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RLJE - Q4 2017 RLJ Entertainment Inc Earnings Call

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CORPORATE PARTICIPANTS

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Steve Weiss *NextGen Investors - Analyst*

Bruce Galloway *Galloway Capital - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen and welcome to the Fourth Quarter 2017 RLJ Entertainment, Inc. Earnings Conference Call. (Operator Instructions) I would like to introduce your host for today's conference, Ms. Dawn Martens, Corporate Secretary. Ma'am, please begin.

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

Thank you and good morning. I am joined on the call today by Miguel Penella, RLJ Entertainment's Chief Executive Officer; and Nazir Rostom, RLJ Entertainment's 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, March 15, 2018, 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 fourth quarter and full year 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 are provided in today's press release, and is posted on the Investor Relations section of our website.

Additionally, as has been publicly disclosed, RLJ Entertainment Board of Directors has appointed a special committee of independent directors to consider the February 26, 2018 proposal from AMC Networks to acquire for $4.25 per share in cash all outstanding shares and rights to acquire shares of common stock of RLJ Entertainment not currently owned by AMC Networks or entities affiliated with the Chairman of RLJ Entertainment Board of Directors, Robert L. Johnson.

The Special Committee has granted independent authority to evaluate and respond to the proposed transaction, has not set a definitive timetable for the completion of its evaluation of the proposal, and does not currently intend to announce developments unless and in the event a definitive agreement has been reached. As such, management will not comment on this matter today. We refer you to the press release and Form 8-K RLJ Entertainment issued on February 27, 2018.

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. Last year was a pivotal year for RLJ Entertainment by every measure. In 2017, we advanced greatly towards our 1 million subscriber goal, while growing our revenues and significantly increasing our profitability. Today, I will recap the key business developments in 2017 and also go over our key priorities for 2018. Then Nazir will walk you through the financials. After which, we will take your questions.

In 2017, we executed our strategy -- our strategic plan and delivered solid financial and operating results, benchmarking well against our long-term growth plans. Our Digital Channels subscriber growth was tremendous, increasing over 50% year-on-year by the end of Q4, and solidifying Acorn TV and Urban Movie Channel positioned in the OTT landscape.

The higher margin revenue from our Digital Channels, combined with the successful transformation of our Wholesale business and the strength of our IP licensing segment, drove a 27% growth in adjusted EBITDA and an improvement of $15.8 million in net income. In the fourth quarter, the subscriber growth in our Digital Channels was led by our decision to increase our investments in original and compelling programming and in our consumer awareness programs.

On the content side, on Acorn TV, which offers curated British and English language international dramas and mysteries, we released both new titles and returning franchises. New programs included Acceptable Risk and Love, Lies and Records; while Doc Martin, George Gently, A Place to Call Home, and Brokenwood Mysteries were returning franchises.

On Urban Movie Channel, or UMC, which offers compelling feature films, documentaries, comedies, and other exclusive content for urban audiences, we increased our hours of programming, which included 19-2 in a shared window with Acorn TV, Atlanta Heat, Hogtown, Minimum Wage, David Talbert Trilogy, and our Dream Christmas. We supported these investments in programming with a larger distribution footprint and expanded marketing efforts. We increased the investment in marketing across platforms that create subscriber awareness and generate new subscriptions. Importantly, as we increase our level of investments, our consumer acquisition cost remained steady, something that increases how scalable our channels can be.

In our Wholesale segment, we have created a strong success story, transforming this business by reducing our dependence on physical media. We are focusing particularly on digital distribution, with digital content revenues increasing as a percent of the mix every quarter and creating an even more sustainable and profitable contributor to our future growth.

Fourth quarter 2017 Wholesale revenue outperformed fourth quarter 2016, with revenue coming primarily from digital sales as we released a solid slate of feature film titles, such as Brawl in Cellblock 99, Osiris Child, and Mayhem. Wholesale now functions as it should as both a support for and a beneficiary of our Digital Channels segment strategy, and we are very pleased with this outcome.

