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RLJE - Q3 2017 RLJ Entertainment Inc Earnings Call

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CORPORATE PARTICIPANTS

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Roberta Hendricks *Couchman Capital - Analyst*

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Michael Kupinski *Noble Capital Markets - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the RLJ Entertainment Q3 2017 Financial Results Conference Call. (Operator Instructions)

I would now like to introduce your host for today's conference, Dawn Martens of RLJ Entertainment. Please go ahead.

Dawn Martens - *RLJ Entertainment, Inc. - Corporate Secretary*

Thank you and good morning. I am joined on the call today by Miguel Penella, RLJ Entertainment Chief Executive Officer; and Nazir Rostom, RLJ Entertainment Chief Financial Officer. Today's discussion is being made available via conference call and webcast through the company's website, rljentertainment.com under the Investors section. A replay of the webcast will be available on our website.

Before we begin, I'd like to remind you that during today's call, management will be making forward-looking statements regarding future events and financial performance made under the Safe Harbor Provision of the U.S. Securities Laws, including revenue and margin expectations, projections or references to trends in the industry and RLJ Entertainment's business. We caution you that such statements reflect the company's best judgments as of today, November 9, 2017, based on factors that are currently known, and that actual future events could differ materially due to a number of factors, many of which are beyond RLJ Entertainment's control.

For a more detailed discussion of the risks and uncertainties affecting our future results, I refer you to the company's filings with the SEC including the 8-K filed earlier today, which contains our third quarter 2017 earnings release. RLJ Entertainment disclaims any obligation to update or revise these forward-looking statements to reflect future events or circumstances.

During the call, management will also discuss non-GAAP financial measures, including certain pro forma information. Unless specifically stated otherwise, the non-GAAP financial measures discussed today were not prepared in accordance with GAAP. A reconciliation of GAAP and non-GAAP results is provided in today's press release, and is posted on the Investor Relations section of our website.

I will now turn the call over to Miguel Penella. Miguel?

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Thank you, Dawn, and good morning, everyone. Thank you for joining us. Q3 was a terrific quarter focused on accelerating progress toward our strategic and financial goals. I will begin by providing an update on our initiatives for the quarter and the remainder of the year. Then, Nazir will walk you through the financials; after which we will take your questions.

RLJ Entertainment's objective within the next 12 to 18 months is to exceed 1 million subscribers to our digital channels, Acorn TV, which offers curated British and English language international dramas and mysteries; and Urban Movie Channel or UMC, which offers quality feature films, documentaries, comedies, and other exclusive content for urban audiences.

As our progress in Q3 shows, we are very much on track to achieve this objective. Having surpassed the 600,000 mark in early September, we are increasingly confident that we can reach and exceed the 1 million mark within our target timeframe. As you are aware, the OTT marketplace is growing rapidly as consumers increasingly adapt to the medium, and we enjoy a very significant and immediate opportunity to establish our two standalone channels as must-have OTT destinations.

Our strategy is to further define them as unique brands that speak to and capture their dedicated audiences by investing in the development and acquisition of compelling, unique, and original content backed by superior service. This is a value proposition that consumers have demonstrated they are willing to pay for, compelling stories that inspire them and speak to their interests. We aim to be their choice.

As testimony to this, our subscriber -- subscription growth in Q3 was spectacular. We grew more than 50% from last year to over 620,000 subscribers and accelerated sequentially from Q2's rate of growth as we increased our content and expanded our consumer's outreach programs. As we discussed on our last call, our focus in the second half of the year has been to increase the amount, exclusivity, and originality of our digital channel content.

In the third quarter, Acorn TV had a number of new franchise releases including Loch Ness, Striking Out, and Good Karma Hospital, and returning franchises such as Doc Martin Season 8 and 19-2 Season 4. UMC's key title releases in the quarter included #Digital Lives Matter, The Rich & the Ruthless, and Lawd Have Mercy. All of which were part of the return of Fall Out Fridays.

The companion to increasing the breadth and uniqueness of our content is driving awareness of our channels. We increased our investment in marketing and advertising accordingly. The combination of strong titles and heightened awareness drove increased trial activity and a compelling new customer acquisition rate in the quarter.

With respect to digital channel distribution, we continue to broaden our digital footprint and expect to be on additional platforms domestically and internationally in Q4 and next year. Our other businesses also continue to show strong results. In particular, our wholesale distribution segment revenue showed increasing stability in Q3.

