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ATV - Q2 2019 Acorn International Inc Earnings Call

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## CORPORATE PARTICIPANTS

**Jacob A. Fisch** *Acorn International, Inc. - President & CEO*

**Martin Oneal Key** *Acorn International, Inc. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Richard E. Greulich** *REG Capital Advisors - President & CEO*

**Elaine Ketchmere** *Compass Investor Relations - Partner*

## PRESENTATION

### Operator

Good day, and welcome to the Acorn International Q2 Earnings Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Elaine Ketchmere. Please go ahead.

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### Elaine Ketchmere - Compass Investor Relations - Partner

Thank you, operator, and good morning, everyone. Thank you for joining us today for the discussion of our unaudited financial results for the second quarter of 2019. With me today are Mr. Jacob Fisch, our CEO and President; and Mr. Martin Key, our Acting CFO. After our prepared remarks, we will open the line for questions.

Before we continue, I would like to remind you that the discussion today will contain certain forward-looking statements. These forward-looking statements include, among others, statements with respect to the company's continued focus on building brands and growing e-commerce sales, particularly Babaka-branded products and Acorn Fresh, its plan for continued development of Acorn Digital Services and the company's expected completion of the shutdown of its call center in the third quarter of 2019, the classification and presentation of such shutdown as well as the further increase in efficiency, reduction in costs and increase in profit from continuing operations for the year such shutdown is expected to generate, among others. A number of the potential inherent risks and uncertainties that Acorn's business involves are outlined in the company's public filings with the U.S. Securities and Exchange Commission. As such, actual results may be materially different from the views expressed or anticipated results described today.

Acorn International does not undertake any obligation to update any forward-looking statement, except as required by applicable law. Furthermore, the unaudited financial information discussed today is preliminary and subject to potential adjustments. Adjustments may be identified when audit work has been performed for the company's year-end audit, which could result in significant differences from this preliminary unaudited financial information.

Now I will turn the call over to Jacob Fisch, Acorn's CEO and President, who will discuss some operational highlights for the quarter. Jake?

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### Jacob A. Fisch - Acorn International, Inc. - President & CEO

Great. Thank you, Elaine. Acorn posted another quarter of solid sales growth in the second quarter of 2019 with revenues up 38.6% from the second quarter of 2018 due to continued strong performance of Babaka-branded products and Acorn Fresh on our e-commerce channels with gross margins improving to 71.8%.

Due to increased investment in sales and marketing to support growth of our new business, our results were just below breakeven at the operating level, while net income was \$100,000.

During the second quarter of 2019, our Babaka brand of posture correction products continued to achieve record sales driven by the successful promotion of our core products through digital media in China and sale of these products through third-party e-commerce B2C platforms. Acorn Fresh, which offers high-quality fresh food products via e-commerce, continued to build momentum.

During the quarter, we created a new business unit, Acorn Digital Services, under which we consolidated Acorn Entertainment, our social media management business; Acorn Streaming, our digital content business; and AKOL, standing for Acorn Key Opinion Leader, which facilitates the development of local China influencers with the objective to optimize our ability to convert Acorn content into product sales.

Acorn Digital Services has been gaining momentum recently entering into new agreements with brands and influencers across a range of industries. We are excited to represent Chef Works, a global leader in culinary and hospitality apparel, serving some of world's top hotel brands, restaurants and culinary academies, to provide them with social media and digital management services to help grow and further monetize the value of their brands in China.

In addition, we recently signed a high-profile Dutch media influencer to provide social media and digital management services to help establish and monetize the brands in China. We are also exploring opportunities to expand our relationship with state-owned media powerhouse, Shanghai Media Group, with a focus on content creation and licensing.

On August 28, our Board of Directors declared a cash dividend of \$0.0125 per ordinary share or \$0.25 per ADS for the second quarter of 2019. Our dividend policy calls for recurring quarterly dividend of \$0.0125 per ordinary share or \$0.25 per ADS subject to quarterly review, approval and declaration by the Board.

Looking ahead, Acorn will continue to focus on building brands and growing e-commerce through those brands. We will focus our principle -- focus on our principal brands, including currently Babaka-branded products and Acorn Fresh, while also providing services to third-party brands through Acorn Digital, through which, in certain cases, we have the opportunity to incubate new self-owned brands for the principal side of the business in a risk-managed manner.

We are also in the process of shutting down our call center operations in Wuxi, China, which are increasingly unproductive as a sales channel in China's new digital economy. We expect this will further allow us to focus our energies on digital and e-commerce, increase efficiency and lower cost. And we hope to complete the process within the next few weeks.

Once completed, we will be required by applicable accounting rules to treat the historical operations of the call center as discontinued operations, which we believe, based on our estimates, will have a positive impact on our profit from continuing operations for the year.

