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EDITED TRANSCRIPT

MAT.OQ - Q3 2022 Mattel Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. My name is Brent, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mattel, Inc. [Third] (corrected by company after the call) Quarter 2022 Earnings Conference Call. (Operator Instructions) Thank you very much.

At this time, I would like to turn the call over to Mr. David Zbojniewicz, Head of Investor Relations. Sir, please go ahead.

David Zbojniewicz - *Mattel, Inc. - Vice-President IR*

Thank you, operator. And good afternoon, everyone. Joining me today are Ynon Kreiz, Mattel's Chairman and Chief Executive Officer; Richard Dickson, Mattel's President and Chief Operating Officer; and Anthony DiSilvestro, Mattel's Chief Financial Officer.

As you know, this afternoon, we reported Mattel's 2022 third quarter financial results. We will begin today's call with Ynon and Anthony providing commentary on our results, after which, we will provide some time for Ynon, Richard and Anthony to take questions. To help supplement our discussion today, we have provided you with a slide presentation.

Our discussion, slide presentation and earnings release may reference non-GAAP financial measures, including Adjusted Gross Profit and Adjusted Gross Margin; Adjusted other Selling and Administrative Expenses; Adjusted Operating Income or Loss and Adjusted Operating Income or Loss Margin; Adjusted Earnings Per Share; Adjusted Tax Rate; Earnings Before Interest, Taxes, Depreciation and Amortization or EBITDA; Adjusted EBITDA; Free Cash Flow; Free Cash Flow Conversion; Leverage Ratio; Net Debt; and Constant Currency.

In addition, we present changes in Gross Billings, a key performance indicator. Please note that we may refer to Gross Billings as Billings in our presentation and that Gross Billings figures referenced on this call will be stated in Constant Currency unless stated otherwise.

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Our accompanying slide presentation can be viewed in sync with today's call when you access it through the Investors section of our corporate website, corporate.mattel.com. The information required by Regulation G regarding non-GAAP financial measures as well as information regarding our key performance indicator is included in our earnings release and slide presentation, and both documents are also available in the Investors section of our corporate website.

The preliminary financial results included in the press 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 from these preliminary results as a result of the completion of the company's financial closing procedures, final adjustments, completion of the review by the company's independent 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. 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, including risks and uncertainties associated with the COVID-19 pandemic and the Russia-Ukraine war. We describe some of these uncertainties in the Risk Factors section of our 2021 annual report on Form 10-K and on our second quarter 2022 quarterly report on Form 10-Q, our earnings release and the presentation accompanying this call 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. - Executive Chairman & CEO*

Thank you for joining our third quarter 2022 earnings call.

The third quarter results reflect the resilience of our diversified portfolio and the success in executing our strategy. Despite significant inflation, foreign exchange headwinds and a challenging macroeconomic environment, we achieved growth in Net Sales in Constant Currency and Adjusted EBITDA.

Looking at the third quarter financial highlights compared to the prior year third quarter.

Net Sales were flat and up 3% in Constant Currency, making it the ninth consecutive quarter of growth. Year-to-date, Net Sales increased 10% and 13% in Constant Currency.

Adjusted Operating Income was down 1%. Year-to-date, Adjusted Operating Income was up 22%.

Adjusted Earnings Per Share was down $0.02. Year-to-date, Adjusted EPS was up $0.30 or 38%.

Adjusted EBITDA increased $10 million or 2%. Year-to-date, Adjusted EBITDA was up $125 million or 18%.

Per The NPD Group, for the third quarter and year-to-date, Mattel was the #1 toy company in the U.S. overall and #1 globally in our leader categories: Dolls, Vehicles and Infant, Toddler and Preschool. And our power brands, Barbie, Hot Wheels and Fisher-Price, were each the #1 property in their respective categories.

Looking at Gross Billings in the third quarter in Constant Currency compared to the prior year.

Mattel grew 3%.

Vehicles, Action Figures, and Building Sets all grew double digits, while Dolls was flat, and Infant, Toddler, and Preschool declined single digits.

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And geographically, our International segment grew double digits, partially offset by a mid-single-digit decline in North America.

Year-to-date, total company Gross Billings grew 13%.

Total company POS was essentially flat in the third quarter with growth in all international regions, offset by a decline in North America.

Our 2022 price increases have been successfully implemented. While it is still early, we have not seen a meaningful impact on consumer demand.

Adjusted EBITDA benefited from pricing actions and cost savings, which more than offset significant cost inflation.

We are maintaining guidance for the full year 2022 Net Sales growth in Constant Currency of 8% to 10%, yet we do see a more challenging macroeconomic environment and increased volatility heading into the latter part of the year.

As we expect higher pressure on Gross Margin, we are revising guidance for 2022 Adjusted EBITDA down slightly to $1.05 billion to $1.1 billion, representing growth of 4% to 9% versus 2021.

