Spin Master Corp.

First Quarter 2020 Earnings Conference Call

Event Date/Time: May 7, 2020 — 9:30 a.m. E.T.

Length: 82 minutes

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PRESENTATION

Operator

Good morning. My name is Erin (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Spin Master First Quarter 2020 Earnings Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. Thank you.

Sophia Bisoukis, you may begin your conference.

Sophia Bisoukis — Vice President, Investor Relations, Spin Master Corp.

Thank you, Erin. Good morning, everybody, and welcome to Spin Master's financial results conference call for the first quarter ended March 31, 2020.

I am joined this morning by Ronnen Harary, Co-CEO; and Mark Segal, Spin Master's Chief Financial Officer.

For your convenience, the press release, MD&A, and unaudited interim financial statements for the first quarter 2020 are available on the Investor Relations section of our website at spinmaster.com and on SEDAR.

Before we begin, please note that remarks on this conference call may contain forward-looking statements about Spin Master's current and future plans, expectations, intentions, results, levels of activity, performance, goals, or achievements or any other future events or developments. Forward-looking statements are based on information currently available to management and on estimates and assumptions made based on factors that management believes are appropriate and reasonable in the

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Many factors could cause actual results to differ materially from those expressed or implied by the forward-looking statements. As a result, Spin Master cannot guarantee that any forward-looking statements will materialize, and you are cautioned not to place undue reliance on these forward-looking statements.

Except as may be required by law, Spin Master has no obligation to update or revise any forward-looking statements whether because of new information, future events, or otherwise.

For additional information on these assumptions and risks, please consult our cautionary statement regarding forward-looking information contained in the Company's earnings release dated May 6, 2020.

Please note that Spin Master reports in US dollars and all dollar amounts to be expressed today are in US currency.

I would now like to turn the conference call over to Ronnen.

Ronnen Harary — Co-Chief Executive Officer, Spin Master Corp.

Thank you, Sophia. Good morning, and thanks for joining us today. Like most businesses, we find ourselves navigating through unchartered waters. The COVID-19 pandemic has affected us all, all of us in some way. Work routines have changed, the retail environment has been altered, supply chains have been disrupted, and ultimately consumer demand for many items has been affected.

The important things we want to emphasize today are that while COVID-19 is having a negative impact on our business, our teams are working diligently to address the obstacles in the face of this

challenge. We are seeing signs of progress and we are financially strong, and we remain committed to our core principles that have contributed to our past success.

Although COVID-19 affected our global supply chain in Q1, before it was even recognized as a global pandemic, we moved quickly and prudently adopting measures to help mitigate the impact to our team, our customers, our suppliers, and our business as a whole.

Our highest priority is to protect the health and safety of our 1,800 employees working in 28 offices spread over 18 countries. Since early January, we've been balancing multiple dimensions in our global response focusing on employees' well-being and safety, workforce engagement and productivity, business continuity and health, and finally ensuring that we continue to live up to our core values.

All offices except for our Hong Kong, China, and Vietnam offices moved to a work-from-home protocol in early March, and this remains in place currently. We're expecting to be back in our offices in North America and Europe sometime in June. In the meantime, we've enabled technology tools to assist people working remotely.

We've successfully migrated our complex design, development, and engineering functions to home-based operations together with all other functions. Our team has really pulled together, and I'm very proud in how well we have operated under the circumstances.

Giving back to the community has long been a part of our DNA, so in addition to making the safety of our employees a top priority, we've also been doing what we can to help fill the need for personal protection equipment for frontline health care workers. Our product development team came up with an ingenious solution to create PPE in late March. Using existing headbands from our Hedbanz game, the team created a face shield for health care workers, and we are now producing 20,000 a day at three facilities in Mexico.

To date, we have distributed over 200,000 units to over 100 health care facilities in Toronto, New York, California, Mexico, with plans to send to other locations globally. We receive many positive comments from hospitals and it has been overwhelming to see what they are dealing with.

When COVID-19 first emerged in early Q1, it affected the capacity of our supply chain in Asia, especially the 60 to 65 percent of our capacity located in China. Since early April, our key factories in China and Vietnam have been operating close to full capacity.

Elsewhere, factories in India and Mexico are currently closed or operating below capacity, but these represent a small part of our supply network. Although the disruption in Asia in Q1 will have an effect on our availability of product in Q2, I want to acknowledge our entire Asian team who did an amazing, outstanding job at reacting to and mitigating this disruption.

In many countries since mid March, consumer demand for our products has been impacted by the disruption caused by the virus. However, we began 2020 with a strong start with double-digit POS growth in the first quarter. Areas of strength included the launch of the new DC Comics toy line, Bakugan, Monster Jam, Kinetic Sand, and games and puzzles.

At that point from a brand and product perspective, we observed very strong demand in categories such as games and puzzles and activities, which includes arts and crafts, given the new imperative for parents to keep their kids occupied while indoors. Kinetic Sand was already seeing exceptional sales increases early 2020, and the entire line has further benefitted from the stay-at-home guidelines.

We saw similar trends following 9/11 and the lasting, positive effects on the category were felt for years. We were leading against these categories, and we believe that demand will continue throughout

2020 and going forward. Keep in mind that we are the second-largest games and puzzles manufacturer in the US and are a major player in activities.

Where games, puzzles, and activities benefit from stay-at-home, other product categories across the industry have struggled. Purchases driven by events such as birthdays have declined, as kids cannot get together in the current environment. This has affected PAW Patrol. Collectibles and action figures are also categories that are seeing declines which had adversely affected Bakugan and DC Comics, both of which had a very strong start to the year.

Monster Jam also had a strong start this year building on 2019, the most successful year in the franchise’s history. However, the lack of live events has reduced some of the focus on the brand.

From a channel perspective, we’re very fortunate that Walmart and Target, our two largest customers, stayed open and continued normal operating patterns. Amazon paused all purchases of nonessential products, including toys for a few weeks in March, but has since resumed purchases. We observed a strong surge globally in online and E-commerce shopping in Q1, especially buy-online-and-pick-up-at-stores purchases in the United States.

Sales of our digital toys have grown as parents look for ways to entertain and educate their kids at home. Overall, we saw views up over 30 percent on our Toca Boca and Sago Mini platforms in Q1 and views are up 100 percent currently. Toca Boca and Sago Mini combined now average 25 million monthly average users per month globally, giving us a strong base of users to expand both app sales and direct-to-consumers subscription-based products.

Sago now has over 150,000 subscribers across its platforms, including Sago School, which went live late in March after 16 months of development and is building very nicely.

We've encouraged you to think about Spin Master not only as a toy company, but as an integrated entertainment business with toys, entertainment, and digital toys and games. With kids at home all day and parents being more flexible with screen time, we're seeing a strong rise in viewing demand for both our digital offering and entertainment franchises.

In February, we announced our newest preschool franchise, Mighty Express, will debut as planned on Netflix in September. Mighty Express features a cast of trains to give kids an expansive world filled with amazing adventures. Mighty Express is our biggest production to date and marks our first series launching directly on a streaming platform. The launch marks a shift for Spin Master, as we will hold the rights for all consumer products, not only for toys. This will allow us to improve the margins we make on non-toy licensing and merchandising revenue streams.

