WildBrain Ltd.

Fiscal 2024 Q1 Earnings Conference Call

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CORPORATE PARTICIPANTS

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David McFadgen
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PRESENTATION

Operator

Hello and welcome to WildBrain's Fiscal 2024 Q1 Earnings Call. Today's conference is being recorded. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. To ask a question during that time, please press star then one on your telephone keypad. If you would like to withdraw from the queue, press star two.

I'd now like to turn the call over to Kathleen Persaud, Vice President, Investor Relations at WildBrain. You may begin the conference.

Kathleen Persaud — Vice President, Investor Relations, WildBrain Ltd.

Thank you, everyone, for joining us today for WildBrain's First Quarter 2024 earnings call. Joining me today are Josh Scherba, our President and CEO, and Aaron Ames, our outgoing CFO. Also with us and available during the question-and-answer session is Danielle Neath, our EVP of Finance and Chief Accounting Officer.

Before we begin, please note the matters discussed on this call include forward-looking statements under applicable securities laws with respect to WildBrain, including, but not limited to, statements regarding investments and acquisitions by the Company; commercial arrangements of the Company; the business strategies and operational activities of the Company; the markets and industries in which the Company operates; cost and expense management; the Company's leverage and plans for debt and leverage reduction; refinancing of the Company's indebtedness; the value of the Company's assets; and the future growth, objectives, targets, and financial and operating performance of the Company and its businesses. Such statements are based on factors and assumptions that Management believes are reasonable at the time they were made and information currently available.

Forward-looking statements are subject to number of risks and uncertainties. Actual results or events in the future could materially differ and adversely from those described in the forward-looking statements as a result of various important factors, including the risk factors set out in the Company's most recent MD&A and Annual Information Form, which are available on the Investor Relations section of our website at wildbrain.com.

Please note that all currency numbers are in Canadian dollars, unless otherwise stated. After our remarks, we will open the call for questions.

I will now turn the call over to our President and CEO, Josh Scherba.

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

Thanks for joining us today. Last quarter, I outlined our three strategic pillars of Content Creation, Audience Engagement and Global Licensing. Through these pillars, we cultivate and create exceptional entertainment experiences for our own and partner brands that captivate and delight fans new and old. We commonly refer to these three strategic pillars as our 360° capabilities.

I also detailed our sharpened focus on key brands and partnerships. As part of those efforts, during the first quarter we realigned our senior management team and business under our three pillars and core capabilities to focus on fully unlocking the significant growth potential for key proprietary brands, including Peanuts, Teletubbies, and Strawberry Shortcake, as well as key partner brands. In this realignment, we have three distinct businesses and teams supporting each of these capabilities.

Content Creation integrates all of WildBrain's development and production capabilities, including our Vancouver animation studio; the London-based digital studio, formerly the WildBrain Spark digital studio; our Toronto animation pre-production business, House of Cool; and live action production business, bringing creative excellence across all formats for WildBrain's proprietary content as well as partner projects.

Audience Engagement integrates WildBrain's extensive capabilities in delivering entertainment content to audiences around the world, including our global distribution business, our world-leading YouTube network, digital marketing expertise, and our digital advertising business.

Global Licensing includes the activities of our leading licensing agency, WildBrain CPLG; our franchise management activities for key owned brands, including Teletubbies and Strawberry Shortcake; the management of key third-party IP partnerships; and our interest in the Peanuts brand operated by the Peanuts Worldwide subsidiary.

Under this structure, with teams working cohesively, we will fully unlock the 360° capabilities.

As part of the overall realignment, we are unifying our premium and digital-first content under the WildBrain banner as we phase out the Spark sub-brand to strengthen our positioning in the market as the best-in-class solution for IP owners across our entire ecosystem. As media consumption has evolved to become more fragmented, omni-platform content has become critical in building an ecosystem around each IP in order to reach a scaled audience. This is non-exclusive, audience-led content that can be distributed and licensed across a multitude of platforms. It represents the single largest amount of consumption in today's kids' market with YouTube accounting for the vast majority of this viewership.

Thinking back to my earlier days here at WildBrain, my team first started uploading videos to YouTube as a simple form of distribution and monetization of our own library of some 13,000 half hours on YouTube. The size of the library enabled us to quickly build scale and, in turn, become a leader in optimization of that content as well as a leader in content discovery. This expertise began to attract partners from across the kids' media industry to our network, further allowing us to grow our viewership, which increased insights, deepening our expertise, which attracted even more partners to our platform. Fast forward to today and our YouTube network is among the largest kids' networks globally, which we are leveraging to drive increased engagement for our owned brands and partner brands.

