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MAT.OQ - Q2 2023 Mattel Inc Earnings Call

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OVERVIEW:

Company reported Net sales of \$1.087 billion, Adjusted operating income of \$75 million, Adjusted EPS of \$0.10, adjusted EBITDA of \$37 million, Adjusted SG&A of \$324 million, cash from operations of \$326 million, free cash flow of \$399 million, free cash flow of \$361 million, Total debt of \$2.328 billion, free cash flow of \$400 million.

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PRESENTATION

Operator

Good afternoon. My name is Emma, and I will be your conference operator today. At this time, I would like to welcome everyone to the Mattel, Inc. Second Quarter 2023 Earnings Conference Call. (Operator Instructions) David Zbojniewicz, Head of Investor Relations, you may begin your conference.

David Zbojniewicz - Mattel, Inc. - VP & Head of 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 2023 second 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 may 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. For today's presentation, references to POS and consumer demand exclude the impact related to our Russia business, given our decision to pause all shipments into Russia in 2022.

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. 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.

We describe some of these uncertainties in the Risk Factors section of our 2022 annual report on Form 10-K, our Q1 2023 quarterly report on Form 10-Q, our earnings release and presentation and other filings we make with the SEC from time to time as well as in other public statements. Mattel does not update forward-looking statements and expressly disclaims any obligation to do so, except as required by law. Now I'd like to turn the call over to Ynon.

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

Thank you for joining our second quarter 2023 earnings call. Mattel's second quarter financial results were in line with company expectations. But this moment in time will largely be remembered as a key milestone in our company's history, the release of our first-ever theatrical movie to a global audience as part of our strategy to expand our entertainment offering and capture the full value of our IP. We will talk more about the Barbie movie shortly.

Turning to financials. Sales trends improved significantly from the first quarter but were down versus the prior year. This was primarily due to the continued impact of retailers managing inventory levels and industry softness as well as comparisons to the year ago quarter, which benefited from retailers building inventories earlier in the season.

Looking at key financial metrics for the second quarter as compared to last year. Net sales declined 12% as reported or 13% in constant currency. Adjusted EBITDA declined \$37 million to \$148 million and trailing 12-month free cash flow increased by \$214 million to \$361 million.

POS was down high single digits in the quarter and down low single digits for the first half of the year. POS continued to exceed shipping.

Per Circana, in the second quarter and year-to-date, Mattel gained share globally and in our 3 leader categories, Dolls, Vehicles and Infant, Toddler and Preschool.

Reflecting our strong financial position and confidence in our strategy, we continued to repurchase shares in the quarter, and we look to make further repurchases this year.

Our retailers have made considerable progress in adjusting their inventories of Mattel products and are below prior year levels. While the toy industry declined more than we expected in the second quarter, we believe consumers are deferring purchases in anticipation of increased spending during the holiday season.

However, given first half trends, we now expect the industry to decline modestly for the year, but remain significantly above pre-pandemic levels.

The fundamentals of our business are strong. We expect to outpace the industry, gain market share and are reiterating our full year guidance.

Looking at gross billings in the quarter. Dolls and Vehicles grew while Infant, Toddler and Preschool and our Challenger categories declined.

With respect to the Power Brands, Barbie and Fisher-Price declined, while Hot Wheels grew. The global rollout of Monster High and the launch of Disney Princess and Disney Frozen are building momentum.

We continue to successfully execute our strategy to grow Mattel's IP-driven toy business and expand our entertainment offering in the second quarter.

As it relates to our Toy business, we launched a wide range of Barbie movie-related toys and products. Releases to date have sold out across major distribution channels, and we will be expanding the range in the second half. We continue to expand our franchise brands with the launch of new innovative products, including Hot Wheels Racerverse, a new character-driven play system.

We renewed our multi-category licensing partnership with Warner Bros. for their portfolio, including the DC Universe, Batwheels and Harry Potter, among others.

As it relates to our entertainment business, the Barbie movie premiered globally last Friday to incredible success and became the largest opening weekend at the box office of 2023.

This first production of Mattel Films brought together some of the world's most prolific filmmakers and talent of our generation. The world-class Barbie marketing organization and Mattel's broad expertise in demand creation in strong collaboration with Warner Bros. team promotional engine and global distribution platform have made the movie hard to ignore.

