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MAT.OQ - Q3 2023 Mattel Inc Earnings Call

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OVERVIEW:

Company Summary

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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 Third Quarter 2023 Earnings Conference Call. (Operator Instructions).

David Zbojniewicz, Vice President 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; and Anthony DiSilvestro, Mattel's Chief Financial Officer. As you know, this afternoon, we reported Mattel's 2023 3rd 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 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 buildings 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 Operating Report or Form 10-K, our Q2 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 third quarter 2023 earnings call. Mattel's strong third quarter performance reflects the successful execution of our strategy to grow material's IP-driven toy business and expand our entertainment offering. Our financial results exceeded expectations and showed meaningful sales growth and margin expansion with very strong free cash flow. Consumer demand for our products increased in the quarter and we continued to outpace the industry. The company benefited from the success of the Barbie movie with significant contributions from box office participation, the movie toy line, and consumer product partnerships.

Looking at key financial metrics for the third quarter as compared to the year ago period. Net sales increased 9% as reported or 7% in constant currency. Adjusted gross margin improved 270 basis points to 51%. Adjusted EBITDA increased 22% to \$580 million and trailing 12-month free cash flow increased by \$158 million to \$461 million.

POS was up mid-single digits in the quarter and up low single digits year-to-date. We expect POS to continue to grow as we enter the holiday season.

Per Circana in the third quarter and year-to-date, Mattel gained share globally and in its 3 leader categories; Dolls, Vehicles and Infant, Toddler, and Preschool as well as in Building Sets.

Following 22% growth from 2019 to 2022, the global toy industry was down year-to-date and in the third quarter per Circana. We expect the industry to decline mid-single digits for the full year.

As it relates to Mattel, we are very well positioned competitively and expect a strong holiday season. Going into the fourth quarter, we have a broad-based lineup of innovative toys across multiple categories, play patterns, and price points. This applies to our own franchises as well as partner IP, including the upcoming Universal Trolls and Disney Wish movies.

We have greater retailer support versus the prior year with more shelf space, larger representation across major holiday catalogs, and plans for increased advertising. We expect to continue to outpace the industry and gain market share in the fourth quarter and full year. Given Mattel's year-to-date performance and expectations for the fourth quarter, we are updating our 2023 guidance to reflect an improved margin and profit outlook. Anthony will provide more detail shortly.

Reflecting the strength of our financial position and confidence in creating long-term shareholder value, we made additional share repurchases in the quarter and expect to continue repurchases as part of our capital allocation priorities.

Our strategy to grow our IP-driven toy business and expand our entertainment offering is serving us well. We are focused on accelerating top line by scaling our portfolio, growing franchise brands and advancing e-commerce and DTC, increasing profitability by continuing to optimize our operations and capturing the full value of our IP outside the toy aisle.

As it relates to the performance of our toy business in the third quarter, Dolls continue to grow with the benefit from the Barbie movie related toy line and adult collector base, the expanded Disney Princess and Disney Frozen line, and the global rollout of Monster High.

Vehicles performed exceptionally well, driven by Hot Wheels. The franchise is on track for a sixth consecutive record year of growth as we continue to innovate in new segments, including the new Racerverse line.

In Infant, Toddler, and Preschool, Fisher-Price declined, but shipping and POS trends improved in the quarter. Little People Collector continued to expand and now features all 32 NFL teams.

Challenger categories in aggregate declined as it comped an exceptionally strong film slate last year. Building sets grew. And in games, we announced Pictionary versus AI, the first physical board game to integrate AI into gameplay. We also renewed Mattel's multi-category agreement with Nintendo.

In terms of our entertainment business, this was a breakout quarter for Mattel. The Barbie movie, Mattel's first major theatrical release became a global cultural phenomenon, breaking numerous box office records and becoming the highest-grossing film of 2023. The movie was a showcase for the cultural relevance of our IP, our ability to attract and collaborate with top creative talent, and our demand creation capabilities at a global scale. The movie has broadened Barbie's fan base which will be an important contributor for the brand as part of our long-term franchise management strategy. It also speaks to the potential of Mattel films and the significant progress of our strategy to capture the full value of our IP.