We made tremendous strides in this segment. We significantly decreased our dependency on physical medial sales. We see a growing contribution from digital medial sales in our revenue mix due to our shift to delivering content on digital and broadcast platforms. Wholesale is also enjoying a strong slate of titles. A lead title in the quarter, Brawl in Cell Block 99, starring Vince Vaughn, released in theaters in September, and is doing very well in VOD and licensing in Q4.

Our IP business through our equity stake in Agatha Christie Limited is also performing very well. Many, many Agatha Christie Limited series, characters, and story lines are enjoying renewed attention. Agatha Christie is capturing this growth through licensed sales across all media types including feature film, TV, publishing, and even a London stage play. We expect this interest to continue to accelerate. Murder on the Orient Express produced through Fox Studios with an all-star cast including Kenneth Branagh, Johnny Depp, Penelope Cruz, and Judi Dench opens tomorrow in theaters in the U.S., and we're very excited about this premiere.

As we enter the final weeks of the year, we remained focus on driving subscriber growth with a compelling slate of unique and exclusive programming at both Acorn TV and UMC, including new releases and returning franchises, supported by higher marketing spend and continued robust customer engagement across platforms.

Just released or upcoming key titles for Acorn TV include A Place to Call Home Season 5, Acceptable Risk, and the final season of George Gently. Key titles for UMC in the fourth quarter include Minimum Wage, World Wide Nate, David Talbert trilogy, and Our Dream Christmas. RLJ Entertainment and AMC Networks continue to collaborate well as we leverage relationships and increase our co-acquisition activities. Our first title, the action thriller, Mayhem, starring Steven Yuen of The Walking Dead, is releasing in theaters tomorrow for RLJE Films and will stream in early 2018 on AMC's Shudder.

In total, the results we have delivered to date in 2017 demonstrate that we are realizing the business model that we envisioned. We have grown total revenue for the [first nine months of the year] (corrected by company after the call), and we are on track for a very strong 2017 performance. Acorn TV and UMC have become must-have destinations in a transforming media and entertainment industry. And we are in the heart of the direct-to-consumer digital space.

The investments we're making in our digital channels are paying off as this -- as this segment comprises a more meaningful component of total revenue. And the transformation of our wholesale segment is succeeding in stabilizing this revenue base for future growth. Through increased financial flexibility afforded by our strategic partnership with AMC Networks, we are increasing our investments in content and marketing accelerating subscriber growth. Agatha Christie Limited is a thriving brand and delivering growth in equity earnings. And lastly, we are on track to deliver subscriber growth and to reach our 1 million-subscriber milestone in the next 12 to 18 months.

I will now turn it over to Nazir Rostom, our Chief Financial Officer, to discuss our financial results. Nazir?

Nazir Rostom - *RLJ Entertainment, Inc. - CFO*

Thanks, Miguel. Q3 2017 results demonstrate RLJE's transformation into a strong digital company. We accelerated subscriber growth, stabilized wholesale segment growth, and improved our operating metrics. Let's review our numbers.

Starting with our income statement, digital channel revenue represented 33% of our total Q3 2017 revenue compared to 24% in Q3 2016. Digital channel revenue increased by 59% year-over-year to $7 million in third quarter of 2017 from $4.4 million in third quarter 2016. This increase was driven by strong subscription growth at Acorn TV and UMC combined, exceeded 620,000 subscribers, growing more than 50% from Q3 of last year. As previously announced, we are increasing our investment in marketing to drive future subscriber growth. And as a result, our digital channel segment contribution decreased by 21% to $1.4 million in Q3 2017 from $1.8 million in Q3 2016.

In our wholesale distribution segment, revenue was essentially flat at $13.9 million in Q3 2017. While we released similar number of titles this quarter compared to Q3 2016, our releases for domestic distribution performed very well.

Strong Acorn releases included Line of Duty Series 4, Murdoch Mysteries Season 10, and The Heart Guy Series 1, as well as feature film releases including Brawl in Cell Block 99. Notably, the proportion of digital media in our wholesale distribution mix is rising significantly and was 57% of segment revenue in Q3 2017 compared to 46% in Q3 2016. We have reduced our dependency on physical sales and eliminated poorly performing retailers.