One clear example of the power of this integrated approach is how we are bringing our own Strawberry Shortcake brand back to life. We have been able to drive significant increased engagement across AVOD with over 1.2 billion views on YouTube and social media engagement rising. Year to date, we've seen growth of over 500 percent on TikTok and nearly doubled Instagram in that same timeframe. More recently, we've seen our engaged Facebook community reach over a million followers and we have started collaborations with podcasts to further drive engagement. The brand strategy we put in place 12 months ago is showing real traction on our social media engagement and AVOD viewing, which, in turn, is leading to new licensing deals across multiple categories.

Another important distinction for today's market versus 2013 when we started Spark is the viewing device kids and families used to consume content. YouTube is no longer just on your phone or tablet. Through the proliferation of connected TVs, it's on nearly every screen. Indeed, in the US, 88 percent of households own at least one Internet-connected TV device. The world is becoming screen agnostic. The device you watch Netflix or Peacock on is the same device you can watch YouTube videos.

Many of you may recall, about 18 months ago, we set out on a path to improve the quality of our views and our content on YouTube. We concentrated on increasing the quality of our owned and partner content on the platform while pruning and cutting back on lower-quality views. This strategy was informed by the deep insights and real-time feedback we are getting from our viewers on how they want to engage on our network. We are seeing very strong results in this endeavour and over the last 12 months have seen sequential improvement every month across total network watch time and average duration of viewing. This higher and deeper engagement has also resulted in improving CPMs. In fact, CPMs have similarly improved every month over the last 12 months. With all three of these KPIs now showing year-on-year growth over the last three months, it's clear that managing towards higher-quality engagement is the single most important driver of sustained success across this ecosystem.

We just wrapped up a busy season of industry trade shows and we heard consistent feedback from IP owners and partners: WildBrain is truly unique in the marketplace with its ability to grow audience engagement organically. Quite simply, there are not a lot of companies that have the scale and capabilities to provide services to brand owners who are looking for higher-quality engagement. WildBrain is that solution. With Content Creation, Audience Engagement, and Global Licensing under the WildBrain banner, we are positioning ourselves as the best-in-class solution for not only our own IP, but for global partners.

With our strong leadership team, I'm confident this new simplified structure will supercharge our plans to focus on the growth of key owned IP such as Peanuts, Teletubbies and Strawberry Shortcake alongside the key partnership brands. This new structure is leaner, faster, and brings us back to our entrepreneurial roots where great ideas and great execution can live and happen fast.

A key theme for our company is focus, and by focusing our efforts on a few brands we can leverage our full capabilities to build brand awareness and affinity, which drives monetization. Both during the quarter and shortly after quarter end, we signed a number of deals on some of these key brands. We're seeing the results of focusing on our owned key brands in the first quarter results. We saw growth of over 100 percent in our WildBrain brands, largely driven by licensing in Strawberry Shortcake. One of the advantages of growing our owned brands is the benefit of gross margin expansion, even from a smaller revenue base, growth in our owned brands can have a real impact on our profitability, which we saw this quarter. The engagement trends across premium content, digital-first content and social media engagement has led to an increase in licensing revenue. In premium content, the first two of four CG-animated specials for Halloween and Christmas debuted on Netflix. Building on the brand activity, product launches and activations are set to roll out into 2024, further expanding the choices for fans, both young and young-at-heart, to enjoy the World of Strawberry Shortcake both on and off screen. With different iterations gaining strong momentum, particularly in this nostalgic era of Strawberry, we see multiple categories getting traction in certain geographies, including the US, EMEA, and Asia.

Teletubbies secured new licensing partners and content deals to expand the brand into additional categories with growth in the digital space and fresh promotional activations in key markets. Highlights include a brand-new e-commerce site, new apparel ranges from Dolls Kill, multiple fan-focused activations, and location-based events in China.

