Spin Master Corporation

Third Quarter 2022 Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the Spin Master Corp. Third Quarter 2022 Earnings Call.

Today's conference is being recorded.

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

Sophia Bisoukis — Investor Relations, Spin Master Corp.

Thank you, Justin. Good morning, and welcome to Spin Master's financial results conference call for the third quarter ended September 30, 2022.

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

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

However, there can be no assurance that the estimate and assumptions will prove to be correct. Many factors could cause actual results to differ materially from those expected or implied by the forward-looking statements. As a result, Spin Master cannot guarantee that any forward-looking statements will materialize, and you are cautioned not to place undue reliance on these forward-looking statements.

Except as may be required by law, Spin Master has no obligation to update or revise any forward-looking statements, whether because of new information, future events or otherwise. For additional information on these assumptions and risks, please consult our cautionary statements regarding forward-looking information in the Company's earnings release dated November 2, 2022. Please note that Spin Master reports in U.S. dollars and all dollar amounts to be expressed today are in U.S. currency unless otherwise noted.

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

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

Thank you, Sophia. Good morning. Thank you for joining us today to review our third quarter results.

To begin, let me remind you that we are committed to building on our legacy as a growth company by reimagining everyday play and leveraging common IP across our three creative centers including innovative toys, engaging multi-platform entertainment content, and open-ended digital game experiences.

We believe this powerful combination provides Spin Master with a distinct competitive advantage while also creating a robust platform to deeply engage with, entertain and inspire children and their families globally. We are investing in our share capabilities to sustain our presence and influence in children's lives now and for generations to come.

Following strong performance over the first half of the year, our total revenue for the third quarter was $624 million, a decline of 12.7 percent compared to last year primarily due to the pull forward of toy shipments into Q2 this year, coupled with inventory correction by retailers in Q3, given lower category consumption as inflation pressure consumer spending.

The difficult, although expected comparison against the PAW Patrol movie launch last year, decelerating digital games revenue and foreign exchange were also factors. Excluding the distribution revenue from the PAW Patrol movie last year, revenue in Q3 in constant currency declined by 6.5 percent compared to 2021. For the third quarter, Adjusted EBITDA margin declined to 26.9 percent from 30.4 percent, and Mark will provide further colour on this later in the call.

As you are aware, we are operating in a very uncertain macroeconomic environment. We spoke last quarter about the possibility of declining consumer confidence and the pressures of inflation impacting discretionary spending. The toy category has historically been more resilient than others during recessionary environments. Since 2005, for example, industry growth has consistently exceeded

GDP growth. However, we have seen an impact on point-of-sale trends in the category as the year has progressed, and the average consumer becomes increasingly price-sensitive.

According to NPD, while toy demand remained stronger than 2019 levels, it has been slowing. On a year-to-date basis, our POS is up 3 percent and has continued to grow ahead of the toy industry globally, which grew at 1 percent per NPD. We also remain the number four manufacturer globally, making this the fourth consecutive quarter we have held this position. We are starting to see the effects of the current economic climate and shifting customer dynamics.

Retailers have begun to reduce orders due to higher inventory levels industry-wide and have put a greater focus on profitability over growth. Consumers are more price sensitive given inflationary pressures and are more susceptible to promotions as a result. This activity has had an adverse impact on the launch of new items at retail. While our year-to-date growth is ahead of category performance, our third quarter POS declined compared to the total industry, which grew 2 percent.

A material part of our year-over-year decline is from lower PAW Patrol POS lapping movie POS last year. We anticipated a decline in preschool dolls and interactive category in Q3 this year, given the exceptional growth we experienced last year coming off the heels of the strength of the PAW Patrol movie toy line. While global POS for PAW Patrol decreased in Q3, the franchise remains the number one preschool toy property globally, both on a quarterly and year-to-date basis per NPD. If we exclude PAW Patrol POS, our point of sale grew by 4.5 percent in Q3 and 7.8 percent year-to-date for the G11 countries per NPD.

We firmly believe in PAW Patrol's tremendous brand equity with preschoolers and are looking forward to celebrating PAW Patrol's tenth anniversary in 2023 with the launch of our second POP movie in the fall. The ruble spin-off and new content. Our retail customers toured our LA trade show in September, and we're very excited about the innovation we are bringing to both the core and the movie toy line. You will have the opportunity to see our full 23 showroom in LA this coming January, so stay tuned for your invite coming soon. With fresh content, a blockbuster movie and a milestone anniversary, we believe we can continue to attract new PAW fans and further solidify our position with our current preschool fan base.

I wanted to speak to Gabby's Dollhouse, which has been a tremendous partnership with Universal Studios. Gabby's has been a runaway success since the launch of the animated property last year and speaks to the power of strong entertainment driving consumer demand. The Gabby's Dollhouse perfect play set was the number one item in the infant toddler and preschool super category in Q3 and even year-to-date in the U.S. per NPD.

Gabby is a great example of how we apply innovation to license brands. Our license portfolio continues to resonate with consumers. According to NPD, our license portfolio POS was up 32 percent in Q3 on a year-to-date basis, up 39 percent, and this is mostly driven by Gabby's Dollhouse, Wizarding World and Monster Jam. Within Wilson Action, our licensed toy properties continue to perform well. According to NPD, DC Universe POS decreased in Q3 as gains in the first half connected to the Batman movie tapered off.

Our new Black Adam toy line inspired by the feature film that debuted October 21 is announced it at retail, and we have an early indication of solid performance. In 2023, we have a series of DC Universe movies slated for theaters as well as an Epic new place set for the line.

