FINAL TRANSCRIPT

**WildBrain Ltd.**

**Fiscal 2020 Second Quarter Earnings Call**

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## PRESENTATION

**Operator**

Good morning, and welcome to the WildBrain Fiscal 2020 Second Quarter Earnings Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. To ask a question during that time, please press *, then 1 on your telephone keypad. If you'd like to withdraw your question, please press the # key.

I'd like to turn the call over to Nancy Chan-Palmateer, Director, Investor Relations at WildBrain.

You may begin your conference

**Nancy Chan-Palmateer** — Director, Investor Relations, WildBrain Ltd.

Thank you, Operator, and thank you, everyone, for joining us today. Speaking on the call today are Eric Ellenbogen, our CEO; and Aaron Ames, our CFO. With us for the question-and-answer session are Josh Scherba, our President; and Danielle Neath, our EVP of Finance and Chief Accounting Officer.

First, we have some standard cautionary statements. The matters discussed on this call include forward-looking statements under applicable security laws with respect to WildBrain, including, but not limited to, statements regarding the management and business reorganization; expected costs and savings associated with such reorganization and such savings; changes to YouTube; the business strategies and operational activities of the Company; and the future financial and operating performance of the Company and its assets.

Such statements are based on information currently available and are subject to a number of risks and uncertainties. Actual information currently available, actual results, or events in the future could differ materially and adversely from those described in the forward-looking statements as a result of various important factors, including the risk factors set out in the Company's most recent MD&A and Annual Information Form.

Please note that all currency numbers are in Canadian dollars.

For the question-and-answer session that will follow, we ask that each analyst keep to one question with one follow-up so that everyone has a chance to ask questions. If you would like to ask an additional question, please rejoin the queue.

I will now hand the call over to our CEO, Eric Ellenbogen.

**Eric Ellenbogen** — CEO, WildBrain Ltd.

Thanks, Nancy, and good morning to everyone on the call. Thanks for joining. Before Aaron walks us through the earnings results, I want to share some highlights from the second quarter.

We continue to make good progress on all fronts. We're creating premium content, and we're growing our viewership on WildBrain Spark, and we're improving our financial position as well.

The progress is showing up in our numbers. Our revenue, EBITDA, and cash flow are all up quarter over quarter.

We're also getting positive responses on our premium kids' content. The first new Peanuts series, *Snoopy in Space*, is one of the most-watched shows on Apple's new streaming service. The show is popular across a broad demographic of viewers from kids to adults. This is the first new global series for Peanuts in decades and we see this new content as a huge brand driver across consumer products, which has been the mainstay of the Peanuts business. Beyond *Snoopy in Space*, more Peanuts content is underway for Apple TV+, so stay tuned.

Another viewer favourite has become *Chip and Potato*, now a top-ten kids' show on Netflix in several key markets. We're moving forward on the second season of this original preschool series, and we're accelerating development of other famous IP too.

To help lead our initiatives in brand building, creativity, and premium content, last week we announced several key management appointments. Michael Riley joined us as our new Chief Brands Officer; Deirdre Brennan came on board EVP, Content Partnerships; and Jianbo Wei was appointed Managing Director, China.

We're adding expertise at the board level, too, with two new directors: Tom McGrath, a studio veteran and entertainment industry entrepreneur who served on my Classic Media board for many years. And Erin Elofson, who's the Country Manager for Pinterest Canada, and she brings a long track record of success in digital advertising and social media, including stints at Facebook and Microsoft.

Now I'd like to address one of the significant and anticipated changes that's occurred since our last earnings call, and that's the introduction of the so-called Made for Kids content category on YouTube. These changes were implemented in early January, and even though this is after the end of the second quarter, we want to provide some clarity on what's happened and its initial impact.

The creation of Made for Kids is a big step forward for the sector as a whole. Our analysis indicates that kids' content is the third-biggest genre on YouTube in terms of views and has therefore been a very significant driver of YouTube's business. You may have followed Google's recent disclosure that YouTube makes US$15 billion a year in advertising revenues, which in turn contributes 10% of Google's overall revenues. We expect that the changes they've introduced will improve the quality of the content that's viewed, and in turn, create new opportunities for advertisers who are finding it increasingly difficult to reach younger audiences on linear television.

