

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This management's discussion and analysis ("MD&A") of the financial condition and results of operations of the Company should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes for the three and nine months ended September 30, 2017 and 2016, which have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP"). All dollar amounts are in U.S. dollars ("US\$" or "\$") unless stated otherwise. As at October 30, 2017, the Bank of Canada daily exchange rate for conversion of United States dollars to Canadian dollars ("CDN\$") was US\$1 to CDN\$1.2837.

Our MD&A is intended to enable readers to gain an understanding of our current operating results and financial position. To do so, we provide information and analysis comparing the results of operations and financial position for the current period to those of the preceding comparable period. We also provide analysis and commentary that we believe is required to assess our future prospects. Accordingly, certain sections of this report contain forward-looking statements that are based on current plans and expectations. These forward-looking statements are affected by risks and uncertainties that are discussed in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 ("Annual Report"), and below in the section titled "Cautions Regarding Forward-Looking Statements" and that could have a material impact on future prospects. Readers are cautioned that actual results could vary from those forecasted in this MD&A.

Cautions Regarding Forward-Looking Statements

This MD&A contains certain forward-looking statements that reflect management's expectations regarding our growth, results of operations, performance and business prospects and opportunities.

Statements about our future plans and intentions, results, levels of activity, performance, goals, achievements or other future events constitute forward-looking statements. Wherever possible, words such as "may," "will," "should," "could," "expect," "plan," "intend," "anticipate," "believe," "estimate," "predict," or "potential" or the negative or other variations of these words, or similar words or phrases, have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information available to management as of the date of this Quarterly Report on Form 10-Q ("Quarterly Report").

Forward-looking statements involve significant risks, uncertainties and assumptions. Although the forward-looking statements contained in this Quarterly Report are based upon what management believes to be reasonable assumptions, we cannot assure readers that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this Quarterly Report and we assume no obligation to update or revise them to reflect new events or circumstances, except as required by law. Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements, including: our ability to derive anticipated benefits from acquisitions; our ability to realize some or all of the anticipated benefits of our partnerships; our ability to increase revenue; general economic and market segment conditions; our customers' subscriber levels and financial health; our ability to pursue and consummate acquisitions in a timely manner; our continued relationships with our customers; our ability to negotiate favorable terms for contract renewals; competitor activity; product capability and acceptance rates; technology changes; regulatory changes; foreign exchange risk; interest rate risk; and credit risk. These factors should be considered carefully and readers should not place undue reliance on the forward-looking statements. A more detailed assessment of the risks that could cause actual results to materially differ from current expectations is contained in Item 1A, "Risk Factors," of our Annual Report.

Overview

We are a leading provider of enterprise digital video solutions with the mission to deliver and enable the highest quality live and on-demand digital video content experiences anywhere and on any device. Our flagship solution, the NeuLion Digital Platform, is a proprietary, cloud-based, fully integrated, turnkey solution that enables the delivery and monetization of digital video content.

Enterprises throughout the entire digital video ecosystem use our solutions to better grow, engage and monetize their customer bases. The NeuLion Digital Platform offers content owners and rightsholders a highly configurable and scalable suite of digital technologies, together with services for back-end content preparation, management, secure delivery and monetization, in an end-to-end solution that addresses the complexities associated with successfully streaming and marketing their content. Our solutions also include our NeuLion consumer electronics (“CE”) technologies, which allow CE manufacturers to provide a secure, high quality video experience with premium screen resolution, up to Ultra HD/4K, across virtually all content formats, for a wide range of connected devices. Additionally, NeuLion offers a library of high quality video compression-decompression programs, or codecs, that we license under the MainConcept brand. Our codecs are used by leading technology companies to encode and decode audio and video files. All three solutions comprise the entire digital video ecosystem.