The success of the box office during the first weekend combined with positive film reviews and the entire buildup towards its release made it more than a movie. It has become a cultural phenomenon. Exceptional media coverage and product tie-ins, cross-platform amplification from Warner Bros. Discovery cable and streaming services, a global philanthropic campaign and of course, a sellout toy line, significantly broadened the film's reach and fan engagement.

We could not be prouder of the creative vision and execution of Greta Gerwig and are grateful for the partnership with Margot Robbie and LuckyChap Entertainment, Noah Baumbach, David Heyman, and of course, Warner Bros. commitment to the project from the very beginning. This would also not have been possible without the dedication of the Mattel Films and Barbie teams and everyone at Mattel who have been a part of the Barbie movie.

This is a milestone moment for Mattel in a showcase for the cultural resonance of our IP, our ability to attract and collaborate with top creative talent and the capabilities of our franchise management organization. This also speaks to the potential of Mattel Films and the significant progress of our strategy to capture the full value of our IP.

We continued to make good progress in capturing value of our IP outside the toy aisle in other areas as well. As part of the Barbie movie, Mattel partnered with Warner Bros. and Warner Music Group to release the Barbie music album produced by Marc Ronson. The album features a stellar lineup of some of the most celebrated music artists in the world, including Dua Lipa, Nicki Minaj and Ice Spice, Billie Eilish, Lizzo, Sam Smith and other major global talent.

Mattel also entered into over 165 consumer product partnerships tied to the Barbie movie with cross-category displays in thousands of stores globally.

In television, the Barbie Dream House Challenge, a home makeover competition series hosted by Ashley Graham, premiered July 16 on HGTV to great success.

The episode ranked as a top 5 cable premiere among women and adults 25 to 54 years old. The Hot Wheels Ultimate Challenge prime time show which premiered on NBC and Peacock on May 30, has performed well and ranks as a top NBC alternative series to launch on Peacock.

In digital gaming, Hot Wheels Unleashed 2: Turbocharged, the upcoming sequel to the successful digital game for console and PC was announced.

The game will launch this fall.

And in live events, Mattel announced the Monster High live tour also coming this fall in partnership with the Family Entertainment Live.

As we announced today, Richard Dickson, President and Chief Operating Officer, will step down from his position with the company effective August 3, 2023.

I would like to thank Richard for his tremendous contributions to the company and congratulate him on his opportunity to become CEO of Gap Inc. Richard has led the growth of some of the world's most iconic and purpose-driven brands. I'm personally grateful for the friendship, the partnership and for his work in developing and growing the best brand and franchise team in the business today. We wish Richard great success in his new role.

The company has promoted Lisa McKnight to Executive Vice President and Chief Brand Officer, overseeing all of Mattel's Toy categories and global brands as well as design and development. Josh Silverman has been promoted to Executive Vice President and Chief Franchise Officer. His role has expanded to include leadership of digital gaming and license entertainment, in addition to his responsibilities overseeing global consumer products, publishing, promotions and location-based entertainment businesses as well as franchise strategy and management for Mattel.

Lisa and Josh will report to me. The company has also promoted Chris Down to Executive Vice President and Chief Design Officer, reporting to Lisa.

Lisa has held senior leadership positions at Mattel for nearly 25 years and has been the Global Head of Barbie since 2016 and Dolls since 2019. In this role, she has led the charge in repositioning and scaling the Barbie brand and driven significant portfolio expansion with complementary brands.

She has also led the successful relaunch of Monster High and played a key role in winning back the licensing rights to Disney Princess and Disney Frozen franchises.

Josh Silverman joined Mattel in 2022 as Global Head of Consumer Products and Chief Franchise Officer, following 20 years in leadership roles with The Walt Disney Company and Marvel. Since joining Mattel, he has expanded the company's consumer products, location-based entertainment and publishing businesses.

Most notably, Josh oversaw the execution of more than 165 consumer products partnerships and retail tie-ins related to the Barbie movie. Our strong and talented leadership team and the entire brand management organization are in an excellent position to continue to execute our strategy to grow our IP-driven Toy business and expand our entertainment offering.

In closing, our second quarter financial results were in line with expectations. But it was much more than that in terms of advancing our entertainment strategy. Following the incredibly successful Barbie movie release, we look forward to continue capitalizing on the many exciting opportunities to capture the full value of our iconic brands outside the toy aisle.

We expect to achieve our full year guidance to outpace the industry and gain market share. We are well positioned to continue executing our multi-year strategy and create long-term shareholder value.

