the market to compare this half with prior periods on a like for like basis.

Importantly, this reconciliation issue has had no impact on artists. The increase in the Group's profitability has been driven by Redbubble and TeePublic improving their GPAPA alongside a reduction in the Group's operating expenditure. The waterfalls on this slide highlight the significant improvement to both marketplaces' gross profits due to the successful delivery of a number of initiatives in the last 12 months. This includes a review of base prices, which has been enabled by a greater understanding of unit economics by product and geography, supply chain efficiencies, which is particularly significant for the Redbubble marketplace following the introduction of a dynamic order routing system and the introduction of artist account categories.

TeePublic scaled their marketing spend in line with their NPR during the half which is why there is no margin benefit here. As Martin emphasised, as both marketplaces run their paid marketing to be profitable on first order, this is a positive outcome. For Redbubble, the paid marketing spend as a proportion of revenue has come down as they refine their bidding strategy to ensure that each transaction was profitable on a first order basis.

In the first half of FY24 the team has been focused on improving our capability in this area, which will enable us to profitably scale Redbubble spend while maintaining our discipline and setting appropriate ROAS hurdles. Our cash position is something that we continue to monitor closely. Our closing cash balance at 31 December was $87 million which is above our first half FY20 position. Consistent with seasonal payments to marketplace participants, we have a significant cash outflow in January as we pay third party fulfillers and artists for December sales.

As a result, our cash balance at the end of January provides a more accurate picture of the Group's cash position. As of 31 January, the Group's cash balance was $41 million. This is $5 million higher than at 30 June. In the first half, our underlying cash flow was $8.8 million, up $36.4 million on the first half FY23, a remarkable turnaround. We do not expect underlying cash flow to be positive in the second half but continue to aim to deliver positive underlying cash flow for FY24. I'll now hand you back to Martin.

Martin Hosking: Thank you, Rob. As highlighted throughout this presentation, we have a very clear focus for the Group in the near term, returning to profitable revenue growth. For Redbubble, we're focused on addressing identified issues which are inhibiting the flywheel from operating efficiently. First and foremost, this is optimising our paid marketing spend. This is an area where TeePublic is performing strongly and we are confident that we can use this expertise and recent improvements in data to make some meaningful improvements to enhance Redbubble’s approach in the near term.

TeePublic’s flywheel is operating well as evident by the result of the half. There will always be work to be done to ensure the marketplace stays in balance but TeePublic is in the position to be looking at opportunities to grow their flywheel by expanding into new geographies and customer segments and building their presence outside the US. As a Group, our role is to support the marketplaces to leverage their core strengths and ensure we're generating synergies from operating as a Group.

We are also very focused on maintaining cost discipline. We are thinking about our longer term growth strategy. We have stabilised the foundation of the business putting in place the necessary framework to achieve positive underlying cash flow for this financial year. This was a necessary first step. We're now moving into phase 2, highlighted on slide 15, and shifting our focus to delivering profitable revenue growth for the Group by maximising the performance of our existing marketplaces.

This is where the vast majority of our time and resources is focused. We will consider adding new operating companies that leverage and or add to our Group assets and capabilities. This includes the global fulfillment network, the artist base and technology and marketing expertise. As our focus is on the existing marketplaces we are still in the early stages of progressing this strategy. However, we are monitoring our environment to make sure we are aware of opportunities and are ready to act at the right time.

Finally, our FY24 guidance. In the first half of FY24 the Group demonstrated its ability to drive absolute GPAPA growth by focusing on unit economics and optimising its paid marketing activities. While the Group expects trading conditions remain soft in the near term, it is confident in the execution of its strategy and as a result, it has narrowed its FY24 GPAPA margin range to between 24% and 26%. The higher end of its previously given guidance 23% to 26%.

The Group expects the decline in Group marketplace revenue to be more moderate in the second half of the financial year as the Group revised its strategy to focus on profitability in a comparable period in FY23. The Group realised the full benefit of cost saving measures implemented in FY23 in the first half of FY24. We will continue to focus on strong cost discipline in the second half of the financial year largely due to foreign exchange rate movements and a decision to change the executive team’s short term incentive to an at risk cash reward.

The Group now expects its FY24 operating expenditure to be between $97 and $100 million, previously $92 to $100 million. After delivering positive underlying cash flow for the Group and both marketplaces in the first half of FY24 the Group is continuing to focus on its aim to deliver positive underlying cash flow for FY24. Thank you for joining us today. We're now happy to take any 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. During speakerphone, please pick up the handset to answer your question. The first question comes from Owen Humphries at Canaccord, please go ahead.

Owen Humphries: (Canaccord, Analyst) Good day, guys. Just a quick one for me, just to understand around that OpEx, Martin, can you just go through what the OpEx increase relates to? It sounds like just around the change in the short term incentive packages?

Martin Hosking: That’s the smaller [unclear]. I’ll hand it over to Robert. It’s actually overwhelmingly [unclear].

Rob Doyle: Yes, it's mostly foreign exchange movement owing. So sort of low single digit millions and then about $1.5 million of the change to a cash based STI. Obviously that's only payable based on performance so that can flex but that's really the change in why we've narrowed that OpEx guidance towards the upper end of the range.

Owen Humphries: (Canaccord, Analyst) Okay. Just to understand the guidance there around the moderating the decline in revenue growth in the second half, is - can you give an indication of where the first six weeks stands relative to that target and when the expectation is that the Group will return to positive growth?

Rob Doyle: Yes, we're not going to give detail of the last few weeks. I think we've given enough in the outlook statement and sort of working back to a moderation of the decline in revenue in the second half. So I think that's fairly clear. We're obviously not going to guide beyond this financial year but as Martin said in his commentary, it's kind of the absolute focus of the Group at the moment is to really make sure that we can return to revenue growth and that's a commitment that we've made.

We're not going to put a timeline on it but I think it's fair to say we know the recipe, you can see that TeePublic's revenue has been up slightly and growing profitably so we kind of know that the recipe that goes into that and we're very much focused on executing that particularly within the Redbubble marketplace.

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

Operator: Once again, if you wish to ask a question, please press star then one on your telephone and wait for your names to be announced. Please press star then one now. As there are no further questions at this time, I'll now hand it back over to Mr Hosking for closing remarks.

Martin Hosking: Well, thank you, everyone. So if you have further questions, obviously you can follow up with Virginia and we look forward to updating you at the next call.

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

[END OF TRANSCRIPT]