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MAT - Q4 2016 Mattel Inc Earnings Call

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Co. reported 2016 adjusted EPS of $1.06 and 4Q16 adjusted EPS of $0.52.

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Mattel, Inc., fourth quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference is being recorded.

I would now like to introduce your host for today's conference, Mr. Martin Gilkes, Head of Investor Relations. Mr. Gilkes, you may begin.

Martin Gilkes - *Mattel, Inc. - VP, Corporate Strategy & 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 full year and fourth quarter financial results. We will begin today's call with Chris, Richard, and Kevin providing commentary on our results, and then we'll 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 gross margin and adjusted gross profit, adjusted selling and administrative expenses, adjusted operating income and loss, and adjusted earnings and loss per share, as well as 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 in the "Investors" section of our 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, in 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*

Thank you, Martin, and welcome, everyone. I want to thank you for joining us on short notice. We decided to accelerate the earnings release because of our commitment to transparency, which we know is important to all of you, and because of the uncertainty coming out of the holiday season.

And today, as usual, I'll lead things off with a perspective on both the full year and the quarter, and then Richard and Kevin will each provide additional details. And as customary, we'll open things up at the end for any questions that you may have.

Okay. So, let's begin. It's fair to say that this was a very difficult quarter, characterized by a significant category slowdown led by the United States and by increased foreign exchange headwinds. The key holiday period saw a significant decline in industry sales growth, and while the trend of the consumer coming out later isn't surprising, the pattern this year was much more dramatic. And the result of this slowdown and shift in sales led to a significant increase in retail discounting and pressured shipments, particularly in December.

Now, in this difficult environment I think we've performed pretty well in some areas, but we're clearly disappointed in others.

On the positive front, we did overcome a significant revenue challenge for the year, and we continued to see very solid growth with our key core brands in the quarter. We also continue to perform well in our priority emerging markets. And here, it's important to note that, excluding Disney Princess in the quarter, our POS growth was very much in line with the industry. We also continued to manage our overhead costs very tightly.

On the downside, our gross margins were significantly impacted by elevated sales adjustments and by heavier discounting in some markets as we responded to the evolving conditions. They were also impacted by foreign exchange headwinds and by the fact that we fell a bit short of our own internal shipping expectations. Not surprisingly, the poor margin results did impact cash from operations, which Kevin is going to address in his remarks in a few minutes.

So, in sum, as we look at the full year and the quarter, we see a continuation of good performance against our key brand, market, and cost priorities, but a very difficult result on gross margin.

Now, shifting to 2017, we continue to feel that we're still well positioned for a good year of performance. With the late-December pickup in POS, our inventories are moderately elevated, but within a manageable range, and we're in good position on programming and support with our key retail partners to move it through the channel.

We also have a very strong lineup of entertainment properties, continued momentum on our key core brands, and an excellent set of initiatives kicking in in our priority emerging market, China.

We'll also continue to drive strong cost and productivity initiatives to support our growth and to help rebuild margins. And we anticipate capturing a bit more in pricing, as well.

And finally, at this point we remain comfortable with our cash outlook for the year, and the Board has authorized the continued funding of the quarterly dividend.

Now, before I hand the call over to Richard and Kevin, I would like to welcome Margo Georgiadis to the Mattel organization. While the industry slowdown did not allow us to end the year on the most positive note, we have made some excellent progress on the strategic priorities that the Board and I laid out as part of our transformation. I firmly believe we've established a much stronger foundation with the right strategies, resources, and capabilities in place for Margo to hit the ground running and continue the work.

Her proven leadership and strengths make her an ideal candidate to lead Mattel, going forward. And she inherits a very capable leadership team, including Richard, who will remain as President and Chief Operating Officer, and Kevin, who remains as CFO. And of course, I'll continue to have an active role as Executive Chairman and will be supporting Margo and the rest of the team as they drive the transformation. I'm very excited about this change and look forward to introducing you to Margo as soon as she comes on board.

And with that, let me now turn things over to Richard to highlight some of our top line progress and core initiatives. Richard?

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

Thank you, Chris.

Well, we knew going in that 2016 would be a very challenging year for us. In the midst of significant organizational change, we focused on the basics: prioritizing our core brands, leveraging license partnerships, and accelerating growth in emerging markets. And while recognizing the fourth quarter financial results are below expectations, the progress that we made and what we achieved in 2016 is not just top-line success, but a multitude of accomplishments which, ultimately, set us up well for the opportunity to grow in 2017. And I'll touch upon a few of these as we go through the results.

For 2016, full-year gross sales were flat in constant currency and are down only 3% as reported. This does mean we covered the Disney Princess gap and offset the continued softness in Monster High. And as we enter 2017, our global POS, excluding the impact of Disney Princess, remains solid, highlighted by very strong momentum in a number of our key core brands.

