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MAT - Q2 2016 Mattel Inc Earnings Call

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OVERVIEW:

Co. reported 2Q16 reported EPS of negative $0.06. Expects 2016 net sales to be relatively flat in constant currency.

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CORPORATE PARTICIPANTS

Martin Gilkes *Mattel Inc. - VP of IR*

Chris Sinclair *Mattel Inc. - Chairman & CEO*

Richard Dickson *Mattel Inc. - President & COO*

Kevin Farr *Mattel Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Drew Crum *Stifel Nicolaus - Analyst*

Felicia Hendrix *Barclays Capital - Analyst*

Arpine Kocharyan *UBS - Analyst*

Tim Conder *Wells Fargo Securities, LLC - Analyst*

Linda Bolton Weiser *B. Riley & Co. - Analyst*

Gerrick Johnson *BMO Capital Markets - Analyst*

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

PRESENTATION

Operator

Good day, ladies and gentlemen. And welcome to the Mattel Incorporated second quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, today's conference call is being recorded. I would now like to introduce your first speaker for today, Martin Gilkes, Mattel's Vice President of Investor Relations. You have the floor, sir.

Martin Gilkes - *Mattel Inc. - VP of IR*

Thank you, operator. And good afternoon, everyone. Joining me today are Chris Sinclair, Mattel's Chairman and Chief Executive Officer; Richard Dickson, Mattel's President and Chief Operating Officer; and Kevin Farr, Mattel's Chief Financial Officer.

As you know, this afternoon, we reported Mattel's 2016 second quarter financial results. We will begin today's call with Chris, Richard and Kevin providing commentary on our results and then we will take your questions.

To help guide our discussion today, we have provided you with a slide presentation. Our discussion and our slide presentation will reference non-GAAP financial measures, such as gross sales, adjusted selling and administrative expense, adjusted operating income, adjusted earnings (loss) per share, and constant currency. Our earnings release also includes non-GAAP financial measures. The information required by Regulation G regarding non-GAAP financial measures is included in our earnings release and slide presentation. And both documents are available on the investors section of our corporate website, corporate.mattel.com.

Before we begin, I'd like to remind you that certain statements made during the call may include forward-looking statements relating to the future performance of our overall business, brands, and product lines. These statements are based on currently available information and they are subject to a number of significant risks and uncertainties that could cause our actual results to differ materially from those projected in the forward-looking statements.

We describe some of these uncertainties in the Risk Factors section of our 2015 annual report on Form 10-K, our 2016 quarterly reports on Form 10-Q, and other filings we make with the SEC from time to time, as well as in our other public statements. Mattel does not update forward-looking statements and expressly disclaims any obligation to do so. Now I'd like to turn the call over to Chris.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

Great. Thanks, Martin, and welcome, everyone. I'd like to thank you all for joining us. Today, I'm going to lead things off with a brief perspective on the quarter and the full year, and then Richard and Kevin will each provide some additional details. As usual, as Martin indicated, we'll open things up at the end for any questions that you might have.

So let me begin by saying that overall, we're very encouraged by the quarter, which reflected some continuing progress on our turnaround and importantly, kept us on track to deliver on our challenging 2016 top line objectives. We also made good progress against our cost reduction goals, both in cost of goods and in SG&A.

Now, as you know, our biggest executional challenge this year is to offset the loss of Disney Princess. And despite continuing foreign exchange headwinds, our Q2 and first half results show that we made great strides in this area. We continue to see positive and improving trends globally in our consumer take-away, and our shipping is aligning with this favorable trend. Encouragingly, we're also seeing some very solid performance in some of our key core brands, with a strong uptick in Barbie and continuing strength in Fisher-Price and Hot Wheels.

We're also getting some excellent traction in our Toy Box, with our games and entertainment properties and with MEGA brands. Now supporting these favorable trends, our focus on strengthening our brands with more effective positionings, advertising and more competitive pricing, and our rapid push in emerging markets is proving successful. We're also executing well and we're doing so broadly across much of our customer base.

In addition, we're quite gratified by the continued strengthening of our licensing partnerships. Exemplified by our recent announcements with Universal on Fast & Furious and the Jurassic World franchises; both of which will give us some excellent opportunities to accelerate growth in 2017 and beyond.

Now, as for the middle of the P&L, we also made good progress this quarter and we do remain on track to deliver on our cost targets. Our work to streamline and prioritize SG&A spending is progressing well. We're also capturing some significant supply chain efficiencies and cost savings. Now the offsets, of course, continue to be negative foreign exchange and unfavorable shifts in our brand mix, which are pressuring our gross margins. We would expect these factors to remain a challenge as we navigate through the balance of the year. Kevin's going to provide some more perspective on both of these subjects shortly.

So to sum up the quarter, I'd say very good progress and on many fronts and particularly against the difficult backdrop and some strong external headwinds. Looking ahead, the picture for the year is largely the same as what we've previously outlined, with perhaps a few moderate puts and takes. And our momentum is setting up extremely well for the future. We expect the year-to-date positive trends in POS and shipping to continue and we expect to see improving flow-through on many of our cost savings initiatives. We also expect foreign exchange impacts will begin to moderate somewhat, offset partially, of course, by mix which will remain a challenge.

So overall, our strategies are gaining traction and are helping us to drive the top line, to right-size our cost structure and to fund investments in brand building, commercial excellence, and emerging market expansion. We're also managing our balance sheet well, and we're continuing to fund our dividend.

