FINAL TRANSCRIPT

Spin Master Limited

2015 Q3 Financial Results Conference Call

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PRESENTATION

Operator

Good morning. My name is Melissa and I will be your conference Operator today. I would like to welcome everyone to the Spin Master 2015 Q3 Financial Results Conference Call. Prior to proceeding with the call, since it's Remembrance Day, the Management Team at Spin Master has asked that we observe a minute of silence.

Thank you. I'd like to remind you that all lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key.

Thank you. Mr. Segal, you may begin your conference.

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

Thank you. Good morning and welcome to Spin Master's financial results conference call for the third quarter ended September 30, 2015. My name is Mark Segal and I am Spin Master's Chief Financial Officer. I'm joined this morning by Ronnen Harary, Co-Chief Executive Officer; and Ben Gadbois, Global President and Chief Operating Officer. Following our formal remarks, we will open up the lines for your questions.

For your convenience, a press release containing our third quarter financial results is available on the Investor Relations section of our website at www.spinmaster.com, as are our Q3 MD&A and financial statements. This information is also available on SEDAR.

Before we start, please note that remarks on this conference call may contain forward-looking statements about Spin Master's current and future plans, expectations, intentions, results, levels of activity, performance, goals or achievements, or any other future events or developments. Forward-looking statements are based on the information currently available to Management and on estimates and assumptions made based on factors that Management believes are appropriate and reasonable in the circumstances. However, there can be no assurance that such estimates and assumptions will prove to be correct. Many factors could cause actual results to differ materially from those expressed or implied by the forward-looking statements. As a result, Spin Master cannot guarantee that any forward-looking statements will materialize and you are cautioned not to place undue reliance on these forward-looking statements. Except as may be required by law, Spin Master has no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. For additional information on these assumptions and risks, please consult the cautionary statement regarding forward-looking information contained in our earnings release dated November 10, 2015.

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

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

Ronnen Harary – Director and Co-Chief Executive Officer, Spin Master Limited

Thank you, Mark. Good morning, everybody, and thanks for your interest in this Spin Master. Yesterday, we reported strong financial results for the third quarter and nine months ended December 30, 2015. I'll begin the call with some brief highlights of our revenue and product growth during the third quarter before Mark provides you with a more detailed review of our financial results. Then we'll then take a few minutes to discuss our operational results.

We are very pleased to report that in the third quarter 2015 revenue increased by 31.7 percent to $386.8 million. Revenue increased across all geographic markets, with North America up 35.1 percent, Europe up 45.4 percent, and the rest of the world up 10.3 percent. Q3 2015 revenue was enhanced by improvements in operational efficiency that enabled us to ship a lot of products in Q3 that in past years was shipped in Q4. Mark and Ben will provide further colour with respect to this initiative in their upcoming remarks.

On a business segment basis for Q3, all segments were up. Gross product sales in our Activities, Games, Puzzles and Fun Furniture segment increased 25.4 percent, $74.6 million, primarily driven by the launch of Bunchems, Text Cool and Knit Cool, and increased sales in Aquadoodle and the Mashmallow Furniture line.

In Remote Control and Interactive Character segment, gross product sales increased 6 percent to $137.8 million, resulting from strong sales of Star Wars licensed products, Air Hogs, partially offset by lower sales to Zoomer and DigiBirds.

Gross product sales in Boys Action and High-Tech Construction segment increased 52 percent to $95.3 million, primarily driven by the launch of Meccanoid and Star Wars licensed products, partially offset by lower sales of How to Train a Dragon, Minecraft, and Ionix Tenkai Knights products.

Some additional comments on our Star Wars product licences and merchandise will be launched—were launched on September 4, and as part of both the Remote Control and Interactive Characters of Boys Action High-Tech Construction segment. The new Star Wars movie goes into general release on December 18th, and there's obviously tremendous excitement about it. We have a great product line that generated very strong reception out of the gate. Similar to other industry partners, sales paused after initial strong surge, but we expect sales to pick up again as we get closer to the movie launch and our fall media kicks in.