Anthony will cover our updated guidance in more detail shortly.

In the fourth quarter, we have higher advertising and planned promotional activity and have secured more shelf space and omni-channel retailer support compared to the prior year. We also have greater holiday toy list representation and a much stronger in-stock and inventory levels than this time last year.

We expect POS to accelerate in the fourth quarter and to outpace shipping.

Beyond this year, 2023 is shaping up well. This will be driven by strong cross-category innovation and the broadening of our portfolio, including the global rollout of Monster High, the return of Disney Princess and Frozen franchises, and the addition of Universal's Trolls, as well as the global premiere of the Barbie movie, our first theatrical release.

We plan to provide full year guidance for 2023 during our 2022 fourth quarter call.

The year-to-date performance and full year outlook are in line with our strategy to grow Mattel's IP-driven toy business and expand our entertainment offering.

Mattel strengthened its position as a partner of choice for the major entertainment companies. We recently extended our relationship with The Pokemon Company by signing a multiyear license renewal for building sets in all major markets.

Mattel Creations continues to gain momentum as a highly curated DTC experience targeting the collector market with exciting new products and an international expansion.

We continue to make progress on capturing the full value of our IP in highly accretive business verticals outside of the toy aisle.

The Monster High live-action television musical movie premiered earlier this month and was the #1 kids and family movie on Paramount+ during its launch week. The movie also reached over 4 million total viewers on linear Nickelodeon networks. Following this strong performance, the sequel has just been greenlit. The Monster High animated series will launch just in time for Halloween.

Pictionary premiered on Fox and CBS affiliates in September and is growing audience week-over-week. A second season of the new animated preschool series, Deepa & Anoop, will premiere on Netflix in November. And we recently announced new seasons for Thomas & Friends, Polly Pocket and Fireman Sam.

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The latest Barbie animated movie was just released on Netflix today, part of a new multiyear agreement with Netflix for exclusive content that will also include 3 original series.

The Barbie theatrical film continues to generate audience excitement. Having completed principal photography this past summer, the movie is currently in post production, and we eagerly anticipate its global release in July next year.

We also expanded our presence in Roblox to include Barbie and Polly Pocket in the Livetopia virtual world, in addition to our Hot Wheels and Masters of the Universe stand-alone games on the platform.

In the growing space of NFTs, we announced a digital art collaboration for Barbie with women's empowerment brand, Boss Beauties, for 15,000 one-of-a-kind NFTs to debut later this year on Mattel Creations.

Mattel is being recognized for its achievements in workplace culture and employee well-being. Mattel was recently included among the World's Best Employers by Forbes, Best Workplaces for Innovators by Fast Company, 100 Best Companies by Seramount and the Healthiest 100 Workplaces in America.

All in all, this was a good quarter for Mattel with the ninth consecutive quarter of year-over-year net sales growth in constant currency.

Year-to-date results show that we are successfully navigating a complex environment. The strategy to grow our IP-driven toy business and expand our entertainment offering is working.

We look forward to the all-important holiday season and believe we are on track to achieve another growth year for the company.

While we are seeing higher volatility related to macroeconomic challenges that may impact consumer spending, the toy industry has historically demonstrated its resilience during difficult economic times and is forecast to grow for the full year and thereafter.

We believe our fundamentals are strong. Mattel's portfolio is resilient and well balanced with thriving brands that continue to drive increased consumer engagement and cultural relevance. There is new product innovation in all categories, and we are entering new white space opportunities.

Our partnerships with the major entertainment companies are growing, and we are winning new key licenses. We are making progress on capturing the full value of our IP in highly accretive business verticals outside the toy aisle with more opportunities in content, digital experiences, and consumer products.

The balance sheet is healthy and about to become another growth lever. Our world-class leadership team and global organization are executing with excellence. We believe we are well positioned to further grow the business, increase market share and create long-term shareholder value.

And now Anthony will cover the financial performance in more detail.

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Thanks, Ynon, and good afternoon. As Ynon said, we achieved good results for the quarter, in the midst of a challenging macroeconomic environment. We generated Net Sales of $1.756 billion, flat to the prior year and up 3% excluding the negative impact of currency translation.

Adjusted Gross Margin increased by 50 basis points as the benefit of pricing actions and cost savings more than offset cost inflation.

Adjusted Operating Income was $398 million, declining 1% due primarily to an increase in advertising expense, mostly offset by the increased Adjusted Gross Margin percentage.

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Adjusted EPS was $0.82 compared to $0.84 in the prior period, a decline of 2%. Excluding the one-time costs associated with the debt paydown in the prior year, interest expense was comparable to the prior year, while the Adjusted Tax Rate increased 2 percentage points to 22%.

Adjusted EBITDA increased $10 million or 2% to $473 million.