Monster Jam remained the number two property in vehicles for the third quarter per NPD and POS increased 3.7 percent. Tandem for Monster Jam is being driven by a combination of spectacular live events complemented by new Spin Master innovation. In 2023, we will have a new all-terrain vehicle and new play patterns within the traditional 164 vehicle lineup. We are excited to launch two new license partnerships in 2023.

The first years for Disney's new preschool animated series, Fire Bots, with toy launches beginning in spring '23 and a full rollout in the summer. The second is with Sony Interactive Entertainment, which will see us become the global master toy licensee for PlayStation games, including titles such as God of War, Horizon Zero Down, The Last of Us and others.

In activities, Kinetics MPOS was down by 4.4 percent in Q3 in a category which also saw overall declines. Kinetic Sand has made such amazing strides over the past few years and remains the number two brand within the arts and crafts category. Strong brand affinity and continued innovation in the line gives us confidence for the remaining holiday season and for 2023.

I wanted to touch on sales within our Games and Puzzles category. During the pandemic, we saw a tremendous resurgence of classic games. Today, much of the growth in this category is being fueled by trading cards and new board game titles. Our POS sales are mirroring the trends within the category at large, with continued softness in classic titles such as chess and checkers, offset by the introduction of new titles and next additions of our own IP, like Headbands.

Rubik's Cube was the number eight brand within the category for the quarter with POS up 13 percent compared to 4.7 percent for the category. Phantom for Rubik runs deep and when we introduce our own spin on the classic puzzle this fall, the Rubik Phantom, featuring thermochromic technology, it quickly sold out. We are chasing opportunities to ship new inventory into retailers over the next few months.

We know that innovative marketing is critical for the peak holiday season. We are leveraging our in-house agile team to adjust our marketing with precision. Most of our marketing investments is against our priority brands, designed to sustain and build momentum in support of selling through our key toy drivers. E-commerce sales continue to outpace brick-and-mortar, although we are expecting brick-and-mortar to accelerate later in the season. We are making the necessary investments in marketing from an omnichannel perspective to ensure an exceptional experience and a clear path to purchase for the consumer. As mentioned last quarter, we are taking a balanced approach to pricing and promotions, investing where it makes sense to remain competitive while also preserving our profitability.

Turning to entertainment. Our team, our experts are creating engaging stories that transcend boundaries and platforms. In turn, this content will serve as a catalyst for growth and innovation in toys, digital games, and licensed consumer products. This quarter, the team launched Sago Mini friends on Apple TV, our first major collaboration between the digital games and entertainment creative centers, which saw us bring the popular characters from the award-winning Sago Mini app to episodic content.

The launch in Apple TV in September was our first distribution deal with the streamer and we have been thrilled to see the enthusiastic reception to the series across the world. Looking ahead to 2023, our entertainment creative center will have one of the biggest years ever. Twenty-twenty-one was a landmark year for us as a result of the release of our first movie. The box office results for PAW Patrol: The Movie demonstrated our ability to tell a story for PAW on a much bigger canvas. Fans globally are eagerly awaiting our second feature film for the franchise, PAW Patrol: The mighty movie, which will be hitting theaters in October 2023.

Further building on the PAW Patrol world, Ruble and Crew, our first spin-off, will debut in Q1 2023. We will also introduce a series of specials throughout the 2023 year to commemorate PAW's tenth anniversary. Our new animated series, Vida the Vet, will debut on premier children's and broadcasters, BBC in the U.K. and Chorus Entertainment's Treehouse in Canada in the fall of ‘23 with more international broadcasters to follow. A new toy line and full consumer products program will follow in 2024.

While we have seen exceptional growth within our Digital Games creative center over the past two years driven by new content and features as well as COVID-related lockdowns, we are starting to see the market normalize. We are seeing this play out more broadly across the video game and mobile demand industry landscape. Last quarter, we commented on the overall slowdown of revenue growth across the digital games industry as kids return to in-person schooling, play dates and extracurricular sports driving lower in-app purchases.

As a result, we saw a decline in revenue in quarter three despite MAU remaining at comparable levels to 2021. We have an ambitious growth plan for our Digital Games creative center. In the long term, the mobile game market's growth potential is very attractive with mobile gaming being the largest and most popular form of gaming for kids. We are not discouraged by the revenue decline we experienced in the quarter compared to 2021.

As I mentioned, we continue to see strong engagement with our properties despite a decline in in-app purchases. Monthly active users for Toca Boca were flat in the third quarter with some decline coming in September as children return to school following the summer break. For Toca Life World, we were at 49 million monthly active users for the quarter. Sago Mini downloads increased in the quarter, but the active subscriber base was flat at 340,000 subscribers. With the help of the Sago Mini Friend series, we hope to continue to attract new users and drive further downloads of the award-winning app.

We are evaluating a Sago bundle approach for 2023, which will combine several apps into one cost-effective subscription. We think this will drive growth and will be a simpler, more cost-effective way for parents to manage a subscription for their kids. Originators teams continue to work on two major initiatives, including a PAW Patrol digital game, PAW and Friends, which will launch together with the second PAW movie in 2023 and an exciting new educational learning game.

We expanded our digital game ecosystem with the acquisition of Norlite in August, following an initial investment in the gaming studio through Spin Master Ventures. The gaming studio has been working on the development of the Rubik’s digital game in the casual gaming space set to launch in

2023. In addition to collaborating with Norlite on the Rubik game, our NOID studio is working on several other digital game initiatives, leveraging our toy and entertainment IP.

We continue to drive towards our long-term goal, which is for digital games revenue to represent 20 percent of our total revenue. We will achieve this through a combination of growth in existing games, the development of new games and accretive M&A. With our 2,500 employees around the world, we are excited to bring our magical content and experiences to children and their families this holiday season.