In Pre-School and the Girls segment, Girls product sales continued to grow strongly, increasing 71.7 percent to $131.9 million. The sales reflect the continuous robust growth of Paw Patrol products, in addition to the launches of Chubby Puppies and Little Charmers, offset by declines in Flutterbye Fairy and Chatsters.

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

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

Thanks, Ronnen. Our third quarter 2015 revenues increased by 31.7 percent, from $293.8 million in Q3 2014 to $386.8 million in Q3 2015. Our strong performance was achieved despite the headwinds associated with the US dollar that was rising relative to other currencies, reducing our revenue by $8 million during the quarter. In constant currency terms, revenue increased by 34.3 percent in Q3 2015, relative to the comparable period in 2014.

In the third quarter, our gross profit increased to $205.2 million, representing 53.1 percent of revenue, compared with $149.8 million or 51 percent of revenue in Q3 '14.

Total SG&A expenses increased 84.1 percent to $135.5 million for the three months ended September 30, driven primarily by IPO-related costs, in particular, the $43.4 million in stock-based compensation expense. Excluding these one-time costs, total SG&A as a percentage of revenue was 23.8 percent in the third quarter of '15, compared with 25 percent in the same quarter of 2014. For those interested, more detailed analysis of our SG&A expenses are presented in the MD&A.

Adjusted EBITDA increased by 47.7 percent in Q3 2015 to $118.7 million, compared to $80.4 million in Q3 of '14. Adjusted EBITDA margins improved from 27.4 percent in the 2014 period to 30.7 percent in Q3 2015, reflecting higher gross margins, increased sales of products under own brands, and operating leverage. This operating leverage underlines the benefit of our flexible business model that emphasizes variable costs over fixed costs, with only a nominal investment in manufacturing and no investment in warehousing or animation studio assets.

Adjusted net income, excluding the effects of the IPO-related expenses, increased 32.3 percent in Q3 2015 to $74.1 million, up from $56 million in the previous year. Free cash flow increased from $72.6 million in Q3 '14 to $75.8 million in Q3 of '15.

Turning now to our year-to-date September 30 results, our revenues increased by 29.9 percent, from $478 million in 2014 to $621 million this year. FX headwinds reduced overall revenue by $16.5 million for the nine months. In constant currency terms, revenue increased by 33.3 percent for the nine months relative to the comparable period in 2014.

Our gross profit for the nine month period this year was $327.3 million, representing 52.7 percent of revenue, compared with $240.1 million or 50.2 percent of revenue in the corresponding period of 2014. The increase in gross profit margin of 2.5 percent on a year-over-year basis primarily results from increased sales of higher-margin products, increased licensing and merchandising revenue, and ongoing productivity initiatives.

Total SG&A expenses increased 50 percent to $243 million for the nine months ended September 30. Adjusted to exclude the cost associated with the IPO that I referenced earlier, total SG&A expenses for the first nine months of 2015 were $199.6 million, compared to $162 million during the same period last year. SG&A as a percentage of revenue, excluding IPO costs, declined from 33.9 percent of revenue in 2014 to 32.1 percent of revenue in 2015, reflecting ongoing cost discipline and operating leverage.

Adjusted EBITDA for the nine months ended September 30, 2015 was very strong, increasing 63.9 percent to $147.7 million, from $90.1 million in the corresponding period of 2014. Adjusted EBITDA margins for the first nine months of 2015 were 23.8 percent, compared with 18.8 percent last year. As in the third quarter, the Company benefited from higher gross margins, increased sales of product under own brands, and operating leverage.

Adjusted net income increased to $85.9 million for the first nine months of 2015, from $56.8 million for the same period last year, a 51.2 percent increase.

Free cash flow for the nine month ended September 30 was $73.4 million, 10.7 percent above the corresponding 2014 level of $63.3 million.