Our year-to-date performance, which benefited from retailers increasing inventories in the first half, has been very strong with key metrics increasing double digits. Net Sales grew 10% and were up 13% excluding the negative impact of currency translation. Adjusted Operating Income increased 22%, and Adjusted EBITDA grew by $125 million or 18%.

Turning to Gross Billings in Constant Currency. The third quarter was up 3% and year-to-date was up 13%.

Dolls was flat, with growth in Monster High and Polly Pocket, offset by a decline in Barbie and licensed properties. Barbie was down 3% after 2 full years of double-digit gains and the highest year on record. Year-to-date, category Gross Billings grew 3%.

Vehicles increased 17%, driven by Hot Wheels, which also grew 17%, achieving a record third quarter. Year-to-date, category Gross Billings grew 25%.

Infant, Toddler, and Preschool was down 6% due to declines in BabyGear, Newborn, and Infant, partly offset by growth in Imaginext and Little People. Year-to-date, category Gross Billings grew 7%.

Challenger categories in aggregate increased 3%, driven by double-digit growth in Action Figures and in Building Sets, partly offset by declines in Plush and Games. Year-to-date, Challenger categories Gross Billings grew 25%.

From a geographic perspective, we achieved growth in 3 of 4 regions.

North America declined 4% following a first half in which retailers accelerated purchases. Gross Billings year-to-date were up 12%. Consistent with Gross Billings, POS declined by mid-single digits in the third quarter.

EMEA achieved another strong quarter of growth with Gross Billings increasing by 8%. POS was up low single digits and outpaced the industry.

Latin America had an exceptionally strong quarter with Gross Billings increasing by 23%, driven by growth in all reported categories and key markets. POS was up mid-single digits.

Asia Pacific Gross Billings grew 11%, driven primarily by strong growth in Australia and Japan, partly offset by declines in China, which continues to be impacted by COVID-related retail closures. POS increased double digits, primarily driven by gains in Australia.

Quarter end retail inventory levels were up in both dollars and weeks of supply as we head into the holiday season. Inventory is of good quality, and we are working closely with our partners to meet the anticipated acceleration in POS.

Adjusted Gross Margin increased 50 basis points to 48.3% as pricing and cost savings exceeded significant cost inflation.

Here are the components of the increase in Gross Margin. On the positive side, pricing, primarily the benefit of our midyear actions, contributed 240 basis points. Savings from Optimizing For Growth added 140 basis points, and other factors added 30 basis points.

These gains were partly offset by the impact of cost inflation, a negative 330 basis points; and royalties, negative 30 basis points, associated with the high growth of licensed properties.

Moving down the P&L. Advertising expenses increased 8% to $128 million as we support our brands and drive demand.

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Adjusted SG&A expenses of $323 million were comparable to last year as salary inflation was offset by lower incentive compensation expense and incremental optimizing for growth savings.

Adjusted Operating Income declined by 1% to $398 million due to higher advertising expense, mostly offset by an increase in Adjusted Gross Margin.

Adjusted EBITDA increased by $10 million or 2% to $473 million. Year-to-date, Adjusted EBITDA was up strongly by $125 million or 18%.

Cash from Operations for the year-to-date period was a use of $275 million, reflecting the seasonality of the business compared to $256 million in the prior year. The increased use of cash was primarily due to higher working capital usage, mostly offset by higher net income, excluding the impact of non-cash items, which in the prior year included the release of the deferred tax valuation allowances.

Free Cash Flow year-to-date was negative $402 million compared to negative $371 million in the prior year. Capital expenditures increased to $127 million compared to $115 million in the prior year period.

On a trailing 12-month basis, we generated $303 million of Free Cash Flow compared to $320 million in the prior period. The decline is due to increased working capital usage and higher capital expenditures, mostly offset by higher cash earnings. Increased working capital requirements are primarily due to declines in current liabilities and growth in inventory.

Free Cash Flow conversion for the trailing 12-month period was 27% compared to 33% in the prior year period.

Taking a look at the balance sheet. Cash balance was $349 million compared to $149 million in the prior year.

Total Debt was $2.574 billion compared to $2.698 billion. Total Debt net of the cash balance or Net Debt declined to $2.225 billion compared to $2.549 billion in the prior year, an improvement of $324 million, reflecting our Free Cash Flow generation over the last 12 months.

Looking ahead, we intend to use available cash in the fourth quarter to repay the upcoming maturity of the $250 million 3.15% notes.

Accounts Receivable declined by $56 million to $1.382 billion due primarily to the negative impact of foreign currency translation.

Inventory was $1.084 billion compared to $854 million last year, an increase of $230 million or 27%. The increase reflects higher quantities as we accelerated seasonal production and the impact of cost inflation, partly offset by currency translation. This position has improved meaningfully relative to last quarter when Inventory was up $360 million or 44%, and we expect the trend to continue to improve.

