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MAT.OQ - Q3 2024 Mattel Inc Earnings Call

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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Thank you for standing by, and welcome to the Mattel Inc. third quarter 2024 earnings conference call.

(Operator Instructions) Thank you. I'd now like to turn the call over to Jenn Kettnich, Vice President of Investor Relations. You may begin.

Jenn Kettnich - Mattel Inc - VP, IR

Thank you, operator, and good afternoon, everyone. Joining me today are Ynon Kreiz, Mattel's Chairman and Chief Executive Officer, and Anthony DiSilvestro, Mattel's Chief Financial Officer. As you know, this afternoon, we reported Mattel's third quarter 2024 financial results. We will begin today's call with the Ynon and Anthony providing commentary on our results, after which we will provide some time for questions.

Today's discussion, earnings release, and slide presentation may reference certain non-GAAP financial measures and key performance indicators, which are defined in the slide presentation and earnings release appendices. Please note that gross billings figures referenced on this call will be stated in constant currency, unless stated otherwise.

Our earnings release, slide presentation, and supplemental non-GAAP information can be accessed through the Investors section of our corporate website corporate.mattel.com and the information required by Regulation G regarding non-GAAP financial measures as well as information regarding our key performance indicators is included in those documents.

The preliminary financial results included in the earnings release and slide presentation represent the most current information available to management. The company's actual results when disclosed in its Form 10-Q may differ as a result of the completion of the company's financial closing procedures, final adjustments, completion of the review by the company's independent or registered public accounting firm and other developments that may arise between now and the disclosure of the final results.

Before we begin, I'd like to caution you that certain statements made during the call are forward-looking, including statements related to the future performance of our business brands, categories, and product lines. Any statements we make about the future are, by their nature, uncertain and these statements are based on currently available information and assumptions, and they are subject to a number of significant risks and uncertainties that could cause our actual results to differ from those projected in the forward-looking statements.

We describe some of these uncertainties in the risk factors section of our latest Form 10-K annual report, our latest Form 10-Q quarterly report, our most recent earnings release and slide presentation, and other filings we make with the SEC from time to time, as well as in other public statements. Mattel does not update forward-looking statements and expressly disclaims any obligation to do so, except as required by law. Now I'd like to turn the call over to Ynon.

Ynon Kreiz - Mattel Inc - Chairman & CEO

Thank you for joining Mattel's third quarter of 2024 earnings call. This quarter we continued to execute our multi-year strategy to grow Mattel's IP-driven toy business and expand our entertainment offering. Coming into the quarter, we always knew there would be a tough comp relative to the prior year, which benefited from the success of the Barbie movie. The highlight of the quarter was that we fully offset this comp in our bottom line through strong gross margin performance.

Our balance sheet continued to strengthen and free cash flow was up significantly in the trailing 12 months. This is in line with our priorities this year to grow profitability, expand gross margin, and generate strong cash flow. Looking at key financial metrics compared to the year-ago quarter, net sales declined 4% as reported and 3% in constant currency, Adjusted gross margin increased 210 basis points to 53.1%, Adjusted EBITDA improved 1% to \$584 million, and adjusted EPS grew 6% to \$1.14.

Free cash flow in the trailing 12 months improved nearly 50% to \$688 million, compared to the same period a year ago. Supported by our strong balance sheet, we have now repurchased \$268 million of shares through the first nine months of the year and expect to make further share repurchases in line with our capital allocation priorities.

Given where we are in the year, while we now anticipate our net sales to be comparable to slightly down for the full year, we expect growth in the fourth quarter and are on track to achieve our full-year adjusted EBITDA and EPS guidance, driven by strong gross margin performance.

Looking at third quarter performance by category as compared to the prior year: Dolls gross billings were down as expected, with comparisons impacted by the success of the Barbie movie in the year-ago quarter. Within the Dolls portfolio, Monster High continued to grow as we expand this key franchise. Vehicles performance was very strong, led by Hot Wheels' core die-cast, innovation in new segments, and adult collector expansions. Hot Wheels is expanding its fan base, and we recently announced a multi-year licensing partnership with Formula 1 that includes a broad range of products and experiences. Hot Wheels is on track for its seventh consecutive record year and is well positioned for long-term growth. Infant, toddler, and preschool declined as we exit certain product lines in baby gear and Power Wheels in line with our stated strategy. Fisher-Price grew for the second consecutive quarter, driven in part by the early success of the Wood line as we expand globally. Challenger categories collectively grew, with UNO achieving its largest quarter on record as we drive innovation and new forms of play. Mattel's total market share declined slightly year-to-date, though we gained in Dolls, Vehicles, and Games, per Circana. Looking ahead, we expect to gain market share in the fourth quarter and full year.