Turning now to our outlook for the balance of 2015, I want to remind you about the changes in the timing of shipments in the current year versus the prior year. Shipments in the third quarter of 2015 were enhanced relative to the prior year due to improvements in operational efficiency. This allowed the Company to ship product in Q3 that in previous years was not available for shipment until Q4. Shipping earlier allows our retail customers to avoid early season out-of-stocks on popular items and provides them with additional time for sell-through to consumers.

Due to the accelerated shipments in Q3, we expect organic gross product sales in Q4 2015 to be slightly below Q4 2014. For the second half of the year, we expect organic gross product sales growth to be at the mid to upper end of the previously stated range of 8 to 12 percent, compared to the second half of 2014, with full-year 2015 organic gross product sales growth at the upper end of the previously stated 12 to 15 percent range, compared to last year.

From a profitability perspective, a significant portion of our annual marketing expenses are incurred in Q4, in order to maximize their impact on consumer purchases and the return on investment.

This typically causes a misalignment of sales and spending between Q3 and Q4, resulting in Adjusted EBITDA margins in Q4 significantly below those in Q3. Given that the adjusted timing of shipments discussed above will magnify this effect, it is important to consider the second half of 2015 in the aggregate. While Adjusted EBITDA margins for the second half of 2015 are expected to be consistent with those of last year, we continue to expect full-year 2015 Adjusted EBITDA margins to be higher than 2014, demonstrating continued improvement in annual profitability.

To be clear, this target growth rate excludes the acquisition of Cardinal on both our gross product sales and EBITDA margins. Cardinal, which has over US$50 million of annual sales, has a similar seasonality profile as Spin Master, with 75 percent to 80 percent of its revenue typically in the second half of the year. Cardinal's Q4 sales and margins will be incremental to our Q4 results.

Regarding 2016, we expect Spin Master to continue to grow in line with our previous guidance of mid to high single-digit organic gross product sales growth. However, it is a little early to be too definitive on sales or profitability guidance for 2016, and we will provide you with further updates on 2016 expectations when we release our final 2015 results.

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

Ben J. Gadbois – Global President and Chief Operating Officer, Spin Master Limited

Thank you, Mark, and good morning to everyone. Overall, we're very pleased with the financial and operating performance of the Company through the first nine months of 2015. I'd like to provide some additional context into our initiatives, referenced earlier by Ronnen and Mark, to accelerate a significant level of our shipments.

We've been focused on moving products as early as possible into Q3 shipping window. Accordingly, we shipped product our retailers about three weeks earlier this year than in 2014. This moved a significant amount of sales into Q3 that would otherwise have occurred in Q4. In addition, the Star Wars launch on September 4th resulted in heavier than normal shipments in July and August, and, on a relative basis, the port strike in 2014 also moved a number of shipment into Q4 2014.

As we discussed previously, we ship a significant proportion of our goods FOB Hong Kong. By shipping earlier—in September, for example, versus October—we ensure that our goods arrive at our retail customers on or before December 1st, thereby reducing the risk of late arrival and missing key selling weeks. The earlier shipments will also ensure that retailers have higher lines fill rates and remain in stock through the critical selling windows of November and December, which will improve product sell-through, as well as reducing year-end inventory. This will hopefully also set us up for a strong front half of 2016, as we refill customer inventories. In addition, we held back on a significant proportion of our marketing this year to spend later in the fourth quarter, in order to maximize impact on consumer purchases and also maximize our return on investment.

POS response to these new fall campaigns is looking strong and we are driving towards clean sell-through by the end of the year.

In general, retailers are pleased with the year-over-year increase in POS across our portfolio. We are seeing strength across all four of our business segments. Let me walk you through some detail.

RC is being led by the launch of the Air Hog brand and Star Wars product, the top item being the Air Hogs Millennium Falcon, which is trending to be sold out in early December. It was also number six in NPD sales for all toys in September. Our Air Hog Shadow Launcher and Jump Jet are also off to a strong start. Zoomer products are comparing well to the breakthrough year we had in 2014, with both Kitty and Zuppy showing strong year-over-year success. Meccanoid and Legendary Yoda have been slow for the first 90 days, but have started to accelerate in POS over the last few weeks very nicely. Higher price point items in the industry this year are selling later than 2014, and we still expect a strong November/December in both these products as we ramp up our marketing activities in Q4.

