Old West Investment Management, LLC

October 8, 2018

Dear Investor,

In just two short weeks Old West Investment Management will celebrate our tenth anniversary. It's amazing to me how fast these ten years have gone by. It was November 1, 2008 that we opened our doors, right in the middle of the financial crisis now called the Great Recession. It is often said that the worst of times might be the best of times to start something new, and in our case, I believe that was true. As we began investing clients' money along with our own money, the market was in free fall for the first four months, finally reaching a bottom on March 9, 2009. From that bottom the market has soared to heights unimaginable at the time, and ten years later markets are near all-time highs. That begs the question, where do we go from here?

Our team at Old West has much to be thankful for. We began with $20 million of money from friends, family and principles, and we have steadily grown to nearly $200 million under management. The vast majority of money management firms do not survive ten years in business, and we are blessed with loyal and supportive clientele to whom we are very grateful.

A question that should be posed to any investment professional is, what are you more concerned with, a client's loss of capital or loss of opportunity? Throughout our ten years in business it is preservation of capital that has been rule number one. Rule number two is not to forget rule number one. Believe me, we have made plenty of mistakes, but by sticking to our investment process we have grown client's assets in a safe and conservative manner. Our All Cap portfolio, which is comprised of our best 30 ideas regardless of company size, is up 11% per year from inception, never having owned any of the high flyers like Google, Amazon, Netflix, Apple and Facebook. Why haven't we owned any of these companies? Because there was never a point in time where any of them seemed to have a margin of safety where we felt comfortable. Looking back, of course they have been great investments for others, but it's always easier looking back than forward.

Each one of the aforementioned highflyers has a unique story and investment thesis, but trillions of dollars have gone into these names, not for the investment thesis but because these trillions are invested in passive index funds. For every $100 invested in a S&P 500 index fund, $22 goes into the top 10 names (Apple, Microsoft, Amazon, Google, etc.), while only 18 cents is invested in the bottom 10 names. As a result of this top-heaviness, the top 10 S&P 500 stocks have contributed more than 100% of the index's year-to-date gains, which means that the other 490 stocks in the S&P 500 have a negative year-to-date return. This phenomenon has been going on for several years now, and as trillions of dollars continue to flow into passive index funds, the stock markets top-heaviness becomes more and more skewed and worrisome. An even more alarming example is the Nasdaq 100, another beneficiary of billions of dollars of fund flows. For every $100 invested in a Nasdaq 100 index fund, $56 goes into the top 10 names. Millions of passive investors who think they are diversified across 100 stocks, are actually very concentrated and at great risk of principal loss. These top names in widely owned index funds like the S&P 500 and Nasdaq 100 are what we call "crowded trades." Time and time again this story plays out: millions of investors crowded into the same stocks, and everyone goes over the cliff together.

Let me take you back to 2000 when technology and internet stocks were the rage, and if you didn't own them you felt like an idiot. The December of 1999 cover of Barron's magazine had the headline "WHAT'S WRONG, WARREN? After 30 years of unrivaled investment success, Warren Buffet may be losing his magic touch." Really??? How different is it today from 2000? I will argue not that different. In September of 2000, nine months after the Barron's headline, Intel, the bellwether chip maker was trading at 55 times earnings, compared to Amazon today trading at 160 times earnings or Netflix trading at 150 times earnings. In the month of September 2000, Intel lost 45% of its market value in a single month. From that September to October of 2002, the bottom of the tech bubble, Intel would lose 82% of its value, Cisco Systems lost 90%, Nokia lost 79% and Sun Microsystems lost 96%. These were all good companies run by very smart people, but the herd mentality drove them to ridiculous valuations that created a true bubble. Mark Twain's saying "history doesn't repeat itself, it just rhymes" has been repeated ad nauseam, but it is worth repeating.

