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DHX Media Q2 2017 Earnings Call
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C: Dana Landry; DHX Media; CEO
C: Keith Abriel; DHX Media; CFO

P: Drew McReynolds; RBC Capital Markets; Analyst
P: Aravinda Galappathige; Canaccord Genuity; Analyst
P: Adam Shine; National Bank; Analyst
P: Rob Goff; Echelon; Analyst
P: Deepak Kaushal; GMP Securities; Analyst
P: Bentley Cross; TD Securities; Analyst

+++ presentation

Operator^ Good morning. My name is Kevin, and I will be your conference operator today.

At this time, I would like to welcome everyone to the DHX Media second quarter results conference call.

(Operator Instructions)

I would now like to turn the call over to Nancy Chan-Palmateer, Director of Investor Relations. You may begin.

Nancy Chan-Palmateer^ Thank you, Operator. Thank you, everyone, for dialing in this morning.

On the call with us today are Michael Donovan, our Executive Chairman; Dana Landry, our Chief Executive Officer; Keith Abriel, our Chief Financial Officer; and David Reagan, our Executive Vice President of Strategy and Corporate Development. Before we proceed, we have some standard cautionary statements. The matters discussed on this call include forward-looking statements under applicable securities law with respect to DHX, including, but not limited to trends in digital advertising, growth potential in AVOD platforms, the growth and performance of WildBrain and Teletubbies, the timing of production schedules and deliveries, the markets and industries in which the company operate including demand from new digital customers, platforms, and territories.

The business strategies and operational activities of DHX and its subsidiaries, including acquisition opportunities and the growth and financial -- and operating performance of DHX, its subsidiaries, and investments including fiscal 2017 revenue outlook for the

company. Such statements are based on information currently available and are subject to a number of risks and uncertainties. Actual results or events in the future could differ materially and adversely from those described in forward-looking statements as a result of various important factors, including the Risk Factors set out in the company's MD&A and the company's Annual Information Form, which also form part of the company's Annual Report on Form 40-F.

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 a question. If you would like to ask an additional question, please rejoin the queue.

With that, I will hand the call over to Michael Donovan.

Michael Donovan^ Yes. Thank you, Nancy and thanks everyone for joining us on the call this morning.

Ten months ago, we unveiled WildBrain, our multiplatform kids' network, which we have dealt to exploit AVOD platforms such as YouTube and others. AVOD stands for advertising supported video on-demand and it represents a major new growth opportunity for DHX Media. Since 2012, the daily average time spent watching online video in the U.S., for example have increased on average by 22% annually. In the same period, the global annual spend on digital advertising has more than tripled to 24 billion U.S. As a content company, we benefit greatly from these digital trends. Last fall, the DHX Media Ipsos Global parent survey revealed that YouTube's AVOD service has become the single most popular streaming platform with kids in Canada and the U.S. and the U.K. beating even Netflix.

WildBrain, our service is one of the largest networks of children's content on YouTube. Twelve of the Top-20 channels on all of YouTube are kids' channels. And taken as a network, WildBrain gets more monthly views than any of them. In January, for example, we crossed the 1 billion views threshold across the entire network for the first time. With over five billion minutes of content watched in that month. And we are continuing to grow organically quarter-over-quarter. Dana will expand further on WildBrain's tremendous growth potential in just a few minutes.

I want to highlight some of the recent WildBrain deals we have done. First in January, we announced deal to manage Turner's kids YouTube channels for PowerPuff Girls, Benton and Adventure Time in Europe, the Middle East, Africa, Latin America. This follows our successful management of Turner's Lazy Town channel.

Secondly, we announced in January a deal to manage on a global basis, the YouTube channels for the top Moose toys brand Shopkins, Happy Places, Grossery Gang and Twozies. Further to these deals, we are pleased to announce today that we have just signed our second term sheet for WildBrain channel acquisition. We can't disclose details at this point, but it is a very popular preschool channel generating currently approximately 40 million views per month and it's a perfect preschool fit for WildBrain.

We have several other similar acquisitions or potential acquisitions in the pipeline, which we are hoping to announce over the next several months. These deals are a testament to the strength and reach of our WildBrain network and the momentum its building.