Activities is being led by Kinetic Sand and a number of new product lines, particularly Bunchems, our new activity construction toys, and we are planning healthy growth for this brand in 2016. Our new game QUICK CUPS is also performing very well.

Our Pre-school and Girls segment is continuing to be led by Paw Patrol, which is maintaining and accelerating in its consumer engagement in POS performance. Our new Chubby Puppies brand is also on track to do very well and looks promising for 2016.

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

Our first growth strategy, to continue to innovative the core, relies in our ability to consistently infuse innovation into our portfolio of brands and products. Our internal 36-month brand innovation process will continue to allow us to build a sustainable and profitable business. As I have just described, core brands are performing well. We will provide further guidance on our 2016 initiative in our year-end call in Q1 '16. Our Team is already hard at work on the 2017 and 2018 innovation pipeline, as well.

Our second growth strategy is to continue to develop evergreen global entertainment properties. Our entertainment group plans to launch one to two new properties every year and we are actively working on new shows with 2016, '17 and beyond integrated with our toy line. We'll continue to leverage our broadcast relationship to create new revenue streams, including licensing out opportunities for each property, which will continue to help drive our margin expansion.

We continue to have success in building our entertainment franchises. Season 3 of Paw Patrol is now in production and Season 4 has already been picked up. Paw Patrol continues to generate high ratings, crosses many cultural boundaries, and has strong support from our partners globally. In addition, Rusty Rivets Season 1 is in production; Little Charmers launched earlier this year, is continuing to build an audience; and we also have started work on Abby Hatcher Monster Catcher and the re-launch of Bakugan. We also have a number of other exciting properties in the early stage of development.

Third, we plan to significantly grow our international sales. International sales represented approximately 72 percent of the global toy industry, but our sales outside of North America at the end of '14 were only 28 percent of our total sales. We continue to experience robust growth in Europe, with Q3 year-over-year gross product sales ahead by 45 percent and year-to-date gross product sales ahead in Europe by 63 percent. We are experiencing strong performance in Italy, Germany, France, UK and other European markets, as our credibility with retailers increase and our brands and products continue to resonate well with consumers.

We're making solid progress toward our goal of growing our international sales to 35/40 percent of our total sales in the next few years, which would represent approximately $150 million to $200 million in incremental sales using 2014 as a base. At 29.4 percent of our total sales through nine months of this year, we're well on the path to achieve this objective. For the full year, we expect our international sales as a percentage of total sales to exceed our year-to-date position.

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

As Mark indicated earlier, we closed the Cardinal acquisition on actual October 2. Even before the legal closing, lots of work was done in Q3 to integrate the two businesses. This integration went smoothly and we've hit the ground running. Cardinals' previous President is staying with the operation, ensuring consistency and maximizing the resources of the two organizations. We now have the number two market share position in the US games sub-segment and we see lots of growth potential in Europe and internationally.

Last, we're pleased overall with our performance to date. Early POS reads are encouraging and we are anticipating strong sell-through at the retail level. We are already hard at work on 2016, '17, and beyond. Our four key growth strategies are the right ones for Spin Master and will continue to create new growth opportunity as we move forward.

That concludes our formal remarks at this time. Ronnen, Mark and I will now be pleased to answer your questions. Operator, you can open it up for questions, please.

Q & A

Operator

At this time I would like to remind everyone in order to ask a question, press star, then the number one on your telephone keypad.

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

Adam Shine – Analyst, National Bank Financial

Thanks a lot. Good morning. So maybe we can start with the context of any success you may elaborate on in terms of other channels beyond the big three; and inasmuch as there was certainly no shortage of shipments in the quarter, did anything for Walmart possibly slip into Q4, given that we didn't see a big move in the Q3 period? Thanks.