While it is too early to discuss specific guidance for 2023, we want to provide some context on how we are approaching next year. We expect the external environment to be dynamic and challenging in 2023 and we are taking actions to ensure we navigate this backdrop and position Spin Master to thrive. We continue to look for accretive acquisition opportunities and balance investments designed to deliver on our long-term business strategy, while also effectively managing our costs and navigating retailer and consumer dynamics to deliver profitable growth.

We remain very excited about our prospects, both for 2023 and beyond, and continue to focus on driving growth throughout all our creative centers driven by innovation and collaboration. We firmly believe the power of our innovative toy portfolio; diversified entertainment, pipeline and our suite of digital games will drive shareholder value now and into the future.

I am going to now pass it over to Chief Financial Officer, Mark who will share more details on our financial performance and outlook.

Mark Segal — Chief Financial Officer, Spin Master Corp.

Thank you, Max, and good morning, everyone.

Before we get into the quarter, I briefly want to step back. Since our IPO, we have more than doubled revenue from under $1 billion in 2015 to over $2 billion in 2021 delivering a compound annual growth rate of over 12 percent. Our gross product sales CAGR over the last five years of over 9 percent is approximately twice the toy industry growth rate. We have diversified the business globally, we have broadened our lines and developed stronger brands, and we have grown our entertainment and digital games creative centers meaningfully as a proportion of total revenue.

Our strategy is designed to achieve long-term diversified growth, and we are delivering on that strategy. Year-to-date Q3, we have generated just over $1.5 billion in revenue, a 9.3 percent increase over last year. On a constant currency basis, our year-to-date Q3 revenue is up 11.7 percent. Year-to-date gross product sales growth of 12.3 percent and 14.9 percent in constant currency has outpaced the toy industry globally.

Currency continues to be a meaningful headwind, as you can see, and I wanted to remind you of our transactional currency exposures. While most of our buying and selling transactions are in U.S. dollars, and we are, therefore, naturally hedged. Our European region saw euro, pound and kronor weakness impact our top line. This was partially offset on the bottom line by the reduction in costs we benefit from as a result of a strengthening U.S. dollar relative to the euro, pound, kronor, and especially the Canadian dollar, where we have a large naturally short position arising from our Canadian cost base.

As expected, revenue growth in Q3 was a difficult comparison. Revenue was $624 million in constant currency, down from $714.5 million last year, a decrease of 12.7 percent, reflecting customer order timing shifts in our toy creative center, along with the decline in digital games and entertainment revenue where we recognized $26 million in PAW Patrol movie distribution revenue last year.

Retailers brought in goods earlier this year to avoid anticipated supply chain disruptions in the fall. As a result, and as we discussed in previous earnings calls, first half 2022 gross product sales represented a larger proportion of full year gross product sales than in prior years. In constant currency terms, Q3 revenue declined 9.9 percent and excluding the revenue from the PAW Patrol movie last year, revenue in constant currency declined by only 6.5 percent.

Let me now briefly review a few details on Q3 Creative center performance. Toy gross product sales were $617.7 million, a decline of $63.5 million or 9.3 percent. On a constant currency basis, gross product sales declined 6 percent. Preschool and dolls in interactive declined by $26.3 million or 8.5 percent, driven by lower sales of PAW Patrol, which as Max noted, was strong last year in the wake of the forms release, as well as declines in present Pets and Pika Rub offset by higher sales of Gabby's Dollhouse.

Activities, Games & Puzzles and Plush was down 10.3 percent mainly due to the Games & Puzzles portfolio, School Maker and GUND, offset by higher sales of Rubik's. Wheels & Action decreased $8.5 million, led by Monster Jam RC, DC Comics licensed products and Air Hogs offset by higher sales of the Monster Jam core line and Tech Deck. Outdoor declined by $8.5 million, mostly from brands that were divested in Q1 this year.

Geographically, North America saw the biggest drop in Q3 due to retailers shifting more buying into Q2. International sales comprising Europe and the rest of the world rose 3.8 percent to 43.3 percent of gross product sales. Q3 sales allowances were 10.6 percent of gross product sales, down from 10.8 percent driven by a favourable change in customer and geographic mix offset by higher markdowns. On a year-to-date basis, sales allowances were 10.6 percent compared to 10.9 percent. Historically, we have operated in the 10 percent to 12 percent range. We expect sales allowances to be right at the upper end of the range for 2022 as we manage retail inventory levels and promotional activity in Q4.

Toy revenue or gross product sales, net of sales allowances declined 9.1 percent to $552.4 million from $607.8 million. Adjusted EBITDA for toys was slightly down at $126.9 million at a 23 percent EBITDA margin compared to $146.5 million or 24.1 percent due to higher administrative and marketing expenses as a percentage of revenue, partially offset by improved gross margin from product mix and price increases we implemented earlier in 2022 to offset inflation.

Entertainment revenue declined $50.9 million to $37.5 million from $52.9 million. Note that in Q3 '21, we recognized $26 million of distribution revenue from the PAW Patrol movie. Adjusted operating margin in Q3 was up significantly to 78.9 percent compared to 34.6 percent. The increase was driven by the dilutive effect of the lower-margin movie distribution revenue last year and fewer margin-dilutive content deliveries this year. As a reminder, our content distribution revenue is lower margin and is a catalyst for higher-margin toy sales and licensing and merchandising revenue. Also remember that when we discuss entertainment profitability performance on a stand-alone basis, we focused on adjusted operating margin as this is after content amortization.

Digital games revenue declined 35.7 percent to $34.6 million, driven by lower in-app purchases in Toca Life World. In Q3 last year, we saw heightened levels of activity due to COVID-related lockdowns. Adjusted operating margin was 28.9 percent, down from 48.3 percent from lower revenue and higher product development and personnel costs for future game development. From a consolidated P&L perspective, Q3 gross margin was 56.2 percent compared to 51.2 percent. The 500 basis point improvement was largely driven by strong toy and entertainment gross margins.