Old West had an outstanding first half of this year, but we had a very disappointing third quarter as you can see in your enclosed statement. Approximately 1/3 of our portfolios are invested in companies that produce commodities. We have investments in oil and gas (Carrizo, Antero, Matador) gold mining (Barrick, Goldcorp, Novagold) copper mining (Freeport) and uranium mining (Cameco). Worldwide commodities are priced in U.S. dollars, and a very high dollar caused sharp declines in commodity prices in August and September. We view this as a temporary situation, and we are fully confident commodity prices and the stock prices of these companies will fully recover and go much higher. In fact, we have already seen this in late September and early October. Why the high weighting to commodity related companies? Going back to 1880, stocks have never been higher versus a basket of commodity prices. As we look to the next ten years at Old West, we see tremendous opportunity in the stocks mentioned above, mostly trading at multi year lows.

In every quarterly letter we like to highlight one or more of the companies we are invested in. Old West co-founder Joe Boskovich Jr. has done a tremendous amount of research on a Canada based company DHX Media. Enclosed is a research report written by Joe on this very exciting opportunity. We thank you for your continued loyalty and support, and we look forward to a strong finish to the year.

Sincerely,

Joseph Boskovich, Sr.
Chairman and Chief Investment Officer

DHX Media

DHX Media Ltd. (TSX: DHX; NASDAQ: DHXM) is a global children's content and brands company, recognized for such high-profile properties as *Peanuts*, *Teletubbies, Strawberry Shortcake, Caillou, Inspector Gadget*, *Johnny Test,* and the *Degrassi* franchise. One of the world's foremost producers of children's shows, DHX Media owns the world's largest independent library of children's content, at 13,000 half-hours. It licenses its content to broadcasters and streaming services worldwide and generates royalties through its global consumer products division. Through its subsidiary, WildBrain, DHX Media also operates one of the largest networks of children's channels on YouTube, which has the potential to be a significant growth catalyst in the coming years

Because DHX Media is a fully integrated producer and owner of children's content, it's helpful to better understand the different business segments responsible for generating revenue. For Fiscal 2018 (6/30/2017 – 6/30/2018), DHX Media generated $434 million in revenue and $97.5 million EBITDA. The company earns revenue from the following seven categories:

1) **Proprietary Production revenues** **(5%)**. This includes 1st window initial broadcast license revenues for DHX's owned content and any pre-sales or advances included in the initial financing of the production budget of a film and television program. DHX has a low-risk production model, with 85% of its budget typically being covered before greenlighting a project.

Total Proprietary Production revenue decreased $17.1 million to $19.8 million in Fiscal 2018, compared to $36.9 million in Fiscal 2017. The decrease was more than offset by an increase in the Company's Producer and Service Fees, which utilize the same production studios to earn revenues. During Fiscal 2018, the Company added 103 proprietary half-hours and 125 half-hours of third-party produced titles with distribution rights to the library. This compares to Fiscal 2017 when the company produced 194 proprietary half-hours and 101 half hours for third-party titles with distribution rights. Third-party titles with distribution rights largely arise because of the operational synergies associated with owning linear television channels.

2) **Distribution revenues – excluding WildBrain (15%):** This mainly includes the 2nd window and latter distribution of its wholly owned titles. After a production is completed and delivered, the program is then included in the Company's library of film and television programing. After generating revenues from proprietary productions (1st window), DHX is then able to generate revenues from the sale of broadcast rights in other jurisdictions and to other broadcasters, streaming platforms, and on-demand services such as Netflix, Amazon, etc. Distribution revenues also includes third party titles where DHX maintains global distribution rights, such as with its Mattel partnership.

   For Fiscal 2018, distribution revenues were $66.81 million, up 1% from $66.38 million for Fiscal 2017. This was driven by acquisitive revenues from Peanuts and organic growth from the continued strong demand for content from the competing streaming video on demand (SVOD) services. For Fiscal 2018, the Company closed significant deals with Netflix, Viacom, Hulu, Disney, etc. This was offset by fewer new titles being added as the company shifts to select productions to meet the rising demand for exclusive original programming.

3) **WildBrain Revenues (14%):** Revenues from WildBrain, the Company's Multi-Platform Kids' AVOD (advertising video on demand) Network, is one of the largest networks of Kid's content on YouTube, Amazon Video Direct and others. This segment has historically been included in distribution revenue and has only recently been separated as growth accelerates. **WildBrain is DHX's fastest growing segment and will be a significant growth catalyst in the coming years.**

   Revenues from WildBrain were $57.28 million for Fiscal 2018, reflecting an increase of 68% from Fiscal 2017 revenues of $34.029 million.