And now I will turn the call over to Anthony.

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Thanks, Ynon. While comparisons improved from the first quarter, our second quarter financial results were negatively impacted as retailers continued to manage inventory levels compared to the buildup in the prior year. And while we gained share, we saw some overall industry softness.

Net sales of \$1.087 billion declined 12% or 13% in constant currency, compared to the prior year. Adjusted gross margin of 44.9% was comparable to the prior year and a significant improvement from the first quarter comparison to the prior year. Adjusted operating income was \$75 million, a decline of \$47 million compared to the prior year due primarily to lower sales.

Adjusted EPS was \$0.10 compared to \$0.18 a year ago. And adjusted EBITDA of \$148 million was \$37 million below the prior year.

We continue to expect consumer demand for Mattel product will be positive for the full year and revenue comparisons to improve in the second half as shipping patterns revert to historical trends. Given our first half performance and outlook for the balance of the year, we are reiterating our guidance, including for net sales growth in constant currency, adjusted EPS and adjusted EBITDA.

Turning to gross billings in constant currency, first, by category. Overall, gross billings declined 12%, including a 2-point negative impact from Russia. Our POS in the quarter, which excludes Russia, declined by high single digits. That said, we continued to significantly outpace the industry and gain market share globally.

Dolls grew 9%, driven by Disney Princess and Disney Frozen and the global rollout of Monster High, partly offset by Barbie. POS for Dolls declined mid-single digits, reflecting overall declines in the category.

Barbie declined 7% with POS down low double digits.

Barbie POS continued to be impacted by the shift of promotions to better align with the theatrical release of the movie. With the success of the Barbie movie and our robust marketing plans for the second half, we have seen improving trends with Barbie's month-to-date POS in July turning positive.

Mattel outperformed the industry and gained over 400 basis points of market share in the Dolls category year-to-date. And Barbie was the #1 Doll property globally, per Circana.

Vehicles continued its strong performance, growing 10%, in line with POS. Growth was primarily driven by Hot Wheels die-cast vehicles, which continue to perform well.

Year-to-date, Mattel gained over 450 basis points of market share in the Vehicles category, achieving the highest first half share on record, per Circana.

Infant, Toddler and Preschool declined 29%, reflecting the impact of retailer inventory movements and overall category weakness. POS was down low double digits, less than gross billings, primarily due to Baby Gear as we continue to realign the business to more profitable segments.

Mattel outperformed the category, gained 60 basis points of market share year-to-date and was the #1 toy company globally in the Infant, Toddler and Preschool category, per Circana.

Challenger categories, in aggregate, declined 40% due primarily to lower sales and Action Figures as we lap the theatrical tie-ins in the prior year. POS declined low double digits, but ahead of gross billings.

Regional performance was impacted by retail inventory headwinds in various markets as well as some industry softness in key regions.

North America gross billings declined 18%, POS declined low double digits. For the first half, per Circana, Mattel gained market share in North America.

EMEA declined 8%, reflecting a negative 8 percentage point impact from Russia.

POS, excluding Russia, increased high single digits.

Latin America grew 3% with POS comparable to the prior year. Per Circana, Mattel gained market share in Latin America year-to-date, extending our #1 market position.

Asia Pacific increased 7% driven primarily by growth in China and India. POS declined low single digits.

As previously discussed, retailer inventory levels were elevated heading into 2023. The position improved in the first quarter and has improved further this quarter. At the end of the second quarter, retailer inventory levels in dollars are below prior year levels by a double-digit percentage, with weeks of supply declining high single digits. At this point, we believe the retail inventory correction is mostly behind us.

Adjusted gross margin of 44.9% in the quarter was comparable to the prior year. There were several puts and takes to this performance. On the positive side, price increases, primarily the carryover benefit from 2022 actions, contributed 170 basis points. Savings from the Optimizing for Growth program had a positive impact of 150 basis points, and foreign exchange had a positive benefit of 90 basis points.

These positive factors were offset by cost inflation, while continuing to moderate, had a 140 basis point impact; fixed cost absorption of 100 basis points associated with lower volumes; inventory management costs, primarily closeout sales and obsolescence of 90 basis points; and mix and other factors of 80 basis points.