We also announced PAW Patrol: The Movie will be launched in August 2021 in association with Nickelodeon Movies and distributed by Paramount Pictures. The entertainment team is working on completing the voice talent, and we hope to share an update on the exciting cast soon.

We are equally excited about our PAW Patrol theme for the fall, Dino Rescue, which will air on Nickelodeon beginning in June. It is one of our strongest themes ever. Our entertainment team is working on our third-party animation—is working with our third-party animation studios to keep the production of all our TV shows and movies on track in a work-from-home environment. And we are fortunate that the animation and production lends itself more easily to a virtual work environment, unlike live action, which is being severely disrupted by COVID-19.

I want to now update you on the key actions we've taken to address the operational challenges we experienced in the latter part of 2019. Although this quarter we continued to see higher costs carried

over from challenges and management mistakes in 2019, I am pleased to say that we have made significant progress in remediating the issues.

Our goal remains to have the operational issues that caused such a disruption in 2019 largely behind us as we enter Q3, and to make sure we enter 2021 with a warehousing and distribution cost run rate in line with historical norms.

There are two key areas that we have focused on that I will discuss with you now and Mark will provide further details later. Firstly, we have reorganized the structure of our existing North American third-party supply chain network. We have focused on the consolidation, realignment, and simplification of our third-party distribution centres, while ensuring we remain sufficiently agile to respond to the evolving industry and retail environment.

We are targeting to ship more cost effectively and manage inventory flow to minimize storage requirements, all whilst improving service levels to customers. The planning phase has been completed, and we are now implementing the changes.

Secondly, we have focused on rebuilding our operation IT teams and improving internal and external cross-functional collaboration, particularly in connection with our forecasting and planning processes. We made some key senior leadership changes in Q1, and are continuing to strengthen our operations and IT teams. We have refreshed and reenergized these areas with highly confident individuals with deep functional expertise.

We also created consumer-focus teams. These are consumer first internal hubs focused on single-large customers and consumer groups and comprise a blend of dedicated sales, order management, demand planning, logistics, and other credit management team members all purpose focused on serving customers.

To conclude, we are fortunate that we operate in an industry that has shown in the past to be very resilient in the face of recession and other disruptions, driven by low average selling prices for products, potential substitution for more expensive forms of leisure, and most importantly, since parents tend to sacrifice for themselves before their children.

Together with this industry resilience, we have diversified Spin Master's product portfolio across all 11 categories in the toy industry, as measured by NPD.

Remember in 2019, our sales increased 16 percent, excluding the $239 million decline on Hatchimals. We have also diversified geographically into 28 direct-to-consumer markets and now serve over 100 markets worldwide.

Finally, we have invested in our in-house entertainment and digital platforms that have further diversified and strengthened Spin Master. We are not the same company we were only five years ago.

Looking forward, social distancing ramifications are likely to continue to create some shifts in consumer behaviour even while we're beyond the immediate crisis. We expect to see some closures of small-scale specialty stores. We anticipate more controlled foot traffic in stores with shorter focused trips and less opportunity for impulse purchases in-store.

We expect to see greater sophistication of online buying and price sensitivity and more parent-driven online shopping without kids' presence. We are also seeing a significant increase in screen time by kids 2 to 11. In March and April, screen time was up over 50 percent. This may decrease as the weather warms up and kids return to a more normal routine, but adoption of more sophisticated entertainment consumption habits will continue.

This applies to the gaming acceleration as well. This bodes well for our Toca Boca and Sago Mini platforms. We are also sensing a shift towards co-viewing opportunities as new family rituals around TV emerge in the COVID shutdown.

We are seeing a strong desire to comfort kids and return them to a sense of normalcy combined with grandparent separation guilt. Recall 40 percent of toy POS come from households without children.

We're going to adjust our business to recognize these trends. Our goal remains to create excitement and magic for children globally. Our performance in Q1 is not an indicator of our future potential and we remain cautious optimistic for 2020, assuming the world returns to a degree of normalcy, which it appears to be heading towards.

We have an exciting, innovative, and diverse product offering for 2020 and 2021 and great entertainment and digital toy content. Our brands, partnerships, products, entertainment, and mobile digital franchise continue to resonate with children, as our POS demonstrates.

Through our integrated and resilient innovation-led business model, our big (phon) diverse geographic platform, and our stable financial position, we believe we are well positioned to take advantage of emerging opportunities and regain our momentum.

We have made strong progress and expect to exit Q2 with a much simplified and better-structured supply chain infrastructure ready to handle seasonal volumes. With a solid financial foundation we can weather this crisis, and we're poised to take advantage of any organic or acquisition opportunities as they arise.

I'll now turn it over to Mark.

Mark Segal — Chief Financial Officer, Spin Master Corp.

Thank you, Ronnen. On today's call, I will briefly summarize our Q1 performance and then turn to a discussion of our ongoing initiatives to improve operating performance and the business considering COVID-19.

Gross product sales grew by 0.7 percent in Q1 to 242.3 million with an unfavourable foreign exchange impact of 7.9 million. On a constant currency basis, gross product sales grew 4 percent, in line with global industry growth.

On a geographic basis, Europe continued to lead growth, up 13.6 percent in the quarter, followed by 2.2 percent growth in North America, and a 29.4 percent decline in the rest of the world. The decline in the rest of the world was as a result of lower sales in some markets in Asia and Australia, with COVID-19 impacting those markets earlier in the quarter. International gross product sales represented just over 40 percent of total product sales.

Historically, we outlined a goal to reach 40 percent of annual sales generated from international markets. We have increased that target to 45 percent, which we consider achievable.

As a reminder, approximately 70 percent of global toy industry sales occur outside of North America, and we have significant runway for future international growth.

Gross product sales growth was led by the Activities, Games & Puzzles and Plush segment, which grew 24 percent. Overall, according to NPD, the US games and puzzles category grew over $200 million in Q1, and we benefitted from this. We are seeing growth across our entire Activities and Games & Puzzles portfolio, with the exceptional performance in Kinetic Sand, which more than doubled this quarter.

Based on what we've seen so far in Q2, we would expect another strong quarter from this segment, particularly in the US market, which continues to shows extremely strong POS through April.

Although the segment overall was up, our Plush subsegment has been disproportionately hard hit by COVID-19. This quarter, we saw a decline, as most plush customers are US-based specialty retailers who have closed through the back half of March and have not yet reopened.

We saw strong growth in the Boys Action and Construction segment, which grew 19.6 percent, led by the launch of DC Comics licensed products and growth in Bakugan. Bakugan sales were strong in Q1 following the global launch of the second season of the show.

Although we were pleased to see very strong sales momentum at the beginning of the year, these brands, along with most other collectible toys, have since felt the impact of COVID-19.

Gross product sales in Pre-school and Girls decreased by 10.9 percent in Q1. PAW Patrol, which was down for the quarter, saw pressure from a combination of high inventory carryover from the 2019 holiday season, later media airing, and in particular COVID-19, as the cancellation of birthday parties and other event-driven sales affected the brand later in the quarter leading up to Easter.

We are still seeing PAW selling well across many markets outside of North America, including the UK, Germany, Russia, and Mexico, where we saw POS go up in the quarter.

The Remote Control and Interactive Character segment continued to show declines lead by Hatchimals, offset by growth in PAW Patrol RC and Monster Jam RC.