We're also making further progress with our entertainment strategy. Here are some recent highlights: In film, the Masters of the Universe live-action movie with Amazon MGM Studios has started pre-production with a worldwide theatrical release scheduled for June 5, 2026. The Matchbox live-action movie with Skydance and Apple Original Films, was greenlit, and will star John Cena. And just last week, we announced that a View-Master live-action movie will be co-developed with Sony Pictures Entertainment and Escape Artists.

In television, Hot Wheels Let's Race animated series season 2 was released on Netflix last month and ranked as a top 10 TV series in 27 countries across the platform, and Barney's World premiered on Max last week, as we relaunch of the franchise for a new generation of fans.

In digital gaming, Mattel163, our joint venture with NetEase, continued to grow and is expected to exceed \$200 million in gross billings this year. Our 50% interest in the JV contributed \$7 million to net income in the quarter and over \$18 million year to date.

As it relates to the toy industry, it continued to perform better than first anticipated heading into this year. The industry was down a low single digit in the first nine months as compared to the same period in the prior year and our expectation for it to decline modestly in 2024 is unchanged.

Beyond this year, we believe trends will further improve and that the industry will return to growth and continue to grow over the long term. The fundamentals are strong, toys are an important part of consumers' lives, and retailers prioritize the category as a strategic lever.

Mattel is well positioned competitively in the fourth quarter with a broad-based lineup of innovative product offerings and segment launches with a range of play patterns and price points across our portfolio.

We also have an exciting lineup of product tied to the theatrical movie releases of Disney's Moana 2 and Universal's Wicked in November. We expect a good holiday season for Mattel with more retail support, additional shelf space, greater representation across major holiday catalogs, and increased marketing and promotions as compared to the prior year.

In closing, we continue to execute on our multi-year strategy, and this year are prioritizing profitability, gross margin expansion, and cash generation. We expect top-line growth in the fourth quarter, driven by a good holiday season, market share gains, and a toyetic theatrical slate and are well positioned for long-term growth and shareholder value creation.

And now I will turn the call over to Anthony.

Anthony DiSilvestro - Mattel Inc - CFO

Thanks, Ynon. We achieved another strong quarter of profitability with significant margin gains fully offsetting the impact of wrapping the Barbie movie related benefits in the prior year. Net sales were \$1.84 billion, a decline of 4% as reported or 3% in constant currency. The decline was primarily due to the Barbie movie comparison, which benefited the prior year. Adjusted gross margin reached 53.1%, an increase of 210 basis points, benefiting from supply chain improvements and cost savings. Adjusted operating income was comparable at \$504 million as the net sales decline was offset by margin improvement. Adjusted EPS increased 6% to \$1.14, benefiting from fewer shares outstanding as a result of share repurchases.

Turning to gross billings in constant currency, first by category. Overall, gross billings declined 3% in the quarter. Excluding the movie related benefit in Q3 of last year, gross billings would have increased modestly. POS declined high single digits in the quarter and was down low single digits through the first nine months due primarily to the Barbie related decline in dolls. Dolls billings declined 14% and POS declined low double digits. Barbie gross billings declined 17% and POS declined low double digits. Vehicles had an outstanding quarter growing 13%. Growth was primarily driven by Hot Wheels with gains in die-cast cars and R/C, and supported by the Hot Wheels' Let's Race streaming content. Matchbox and Disney Cars also contributed to growth. Vehicles POS increased mid-single digits. Infant, toddler, and preschool declined 2% due to Baby Gear and Power Wheels as we exit certain product lines in those segments, partly offset by 2% growth in Fisher-Price, which benefited from wood as we expand distribution to more markets. Category POS declined low double digits overall, with Fisher-Price down mid-single digits. Challenger categories in aggregate grew 3%. The Games category achieved double-digit growth, driven by UNO. The Action Figures business also grew while Building Sets declined.

Turning to gross billings by region. North America declined 3% due primarily to the Barbie movie-related comparison. The other power brands, Hot Wheels and Fisher-Price achieved growth in the quarter. POS declined high single digits. EMEA declined 6%, also impacted by the movie related comparison. POS declined high single digits. Latin America grew 2%, driven by gains in our two largest markets, Mexico and Brazil. POS declined high single digits. Asia Pacific had a strong quarter, growing 8%, driven by gains in India and Japan. POS increased low single digits. Retail inventory levels ended the quarter down high single digits compared to the prior year, and we are well-positioned for the holiday season.