So in summary, I remain optimistic about the year. But with the bulk of the year still in front of us, I do want to urge a little bit of caution as we still have a lot of work to do. With that as a set-up, let me turn things over to Richard, who's going to highlight some of our top-line progress and our core initiatives. Richard?

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

Thank you, Chris. So as Chris mentioned, this year we have both the challenge of overcoming a significant revenue gap and the opportunity to position Mattel for growth in 2017. The Q2 results and the effectiveness of our execution throughout the first half of the year are demonstrating our ability to do both.

Excluding the year-over-year impact of Disney Princess, global POS is up mid-single digits for the quarter and year-to-date, with solid results across the majority of our brands and comparable sales in constant currency are up high single digits for the quarter and year-to-date. We have almost completely offset the year-to-date Disney Princess shortfall, reflecting strength across a number of brands, licenses and geographies. This performance is significant in many ways, indicative of our ability and potential to further build momentum into the second half of the year.

So let me briefly touch on some specifics, starting with our core brands. We are pleased with Barbie's resurgence, with global sales in constant currency up 24% in the quarter and up 11% year-to-date. This is the result of a return to the fundamentals that make this brand continuously relevant, including a clear and motivating positioning that is inspiring to girls worldwide, very effective execution throughout the organization, and growing momentum fueled by increasing cultural significance.

Consumer confidence in the brand is increasing. This is evidenced by continued enthusiasm for the new Fashionista line. The I Can Be content marketing; the success of our new younger girls segment, Dreamtopia; stronger brand equity scores; and a sharp uptick in pop culture references to Barbie.

Retailer confidence is also up, demonstrated by increased shelf space. And licensor confidence is building as we renewed our Barbie content distribution agreement with Universal in the quarter. The entire Mattel organization took on the challenge to reset this storied brand and has made tremendous strides in a very short period of time. And with the Barbie team now set up and running, we are obviously gaining traction. In the back half of the year, you'll see us build on Barbie's success across the board as well as deepen the brand's connection with moms worldwide.

Fisher-Price. With a renewed emphasis on early childhood development, continues to grow with global sales in constant currency up 6% in the quarter and 7% year-to-date. Brand progress is largely the result of a concerted effort to build strong, valuable relationships with parents worldwide, rooted in great product and motivated brand values.

We're building on the momentum of the largest Fisher-Price segment, Baby, by engaging with moms in innovative and meaningful ways in the digital space. The brand's very successful Film By You campaign will be enhanced by our new gold medal moments initiative in the Fall.

In product, we continue to emphasize innovation, creating developmentally forward ideas like our hit Code-a-Pillar for a vast and growing segment of parents who are eager to expose STEM learning early on. We're building fresh momentum in our Fisher-Price Friends line, driven in part by new Nickelodeon licenses.

Hot Wheels. Hot Wheels POS and shipping trends continue to be very strong with global POS up double-digits year-to-date, and sales in constant currency up 9% year-to-date. We expect to build on this in the second half of the year, with new and exciting products, some of which we're previewing this week at Comic-Con. And while we continue to build a strong component of the business with our DC Comic, Marvel and Star Wars license, the success of our Basic Car and Play Sets should more than offset challenging comps going into the Fall.

Thomas POS also continues to be strong, with global POS also up double-digits in the quarter and year-to-date. Brand strength, particularly in key emerging markets, should continue as we introduce 12 new characters later this year. This impressive new line-up of culturally diverse characters is the most significant evolution of the brand in quite some time and will create excitement, global relevance, enhanced collectability and numerous other opportunities for the brand.

Monster High, as you know, has persistent challenges. Nevertheless, Monster High remains the number two doll brand worldwide and a brand with strong consumer engagement. We're seeing some success with new product offerings and scales that are expanding play patterns. Shelf space challenges, unfortunately, offsetting new gains but we're working hard to capture those facings. We're looking to reboot this brand in the second half with new entertainment and product offerings that emphasize the core characters and The Origin Story.

With American Girl, we have strategic plans in place to rejuvenate the brand and achieve its full potential. With these plans focused on the second half, we've not been surprised by the brand's year-to-date performance, where reduced promotions and a shift in spending to the second half negatively impacted sales as we expect a better return on the spending in the second half.

The first of these new major American Girl brand initiatives is our recent introduction of Wellie Wishers. We are encouraged with the results so far. While Wellie Wishers provides an opportunity to expand the American Girl experience to a younger girl, we remain committed to older girls and we'll launch our latest historical character, Melody, this August. Look forward to a lot more news regarding American Girl and will be coming out this quarter and next. And we're excited about the strategies in place to provide new ways for girls and their families to engage with the brand.

Now moving on to Toy Box. Licensing is demonstrating continued strength, particularly our Warner Brothers partnership which will benefit from this week's release of Batman Versus Superman DVD as well as expanded distribution of our successful DC Super Hero Girl line. As Chris mentioned, Mattel is now a key licensing partner with NBC-Universal for their Fast & Furious and Jurassic World franchises, which will begin to roll out next year. These are exciting wins for us and we believe that this is only the beginning of a much bigger partnership with Universal going forward.

A major focus of our Toy Box capability is developing innovative and insightful category expertise to accelerate brand growth. And we are thrilled with the growth Toy Box is driving for our construction brand, MEGA, as it gains scale globally. MEGA sales, in constant currency, are up 22% in the quarter and up 42% year-to-date. MEGA has proven be a strategic driver of organic growth, expanding play patterns for many of our brands, notably Monster High and American Girl. And we will continue to mine the great potential in MEGA going forward. Invention and brand creation are our other key priorities at Toy Box and these are areas emphasized in the last year.