Turning to our IP licensing segment. Agatha Christie Limited performed remarkably in 2017. The fundamentals behind Agatha Christie's success are a strong IP content library that is enjoying a renaissance, delivering reliable and sustainable TV, film, and publishing revenue

Murder on the Orient Express, produced by Fox Studios with an all-star cast including Kenneth Branagh, Johnny Depp, Penelope Cruz, and Judy Dench, exceeded our 2017 expectations. This feature premiered in theaters in the U.S. and in the U.K. last November, and Fox is looking to continue to franchise with Death on the Nile, also with Kenneth Branagh in the lead role as Poirot. The success of this film is a great example of the strength and evergreen status of the Agatha Christie stories and the Agatha Christie brand.

With the strong performance in 2017 of all three of our operating segments, we have entered 2018 poised for growth and on a trajectory to become a powerhouse as a premier global digital network company for discerning audiences. Our Digital Channels are a growing driver of total revenue as our increased investment in content and marketing drive subscriber growth. With our Wholesale business transformed, total revenue has grown for three consecutive quarters. We have proven our business model with growth and operating margin spending and reporting positive net income in Q4.

Agatha Christie is an expanding brand with a reinvigorated film franchise and is accelerating our equity earnings. We are investing in the process we're generating into our digital channel growth initiatives, focused on achieving our 1 million subscriber target.

Over the next 12 to 18 months, we have a strong slate of new releases and returning franchises, reflecting our efforts to continue to enhance the brand value and appeal of Acorn TV and UMC. Our returning franchises for Acorn are A Place to Call Home, 800 Words, Detectorists, Good Karma Hospital, Midsomer Murders, and the list of notable titles. And new Acorn titles that we are co-producing are Agatha Raisin, [London Kills] and Queens of Crime, among others. For UMC, we have feature film comedies like The Rich and The Ruthless, dramas like Monogamy, and original series like 5th Ward.

We're expanding the mobility and footprint of our channels domestically and very shortly, internationally. And we surpassed the 700,000 subscriber mark in early January, and are well on our way to achieving our 1 million target sometime in the next nine to 12 months.

In our Wholesale Distribution business, we are focused on growing digital sales that add revenue and cash flow sustainability. We will leverage this by the broader distribution rights -- this with the broader distribution rights to achieve economies of sale both domestically and internationally. In our IP segment and Agatha Christie equity stake, in 2018, we expect strong performance consistent with 2017.

In summary, we are realizing the future we envisioned for OTT [surging] as a force in media and entertainment, driven by dedicated direct-to-consumer Digital Channels. We have established Acorn TV and UMC as must-have branded destinations with our wholesale capability and stake in Agatha Christie supporting the growth of our Digital Channels. We're confident in our continued subscriber growth and are looking forward to accelerating our momentum and executing another great year in 2018.

Now, I will turn the call over to Nazir for our review of the financials. Nazir?

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

Yes, thanks, Miguel. Fourth quarter results demonstrated consistent growth towards our 1 million subscriber objective as well as the growing power of our operating model. The success is a direct result of the substantial growth in our Digital Channel revenue as a percentage of our top line mix. We successfully transformed the Wholesale segment to achieve economies of scale for our Digital Channel content, and Agatha Christie, our IP segment, has contributed substantially to our fourth quarter result.

Let's review our numbers. Starting with our income statement, Digital Channel revenue represented 24% of our Q4 2017 revenue compared to 19% in Q4 2016. Digital Channel revenue increased 47% year-over-year to $7.8 million in fourth quarter 2017 from $5.3 million in fourth quarter 2016. This increase was driven by strong subscription growth of as Acorn TV and UMC combined exceeded 680,000 subscribers growing more than 50% from Q4 of last year.