Adjusted gross margin increased 210 basis points to 53.1%. The improvement was driven by several factors. Supply chain efficiencies, including fixed cost absorption added 190 basis points. The optimizing for profitable growth program added 80 basis points as we continue to generate cost savings. Foreign exchange rate movements added 70 basis points, and cost deflation contributed 50 basis points. These gains were partly offset by a negative mix impact of 180 basis points as we wrap the margin accretive benefits associated with the Barbie movie.

Moving down the P&L, advertising expense declined \$19 million or 16% versus the prior year. The reduction reflects our strategy to shift advertising to later in the year. Adjusted SG&A increased \$23 million or 7%, primarily driven by higher compensation expenses, partly offset by savings from the optimizing for profitable growth program.

Adjusted operating income was comparable at \$504 million with lower net sales and higher adjusted SG&A, offset by adjusted gross margin expansion and lower advertising. Adjusted operating income margin for the first nine months of 2024 was 15.5%, an expansion of 260 basis points versus the prior year period. Adjusted EBITDA in the third quarter increased 1% to \$584 million, benefiting from the previously mentioned margin improvement. Adjusted EPS was \$1.14 compared to \$1.08, an increase of 6%. The increase benefited from a lower share count, reflecting our continuing share repurchase activity.

Year to date, cash from operations was a use of \$62 million compared to a use of \$80 million in the prior year period. Capital expenditures increased by \$39 million, primarily driven by the acquisition of a property that will serve as our new global design center and replace our current leased facility. This resulted in free cash flow of a use of \$219 million compared to a use of \$197 million in the prior year. On a trailing 12-month basis, free cash flow was \$688 million, an increase of 49% from the prior year period. The improvement was driven by increased cash from operations, partly offset by higher capital expenditures. In line with our capital allocation priorities, we have utilized a portion of free cash flow to repurchase shares. During the first nine months of 2024, we repurchased \$268 million of shares and during the trailing 12-month period, we have now repurchased \$361 million.

Turning to the balance sheet, we finished the quarter with a cash balance of \$724 million, an increase of \$268 million versus the prior year. The increase reflects the free cash flow generated over the past 12 months, partly offset by the use of cash to repurchase shares. Total debt of \$2.35 billion was comparable to last year with no scheduled maturities until 2026. Accounts receivable declined \$94 million due primarily to lower sales. Inventory levels remained below the prior year as we ended the quarter at \$737 million, down \$53 million. Our leverage ratio continued to improve compared to the prior year. Debt to adjusted EBITDA finished the quarter at 2.3 times, compared to 2.7 times in the prior year quarter. The improvement was driven by the increase in our trailing 12-month adjusted EBITDA.

We had another quarter of achieving significant cost savings. Under our optimizing for profitable growth program, which we commenced this year, we generated \$23 million of savings in the quarter with \$15 million benefiting cost of goods sold and \$8 million in SG&A. For the nine-month period, we achieved \$60 million of savings. Given the progress to date, we now expect to generate approximately \$75 million of savings in 2024, exceeding our original target of \$60 million, and are on track to achieve total program savings of \$200 million by 2026.

As we draw closer to the end of the year, we are updating our guidance for 2024. We expect net sales in constant currency to be comparable to slightly down given our year-to-date results and outlook for the remainder of the year. From a category perspective for the full year, we expect Vehicles to grow; Infant, Toddler, and Preschool and Challenger categories to be comparable; and Dolls to decline. With respect to the power brands, we expect Hot Wheels and Fisher-Price to grow and Barbie to decline as we wrap the movie benefit. This guidance reflects our expectation for top-line growth in the fourth quarter as we continue to anticipate a good holiday season. Full year 2024 adjusted gross margin is expected to increase to approximately 50% compared to 47.5% in 2023. The improved outlook reflects incremental cost savings and improved supply chain performance. Advertising is expected to remain relatively stable as a percent of net sales and adjusted SG&A to now increase slightly as a percent of net sales versus 2023. We continue to expect adjusted EBITDA to be in the range of \$975 million to \$1,025 million and for adjusted EPS to grow by double digits to the range of \$1.35 to \$1.45. The adjusted tax rate is projected to be 21% to 22%. Capital expenditures are forecasted to be in the range of \$200 million to \$225 million, which includes our recent purchase of a global design center to replace the current leased facility. Free cash flow is still expected to be approximately \$500 million. We will provide full year 2025 guidance on our 2024 fourth quarter call. The guidance considers what the company is aware of today, but remains subject to further market volatility, any unexpected disruption, and other macroeconomic risks and uncertainties.

In closing, the highlight of the quarter was achieving meaningful expansion in gross margin and growth in adjusted EPS, despite a challenging comparison. We generated significant cash flow on a trailing 12-month basis, further strengthened our balance sheet, and repurchased additional shares. We are in a strong position to continue executing our multi-year strategy to grow our IP-driven toy business and expand our entertainment offering and create long-term shareholder value. And now I will turn the call over to the operator and we'll be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Arpine Kocharyan, UBS.