4) **Television Revenues (13%):** DHX is the largest children's broadcaster in Canada and generates television revenues through its ownership of Family Channel, Family Jr, Telemagino and Family CHRGD. This division derives revenues primarily through subscription fees earned by charging a monthly subscriber fee to various Canadian cable and satellite television distributors.

   For Fiscal 2018, television revenues were $55.01 million compared to $57.38 million for Fiscal 2017, a decrease of 4%. As subscribers to pay-tv continue to decrease, DHX Media has been very aggressive at establishing itself in the digital space on quickly growing SVOD (streaming video-on-demand) and AVOD (advertising video-on-demand) platforms.

5) **<u>Consumer products – owned revenues</u> (32%):** This includes revenues from DHX's proprietary brands, consumer products royalties earned pursuant to the Company's strategic pacts with Mattel, royalties from interactive games and apps, music and digital royalties, and live tour revenue.

   For Fiscal 2018, the consumer products-owned revenues were $144.71 million, up 451% compared to $26.25 million for Fiscal 2017, a direct result of the Peanuts acquisition. The expanded consumer products business enhances the stability of free cash flow generation for the company.

6) **<u>Consumer Products - represented revenues</u> (3%):** This includes revenues earned from CPLG (Copyright Promotions Licensing Group). CPLG is a wholly owned agency business that earns commissions on consumer products from representing independently owned brands from film studios and other third parties, primarily outside of the United States. For example, CPLG was recently appointed as the licensing agent for the Dr. Seuss franchise in Europe, Middle East & Africa. CPLG will focus on apparel, gifting, stationery and toys, targeting adults who grew up reading the books and a new generation of children enjoying the books for the first time. CPLG serves as a brand licensing agent to other popular brands like Sesame Street, Pink Panther, Paw Patrol, SpongeBob Square Pants, Hatchimals, Paramount, and Sonic the Hedgehog. CPLG operates in 30 countries and has 40 years of licensing experience.

   For Fiscal 2018, consumer products-represented revenues were down $31%, to $13.03 million (all organic) compared to Fiscal 2017 revenues of $18.81 million. The decline reflected the continuing transition of the business unit in shifting its customer base as revenues dropped off from Despicable Me and Minions, which benefited Fiscal 2017.

7) **<u>Producer and service fees</u> (18%):** This includes revenue earned for producing animated and live-action television shows, feature films, and direct to digital movies for roughly 500 third party titles.

   For Fiscal 2018, the Company earned $77.77 million, an increase of 32% versus $58.98 million from Fiscal 2017. The increase was due to several key service projects, including My Little Pony for Hasbro, Carmen Sandiego for Netflix, and Rocky and Bullwinkle. $13.3 million in Producer and Service Fees were related to new content produced as part of the Company's strategic pact with Mattel on Bob the Builder, Fireman Sam, Little People, and Polly Pocket.

DHX Media has successfully built a large, vertically integrated children's content company with multiple sources of revenue. Each segment offers the opportunity to drive growth to other parts of the business, and we believe that the company will intelligently capitalize on these synergies. For example, CPLG's agency relationship with Dr. Seuss internationally could also grow into WildBrain creating Dr. Seuss content for YouTube and/or Producer and Service Fees if they are hired to produce television shows or digital movies. Another example could be related to Popeye WildBrain content on YouTube. King Features Syndicate, a division of Hearst Corporation, recently appointed

WildBrain to manage and produce the first original Popeye content in over 10 years. As WildBrain grows the brands awareness, CPLG could possibly serve as a territorial agent in parts of the world and help sell toys, clothes and other merchandise for the Popeye the Sailorman franchise.

PEANUTS ACQUISITION AND SUBSEQUENT PARTNERSHIPS

In June 2017, DHX acquired the entertainment division of Iconix Brand Group, Inc, which included an 80% controlling interest in Peanuts and a 100% interest in Strawberry Shortcake for CAD$453 Million. The remaining 20% interest in Peanuts Holdings LLC would remain owned by members of the Charles Schulz family. The company highlighted its plans to further develop the Peanuts and Strawberry Shortcake properties in new ways, and leverage its platform in content production, distribution & consumer products. The recent launch of the Snoopy channel on WildBrain is one such example of the company creating new content to re-engage the kids of today.