In our Wholesale Distribution segment, revenue increased 8% to $24.8 million in Q4 2017. The increase was driven by the quality of solid titles released in the quarter as Miguel mentioned, as well as the Wholesale revenue mix shifting from physical to digital media. Combined, total fourth quarter 2017 revenue increased 15.3% to $32.7 million from fourth quarter 2016.

Our total gross margin was 44.2%. This represents an increase of over 10 percentage points from Q4 2016. The increase in Digital Channels in our revenue mix is driving this overall growth. In addition, our Wholesale gross margin is expanding with improving royalty expenses, declining impairment charges, and lower step-up amortization.

Equity earnings from our Agatha Christie subsidiary increased 220% year-over-year to $2.8 million. This acceleration results mainly from the theatrical release of Murder on the Orient Express. Net income from the fourth quarter 2017 was a positive $3.8 million, an improvement of $8 million from a net loss of $4.3 million in fourth quarter 2016.

For the full year 2017, total revenue increased 7.6% to $86.3 million, primarily driven by 65.3% revenue growth in our Digital Channel segment. Our gross margin increased over 10 percentage points to 43% in 2017 over last year. Net loss improved by $22 million to $6.3 million for the year.

Adjusted EBITDA improved 26.6% to $16.6 million. These are tremendous results that position us well for 2018.

Moving to our balance sheet. Total assets at December 31, 2017 and 2016 were $147.6 million and $136 million, respectively. The increase of $11.6 million in assets is mostly attributed to increased -- increases in investment in content of $9.8 million, equity investment in Agatha Christie of $5.1 million, and an increase in accounts receivable of $1.2 million.

This improvement was offset by decreases in other tangible assets of $1.6 million, cash of $1.6 million, and inventories of $1.3 million. The decrease in cash is primarily due to an increased -- due to increased investment in content and increased royalty payments, offset by the expansion of our debt, which generated $9.3 million of cash and cash dividends received from Agatha Christie of $2.5 million.

The increase of liabilities and equity of $11.6 million to $147.6 million is mainly due to $10.6 million increase in our debt balance. The increases in our stock price increased our stock warrant liability by $3.9 million. Our stock price increased by 130% from $1.60 at year-end 2016 to $3.68 at year end 2017. This year, we will further increase our investments in digital programming and marketing to drive forward 1 million subscribers.

We expect our gross margin and EBITDA margin to continue to expand as our Digital Channel revenue continues to grow. With strong momentum, a solid balance sheet, and clear 2018 priorities, we look forward to delivering another year of even stronger results.

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 [Steve Weiss] with [NextGen Investors].

Steve Weiss - *NextGen Investors - Analyst*

Just a couple of questions. Can you go over the main catalysts for growth in 2018 and potential for acceleration of growth? That's the first question.

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

Sure. For 2018, we are looking at our subscriber growth as we have stated in our remarks for growth, subscriber growth for both Acorn TV and UMC. And that subscriber growth, as we see it, is going to come both from organic growth on existing platforms and existing marketing initiatives. A key metric that we have talked about in the past is our cost per subscriber, which has remained remarkably stable over the last few years.

What that is allowing us to stay increase our marketing expenditures year-on-year and continue to increase our acquisition funnel without hurting our margins. So we very much are going to continue with our organic, as I said marketing, plans programs on existing platforms. If anything, we're going to increase significantly our marketing spending support of those initiatives. But in addition to that, we're looking to expand the footprints of Acorn TV and UMC on platforms both domestically and internationally, and we expect to do that over the next couple of months.

Steve Weiss - *NextGen Investors - Analyst*

The second thing maybe give us a little more color in terms of 2018 gross margins and adjusted EBITDA?

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

Yes. We don't give guidance outside of the target subscriber goal of 1 million that we have stated in the past. Having said that, I think as clearly shown in our 2017 results, the growth of our Digital Channels is going to continue to improve our margins. We expect our gross profit margin, EBITDA margin, and net income margin to continue to improve over time, even though that is not right now our primary goal. Our primary goal is to take advantage of the opportunity in the marketplace, in particular the OTT marketplace, and maximize the opportunity for growth of subscribers. We think that growth is going to be a natural result in our growth of our margins. Continued growth in our margins is going to be a natural result of that.

