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Spin Master Corp.

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PRESENTATION

Operator

Good afternoon. My name is Sally (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Spin Master 2015 Q4 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, press the # key. Thank you.

Mr. Segal, you may begin your conference.

Mark Segal — Chief Financial Officer, Spin Master Corp.

Thank you, Sally. Good afternoon, and welcome to Spin Master's financial results conference call for the fourth quarter and year ended December 31, 2015.

My name is Mark Segal, and I am Spin Master's Chief Financial Officer. I'm joined by Ronnen Harary, Co-Chief Executive Officer, and Ben Gadbois, Global President and Chief Operating Officer. Following our formal remarks, we will open up the lines for your questions.

For your convenience, the press release containing our fourth quarter financial results is available on the Investor Relations section of the Company's website at www.spinmaster.com. Our Q4 MD&A and financial statements will be posted on our website and on SEDAR by March the 30th.

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 the 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 March 24, 2016.

Please note that Spin Master reports in US dollars, and all amounts expressed today, unless otherwise stated, are in United States currency.

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

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

Thank you, Mark. Good afternoon, and thanks for your interest in Spin Master. Earlier today, we reported strong financial results for the fourth quarter and year ended December 31, 2015.

I'll begin the call with some brief highlights of our revenue and product growth before Mark provides you with a more detailed review of our financial results, including our outlook for 2016. Ben will then take a few minutes to discuss our operational results.

We are very pleased to report that 2015 gross product sales increased 21.1 percent to 982.7 million from 811.9 million in 2014. Excluding gross product sales from the acquisition of Cardinal, gross product sales increased 17 percent to $950 million.

Growth relative to 2014 was driven by strong contributions from PAW Patrol and Star Wars licensed products, as well as new product launches, including Meccanoid, Bunchems, and Chubby Puppies, in addition to revenue from the Cardinal acquisition. This increase was offset in part by declines in Zoomer, DigiBirds, and Flutterbye Fairy lines, and products associated with the How to Train a Dragon movie.

On a business segment basis for 2015, gross product sales in the Activities, Games & Puzzles and Fun Furniture segment increased 21.5 percent to $231.4 million, primarily driven by the launch of Bunchems, increased sales in Marshmallow Furniture, as well as sales from Cardinal following our acquisition.

In the Remote Control and Interactive Character segment, gross product sales decreased 13.1 percent to 233.3 million, resulting from lower sales of Zoomer and DigiBirds, partially offset by strong sales of Star Wars licensed Air Hogs products.

Gross product sales in the Boys Action and High-Tech Construction segment increased slightly by 0.3 percent to 192.3 million, primarily driven by the launch of Meccanoid and Star Wars licensed products, partially offset by lower sales of How to Train a Dragon and Minecraft.

In the Pre-School and Girls segment, gross product sales continued to grow steadily, increasing 102.3 percent to $325.7 million. The sales reflect the continuous robust growth of PAW Patrol products in addition to the launch of Chubby Puppies, offset by declines in Flutterbye Fairy and Chatsters.

In the fourth quarter of 2015, including Cardinal, Spin Master’s gross product sales increased 3.6 percent relative to the same period in 2014. Excluding Cardinal, Spin Master’s gross product sales in Q4 2015 decreased 22.7 million, or 8.2 percent, relative to the comparable period in 2014, reflecting this year’s acceleration of sales into the third quarter.

Overall, we are very pleased with our performance in 2015. We’ve established a strong platform from which we can continue to build in order to meet our long-term growth and value objectives.

I’ll now hand it over to Mark Segal, our Chief Financial Officer, to review our financial results in more detail.

Mark Segal

Thanks, Ronnen. Before I begin a detailed review of the quarter and 2015, I want to highlight three factors which impacted our fourth quarter, in particular, and our 2015 results.

The first was the changes in the timing of shipments in the current year versus the prior year, which we highlighted in our Q3 call. Shipments in the third quarter of 2015 were enhanced relative to the prior year due to improvements in operational efficiency. As we discussed previously, we ship a significant proportion of our goods FOB Hong Kong.

By shipping earlier—in September, for example, versus October—we ensure that our goods arrive at our retail customers on or before December the 1st, thereby reducing the risk of late arrival and missing key selling weeks. This allowed the Company to ship product in Q3 that in previous years was not available for shipment until Q4.

Shipping earlier allows our retail customers to avoid early season out of stocks on popular items, and provides them with additional time for sell through to consumers. This moved some revenue from Q4 2015 into Q3 2015.

Secondly, we closed the Cardinal acquisition on October the 2nd, and therefore included Cardinal in our Q4 2015 consolidated results. The integration of Cardinal into our Activities, Games & Puzzles and Fun Furniture business segment is already well underway, and the earnings contribution will be reflected on an integrated basis going forward.

Finally, during the fourth quarter, Spin Master reached a settlement agreement with the Canada Revenue Agency regarding the CRA's audit for the cost-sharing arrangements between various subsidiaries during the period 2004 to 2013. The total liability for Canadian federal and Ontario corporate income tax, penalties, and interest under the proposed adjustments by the CRA would have been approximately $58 million for the 2004 to 2012 taxation years.

Spin Master had also estimated that potential additional tax, interest, and penalties in the amount of 7 million would have been payable for the 2013 to 2015 taxation years if the CRA's proposed transfer pricing methodology were applied to these later years. Spin Master and the CRA have agreed on the amounts of the transfer pricing adjustments for the 2004 to 2013 taxation years, and that no transfer pricing penalties will apply.

The total liability for Canadian federal and Ontario corporate income tax and interest in respect of the agreed transfer pricing adjustments is approximately CAD 15 million to be paid in cash upon the receipt of the final reassessments from the CRA, expected in the second quarter of 2016.