Mattel Television premiered new episodes of the Monster High animated series and a live-action movie sequel, a special for Polly Pocket, a new series for Barbie and new seasons of Thomas & Friends, Fireman Sam and the Pictionary game show. We also announced Hot Wheels Let's Race, a new animated series that will premiere on Netflix in spring 2024.

In digital gaming, Mattel and Gamefam unveiled a Barbie DreamHouse experience on Roblox, Barbie's first-ever stand-alone game on the platform.

Our commitment to workplace culture and corporate citizenship continues. Mattel was named as one of the World's Best Employers by Forbes for the third year in a row and one of the 100 Best Companies by Seramount for the second year in a row. It is a reflection of how we are empowering a culture of growth, optimism and well-being for our global team.

In September, Mattel published its latest Citizenship Report, which highlights the progress we have made across our 3 ESG pillars: sustainable design and development, responsible sourcing and production, and thriving and inclusive communities. We are committed to being a responsible corporate citizen and to our aim to contribute to a more diverse, equitable, inclusive and sustainable future.

In closing, Mattel's third quarter results reflect our success in executing our strategy, with Barbie movie marking a milestone for the company. We look forward to a strong holiday season for Mattel and expect to achieve our updated full year guidance and continue to grow market share. Looking beyond 2023, we believe we are well positioned to grow our IP-driven toy business and expand our entertainment offering. We will benefit from the cultural relevance of our brands, continued innovation and demand creation capabilities across our portfolio, increase content and consumer product executions, as well as ongoing financial discipline and cash flow management. We plan to provide full year guidance for 2024 on our 2023 4th quarter call.

I would like to thank the entire Mattel organization for their achievements, hard work and commitment to creating shareholder value.

Before I turn the call over to Anthony, on behalf of Mattel, I would like to express our sadness following the horrific attacks in Israel. We condemn terrorism and the unthinkable violence taking place, including the ongoing hostage situation. Our thoughts are with all those who are suffering, have lost loved ones and are still in harm's way.

And now I will turn the call over to Anthony.

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

Thanks, Ynon. We had a strong third quarter with top and bottom-line growth and significant free cash flow. Net sales of \$1.919 billion increased 9% or 7% in constant currency compared to the prior year. Adjusted gross margin of 51% increased 270 basis points compared to the prior year, benefiting from the accretive Barbie movie related economics. Adjusted operating income was \$506 million, an increase of \$108 million or 27% compared to the prior year, primarily driven by sales growth and gross margin expansion. Adjusted EPS was \$1.08 compared to \$0.82 a year ago, an increase of 32%. Adjusted EBITDA was \$580 million, an increase of \$106 million compared to the prior year.

Turning to gross billings in constant currency. Overall, gross billings increased by 6%. POS increased by mid-single digits. Mattel continued to outpace the industry and gained 60 basis points of market share year-to-date per Circana.

Looking at performance by category. Dolls grew 24%, driven by Disney Princess and Disney Frozen, Barbie including the movie-related benefit, and the global rollout of Monster High. POS for Dolls improved significantly and was in line with shipping. Barbie increased 14% with comparable POS growth. Barbie POS reflects strong gains in toys, benefiting from the theatrical release of the movie and our robust marketing efforts. Mattel outperformed the industry in the Dolls category and gained over 670 basis points of market share year-to-date, and Barbie was the #1 Doll property globally per Circana.

Vehicles continued its strong performance, growing 15%, in line with POS. Growth was primarily driven by Hot Wheels die-cast vehicles and new innovation, including the RC and Skate segments. Mattel gained 410 basis points of market share year-to-date in the Vehicles category per Circana.