Keep in mind, gross margin was reduced last year by the dilutive effect of the PAW Patrol movie. Excluding the movie last year, gross margin was 52.7 percent, which equates to a very strong 350 basis point year-over-year gross margin expansion driven by product mix, higher pricing, and licensing and merchandising revenue.

SG&A was $195.3 million compared to $187.1 million, representing 31.3 percent of consolidated revenue, up from 26.2 percent because of the decline in revenue. Adjusted SG&A was $191 million compared to $183 million, representing 30.6 percent of consolidated revenue, up from 25.5 percent. Marketing expenses increased by $5.6 million to $39.8 million. We continue to expect marketing to be between 9 percent and 10 percent of revenue in '22 as we invest in marketing strategically in Q4 to support sell-through, share growth, brand momentum and channel and mixed goals.

Administrative expenses grew by 4.9 percent due to higher personnel-related costs and professional services expenses offset by lower incentive compensation. As a percentage of revenue, administrative expenses increased to 13.4 percent from 11.2 percent. Selling expenses increased to 8.2 percent of toy revenue from 7.8 percent due to higher royalties on sales of partner licensed products. In

Q3, we recorded net income of $141.4 million or $1.33 per diluted share compared to net income of $135.4 million or $1.29 per diluted share.

Adjusted net income in Q3, which excludes FX, was $114.4 million or $1.08 per diluted share compared to $132.6 million or $1.26 per diluted share. Adjusted EBITDA declined to $167.6 million compared to $217.3 million. Adjusted EBITDA margin was 26.9 percent, down 350 basis points from 30.4 percent. However, excluding the PAW Patrol movie revenue in Q3 2021, Adjusted EBITDA was $191 million or 27.8 percent, which equates to a comparable 90 basis point year-over-year margin decline.

The decline was due to higher selling, general and admin expenses partially offset by higher toy and entertainment gross margins. Turning to the balance sheet. Inventory at the end of Q3 was $178 million, down $5 million compared to $183 million last year. Our inventory continues to be of high quality, and we continue to adjust our demand and supply forecast to reflect current realities. We expect to be in line with our inventory goals by year-end. Core net working capital as a percentage of LTM revenue was 11.3 percent, down 450 basis points compared to last year, driven by lower trade receivables, lower inventory and accounts payable.

Free cash flow in Q3 was $175.3 million compared to $65.8 million, driven primarily by higher cash from operations. Year-to-date free cash flow was $180 million compared to $128.3 million from higher cash flows provided by operating activities. Our free cash flow to Adjusted EBITDA conversion ratio was 105 percent for Q3 and just under 50 percent year-to-date. We ended the quarter with $675 million in cash. We continue to be an extremely strong liquidity position with available liquidity of well over $1 billion. We continue to remain focused on increasing opportunities to leverage our diverse and global platform by making accretive acquisitions across all three of our creative centers.

This quarter, we closed the acquisition of solid roots and Oklahoma-based broad game manufacturer, best known for the trivia game Mine the Gap, and the Nordlight Digital game studio, which Max described earlier.

Turning now to our '22 outlook. We are lowering our full year gross product sales and revenue growth guidance to low single digits in constant currency and excluding the PAW Patrol movie amidst a challenging second half macroeconomic backdrop that has deteriorated rapidly. We are now expecting a more difficult fourth quarter comparison than initially forecasted, driven by lower retail orders from weakening consumer demand in the U.S. and Europe and elevated inventory levels at retail industry-wide. As a reminder, in Q4 last year, there were three specific factors that generated very strong sales in toys in addition to strong consumer demand, overall, fueled by supply chain concerns.

Firstly, we made initial shipments for the Batman movie. We generated strong sales of Paul movie toys following the movie launch, and finally, we saw very robust initial Gabby's Dollhouse sales on its launch in the U.S. We are also seeing pressure on digital games revenue in Q4 compared to Q4 2021 due to the current macroeconomic environment impact on consumer spending and lower activity levels compared to the heightened activity levels due to COVID-related lockdowns last year. We do, however, anticipate sequential growth based on a number of new Toca Life World content launches in Q4.

We are reducing our 2022 Adjusted EBITDA margin outlook to slightly below 2021 Adjusted EBITDA margins, excluding the PAW Patrol movie distribution revenue of $26 million due to the expected reduction in high-margin revenue in Q4 relative to our prior outlook, and some deleveraging. We expect gross product sales seasonality in 2023 to return to historical trends of 30 percent to 35 percent H1 after an unusual year in 2022, where significant volume was pulled forward from Q3 into Q2, resulting in a very strong H1 with gross product sales representing over 40 percent of expected gross product sales. This will make our H1 2023 challenging relative to H1 2022 with a correspondingly stronger H2 comparison in 2023 relative to H2 in 2022.

Regarding inflation, costs overall continue to remain at elevated levels relative to prior years. However, we have seen supply chain pressures begin to ease as there is greater availability of ocean containers and raw materials and the cost inflation environment for both commodity and transportation prices in 2023 is trending favourably as they move off their peaks. We are remaining vigilant and are continuing to remain close to suppliers and focus on accelerating productivity and efficiency.

In 2023, we expect consumers' disposable spending power to remain under pressure due to inflation in food, housing and energy. As such, we intend to plan the top line prudently and to manage our cost structure appropriately. We do, however, remain very excited about our prospects for '23 and beyond. We are not providing further specific 2023 details now as usual, and we will do so when we release Q4 and 2022 full year results in March.