Following the acquisition, DHX was heavily scrutinized by the investment community for potentially over levering and overpaying for the Peanuts franchise (12x EBITDA). Coupled with several quarters of missed guidance by the former management team, the company's stock had plummeted from around $6 per share to $0.80, where we bought a large percentage of our investment stake.

In May 2018, 11 months after the Peanuts/Strawberry Shortcake acquisition, DHX sold a 49% non-controlling stake of its 80% interest in Peanuts to Sony Music Entertainment Japan for CAD$237 million. Through this transaction, not only did DHX reduce its debt by one turn while maintaining control of Peanuts, but they also got back roughly $20 million more than it paid for the stake just one year ago (and excluding Strawberry Shortcake), which provides validation for DHX's initial purchase. Now combined with the international world leading entertainment and consumer products right management expertise of Sony, we believe that DHX/Sony will jointly continue to drive the growth of Peanuts. As its territorial agent in just Japan, Sony had grown Peanuts by 200% since 2010 into the country's leading family brand, and sales in Japan now represent roughly 40 percent of Peanuts overall revenue.

Most recently, DHX Media announced that they have signed an exclusive agency representation agreement with CAA-GBG for Peanuts in China and Asia (excluding Japan), through June 2023. CAA -GBG (joint venture between Creative Artists Agency and Global Brands Group) is the world's largest licensing and brand management company. This multi-million-dollar agreement is expected to contribute to an approximately 35% increase in revenue for Peanuts Worldwide from this region over its term. By using the same template that yielded massive success for Sony in its marketing of the Peanuts brand in Japan, we expect CAA-GBG to have similar success with the Peanuts franchise in China and throughout the rest of Asia.

HIDDEN WILDBRAIN VALUE

WildBrain, a wholly owned subsidiary of DHX Media and its fastest growing segment, is one of the largest networks of children's content on YouTube, accounting for about 5% of all kids' views.

WildBrain specializes in the creation of new, original content, such as animated and live-action shorts; toy-play and stop-motion videos; preschool counting and alphabet videos; nursery rhymes and more. WildBrain owns and operates 575 channels for over 600 kids' brands and produces its content in 239 territories and 22 languages.

As content viewing habits continue to evolve through advancements in technology and media platforms, YouTube has become the leading platform for children watching video, grabbing 15% of their viewing time. That exceeds the 13% of their time that goes to traditional TV and the 9% that goes to Netflix. Since its incubation four years ago, total watch time on WildBrain has grown from 13 million minutes in June 2013 to 13 Billion minutes in March 2018, a four-year compounded annual growth rate of 390%. As growing monthly watch time continues to attract premium ad rates, revenues attributed to the WildBrain segment have also grown significantly from $6.7 million in Fiscal 2014 to $57.28 million in DHX's Fiscal 2018, an 80+% Compounded Annual Growth Rate.

When first launched in 2014, WildBrain began by developing YouTube content using its owned catalogue of children's cartoons. These segments are usually three to five minutes in length. WildBrain gets 55 percent of the ad revenue from this content, which adds up given the cartoons are often watched a million times or more. This content can be produced quickly at one-20th the cost of a cartoon for TV because YouTube cartoons are shorter and of varying quality, which means a production can become profitable rather quickly on the ad revenue it earns. What's more, there's extremely fast feedback from WildBrain's proprietary analytics tools, which helps the company produce related content, often within two months.

Since its launch, WildBrain has become so good at producing YouTube content that other media companies, such as NBC Universal and Turner, have approached WildBrain to produce their YouTube animation. Toy companies like Mattel have also contracted WildBrain to produce their YouTube content, which can range from animation to videos of kids playing with the toys. The WildBrain network currently features popular third-party brands such as Fireman Sam, Curious George, Shopkins, Ben 10, Popeye, Chuggington, and many, many more. One such example is a segment for Mattel's Fireman Sam that consisted of a two-minute animation, followed by a paid advertisement for the toys shown in the animation. It helped to build brand awareness for the toys, and the analytics can inform Mattel which toys resonate best with children.