Leverage Ratio at the end of the third quarter was 2.3x Debt to Adjusted EBITDA compared to 2.8x in the prior year. The improvement is driven by the combination of growth in Adjusted EBITDA and debt reductions. We continue to make progress toward our goal of achieving an investment-grade rating.

We continue to generate significant cost savings. Optimizing For Growth program savings were $29 million in the quarter, $24 million of which benefited Cost Of Goods Sold. Looking ahead, we continue to expect the program to achieve incremental savings of $80 million to $90 million in 2022 and total savings of $250 million by 2023, since launching the program in 2021.

As Ynon mentioned, we are maintaining our guidance for full year 2022 Net Sales growth in Constant Currency of 8% to 10%. This is expected to be driven by Vehicles and Infant, Toddler, and Preschool categories, led by Hot Wheels and Fisher-Price and Thomas & Friends, respectively, as well as our Challenger categories in aggregate led by Action Figures.

We now expect the Dolls category to decline slightly with Barbie and American Girl to decline low single digits. We are confident about the long-term growth trajectory of Barbie and American Girl.

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We now anticipate that currency translation will have a negative impact of 3 to 4 percentage points on Net Sales, reflecting the recent adverse movement in foreign currency rates.

Adjusted Gross Margin is now expected to be approximately 47% and compared to 48.2% in 2021. This is modestly below our prior guidance from July and reflects the financial impact of managing higher inventory levels through the balance of the year.

Adjusted EBITDA is now expected to be in the range of $1.05 billion to $1.1 billion, slightly below our prior guidance and up from a 2021 base of $1.007 billion, representing growth of 4% to 9%. The change from the prior guidance reflects the lower Gross Margin expectation and the impact of currency translation.

We continue to expect, as a percent of Net Sales, SG&A to decline and for Advertising to remain relatively flat.

From our 2021 base of $1.30, Adjusted EPS is now expected to increase to a range of $1.32 to $1.42 per share. We continue to expect an Adjusted 2022 Tax Rate of 26% to 28% compared to 25% in 2021. Consistent with prior guidance, capital expenditures are forecast to be in the range of $175 million to $200 million, an increase from prior year as we strategically invest to increase manufacturing capacity in our owned Dolls and Vehicles facilities in which we have a significant competitive cost advantage.

We are operating in a challenging macroeconomic environment with higher volatility, including inflation that may impact consumer demand. 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.

With respect to our previously stated 2023 goals, given the increased volatility in the market as well as the revised 2022 outlook, we are re-evaluating our expectations and will provide annual guidance for 2023 on our 2022 fourth quarter earnings call. That said, we are confident in our continuing growth trajectory and expect top and bottom-line growth next year.

In closing, Mattel executed a good quarter, and we are very pleased with our year-to-date results with double-digit top and bottom-line growth. We are improving our Leverage Ratio, and consistent with our capital allocation priorities, are making progress towards achieving investment-grade credit ratings. We believe we are well positioned to continue our growth trajectory.

Thanks for your time today, and I will now turn it over to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Drew Crum with Stifel.

Andrew Edward Crum - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP and Analyst*

So on the last call, as it relates to POS, I think you indicated that POS in the second half would outpace the first half. 3Q, flattish. 4Q, if I heard you correctly, you're suggesting it will outpace shipment growth. With that in mind, can you still achieve that second half POS goal? And then I have a follow-up.

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Yes. This is Anthony. I'll start. I mean as we look ahead, we expect fourth quarter POS to accelerate and to outpace shipping. And I mean obviously, we're working closely with our retail partners to meet the anticipated acceleration. I mean there's a number of reasons and demand drivers that

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are out there. We have increased advertising support in the fourth quarter, more promotional activity with our retailers. We have more shelf space and greater representation in toy list. So a lot of reasons to believe and our expectation is that POS will accelerate.

Ynon Kreiz - *Mattel, Inc. - Executive Chairman & CEO*

I'd also add that quarter-to-date POS is in line with expectations, and we are pleased with our performance. And also worth noting that shoppers are returning to traditional purchasing patterns closer to the holiday season, so we expect to see POS accelerating and outpace shipping.

Andrew Edward Crum - *Stifel, Nicolaus & Company, Incorporated, Research Division - VP and Analyst*

Got it. Okay. Okay. And then just as a follow-up. You mentioned in your preamble acceleration in ordering by the domestic retailers during 2Q. Was there anything else to explain the divergence between the North American performance and international performance on Gross Billings during 3Q?

Ynon Kreiz - *Mattel, Inc. - Executive Chairman & CEO*

Yes. In the U.S., there were certain categories that performed disproportionately well, where we traditionally under-indexed, specifically Plush and Trading Cards. But I wouldn't take the quarter in isolation. I wouldn't look at it in isolation. Year-to-date, we're up 12% including the third quarter. And year-to-date, we were the #1 company in the U.S. overall. We've been #1 in the U.S. for 28 consecutive years. We're also #1 in our leader category, and our power brands are each #1 in their respective categories. So we're very confident about our success in North America and believe we are well positioned to continue the growth trajectory.