Gross product sales in Outdoor declined by 15.5 percent, driven in part due to supply chain disruptions and beach and outdoor area closures later in the quarter. Keep in mind that our Outdoor business is mainly water-focused, and the industry increase was more backyard-focused. Approximately $2 million of shipments in Outdoor will move into Q2 as a result of Q1 COVID-19 supply chain issues.

Let’s turn now to POS. According to NPD, the global toy industry grew 4 percent in Q1 and 8 percent in the US. Globally, our Q1 POS, including Hatchimals, was up 10 percent, 2.5 times higher than

the industry. Global POS, excluding Hatchimals, was up 19 percent. We are very pleased with this performance, as it demonstrates that overall our brand are resonating with consumers.

In the US, POS for the quarter was up 11 percent, including Hatchimals, and up 19 percent, excluding Hatchimals. In the US and globally, Activities and Games & Puzzles POS was up triple digits, led by Kinetic Sand and Cardinal. PAW Patrol POS was down for the quarter for the reasons I described earlier. Current global POS remained up mid-to-high single digits and is bifurcated by region.

In the US, POS in the last four weeks is continuing to grow at even higher rates than we saw in Q1. Activities and Games & Puzzles POS is showing continued strength. We are encouraged to see that recent POS for PAW Patrol, Bakugan, and Monster Jam has now turned positive together with Outdoors as the weather warms up.

However, in Europe, except for Russia and Germany and in countries such as Canada, we are seeing a decline in POS over the last four weeks due to the impact of retail closures in these countries.

We are observing several trends which affected our shipments and POS. As Ronnen mentioned, we saw a decline in event- or holiday-driven toy categories, such as preschooler vehicles, offset by a significant increase in demand for arts and crafts, games and puzzles, and outdoor toys, driven by parents' desire to manage their children activities at home.

With less brick-and-mortar shopping, there are fewer in-store impulse purchases. And when shopping online, parents tend to see less value in lower-price point lineups. This reduced demand for collectible brands, such as—this reduced demand for collectible brands, such as Bakugan, Monster Jam, Colleggtibles, and Twisty Petz in Q1.

As a result of the shift away from collectibles and towards games, puzzles, and activities and more generally towards online purchases, we have seen average retail prices move from the $17 range

into the 10 to $20 range. From a customer perspective, we are fortunate in that some of our largest customers have been able to stay open and are among the strongest retailers in the world.

In the US, as Ronnen mentioned, Walmart and Target both continued purchasing for both brick-and-mortar and online through Q1 and have continued to do so. Together, they comprise close to 40 percent of our global sales for 2019 and well over 35 percent in Q1. Including Amazon, our third-largest customer globally, these percentages would be approximately 50 percent and 45 percent, respectively.

In the US, online sales showed strong growth in Q1 and have continued to comprise a larger component of our customers' volume. For the quarter, our sales through the online and E-commerce channel in the US grew 30 percent compared to last year. We expect sales to US online and E-commerce channels to comprise over 25 percent of our volume in 2020 and 30 percent in Q4 alone, as consumers continue to gravitate away from brick-and-mortar.

In Europe, which has a very large specialty store element, many customers closed their brick-and-mortar locations. Online and E-commerce showed strong growth in some European markets, but Italy and France were hard hit, as online shopping is less developed there.

Turning back to the P&L. We generated revenue of 227.3 million in Q1, which was down 4.9 percent from the same period last year and was down 1.4 percent on a constant currency basis.

Sales allowances increased to 15.2 percent of gross product sales compared to 12.6 percent in Q1 last year. This increase was partly related to the continued expansion in Europe and Russia in particular, which has both higher prices and a higher overall sales allowance rate than the global average.

We also experienced continued noncompliance charges from customers related directly to our performance issues which began in the second half of 2019, as well as higher year-over-year markdowns. While the higher rates exhibit that in Europe and Russia our market-related structural factors will

continue, both markdowns and noncompliance charges are controllable and part of our efforts to improve our operations and service in 2020.

Other revenue, which primarily reflects licensing and merchandising royalties, television distribution revenue, and app revenue, declined by 7 million in Q1 compared to last year. The decline resulted from lower licensing and merchandising royalties from PAW Patrol and Hatchimals, and was partially offset by increased revenue from Toca Boca and Sago Mini. We expect this trend to continue through the balance of 2020.

Gross profit for the quarter was 90.8 million, or 39.9 percent of revenue compared to 107.7 million, or 45.1 percent last year. Gross profit was lower due to higher inland and ocean freight, inventory provisions and rework expenses, higher sales allowances, and lower other revenue. We estimate that approximately $14 million from the $17 million decline in gross profit related to inefficiencies which started in the second half of 2019.

SG&A as a percentage of revenue was 64.5 percent in Q1, up from 50.3 percent last year. Please keep in mind Q1 is our seasonally lowest quarter, and SG&A is always insulated in Q1 relative to the year as a whole.

Warehousing and distribution expenses were the largest component of the SG&A increase, increasing 11.6 million year over year. We estimate that approximately 9 million of the 11.6 million related directly to inefficiencies arising from 2019. Although inventory levels decreased from year-end, they were still significantly elevated relative to Q1 last year, resulting in increased storage costs. Higher inventory levels caused an increase of almost 20 percent in our domestic versus (phon) FOB sales mix, which combined with our inefficient North American warehouse structure compared to last year, drove outbound transportation and activity-based warehousing costs significantly higher.

Marketing expenses were higher in Q1 driven by the launch of the DC line and the new season of Bakugan.

Tradeshow spend was also higher, as well as marketing related to the launches of new products in Toca Boca and Sago Mini.

Looking forward, as a result of the current environment we have taken measures to reduce our overall marketing spend and focus it to match where consumers are active, such as online and E-commerce. We expect to see the dollars we do spend going further as non-toy advertisers decrease their ad spend. As ad spend declines on TV, we are seeing rates decline, which will be margin accretive for us later in the year.

From a tax perspective, we had an income tax recovery of just over 48 million in the quarter. Approximately 33 million of this related to a one-time internal transfer of intangible property. Our annual tax rate is typically between 24 and 26 percent. Our expectation for the annual expected tax rate in 2020 is in the range of 20 percent. This lower rate in 2020 is driven by where we expect pretax income to be generated and the tax rates in the various jurisdictions in which we operate. We expect the 2021 tax rates will (unintelligible) slightly.

For the quarter, we reported an adjusted net loss of 46.8 million, or $0.45 per diluted share compared with an adjusted net loss of 12.5 million, or $0.12 per share last year.

Adjusted EBITDA declined to negative 32.3 million in the quarter compared to positive 7 million last year. As I mentioned earlier, we believe that approximately $23 million of the year-over-year decline in profitability can be attributed directly to the operational inefficiencies that continued into Q1 arising in 2019.

Turning to the balance sheet and cash flows. Total net working capital was 210 million at the end of Q1 compared to 102 million at the end of Q1 2019 and 266 million at the end of the year.

Free cash flow for the quarter, excluding working capital, was negative 74.9 million compared to negative 39.9 million. Free cash flow for the quarter, including working capital, was negative 27.8 million, the same as 2019.

Inventory ended the quarter at 156 million compared to 185 million at the end of 2019 and 112 million last year.

