FINAL TRANSCRIPT

Spin Master Corp.

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PRESENTATION

Operator

Good morning, afternoon, evening. My name is Cheryl and I will be your conference Operator today. At this time, I would like to welcome everyone to the Spit Master Third Quarter 2020 Earnings Conference Call. All lines have been placed on mute to prevent any background noise.

After the speaker's remarks, there will be a question and answer session. If you would like to ask a question during that time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, please press the pound key. Thank you.

Ms. Bisoukis, you may begin your conference.

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

Thank you, Cheryl. Good morning, everybody. Welcome to Spin Master's financial results conference call for the third quarter ended September 30, 2020. I'm joined this morning by Ronnen Harary, Spin Master's, Co-CEO and Mark Segal, Spin Master's, Chief Financial Officer. For your convenience, the press release, MD&A and unaudited interim consolidated financial statements for the third quarter 2020 are available on the Investor Relations section of our website 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, levels of activity, performance goals, or achievements or any other future events or development. Forward-looking statements are based on information currently available to management and on estimates and assumptions made based on factors that management believes that are appropriate and are 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 statements, whether because of new information, future events or otherwise.

For additional information on these assumptions and risks, please consult our cautionary statements regarding forward-looking information contained in the company's earnings release dated November 11, 2020. Please note that Spin Master reports in U.S. dollars and all dollar amounts to be expressed today are in U.S. currency. I would now like to turn the conference call over to Ronnen.

Ronnen Harary – Director, Co-Founder, and Co-Chief Executive Officer, Spin Master Corp.

Thanks, Sophia. Good morning, and thanks for joining us today. For Spin Master, 2020 has been about adapting to a shifting and evolving landscape. Over the past nine months, we have worked remarkably well to adapt to the various ways and stages of the pandemic, in order to continue to provide a magical place to kids around the world at a time when connecting with family has never been more important.

We've had to remain agile and flexible to best serve customers and consumers however they buy. We're monitoring the current COVID-19 situation closely as it continues to unfold. We're seeing some disruption in parts of Europe, such as France, UK, and Italy, but e-commerce channels and many brick and mortar retailers remain open currently.

In countries where our offices are open, the work from home protocol remains in place and office re-entry is voluntary. In countries where our offices are closed and employees are working from home, we will only open offices if we are able to meet the re-entry safety protocols mandated by local governments.

Overall, I'm exceptionally proud of our team's focus, adaptability, agility to execute our normal business and to simultaneously make significant progress against our goals for improving our operational performance. I believe we are in far better shape today than we were a year ago.

Let me highlight a few key areas of importance to you. We grew our gross product sales and revenues in the third quarter despite sales declines in two of our large business segments. Our POS performance and the momentum we are carrying in the critical fourth quarter continues to be strong for many of our key brands and holiday drivers. We launched several new product lines and line extensions that have met with positive response from customers and consumers. We reduced our SKU count by over 40 percent since the end of 2019. The total number of our DCs and warehouses from 18 to five ahead of our original schedule. We reduced our inventory 28 percent compared to last year while growing sales. We increased our sales for e-commerce channels by 65 percent. We continue to evolve our offering and strengthen our positioning as a diversified and fully integrated children's entertainment business.

To that end, we just concluded our virtual October Trade Show for fall 2021, which went very well. We quadrupled our digital games revenue in Q3 through the growth of our Toca Life World platform. We've launched our new franchise Mighty Express in Q3 and announced the launch of Bakugan Nintendo Switch video game. Finally, we announced the acquisition of Rubik's, one of the industry's most iconic brands.

I believe more than ever, our performance quarter demonstrates the power of a diversified portfolio of brands, entertainment franchises, and digital games, and the benefits of having sound balance sheet.

Our gross product sales were up about 1 percent in Q3, which exceeded our expectations. Parents are doing what they can to make sure their children are able to enjoy the holidays despite the pandemic, and we are experiencing that sentiment in our sales. The categories in the industry that are doing the best continues to be those that benefit from people spending time together, or from kids spending more time at home.

Over the summer Outdoor Toys also did well due to many organized outdoor activities like sports teams and camps being cancelled. According to NPD the toy categories that performed best this year are building sets, outdoor sport toys, and games and puzzles. We saw a strong demand for our home-based products from our activities games and puzzles and outdoor segments, both of which grew in the quarter. In addition to games and puzzles, the activity categories performed extremely well.

As we continue to see exceptional sales increase in Kinetic Sand with existing and new customers discovering the endless creative possibilities and sensory play that Kinetic Sand provides. With kids spending more time at home even in the summer, and parents being more flexible with screen time, we continue to see strong demand for our entertainment content and digital gaming in the quarter.

Our digital games revenue increased fourfold in Q3. This was driven primarily by the growth of our Toca Life World platform. This needs to be viewed from an industry perspective. Mobile device gaming is the fastest growing segment of the video game industry, and 67 percent of all games are now played on mobile devices. Within this, 94 percent of kids aged 2 to 12 play games on mobile devices. They are playing games, videoing themselves, and stream this to TikTok, Twitch, and YouTube for others to watch. We believe this is a major factor behind Toca Life World's growth.

For Toca Life World, we now have around 5 million daily active users, and over 17 million monthly active users, with over 42 million downloads since its launch. In total Toca Boca now has over 30 million monthly active users compared to 16 million last year. In addition, we also saw strong growth in our Sago Mini subscription business, where we now have nearly 220,000 subscribers across Sago Mini world, Sago Mini school, and Sago Mini box compared to just over 100,000 in Q3 last year.

We are now working very hard on our next digital game product launches, including a new Toca Boca box targeted at kids 5 to 9, and multiplayer game launching in Q4 2021 called Toca days, as well as continuing to grow our Sago Mini subscription business. In late June, the first episode of the new PAW Patrol theme Dino Rescue premiered on Nickelodeon. Retailers said it is one of our strongest themes to date for the PAW Patrol franchise.

Overall, Dino Rescue marked the number one show on television in Q3 amongst preschoolers. Excitement is building for our first feature film, and we remain on track to deliver the PAW Patrol movie in August ‘21 as planned.

During the quarter, we announced world-class voice talent for the movie, including Jimmy Kimmel, Kim Kardashian and Tyler Perry.

Our new preschool franchise Mighty Express launched on Netflix September 22. This was our first series launching directly on a streaming platform. This launch is another example of our ability to push the boundaries of quality children's entertainment. The Mighty Express toy line will launch in fall '21 following the global entertainment rollout.