As we expected, segment gross margin which was elevated in Q2 by an early license renewal and higher margin inventory sales normalized in Q3. Combined, third quarter 2017 revenue from all segments increased 13.9% to $20.9 million from third quarter 2016. Total gross margin expanded 80 basis points to 39.2% from Q3 2016 as we continue to grow our digital channel's gross margin.

Equity earnings from our Agatha Christie subsidiary increased 74% year-over-year to $1.7 million. Part of this increase resulted from the collection of legacy royalties. ACL, Agatha Christie, enjoys a better than expected performance from strong momentum across its film, TV distribution, and publishing businesses. Net loss for third quarter of 2017 was $2.7 million, an improvement of $1.2 million from third quarter 2016.

Q3 2017 loss included a $3.6 million non-cash charge related to the change in fair value of stock warrants. We now see a trend in our shrinking net loss and the factors contributing to our net loss of primarily non-operational contributions such as non-cash warrant expense, non-cash interest expense, and non-cash amortization.

Our adjusted EBITDA for Q3 2017 was positive $2.9 million, a 3% improvement over Q3 2016. While we are strategically investing in our marketing plan to grow our digital channels, the growth in EBITDA is primarily driven by higher margin digital channels segment and higher equity earnings from ACL.

Moving to our balance sheet, our cash balance increased to $6.6 million down from $7.8 million at year-end. We significantly increased our investments in content to expand our program library to support digital channel growth and purchase strong wholesale titles to be released later in the year. Our film content balance is now $75 million from $60 million at yearend. In addition, we continue to make significant strides in reducing our past due accounts payable. Increases in our stock price increased our stock warrant liability by $3.6 million. Our stock price increased from a $1.60 yearend to $3.55 at Q3 2017.

In summary, we are committed to invest in our digital content and increase our marketing to accelerate our growth to achieve our 1 million subscriber goal. With our growing subscriber base, increasing digital channels revenue and improving overall profitability. We expect to deliver strong results for 2017.

This concludes our prepared remarks. I will turn it back to the operator, who will open the call to your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of [Roberta Hendricks] from Couchman Capital.

Roberta Hendricks - *Couchman Capital - Analyst*

Good morning. Thank you for taking my questions. I have just a couple. First, how competitive are you finding the bidding process in the marketplace for programming? And are you able to secure the content you want?

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Yes, thank you for the question. There's certainly more competition for content, for the programs that we are interested in, our audiences are interested in, namely high-quality dramas and mysteries, and general entertainment, television entertainment and programming nowadays that the consumption of media is more fragmented, especially with the advent and growth of digital channels starting with Netflix, Amazon, Hulu but also like you know, channels like Acorn TV and UMC.

Having said that, our strategy is to be very focused on specific audiences and to have a deep, and in fact deeper, programming offering for these audiences that a lot of our competitors or almost every one of our competitors has. So we tend to be specialized. And by doing so, we are looking to acquire programs that oftentimes have less competition than for other type of categories or our programs that tend to appeal to more mass audiences.

Also, our key strategy of our growth is to develop of our own programs. This is something that we have done for a number of years now with Acorn TV. I think it's actually one of the main reasons why Acorn TV has been growing at the quick pace that it has. These are original programs that we have produced ourselves or co-produced in partnership with independent producers or broadcasters throughout the world.

This year alone we had titles like Witness for the Prosecution, an Agatha Christie program, that we produced ourselves in partnership with the BBC. We had a title called Striking Out that was developed in partnership with RTE, the public broadcaster in Ireland. So, we are producing content ourselves, and by doing so we control content in a way that we could not if we were just competing for finished programs like many others are doing. And that's strategy that has worked out for Acorn TV we are starting to apply now to UMC. A good example of that is a title called Minimum Wage that we just released this month is I think is the first original production that we are releasing on UMC.

So that's our strategy. So there's more competition for content. But I think that because we're focused on specific audiences and because we are developing original programs ourselves, I think we are successful in getting the programs that we want.

Roberta Hendricks - *Couchman Capital - Analyst*

Okay, great, thank you for that. My last question is can you discuss your outlook for cash flow this year? And will you need more cash as you invest in growth?