Another illustration of WildBrain's effectiveness in producing YouTube content for third parties was recently featured by Google as a case study on their site, thinkwithgoogle.com. *ThinkWithGoogle*.com is a digital resource portal that's packed full of insights, data and analysis, that have been handpicked by Google as best in class industry examples, which serve to inspire and inform others. The site is mainly used by media agencies, brand managers and directors across the globe. The case study involved a children's animated cartoon, *Sunny Bunnies*. After season one aired on the Disney Channel in Russia, the official *Sunny Bunnies* YouTube channel had just 1,200 subscribers. Wanting to expand the brand to a much wider audience, the creators, Belarus-based Digital Light Studio, approached WildBrain to grow *Sunny Bunnies* global reach. Google's case study showcased how WildBrain's team of talented YouTube experts transformed the official *"Sunny Bunnies"* channel from 1,200 subscribers to a top 1% global YouTube channel in just over 18 months, using a combination of best-in-class channel management, video discovery ads, and a smart paid media strategy. WildBrain was able to generate more than 600,000 views per day on average and grew the channel to 325,000 subscribers and 1.88 billion minutes of watch time. Leveraging this enormous increase in awareness, the *Sunny Bunnies* brand has secured a master toy partner, and earnings from the channel are able to fund further content and support the brand's future growth.

There is no end in sight for the WildBrain segment, which is becoming an increasingly significant part of DHX Media's business. Children's love of YouTube continues to grow, and WildBrain continues to gain recognition amongst parents as a leading brand of appropriate content for children.

<u>POSSIBLE WILDBRAIN VALUATION</u>

Over the past several years, there have been a few acquisitions of MCN's (Multi-Channel Network) that may be helpful in determining a fair valuation for WildBrain;

1) <u>Awesomeness TV</u>

Awesomeness TV was founded in June 2012 as part of You Tube's original programming initiative to build out a youth-oriented media business. By January 2013, Awesomeness TV's YouTube network of channels hit one billion views and was acquired by DreamWorks Animation in one of the first acquisitions of an MCN. Under its new ownership, Awesomeness launched DreamWorks TV, a YouTube channel aimed at families and kids ages 6 to 12 that produced short-form content for DreamWorks Animation library of characters such as Shrek, Trolls and Kung Fu Panda. Awesomeness TV continued to build scale and expand by producing and managing the YouTube content for 3rd Party brands such as Hearst Corporation owned Seventeen Magazine's channel featuring fashion, food, beauty, celebrity and lifestyle content. In April 2016, Verizon Communication acquired a 24.5% stake in Awesomeness TV for $159 million, valuing the operation at $650 million. The purchase price equated to about 9x's revenue. At the time of the acquisition, Awesomeness TV had roughly 800 million monthly views.

2) <u>Maker Studios</u>

Maker Studios was founded in 2009 by a collection of top YouTubers to create a multichannel network on YouTube. Maker Studios represented many popular talents and helped those talents produce and monetize their content. Maker grew to become one of the top networks on YouTube with a reach of 5.5 billion monthly views. In March 2014, the Walt Disney Co. announced the acquisition of Maker Studios for up to $950 million ($500 million up front, with a performance-based earn-out of up to $450 million). The acquisition would allow Disney to gain access to Maker's pipeline of young consumers for Disney characters and franchises, allow Disney to learn how to best interact with the raised on the web generation, and teach Disney how to manage big brands on YouTube for distribution purposes.

WildBrain boasts a large reach like both Awesomeness TV and Maker Studios, both of which sold for 9x's revenue or more. Awesomeness TV had roughly 800 million monthly views at the time of the Verizon acquisition, and Maker Studios had roughly 5.5 billion monthly views when Disney acquired the company. This compares to WildBrains 2.5 Billion monthly views. At 9x's WildBrain's projected Fiscal 2018 revenue, the asset could be worth an estimated $500 million, which equates to about 70% of DHX Media's entire enterprise value. Furthermore, unlike Awesomeness TV and Maker Studios, WildBrain owns much of the original content on its platform and is growing organically at 80%+ annually. It's very likely that just WildBrain as an asset is worth more than the entire current market capitalization of DHX Media.