Operator

Your next question comes from the line of Eric Handler with MKM Partners.

Eric Owen Handler - *MKM Partners LLC, Research Division - MD*

Wondering if you could talk a little bit more about sort of the state of retail, particularly in North America right now. You're seeing increased market volatility. Does that mean are retailers cutting back on orders at all? Are they reducing the amount of days inventory being held at stores? Just can you give us some perspective on what's going on, particularly also as you look at the various platforms, maybe mass merchant versus dollar stores versus online platforms? And then I have a follow-up.

Ynon Kreiz - *Mattel, Inc. - Executive Chairman & CEO*

So there's no secret that there is a volatile environment and macroeconomic challenges, and that could affect consumer demand. But with all of that, the toy industry has historically demonstrated its resilience during challenging economic times. It has grown year-to-date. It's expected to grow for the full year. And according to Euromonitor, they continue to expect the industry to grow at 5.5% CAGR through 2026. So we are seeing the industry continue to demonstrate strong fundamentals.

According to our own internal research, we expect consumers to spend the same or more this coming Christmas or the holiday season relative to last year. We are seeing purposeful brands and quality toys resonating with consumers now more than ever. And we believe that important -- big brands, quality products will end up winning the season. This is what we're focused on. This is where we excel. And as Anthony mentioned, we do have -- expect we have more advertising and promotion in the quarter, more shelf space, better representation on the holiday toy list and in-stock inventory. So we believe we are well positioned for the coming season and continue to grow next year in 2023, both top line and bottom line.

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Eric Owen Handler - *MKM Partners LLC, Research Division - MD*

Okay. And then a follow-up for Anthony. I imagine it's been a little frustrating waiting for the investment-grade credit rating upgrade. Can you sort of give us an update on where that stands? What sort of the credit ratings may be waiting on? And once you do get that upgrade, what are some of the immediate things you could sort of do because of that?

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Yes. I think the first comment to make is we continue to make really good progress in improving our balance sheet and our Leverage Ratio. We finished Q3 at 2.3x Debt to Adjusted EBITDA, and that's down from 2.8x in the prior year. And if you recall our capital allocation priorities, the first one was to invest in organic growth, and the second was to get our leverage down and maintain a target range of 2 to 2.5x, and we've done that. And look, as we look at an investment-grade rating, it is an important milestone for Mattel. And with that stronger balance sheet, we will have the flexibility to consider other priorities such as M&A and share repurchases. So we continue to make progress, and we continue with our dialogue with the rating agencies and continue to deliver against improving that balance sheet and reducing leverage.

Ynon Kreiz - *Mattel, Inc. - Executive Chairman & CEO*

And Eric, just to add to Anthony's comments. As we said on the note, we do see our balance sheet and capital structure becoming another growth lever. We've been very focused on bringing it to a good place. We're very much within our target range and continue to improve it. We also talked about repaying another $250 million notes before the end of the year. So continue to strengthen our position and turning our balance sheet to another lever of growth.

Operator

Your next question comes from the line of Linda Bolton-Weiser with D.A. Davidson.

Linda Ann Bolton-Weiser - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

(technical difficulty)

Barbie, I think you had said before that it was kind of like the higher price point like the Dreamhouse-type items, which were most impacted. Is that still the case? Or is there something else that has spread a little bit more in terms of the weakness in Barbie?

Richard Dickson - *Mattel, Inc. - President & COO*

Linda, it's Richard. You cut out on the first part of the question. But I did catch the second part, which might sum it up. So I'll answer it from a Barbie perspective in total. Look, we're very confident in Barbie's long-term growth trajectory. Clearly, she's the #1 global doll property. We continue to execute in line with our playbook. Year-to-date, Barbie Gross selling -- Gross Billings were up 3% in Constant Currency, which again is an excellent achievement when we compare it to '21, which, as you recall, is the highest year on record.

So as expected, Barbie did see a modest decline in the third quarter and more specifically on higher price point items like the Dreamhouse, which you mentioned and which we shared last quarter. The brand, however, continues to be on the forefront of cultural conversation. Incredibly successful initiatives ranging from inspiring women such as Jane Goodall. We drove the biggest style trend in fashion recently with the Barbie-core trend.

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We're obviously looking forward to '23. We've got a great, strong innovation pipeline. We've got continued expansion of brand experiences. By the way, this is across multiple platforms. This includes a new slate of content with Netflix as well as the highly anticipated Barbie theatrical movie release for next summer.

It's also, I think, important to note, Barbie has doubled in size over the past 5 years and was the #1 global toy property overall for the last 2 years, which speaks to the strength of the brand.