Arpine Kocharyan - UBS Securities LLC - Analyst

Hi. Thanks so much. Thanks for taking my question. And Jenn welcome to Mattel, look forward to working with you. Ynon, could you a quick sense on the retail environment? There is a lot of concern about macro, Paris, the election, persistent inflation, and generally about the consumers sort of holding up into Q4. What gives you confidence for what you said to, I guess, reiterate growth guidance for Q4? And then I have a quick follow-up.

Ynon Kreiz - Mattel Inc - Chairman & CEO

Sure. Hi Arpine. From where we sit, the toy industry continues to perform better than initially expected at the start of the year. We expect growth in our business in the fourth quarter and see demand for our products. We also are seeing different studies. One, that is interesting is the National Retail Federation that recently said that they expect holiday season, holiday sales to grow between 2.5% to 3.5%, which is generally in line with other external forecasts that we're seeing. Our own internal research shows that more consumer plan to show for toys in the fourth quarter and that the majority of toys shoppers are looking for evergreen well-known brands, which bodes well for Mattel. So all in all, we do expect a good holiday season. We expect to grow sales, gain market share, and continue to execute our strategy.

Arpine Kocharyan - UBS Securities LLC - Analyst

Wonderful. Thank you. And this is maybe for Anthony. Anthony, when you look at the implied margin for Q4, it is closer to, if my math is right, 47.9%, something like that, closer to 48%. But comp's were toughest in margin in Q3, I think, right, given the Barbie proceeds, if I'm not mistaken. Then why are margins a bit more pressured in Q4. Is it you sort of being conservative given, so much of retail is still ahead of you or what is driving this margin outlook for Q4? Thank you.

Anthony DiSilvestro - Mattel Inc - CFO

Yeah, sure Arpine. As we said, we're guiding to 50% on a full year. That's up 250 basis points. And it does imply that year to go down slightly. And there's a couple of reasons for that. One is, and we've seen cost deflation year to date, we expect to see a little bit of cost inflation in the fourth quarter. And we're also continuing to have some of the movie wrap, one-third of last years' benefit occurred in the fourth quarter. So we have a little bit of a wrap to go, so those are the two drivers. The other driver in terms of operating income margin really reflects our strategy to shift advertising into the fourth quarter. On a year-to-date basis, our advertising is actually down \$40 million and we're guiding for it to be comparable as a percent of net sales, which implies a pretty significant increase in advertising in Q4, which is impacting the margin as well.

Arpine Kocharyan - UBS Securities LLC - Analyst

That's really helpful. Thank you.

Operator

Megan Alexander, Morgan Stanley.

Megan Alexander - Morgan Stanley - Analyst

Hi, thanks. Good evening. Thanks for taking our questions. I wanted to start, Anthony, I think you said POS was down high single digits in the quarter. Gross billings and constant currency were down 3%. And I think you said would have actually increased modestly if you take out some of the movie-related impact last year, which I think that wasn't toy, but correct me if I'm wrong. And retail inventories were also down high single digits which is, I think the same as they were last quarter. So can you just help us understand how that all works together? The POS down, high singles, gross billings down 3%, would imply that you over shipped POS in the third quarter.

Anthony DiSilvestro - Mattel Inc - CFO

Yeah. So look, there's typically some volatility in our retail inventory movements and the correlation between POS and gross billings is not an exact science. And what I would point you to is on a year-to-date basis both gross billings and POS are down slightly and fairly aligned. I think also importantly, as we look at the retailer inventory positions at the end of Q3, they are down high single digits versus last year, they are very good quality, and we believe we are well positioned as we head into the holiday season.

Megan Alexander - Morgan Stanley - Analyst

Okay, that's helpful. And then just on the top line guide, the change now you're saying comparable to slightly down. I don't think you changed your expectations for the industry and you said you still expect to gain share. So can you just help us understand what changed? Did you change your market share total expectation? Or do you no longer expect to ship ahead of POS? And I guess if that's the case, do you expect POS to be positive in the fourth quarter?

Anthony DiSilvestro - Mattel Inc - CFO

Yeah, I would say there's no specific drivers to call out. It's based on an assessment of our results year to date and our outlook for the remainder of the year. And importantly, to note, we do expect a good holiday season, we do expect POS to grow in the fourth quarter. We expect our sales to be up in the fourth quarter, outpace the industry and gain share, not only for the fourth quarter, but for the full year as well.

Megan Alexander - Morgan Stanley - Analyst

Okay. Thank you so much.

Operator

Drew Crum, Stifel.

