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PRESENTATION

Operator

Good morning. My name is Stephanie (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the DHX Media Third Quarter Results Conference 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. If you'd like to ask a question during this time, please press *, then the number 1 on your telephone keypad. If you'd like to withdraw your question, please press the # key. Thank you.

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

Nancy Chan-Palmateer — Director, Investor Relations, DHX Media Limited

Thank you, Operator, and thank you, everyone, for joining us 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 in this call include forward-looking statements under applicable securities laws with respect to DHX, including, but not limited to, statements regarding DHX's library; the goals of the Company; the business strategies and operational activities of DHX, and timing thereof; the use of proceeds from the Company's recent bought deal equity public offering and issuance of senior unsecured notes and the allocation of other resources of the Company; the growth and financial and operating performance of DHX, its subsidiaries, and investments; and the markets and industries in which the Company operates.

Such statements are based on information currently available, and is subject to a number of risks and uncertainties. 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 MD&A and the Company's Annual Information Form, which also form part of the Company's annual report on Form 40-F

With that, I turn it over to our Executive Chairman, Michael Donovan. Michael?

Michael Donovan — Executive Chairman, DHX Media Limited

Yeah. Thank you, Nancy, and thanks, everyone, for dialling in today. Three days from now on May 19, DHX Media will mark the 10th anniversary of its initial public offering.

DHX was launched in 2006 with a vision to become a global leader in children's and family content. Over the last 10 years as the demand for such content has increased, fuelled in large part by the global proliferation of on-demand services, DHX has grown from a market cap of 76 million at its IPO to approximately today 1 billion.

Our annual revenues have grown from 60 million during that period to approximately 300 million today, and we have expanded our library tenfold to become the world's largest independent library of children's and family content.

Our shows such as Teletubbies, Degrassi, Inspector Gadget, and many others are carried around the world by all the leading broadcasters and streaming platforms.

Most recently, Nick Jr. in the United States announced they will premiere the new Teletubbies on May 30th in that country. This is a tremendous milestone for the brand that will introduce the series to millions of children across the US, a whole new generation.

Meanwhile, the UK's leading preschool broadcaster, CBeebies, has ordered a second season of the new Teletubbies, reporting that the series has become one of their most popular shows since it premiered in November.

I’m very proud of what we've accomplished thus far at DHX, and look forward to many more years of providing engaging, high-quality children's content to the world.

And with that, I'll hand it over to Dana. Dana?

Dana Landry — Chief Executive Officer, DHX Media Limited

Thank you, Michael, and thanks, everyone, for joining us this morning. It is indeed an exciting time to be celebrating our 10th anniversary of going public this week, as Michael mentioned.

If you will indulge me, I'll look back and I'll read a small excerpt from our IPO release. On May 19th, 2006, we stated we plan to grow the group by a combination of merchandizing and licensing agreements, developing new programs, exploiting the worldwide television market where we already have a good footprint, as well as through the home entertainment market. We also plan to pursue selective acquisitions and enter the market for new digital platform content, particularly given the youth market's appetite for digital media.

I think you'll agree that we've delivered on that plan, and that a decade ago, through Michael's leadership and direction we had, we were able to have the vision to see the trends for the future.

Going forward, we intend to build on our achievements by investing in content and seeking out those trends that will strengthen the Company on the global stage for years to come.

We are very excited about a future that sees DHX Media continuously adapting its creative process and business strategies to meet the ongoing evolution in technology and platforms that will allow children and their families to enjoy our content.

Over the last decade, three key imperatives have driven our growth. The first is creating engaging, high-quality content for kids and family. Second is distribution of our content worldwide to pursue growth across all media platforms. And third is leveraging our content to create high-profile global brands with increased merchandizing and licensing potential. These imperatives have served us well, and we plan to continue to be guided by them.

Going forward, we aim to produce more hit brands that generate returns across all of our business lines; grow our presence in emerging markets; expand into new content platforms; and anticipate and meet the demands of evolving technologies and markets.

That brief summary provides a picture of what we see as our potential. Our successful strategy to date has been to become the go-to company for children's content, and we plan to continue building on that strategy in the years to come.

As seen by our results today, it is a strategy that is delivering strong returns. Revenues for Q3 2016 were 84 million, our second highest quarterly revenue to date on record, adjusted EBITDA for Q3 was our highest ever recorded in a single quarter by the Company at 33 million, and gross margin grew to 51 million compared to 45 million for Q3 2015.

Keith will take a deeper dive into the quarterly numbers in a moment, but I'd like to also touch on some highlights from our nine-month metrics.

Revenues for the first nine months of fiscal 2016 were 230 million, up 19 percent over the same period for fiscal 2015; adjusted EBITDA was 79 million for the first nine months for fiscal 2016, an increase of 17 percent over the same period last year; and gross margin grew to 129 million, an increase of 20 percent over the first nine months of 2015.

So year-to-date shows—continues our strong momentum, and of course what's behind results like these is high-quality kid's content, which our library possesses.

We continued to grow our library in Q3 by adding 63.5 hours of proprietary content. We announced commissions for three original animated series this quarter: Chuck's Choice, Space Ranger Roger and Season 2 of Inspector Gadget, which collectively represents almost 60.5 hours of proprietary content, and reflects just a portion of our robust development and production slate.