Linda Ann Bolton-Weiser - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Okay. And then sticking with Dolls for a minute. In terms of your Monster High sell-in, your shipments into the channel, in terms of what was planned for the second half, what percentage of that was like roughly done in the third quarter? And then like what percentage would be done in the fourth quarter in terms of the sell-in?

Richard Dickson - *Mattel, Inc. - President & COO*

Yes, Linda, we can't share the percentages, but what I can tell you is that we're incredibly happy and encouraged with the performance that we've had to date on the relaunch of Monster High. As you know, we've launched it with a live-action television musical movie, which premiered this month. It was also the #1 kids and family movie on Paramount+ during the week of its launch. We reached over 4 million total viewers on linear Nickelodeon networks. And following actually this strong performance, we've just greenlit the sequel.

We've also got 26 episodes of Monster High animated series, which is going to launch on Friday, October 28, on Nickelodeon. Of course, just in time for Halloween. We've got the new kid-targeted product that's hitting shelves, which will coincide with the content releases. And as I mentioned, it's really off to a spectacular start.

We've also been nurturing and developing the brand with our collector community, which has been incredibly loyal. We've done multiple drops on Mattel Creations, which has been selling out in literally minutes. So we're very happy. We're looking forward to the continued rollout of Monster High in North America this year and also internationally in 2023.

Linda Ann Bolton-Weiser - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

And can I just sneak in one more? Do you guys have a target for your own inventory balance roughly at the end of the year?

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Yes. I think as we look at our inventory level -- and we finished the third quarter up $230 million to 27%, and we're making improvements sequentially. Q2 was up $360 million or 44%, and we expect that trend to continue and improve through the balance of the year and believe that our year-end inventories will be modestly above prior year levels.

Operator

Your next question comes from the line of Megan Alexander with JPMorgan.

Megan Christine Alexander - *JPMorgan Chase & Co, Research Division - Research Analyst*

Maybe just a quick follow-up on Drew's question earlier. Can you maybe clarify what's implied in the 4Q guide from a POS standpoint? Ynon, you said quarter-to-date is in line with expectation. So does that mean it's accelerated versus 3Q and it's positive now? Or are you expecting a further

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acceleration from here? I think it makes a lot of sense that consumers are shifting their spending back to more traditional patterns, but you've also highlighted increased volatility multiple times. So just trying to reconcile what maybe sounds like more caution on the consumer spending outlook with an expectation that POS accelerates from here.

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Yes. Look, so I think a little early to talk about quarter-to-date POS performance in any detail. What we did say is that we expect POS to accelerate in the fourth quarter and outpace shipping. And remember, that's in the context Ynon mentioned about shoppers returning to traditional buying patterns, where they buy closer to the holiday season. And as we also mentioned, there's many reasons to believe that, that POS is going to accelerate based on advertising, promotional activity, shelf space and the circulars and toy lists that are out there. So again, we're very confident in the statement about POS accelerating in the fourth quarter.

Megan Christine Alexander - *JPMorgan Chase & Co, Research Division - Research Analyst*

Okay. That's helpful. And then maybe a question on '23. You talked about expecting top line and bottom-line growth. Can you spend a little bit of time just talking about maybe some of the puts and takes on the margins? Like are you seeing costs sequentially improve? And should we anticipate that Gross -- that's a tailwind to Gross Margin in '23 and Gross Margin can be up in '23 if sales are up? And then on the SG&A side, you do still have cost savings there. And are there other levers to pull if the top line comes in a bit weaker than you had previously expected?

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Yes. So let me make a couple of comments with respect to 2023. Again, we're going to provide guidance on our fourth quarter call. But in terms of inflation, you saw in the P&L, it did have a fairly significant impact in Q3, 330 basis points. But we are seeing some improvement in market prices for ocean freight, for materials, but continuing pressure on wage rates. And as we've said before, overall, we expect inflation to moderate as we go into 2023. I think it's premature to talk about our overall Gross Margin.

But additionally, as we look at next year, it's shaping up well. We've got the global rollout of Monster High. We've got Disney Princess and Frozen, Universal Trolls, and the Barbie movie. So again, a lot to be -- a lot of positive drivers on the top line. And again, moderating inflation in the middle of the P&L. And just to add to that, also, as we said, we do expect to grow the top and bottom-line next year.

Operator

Your next question comes from the line of Arpine Kocharyan with UBS.

Arpine Kocharyan - *UBS Investment Bank, Research Division - Director and Analyst*

Could we go back to Barbie for a second? There is a lot of skepticism around whether Barbie can grow next year. I guess what are your thoughts around that? You obviously have never had such a big box office event for the brand at the same time, it's not animation. It's live action, which can be a bit tricky. I know it's very early at this point. But as you think about the brand and what's in store for 2020 -- 2023, do you see that growing from these really sort of record levels?