Moving down the P&L. Advertising expenses of \$90 million were comparable to the prior year and up 100 basis points as a percentage of net sales. Looking ahead, we are planning for increased advertising spend in the second half. Adjusted SG&A declined 6% to \$324 million, primarily driven by our cost management efforts and savings from our Optimizing for Growth program.

Adjusted operating income was \$75 million compared to \$121 million a year ago. The \$47 million decline was due to lower sales partly offset by lower adjusted SG&A. Adjusted EBITDA declined by \$37 million to \$148 million, impacted by the same factors.

On a year-to-date basis, cash from operations, reflecting seasonality of the business was a use of \$326 million compared to a use of \$425 million in the prior year. The \$99 million improvement was primarily driven by improved working capital performance, primarily inventories, partly offset by lower net income.

Capital expenditures were \$73 million compared to \$79 million a year ago, and free cash flow was a use of \$399 million compared to \$503 million in the prior year.

On a trailing 12-month basis, we generated \$361 million in free cash flow compared to \$147 million in the prior year, an increase of \$214 million. The increase was primarily driven by cash from operations, benefiting from improved working capital performance, partly offset by higher capital expenditures supporting recent capacity additions.

We have utilized a portion of our free cash flow to repurchase shares. In the first half, we repurchased \$50 million of our shares and look to continue repurchases in the second half.

Taking a look at the balance sheet. We finished the quarter with a cash balance of \$300 million compared to \$275 million in the prior year. The increase reflects the free cash flow generated over the trailing 12 months, mostly offset by the use of cash to reduce debt and repurchase shares.

Total debt declined to \$2.328 billion from \$2.576 billion last year, reflecting the repayment of \$250 million of debt in the fourth quarter last year.

Accounts receivable declined by \$98 million to \$891 million, broadly in line with the decline in sales.

We continue to make good progress in reducing owned inventories. Inventory was \$972 million compared to \$1.178 billion in the prior year, a reduction of \$206 million.

Looking ahead, we are well positioned to achieve our targeted inventory reductions in 2023, which will contribute to free cash flow generation.

Our leverage ratio increased to 3.1x at the end of the second quarter compared to 2.3x a year ago. The increase is primarily due to the timing of our quarterly results. We expect to end 2023 with a leverage ratio of approximately 2.5x.

We generated \$24 million of savings in the quarter as we continue to execute the Optimizing for Growth program launched in 2021. We remain on track to achieve our program savings goal of \$300 million by 2023.

Total estimated cash expenditures to implement the program are expected to be \$155 million to \$185 million.

We are reiterating our full year 2023 guidance consistent with our first quarter earnings call. This includes our expectation for net sales to be comparable to last year in constant currency, adjusted EPS in the range of \$1.10 to \$1.20, adjusted EBITDA of \$900 million to \$950 million and for free cash flow to exceed \$400 million.

We continue to expect growth in the Dolls and Vehicles categories, offset by declines in Infant, Toddler and Preschool and in our Challenger categories in aggregate. For our Power Brands, we expect Barbie and Hot Wheels to grow and for Fisher-Price to decline.

At current spot rates, we expect foreign exchange translation will have a positive impact of approximately 2 percentage points on 2023 net sales.

In terms of phasing and with the retailer inventory correction mostly behind us, we expect gross billings to return to historical trends with 2/3 of annual shipments in the second half. This will result in an accelerated growth rate, particularly in Q4, as we wrap an atypical retailer inventory decline in the prior year.

We are operating in a challenging macroeconomic environment with higher volatility 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.

In closing, Mattel's second quarter performance and first half was in line with expectations, and we believe we are well positioned to achieve our full year guidance. The balance sheet is strong, and business fundamentals are sound.

Retailer inventories are well positioned, and we look forward to meeting consumer demand for our products as we enter the second half of the year and the all-important holiday season.

And now I will turn it over to the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question today comes from the line of Eric Handler with ROTH.

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

So in looking at Barbie and trying to sort of figure out the growth trajectory for this year, I wondered if you could talk about maybe give us some directional expectations and how much of the growth is from the toy aisle, how much is increased licensing and then maybe give us a hint on movie economics?

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

I'll start, it's Richard. Clearly on the Barbie front, we are incredibly pleased with the Barbie brand performance. I mean the success of the Barbie movie is a milestone moment for Mattel, and it really is a showcase for the cultural resonance of the brand. As we've seen, the success is far beyond the film. We've seen POS impacted on our toy business, on our consumer product partner business, which has really begun to accelerate meaningfully.