Our top-rated shows continue strong demand for major digital and linear customers. Netflix has ordered 20 more episodes of Degrassi Next Class. Nickelodeon premiered our latest live-action twee show, The Other Kingdom, in April. Michael mentioned earlier that Teletubbies rolled out in the US at the end of this month, and also the brand’s popularity in the UK

Not only is Teletubbies a hit on TV in the UK, but Teletubbies toys which, launched in the UK in January, are one of the best-selling new properties to hit the UK toy market this year with a few of our products cracking into the top 10 only after a few months. And we’re also enjoying strong continuing commitment from retailers across the product range.

With 16 broadcasters and more than 65 global licensing deals signed to date, Teletubbies is a superb example of how DHX can monetize brands.

We are also growing an online audience, both for own content and third-party brand owners through WildBrain, and we're extremely excited about the unveiling of that a few weeks ago.

WildBrain is our multi-platform kid’s network dedicated to connecting content owners with advertisers on platforms such as YouTube, Dailymotion, and others. The network, which is attracting 750 million monthly views, is a reflection of how we are benefitting from and leveraging the migration of content delivery to digital media platforms.

Through WildBrain, we are delivering kids content to the new on-demand generation through the mobile platforms that kids prefer. In the first nine months of fiscal 2016, WildBrain generated approximately 13 million in gross revenue, and as more and more kids continue consuming content on mobile devices, we believe WildBrain represents a significant growth opportunity for DHX.

Another way we are expanding our content lineup is positioning—and positioning the Company for long-term growth is through strategic partnerships on world-leading brands to generate new, high-quality content for distribution around the world, and to participate in consumer product offerings for such properties.

As recently announced, we've expanded our strategic partnership with Mattel to a fifth property, Rainbow Magic, a brand which enjoys enormous popularity with girls around the world driven by an extensive publishing program.

We aim to grow this global girls' publishing brand with new content, toys, and other merchandise for platforms—participation across multiple revenue streams. The Rainbow Magic deal builds on the partnership we announced last December around the celebrated Mattel brand's Bob the Builder; Fireman Sam; Little People; and Polly Pocket, which we expect to be accretive for DHX for fiscal 2017.

Deals such as these levers a strong and highly complementary relationship that exists between DHX and Mattel.

Going forward, we have ambitious and exciting plans for DHX. To help execute on our strategies and achieve our goals, we recently closed an equity offering for 65 million, and we have also issued a top-up of 50 million in senior unsecured notes to repay some indebtedness under our senior secured credit facilities.

We will use these proceeds as we have in the past to deliver growth organically through strategic alliances and acquisitions. I would remind listeners the last time the Company issued new equity was on—from treasury was in November 2013. In the two-and-a-half years since then, our share price and market cap have doubled, and our revenues are on track to have tripled by the end of this year.

The recent capital raises strengthen our balance sheet so that we can continue to move quickly on other opportunities as they arise. DHX is building for the long term. We believe that monetizing kids' content holds tremendous potential for the future.

At DHX, we produce high-quality, world-renowned kids and family content. We license that content to broadcasters and video-on-demand platforms worldwide, including our own channels in Canada, and we grow brands from our content through merchandizing and licensing worldwide.

We built a company over the last 10 years that is poised for continued strong growth for years to come.

With that, I'll turn the call to Keith.

Keith Abriel — Chief Financial Officer, DHX Media Limited

Thank you, Dana, and thanks to everyone for dialling in today. Management is pleased to report its Q3 fiscal 2016 results today.

Revenues for Q3 2016 were 84.1 million, down 2 percent from 85.6 million for Q3 2015. The decrease in the quarter was largely a result of distribution revenues in Q3 2015 having included approximately 12.8 in streaming revenues for Degrassi, approximately 6 million to 8 million of which represented a catch-up from the prior year.

Q3 2016 adjusted EBITDA was 32.7 million, up 2.9 million or 10 percent over 29.8 million for Q3 2015. Gross margin for Q3 2016 was 50.5 million, an increase in absolute dollars of 5.7 million, or 13 percent compared to 44.8 million for Q3 2015.

The overall gross margin for Q3 2016 at 60 percent of revenue was above the midpoint of management's quarterly expectations, as reported in the prior MD&A, being Q2 2016; it was the result of strong margins for DHX Television, which at 71 percent were above the high end of management's expectations; and higher-than-expected margins for net producer and service fee revenues, offset by slightly lower than expected distribution margins and lower proprietary production margins, as the proprietary production delivery mix for the quarter contained a higher than normal percentage of live action shows, which typically carry lower margins.

Net income for the quarter was 10.2 million, or $0.08 basic and diluted earnings per share compared to net income of 18 million, or $0.15 basic and $0.14 diluted earnings per share for Q3 2015.

Proprietary production revenues for Q3 2016 were 12.1 million, a decrease of 20 percent compared to 15 million for Q3 2015, partially a result of certain titles being delivered early in Q2 of 2016, as we noted on our call last quarter.

For Q3 2016, the Company added 63 proprietary half-hours to the library, up 5 percent versus 60 proprietary half-hours for Q3 2015.

For Q3 2016, distribution revenues were down 21 percent to 23.9 million from 30.5 million for Q3 2015; a tough comparison, as previously mentioned, Q3 2015 distribution revenues included 12.8 million in streaming revenues for Degrassi, approximately 6 million to 8 million of which represented a catch-up from Calendar 2014.

Management continues to see strong annual growth from new digital customers, platforms, and territories.

