# FINAL TRANSCRIPT

**Spin Master Corp.**

**Second Quarter Financial Results Conference Call**

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## CORPORATE PARTICIPANTS

**Mark Segal**
*Spin Master Corp. — Executive Vice President and Chief Financial Officer*

**Ronnen Harary**
*Spin Master Corp. — Director and Co-Chief Executive Officer*

**Ben Gadbois**
*Spin Master Corp. — Director, Global President and Chief Operating Officer*

## CONFERENCE CALL PARTICIPANTS

**Sabahat Khan**
*RBC Capital Markets — Analyst*

**Brian Morrison**
*TD Securities — Analyst*

## PRESENTATION

**Operator**

Good morning. My name is Laurel (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Spin Master 2015 Second Quarter Financial Results 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, please press the # key. Thank you.

Mr. Segal, you may begin your conference.

**Mark Segal** — Executive Vice President and Chief Financial Officer, Spin Master Corp.

Thanks, Laurel. Good morning, and welcome to Spin Master's financial results conference call for the second quarter ended June 30, 2015, and Spin Master's first earnings call as a public company.

My name is Mark Segal, and I am Spin Master's Chief Financial Officer. I am joined this morning by Ronnen Harary, Co-CEO, and Ben Gadbois, Global President and Chief Operating Officer.

For your convenience, the press release containing our second quarter financial results is available on the Investor Relations section of the Company's website at spinmaster.com. It is also available on SEDAR.

Before we start, 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 circumstances. However, there can be no assurance that such estimates and assumptions will prove to be correct.

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 statement, whether as a result of new information, future events, or otherwise.

For additional information on these assumptions and risks, please consult the cautionary statement regarding forward-looking information contained in the Company's earnings release dated August 11, 2015, which is also available at sedar.com.

Please note two further points in connection with the press release and today's call. Firstly, Spin Master reports in US dollars, and all dollar amounts expressed today are in United States currency. Secondly, we have outlined some of the key drivers for period-over-period changes in our earnings press release, but Canadian securities laws do not require us to provide an MD&A for Q2, as this period ended before we became a public company. We will answer questions regarding our publicly released Q2 2015 financial results after we've been through the script.

I would now like to turn the conference over to Ronnen Harary. Ronnen?

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

Thanks, Mark. Good morning, everyone, and welcome to our first earnings call following our initial public offering, which closed on July 30, 2015. Yesterday we reported strong financial results for the second quarter and six months ended June 30, 2015. I'll begin the call with some brief highlights of our revenue and product growth during the second quarter before Mark provides you with a more detailed review of our financial results. Then we'll then take a few minutes to discuss our outlook for continued growth.

We are very pleased to report that in the second quarter of 2015 revenue increased by 19.9 percent to $127.7 million. Revenue increased across all geographic markets, with Europe providing the most significant increase.

On a business segment basis for Q2, gross product sales in our activities, games, puzzles, and fun furniture segment were slightly below 2014, but on a year-to-date basis, gross products sales were 23 percent ahead of the same period last year. The year-to-date increases are attributed to Kinetic Sand, Sew Cool, and Marshmallow Fun Furniture, partially offset by a decline in The Chill Factory.

In the remote control and interact character segments, gross product sales increased by 19.7 percent for the quarter, driven by strong performances of Zoomer and DigiBird. As expected, sales in the boys' action and high-tech construction segment declined on a Q2 and year-to-date basis due to a decline in demand for products associated with the 2014 Teenage Mutant Ninja Turtles and How to Train a Dragon movies. We are confident that the recent launches of the Meccanoid, Ionix PAW Patrol, and licensed products associated with the new Star Wars movie will drive growth in the segment during the second half of 2015.

In the preschool and girls' segment, PAW Patrol drove substantial sales increase, supported by sales of the recently introduced Little Charmers and Chubby Puppy lines, partially offset by a decline in Flutterbye Fairy.

I will now hand over to Mark Segal, our Chief Financial Officer, to review our financial results in more detail. Mark?

**Mark Segal**

Thanks, Ronnen. As Ronnen highlighted, our second quarter 2015 revenues increased by 19.9 percent from $106.5 million in Q2 2014 to $127.7 million in Q2 2015. This strong increase was achieved despite the headwinds associated with the US dollar that was rising relative to other currencies, reducing our revenue by 3 percent during the quarter.

In constant currency terms, revenue increased by 22.9 percent in Q2 2015, relative to the comparable period in 2014. In the second quarter, our gross profit increased to $65.4 million, representing 51.2 percent of revenue, compared with $52.4 million, or 49.2 percent of revenue, in Q2 2014. This represents an increase in gross profits of just under 25 percent on a year-on-year basis, and primarily results from increased sales of products under owned brands and productivity initiatives.