We primarily generate revenue by offering the NeuLion Digital Platform on a subscription license basis. Our revenue is generated from fees determined by the number of events and linear channels we stream, the number of connected devices we enable, and variable fees determined by the volume of digital video content we deliver and/or the end user revenue generated by our customers. We also generate revenue from licensing our NeuLion technologies, including our CE software development kit, or SDK, to CE manufacturers and our MainConcept technologies to video solution developers and others.

We believe that the proliferation of Internet-connected devices, the increasing amount of digital video content, the growth in video consumption, particularly sports and entertainment content, on mobile and other connected devices and the demand for continually improving and personalizing viewing experiences will be the principal drivers of our growth. As enterprises continue to struggle with the complexities of managing growing libraries of digital content, creating compelling branded user experiences and delivering those experiences across a wide range of connected devices in high-quality resolutions, our comprehensive suite of products and focus on innovation will allow us to increase revenues from existing customers and expand our customer base in the Americas, Europe and beyond.

In June 2016, the Company acquired the assets of Saffron Digital Limited (“Saffron Digital”). The Saffron Digital solution, which has been integrated into the NeuLion Digital Platform, helps customers build digital video services for entertainment delivered over-the-top to Internet-connected devices. These digital video services support advanced implementations of subscription video on demand, electronic sell-through and advertising-supported video.

We have traded on the Toronto Stock Exchange (“TSX”) since August 9, 2006.

Key Performance Metrics

We regularly review a number of metrics, including the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions.

	Three months ended September 30,			Nine months ended September 30,		
	2017	2016	% change	2017	2016	% change
Revenue - NeuLion Digital Platform (amounts in millions) \$	14.5	\$ 16.3	-11%	\$ 46.7	\$ 50.4	-7%

We monitor our revenue from our NeuLion Digital Platform because we expect it to grow faster than revenue from our other solutions as we add new customers and increase the variable revenue we realize from existing customers. As a result, we expect our platform revenue to grow in absolute dollars and as a percentage of revenue. Our platform revenue decreased 11% for the three months ended September 30, 2017 and decreased 7% for the nine months ended September 30, 2017, compared to the prior comparable periods. NeuLion Digital Platform revenue is seasonal, related to the timing and size of events that our customers deliver through our solution. The fourth quarter has historically been our highest revenue quarter, but this seasonality may change as we add new customers and events.

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Cost of Revenue as a % of Revenue	20%	18%	19%	18%

Cost of revenue consists principally of bandwidth costs paid in connection with our delivery of digital video content, and to a lesser extent, license fees paid to certain customers for whom we recognize revenue on a gross basis. We use cost of revenue as a percentage of revenue, together with Adjusted EBITDA, to measure the operating performance of our business. Historically, we have been able to reduce our cost of revenue as a percentage of revenue as we have increased the digital video content we deliver on the NeuLion Digital Platform and increased revenue contribution from our CE and MainConcept solutions. Our cost per unit of bandwidth decreases as we deliver more digital video content. Our cost of revenue as a percentage of revenue going forward will also be affected by our revenue mix.

	Three months ended September 30,			Nine months ended September 30,		
	2017	2016	% change	2017	2016	% change
Adjusted EBITDA (amounts in millions)	\$ (1.1)	\$ 2.3	-148%	\$ 1.1	\$ 12.7	-91%

We monitor Adjusted EBITDA, together with cost of revenue as a percentage of revenue, to measure the operating performance of our business. We expect Adjusted EBITDA to improve over time as we grow our revenue and improve our operating performance, but Adjusted EBITDA as a percentage of revenue will vary based on the timing of revenue and expenses. Refer to Reconciliation of Net Loss to Adjusted EBITDA, below, for full details.