Richard Dickson - *Mattel, Inc. - President & COO*

Yes, Arpine. Thank you for the question. As I said, we're incredibly confident in Barbie for, I mean, a whole list of reasons but, in particular, the last 5 years of proof. Doubling in size over the last 5 years is quite an achievement. We've got strong innovation. We've got Netflix slates. We've got franchise initiatives, and we've got probably the highest anticipated Barbie movie, a theatrical release next summer.

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So look, all things considering, we are incredibly confident in the long-term growth trajectory of Barbie. It's been the reigning #1 doll of all time. And again, the performance that we've had consistently gives us the confidence as we move forward. We've got an extraordinary team. As you know, our category structure complements our overall doll performance. We've got category management, which allows our brands collectively to have a unique reason for being. And as a result, we're confident that all our brands can thrive together.

We've got an incredible portfolio, Monster High, which, of course, is rolling out now with great excitement. We've got the return of Disney Princess and Frozen franchises. We've got the addition of Universal Trolls as well again as the premiere of the Barbie movie. So look, all in all, we couldn't be more excited about what the future holds in the Dolls space and, in particular, Barbie as the leading fashion doll and global doll property of all time.

Arpine Kocharyan - *UBS Investment Bank, Research Division - Director and Analyst*

Great. And most of my questions on margin have been answered. I was hoping you could talk a little bit on Monster High and kind of sizing that opportunity. Back in the day, it was a significant brand, certainly north of $500 million and very high margin. What are your targets after that sort of initial launch as a kind of a more near-term goal thinking about sort of next 12 months, 2023 versus what this could be in 2 years or 3 years?

Richard Dickson - *Mattel, Inc. - President & COO*

Well, look, again, Monster High is an incredible property within Mattel's treasure trove of properties. We've taken a very strategic approach to the relaunch of the brand. As you know, we started with our Mattel Creations collector drops, which have been going on throughout the year to extraordinary fanfare and sell-outs. We then have coordinated and partnered with Nickelodeon and Viacom to create a compelling live-action television musical movie, which, of course, premiered earlier this month and did incredibly well. We've got the 26 episodes, which I mentioned as well, dropping on Friday, the 28th. And we've got a really robust, innovative pipeline of product that's going to be hitting the marketplace.

As well, as mentioned, North America has just started. We've got incrementality for 2023 as it rolls out throughout the world. And while we're not going to size the business itself, it is a significant opportunity, certainly, in our portfolio and will be a top 10 property overall in the fashion doll ranking.

Operator

Your next question comes from the line of Andrew Uerkwitz with Jefferies.

Andrew Paul Uerkwitz - *Jefferies LLC, Research Division - Equity Analyst*

I apologize if these are too simplistic. But could you quantify a little bit of the different pieces kind of in that inflation -- in that inflation headwind as far as what's the biggest pieces, smallest pieces, please?

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Sure, I can do that. So as you saw in our Q3, the negative impact of inflation was 330 basis points. It's 410 basis points year-to-date. And there's 3 primary drivers. And the most significant impact is the increase in ocean freight rates that we incurred this year. So again, that's the primary factor and then to a lesser extent -- and about equal proportion an increase in materials, primarily resins and zinc, and the balance being an increase in the labor cost in our key supply chain markets.

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Andrew Paul Uerkwitz - *Jefferies LLC, Research Division - Equity Analyst*

Got it. That's helpful. And then just one other one, kind of on the entertainment side. Are you guys able to kind of quantify, whether internally or what you can share with us, like the impact of some of these -- like some of these initiatives around entertainment, if it hits a certain target, it represents x improvement in sales? Or is it -- or is a lot of these things just more around just kind of customer awareness, brand awareness strategies when I think about the multiple entertainment properties you now have?

Ynon Kreiz - *Mattel, Inc. - Executive Chairman & CEO*

Yes. Thanks, Andrew. What we've said before is that we see the opportunity to capture the full value of our IP as accretive to what we do on the toy side. So we view these opportunities as areas where we can create -- achieve growth and develop business units that are profitable and will contribute meaningfully to our sales and business overall. Of course, there will be a halo effect on toy sales, but the opportunity is to build accretive businesses that will be successful in and of themselves.

We haven't broken down the various components. What we've said that -- we believe that in success, this could be meaningful. When we talk about these areas, it includes content, consumer products and digital experiences. And the content, it includes film and television, where we have a robust slate. On film, it's more one project in production, as you know, and 14 in development that we've announced with more coming. On the television side, we have this year 12 series and specials that will be on air, including 8 new projects. And the list goes on and on. There's a lot of activity. Still early days, but we are putting the building blocks, assembling a very strong leadership team on that side of the business and seeing real traction.

Operator

Your next question comes from the line of Fred Wightman with Wolfe Research.

Frederick Charles Wightman - *Wolfe Research, LLC - Research Analyst*

I just wanted to dig into the Gross Margin guidance. I think that you guys called out what sounds like some higher promo spend in the fourth quarter but then also FX. Is there any way that you can sort of split out those 2 within the, what looks like, call it, 50 basis point update for Gross Margin?