We all see the world is playing with Barbie, whether it's our toys, fashion, accessories or content. I mean there's no doubt that the brand has reached a new level of cultural relevance. Tie-ins to date have been extraordinary with a movie soundtrack, television shows. We've announced over 165 different consumer product partnerships and live experiences.

So all in all, it has been just a tremendous moment for the brand. And our guidance includes expectations for significant growth for Barbie in the second half and to be positive for the full year, certainly with the halo effect of the movie and its economics benefiting Mattel over the next several quarters and years. And ultimately, we've never been more confident in Barbie and our Dolls portfolio's future in both the back half and certainly years and beyond.

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

Okay. Great. And by the way, Richard, congratulations well deserved, and good luck to you.

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

Thank you.

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

Ynon, maybe you could talk a little bit about the big picture for what's next for the movie business. Does the success of Barbie make it easier to get other films that have been in the pipeline maybe greenlit and starting to move forward with -- I don't know -- I have no idea how far along scripts are or where they are in the process. But maybe you could talk a little bit about how to think about that, strike issues notwithstanding.

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

Yes. So let's start by saying that from the beginning, this was not just about making a movie. This was about creating a cultural event and leverage our brands in a way that we've never done before. What we saw in this movie with this project and the way the Barbie movie was released and received in the marketplace, it was really a showcase for the cultural resonance of our brands, the way we work, attract and collaborate with top talent and our marketing and demand creation capabilities to create what effectively became a cultural phenomenon.

So this is not just about releasing a movie, but really executing our strategy at the highest level. You've been following us for a while. This has been the strategy. This is what we were aiming to achieve. And it's great to see it playing out in that way in real time. We're not saying that every new movie will achieve the same level of success, but we absolutely plan to execute the same strategy, the same approach, the same methodology in collaborating with top talent in inspiring, in amplifying and trusting and promoting top talent and then bringing our marketing machine and demand creative capabilities to create special, iconic moments in culture.

And yes, there is momentum right now overall, not just for Barbie, the brand, but for other brands. And of course, even on Barbie, this is not just about one movie. The goal was to create -- to build the film franchise and continue to extend the brand in more ways, and success breeds success. We believe we're in a very good place and hope to achieve more with Barbie and other brands.

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*

Yes. So I'm just curious, in terms of this year needing to have -- the retailers needing to reduce inventory, did that affect the original plans for how big of a product line for Barbie related to the movie that you actually shipped into retail? I mean was that affected by the macro situation or not versus original plan?

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

No. Linda, there are really 2 independent issues. In our original and our current guidance, we're anticipating a macro retail inventory impact of 3 to 4 percentage points. That continues to be our expectation. The movie toy line is kind of separate from that, and it's going very well.

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

Okay. And then -- can I just ask about -- it seems when you gave the shipment and the POS data for the outside the U.S., Latin America and Asia, it seemed like the shipment growth exceeded the POS growth. So I'm just curious, was that the retailers actually build -- rebuilding inventory? Or should we be concerned because the POS wasn't stronger in those markets?

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

We feel good about the performance internationally. And I think in both Latin America and Asia Pacific, they didn't start with the retailer inventory situation that the other markets did. So we didn't expect to see that divergence, right, that we're seeing more in North America and EMEA where most that inventory correction actually has occurred. And sitting here at the end of Q2, we believe that the inventory correction is now mostly behind us, right? And this will bode well as we get into the second half with the expectation that will go back to those historical trends of 2/3 of gross billings happening in the second half, and that will certainly support an accelerated growth rate for us in H2.

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

Okay. And if I could just sneak in one more. So in terms of the Barbie movie, I think you said that in a couple of quarters or something, if the box office was really big, you would share in the economics and we might actually see it affect your earnings in a positive way. So I guess why -- given the success of the box office, why would that not be something that could make you raise your guidance for the year? Is it just not material enough?

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

Yes. So in terms of the guidance, and as Ynon stated, the second quarter results were in line with company expectations. We are reiterating our guidance for net sales in constant currency to be comparable to 2022. And as I mentioned, this includes the retail inventory headwind of 3 to 4 points. And if you break down our guidance, it implies significant growth in the second half, including for Barbie, which we expect to be positive for the full year.