Reconciliation of Net Loss to Adjusted EBITDA (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
Net Loss	\$ (5,053)	\$ (2,715)	\$ (9,285)	\$ (1,409)
Revenue excluded due to purchase accounting	-	68	31	1,015
Depreciation and amortization	2,614	2,401	7,483	6,499
Stock-based compensation	1,162	1,361	3,158	3,489
Loss on assets held for sale	395	-	395	-
Acquisition-related expenses	-	-	-	102
Income tax expense (benefit)	173	1,155	(163)	3,033
Other (income) expense	(370)	53	(560)	(73)
Adjusted EBITDA	\$ (1,079)	\$ 2,323	\$ 1,059	\$ 12,656

We report Adjusted EBITDA because it is a key measure used by management to evaluate our results and make strategic decisions about the Company, including potential acquisitions. Adjusted EBITDA represents net loss before interest, income taxes, depreciation and amortization, stock-based compensation, acquisition-related expenses, purchase accounting adjustments, investment income and foreign exchange gain/loss. This measure does not have any standardized meaning prescribed by U.S. GAAP and therefore is unlikely to be comparable to the calculation of a similar measure used by other companies, and should not be viewed as an alternative to measures of financial performance or changes in cash flows calculated in accordance with U.S. GAAP.

COMPONENTS OF OPERATING RESULTS

We operate in one segment. Our chief operating decision-maker reviews our operating results on an aggregate basis and manages our operations as a single operating segment.

Revenue

We generate revenue by offering the NeuLion Digital Platform on a subscription license basis. Our revenue from the NeuLion Digital Platform is generated from fees determined by the number of channels through which we deliver our customers' content, the number of events we stream and the number of connected devices we enable, as well as from variable fees determined by the volume of digital video content we deliver and the end user revenue generated by our customers. In addition, we generate revenue from the NeuLion CE technologies through software license agreements with CE manufacturers, video solution developers and others.

Our contracts with customers are typically between two and five years long. Our contracts are generally on an exclusive basis. We recognize recurring fees in the period in which services are provided and when collection of fees is reasonably assured and the amount of fees is fixed or determinable.

Our platform revenue is seasonal and is based significantly on the timing and size of events that our customers deliver through our solution. The fourth quarter has historically been our highest revenue quarter, but this seasonality may change as we add new customers and events.

Cost and Expenses

Cost of revenue

Cost of revenue consists principally of bandwidth costs paid in connection with our distribution of digital video content and, to a lesser extent, license fees paid to certain customers for whom we recognize revenue on a gross basis. Cost of revenue excludes amortization and depreciation and labor costs.

We expect cost of revenue to increase in absolute dollars as revenue increases; however, we expect cost of revenue as a percentage of revenue to decrease in the foreseeable future.

Selling, general and administrative expenses, including stock-based compensation

Selling, general and administrative expenses, including stock-based compensation, or SG&A expenses, include wages and benefits, stock-based compensation, acquisition-related expenses, professional fees, marketing costs, travel expenses, rent, office supplies, corporate IT services, credit card processing fees and other general operating expenses. Historically, approximately 65% of SG&A has consisted of wages and benefits for our employees.

We expect SG&A expenses to increase in absolute dollars as we add personnel, increase our spending on sales and marketing and grow our business; however, we expect SG&A expenses to decline as a percentage of revenue over time.

Research and development

Historically, approximately 90% of our research and development expenses have consisted of wages and benefits for research and development personnel.

We expect research and development expenses to increase in absolute dollars as we continue to add personnel to enhance and grow our solutions; however, we expect research and development expenses to decline as a percentage of revenue over time.

Key Trends and Factors That May Impact Our Performance

We believe that there are many factors that will continue to affect our ability to sustain and increase both revenue and profitability and impact the nature and amount of our expenditures, including:

Market acceptance of our services. We compete in markets where the value of certain aspects of our services is still in the process of market acceptance. We believe that our future growth depends in part on the continued and increasing acceptance and realization of the value of our service offerings.

Technological change. Our success depends in part on our ability to keep pace with technological changes and evolving industry standards in our service offerings and to successfully develop, launch, and drive demand for new and enhanced, innovative, high-quality solutions that meet or exceed customer needs.

Technology spending. Our growth and results depend in part on general economic conditions and the pace and level of technology spending by potential customers to take their content digital.