Total SG&A expenses decreased from 45 percent of revenue in Q2 2014 to 43.1 percent of revenue in Q2 2015, reflecting continued cost discipline and operating leverage. This leverage relates to our flexible business model that emphasizes variable costs over fixed costs. We do not own any material manufacturing assets except for a small Meccano facility in France, nor do we own any warehousing facilities or animation studios. Accordingly, incremental sales increases can have a significant impact on profitability and cash flow. This was evident in Q2 2015, as our adjusted EBITDA increased by 113 percent to $17.9 million, compared to $8.4 million in Q2 2014. Our adjusted EBITDA margin improved from 7.9 percent in the 2014 period to 14.1 percent in Q2 2015.

Similarly, adjusted net income increased 189.3 percent in Q2 2015 to $8.1 million, up from $2.8 million in the previous year. Free cash flow improved significantly, increasing from $1 million in Q2 2014 to $5.7 million in Q2 2015.

Turning now to our year-to-date June 30 results. Our revenues increased by 27.1 percent from $184.2 million in 2014 to $234.2 million this year. FX headwinds reduced our overall revenue by 3.6 percent for the half year. In constant currency terms, revenue increased by 30.7 percent for the half year, relative to the comparable period in 2014.

Our gross profit for the first half of the year was $122.1 million, representing 52.1 percent of revenue, compared to $90.3 million or 49 percent of revenue in the first half of 2014.

Total SG&A expenses for the first six months of 2015 were $107.5 million or 45.9 percent of revenue, compared to $88.4 million or 48 percent of revenue, during the same period last year.

Adjusted EBITDA in the six months ended June 30, 2015, was robust, increasing 190 percent to $28.1 million from $9.7 million in the corresponding period of 2014. As in Q2, the Company benefitted from the result of increased sales of brands owned by Spin Master, productivity programs, cost discipline, and the operating leverage I mentioned earlier. Adjusted EBITDA margins for the first half of 2015 were 12 percent compared with 5.2 percent last year.

Net income increased substantially to $9.2 million for the first six months of 2015 from $1.4 million for the same period last year. Adjusted net income also increased significantly to $11.5 million this year from $0.7 million for the first six months of 2014.

Free cash flow for the six months ended June 30, 2015 was negative $2.4 million, $6.8 million better than the 2014 level. Typically, our free cash flow and working capital needs peak in the middle of the year in advance of the Q3/Q4 sales cycle.

Turning now to our outlook. I wanted to remind you of the seasonality inherent in Spin Master's business. The first six months of each year typically represent approximately only 25 percent to 30 percent of annual gross product sales, with the second six months of each year representing approximately 70 percent to 75 percent of annual gross product sales. With this in mind, looking ahead to the second half of 2015, we expect organic gross product sales to increase by 8 percent to 12 percent over the second half of 2014. This will result in full, year-over-year organic gross product sales growth of 12 percent to 15 percent. This outlook for Spin Master's annual sales growth is well in excess of the industry growth rate of approximately 4 percent.

From a profitability perspective, we expect second half adjusted EBITDA margins to be at least in line with, or slightly higher, than the same period in the prior year, resulting in continued improvement in annual profitability.

To be clear, the above growth rates exclude the impact of the acquisition of Cardinal on both our gross product sales and EBITDA margins. Assuming the acquisition closes as planned on October the 1st, the Cardinal Q4 sales and margins, which have a similar seasonality profile to Spin Master, will be reported in the Q4 and full year results and will be incremental to the outlook above.

I'd now like to turn it over to Ben Gadbois to review our growth strategies in more detail. Ben?

**Ben Gadbois** — Director, Global President and Chief Operating Officer, Spin Master Corp.

Thank you, Mark. Overall we're very pleased with the financial and operating performance of the Company so far this year. We're now shipping off all 2015 lines into retail, and early POS reads, where they are available, are encouraging. That said, we enjoy multiple opportunities for continued growth, and we actively pursuing them. The strong business momentum that characterized the first half of 2015 is the result of our continued strong execution of our growth strategy.

Looking ahead to the balance of 2015 and beyond, the strategies that we're pursuing are the same ones we have successfully delivered for the last few years. First, our industry demands constant innovation, and one of our key competitive strengths lies in our ability to consistently infuse innovation into our portfolio of brands. Our 36-month brand innovation process allows us to build a predictable, sustainable and profitable business, and we will continue to innovate across our portfolio of brands and product lines to drive future growth. We will provide further guidance on our 2015 initiative in our Q3 call in November.