Infant, Toddler, and Preschool declined 5%, in line with POS. In spite of the decline, both gross billings and POS showed significant improvements in trend relative to the second quarter. The decline was primarily due to Fisher-Price Imaginext, as it wraps theatrical times in the prior year, and our Infant business, partly offset by strong growth in Little People.

Mattel outperformed the category, gained 50 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 21%, in line with POS as it comped an exceptionally strong film slate last year, partly offset by growth in both Building Sets and Games.

On a regional basis, our strong performance was broad-based. We grew POS and gross billings in each of our regions, excluding the impact of Russia.

North America gross billings increased 10% and driven by double-digit gains in Dolls and Vehicles. POS increased low single digits.

Year-to-date, Mattel gained market share in North America, per Circana.

EMEA declined 2%, including a negative 3 percentage point impact from Russia. POS, excluding Russia, significantly outpaced shipping increasing low double digits in the quarter.

Latin America grew 5% with POS increasing high single digits. Per Circana, Mattel gained market share in Latin America year-to-date, extending our #1 market position.

Asia Pacific increased 18%, driven primarily by growth in Australia and India. POS increased low single digits.

Consistent with the end of the second quarter, retail inventories remained below prior year levels. At the end of the third quarter, retail inventory levels in dollars declined by double-digit percentage versus the prior year, with weeks of supply down high single digits. The inventory is predominantly current and of good quality. Looking ahead, we believe we are well positioned heading into the holiday season.

As previously discussed, we expect gross billings to return to historical trends with approximately 2/3 of annual shipments in the second half. This is expected to contribute to a high fourth quarter growth rate as we wrap an atypical retailer inventory decline in the prior year.

Adjusted gross margin was 51% in the quarter compared to 48.3% in the prior year, an increase of 270 basis points. The increase in adjusted gross margin was driven by favorable mix, primarily the margin accretive benefits related to the Barbie movie added 170 basis points,

Pricing, which contributed 140 basis points, Savings from the Optimizing for Growth program, which added 130 basis points, and cost deflation which added 70 basis points.

These positive factors were partly offset by the fixed cost absorption impact from significantly lower production volumes and other supply chain costs, totaling 240 basis points.

Moving down the P&L, Advertising expenses of \$124 million declined 3% compared to the prior year. Looking ahead, we are planning to increase advertising spend in the fourth quarter and to end the full year with advertising as a percentage of net sales comparable to the prior year.

Adjusted SG&A increased 8% to \$347 million, primarily driven by higher accrued incentive compensation, and salary and market-related pay increases, partly offset by savings from the Optimizing for Growth program.

Adjusted operating income was \$506 million, an increase of \$108 million or 27%, compared to the prior year. The increase was primarily driven by net sales growth and adjusted gross margin expansion.

Adjusted EBITDA increased by \$106 million to \$580 million, benefiting from the same factors.

Adjusted EPS increased by 32%, ahead of operating income growth, driven by favorable interest costs, a slightly lower adjusted tax rate, and a lower share count resulting from our share repurchase activity.

On a year-to-date basis, cash from operations was a use of \$80 million compared to a use of \$275 million in the prior year, an improvement of \$195 million. The increase was primarily driven by improved working capital performance.

Capital expenditures were \$118 million compared to \$127 million a year ago, and free cash flow was a use of \$197 million compared to \$402 million in the prior year.

On a trailing 12-month basis, we generated \$461 million in free cash flow compared to \$303 million in the prior year, an increase of \$158 million or more than 50%. The increase was primarily driven by cash from operations, benefiting from improved working capital performance, partly offset by higher capital expenditures.

With respect to uses of trailing 12 months free cash flow, we repaid \$250 million of debt in the fourth quarter of last year, and in the first 9 months of 2023, repurchased \$110 million of our shares.

Taking a look at the balance sheet.

We continued to improve our financial position. We finished the quarter with a cash balance of \$456 million compared to \$349 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 \$2.329 billion from \$2.574 billion last year reflecting the repayment of \$250 million of debt in the fourth quarter of last year.