In June 2016, we completed the acquisition of Saffron Digital. The integration of this acquisition has impacted and will continue to impact revenues, expenses and operating results.

RESULTS OF OPERATIONS

Comparison of Three Months Ended September 30, 2017 to Three Months Ended September 30, 2016 (unaudited)

Our condensed consolidated financial statements for the three months ended September 30, 2017 and 2016 have been prepared in accordance with U.S. GAAP. A comparison of our results of operations for those periods is as follows (amounts in thousands):

	Three months ended September 30,	
	2017	2016
Revenue	\$ 22,048	\$ 23,857
Costs and expenses		
Cost of revenue, exclusive of depreciation and amortization shown separately below	4,385	4,322
Selling, general and administrative, including stock-based compensation	15,352	13,429
Research and development	4,552	5,212
Depreciation and amortization	2,614	2,401
Loss on assets held for sale	395	-
	<u>27,298</u>	<u>25,364</u>
Operating loss	(5,250)	(1,507)
Other income (expense)	370	(53)
Net and comprehensive loss before income taxes	(4,880)	(1,560)
Income tax expense	(173)	(1,155)
Net and comprehensive loss	<u>\$ (5,053)</u>	<u>\$ (2,715)</u>

Revenue

Revenue decreased to \$22.0 million for the three months ended September 30, 2017 from \$23.9 million for the three months ended September 30, 2016. The \$1.9 million decrease was primarily the result of the loss of the National Hockey League (“NHL”) related revenues in the amount of \$1.3 million.

Cost of Revenue

Cost of revenue increased to \$4.4 million for the three months ended September 30, 2017 from \$4.3 million for the three months ended September 30, 2016. Cost of revenue as a percentage of revenue increased from 18% for the three months ended September 30, 2016 to 20% for the three months ended September 30, 2017. The increase in cost of revenue as a percentage of revenue is due to the higher bandwidth costs incurred to service our European customers, who represent a larger percentage of overall revenue for the three months ended September 30, 2017 as compared to the three months ended September 30, 2016.

Selling, general and administrative expenses, including stock-based compensation

Selling, general and administrative expenses, including stock-based compensation, increased by \$2.0 million, or 15%, from \$13.4 million for the three months ended September 30, 2016, to \$15.4 million for the three months ended September 30, 2017. The individual variances are as follows:

Wages and benefits increased from \$8.2 million for the three months ended September 30, 2016 to \$9.0 million for the three months ended September 30, 2017. The \$0.8 million increase was primarily due to an increase in employees as a result of an increase in headcount in our sales team.

Stock-based compensation decreased from \$1.4 million for the three months ended September 30, 2016 to \$1.2 million for the three months ended September 30, 2017. The \$0.2 million decrease was primarily the result of certain grants of stock-based compensation being fully vested and recognized prior to September 30, 2017.

Office facilities expenses increased from \$0.8 million for the three months ended September 30, 2016 to \$1.2 million for the three months ended September 30, 2017. The \$0.4 million increase was primarily the result of facility costs associated with the opening of our new European headquarters in London.

Bad debt expense increased from zero for the three months ended September 30, 2016 to \$0.2 million for the three months ended September 30, 2017. The \$0.2 million increase was primarily the result of reserves recorded for a specific customer.

Other SG&A expenses, including travel expenses, office supplies, marketing, professional, corporate IT services, credit card processing fees and other general operating expenses, increased from \$3.0 million for the three months ended September 30, 2016 to \$3.8 million for the three months ended September 30, 2017. The increase in Other SG&A expenses primarily relates to the expansion of our sales force and the opening of our new European headquarters in London.

Research and development

Research and development costs decreased from \$5.2 million for the three months ended September 30, 2016 to \$4.6 million for the three months ended September 30, 2017. The \$0.6 million decrease was primarily a result of a reduction in headcount due to certain redundancies identified by the Company.

