

Spin Master Corporation**First Quarter 2023 Earnings Call**

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PRESENTATION

Operator

Good day and welcome to the Spin Master Corporation First Quarter 2023 Results Call.

Today's conference is being recorded.

At this time, I'd like to turn the conference over to Sophia Bisoukis. Please go ahead ma'am.

Sophia Bisoukis — Investor Relations, Spin Master Corp.

Thank you and good morning. Welcome to Spin Master's financial results conference call for the first quarter ended March 31, 2023.

I am joined this morning by Max Rangel, Spin Master's Global President and CEO, and Mark Segal, Spin Master's Chief Financial Officer. For your convenience, the press release, MD&A, and interim consolidated financial statements are available on the Investor Relations section of our website at spinmaster.com and on SEDAR.

Before we begin, please note the remarks on this conference call may contain forward-looking statements about Spin Master's current and future plans, expectations, intentions, results, level of activity, performance, goals, or achievements, and 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 circumstances.

However, there can be no assurance that certain estimates and/or assumptions will prove to be correct. Many factors could cause actual results to differ materially from those expected 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 info on these assumptions and risks, please consult our cautionary statements regarding forward-looking information in our earnings release dated May 3, 2022. Please note that Spin Master reports in U.S. dollars and all dollar amounts to be expressed today are in U.S. currency, unless otherwise noted.

I would now like to turn the call over to Max.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Good morning. Thank you for joining us today.

Our first quarter performance was ahead of our expectations and reflects both encouraging entertainment and digital games performance, as well as expected Toy performance despite tough comparables against 2022, which were exacerbated by the drawdown of excess toy inventory at retail as

we entered 2023 Our three creative centres provide us with a strong integrated platform to create holistic play experiences for kids and families and help to enact our strategy to reimagine everyday play.

In Q1, as expected, we experienced pressure on Toy Gross Product Sales resulting from excess inventories at retail carried over from Q4 2022. This in turn caused retailers to slow orders for the front half of '23. We are also lapping an unusually strong Q1 '22 characterized by shipments from both our first PAW Movie and the Batman movie. As a result, our Toy revenue in the quarter declined 46.9% year-over-year, in line with expectations.

We see the industry's retail inventory situation improving steadily from a Spin Master perspective, our U.S. retail inventory at the end of 2022 was up \$117 million compared to '21. However, at the end of Q1 2023, our U.S. retail inventory was flat compared to 2022. Since the end of Q1, both industry and our retail inventory continues to decline, and we expect any remaining '22 related retail inventory overhang to unwind by the end of Q2, positioning us for a strong second half.

While historically the toy industry has been resilient amidst economic downturns, the start to '23 for the industry has been soft from a POS perspective. According to Circana, previously known as NPD, in Q1 '23 consumers globally bought fewer toys and spent slightly less on the toys that they purchased. Global Toy POS declined 3.1%, while our global POS was down 4.8% per Circana. In the U.S. our POS declined 9.2% compared to a decline of 4.7% for the industry. Conversely, our international POS performance fared better and in Q1 POS was growing 3.9% compared to the industry, which was flat. We grew POS in 7 of the 11 countries measured by Circana, outperforming the industry in most countries.

It's important to remind you that the first quarter of any year is our seasonally lowest quarter, and this was exacerbated in Q1 '23 for the reasons we have discussed. We believe that Q1 POS data, particularly in the U.S., may not be representative of full year performance. As we look to the fall, we have a strong toy lineup, with breakthrough innovation and impressive launches within our core and licensed brand portfolios, coupled with exciting content releases. Our commercial teams are focused on working closely with our retail partners to deliver on the second half. Execution on shelf will be supported by measured investment in fully integrated marketing plans with digital campaigns and portfolio led initiatives to incent and convert consumers.

We have built an industry leading preschool business, driven by globally acclaimed entertainment series and toy lines with deep character affinity. PAW Patrol, which is celebrating its 10th anniversary this year, continues to lead the way as a number one preschool toy property globally in Q1 '23. According to Circana, global POS for PAW declined by 7.1% in Q1 '23, mainly from declines in Europe. We expected this decline as we were lapping the continuous consumption from the PAW Patrol movie in Q1 2022, and Europe had not yet benefited from the distribution of our Aqua Pups theme, or the Rubble and Crew product launch. While overall, POS was down the availability of the strong theme and Rubble distribution drove POS gains in some key markets, including the U.S.

In the broader infant/toddler/preschool toys super category as defined by Circana, we had three of the top 10 items in the U.S., including some of the new items for 2023. This demonstrates our ability to win by innovating our core brands. Another example of winning with innovation is Bakugan within our Wheels & Action category. Bakugan was relaunched in 2019 after its first reign as a global phenomenon from 2007 to 2010 and has proven to be an evergreen brand with a strong following. In Q1 we

introduced Bakugan Legends, and the brand reached number one in the battling toys and playsets class globally, up from number two in 2020 per Circana.

We are excited to launch a whole new way to battle with Bakugan this fall, supported by new content. Speaking to older successful IP, Hatchimals was a global breakthrough toy when it launched in 2016, creating a new play pattern with a toy that unboxed itself, generating over a \$1 billion in gross product sales from 2016 to 2018. Over time, we have evolved the brand beyond the initial big egg extending it to a successful line of collectibles. As many of you saw in our LA showroom in January, we are launching a new way to hatch characters this fall with the launch of Hatchimals Alive, using water to unveil the characters inside. We continue to explore infusing innovation into the Hatchimals line with exciting new product innovations in 2024 and beyond. We have invested in our ability to secure top licenses, and over time we have steadily grown our reputation as an innovative and collaborative global partner. Licensed products now comprise just under 30% of our POS per Circana.