We are beginning to make meaningful progress reducing our inventory levels, although our progress has been hindered to some extent by COVID-19, as some customer outputs are closed. There is a risk of gross margin compression in 2020 as a result of this inventory carryover, as we saw in Q1, and we are constantly weighing gross margin against inventory levels and inventory carrying costs, especially as we restructure our North American supply chain.

Our balance sheet remains very strong. We ended the quarter with just under 425 million in cash and net cash of 74 million. During March, the impact of COVID-19 on the capital markets and on the availability of the liquidity in the financial system is of real concern. As a result, we drew a total of 350 million on our committed $510 million revolving credit facility.

Given the amount of cash we had on hand at the end of the quarter, together with cash flow we will generate in the second half and the additional capacity on our credit facility, we are solidly positioned with regard to available liquidity. We are constantly modelling the steps necessary to ensure business continuity, even if this crisis lasts much longer than is currently expected.

For 2020, we expect interest costs to increase by approximately 5 million over 2019.

I want to now turn to our view on the balance of 2020. On our Q4 call in early March, we focused on the supply side impact of COVID-19 for 2020. The primary impact we now expect, and which we started to see in late Q1, is a reduction of overall sales volumes given the disruption of many customer markets. We have taken several steps to reduce SG&A, which includes the restructuring of our North American supply chain. We are pleased to say we have made significant progress, which is aimed at driving structural cost savings and improvements in order to get our margins back to where they belong.

Let me run through a few of the key areas. We are optimizing our warehouse network in North America by simplifying the structure, reducing the total number of DCs, and the number of shipping points to customers.

To put this into perspective, in Canada and the US, we are looking to go from 18 DCs and storage locations to 5 ultimately. From 18 individual facilities at end of 2019, we are now at 15. By the end of Q2, we expect to close 4 more to get to 11. In Q3, we will close a further three, so that by the end of Q3, we will be at eight. Entering 2021, we are targeting to be at five.

As a reminder, these are third party-owned facilities, and we will incur minimal costs in exiting these facilities.

These changes will help in reducing customer noncompliance charges, eliminating cost drivers such as prepaid freight, unloading delays, demurrage charges, and into warehouse transits. We are improving our forecasting process and matching the flow of inventory so the timing of shipments will reduce storage requirements. We are reducing SKU counts and eliminating those that are not profitable.

We are driving improvements in IT systems, especially connectivity with customers and warehouses, and focusing on improved data accuracy. We are enhancing reporting, monitoring, and accountability around our KPIs and implementing global best practices.

Our sales team is working hard with customers to ship as much volume as possible to FOB in the US in the second half of 2020, which will take pressure off our domestic warehousing infrastructure.

Finally, we are strengthening the quality and capability of our operations here in (phon) North America. It is our goal to enter Q3 with a substantially more refined supply chain infrastructure and to exit 2020 at or very close to a normalized warehousing and distribution run rate. This will yield a dual benefit from a gross and EBITDA margin perspective, as both the noncompliance elements of sales analysis, which is directly correlated to the performance of our supply chain and warehousing and distribution costs will decline.

Equally importantly, we'll be able to service our customers better through customer teams focused on higher (unintelligible) and better flow rates. We are also slowing down new employee hiring, focusing on extracting procurement efficiencies globally, particularly around potential commodity, plastic resin, and fuel surcharge cost relief, reflecting and reallocating working (phon) dollars to brands most likely to exhibit strong sell-through in the current environment, and reducing controllable expenses, such as travel, legal, rent, consulting, and many others.

With the continuing uncertainty regarding the pandemic, we have elected not to provide formal guidance at this time. Given the dynamic nature of the circumstances and since the pace of recovery has yet to be determined with any specificity, we continue to regularly assess the business environment and our strategies and plans. This will determine our capacity and willingness to provide formal guidance.

Directionally, we are comfortable to say that we expect the current COVID-19-related retail headwinds to continue through Q2. Combined with the Q1 supply chain disruptions, we expect Q2 sales volumes to be lower than 2019. We also expect some continued cost pressure from our 2019 operation inefficiencies to carry forward through Q2.

Looking beyond Q2, we will have our operational issues largely behind us, and we are encouraged that many countries are now beginning the early stages of lifting retail and other restrictions. Based on this, we are cautiously optimistic that the second half of 2020 will return to some degree of normality in most key markets. And we believe that we are well-positioned to take advantage of this reemergence.

That concludes my comments. I will now turn the call back over to Ronnen for some additional comments, and then we'll be pleased to take questions.

Ronnen?

Ronnen Harary

Thanks, Mark. Before we go to Q&A, I want to take a moment to talk about our culture, thank all of our employees who at every level have demonstrated incredible dedication during this difficult time.

We've been amazed by the levels of productivity that have been achieved and the camaraderie of employees globally throughout this crisis. Our employees are all dealing with a situation that is new and which represents challenges on many levels, including having families at home, their own needs, technological issues, disruptions in kinds (phon) of plans, and a level of anxiety that has lasted longer than expected. We truly appreciate all our employees' efforts.

The way we work together has changed permanently. Our ability to lead, leverage, and harness the potential of our globally distributed workforce is being tested and proven. This experience has tested our notions of distributed work and talent, and the results are positive.

Coming out of COVID-19, we will continue to think more globally as we build talent, more teams, and think about how to bring the best of Spin Master together to achieve this strategy.

Allowing our team members to have greater control over the work day supports our commitment to push boundaries, move together, and making an impact. The technology we used and the workforce flexibility benefits we introduced from COVID-19 are here to stay and will only strengthen Spin Master's employee value proposition.

COVID-19 has brought our people together. And for a global company such as ours, the team has increased productivity and collaborated in a great way.

With that, we'll open it up for questions. Operator, can you open the line, please?

Q&A

Operator

Certainly. As a reminder, to ask a question, you will need to press *, 1 on your telephone. To withdraw your question, press the pound or # key. Please stand by while we compile the Q&A roster.

Your first question comes from the line of Stephanie Wissink with Jefferies. Your line is open.

Stephanie Wissink — Jefferies

Hi. Good morning, everyone. Mark, I think this question is probably best suited for you. But, Ronnen, I would love for you to join in. Just hoping you can help us dimensionalize the year by semesters. There's a lot of conflicting vectors going on right now: demand, getting goods through to the channel, your own operational inefficiency remediation. So can you help us think about the first half? And then relative to your comments of a tail-end regarding the second half where you'll be on the back side of your operational issues? It sounds like some holiday order flow. Initial look to be pretty solid. So just help us think about the year kind of in two parts, if you could.

Mark Segal

Sure, Steph. I'll go first, and then I'll pass it back to Ronnen. So as we said in Q1, we started the year with a strong performance from a sales perspective overall. And then from late March onwards, we actually had COVID hit us. We did have some supply chain disruptions that occurred in Asia, but most of that will be felt in Q2. And then in Activities, Games & Puzzles and those categories really started picking up in late March.

We do see Q2 being down year over year as a result of some disruption of Q1 supply chain and also because of maybe the customer closures. At the same time, we were working on our supply chain restructuring, and we've made significant progress.

So the goal is to exit Q2 with our supply chain problems largely behind us. We did see a significant carryover from Q4 of the profitability issues and the additional costs that affected us in Q3 and Q4 of 2019.