The settlement agreement resulted in a charge of approximately US $14 million, or CAD 19 million, in the P&L in Q4 2015. This had an impact of 13.2 percent on our tax rate in Q4. Going forward, the settlement is expected to increase Spin Master's overall tax rate by less than 0.5 percent.

With that context, let me begin a review of the full year 2015 and the fourth quarter. Turning first to our full year results.

Our revenues increased by 22.9 percent from $715.7 million in 2014 to $879.4 million this year. FX headwinds reduced overall revenue by $28.4 million for the 12 months. In constant currency terms, revenue increased by 26.9 percent for 2015 relative to 2014.

2015 gross product sales increased 21.1 percent to 982.7 million from 811.9 million in 2014. Excluding the acquisition of Cardinal, gross product sales increased 17 percent to 950 million, which is above the high end of the guidance range we provided in connection with our Q3 earnings release.

Other revenue, which primarily reflects merchandising royalty and television distribution income from products marketed by third parties using Spin Master's own intellectual property, more than doubled from $8.8 million in 2014 to $19.2 million in 2015. Including other revenue, the Company's total sales in 2015 were just over $1 billion compared to $820.7 million in 2014, a 21.8 percent increase.

Our gross profit for 2015 was $458.9 million, representing 52.2 percent of revenue compared with $358.1 million, or 50 percent of revenue in 2014. The increase in gross profit margin of 2.2 percent on a year-over-year basis primarily results from increased sales of higher-margin products, increased licensing and merchandising revenue, and ongoing productivity initiatives.

Total SG&A expenses were 379.7 million, or 43.2 percent of revenue for the 12 months ended December 31, 2015. Adjusted to exclude IPO and stock compensation costs, total SG&A expenses were $328.1 million compared to $263 million for 2014, reflecting higher royalties on licensed properties and increased marketing spend.

SG&A as a percentage of revenue, excluding IPO and stock compensation costs, increased slightly to 37.3 percent of revenue in 2015 compared to 36.8 percent of revenue in 2014, primarily reflecting higher royalties on licensed products.

Administrative expenses, excluding IPO and stock compensation costs, were 16.4 percent of revenue compared to 17.3 percent in 2014, reflecting improved operating leverage.

Net income of 47.1 million, or $0.48 per share, decreased 24.3 percent compared to 2014, reflecting the effects of IPO-related expenses, including $50.7 million of stock-based compensation expense. Adjusted net income increased to $98.6 million in 2015, or $1.04 per share from $66.3 million last year, a 48.6 percent increase.

Adjusted EBITDA for 2015 was very strong, increasing 43.5 percent to $160.4 million from $111.7 million in 2014. Adjusted EBITDA margins for 2015 increased to 18.2 percent compared with 15.6 percent last year.

The Company benefitted from higher gross margins, increased sales of products under owned brands, and increased licensing and merchandising income. These results are consistent with the guidance provided in Q3 of continued improvement in annual profitability.

Operating cash flow increased 17 percent to 105.7 million in 2015. Free cash flow of 67.2 million in 2015 was slightly above 2014, despite a $20.3 million onetime cash payment to settle equity participation arrangements at the time of the IPO, and a $13.6 million increase in investing activities, excluding licence, brand, and business acquisitions.

Turning now to our quarterly results. Our fourth quarter 2015 revenues increased by 8.8 percent from $237.6 million in Q4 to $258.4 million in Q4 2015.

Our strong performance was achieved despite the headwinds associated with a US dollar that was rising relative to other currencies, reducing our revenue by $8.9 million during the quarter. In constant currency terms, revenue increased by 12.4 percent in Q4 2015 relative to the comparable period in 2014.

For the quarter ended December 31, 2015, Spin Master generated gross product sales of $287.5 million, an increase of 3.6 percent from 277.5 million relative to 2014. Cardinal reported $32.7 million in gross product sales in Q4 and $29.9 million in revenue. Excluding Cardinal shipments in Q4, gross product sales in Q4 2015 were 8.2 percent below Q4 2014, and revenue was 3.9 percent below Q4 2014.

Sales allowances decreased by 17 percent relative to the same period in ’14 despite the increase in revenue.

In the fourth quarter our gross profit increased 11.5 percent to $131.6 million, representing 50.9 percent of revenue compared with $118 million, or 49.7 percent of revenue in Q4 2014.

Total SG&A expenses increased 34 percent to 136.7 million for the quarter ended December 31, ’15, driven primarily by 7.2 million in IPO and stock-based compensation expenses. Excluding this cost, total SG&A as a percentage of revenue was 50 percent in Q4 compared with 42.6 percent in 2014, driven by increased selling and marketing expenses.

Adjusted EBITDA decreased in Q4 2015 to $13.7 million compared to $22.4 million in Q4 of 2014, but was above management's expectations. Adjusted EBITDA margins were 5.3 percent in Q4 2015 compared to 9.4 percent in the 2014 period, reflecting the timing of sales shifting from Q4 to Q3, as described earlier, higher royalties on licensed properties, and increasing marketing spend in Q4 2015 relative to 2014.

As a reminder, from a profitability perspective a significant portion of our annual marketing expenses are incurred in Q4 in order to maximize their impact on consumer purchases and our return on investment. This typically causes a misalignment of sales and spending between Q4 and Q3, resulting in adjusted EBITDA margins in Q4 significantly below those in Q3.

We recorded a net loss for Q4 2015 of $13.3 million, or $0.13 per share, compared with $5.7 million in Q4 2014. Adjusted net income for Q4 2015, excluding the effects of the IPO-related expenses and CRA settlement, was $6.7 million or $0.06 per share compared with $9.5 million in Q4 2014.