DHX Television revenues for Q3 2016 were down 23 percent to 15.7 million from 20.4 million from Q3 2015. This was within management's expected range based on the Q2 2016 MD&A. Management has slightly reduced its annual revenue expectations for DHX Television.

M&L-owned revenues for Q3 2016 were 10.4 million, up 63 percent compared to 6.4 million for Q3 2015. For Q3 2016, M&L-owned revenues included 3.65 million from the 22-city Canadian leg of The Next Step Wild Rhythm Tour compared to Q2 2015, which included combined revenues of 2 million for The Next Step Live Tour and our Yo Gabba! Live! shows.

Excluding the live tour revenues, management was very pleased with the M&L-owned revenues for Q3 2016, which were up 52 percent as the Company continued to recognize revenues related to the nonrefundable minimum guarantees associated with Teletubbies, In The Night Garden, and Twirlywoos.

M&L-owned revenues were above the midpoint of management's quarterly expectations based on the Q2 2016 MD&A, largely a result of the quarterly timing of recognizing certain of the minimum guarantees.

M&L-represented revenues for Q3 2016 increased 3.9 million to 7.4 million compared to Q2 2015 at 3.5 million, and were above the high end of management’s previously reported expectations from the Q2 2016 MD&A. As a result, management has increased its annual revenue expectations for M&L-rep.

Revenues from producer and service fees came in at 14.2 million for Q3 2016, an increase of 71 percent versus the 8.2 million for Q3 2015. This was at the high end of management’s expectations, and as a result, we have increased our annual revenue expectations for this particular business line.

Turning to SG&A. Costs for Q3 2016 increased 18 percent to 19.3 million compared to 16.4 million for Q3 2015. This reflects increased levels of SG&A associated with DHX Brands, DHX Distribution, as management has continued to add resources in these areas to take advantage of the M&L opportunities associated with Teletubbies and Twirlywoos, and the global expansion of digital distribution platforms, including opportunities in China.

Resources have also been added and will continue to be added to grow the Company's recently unveiled WildBrain multi-platform kids' network.

The Q3 2016 SG&A also includes accruals for certain contractually required incentives, a direct result of the strong year-to-date performance of CPLG, the Company's M&L represented business unit.

SG&A includes 1.5 million in noncash share-based compensation, the result of the accelerated vesting of certain stock options based on performance. When adjusted, cash SG&A at 17.8 million was slightly above the top end of management's quarterly SG&A expectations.

Management has reaffirmed its favourable outlook for fiscal 2016 with ranges presented in our Q3 MD&A, and targeting a midpoint of 302.5 million in revenue and a 59 percent gross margin for the fiscal year.

For further specifics on our Q3 2016 results, as well as additional information on management's fiscal 2016 outlook and various other information, including our reconciliation of

GAAP and non-GAAP financial measures, I would refer to you—I would refer you to the Company's 2016 Q3 MD&A, which was posted on SEDAR and EDGAR this morning.

I'll now turn it back to Dana.

Dana Landry

Thank you, Keith. After 10 strong years of execution, we're excited for the future.

We have a proven track record of delivering on our commitments. We have taken action to strengthening our capital structure so that we can take advantage of opportunities as they arise. We are building a company for the future while delivering strong results.

With that, we'll turn the call over to the Operator for questions from analysts.

Q&A

Operator

Thank you. As a reminder, if you would like to ask a question, please press *, followed by the number 1 on your telephone keypad. If your question has been answered, you may remove your question from the queue by pressing the # key. We will pause for just a moment.

Your first question comes from the line of Aravinda Galappathige with Canaccord. Your line is open.

Aravinda Galappathige — Canaccord

Good morning. Thanks for taking my question. I'll start with the SVOD side. I was wondering maybe, Dana, if you can comment on the composition of the SVOD sales? The transition we're seeing historically, most of the sales were sort of in those bundled deals where you sold X number of titles all in one to, say, Netflix or Amazon. Obviously there's a movement in that towards sort of the more title-by-title sales. I was wondering if you can just talk to that and how that's driving the growth and the average pricing? And where you see that going on a go-forward basis?

Dana Landry

Great. Thanks, Aravinda. Thanks for that question. Good morning. So yes, exactly the trend we're seeing is exactly as your question would dictate. Right now what we're seeing is from Netflix, Amazon, and others, we're seeing a real trend towards originals. And I think this really is being driven by the fact that they've both come out publicly recently saying that kids is providing a real stickiness to their subscriber base.

And so in the past I think less than 25 percent of their entire content spend has been allocated toward kids. Now they're ramping that up considerably, and I think they're in excess of 30 new shows that they're out there basically commissioning as we speak.

So what that is presenting is a major opportunity for us in the original department. And really the high, as we've discussed in the past, the A titles are getting a much higher per half-hour fee from those SVOD platforms. And so we are seeing a bit of a transition from a lot of library deals in the past to fewer deals, but higher price point for the original content.

And we're sort of seeing that trend move from, I think, a year or two ago we had in excess of 65 percent of our distribution revenues were related to library titles, and I think that's probably moving more towards a 50:50 ratio. And going forward we think it might even inverse back to sort of a 60:40 on the original side.

Aravinda Galappathige

Great. Thanks for that. And just switching gears to Teletubbies, the comment you made about the initial product sales in general. I was wondering if you can provide a little bit more clarity when you said it's like—you said it's one of the strongest-performing children's toys at the initial stages. Just wondering what comparisons you're looking at? And related to that, can you just remind us what the path is from here? I mean when is the North American launch scheduled for it?