So looking ahead, we don't see any pull forward currently of demand. What's happening right now from a demand perspective is customers are filling current demand, particularly in the activities, games and puzzles area. And then looking forward where we actually do 70 percent of our volume in the second half of the year, we will see that from a supply chain perspective, and as demand comes back to normal, we think we are very well positioned to take advantage of opportunities going into Q3 and Q4.

Our goal exiting Q4 is to reenter 2021 with a normalized run rate on our operational costs, particularly our warehousing and distribution, and then to get back where we want to be in 2021 and beyond.

Ronnen, do you want to add anything?

Ronnen Harary

Yes. Just from a macro perspective, I think we're very fortunate, Stephanie. First of all from an industry perspective whereby the industry has shown itself to be quite resilient in these times. And I think

that the macro trends are helpful for or fortunate for families spending more time at home. And we're seeing that family time is lending itself towards the fact that we have a diversified portfolio in certain categories, like Mark mentioned, the activities category that we've been in for many years, and the games and puzzles obviously, which we've talked about.

And I think that it will be interesting when kids go back to school, there'll be an opportunity for those other categories that are more school-based, like collectibles and lower-price point items where kids have to share and interact together, we think we'll have an opportunity to pick up in during the fourth quarter. And the retailers are very focused on meeting consumer demands for the third and fourth quarter.

And then the other thing which is quite amazing, which I think we have to be very thankful for in our industry, is that our Asian teams and our supply base has done an incredible job to catch up in the first quarter and now in the second quarter to meet all the demands for the third and fourth quarter.

And so from a timing perspective, we were very fortunate. I think that the way that Asia's actually handled the COVID crisis will enable us to actually meet demand, whatever that demand will be in the third and fourth quarter, but we'll be able to meet that demand from a supply chain perspective. And that's super encouraging for us.

Stephanie Wissink

Thanks. That's great. Just one follow-up, more housekeeping. On Mighty Express, which I think you mentioned launches September on Netflix, so I guess two-part question. One, you made a point to call out that you have the full category rights for that? If you could just talk a little bit more about how that's distinct from other entertainment properties? And then secondly, will you be launching with toys and merchandise when this series launches?

Ronnen Harary

Yes. Okay. So in the past we used to do things in partnership. So, for example, with PAW Patrol we had a partnership with Nickelodeon and so they handled the licensing, the merchandising, so they managed the interaction with all the various different licensees.

And so this time around we've actually built up our own internal team that will manage those relationships. Put up the style guide (phon), will do the overall marketing for the franchise. So we've turned the entertainment team into not only a content production team, but now a full franchise management and entertainment team in the Company.

And then in terms of day and date, we're going to actually let the property build and we'll bring out the toys for Mighty Express in 2021, and we'll bring it out with complementary partners in other categories in 2021. But we want to give it a little bit of time, Stephanie, to build and build up the awareness. We've basically figured out that awareness really needs to reach about 50 percent before you can actually put product out into the marketplace. And so that's what we're very focused on doing with Mighty Express with Nick—with our SVOD partner and also with other marketing tools to build out that awareness.

Stephanie Wissink

Thank you.

Operator

Your next question comes from the line of Sabahat Khan with RBC Capital. Your line is open.

Sabahat Khan — RBC Capital

Great. Thanks, and good morning. Just on the commentary that you gave around some of the specifics on the gross profit and SG&A impact of the inefficiencies, I think the totals were 14 million of the

gross profit decrease and 9 million of the SG&A. How should we think about those numbers heading into Q2? Like is sort of like an actual dollar amount that we think can continue into Q2? Just trying to think of kind of the drag, the fixed nature of it into next quarter, and obviously if there's a separate sales impact, just given the background. But just wanted to get your thoughts on that.

Mark Segal

Yeah. So, Sabahat, good morning. As we said, of the $39 million year-over-year decline, approximately 23 million was related to operational inefficiencies carried forward from last year. And of that, 14 million are related to items affecting gross profit and 9 million related to distribution. So looking at Q2, we're making significant progress in remediating some of these problems. We don't think that all of them are going to be remediated during Q2.

But certainly from a structural perspective, by the end of Q2 we hope to be in a position leading into Q3 to see some significant efficiencies starting to flow through, and thereby at the end of the year to be in a position where we are leading back to normalized run rates.

So you will see some carryover of these costs into Q2, both gross margin impact and at the distribution level, hopefully at a slightly reduced rate, but that there will be some in Q2, for sure.

Sabahat Khan

Okay. And then sort of related to that, as things you indicated start to normalize heading into Q2, and as you get into your bigger selling season in Q3, I guess, just based on current visibility, though, what you're thinking about the business? Would you expect top line to be kind of up Q3 specifically year over year? And obviously, there's a lot of moving parts; what's sort of your base case operating assumptions at this point, given what you can kind of see out there?

Mark Segal

Yeah. So we don't want to be too specific because we're not giving formal guidance. But I can tell you that retailers are in good shape. Certainly, our primary customers in the US are buying normally. We're actually having a lot of good conversations. There's discussions around planogram dates to make sure that we don't have any impact from the Q1 supply chain affecting Q3 and Q4.

It remains to be seen how the rest of the world comes back normally. I think we're a little bit more confident in the US. But certainly, things are turning back to normal in Europe and in other regions where markets are starting to come back a little bit. And as you know, we do 70 percent of our volume in the second half of the year. We are shifting and pushing our retailers to take more on an FOB basis than we saw last year. And so that tends towards more in Q3 than it does in Q4.

But we are quietly confident and optimistic that we will have a solid second half of the year. Exactly how big that is going to be remains to be seen at this point in time.

Sabahat Khan

Okay. And then you shared some colour on your thoughts around some of the headwinds that you have going into Q2 in terms of the top line. Are you giving kind of that commentary taking into account that there was a bit of a timing benefit in Q2 last year because of the Easter shift? Does that kind of add to the headwinds? Or do you think sort of the commentary you gave takes all that into account and the real headwind is sort of the store closures that were there over the course of April onwards?

Mark Segal

Yeah. So as we said to you, we do expect sales to be down in Q2 year over year. Just keep in mind that Easter this year was April the 12th. Last year it was April the 21st. So really, Easter is a little bit of a nonevent this year in terms of our quarter-over-quarter comparisons, Sabahat. It's not a material factor one way or the other. And we have built it into everything that we've already described to you.

Sabahat Khan

Okay. And then just one last one on the cash flow. The balance sheet is still in good shape, but I just want to get an idea of your expected cash usage at least through Q2. It looks like you drew some amount down on the credit facility. But just want to get your thoughts on cash burn over the next couple of quarters until you get into sort of the big selling season.

Mark Segal

Okay. So let me just level-set everybody because I think it's important to understand structurally how our cash flow works. If you recall, our traditional cash flow profile is that we consume cash in Q1, we consume cash in Q2 as we build up for our seasonal peak. We then start selling in Q3 extensively. We convert inventory into receivables, and we start collecting cash in Q3 and Q4.

And by the end of the year, we are solidly cash positive and we don't see any change to that profile this year. The only nuance which you actually did see in Q1 was that because we had such high inventory levels exiting 2019, we started to draw down on that, and we actually saw a contribution was a source of cash from working capital in Q1, which was larger than normal.

But generally, our cash profile is as I described and I don't see it significantly changing. We did draw down, as you know, $350 million in the quarter on our revolver, which was kind of a preemptive measure just to be safe, given what was going on at the time.