Our latest invention is a new brand called My Mini MixieQs. A highly differentiated execution into the growing Mini collector figure market that demonstrates our new speed-to-market capability and our expertise in girl play. We're pleased with the strong early reads and I'll look forward to updating you on future calls.

Now, as we move toward the most significant part of the year, I'm encouraged with our progress, the growing traction for our brands and our significant wins in licensed partnerships. Significant challenges remain but we are meeting these head on while we create major new opportunities for growth. We've said our success this year will largely be a function of Mattel's ability to overcome a unique and significant revenue gap. We're increasingly confident that we have the momentum to do just that, given the alignment of a very talented organization and the continued strong performance from key core brands, Toy Box, and emerging markets. We will continue to look to stabilize our business this year and create the solid foundation for growth in 2017 and beyond.

Now I'd like to turn the call over to Kevin Farr. Kevin?

Kevin Farr - *Mattel Inc. - CFO*

Thank you, Richard, and good afternoon, everyone. As Chris and Richard said, despite the impact of foreign exchange, we continue to execute well on our top line. And we made significant progress in our cost savings programs, which help offset some of the ForEx headwinds in the middle of the P&L. As a result, our overall performance was in line with our expectations for the quarter and the first half.

Before going into some of the details, I'd like to remind everyone that unless otherwise noted, I'll be referring to gross sales in constant currency in order to provide better visibility into the underlying top-line trends. In order to provide more transparency into the fundamentals of the business, I will also reference some adjusted financial results that exclude certain nonrecurring items related to the acquisitions of MEGA, Fuhu and Sproutling, as well as severance related to business transformation and cost savings initiatives. As always, reconciliation to GAAP numbers are provided in our press release and the slide deck.

Also want to take a moment to discuss the impact of Brexit on our business. Since it occurred so late in the quarter, Brexit had a minimal impact on Q2 results. And assuming the continued uncertainty doesn't further impact financial markets or the consumer economic outlook, Brexit will only have a modest impact on our full-year results. Based upon current trends, we believe the negative impact from foreign exchange will be roughly $0.02 to $0.05 of EPS for the year related to Brexit.

Now, moving to the highlights of some top line trends. Gross sales were down 1% in the quarter in constant currency and down 4% as reported. On a year-to-date basis, gross sales were 1% down in constant currency and down 5% as reported. Gross sales were up in North America and Asia-Pacific, with Latin America down 7%, and Europe down slightly at 2%.

Finally, on a year-to-date basis, we continue to see strong growth in key emerging markets like China and Russia. And as Richard mentioned, the underlying trends look even more favorable when we exclude Disney Princess and we remain quite confident that we'll achieve our full-year goal of relatively flat net sales in constant currency.

Moving to the rest of the P&L. While we continue to invest in retail promotions and work more closely with the retail consumers in support of our ongoing turnaround efforts, sales adjustments were 9.1% in the quarter versus 9.8% in the prior period. Year-to-date sales adjustments were 9.3% versus 9.7% as we continue to see positive POS trends in our core brands and Toy Box.

Our reported gross margin in the second quarter were 45.3%, with ForEx once again the major driver of the decline. If the year-over-year impact of foreign exchange is excluded, our gross margin rate was relatively flat to Q2 2015.

The other key driver of declining gross margin rate in the quarter was mix, with strong growth in profitable lower margin brands like MEGA and Fisher-Price, and a shift away from our higher margin doll business. Overall, the negative impact of foreign exchange and mix was partially offset by our cost savings initiatives and the strategic pricing of our 2016 product line.

Moving beyond gross margin, advertising was lower, as we continued to move closer to 12% for the full year, coupled with the benefit from foreign exchange. We also remained disciplined in SG&A, with adjusted SG&A being down by approximately $17 million, or 5% in the quarter, and down by $43 million, or 6% year-to-date. These results were due in part to cost saving initiatives which more than offset expected wage inflation.

As described in the slide deck that accompanies our earnings release, please note that we now include MEGA acquisition-related amortization expenses in our adjusted SG&A numbers. Importantly, we are still on track to deliver at the high end of the $250 million to $300 million range for our two-year Funding the Future cost savings program. We delivered approximately $31 million of gross savings in Q2 and $77 million year-to-date.

Finally, adjusted EPS for the second quarter was a negative $0.02 per share or a negative $0.06 per share as reported. As it relates to our balance sheet and cash flow, we ended the first half of the year with $318 million of cash. This was in line with our expectations and reflects solid performance as we continue to tightly manage working capital. Not surprisingly, owned inventory on balance sheet was up year-over-year, as we position the business to deliver in the second half.

Finally, we continued to reward our shareholders by deploying capital in a disciplined manner and maintaining the dividend. As we've said, dividends remain our first priority after reinvesting in the business. And the Board declared a third quarter dividend of $0.38 per share, which is flat compared to the third quarter of 2015.

As many of you know, we have some debt coming due this year. Given current rates, we plan to refinance the $300 million of senior unsecured debt that is maturing in November of 2016. So overall, our balance sheet remains strong and we expect to end the year with cash of $800 million to $1 billion.