Dana Landry

Right. Yeah. Thanks for that question, Aravinda. Yeah. So it's—we're about two-and-a-half months into the launch. The industry standard out there is MPD. So a lot of the licensing revenues and sourcing is coming from those statistics. But right now to date we're in the top 10 on a few different product lines, and certainly in the top—we're in the top five, actually, of new product launches in the UK. And there's only sort at the moment been less than 10 sort of SKUs out there in the market for a great period of time.

Where now we now have many, many SKUs that are in the market as of last month, and so we're looking forward to results—further better results in the next quarter or so. And what I would say on the UK is we're off to a very fast start, and all of our licensees are extremely excited. And we're all keenly gearing up obviously for Christmas.

The other thing I would repeat here is we've got strong commitment from UK retailers, which of course is a huge boost to the whole cycle for us in actually achieving success in the toy market. It's great if you’ve got the product out there, but you got to get the commitment. And we're seeing that as well.

On to the second part of your question on the North American and the rest of the world toy rollout, Canada will see some product come into the market in summer of 2016. Now you remember, we usually typically like to have six months to nine months of lag between the show gets on the air in the particular territory before toys come out. And so you'll see that sort of 6- to 12-month lag happen once the show is starting to broadcast in each of the territories. And the next, obviously, territory that everyone on the call is looking towards is the US.

As Michael said, we're very pleased now that Nick Jr. has rolled out the launch date, which is May 30th, I believe, in 2016, so very soon. We're obviously expecting big things out of the Teletubbies, and there we're getting great commitment and interest from Nick Jr. to help move that forward.

And then the toys will come in early 2017 after we've had it in the market for, I guess, it’ll be about eight months or so. So this is really a 2017 story and on into '18.

Aravinda Galappathige

Great. Just two more quick ones for me. I'll ask them back-to-back. Number one, with respect to WildBrain, the multi-platform network, I was wondering if you can—I'm not sure if you can comment on it, but I was wondering if you can talk to the prospect of given the valuations we're seeing for these entities, given what DreamWorks has been doing, I mean is there a likelihood or maybe a thought around spinning out or selling a stake, a minority stake to sort of crystallize that value? And then number two, on the production spend I was wondering, either Dana or Keith, if you can just talk to the way you see the cash production spend headed in 2017? Thanks.

Dana Landry

Okay. So I'll take the first one and do a top-level on the second, then I'll turn to Keith for any follow-up. So on WildBrain, all things are on table. One of the reasons that we've unveiled it, obviously, is to get the brand out there to a greater extent, number one, but also to explore things like strategic partnerships.

We felt quite bluntly that we weren't getting proper value for WildBrain; it's buried in part of DHX. Right now it's currently trading at a multiple of the EBITDA that it will be generating in that particular piece of the business. We think that obviously the prospects are much greater.

So we're exploring all things, including potential strategic partnerships and also growing inorganically on our own. We now have some resources as a result of our recent capital top ups that will provide us some fuel there we think. So stay tuned. It's an exciting area.

Mobile we think is a huge space for us, and really why we're excited about this is obviously the brand is building and more eyeballs—the eyeballs are increasing; with increasing eyeballs, ad revenue potential goes up hugely, and new platforms like Facebook and Dailymotion, which are looking to launch, which we're looking forward to really some great upside there. And then lastly, of course, consumer products potential we think with respect to that business.

With respect to—I'll move on then to your second question, production spend—right now I think we're net for the first nine months of around 50-ish million of investment in content around the slate. This has been—there’s three sort of factors this year that has been a very heavy year.

Number one, we were transitioning from our old outfit arrangement to our new one, which required investment heavily in particularly live action where Family Channel we feel needs to be, continue to be going forward. So there was a really heavy spend there.

And number two, we also saw some opportunity on our own just in terms of live action. So right now Keith will get into the numbers of shows, but we've got many, many live action shows that are going. And what happens on live action, of course, is it's a heavy spend upfront and it happens all within a couple of months versus animation, which is typically over a couple years and much more predictable and sort of steady as she goes.

And then the last item really is we're seeing a real opportunity in the platforms, as we talked about earlier on your question with respect to Netflix, for growth. And as we're seeing that we want to take advantage to capture further market share by growing our library doing more of what we do well, which is growing our strong kids brands, which we think will pay off dividends in the long run through multiple revenue sources, but particularly in consumer products.

And, Keith, I don't know if you want to add to that.

Keith Abriel

Sure. Yeah. Just a couple things to Dana's point. We had nine shows with deliveries in Q3. That number—and we had another—we had 11 shows in progress at March 31st that had what I would say material spend on them. That number will come down a little bit for Q4, and then begin to reverse as we ramp into the normal production season into Q1.

Aravinda Galappathige

Great. Thanks a lot. I'll pass the line.

Dana Landry

Thanks, Aravinda.

Operator

Your next question comes from the line of Bentley Cross with TD Securities. Your line is open.

Bentley Cross — TD Securities

Good morning, gentlemen. I just wanted to ask initially about the growth outlook. Traditionally you've talked about kind of a 10 and 10 mix of 10 percent organic, 10 percent acquisition. Just wondering as we're looking out to the future is that kind of still the way you're thinking?

Dana Landry

Yeah. Absolutely, Bentley. I think that as the Company has evolved in the past those would have been company-specific opportunities like we did on either for, say, Cookie Jar or Epitome or even Nerd Corps. Now what we're seeing, though, is opportunities on the acquisition side really more on platforms expansion and the strategic alliance side. Very much, though, those opportunities are continued and have accelerated in the last 60 days or so.