To conclude, we continue to demonstrate our ability to produce compelling entertainment and digital games content, magical toy expenses and be a great licensing partner. We remain committed to growth with sound investments, disciplined cost management, operational efficiency and productivity. We continue to believe in our long-term financial framework and remain focused on maintaining operational agility and strategic execution to position Spin Master for sustainable and profitable growth over the long term.

That concludes our remarks. We will now open the line and take questions. Operator, please go ahead.

Operator

Thank you.

Our first question will come from Martin Landry with Stifel.

Martin Landry —Analyst, Stifel GMP

Hi. Good morning, everyone.

I was wondering if you could touch a little bit more on your revised guidance. I was wondering if you can walk us through a little bit what's changed since August to prompt you to bring down your back half revenue guidance lower? Is it a function of too much inventory in the channel? Is it a function of customers trading down? Is the competitive environment becoming more challenging? A bit more colour would be super helpful.

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

Good morning, Martin. I'm going to start and then pass it on to Mark.

From August, the toy market deteriorated and sequentially, POS got materially worse. With now the benefit of the last two to three weeks' worth of POS, Mark and I had to look at the facts, and all the August, September promotional investments to reduce inventory did not bring the inventory down as expected. That's number one.

Number two, as the POS declined more significantly than anyone expected, retailers specifically, obviously, actions by them resulting in delayed orders, canceled orders or sometimes even shutting down replenishment were things that we knew just recently.

As we head into Q4, despite the fact that we have a great plan, we also now have to take into account that it's going to be about consumers returning to more traditional patterns of consumption late in the game, and we wanted to be prudent and basically plan accordingly. That is really what drove the change for us.

Mark Segal — Chief Financial Officer, Spin Master Corp.

So just to add to what Max said in connection with POS and the weakening in consumer discretionary spend and inventory reduction plans not working, obviously, that has actually taken our top line down. A lot of that revenue is high-margin revenue, so we anticipate losing some of that revenue. As volume comes down, obviously, we see some deleveraging in our SG&A lines. As a result of that, we actually have called down our guidance on both the top line and slightly on the bottom line as well.

Martin, I do want to say to you and everyone else, though, that in the context of the reduced guidance, we still have very high EBITDA margins, they're still within our long-term target range, and they're still very good relative to our peers in the industry at both a gross margin and Adjusted EBITDA margin level. While I'm sure people are disappointed, I want to make sure that everyone at least understands that we're still doing extremely well as a company.

Martin Landry —Analyst, Stifel GMP

Great. That's helpful. I was wondering if you can talk a little bit about the evolution of your point of sales maybe in October and maybe also, yes, post quarter. What's happened? Has this slowed down? And recently, has the slowdown increased? Any data on the evolution of your point-of-sale post quarter end would be great.

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

Yes. So, I think talking about the third quarter POS is basically about three different things specifically. One is in the context of our year-ago base, we had planned, of course, to have PAW Patrol in the year-ago base, which is obviously something we had planned down this year. So this was already a planned decline. And by the way, in line with what we expected. Outside of PAW Patrol margin, our point- of-sale is growing 4.5 percent, okay, and it's growing 7.8 percent year-to-date when we just basically quoted to you industry numbers, which were lower than that. When I think about quarter three and our POS outside of PAW Patrol, we were seeing that.

One thing that happened, I'm now moving to the second part of my answer is as pricing in the category was exacerbated to decrease the inventory levels, the effect of items that were new to the category was lessened. And as you know, we have obviously an important part of our revenue that is innovation, and that was so far less effective, given all the promotional investments in the marketplace.

I think those are the two more important factors. The third factor is really ASPs. And so, as we had basically gotten into quarter three with a healthier inventory, investments were basically utilized on other portfolios, we had some ASP gaps in some areas, but I think that is a minor component to our gap in POS. Remind yourself, our quarter three POS outside of PAW Patrol was significantly better.

The last piece is important because the last two to three weeks that we have, which is indeed new information for all of you from what you may have seen from other competitive players has really worsened and it's really come down quite materially and Mark and I had to look at that and make a call. It's not just about Spin Master. Like I said, we're still better but it's about the total industry, so we wanted to be prudent when we actually took the guidance approach.

Martin Landry —Analyst, Stifel GMP

Okay, and then maybe just switching gears, my last question is on digital games. I was wondering if you could maybe just refresh us. You talked about Rubik's Cube being launched in 2023. Maybe just a bit more details on timing would be great, and then are there other digital games being launched next year?

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

Martin, we have a slate of new games being launched next year. Some was soft launch. Timings are basically still being finalized. Definitely, Rubik's more in the first half and then PAW and Friends more on the back half. So, that is basically our current plan. The plan for Toca Life World, which is really our biggest revenue driver and 49 million people in the ecosystem is quite a strong plan with content drops every month of the year. So, I want to also emphasize that because that's really important.

Martin Landry —Analyst, Stifel GMP

Okay, perfect. Thank you.

Operator

Our next question will come from Luke Hannan with Canaccord Genuity.

Luke Hannan — Analyst, Canaccord Genuity

Thanks. Good morning.

Max, you've talked on past calls about what the demand trends have been across price points in your portfolio. Can you give us an update on how that trended in Q3 and how that's playing out thus far in in Q4, please?

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

Sure. Luke, good morning.

The higher end of the price points have obviously declined a bit more than the total market and the very, very $0 to $10 range has also declined more than the market has declined. So, in that respect, things basically are behaving very similarly to what it would have happened when we spoke last.

The whole market has declining POS consumption. It has not been driven by one necessarily segment more than others. The price reductions, however, have been more pronounced in certain price points and those would fall in the middle of the pack, so just wanted to add that colour. So, even though we would see similar behaviour, the price promotion depth of discount has been bigger in the middle of the pack.