Drew Crum - *Stifel, Nicolaus & Company, Inc. - Analyst*

Thanks, guys. Good afternoon. Ynon, you've continued to endorse industry growth in '25. Can you remind us or share with us what the source of optimism is? What are the factors you see driving a rebound to the market next year? And then I have a follow-up.

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

Thanks, Drew. Well, first of all, the toy industry is a growth industry and it has grown in 23 of the past 25 years. It continues to perform better than initially expected at the start of the year. Although we still expect it to decline modestly for the full year. Beyond this year, we do believe, as we said before, that trends will improve and that the industry will return to growth and continue to grow over the long term. We still see strong industry fundamentals in that toys are an important part of consumers' lives. Retailers prioritize the category as a strategic lever. Toy shoppers drive traffic to the store, they spend more time in the store, and they have typically a bigger basket or basket that is worth more. Overtime, toy POS has been growing and outpacing the decline in birth rates. The industry growth has been driven, if you look at the big -- the top -- the key markets, has been driven by both pricing and units. And we're also seeing positive drivers for the industry overall and that more theatrical or toyetic theatrical movies are coming online. You are seeing a fast growing adult segment, not just collector, but adults buying toys. And all in all, it's been -- you have good, positive, healthy fundamentals. Within all of that, we believe that we are very well positioned to capitalize on future industry growth. We continue to invest in organic growth, focus on great product innovation, supply chain, commercial capabilities, demand creation capabilities, and expect to outpace the industry and continue to gain share.

Drew Crum - *Stifel, Nicolaus & Company, Inc. - Analyst*

Got it. Thank you, Ynon. And maybe for Anthony, we've heard that one of your major retail partners has changed their payment terms. And I'm just curious, if that in any way shifts working capital and puts your free cash flow guidance at risk for the year? I mean you're reiterating it today, but I just want to understand if that in any way impacts working capital. Thanks.

Anthony DiSilvestro - *Mattel Inc - CFO*

No, impact on us. As we talked about, we continue to guide to \$500 million of free cash flow despite a little bit of uptick in capital expenditures.

Drew Crum - *Stifel, Nicolaus & Company, Inc. - Analyst*

Got it. Okay. Thanks, guys.

Operator

Stephen Laszczyk, Goldman Sachs.

Stephen Laszczyk - *Goldman Sachs & Company, Inc. - Analyst*

Great. Good afternoon, and thanks for taking the questions. Maybe first for Anthony on capex. You called out the acquisition of the new global design center. Just talk a little bit more about the sizing of the investment you're making there, any longer term related capex you're expecting from the build. And then for longer term capex, is the \$200 million to \$225 million, perhaps a good proxy to think about that going forward? Thanks.

Anthony DiSilvestro - *Mattel Inc - CFO*

Yes. So as we said, we purchased a building in El Segundo that will serve as our global design center going forward. It does replace an existing leased facility in El Segundo, as well. And that's the reason for the capex guide going up a little bit. Although, it's not going up by the full amount

as we manage the rest of the spend. We'll have a little bit of build out related to that for next year. And as we get closer to next year, we can give you an update on what we expect for next year.

Stephen Laszczyk - *Goldman Sachs & Company, Inc. - Analyst*

Got it. And then maybe just a follow-up question on capital allocation. Share repurchases, you bought back \$68 million in the quarter, which is a bit slower than what we've seen over the first two quarters of the year. Could you maybe just talk a little bit about the pace of share repurchases going forward? Maybe the opportunity to ramp up as we look into the back half of the year and maybe how you're balancing that versus other capital allocation priorities heading into '25? Thank you.

Anthony DiSilvestro - *Mattel Inc - CFO*

What I would say is that we've been very active on the share repurchase front and, you know, \$68 million in Q3 brings the year-to-date total to \$268 million. On a trailing 12-month basis, we're now at about \$360 million. And since we resumed share repurchases last year, we've now bought back \$471 million of shares. Now, in terms of the pace we believe it's appropriate and really consistent with our stated capital allocation priorities. And looking ahead, we would expect we'll continue to buy back stock in line with those capital allocation priorities and fund that with free cash flow.

Stephen Laszczyk - *Goldman Sachs & Company, Inc. - Analyst*

Got it. Thanks, Anthony.

Operator

Jim Chartier, Monness, Crespi and Hardt.

Jim Chartier - *Monness, Crespi, Hardt & Co., Inc - Analyst*

Hi, thanks for taking my question. Can you just talk about your digital gaming initiatives longer-term? What's kind of a planned launch schedule within Mattel163? Last quarter, you talked about developing some casual games internally. What's the timeframe for launching the first game there? And then any other initiatives you might have? Thanks.

