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EDITED TRANSCRIPT

MAT.OQ - Q4 2022 Mattel Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Mattel's Fourth Quarter and Full Year 2022 Earnings Call. (Operator Instructions)

At this time, I would like to turn the call over to Mr. David Zbojniewicz, Vice President of Investor Relations. Please go ahead, sir.

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 fourth quarter and full year 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. Our 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.

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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-K 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. We described some of these uncertainties in the Risk Factors section of our 2021 annual report on Form 10-K, our first quarter 2022 quarterly report on Form 10-Q, our earnings release and the presentation and the 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 fourth quarter and full year 2022 earnings call.

Our fourth quarter results were below our expectations as the macroeconomic environment was more challenging than anticipated. We entered the quarter expecting POS to accelerate. We did see POS growth in the quarter, including double-digit growth in December, but it came later than expected and was not enough to offset lower-than-anticipated consumer demand in October and November. This led to increased discounts and promotions by retailers and a more cautious approach to their inventory replenishment as they manage their existing stock. Our gross margin was negatively affected by higher cost to manage our inventory, but lower operating expenses helped reduce the impact on our bottom-line results.

Despite the very challenging environment, we achieved full year growth in net sales in constant currency for the fourth consecutive year, including over 2021, which had the company's highest annual growth rate in decades. We lowered our debt, further improved leverage ratio and ended the year on strong financial footing. Our balance sheet is in the best position it has been in years, which will provide more flexibility to execute our strategy.

Looking at key financial metrics in the fourth quarter as compared to the prior year. Net sales declined 22%, or 19% in constant currency. Adjusted operating income declined $185 million to $79 million. Adjusted earnings per share declined $0.35 to $0.18, and adjusted EBITDA declined $163 million to $158 million. POS for the quarter was up mid-single digits and up in all four regions. Mattel outpaced the industry and gained market share in the fourth quarter per NPD. Putting it in historical context, this was Mattel's highest fourth quarter POS in eight years.

Looking at key financial metrics for the full year as compared to the prior year. Net sales were flat or up 3% in constant currency, with growth in gross billings in all four regions. Adjusted operating income declined 10% to $689 million. Adjusted earnings per share declined 4% to $1.25. Adjusted EBITDA declined by 4% to $968 million. And leverage ratio improved to 2.4x compared to 2.6x a year ago. POS for the year grew low single digits and was up in all four regions. This was the highest full year POS in nine years and second highest on record.

Comparing 2022 results to 2019, before the pandemic, net sales in constant currency were up more than 20% and adjusted EBITDA more than doubled.

The toy industry continued to show its resilience despite macroeconomic challenges. Per NPD, following two years of double-digit growth and a record year in 2021, the toy industry finished flat compared to the prior year and up 22% compared to 2019, prior to the pandemic. We believe the toy industry is a growth industry, and we expect it will continue to grow over time. That said, given continuing macroeconomic headwinds and market volatility that may impact consumer demand, we expect the industry to be flat to slightly up in 2023.

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Looking at gross billings in constant currency by category. In the fourth quarter, Dolls, Infant, Toddler, and Preschool, or ITPS, and our Challenger categories in aggregate were down significantly as retailers reduced replenishment orders. Vehicles was up strongly. POS significantly outpaced gross billings and was positive for Dolls, Vehicles and Challenger categories and flat for ITPS.

For the full year, Vehicles and Challenger categories gross billings grew meaningfully, while Dolls and ITPS declined. POS for Vehicles and Challenger grew low double digits, while for Dolls and ITPS, POS declined low single digits. Per NPD, 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, for both the fourth quarter and full year.

As it relates to our power brands. Barbie and Fisher-Price and Thomas & Friends were down significantly as retailers reduced replenishment orders. Hot Wheels was up strongly. POS for each of our power brands significantly outpaced gross billings for the quarter. For the full year, Barbie was down following two years of double-digit growth, including the highest year on record. We are very confident about Barbie's strength and continued long-term growth. Hot Wheels performed extremely well and achieved its fifth consecutive record year. Fisher-Price and Thomas declined. Hot Wheels' POS was up low double digits, while Barbie and Fisher-Price and Thomas' POS were down low single digits. Per NPD, for both the fourth quarter and full year, Barbie, Hot Wheels and Fisher-Price were each the #1 global property in their respective categories, and Barbie was the #2 global property overall.

Looking at our multiyear performance, we have been successfully executing our strategy to grow Mattel's IP-driven toy business and expand our entertainment offering. Our portfolio is well balanced by category, genre, target demographics and retail channel. Inherently, there will be puts and takes by individual brand varying by quarter and by year. But our business model leverages our global assets and capabilities and allows us to scale our portfolio as a whole.