Turning to 2016. Before I discuss our specific guidance, I want to provide more details on the acquisitions we made in Q1 2016: EG Games in Italy and Etch A Sketch. Ben will discuss the strategic rationale behind these acquisitions shortly.

EG was an asset transaction whereby we purchased the library of board games, tooling, and inventory owned by Editrice Giochi, one of the oldest privately held game companies in Italy. The purchase consideration was a cash payment at closing, plus an earn-out over a seven-year period. The transaction was completed using cash on hand.

Going forward, we estimate that EG will generate approximately 5 million to $7 million of incremental gross product sales per annum.

The Etch A Sketch and Doodle Sketch brands were acquired by an asset purchase transaction that includes all brand-related patents, trademarks, tooling, and inventory. Etch A Sketch is a classic toy brand known around the world with over 150 million units sold globally since 1960. Today there is a steady-base business that we intend to grow through multiple levers.

The purchase consideration was a cash payment at closing, plus a royalty on net sales for eight years commencing January 1, 2016. The royalty is graduated for existing classic product, licensed product, or for new innovation, with a cumulative guaranteed minimum and maximum royalty over the eight-year royalty period. The transaction was completed using cash on hand.

Going forward, we estimate that Etch A Sketch and Doodle Sketch will generate approximately 9 million to $11 million of incremental gross product sales per year.

In both cases, the purchase price and return metrics were within the valuation target range that we described during the IPO road show of 3 to 7 times trailing EBITDA pre-synergies and a 20 percent plus IRR.

For 2016, Spin Master expects organic gross product sales growth to be towards the upper end of the Company's long-term target range of mid- to high-single digits. In terms of seasonality, we expect gross product sales for the first half of 2016 to be at the upper end of the 25 to 30 percent range of total sales that we have previously communicated as typical for Spin Master. Adjusted EBITDA margins are expected to be consistent with 2015.

I want to add a brief point on Cardinal for 2016. In 2016, we will have a full year of Cardinal versus only the fourth quarter in 2015, which will provide some modest acquisition-related growth in the first three quarters of 2016.

Overall, we expect Cardinal's North American business to grow in a manner consistent with Spin Master overall, and in 2016 we hope to begin to realize on potential revenue synergies associated with the expansion of Cardinal's business in the international market. The guidance provided above for gross product sales therefore represents a blended growth range for both Spin Master and Cardinal.

I'd now like to turn it over to Ben Gadbois. Ben?

Ben Gadbois — 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 for 2015.

The earlier shipment from Q4 into Q3, which Mark describer earlier and that we discussed in our Q3 called, ensured that retailers had higher line fill rates and remained in stock through the critical selling windows of November and December, which improved product sell through. This sets us up for a strong front half of 2016 as we refill customer inventories.

In addition, we held back on a significant proportion of our marketing this year to spend later in the fourth quarter in order to maximize impact on consumer purchases and maximize our return on investment.

POS response to our new fall campaigns were strong, and we had clean sell through on most items by the end of the year. We ended the year where we wanted to be.

In general, retailers were pleased with the year-over-year increase in POS across our portfolio. Let me walk you through some details.

Activities, Games & Puzzle and Fun Furniture was led by growth in Kinetic Sand and Marshmallow Furniture, as well as a number of new product lines, particularly Bunchems, our new activity construction toy.

Cardinal also contributed to the growth in this segment. We are pleased with the way we have integrated Cardinal into the Spin Master fold. We now have the number 2 market share position in the US game subsegment, and we are seeing lots of growth potential in Europe and internationally.

In Radio Control and Interactive Characters, although sales overall declined year over year in this business segment there were elements of strong success. Radio control was led by the launch of Air Hogs Star Wars products, the top item being the Air Hogs Millennium Falcon, which was one of the top items in the industry for Q4.

Zoomer products compared well in 2015 to the breakthrough year we had in 2014, with both Kitty and Zuppies showing strong success. This continues to demonstrate children engage many of the interactive character category. Zoomer remains a very strong brand, and we are working on a lot of exciting innovation in this category for the next few years.

In Boy Action and High-Tech Construction, Meccanoid was slow in Q3, but finished 2015 very well. Higher price points in the industry in 2015 sold later than 2014, and we had a strong November/December as we ramped up our marketing activities in Q4.

Consumer reaction to the item was excellent. The Meccanoid was the number 1 item in the US building set category in Q4 2015. The Meccanoid reflects the relaunch of the Meccano brand globally, positioning the product line in the engineering/robotic segment.

Early on we realized that the price point was too high to get it to the maximum amount of consumers. So in Q4 we moved the price point down in partnership with our retail customers to ensure we achieved successful sell through and consumer engagement.

We will launch Version 2 of the Meccanoid later in 2016 with a lower retail price point, driven by design enhancement and cost reduction in our supply chain.

Our Yoda robotic item was a disappointment. It was a great product and succeeded as a collector item. However, it did not resonate well with the mass market at its price point. In partnership with retailers we discounted it to accelerate sell through.

Our Pre-School and Girls segment continues to be led by PAW Patrol, which is maintaining and accelerating its consumer engagement and POS performance. In the US, PAW Patrol as a property was ranked number 1 in the pre-school segment compared to number 7 in 2014. The basic vehicle with pups was the number 1 item in pre-school and number 4 in all toy categories. Our new Chubbie Puppies brand also did very well and look promising for 2016.

I would also like to review a few other operational highlights in the context of our four key growth strategies, which are and remain to continue to innovate the core; create successful entertainment properties; grow our international business; and identify and execute acquisitions.