Luke Hannan — Analyst, Canaccord Genuity

Got it. Okay

Max, sticking with you for a second. You had mentioned before that and I just want to make sure I understand the dynamic that the consumer spending environment had negatively impacted your ability to bring out new launches. Just to clarify, that means that you were selling your new launch products at lower prices than you ordinarily would have because of that consumer spending environment?

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

No. Absolutely not. What he basically is meant to give to you guys very transparently is in an environment where innovation is competing with items that are basically half off or 75 percent off and when actions by retailers are basically trying to clear that inventory. Putting that on end caps or just displays. Then obviously, that was the number one priority before they would give focus to new items. That's really more what I mean.

Luke Hannan — Analyst, Canaccord Genuity

Okay. Understood. Last one for me and then I'll pass the line. Just what are your expectations either on a dollar basis or a unit basis for where you expect your own inventory balances to trend for the balance of the year and into the new year?

Mark Segal — Chief Financial Officer, Spin Master Corp.

Morning, Luke.

Obviously, just given the environment that we're in, we're managing our inventory flows very, very tightly. Last year, actually, at the end of Q3, we were at over $180 million. We're below $180 million this year. We're actually down year-over-year on inventory as you can see. Our inventory is pretty clean and high quality. This is owned inventory, obviously. Our days inventory on hand is up slightly, but we're down in dollars. And we expect to end the year down below where we are now as Q4 plays out, but we will be slightly higher than where we finished at the end of last year.

Last year, inventory levels were very low because demand was so high in Q4 of last year. We'll be above that, but we'll still be well within our targets. I just want to mention to you and everyone, if you actually look at probably the most important metric that we track from a working capital perspective is net working capital as a percentage of LTM sales. Our results are really quite extraordinary relative to our peers and we're below last year as well. We're at around 11 percent of LTM sales down nearly 450 basis points. We really are managing our working capital very well, and I'm quite proud of how we're and the teams are doing that. I just wanted to call that out. It's not just inventory.

Luke Hannan — Analyst, Canaccord Genuity

Got it. Okay. Thank you very much.

Operator

Our next question comes from David McFadgen with Cormark Securities.

David McFadgen — Analyst, Cormark Securities

Yes. A couple of questions on the digital games business. So, just looking at Toca, we saw the MAUs decline year-over-year. I was wondering if you could give us an idea on what you expect for the fourth quarter, maybe going into '23. Then just looking at the ARPU, obviously, that's down quite a bit due to lower in-app purchases. This business, particularly the ARPU really benefited from COVID and the lockdowns and so now it's coming off a fair bit. I was just wondering, do you think that, that could actually go back to pre-COVID levels? I'm just kind of wondering where your views are on the business right now?

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

David, so there are two or three parts to your question. Let me take them one by one.

So, on the level of monthly active users, the monthly active users are holding close to 50 million MAUs. You call that a slight decline, and you're correct. We're actually very encouraged that when you consider that versus what's happening in the marketplace across other competitive games, we're actually faring quite better. So, that's number one.

It doesn't make us stay dormant. In fact, we're actually working really hard on the quality of our content to actually drive that further engagement and for kids to monetize the love they have for the game, and that's what our teams are focused on doing, which gets into your second part of the question, which is ARPU. I think we've seen precisely as you described, that ARPU decline, but I want to just make sure you understand as well that what we want is more kids to come to the game and experience something they love and then buy in our purchase content.

While we're seeing that, the fact that kids are spending a little bit less time on screen is what's actually driving that behaviour too and so you're right. As we get into the post-COVID normal, that number of minutes will make potentially is returning to the pre-COVID levels, but we're working on trying to get the content basically more now exposed to all the users in the ecosystem so that basically they can then enjoy it and then purchase it. That's our action item.

We have some tests that we've actually executed in start of Q3. As we actually get to the most important month of the year, which is December, and as you remind ourselves that, that is the most critical month for us in Toca Life World, we have great content and the benefit of some of these tests, we should actually boost our ARPU as we actually close the year.

David McFadgen — Analyst, Cormark Securities

Okay. I mean, I guess it's just tough to really say how it's going to unfold, right? I mean you guys are doing everything you can. So, okay, thanks.

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

Thanks David.

Operator

And moving on to Brian Morrison with TD Securities.

Brian Morrison —Analyst, TD Securities

Maybe Max, if we can just stick with digital for one minute. You reiterated the ramp to 20 percent of total revenue in time. Maybe just help me get some comfort on the cadence and the time to ramp including NOID, how that should flow through? Then, Mark, maybe discuss if acquisition multiples have come down and how active you think you can be in the near term on that front?

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

So, we will continue to be focused on driving organic growth behind the Toca Life world. Obviously, incredible property we own and are proud of. So, that's actually action number one.

Action number two, our Nordlight studio is getting us into cash flow gains market, which is really expensive, accretive to us and a new audience. That should bring significant new players and revenue to us, and that's a big part of actually capturing that.

We have yet another property that we're working on that gets us get into another segment of the market, which is one we're not playing in today and it's an audience we're not serving today. Then importantly, in the second half of the year, we're actually doing a multi-creative center, a big bang behind the movie launch of PAW Patrol and PAW and Friends, the digital game will actually come to market. That's yet another important contributor to our growth towards that ambition.

Last but not least, we have two or three other games that we're actually working on in soft launching and there are games that are now developed and we feel really strongly about it. We are basically trying to get the IP of our Company digitize to actually try and get new players to experience parts of the digital gaming market segments, we're not playing in today. Let me turn it over to Mark so that he can then complement with the M&A angle.

Brian Morrison —Analyst, TD Securities

Yes.

Mark Segal — Chief Financial Officer, Spin Master Corp.