For the Peanuts brand, WildBrain CPLG, which represents Peanuts on behalf of Peanuts Worldwide across Europe, EMEA, APAC and India, expanded the consumer products offering for the beloved brand with the signing of new and expanded partnerships across the globe, including cross-category, global partnerships, new APAC and China partnerships, and new European and UK partnerships. The new licensing deals span sustainable lifestyle plush featuring Snoopy, a collection of puzzles and games, Peanuts-inspired posters and wall art and apparel, accessories for baby, kids, and adults. Last quarter we spoke about the global partnership with leading lifestyle retailer, MINISO. It’s still early days in this MINISO partnership, but they have shared with us that it is the best IP launch in MINISO history, which has led to a further commitment of more collaborations in 2024.

We also secured a number of deals for our third-party partners, including multiple new cross-category consumer products licensing deals for the Sonic Prime brand in territories across the UK, Europe and the Middle East, building on our partnership with SEGA, following the launch of season two of a series on Netflix.

As a reminder, many of our licensing deals have a minimum guarantee component, so the upside to a lot of these deals will typically flow into our financial results in the following year. But with each new partner and activation, we are building a strong pipeline of future profit for years to come.

Lastly, I'd be remiss to not mention our China team has won the Best Licensing Service Award at China Licensing Expo. With the investments we've had in APAC over the past couple of years, we are already seeing significant demand for our IP and, most importantly, we see a long runway of growth.

Turning to the content market, since we spoke last quarter, one of the labour strikes has been resolved. As a Canadian-based studio, most of our projects were not directly impacted by the strikes. Instead, we saw more of the indirect impact, which was an overall slowing of greenlights. While we haven't fully normalized, anecdotally, we are seeing some green shoots in the content landscape. As you may have seen earlier this week, Apple announced the greenlight of a new CG-animated Peanuts feature film. In the untitled feature, Snoopy, Charlie Brown and the gang take on a new adventure in the big city. Over the last several years we have invested in our creative talent and capabilities, including the recent House of Cool acquisition. Expanding to full-length features for Peanuts is another step in that journey. We expect the content market to continue normalizing over time and, with a full pipeline, our outlook for growth in Fiscal 2025 and beyond is strong.

So, it's been less than 60 days since our last earnings call when we discussed the sale of non-core assets. Reducing leverage and simplifying our company and capital structure remain a top commitment. It's still early days in the potential sale process, but we are encouraged by the level of interest in our deep asset base, including some brands within our vast library of IP that we would view as non-core. We are limited at this stage in terms of what we can discuss, but I would note we have several participants under NDA and expect that number to continue to grow over the very near term. While we cannot predict the exact timing, we are working diligently to conduct a relatively quick process. Known IP is a scarce resource and these past several years have done nothing but prove its value as audiences fragment. Having IP that is known and branded is a huge advantage. Given our large portfolio of assets, we're confident that, through the sale process, we can accomplish the three core objectives we outlined last quarter. That's one, simplify and focus our business; two, improve our balance sheet; and three, drive shareholder value.

Turning to guidance, we are reiterating our expectations and continue to expect revenue to be down moderately year over year and adjusted EBITDA to be slightly higher. This is not a change from our prior guidance, as you can see in our MD&A. Excluding the studio and TV, we're confident all our other businesses combined are expected to grow EBITDA 15 percent to 20 percent year over year. We expect strong growth across our business outside of the studio and television in 2024 and, when we look to 2025 and beyond, our confidence is strong as we expect continued growth in our core business.

In conjunction with our earnings release, we announced that Nick Gawne has been appointed as our new Chief Financial Officer, succeeding Aaron Ames, who will stay on in an advisory role. I'm delighted Nick has joined us as CFO. He brings over 20 years of experience in finance, operation and business development. Having spent the bulk of his career at eOne, he has a deep background and strong track record in the global growth and monetization of kids' IP and consumer products. As licensing increasingly becomes a bigger piece of our business, Nick's experience will be hugely valuable, not only from a finance perspective, but we will also leverage his skill set on the operational side. We're thrilled to welcome him to the team. You'll hear from Nick next quarter.

Aaron has been an integral part of WildBrain for over five years and he will be with us during this transition to ensure the near-term strategic priorities we've outlined—refinancing or paying down the convertible debentures and the non-core asset sales—continue to move through their respective processes. Before I turn it over to Aaron to review our results, let me take this opportunity to thank him for his years of leadership and dedication to WildBrain. Aaron has been a trusted partner and passionate champion of our company. As I mentioned, he will be staying with us in an advisory role to ensure a seamless transition.

With that, I will turn it over to Aaron, who is suffering from a cold, so I will cross my fingers that he can get through the next couple of paragraphs.