We've seen strong early levels of awareness for Mighty Express and we have a solid start viewership with the show ranking in the top five U.S. children's shows for kids 2 to 5 in its first two weeks post-launch premiers and SVOD rankings. Secondary indicators are also moving in the right direction with organic viewership, watch time and completion rate growing, and outpacing all benchmarks at this stage.

We announced earlier that we secured the global master toy license for DreamWorks animation for the new animated preschool series, Gabby's Dollhouse, which debuts globally on Netflix this month. Beginning fall '21 we will bring the characters from the show to life through a new toy line that we will include toy sets, figures, flash games and puzzles. We also continue to build our presence as a toy partner for high profile brands.

This quarter we announced the multi-year agreement to become the global master toy license for Riot Games League of Legends franchise, which is the most played PC game globally. We'll develop a toy line with action figures, play sets, role-play items, which are anticipated to launch in fall '21 targeting an older collect of fan demographic. The global nature of this property is also attractive, potentially allowing us to further penetrate markets where we have previously been underrepresented, such as China where the franchise is very strong.

We continue to grow our franchises with multiple partners. On November 3, we launched Bakugan Champions of Vestroia, a new game developed for the Nintendo Switch Platform in conjunction with Warner brothers and WayForward.

I want to briefly update you on the progress we've made on our operational challenges we encountered last year and Mark will add more details later. We're already seeing the benefits of the remediation efforts we discussed in Q1 and Q2 and we are gaining strong momentum.

We have focused on consolidation, realignments and simplification while ensuring we remain sufficiently agile to respond to the evolving industry and retail environment. We have used the process of addressing our 2019 operational challenges to build a continuous improvement mindset, which has become embedded in our organization globally. We plan to continue to drive operational efficiencies in every area. We're doing deeper and more proactive planning for 2021, earlier and more detailed than ever before. We've also improved accountability over every line in the P&L in our building operating procedures to ensure that we manage more consistently globally.

Let me briefly review with you some of the changes in consumer behaviour we are currently seeing and how we are adapting our marketing.

Consumers have been more mission-focused in their shopping, looking to reduce the amount of time they spent shopping in stores. We believe retailers had this in mind when they started offering their black Friday discounts earlier and spread them out, so the consumers would not need to go into crowded shopping environments. Consumer spending had shifted earlier. We estimate around 20 percent of December POS will be pulled forward due to retailer price promotions, such as Amazon prime day in October and pull forward Black Friday deals from target Walmart to reduce and spread in-store foot traffic, as well as consumer concern around the supply of hot toys given the potential of COVID related industry, shipping delays may occur. We expect the shift to e-commerce to continue.

Q4 state is pacing above 30 percent of our POS. NPD is predicting online could represent as much as 45 percent to 50 percent of Q4 sales. Increase in screen time continue and content consumption continues to shift away from the linear TV towards SVOD gaming and YouTube. Recognizing that parents and grandparents are shopping with less kid influence near the purchase point, we've increased our investment against this audience with campaigns to help make purchase decisions compelling, simple, and easy.

We transformed our approach to marketing with digital at the core building extensive in-house capabilities that have helped us to optimize our plans in real time, guiding kids and shoppers through this year's new omni-channel journey. For our fall marketing plans, we've been spending less on linear TV and more on the mix of digital, including social influencer and e-commerce. For fall mix, will see us spending around 50 percent of our total budget on digital versus around 35 percent in 2019.

From welcoming new preschool parents to the PAW Patrol years with a viral video campaign and later encouraging them to convert to sale, and our new Present Pet lines to distributing hundreds of videos across YouTube and social, recreating the Monster Jam action with our innovative Megalodon RC, our fall plans are driving consistently stronger lifts in POS than last year, setting us up for strong self through for the season.

Just after the quarter, we announced that we had reached an agreement to acquire Rubik's Brands Limited, owner of the world's famous Rubik's Cube. The Rubik's Cube has sold more than 450 million units since its introduction in 1980. The Rubik's Cube is an iconic puzzle that has permeated pop culture and we are excited for the opportunity to put our innovation from the entire Rubik's portfolio and expand distribution through our global footprint.

We're always on the lookout for creative M&A opportunities that complement our clinic growth strategy, and we continue to apply a disciplined approach to assessing all opportunities. We're also increasingly focused on the entertainment and digital areas for M&A opportunities.

To conclude, we remain very confident in our ability to create magic for children globally through the strength of our diversified portfolio brands, entertainment franchises, and digital game offerings.

We are cautiously optimistic that at Q4 given our strong toy lineup, momentum in digital games, revenue, and consumption of our entertainment context. We are however mindful of the unknowns ahead of us, including the ever evolving COVID situation. Overall, our strategic direction, our solid financial foundation, and diverse geographic platform combined with the commitment of our global teams positions us to take advantage of the evolving opportunities and drive long-term success. I'll now turn over the call to Mark.

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

Thanks, Ronnen. We delivered a solid third quarter with meaningful progress on our operational improvement plan and stronger than expected revenue growth. We reduced our inventory carry over from 2019 and significantly improved our networking capital position further strengthening our balance sheet.

Revenue for Q3 was $571.6 million, up 4.3 percent from the same period last year and up 3.5 percent on a constant currency basis. Gross product sales rose by approximately 1 percent in the quarter to $587.4 million, which included favourable foreign exchange of $3.2 million. On a constant currency basis, gross product sales were slightly above last year.

On a geographic basis, Europe was our strongest region with gross product sales of $159.8 million, up 15.6 percent compared to last year. We saw growth across a large part of our product portfolio in Europe, but especially from PAW Patrol. The strength in Europe was offset by a 2.6 percent decline in North America to $362.4 million and a 10.8 percent decline in the rest of the world to $65.2 million.

International gross product sales represented approximately 38 percent of total gross product sales, up from 36 percent in 2019. The relative strength in Europe offset by the decline in North America drove this increase.

From a channel perspective, we are seeing a sizeable shift to e-commerce. Year to date e-com POS has grown 65 percent in the U.S. As a result of the shift, e-commerce now is quite still around 30 percent of our POS, up from 25 percent in Q2. The trend we expect to continue into Q4. We believe we are growing e-commerce at a faster rate than many of our competitors. The activities, games and puzzles, and plus segment was up 13.2 percent in the quarter to $172.5 million, a trend that has been consistent all year. According to NPD the U.S. games and puzzles market was up 42 percent year to date and 31 percent during Q3. We have benefited from this trend this year which strengthened our Cardinal games and puzzles portfolio. The acquisition of Rubik's for $50 million will mark our 12th acquisition since our IPO in 2015, and Rubik's will fall into the games and puzzles category. The transaction is expected to close January 4, 2021.