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

Thank Jim. As we've said before, our goal when it comes to digital gaming is to extend the physical play to the virtual world by creating digital games and experiences that drive sustained engagement for fans of all ages. Our strategy has three components - licensing, our joint venture with NetEase, that we call on with NetEase, and self-publishing which we recently started to talk about. We continue to make progress on the licensing front with more games where we work with third parties. Mattel163 is expected to exceed \$200 million of gross billings this year with very attractive margins. And this is so far on the back of only three games released until now. And when it comes to self-publishing, this is where we see asymmetric opportunities for us in the mobile space -- mobile gaming space, given the strength of our brands. And we are starting to ramp this strategy, working on already the first game with a very strong studio, and we will be happy to share more as we progress the strategy. But we see our digital gaming strategy as an important growth driver, both for top line and profitability.

Jim Chartier - *Monness, Crespi, Hardt & Co., Inc - Analyst*

Great. And then Anthony, how should we think about SG&A for the year? And then is the compensation growth driven by just merit raises and inflation? Or are there places where you're adding employees and investing?

Anthony DiSilvestro - *Mattel Inc - CFO*

Sure. In terms of full year guidance, we do expect SG&A as a percent of sales to be up slightly and a primary driver of that is investment decisions that we've made, particularly to build capabilities in areas like digital gaming. We're also investing in some of our information technology, but those would be the two primary drivers coming through.

Jim Chartier - *Monness, Crespi, Hardt & Co., Inc - Analyst*

Great. Thank you.

Operator

Christopher Horvers, JPMorgan.

Christopher Horvers - *J.P. Morgan Securities LLC - Analyst*

Thanks, guys. Good evening. So I'll take a shot to at the sort of change in the top line outlook. So as you think about the subtle change to the guide for the year on sales, I guess to what degree was that what you've seen year to date versus taking a different view on how you thought about the fourth quarter prior to today?

Anthony DiSilvestro - *Mattel Inc - CFO*

Yeah. So as we said, I mean, we continue to expect growth in the fourth quarter. Obviously, it's a critical quarter for us. We're well positioned in terms of the demand creation activities. And as we said, we expect to grow the top line. It's probably more of a function of looking at our year-to-date performance that's causing us to be a little bit cautious in terms of top line. But we feel really good as we head into the fourth quarter in terms of more innovative product, more advertising, more shelf space, more retailer support. All those things give us confidence for a good holiday season ahead of us.

Christopher Horvers - *J.P. Morgan Securities LLC - Analyst*

Got it. Appreciate that. And my follow up question is on tariffs. It's pretty popular topic right now with the election right in front of us. Can you just help us remind us how you're thinking about your tariff exposure from a manufacturing base in China versus what your sales are in the United States? And think about what your experience was last time, understanding, and I don't think list four went in, but how are you thinking about that today versus what it was prior? Thank you.

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

Well, we're always looking at different changes, whether it's government policy or regulatory dynamics that could impact our business. And our job is to design a flexible and responsive organization that can react to changing market conditions. And this is exactly what we've been doing over the last few years. Our supply chain today is a competitive advantage for Mattel. It's geographically diversified. We make products in six different countries and we continue to ensure that we have flexibility in our system to respond to changes in the marketplace.

Christopher Horvers - *J.P. Morgan Securities LLC - Analyst*

So I guess just in terms of like how much do you actually source out of China and how much of that is directed at US sales?

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

We make, our product that is made in China is approximately 50% of our manufacturing. This is compared to an industry average of about 80% to 85%. These numbers are as of the end of 2023. We also talked about the fact that we continue to further diversify our manufacturing footprint and intend to continue to adjust for more flexibility in the system.

The US product -- heading into the US is just around 50% in China. And that number has been declining over time as we continue to further diversify our manufacturing across different countries.

Christopher Horvers - *J.P. Morgan Securities LLC - Analyst*

Thanks very much.

Operator

Kylie Cochu, Jefferies.

Kylie Cochu - *Jefferies LLC - Analyst*

Thank you guys so much for taking my question. I was wanting to dig a little deeper into optimizing for profitable growth program. I was curious what's going really well so far. What's next to optimize. Is there any change to that total targeted \$200 million number? Thank you.

Anthony DiSilvestro - *Mattel Inc - CFO*

Sure. So the optimizing for profitable growth program, we initiated that at the beginning of the year, targeting \$200 million of savings by 2026, a combination of cost of goods sold and SG&A. And we're off to a very good start. Our initial target for the full year 2024 was \$60 million. We hit that year to date at nine months and are increasing the expectation for 2024 from that \$60 million to \$75 million. And most of that upside coming through the cost of goods sold line.