So, let's start by taking a deeper dive into what happened to the industry in the fourth quarter, using the US industry trends published by NPD. As Chris pointed out, while the overall toy category started the year incredibly strong and ended the year up 5%, the pace of sales slowed and shifted in the critical holiday period, with the quarter finishing up only 3%.

More importantly, as the pace slowed in December the retail environment became much more cautious, and we saw increased promotional activity and heavy discounting in the marketplace, which unexpectedly led to delayed and reduced shipping.

You can get a feel for how this unfolded when you look into the monthly NPD details. Industry sales in October were positive, but slower, compared to an earlier in the year. And November sales, which included the US election, were positive, with a slow start in the first two weeks offset by a strong Thanksgiving and Black Friday.

Then came December, where roughly a third of the entire year's POS historically takes place. And, as many of you know, the first three weeks of December saw some of the steepest category declines of the year, which was likely the trigger for increased retail promotions and discounting that slowed the need for additional shipping.

So, while the consumer did come out the last two weeks of December, aided by additional shopping days, it simply was not enough to offset the overall unfavorable holiday trends.

This US category slowdown has also been validated by recent retail reports, and we feel it is a reasonable proxy for what happened in the global market.

So, how did this category slowdown impact Mattel? Mattel's POS, excluding Disney Princess, was positive in October and November and very consistent with the category results. But as we moved into early December, we saw the dramatic drop in category sales and faced a very concerned retailer customer base, as well as heavy promotional activity.

As a result, we decided to proactively work with our retail partners to maximize the opportunity while the consumers were still in the store. These efforts resulted in elevated sales adjustments as we supported additional discounting in some markets; new promotional programs; and created additional ship-in opportunities to leverage our strong POS trends. And while it is difficult to assess the overall impact of these type of efforts in the moment, given the volume and pace of sales, we do believe they helped us to navigate this very challenging period.

Because of the very short time frame we had to activate and execute these programs, we didn't know the financial impact until after year-end and, ultimately, as you could see in our results, the category slowdown significantly impacted gross margin and our overall financial results.

Retail inventory was another area that was impacted by this. While a strong finish to the year helped some, our retail inventories are moderately higher in the US and western Europe. Fortunately, it is of good quality and composed of brands that continue to have positive POS momentum, and we're working diligently with our retail partners to manage it down.

So, let me take the remaining few minutes to provide a little more detail on the top line and POS. Now, as I mentioned earlier, full-year growth sales were flat in constant currency and down 3% as reported, which is consistent with year-to-date POS of roughly minus 1%.

But, excluding Disney Princess provides a much clearer window into the health of the underlying business and a view into why we are confident about 2017. Here, we see both global POS and worldwide gross sales in constant currency are aligned and up mid-single digits for both the year and the quarter. And on a reported basis, full-year worldwide gross sales are up mid-single digits and flat in Q4. And finally, we did see positive and improving sales in constant currency in all three international regions in the quarter.

Let's take a look at sales performance from a brand perspective. Now, as you know, we began restructuring the organization in 2015 to focus on two separate, but related, business models: core brands and the Toy Box. We did this, recognizing that core brands, which are the essence of Mattel, require a different level of expertise to connect marketing, content, and product and bring it all to life. While Toy Box gives us the opportunity to return to our roots as the best partner for entertainment brands and to increase spend to market, speed to market, and promote invention as we make and market the greatest toys.

And while we still have work to do, our results in 2016 reflect incredible progress in both areas, and that inspires me to believe that we are poised for a successful 2017 and beyond. As you know, we spent significant time repositioning our core brands like Barbie, Hot Wheels, and Fisher-Price back to their roots as purposeful brands. New marketing, refreshed product, and excellent execution led to one of the best years these brands have had in many years.

Barbie POS continued to be very strong, up double digits for the year, the quarter, and the last six weeks. And despite a very challenging year-over-year comp, where Barbie was up 8% in the quarter last year, and the impact of category slowdowns, fourth quarter sales were still up 1% in constant currency, with POS trending well above that. For the first time in three years, full-year gross sales in constant currency were positive, with 2016 ending up a very strong 9%. Clearly, Barbie is on the right track.

Fisher-Price continued to see strong results, with gross sales in constant currency up 6% for the year and up 2% in the quarter. Our emphasis on child development helped deliver strong results in our key infant and baby gear lines, and we saw good performance with our Nickelodeon licenses, including the successful launch of Shimmer and Shine. Global POS remains positive, and very strong consumer takeaway internationally.