In activities, we continue to see exceptional growth in Kinetic Sand which almost doubled in Q3 over last year. Flush which comprises Gund, continues to be negatively affected by specialty channel closures related to COVID in the U.S. Despite the decline in Flush, the segment is up 17.1 percent year to date.

The remote control and interactive character segment was down 24.5 percent to $88.6 million driven by lower sales of (inaudible) and Hatchimals, partially offset by Monster Jam RC, and Air Hogs Stunt Shot. The decline of Hatchimals was in line with our plans, and while the impact of the decline has diminished significantly, it's still a drag on the segment.

Monster Jam, again performed exceptionally during the quarter with over 50 percent growth compared to the prior year. Despite the cancellations of many live Monster Jam shows in Q3 due to the pandemic, the brand continues to show strength propelled by innovation with Megalodon Storm, as well as the Monster Jam Transforming Hauler, which is expected to sell out in the U.S. Encouragingly, Feld entertainment, our Monster Jam partner has recently relaunched live Monster Jam events in the U.S. Year to date the segment is down 26.3 percent.

In our Boys' Action and Construction segment, gross product sales were up 27.5 percent to $131.6 million driven by strong performance of DC license products and the just launched Present Pets line, which more than offset the declines in DreamWorks Dragons and Bakugan. Our Batman toy sales are well ahead of those of the previous license program, despite this being a non-movie year.

Although we saw Bakugan shipments decline in the third quarter, Bakugan has seen a very strong lift in POS following the launch of the new season on Netflix, which dropped on October 1, and the launch of the new TV item also in early October. Bakugan is now currently seeing a highest POS total so far in 2020, up 30 percent from the levels it was there prior to the Netflix launch. Year to date, the segment continues to show growth up 8.6 percent.

Gross product sales in preschool and girls declined by 10.6 percent to $182.4 million in Q3. The decline was largely due to PAW Patrol and was attributable to a year-over-year decline in poor shipments in the U.S. PAW Patrol sales in Europe and the rest of the world showed strong growth in Q3. The new Dino theme continues to be very strong globally, and retailers increased Q4 orders once they got POS (inaudible) for August and September. We expect the strength to continue in October and November shipments.

Other products in the segment that declined include Twisty Petz, Candylocks, and Awesome Blossoms, partially offset by Pre Cool. Year-to-date, the segment is down 13.9 percent. Gross product sales in our outdoor segment, which comprises Swimways and aerobics (phon) nearly doubled rising by 92.2 percent at $12.3 million, driven by Swimways which benefited from favourable weather and the desire to go to pools and beaches after so many months at home. Year to date, the segment is up 5.2 percent.

Let's now look more closely at POS. According to NPD, the global toy industry grew 15 percent for the June to September post lockdown period. Our global POS was up 20 percent for that same period. In the U.S. our POS for Q3 rose 17 percent compared with an increase of 21 percent for the industry. We believe a big factor in this gap is the strength of categories in which Spin Master does not have a significant presence, such as building sets and construction or science and exploration toys, which were up well over 30 percent in U.S. POS. Excluding these categories, industry POS in the U.S. was up just under 19 percent.

We saw an overall strong rebound in our European POS, especially in France, UK, and Germany driven by growth in PAW Patrol, Bakugan and other core brands. Looking at the first nine months of the year according to NPD, POS for the global toy industry was up approximately 12 percent and our POS was up 14 percent.

Our POS was particularly strong in Europe year to date, approximately three times the market POS growth rate. In the U.S. our year-to-date POS was up 16 percent compared to 19 percent for the industry. Again, we believe the outside strength and outdoor play sets and construction was a big factor. In fact, if you only look at categories in which Spin Master has at least $1 million in sales year-to-date, our year-to-date POS is up 18 percent compared to 12 percent for the industry. We believe that we are outperforming the industry in the categories where we compete.

Among our brands, we have many showing triple digits and high double-digit year-to-date POS increases, including Kinetic Sand, Games, and Monster Jam RC. I want to share some more details on PAW Patrol POS. PAW experienced a decline during the first half of 2020, as we entered the year with heavy retail inventory, and took until mid-summer to get it down to a healthy position due to the COVID-driven reduction in birthday parties and other events. We've since seen strong POS performance.

Globally, Q3 PAW Patrol POS was up 18 percent. In the U.S., Q3 PAW Patrol POS was up 10 percent. This is driven by the Dino Rescue Theme and related new fall items such as the Dino Patroller and the Adventure Bay Playset. Also, in the U.S., in September 2019, we shipped our exclusive feature supported by dedicated entertainment content. This annual PAW event shipped later in September this year, resulting in most of the POA shifting to Q4 from Q3.

Q3 year-to-date global PAW Patrol POS is up 7 percent. Year-to-date Q3 PAW Patrol in the U.S. has led, but all other major markets are positive and the U.S. trend is positive in Q4. The brand is currently strong due to fresh product, the strong theme, and content exposure, while retail inventory is down 18 percent compared to the same time last year. Increased marketing support through the fourth quarter will continue to boost PAW Patrol, and we expect PAW Patrol to finish the year up in POS for 2019, both in the U.S. and globally.

I also want to briefly mention a few highlights from our incredible fall toy lineup. POS has been strong on most of our key new items we have brought to market, and is approximately 15 percent better than the last few years. These items include our Monster Jam Megalodon Storm and RC Truck for both Land and Water; the latest Hatchimals iteration called Crystal Flyers, which is a Hatchimals Pixie that can be flown and controlled with one hand; the Air Hogs Stunt Shot and Present Pets, puppies that unbox themselves.

To conclude, on POS from a fourth quarter perspective, while industry POS remain strong, retailers have continued to be cautious when replenishing inventory, resulting in POS exceeding shipments and retail inventory levels being drawn down. We expect POS to continue to exceed shipments in the fourth quarter due to retailer caution around COVID. Over time, the sell-in, sell-through relationship will balance out.

We see opportunities for this to occur in H1 2021. Turning back to the P&L, sales allowances in the third quarter were 10.9 percent of gross product sales. This is up slightly from 10.6 percent last year, mostly due to the shift in sales from North America to Europe, which has a higher sales allowance environment.

On a year-to-date basis, sales allowances are 11.7 percent. We have seen our sales allowances normalize in tandem with our operational performance improvements and we continue to expect to end the year in this range. We are encouraged by the strong performance of other revenue, which primarily consists of licensing and merchandising world peace (phon), television distribution revenue, and digital games revenue, which rose by over 80 percent in Q3 to $48.3 million. The main driver of the increase was digital games revenue, which more than quadrupled in the quarter compared to last year. Most of this growth was driven by the Toca Life World platform, where we saw very strong consumer engagement.