And what I would say is really the focus really is more on specific brands, global brands, things to round out and broaden the portfolio. As we talked about in the past, the girls' category is an area of interest for us to expand into, and we've made good progress with some development shows, and our two—two of the five properties that we have from Mattel in Polly Pocket and Rainbow Magic.

But we're also seeing some really interesting opportunities, and I would say stay tuned in that regard because I think we're pretty excited about where the future will go there.

On the organic side, yes, absolutely we're seeing great opportunities for growth, and they all really are in sort of three core areas for us, which is content, platforms, and new territories.

Bentley Cross

And related to that, I mean just reading between the lines there, is kind of your commentary on acquisitions driven by increased pricing in the market, is it harder to get those deals done and still be accretive than it was two, three years ago?

Dana Landry

It's interesting. Obviously, it's kind of an interesting moment in the cycle. I think our view is that the prime, the absolute prime assets are to your point going at extremely prime prices; as evidenced, a DreamWorks deal at somewhere between 18 to 19 times announced 10 days or so ago.

So we're seeing high prices for the absolute prime, and we’re in that prime category. We don’t really need to grow our library for the sake of just critical mass now. I think on perhaps on some of the private ends there are some opportunities for accretive deals. And we think that really the angle for us there would be in the territories, expanding in the territories to help broaden our existing platform, but also into—in the new areas, which is things like mobile and some consumer products opportunities, which I think—we think there is some really interesting accretive deals to be done there as well.

Bentley Cross

Okay. And then sticking with the theme of growth, obviously CPLG has done tremendously this year, but obviously those serve as very difficult comps next year. Given the pipeline and the fact that probably Minions is not going to be the same type of hit it was this year, should we still expect growth for that business next year?

Dana Landry

Well, growth in merchandizing and revenue, licensing revenue, absolutely, but on the proprietary side, obviously we haven't formulated our guidance yet. We'll do so in the next few months, but looking into the future I would say you're right that Minions it would be hard to expect tremendous growth in the CPLG business.

Having said that, we don’t think it will decline to any great degree and we’re still evaluating, but yes, that will provide at a bit of a tough comp. But we think that the Teletubbies M&L, the Twirlywoos M&L, and many other things that we're developing in our own slate will make it up and then some. And obviously on the margin side in the long term that’s a much better bang for our buck.

Bentley Cross

Okay. And last one, just a housekeeping one for Keith. What FX rates you are assuming in your guidance, Keith?

Keith Abriel

We basically have assumed about 1.25.

Bentley Cross

Okay. Thank you.

Dana Landry

Thank you, Bentley.

Operator

Your next question comes from the line of Deepak Kaushal with GMP Securities. Your line is open.

Deepak Kaushal — GMP Securities

Hi. Good morning, guys. Can you hear me okay?

Dana Landry

Yes. Deepak, good morning.

Deepak Kaushal

Hi. So I had a couple questions. I'll try to be brief. First just to follow up on the WildBrain opportunity, did I hear correctly that it was 13 million year-to-date? And that's—I guess that's roughly double year over year. Is that correct?

Dana Landry

Yes. That's nine months, yeah.

Deepak Kaushal

Okay. And does that now include more than just YouTube? Can you offer a breakdown? I know that you have a similar deal in China with CCTV. Is that part of this venture?

Dana Landry

We have some early, early new platforms, but there's really nothing material in there. Most of that—that's all YouTube right now.

Deepak Kaushal

Okay. But it's safe to understand then that all of your AdVOD business would be kind of under the banner of WildBrain. Is that correct?

Dana Landry

That's correct. That's correct. Yeah. And obviously those platforms have launched and we're very excited about those going forward, including Facebook as well in addition to the opportunities you mentioned.

Deepak Kaushal

Okay. And can you offer any kind of further insight or details on the split between fixed and variable costs? And is this business profitable today? Or when might be the crossover point for profitability in that business?

Dana Landry

Fixed and variable costs on WildBrain?

Deepak Kaushal

Yes. On WildBrain.

Dana Landry

Yeah. So the fixed cost right now we have—we’ve got the great advantage that all of this is library content at this point. So it’s basically 95 percent-plus cash margins for what—the net that we get from YouTube, obviously.

We’ve ramped, up to Keith's point, in past SG&A quarterly updates, we’ve ramped up to the tune, I think we’re running at 3 million or 4 million…

Keith Abriel

Yeah.

Dana Landry

Annually I think in SG&A related to that particularly category. And so we’re looking to ramp that up a little bit. So right now it’s very profitable, but we think that there’s a real opportunity for growth there. So we’ll—this will be a big area of focus for us, and obviously for our guidance for the next quarter.

Deepak Kaushal

Okay. Great. And I guess going forward, do you expect a split between your own content and third-party content to kind of be 50-50 evenly split? And presumably then that implies the margin for third-party content slightly lower than your own content. How should we think about the margin profile …

Dana Landry

Well, I think that the split it sort of settled in at 50-50, but I think that there's—the opportunity that we're seeing on the content side from a capacity perspective, particularly when you look at the strategic partnership we have with Mattel and DreamWorks, we will be using some of that capacity for rights—content that we have rights and additional revenue streams on.