In the short term, however, we're in a period of transition. The changes that have been rolled out on Made for Kids content remove features that use data that is associated with an individual viewer. And some of the disabled features affect the viewing experience, such as comments and notifications. Others affect some categories of advertising which have previously been shown to viewers of kids' content, and other genres, based on the interests of the individual viewer. It's these ads that target an individual viewer based on their interests and viewing history that will no longer be served on kids' content.

We do expect, however, that the demise of interest-based advertising will enable growth in other advertising formats on Made for Kids content. So in some ways, we're actually going back to the future. Going forward, we expect the major growth in advertising revenue will come from ads that are targeted based on the context that they are served in – the channel, the show, even the individual video – rather than based on the guess that an algorithm is making about who is watching. And the metrics for advertisers will be based on familiar measures, such as views, reach, watch time and frequency.

The way that Made for Kids advertising is sold in the future will share many similarities with the way that TV advertising has always been sold, and those are dynamics we understand well from our broadcast operations in Canada. We've been piloting direct sales of ads onto our WildBrain Spark channels in Canada, and we've been achieving a significant price premium compared to interest-based ads, which reflects the quality of our content and overall proposition.

In the meantime, we're responding rapidly to the new environment. We've now secured the technology we need, and we have an ads sales team in place in the UK, the US and Canada. We're open for business and have now started direct sales to advertisers this month.

The initial response from brands and agencies has been encouraging. They're welcoming our unique combination of placement of high-quality programming at significant scale, supported by analytics, and the opportunity to create and promote custom content. We're also working closely with YouTube as the Made for Kids category evolves across both the main YouTube site and the YouTube Kids app. Our ambition is to build a sustainable new model for AVOD that works for viewers, advertisers and creators.

We believe that we're very well-positioned to benefit from these changes in the long run. WildBrain Spark is a leader in the kids' space on YouTube, attracting on average over 3.5 billion monthly views. And this makes us an incredibly valuable platform for advertisers and to drive audience engagement for amplifying brands. What we've built is very difficult to replicate. We have a network of significant scale with 700 channels full of premium content, a highly engaged audience and proprietary analytical tools. We believe that Made for Kids will further accelerate the flight to quality that we will continue to benefit from.

So in addition to the actions that I've already shared, a few more things. We're also expanding out our data analytics, which give us valuable insights in developing and exploiting IP. We're continuing to mine our content library. We're adding more partner brands and growing our own brands; and we're expanding into new revenue areas and platforms to drive future growth.

We're also finding ways to build bridges for clients and our own IP across our studio, AVOD, and licensing agency businesses, to drive new opportunities. To that end, Steve Manners, who's been a longtime executive with our licensing agency, WildBrain CPLG, was recently appointed VP of Business Development to work with both WildBrain Spark and the licensing business, CPLG. Steve will pursue opportunities to help licensors and content creators to increase their exposure on digital platforms with WildBrain Spark, which could lead to increased consumer product opportunities with WildBrain CPLG.

That fits our strategy to become life-cycle managers for brands. We're continuing to take a 360° approach to drive creativity and collaboration across our business units to realize growth.

And with that, I'll turn it over to Aaron.

**Aaron Ames** — CFO, WildBrain Ltd.

Thanks, Eric.

In Q2, revenue rose 4% to $122.1 million and was up 6% to $234.4 million in the first half of Fiscal 2020, compared with the prior-year period. The increases for both periods were driven by higher total distribution revenue and royalties from our consumer products-owned business.

WildBrain Spark revenue grew 21% to $24.2 million in Q2 2020. This increase was fuelled by growing viewership on our AVOD network, which rose 36% to over 9.9 billion views in Q2 2020.

As Eric mentioned, YouTube introduced new rules and policies regarding targeted advertising on kids' content in January 2020. Absent our own initiatives and direct advertising sales taking hold and any mitigating actions taken by YouTube, we expect there would be a negative impact on revenue at WildBrain Spark in the latter half of fiscal 2020. Initially, in the first few weeks following the change, WildBrain Spark experienced a revenue decline of approximately 40% compared with the same period last year. We're taking actions to address this change, and continue to see significant value in our large and growing user base.