In addition to digital games revenue growth, we saw high entertainment revenue from television distribution, partially offset by lower licensing and merchandising world peace on third party sales or products using our IP. Given the growing importance of the other revenue line, driven by the growth in our entertainment and digital games businesses, going forward, we will provide further details on the components of other revenue.

Beginning in Q4, we plan to break out other revenue into its two primary components, comprising digital games revenue and entertainment revenue. As our entertainment and digital games business continues to grow, we will continue to refine our key performance metrics to better reflect the results. Gross profit for the quarter was $277.9 million or 48.6 percent of revenue, compared to $286.9 million or 52.3 percent last year. The decline in gross profit margin resulted from several factors. Unfavourable shifts in product mix from increased volumes in lower margin products such as cardinal games and puzzles and outdoor. As a reminder, cardinal and outdoor have always been lower gross margin businesses, but there is a natural offset to lower gross margins from lower selling and marketing costs. The sale of inventory arising from the operational challenges we experienced in 2019. We had higher closeout volume in the quarter, which is directly related to our efforts to reduce inventory and streamline our American distribution centers. Higher inland and ocean freight expenses this quarter, compared to last year, as we sold through inventory that was built in 2019. These factors were partially offset by an increase in other revenue.

We estimate that we incurred over $7 million in costs affecting gross profit in Q3 relating to inefficiencies arising from Q4 2019. You may recall from our Q2 conference call that we expected the gross margin pressure would continue in the second half of 2020 as a result of our ongoing imagery cleanup, but that the scale of the impact would decline as we shipped that fall line. In Q4, we will see some final elements about 2019 imagery cleanup, but overall, we expect Q4 gross margins to be in line with prior years.

As a management team, we are focused intensively on ensuring that our gross margin in 2021 meets or exceeds historical levels, which have been in the low 50 percent range. SG&A as a percentage of revenue declined slightly to 27.9 percent in Q3, down from 28.1 percent last year. The biggest driver of the decline was a $10.1 million reduction in marketing costs. As a percentage of revenue, marketing decreased to 4.4 percent from 6.4 percent.

We intend to increase our marketing spend in the fourth quarter and expect marketing as a percentage of revenue for 2020 to be approximately in line with prior years. Selling expenses were 7 percent compared to 6.7 percent in Q3 of last year, due to an increase in the sales mix of licensed products.

Warehousing and distribution expenses increased to $20.7 million or 3.6 percent of revenue, up from $18.4 million or 3.4 percent. The $2.3 million increase related primarily to higher handling charges in Q3 driven by an increased (inaudible) APB mix relative to 2019, as well as costs related to inter warehouse transfers, which were incurred as part of the completion of our ongoing operational improvement initiative as we finalizes the inventory positioning under our one SKU, one location strategy.

We estimate that we incurred $2.7 million in additional warehousing costs in Q3 relating to inefficiencies arising from Q4 2019. Excluding the $2.7 million, warehousing and distribution expenses declined relative to Q3 last year. As a reminder, the negative cost impact of our 2019 operational issues did not emerge until Q4 2019. We have not yet anniversaried those issues or our efforts to remediate them this year.

We are now largely set up to successfully execute our go-forward distribution strategy as we have reached our goal of reducing our North American DC suppliers earlier than we anticipated. We are now in a position to exit 2020 at a run rate that approximates our historical cost levels or set slightly bias shipped towards Europe, which has a higher warehousing and distribution cost infrastructure than North America.

Administrative expenses in the third quarter rose to $67 million or 11.7 percent of revenue, up from $55.5 million or 10.1 percent last year. The increase was driven by higher personnel and professional services costs. In Q3, our adjusted net income was $95.1 million or $0.91 per diluted share, compared with $93.3 million or $0.91 per diluted share last year. Adjusted EBITDA was $139.9 compared to $150.2 million last year. The decrease reflects the declining gross margins and highest selling warehousing and administration costs offset by lower marketing.

Adjusted EBITDA margin was 24.5 percent compared to 27.4 percent in the prior year. We estimate that most of the $10 million decline in EBITDA in Q3 relates to inefficiencies arising from the second half of 2019. The tax rate for the quarter was 14.5 percent compared to 26.4 percent last year. As we said on our last earnings call, we expect the tax rate for 2020 to be approximately 14 percent, well below our normal rates of approximately 26 percent, driven by the results for the first half and the jurisdictions where we expect taxable income to be earned. For 2021 and beyond, we expect to revert to our historical rates of taxation.

From a capital allocation leverage and liquidity perspective, we continue to be in a strong position. We ended the quarter with $207 million in cash, up $56 million from $151 million last year. You will recall that in the first quarter, we drew a total of $350 million on our revolving credit facility and during Q2, we repaid $50 million. We repaid yet the remaining outstanding balance of $300 million in full in Q3.

Given the amounts of cash on hand at the end of the quarter, the cashflow we expect to generate in Q4, and the capacity on our credit facility, we are solidly positioned regarding available liquidity. Networking capital was $185 million at the end of Q3, down $75 million from $260 million last year. Inventory was $155.9 million, down just over $60 million, compared to $216 million last year, highlighting the significant progress we have made since our operational problems arose.

Ending inventory in our warehouses and at retail is trending to be healthy and down double digits by year-end. Free cashflow for Q3 before changes in working capital was $108.3 million compared to $128.6 million. Free cashflow for the quarter after changes in working capital was $96 million compared to $86.5 million. On a year-to-date basis, free cashflow after changes in working capital was up over $84 million to $108.4 million, compared to only $24 million last year.

Let me now turn to our ongoing efforts to improve operating efficiency. I'm pleased to say that in Q3, we continued our strong momentum towards remediating the challenges that emerged late last year, and in Q3, we began to see a decline in elevated cost levels from Q4 2019 and the first half of 2020.

We made significant progress in reorganizing and simplifying the structure of our third party industry distribution center network, and are, in fact, ahead of schedule. In the U.S. and Canada, we began 2020 with 18 DCs and storage locations. We now are at five distribution centers, which was our goal for the end of the year. Four of these are in the U.S. and one is in Canada, and we believe this is now the right structure to operate efficiently, but we will continue to refine our distribution network in 2021 and beyond.

One measure of this improved efficiency is our SKU counts. As of today, we've reduced the number of our SKUs by nearly 44 percent, starting the year with over 13,000 SKUs and pairing that down to about 7,500 currently. This simplifies our forecasting in the imagery management process. In addition, one of the issues we had last year was that we created increased inventory management complexity by stocking the SKUs in multiple locations. We have now implemented a one SKU, one location strategy. The reduction in SKUs and our fine logistics network go hand-in-hand and are part of our broader drive for increased efficiency and a return to historical margin levels in 2021. Our goal is to exit Q3 with a more refined supply chain infrastructure and to exit 2020 at, or very close to a normalized warehousing and distribution run rate. We are ahead of schedule on this goal.