Aaron Ames — Outgoing Chief Financial Officer, WildBrain Ltd.

Thanks, Josh. I hope I can get through them as well.

First quarter 2024 consolidated revenue was $105 million, down 17 percent, driven by the slowdown in the content market impacting the timing of project greenlights, which we discussed last quarter. As Josh mentioned, we realigned our business around the three strategic pillars. Against that backdrop, we took the opportunity to rename our revenue segment. Financial results will be reported as "Content Creation and Audience Engagement" and "Global Licensing". Legacy "Content Production and Distribution" and legacy "WildBrain Spark" revenue is combined into the renamed "Content Creation and Audience Engagement". "Consumer Products" was renamed "Global Licensing". Television will continue to be reported separately. As AVOD becomes an even more important form of distribution and the integral part of our overall engagement, the interconnectedness of the network's scale and reach is best reflected on a combined basis. For the transition period of Fiscal 2024, we will provide standalone legacy Spark results for comparability.

First quarter 2024 Content Creation and Audience Engagement revenue was $47 million, down 27 percent year over year. Legacy Spark revenue was $11 million in the quarter compared to $12 million in the prior year. This was a sequential improvement of 5 percent from the fourth quarter and, as Josh mentioned, we've seen improving CPMs. Global Licensing revenue in the quarter was $49 million compared to $52 million in the prior year period. Revenue in the quarter was primarily driven by strength in the US, offset by the timing of deals within the Peanuts brand, as well as FX headwinds related to the Japanese yen. We saw double-digit growth in revenue in CPLG and our owned brands, which was the benefit to gross margin. Television revenue was $9 million.

Gross margins in the quarter were up over 500 basis points with fewer live-action productions in the current quarter versus a year ago, as well as strength in our owned brands. Gross margin dollars were down $3 million on the lower revenue. We recorded a net loss of $16 million in the quarter, driven by lower revenue and higher finance costs.

SG&A expenses were $25 million in the quarter, down 4 percent year over year. First quarter SG&A benefitted from a recovery of amounts previously provided for. We are continuing to moderate our expenses.

Adjusted EBITDA of $19 million was down 5 percent year over year. Free Cash Flow for the quarter was negative $25 million related to working capital timing.

Our leverage at the end of the quarter was 4.61x. Leverage may fluctuate quarter to quarter but, as we've discussed, the Company is very focused on deleveraging the balance sheet. We're exploring several options to refinance or pay down the 2024 convertible debentures and are confident we will make meaningful strides in deleveraging in the near term.

Before I turn it back to Josh, I want to thank everyone here at WildBrain. I've greatly enjoyed working with the people here at WildBrain and I have every confidence in the future of WildBrain and its continued success.

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

Thank you, Aaron.

In the evolving landscape of kids' and family entertainment, WildBrain is in a position of leadership, as the only independent company with a comprehensive 360° suite of in-house expertise across Content Creation, Audience Engagement, and Global Licensing. With this new simplified structure and a strong leadership team, we will supercharge our plans to focus on the growth of key owned IP such as Peanuts, Teletubbies, and Strawberry Shortcake alongside key partnership brands.

Last quarter I highlighted the several areas of growth we see as we look out over the next three-plus years. We have experienced encouraging progress on each of those that give us confidence our focused strategy and investments over the prior 18 months are paying off. To delineate this progress:

- Our owned IPs remain priorities, as the economics are advantageous with high margin. The strength we see in Strawberry Shortcake is showing that our strategy is leading to increased licensees, which is directly impacting profitability.

- Within premium content, known IP will continue to drive family co-viewing. While there is short-term volatility in the content market, we are confident in our pipeline over the long term, as evidenced by the greenlight of the new Peanuts feature.
- AVOD and FAST channels are a growing industry opportunity, and we are well positioned to capitalize on that growth with our full range of content and expansion to new platforms. We are on track to have over 100 channels by 2024, the largest number of channels by any one distributor in the kids' space.
- Lastly, CPLG remains a hugely important driver of our growth. We saw strong double-digit CPLG revenue growth in the quarter, which has a meaningful impact on EBITDA. As CPLG grows faster than the consolidated business, we will see that flow through in the form of expanding EBITDA margins. Additionally, with new geographies and new capabilities like location-based entertainment, we see several years of growth ahead.