While the fourth quarter was below our expectations, the full year results tell a more complete story in the context of our multiyear growth trajectory. Notably, quarterly results were heavily skewed by the volatility and timing of retail inventory movement throughout the year, not by the underlying marketplace performance of our business, with growth in POS for both the fourth quarter and the year.

2022 was another year where we made meaningful progress on key priorities. Here are just a few highlights. We expanded Hot Wheels to new categories such as remote control and skate. We revitalized and relaunched Monster High, which was the #1 relaunch property within Dolls in the U.S. in the fourth quarter. We continued to strengthen our relationships with the major entertainment companies with additions or extensions of key licenses, including Disney Princess and Disney Frozen, Pokemon and Universal's Trolls.

We have grown Mattel Creations, our collector DTC business, which is capitalizing on the strength of our franchises and built-in fan base, increasing traffic by over 40% and volume by over 85%. We achieved $106 million of cost savings in 2022 from our Optimizing for Growth program and increased the targeted 2023 cost savings goal to $300 million from $250 million.

We also made meaningful progress on capturing the full value of our IP. We partnered with Skydance Media to develop a Matchbox live action motion picture as part of our growing development slate and announced that J.J. Abrams' Bad Robot will produce the Hot Wheels movie with Warner Bros. The Barbie movie completed principal photography and is in post-production towards its global theatrical release this summer. On the television side, we launched 11 series and specials, including our first live action movie musical, Monster High, which premiered on Nickelodeon and Paramount+. The Mattel Adventure Park is under construction and is expected to open in the fourth quarter of 2023. And the Mattel163 mobile gaming joint venture with NetEase grew to over $175 million in revenue.

As we look ahead to 2023, we continue to foresee a period of volatility and macroeconomic challenges impacting consumer demand. Additionally, there are two significant factors that will impact our 2023 performance. These are elevated retailer inventory levels, which will have a one-time negative impact on our top line; and incentive compensation returning to target levels, which will increase SG&A.

With that context, in 2023, we expect Mattel's full year net sales in constant currency to be comparable to 2022 and for adjusted EBITDA to be in the range of $900 million to $950 million. Our guidance assumes growth in consumer demand for our product and positive POS for the year. We aim to outpace the toy industry and gain market share. Beyond 2023, we believe our strategy will drive top and bottom-line growth.

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In closing, while the fourth quarter was below expectations, the full year growth in constant currency and increase in consumer demand for our product speak to the strength of our portfolio as a whole, even in a challenging macroeconomic environment. We believe we are well positioned to continue executing our multiyear strategy to grow our IP-driven toy business and expand our entertainment offering and create long-term shareholder value. Reflecting our improved financial position and confidence in our strategy, we expect to resume share repurchases in 2023.

We are committed to Mattel's purpose to empower the next generation to explore the wonder of childhood and reach their full potential, and to our mission to create innovative products and experiences that inspire, entertain and develop children through play. We look forward to updating you on the progress of our strategy at our upcoming virtual investor presentation.

And now Anthony will cover the financials in more detail.

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

Thanks, Ynon. As Ynon mentioned, Mattel's fourth quarter performance was below expectations. I will start with a discussion of those items which negatively impacted our performance relative to guidance.

Our consumer takeaway or POS was below expectations as the macroeconomic environment proved more challenging than anticipated. Retailers reduced replenishment orders more than we anticipated, and we incurred higher costs to manage our inventories, including closeout sales as well as the negative fixed cost absorption impact from lower sales in the fourth quarter. With the shortfall to expectations, we significantly reduced incentive compensation, which mitigated the earnings impact in 2022.

With that context, while POS increased by mid-single digits in the fourth quarter, net sales were $1.402 billion, down 22% compared to the prior year or down 19% in constant currency. Adjusted gross margin declined by 620 basis points, reflecting the impact of managing inventory levels and cost inflation. Adjusted operating income declined by $185 million to $79 million, adjusted EPS declined by $0.35 to $0.18, and adjusted EBITDA declined by $163 million to $158 million.

Looking at our full year results. Net sales were flat as reported or up 3% in constant currency. Adjusted gross margin declined 230 basis points to 45.9% due primarily to cost inflation, higher cost of managing inventories and increased royalties, partly offset by price increases and cost savings. Adjusted operating income was $689 million compared to $763 million in the prior year, while adjusted EPS declined by $0.05 to $1.25. Adjusted EBITDA declined by $39 million or 4% to $968 million, primarily due to the lower adjusted gross margin, partly offset by lower adjusted SG&A.

Turning to gross billings in constant currency, beginning with the fourth quarter. As we've discussed on prior calls, first half gross billings outpaced POS as retailers were replenishing lower inventory exiting the prior year and building inventory levels ahead of the holiday season. We expected this to reverse in the third quarter and accelerate in the fourth quarter, with POS outpacing gross billings.

