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RLJE - Q1 2018 RLJ Entertainment Inc Earnings Call

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CORPORATE PARTICIPANTS

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

Miguel Penella *RLJ Entertainment, Inc. - CEO*

Nazir Rostom *RLJ Entertainment, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Steve Weiss *NextGen Investors - Analyst*

Bruce Galloway *Galloway Capital - Analyst*

PRESENTATION

Operator

Welcome to the RLJ Entertainment First Quarter 2018 Earnings conference call.

(Operator Instructions)

As a reminder, this call may be recorded.

I would like to introduce your host for today's conference, Miss Dawn Martens, Corporate Secretary.

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

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 Web Site, rljentertainment.com under the Investors section. A replay of the webcast will be available on our Web Site.

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, May 10th, 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 first quarter 2018 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 Web Site.

Lastly, as previously announced, the special committee of independent directors that was appointed by RLJ Entertainment Board of Directors to consider the February 26th, 2018 acquisition proposal from AMC Networks do not currently intend to announce developments unless, and in the event, a definitive agreement has been reached. Therefore, management will not comment today on this matter. We refer you to the Press Release and Form 8-K RLJ Entertainment issued on February 27, 2018.



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I will now turn the call over to Miguel Penella.

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

Two-thousand-eighteen has started with a very strong first quarter performance. We have already achieved significant milestones indicating that we are actively in growth mode.

We've reported our fourth consecutive quarter of revenue and gross profit growth with trailing 12 months revenue increasing 19% and adjusted EBITDA of \$17.9 million improving \$4.3 million over the prior 12 months.

We grew revenue in all three segments, Digital Channels, IP Licensing and Wholesale. Our subscriber count exceeded three quarters of a million at the end of the quarter, heading for 800,000 in the second quarter and rapidly nearing our 1 million subscriber objective.

And we continue to expand our operating margin, transforming our model economics as higher margin of Digital Channels revenues to further expand our profitability. Nazir will take you through the financials in a few minutes.

Looking in detail at the operations in the quarter, Digital Channels subscribers growth exceeded 44% from the first quarter last year. Our organic growth strategy that has been our focus for the last few years has paid off. Our continued Digital Channels performance demonstrates our ability to invest in differentiated content, targeted marketing and subscriber engagement.

At Acorn TV, which offers curated British and English language international dramas and mysteries, we were successful in selecting new and returning franchises. The first quarter returning franchises, Murdoch Mysteries, The Detectorists, Delicious, The Heart Guy and Striking Out. New series included Girlfriends and Ackley Bridge.

On UMC, our Urban Movie Channel, which showcases original series, drama, romance, comedy, thrillers, stage plays, documentaries and other exclusive content for African American and Urban audiences. Our new content offerings performed well. Our new titles in the first quarter were Couples' Night, Black Love, Patterns of Attraction, 5th Ward, He Say--She Say and Love N Success.

While we have seen significant growth across all of our platforms in Q1, the expansion of our footprint is a priority for 2018.

In March, we launched Acorn TV on Comcast in Xfinity On Demand. Both the Comcast subscribers in the home and on the go, we have Xfinity stream app and portal. This our first launch on an MVPD set-top box and it's an important first step taken with one of the largest cable providers in the U.S.

We're looking to expand Acorn TV and UMC's footprints further this year in the U.S. and internationally. In the immediate future, we have a significant opportunity to reach subscribers both on OTT platforms and through traditional cable providers who are now offering OTT channels in their services.

We have also continued to support our Digital Channels growth through strengthened investments in targeted marketing and are pleased with the reach and ROI of our campaigns demonstrating the scalability of our channels.

Our IP Licensing segment, which primarily includes our equity stake in Agatha Christie Limited, performed remarkably well in the first quarter. Interest in this brand and its stories and characters increased across all forms of media. The demand is rising as a number of these stories and characters are reintroduced and reimagined giving them new life and giving us new opportunities.

Agatha Christie not only benefits our Acorn TV segment as we host a significant number of Agatha Christie shows, but it also benefits RLJ Entertainment through dividends received and increased equity earnings. We received \$432,000 of ACL dividends in the first quarter and expect to receive substantial additional dividends during the remainder of the year.

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Our Wholesale segment also had a very strong first quarter. This business is a positive contributor in terms of revenue growth and profitability, while it also supports and benefits from the Digital Channels segment.

Digital sales led the growth of Wholesale in Q1, with strong feature film titles including Houses October Built [2], I Kill Giants and Kill Order and strong titles including Rebecka Martinsson, Love, Lies and Records and Brokenwood Mysteries.

As DVD offerings tighten, we are also experiencing lower returns of physical media which improves net revenue. Overall, this segment continues to be profitable and is benefiting at the gross margin line from the shift to digital.

Looking ahead, RLJE is gaining momentum towards becoming a powerhouse as a premiere global digital network Company for discerning audiences. We're executing well and continue to strategically stay on plan.

In our Digital Channels segment on the content side, we expect significant growth in original programming over the next 12 to 18 months stepping up our investment in compelling content to further differentiate our brand's position.