Gabby's Dollhouse, in partnership with Universal DreamWorks Animation, continues to win the hearts of children everywhere. In Q1 '23, Gabby was the number five Preschool Toys property, compared to number 10 in Q1 2022, and was the largest dollar global growth property in the super category per Circana.

Sales for the DC line softened in Q1 as we lapped the Batman Movie toy line launch last year. However, we regained our number one manufacturer position in Q1 for DC Universe globally, per Circana. With four new films in the DC Universe planned for 2023, we are excited about our lineup of action figures, vehicles, and role play items, to enable kids and collectors to bring the action and

adventure from the big screen into their homes. Warner Brothers is committed to investing in these franchises with more theatrical releases and content extensions launching over the next several years. Our design teams are looking forward to working on the toy lines, which will accompany the upcoming Batman and Superman movies in 2025, which are included in our multi-year licensing agreement.

The last major license I want to comment on is Monster Jam, in partnership with Feld Entertainment. Monster Jam outpaced the category globally in Q1 and remained the number two property in the Vehicles category and the number one licensed brand in Vehicles.

Within Games, category growth is being led by the trading card games and adult party games. Many of these games are inspired by social media trends and viral concepts. We are leaning into the popularity of these types of games in 2023 with several new titles, including If You Know You Know!, and Dumb Ways to Die. The catchy song for Dumb Ways to Die was originally created to promote railway safety in Australia and has become a viral sensation on social media. Our Dumb Ways to Die card game will launch this summer.

We're also leaning into giant games, which are also becoming increasingly popular, with the license of Monopoly, and we will launch Giant Monopoly late this fall. We have always been a disruptor in the toy industry known for our innovation. We expect to deliver exciting innovations for the holiday season, as retailers look to differentiate themselves on shelf and in the hearts of kids and families around the globe.

Looking forward we are doubling down on innovation by starting a new internal group that will be solely focused on developing breakthrough innovation. Our most innovative and creative talents will

be working in this group with a sharp focus to deliver significant disruptive breakthrough toys for the future.

Entertainment had a very strong quarter with revenue increasing 69.4% driven by higher distribution and licensing and merchandising revenue, primarily related to the PAW Patrol universe. Our strategy to invest in the creation of multi-platform content will result in the release in 2023 and '24, of our most diverse entertainment slate in our history. Part of that success can be attributed to PAW Patrol, a franchise, which continues to expand its reach, attracting new audiences in connection to these heroic pups. This fandom has allowed us to grow the PAW universe with the launch of the Rubble & Crew series, which debuted on Nickelodeon in February. Rubble & Crew delivered top performing ratings, with the premiere ranked as the number one show on cable with kids, two to five in its time slot, pacing double digits ahead of competition. Rubble & Crew also boasted the strongest share for a preschool series launch since 2019, capturing viewership with over 20% of kids two to five in the U.S.

PAW continues to perform well on both linear and streaming platforms. We have strong momentum heading into our movie launch and are looking forward to entertaining preschoolers and their families with another epic big screen adventure. We remain on track to deliver the second PAW Patrol movie, which is set to debut September 29. We are launching two brand new properties in 2023, Vida the Vet, our new preschool series, is set to debut on BBC's CBeebies in the UK and Corus' TreeHouse in Canada this fall. In addition to these initial broadcasters, we are pleased to share that Netflix has acquired streaming rights for Vida for the U.S. market. The team is also closing a raft of other international distribution deals, which should be announced soon.

We're also very excited for the launch of Unicorn Academy, our fantasy-adventure series, which is launching on Netflix in November. We are putting our full franchise development and Management support behind Unicorn Academy, which will cross over from entertainment into both toys and digital games in 2024. We are building an expansive licensed consumer products program that will span apparel, publishing, accessories, and many other categories. We can't wait to show you Unicorn Academy. It is unlike any other property that we've created and it's sure to enchant kids and families.

Turning to our Digital Games Creative Centre, in March we indicated we we're seeing some positive momentum. The industry new baseline is lower than it was during the COVID years but has stabilized at a much higher plateau than in pre-pandemic years. We are seeing a similar pattern in our own digital games business. We are actively expanding our digital games portfolio with several new digital games launching this year. We will be entering new and large mobile gaming categories that will increase our addressable market and broaden our audience base.

Our anchor games including Toca Life World and Sago Mini have been created for children, but we are thinking more broadly in designing digital games play that will attract kids of all ages and spawn a growing player network anchored in safe and fun play. In Toca Life World player engagement remains high. In early April, we hit a new record of 12.5 million daily active users in Toca Life World, beating our previous record in early 2022. This reflects the success of the Games-as-a-Service model, where fresh and relevant content drives player satisfaction and engagement. We have more exciting content drops planned throughout 2023, including an exciting collaboration to be announced in June, as well as enhancements to our Creator Tools, which will allow players to express themselves creatively and share their stories.

We've talked to you in the past about Toca Days, our first 3D multiplayer game set in the same universe as Toca Life World. At its core, the game is about social interactions between players, but also within a broader community. Toca Days is currently in early soft launch, and we are testing cross promotion between Toca Life World and Toca Days to drive traffic across the Toca universe. Player sentiment has been high so far and based on the initial feedback and learnings, we are fixing bugs and prioritizing features. We will continue to roll out soft launch to additional markets in 2023 with a full go-live planned for 2024.

In Sago Mini, we are also focusing on new content and late in Q1, we saw indications of growth in subscriptions and downloads. We are launching our Sago Mini subscription bundle in Q3 to give families more access to content at a better value. Between Sago and Originator, we currently have around 330,000 subscribers, and the bundle will allow parents to make one streamline purchase that will provide access to hundreds of games and activities including all the Sago World, Sago School, Sago First Words, and Originator developed Endless Learning and Math Tango apps, as well as the Toca Junior app library content, with six titles growing to nine by the end of 2023. Leveraging Spin Master's trove of IP is a key priority for our digital games Creative Centre.