Online video consumption is growing, digital advertising is growing, kids are flocking to YouTube, a founding principal of DHX is to be on the ahead of the curve and we believe that precisely where we are with WildBrain.

Dana, please?

Dana Landry^ Thank you, Michael, and thanks to everyone for joining us on the call this morning.

These are indeed exciting times. Over the past decade or so, we built the company that is positioned extremely well for a long-term global growth. Consumption of kids content is booming around the around and DHX is central to that growth. Our content is enjoyed by kids in virtually every nation on every major streaming and broadcast platform available to them.

In fact, our WildBrain network alone reaches more than 238 territories worldwide in 21 languages. We understand how and where kids consume content in today's digital world. Our DHX Ipsos global survey of parents reveal that 72% of kids content consumption is done on streaming services such as YouTube and Netflix and that 61% are watching on tablets and 40% on smart phones.

Through our integrated model of content creation, distribution and content driven consumer products, we are delivering our shows and brands to a whole new generation of kids worldwide. Content is the core of everything that we do. So we are pleased to report that revenues from our proprietary content business which is comprised of proprietary production and distribution including WildBrain and consumer products owned has grown 10% over Q2 2016 for Q2 2017. This is a testament to the quality of content we produced and to the investments we've made over the past few years, which are gaining traction.

I'd like to talk a little more about how our integrated model revolves around content to drive such growth. There are three stages to our content model. First, we developed and produced high quality children's content. Collaboration is the cornerstone of how we operate, which includes leveraging our studios and working with top-tier partners around the world.

Secondly, because of the leadership position we hold in kids' distribution market -- in the kids' distribution market, we have built relationships to help us license our content to broadcasters and streaming platforms in more than 300 territories. Through WildBrain, we give our content, the broadcast possible exposure on YouTube and we are poised to expand our network across our emerging AVOD platforms.

In fact just recently we launched a small amount of content in a beta test on Amazon Prime's emerging AVOD platform. It's very early stages, but result so far looked promising. And finally, we leveraged our content to create global brands that drive consumer products. When kids watch the shows, they love such as Teletubbies,

Twirlywoos and Caillou and others. They want those shows and character to be part of their everyday lives through toys, books, clothes, and so much more. Our global team of licensing professionals is highly skilled in building brands and bringing content driven consumer products to market.

This cycle which we call a virtuous circle -- drives itself as content generates demand for consumer products and that brand awareness then drives demand for more content.

We saw early that the coming digital era were significantly revalued children's content upward especially in animation content. We have since then become leading global experts in children's content.

Our library which now stands at more than 12,500 half hours provides scale and makes DHX Media available at one stop shop for our customers. This morning, for example, we announced our third deal with Amazon Prime Video, which will see more than three dozen of our shows made available on their new service in India. This follows on similar deals announced last fall with Amazon SVOD service in the U.S., U.K., and Germany.

We have also become experts in the AVOD space for kids.

WildBrain as Michael mentioned earlier and AVOD represents an opportunity of tremendous growth. By leveraging our library across that network, we have expanded the audience for our library and extended the life of our shows across a new growth channel where it can live on for decades. There was enormous appetite for kids' content on YouTube and we believe the AVOD model holds potential to ultimately eclipse the SVOD market. As Michael mentioned this January, we crossed the threshold of 1 billion views per month on the WildBrain network.

In the last four years, watch times in WildBrain have climbed from about 255 million minutes per month to now more than 5 billion minutes per month. Revenue for WildBrain is projected to hit the mid 30s million this year for fiscal 2017 representing growth of 75% to 100% over last year. We believe from our research and growth metrics that kids are going mobile and they love YouTube. As other platforms such as Facebook and Amazon as I mentioned earlier launched AVOD offerings, the WildBrain network is designed to be replicated across such platforms to expand the monetization of our content.

One of the major advantages of YouTube is that it's free to the consumer, yet generates revenues for us through advertising. Across all categories and genres, it's estimated that

YouTube generates approximately 9 billion in gross revenue up from advertising annually and that figure has been forecast by some industry observers to triple by 2020. WildBrain captures only a fraction of that 9 billion, but even if we just hold our current market share which our intention of course is to grow it aggressively, but even if we hold WildBrain is poised to grow significantly as YouTube grows.