So we think that's probably going to grow probably to about 60/40, or maybe even a 70/30 from a proprietary perspective. On the—if you're asking—your question was on the gross margin for the particular category, obviously production revenue it varies show by show, but I think historically the production revenue margins for both have been relatively similar.

The big upside, obviously, on the original shows is rights for the future, which obviously will generate revenues and margins for years to come.

Deepak Kaushal

Okay. Great. Great. That's helpful. I guess what I'm leading towards is when we look at this business versus other multichannel networks, whether it's on YouTube or other platforms, you guys bring a large library of owned content in these relationships with Mattel and DreamWorks. Should we expect higher margins for your business relative to some of these other multichannel networks, whether its sports or kids-related or whatever?

Dana Landry

Yes. Absolutely, absolutely. That's a huge—that's the huge competitive advantage that we have over all of them at the moment. Because it's 100 percent owned by DHX, WildBrain own its content, which most of these channels don’t. They rent it. So it’s a huge advantage going forward; lots of torque.

Deepak Kaushal

Great. And am I correct to understand also that you’ll be negotiating the advertising rates directly with the advertisers rather than the platform? So you'll be assuming that responsibility on behalf of the AdVOD platform like YouTube. Is that correct?

Dana Landry

Well, that is a likely outcome. It's not something that we are currently doing, but it's something that we’re looking at in terms of potential to increase the ad dollars: a better curation, a better matching of our content directly to advertiser.

So whether we go to the step of having our own sales team, or whether we get more embedded with the platforms and work to curate, yet to determined. We’re looking at both those as potential.

Deepak Kaushal

Okay. Okay. Great. That’s helpful. We'll watch that business very carefully and closely going forward. The second kind of category question I wanted to ask, you offered a great history of where you've come from over the last 10 years. In that period of time, how have your average return expectations changed or increased on your production? I mean clearly you're getting more participation revenue streams on the M&L side and the distribution side and even the live action side.

Dana Landry

Yeah. Absolutely. I think the model has evolved greatly. I think that in the beginning—thanks for that question—we were focused on getting the infrastructure, sort of the four pillars, or at least three pillars and then the TV being a bit of a bonus pillar, but the three pillars being content and vertical integration, the studios, distribution, and then obviously the licensing as the third.

And so those are—those were the areas that we invested in heavily early on, which from an infrastructure play meant that the return on those equities was lower in the early years. We've had a good track record over the last three, four years as the platforms have expanded and we've had great margins, and obviously distribution and licensing, so those have increased to a great degree.

I think going forward, to your point, we've now clearly established that we can produce content for the global market. In the beginning, I think folks thought we were just going to be delivering singles and perhaps the odd double, to use a baseball analogy, but we absolutely now can deliver home runs. And I believe we have a couple already that were—that are in our portfolio and more to come.

So margins obviously will go up tremendously, and, therefore, the return on equity we think has huge potential going forward.

Deepak Kaushal

Okay. So margins going up. Now I guess in the same vein, now that you have more participation on this longer tail, does the amortization when you—of the new content that you create, does that—has that extended? Has that changed materially? Or do you expect the margins to kind of ramp up as you...

Dana Landry

Yeah. The gap dictates what the amortization terms are. So those haven't changed from day one. What changes is is really your future revenue potential, what Keith probably talks to many of you about the ultimate revenues. And those, really, is again you can't really estimate those until you have a history.

And so now that we have a history and increasing new platforms and new distribution opportunities then yes, there's an ability to also project and then to hit those projections. One of the great things that we've done is we've hit our projections for many, many years going back to basically day one. So we're very good at estimating and exceeding those expectations.

So as new platforms come on, those represent new opportunities for revenue, which ultimately you still—your costs have to be amortized over the same period of time, but your revenue base is increasing. So margins, therefore, have gone up and should continue.

Deepak Kaushal

Okay. So on the cost side, the amortization period of the cost side and the number of years hasn't changed materially?

Dana Landry

Correct.

Deepak Kaushal

Okay. So the margins should go up as you capture those sales (phon). Great. It's very helpful. Thanks again, guys. Looking forward to Q4 later in the summer.

Dana Landry

Thanks, Deepak.

Operator

Your next question comes from the line of Drew McReynolds with RBC. Your line is open.

Drew McReynolds — RBC

Thanks very much. Good morning.

Dana Landry

Good morning, Drew, and welcome, Drew.

Drew McReynolds

Yeah. Thanks. So, Dana, just three kind of big picture from my end. First, just when you look at kind of what Comcast is proposing to do with the DreamWorks Animation, does that impact your relationship down the road with them in any way?

Second, just can you provide an update on just the television ratings at DHX Television?

And then lastly, when you look at your territories that you're targeting where you see the greatest potential—obviously you made some announcements in China over the last several months—which are the kind of unexploited, but large potential territories that you see, let’s say, over the next to two three years? Thank you.

Dana Landry

Okay. Great. Thanks. So relationship with Comcast and DreamWorks. With Comcast we think that the relationship is still significant going forward. Obviously, with DreamWorks they've filled in a bit of a gap with respect to kids’ content, although their content really is within the film category and really didn’t cross over too much with respect to ours. So really we think there’s a big opportunity in preschool and girls going forward with Comcast and really many other platforms.

On the DreamWorks side, I actually just had a phone call with the CFO last week. So it’s sort of business as usual on the commercial side. So we think there’s some real interesting ways to partner going forward. And we don’t really see any—certainly no downside on that; if anything, upside, given that obviously they’ll have a much bigger balance sheet and a more focused long-term strategy than they had as a single relatively small public.