Although POS did improve and outpaced shipping in the fourth quarter, consumer demand was lower and came later than expected. This caused retailers to reduce replenishment orders throughout the quarter, which impacted our performance across categories and regions. With that context, while POS increased by mid-single digits in the quarter, total company gross billings declined 19%.

Looking at gross billings in the fourth quarter by category. Dolls was down 24% with declines in Barbie and American Girl, partly offset by growth in Monster High and early shipments of Disney Princess and Disney Frozen. Barbie gross billings declined 30% with POS down 1%. Barbie outpaced the industry in the fourth quarter and gained global market share per NPD. Vehicles grew 10%, driven by double-digit growth in Hot Wheels and the successful launches of remote control and skate. Infant, Toddler, and Preschool declined 31%, while POS was flat. Mattel was #1 globally in the infant/toddler/preschool category and gained share in the quarter per NPD.

Challenger categories in aggregate declined 22% due to lower sales of Action Figures, Games and Plush. Building sets was comparable to the prior year.

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For the full year, total company gross billings grew 3%, with POS increasing low single digits. Dolls was down 6% due to declines in Barbie, American Girl and Spirit, partly offset by growth in Monster High, early shipments on Disney Princess and Disney Frozen, and strength in Polly Pocket.

As discussed last quarter, sales of higher-priced items have been negatively impacted by macroeconomic challenges facing consumers. Barbie was down 8% following two years of double-digit growth. American Girl declined 16%, primarily due to soft performance for 2022's Girl of the Year and historical characters. Vehicles grew 20%, driven by Hot Wheels and Matchbox. Hot Wheels grew 22%, driven by core die cast cars, Monster Trucks and category expansion. Infant, Toddler, and Preschool was down 6% due to declines in baby gear and infant, partly offset by growth in Imaginext and Little People. Mattel outperformed the industry and gained global share for the full year per NPD.

Challenger categories increased 10% overall, with gains in Action Figures and Building Sets, partly offset by declines in Plush and Games.

As Ynon mentioned, quarterly results were heavily skewed by the volatility and timing of retailer inventory movement throughout the year, not by the underlying marketplace performance of our business, with growth in POS for both the fourth quarter and year.

Looking at fourth quarter gross billings in constant currency by region. North America declined 25% while POS increased mid-single digits. EMEA declined 16% and POS increased mid-single digits. Latin America declined 8% with POS up low single digits. And Asia Pacific declined 5% with POS increasing high single digits.

Ending retailer inventory levels were up in both dollars and weeks of supply compared to low levels a year ago and are elevated as we head into 2023. Retail inventory is predominantly current and of good quality.

For the full year, gross billings and POS grew in each of our four regions. North America gross billings grew 1% with POS up low single digits. EMEA increased 5% with gains in all key markets. POS increased high single digits. Latin America increased 14%, with strong growth in Mexico and Brazil. POS increased low single digits. Asia Pacific sales grew 1% with gains in Australia and Japan, offset by the impact of COVID-related closures in China. POS increased mid-single digits. Per NPD, Mattel was #1 in the U.S. for the 29th consecutive year, #2 in EMEA and #1 in Latin America.

Adjusted gross margin declined 620 basis points to 43.1% in the quarter. The decline was due to several factors: inventory management, primarily closeout sales and obsolescence of 350 basis points; cost inflation of 330 basis points; fixed cost absorption of 180 basis points associated with lower volume; and increased royalties and other of 140 basis points. These negative factors were partly offset by price increases, which contributed 220 basis points, and savings from our Optimizing for Growth program, which had a positive impact of 170 basis points. For the full year, adjusted gross margin declined 230 basis points to 45.9%.

Moving down the P&L. In the fourth quarter, advertising expenses declined 9% to $243 million as we reduced advertising in response to lower volume. For the full year, advertising expense declined 2%, and as a percentage of net sales declined 20 basis points to 9.8%. Adjusted SG&A in the fourth quarter declined $73 million or 21% to $282 million. The decline was primarily due to significantly reduced incentive compensation as well as cost savings, partly offset by increases in compensation and bad debt expense.

Adjusted operating income in the fourth quarter was $79 million compared to $264 million a year ago. The decline was due to lower sales and adjusted gross margin, partly offset by lower advertising and adjusted SG&A. Adjusted EBITDA declined by $163 million to $158 million, impacted by the same factors.

Cash from operations for the full year was $443 million compared to $485 million in the prior year. The decline was primarily due to higher working capital usage, partly offset by improvements in net income, excluding the impact of noncash items.

Free cash flow was $256 million compared to $334 million in the prior year. The decline was due to lower cash from operations and increased capital expenditures. Capital expenditures increased by $35 million to $187 million, reflecting investments to increase production capacity in fashion dolls and die cast cars to support future growth. As a percentage of adjusted EBITDA, free cash flow conversion was 26% compared to 33% in the prior year.