Another major benefit from the wide dissemination of content across the globe is that it lays the runway for consumer products. In AVOD, we see an opportunity beyond just advertising revenues. Through such platforms, content can be used to connect consumers directly to e-commerce sites for the purchase of merchandise furthering consumer engagement with our brands and expanding our revenue stream.

Just as we saw this intermediation of traditional television over the last number of years where consumer shifted away from Linear TV to an on-demand model, we are now seeing a similar disruptive dynamics spreading through the retail sector. With consumer shifting away from bricks-and-mortar stores to e-commerce, such an environment is very positive for brand owners because it lessens the need to compete for valuable shelf-space in retail stores and provides direct access to the consumers.

I'd like to now turn to an update on Teletubbies. When we bought the Teletubbies back in 2013, the brand was virtually dormant. We embarked upon a multiyear strategy to fresh and re-gauge kids with the brand. Today following the launch of our new Teletubbies series in the U.K., in the fall of 2015, I'm happy to report how that Tinky Winky, Dipsy, Laa-Laa and Po have been revived and are thriving. Character options, the brands, master toy licensee reported that Teletubbies toys were top sellers this Christmas in U.K, ending the year as the top-five pre-scale property for the territory.

In the plush category, three quarters of a million toys have been sold in the U.K. since launch and as the peak one Teletubbies toy was sold every 30 seconds in the U.K. Interactive toys which launched this summer are also doing well, performing strongly for Christmas and the U.K. for licensee VTech and DVD's from worldwide home entertainment licensee Sony have enjoyed solid sales since launch in October of last year.

The series meanwhile is a huge hit with British preschoolers consistently placing in the top 5% programs on all U.K. kids' channels and season two is expected to premiere this spring on CBBs. In the U.S., Nick Jr. picked up recently season two of the new Teletubbies actually last month to extend their exclusive deal for the show in that territory. This news comes just as Teletubbies toys and consumer products are rolling out in the U.S. Other territories will soon follow.

It should be noted that we are in year two of a 10 to 15 year revival and it is not unexpected that some of the activity for Teletubbies consumer products may shift from one year to the next. It takes many years to refresh and rebuild a kids brand like this, but Teletubbies is a superb example of how once popular brand can be rejuvenated with new content and consumer products so that today's parents who enjoyed the brand as kids, can

share them with their children. We expect Teletubbies global momentum to continue building for strong mid and long-term returns.

Kid's content is one of the most enduring categories in the entertainment market. We have assembled the powerful platform at DHX Media built to produce and deliver amazing kids content and drive consumer products worldwide. A new phase is now ramping up as we anticipate that AVOD and the potential for new e-commerce opportunities will generate huge growth to help drive brand awareness and appetite for consumer products. We've got many exciting projects and initiatives in the pipeline that we believe will propel us forward on our journey for long-term growth. With that, I'll turn the call to Keith.

Keith Abriel^ Thank you, Dana, and thanks everyone for dialing this morning. Let's discuss some of the high level results for the second quarter of fiscal 2017. Revenues for Q2 2017 were \$78.8 million down 3% from \$81.5 million for Q2 2016. In absolute dollars, the decrease in Q2 2017 was due largely to expected declines in line with quarterly targets in DHX Television, consumer products represented revenues, proprietary production and producer and service fees, offset by increases in distribution and consumer products owned revenues. Overall, revenues were at the high end of management's quarterly expectations.

The company's proprietary content business revenue for Q2 2017 was up 10% to \$48.8 million from \$44.1 million for Q2 2016. Management is pleased that its strategic priorities of investment in content are materializing.

The company's proprietary content business is comprised of proprietary production, distribution including WildBrain; consumer products owned a new media and other revenues. Proprietary production revenues for Q2 2017 were \$17.68 million, a decrease of 15% compared to \$20.71 million for Q2 2016.

The company added 53 proprietary half hours to the library this quarter, down 30% versus 76 proprietary half hours for Q2 2016. For Q2 2017, the company added 23 half hours of third party producer tiles with distribution rates up 16 half hours up from 16 half hours in the same period last year representing an increase of 44%. The increase is an example of the operational synergies associated with owning DHX Television.