That said, in the context of our overall portfolio, some industry softness we saw in Q2. And given it's still early in the year, we've got 2/3 of our sales still to go, we are maintaining our guidance. That said, we're off to a good start in Q3. Q3 quarter-to-date POS for the total company is now positive as well as for Barbie, and we continue to outpace the industry and to gain market share.

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

Okay. And let me slip in a congratulations to Richard. Good luck.

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

Thank you, Linda, very much.

Operator

Your next question comes from the line of Stephen Laszczyk with Goldman Sachs.

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

First on Barbie, Ynon. I was wondering if the success of the Barbie movie this past month has changed the way you look at capital allocation at all. Are there opportunities that you think make more sense today, perhaps committing more capital towards future media productions or acquiring other forms of IP that you think make more sense today than they may have a few months ago?

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

Okay. At this point, we're still absorbing and amplifying the initial rollout of the movie. It's early to comment on further plans. We're not changing strategy in the near term, but as we continue to strengthen our balance sheet and drive more cash and see a significant increase in cash flow, we continue to look for ways to invest in organic growth, always in the interest of our shareholders. So whatever we do will be the most prudent and impactful way, risk-adjusted strategy to amplify return for our shareholders.

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

Got it. And then maybe one for Anthony. You called out overall industry softness in your prepared remarks. I was hoping you can maybe unpack that a little bit more for us. What areas of the retail market are you seeing the most softness in? Looking ahead, I'm curious if there's anything you're hearing specifically from your retail partners that gives you confidence in achieving your top line guidance for the year? Any commentary around that would be helpful.

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

Yes. So as we've said, we are seeing some industry softness. We believe that consumers are deferring some of their current purchases and intend to spend more in the second half and the holiday season. And that's why we're calling for a positive holiday season with the inventory correction now behind us, we're working closely with our retailers to meet the demand, the anticipated demand for our product in the second half. So we think we're in a very good position and look forward to the holiday season.

Operator

Your next question comes from the line of Jason Haas with Bank of America.

Jason Daniel Haas - BofA Securities, Research Division - VP

It sounds like there's an incremental to -- I think you called out a 2 percentage point benefit from FX. So I guess my question is, why not raise the EPS guidance on the back of that? Is there anything that's incremental that's going to pressure EPS that wasn't contemplated in the guidance before?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Sure. Look, inside of our gross margin, there are always kind of puts and takes. We had already anticipated some uplift from foreign exchange. Now we're quantifying it for you that based on current exchange rate, it's a 2-point positive to the top line, but there are other puts and takes. And at this point, we are reiterating the guidance, which is 47% on the year.

And given our first half, that does imply significant gross margin in the second half, which will come from a number of factors, continued savings on our optimizing for growth program, the benefit of the top line. We're wrapping some onetime inventory management costs in Q4 of last year, and those all kind of factor in. So we feel good about where we are in the second half.

Jason Daniel Haas - BofA Securities, Research Division - VP

That's great. Are you able to give any color on what the cadence of revenue should look like between 3Q and 4Q? Will those also follow a normal seasonality?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. I think you'll see more of an acceleration in Q4 as we wrap the atypical inventory decline that happened in the fourth quarter of last year.

Jason Daniel Haas - BofA Securities, Research Division - VP

Great. And if I could squeeze one more in. Just on the Barbie movie, it sounds like things are off to a really good start. There's always this big question around this movie just because it's geared towards an older audience. The question was around how well the toy sales would do alongside it? So I know it's early, but is your initial -- the initial read that you are seeing those incremental toy sales alongside the movie? And then how about from the retailers? Are they seeing the success of the movie at the box office? And are they increasing their orders for Barbie at this point?

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

The initial take-up in movie-related product has been selling out very fast. We've said that before. In terms of the actual toy brands and over 165 retail partnerships that we've had, so we've seen very strong success of that. We haven't commented yet on Barbie classic toys, which is what is factored into our full year guidance.

But all in all, the -- we're clearly seeing a halo effect of the movie. But important to say that the -- this is not just about the quarter or about the year, this is about long-term franchise management. And we absolutely expect to see continued momentum with the brand on the back of such a strong initial release. And what is interesting to note is that with this movie, we're seeing a real expansion in fan base, more male audience that go to the theaters.

We're seeing very strong performance internationally. This is important to say because there was some commentary before the movie release that people thought it would be more successful domestically in the U.S., but we're actually seeing -- in spite of -- on top of the success in the U.S., we're seeing a very strong performance internationally, and this is before Japan even release, which will happen in August. So within the movie store,

there are some very important indications about the strength of the brand, the take-up and the continued expansion of the fan base and audience overall.