Based on our estimates, the net effect of these discontinued operations in the first half of 2019 would have been a decrease in revenue and gross profit by approximately \$0.7 million and \$0.4 million, respectively, and improve income loss from continued operations for the first half of 2019 by approximately \$0.2 million. The results for full year 2019 will include the call center's operations as discontinued operations throughout the period.

With that, I will turn the call over to Martin to discuss our financial results. Martin.

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**Martin Oneal Key** - *Acorn International, Inc. - CFO*

Thanks, Jake. So for the second quarter, total net revenues were \$8.7 million, up 38.6% from \$6.3 million in the second quarter of 2018, primarily due to an increase in e-commerce sales of Babaka-branded products as well as other products.

Gross profit in the second quarter of 2019 was \$6.3 million, up 39.9% from USD 4.5 million in the second quarter of 2018.

Gross margin was 71.8% in the second quarter of 2019, up from 71.2% in the second quarter of 2018, due primarily to a higher proportion of sales from Babaka-branded products.

Total operating expenses in the second quarter of 2019 were USD 6.7 million, up 35.5% from USD 5 million in the second quarter of 2018. The increase in operating expenses were due primarily to an increase in selling and marketing expenses to support e-commerce sales, which were partially offset by a slight decrease of general and administrative expenses and an increase in other operating income due to increased revenues from Acorn Digital Services and interest from the loan to Cachet.

Loss from continuing operations was USD 0.5 million in the second quarter of 2019, which is comparable to a loss of continuing -- loss from continuing operations of USD 0.5 million in the second quarter of 2018.

Other income was USD 0.3 million in second quarter of 2019 compared to other income of USD 27.7 million in the second quarter of 2018. The year ago period included a \$27.7 million capital gain from the sale of Bright Rainbow Investments Limited subsidiary in April 2018.

Net income from continuing operations was USD 0.1 million from the second quarter of 2019. This compares to net income from continuing operations of USD 25.1 million in the second quarter of 2018, which is primarily due to the previously mentioned USD 27.7 million gain -- capital gain from the sale of Bright Rainbow.

Net loss from discontinued operations, which reflects the sale of the majority stake in the company's [HJX] electronic learning products business to a third-party investor and operator in 2017, was USD 5,000 in the second quarter of 2019 compared to a net loss from discontinued operations of USD 1.3 million in the second quarter of 2018.

I'd like to point out that our call center operations will be included in discontinued operations once we have completed shutting down those operations, which is most likely in the third quarter of 2019.

Net income attributable to Acorn was USD 0.1 million in the second quarter of 2019. This compares to a net loss attributable to Acorn of USD 23.8 million in the second quarter of 2018.

Now turning to the first half results. Total net revenues were USD 17.8 million in the first half of 2019, up 52.5% from USD 11.7 million in the first half of 2018, primarily due to an increase in e-commerce sales of Babaka-branded products as well as other products.

Gross profit in the first half of 2019 was USD 12.8 million, up 55.1% from USD 8.3 million in the first half of 2018. Gross margin was 71.8% in the first half of 2019, up from 70.6% in the first half of 2018. The increase in gross margin was due to a higher proportion of sales from Babaka-branded products.

Total operating expenses in the first half of 2019 were USD 12.8 million, up from USD 8.9 million in the first half of 2018. The increase in operating expenses were due primarily to an increase in selling and marketing expenses to support e-commerce sales.

Income from continuing operations was USD 3,000 in the first half of 2019 as compared to a loss from continuing operations of USD 0.6 million in the first half of 2018.

Other income was USD 4.9 million in the first half of 2019, primarily associated with the gain on the sales of the company's former principal office in Shanghai to a third party. This compared to other income of USD 27.8 million in the first half of 2018, which was primarily due to a gain on the sale of the company's Bright Rainbow Investments Limited subsidiary in April of 2018.

Net income from continuing operations was USD 5 million in the first half of 2019. This compares to a net income from continuing operations of USD 25.1 million in the first half of 2018, which was primarily due to the previously mentioned USD 27.7 million capital gain from the sales of Bright Rainbow.

Net loss from discontinued operations, which reflects the sale of the majority stake in the company's HJX electronic learning products business to a third-party investor and operator in 2017 was USD 41,000 in the first half of 2019 compared to a net loss from discontinued operations of USD 1.6 million in the first half of 2018.



Net income attributable to Acorn was USD 4.9 million in the first half of 2019, which compares to net income attributable to Acorn of USD 23.5 million in the first half of 2018.

As of June 30, 2019, Acorn's cash and cash equivalents with restricted cash totaled USD 11.6 million. The cash balance at the end of the first half of 2019 reflects the payment of cash dividends totaling approximately USD 3.2 million in June 2019. This compares to cash and equivalents with restricted cash of \$20.2 million as of December 31, 2018.

Now I'll turn the call back over to Jake for some closing remarks.