Proprietary revenue was at the top end of management's previously reported quarterly expectations.

Total distribution revenues were up 21% to \$22.4 million from \$18.6 million for Q2 2016 driven by very strong growth in WildBrain.

For Q2 2017, distribution revenues excluding WildBrain were generally in line with the previous year's quarter at \$12.9 million down slightly by \$0.32 million. Management is very pleased to report that revenues from WildBrain were \$9.4 million for Q2 2017 reflecting 78% growth versus Q2 2016 revenues up \$5.3 million.

Distribution revenues excluding WildBrain were at the top end of management's previously reported quarterly expectations. Consumer products owned revenues for Q2 2017 were \$7.9 million up 82% compared to \$4.3 million for Q2 2016. For Q2 2017 consumer products owned revenues included \$3.9 million from the international portion of the next step Wild Rhythm Tour compared to Q2 2016 when the company had no live tour revenues.

Excluding the live tour revenues, consumer products owned revenues for Q2 2017 were \$4 million compared to \$4.3 million for Q2 2016, a decrease of approximately 7% as the company continued to recognize non-refundable minimum guarantees associated with Teletubbies, In The Night Garden and Twirlywoos.

Management expects consumer products owned revenues from Teletubbies to continue to ramp-up in late fiscal 2017 and into fiscal 2018 as Teletubbies toys are rolled over into the U.S. and other markets.

Consumer products owned revenues were well above the high-end of management's quarterly expectations generally driven by higher than expected live tour revenues. Producer and service fee revenues for Q2 2017 were \$10.4 million; a decrease of 9% versus an \$11.5 million for Q2 2016 and at the low end of management's previously reported quarterly expectations. Management expects progress to accelerate for the remainder of fiscal 2017 on a number of key service projects.

DHX Television revenues for the quarter were down 18% to \$15.4 million from \$18.8 million for Q2 2016 and were near the low-end of management's quarterly expectations. Consumer products represented revenues were \$4.6 million down \$2.48 million compared to Q2 of last year. This was at the top end of management's previously reported quarterly expectations.

Gross margins for Q2 2017 were \$42.02 million, a decrease in absolute dollars of \$2.27 million or 5% compared to \$44.29 million for Q2 2016. The overall gross margin for Q2 2017 at 53% of revenue was near the midpoint of management's previously reported quarterly expectations.

Turning to operating expenses, SG&A costs for Q2 2017 increased 17% to \$19.64 million compared to \$18.35 million for Q2 2016. SG&A includes \$1.6 million, the comparative figure for Q2 2016 is \$1.82 million in non-cash share based compensation, when adjusted cash SG&A at \$18 million was at the high end of management's previously reported quarterly expectations driven by both increased SG&A cost at WildBrain and increased corporate development activities as management continues to pursue acquisition opportunities.

For Q2 2017, adjusted EBITDA was \$23.98 million down \$3.78 million or 14% over \$27.76 million for Q2 2016. Net income for Q2 was \$5.8 million compared to \$11.7 million for Q2 2016 a decrease of \$6 million.

Net income for Q2 2017 was materially impacted by a foreign exchange loss of \$2.2 million versus a foreign exchange gain of \$2.6 million for Q2 2017. Foreign exchange loss for Q2 2017 was primarily driven by the impact of exchange rate fluctuations on foreign currency denominated receivables and payables, a significant portion of which are comprised of inter-company balances.

Looking at cash flows now. For the six months ended December 31, 2016, cash flows used in operations were \$7.5 million, the net cash outflow from operations for six months 2017 has been directly impacted by the following: first, the company continued with an aggressive production slate at a time when demand for content is robust, specifically the company's productions and progress were at \$31.4 million at December 31, 2016 compared to \$25.1 million at June 30, 2016.

Secondly, the company's acquiring third-party content for DHX Television in advance of the fall season which accounted for a net cash outflow for approximately \$1.5 million an expected reversal of \$4.5 million from September 30, 2016.