Adjusted EBITDA rose to $25.6 million this quarter and to $45.2 million in the first half of 2020. This compared with $22.0 million in Q2 2019 and $39.3 million in the first half of 2019. Adoption of the IFRS 16 accounting standard for leases positively impacted adjusted EBITDA by $2.3 million in Q2. Normalizing for this impact, adjusted EBITDA was up $1.3 million in Q2.

In the first half of Fiscal 2020, IFRS 16 positively impacted adjusted EBITDA by $4.1 million, while the first quarter of Fiscal 2019 included an incremental $1.3 million due to a higher ownership stake in Peanuts for part of last year's quarter. Normalizing for both these items, adjusted EBITDA rose by $3.0 million in the first six months of Fiscal 2020.

In Q2 2020, the net loss was $2.3 million versus a net loss of $17.9 million in the same quarter last year. This improvement was partly due to the positive impact of non-cash unrealized foreign exchange gains of $22.4 million and higher gross margins of $5.7 million in the current quarter.

In the first half of Fiscal 2020, net loss was $18.3 million versus a net loss of $20.3 million in the same period a year ago. The improvement was due in part to positive change in non-cash unrealized foreign exchange gain of $14.7 million and higher gross margins of $12.3 million in the current period. This was offset by a higher write-down of $4.8 million for certain investments in film and television titles determined in the context of current market conditions.

Cash generation continues to improve. We generated $46.6 million of positive operating cash flow for Q2 2020 versus $11.6 million in Q2 2019. We recorded positive free cash flow of $13.3 million in the current quarter versus $12.9 million in Q2 2019.

During Q2 2020, we continued to reduce debt. We paid down $50.2 million on our term loan from the net proceeds of the rights offering that closed during the quarter. As a result, our net leverage ratio was 5.09x at December 31, 2019, compared to 5.92x at year-end June 30, 2019. Concurrent with this debt repayment, our net leverage ratio covenant requirement under the term loan was fixed at 6.75x with no step-downs for the remainder of the term through December 2023.

With that, I'll hand the call back to Eric.

**Eric Ellenbogen**

Thanks, Aaron.

We're in a transitional period, but I can say it's definitely not the first with YouTube and our AVOD business. And for those of you who follow this sector, you'll know this is highly characteristic of the digital media business.

Since the founding of WildBrain Spark, we've worked through myriad changes with YouTube that significantly impacted both viewership and CPMs. And yet every time, we've come through with more content, bigger audiences and more revenue. This time actually feels no different, as we're repositioning aggressively to improve our platform, our viewership and monetization.

Now, we'll open up to questions.

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## Q&A

**Operator**

Thank you. At this time, I would like to remind everyone in order to ask a question, please press *, 1 on your telephone keypad. To withdraw your question, please press the # key.

Our first question today comes from Aravinda Galappathige from Canaccord Genuity. Please go ahead.

**Aravinda Galappathige** — Canaccord Genuity Corp.

Good morning. Thanks for taking my question. Eric, I wanted to start with I know you've given some good colour on your sort of—the roadmap for WildBrain Spark, but I wanted to dig a little deeper in terms of the direct sales initiative. My understanding is that there is a significant variance between the CPMs you get when you're selling through YouTube and when you go direct. Can you talk to that upside in terms of ad revenues? And connected to that, as you look to move beyond the typical YouTube MCN model, what are the other areas that you believe can be built up? I know that once you have an audience of a particular size and certain brands you're in position to build apps and build e-commerce around it and so on. Is that all part of your broader vision?

**Eric Ellenbogen**

So let me start with your second half of your question first, and then address CPMs and direct sales and our experience so far.

On the audience build side, I think there have been some experiments that we've seen across the industry about apps. I think the jury is still out on that. And being able to convert YouTube viewers into app viewers, I don't know yet. We're just going to watch that space. I don't know that we will necessarily be the innovators. There are a lot of industry participants there, and we'll watch those experiences.

On the e-commerce side, I think definitively there's an opportunity, and we are in a way already engaged in e-commerce through toy-play video and unboxing videos with the audience engagement that we have, and we clearly still have data regarding number of views, where they're viewed, languages, countries, et cetera. So that's extremely helpful, and we are looking very carefully at e-commerce partners and possibilities. So I would say less so on apps. E-commerce opportunities, I think, are meaningful.