I want to now turn to our view on the balance of 2020. As we've discussed, we've taken steps throughout 2020 to remediate the issues that emerged last year, and we've made great progress. We look forward to showing the effect of these improvements in our Q4 results.

We continue to be very encouraged by the strength of our POS across almost the entire product line by the growth in our digital games revenue, and by the progress we have made with our operational efficiency improvements. That said, we are still holding off on providing formal guidance at this time for essentially the same reasons we have cited earlier this year. This includes the resurgence of COVID in some markets, which could result in volatility and economic activity.

We will provide a detailed outlook when a clearer picture emerges. That caution notwithstanding, we have an exciting, innovative product portfolio and strong entertainment and digital game content, a financial foundation, a diversified base of products, and our asset line platform continues to give us a strong, competitive advantage.

We look forward to demonstrating further operational improvement in the fourth quarter and 2021, and showcasing the platform we have built for sustainable long-term growth.

Finally, I wanted to acknowledge the efforts of our team globally. Twenty-twenty has not been an easy year on many levels and the global Spin Master team has performed outstandingly well to get us to where we are now.

That concludes our formal presentation. Ronnen and I are now happy to take questions. Operator, please open the line.

Q & A

Operator

Thank you. If you would like to ask a question, please press star, one.

Our first question comes from Adam Shine, National Bank. Please go ahead. Your line is open.

Adam Shine – Analyst, National Bank

Thanks a lot. Good morning. I'm trying to read through, I guess, some of the commentary around, obviously, some of the efficiency gains that have been achieved, and yet I guess the context that the gross margin somehow is going to be somewhat flattish to a depressed margin in Q4 of a year ago now that we've very much lapped the issue and we've seen, I think, obviously, an evolving progress, certainly a material progress sequentially from the Q2 into the Q3.

With the inventory cleanup, with other revenues that presumably have a higher margin stepping up fairly meaningfully, can you maybe just elaborate a little bit further, Mark, as to why margins would be presumed to be flat rather than up year-over-year in the Q4?

Mark Segal – Executive Vice President and Chief Financial Officer, Spin Mater Corp.

Hi, Adam. Thanks. To be clear, we've got kind of contrasting things going on in the gross margin line. We have continued inventory cleanup. We're still going to see some impact on that in Q4, although we weed through the vast majority of it so that will bring margins down in Q4. We've also still got a lot of cardinal and outdoor and Canadian standard shipping, which tend to be lower margin lines, and those are going to be offset by increased other revenue.

In terms of benchmarking against prior years, you really should be looking at 2018 as a benchmark rather than Q4 2019, Adam, because Q4 2019 was when we started experiencing a lot of the operational issues and that was a very messy, difficult quarter. If you look back at 2018, we're in the 48, 49 percent range for Q4 and I think that's where we'll land given everything for Q4 this year as well.

Adam Shine – Analyst, National Bank

Okay. All right. That's helpful because it's not quite as bearish as you initially implied. When I go back to, Ronnen, in the context of the quarter outperforming your expectations, was that simply a function of some of the COVID stimulated outdoor and activity sort of dynamic, or were there other pockets of perhaps outside performance, maybe including some of the strengths that we saw in the DC licensed products? Any other sort of insight to what surprised you?

Ronnen Harary – Director, Co-Founder, and Co-Chief Executive Officer, Spin Master Corp.

First of all, hi. I think that we're in a COVID year and it's just been very wonky in terms of open store closures and the power of e-commerce and delivery and consumer patterns and shopping patterns changing. It's just been a wonky year and I think that we're just very grateful that our product lines are holding up, people are shopping, people are spending on their kids, we are able to have our supply chains open, our factories are able to deliver the goods. I mean, we can go back to February last year where we were worried about getting products and it's amazing how ADA has just being able to hold up and to deliver the goods. It's from a macro perspective but we're very pleased and we're very grateful.

When you go into the portfolios, you've got things like DC, which is performing exceptionally well. You got the POS of PAW Patrol doing very, very well and a franchise that is just continuing to resonate with kids globally around the world. You have Bakugan, which is on an uptick again, and the power of the content as a result of the drop on Netflix connecting with the kids and the kids now knowing where to go and find the show, which is something very important around discoverability because that's one of the issues that Netflix had. Now kids are getting used to having Bakugan on Netflix and that's driving sales, and activities games and puzzles business continuing to do very well and thrive, but then you've got some other parts of business like the guns part of our business, which is down, and Hatchimals, which is down, so it's on balance. We're very pleased with how the overall portfolio is going.

Then again, if you look at the stuff that's happening on the digital front, that's also for many years in the making that's coming into fruition and it's going to continue coming to the fruition, so we're very pleased.

Adam Shine – Analyst, National Bank

Maybe just as one last follow-up. Just in regards to other revenue, does this become a sort of a new normal run rate, or was there a lot of sort of the TV distribution revenue that was incrementally contributory to the pop in the Q3?

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

Adam, in the quarter, most of the growth in other revenue came from our digital games business and we saw a very significant increase in Toca Life World revenue. TV distribution was up a little bit, LNA was down a little bit, but hopefully, that is the new normal.

I mean, we're building that business, we're investing in that business, we're growing that business, it's a strategic initiative for us. If you look at the growth in the revenue and in subscribers and in monthly active users, everything is going in the right direction and we hope to continue to see that happening through Q4 and to 2021.

Adam Shine – Analyst, National Bank

Okay. Thanks. I'll queue up again. Appreciate it.

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

Thanks.

Operator

Thank you. Our next question comes from George Doumet from Scotiabank. Please go ahead. Your line is open.

Jon Garfinkle – Analyst, Scotiabank

Hi, this is Jon Garfinkle stepping in for George. Just focusing on Europe, it was surprising to see the growth in sales there. I know PAW was called out as a contributing factor. Was this also a result of an overall catch up in e-commerce sales in the region?

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

Yes, I think Europe had a very strong Q3 across the board. I think Europe was down further than some of the other regions in Q2 due to COVID and Europe bounced back very strongly in Q3. We saw that across the board. In particular, though, we call that PAW Patrol, Bakugan. Some of our major franchises performed really well in Europe.

Jon Garfinkle – Analyst, Scotiabank

Okay, and on the rest of the world segment, which geographies and product categories would you say improved and which are still struggling?