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Taking a look at the balance sheet. We finished the year with a cash balance of $761 million compared to $731 million in the prior year as free cash flow was primarily used to reduce debt. In the fourth quarter, we redeemed the $250 million 3.15% notes due 2023. Total debt was $2.326 billion compared to $2.571 billion in the prior year, a reduction of $245 million. Accounts receivable declined by $212 million to $860 million, primarily due to the decline in fourth quarter net sales.

Inventory was $894 million compared to $777 million in the prior year, an increase of $117 million or 15%. Leverage ratio improved to 2.4x at the end of the year compared to 2.6x in the prior year. We continued to improve our credit metrics as highlighted by the recent action by Moody's Investor Services to upgrade our credit rating to investment grade.

We continued to generate significant cost savings. Optimizing for gross savings were $39 million in the quarter and $106 million for the full year, exceeding our prior forecast of $80 million to $90 million. Since 2021, when we launched the program, we have achieved $204 million of annualized savings. Based on our progress and continued focus on optimizing our operations, including actions to further streamline our organizational structure, we are increasing the targeted 2023 cost saving goal to $300 million from $250 million. Total estimated cash expenditures to implement the program are now forecasted to be $135 million to $165 million.

As Ynon said, looking ahead to 2023, we continue to foresee a period of volatility and macroeconomic challenges impacting the consumer. Additionally, there are two significant factors that will impact our 2023 performance. Anticipated retail inventory reductions will have a onetime negative impact of 3-to-4 percentage points on our top line, particularly in the first half, and incentive compensation returning to target levels will increase SG&A by approximately $100 million.

With that context, we expect full year net sales in constant currency to be comparable to the prior year, with growth in the Dolls and Vehicles categories offset by declines in Infant, Toddler, and Preschool and in our Challenger categories in aggregate, primarily due to Action Figures as we lap theatrical tie-ins in 2022. Our guidance assumes growth in consumer demand for our product with positive POS performance for the year.

With respect to the power brands, we expect Barbie and Hot Wheels to grow and for Fisher-Price to decline. Going forward, the Fisher-Price power brand will exclude Thomas & Friends, allowing greater clarity on the brand's performance. In connection with the Barbie movie, and as part of our capital-light approach, 2023 guidance includes movie-specific toy sales, a producer fee, and estimated participation in the movie's success for licensing the IP.

Foreign currency translation is expected to have a slightly positive impact on our top line performance based on current spot rates. Adjusted gross margin is expected to increase to approximately 47% compared to 45.9% in 2022. This reflects the anticipated benefit from pricing and cost savings, partly offset by cost inflation and fixed cost absorption associated with lower production volumes. With respect to timing, we expect the gross margin improvement in the second half.

In the middle of the P&L, we expect SG&A to increase as incentive compensation is forecast to return to target levels, while advertising is expected to remain relatively stable as a percent of net sales. Adjusted EBITDA is expected to be in the range of $900 million to $950 million. And adjusted EPS is expected to be in the range of $1.10 to $1.20 per share.

Interest expense in 2023 is expected to benefit from the redemption of the $250 million 3.15% notes at the end of 2022, and the adjusted tax rate is forecasted to be approximately 25% to 26% compared to 24% in 2022. Capital expenditures are forecast to be in the range of $175 million to $200 million compared to $187 million in 2022. Anticipated spending in 2023 includes continuing spend to increase capacity of fashion dolls and die cast cars supporting future growth as previously announced.

Free cash flow in 2023 is expected to exceed $400 million, driven by a higher conversion ratio as we improve our working capital performance. In terms of phasing, sales and earnings are expected to be down significantly in the first half as we wrap 20% top line growth last year and further reflecting anticipated retail inventory reductions in 2023. This is expected to be followed by top and bottom-line growth in the second half.

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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 our improved balance sheet and outlook for increased free cash flow, we expect to resume share repurchases in 2023, with approximately $200 million remaining under the company's current authorization. This action is consistent with our capital allocation priorities and reflects confidence in our strategy to create significant long-term shareholder value.

While Mattel's fourth quarter was below expectations, we outpaced the industry and gained market share. In 2022, we continued to improve our financial position, further reduced our debt and achieved an investment-grade rating from Moody's, one of the three major ratings agencies. We look forward to sharing more information on our financial outlook and capital deployment priorities at our upcoming virtual investor presentation.

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 Eric Handler of ROTH MKM.

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

Anthony, I wonder if you could give just a little perspective on inventories at retail. Like specifically, how far below normalized levels are retail inventories? And do you get a sense of how willing they are at this point to get back to normalized levels at some point during the year? And then I've got a follow-up.