Brian, let me just make a point overall in terms of M&A for you and everyone else. We've invested a lot in the last 12 months in building up our M&A team. We've now got specialized roles in each of our creative centers who are focused on building up our pipeline and our pipeline in M&A in general is much larger than it has been in the history. We're really encouraged by that.

In terms of multiples, I think just given the environment, we are seeing multiples come down. I would say to you in terms of the deals that we've actually done, we've structured our deals in a way that we make a smaller cash payment upfront and then there's future payouts based on both performance and retention in terms of the teams that we acquire, and that's the most recent acquisitions and some that we've done in the past as well so in a way that derisks the acquisition itself.

Overall, multiples are coming down. We expect that to play out in '23 and '24. I think we're in a good cash position, just given our liquidity to take advantage of some of the acquisition opportunities that we see flowing in our pipeline.

Brian Morrison —Analyst, TD Securities

And Mark, timing to 20 percent, do you have any colour on that.

Mark Segal — Chief Financial Officer, Spin Master Corp.

The 20 percent target that Max referred to on digital games is more of a medium to long-term target. I don't want to call a specific year on that, Brian, because that's going to be driven by both acquisition as well as new products and organic growth in existing. It's going to be a mid- to long-term target, but we are still firmly focused on that target.

Brian Morrison —Analyst, TD Securities

Okay. Then second question, just on inventory. I just want to go back. Obviously, it's elevated at retail and then you're somewhat your warehouse right now, but I think you said that actions have been taken. They hadn't received desired results. Maybe just elaborate on what the actions are that you're taking as we get into Q4 here, I assume it's price and heightened marketing. What is the risk that you end the year with elevated inventories with POS declining substantially in the last couple of weeks?

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

Great question. I think we started taking actions on our owned inventory, okay, a few months ago, as we actually were beginning in August to see the deterioration and the exiting of retail inventory at a high level as of when we spoke last. We immediately actioned our domestic inventory ownership. Then obviously, we began to push contracts and production into 2023.

We only focus on things that are basically items we can actually bring forward to '23 and are recurring. So, we took good actions with enough time and have been able to mitigate quite a bit of that. Recall that the retail inventory that you're alluding to, most of it was really brought forward into H1 FOB by retailers, so that is something that was basically done that way.

Then in Europe, where we actually do manage the inventory, by and large, we've been doing this now for about three, four months. So, I think all the actions we took a few months back have paid dividends and position as well as we actually approach the end of the year.

Mark Segal — Chief Financial Officer, Spin Master Corp.

Just to add very briefly to what Max said, Brian, obviously, we're sensitive to retail inventory levels. And to the extent that we need to actually take action at retail with markdowns, we've built that into our projections. We've guided towards the higher end of that 10 percent to 12 percent range, which takes into account, we think, a reasonable level of markdowns to manage any retail inventory problems.

Brian Morrison —Analyst, TD Securities

Thank you very much.

Operator

Our next question comes from Adam Shine with National Bank Financial.

Adam Shine — Analyst, National Bank Financial

Thanks a lot. Good morning.

Max, just in terms of how things have come off in the last, let's call it, well, post August effectively. Were there any opportunities for you to delay any particular launches scheduled towards the end of the year? I suspect not perhaps based on prior plans, but who knows, maybe there was such an opportunity in terms of pushing some launches out into the new year? Maybe start there and a couple more.

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

Yes. Good morning, Adam.

There were some items that actually we are getting behind in the spring, and as you can imagine, with the situation that we were facing, exactly what's going to happen, and they're getting massive supporting the spring. We've taken opportunistically one or two of those items and are going to get behind it in a very important way starting next spring and into the summer, so that is a very acute observation on your part and we've done it.

Other things were basically in flight and so now we're just re-promoting those as we get into what's going to be Christmas falling on a Sunday of the 51st week. We just have tweaked our marketing approach to kind of give those innovations the right chance with consumers. That's the other thing we've done. We haven't just basically seen this situation pass and not acted on it. We've actually redirected our investments in marketing and our plan accordingly to make sure we give that innovation it's to day in court.

Adam Shine — Analyst, National Bank Financial

Okay. Just the other elements in regards to COVID, I mean we've got the situation of, obviously, couple of years of COVID that elevated a number of product items. You've highlighted that a few times in terms of games and puzzles. But those categories seem to have remained robust, at least for a good chunk of this year. So, maybe in the context of some of the weakening in POS that generally in the marketplace, are you getting a better feel for let's call it, a post-COVID bubble bursting in regards to some of these categories that certainly did elevate strongly during the course of the prior, let's call it, two, two and a half years?

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

We have. We commented on the script and have seen, for example, when you think about all the craft portions and subcategories. We've actually kept a little bit better than the decline, so those are about low single-digit declines. We're actually covering that in that space, and that's been happening now for a few quarters. So, we've seen that and has moderated and stabilized. We don't have a big business in outdoor. That has been a very volatile category and have seen some massive declines.

We have taken all these different categories and perhaps plan or '23 with those facts in mind. When you think about preschool, when you think about wheels and actions with all the slate of new content, I think those have been actually quite more positive. As we look forward because, a, we have great new content on our own IP or licensed IP, then we feel more confident.

Adam Shine — Analyst, National Bank Financial

Okay. Just lastly, in regards to digital games, you've answered a few questions already there, but coming out of Q2, one of the items highlighted in the Q2 was that Sac spending was sort of elevated in terms of subscriber acquisition efforts. Is that something that is continuing to be pushed to help support some of the MAU and any other traction in the digital games business, or is there perhaps some pruning of that activity at least through year-end?

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

We definitely have a dynamic mark tech algorithm for user acquisition and we are very obviously disciplined about deploying those dollars and seeing the effect and we continue to do that. Nothing has changed in our approach to try and get new users into both our game for in-app purchases, but also into our subscriptions. While I have the opportunity on subscriptions, in particular, your comment about bringing new users, I did comment in my script that we had a new way to actually manage our subscription business which actually we are very encouraged by.