One final note regarding foreign exchange. Given the significant volatility in foreign exchange rates over the past 18 months, we recently conducted a thorough review of our approach to quantifying their impact on each element of our P&L. As a result of these efforts, we reclassified some forecasted foreign exchange benefits that were previously embedded in product costs. Importantly, this reclassification does not change our total gross margin expectations for the year or Funding Our Future cost savings targets. However, it does result in a moderately lower ForEx impact on margins and earnings. For the full year, we now expect the negative impact of foreign exchange on net sales would be 2% to 4%; and EPS will be at the low end of our original $0.30 to $0.40 per share outlook when you include the impact of recent events like Brexit.

Looking forward and summarizing our current 2016 outlook. We're still targeting relatively flat net sales in constant currency for the year. Similar to last year, we expect second half sales to be more weighted to Q4 due to the timing of our promotional efforts and our marketing spend, the timing of new product and distribution initiatives, and how retailers are likely to tightly manage the inventory leading up to the holiday season.

As Chris mentioned, while we expect the negative impact to currency to lessen in the back half of the year, we see additional challenges, primarily mix, continuing. While these challenges will be partially offset by strategic pricing, supply chain efficiencies and cost savings initiatives, we recognize we'll likely come up a bit short to our 2016 gross margin outlook.

At this point, we believe gross margins for the full year will be around 48.5%, with ForEx headwinds and mix driving the majority of the decline. However, with additional sales volume, improved mix and more cost savings dropped in the bottom line, we expect gross margins will improve sequentially in the second half of the year. That means the second half gross margin of about 50%, which is roughly equivalent to what we achieved in the second half of 2015.

More specifically, for the third quarter we expect a step-up in margin versus the second quarter to be similar to our historical averages of around 300 basis points, driven by the seasonal scale of our revenues relative to the second quarter, less headwind from foreign exchange, slightly better mix, and incremental supply chain and other cost savings initiatives.

We expect the fourth quarter gross margin to be in line with our historical averages. The expected improvement over Q3 will be driven by our girls' properties gaining momentum, less impact of Disney Princess, and we get incremental flow-through from our supply chain and other cost savings initiatives. Finally, it's important to mention that our long-term objective remains to achieve about 50% gross margins in the future.

Shifting to SG&A. While the impact of including MEGA amortization and adjusted SG&A increases the 2015 SG&A base to $1.465 billion, we continue to target adjusted SG&A to be down $55 million to $65 million versus last year's $1.448 billion adjusted SG&A baseline. The year-over-year impact of adding the MEGA amortization back into adjusted SG&A is $9 million.

This target reflects the full absorption of overhead related to the Q1 acquisition of Fuhu and Sproutling where we are aggressively pursuing cost savings opportunities across the Company to absorb the bulk of overhead from those acquisitions. This change in the treatment of MEGA amortization does not impact reported SG&A.

Finally, looking beyond this year of transition. In addition to the ongoing brand momentum and new initiatives that Richard covered, we expect 2017 to benefit as we leverage Fuhu and Sproutling technology platforms across our portfolio, and expand our market opportunities. We also have a tailwind on the top line revenues from Cars 3 movie and continued traction in China, Russia and other emerging markets.

Further, we have a strong revenue pipeline for growth in 2018 with our entertainment line-up of Toy Story 4 and Jurassic World. As we previously stated, we continue to see an ability to approach more normal operating margins in 2017 and beyond.

Overall, we view the second quarter results positively and continue to focus on the turnaround and setting up the business for sales and profit growth in 2017 and beyond. We look forward to updating you on the progress throughout the rest of the year. We will now open the call up to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We'll be taking our first question from the line of Drew Crum from Stifel. Your line is open.

Drew Crum - *Stifel Nicolaus - Analyst*

Ok, thanks. Good afternoon, everyone. Wonder if you could quantify point of sales for Barbie during the quarter? You mentioned that shipments were up 24% ex currency. What was the consumer take-away for that brand?

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

Hey, Drew, it's Richard. You know, we've seen great consistency in the US with our POS up double-digits in the US for the second quarter and up single-digits in International. Globally, we're really obviously pleased with the performance.

There was some licensing revenue realized in the second quarter with our partnership with Universal. That being said, we still had strong shipping numbers and the POS is certainly commensurate with that. Lastly, as I mentioned in my remarks, we've had some great space increases in the second half, which we've obviously started to ship into as part of the Barbie sales plan.

Drew Crum - *Stifel Nicolaus - Analyst*

Okay. Richard, could you comment on the competitive dynamics you're seeing in the doll category generally? Has that changed from what you saw last year and are you anticipating any change as you get into the second half of this year?

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

You know, The fashion doll category, always in the back half, has certainly strong elements of competition. There could always be a surprise here or there. This year I think, really, in particular, the Shopkins brand has been very successful.

It continues to be a trend, particularly in the small doll category that is capturing girls' attention. Clearly, we're competing now with the Disney Princess franchise. But in particular, I would say the strength of the Barbie brand and its renewed positioning, the additional marketing and merchandising and execution that we've done to get that brand to be more culturally relevant has seen a resurgence.

And we're feeling confident with our plans on that brand in particular. As I mentioned, of course, Monster High, we have a lot of programs in place in the back half. It still remains, as I mentioned again, the second largest fashion doll business in the world. I continue to be bullish on the brand as intellectual property, as engagement remains consistent, and in fact, increasing, as we get more pronounced in digital apps and storytelling, our websites and entertainment continue to attract girls.