Our new casualmobile game leveraging the iconic Rubik's Cube will soft launch this summer. We will also appeal to the deep global fan base for PAW Patrol through the creation of our first in house developed digital game, PAW Patrol Academy. The app combines hundreds of show clips that are unlocked through play, creating a seamless and immersive experience between our entertainment and game playing content. There are also exciting missions and educational content that will keep pre-

schoolers engaged in fun and emotional learning. PAW Patrol Academy will launch in tandem with the movie in October and will also be available as part of the Sago subscription bundle.

In 2024 we will be launching the Unicorn Academy digital game, which will bring the magic of Unicorn Island into the digital world with an action-adventure game designed for mobile devices. We have an exciting 2023 and 2024 planned for Digital Games and we look forward to sharing more details and live demos with you at our Analyst and Investor Day in Stockholm in late August.

While we are investing for growth, we are also closely managing our costs. Our prudent fiscal management has put us in a strong financial position and allows us to invest in acquisition opportunities within each creative center. We remain confident in our strategy to reimagine everyday play, leveraging the power of our three creative and integrated creative centers to capture market share, deliver profitable growth, and create long-term Shareholder value.

I am now going to pass it over to our CFO, Mark Segal, to provide further commentary on our performance in the quarter, and our outlook. Mark?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Thank you, Max, and good morning.

Against challenging comps, we delivered \$271.4 million in revenue in Q1 '23 across all three creative centers, down 36% from 2022. This performance was in line with our expectations. The year-over-year decline is primarily reflected in a shift in order timing in the Toy creative center, offset by an increase in revenue in entertainment. In March, we discussed how the Toy industry felt the impact of

retailers entering Q1 '23 with significant carryover inventory from Q4 '22. Comparisons to Q1 '22 look especially unfavorable since we had unusually high sales as retailers brought inventory in early to avoid anticipated supply chain disruptions as well as some large entertainment-related shipments.

Thanks to the hard work of our commercial teams, we ended Q4 '22 with very clean on-hand inventory, reducing the need for aggressive clearance activity in Q1, which, together with high entertainment and digital games revenue led to solid gross margins and a better-than-expected Adjusted EBITDA margin.

Looking at Q1 performance by creative center, Toy gross product sales were \$216.3 million, down 45.6%. Foreign exchange did not have a material impact, and on a constant currency basis, gross product sales declined 44.7%. In 2022, 45% of our gross product sales occurred in H1, compared to 30% to 35% typically, which creates a tough H1 comparative for us. Difficult Q1 '23 comps against last year are exacerbated further by the large volume of toys we shipped in Q1 '22 for the Batman movie, as well as toys for the first PAW movie from 2021, for which demand continued into Q1 '22. We also had \$11 million of sales in Russia in Q1 of 2022.

Geographically in Q1, North America saw the biggest decline both in dollars and percentage terms, as the trends discussed earlier were more pronounced in this region. Revenue declined \$133.1 million or 56%, to \$105.5 million and accounted for 48.7% of Q1 GPS, down from 60%. International Sales comprising Europe and the Rest of the World declined \$48.1 million or 30%, to \$110.8 million comprising 51.2% of Q1 GPS. Preschool and dolls and Interactive declined 44.7% primarily from a drop in sales of PAW Patrol, Hatchimals, Wizarding World, and Purse Pets, partially offset by an increase in

Gabby's Dollhouse and Rubble & Crew. Activities, Games and Puzzles, and Plush, were down 40%, mainly due to a decrease in the Games and Puzzles portfolio and Kinetic Sand. Wheels and Action dropped 56.1% driven by a decline in DC, especially Batman, as well as Bakugan, and Monster Jam. Outdoor was down 37.9%.

Q1 sales allowances were 13.9% as a percentage of gross product sales compared to 11.7%. Whilst higher than 2022 it was a good result considering the broader retail environment we were operating in. We continue to expect sales allowances of approximately 12% for 2023. Q1 Adjusted EBITDA for Toys was a loss of \$21.4 million compared to Adjusted EBITDA of \$58.9 million, a margin of negative 11.5% compared to 16.8%. The lower volumes driving deleveraging was the main driver of the EBITDA margin differential.

In Q1 Entertainment revenue increased \$15.4 million or 69.4%, to \$37.6 million from higher distribution and L&M revenue. Adjusted operating income was \$29.9 million up 162.3% and adjusted operating margin was 79.5% compared to 51.4%. The increase in Entertainment profitability was driven by higher distribution and L&M revenue and lower costs from fewer content deliveries. Q1 revenue and digital games was down 7% to \$47.5 million compared to last year from lower in app revenue in Toca Life World, but was up 25.3% compared to Q4 '22 from higher engagement and in app revenue in Toca Life World.

Over the last three years, our digital games revenue has grown significantly, and we have increased revenue by over 575% since Q1 of 2020. Digital games adjusted operating margin in Q1 was 40% down from 42.3%, due to higher development costs related to investments in future games. Q1

consolidated gross margin was 58.4% compared to 55.9%, an outstanding result. The 250-basis point increase arose primarily from high margin entertainment revenue and lower ocean freight, partially offset by higher sales allowances. The deleveraging I referred to earlier was evident in our SG&A of \$149.3 million, representing 55% of consolidated revenue, compared to \$158.6 million or 37.4%. Marketing costs were down \$2.9 million at 9% of revenue compared to 6.4%.

Administrative expenses were up due to higher personnel and travel expenses, offset by lower incentive comp. During the quarter, we implemented a global workforce reduction program and booked a restructuring charge of \$3.8 million included in administrative costs.