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

The two biggest markets in that category would be Australia and Mexico. I would say Australia is doing reasonably well. Mexico is the one that's suffering the most in that area. I think the whole of Latin America is down. If you look at some of our competitors, I think they called that out as well. The overall market is really a hard hit in Latin American and we're experiencing that in Mexico for sure.

Jon Garfinkle – Analyst, Scotiabank

Okay. Thanks for that. I know it will be broken out next quarter, but is it possible to get a rough breakdown of the portion of other revenue that comes from digital games?

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

Yes. We'll start with that next quarter. We'll give you all the details.

Jon Garfinkle – Analyst, Scotiabank

Okay. Just one more for me. Just looking at free cashflow generation, how should we think of working capital and CAPEX for next year?

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

Well, you have to look at that over the history of ‘19 and ‘20. In ‘19, you saw a significant buildup in inventory and working capital in general. This year we focused very hard on bringing that down and you've seen networking capital at the end of Q3 come down around $80 million relative to the same time last year.

We're still not at the levels that we want to be at to be fair, but we are trending in the right direction. Our goal for next year would be to continue to see networking capital decline and to continue to improve our free cashflow, but not at the rate that we've actually done it this year.

Jon Garfinkle – Analyst, Scotiabank

Okay, great. Thank you for the answers.

Operator

Thank you. Our next question comes from Steph Wissink from Jefferies. Please go ahead. Your line is open.

Stephanie Wissink – Analyst, Jefferies

Thank you. Good morning, everyone. Gentlemen, thank you so much for the additional detail. It's always very helpful. I want to just unpack three comments that you made. First was related to consumer behaviour. You talked about a 20 percent shift from December POS forward into the early part of the fourth quarter. If you could just extrapolate a little bit on that, how you expect the quarter by months to play out, and how you're preparing for that. I think you also mentioned that your retailers are being somewhat cautious about reordering, so that would also reinforce possibly a slightly more reduced December month.

Then secondly on PAW Patrol, I just wanted to unpack some of the things that you're seeing on a global basis, recognizing that the brand is far more mature in the North American market than it is in some of your international markets. Can you just remind us how the content flows around the world? Is it day and date you're launching the Dino Rescue content around the world at the same time and following that with product, or there's somewhat of a lag? How should we think about how you're planning to manage the content and the product and merchandising assortment for that brand going forward? Thank you.

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

Ronnen, maybe I'll take the first one and then you'll take the second part of that.

Hi Steph. Good morning. I think what we're seeing is that there definitely is a pull forward from December in terms of POS. We think, firstly, Amazon with Prime Day in October, with Walmart and Target with their Black Friday promotions is effectively—Black Friday is really spread over the month of November now, and so I think with consumers focused on COVID and some of the potential issues around congestion, not in our warehouses, but just in general with transportation due to COVID, I think there's a sense that people are buying a little bit earlier than they otherwise might have.

Usually they would have bought in December and felt very confident that if they'd order the week before, they could get the delivery in time for Christmas. Now we're getting the sense that consumers are actually being a little cautious and buying a little earlier from what we've seen. That, from a Q4 perspective, has pulled a little bit of POS into October and November away from December. That was the context of that comment.

Ronnen, do you want to talk about the PAW Patrol content flow?

Ronnen Harary – Director, Co-Founder, and Co-Chief Executive Officer, Spin Master Corp.

For sure. We're in our seventh or eighth year PAW Patrol, Steph, and it's pretty much the same content that's coming out every year. The European content is matching the North American content. At the beginning when we started out, it was a little bit behind, but it's pretty much caught up. I think some of the differences that you'll find in Europe is where the show is actually broadcast.

In Europe, you have a more dynamic broadcast platform where you have linear and you have SPOD, so in a lot of countries in Europe, you can find PAW Patrol on Netflix and you can find it on Milkshake!, let's say for example, in U.K. There's multiple combinations and iterations like that through different countries in Europe, and so you just see a different broadcast or dynamic than you do necessarily in United States. For the most part, in terms of franchise management, it's pretty much uniform throughout the world.

Again, like you see the movie that's coming out in 2021, it's also going to be a worldwide launch. It's not going to be staggered six months apart in various different countries. We're trying to keep everything uniform and consistent.

Stephanie Wissink – Analyst, Jefferies

That's great. One final question for you, Mark. I was really taken back by the amount of SKU count rationalization you've done. I think 44 percent was the number you mentioned, right around 7,500 now. Is that the right level for you if you think about Spin Master's advantage in innovation, and really unlocking innovation in the marketplace? Is that 7,500 about what you feel like is appropriate for your go-forward business?

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

Yes, I think, Steph, we were way, way over SKU'd and I think that was a big part of what hurt us in 2019 with all the other changes that we made in our infrastructure. So, 7,500—it depends on the product line to some extent, but in that order of magnitude is about right, but we'll continue to refine that and get it even better. It's all about continuous improvement now.

Ronnen Harary – Director, Co-Founder, and Co-Chief Executive Officer, Spin Master Corp.

Yes, and just to build on Mark's comments, Steph, I think that, one way you could look at it is you can say the less SKUs, the less revenue, but in actuality, it makes the company way more efficient and gives the opportunity for the product lines that really have the most potential, the room and the oxygen to breathe and actually resonate with the consumer at the end of the day.

It makes it much better, and the product development teams are actually much happier that we've trimmed the line and we're really focusing on what's going to resonate with the consumer at the end of the day. It's a much healthier way to run the business.

Stephanie Wissink – Analyst**,** Jefferies

Thank you.

Operator

Thank you. Our next question comes from Martin Landry from Stifel GMT. Please go ahead. Your line is open.

Martin Landry – Analyst, Stifel GMT

Hi, good morning. Just wanted to touch on your Toca Boca platform. It looks like it performed extremely well this quarter. Just wondering if you can point to anything that's happened that's been different this quarter than, let's say, Q1 or Q2 for us to understand a little bit of jump there.

Ronnen Harary – Director, Co-Founder, and Co-Chief Executive Officer, Spin Master Corp.

Sure. The one thing you've got to understand about Toca Life, which is the main driver right now, is that it began as a service, so it's constantly being updated and iterated. Since the last quarter, we've added a bunch of new playsets to the game, one is the Bohemian House, the other one is Pool Villa, we also the did the Harvest Villa and the Mystic Cottage Cabin. Two of those, actually, they have crater tools, so the kids were able to go in and decorate their environments, and two other ones were playsets. So, it's just a constant iteration of the game. Other things that have been kicking in is the short-form TV series that we created, that we put on YouTube only, called Toca Life Stories, and we've seen an uptick in viewership of that content.