Last, but not least, we're really pleased with our Mini MixieQs as an early start going after, if you will, the small doll collectible space. That is obviously a trend in the market. So overall, feeling confident of our positioning in the portfolio, and as we continue to extend the DC Super Hero Girls line out to the mass markets, we think that we've got a great line-up for the back half.

Drew Crum - *Stifel Nicolaus - Analyst*

Great. Okay. I'll jump back into the queue. Thanks guys.

Operator

Thank you. Our next question comes from the line of Felicia Hendrix from Barclays.

Felicia Hendrix - *Barclays Capital - Analyst*

Hi, good afternoon. Thank you. Kevin, you gave us some nice color on your outlook and particularly, your gross margins. I just -- if we could just revisit your gross margin forecast, which seems to be revised. Can you just expand upon your prepared remarks regarding the rationale for that change?

Kevin Farr - *Mattel Inc. - CFO*

Yes, I think the rationale for the change is it's difficult to predict but at this point, we believe that mix will be a bit more challenging to the full year. That said, we expect to see incremental sequential improvement in gross margin in the second half. As I said in my prepared remarks, to achieve that, we need a 50% gross margin for the balance of the year.

That's consistent with what we delivered in 2015. And you look at what's going to drive it, I think sequentially, in the third quarter, we're going to see a step-up consistent with our historical averages of about 300 basis points and the biggest driver of that is really the scale of our business. The third quarter is twice the size, in general, of the first quarter -- I mean first and second quarter, separately.

And then I think also as we talked about and Chris mentioned, we see less of a headwind in Forex. We see mix getting slightly better in the third quarter. And then also we see the cost savings flow through in the third quarter that we achieved in manufacturing in the second quarter, because about one lag, one quarter lag in production and the time we sell it, and also our other cost savings initiatives that impact gross margins.

And then in the fourth quarter we see getting back to the historical levels and the biggest driver of that incrementally is better mix as a result of, as Richard just said, we see in the holiday season, our doll portfolio performing better, Barbie, DC Super Heroes, and American Girl. And that's going to be the biggest driver to increase sequentially gross margins in the fourth quarter. Along with, again, we'll see more flow-through of supply chain savings and other cost savings initiatives around the Company.

Felicia Hendrix - *Barclays Capital - Analyst*

Okay. That's helpful.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

Felicia, it's Chris. If I can just add just a parenthetical here. Look, if you stand back from it all, I think the broad stroke is we're very close to where we thought we were tracking. I think foreign exchange is about what we were expecting. If anything, though, we've been struggling a little bit more on the mix side and the good news is the revenue has been strong.

But the mix has been a little off. So we're trying to flag a little prudence here for you. I think that's the biggest shift we're seeing as we forecast the balance of the year on margin.

Felicia Hendrix - *Barclays Capital - Analyst*

When you say struggling on the mix, does that just mean that some things are more fluid than you had expected before? Because like last quarter, you had attributed the mix headwinds to boys and infant, preschool; and this quarter, you're talking about MEGA and Fisher-Price so it sounds like mix is a bit fluid.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

I think that's fair. I think those are the elements that are driving strong and we've been a little soft on the doll business, which is, obviously, a higher margin. So some of that will probably continue through even if it improves the balance of the year.

Felicia Hendrix - *Barclays Capital - Analyst*

Okay. Helpful. Richard, can you just walk us through your decision to pick up the Jurassic World franchise? Hasbro didn't speak very favorably about that. It's a franchise that seems to drop off precipitously in a year following a movie. So just wondering -- I'm sure you guys have plans to make it more of a sustainable brand. If you could talk about some of your thoughts there?

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

Yes, we are thrilled to win the Jurassic license and believe there is significant opportunity to grow this business, certainly given our global scale and expertise. But the story telling themselves, obviously, the penetration of the property. And, frankly, dinosaurs, in general, are a proven play pattern for a very long time. Our license includes multi-categories and obviously, a great line-up for 2018 and beyond.

And it emphasizes, obviously, our continued partnership with Universal as we mentioned. Fast & Furious is also an announcement that we've made that we're pretty excited about. I think in general, it adds a perfect sort of new brand to our portfolio. We're very excited about the partnership with NBC-Universal.

It's a great team operating there that we're incredibly synergistic with and I think, certainly, as the teams get started on creative development, we're truly excited about what the opportunities lay ahead for 2018 and beyond.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

Let me just add, Felicia. This is one -- this is clearly the flagship franchise for Universal. It was a highly competitive process. It was one that was highly sought after. I think we feel excellent about the fact that we were awarded this and given the opportunity, we see huge upside to it.

So I just would want to make sure this doesn't get characterized as a difficult franchise or one that was maybe there for the picking up. This was a highly, highly competitive process and one where it was highly sought after. So we're ecstatic about it, to be honest with you.

Felicia Hendrix - *Barclays Capital - Analyst*

Well, that's great. Congratulations. And then just housekeeping, on Cars 3, just, are you still expecting that to generate $350 million in revenues next year?

Kevin Farr - *Mattel Inc. - CFO*

Yes.

Felicia Hendrix - *Barclays Capital - Analyst*

Great. Thank you.

Kevin Farr - *Mattel Inc. - CFO*

Thank you, Felicia.

Operator

Thank you. Our next question comes from the line of Arpine Kocharyan from UBS Investment Bank. Your line is open.

Arpine Kocharyan - *UBS - Analyst*

Thank you. Thanks for taking the question. So ex-Disney, mid-single digit POS is pretty encouraging for the quarter but I wanted to address for a second the sustainability of it into the second half. As you look into the second half of the year and compare shelf space gained or not gained, both in core brands and Toy Box-related products, could you give an indication where Mattel is in terms of what retailers are indexing for the back half?