And third, the company used cash of approximately \$3 million to satisfy its tangible benefit obligation representing the full amount of its expected annual expenditure for fiscal 2017. For further specifics on the Q2 2017 results as well as additional information on management's fiscal 2017 outlook and various other information including a reconciliation of GAAP and non-GAAP financial measures, I would refer you to the company's MD&A and financial statements for Q2 fiscal 2017, which were posted on SEDAR and EDGAR today.

With that, I will turn it back to Dana.

Dana Landry^ Thank you, Keith. And I will just turn it to the operator now for questions from analysts.

+++ q-and-a

Operator^ (Operator Instructions) Our first question comes from Drew McReynolds with RBC Capital Markets.

Drew McReynolds^ Yes. Thanks very much. Good morning. Dana I just wanted -- one in here on the distribution revenue guidance and obviously the tweak down from 12% to 15%, the 2% to 5%, I'm just trying to better understand what is timing related, what's alternate revenue related and just overall your comment on the distribution outlook x WildBrain. Thank you.

Dana Landry^ Thanks Drew. Thanks for that question. So, look I think the -- from a high-level of the business is -- it's very positive in terms of the demand for our content. There is a combination of things there what we have is -- as a mix between library sales and also original. But specifically for 2017, there was a couple of buybacks in shows and you will see this in the proprietary guidance as well that we were projecting deliver late fiscal

2017 that have been pushed into 2018, and obviously, the follow-on distribution revenues that would come from those as well rather than push to number one.

Number two, we were expecting that China in particular and some of the other expansion of Amazon and others would happen at a greater pace that it has over the last six months. We had anticipated that we would grow along side of that, some of that has happened at a little slower pace. And China in particular the consolidation specifically Alibaba buying Youku Tudou, which took awhile to get closed and ultimately get a hand along where from a management perspective where those conversations would go, which has slipped some of that distribution revenue from 2017 and 2018.

So, I think that overall, we are seeing a nice friend for our library and content. I think it's fair to say that distribution is a little lumpy in terms of -- also driven by proprietary deliveries but also by the nature of how quickly our customers expands relative to growth.

On a positive side, obviously, we reported today another deal with Amazon in India, so we are seeing those conversations continue. But, we are in a period of a year where if you strip to your point WildBrain, it looks like we are going to be flat to slightly up on distribution x that which is probably a bit of a testament where we are in the cycle.

Drew McReynolds^ Okay. And just one follow-up to that Dana, you and Michael have obviously flushed through the AVOD opportunity. When you look at AVOD versus SVOD versus linear, and I have asked you this question in the past, do you see anything underneath the hood where the cannibalization of demand for SVOD and linear is kind of getting the levels where, they are worth noting or do you see that demand curve still largely additive across the globe. Thank you.

Dana Landry^ Yes. Maybe I will put it to Michael for headlines or comment. Then I will get into...

Michael Donovan^ Yes. No, no. We are not seeing any cannibalization at all. SVOD continues. For us it's timing. And we expect in future years for that to continue a pace. Eventually that cycle will come to an end but we are not seeing any evidence at all of that yet.

Linear of course is in terms of its revenues its flat, but linear services are continuing to compete by buying programming et cetera. So again, no lessening there, although eventually that will come to an end too, we think. But, AVOD is on fire.

Dana Landry^ The only one I will add to that I think is that a little to my comment on mix is that, we are seeing that the original orders coming out of the SVODs and others are continuing at great pace. And if you look at -- Keith mentioned in his comments \$32 million in WIP, work in progress investment in film, which is up considerably from year end and last year. And so we are seeing that demand there, so which is kind of why we're now going into an era of grouping all the content into one bucket because really we view

it as one bucket proprietary production, distribution and consumer products. And we are seeing good growth with that going forward.

Drew McReynolds^ Thank you.

Dana Landry^ Thank you.

Operator^ Your next question comes from Aravinda Galappaththige with Canaccord Genuity.

Aravinda Galappaththige^ Good morning. Thanks for taking my question. Just to follow-up on -- the question about guidance. I have also noticed that produce and service fees the other item that obviously was revised down. It was always sort of a very much backend loaded revenue stream. Can you just touch on what sort of drove back provision down and do you sort of see that growth sort of continuing into 2018?