On Acorn TV, we have exclusive returning series with large followings such as Agatha Raisin, London Kills, Keeping Faith, Striking Out. We're not only co-producing, but in some cases we are also -- we are also leading the production of these titles.

On UMC, we're also committed to invest substantially to bring exclusive programs that will enhance UMC's subscriber's experience.

As we expand our footprint, we're looking to introduce our exclusive programming to an increasingly larger audience. We expect Comcast and international markets to be significant contributors to our expansion this year. And we will also continue to support all these efforts with increased investment in digital channel marketing. We expect Agatha Christie to have terrific year with growing interest in the brand across publishing, television and feature film platforms.

And in our Wholesale Distribution segment, we're excited about one of our feature film acquisitions for Q2. A noir thriller titled Terminal starring and co-produced by Margot Robbie and written and directed by Vaughn Stein. Terminal also stars Simon Pegg and Mike Myers and is planned for theatrical release opening tomorrow, May 11th. A horror action titled Another Wolfcop is expected to also be a strong title in Q2. Our upcoming Acorn titles for Wholesale video on demand, EST and physical distribution are Humans, A Place to Call Home and Girlfriends.

RLJ Entertainment is poised for tremendous growth. Our audience-specific brands, Acorn TV and UMC, are becoming must have destinations and we are investing in their growth by expanding content, distribution and marketing. Our growing OTT presence, supported by our stake in Agatha Christie, our Wholesale capabilities and the surge of consumers migrating to OTT is driving our momentum. We're rapidly approaching our 1 million subscriber objective and remain confident of achieving it by early 2019.

Before I turn the call to Nazir who will review the financials, I want to close today with a personal note to Nazir. As previously announced, Nazir Rostom, our CFO, will be leaving tomorrow, May 11th. Nazir has been a key member of our executive team and was a major contributor to RLJ Entertainment's success during the last two years. The Board and I thank Nazir for his outstanding performance and we wish him the best -- the very best in his career.

Mark Nunis, who is our current Chief Accounting Officer, will serve as interim Principal Financial and Accounting Officer of the Company. The search for a permanent CFO is underway.

I will now turn the call over to Nazir.

Nazir Rostom - RLJ Entertainment, Inc. - CFO

Thank you, Miguel. It has been a privilege to be part of the team over the past two years and to see the Company transform into a premiere digital channel Company. This is a very exciting time for RLJ Entertainment and the best days are ahead.

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First quarter results demonstrated consistent execution and continued growth toward the Company's 1 million subscriber objective and incremental margin expansion as our operating model gains power.

Starting with our income statement, Digital Channel revenue represented 47% of our total Q1 2018 revenue compared to 43% in Q1 2017. Digital Channel revenue increased 45% year-over-year to \$8.7 million in the first quarter of 2018 from \$6 million in the first quarter of 2017. This increase was driven by strong subscription growth as Acorn TV and UMC combined exceeded 750,000 subscribers growing more than 44% from Q1 of last year.

In our Wholesale Distribution segment, revenue increased 25% to \$10 million in Q1 2018. 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 first quarter 2018 revenue increased 34% to \$18.6 million from first quarter 2017.

Our total gross margin was 47%. This represents an increase of 13 percentage points from Q1 2017. The increase in Digital Channels in our revenue mix continues to drive the overall gross margin 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 42% year-over-year to \$784,000. This acceleration results primarily from continued growth of the film and publishing businesses. As Miguel mentioned, we received a dividend of \$432,000 in Q1.

Net loss for the first quarter of 2018 was \$6.5 million compared to \$6.1 million in the first quarter of 2017. Of the net loss in each quarter, non-cash warrant expense of \$3 million was due to stock price increase.

Moving to our balance sheet, total assets at March 31, 2018 and December 31, 2017 were \$147.8 million and \$151.8 million respectively. The decrease of \$4 million in assets is primarily attributed to decreasing cash and accounts receivables offset by increases in investment in content and equity earnings increase from Agatha Christie.

The decrease of liabilities and equity of \$4 million to \$147.8 million is primarily due to decrease in accounts payable and accrued royalties and decrease in shareholders' equity which was offset by increase in debt discount and warrant liability. Our warrant liability increased as a result of a 21% increase in our share price in the first quarter.

As we are increasing investment in content and marketing to gain subscribers and OTT market share, we continue to manage working capital as efficiently as possible to fund our growth plans. We're experiencing rapid delevering as we grow our adjusted EBITDA.

Our trailing 12 months adjusted EBITDA grew from \$13.6 million in Q1 2017 to \$17.9 million in Q1 2018 as a result -- our leverage ratio decreased from 5.4 times to 4.4 times. As we get closer to 4 times, we open new windows of opportunity to refinance our current debt, further reduce our cost of debt and add more liquidity to our balance sheet.

Furthermore, we expect major cash dividend payments from Agatha Christie this year in addition to what we already received in Q1.