Depreciation and amortization

Depreciation and amortization increased from \$2.4 million for the three months ended September 30, 2016 to \$2.6 million for the three months ended September 30, 2017. The \$0.2 million increase was primarily the result of depreciation of fixed assets related to our new European headquarters in London.

Income taxes

The tax provision for the three month period ended September 30, 2017 was \$0.2 million, compared to \$1.2 million for the three month period ended September 30, 2016. The annual provision for income taxes during 2017 and 2016 is primarily comprised of current and deferred tax expense in the U.S. and in profitable cost-plus foreign jurisdictions, and foreign withholding taxes. The difference between the annual tax provision and the expected statutory rate is primarily due to losses in foreign jurisdictions without tax benefit and permanent differences.

The Company does not believe there are any material uncertain tax positions under ASC 740.

Comparison of Nine Months Ended September 30, 2017 to Nine Months Ended September 30, 2016 (unaudited)

Our condensed consolidated financial statements for the nine months ended September 30, 2017 and 2016 have been prepared in accordance with U.S. GAAP. A comparison of our results of operations for those periods is as follows (amounts in thousands):

	Nine months ended September 30,	
	2017	2016
Revenue	\$ 69,792	\$ 74,261
Costs and expenses		
Cost of revenue, exclusive of depreciation and amortization shown separately below	13,333	13,108
Selling, general and administrative, including stock-based compensation	44,802	38,252
Research and development	13,787	14,851
Depreciation and amortization	7,483	6,499
Loss on assets held for sale	395	-
	<u>79,800</u>	<u>72,710</u>
Operating loss (income)	(10,008)	1,551
Other income	560	73
Net and comprehensive loss (income) before income taxes	(9,448)	1,624
Income tax benefit (expense)	163	(3,033)
Net and comprehensive loss	<u>\$ (9,285)</u>	<u>\$ (1,409)</u>

Revenue

Revenue decreased to \$69.8 million for the nine months ended September 30, 2017 from \$74.3 million for the nine months ended September 30, 2016. The \$4.5 million decrease consisted of a \$3.7 million decrease in our NeuLion Digital Platform revenue and a \$0.8 million decrease in our CE revenue stream. The \$3.7 million decrease in our NeuLion Digital Platform revenue was the result of a decrease in NHL related revenues in the amount of \$7.0 million, partially offset by organic growth.

Cost of Revenue

Cost of revenue increased to \$13.3 million for the nine months ended September 30, 2017 from \$13.1 million for the nine months ended September 30, 2016. Cost of revenue as a percentage of revenue increased from 18% for the nine months ended September 30, 2016 to 19% for the nine months ended September 30, 2017. The increase in cost of revenue as a percentage of revenue is due to the higher bandwidth costs incurred to service our European customers, who represent a larger percentage of overall revenue for the nine months ended September 30, 2017 as compared to the nine months ended September 30, 2016.

Selling, general and administrative expenses, including stock-based compensation

Selling, general and administrative expenses, including stock-based compensation, increased by \$6.5 million, or 17%, from \$38.3 million for the nine months ended September 30, 2016, to \$44.8 million for the nine months ended September 30, 2017. The individual variances are as follows:

Wages and benefits increased from \$24.6 million for the nine months ended September 30, 2016 to \$26.1 million for the nine months ended September 30, 2017. The \$1.5 million increase was primarily the result of an increase in employees due to the acquisition of Saffron Digital and an increase in headcount in our sales team.

Stock-based compensation decreased from \$3.5 million for the nine months ended September 30, 2016 to \$3.2 million for the nine months ended September 30, 2017. The \$0.3 million decrease was primarily the result of certain grants of stock-based compensation being fully vested and recognized prior to September 30, 2017.

Professional fees increased from \$2.9 million for the nine months ended September 30, 2016 to \$3.6 million for the nine months ended September 30, 2017. The \$0.8 million increase was primarily the result of increased legal fees, higher recruitment fees associated with the increased salesforce and increased consulting expenses associated with certain professional compliance requirements.