Dana Landry^ Yes. I mean I think the -- for us it's obviously utilizing capacity if I understand your question correctly; I think it was on the service side, is that right, Aravinda?

Aravinda Galappaththige^ Yes. Correct, yes.

Dana Landry^ Yes, okay. So it's about using the capacity of the studio as you know we have just completed construction of a state-of-the-art facility at Vancouver. There is a number of shows that we've had in the pipeline for quite sometime and obviously given that we have been trying to utilize our capacity for our own proprietary shows, we're going there first as those sort of tend to move of the schedule or shift around, we try to slip-in some of the producer and service stuff. This stuff isn't as easily moved though because often you get these contracts years in advance. So there is a little bit of lumpiness there. But we're not seeing any lack of demand on the service. I mean we could fill our service studios for the foreseeable future if we choose to do so and have great cash flow from it. We think it's the better use of our capacity to focus more specifically on our own proprietary content on rates that we will ultimately hold in the long run. So you will see a little bit up of to and fro in there.

Aravinda Galappaththige^ Okay, thanks. And then, just with respect to I know you've discussed sort of your M&A plans at the AGM and I think prior to that, but your goal is sort of having larger international brands in the portfolio. Are there any update that you can provide on the M&A side of things on that front and with respect to -- connected to that with respect to the leverage, you just give us an update of where you feel comfortable in terms of taking the leverage in connection with those acquisitions?

Dana Landry^ Sure. So look I think that on the M&A front as I said in the last conference call and previous other moments. There has been time over the cycle where that has -- we saw an increase in opportunities and that's where we are right now, there is a ton of opportunities. I think it's interesting because when we are pursuing them, we look at it

internally we say because we are at the size, we are in the perfect spot for acquisitions. We are also in the perfect spot for organic growth just why we are excited about WildBrain. But we're not too big, so founders and creatives who want to deal with us.

In other words we are not a studio, but yet we are big enough that, we have scale with all of the necessary pieces to pull the levers. And so opportunities in terms of revenue and cost synergies are very, very significant when we are looking at some of these adding absolutely core brands within to the infrastructure. And so we are really looking forward to progressing nicely on that in the coming months and quarters, obviously nothing done cannot speak any further on any particular one that we're pursuing.

Other than just a type of opportunities or global opportunities, ones that will be able to lever our entire portfolio. Michael, do you any further comments?

Michael Donovan^ In other words, we are -- we find ourselves that where the opportunity is -- where the unique buyer and those are the ones we're focused on pursuing and there is some that are large, some that are medium, some that are small and that's -- and so we are hoping that there will be further news on that front in the next quarter or two.

Dana Landry^ and I'm going to come back to your question on leverage, but also want to just touch briefly on the WildBrain growth opportunities. As Michael said in his opening, we announced the signing of the second term sheet. We have more than 10 of those conversations going on in as we speak revenue ranging from everywhere from couple of million dollars a year all the way up to 25 million a year. So, we are really expecting some really good growth from an acquisition point on WildBrain.

In addition to the plus 75% growth on the organic side that we are seeing. So that's -- we see that in the future maybe one year or two at the most that will actually surpass both SVOD and linear in terms of revenue.

On leverage, I think what we think about -- the way we think about this we're pretty consistent over the years that if we see opportunities where cash flow is tangible and/or synergies are tangible, we can execute on those relatively quickly then we're not afraid of leveraging the balance sheet. I think back to when we did Cookie Jar or even the channels we took the leverage up into the mid 3s.

And so for the right opportunity absolutely we look at leverage, it's not something that management is at all scared about. I think it's a unique opportunity right now to go and capture some of those global brands and so we're out there looking.

Aravinda Galappaththige^ Great. Thank you.

Operator^ our next question comes from Adam Shine with National Bank.

Adam Shine^ Thanks a lot. Good morning. So Dana and maybe for Keith as well, there are number of pieces of the F'2017 guidance are being pushed out I guess to 2018. We've

got to the live action shows. We've got I think some live tour stuff, and then, obviously, some M&L related to Teletubbies go into the first half of 2018. When we think about some of the adjustments, we're now going to be making to the F'2017 guidance, do we build up into 2018 in that, let's say 10 million of loss F'2017 EBITDA layers on to what otherwise would be F'2018 expectations or is really enhancing visibility going into F'2018?