MANAGEMENT AND OWNERSHIP

Michael Donovan co-founded DHX Media and served as the company's Chief Executive Officer from 2006 to 2014. He gave up his CEO title in favor of executive chairman in 2014 and shifted to more of a strategic focus and less of an operational role. As Executive Chairman, Donovan would shift much of his focus on big picture efforts such as the digital delivery platforms Netflix, Amazon, YouTube, Hulu, etc. as indicated in the following excerpt from a September 2017 interview:

> *"Advertising-supported streaming is a brave new world," says Donovan. When YouTube evolved into Advertising Video on Demand, DHX was able to upload the vast majority of its content library to the platform and turn a profit almost from the first day. "I put a lot of time into that, because I think it's the future," he says.*

After a series of operational mis-steps and missed guidance that saw DHX Media's stock price collapse, the company launched a strategic review, and one of the outcomes of this recently completed strategic review was Michael Donovan's return to the CEO role, in addition to other management changes. The new DHX management team is focused on returning value to shareholders. Michael Donovan holds a significant amount of stock in the company, owning about 5% of DHX's outstanding shares, which we find very attractive.

In addition to Donovan's ownership, we also think that Fine Capital's 25% stake is noteworthy. Fine Capital is an under-the-radar investment manager that manages more than $1 Billion, and we have an immense level of respect for the amount of due diligence that they perform on their investments. They are very smart investors, they have produced an excellent 10+ year track record, and they recently gained a board seat at the company.

Most recently, in late September/early October, CEO, Michael Donovan, increased his ownership stake by purchasing over $1 million of stock on the open market. Fine Capital also increased their already sizeable ownership stake by more than $3 million. Both purchases suggest increased optimism by the people managing the company.

DHX MEDIA VALUATION

We believe that DHX Media shares are extremely undervalued. DHX is the largest owner and distributor of children's animated video content outside of the Hollywood studios. As such, the market is undervaluing the company's licensing opportunities and the value of its content library, while also underestimating its earnings growth potential. The company is currently trading at around a 7x EV/EBITDA multiple, which we find very attractive for a high-quality business with several embedded options that could result in even faster growth, primarily a focus on its WildBrain segment. At these prices, investors are paying very little for portions of DHX Media's business which could grow substantially in the next few years. We feel that a fair price based on DHX Media's growth potential and valuable IP is closer to 12-14x.

POTENTIAL RISKS

- **DHX fails to monetize its library of content**

As SVOD and AVOD platforms continue to grow, children's programming will become increasingly pivotal to content providers (kids represent 35% of all viewership). We believe that DHX Media is perfectly positioned for this environment, particularly because the company now owns an evergreen franchise in Peanuts. Compared to other media genres, children's shows are easy to distribute with little to no dialogue, making the same show transferrable to many locations.

- **DHX Media is amid a content bubble.**

Major streaming services are estimated to spend $21 billion on content in the next year, and as other participants like Apple and Amazon enter the space, a turf war for subscribers should continue to grow content spend in future years.

Even if there was a reduction in content spend, DHX Media has the world's largest independent kids' library and kids' content dominates media platforms. For example, more hours of kids' content are watched on Netflix than any other genre. Kids content is also the major genre on YouTube. More than 30% of the top 10 channels target kids, generating more than 30% of views.

Furthermore, DHX Media has built a Kids' content powerhouse that generates revenue from various segments.

1. The company is a leader in content creation with a robust development and production pipeline of shows that kids love. DHX has 2 animation studios, 1 Live Action studio, and produces 8-12 series every year.

2. The company is a leader in content distribution supplying content to major broadcasters and streaming services worldwide. The company distributes 13,000 half-hours of content to 500+ customers globally and operates one of the world's largest networks of kids' content on YouTube.

3. DHX Media has built a robust content-driven consumer products business and are experts in brand development, creation, licensing and marketing. DHX generates royalties from the merchandising of 10 owned global kids' brands, and through CPLG, the company has 40+ years of licensing experience in 30 countries for hundreds of 3rd party brands.