Because you saw a step-up change perhaps in Q4 of last year, right? So in terms of retailers' willingness to take in more and you've talked about better shelf space this year versus last. Could you just talk about general retail set-up as you look into the second half?

Overall, great quarter. Thanks.

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

Sure. I'll start and then maybe Chris can add some color to it.

Space ebbs and flows with POS performance. And certainly, if you take a look at our core brand performance overall, we've had really consistent delivery of consumer take-away, particularly with core brands like Barbie, as we mentioned, which has had a really strong resurgence and certainly performance this quarter.

And POS continues to obviously get retailers more confident and us more confident in the opportunities for that brand. But across our core brand portfolio, we've been quite pleased with the continued space increases along with POS. In addition to that, in the fourth quarter, particularly during the holiday period, a lot of the space increments are out-of-aisle placement and those are obviously highly competitive spots.

But we are aggressively pursuing those with our retail partners, with great promotional programs, and add-in marketing that justifies getting that space and I think we are commensurate, if not equal to last year, and in some cases, ahead of last year. We have a terrific commercial organization that executes around the world, around space and increments and they've done a terrific job lining up the fourth quarter promotionally programming-wise to get that space.

Arpine Kocharyan - *UBS - Analyst*

That's great. Thank you. And then I have a follow-up on Barbie.

Richard, is it possible to break down whether Barbie would still be up double-digit if you were to exclude the licensing revenue, or perhaps you could just give us the licensing revenue.

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

Barbie would be up double-digits excluding the licensing revenue. As I mentioned, we had a very strong quarter in Barbie in general, both in shipping and POS, and, yes, it would be up double-digits excluding the licensing revenue.

Arpine Kocharyan - *UBS - Analyst*

And would you say that strength is driven by core dolls versus Fashionista? How would you break down that double-digit gain?

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

Sure. Actually, Fashionista is core dolls. Fashionista is within the line architecture of Barbie, the fashion doll segment, that we have renewed, obviously with body types as well as ethnic diversity. Good news is we're seeing that piece of the business grow tremendously.

In fact, just basic core dolls with the Fashionista, cultural noise and new introductions has gained enormous traction. In addition to that, which we classify more as the fashion segment of our business, as you know, we introduced a new segment to the younger girl called Dreamtopia, which has a line-up of both doll and accessory, along with content and various other forms of IP extensions that has resonated incredibly well.

In fact, the younger girl segment of our business is growing exponentially much faster than we had anticipated. We're really pleased with Dreamtopia's connectivity and we believe it's a segment that's going to continue for quite some time.

Last but not least, the estate strategy within Barbie is always a really key component of our back half strategy with Dreamhouse and Campers and various different other accessories that add a lot of volume and certainly, marketing ability for the brand. So we are lined up well for the back half and Fashionista is certainly gaining more and more traction around the world.

Arpine Kocharyan - *UBS - Analyst*

Fantastic. Thank you. Just one more to squeeze in. Regarding DC Super Hero Girls, if you would just address, you obviously rolled it out globally starting from July, and end of June, exclusivity with Target ended. If you were to look full-year potential from that property would you say you are incrementally more positive, or right about in line what you were thinking that property could do for the full year? Because that also, dollar to dollar, offsets Disney Princess margins. So --

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

We had, as you know, we've been working on this project for quite some time. We had high expectations for it and they continue to meet our expectations. We're getting more and more excited about not only the product line-up and the connectivity that we're seeing, consumers have with the brand, certainly indicated by POS.

But the cultural message ultimately of girl empowerment and the franchise, if you will, under DC Super Hero with girl characters that could be extended for years represents a really significant new branded piece of our girl portfolio that we are extremely excited about.

Arpine Kocharyan - *UBS - Analyst*

Thank you very much.

Operator

Thank you. Our next question comes from the line of Tim Conder from Wells Fargo Securities. Your line is open.

Tim Conder - *Wells Fargo Securities, LLC - Analyst*

Thank you. Gentlemen, wanted to circle back on the gross margin and the mix just being slightly weaker in the dolls than you anticipated 90 days ago. Is that -- can we characterize that as being due to within a doll brand, or are we talking about among the doll brands and I guess the latter would be maybe Monster High, maybe your expectations got lowered a little bit there? Or is it something maybe mixed within the Barbie brand itself, the sub-brands within that? A little more color on that, please.

Kevin Farr - *Mattel Inc. - CFO*

It's probably more related to Monster High and how it's been tracking year-to-date that's impacted that gross margin outlook on the doll business.

Tim Conder - *Wells Fargo Securities, LLC - Analyst*

Okay. And then I think, Chris, you said that from an FX perspective, that would come in pretty much as you anticipate 90 days ago.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

I think that's right. Kevin alluded to Brexit. We really don't know. At this point, it looks pretty de minimis. So we're probably tracking pretty close to where we were on overall ForEx. I think he indicated some of the adjustments we made in allocation, but the impact is still basically the same.

Tim Conder - *Wells Fargo Securities, LLC - Analyst*

Okay. Okay. And then Kevin, in your analysis of the geographic areas and this is nothing new, I mean, Brazil for a lot of industries has been a problem child area. But when, from your perspective and Mattel's business, are we getting close to that bottoming? And it would seem the only area where there might be just a hair of inventory, as you mentioned on the slide deck. Just -- how is that -- how do you see that time line unfolding in Brazil, as it impacts Latin America as a whole?