And the other thing which we are doing already is to use a combination of linear television and our WildBrain Spark platform to promote IP, both our proprietary IP and partner IP. And it's sort of the always-on aspect of YouTube, linear television, and frankly any other AVOD platform.

On the CPM and direct sales side, one of the observations is that so much of the advertising on our content and, frankly, on all content on YouTube – the advertiser didn't pick that content. It's done through an algorithm. It was based on estimated viewer data, and it isn't really related to shows.

What's happening now with Made for Kids is that our approaches have been quite encouraging with major consumer product companies because there's a great deal of co-viewing that goes on in the space. It's both kids and caregivers and parents. And the ads are then intentionally associated with content, much like we sell in our broadcast television operations.

I think it's also fair to say it's no big leap that the audience for, call it, Teletubbies prior to December 31st is the same audience after December 31st. And in many or most instances, we have not only that data prior to the changeover, but we also know from linear television and rating services who those audiences are. So it does sell at a higher CPM. We obviously have issues around fill rates. We've got to get out there and begin selling. We have an enormous amount of content and placement. And we are also selling into the YouTube Kids platform.

So we're sort of firing on all cylinders with ad sales and talking directly to advertisers and sponsors, creating content with them, and I think that all of those things are going to be an enhancement to revenue.

**Operator**

Our next question comes from Rob Goff from Echelon. Please go ahead.

**Rob Goff** — Echelon

Good morning, and thank you for taking my question. It's also on the WildBrain Spark side. When you noted the 40% decline year on year, would you characterize that more as a reset or an initial shock to the change?

**Eric Ellenbogen**

Let me attempt that, and then Aaron can elaborate. It's very early data. I mean, it's just the first few weeks of January that we have data for. And we've gone through, in the same way, these algorithm changes that when YouTube went to a push for quality content benefitting large networks like ours, we had an immediate updraft in excess of 30%. So it's hard to say. My expectation is that there will be market equilibrium.

As I pointed out, the revenue associated with kids' content on YouTube is of such a magnitude that we fully expect that YouTube themselves will make algorithm changes, and those have not yet worked their way through the system. So they're highly responsive. They have promulgated these changes, and our experience, once again, is there is an adjustment, transition, and equilibrium is restored in the market.

The part that I think is interesting and opportunistic for WildBrain Spark is now having direct sponsor relationships, which are encouraged by YouTube. We understand the market extremely well and have those relationships now.

So I can see if Aaron wants to add anything, but it's very, very soon to tell what the trend is.

**Aaron Ames**

I guess I'd just add one comment. Obviously, it's very early days. It's been about three to four weeks, and we'll have a better view in coming quarters. But it's been our experience over the last couple years that when these changes are made, things have normalized, and we've been rewarded because of the premium content that we have and we've put on our channels.

And so we expect that to continue to be the case. But in the short term, there is some transition that we're all experiencing.

**Rob Goff**

Okay. And as a follow-up, is there also an opportunity here for you to be more aggressive as an aggregator of content, given the advantages of scale?

**Eric Ellenbogen**

Yeah. I'll—the answer is yes. And I also think that because of scale, two things. One, there, I think, will be opportunities in the market for consolidation as many of the smaller players cannot sustain a direct sales force in multiple countries, don't have the network data analytics, and that should lead to opportunities around further aggregation.

I do think there's a consolidation taking place. I mean, we saw this actually even before the end of the calendar year with the flight to quality on YouTube. And I think that the changes in advertising policy will lead to an opportunity for further aggregation. So I'd say the answer to that is, definitively, yes.

**Operator**

Our next question comes from David McFadgen from Cormark. Please go ahead.

**David McFadgen** — Cormark

Just a couple of questions on the changes with YouTube. Can you define, first of all, what is considered kids? Like what's the age demographic?

**Eric Ellenbogen**

Okay, so the way this works is two-fold. It's up to the network to define the content, first and foremost. But failing that, YouTube through its algorithms will define the content. So we are a scaled player; obviously, a dependable partner of YouTube; and so we're taking a very conservative view of what Made for Kids content is.

So it's really happening in two ways. Either you classify it yourself, or you get classified. But it's basically content that kids will likely be watching.

I don't know if Josh has an amplification on that just in terms of age bracket, but I know it is a self-classification.