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

Sure. So let me comment on the retail inventory situation. As we look at quarter end retailer inventory levels, they are actually up in both dollars and weeks of supply, and that's comparing to a low level coming into 2022. And I will also say that those inventory levels at year-end are elevated as we head into 2023 and also that they are predominantly current and of good quality.

And the issue is, and this is in our 2023 guidance, is we expect retailers globally to reduce inventory levels in 2023. And that's forecasted to have a negative impact on our sales of approximately three to four percentage points. And again, that's what we've reflected in our guidance, and most of this issue will occur in the first half of 2023.

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

Got it. And then it was good to see that Hot Wheels was up and pretty strong in the fourth quarter. I know you've added remote control and skate, but I'm curious, given that they've got relatively low price points, was that just a sweet spot for consumers given that impact?

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

Thank you for bringing up Hot Wheels. It was an incredible performance in 2022. The growth was really fueled by strong performance across the brand, but in particular, our die cast assortment. Hot Wheels Monster Truck segment performed exceptionally well. We also had incredibly exciting

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two new innovative launch segments. We are in the RC category as well as Hot Wheels Skate, which performed exceptionally well. This was also, for the full year, Hot Wheels achieved its fifth consecutive record-breaking year of gross billings.

Our basic car assortment remained the #1 best-selling toy in the world and Hot Wheels was the #1 vehicles property globally, and also, by the way, the #5 property across all toy categories. The momentum continues. We're incredibly confident in Hot Wheels' long-term trajectory, and we're really looking forward to sharing more with you at the virtual investor event.

Operator

Your next question comes from Megan Alexander of JPMorgan.

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

I want to spend a little bit of time on the POS expectation for '23. It seems like you're expecting POS up maybe in 3% to 4%, which is maybe a little bit better than '22. Yet you mentioned a volatile environment several times and the fact that retailers are reducing inventory levels. So maybe you can just help us understand what drives confidence in POS being better in '23 than '22 given these factors? And it clearly seems like we have a weaker consumer than last year.

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

Megan, yes, look, so the toy industry continued to show its resilience over the year despite the macro challenges. And after two years of double-digit growth and a record year in 2021, the toy industry was flat essentially in spite of the economy, but still up 22% relative to 2019 pre-pandemic. So we believe this speaks to the resilience and strength of the industry and that the toy industry is a growth industry and that will continue to grow over time.

Now what we also said is that given the continuing macro challenges, we do expect headwinds that may impact consumer spending and affect consumer demand. So we do expect the industry overall to be slight -- sorry, flat to slightly up in 2023. In this environment, we believe we will outperform the industry, achieve positive POS for Mattel. 2023 is off to a good start in terms of consumer demand for our product. It's still early, obviously, but we are seeing a good start. We have several key initiatives and drivers for the year on top of what we do that you're very familiar with, and all in all, feel confident about the composition of our portfolio. It's well balanced by category, by brand, by retail channel, by target demographic, and we feel well positioned heading into 2023.

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

And then maybe a follow-up for Anthony. You mentioned the phasing of sales and EPS. It should be heavily -- growth heavily weighted to the second half. On that 3% to 4% impact to the top line, can you just help us understand maybe the magnitude of how much the first half should be down? If I'm doing the math correctly, that 3% to 4% is maybe a high single, low double-digit impact to the first half. So is that -- is it more heavily concentrated in 1Q because of where retail inventory levels are? And just any more help in terms of thinking about the phasing of how much the first half should be down.

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

Sure. I think the way to look at it is two parts to it, and you have to think about the phasing in 2022, right? And I would say that our sales and earnings for 2023 are expected to be down significantly. Primarily in the first half, as we wrap 20% top line growth last year, recall our gross billings outpaced POS, so we won't have that. So that's going to be a reversal. And in addition to your point and further, reflecting the anticipated retail inventory reductions in 2023. So we kind of have a compounding effect in terms of what we're wrapping as well as what we're anticipating this year. And certainly, this will lead to growth in the second half, both top and bottom line.

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Operator

Your next question comes from Jason Haas of Bank of America.

Jason Daniel Haas - *BofA Securities, Research Division - VP*

The first one, I was just curious if you could help size up in any way how incremental Monster High and Disney Princess, Frozen could potentially be for you this year?

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

Well, on the Monster High front, first of all, we are very excited about the launch. It was one of the top performing launches this quarter, this past quarter, and we have full global rollout for the year. In connection with that, we've got incredible momentum on our content strategy as well with our partnership with Nickelodeon, new content that's going to be continuing to come out, inspiring and ultimately motivating additional purchases.

We have a great history with the brand itself. Historically, it was one of the top fashion doll brands years ago when it launched. The relaunch itself was such a bright spot for our quarter. As mentioned, it's the #1 relaunch in the United States in 2022 per NPD, and this is being only on shelves for two months. The franchise strategy behind this involves comprehensive content, a musical movie with a live action series, was the #1 kids and family movie on Paramount, launched in 23 countries. We couldn't be more excited about the performance and, of course, with the global rollout.