Second, we'll continue to develop evergreen global entertainment properties. We plan to continue to leverage our current properties, PAW Patrol and Little Charmers, which are already in 160 countries and territory, and they are setting us up with powerful future distribution potential. We plan to launch one to two new properties every year, and we are actively working on new shows for 2016, '17, and beyond. We will also continue to leverage our broadcast relationship to create new revenue streams, including licensing out opportunities for each property, which will continue to help drive our margin expansion.

Third, we plan to significantly grow our international sales. International sales represent approximately 72 percent of the global toy industry, but our sales outside of North America at the end of 2014 were only 28 percent of our total sales. We have significant opportunities to reach deeper into markets where we already have established offices. We also have opportunities to further leverage our existing third-party distributor relationships. Over time we will look at strategically converting third-party distributors to our own distribution.

We're continuing to make progress toward our goal of growing our international sales to 35, 40 percent of our total sales in the next few years, which would represent approximately 150 million to $200 million of incremental sales, using 2014 as a base.

Fourth, we intend to further leverage our global platform through strategic acquisition. We are looking for opportunities to acquire brands, fuse these newly acquired brands with our innovation capabilities and drive growth in sales and margins by leveraging our global infrastructure. We are actively engaged in building our pipeline of future acquisition. And as Mark mentioned earlier, the Cardinal Game acquisition is scheduled to close early October. When closed, this acquisition will make Spin Master the number two player in the North American game segment. Going forward, we will report on our progress against these four key growth initiatives over the coming quarters.

That concludes our formal remarks. Ronnen, Mark, and I will now be pleased to answer your questions. Operator, please begin the question period.

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## Q&A

**Operator**

Thank you. Ladies and gentlemen, as a reminder, if you'd like to ask a question, simply press *, then the number 1 on your telephone keypad.

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

**Sabahat Khan** — RBC Capital Markets

Hi. Thank you. Just looking ahead to H2 and some of the licensed toy launches you have for various movies and TV content, should we expect the majority of them to begin contributing in Q3? Or is there some larger ones coming online in Q4 as well?

**Ben Gadbois**

We have—all of our fall products are being shipping into market now, so you will start seeing them in Q3. So we will see a lot of the sales coming through our financials in Q3, although a lot of the POS will happen in Q4 with the consumers.

**Ronnen Harary**

But, Sabahat, were you specifically asking about our licensed slate of properties?

**Sabahat Khan**

Yeah. Just some of the Jurassic Park and the Star Wars and some of the TV stuff. Those all. Yeah.

**Ronnen Harary**

Yeah. Well, Jurassic Park you'll definitely see third, fourth quarter, and Star Wars in third, fourth quarter.

**Sabahat Khan**

Okay. And just on the geographic mix, it looks like Europe was up quite a bit as a percent of sales. Can you maybe talk about what some of the bigger products that really did well there?

**Ben Gadbois**

Yeah. So our year-to-date, Sabahat, our year-to-date international sales mix is up to 34 percent for the first half of this year. We expect that to come down some in the back half of the year, and the reason why the increase that you're seeing is very strong is driven by the load-in factor of PAW Patrol throughout the global market, as well as Kinetic Sand. So we've had load-in in all of these markets, and that's been a big driver. And the Zoomer line continues to be strong as well.

**Operator**

Your next question comes from the line of Brian Morrison with TD Securities. Your line is open.

**Brian Morrison** — TD Securities

Thank you. Good morning.

**Ronnen Harary**

Morning.

**Brian Morrison**

I have a couple questions for Mark and maybe one for Ben. Mark, when I look at the segmented income, I'm just trying to understand why the income is so skewed to the positive for the rest of the world segment relative to say, North America, that's obviously much greater by revenue?

**Mark Segal**

So, Brian, you're referring to the segmented income that's in the detailed financial statements? Keep in mind, Brian, those results actually do not really reflect the true operating performance on those segments, simply because most of the costs that are inherent in our head office in Canadian cost structure are not allocated out on a segment basis, and that's why you see that skewed performance from a profitability perspective.

**Brian Morrison**

Okay. And then second question. When I look at the improvement in gross margin, I understand what you're saying with respect to the productivity improvement, but has this improvement, and it's really been right through the first half, quite impressive, is this really a function of owing more of your own content such as PAW Patrol? Do we anticipate this margin improvement to further continue as we bring more owned content? And then lastly, is it fair to say with the vast increase in preschool and girls this quarter, that no product is still greater than 20 percent?

**Mark Segal**

Okay. So let me take the gross margin and gross profit question first, and then I'll deal with the question on product concentration.