So that’s on a relationship side. On the TV rating side, look, on the linear world TV ratings across all kids’ platforms have gone down. There isn’t I don't think anyone in all of North America that has been saved.

In Canada, what really happened is an interesting sort of dynamic of three new channels coming into the network in addition to our channels. Obviously, the Disney channels all came on stream as well, and really I think what is a bigger factor is those—the same number of kids, although having said that, not really the same number of kids, a decreasing number of kids on the linear world and more that we're seeing growth obviously on the—going to the on-demand platforms.

So a smaller pool, if you like, of viewers, viewership potential, which is now being split over not 10 channels, but now 13 channels. And so everyone’s pretty well down.

Now our ratings there’s a bit of a transition going on. Obviously, we always knew that this was going to be the case, and in the long run we're very optimistic with our strategy in developing long-term content because we're seeing great ratings globally.

So we’re very optimistic. Right now there is that transition period which we're working through. The good news on our side is we've got, as we mentioned in our MD&A, we’ve got all of our long-term big three contracts locked in for years to come. So it provides a really nice stable subscription revenue base for years to come, which gives us some opportunity to work on the ratings. And we’re very optimistic on that side.

To your third question, territories unexploited. I mean China is the big one. We really, really, really feel that we’ve had some discussions as recently as last week that there—them moving off the one-child policy, some statistics are that there should be within a relatively short period of time an incremental 20 million new kids come into that market. And our programming being preschool, we think we're just right in the sweet spot.

And we also think that the the government is getting pressured to loosen up the content to some degree. And we think that the kids' category is one that's the least politically motivated, and so we think has the best potential for the future.

We're aggressively trying to figure out the right partners of how to go to market. And one of the big things obviously in China is theft of IP, and so we really feel strongly that through a partnership of a local presence that has the wherewithal, the desire, and the ability to enforce things like that, shutdown the thieves and move towards a more original authentic licensing program, we think that there's a real appetite for that in China.

Also I think India is another category, territory, which is hugely complex. It's more than 1 billion people in India which have grown up on mobile devices and smartphones. We're thinking that that could be a potential opportunity as well.

So those are the two big ones.

Drew McReynolds

Thanks very much.

Dana Landry

Thanks, Drew.

Operator

And your next question comes from the line of Adam Shine with National Bank Financial. Your line is open.

Adam Shine — National Bank Financial

Thanks a lot. All my questions have been asked already. Thanks.

Dana Landry

Thanks, Adam.

Operator

Your next question comes from the line of Doug Creutz with Cowen and Company. Your line is open.

Doug Creutz — Cowen and Company

Hey. Thanks for taking my question. If you look at the broader market for television content, I think the number of shows on the air and defining that broadly to include nonlinear stuff has doubled over the last six years. And there's been some debate about whether ultimately that's a sustainable level of investment, given that that viewing hasn't doubled. If you look at your specific vertical, the kids' category, how would you say the growth rate and the supply in the industry has compared to that over the last six years? And to the extent that it's been faster or slower, what's driving that? Thanks.

Dana Landry

Thanks. Welcome. On our side, really, with us in particular the vast majority of what we do is animation. So it's been slower to come on stream for a multiple number of reasons, but the biggest one is that animation takes a couple of years to develop and then two years to produce. So there's a bit of a time lag with respect to that. So there's many people like us that are out ramping up.

Number two, kids has always been if you go back to all the other cycles it's been kind of the last one to come along, and arguably in other cycles never really developed. And that was because most TV literally was always focused on advertising, and kids in particular in most jurisdictions there's regulations around advertising to kids.

And so it was always an abandoned genre, but yet in the household there was a tremendous demand because as we're seeing, for those on the call that have kids or no kids, they are increasingly going to the on-demand world, which is increasing the appetite for content throughout the globe.

And so really I think this is—you've hit on exactly why we set up DHX in the early days, and I think why there's tremendous upside potential still going forward, whereas some of the other genres has the content has—the supply, I would say, has met demand at this point.

We still think there's a gap at least for the next little while.

Doug Creutz

Okay. Thanks. That's very helpful.

Dana Landry

Thanks, Doug.

Operator

Your next question comes from the line of Robert Peters with Credit Suisse. Your line is open.

Robert Peters — Credit Suisse

Hi. Thanks for taking my question. Dana, may be if we just look at the Mattel deal. I think obviously you guys have already seen some additional expansion from the original shows announced. Just wondering how should we think about the run-rate investment level with your relationship with Mattel? Are we at—where do you kind of see that peaking? Or more importantly, are we at the point where we're couple quarters out from kind of the run-rate investment? Or are we there already?

Dana Landry

No. We're definitely a couple of quarters out from the run-rate investment peaking. We started developing on the original four that we picked up in December. And one of those actually was a show that was already going on in our studio, Little People, so certainly that investment has been ongoing and sort of has probably ramped.

But with respect to the other three shows, we're looking at building those out. The thing that you have to note, of course, is that development typically is a minimum of six months to up to two years. Now we won't probably take the full two years on any one of these shows, including Rainbow Magic, but there is a bit of a lag time. And we think that by the time that this reaches its peak some of the other initiatives that we had in terms of live-action growth that we've seen in terms of our content spend we'll be pulling back.

So we think we'll get to a relatively steady state, say, three, four quarters out.