Ben J. Gadbois – Global President and Chief Operating Officer, Spin Master Limited

Yes, I'd be happy to answer this. The first part of your question regarding some of the channel expansion, we're—typically and historically we've been very focused on the big three, Walmart, Target and Toys "R" Us, and over the last few years we have invested internally to start focusing on alternative channels, the value channel, some of the hobby channels, and we're doing this not only in North America but globally, and that strategy is working. So, we are expanding our focus in terms of channels.

As far as the shipments into Walmart, we're actually having an incredible year at Walmart. Our POS is up 20 percent, even if our shipment percentage is lower, and what we're doing is we're very, very focused as a Company on making sure that our year-end inventory position is very clean, so that we can have a very strong 2016, and we're working very closely with the retailers to maximize our ending inventory position, as we make sure that we sell all our products through.

Adam Shine – Analyst, National Bank Financial

Thanks for that colour, Ben. Maybe one quick one for Mark. Adjusted EBITDA guidance in 2H, or for 2H, is now flat to what previously might've been I think flat to slightly higher, so a little bit of a nuance there, but is this due to Cardinal in any way, or is it perhaps the addition of some additional marketing spend heading into the Q4 period?

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

Yes, it's actually not specific to Cardinal, Adam. It's really focused on—firstly, we said that I think it's going to be consistent, and we've kind of tightened the range of guidance from 8 to 12 percent to mid to upper end of that range. So we see consistency with prior year, and it really is to some extent driven by some additional marketing, and this is—it's very difficult to be very precise with marketing spend at this point, but we do see a significant portion of our marketing in Q4 as a driver of those EBITDA margins for the second half of the year, '15 versus '14. Just keep in mind, if you look at the SG&A, our marketing is running at around 5.4 percent year to date, but typically that gets up over 10 to 11 percent, and so we still have a big dollar value of marketing to run through Q4.

Adam Shine – Analyst, National Bank Financial

Great, thanks a lot. I'll queue up again.

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

Thanks, Adam.

Operator

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

Sabahat Khan – Analyst, RBC Capital Markets

Thanks. Just a quick question on the International front. It looks like this year was driven a lot by Paw Patrol, potentially. What are maybe some of the products that you've already disclosed that you think would have good traction in some of your international markets going into 2016?

Ben J. Gadbois – Global President and Chief Operating Officer, Spin Master Limited

Great question. If you put things in context in Europe, there's—I'd like to maybe step back and look at why Europe is working so well. First and foremost, we've changed how we operate in Europe. We're really focusing our business to go from a more North American-centered business to become much more global. How we develop our products, how we look at our mix, how we involve all of our international regions has a really big impact. A couple of years ago we changed our structure to a GBU structure, which means that our international offices are mainly sales and marketing, which allows our Team over there to redeploy all their resources into revenue-generating activity versus some of the back office that we're doing centrally. So that overall is working really, really well in Europe.

You've also often noted that Paw Patrol has worked really well in the front half of the year, will continue to work really well, but we have also a lot of other properties that are doing very well. So we have our Chubby Puppy brand that is being launched in Europe this year. We have Kinetic Sand, is doing very, very well. Our Zoomer line continues to do very well. We have our Meccano line with the Meccanoid that is doing very well. We have some items in Air Hogs that are doing really well. So the portfolio is actually much more balanced in terms of the fuel, I guess, the fuel in the tank in Europe. So there's a lot of different things firing up.

Sabahat Khan – Analyst, RBC Capital Markets

Okay, thanks, and just on the cash flow and CAPEX front, can you maybe comment on historically what kind of—how much cash flow you generate in Q4? It looks like CAPEX was accelerated in Q3. I guess, should we assume that it will decelerate in Q4 and you'll tie into that CAPEX guidance that you've been talking about? Thank you.

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

So, two questions, Sabahat, one, CAPEX, the other free cash flow. So, CAPEX historically has been in the 3.5 to 4 percent of sales range. It's actually picking up, and I think we guided you previously in previous discussions to the fact that CAPEX is actually increasing a little and will continue to increase in '16 and beyond, primarily driven by investments in TV shows.