Adjusted SG&A was \$139.5 million or 51.4% of consolidated revenue, compared to \$153.8 million or 36.3%. On the topic of restructuring, we are making good progress on our Calais France facility shut down project and will account for the onetime restructuring cost in Q2. Combined, our two restructuring projects will, when completed, result in run rate savings of approximately \$15 million in 2024, and beyond.

In Q1, net loss was \$1.9 million, or a loss of \$0.02 per diluted share, compared to net income of \$45.6 million or \$0.43 per diluted share. Adjusted net income in the quarter was \$12.3 million or \$0.12 per diluted share, compared to \$57.5 million or 55 cents per diluted share. Adjusted EBITDA was \$30.6 million compared to \$95.7 million. Adjusted EBITDA margin was 11.3% down from 22.6% in Q1 '22 from low operating leverage, partially offset by higher gross margin.

Turning to our balance sheet, our inventory at the end of Q1 was in very good shape, at just under \$110 million. Inventory was essentially flat to year end, but approximately \$38 million lower than

Q1 2022. Free cash flow in Q1 was \$34.4 million negative compared to negative \$79.4 million, primarily from changes in non-cash working capital. We ended Q1 with \$569.3 million in cash, down \$75 million from the year end of \$644 million, and which is in line with normal seasonality. In Q1, we deployed \$26.5 million for the acquisitions of 4D Brands and HEXBUGs. We invested \$23.4 million in intangible assets for Entertainment and Digital games content. We continue to be in an extremely strong liquidity position with available liquidity of over \$1 billion.

From a capital allocation perspective, investments in innovation, content and M&A remain our priorities. In addition to our dividend, regarding which we will introduce a Dividend Reinvestment Program in Q2, we initiated a share buyback program. The program has been executed through a Normal Course Issuer Bid, which was approved by the TSX in early Q1. We repurchased 241,500 shares in Q1 for \$6.3 million. In April, we repurchased a further 156,200 shares for \$4.2 million. Repurchasing shares at current market prices represents an attractive investment opportunity for us, given our strong liquidity position and growth prospects. We will continue to opportunistically use the NCIB and believe that it, together with a dividend, represents a prudent use of capital and an important part of our efforts to create value for Shareholders.

Turning to our outlook, there remains a long way to go for 2023 but current trends in our business are matching the expectations for 2023 we communicated in March. We continue to expect the 2023 Toy gross product sales to be flat to slightly down compared to 2022. We expect H1 2023 Toy gross product sales to be toward the low to mid point of the seasonality range of 30% to 35% in H1 we guided to in March. We are maintaining our expectations for 2023 revenue to be in line with '22, excluding the \$17 million PAW Patrol movie distribution revenue expected in Q3.

Foreign currency translation is expected to have a neutral impact on revenue based on current rates. We discussed the primary revenue and cost drivers in detail in March and there have been no major changes. We are maintaining '23 Adjusted EBITDA margin expectations, which should be flat to slightly above 2022, excluding for \$17 million PAW Patrol movie distribution revenue.

To remind you, total depreciation and amortization for '23, is expected to increase from \$68 million in '22, to just under \$150 million in '23, primarily from more deliveries of entertainment content. From a phasing perspective, D&A will be approximately \$33 million in Q2, \$53 million in Q3, and \$44 million in Q4.

To conclude, we continue to execute on our growth strategies and build our integrated creative centre platform, to generate above industry growth in the medium to long-term. We have the scale and talent across our creative centres, combined with a strong balance sheet to capitalize on both organic and acquisition opportunities, and in doing so, build long-term Shareholder value.

That concludes our prepared remarks. We will now be pleased to take questions. Operator, please open the line.

Operator

Thank you, sir. (Operator Instructions).

We will take our first question from Martin Landry from Stifel. Please go ahead.

Martin Landry —Analyst, Stifel GMP

Hi, good morning. I was wondering if you can touch a little bit on your entertainment segment. It had a really strong quarter. Operating income was up almost 3x versus last year. You did touch on some of the reasons, but I was wondering if you can expand a little bit as to what explains this nice profitability uptick here.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Good morning, Martin. Thanks. I'll take that one. Entertainment is an interesting segment for us and is quite sensitive to revenue mix. In the quarter, in the first quarter, we had a really strong increase in high margin licensing and merchandising revenue, and also distribution revenue, which is actually characterized as part of the income we get, the rev share income we get from the first PAW movie in 2021, which was still flowing through in the first quarter of this year. That is very high margin accretive revenue and essentially flows straight down to the bottom line. That's what you saw. It impacts gross margin and Adjusted EBITDA margin and EBIT in a very positive way.

I do want to call out, Martin, that it's going to be hard to replicate that kind of performance every quarter, although I would love to. We are going to see some amortization flowing through in Q2 to Q4, which is going to lower that margin, because that distribution revenue and the associated amortization from it, is actually lower margin revenue for us. That's why in our outlook section, we called out those amortization numbers. You know how to model that.

Martin Landry — Analyst, Stifel GMP

Yes. Okay. That's helpful. You also talked in your opening remarks about Gabby's Dollhouse. It continues to perform extremely well. I was wondering, how long is that license going to be ongoing with you, when does it expire? Is there a likelihood of renewal?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Yes. Good morning, Martin. Gabby's Dollhouse has been with us—it started in '21. We're basically have another couple of—year and a half still with it. We're in a really great place with Universal DreamWorks with regards to Gabby's. If you think about it, so far, the success of Gabby's from a toy perspective has been mostly in the U.S., and we're just now beginning to get that going internationally. As Universal expands Gabby beyond the U.S. for obviously the content, we are also expanding that. You can expect we're in a great place with them, and we will continue to reap the benefits of these relationships into the future.