And we'll have a look at our cash flow, and we can either repay that or keep that depending on what actually happens with COVID other the next three, six, nine months.

But we do expect to end the year in a strong, positive cash position.

Sabahat Khan

All right. Thank you.

Operator

Your next question comes from the line of Jaime Katz with Morningstar. Your line is open.

Jamie Katz — Morningstar

Hi. Thanks for my taking my question. First, I'm curious about how you guys are thinking about marketing expenses over the remainder of the year. Is there a better way to strategically put those dollars to work to facilitate sales? Or—and do you think that that sort of evenly eases back to a more normalized level over the course of the year? Or does it sort of escalate towards the holiday season in advance of that key period? Thanks.

Mark Segal

So I'll take that first and then Ronnen will add in some commentary. Typically, marketing runs at around 10 percent of our sales. And we don't see that changing dramatically for 2020. It may be a little bit down from those levels. We are actually looking at our mix and shifting more dollars where consumers are more active, online and E-commerce in particular.

And as I said in my script, you are seeing rates coming down, and so we do expect to get some benefit of lower rates as other advertisers advertise less, especially on TV.

Ronnen Harary

Yeah. Thanks, Mark. I think that as we see consumer shopping patterns shift and change, we'll be matching our marketing to the way those habits are actually evolving, so you'll probably see more of a digital spend. Going into the third and fourth quarter, you'll see some extra spends targeted toward adults.

You'll probably see less kids in the stores. You'll see more social media. What I'd say is more creative content created by our internal teams, and so it'll be more earned marketing where we have to

actually pay money up front to create the content. But we have much more content out into the universe, especially on the YouTube channel.

So you'll see a mix of different things. But I'm very proud of our marketing team. They reacted very quickly and the creative teams internal reacted very quickly. And you actually, if you look, if you look at the Spin Master universe, you'll already start to see some of the shift in marketing that we're doing. That will give you a bit of a taste of what's going to come as we evolve.

Jamie Katz

Okay. And then maybe because I'm a little bit newer to the Spin Master story, I think one of your competitors noticed that outdoor was a pretty strong category and there was a shift to it. But, is there something about your lineup, like is it more tilted to summer products with a swim category that has made that a little bit more difficult in this period for you than I would have thought?

Mark Segal

Yeah. So Outdoor was down 15.5 percent in Q1. There's a number of factors. We had some supply chain disruption. Just remember the seasonality for Outdoor is different to toys because the first half of the year is typically bigger than the second half of the year because as we lead into the summer months.

And in Q1 we had some disruption arising from the Asian COVID situation that arose. So we did see some disruption there. And then later in the quarter we actually had a lot of closures around pools and outdoor areas and beaches which affected demand for Outdoor.

But we are seeing Outdoor, which is mainly—our Outdoor is mainly water-focused. The industry outdoor is maybe more backyard-focus. So what you heard in Q1 was backyard was up in a big way,

whereas water was actually down. What we're seeing now is that water has come back very strongly. And so we're seeing a Swimways demand in POS actually going up quite significantly.

Jamie Katz

Thank you. That's very helpful.

Operator

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

Adam Shine — National Bank Financial

Thanks a lot. Good morning. Maybe one question for Ronnen, one for Mark. Ronnen, usually we start to have you guys building some of your H2 visibility somewhere around the June/July time frame as sort of retailers start to commit to you guys. Can you speak to whether COVID is changing some of that dynamic? Bringing it forward a little bit? Maybe otherwise extending it? And just as a follow-on to the context with retailers, any material changes afoot as we move through the mid part of Q2 compared to what you might have seen amidst the initial scramble at the end of Q1?

And then just for Mark, you've talked quite a bit on the supply chain side with respect to some of the distribution centres storage capabilities. Maybe if you can elaborate on any thoughts around the manufacturing footprint and whether any changes afoot there of any materiality might ultimately be best pursued next year rather than big moves out of China this year? Thanks.

Ronnen Harary

Yeah. I think that—no, I think the buying patterns primarily from the large retailers going into the back half of the year are actually very consistent with previous years. So we don't see any changes there. And I am personally encouraged by the resilience of the industry.

I think that if we go back six weeks when COVID hit and everybody started working from home, I would have thought the industry would have been impacted even more than what it is from what we're actually seeing today.

And your third part of your question was—no, there was two parts of it. That—does that answer your question, Adam?

Adam Shine

Yeah. Yeah. I think the other part was simply around any changes to the dynamic in regards to what's been happening as we get into May. I mean, obviously, as was alluded to previously, nonessentials out of Amazon were curbed for a few weeks—

Ronnen Harary

Oh yeah, yeah, yeah.

Adam Shine

—or more, so in April right?

Ronnen Harary

Yeah.

Adam Shine

That's been freed up of late. But there still seems to be—it's not like you're getting your Prime delivery a day or two, necessarily.

Ronnen Harary

No.

Adam Shine

So.

Ronnen Harary

No. Thank you. Thank you. And what I will tell you is, I mean, in Europe you still have a lot of store closures, so Europe is very different to North America. And they're slowly coming out of it. I think the biggest trend that we're seeing now, which is a really big shift and probably stay here for a long time, which is the online delivery and pickup, so. But there is a big surge right now, big demand, and people just placing orders and literally filling their cars up and the product is getting put into the trunk and people are driving away. And so you see Walmart doing a big business in that area. So I think that's the biggest shift that we've seen. And I think that will probably continue.

And that is actually causing us to actually think about how we actually do our mix of product. Because usually the way you do—you usually do things in assortments. And now to be able to facilitate the at-store pickup from online ordering, you have to ship installments. So it's a bit of a different configuration, but our team's already on that and making the changes so that we can maximize the third and fourth quarter.

Thanks.

Mark Segal

So, Adam, I'll just pick—

Adam Shine

Thank you.

Mark Segal

—up from where … I'll pick up from where Ronnen left off. I just want to add one point to what he said about the customers. We've worked really hard with our main customers to make sure that any of the issues that happened in Asia in Q1 relating to COVID do not impact the second half of the year. The

vast majority of the full product that—and this pertains to tooling in particular—that may have been disrupted in Q1 will still ship in Q3. And retailers are in line (phon) with later set dates on various SKUs. We're working very closely with them on that.

There may be a slight shift Q4 from Q3 where tooling or run rates won't allow us to maximize volume in late Q3 versus early Q4. But overall, that doesn't affect the second half of the year.

And then in connection with your point about manufacturing, we have diversified out of China. We're in Vietnam. We're in India and in Mexico, as you know. Just given what's happened this year, I would suggest that the pace of any further diversification might slow down a little bit in 2020.

We're very happy with the way that the China manufacturing base has picked up following COVID. We're now back at almost full capacity or at full capacity in China and in Vietnam. We still have some issues in India and Mexico, which are closed or partially closed. But that's really immaterial and will not affect our supply in 2020.

Adam Shine

Great. Thanks for that.

Operator

Your next question comes from the line of Luke Hannan with Canaccord. Your line is open.

Luke Hannan — Canaccord

Hey. Thanks. Good morning, guys. The one question I had, actually, first, it's a housekeeping question, Mark. You gave some pretty good commentary on the POS data that you were seeing to date so far in Q2, but I just missed some of those figures. So do you mind repeating those?