Dana Landry^ Yes. I think it's a good question and I think it's both, building on and enhancing visibility. I think that the -- when we start a year out, I think you will appreciate being around the sector for a quite sometime, it's the tough one to really predict when you are looking at one year out, which is why as obviously we've never gone beyond one year in terms of guidance.

For years, the trend was our friend and so with the wind at our back having lofty goals of 15% growth, we were able to achieve and execute on. Now that the -- some of the trends in terms of SVOD and others are perhaps settling down if you could bear with me with my analogy then we can look to execution, I guess. And from our perspective focusing on the core of content growth is where we're at.

And so visibility absolutely improving as you invests into your own content because you can sort of see for the future or for next couple of years, little less predictable when it comes to some of the lumpy size of the business or service and represented.

Adam Shine^ Okay. Thank you very much.

Operator^ our next question comes from Rob Goff with Echelon.

Rob Goff^ Thank you very much. The timing is great. It's bit of a going deeper on Adam's question perhaps. Could you talk to when you see visibility on the M&L revenues from a Teletubbies to the aspects of visibility and recognition of those revenues?

Dana Landry^ Sure. Thanks, Rob. Thanks for that. Yes, I mean look, I think that the -- it's not unexpected as I said in my opening remarks. We're kind of a year or two of 10 to 15 year revival here. We're looking at really a slipping for a quarter or two, one of the things, the two territories that we've been pursuing, Italy and Germany outside of the U.S., we're hoping to get one of those territories off in 2017. And it doesn't look like that's going to be the case, so that's slipped into 2018.

The good news though I think from at least the anecdotal evidence out of the U.K. is the property is performing extremely well on all categories and so we're very, very optimistic that we're on track in the long-term. Right now, there is a little bit of pushing out from year-to-year.

Rob Goff^ Okay. Thank you.

Operator^ the next question comes from Deepak Kaushal with GMP Securities.

Deepak Kaushal^ Hi. Good morning guys. Thanks for taking my question. First one is on WildBrain, just specifically regarding acquisitions, I know you mentioned the term sheets and you don't want to talk specifically about that. But in general, when you are making acquisitions for WildBrain, what are you typically looking to acquire and what you get in terms of enquiring content for the network or the people and how do you retain the talent that's producing some of this content?

Michael Donovan^ Yes. This is Michael speaking. What we're looking for -- because the focus is on preschool, so and we want to be number one in our goal is to be number one in that area, which have the benefit of co-viewing that both the caregiver, the young mother or father plus the child watching together to a high degree, so that's a great -- huge attraction for advertisers for preschool.

So our focus is on acquisitions proven content in preschool and we have been discovering that once we bolt-on such one-off content and IP to our growing network that immediately we can revalue it. And obtain a higher -- typically higher CPMs. And gain momentum and as a consequence, it has a return on investments that occurs very, very quickly in the cycle. And so our focus is on those pre-school brands and once that bolt-on that we can revalue and reprice and get a quick return on investment. We are looking at different things but that's our priority -- our focus. Dana?

Dana Landry^ So what I would add to that is that the -- the IP that Michael is referring to in the preschool categories are IP that perhaps you would never heard off. These are things that are trending extremely positively on YouTube, which is obviously as we talked about where the kids are.

And the other thing I would say is that you got to think about the kind of leverage that we can apply because this is kind of a network effect. In the past, in all of DHX's other opportunities for growth when we saw the trends, we focused only on content. What's interesting in this AVOD YouTube is, we are kind of on the thin-edge of the wedge, we are -- yes, we are content. But, we are also a [tech squad]. And so, that gives us a unique opportunity to actually excel and accelerate the growth because we are able to springboard the CPMs from where they are currently to our numbers and hopefully higher. And that becomes a virtual circle as we -- as more views the higher the CPM, the more CPM, the more views and that just builds upon.

Michael Donovan^ Yes. And just to add to that the linear of the future if AVOD, in our opinion. And the reason for that is that linear core value for the consumer was the fact that it was free because that's what AVOD is. It's free. So, we are going from free to free. But, free that's much, much better more targeted advertising.