Martin Landry — Analyst, Stifel GMP

Okay, and then maybe last question for me, just broader outlook. Wondering if you can talk a little bit about the discussions you're having with retail buyers right now. How are they approaching the summer and the back-to-school season? I would expect at some point with retail inventories being right sized, is there a potential for replenishment in the back half? Just trying to get a sense as to how they're approaching the coming months and all the way up into the holiday season.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Sure, I think Mark has in his remarks, referenced a return to historical weightings between the quarters and the halves. Retailers are—just to answer your question, planning for that exact condition. Therefore, quite a bit of the shelves are being set in the summer, which coincides with what Mark and I have said, again, regarding retail inventories, which should be down by the end of the summer. As you think about back to school and people resetting shelves and a few theatrical releases, including ours on PAW, correct, September 29, you're going to begin to see that activity.

Yes, when things begin to do well, there's an opportunity for replenishment. This year, unlike last, and it only dates back to 2016-'17, Christmas falls on a Monday, and it has basically therefore, two previous weekends of purchasing. That last weekend is really important. Retailers are also planning accordingly.

Martin Landry —Analyst, Stifel GMP

Okay, that's helpful. That's it for me. Thank you.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Thanks, Martin.

Operator

Thank you. We'll take our next question from Adam Shine from National Financial.

Adam Shine — Analyst, National Financial

Hi, good morning. Mark, I don't want to push you on guidance, heard your comments. It's certainly very early in the year, but maybe, just in the context of digital games and entertainment. Then maybe, perhaps one more for you later, Max. Specifically, on digital games, we had seen three prior quarters of a step down. The step down in Q1 wasn't to the same extent as you alluded to, and there's sort of more product flowing into the back half of the year, let alone this summer. Can you talk about some of your expectations, starting with digital games, is this a revenue line, that frankly, should see some degree of growth as compared to what perhaps some people might have assumed would be a decline for the year?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Adam, we're encouraged by what we saw in Q1 for digital games. Even though we were down relative to Q1 last year, we were more than 25% up sequentially relative to Q4. We're actually encouraged by that. We saw some of that flow through into our performance in Q1, in terms of that segment's EBIT.

Now obviously, we would love to see that that trend continue. We're not calling that out specifically. It is to some extent built into our outlook for the year, but there may be some upside. Hopefully, we'll be able to give you more views on that as the year progresses. Certainly, we're excited about what we're seeing in digital games. We've got a lot of new content in Toca Life World. We're excited about the one sub bundle in Sago. There's a number of products in soft launch, the new product Rubik and the others, Toca Days are not going to have an impact on revenue in 2023. Those will really be

'24 and beyond. Overall, it's a good news story so far, but it is early days. Max, would you like to add anything to that?

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Yes, Adam, we're super thrilled about the start of the year. I won't go into what Mark said. I'd just like to add some color. We kept the engagement, correct. The kids were in the ecosystem. What changed for all of us is that we are monetizing now better. Now the kids are spending more while in the app. That's a reflection of the quality of the content being released, and the engagement it drives with social channels. We saw TikTok, we saw a number of things that gives us quite a bit of confidence that the content is resonating. Vis-à-vis last year's base, we now have content every month going forward, including in the summer month, which is one key period for this property. We're very encouraged, and we are aggressively looking forward to carry the year ahead.

Adam Shine — Analyst, National Financial.

Perfect. Thanks for that Max. Just Mark, next on entertainment. I think you alluded to it and you addressed some of the Martin questions, specific to that. Clearly there's going to be some lumpiness inherent in entertainment, sometimes for episodic deliveries, and sometimes for the L&M dynamic. L&M should arguably continue to build through the year in the context of a lead up to the movie. Can you speak a little bit more to how you see entertainment progressing, acknowledging the lumpiness, and the upside called out for the movie distribution revenue in Q3? How should we be thinking about entertainment overall for the year?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Adam, it's a great question. Entertainment is at essentially a nexus point in '23 because we're actually still dealing and getting the benefit of content that we've delivered in the past, which represents a lot of PAW and other content that we've released and that's actually flowing through the P&L. At the same time, we've built and are launching a lot of new content in '23.

Now that that content, including the movie in the latter part of the year, we have Vida the Vet, we have Unicorn Academy. That is really not going to be generating much licensing and merchandising or toy revenue until '24 and '25. You have the impact of the distribution revenue and the amortization associated with that flowing through in the latter part of the year, which is actually margin dilutive. Then as that content builds in the marketplace, both toy and licensing and merchandising for Vida the Vet and Unicorn and the PAW movie, actually kick in '24 and beyond. That's the dynamic that I've been talking to quite extensively now for some time in entertainment. We're going to see that, really starting to shift a little bit in Q2 and Q3, and Q4, relative to what you saw in Q1.

Adam Shine — Analyst, National Financial

Okay, and just I'd be remiss not to ask a quick question of Max on toy. You were very clear in regards to your positioning, the terms of inventory and the nature of destocking, which we obviously heard from your peers last week in terms of working its way through the Q2. Can you talk at all about some early signs of any replenishment activity from retailers? Because it does sound like you guys—maybe I'm being presumptuous. Sounds like you guys might have been a bit ahead of the game than your two peers in the context of the de-stocking exercise.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Yes, I think we were the prettiest housing in a not so good-looking neighborhood. You know what I mean. I think as we've gotten into the year, we have benefited from that, but the neighborhood is still pretty flooded. I think as they work through that we just have to continue to chug along and do our best. I think the retailers have done a nice job of clearing the industry. As that happens, we benefit.

That's where we are. Recall that there's a second component to the inventory, which is our own inventory. I think we would have told you last time we were together, that we thought we did a terrific job managing that, so that we can be in a position to then attack. As we actually ended Q1, we are still in a great position to do that. It's getting now very sophisticated as we go into the second half, because we just have to basically get our showing the road, but I think we're in good shape.