Mark Segal

Yeah. In Q1 globally, we were positive 10 percent, including Hatch. And excluding Hatchimals, we were at 19 percent. And in the US we were at positive 11 percent, including Hatchimals, and 19 percent excluding Hatchimals.

And we are actually seeing an acceleration in the US to significantly higher rates than what I just described currently. The rest of the world is actually a little bit down, just given the closures we've seen in Europe and other countries. But the US POS right now is extremely strong.

Luke Hannan

Thanks. And then my second question is just on, I guess, how you view your overall financial health of your customers? I notice that the provisions that you have for any doubtful accounts didn't really tick up meaningfully from last year. And I know you mentioned that Walmart, Target, and Amazon represent the lion's share of where your sales come from, and I don't imagine that you anticipate any sort of credit issues there. But as far as the makeup of the rest of that receivables balance in your customer base, how do you view, I guess, their financial health in the near term?

Mark Segal

Okay. That's a great question. Thank you. As you mentioned, roughly half of that sales come from Walmart, Target, and Amazon. So they're very strong from a credit perspective; no issues there.

I would say to you there are two areas that we are seeing pressure on our customers, which is the US mid-tier, the department stores and so on, and small specialty retailers in the US, as well as the small specialty retail component in countries like Italy and France.

But what I do want to say to you is that—and this is really important—we have global credit insurance policies, which are non-cancellable. And so we are very well protected from a credit perspective and we have very limited credit exposure. We do get requests sometimes for extended payment terms,

and we typically don't agree to them. But sometimes, for strategic reasons, we may want to help a customer or two. But overall, it's really small and very immaterial, and we're in good shape from that perspective.

Luke Hannan

Okay. Thanks. Appreciate the colour.

Operator

Your next question comes from the line of Gerrick Johnson with BMO Capital Markets. Your line is open.

Gerrick Johnson — BMO Capital Markets

Hey. Good morning. Thank you. I have two questions—actually, two topics, multiple questions. First, on Amazon, last day of March there were 35 games in the Top 100 sellers on Amazon, but none of them were Spin Master games. Does your portfolio just not lend itself well to selling on Amazon? Or is that part of the supply issue? Why don't we see your games as part of the top sellers on Amazon?

Mark Segal

You know, Gerrick, to be honest, I can't talk to Amazon specifically. Maybe Ronnen has got some colour on that. But what I can tell you is that overall, Games & Puzzles in Q1 grew, according to NPD, at $200 million in total. And we grew our share commensurately with that. In fact, I believe we actually grew our share a little bit.

We are the number two games and puzzles player in the United States, and our demand and volume is extremely high, as well as our POS, which is in the triple-digit range.

So I can't talk to Amazon specifically. Ronnen, maybe you want to?

Ronnen Harary

Yeah. Derek, I think that's a great question. And we can potentially get back to you on it. But from a high-level, I think that one thing you guys need to understand is that the composition of our actual games business. So the big percentage of our games business comes from Cardinal. And Cardinal is a broad-based, multiple SKU business. It's got tonnes and tonnes of SKUs, and it's less about titles and it's more about—a big part of the business is the games is the basics, like backgammon and chess and checkers and dominos and poker chips and all of that type of stuff. So I don't think you'd see that appearing as like the top titles. So they just have a very wide assortment with a lot of SKUs that at the end of the day adds up to a lot of dollars.

And then when you look at the Spin Master side of the business, our titles, like Hedbanz is probably our top title. I would be surprised not to see Hedbanz on the Amazon Top 30 list, but I'll look into that. And we have other titles that are decent. They're not as strong as some of our competitors, but they still sell. And when you add all of the titles up—there's lots of titles out there—they add up to good sales. And then you also have things like Perplexus and stuff like that.

So I think you have to look at our games businesses and puzzle business as something that's got a very wide breadth to it. Also, the puzzle business, a lot of our puzzle businesses is sold at the value channels where you find puzzles for $2, or $4, or $5. And there's multiple SKUs, and there's so many different licences. So it's really spread out over a very large assortment.

Gerrick Johnson

Yeah. That's a great answer. Thank you very much. And mentioning the value channel, that's a pretty strong channel for you guys right now, is it not?

Ronnen Harary

It's a fair question, Mark.

Mark Segal

I think the value channel's pretty decent.

Gerrick Johnson

Okay. And then I want to ask about inventory. Your inventory's up 40 percent. I think you talked about it a little bit. But you kind of faded in and out on the call, so I didn't catch all of what you said about why that inventory's up 40 percent and if it's all good inventory. And then you did have excess channel inventory coming out of fourth quarter. So is that pretty much cleaned up? Or are there still pockets of stuff?

Mark Segal

Yeah. So we did actually exit 2019 with significantly higher domestic inventory than we had at the comparable period of 2018. So there was a big carryover that we had to deal with mainly in our warehouses because of the issues that we had in the second half. So we've been working our way through that in Q1. Inventory has come down quite significantly in Q1 and will come down further in Q2. The vast majority of that inventory is good, and we continue to sell it. But there were some markdowns and there was some margin compression as we actually worked through some of that.

The reality is that having the inventory in a way helped us because we were able to fill a lot of activity, games and puzzles orders that otherwise might have been ordered FOB that we would not have been able to fill normally. We've worked very closely with retailers to take inventory, especially in the COVID environment. It's helped us substitute where needed, especially in games and puzzles. We've actually been able to develop a lot of out-of-aisle features, which has helped us. I mean, overall, Gerrick, Q1 2020 domestic sales were up 20 percent over Q1 '19. And as I said to you, COVID has helped some

categories like activities, games and puzzles, and it's hurting some categories where there have been less stores and no events.

Now we want to shift as much as we can to the fall from an FOB perspective, but we do see some continued pressure on margins in the second quarter. And what we're really essentially balancing off here is gross margin against cash and also inventory carrying costs as we seek to restructure our supply chain. So it's a bit of a mixed bag.

Gerrick Johnson

Okay. So that explains the channel inventory, but the inventory on your books?

Mark Segal

I was talking about the inventory on our books.

Gerrick Johnson

You were?

Mark Segal

Like—yep.

Gerrick Johnson

Okay. Great.

Mark Segal

So at the channel level, there isn't significant issues at the channel level.

Gerrick Johnson

Okay. Okay. Great. Thank you, Mark.

Operator

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

David McFadgen — Cormark Securities

Oh, hi. Yeah. A couple of questions, if I may. So when you first issued your 2020 guidance, you were calling for mid-single-digit, mid-single-high-digit revenue decline. And it seems based on your commentary today and Q1 that that's probably going to be too pessimistic. I don't know if you can comment at all about that, given that you went through your guidance, but it seems that way.

And then secondly, when we look to 2021, you say you'll exit the year with only five facilities and most of the supply chain things will be behind you as you start into Q3. So could we expect a material rebound in the EBITDA margin? And to get back to 18 percent, would that be a little too optimistic?

Mark Segal

So, David, we're not actually giving formal guidance at this time on our top line. I did give some commentary on the second half, how I see that playing out, when I answered Sabah's question earlier. So we are actually confident for the second half and we do feel good about it, but we don't know yet, just given what's happening with COVID. So we have to be somewhat cautious until we see some more substance behind how the second half plays out.

We are cautiously optimistic, though, and we're also cautiously optimistic that by the end of the second quarter we'll have most of our supply chain issues behind us and we'll be then getting the benefit of these improvements over the second half of the year.