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

I'll add to that. One of the theme we see in our income, I think we mentioned on the call, we [couldn't usually see] -- we have a lower step-up amortizations and lower expenses as well as lower impairment. That have been driving our cost of goods sold down and improving our gross margin. So this is a good direction where we see -- where 2018 will land.

Operator

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

Bruce Galloway - *Galloway Capital - Analyst*

Can you sort of elaborate on the acceleration of growth? Does that mean that those subscriber growth on the OTT channel should be greater than 50%, which was last year's growth? And also, can you elaborate a little bit more about the relationship with AMC Networks, how that's working, how it's not working? Are they contributing to content? Are they contributing to distribution? How is that working? And how is that going forward?

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

Sure. Hi, Bruce. In terms of acceleration of growth, we can, I think, pretty accurately forecast continued growth on organic -- on organic activities, meaning activities that we have been engaged in for the last couple of years, specifically our marketing initiatives, acquisition initiatives on social media, on Roku, on Apple, our partnership with Amazon. I think those activities tend to be pretty predictable.

With regards to the growth in those areas, we expect to see accelerated growth, driven primarily by our increased investments in programming and marketing. Our improved cash position in the last year, a year and a half in particular, has allowed us to increase investment in programming. The fact that we are looking to do co-productions like Agatha Raisin or London Kills or Queens of Crime is a very good example of that.

So I think, number one, organic growth, if anything, increased organic growth supported by higher content and marketing investments. But then in addition to that, we fully expect in the next, really in the next couple of months to announce expansion of the footprint of Acorn TV and UMC, both domestically and internationally, on platforms that we have not been [added] to this states. And that's something that we have some expectations on. To be frank, it's hard to exactly forecast those because we don't have a track record of them, but we expect them to be meaningful. If they are meaningful in any way, we think that the growth of Acorn TV and UMC will accelerate. So that's the basis for that view.

In terms of our relationship with AMC, our partnership with AMC has, I will say, increased over time in the last three, six to nine months, as we have gotten to know each other better, specifically at the department level in areas such as content acquisition, distribution, and marketing. I will say in the last quarter or two quarters, we have found several areas where we have been collaborating. We have been sharing some content between WE tv and UMC. We have acquired titles or acquired titles with them where we have shared windows of distribution, just specifically a couple of titles that we have acquired, and AMC has premiered on their shatter OTT platform, and we have secured full distribution rights for them. And we continue to work together in a couple marketing areas and in some content development.

So I will say our partnership with them is good. Always with a caveat that anything that we do with them has to be to the mutual benefit of both companies, given that we have ultimately different ownership structures. But I will say, generally, with that limitation, I think that our partnership has been good.

Bruce Galloway - *Galloway Capital - Analyst*

Is there anyway could give us some updated numbers on the subscriber base? Or are you going to say that for the end of the quarter?

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

Yes. We're going to stick to what we normally do, which is at the end of the quarter, we'll give you some updated counts. If in between we hit milestones that we think are noticeable, we will also continue to announce them, announce those milestones. But I think we're going to what we have done in the past.

Operator

And this does conclude today's Q&A session, and I would like to turn the conference back over to Mr. Penella for any closing remarks.

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

Well, thank you. Thank you, everyone, for joining us today. We are all, I think, very excited about the 2017 numbers and the growth opportunities that 2018 represents for us. We believe that 2017 was an inflection year for us, and that we reverted the trend in the company in terms of top line revenue, with Q4 being the third consecutive quarter in which we achieved growth in revenues. And with the continued activity on Acorn TV and UMC, we fully expect that we are going to by the end of this year be very close to our 1 million subscriber target, and that the profitability and health of the company is going to be significantly improved because of that.

So, again, thank you for joining us today, and we look forward to the next call. Thank you, everyone. 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.