We have laid the foundation for growth by investing in licensing expansion and our 360° ecosystem around select owned and partner brands. The actions we're taking will continue to strengthen our business and build on our foundation for sustainable and profitable growth. We are reiterating our Fiscal year 2024 guidance, supported by growth expectations for our owned brands, CPLG, and AVOD/FAST, offset by declines in content due to timing delays in Fiscal year 2024 and, as discussed, the structural declines of the TV business.

We are at the beginning stages of realizing the positive results of our changes and are confident our strategy focusing on our key brands will continue to drive robust growth for years to come, together with the normalization and growth in the content business moving forward. We are committed to driving results against our outsized growth opportunities while maintaining financial discipline and taking the necessary steps to improve our balance sheet.

With that, let's open the call to questions. Operator?

Q & A

Operator

Thank you, sir. At this time, if you'd like to ask a question, please press star then one on your telephone keypad. Again, that's star then one on your telephone keypad. If you would like to withdraw from the queue, please press star two. Please stand by while we compile the Q&A roster.

We have your first question coming from the line of David McFadgen from Cormark. Please go ahead.

David McFadgen — Analyst, Cormark Securities

Hi. Just a question on the Peanuts feature film. So, are you guys being commissioned to produce that or are you just participating in the exploitation in terms of a royalty?

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

No, WildBrain is going to be producing the feature. Thanks for the question, David. As we talked about, we've been kind of building up our capabilities in this space over the past several years and we've brought some great talent on board—Bonnie Arnold, who is a highly acclaimed producer. We've been developing this project for the better part of 18 months, which has led ultimately to this greenlight, which is really meaningful for us. It's our first feature to be associated with and, yeah, we're really excited about what it does for us in the content space and ultimately how it's going to benefit the brand.

David McFadgen — Analyst, Cormark Securities

So then, obviously, this isn't service deal. Like this is an IP deal for you, because you guys own the IP, right?

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

Yeah. Correct. I mean it's Apple commissioning the film but, yes, it is our IP. And I would also mention, just in terms of our capabilities, it's worth reminding everyone that we did acquire House of Cool earlier this year, which are world leaders in pre-production with most of their experience coming from features, and this is an area that we've looked to expand in and so we're happy to be able to officially talk about it now.

David McFadgen — Analyst, Cormark Securities

And can you give us an idea on the size of the production budget?

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

I can't comment on specifics. I would just say it's a healthy animated feature budget that's befitting of the quality brand that Peanuts is.

David McFadgen — Analyst, Cormark Securities

Okay. And then lastly, in the exploitation of that, would that be just on Apple TV+ or would it actually see a theatrical release?

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

Yeah, it's a great question, David. You're seeing streamers experiment with different models these days. Apple has done now with the most recent Scorsese feature where they've gone theatrical first. At this point, nothing has been determined. It certainly will go to Apple TV+ but, in terms of other forms of distribution, we'll continue to discuss that with Apple.

David McFadgen — Analyst, Cormark Securities

Okay. And then are you seeing any, ah, like a better outlook for advertising on WildBrain Spark? Do you think that's coming in the next quarter or two?

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

Yeah, we've been really encouraged by growth in CPMs. Month over month, they've been improving. And I alluded to it in the script, but we're really happy with how that network has been trending. About 18 months ago we started pruning the network and going after higher-quality views and so, while our total views have dropped over that time, our watch time is now higher than it was and our average view duration has gone up significantly. That combined with the improving ad market has led to consistently improving CPMs for us. So yeah, we're encouraged by what we're seeing across our YouTube network.

David McFadgen — Analyst, Cormark Securities

Okay. And if I can just squeeze in one other one, you gave a leverage ratio that you're targeting, I think to the under 4 times by the end of Fiscal 2024. Is that contingent upon you completing any asset sales or is that just on the growth of the business?

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

We're confident we're going to get to under 4 times. I mean, as we talked about, we are contemplating various asset sales but, regardless, we're confident in this outlook.

David McFadgen — Analyst, Cormark Securities

So you'll get there without the asset sales and if you conclude some asset sales it will be even lower. Is that correct?

Josh Scherba — President & Chief Executive Officer, WildBrain Ltd.

No, I didn't say that. We're confident we're trending down for leverage and we will get there.

David McFadgen — Analyst, Cormark Securities

Okay. Okay. Alright. Thank you.

Operator

Thank you. And again, ladies and gentlemen, at this time, if you'd like to ask a question, please press star then the number one on your telephone keypad.

There seem to be no further questions at this time. Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Have a lovely day.