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Yes. We are generating a good amount of cash, given our business, the run rate of our current business. Our EBITDA, the EBITDA that we report is a pretty good approximation to the run rate, sort of cash generating capacity of our business. Because most of the adjustments that we apply from net income to get to EBITDA are in fact non-cash items. And what we're doing today is basically reinvesting all of that money in the growth of our business. So we are looking to maintain, generally speaking, similar cash balances that we have today.

But as I said, on a run rate basis our business is generating more cash than it had in the past. Our EBITDA calculation is a good approximation to that amount, and we are in the process of reinvesting that in the future growth of Acorn TV and UMC in particular. So, we are very aggressively increasing our investments in content on a year-on-year basis. And the same thing is true for in particular marketing, online marketing, you know, subscriber outreach promotions for Acorn TV and UMC as well as our IT development projects. So, we are growing our investments using the cash that our business is generating.

In terms of whether we will need more cash in the future, we are not in a -- we don't have an immediate need for more cash. But as a company, we believe that the OTT space represents a really big opportunity for us in the coming future, and we want to make sure that we are doing everything we can to take full advantage of it. So in the next few years, we're always going to be thinking about what do we need in terms of assets and so forth to achieve that. Again, as I said, for now I will say that's not a key priority for us because we have more cash today than we did, than we have had in the last few years, but that's sort of the outlook that we have.

Operator

Our next question comes from the line of Bruce Galloway from Galloway Capital.

Bruce Galloway - *Galloway Capital - Analyst*

Hey, guys, congratulations. You also have the opportunity to get the warrant exercise also, which would generate a bunch of cash for you, guys, to, you know, on that other question. But my question is OTT is heating up right now, and everyone and their mother is jumping in to this marketplace. So have you looked at other avenues? You're going at a de novo right now. You're doing a great job of getting up 620,000 subscribers. But are there other options and avenues and other pipes that you could go on to really accelerate that growth? And what are the options out there?

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Yes, thank you, Bruce. First of all, I do want to clarify that, yes, we do have a significant amount of warrants. I think the total number of our warrants is like 21 million or so; with the strike price, I think, on average close to, maybe not quite, but close to $3.00. From a cash flow point of view, we look at those warrants, at least the majority of those warrants, as warrants that if and when converted would basically get rid of our debt. The amount of our debt credit facility is very close to the value of the warrants once they convert or exercise. So, that's sort of how we look at it but just to clarify your point, but nevertheless that's a good point, Bruce.

With regard to accelerating the growth of our digital channels, in the last couple of years the growth that we have obtained has been based on what I think is fairly limited footprint for our channels, namely for Acorn TV, to give everyone some perspective. We have had -- we have today apps on iOS devices, Apple devices, iPhones, iPads, and Apple TV. We have an app for Roku, the Roku OTT device. And we are -- we have included Amazon or Amazon -- I mean Acorn is included in the Amazon platform, the Amazon TV digital channel platform. But we have not had yet an app for Android, one that we are working on, or we don't show -- we don't include -- we have not included Acorn TV on traditional set-top boxes or new platforms that are coming along or that are growing very rapidly in this OTT space like Sling TV, for example. And UMC is in a very similar situation than Acorn TV is, but actually maybe slightly worse because all these apps that we have had for Acorn for a year or two have been launching for, in the case of UMC, just in the last 12 months.

So as I said, we have obtained what we think is a very good rate of growth with what we think is a fairly limited footprint, especially because we have not grown anywhere in terms of territories beyond North America, the U.S., and Canada. So when we think about 2018 and beyond, in addition to spending more marketing dollars and enhancing, growing, expanding our marketing online promotions, online marketing promotions, we're actively looking to launch an extensive portfolio of digital apps like Android, Samsung, and others. And we're also in conversations with the number of new platforms that we are not in. Platforms that are either traditional set-top boxes from traditional broadcast cable satellite providers or digital platforms; you know, more similar to that Amazon provides today. And we think of those as, again, huge opportunities in the same way that Amazon was for us about 18 months ago.

I think that's in my mind the biggest opportunity that we have to significantly accelerate the growth of our -- of both Acorn TV and UMC in the next 12 months. And if that happens, I think that we could reach and exceed our 1 million subscriber mark sooner than expected. Just to give everyone some perspective on it as well, when we are -- when we set this target of 1 million subscribers, we did so based on organic growth, meaning on activities that we currently have. If any one of these platforms comes in -- comes along and we launch on them in the next six months or so, that might very well help us accelerate our growth including international expansion by the way. We're looking to launch at least Acorn TV in international territories sometime in the next six months. So, I think that could be an accelerator of our growth.