Accounts receivable increased by \$190 million to \$1.571 billion due primarily to the increase in net sales.

We have made significant progress in reducing owned inventory levels. Inventory was \$791 million compared to \$1.084 billion in the prior year, a reduction of \$293 million, and a key driver of free cash flow generation.

Our leverage ratio was 2.7x at the end of the third quarter. This compares to 3.1x at the end of the second quarter and 2.3x a year ago.

We generated \$40 million of savings in the quarter under our Optimizing for Growth program.

Since launching the program in 2021, we have achieved cost savings of \$297 million. We are now on track to exceed our \$300 million goal by the end of 2023. Total estimated cash expenditures to implement the program are expected to be \$155 million to \$185 million.

We are updating our full year 2023 guidance to reflect anticipated upside to our margin and bottom-line results.

We continue to expect net sales to be comparable to last year in constant currency.

Our sales guidance reflects higher-than-anticipated benefits associated with the Barbie movie, offset by the impact of overall toy industry declines. We expect growth in Dolls and Vehicles, offset by declines in Infant, Toddler, and Preschool and in our Challenger categories, in aggregate. And for our power brands, we expect Barbie and Hot Wheels to grow, and Fisher-Price to decline.

At current spot rates, we expect foreign exchange translation will have a positive impact of approximately 1 percentage point on 2023 net sales.

Adjusted gross margin is now expected to be in the range of 47% to 48% compared to our previous expectation of approximately 47% and 45.9% in the prior year.

The improved outlook is primarily driven by the incremental margin benefit associated with the Barbie movie and related consumer products upside.

We are raising our guidance for adjusted EBITDA to \$925 million to \$975 million and adjusted EPS to \$1.15 to \$1.25, compared to the prior ranges of \$900 million to \$950 million, and \$1.10 to \$1.20, respectively. Free cash flow is still expected to exceed \$400 million.

Our guidance implies strong fourth quarter performance in terms of top line growth and gross margin expansion compared to the prior year. As we previously stated, our annual guidance includes an increase in SG&A of approximately \$100 million as incentive compensation returns to targeted levels, most of which will impact the fourth quarter.

Our guidance also includes the forecast benefits related to the Barbie movie. The total impact from our direct movie participation, movie-related toy sales, and consumer products is expected to generate more than \$125 million in sales with a blended operating income margin exceeding 60%. The majority of this benefit is reflected in our third quarter results.

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, unexpected disruptions and other macroeconomic risks and uncertainties.

In closing, our performance in the third quarter was comprehensive with top line growth, market share gains, adjusted gross margin expansion and significant free cash flow improvement. We expect a strong holiday season and are well positioned to achieve our full year guidance.

And now I will turn it over to the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Arpine Kocharyan with UBS.

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

Obviously, very strong numbers for the quarter against a pretty weak industry. Your Q4 guidance implies kind of cautious out to outlook in terms of flow-through. And you mentioned kind of increased advertising spend, and I know that SG&A is up also year-over-year given accrued incentive comp, et cetera. But revenues are still implied to be up about 18% on a constant currency basis when I do the math of flat sales. Maybe if you could play out why such strong revenue isn't flowing through a little bit better given sort of Barbie's strength and consumer product strength that is probably also higher margin? And then generally, if you could just give kind of an overview of what you're seeing with the consumer as we head into Q4. That would be very, very helpful?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Sure, Arpine. I'll start with that. I'll first say that the majority of the movie related benefits is being recognized. And so when we talk about our full year guidance, it does imply accelerated top line growth in Q4, and that's because we expect shipment trends to revert to historical patterns, and we're wrapping an atypical retail inventory decline in the prior year.

As we said in our remarks, we're also expecting growth in consumer demand. We've got more shelf space. We're going to spend more on advertising. We've got new innovation, greater representation in catalogs, so that's in terms of the top line. The guidance also implies significant gross margin expansion compared to last year and last year being negatively impacted by inventory management costs. And as you noted, SG&A is expected to increase as we wrap below target incentive compensation levels in the prior year. But net-net, our guidance implies a very strong Q4 bottom line growth.