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

I'll take that, Tim. Look, Brazil is obviously the continued soft spot. I'd throw Venezuela in there but it's kind of down to a rounding error at this point. But I think Brazil has probably got a few -- a couple more quarters to get through, from our perspective. The good news is currency stabilizing. I think some of the retail problems we had with credit and so forth, hopefully, are bottoming out.

So I would expect as we get through this year, Brazil will become hopefully not as much of a factor, if you will. The good news is other parts of South America are doing quite well. Mexico's holding up and part of the south cone, so that's probably our biggest soft spot at this point.

Tim Conder - *Wells Fargo Securities, LLC - Analyst*

Okay. And then gentlemen, just from a definitional perspective, we get this from clients a lot. When you say relatively flat, any type of range of parameters you can put on that, plus or minus? Are we talking like 50 bps or whatever? And thank you again for the color on the gross margins in your preamble and in the answers here.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

Nobody here seems to be stepping up to this one, Tim. But look, we tried to say we want to hold it flat in constant currency. That's still our objective and I think we've been close. We're getting more confidence in it. So I think that's still a fair target for all of you.

Tim Conder - *Wells Fargo Securities, LLC - Analyst*

Okay. Okay. Gentlemen, thank you very much.

Operator

Thank you. Our next question comes from the line of Linda Bolton Weiser from B. Riley & Company. Your line is open.

Linda Bolton Weiser - *B. Riley & Co. - Analyst*

Hi. Can you give us some color on whether the DC Hero Girls distribution beyond Target helped materially in the quarter, or is that shipment into the channel more happening starting in the third quarter?

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

Hi, Linda. It's Richard. No, I wouldn't say materially helping the quarter. It does more shipping in the third quarter.

Linda Bolton Weiser - *B. Riley & Co. - Analyst*

Okay. And then getting back to the mix question, since that seems to be what everybody is interested in here, I guess, I wouldn't have started out the year thinking Barbie sales would be up 20% or so. So that piece is clearly, maybe even better than you expected.

So when you put together the Barbie and the Monster High, I mean, we all knew Monster High would be challenging. Are you saying that just those two things put together, net-net, is still coming in a little below what you would have expected? Is that kind of -- and then therefore, that's affecting the mix for the whole Company?

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

Look, I think, Linda, it's a combination of things. But it's largely that. Barbie is doing extremely well. I think as we look at the full year, probably, hopefully a little better than we would have expected. Conversely, Monster High is softer than we had hoped at this point. I think it probably more than offsets the uptick on that side. Obviously we're building on American Girl, so that's been a bit of an issue, as well.

So when you aggregate it, it's not a huge differential, but enough that we at least have been struggling through it the last quarter or so, and we just want to make sure that we don't get out ahead of ourselves. If we keep driving success with some of these girls properties, well, we would hope that becomes maybe less of an issue. But at least we thought we would flag it.

Kevin Farr - *Mattel Inc. - CFO*

I think also the other thing, this is a positive thing, we're seeing greater growth out of MEGA than we anticipated as well as in Fisher-Price. So more of this also relates to that fact that we're seeing good growth there and somewhat a little bit less in dolls. But overall, it's going to have slight impact in the year on gross margins of 48.5%.

Linda Bolton Weiser - *B. Riley & Co. - Analyst*

Right. And then again, not to beat a dead horse here, but on the Monster High, would you say that relative to your expectations, is the shortfall more on the shelf space situation, or the POS?

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

Well, generally, the two go hand in hand in many cases. The brand presence, also defined by space, can help promote POS. Much of the retail decision consumers make is actually in the aisle. That being said, as you know, we took a strategic direction to edit the character assortment that we had in Monster High, which was a strategic intent. At the same time that we are losing some shelf space, we are also seeing some traction in a concentrated effort on the core characters; our new mini collectibles are obviously gaining traction, as I mentioned. And there's some other products in there that is giving us great encouragement to believe that actually as the brand resets itself with new product offerings, that POS will be commensurate.

Again, we are putting a lot on the back half, ultimately with the reboot of the content strategy which talks to the origins of the brand again. We are introducing the brand to a whole new generation of girls, frankly, which is an opportunity that we have in our business that's particularly unique and we're pretty confident that our -- the brand is resonating with consumer engagement and connectivity. We just need to get that connectivity back to merchandising and certainly once we get that POS back on track, you can be sure that we will aggressively pursue commensurate space.

Linda Bolton Weiser - *B. Riley & Co. - Analyst*

Okay. And just Kevin, on the SG&A, I didn't quite catch the $55 million to $65 million reduction year over year is off what base now for 2015?

Kevin Farr - *Mattel Inc. - CFO*

It's off the adjusted base before the change that we made with respect to the treatment of MEGA-related intangible amortization. So I guess what the headline here is, look, our target remains the same, to reduce our SG&A, adjusted SG&A by $55 million to $65 million, based upon using the original base of $1.448 billion.

And then I think with regard to that calculation, you then would have to add back $9 million to your estimate because we're going to include MEGA intangible amortization in SG&A and that's really to comply with SEC guidelines about non-GAAP reporting. We consider this to be less nonrecurring because we do have amortization expense. But if you look at this change in amortization expense for MEGA, overall reported SG&A will not increase.

Linda Bolton Weiser - *B. Riley & Co. - Analyst*

Okay. And sorry if I missed it, but on the Jurassic license, did you say there actually would be some shipments and sales in second half 2017 or not until 2018?