**David McFadgen**

Okay. And in the past you talked a lot about the revenue of your YouTube business and how it's been growing so quickly and how you guys are really excited about that business, but you never disclosed the EBITDA contribution. So, if the revenue's going to be declining by 40%, it would really help investors to understand what the impact is to EBITDA, and particularly in light of your financial leverage, the 5.1x in this last quarter. So can you give us any additional information about that?

**Eric Ellenbogen**

So let me start, and then Aaron can chime in. We don't disclose the EBITDA, and I will go so far as to say while it is positive, it is not the metric that I believe the WildBrain Spark business or analogous similar businesses are or should be measured on. This is a business of audience engagement, scale and network size. And it is a growth in viewership which has been sustained in building our network very, very quickly, so up to 3.5 billion views a month. So I think revenue is important, and revenue has continued to grow. We have hit this change to Made for Kids, which has had an impact which we're sharing with you. Again, though, it's outside of the quarter, but that's really where this has played.

I think it is probably more appropriate when talking about IP exploitation to look at EBITDA as a measure. I think that's totally legitimate. In this case, though, I think that my focus is to take every dollar that we can generate within the WildBrain Spark business and put it back into the business to further grow content and audience.

Aaron?

**Aaron Ames**

Thanks, Eric. In my view, we're lucky because we're an integrated business. And so we grow awareness on WildBrain Spark. And as you saw, we had 36% increase in views. That allows us to increase brand awareness, and therefore, grow the other parts of our business, which we're very focused on. So I think that's why we're lucky.

And I think on the other side, we've taken a number of steps to improve our balance sheet and pay down debt and improve leverage. So I feel confident that our balance sheet can withstand the short-term variabilities.

**David McFadgen**

I mean, with all due respect, when you have 5.1x leverage and this revenue is potentially coming off 40%, it is a cause, I think, of concern for investors to wonder what the impact is to EBITDA. If your leverage was 1.5x, it probably wouldn't matter, but at 5.1x it matters.

**Aaron Ames**

Yeah. As I said, I think we've taken a number of steps to improve our balance sheet. And so we're confident that we can manage through the short-term nature of any variations here.

**David McFadgen**

Okay. All right. That's it for me.

**Operator**

Our next question comes from Deepak Kaushal from Stifel GMP. Please go ahead.

**Deepak Kaushal** — Stifel GMP

Hi, guys. Good morning. Thanks for taking my question. So maybe I'm going to look at this in a simplistic view, perhaps too simplistic. So YouTube has changed the way it advertises to kids in January because of regulations around advertising to kids and data collection. But it sounds from what you're saying that you still collect a rich set of data from the audience that views your content that is primarily children. So I'm just wondering what are the risks and how you see the risks on the data collection side in general for what you're collecting from kids through the platform, whether it's personally identifiable or not? And particularly in the age of GDPR with the new rules in California coming?

**Eric Ellenbogen**

Yeah. I think that there is no individual data post-January 1st. It's more in the nature of what you would see in a television rating. So the data that we collect, which is off of YouTube as well, based on linear telecasts of that same content, often, on a country-by-country basis we know who the audience is. And once again, and I'm not being sarcastic, we kind of know who the Teletubbies audience is. We don't necessarily need a lot of viewer data around that.

But in terms of number of views, where the views are taking place, languages -- that data comes up on YouTube just in terms of number of views. We get a little bit more refined, obviously, with some of the data analytics. So everything is consistent, COPPA-compliant. We definitively endorse the safer viewing environment for kids.

So there's nothing inconsistent with the data that we collect. It's ratings data, and that's what's being provided to advertisers along with what is called contextual advertising.

Prior to YouTube or even today when an advertiser is buying into an audience, they're buying a demographic. They understand from the content that they're placing or the advertising they're placing within content who is watching that content. Not on an individual basis. It's not targeted in that way, but shows for kids are going to get kids viewers.

And also in the preschool category, you're going to see co-viewing with parents and caregivers. So that's the data that we're supplying.

**Deepak Kaushal**

Okay. So to be clear, you don't see any risk from a regulatory perspective in the way you're collecting data or the data that you're collecting?