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

And if Ynon could comment on -- maybe, yes.

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

Yes. Yes, I'll comment on the toy industry. So we saw the industry declining year-to-date and in the third quarter, and we now expect the industry to decline mid-single digits for the full year. But remember, this follows the industry being up 22% from 2019 to 2022, reaching an all-time high.

So we're very confident about the long-term growth trajectory of the industry. But this year, coming off that high in a challenging economy is not to be surprised by. In that context, just important to reiterate, while the industry is expected to be down, our POS is expected to be up for the year. It was up in the third quarter. It was up year-to-date. We expect it to be up in the holiday season, up in the fourth quarter and up for the full year. So we are very well positioned competitively and to see us continuing to perform well.

We did mention that heading into the fourth quarter, we have a very strong broad-based lineup of innovative toys across multiple categories, play patterns, price points, for both our own brands as well as third-party brands in Universal Trolls and Disney Wish. So all in all, expect to continue to outpace the industry and gain market share in the fourth quarter and the full year.

Operator

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

Megan Christine Alexander - *Morgan Stanley, Research Division - VP*

I guess, maybe can we touch on that point Ynon on for a bit in terms of what you're seeing quarter-to-date from a POS perspective and with the expectation that it's up in the fourth quarter. I guess, how much of that is driven by ongoing strength in Barbie? And are you kind of expecting the rest of your categories to be more in line with the industry?

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

It's still early in the quarter, but quarter-to-date POS is positive for Mattel. And our full year guidance assumes growth in consumer demand for our products in the fourth quarter and the full year. When we talk POS, this is not the movie participation, box office participation. This is in toys. So we are performing well, and this is not just Barbie. The Dolls category as a whole is performing well.

Disney Princess and Frozen is doing well. Monster High is doing very well. Hot Wheels grew 19% in the quarter, on track to achieve sixth record year with more innovation and very exciting product line. So this is not just about Barbie. It's broad-based strength, not in every part. I mean, we declined in Fisher-Price. So this -- there are some areas where we still have challenges. But all in all, the portfolio as a whole is very strong. And we believe that competitively, we are very well positioned, and the fundamentals of the company are very strong.

Megan Christine Alexander - *Morgan Stanley, Research Division - VP*

Okay. And I guess maybe on the back of that, how would you characterize the retail environment today? Maybe more specifically, can you expand on what inventory levels look like and stock levels for your brands? Are you seeing retailers replenish in line with POS or taking a more cautious stance given the macro?

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

Sure. In terms of retail inventories, I'll start by saying, in the third quarter, gross billings and POS were fairly well aligned and retail inventories remain below prior year levels. So at the end of Q3 retail inventory levels in dollars were down by double-digit percentage. And as we said, predominantly current and of good quality. We're working very closely with our retailers and believe we are very well positioned heading into the holiday season with respect to those inventory levels.

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

And Megan, just to, to add and following Arpine's question earlier, we very long on the toy industry, industry is resilient, notwithstanding the decline this year, we've had over 10 years of growth. And we believe as a category, as a sector, it has very strong fundamentals in -- playing into basic human behavior of play, being a strategic category for retailers, attractive and affordable price points, and an industry that continues to perform and show resilience, especially in challenging economic times.

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

Maybe on Hot Wheels, the category or the brand posted impressive year-over-year growth in the quarter north of 20%. Could you maybe unpack the drivers of that underlying performance? How much of it was category strength versus market share gains versus perhaps just timing of orders coming through in the third quarter?

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

So Stephen, vehicles continue to perform very strongly growing 15%, in line with POS. We continued to gain share, per Circana, 410 basis points. So meaningful growth in already, from a strong baseline for Mattel. The growth was primarily driven by die-cast vehicles and new innovation. We talked a lot about the RC line and skate segment. So that's great to see new parts of the category growing. We also continue to leverage the core die-cast vehicles, we target both kids and adult collectors, that's another segment that is growing well.