Then we started to see a very large uptick of people creating videos or what we call game walkthroughs, and posting them on TikTok, and putting music to them and telling stories, and that really shot up the amount of people that became aware of the game, and as a result of that, went in and started to try the game and start to buy the different packages of game offers.

So, I think it's a combination of multiple things happening at the same time, and that created the increased awareness, and then, obviously, the increase of sales.

Martin Landry – Analyst, Stifel GMT

Okay, well done. Just to be clear, I guess there's little seasonality in these digital games. Do you expect momentum to carry into Q4 for that platform?

Ronnen Harary – Director, Co-Founder, and Co-Chief Executive Officer, Spin Master Corp.

There is some seasonality, and we expect with—there's seasonality in terms of Christmas. We get a lot of gift card purchases, where parents buy gift cards for their kids, particularly, iOS Apple gift cards, and then kids actually are able to redeem those in the game, so after Christmas we usually see a spike. This is constantly steady throughout the year.

Martin Landry – Analyst, Stifel GMT

Okay. Mark, maybe just a question on the tax rate. Wondering, you mentioned that your tax rate's going to return to probably a more normalized level next year. Can you remind us again what explains the wide variation in the tax rate this year?

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

Yes, it's really in relation to three things. One is, firstly, the losses we had in the first half of the year. The second element is the jurisdictions where we earned income this year, and thirdly, we had a one-time reorganization of our IP at the beginning of the year, which has also created a little bit of a distortion in our tax rate this year that will not be repeated next year. So, for your models, you should really be using close to our statutory rate, which is in the 25 percent to 26 percent range.

Martin Landry – Analyst, Stifel GMT

Okay. Perfect. Thank you.

Operator

Thank you. Our next question comes from Brian Morrison from TD Securities. Please go ahead. Your line is open.

Brian Morrison – Analyst, TD Securities

Hey, good morning, guys. First question's for Mark. You had very strong growth at two of your three top customers, but customer one in your notes is down about 17 percent. Can you maybe reconcile the strong POS commentary to the decline at your largest customer? Does this have anything to do with the PAW inventory and the shift to Q4 you talked about?

Mark Segel – Executive Vice President and Chief Financial Officer, Spin Master Corp.

Brian, yes, hi. You're referring to the breakdown of our top three, and Walmart, essentially, I think, being down versus Q3 of 2019. It really was related to one specific item only, and that was in Q3 last year, we did a PAW movie, which was exclusive to Walmart called Ready, Race, Rescue, and we shipped that in Q3 of last year. This year, we did it with another one of our customers, and so that actually explains the year-over-year decline. That's almost the vast majority of the delta.

Brian Morrison – Analyst, TD Securities

Okay. I appreciate your comments with respect to Q4 margins. If we're just looking ahead at 2021, you've got your DC issues ahead of forecast, you've got Toca, which is high margin in flight, your inventory is clean. You talk about your gross margin for 2021, so are we tracking the return to historical EBITDA margins? COVID impacts aside, I guess the question is, is your SG&A on track?

Mark Segel – Executive Vice President and Chief Financial Officer, Spin Master Corp.

So, Brian, we obviously, we're not giving 2021 guidance yet. Hope to do so in March, if we reinstate guidance, but obviously our goal is to get there. Historically, our benchmark is in that 18.5 percent to 19 percent zone, and we want to get back there as soon as possible. Hopefully we can get there in 2021. That's our goal. As a team, as a management team, we are working exceptionally hard to get there for 2021, both at the gross margin level in relation to historical gross margins, and also at the EBITDA level, in terms of Adjusted EBITDA margins. We're certainly doing everything we can to get there, Brian.

Brian Morrison – Analyst, TD Securities

Okay. The last question on the digital platform, Ronnen. Can you just remind us what you said the growth rate was, how you look at the trajectory of the revenue platform going forward, and just remind us, in terms of the business model, the structure, how the subscription models work, and how you get paid by things such as uploads to TikTok.

Ronnen Harary – Director, Co-Founder, and Co-Chief Executive Officer, Spin Master Corp.

Yes, maybe I'll answer the second question. The business model is, if you look at the Toca Boca part of the busines which focuses on kids that are 5 to 10 years old, some of the games are stand alone; you pay for the game, and you get the game, but where the most growth is coming from is from Toca

Life World, which you get to play for free, and then if you want to bolt on certain modules, like, for example, the Harvest Villa, or the Pool Villa, or Bohemian House, then you'd have to pay for those modules. So, free to play, and then as you get into the game, and you want to bolt on into your world, you pay as you go. That's games as a service.

As it relates to TikTok, the videos that are created for TikTok, there is no revenue. There is no advertising model associated with that. That's just complete user-generated content that people are creating and sharing with their friends that just creates a lot of visibility for us, which actually what that does, is it reduces the cost of the customer acquisition and reduces our marketing cost. We've actually seen, we have now 2.6 billion views of Toca Life game walkthroughs on TikTok, and so that's basically just user-generated content and advertising that we don't have to pay, and that drives people to the game. That's on the Toca side.

Then on the Sago Mini side, that's a subscription-based business, that's a subscription-based business where people come in and they pay $5.95 a month, and they buy a year package or a six-month package, or they pay month-by-month. As a result of that, they get all the aspects of the world. It's just like a buffet. They're a buffet, and Toca Boca is an a la carte. That's how you'd think about it. The nice thing about the buffet is that you have long-term revenue that comes as a result of that person that's a subscriber over time. So, those are the two.

In terms of your answer about growth, I think we'll share more about that as the business starts to get bigger with you guys, and as the user base goes up, but I think the most important thing for you guys to focus on is the amount of daily active users. For example, in Toca Life, there's 5 million daily active users, there's 17 million monthly active users, and we have over 30 million users in our network. There's a whole value to the amount of users in your network, which again goes to the ability to bring people into your games for a lower cost because this whole business is based around bringing users in, and if your cost for acquisitions for the users is high, then your margins, it's a tough go, and it's hard to start again from scratch. So that's the really interesting thing, seeing the actual user base and the magnitude of the user base growing and how we can actually use that in the future, so for things like Toca (inaudible) which is our first multiplayer game that we're going to launch in 2021. We have the ability to tap into that 30 million monthly active users to get people to come in to get trial over and above the marketing that we do and customer acquisition stuff that we do on the side.

Then on Sagos part of the business, again, watching that subscriber base and watching that go up on a quarter-by-quarter basis.

Brian Morrison – Analyst, TD Securities

All right. Thank you kindly.

Operator

Thank you. Our next question comes from Sabahat Khan from RBC Capital Markets. Please go ahead, your line is open.