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**Jacob A. Fisch** - *Acorn International, Inc. - President & CEO*

Great. Thank you, Martin. In closing, Acorn is performing well so far in 2019 with continued sales growth on e-commerce of our Babaka-branded products and Acorn Fresh. Acorn Digital Services is beginning to ramp with new client engagements and partnerships, and we are further streamlining operations by eliminating call center.

We will continue to leverage our 20 years of direct marketing experience in China and to build brands and expand e-commerce sales into the future. That concludes the prepared remarks section of this call, and we will now open the call for questions.

And I turn it back to the operator.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We'll have our first question from [Anthony Mickey] from a private investor.

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### Unidentified Participant

A couple of questions for you. The increased expenses for marketing for this quarter, is this -- can we anticipate this could be a permanent higher level of spend or is this something that will -- my first question, is this something that's just unusual in the quarter or can we anticipate that this will remain this way for the foreseeable future?

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**Jacob A. Fisch** - *Acorn International, Inc. - President & CEO*

To some extent, the increase in expenses are correlated to the growth. And to some extent, there was investment in growth in other parts of the business. So part of the business is simply driven by increase in selling expenses and other parts of the business as we required some investment.

I would -- in terms of estimating the future, I'm not going to do it from a financial perspective. But in terms of the degree of investment needed to grow the business, that will continue to be managed. We've said it time and time again that we want to grow profitably and that doesn't mean that there isn't going to be investment in that growth, but it's going to be managed growth, and that is key.

So there may be certain periods in which we're investing more, and certain periods in which we're investing less. But overall, our strategy is to grow in a managed manner and ultimately, to focus on profitability. I hope that answers your question.

**Unidentified Participant**

Okay. Yes. And just as sort of a follow-up. I know you mentioned you're not going to giving forward-looking predictions in terms of profitability, but I believe one of the reasons the stock is trading close to its 52-week low is just investors' uncertainty as to where the business is going. So to that extent, can we anticipate that future quarters should be better than breakeven at this point?

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**Jacob A. Fisch** - *Acorn International, Inc. - President & CEO*

Yes. I mean, again, I would stay away from making those kinds of financial projections, but we are -- our goal is to maintain a profitable position certainly as we round out the year. That is -- that would be what we would like to be able to do. So that's about as far as I should go comfortable responding at this point. I hope that's helpful.

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**Unidentified Participant**

Yes. And the final question, with the stock trading at these levels, and if one does basic math, which I think unfortunately a lot of people don't, is there a buyback program or has the company considered buying back the stock? And if so, have they bought back any stock?

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**Jacob A. Fisch** - *Acorn International, Inc. - President & CEO*

We, you may know, have had buyback programs in place in the past. We have and currently are continued to assess the possibility of doing that. Obviously, one downside at this stage is that we are -- we would be narrowing already fairly thin float. So that's sort of the countervailing concern of putting in place -- putting back in place a program, and we received comments from shareholders about the thinness of the flow being a concern. So we're trying to balance that. But at the same time, we continue to consider options and -- continue to consider that as an option. I think you would be -- you would -- I was going to say...

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**Unidentified Participant**

I'll make a comment though for the people, the investors that say, gee, does the flow is too thin you should buyback the stock, and they should be buying -- that they should be buying the stock in the open market. You can't have it both ways. We tell the company not to buy the stock back, but then you and I will have to buy the stock in the open market. So it's just my own opinion. I appreciate the comments.

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**Jacob A. Fisch** - *Acorn International, Inc. - President & CEO*

Got it. Thank you very much.

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**Operator**

(Operator Instructions) And our next question comes from Richard Greulich from REG Capital Advisors.

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**Richard E. Greulich** - *REG Capital Advisors - President & CEO*

I wanted to follow-up on the share repurchase question. It would seem to me that given the book value and the current stock price, it's a pretty good investment. And I would suggest not worrying too much about the flow. That usually will take care of itself in valuation. So may be let me phrase it in a question. Why would you not be buying back stock of yours?



**Jacob A. Fisch** - *Acorn International, Inc. - President & CEO*

I -- it's a good question. I mean, once again, we've considered the concerns that we've received on sort of both sides of the fence, and I appreciate your rhetorical question perhaps and let's take that onboard and take another look at it.

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**Operator**

(Operator Instructions) Since there are no further questions at this time, I would like to turn the conference back to you for additional remarks.

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**Elaine Ketchmere** - *Compass Investor Relations - Partner*

Thank you, everyone. With that, we will conclude our call for today. For additional questions, feel free to contact us at [ir@chinadrvtv.com](mailto:ir@chinadrvtv.com), and thank you again and have a good day.

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**Jacob A. Fisch** - *Acorn International, Inc. - President & CEO*

Thank you.

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**Operator**

This concludes today's call and thank you for your participation. You may now disconnect.

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