So, CAPEX comprises two primary elements. One is tooling, which is the high IT components of our supply chain, and we own now tooling and invest in our tooling. The second element is our investment in TV show production costs, and that's capitalized and amortized as we deliver the show.

Now, as we build the entertainment element of our business, and we're committed to doing one to two new shows per year, as we described earlier, you will see CAPEX starting to tick up a little bit, and that's what you see now as we're investing in these shows.

In connection with the free cash flow, our seasonality is skewed towards a strong Q4 in terms of free cash flow. We typically build up our working capital into the third quarter and then as we start shipping significantly, we start generating a lot of free cash in the fourth quarter. We ended Q3 at around $55 million of cash, and you will see that increasing in the fourth quarter, net of any repayments of debt that we may choose to make in terms of the term loan that we raised the IPO, but we are committed to pay that down, as we've described earlier. But in general, the fourth quarter is our strong period for free cash flow production.

Sabahat Khan – Analyst, RBC Capital Markets

Thank you.

Operator

Your next question comes from the line of Brian Morrison from TD Securities. You're line is open.

Brian Morrison – Analyst, TD Securities, Inc.

Good morning. Thank you. Just in terms of the operational efficiencies, I see the advantage of you shipping earlier to the retailers, but can you maybe just elaborate on what they are? Is this simply a planning process? Can you give us an idea of how much of this pull-forward would've been due to the timing of Force Friday?

Ben J. Gadbois – Global President & Chief Operating Officer, Spin Master Limited

Sure, absolutely, Brian. So, first we—as far as our earlier shipment, it's really important to know that the retailers have asked us to ship earlier, so the early shipments are done hand-in-hand with our retailer plans and we're working collaboratively to get together, and we've had incredible collaboration and improved collaboration in terms of how we make our plans with our retailer partners this year. As far as operational efficiency, it really starts from how we—you know, we keep referencing our 36-month brand innovation process and then it goes into our different customers shows, and what we've done is from very, very early on in the process we actually spend more time with retailers. We make sure that the plans are firmed up earlier, and we've also built and created a lot of efficiencies into our product development process.

We really look at everything in the Company to try to move the needle closer and closer to best-in-class, and what it has allowed us is in prior years sometimes we maybe could not accommodate some of these early shipment requests and this year we've been able to.

In terms of the materiality of it, it's approximately, Mark, $60 million, $70 million?

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

Yes, somewhere in there, Ben. I would say somewhere around $60 million. I mean, Brian, just to add to what Ben said, the shipping windows that we're talking about are typically around 30 days long, and so we can ship on the first day of the shipping window or the last day of the shipping window. If that shipping window happens to straddle a quarter end, then obviously you're going to have sales either going into Q3 or going into Q4, but you've still actually complied with the terms of your shipping window.

In our particular case, we've shipped earlier in the window and quantifying—you know, just to quantify for what we were talking about in terms of dollars, that probably represents around $60 million of sales that would otherwise have been in the Q4 of prior years. Ben, you want to add?

Ben J. Gadbois – Global President and Chief Operating Officer, Spin Master Limited

Yes, the only thing, too, Brian, and everyone, that is really important to know is that by shipping earlier, it also allows the retailers to make sure that all of our products are properly displayed, they're in the aisle, and we maximize all the sales with the consumers, we prevent stock-out, we prevent issues, and it really allows us to maximize not just our POS, but also our year-end inventory position. So, from a strategic standpoint, being able to accommodate the retailers request to do this is actually very good for our Company.

Brian Morrison – Analyst, TD Securities, Inc.

Right, thank you. I understand the benefits of that, and it seems like the Star Wars phenomenon is clearly—it's still in its infancy stages. Paw Patrol continues to go very well. So, this may be a bit of an unfair question, but is there potentially a degree of conservativism on your top line outlook with the revision up to the high end of the 8 to 12 percent range? It just seems like things are continuing to go very well.

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

Well, I think—Brian, I appreciate the question. I wouldn't say were being conservative. I think we're being realistic and I think we're being reasonable with our guidance. You know, as Ben described, we did get the goods onto the shelf earlier, there's still a lot of replenishment time to go, so there's always the potential that there might be some upside, but we're very comfortable with the guidance that we've actually given you.