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Yes, I can address that. So the updated guidance for Gross Margin, as you saw, approximately 47% compared to our prior guidance of 47% to 48%. So again, ticking down just a bit, and the primary factor is the financial impact of managing inventory through the balance of the year. The FX impact is more to EBITDA and EPS because it's not really affecting the margin in the current period. So that translation impact doesn't affect Gross Margin percent, although it does affect Gross Margin and EBITDA dollars flowing through. But again, the primary change here is that financial impact of managing inventory.

Frederick Charles Wightman - *Wolfe Research, LLC - Research Analyst*

Makes sense. And then if we just think about the '23 targets and the decision to remove them sort of holistically, I think you guys introduced those back in early 2021. And I know that they've been updated a few times since then. But can you just sort of frame what you guys are looking for over the next 8 weeks against a backdrop of targets that have been out there for almost 2 years? Is it really just a matter of POS and sell-through is going to sort of be the big moving swing factor? Is it promos? Like what is sort of the big thing that you're waiting for?

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Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Yes. I think the biggest issue is we are seeing a challenging macroeconomic environment, consumers under pressure that's manifesting itself and much higher volatility in the market. So it makes it very difficult to forecast. So we also -- as you know, we revised our 2022 outlook. So the base has moved around a little bit, right, coupled with the increased volatility. It's just causing us to step back and reevaluate those 2023 expectations. So we'll get through 4Q. We'll see how we come out, and then we'll provide guidance for 2023 when we get to our fourth quarter earnings call. That being said, we are confident in not only continuing to grow the top and bottom-line this year but continuing that trajectory next year with, again, delivering top and bottom-line growth.

Ynon Kreiz - *Mattel, Inc. - Executive Chairman & CEO*

And Fred, just to add and repeat some of the things that we said, 2023 is shaping up well. We have some very distinct drivers that we talked about in aggregate. We mentioned Monster High, the global rollout. The return of Disney Princess and Frozen franchises, that's a big event, a big driver that is important to highlight, which is going to be a key addition to our portfolio. And other properties such as Trolls that will be added to what we're doing then. The Barbie movie, which -- while not animated, we still expect to drive significant halo for the Barbie brand. So we have some -- on top of what we do organically, we have these unique additions, distinct additions to our business next year.

Operator

Your final question comes from the line of Gerrick Johnson with BMO Capital Markets.

Gerrick Luke Johnson - *BMO Capital Markets Equity Research - Senior Toys and Leisure Analyst*

Can you just talk about the incremental pressure on Gross Margin coming from managing higher inventory levels? Just talk about that. What are you doing to manage higher inventory levels? Where are the higher inventory levels? And I noticed that your sales allowances as a percent of gross sales were actually lower year-over-year. So it doesn't look like you're managing inventories in the third quarter. What are those inventories that need to be managed and how?

Anthony P. DiSilvestro - *Mattel, Inc. - CFO*

Thanks, Gerrick, for the question. Let me address this by talking comprehensively about the inventory situation because that's how it arises. And on our prior calls, we did talk about the fact that we accelerated production to improve service levels and to reduce supply chain risk. At the same time, retailers also increased inventory levels to meet expected growth in demand and ahead of the holiday season to reduce risk. And reflecting our strategy, owned inventory levels at the end of Q3 are up $230 million. That's a 27% increase, and that position has improved meaningfully relative to last quarter when we were up $360 million or 44%. And as I said earlier, we expect that trend to continue to improve.

The inventory is current and of good quality. But as we assess the situation today and recognizing increased marketplace challenges and volatility, inventory levels are elevated. And as we manage through the balance of the year, we now expect increased discounts and promotions. These will have a negative impact on Q4 margins, and this is what we've factored into our guidance.

Operator

There are no further questions at this time. I will now turn the call back over to the Chairman and CEO, Mr. Kreiz.

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Ynon Kreiz - *Mattel, Inc. - Executive Chairman & CEO*

Thank you, operator. And thank you, everyone, for your questions today. In summary, this was a good quarter in the midst of a challenging macroeconomic environment. We believe our fundamentals are strong, and we are very confident about our multiyear growth trajectory.

As we said in the prepared remarks, our strategy is working, and we are operating as an IP-driven, high-performing toy company. We look forward to the holiday season and believe we are on track to achieve another growth year for Mattel. Thank you, again, and appreciate your interest in the company. And now I'm going to turn it over back to Dave.

David Zbojniewicz - *Mattel, Inc. - Vice-President IR*

Thank you, Ynon. And thank you, everyone, for joining the call today. A replay of this call will be available via webcast beginning at about 8:30 p.m. Eastern Time today. The webcast link can be found in the Events and Presentations section of our Investors section of the corporate website, corporate.mattel.com. Thank you for participating in today's call.

Operator

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

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