Sabahat Khan — Analyst, RBC Capital Markets

Thanks, and good morning. On the SKU rationalization that you talked about. Can you give us some perspective on what drove that? Was it really just a review of the supply chain and it made sense to do it in conjunction with that? The second part around—can you maybe share which platforms or categories most of the SKU reduction was concentrated in?

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

Sabahat. Hi. Good morning. It was really across the board but I think, it was also driven, I think, by a couple of categories in particular; Cardinal, Swimways*,* some of the areas that we had actually made acquisitions in, was a particular area of focus. Because we had acquired those businesses, we had grown them and we have never really gone through a full product portfolio review and we really did a very deep dive on all of that to make sure that everything in our product line actually met certain profitability thresholds.

We didn't stop only at Cardinal and Swimways, we actually looked across the board and we looked at every aspect of product profitability, and as Ronnen described, in order to make sure that all the products breath and get the right attention and focus, we really looked at everything to make sure that what we had in our line met our profitability thresholds, and also tied into our whole goal of operational efficiency.

Ronnen do you want to add anything?

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

No, I think that’s great. I’d also mention that guns had a lot of trimming because they had a lot of SKU’s that were not so profitable. We cut a lot of that.

Sabahat Khan — Analyst, RBC Capital Markets

Okay. Great. Thanks for that. Then you indicated that most of the—or the supply chain rationalization initiatives are largely done. If we look into next year, should we assume that any of the one-off costs associated with this warehouse and DC rationalizations, theoretically those should repeat? Is that the right way to think about it?

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

Yes, that’s the right way to look at it, Sabahat. From this point onwards we are really talking about refining and continuous improvement. The basic structure is there and we’ll continue to improve it, but you won’t see anywhere close to what we saw this year in terms of remediating the problems from 2019.

Sabahat Khan — Analyst, RBC Capital Markets

Okay. Then on the remote control segment, there was some drag from Hatchimals. I guess should we assume that Allies (phon) and Hatchimals at this point—I know there are a lot just getting into Q4, is that largely out of the system or should we expect some more during Q4?

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

Well, Allies is largely out of the system. There might be a little bit of carry through into Q4, that in terms of shipments that were made last year. Hatchimals actually, in Q4 is doing pretty well with the Crystal Flyers item and some of the Pixie's items as well. I think that line is basically performing in line with our expectations and it's okay. I don't think you're going to see anywhere near the kind of year-over-year decline that you saw in 2019 versus 2018. It's relatively insignificant now, overall to the business. Although, it does have an impact on that segment itself.

Sabahat Khan — Analyst, RBC Capital Markets

Okay. Then just on cash flow and capital allocation, obviously the cash and balance sheet are in good shape. Do you have any thoughts on—is it the right environment to think about M&A, or how are you just generally thinking about capital allocation at this point?

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

Well, I think that we are very pleased with the way that our cash flow has improved this year relative to last year. If you look at the fact that free cash flow is really around $85 million higher after working capital this year, it's a very significant improvement. Our free cash flow to EBITDA conversion ratios are going in the right direction and we think we can continue to improve them even more. We will be generating excess cash, and as you saw with Rubics, we'll continue to deploy strategically.

As Ronnen has described, we're looking now at the digital and entertainment also as areas to continue to invest from an M&A perspective, but our model remains the same, which is to keep ourselves asset light, manage our working capital very tightly, generate strong free cash flow, have high free cash flow to EBITDA conversion ratios and then deploy this strategically. Ronnen?

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

That's great Mark.

Sabahat Khan — Analyst, RBC Capital Markets

Then this last for me. I guess on the entertainment side, we've seen some headlines around the Batman Movie for next year. Is there anything else on the DC Comic side or how are the discussions going there during some of the uncertainty on the entertainment and movie theater side? Just want to get an idea of what you're expecting on that platform for the course of '21.

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

Well, I think the amazing thing is that without movies, the business is up. It's very robust and it's very strong, doing great. We will continue to see that, that's our expectations, and they have a very rich robust slate of movies. As you know, the live action movie part of the market is definitely being impacted by COVID and the studios are having to move things around in terms of dates and shifting things around. We're working with them and that's really their call to make, it's their IP. The good news is they have a rich slate of things that are ready to come out. How they decide to market them, whether or not some of them go PVOD which is Premium Video on Demand or whether they go in the theaters, still yet to be determined and we'll follow suit when they make those decisions.

Sabahat Khan — Analyst, RBC Capital Markets

Great. Thank you.

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

Operator, I think we can have time for one more question. Thank you.

Operator

Thank you. Our final question comes from David McFadgen from Cormark Securities. Please go ahead, your line is open.

David McFadgen — Analyst, Cormark Securities

Great. Thanks for squeezing me in. I was just wondering when you talk about going back to your previous gross margin, your previous EBITDA margin and then when you look at what's happening in the industry, how the industry is really shifting to e-commerce. I was just wondering how does that impact the ability to go back to your historical margins, and what does that do in terms of working capital or inventory levels if the industry keeps shifting quickly to e-commerce?

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

Thanks David. Good morning. We're relatively neutral when it comes to gross margin as it relates to e-commerce versus brick and mortar. There is no significant impact in terms of us shifting through our e-commerce partners or through brick and mortar. So, that's really not a factor in our gross margin. I think really what the drivers are, product mix and other revenue and sales allowances, the key issues that really drive gross margin.

We think looking at all of that, we can get back there to historical levels. This year was an aberration for all the reasons we've described and we're pretty confident that we can get back to historical levels next year and beyond.

Sorry, what was the second part to your question?

David McFadgen — Analyst, Cormark Securities

Are there any implications for working capital in terms of inventory; how much inventory…

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

Oh right. The one thing that e-commerce does change is a little bit of the timing of shipments. It does drive more of a shift from FOB towards domestic as the e-commerce channel pulls more on a domestic basis than on an FOB basis. What that will mean is really a shift towards a slightly smaller Q3 and a slightly smaller Q4—sorry a larger Q4. Ignoring COVID for a second here—just in a normal steady state business, we should see Q3 go down a little bit and Q4 go up a little bit.

David McFadgen — Analyst, Cormark Securities

Okay. All right that's all for me. Thanks.

Operator

Thank you. I'll now turn the call back to Mark Segal for closing comments.

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

Well, thank you everyone. Appreciate your time. We went over a little bit because we wanted to give you all an opportunity to ask questions. We look forward to talking to you again in March with our year-end and Q4 results. Thank you. Take care.

Operator

Thank you for joining us today ladies and gentlemen. This concludes our call and you may now disconnect.