Robert Peters

Perfect. Thank you. And with that deal, I think Rainbow Magic was particularly interesting, given its not—it's not something that has had a TV property before. Do you see more opportunities to do some of that where it's not necessarily a kind of rebooting of a very popular series, but more of taking a new property and bringing it through?

Dana Landry

Absolutely. I think that one of the real opportunities that we have is we have our own library that we are mining, but as we get more and more in bed, not only with Mattel, but other large licensing IP holders, we're seeing that more and more of them are acknowledging that we need scale in content creation and distribution, which is the absolute critical piece.

And just because you're good at making toys or whatever it might be it doesn't necessarily mean that you're great at making and distributing kids' content. It's one of the areas that obviously have huge strength for us, and so we really think that there is a lot of these sort of strength-on-strength relationships that we can use going forward to build.

Robert Peters

Perfect. Thank you. And maybe one last question switching to the distribution side of the business, and apologies if this has kind of already been addressed. But I was just wondering if you could give us an update on kind of the pricing trends you're seeing on the digital distribution side in terms of like per half-hour, particularly as we are seeing less episodes coming out of the library?

Dana Landry

Yeah. We touched on it a little bit off the top, but happy to answer it again. I mean pricing what I would say on is the prime shows are pricing at—they're increasing—the prices are increasing at a pretty rapid pace. In some cases those prices are in excess of 100 percent of the budget, and we see that sort of accelerating at least for the next few quarters.

With respect to library, it's growing, but not at the same pace. I think for us really it's the point that came up in the last question is the mix is moving more from the past where we did a number of sort of library deals to more—a little more balanced perhaps viewpoint of where the future will be, which is sort of ultimately going to say a 60/40 on the original slate to the library.

Robert Peters

Perfect. Thank you very much.

Dana Landry

Thanks, Rob.

Operator

Your next question comes from the line of Bentley Cross with TD Securities. Your line is open.

Bentley Cross

Hi, guys, I just wanted to follow up on margin expectations. Dana, you'd highlighted the potential to see margins increase over time, but at the same time if we see more originals versus library deals, to me that would suggest that margins would actually fall. Just wondering if you could help me reconcile those two ideas?

Dana Landry

Well, short term you're right, absolutely. Over the next 12 months you would see some compression, but in the long run prime wins. And prime assets tend to have a much longer tail, and therefore ultimately have more value in the library going forward.

So there's a bit of a reconciling between the current amortization policy versus building for the future.

Bentley Cross

Okay. Thanks.

Dana Landry

Thank you.

Operator

Your next question comes from the line of David McFadgen with Cormark Securities. Your line is open.

David McFadgen — Cormark Securities

Thanks so much. I have a couple of questions. Could you give us the actual number of licensors that you have for Teletubbies right now?

Dana Landry

Sixty-five global, David.

David McFadgen

Sixty-five. Okay. And now that you've completed the bond offering, are the debt covenants expected to change? Or are they staying the same?

Keith Abriel

No change to the debt covenants.

David McFadgen

Okay.

Keith Abriel

We were at 2.9 times.

David McFadgen

Okay.

Dana Landry

I mean we have—obviously we'll have flexibility going forward to take a look at that because in terms of the number of—the amount will be relatively low.

David McFadgen

Okay. And then you talked about ratings for Family Channel. I mean you acknowledged that they're down, but can you give us how much they're down year to date? And you talked about the fact that your three largest distributors you've signed distribution agreements with them, so they're locked in. But are there any other ones that are coming up for renewal in the next 12 to 24 months?

Dana Landry

Well, I'll deal with the second one first. So there's always—we have around eight or nine sort of customers in that business, and they all come up from time to time. The three big ones, which represent 85 percent of the overall revenue base, are sort of locked in and, yes, there will be some of the small but mighty ones that will come up over the next couple years.

But we've had touch points on all those, and we're quite optimistic that from in terms of a where we're going to be offered is in a similar place to where we are now. Where we see in the future, obviously, we've offered some reduction with respect to the locking-down on the big guys that we expect that some of that will be happening in the smaller guys too. As we've mentioned, we've already updated our annual guidance, so we're pretty comfortable, and we think that that's a really relatively stable revenue base going forward.

On the ratings side, we've sort of seen I would say into the double-digits in terms of some decline. As you know, ratings is a very difficult one to kind of pin down because some shows are rating as well as they've always been in terms of Next Step, and we're seeing some real uptick in terms of some of the live action stuff. And some of those are still rating number one and increasing, but overall I would say we're down in the 10-ish percent.

David McFadgen

Okay. And then just on WildBrain, you talked about the fact that most of the content is library content with I think you said 95 percent margin. Wouldn't a lot of those shows still have some book value on your balance sheet that you'd have to amortize?

Dana Landry

Yeah. They would in terms of what I said cash margin is around 95 percent, the amortization obviously would go back to whatever the normal rates are. So it's not going to be that high; it may be 65 percent in terms of the P&L.

David McFadgen

Right. Okay.

Dana Landry

But that doesn't—that still gives me the extra 30 points in cash flow to invest in the rest of the business.

David McFadgen

Mm-hmm. Okay. Okay. That's it for me. Thank you.

Dana Landry

Thanks, David.

Operator

There are no further questions. I turn the call back over to the presenters for closing remarks.

Nancy Chan-Palmateer

Thank you very much for joining us today. And if you have any further questions, please feel free to reach out.

Thank you.

Operator

This concludes today's conference call. You may now disconnect.

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