And so, for that reason we think linear is fundamentally transitioning through SVOD into AVOD and AVOD is its final home.

Dana Landry^ And also we are just getting started, YouTube is just one-off many platforms that we are looking to monetize. There is Facebook. There is Amazon and others, Alibaba that are coming on. So there is lots of growth left.

Michael Donovan^ And we are an absolute leadership and gaining momentum in that area.

Deepak Kaushal^ Got it. Okay. So, just a follow-up on that then for my follow-up question, advertising is not something that's historically been part of family channel or DHX's content business, generally it's been the realm of the broadcasters. How are you guys building that is the people necessary and the network necessary to reach out to advertisers? How is that going in and what kind of investment do we need to see on that in the coming months or quarters to get you up to speed in the advertising world?

Dana Landry^ So -- look it's a great question. I think that the challenge that we have in the advertising space is that we only have four channels and they are all kids specific. And we are dealing with the competition that has multiple channels. However, and having said that we are billing off a very low base. We are also going to be taking the advantage of leveraging some of the YouTube opportunities and looking at new and interesting ideas to blend these together. So, we have an advertising team here. It's small. We think can grow. But, it's something that we are obviously focusing on for the future. And we look forward to coming back with further updates on that.

Deepak Kaushal^ Great. Thanks. Appreciate, taking my questions. I will jump back in the queue.

Dana Landry^ Thank you.

Operator^ (Operator Instructions). Our next question comes from Bentley Cross with TD Securities.

Bentley Cross^ Good morning, gentlemen.

Dana Landry^ Good morning, Bentley.

Bentley Cross^ I first want to just expand on Aravinda's question about M&A. I mean you guys have always talked about robust pipeline and that comes as no surprise. But, it sounds like you might be getting a little bit closer to a deal. I wonder if you are able to offer anything up to myself and other investors as to what gives us confidence that there is something coming soon?

Dana Landry^ Well, again, I think I would go back to the couple of things that came out of Aravinda's question. First of all, leverage, a year or two ago, when we did the family channel, we were into the threes, we are now comfortably into the twos. So the leverage is coming down that gives us an opportunity to really look again.

Also, I think that as content is cyclical; it also applies to opportunities in assets. And we stood to see the dam break when DreamWorks sold to Universal. And then, of course there was a large deal that has been announced between AT&T and others. But, so it's starting to heat up. Also, I think that from a capital markets perspective media overall has struggled and when you struggle at the top end, it means things pop out of the bottom end. So and that's what we are seeing. The velocity of opportunities that has increased considerably and the quality of those opportunities have increased.

Also in the meantime, our sort of place if you like and the industry has elevated both in terms of consumer products and distribution. We are clearly now the number one kids distributor in the globe in the digital space. So, that has garnered a lot of attention, I think individual assets. And it gives us a slight leg up over smaller companies. So, those are the things that feed into our confidence.

Bentley Cross^ Okay. That's helpful. And then, just to get back to the guidance one more time, I was little surprised in that I saw production come down but gross margins also came down. I would have assumed because live action generally carry lower gross margins that we would have seen a tick up, what other nuances that are going on to cause gross margin guidance to come down as well as the revenue guidance?

Keith Abriel^ It was only margins come down -- I think it was 1% weighted average on there that was literally just a project by project build-up not a huge impact at all having tweaked that model a number of times. I think down a little bit but nothing really specifically driving that. Distribution margins under the new accounting standard have -- distribution in content margins have held pretty steady and the rest of the margins are more or less in line.

Bentley Cross^ Okay. Thank you.

Dana Landry^ And maybe I can invite you guys -- you guys could obviously have a more detailed call after if you want.

Bentley Cross^ Yes. For sure. Thank you, gentlemen.

Dana Landry^ Thank you.

Keith Abriel^ Thank you.

Operator^ And I'm not showing any further questions at this time. I would like to turn the call back over to our host.

Nancy Chan-Palmateer^ Thank you very much everyone for joining us today and we look forward to updating you next quarter. Have a good day.

Operator^ Ladies and gentlemen, this concludes today's presentation. You may now disconnect and have a wonderful day.