So I would say to you there's a couple of things to keep in mind. When we have owned IP, typically those products are more profitable to us. So there is some element of that happening with gross profit margin. The productivity initiatives are also driving a significant increase in our gross margin, and those are value engineering programs, strategic sourcing programs, and so on.

The real impact of owing IP is actually felt on the adjusted EBITDA line and not so much on the gross margin line, simply because the royalties associated with owned IP and non-owned IP actually go below the gross profit line. So to the extent that we save paying external royalties, that could really be an enhancement to adjusted EBITDA or EBITDA in the case, not gross profit. But certainly, from a strategic perspective, growing our percentage of sales in relation to owned IP is something we're looking to do because those are the highest profit margin products in the Company.

They're also important for the perspective of driving alternative revenue streams. In the case of PAW Patrol, for example, we have a significant amount of licensing and merchandising income starting to be generated, and that's very profitable revenue for us. Most of that just drops straight to the bottom line, and there's not a significant cost associated with that. So we really do value the owned IP product as a percentage of total sales.

In connection with product concentration, you'll recall during the Roadshow process we advised that for 2014 there was no one product that represented more than 20 percent of our sales in 2014. In fact, the actual data was 18.3 percent for the Zoomer product line, which did comprise a number of sublines as well.

For the first six months of the year, PAW Patrol did actually represent more than 20 percent of our total sales, but keep in mind, the seasonality element of this is really important. Only 25 percent to 30 percent of our total sales happen in the first six months of the year, and so when we actually ship in that remaining 70 percent to 75 percent we're going to see the concentration of PAW Patrol starting to decline quite significantly, and we expect that it'll be less than 20 percent by the end of the year when we've shipped in all our full lines for the year.

**Brian Morrison**

That's great, Mark. Last question, if I can, for Ben. When I look at your guidance for the seasonally strong back half of the year and then look at the movement by retailers right now towards more of a just-in-time approach, how much visibility due you have with respect to that 8 percent to 12 percent top-line guidance? Can you see through Q3 at this point in time? And how much into Q4 could you see?

**Ben Gadbois**

Yes. So morning, Brian. Yeah, so we—all of our orders, normally the way the process work is as we meet with the retailers well in advance, most of the retailers give us their order pattern and their plan with us almost six months in advance and we refine them all the way to a few months in advance. But as far as what we're shipping in from a quantity standpoint into all of our retailers, we have very good visibility now and we're shipping these orders now.

The last piece of the year where it all comes down to the effectiveness of our marketing campaign and how our products resonate with the consumer is when we do our reload to replenish these products. So as far as visibility, we have very strong visibility now, but we don't have complete visibility based on the, again, the effectiveness of our marketing campaign and where and how consumer are behaving when it comes to our products at retail.

**Brian Morrison**

That's very helpful. Thank you.

**Operator**

Once again, ladies and gentlemen, if you'd like to ask a question press *, then the number 1 on your telephone keypad.

Your next question comes from the line of Sabahat Khan with RBC Capital Markets. Please go ahead.

**Sabahat Khan**

I just had a couple quick follow-ups. On your concentration of your sales at your top three customer, looks like it's down about 10 percent versus last year. Is that just a function of your sales in Europe increasing and that's diversifying it? Or is there something else there?

**Mark Segal**

So, Sabahat, you're correct. For the same period last year, the concentration of our top three customers was 66 percent. For 2015 half year it was 56 percent. The decline is really temporary in nature and it's primarily due to, as you suggested, the loading of PAW Patrol in many of our international markets where we were selling to non-big three customers as they were launching into various international markets around the world. So for the full year 2014, full year 2014 we're at around 62 percent for the top three, and we expect for 2015 to be at similar levels to that.

Just one other point just to add it. It wasn't only PAW Patrol, it was also Kinetic Sand that we were loading in internationally. So the combination of those two really caused that decline. Does that answer your question, Sabahat?

**Sabahat Khan**

Yeah, it does. And just one more, if I may. On the sales allowances, those are down a bit versus prior year, how should we think about that for the rest of the year as you kind of get into your heavier sales quarter? Just as a percentage of gross product sales?

**Mark Segal**

I think during the roadshow we kind of gave you guidance for the full year of around 11 to 12 percent being the range, and that's consistent with what we see for the balance of the year.

There's nothing in that sales and balance line that would really change the guidance that I've given you previously on that.

**Sabahat Khan**

Thank you.

**Operator**

There are no further questions at this time. I turn the call back to the presenters.

**Mark Segal**

Okay. If there are no further questions, I'd like to thank you for participating in the call, and we will speak to you again for our Q3 results in November. Thank you very much, everyone.

**Ronnen Harary**

Thanks, everyone.

**Operator**

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

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