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

I wouldn't count on that, Linda.

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

Movie comes out in 2018.

Linda Bolton Weiser - *B. Riley & Co. - Analyst*

Okay. Thanks a lot.

Operator

Thank you. Our next question comes from the line of Gerrick Johnson from BMO Capital Markets. Your line is open.

Gerrick Johnson - *BMO Capital Markets - Analyst*

Hey, good afternoon. On MEGA, what's left in international distribution? Is it flowing fully through the Mattel infrastructure at this point or do you still have some distributor agreements to switch over?

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

No, I think we're pretty well in a heavy rollout everywhere at this point, Gerrick. A lot of the growth we're seeing is driving through some of the international expansion.

Gerrick Johnson - *BMO Capital Markets - Analyst*

Right, right. Okay, and then on American Girl Wellie Wishers, what level of concern might you have there that, that sub-brand could affect or hurt the pricing power you have with the core doll?

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

Gerrick, it's Richard. There's a lot of differences between our core brand, particularly historical segment and the context of how it compares to Wellie Wishers. Wellie Wishers is designed to appeal to a younger girl, very specifically.

The content itself, books and episodic animated series are geared towards younger girls, characteristics of friendship, empathy, kindness and so forth. It is positioned very differently than the core brand and so we believe that these can sit complementary to each other, almost as an entry price point and introduction to the American Girl franchise.

Gerrick Johnson - *BMO Capital Markets - Analyst*

Okay.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

We're tracking it very carefully and it's clearly two weeks into it. But early reads are very good and incrementality looks very high. So we'll have more to report. But early signs are very positive.

Gerrick Johnson - *BMO Capital Markets - Analyst*

Okay. Great. And just quickly, have you run the Barbie You Can Be Anything advertising internationally yet or when does that occur? Thanks.

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

We have started to do that. The bulk of that programming is going to happen in the second half, in addition to which you'll start to see different takes of that program in the US, with some great media marketing planned for the back half as well. So that will continue, not only rolling out but also taking new cues in creativity, particularly in the US.

Gerrick Johnson - *BMO Capital Markets - Analyst*

Okay, great. Thank you very much.

Martin Gilkes - *Mattel Inc. - VP of IR*

Operator, I think we have time for one last question.

Operator

Okay. Our last question for the day will come from the line of Jim Chartier from Monness, Crespi, and -- pardon me. It wasn't long enough. Your line is open, sir.

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

Hi. Thanks for taking my question. I noticed the Funding Your Future initiative, you increased the cost savings by $15 million this year versus last quarter. Is that able to offset any of the incremental SG&A from the MEGA amortization?

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

Jim, that's what we've been working on. I think Kevin's reporting on a couple different initiatives here. Ones is the Funding the Future, where we are at the top end and I think he's reporting some of the positive numbers there. We've been driving well beyond that though to get more cost out of the system and that's the area where we're looking to cover some of the incrementality of our acquisition.

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

Okay. And then recently, you guys mentioned you thought you could approach the low end of the 15% to 20% long-term operating margin target last -- next year. Given the gross margin reduction and expectation this year, do you still think that's possible?

Kevin Farr - *Mattel Inc. - CFO*

Yes, I think so. I think the first thing that's going to drive that is scale and I think the addition of Cars 3 and that incremental $350 million is going to help us because that's going to leverage our scale in both gross margin as well as -- I think as we look at 2017, we want to make progress in moving gross margins higher and I think we'll do that with better brand statements and better leverage.

And then again, we're continuing to lean into cost both in the supply chain and across the back-office. So I think with regard to my comments, I indicated that we do expect in 2017 to deliver more normative profitability, and that means moving towards that 15% to 20% operating profit as a percentage of sales.

Chris Sinclair - *Mattel Inc. - Chairman & CEO*

((multiple speakers) The only thing to keep in mind, Jim, is if you get any stability which we seem to be getting on foreign exchange, it becomes a lot easier for us to manage the cost and pricing equation than it has been. So that's another plus as we look to next year.

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

Great. And then my last question, you mentioned some drivers of sales for 2018, Toy Story, Jurassic World and some core initiatives. Is Toy Story, is that big enough to offset an expected Cars decline from 2017?

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

Yes. Toy Story is a huge toy franchise and in particular, historically, been very significant. So the line-up actually is perfect in the context of looking at lapping volume. But we're really excited about the potential of Toy Story. As we know it early on, we'll be able to build an even more robust program.

Kevin Farr - *Mattel Inc. - CFO*

I think you add Jurassic World on top of that, I think history would say that Cars in the second year usually does fairly well, so I don't think you'll see the decline in Cars as much as you do other movies in 2018.

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

And not to add to -- to add to it for one second just because we haven't really talked about it enough, but our partnership with Warner Brothers is significant and laps, again, in 2017, we have Wonder Woman and Justice League and we extend that into 2018, with additional DC major theatrical releases which we're -- which are gaining incredible traction. We are, as we've said, positioning ourselves for great long-term growth.

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

Great. Thanks and best of luck.

Martin Gilkes - *Mattel Inc. - VP of IR*

Great. There will be a replay of this call available beginning at 8:00 PM Eastern time today. The number to call for the replay is 404-537-3406, and the passcode is 353-34734. Thank you for participating in today's discussion.

Operator

Ladies and gentlemen, this now concludes the program and you may all disconnect at this time. Everyone, have a great day.