Jason Daniel Haas - BofA Securities, Research Division - VP

That's great to hear. Congratulations on the success you've been having.

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

Thank you.

Operator

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

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

This is Arpine. This is probably a question for Ynon. You are approaching peak production period, I believe, right around August. What goes into that thinking in terms of upside and downside to your plans? Buyers seem to be very cautious on inventory. At the same time, they are, in some cases, running below target in stock levels, at least in toys, yet not taking inventory.

Do you see a risk that some of that cautious outlook that the retailer maintains sort of has the potential to be reflected in their purchase orders? How do you think about that?

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

Thanks, Arpine. We continue to work collaboratively with our retail partners. This is what we do every year. This is what we do as we head towards the production season and all important holiday period. We continue to monitor the market. We receive input and data points from retailers all over the world, from our own people on the ground in every major market and look to continue to adjust and reflect that in how we map our plans going forward.

The -- overall, the fundamentals are strong. The portfolio is very well balanced. We're seeing strength in -- not just in Barbie, but we talked about Hot Wheels a lot. Hot Wheels is on track to achieve its 6th record year. We have some important incremental drivers that we haven't had in past years, including Disney Princess and Frozen, Disney's Wish, Trolls.

Monster High is rolling out globally. We've talked a lot about the Barbie movie. And that in itself will have its own potential momentum -- expected momentum. And of course, the continued strength across the portfolio. So we're not done. We look to continue to drive the business going forward. We just announced another partnership with Warner Bros. to grow our third-party licensing business as well. So we expect to continue to outpace the industry, gain market share and achieve our full year guidance.

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

Thank you, Ynon. That is very helpful. And then would you be able to size, call it, meaningful consumer product partnerships be for your profitability over time? I think you said more than 160 partnerships for Barbie franchise alone. How should we think about the opportunity over time because, obviously, that can be a very high-margin business for you?

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

Right. You said it right. It's a very high-margin business. We continue to look at the Barbie movie as a template. We think of it as a template in terms of our ability to execute such a comprehensive program of consumer product partnerships. And what is interesting in one of the takeaways of the success of the Barbie movie is our ability to execute our demand creation expertise outside the toy aisle.

As a company, our focus to date has been doing that within the toy side of the business. And now we were able to take -- bring that expertise into amplifying the movie and turning it into a cultural event. Of course, it starts with having a great movie, reflecting the creative vision and masterful execution of a great picture by Greta Gerwig, having superstar cast with Margot Robbie and Ryan Gosling, having an amazing sound track that is now becoming an album and an experience in and of itself produced by Mark Ronson.

But -- and of course, Warner Bros. in terms of their incredible marketing campaign and everything they brought to the table. But it is also very much about our expertise in amplifying all of that and turning it into a cultural event and continuing to drive business, important business outside of our core toy expertise.

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

Great. And just really quickly for Fisher-Price. What are some of the underlying reasons the brand is still under so much pressure? How much of that decline is sort of clean up to shift to more profitable SKUs and get out of, for example, Baby Gear, if you can quantify that quickly?

Richard Dickson - Mattel, Inc. - President & COO

Arpine, it's Richard. First off, Mattel outperformed the category. We gained 60 points -- basis points of market share year-to-date. We are the #1 toy company globally in the category of Infant, Toddler and Preschool. We did decline in the second quarter, but it really reflects the impact of retailer inventory movements and the overall category weakness, we continue to expect trends to improve as we progress through '23.

We're supporting it by Imaginext, expanding its core audience with the release of Trolls later this year, which we're really excited about. We've got continued expansion of Little People that's gaining more and more momentum with our core brands, Barbie and Hot Wheels, which have extended into that property. We've got new strong innovation that is planned for the back half with great demand creation to support the brand.

So there's a lot in the pipeline for Fisher-Price. Of course, we believe in the brand, its position in the market. The opportunity to grow. We'll continue to optimize the category that we're in, both in revenue and most importantly, profitability to extend our leadership position.

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

Congratulations on Barbie's success. And all the best to you, Richard.

Richard Dickson - Mattel, Inc. - President & COO

Thank you, Arpine.

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

Thank you.