RLJ Entertainment will further increase investments in digital programming and marketing to drive toward 1 million subscribers. This year is expected to look stronger than last year with continued growth in all revenue segments, gross profit, gross margin and adjusted EBITDA. This success will be driven by continued growth of our Digital Channels, growth in Agatha Christie in our IP segment and our success in shifting Wholesale revenue from physical to digital.

In summary, 2018 is promising to be another terrific year.

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



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Steve Weiss with NGL.

Steve Weiss - NextGen Investors - Analyst

Do you have any data on what the usage uptake has been since the launch? And how is revenue share calculated and what kind of margins do you get from this agreement?

Miguel Penella - RLJ Entertainment, Inc. - CEO

We do not publish or share specific revenue share or financial arrangements that we have with the different platforms that offer Acorn TV or UMC. We are not in a position to disclose that information. Having said that, I really want to point out that we have always been very mindful of maintaining good margins, healthy margins, and the fact that our ability to interact directly with subscribers allows us to really benefit from those high margins.

Whenever we establish these relationships, that is always paramount in our mind, as it is paramount in our mind the opportunities that some of these platforms provide to us. We launched with Amazon a couple years ago and to-date we have had a very good relationship with them. They give us access to many millions of subscribers that subscribe to Amazon Prime. And now with Comcast, we have access to over 20 million households which we did not have access to before.

Again, we are not in a position to disclose that information, but we are very excited about Comcast. The same thing is true for the subscriber data. We do not break down subscriber data by platform.

However, I do want to share with everyone that we continue to be very pleased with the growth of our Digital Channels because we're seeing that growth happen across the board. The growth of our platforms is not coming from one subscriber -- I mean one platform or another. It's really happening across the board and that is something that we're particularly happy about.

Steve Weiss - NextGen Investors - Analyst

You mentioned in the prepared remarks that growth is bringing down your leverage ratio which I would presume would make you a more attractive borrower. Do you need to seek or plan on seeking any additional capital to fund the growth? Is there anything in your agreement with AMC that would preclude you from repaying early or might you refinance your AMC debt?

Nazir Rostom - RLJ Entertainment, Inc. - CFO

You're correct. We are currently in this rapid delevering mode. If you look at our trailing 12 months in Q1 2018, we're currently at \$17.7 million of EBITDA compared to \$13.6 million in the same quarter of last year. Simultaneously, our debt this year is \$78 million compared to \$73 million last year.

That translates to a 4.4 times leverage ratio this year versus 5.4 time last year. We are delevering by 1 time. And as we continue to grow our Company, we, in the very near term, will be at 4 times leverage ratio and that leverage ratio opens new options and new windows of opportunities for us to really look at our debt balance with what we have with AMC and look at opportunities to reduce our cost of debt and add liquidity to the balance sheet. And more importantly, to look -- to look -- continue to look at how we increase shareholders' value.

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Going back to your second question in terms of are we able to repay early. So currently we are entering into the third anniversary of our debt which allows us to repay the loan, but we have to pay a prepayment penalty of 1.5%. After that -- after the third year anniversary, we will not have any prepayment penalty. And so we continue to rebalance all those factors into place to optimize and look at our cost of debt including any prepayment penalty to make sure that we continue to delever and reduce our cost of debt and continue to increase shareholders' value.

Operator

(Operator Instructions)

Bruce Galloway with Galloway Capital Management.

Bruce Galloway - *Galloway Capital - Analyst*

Getting back to the debt, apparently the deal with AMC Networks was giving you very, very advantageous rates with very little cash out of pocket. And I noticed that in the quarter, your interest expense went up to \$2.2 million which is \$8.8 million annualized which is probably about 11%, 11.5% on your debt level. Can you explain that?

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

Last year our debt balance was \$73 million and this year our debt balance is \$78 million. The result of that, while we did delever from our cost of debt because our subordinated note was going to increase from 1.5% to 12%. We have reduced our cost of debt down to a weighted average of between 6.5% to 7%. We also --

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

Basically, we had these \$8.5 million of subordinated notes which was going to see a change in interest rate from 1.5% to 12% in the quarter last year. And we were able to bring that into the AMC facility at a lower -- at a much lower interest rate. It looks like we paid more and we paid more, in fact, than last year, but had we not done that, the increasing interest rate would have been higher.

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

Yes, it would have been much more substantial. As a result of that we have reduced our cost of debt and have looked at it -- looked at our debt to make sure that we are optimizing our balance sheet to do so.

And as we continue to increase our EBITDA, we will have other options to look at how we can continue to reduce our cost of debt, reduce our interest rate and also recapitalize and add more liquidity, you just mentioned, to the balance sheet if we needed to, to grow our Company.

Operator

At this time, I'm showing no further questions. I would like to turn the call back over to Mr. Penella for closing remarks.

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

Well, thank you, everyone, for joining us today. We look forward to the next call after we release our Q2 results. I think we will do that in July or mid-July. I'm sorry, August. Well, thank you, everyone. Bye-bye.



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Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. You may now disconnect.

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