As you know, we have a strong track record of identifying and achieving our targeted cost savings and are certainly very confident in our ability to achieve the \$200 million goal, although we're not making any changes in that goal at this point. But we're off to a very good start on this one.

Kylie Cochu - *Jefferies LLC - Analyst*

Perfect. And then just one last follow-up for me. Obviously you talked a little bit about what you're seeing in your international markets, I was just wondering if you could expand there. And I was wondering if there were any regional changes to call out quarter over quarter?

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

No, nothing specific about any specific call-outs. We continue to execute well. There are always going to be puts and takes within the business, but as a whole, we feel very good about our execution across region and continued focus on executional excellence.

Kylie Cochu - *Jefferies LLC - Analyst*

Well, thank you very much.

Operator

Alex Perry, Bank of America.

Alexander Perry - *BofA Global Research - Analyst*

Hi. Thanks for taking my questions here. I guess first, it seems like there's a lot of optimism around holiday. Can you maybe touch on how your top retailers are feeling about the category as we inch closer to holiday? And then can you talk about if you saw any shift in shipments from 3Q to 4Q as retailers take inventory on a more just-in-time basis? Thanks.

Anthony DiSilvestro - *Mattel Inc - CFO*

Sure, so I would say overall, retailer sentiment is positive. They prioritize toys as a strategic category. It drives foot traffic in brick-and-mortar and in e-commerce among other benefits for them. I'd say we work very closely with our key retail partners and we've planned for the holiday season. And we have a full slate of demand drivers from new products to increased shelf space, more presence in the holiday catalog. We're planning for significantly higher advertising on our part. And that's coupled with, the inventory levels are appropriate. We're working with them to make sure we have the right product in the right place and the right quantity. And are very confident in that we'll see a good holiday season.

Alexander Perry - *BofA Global Research - Analyst*

Perfect. And then I guess any change in sort of your outlook for the power brands? Is the expectation that Barbie is going to be down more significantly than you thought previously in the fourth quarter? And did your expectation come up for any of the other power brands, maybe Hot Wheels, for instance? Thanks.

Anthony DiSilvestro - *Mattel Inc - CFO*

Yeah, I would say no change in the overall category guidance nor for the power brands themselves. So all moving ahead.

Operator

Linda Bolton-Weiser, D.A. Davidson.

Linda Bolton-Weiser - *D.A. Davidson & Company - Analyst*

Yes. Hi. So on your Fisher-Price wood line, it sounds like it's off to a good start. I believe there might have been exclusive period of time at Wal-Mart. What's the timing of when exclusivity ends and kind of like what's the timeframe for that ramp up and expansion more globally? Thank you.

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

Hi, Linda. Yes, we started off with an exclusive period with Wal-Mart and we are now expanding the product globally. We're adding new franchises to little people as well. And Fisher-Price as a whole is having great momentum. It's up for the second quarter in a row. As you know, we have a new strategy, new leadership. Fisher-Price is still the number one brand in the category, and we believe it's very well positioned for continued growth.

Linda Bolton-Weiser - *D.A. Davidson & Company - Analyst*

Thank you. Can I also ask about Hasbro. Hasbro has changed their approach with, they're outsourcing more of their brands to other toymakers to market. Does that somehow benefit you when you're dealing with the retailers, because that sort of fragments Hasbro's brand portfolio among more companies that are marketing, supplying to the retailers. So does that somehow benefit you in terms of what their strategy is that they're undertaking? Thanks.

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

We continue to focus on our strategy to grow our toy business and expand our entertainment offering. When it comes to supply chain, we do believe we have a competitive advantage, both in terms of scale, quality, service levels for the retailers, and we continue to see the benefits and it's in the numbers. So we believe in the toy business, we believe in the benefits of the toy business. And we believe that the toy business is foundational for the opportunities we see outside of the toy aisle. It is very symbiotic. A strong toy business is good for our entertainment and franchise strategy and vice versa. So it's not either or, it's both that work together hand in hand. And the Barbie movie and the Barbie franchise is one good example and you will see that across other executions that we will perform across other key franchise.

Linda Bolton-Weiser - *D.A. Davidson & Company - Analyst*

Thank you.

Operator

Jaime Katz, Morningstar.

Jaime Katz - *Morningstar, Inc - Analyst*

Hi, good morning or afternoon. I'm hoping you guys could share a little bit about what you guys are seeing on any sort of shift to value products, if there is some price mix headwind we should anticipate ahead? Thanks.

Anthony DiSilvestro - *Mattel Inc - CFO*

Yeah. I mean, we're certainly cognizant of what's happening in the consumer space. Some cohorts are under a little bit of pressure and are seeking value. We know that price is important to many of those consumers. And I think we are well positioned in that regard. And we offer quite a range of price points, everything from a Hot Wheel die-cast single to a Barbie Dreamhouse to Mattel Creations collector items. So again, we think where we play into that very well with our brands and our product line.