There's also, obviously, within our Doll portfolio an incredible lineup. The industry itself is calling it the year of the dolls. We've got, obviously, the leadership position with Barbie and our Barbie theatrical, the continued global rollout of Monster High and new Disney Princess, Frozen products. They've already started to hit shelves earlier this year. In addition to that, we also have Universal's Trolls.

So net-net, we couldn't be more excited about the portfolio that we have. We are the #1 doll category-driven business in the industry, and 2023 will be a very exciting year for us. And again, we will share a lot more detail at our virtual investor event.

Jason Daniel Haas - *BofA Securities, Research Division - VP*

Great. That's great to hear. And then as a follow-up, maybe for Anthony, I know you mentioned that the expectation for gross margin would be that we should see an improvement through the year. If you could help dimensionalize that in any way. I'm curious to what extent we -- are we expecting to see more discounting in the first half of the year? Or can you just talk about what the puts and takes are on that cadence?

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

Sure. Four primary drivers in our gross margin guidance. We are forecasting 47% in 2023, up from 45.9% this year. And the two positive drivers for us being pricing, and that's mostly the carryover impact of our 2022 actions. Second is our optimizing for growth savings. As Ynon said in the remarks, we have increased our OFG target to $300 million from $250 million and the majority of this program benefiting cost of goods sold.

And then going the other way, we continue to see some inflation in COGS, although it's significantly moderated from what happened in 2022. And that's because although we foresee some deflation in ocean freight, it's more than offset by increases in labor rates in some of our supply chain markets as well as some inflation on certain material and packaging items.

And then the fourth item, which is a negative, we ended a bit high with owned inventory levels, which we plan to reduce in 2023. So we lowered our production schedule to do that, and that comes with a negative fixed cost absorption impact, which we factored into our guidance as well.

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Jason Daniel Haas - *BofA Securities, Research Division - VP*

Got it. That's -- just to clarify, I think there was like a 350 bps headwind from discounting in the gross margin rate for 4Q. But I'm guessing that was more related just to the holiday season. We're past that at this point, we shouldn't expect that to be a meaningful headwind in the first half of '23?

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

Correct.

Operator

Your next question comes from Gerrick Johnson of BMO Capital Markets.

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

Advertising declined about, what, 9% in the fourth quarter. It was down last year as well in the fourth quarter, but that's because you had no inventory to sell. So this year, plenty of inventory, why spend less on advertising? Why do that and not try and stimulate some demand and stimulate more POS?

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

Yes. So Gerrick, as you know, heading into the fourth quarter, we had planned to actually increase advertising, assuming we hit our POS aspirations. But as we went through the quarter, we did see lower volumes, and given a good portion of our spend is on digital media, that gives us flexibility to make adjustments in real time. And as we saw the volumes come in a little soft, we made some adjustments to our advertising. It wasn't all that significant, I don't think. We finished the year, I think, down just 2% and at 9.8% of net sales, so down 20 basis points versus last year. So a full spend there to support demand drivers in our products and our brands.

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

Okay. This question was asked before, but it wasn't answered, so I'm going to ask it again. Disney Princess, how much do you think that will contribute to the year? What's built in your guidance there? And how much was shipped in the fourth quarter?

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

Yes. So as we, again, give the guidance, one of the primary drivers is anticipated growth in our Dolls category. As Richard said, we've got Monster High, we've got Disney Princess, we've got Trolls, we've got the Barbie movie, so that's all inside of that. And we also expect Vehicles to grow. So those are the key primary drivers, and that's all inside of our guidance. I don't know if that answers the question, Gerrick?

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

No, a number would answer the question, like $250 million, $400 million.

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

Yes, we're not going to break it down by specific property.

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

Okay. Well, we know it was, what, roughly a $250 million property when it left Hasbro. It was a $400 million property when it left you 6 years ago. So maybe somewhere in between?

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

Yes. We can't comment, Gerrick, on that specifically. But what we are comfortable in saying is we feel very -- that we have great plans and exciting opportunity to scale Disney Princes and Frozen and take it to new levels.

Operator

Your next question comes from Andrew Uerkwitz of Jefferies.

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

I'm just trying to reconcile a couple of your comments, and I may have missed this in the comments earlier because it was very thorough. You're calling for POS to be up, you're calling for an industry to be up, you're going to be flat. You have a couple of lines that are effectively starting from 0, Disney Trolls and Monster High, in the year. So I'm just kind of curious -- and I think you also said Vehicles will be up for the year. So I'm just -- could you give us a little bit more color on where the weakness is, the quality of the inventory of those lines that are weaker, and what's your confidence on moving through some of those segments?