Adam Shine — Analyst, National Financial

Okay, I'll leave it there. Thank you very much.

Operator

Our next question comes from Luke Hannan from Canaccord Genuity. Please go ahead.

Luke Hannan — Analyst, Canaccord Genuity

I just want to get a better sense of—I appreciate that there was a lot of cost inflation in Q1 in the toy business. I'm just curious to know how much of a headwind that acted as in the quarter and how you see it progressing thus far into Q2. Specifically, any color on resins or other input costs as well as freight?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Yes. We actually provided a lot of color on that in March. I would say to you, not a lot has changed on that front. The one call out, was actually on ocean freight. We did see some tailwinds on ocean freight. Ocean freight rates came down from where they were in Q4. We continue to see that trend for the balance of 2023. We will get some tailwinds from that.

I think, not a lot of news on resin or electronic components or on paper and packaging. That was pretty much in line with what we said in March. For the most part, we see tail winds in our COGS, not headwinds in terms of increases.

Luke Hannan — Analyst, Canaccord Genuity

Understood. Then switching gears here to Hatchimals, Max, you called out that we are going to be seeing some innovation towards the end of the year and beyond. I'm just curious to know how you guys are going to be approaching the sort of lifecycle management of this brand going forward. Maybe areas where you're going to be a little bit deeper in relative to the last time where the brand was very successful.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Yes. As we said in the prepared remarks, and let me go deeper for your question, we went through collectibles, right, and we're now getting ready to reset the shelves, ahead of the Hatchimals live launch. That's a really important launch for us. That precedes us, once again disrupting play with that brand, in '24 and beyond. We are basically going back to what the brand did so well and the magic

that it brought to the category, including creating new play. That's what you can expect from us without me, unfortunately not being able to tell you a lot more in terms of what those innovations are. Hopefully you'll get to see those next time you come to the LA showroom in 2024. I apologize that I can't go further, but you can expect that you'll see something potentially bigger than what you're seeing this coming fall.

Luke Hannan — Analyst, Canaccord Genuity

Understood. Last one for me, and then I'll pass the line. Max again, for you, you've given a bit of color in the past about performance by price point, when it comes to your SKUs on shelf. I think you've called out those toys costing less than \$10, those above \$100, then there's that big happy middle. You did also mention that per Circana, there is a bit of softness when it comes to the amount of toys in the basket and the amount spent per toy. Curious to know how to reconcile all that together, you still seem soft on either side of the spectrum, or any trends to call out there.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Yes, it's a great area, and there has been some change. The \$70 plus bracket has declined. It has likely had the largest decline. The price compression on the \$0 to \$10 continues to be the case. What's happened differently is that we've seen more middle of the pack price points that have actually compressed this time. We've seen, for example, toys that would have been \$99, basically dipping, because people are trying to get inventories flushed, and those are now coming into the \$59 to \$79. Then that's driving a little bit of growth in that area. Or toys that would have been between \$50 and \$79

have been promoted deeply. They've gone into another. That's what you're seeing. But by and large, there's an interplay in those middle price points, some declining, some increasing.

I will tell you that the noise in those results is strictly driven by promotions, not by new items that are doing super well. I hope that's clear.

Luke Hannan — Analyst, Canaccord Genuity

It is. I appreciate it. Thank you.

Operator

Thank you. Our next question comes from John Zamparo from CIBC.

John Zamparo — Analyst, CIBC Capital Markets

Thanks, good morning. I wanted to get back to the inventory reduction process of retail partners and appreciate the color on what you've given so far. I think you've said you are flat year-over-year at retail partners. I wonder where does that have to get to by the end of Q2, or where do your retail partners want it to get to on a year-over-year basis? Really the goal here is just to try to get a sense of how much more progress needs to be done in an attempt to de-stock.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Sure. I think it varies by channel. It varies by customer. We obviously won't get into what each customer wants to do. I think there's a combination of customers wanting to get maybe a week of

supply out of their system, others trying to get the fact that shipping lanes have gotten more efficient and getting working capital, obviously shortened as well.

When it all basically gets summarized people are trying to get maybe a week or so out of their inventory. You have to, by virtue of that, be flat or lower. That's what we're trying to get to. I would tell you that if I were to say in two out of three places, we see really positive signs already. We're actually incredibly encouraged. Maybe one or two pockets of issues that are basically working themselves out. We can see clearly that they will be done by the end of the summer. That's where we are.

It's a combination of continued promotions, the combination of basically people moving items into other places. The whole Omni commerce and Omni channel play has deepened. There's a lot more people coming to store. A lot more out of aisle placement for toys. Everyone's doing their job to try to get these things sorted. That's what we're seeing.

John Zamparo — Analyst, CIBC Capital Markets

Okay, that's helpful. Thank you for that. On the international business Spin Master outperformed the industry on PLS pretty meaningfully here. You'd also mentioned that Europe hasn't seen the benefit from some of your PAW Patrol releases. Can you add some more color on what's driving international performance?

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

International, it's a really strong market for us. The market channel structure is a little bit different. You don't have concentration as you might in the U.S. We have a really experienced team in

Europe that's doing a terrific job with our core brands. We are gaining in the majority of the categories and brands where we play. It's a bit of execution. I just don't want to leave you with what does that mean? There's a lot of blocking and tackling with our brands in Europe that doesn't just get determined by one or two large players. That's really encouraging. It allows for our know-how to be brought to the market and expressed into share gains. That's number one.

Number two, we have been able to take our global properties and market them locally in a relevant way for that child and his or her family. That's also working well for us. Last but not least, we do our inventory management and how we handle Europe differently than we do in the U.S. That has also helped us.