Jaime Katz - *Morningstar, Inc - Analyst*

And then is there any sort of bifurcation in cadence between the benefits to gross margin and SG&A of the optimizing for profitable growth program, like is it more front-loaded to benefit gross margin. I'm just trying to think about where the trajectory of the gross margin goes after this year or what the potential is, or do we see more benefits in the early portion, or is it just split?

Anthony DiSilvestro - *Mattel Inc - CFO*

Yeah, I would say -- like I said, we're off to a really good start, \$60 million year to date, and we probably under-index in terms of COGS. I think we're about 60% COGS, where the whole program is going to be 70%. So more to come on the COGS side. And as we also said, we're taking our full year forecast up to [\$75 million] (corrected by company after the call), holding the \$200 million target for 2026 for now, but off to a really good start.

Jaime Katz - Morningstar, Inc - Analyst

Excellent. Thank you so much.

Operator

James Hardiman, Citi.

James Hardiman - Citi Investment Research - Analyst

Hey, good afternoon. Thanks for taking my question. So couple of follow-ups from earlier questions that were asked, Anthony, I think you mentioned versus the nice cost deflation that we've seen year to date, you expect that to flip back to inflation in the fourth quarter? I guess, maybe early thoughts on inflation or deflation in 2025. And I guess more broadly, I'm assuming it's way too early to quantify, but just qualitatively, any other puts and takes as we think about margins for 2025. Obviously, you're going to continue to push the optimizing for profitable growth program, but curious if there's any other puts and takes?

Anthony DiSilvestro - Mattel Inc - CFO

Yeah. I would say generally a bit early for us to comment on 2025, but we have experienced that deflation benefit each of our first three quarters. But it's getting less of a benefit. I think we did a little over 200 basis points in Q1, , 100 basis point benefit in Q2, and 50 basis points in Q3, and we think that's going to flip to a little bit of inflation in Q4. And to date in 2024, currently benefiting from some lower material prices and some declines in ocean freight, but again, too early to talk about next year.

James Hardiman - Citi Investment Research - Analyst

Fair enough. And then as you spoke about the retailer excitement towards the holiday season, sounds like they feel like they have a pretty good, the right amount of inventory. Should we be expecting basically one to one wholesale to retail in that back key fourth quarter? And can you remind us on what that looked like a year ago? Were we still in destocking mode a year ago? In which case, there might be a little bit of a good guy as we speak about wholesale potentially outpacing retail.

Anthony DiSilvestro - Mattel Inc - CFO

Yeah, I would say all things the same, potential for a little bit of a tailwind on that front. We came into the year after having made significant progress in 2023, we came into 2024 slightly elevated so year on year a bit of a tailwind all things, all else the same.

James Hardiman - Citi Investment Research - Analyst

Got it. Very helpful. Thank you.

Operator

Fred Wightman, Wolfe Research.

Fred Wightman - *Wolfe Research, LLC - Analyst*

Hey, guys. Just one quick one. If we just look at the EBITDA and EPS guidance, you guys kept EBITDA guidance unchanged, but made a pretty big change to the tax rate and EPS didn't move. Was there something else below-the-line that's offsetting that.

Anthony DiSilvestro - *Mattel Inc - CFO*

Fred, give me that one more time.

Fred Wightman - *Wolfe Research, LLC - Analyst*

Yeah, it's really just the EBITDA and EPS guidance didn't move, but the tax rate came down pretty significantly. Is there another offset below the line?

Anthony DiSilvestro - *Mattel Inc - CFO*

No, I'd say all else the same, the tax rate favorability would move us up a little bit in the EPS range, but it's not significant.

Fred Wightman - *Wolfe Research, LLC - Analyst*

Okay. Thanks, a lot.

Ynon Kreiz - *Mattel Inc - Chairman & CEO*

Thank you. Thank you everyone for your questions. Our priorities for the year were to improve profitability, expand gross margin, and generate significant cash flow. In line with our priorities, we did exactly that. We achieved another strong quarter of profitability. We expect to grow our EBITDA, achieve double digit growth in adjusted EPS in 2024, and generate strong cash flow. And this is despite wrapping the incredible success of the Barbie movie in the prior year.

The company is in the strongest financial position it has been in many years, and we continue to execute our multi-year strategy to grow our IP-driven toy business and expand our entertainment offering. We expect to grow the top line in the fourth quarter and we look forward to a good holiday season for Mattel with 62 shopping days to go. And now, I'll turn the call back to the operator.

Operator

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

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