**Eric Ellenbogen**

No, not at all. To the contrary. Remember that this data was YouTube-supplied data. So YouTube is no longer targeting and supplying that data. So that's where it's coming from. YouTube is the source of this information. And prior to January 1st, the targeting was taking place. The way the advertising model worked is YouTube was serving up ads based on individual viewer data. That's no longer happening.

So if an advertiser now wants to buy in Caillou, they are just buying into Caillou. What we can tell them is how large the audience is, that's for sure. We can tell them the number of views. You can share watch time, as an example, and how persistent the audience is around particular episodes or series. That's all readily available and has nothing to do with individuals. It's sort of exactly the same as buying in linear television.

**Deepak Kaushal**

Got it. Thanks. I had a follow-up for Aaron as my follow-up question. I kind of missed most of the EBITDA commentary in your prepared remarks. I'm trying to understand if you exclude the piece that goes out to the non-controlling interest, what's the EBITDA growth on the remaining piece that you guys keep year over year?

**Aaron Ames**

Well, if you take that out—well, it was $1.3 million for the quarter. So $1.3 million divided by 25, so I think that's the number that … that's the percentage, I guess, prior year.

**Deepak Kaushal**

That's the growth rate of the baseline EBITDA?

**Aaron Ames**

That was the increase in EBITDA, normalizing for both—

**Deepak Kaushal**

Got it.

**Aaron Ames**

—IFRS 16, as well as the lease—sorry, IFRS 16 and then the, yeah, the half a year of Peanuts, the small portion for Peanuts. So in the half year, it was $3.0 million for the six months normalized for the IFRS 16.

**Deepak Kaushal**

Okay. Okay. I think I got it. Thank you.

**Operator**

Our next question comes from Tim Casey from BMO. Please go ahead.

**Tim Casey** — BMO

Thanks. Just back to YouTube and WildBrain Spark. So initially you've seen a hit to revenue. I mean, we're halfway through the quarter. Can you help us directionally how should we think about that revenue line through the balance of this year and then into next in terms of trend? And I have to go back to David's point. I mean, we can't ignore EBITDA. Like to say it's not a meaningful metric, it just—I don't understand that. So can you help us out there? Thanks.

**Eric Ellenbogen**

So let me take the last part of your question first. You can't ignore EBITDA on a company-wide basis, and I think that it is relevant in our ability to make EBITDA inside of WildBrain Spark as a demonstrated profitable platform, I agree is important.

As to the quantum, provided that we have dry powder and a business that is quite diversified in its sources of revenue, I continue to look at the business—and you may take issue with it—I look at digital businesses around audience growth and engagement, and that to me—and revenue—be able to build top line, as mission-critical. And we're not alone in this category. I mean there are myriad digital businesses that are measured on an identical basis. And so in our industry sector, that's the yardstick by which a digital business should be measured. So it's about growing revenue, growing audience, and making sure that it's a sticky audience and they're constantly engaged in our network. So that's one piece.

On the second part, and I'll let Aaron take that up, it is such early days and we're sharing with you sort of real time what we're seeing. Just as the algorithm switched on us in the back half of the last two quarters, very likely there will be an adjustment, if history is any lesson to us in the way that YouTube operates. So it just is not possible for us, based on a few weeks worth of data, to make a forecast on where it's going, as well as our own efforts in direct ad sales.

So it's both expectation on our part that there will be adjustments that YouTube makes and, on the other hand, our own direct efforts in advertising sales at higher CPMs than we were enjoying through the auction mechanism on YouTube.

Aaron may have a contribution to this as well.

**Aaron Ames**

Yeah. I mean, I guess from a modelling perspective, which I think is where you guys are driving to, the only thing you can do is use our consolidated EBITDA percentage, which for the quarter before NCI was 28% and then for the first half is 26%. But, from our perspective this is a very short term—first of all, we only have four weeks of data. Historically, we've come back and improvements have—algorithms have changed and things have normalized, and so we don't anticipate this to be a long-term situation. And it will come back and it will normalize. But from your modelling perspective, that's about as best as I can give you.

**Operator**

I'll turn the call back to the presenters for closing remarks.

**Nancy Chan-Palmateer**

Well, thank you, everyone, for joining us today, and we look forward to updating you next quarter.

**Operator**

This concludes today's conference call. Thank you for participating. You may now disconnect.