We have a really good thing going in Europe. What I mentioned earlier about PAW Patrol specifically is used to demystify that. When we actually did the movie two years ago, precisely, that movie would have actually launched in Europe, depending on the market, might have happened a little bit later. The toys trail what would have happened in the U.S., remember, August 2021, was the movie here in the U.S. In Europe, the remaining stock that we had to clear in '22, basically pushed in to '23. Aqua Pups and or Rubble would have not gotten to Europe on time. Those two things have done really well. That's really what we're seeing.

We've seen a sequential improvement in Europe on PAW Patrol, just to not leave a concern on fall in Europe.

John Zamparo — Analyst, CIBC Capital Markets

Okay, that's great. Then one last one back to the industry, the POS in Q1 was pretty soft, overall industry wide, most of that from the US. I think you've made a comment, Max, that you don't expect that to be indicative of the full year. Correct me, but I think that was referring to the industry rather than solely Spin Master. If that's the case, I wonder if you can elaborate a bit on that, and what you attribute it to? Is it just an assumption of economic recovery and healthier spending among consumers? Or is there something more in depth with that?

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

No, I think the common stand on parents bought less, spent less per purchase. That's a fact. The spend less per purchase is also driven by the ASP, the average selling price, and all the inventory glut and how that has to get consumed. I just want to give you some confidence that when you extract the two or three big things that drove whatever growth was in the market, whether it was Squishmallow or strategic trading cards, the U.S. POS is in line with obviously Spin Master's POS. That's one fact.

When you then take a look at that, and then get into our properties, PAW Patrol in the U.S. did well. We talked about it, grew more than mid-single digit which is positive. We actually have some really good things going. Gabby's Dollhouse is on fire still. We're talking about double-digit growth. We're talking about strong double-digit growth out of Gabby's Dollhouse and Rubik's Cube. We have that property on fire. We're talking about Monster Jam growing high-single digit in the U.S., which is incredibly positive. We have some of our core brands doing well, which gave us confidence. Those lines have innovation in the back half too. That's not to say that we have one or two pockets of opportunities that we're working through. But that's the color I want to just give you beyond what's on the remarks so

that you understand from our position as we look to the fall, that's where the game is won or lost. We are we standing to gain, and we want to win.

John Zamparo — Analyst, CIBC Capital Markets

All right. I will leave it there. I appreciate the color. Thank you very much.

Operator

Thank you. Our next question comes from Brian Morrison from TD Securities. Please go ahead.

Brian Morrison —Analyst, TD Securities

Thank you, Max. Just to follow up on that POS question. The relative POS, the way that I think of it is, this is just really who had more hangover to clear rather than real market share gains. Is that correct? Then you would expect Spin Master from a relative perspective that a material reversion in the second half?

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Yes, I think that's a very fair way to put it, Brian. I can comment further, but you've nailed it. You look at the gross margins by players and how to invest more to clean up more. They basically bought share, but they really bought share because they had to clean up. If you look at our margin, our profitability than we entered the year better and we didn't have to do that. That's a very logical conclusion on your part.

Brian Morrison —Analyst, TD Securities

I want to go back to digital because of the opportunity there. You mentioned the PAW Patrol app within the Sago subscription model, if I understood it correctly. How should we think about this? This is a monthly fee for parents. What is the price? Probably putting you on the spot but, from a high level, what's the impact this could have on your subscriber base? Can you confirm that it's a global movie launch for September 29?

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

It is a global movie launch for September 29. It's different than last movie because obviously we don't have, knock on wood, and we expect that to be the case in September, the lockdown conditions. We're in a bit of a different place. That's just to set the record clear is different.

Second, from an eyeball and getting this property exposed to more kids outside of Network TV or streaming TV, it is, right, as many parents are logically in digital spaces. We would actually have the property brought to kids digitally as well. We're basically utilizing the content of the PAW Patrol property to basically immerse kids in missions, and what the actual property is really all about. Then having the kids' experience, getting in a car or doing—and also doing that, and also providing education as we go along. It will be more about engagement. There's obviously an opportunity to monetize. There's all of that going on.

I think beyond that, what I would say is, that PAW Patrol, the app as it belongs in our sub bundle, is an opportunity for those families to be exposed with one monthly fee to great content beyond PAW

Patrol. That's Sago Mini, Endless Learning Academy, MathTango, and the list goes on, offer families, these variety of play in a very convenient way. We're very excited about that, and PAW, because of its notoriety and awareness, has the ability to bring new subscribers to our model.

The combination of all those things gave us a lot of hope, as Mark expressed on our subscription business for the back half. Those two coincide. The subscription bundle will kick off in September, and the PAW Movie September 29, and the PAW game will be in early October. I think everything's converging around that time. I hope that that answers your question.

Brian Morrison —Analyst, TD Securities

Yes, that's very good. Thanks very much guys.

Operator

Thank you. We take our next question from Sabahat Khan from RBC. Please go ahead.

Sabahat Khan —Analyst, RBC

Great, thanks. Good morning. I think Max, really you mentioned there's a number of DC movies that are probably being released or that are being released later this year. Maybe we can talk about your expectation for those and any ones that you think could be maybe a more of a meaningful contributor than others?

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Sure. We have the Flash coming up in June. That's the earlier one. We have one later in the summer, which is Blue Beetle. That's basically late summer, early fall. Then we have Aquaman 2, which will be for Christmas, late December. As you know, we have all those toy rights. The Flash is a huge push from Warner Brothers and has two strong Batman characters. We actually have a lot of hope for the Flash. We're excited about that.

Then Aquaman 2 is the sequel to the biggest DC movie ever. There's a lot of strong toyotic appeal for that movie, and connection to our toys. We are excited about everything, but those two, to your question, hold the largest opportunity for us.