And as you mentioned, we want to have a significantly restructured North American supply chain by the end of 2020 where we have only five facilities, which would be down significantly from what we have currently. And that will allow us to be much more efficient. But going forward, we hope to recapture

some of our margins as a result of that, but I don't want to be too specific about what that looks like yet because there are obviously going to be puts and takes for 2021, which we are not commenting on at this time.

David McFadgen

Okay. And then if I can just ask one more. Can you give us an idea how PAW Patrol is doing so far in Q2? Or how it did in April?

Mark Segal

So PAW Patrol for the year has largely been down in North America. In Europe it's been stronger, but overall PAW has been down from both a sales and a POS perspective. The good news is that in the last couple of weeks, though, we've seen a fairly material rebound in PAW from a POS perspective. And so they're starting to trend more positively.

The reason PAW is down for the year is really in relation to inventory carryover that we saw from 2019. The fall TV driver for PAW Patrol, which was the jet, did not do very well; not as well as we expected. And so that actually caused some carryover into the first quarter.

We also had our marketing start later in the first quarter. And probably most significantly of all, the reality is that a lot of PAW Patrol purchases are more events-driven around birthday parties or Easter or other kinds of events. And so PAW has suffered from COVID. But overall long term, we still feel very comfortable with PAW. We're very excited about it, the new content that Ronnen told us about.

Ronnen Harary

Yeah. Just to build on that is that the Pre-school category is down, David, across the board as result of COVID. I would put it in the harder-hit category side of the ledger. But from a franchise perspective, we're super, super excited about our new theme, which is Dino Island. I'm extremely proud

of our team for producing in our seventh season such an incredible theme. Very excited for you guys to see it. It is probably one of our best productions to date, and we have a new character, which is Rex, who's a handicapped dog who's coming. He's a great aspirational character.

We have the Dino Patroller, which is extremely aspirational. We have a new headquarters which is located on Dino Island, which is aspirational. We have the dinosaurs mixed in with the pups, which is a whole unique world for kids to really enjoy it, and dinosaurs are a classic play pattern for kids.

So I think it's quite amazing that the team were able to blend those worlds together. And then looking forward, obviously the movie for 2021, and that is currently on track, it's on schedule, and we're working very closely with Paramount currently now on what are the marketing plans for that; very, very engaged with their teams well in advance of the movie to market it properly.

And also realign all our licensees to make sure that they are getting all the collateral material so that they can start their product development process early on now to make sure that for Fall 2021 we have a very fresh, new, dynamic-looking PAW Patrol line for the movie that's very different than the traditional TV-themed one.

David McFadgen

Okay. Well, thank you.

Operator

And your last question comes from the line of Brian Morrison with TD Securities. Your line is open.

Brian Morrison — TD Securities

Thank you. Good morning, guys. Just in terms of PAW Patrol, do you have any feedback from your buyers on the new theme? It sounds like you're pretty excited about it.

Ronnen Harary

The Dino theme, it's got an incredible reaction. Incredible reaction. There is talking dinosaurs together. It's extremely positive. Extremely positive.

Brian Morrison

Okay. And I guess more of my focus, Ronnen or Mark, is as you have more costs of handling as inventory's going through your system, I'm wondering what processes or safety measures you have in place as you reduce your DC specifically in Q3 and Q4 of this year just to ensure that we don't run into these inefficiencies once again?

Ronnen Harary

Yeah. No, it's a great question. I mean, I personally, Brian, have been focused on this for like the last 10 weeks. It's occupying a lot of my time. And what we're doing is we are strengthening existing partners. So we have some very good partners in place, but we're strengthening those partners. And when I say strengthening, I'm talking about the amount of meetings we're having with them, making sure that the owners are engaged in our business now, they're actively coming to the meetings, making sure that we have people on-site in those facilities that are Spin Master people.

We basically retooled our whole customer focus team. We've actually, I would say, done an internal organizational review, and we've reallocated 90 people in our company to actually to cross-functional consumer teams per account, per location on (unintelligible). We've also let go of certain partners that were underperforming, and we've moved (unintelligible). We've actually moved them to (unintelligible). Sorry, if someone can just on mute; it's a bit distracting. We've let go of some of our poor performers from a warehouse perspective, and we've moved those to some of our stronger third-party warehouses that were doing well last year and we've given them (unintelligible).

So we're relentlessly focused on this area. We've made management changes (unintelligible) where we brought in people, Brian, that had DC (unintelligible) in warehousing, in logistics, in supply chain. We brought back old people that either had (unintelligible) that were in operation from Spin Master that moved to other departments. We've brought them back, especially in the whole area of we had (unintelligible) process, people with a long institutional (unintelligible) key (unintelligible) knowledge when it comes to getting (unintelligible) and global management and management (unintelligible).

I do want to say that it is our goal to end this year at a much lower inventory level. We're relentlessly focused on inventory. We're relentlessly focused on the supply of the shipment and the movements of the goods so we see the efficiencies. There were challenges last year in terms in ordering patterns. It was not only in quantity, but it was just the ordering patterns themselves.

And we have (unintelligible) attention that we're not going to tolerate giving back problems—sorry, we're not going to tolerate giving back profits as a result of operational inefficiencies. That is just not going to happen. It's not acceptable. (unintelligible). And it's just not going to be tolerated. So we're very focused on this. And I think we have the right team in place. I think we have the right (unintelligible). I think we have the right external partners. I think we have the right overall company focus to make sure that we achieve our goals starting in the third quarter. And that's what the whole company has been rallying behind for months now (phon).

Brian Morrison

Sorry. So, Ronnen, I understand the gist of the answer. I think one of our phones is breaking up more. But I guess that the gist of the question is these restructuring initiatives and inefficiencies that you're taking on, when I look at the long-term EBITDA margin potential, not 2020, but 2021 and beyond,

is your aspiration that you can get back to a 19 percent EBITDA margin or above based on the undertakings right now that you're enduring?

Ronnen Harary

Well, I will say from a—I'll take the first part. From an operation perspective, we want to get our percentages in line from that area of the income statement. They need to be back to normalized rates, and that's what we're very focused on.

Mark Segal

So, Brian, I mean, long term our goal is to be in that 18 percent-plus zone. That's where we were in '17 and '18. That's where we think we want to be. We've got a lot of levers to pull. And as Ronnen said, we do not want to have any dilution from warehousing and distribution. That's just basic table stakes for us.

There are lots of other levers that we can focus on in terms of licensing and merchandising income: Our product mix, our productivity, how all of our operating leverage issues that we're focusing on getting back to where we want to be, and certainly 18 percent is the goal.

The trajectory to get back, we will not be there in 2020, obviously. But we want to be in a position where we have some very good trajectory to get back there into 2021 and beyond.

Brian Morrison

Yeah. I appreciate that. Not to nitpick here, Mark, but is it not 19 percent with IFRS 16?

Mark Segal

Yeah. 2018 was 19.3 percent, including the IFRS adjustment, that's correct.

Brian Morrison

Right. Okay. Well, it sounds good. Thank you very much, guys.

Operator

And there are no further questions at this time. I'll turn the call back over to Mark.

Mark Segal

Okay. Well, thank you, everyone. Much appreciated, and we look forward to talking to you in August for our Q2 call.

Thanks, everyone.

Operator

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