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

Sure. Let me unpack the top line guidance again. I mean overall, we expect constant currency net sales to be flat with growth in the Dolls and Vehicles categories, offset by decline in Infant, Toddler, and Preschool and Challenger categories, that's primarily in Action Figures as we wrap the theatrical tie-ins in 2022. Our guidance includes a onetime negative impact from the anticipated reduction in retailer inventory levels, and that's about three to four percentage points that's inside the guidance.

We're also assuming underlying growth in consumer demand as measured by POS. And as Ynon said, our expectation for the toy industry is it -- for it to be flat to slightly positive. So that implies that we expect to outpace the industry and gain market share in 2023.

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

Got it. And I guess my second question, if I could. What kind of impact should we expect from the Barbie movie? And what kind of mix do you see in the doll category between Barbie, Monster High and American Doll and Disney Princess?

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

In terms of the Barbie movie, we've made certain assumptions and factored into our guidance the impact of movie-specific toy sales, and then more closely related to the movie, a producer fee and estimated participation in the movie success for licensing the IP. And again, that's all factored into the guidance that we gave.

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Operator

Your next question comes from Arpine Kocharyan of UBS Investment Bank.

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

Can I go back to the inventory levels at retail for just a second? How much exactly are weeks of inventory up year-over-year? Because it seems to be that there's this big gap between POS and sales declines for the quarter close to something like 30% delta, which shows you took very aggressive actions in the quarter for the quarter to clean that inventory. How -- I'm just trying to understand how is it still impacting full year by as much as four percentage points. Is there anything that would break that math of how inventories can be up significantly? Or are they not up significantly? Because being up is not surprising because you were -- you're comping not so optimal levels of inventory given supply chain disruption in the year prior. So just trying to understand that a little bit better. And then I have a quick follow-up.

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

Yes. I think the thing to recognize the typical pattern for retailer inventory is for them to build through the first three quarters of the year and then for it to decline in the fourth quarter. So we typically do see an inventory reduction in Q4. So that's not unusual. And although, right, it's been a little more significant in the fourth quarter than it's been in the past, as we look at the data, and we've got good data on retailer inventory levels, we do believe they're elevated. And the quantification of that is the correction we're anticipating for 2023, which is that three to four percentage points of top line impact. So little more to burn off here going into 2023.

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

Okay. And then on Barbie, it's very clear that it's very hard to sustain margins when Barbie declines. So my question is whether you're planning for that brand to grow. And I think you did say you're planning on Barbie to grow for the year. What offsetting factors are there in case that doesn't happen from sort of Monster High? If you could take a moment to discuss kind of margin differential in Barbie versus Monster High, it would be super helpful. And then just an unrelated housekeeping question, does your EPS guide incorporate share buyback?

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

So I'll start with the Barbie question and overall portfolio. First off, it's important to recognize Barbie actually outpaced the industry in the fourth quarter and gained global market share per NPD. It was also the #1 global dolls property and also the #2 global industry property in the fourth quarter. Now the fourth quarter performance was below expectations. POS, however, was only down 1% for the quarter which, of course, significantly outpaced shipping.

When we look at the brand's performance in context of the economic environment, retail volatility, category dynamics and, of course, consumer takeaway, we're very confident that our brand is really in a strong position to continue its leadership in the industry and, of course, its long-term potential. It continues to resonate with consumers in a profound way. And the movie expectation is just one example of that. But we're expanding our category reach. We're continuing to grow share. All of this is an indication of the overall health of the brand.

Now as you asked, it's also really important to recognize, and we talk a lot about category management, that Barbie is part of our Dolls portfolio, which also continues to be the #1 portfolio in the world in the doll category, and Mattel overall continued to grow share in both the quarter and the full year in the doll category per NPD. The lineup that we have coming for 2023 really will be the year of the doll. And of course, Barbie leading the pack in the context of what she represents, but there are incredible things happening from Mattel in the doll category, most notably, of course, the theatrical for Barbie, but the Disney Princess collection and Frozen product lines that have already started hitting shelves earlier this year have already started to gain traction. Monster High, global rollout as we mentioned before, and of course, the addition of Universal's Trolls, Polly Pocket, one of our strongest legacy brands as well.

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So there is really a great winning hand in the doll category that will really show up on the scoreboard. And again, I think we'll get into much more detail in our Investor Day coming up soon.

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

And Arpine, can you repeat the question on the share buyback?

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

Yes. Just a quick question for Anthony. Does the EPS guide includes share buybacks or not?

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

Yes. So we were happy to be able to announce that we expect to resume share repurchases in 2023. That's really a reflection of our improved financial position, our improved outlook for free cash flow. We expect to do over $400 million in 2023. And it's really consistent with the capital allocation priorities that we've talked about. And we've got $200 million remaining under the current authorization and, yes, we've made some assumptions. It is reflected in our 2023 guidance.