Our first growth strategy, to continue to innovate the core, relies on our ability to consistently infuse innovation into our portfolio of brands and products. Our internal 36-month brand innovation process continues to facilitate the product development that is the foundation of a sustainable and profitable business.

As I have just described, core brands are performing well. Our team is already hard at work on the 2017, 2018, and 2019 innovation pipeline, and we have a lot of exciting innovation in the works already.

Our second growth strategy is 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. Excluding Cardinal, our international sales increased to 30.5 percent of our total sales in 2015, reflecting our ability to leverage our global platform.

We continue to experience robust growth in Europe, with year-over-year gross product sales ahead by over 35 percent in 2015. We are experiencing strong performance in Italy, Germany, France, UK, and other European markets as we increase the number of channels and doors in these territories.

Our credibility with retailers has increased, and our brands are continuing to resonate with consumers as we improve our local marketing execution.

The rest of the world grew at over 21 percent year over year. North America grew at over 12 percent, substantially higher than the US industry growth rate of 7 percent.

Overall, we're making solid progress toward our goal of growing our international sales to 35, 40 percent of our total sales in the next few years.

Third, we continue to develop evergreen global entertainment properties. Our entertainment group plans to launch one to two new properties every year, and we are actively working on new shows for this year, 2017, and beyond, integrated with our toy lines. We will 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.

We continued to have success in building our entertainment franchises. Season 3 of PAW Patrol launched on air in late 2015, and season 4 is in production. PAW Patrol continues to generate high ratings, crosses many cultural boundaries, and has strong support from our partners globally.

In addition, Rusty Rivets season 1 is in production and is expected to launch in the summer of 2016. Little Charmers launched earlier in 2015. Little Charmers products did not perform at retail in the US at the level we had expected; however, the show and the product line remain strong in Canada, and is being launched in Europe in 2016.

We also have a number of other exciting properties in earlier stage of development, which we will review in the future, including Abby Hatcher Monster Catcher for 2017, and the relaunch of Bakugan.

Fourth, we intend to further leverage our global platform through strategic acquisitions. We're looking for opportunities to acquire brands, infuse these newly acquired brands with our innovation capabilities, and drive growth in our sales and margin by leveraging our global infrastructure. We are actively engaged in building our pipeline of future acquisitions.

As Mark indicated, we closed the Cardinal acquisition on October 2nd. We hit the ground running, and the integrating is going smoothly.

Subsequent to year-end, as Mark advised earlier, we announced two other strategic acquisitions. First, we acquired the library of board games owned by Editrice Giochi, one of the oldest privately held toy companies in Italy, with a rich legacy in the games category. The sale includes the historic EG brand, which has stood for quality game products in the Italian market for more than 70 years.

This acquisition enables Spin Master to expand its award-winning selections of games and licensed products in the Italian market with such well-known games as Risiko, Italy's most popular strategic game, and Scarabeo, the leading word game in Italy.

The EG brand complements Spin Master's recent acquisition of Cardinal. We intend to use EG's strong brand recognition and deep channel access in Italy to further grow both Spin Master's and Cardinal's game portfolio in the region.

Second, we acquired the Etch A Sketch and Doodle Sketch brands from The Ohio Art Company. We view Etch A Sketch and Doddle Sketch as iconic brands ideally positioned for value-added initiatives developed through our proven innovation model.

This acquisition allows us to create an arts and crafts umbrella within our Activities, Games & Puzzles business segment by developing and distributing new products under both brands. We see the potential to use the Etch A Sketch name as an umbrella brand to enter children's stationary. We also plan to increase the distribution of Etch A Sketch and Doodle Sketch by leveraging our global sales and partnership network.

Turning now to our prospects for 2016. We have just come out of our key period for annual toy shows in Hong Kong, Nuremburg, and New York, and we had very positive reactions to our 2016 product line.

In Activities, Games & Puzzles and Fun Furniture we will see strong growth driven by Cardinal, Bunchems, Pottery Cool, and Kinetic Foam. In Remote Control and Interactive Characters, we expect growth driven by a number of new Air Hogs products, and we are optimistic about the innovation in the Zoomer line, such as the Chimp, Paw Patrol Mashall, and the introduction of Hatchimal.

In Boys Action and High-Tech Construction, Meccano will be launching the Meccanoid 2, the Meccasaur, Micronoids, together with Star Wars BB-8, and toys with two new licensed properties: Secret Life of Pets and Angry Birds.

Keep in mind, however, that while we expect volume growth in this segment, our average price point will decline relative to 2015.

In Pre-school and Girls, we expect growth to be driven by Brightlings, Popples, Chubby Puppies, and PAW Patrol. We will also launch toys based on Powerpuff Girls and Masha and the Bear.

The toy industry is continuing to show growth across the globe, driven by an explosion in content, higher price point, and online growth. Our 2015 performance was very encouraging, and we are anticipating further growth in 2016 and beyond.

Our four key growth strategies have delivered strong results, are the right ones for Spin Master, and will continue to create new growth opportunities as we move forward.

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

Q&A

Operator

Certainly. At this time, I would like to remind everyone if you would like to ask a question, please *, 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

Thanks. Maybe just a question on licensed toys; can you talk about when you expect the majority of those licensed toys in 2016 to come online? Would it be in H2? Or is there some expected in the first half? And can you maybe remind us which of these licences for the TV shows are master toy licences?

Ben Gadbois

The master toy licence, we have The Secret Life of Pets, as well as Angry Birds. We also have Powerpuff Girls. And then we will also have licensed in the first half we will have Batman vs Superman, which we have some RC products. If you guys haven't checked out our new Batmobile, you should all go buy it this weekend. It's incredible.