Brian Morrison – Analyst, TD Securities, Inc.

Okay, and then last question. Just on Paw Patrol, obviously it continues to hit the ball out of the park. Does it remain greater than 20 percent of your sales, and in the circumstances that it does—and this is probably for Ben—if it remains at an elevated level, what steps do you take to sort of manage this to your product concentration risk—or target, pardon me?

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

So, Brian, that's a great question. I'll answer it and then I'll also pass it off to Ronnen and Ben to add some colour, because I think it's an important point. So, in terms of our Q3 year-to-date sales position, Paw Patrol represents at around 27 percent of sales. However, with our remaining shipments still to go for Q4, we expect that percentage to come down to around 20 percent by the end of the year. Ronnen, do you want to …

Ronnen Harary – Director and Co-Chief Executive Officer, Spin Master Limited

Yes, hey, Brian. So, the other nice thing about Paw Patrol is it's giving us a strong ability to feed in our future pre-school shows, like Rusty Rivet, Abby Hatcher Monster Catcher. Not only are those shows able to be aired in North America, but they're able to be aired globally. So it's really give us a strong foundation to follow it up with what we believe to be some exciting pre-school shows, both for boys, girls, and dual gender, to really enhance our portfolio of pre-school properties and to grow our overall share in the segment, and so really become potentially a leader in the Licensed Pre-school category.

Ben J. Gadbois – Global President and Chief Operating Officer, Spin Master Limited

Yes, and then, Brian, to add your—to answer your other question in terms of what does it mean from us in terms of how we operate it, I mean, first, as you could understand, we're very, very happy to have Paw Patrol for not just the results that it creates, but also for the strategic relevance and future that Ronnen just described. But, internally, what we do is we manage all of our portfolio with very, very tight metrics, and we have ranges and projections for everything that we do. When we look at our 36-month brand innovation process, we have certain techniques and tools that we model the business with, without, and also different things that could happen, we do a lot of what-if analysis, and what it does is it creates a few very important focus points for the businesses, in that we're not slowing down the growth in all of these portfolios, meaning we're making sure that we don't overly rely on any property, even if it's on fire, we make sure everything else moves at the right pace, and we also make sure that in terms of how we manage the cost structure of the business, that we extract all the leverage that we can get and that we need to get, and we don't get ahead of ourselves in terms of how we invest in the infrastructure. So there's a lot of metrics and discipline in the business, Brian.

Brian Morrison – Analyst, TD Securities, Inc.

That's helpful. I'm going to sneak one more question, if I can. Just on the balance sheet, going back to Sabahat's question, it's clearly in a position of strength. You've got the free cash flow from working capital versus what's going to come through in Q4. This is probably a question for Anton, but I open the floor to whomever. In terms of the acquisition environment, can you maybe go into, without too much detail, are there opportunities potentially on the near-term horizon?

Ben J. Gadbois – Global President & Chief Operating Officer, Spin Master Limited

Okay, well, anyone of us can answer it. Go ahead, Ronnen.

Ronnen Harary – Director and Co-Chief Executive Officer, Spin Master Limited

So, Brian, Anton's actually not here so—but sometimes we're one and the same and sometimes people call me Anton, so that's okay. You know, I would say that the pipeline of opportunities is quite robust, and we're actively looking and investigating and doing due diligence and looking at a lot of opportunities, and so we're actively out there speaking. That being said, we are looking for things that are very strategic, things that are accretive to our business, things that are going to add growth, stability, iconic brands that we can fuel our innovation with, and we want—we are patient, and we want to be very patient with our strategies in terms of what we're going to deploy our capital towards.

Brian Morrison – Analyst, TD Securities, Inc.

That's helpful, Ronnen. Thank you very much all.

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

Thanks, Brian.

Operator

Again, if you would like to ask a question, press star, then the number one on your telephone keypad. Your next question comes from the line of Garrett Johnson from BMO Capital Markets. Your line is open.