We continue to innovate and expand into additional segments this fall, including the Racerverse, the new character baseline, which is also very innovative and exciting to see. So this is all driving incredible performance. And this is before the movie that is still being developed and is coming out, and we are now developing. We hope will be an exciting project. Hot Wheels live action movie produced by JJ Abrams, who, as you know, is one of the most prolific filmmakers of generation. He is a great partner, very excited. And there's more -- a lot more to expect from Hot Wheels, a very strong driver.

I also want to mention Matchbox, an important part of the Vehicles category, which did well in the quarter, gross billings were stable, but POS was up double digits, driven by strength in the die-cast segment. And there's another movie that we're developing for Matchbox with Skydance, which is the producer of the Mission Impossible series and Top Gun. So a great -- another great partner, and we are very excited also about this project in the making.

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

Great. And then just one for Anthony. Anthony, on free cash flow. Is there any reason why the extra \$25 million in EBITDA guide for this year wouldn't flow down to free cash flow with the outlook for CapEx remaining in the same, perhaps something on working cap worth going out? Or should we expect that to flow-through?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes, it's pretty much dependent on the timing of the collections related to the upside around the Barbie movie, and it's hard to say exactly when that's going to come through. So that's the reason that we didn't change that.

Operator

Your next question comes from the line of James Hardiman with Citi.

James Lloyd Hardiman - Citigroup Inc., Research Division - Director

So if I think about sort of the implied fourth quarter guidance in that -- on the revenue side in that mid- to high teens, is there any way to think about what the growth in POS needs to be to allow for that reported number in the fourth quarter?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. We haven't broken down to that level, but we had said that we expect growth in consumer demand in the fourth quarter for Mattel. We expect to outpace the industry. But we do expect gross billings to be ahead of POS and that's because we're wrapping that retail inventory decline in the prior year. But we're expecting a strong fourth quarter with respect to consumer demand or POS.

James Lloyd Hardiman - Citigroup Inc., Research Division - Director

Got it. That makes sense. And it sort of leads to my next question. Obviously, we haven't even gotten to the holiday season. So a lot of the 2024 color is way too early. But if I just think about 2023 right? It was a tale of 2 halves. First half, there was a lot of inventory drawdown. And so you were -- your sales levels were way worse than POS. Second half is really about Barbie and the benefit that you're getting there. Is there any way to compare those 2 effects as we think about lapping them? I think the big concern is that as you get to \$125 million of headwind that it's going to be real hard to lap that for the year, but just trying to make sure I understand the moving pieces?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Sure. A couple of points there. I would say that the year is kind of unfolding as we expected. And we did expect 2023 to revert to normal shipping patterns. 1/3 in the first half, 2/3 in the second half. That is what we're seeing, and that led to declines in the first half, growth in the second half, with accelerated growth in Q4, given what we're wrapping. In terms of the Barbie movie and economics, we expect this to be a catalyst for the brand and to benefit the franchise for quarters and years to come. So we don't necessarily view it as, hey, something, we're just going to wrap, so to speak.

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, I was wondering if you could update us on your earlier comment about your theory that consumers were not as strong in their buying behaviors maybe in the summer because they were saving up in order to spend more for Christmas. Can you update us on, do you have any survey work or anything that, update us on how consumers might more recently be thinking about things?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. We don't have any new survey to point to, but I would say things are unfolding as we had expected. Q4 to date, POS is positive for us. And we continue to expect that consumers will revert back to more historical shopping patterns and make their purchases closer to the holiday season. And with that, we would expect POS to accelerate as we progress through the fourth quarter.

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

Okay. And I was also wondering if you could say whether or not you looked at the Melissa & Doug company that was sold. Did you consider looking at that or why or why not?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. I would say, look, we don't really comment on competitor M&A. We are very focused on executing our capital deployment priorities, which we've talked about in terms of investing to drive organic growth, maintaining net leverage ratio of 2x to 2.5x in our investment-grade rating, and

that gives us flexibility to consider M&A as well as share buyback. We're very happy with our position in the ITPS category. We are a leader and the #1 toy company globally. And Fisher-Price is the #1 property in the category. So we love our position and the prospects for our business.