And in the back half we will have other brands that will—licences that will come on, but we also have Popples right now in the market, which is doing fairly well.

Mark Segal

Star Trek as well.

Ben Gadbois

Yeah. That's true, Star Trek.

Sabahat Khan

All right. And just in terms of what you're seeing in the market, can you maybe comment on what your retail partners are saying in terms of the sell-through in both Europe versus North America? Are you seeing any impact from the overall economy; if you could just comment on that?

Ben Gadbois

Yeah. Overall for us—I can't comment for necessarily the industry as a whole to our competitors, but for Spin Master we work very closely with the retailers on our ship-in, and we're very, very focused on our POS and sell through, and we'll work very closely with our retailers.

So overall I would say that 2015 was a very good year for Spin Master in terms of where our inventories ended. And we continuously make improvement, and we continuously work closer and closer in our—the whole supply chain with our retailers to maximize the sell-through.

Sabahat Khan

Okay. And just one last one on the Construction segment; you said to expect volume growth, but lower price points. Is that largely because of the lower price on the Meccanoid? Or is there other products as well?

Ben Gadbois

Yeah. So in 2015, it was really the relaunch of Meccano where we launched Meccano tech with the Meccanoid, and the item has done incredibly well for us. And we’re very pleased with what it’s done for the brand. And we really, really want the kids to experience the brand. And what we also found out is that the Meccanoid was at, as you know, a much higher price point in the high 100 and the bigger one closer to the $400 originally.

So we want to make sure that we also allow a kid that maybe don't or can't spend $200, $150, access to the Meccano tech new product line, so we're launching a product called Micronoids that in the US will retail—will have an MSRP of $40, which will allow easier access into the brand. We're also launching the Meccasaur, which will be a dinosaur that will be approximately $99.

And furthermore, what we've been able to do because we've had such great feedback on the Meccanoid that we've also redesigned the product so that not only we only have more memories, more tricks into Version 2, but we've been able to work with from a design standpoint and our partners into bringing the price point down so that we can make sure that really the Meccano tech is accessible by all.

And we've also redesigned the core, and you will see that launch; new packaging; we will have a new licence this year with the Meccano brand with Ferrari; Lamborghini; Boeing; Ducati, which will be a lower price point as well.

Sabahat Khan

All right. Thank you.

Operator

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

Adam Shine — National Bank Financial

Hi. Good afternoon. Maybe a question for Ben; Ben, notwithstanding the comment on lower pricing for some of the high-tech construction products, when we look at some of the products on offer at Toy Fair, particularly the expanding Air Hogs line with a lot of these interesting licences, are we not likely to see your average selling price skew a bit higher in 2016? Am I wrong in that regard? And is there any particular strategy as the Air Hogs, in particular, and maybe Meccano ultimately going forward after 2016 as those product lines expand maybe talk to your pricing strategy into ’16 and beyond?

Ben Gadbois

Yeah. I think if you look at the Air Hogs category—and, Ronnen, I will also let you comment—but I think when you look at the 2016 offering, we have some incredible innovation that goes to over $100. So for example, we have the Air Hogs Star Trek Enterprise, so it will be the first time that you will be able to buy Star Trek Enterprise and fly it, and that will be over $100.

We also will have an Air Hogs Millennium Falcon extra-large that will be at the upper end of 200. So those are really the special more expensive items. But we’re also moving the technology forward with Air Hogs Connect, which was really successful at the CES show in Las Vegas, which is really a breakthrough in the flying, so it is a—so you’re flying a drone with augmented reality in a game that you play on a tablet.

With that said, we want to make sure that we continuously push the technology forward, but we don't want to forget to the lower price point, where a lot of the industry has done. So we continuously also make sure that we can innovate with a great price point feature and great innovation at the lower price point so that everyone can actually enjoy the Air Hogs brand and pick and choose what they prefer.

Ronnen Harary

Yeah. I think, Adam, if I can just add to that. I think there's an interesting dynamic happening in the marketplace where you have brands like Meccano, which really stand for STEM and stand for engineering. And we're seeing the ability to capture both the high end of the marketplace from a price point perspective and the lower price points.

And what you're seeing in the marketplace is that you have this incredible appetite by parents who when there's something that's educational-based or there's something where they can—parents can actually engage with their kids for more than five minutes—and I'm talking about like half an hour or two hours, or if I'm putting together a Meccanoid it could take me 10 hours, but you don't want to build it with me—I think there's a strong pull for families to spend quality time together. And if there's $100 price point for something and they can spend hours, they see the value there. So that's driving things up.

There's also an older age segment of consumers who love toys and grew up on toys, and want to play with them themselves. And so that's why we're pushing some of the price points up with the Air Hogs product line. But that being said, the core bread and butter of the business is that 24.99, 19.99, 29.99, and 39.99. And so we're filling those in the various brands, so that's why you see things like Micronoids in theory strategic.

We started out with the high points with Meccanoid. We wanted to establish ourselves with a halo item, we wanted to establish ourselves as a robotic STEM system, and then we wanted to bring that available to the younger kids and the younger marketplace at lower accessible price points.

So you'll continue to see that strategy play out with Spin Master over the next years the higher price point and the lower price points.

Adam Shine

Great. Thanks.

Mark Segal

And I just wanted to add on to the point about licensing. It's a good segue into a comment I was hoping to make, and that is that we did see selling expenses tick up a little bit in 2015. And our licensed content as a proportion of the total was a little bit higher, and going forward in '16 we see that as well.

So historically I've guided you towards around 5 percent of sales for our selling expenses. Just given the number of licences we have in '16, that will probably increase to around 6, 6.5 percent.