Garrett Johnson – Analyst, BMO Capital Markets

Hey, good morning, everybody. I actually have three here. First, on sales allowances, it looks like they increased about 55 percent to 13 percent of sales, from 11.2 percent, if I did my math right. Why the big increase? Then second, on Little Charmers, is that performing to your expectations? Lastly—this might be more of a statement than a question, so you can tell me where I'm wrong—and it's about the sales pull-forward. You said that the retailers are asking for product early, but everyone else I've talked to in the industry is saying that retailers want product later, not earlier. So, if they're shipping early, they must want it because it's selling. So, wouldn't that mean that the 4Q gap would be filled with reorders as opposed to just being a gap?

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

Thanks, Garrett. So three questions. I'll do the first one and then I'll hand off Little Charmers and the sales question to Ronnen and Ben. Garrett, there's nothing untoward in the sales allowances. We had a lot of shipping of higher price point items, and so in terms of the allowances, the dollars would've gone up, but we're not seeing anything unusual or any trend. There's nothing in there that should give you any cause for concern. I think it was really just a product mix and a geographic mix issue, and I think we'll be in line with our regular percentages by the end of the year.

In connection with Little Charmers, I'll pass that off.

Ronnen Harary – Director and Co-Chief Executive Officer, Spin Master Limited

Hey, Garrett. You know, with Little Charmers, it started airing at the beginning of this year and the frequency was okay, and the frequency is actually starting to increase as we go into the fourth quarter, as we start to deliver a lot of episodes to the broadcaster. As you can appreciate, when you start delivering, they don't want to increase the frequency until they have more than 26 to 30 episodes actually in their library, and so the library's actually starting to build now. The show is actually just starting to find its audience. The sales results are okay. The product's not—the product's doing okay, it's doing okay at retail, but it's starting to find an audience and it needs time, so I think we ought to give it the opportunity to find its footing in the marketplace, but I think it's going to definitely help by the fact that there's going to be more episodes with broadcasters to put out for consumers to see and they're going to increase the frequency of coverage.

Ben J. Gadbois – Global President & Chief Operating Officer, Spin Master Limited

Your third question, Garrett, as far as the earlier shipments in partnership with the retailers, so there's a few things happening in the industry now as far as our observation and what we're seeing, is that, first, the higher price point items are actually selling later the year, and I think other companies are witnessing and experiencing the same. Nonetheless, when you look at—if you look at how our products we're doing—just for example, in the month of September, we have three of the top 10 items on NPDs (phon), being Paw Patrol Basic Vehicle, we have the Paw Patroller, we have Star Wars Head, Air Hogs Millennium. So, you're right, our products are selling well today. A lot of our marketing campaign just kicked in at the end of October, so this is where, as Mark referenced earlier, a lot of our investment is actually going live now and we'll continue to press forward.

To your point, Garrett, if we need more products—and of course there'll be replenishment—but the one key thing that is really, really important for us is that as we continuously improve our metrics as a Company, and we want to make sure that we partner up better and better with our retailers, is every year we want to make sure that our ending inventory is high quality and lower than the prior year, and we're always trying to achieve higher sell-through, and what that does is it obviously eliminates a lot of difficult conversation with retailers, that you guys are all familiar with, but it also really sets us up well for 2016, where our inventory is high-quality and then we turn the page and we start the first half of next year very fresh.

So hopefully—does this answer your question?

Garrett Johnson – Analyst, BMO Capital Markets

Yes, yes, it answers my question. Thanks a lot, guys.

Ben J. Gadbois – Global President & Chief Operating Officer, Spin Master Limited

Thanks, Garrett.

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

Thanks, Garrett.

Operator

There are no further questions at this time. Mr. Segal, I turn the call back over to you.

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

Okay. Well, thank you, everyone. If there are no further questions, we will now end the call. Thank you for participating and we will speak to you in Q1 with our year-end results. Thank you.

Ben J. Gadbois – Global President and Chief Operating Officer, Spin Master Limited

Thanks, everyone. Have a great day.

Operator

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