Operator

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

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

Okay. Anthony, on adjusted gross margin, any notable swing factors to consider for 4Q? And just want to confirm that 4Q gross margin should decline quarter-on-quarter versus 3Q?

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

Yes. In terms of commenting relative to the prior year as we think about fourth quarter, and when you do the math, it implies pretty significant gross margin expansion in Q4 versus 2022 and there a couple of reasons for that. One is the prior year was about 43%, and it was negatively impacted from considerably significant inventory management costs. So we're wrapping that. And as I think about the current year, we'll benefit from scale from our Optimizing Growth program as well as cost deflation. We did see some deflation in Q3 and would expect to see additional deflation in Q4. So that gives us confidence in terms of getting to that implied fourth quarter gross margin, which is more in line with the historical levels as well.

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

Got it. Okay. And then just to circle back to the toy industry and your outlook now down mid-single digits for the year. I think previously, you were assuming down slightly. Is this adjustment based on a weaker 3Q relative to your expectations? Is it something you're anticipating for 4Q or a combination of the two? And did I hear you correctly, Anthony, that you expect POS to accelerate in 4Q over 3Q? I just want to clarify that.

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

Let me clarify that quickly. So what I said is fourth quarter to date POS is positive. And from that level, we expect to accelerate. It wasn't relative to 3Q.

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

Yes. And Drew, what we're seeing is year-to-date decline that was more than we expected at the start of the year. We believe it's primarily driven by macroeconomic factors, inflation, higher interest rates and other elements that we all know and read about and experience. We believe consumers are returning to normalized shopping patterns closer to the holiday season. So we expect to see some of that playing out in the fourth quarter. We believe that the industry and our retail partners are well prepared for the holiday season. But that said, we now expect, given the performance to date, the industry to be down mid-single digits.

Operator

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

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

I wonder if you could talk a little bit about your movie expectations. Obviously, a huge success with Barbie. And I imagine that makes it easier to greenlight some additional films. Obviously, Hollywood is closed right now because of the strikes. But do you get -- should we be thinking about maybe it could be sooner than later before we see the next Mattel brand movie's coming out? Or how should we think about that?

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

Yes, Eric, the vision from the outset was to collaborate with leading filmmakers, to make standout quality movies based on our iconic brands that will resonate in culture and appeal to global audiences. And I think it's safe to say that we managed to achieve that with this movie. And there is no question that the success of Barbie, repositioned Mattel as an important player in Hollywood. The strength of our brands and cultural resonance of our franchises is an important factor playing outside of the Toy aisle and appealing to very broad audiences. We demonstrated our ability to attract, collaborate partner and amplify top creative talent.

And the other dimension that people didn't really fully appreciate and frankly, we also, to some degree, were not -- didn't fully recognize until it actually happened is our marketing capability outside of the toy aisle. We're a company -- we are a creative company. We're an innovative company, but we are also experts in demand creation. And we generate year in and year out, billions worth of demand to our product from the start. Yet here, what we did, we leveraged our capabilities and our retail reach and expertise to promote and market the movie together with Warner Brothers, who did an excellent job, but we truly amplified that and turned it into a cultural phenomenon.

So those assets, relationships and capabilities make us an attractive player. And we believe that the success of the Barbie movie for all of those reasons will accelerate our strategy and not just in movies, but in other verticals given the strength of our brands and the fact that they resonate so strongly in culture. So we're very excited to be where we are. Clearly, it was a breakthrough quarter for our entertainment strategy, and we expect that it will help us accelerate things in the coming quarters.

Operator

Your next question is from the line of Chris Horvers with JPMorgan.