Adam Shine

Great. Thank you for that, and maybe I'll just follow up with a quick obvious question. The percent of gross product sales ultimately for PAW Patrol in 2015, and as a final follow-up, acknowledging a related push for PAW Patrol internationally, but on the other hand the diversity of your 2016 offering, does PAW Patrol ultimately go below 20 percent in 2016? Thanks.

Mark Segal

So in 2015 PAW Patrol actually exceeded 25 percent of our sales. At the time of our Q3 call I said to you that we expected PAW Patrol to come down as much as 28 percent in Q3. We expected it to come down to 20 percent approximately by the end of the year.

In fact, what we saw in Q4 was significant strength in PAW Patrol globally. And we shipped a little bit more than we expected in 2015 to keep the momentum and the health of the brand going. For 2016, we still see PAW Patrol growing strongly and probably remaining at similar levels in terms of the total percentage of gross product sales for '16.

However, I will say, and as Ronnen and Ben both described, there are a number of very significant new lines coming into Pre-School and Girls area that we're pretty excited about, which could represent some upside in terms of Popples and some of the other, Powerpuff Girls and Masha and the Bear and other areas of Pre-School and Girls that we think will continue to grow that area outside of PAW Patrol.

Adam Shine

Great. Thank you for that.

Operator

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

Garrett Johnson — BMO Capital Markets

Hey. Good afternoon. Hey, Mark, I just wanted to ask you something about something you just said. In the quarter, marketing spend was up a lot, 24 million or 680 basis points as a percent of sales. And were you saying that royalties were the reason why that was higher? Or did I get that wrong?

Mark Segal

No. No. That was a separate point, Garrett. Thanks. So in Q4 our marketing spend was higher than in Q4 2014. In fact, we actually guided you to that point in Q3 when we had the call. We actually deliberately and strategically shipped a tonne of our marketing spend into Q4 to get us closer to the time when customers were in retail stores, and we wanted to maximize our return on investment by doing so, which actually worked quite well.

For the year as whole marketing spend was very much in line with 2014. It was simply a shift from Q3 into Q4. And marketing spend remains at around 10 percent of sales.

The point I made on selling expenses was that trademark royalties, which are part of the selling expense line, will tick up a little bit in 2016 to around 6 to 6.5 percent of sales from around 5 percent in 2014—sorry, 5 percent in 2014, 6 percent in 2015, and then it'll tick up a little bit in 2016. Does that...

Garrett Johnson

Okay.

Mark Segal

Clarify?

Garrett Johnson

Yeah. Yeah. It does. But then I want to get back on to the marketing spend. You said it's pushing out to the fourth quarter, but that kind of doesn't jive with the shipments arriving earlier at retail. Wouldn't you want to drive some point of sale with those early shipments? And shouldn't it have been more level-loaded then? I'm just confused at how the marketing flows more in the fourth quarter, but you're products are shifting more to the third.

Ben Gadbois

Yeah. Garrett, a lot of it actually was a matter of two or three weeks' difference. So it did not necessarily allow us to move our marketing plan forward. So it was literally by the time the goods would get at the retails shelves and by the time the products were set and ready to go and in stock on the floor then it would literally—then it would shift from Q3 to Q4. So we're not talking about moving everything three months forward. It was literally a matter of a few weeks.

Garrett Johnson

Okay. That makes sense. All right. And then on allowances, those were down year over year. Can you go through the puts and takes there? How were you able to drive lower sales allowances, especially with some discounting on things like Yoda and bringing Meccanoid down a couple hundred bucks? Thanks.

Mark Segal

Sure. Sure. Good question. Sales allowances for 2015 were 12.4 percent compared to 12.9 percent.

Garrett Johnson

I'm talking the quarter; the quarter, Mark.

Mark Segal

In the quarter? Well, the reality is, though, Garrett, is the answer is really the same. I mean Cardinal was a component of that. Cardinal sells—and Cardinal sells at kind of a lower allowance structure than our typical structure, so there's an element of Cardinal bringing the average down a little bit.

We managed our allowances very tightly as well not only in the quarter, but also in the year. And so we were very focused on making sure that any allowance we spent drove the maximum ROI, and we were very pleased with our results in that regard.

The final element of the sales allowance reduction, Garrett, was also the fact that there was an international mix. And as we drove international sales our sales allowance structures internationally are typically less than North America.

And so it was the combination of those three.

Garrett Johnson

Okay. Okay. That makes sense too. And then I have a few more here while we're going. Ben, you talked quite positively about Zoomer is up even as (phon) off-shoots, but the RC category was down 50 percent in the quarter. So if Zoomer was fine and it was strong, what was the reason for the decline there?

Ben Gadbois

Well, I think, Garrett, if you go back into 2014 and Zoomer Dino was the Toy of the Year, so it was incredibly strong. And then when you look at 2015, the Zoomer Kitty did well, Zoomer Zuppy did well, so everything did really well. The brand remains very strong; the engagement is very high, but we were not able in the Zoomer brand to top off the 2014 Zoomer Dino sales level, again, given it was the Toy of the Year.

And with that said, we're continuously innovating in the Zoomer brand for this year, and '16 we will be launching a Zoomer Chimp. We will have a Zoomer PAW Patrol Marshall. We're doing Zoomer Meowzies, Zoomer Hedgiez, so we're continuously innovating the Zoomer brand.

It is a very nice business for us. It continues to have global relevance, and it's just that between '14 and '15, '14 was such a breakout year for us that we just did not comp it.

Garrett Johnson

Okay. All right. Thank you for answering all my questions. I do have more, but I'll get back in queue. Thanks.

Operator

Your next question comes from the line of Jeffrey Balkind, a private investor. Your line is open.