Operator

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

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

I was just wondering if you could give a little color on the 17% American Girl decline in the quarter. Since it's mostly a DTC brand, shouldn't have had such channel inventory issues, so I'm just curious why the demand was down so much in the quarter.

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

Yes. Linda, again, I'll start by reinforcing this is truly one of the most treasured brands in the industry, let alone the Mattel Doll portfolio. And the decline was primarily due to the soft performance of our 2022 Girl of the Year and in certain historical characters. You're right, Linda, American Girl is a premium brand where the majority of our sales are in our proprietary channels. But like general retail, we did see the POS accelerate in December, but it was not enough to offset the lower than anticipated sales that we had in October and November.

We did see strong sales in our New York City flagship store, which was really encouraging. But again, the flagship was impacted overall because our Los Angeles store was closed as we're in the process of relocating that store. We continue to believe and progress on our strategy. We're optimizing our retail footprint. We're driving a consumer omnichannel experience. There are a lot of learnings in 2022, but ultimately, we are really reaffirming our strategy as a purpose-driven, premium DTC offering.

2023, there's a lot to look forward to. We've got new characters, new product launch timing, new partnerships that we're going to be revealing soon and of course, the opening of our new L.A. flagship store. Again, confident in the future and looking forward to sharing more detail with you soon.

Operator

Your next question comes from Stephen Laszczyk of Goldman Sachs.

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Stephen Neild Laszczyk - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Great. Maybe just one more on inventory. I was wondering if you could touch a little bit more on if there are any categories in particular where retail inventory levels ended the year in a particularly better worse or better spot? And maybe Hot Wheels fared better than the doll category, for example? And then just as a follow-up on capital allocation, maybe for Anthony, it was great to see the credit upgrade in November. I was curious where the conversation stands with the other two agencies and what they're looking for maybe in terms of a potential upgrade this year? And maybe as it relates to that, how you're thinking about the magnitude of share repurchases that are incorporated in your guidance for 2023?

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

Yes. So in terms of inventory or retail inventory levels, there's no category that materially over indexes either way in terms of this situation. With respect to the rating agencies, we're in continuing dialogue with them and discussing our results. So we'll have to wait and see what, if any, actions that they take in the near term. We feel really good about where our numbers are, 2.4x debt to EBITDA. We're down from 2.6x last year, down from 4.1x the year before. So we've made consistent improvement in that metric.

And then lastly, on share repurchases. As I mentioned, we have $200 million of remaining current authorization, but not ready to share a specific number in terms of what our forecasted repurchases are for 2023.

Operator

We have time for one more question. Your final question comes from Fred Wightman of Wolfe Research.

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

I just wanted to ask about the expectation for higher incentive comp in '23. I think you sized that at $100 million year-over-year. I would assume most of that came out of 4Q, but how should we think about the sequencing? Do you guys have to book some of that as we move throughout the year? Or should it really just hit all in the fourth quarter year-over-year?

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

A good point. The reduction this year came predominantly in the fourth quarter. But in a normal year, we would accrue that ratably through the year and adjust as we update our forecast.

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

Okay. And then there was a comment earlier just that you're assuming some film participation in the top line guide. I'm wondering if that is sort of a new treatment or a new expectation? Or if we think about some of the prior 2023 targets that were out there that you guys had obviously removed last quarter, but if you were sort of always assuming there would be some film participation when you were putting numbers into the market?

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

Yes. We've consistently made that assumption in terms of film participation, since some of the franchise adjacencies that we do have get included in our category reporting as well.

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Operator

This concludes the question-and-answer session for today's call. I would now like to turn the call back over to Chairman and CEO, Ynon Kreiz, for final remarks.

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

Thank you, operator, and thank you, everyone, for joining us today. Just to recap a few words. Despite the challenges in the fourth quarter, the full year results tell a more complete story in the context of our multiyear growth trajectory. As you can see in positive POS for both the quarter and the year, and positive POS in every region for the quarter and the year, our product is in demand, and we ended the year on strong financial footing with a stronger balance sheet, a lower leverage ratio, a better leverage ratio, and as we see it, in the strongest financial position we've been in years. We are confident about our plans and look forward to next year.

I also want to thank the entire Mattel global team for doing such a great job in a challenging environment and for the contribution in 2022, an ongoing commitment to executing our strategy. We hope everyone will join us on the virtual investors presentation in March. Thank you again for joining us. We will share more information on that call soon. Appreciate your interest in the company.

And now 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 8:30 p.m. Eastern Time today. The webcast link can be found in the Events and Presentations section of our Investors section of our corporate website, corporate.mattel.com. Thank you for participating in today's call.

Operator

Ladies and gentlemen, again, thank you for your participation in today's event. This concludes today's call. You may now disconnect.

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