Christopher Michael Horvers - JPMorgan Chase & Co, Research Division - Senior Analyst

So my question is, in the gross margin, there was 170 bps related to the Barbie movie. Can you talk about how -- what that broke down in terms of box office participation versus the toy sales in the merchandise -- third-party merchandise? And how are you thinking about that benefit in the fourth quarter?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Sure. We're not going to break it down to that level, but let me comment on the impact. So within our gross margin bridge you saw a 170 basis point mix benefit. That's not all Barbie related, but it's primarily related to our direct movie participation, movie-related toy sales and consumer products, all kind of bundled together. Also, what we did say is for the full year, we expect those 3 items to deliver more than \$125 million in sales with a blended operating income margin of over 60%. And the majority of all that was recognized in Q3 and probably with a skew more towards the movie relative to the other items.

Christopher Michael Horvers - JPMorgan Chase & Co, Research Division - Senior Analyst

So as we think about the fourth quarter, how are you thinking about the sort of specific Barbie movie lift in terms of the top line and margin perspective, the participation point goes down, but are you largely sold through directly -- toys directly related to the movie? And would you expect the merchandise portion to accelerate?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. I would say less margin accretion related to these items in Q4 than Q3.

Operator

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

Jason Daniel Haas - BofA Securities, Research Division - VP

I'm curious if you could help size up how much of a headwinds destocking was to revenue in the first half of the year? The reason I ask is just because as we're thinking through our models for next year is there an embedded uplift to revenue just because you'll be lapping over that destocking? Or is it the case that the reason there was that destocking was because there was a restocking in the first half of 2022. So it was really more of a return to normal. Trying to figure out if there's like an embedded revenue upside and what that could, stay, be for next year?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

It's very difficult to say in sort of the impact in 2024. But you're right, in the first half of 2023, we saw most of the inventory correction happened at retail. And in the context of our full year guidance, it's 3 to 4 points of headwind. Again, most of that occurred in the first half of 2023. And depending on what retailers do going into 2024, again, sitting here today, right? It's hard to say that there will be a bounce back relative to that destocking.

Jason Daniel Haas - BofA Securities, Research Division - VP

Got it. That's helpful. And then when I look at Barbie in the first half of the year for worldwide gross billings excluding -- just excluding FX, it's down a little over 20% or so in the first half of the year. And then we saw in 3Q, it went up 14% in the quarter. Is it fair to assume that a lot of that acceleration was driven by the Barbie movie. I'm trying to understand if the Barbie movie did drive that halo effect to all Barbie toys, not just the movie-related SKUs. The concern being there that you may have to lap that next year since you don't have another major motion picture for Barbie. But I'm curious, I don't know if there were promotions that shifted or other things to consider and maybe it just wasn't all the movie.

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. I think the way to think about Q3 and Barbie, first, in terms of the 14% increase in gross billings, I would say that's primarily attributable to the movie related items. But when you think about POS, which is up low double digits as well, right? That's primarily driven by the improvement in consumer demand around toys.

And as we think about the impact of the movie, we believe it's going to have a long-lasting effect in terms of broadening Barbie's fan base, right? And that will be an important contributor to the brand. It's really part of our long-term franchise management strategy. And with respect to 2023 in aggregate, right, we expect Barbie to grow in Q4 and for it to be positive on a full year basis, which is part of the guidance that we updated today as well.

Operator

This concludes our question-and-answer portion for today. I turn the call back to Ynon Kreiz, Chairman and CEO.

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

Thank you, operator, and thank you, everyone, for your questions. I would like to conclude the call by expressing our hope for the safety of Israeli and Palestinian children, children and families caught in the Israel-Hamas war. Since the attacks of October 7, the Mattel Children's Foundation has been focused on humanitarian work, including cash and toy donations to shelters and hospitals to support children who are suffering.

On a personal note, I would like also to thank all of those who have reached out to me directly to express their concern and condolences. We wish for a swift resolution to the war and more peaceful times in the future. And now I'll turn the call back to Dave.

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

Thank you, Ynon. The 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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