Jeffrey Balkind — Private Investor

Hello. I'm calling from Washington, DC. My best regards to Anton Rabie. Has the Company experienced any production difficulties coming out of China and has all the distribution chain? Thank you.

Mark Segal

Yeah. I can answer this. So our supply chain is very stable. Our strategy continues to remain to diversify our global footprint in terms of our supply chain, but we have not experienced any disruption in our supply chain in 2015, and we're currently not seeing anything either.

Jeffrey Balkind

Thank you very much.

Operator

Your next question comes from John Taylor from Arcadia. Your line is open.

John Taylor — Arcadia

Hi. I got a number of questions too. Let me take a stab at a couple of them. Earlier somebody asked I think about point of sale trends at retail so far this year. I wonder if—and you guys answered about sort of about being a line between shipment and sell through kind of thing with your retail partners, but could an you give us a little sense of kind of what you're hearing from retail so far this year pre-Easter?

Ben Gadbois

Yeah. I think our retailers overall—and I'm going to speak from North America first and maybe then from a global standpoint—is that typically just answering your first part of your question, the price points are normally lower in the front half than the second half. The higher price point item normally sells at higher volume in the back half of the year, and this is also where most higher price point items are introduced, okay? So with that said, the price point in the front half will normally tend to be a little bit lower.

As far as what the retailers are seeing and when we look at the POS overall, the year started positively. I think the retailers are overall feeling confident about this year, so the expectation is that the industry will not shrink this year. So everybody is bullish and they're making some strong plans for not just the spring that obviously is being executing now, but also for the fall.

And as far as internationally, I just spent a week in Europe a couple weeks ago, and the feedback we're getting from all of our countries in Europe is that Europe is also feeling strong about 2016 for the—the retailers are feeling very positive for 2016.

John Taylor

Mm-hmm. Okay. Good. All right. And then, Mark, I don't know if you talk about this or not, but do you have kind of a back of the envelope goal of the revenue mix between licence product and product you own?

Mark Segal

So, John, we discussed this during the road show. Typically if you look at the toy industry—and you would know this—the toy industry really is—sorry, the licence product components of the toy industry is around 26 percent.

John Taylor

Mm-hmm.

Mark Segal

We typically have been a little bit below that, but for 2016 we'll likely be at or close to that split. And that's why we've seen a little bit of a tick-up in our trademark royalties, but we're in that same ballpark as the industry as a whole, John.

John Taylor

Okay. Great. And then as you move more into IT creation, I assume you're participating in the programming cost, the cost to build out the programs and whatnot. So can you talk a little bit about what your budget trend looks like for that? How much of that might have been in ’15, and kind of on a go-forward basis whether that's ramping or stabilized; where you are in that process?

Mark Segal

Okay. So as we had disclosed previously, our goal is develop around one to two shows per year. And really the way it works, John, is that we actually—we spend around 10 million to $15 million per season, and then we capitalize that. And then as we deliver the shows we amortize that, and that goes through our CapEx line.

Now our CapEx for 2015 was around 4 percent. And we see that staying consistent; maybe ticking up a little bit for 2016 somewhere around 4 percent of sales.

John Taylor

Okay. Great. Yeah. I'm sorry, I didn't attend your road show, so I missed some of these things.

Mark Segal

It’s all right.

John Taylor

Let's see, rest of the world. What are the main countries in there? And are there any particular drivers or brands or regions that are pushing that number?

Ben Gadbois

Okay. So our key offices in Europe would be UK, France, Benelux, Germany, and Italy. We also have an office in Mexico where we do most of our selling, and then for several others we use third-party distributors.

And as far as what is working is I'm going to step back a little bit and explain why we're seeing the kind of growth we're seeing, especially in Europe, is that what we've done a couple years back is that we've really stepped back and looked at how we could grow internationally. So we're now internally from the start of our process we design product with global mindset, okay?

John Taylor

Mm-hmm.

Ben Gadbois

We restructured our offices in Europe two, three years ago. We invested and developed some great people. We've implemented stricter process and discipline, and we're now working on increasing the numbers of doors, as well as stepping up our local execution of marketing.

John Taylor

Mm-hmm.

Ben Gadbois

And when you put all of this together it's creating an incredible equation for us where our product portfolio is very much global now as a company, and it's resonating very well in pretty much all part of the world because we're making sure that we're bringing in our global offices and all of our global market at the table for discussion as we design the products.

John Taylor

Mm-hmm. Okay. Okay. Good. So I think you just mentioned a lot of the European offices. So in terms of the rest of the world, non-North America, non-Europe, are there any sort of big baskets there…

Ben Gadbois

So…

John Taylor

Drivers, brands, whatever?

Mark Segal

So, John, the categorization of the rest of the world is really Mexico plus all other countries, which exclude our own subsidiaries in Europe.

John Taylor

Mm-hmm.

Mark Segal

So rest of the world is Mexico and the rest of the world. And then Ben mentioned the 9 or 10 offices that we have in Europe…

John Taylor

Right.

Mark Segal

Which are really subsidiaries of ours which comprise the definition of Europe.

John Taylor

Right. Okay. Good. Okay. Thank you much.

Mark Segal

Okay. Good.

Operator

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

Brian Morrison — TD Securities

Hey. Good afternoon. Mark, if I could just follow up quickly on the PAW Patrol commentary over 25 percent. I understand it's going to remain constant in 2016. Do you know or do you have available what the 2014 contribution was?

Mark Segal

2014 was relatively early on in the launch cycle of PAW Patrol, Brian. It was less than 10 percent.