Travel expenses increased from \$1.2 million for the nine months ended September 30, 2016 to \$1.6 million for the nine months ended September 30, 2017. The \$0.4 million increase was primarily the result of expenses associated with the increase in headcount in our sales team.

Office facilities expenses increased from \$1.9 million for the nine months ended September 30, 2016 to \$2.8 million for the nine months ended September 30, 2017. The \$0.9 million increase was primarily the result of facility costs associated with the acquisition of Saffron Digital and the opening of our new European headquarters in London.

Bad debt expense increased from zero for the nine months ended September 30, 2016 to \$0.4 million for the nine months ended September 30, 2017. The \$0.4 million increase was primarily the result of reserves recorded for a specific customer.

Other SG&A expenses, including office supplies, marketing, corporate IT services, credit card processing fees and other general operating expenses, increased from \$4.2 million for the nine months ended September 30, 2016 to \$7.1 million for the nine months ended September 30, 2017. The increase in Other SG&A expenses primarily relates to the acquisition of Saffron Digital, expansion of sales team and the opening of our new European headquarters in London.

Research and development

Research and development costs decreased from \$14.9 million for the nine months ended September 30, 2016 to \$13.8 million for the nine months ended September 30, 2017. The \$1.1 million decrease was primarily a result of a reduction in headcount due to certain redundancies identified by the Company.

Depreciation and amortization

Depreciation and amortization increased from \$6.5 million for the nine months ended September 30, 2016 to \$7.5 million for the nine months ended September 30, 2017. The \$1.0 million increase was primarily the result of amortization of intangibles associated with the acquisition of Saffron Digital and depreciation of fixed assets related to our new European headquarters in London.

Income taxes

The tax (benefit) provision for the nine month period ended September 30, 2017 was \$(0.2) million, compared to \$3.0 million for the nine month period ended September 30, 2016. The annual provision for income taxes during 2017 and 2016 is primarily comprised of current and deferred tax expense in the U.S. and in profitable cost-plus foreign jurisdictions, and foreign withholding taxes. The difference between the annual tax provision and the expected statutory rate is primarily due to losses in foreign jurisdictions without tax benefit and permanent differences.

LIQUIDITY AND CAPITAL RESOURCES

Our cash position was \$53.9 million at September 30, 2017. During the nine months ended September 30, 2017, cash provided by operating activities was \$18.8 million, which included cash of \$18.7 million from changes in operating assets and liabilities. Cash used in investing activities included \$3.9 million to purchase fixed assets, which was primarily related to the buildout of our European headquarters in London. Cash used in financing activities included \$2.9 million used for repurchases of our common stock.

As of September 30, 2017, our principal sources of liquidity included cash and cash equivalents of \$53.9 million and net trade accounts receivable of \$14.6 million, offset by \$35.5 million in accounts payable and \$10.0 million in accrued liabilities. We continue to closely monitor our cash balances to ensure that we have sufficient cash on hand to meet our operating needs. Management believes that we have sufficient liquidity to meet our working capital and capital expenditure requirements for at least the next 12 months.

In June 2017, the Company listed for sale its office building located in Melville, New York (the “property”). On October 18, 2017, the Company entered into a contract to sell the property, subject to due diligence, for \$7,300. Taking into consideration the contracted sales price, less the expected selling costs, the Company estimated that the fair value of the property was \$6,833 as of September 30, 2017. Since the net book value of the assets held for sale was \$7,228, an impairment loss of \$395 was recognized for the three and nine months ended September 30, 2017.

The Company maintains cash and cash equivalents with various major financial institutions which at times are in excess of the amount insured by the FDIC. As of September 30, 2017, approximately 41% and 59% of the Company’s cash and cash equivalents were held in accounts with US and foreign banks, respectively.

Off Balance Sheet Arrangements

We did not have any off balance sheet arrangements as of September 30, 2017.