Sabahat Khan —Analyst, RBC

Would that be part of sort of your Q3 shift, shift in...

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Yes, some of it is going to be shipping here in a month or so. The other one will be shipping in Q3. Let's not forget, I think we as we do that, also draft and then get Batmen put into that bundle. That's always going to be the biggest, by far, property we have from DC.

You can imagine that Batman will be a play as we do those two other properties. We have great innovation on Batman for the back half. Recall, you may have seen that in LA. Think of DC as that effort by us, dropped in on those two movies.

Sabahat Khan —Analyst, RBC

All right, great. Then just one quick one, maybe for Mark. Over the last year, I think you've indicated maybe a greater focus on M&A there establishing sort of division leads for M&A. Maybe any sort of progress update there, how the pipeline is looking and your willingness to transact. Just given all that's happening in the backdrop right now.

Mark Segal — Chief Financial Officer, Spin Master Corp.

Good morning, Sabahat. I would say our willingness to transact is high. We're actually seeing a fair bit of activity in all of our creative centers. From an M&A perspective, the teams are working well, generating a lot of leads. We have not done any M&A in entertainment, yet, but I suspect that we will, at some point in the near future. Then in the toy area, we'll continue to look at both tuck-ins and larger deals as well. There's ongoing activity across all of these areas. We have seen valuations become a little bit more reasonable, a little more moderate than they were in the past, particularly as interest rates have gone up and stayed high. We are confident in our strategy and our team is working very well, Sabahat.

Sabahat Khan — Analyst, RBC

Great. Thanks very much for that.

Operator

Thank you very much. Our next question comes from Gerrick Johnson from BMO Capital markets. Please go ahead.

Gerrick Johnson — Analyst, BMO Capital Markets

Hey, good morning. Thank you. I wanted to get back to the subject that Adam was talking about lumpiness in entertainment. In the quarter, you beat us by a significant amount and entertainment is a majority of the beat. I mean, you beat us on a lot of metrics, but that was the biggest beat. Honestly, how do we know how to manage our expectations? Or I should say, how do we know to what we should build in for things like Rubble & Crew, the distribution revenue? What kind of tail does it have?

Maybe just some sort of help in how we look at these entertainment properties like Vida the Vet when it comes on? What kind of upfront distribution revenue do you get? Then what kind of tail do you get? How do we account for that?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Gerrick, again, this is a conversation that we can continue in more detail offline in terms of how it all works from an accounting perspective. In general, the way it works in entertainment is that when the show is developed, and we launch it, we actually recognize distribution revenue that we get from our distribution partners. That's our initial partners. Then our second window of distribution as we extend distribution around the world. That is what gets recognized upon delivery.

Then the amortization is essentially the cost of goods sold against that distribution revenue. We've actually provided the amortization on that, and Sophia can actually give you more insights into how that hits COGS and SG&A, because amortization does hit different pieces of the P&L. We're happy to explain that more.

In general, Gerrick, the thesis is that you have relatively low margin, distribution revenue as you launch the property. Then as the property becomes more established, you launch your toy line, you launch your licensing and merchandising program, typically within 12 months of the entertainment launch. Then you start developing that creative sense of revenue across the board.

With Unicorn Academy, for the first time, we're actually doing a digital game as well. We'll have distribution revenue when we launch Unicorn in '23. We'll have toy revenue in '24. We'll have digital games revenue in '24, because we're doing that across all three credit standards, which we're very excited about. That's generally the thesis of how it works. We are happy to spend more time offline with you on that. It is a big part of our financial model.

Gerrick Johnson — Analyst, BMO Capital Markets

Yes, I guess you're suggesting we can back into what the revenue is based on the amortization that you guys just provided?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Yes, you got it.

Gerrick Johnson — Analyst, BMO Capital Markets

All right. That's all I have. Thank you.

Operator

We'll go to our last question from David McFadden from Cormark Securities. Please go ahead.

David McFadgen — Analyst, Cormark Securities

Grown quite a bit. I'm just kind of wondering of the magnitude. I know you don't like to give out revenue on a per property basis, but I was just wondering if you can give us sort of relative size, how would it compare to say PAW Patrol right now?

Mark Segal — Chief Financial Officer, Spin Master Corp.

David, we heard you kind of cut out at the beginning, what property were you referring to in the first part of your question? Can you just repeat that?

David McFadgen — Analyst, Cormark Securities

Yes, sorry. I'm sorry about that. Gabby's Dollhouse, that property has seen quite large growth. I'm just wondering how that property would compare in terms of revenue, if you compare them with PAW Patrol?

Mark Segal — Chief Financial Officer, Spin Master Corp.

We can't give specific revenue. We don't typically do that. We have in the past talked about PAW Patrol, being around 20% to 25% of our sales. It's the number one property in the whole Company. Gabby's is meaningful. It's certainly growing as Max alluded to, with the international launch, which we're very excited about as well. We can't be specific. All I will say to you is that it's meaningful and it's

high margin for us. It's great content as well. It's driving a driving some good business for us in the preschool area.

David McFadgen — Analyst, Cormark Securities

Okay, I mean, you can't give any indication as to 25% of PAW, 20% of PAW, just anything like that?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Typically, since we've been public, we've never given out individual product line revenue. We can't go there unfortunately.

David McFadgen — Analyst, Cormark Securities

Okay, all right. Thank you.

Operator

Thank you, and I'll now turn it back to our speakers for any closing remarks.

Max Rangel — Global President and Chief Executive Officer, Spin Master Corp.

Thank you, everyone. Appreciate your attendance and interest in Spin Master and we look forward to talking to you again for our Q3 results. In early August. Thanks, and have a good day.

Operator

Thank you. Ladies and gentlemen, that does conclude today's conference. We appreciate your participation and have a wonderful day.