Brian Morrison

Okay. And then higher level, when I take a look at your 2016 guidance you state EBITDA margins are going to remain consistent for the year. I think during the IPO process we talked about over the much longer term you were looking at 19 to 20 percent. Clearly you've exceeded expectations; already over 18. What's the next step to drive this leverage? Is it simply economies of scale or is it product mix shift to get you up to that more mature 19 to 20 percent level?

Mark Segal

So, Brian, I think there's a number of levers that we see in terms of continuing to grow margins. We did actually say during the road show for 2015 we were at—sorry, 2014, we were at 15.6 percent, and for '15 we jumped pretty quickly to 18.2 percent. So we really did scale relatively quickly. And so that's why our guidance, I think, is a little conservative in the sense that we need to pause and make sure that these gains are sustainable.

The bottom line is that there's four levers. One is we're going to continue to change the mix towards owned IP; we are going to continue to drive licensing and merchandising income; we're going to continue to focus on operating leverage and maintaining a strong cost structure; and then fourth, we're going to continue with a number of productivity initiatives around value engineering, volume rebates, and strategic sourcing.

So through all of that we still believe that we have a target to get above 18 and go towards 19 and 20, but we really feel that for 2016 we have to absorb the gains that we've made and solidify it.

Ben?

Brian Morrison

Yeah. That's excellent. Thank you for that. And last question I have, so if I look at the international front, obviously there's a big opportunity there. I just want to understand the difference between—and maybe this is for Ben—but can you talk about the difference between the distribution channels, specifically North America versus Europe, because I presume that's where the greatest opportunity is? And then lastly your commentary with respect to the 35 to 40 percent target on international revenues; I presume that that's all organically driven? That does not include any potential acquisitions in there?

Ben Gadbois

Yeah. That's correct, Brian. Let me take the first piece of your question is in terms of how the market is made up in Europe versus North America is in North America if you look at the mass channel being the Wal-Mart, Target, and Toys "R" Us, they make a substantial portion of the market. And in most European markets the market is much more fragmented. So this is the biggest fundamental difference is the markets are just much more fragmented.

So what that means is that in the US if you focus in North America and you sign up Wal-Mart, you get a lot of doors. And most of those markets in Europe, as you know, the countries are smaller and much more fragmented, so you really, really have to work harder to just keep signing up new customers, and it takes years of doing this. And this is what we've embarked on now. And this is why we've actually restructured our offices in Europe so that we can actually execute that with high efficiencies.

Brian Morrison

Okay. So back to my previous question then. Is that additional—because, Mark, you answered that excellent; I understand the four components in terms of taking your margin higher—is that potentially putting pressure or keeping it constant this year because of the additional cost to open up the European market more so?

Ben Gadbois

No. All of these—the greatest thing, Brian, for us is that all of these offices are open right now; the infrastructure is in place. So the only incremental cost—almost the only incremental cost that we have as we grow these offices is really the cost of our marketing, which is our marketing expenses, which is variable. So everything else we're leveraging what is already in place, which is why we—from a profitability standpoint Europe has a very nice profile for us because we're at the point where we're getting incredible leverage out of these offices.

Brian Morrison

So it's a similar geographic margin profiles then?

Mark Segal

Yes. As we discussed earlier during the road show, Brian, we don't see a difference in margins around the world. The primary difference in margins relates to when we don't have our own offices versus a third-party distribution relationship; that's when we have a slight dilution in margins. But we're actually going the other way now. We're growing through our own offices primarily, and so the margin structure is consistent.

And as Ben said, because we already have these offices in place we're going to get significant operating leverage as a result of that.

Brian Morrison

Thank you very much.

Mark Segal

I think we have time for one more question, Sally.

Operator

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

Garrett Johnson

Hello again. Okay. One more, gross margin; maybe you could discuss the puts and takes there what helped drive it higher? What dragged it down? Thanks.

Mark Segal

Are you talking for the year, Garrett?

Garrett Johnson

No. I'm always talking quarter. Thank you.

Mark Segal

Okay. So I think the primary drivers really were product mix where we actually had a larger shift towards owned IP, and that actually helps us in terms of gross margin. It also helps in terms of licensing and merchandising income that arises from that.

So if you look at the licensing and merchandising income line you saw that increased quite significantly in the quarter ’15 versus ’14. And so the combination of product mix, owned IP, and then also we talked about earlier improved sales allowance performance, those three items were the primary drivers of margin increases in the quarter.

Garrett Johnson

Okay. And how are costs out of China these days? Stable? Or still...

Mark Segal

Sorry?

Garrett Johnson

Costs out of China?

Ben Gadbois

Costs out of China? The labour, as you know, if you’re in Southeast Asia, Garrett, the labour keeps going up. But we’ve been successful in mitigating these costs with two key strategies. One is we’re diversifying outside of Southeast China into Mexico, Northern China, and nearby countries such as Vietnam.

And we also have a lot of—we have internally we've implemented over the last couple years an operational excellence program in the Company where we spend a lot of time with our vendors doing some VA/VE engineering. We design our product for efficiencies. We spend time on the floor with our vendors.

So we have a lot of programs where we eliminate with them the non-value-add activities. So overall we're able to not only protect our costs, but also eliminate some cost in the value chain.

Mark Segal

Okay. So at this...

Operator

And that...

Mark Segal

Sally, go ahead. Go ahead.

Operator

There's no further questions at this time.

Mark Segal

Okay. Well, at that point we'll end the call. Thank you very much for your participation, and have a great long weekend, everyone.

Ronnen Harary

Thanks, guys.

Ben Gadbois

Thanks, everyone.

Operator

Thank you, ladies and gentlemen, for your participation. This concludes today's conference call. You may now disconnect.

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