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 ask about the inventory correction time line. It seems like that got pushed out a little bit versus what you guys were expecting last quarter. So wondering what if anything changed? And then just how we should rationalize that with the gross margin impact that we saw? I mean, it was a pretty big sequential change in terms of what you called out that was tied to inventory closeouts. So how does that all work?

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

Sure. I would say the retail inventory situation is unfolding as we expected, right? We made some progress in Q1. We made further progress in Q2. We ended the quarter with retail inventory levels down double-digit percent in dollars and a high single-digit percent as measured in weeks of supply. And we certainly had less inventory management costs in Q2 than we did in Q1.

So as we sit here today, we would say that the correction is mostly behind us. And what that means looking ahead, as gross billings are expected to return normal patterns with 2/3 in the second half, we should see an accelerated growth rate, particularly in Q4 as we wrap last year's movement.

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

Okay. And then there was a comment about some of the POS impact in 2Q as far as consumer shifting spending to the holiday. What exactly has been informing that view? Is it tied to survey work? Or what are you sort of basing that on?

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

Yes, it's based on our own internal research that we do every year in terms of talking to consumers and trying to understand how they're thinking, why they're making purchases or not making purchases. But I would also say -- I would also add to that. I think the economic data also supports what we're expecting in terms of -- consumer spending is expected to increase in the second half. Unemployment remains low. Inflation seems to be subsiding and consumer sentiment seems to be on the rise if you look at a number of indices as well.

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

Makes sense. All the best, Richard.

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

Thank you so much.

Operator

Your last question today comes from the line of Drew Crum with Stifel.

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

Richard, best of luck, and congrats. My first question is how does the current Hollywood labor disputes impact your business this year? Or is this something that if it lingers as more of a headwind in 2024?

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

We -- it is delaying some projects that are in development, but we've made significant progress before the strike, and we expect to continue to make progress after the strike. We're watching the space, and we'll manage accordingly.

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

Okay. And then, Ynon, I think you responded to a question concerning the entertainment strategy in light of the success you've had with Barbie to date. I wanted to drill down maybe a little bit further on that. Maybe it's a little bit premature to be asking this, but given the film hasn't been in release for more than a week, what are your thoughts around what's next for Barbie theatrically. Do you intend to sequel a film? Do you -- can you do spin-offs? Can you improve your participation or economics on the next project? What's next for Barbie?

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

We haven't announced anything, and it's probably a bit early to talk about sequels. But obviously, with the success of the film with a phenomenal release less than a week already at well north of \$400 million of box office and very strong momentum. And as I mentioned, repeat viewing and broad demographics, very strong global performance, that would invite more opportunities.

We operate in an industry where everyone is looking for this moment for these brands, for these cultural events. And they don't -- they happen, but they don't happen often. So we're very proud to be the owners of such an important, iconic brand. We should remember that Barbie has been already successful before the movie, very -- the #1 brand for 2 years in a row, globally.

And last year was #2 only behind Pokemon, but continuing to show strength on very strong footing. So we expect the brand to continue to grow. We expect to have more opportunities in content. And this is not just film, but also television and other areas where we continue to engage people who are -- have an emotional connection with the brand. And on this, I just want to make the point that the biggest shift in our strategy and in our DNA was to realize that people who buy our product are not just consumers, they are fans.

And once you have an audience, the more opportunities open up to engage with your fans in many ways and continue to create value from that engagement. So expect more. Too early to talk about sequel specifically, but we absolutely believe there are more opportunities to continue to extend the Barbie brand.

Operator

This concludes our question and answers for today. I now turn the call back to Ynon Kreiz for closing remarks.

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

Thank you, operator, and thank you, everyone, again, for your questions. Always a good discussion. I would like to close by congratulating the Barbie and Mattel Films teams and the entire global organization on the milestone moment we achieved together in bringing Barbie to life for the first time on the big screen in live action and to advance our entertainment strategy.

Congratulation again to Lisa McKnight, Josh Silverman and Chris Down in their well-deserved promotions. We look forward to their continued strong contributions to Mattel. And of course, thank you, Richard, for helping to make Mattel the company it is today. You will be missed. You're a friend, you're a personal friend to me. Your colleagues will always stay friends, of course. We're going to miss you, but we wish you all the best in the new role, and thank you for everything you've done. And now I'll turn the call back to Dave.

David Zbojnowicz - Mattel, Inc. - VP & Head of IR

Thank you, Ynon, and thank you, everyone, for joining in today's call. 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

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

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