Operator

(Operator Instructions) Our next question comes from the line of Michael Kupinski from Noble Capital Markets.

Michael Kupinski - *Noble Capital Markets - Analyst*

Thank you. I was wondering in terms of -- obviously there's been a lot of national rollouts by OTT providers and the previous caller just mentioned those, and certainly the likes of the YouTube TV for instance. What are the gating factors that you have not -- for the reasons why you may not be participating in those types of rollouts, would it be the pricing is an issue or what are the gating factors?

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Yes, the main factor I will say is margin, in that we benefit from what we think is a very good margin on what we call internally our native platform, meaning our direct relationship with consumers. The fact that we have that direct relationship, allows us to capture most, if not all, of the revenue generated by each one of, you know, each subscription. And the growth that we have experienced on our own has been very significant, and that has allowed us to basically reinvest most of that revenue into the business.

When we talk about platforms like Amazon and others where there's somebody else who has that direct relationship with consumers, the equation always involves a revenue share. And the amount of that revenue share is, I think, the key factor in us getting comfortable launching on those platforms. We are fully aware that not all consumers have migrated online when it comes to television consumption, that many of the consumers still are doing more for their viewership through traditional set-top boxes, cable and satellite, you know, through cable and satellite providers.

So, we are aware that at some point we have to reach that audience. We're also aware that digital platforms like Amazon's or Sling TV provide great marketing and marketing that we can piggyback on to grow a lot more rapidly. But for us as I said, we value greatly our direct relationship with consumers because of multiple reasons but among others the financial benefit that we realize. So whenever we are talking about this partnership or us launching on any one of these platforms, the financial arrangement, i.e., the rev share that we enter into, is probably the biggest consideration.

Michael Kupinski - *Noble Capital Markets - Analyst*

Got you. And so the prospect of getting more scale is not as attractive because of the margin issue at this point? But that could change I would suppose at some point.

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Yes, yes, I mean that could change. I mean we are very much focused on growth, I mean just to make that clear. But we're also mindful that we don't want to grow at the expense of eroding our margins beyond a certain degree, right. And at this point, we're growing very quickly at a very good rate. Our marketing investments give us a very good return in terms of cost per subscriber.

So, we're very happy with the rate that we're growing right now. We think that we can develop a direct relationship with the consumer. So the need to plunge on these platforms and erode our margin is lessened by that. Having said that, we do eventually want to be everywhere that our customers want us to be. So, it is something that we are constantly thinking about and looking at. And as I said -- and as I have said before, I believe, our partnership with Amazon has been great and continues to be great on multiple levels. So as long as we can replicate the type of relationship that we have Amazon, we will be very happy to expand on others like it.

Michael Kupinski - *Noble Capital Markets - Analyst*

In terms of your marketing spend, where are you currently finding the best return, I mean where are you -- where does it seem like you're getting the best increases with subscriber reaction to your marketing?

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Yes, yes. For competitive reasons, that is something that we have not disclosed or -- and would prefer not to disclose. What I can say is that we, to date, have done most of our marketing on online platforms or through online -- through online, basically. And we do everything that you can imagine. We do keyword searches, banner ads, we do advertising on social media across the board. And, obviously, we don't have the same results in any one of those platforms, but generally speaking I mean we are benefitting from I think increased interest in digital television consumption and increased interest in the type of programs that we bring to consumers. So, I think we are fortunate that we are seeing growth and a very good return for the marketing investments across the board.

Operator

And at this time I'm not showing any further questions. I would like to turn the call over to Miguel Penella for any closing comments.

Miguel Penella - *RLJ Entertainment, Inc. - CEO*

Well, no, I just want to thank everyone for attending this call and certainly for the questions. We very much look forward to the earnings call, the next earnings call that will include fourth quarter. So we will be looking at a full-year of results as we have described in our earnings call today, I hope. I think the RLJ Entertainment has what we think a bright future in particular with the prospective growth that we see in the coming years for Acorn TV and UMC; so very much looking forward to continuing these conversations. Thank you, everyone, for joining us today. Bye.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a great day.