Think about everything you've read in the marketplace on subscriptions declining for a lot of different services. For us, we've maintained our subscription level close to 340,000 users, and we're now going to bundle our services and our games actually to come to the parent with a better option and better value, and we're very excited about that. So, this is something we're going to do going forward, and there will be user acquisition on that, but it's something that we have MarTech to manage.

Adam Shine — Analyst, National Bank Financial

Okay. Thank you.

Operator

Our next question comes from Gerrick Johnson with BMO Capital Markets.

Gerrick Johnson — Analyst, BMO Capital Markets

Good morning, and thanks for squeezing me in here.

We're going to dig a little bit deeper in the toy market has some a little bit more specific questions. The retailers seem to have ramped up the private label effort this year, I guess, they'd have some lower-cost options for their customers. How has that worked for them? Has that stolen share and space from you guys?

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

I would argue that in the lower price points where we actually participate less, that has basically been the case. But as you probably know from your own tracking, which is robust, that segment has been really weak, and so whether it's taken from us or it's taken from someone else, it does not necessarily materialize the way that it would have been expected. We don't, as you know, have a huge prevalence of revenue in that space, so for us, it's been less of an impact.

Gerrick Johnson — Analyst, BMO Capital Markets

Okay. Then moving on to collectibles market, which has been red hot. PlayStation license caters to that market, you have legal legends. How are you thinking about that market? It has defied gravity and maintains super robust, how do you see that playing out over the next quarter to year to a couple of years.

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

One of the things we're excited about is precisely what you just mentioned. Black Adam doing really well. We have a Bakugan reboot coming up in 2023. One thing we have discovered is, Garrett, that the Bakugan user from years ago, who's now basically in the age group you're describing when we did something on Roadblocks and something beyond that came back to the franchise, and so we're actually taking actions from that learning.

We have, obviously, the properties you described on Sony, and so we're excited about the skill segment. It's been driving growth in the category, and we have been underdeveloped to your point.

Now, we're actually looking at a lot of macro factors for these audience as basically a lot of these people had a lot of benefits from all the checks and whatnot. As the macro tightens up and inflation has now taken hold, we're now basically tracking that group very closely because, obviously, quite a—the job market is going to change in '23. We're very excited. We're tracking very closely the audience dynamics, and we're going after it.

Gerrick Johnson — Analyst, BMO Capital Markets

Okay. Great. Lastly, will Vida the Vet air in the U.S.?

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

Yes, it will.

Gerrick Johnson — Analyst, BMO Capital Markets

Okay. I didn't hear it. I heard your partner in Canada, but not.

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

Those deals are being finalized. You're correct. You're acutely right about the fact that I didn't mention it because those deals are being finalized.

Gerrick Johnson — Analyst, BMO Capital Markets

Okay, okay, great. Thanks, Max.

Operator

We will take one more question. This question is from John Zamparo with CIBC.

John Zamparo — Analyst, CIBC Capital Markets

Thanks for squeezing me in and good morning.

I also wanted to touch on inventory. You mentioned you're relatively pleased with the health of it, but I wonder how you're positioned for a trade-down environment, in particular, the comment you just made, Max, about not participating as much in the low-price category. Is there anything you can say about what percent of your sales would be considered lower priced items? I'm not sure if you measure it in absolute dollars or versus peers. Any colour you can share on your ability to take share in a trade down space.

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

Mark described the fact that we have some promotional mechanisms to participate more aggressively. However, we don't have the great majority of our volume in that $0 to $10. We do have items there, to be perfectly clear, but we do have quite a bit of plans against. It's more in the price point brackets that follow that, which is where the majority of the market is anyway. Even if you trade down from the $50 to $79, we're going to be incredibly well represented. Even if you go down from 20 to 29, we will still be very well represented. We're very confident that we're going to be represented where the market basically is coming down one price point below. That has been our planning approach and our support model.

John Zamparo — Analyst, CIBC Capital Markets

Okay. That's helpful. Thanks. Then the last one for me is on regional differences you're seeing at point of sale, and apologies if I missed it, but you referenced that your sales were down more in North America and Europe, and that's because of a shift in timing. I wonder what you're seeing at point of sale and what you can say about consumer behaviour in North America and Europe. I think it's no surprise for us to see a more reluctant European customer, but it seems like there's been a material deceleration in North America as well. So, any other colour you can add there would be helpful.

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

No, absolutely. We have basically just to wrap up North America, we have a super strong consumption business in Canada. We've had a really strong business in Mexico and feel very bullish about it. Now as we go to Europe, we have our toughest market in Europe, and that's the U.K.

The U.K. has been, by and large, the toughest market for a lot of people, us included, more from a promotional price deflation and just overall POS decline, and so that is the situation, and it's not new. It's been basically there for quite a few months. The rest of Continental Europe has deteriorated some, and we've had really strong positions there. I think we're still doing very well, and we expect our business to end up very positively in Europe continentally.

In Australia, which we may have in the past hinted at you that we were actually turning around, that turnaround has really happened from a consumption level, so they're now going into the season and summer months. We're excited about our business in Australia more so than we would have been six months ago.

Mark Segal — Chief Financial Officer, Spin Master Corp.

I think, Operator, we're going to have to wrap it up at this point. So, let me just say thank you to everyone for participating, and we look forward to talking to you all again in March when we release our Q4 and full year 2022 results. Thank you, everyone. Have a good day.

John Zamparo — Analyst, CIBC Capital Markets

Thank you.

Operator

Thank you.

That does conclude today's conference. We do thank you for your participation. Have an excellent day.