Hot Wheels also continued to build strong POS and shipping momentum. Despite being up against a very challenging Star Wars comp, the core of the business -- basic cars and track sets -- continued to resonate. POS ended up double digits for the year and in the high-single digits for the quarter and the last six weeks. And shipping in constant currency was very strong, with sales for the year up 9% and an amazing 16% in the quarter.

As we have consistently said, Hot Wheels represents an enormous global opportunity, and the work being done with this brand is really starting to show up in the financial results.

American Girl showed improvement, with sales in constant currency up 4% in the quarter and ending the full year flat. Our new Wellie Wishers line continued to build momentum, and everyone is pleased with the results from our new store partnerships. But while the results are moving in the right direction, they are still below expectations and highlight the need to refresh the product lines, improve the content, and continue to explore distribution options. There will be more to come with this promising brand opportunity.

Thomas also grew, with sales in constant currency up 3% for the year and 1% for the quarter. And we continue to see strong POS and shipping results in the international markets, where Thomas has tremendous potential.

Unfortunately, we didn't see the improvement expected from Monster High. Full-year sales were down over 41% in constant currency, aligned with POS, and we didn't see any significant change in momentum in the fourth quarter. With annual sales around $190 million, it obviously has a following, and we will continue to look at ways to stabilize the brand and prioritize our resources appropriately. There will be more to come at Toy Fair.

Now, briefly looking at Toy Box, as you all know, this is where the Disney Princess brand resided and, as a result, represented our biggest challenge in 2016. We made up considerable ground with our Warner Bros. DC Universe executions, as evidenced by our DC Super Hero Girls and continuing strong demand for our Batman v. Superman products.

We also did well with licenses from Microsoft, Universal, and Sony and also grew our own games business and launched a number of smaller brands in the year.

MEGA held up pretty well against tremendous competitive pressure in the fourth quarter, with sales up 1% in constant currency and finishing the year up 15%. Full-year sales were driven by the introduction of new properties and expanded global distribution, which remains a key strategy for the brand and as we continue to unlock its potential. Shipping and POS grew significantly internationally, while performance domestically was also likely impacted by tough collector comps in the quarter.

Before I hand it over to Kevin, I wanted to remind you that we believed success in 2016 would largely be a function of Mattel's ability to overcome a unique and significant revenue gap. As you recall, we have consistently stated that our key 2016 objective was to fill a significant portion of the Disney Princess gap and offset continued softness in Monster High. And what we were asking the Company to do was essentially replace about $600 million, or 10%, of total Company sales in one year.

In the midst of an ongoing transformation, reestablishing retail and licensing partnerships, punctuated by political and economic uncertainty, a category slowdown, foreign exchange headwinds, and a cultural reset, we achieved that goal. We essentially created a Top 10 toy company in one year's time.

It's an achievement I hope doesn't get lost in today's news. And despite a truly disappointing finish, which is largely attributed to macro industry trends, I am proud of the entire Mattel organization and its enormous efforts right-coursing this Company and setting it up for a great year and a chapter of growth ahead.

We now enter 2017 with an industry that is still growing, with our key core brands back on track, and, arguably, with the strongest licensed entertainment slate that we've had in years. I hope to see you at Toy Fair in a few weeks and continue the discussion around our 2017 opportunities and beyond.

And now, I'd like to turn the call over to Kevin Farr.

Kevin Farr - *Mattel, Inc. - CFO*

Thank you, Richard, and good afternoon to everyone.

As Chris and Richard said, while we achieved our full-year goal of filing the Disney Princess revenue gap, we fell short of aggressive expectations for the fourth quarter. And unfortunately, the impact of the category slowdown required us to take action which impacted margins and cash flow for the year.

Despite this, we continue to be disciplined in our management of the P&L by balancing our response to the category slowdown, increased ForEx headwinds, and slight mix changes with our cost savings initiatives. We successfully delivered at the high end of our two-year cost savings target, with total gross savings of $295 million.

Today, I'll walk you through our 2016 performance and then outline some broad expectations for 2017.

But before going any further, I want to remind you 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. And in order to provide more transparency into the fundamentals of the business, I'll also reference some adjusted financial results that exclude certain non-reocurring items related to the acquisition of MEGA, Fuhu, and Sproutling, as well as severance related to our business transformation and cost savings initiatives. As always, reconciliation to GAAP numbers are provided in our press release and the slide deck.

Since Richard walked you through a summary of the 2016 performance of our top line, I'll begin by focusing on other P&L drivers.

Sales adjustments were 12% in the quarter, versus 8.5% in the prior year. The increase was driven by additional promotional activities in response to the toy category slowdown in the holiday season. Naturally, this type of investment is intended to lift sales, but, ultimately, we do not know the impact of our efforts until after year-end.

Our reported gross margins for the fourth quarter came in at lower than expected, at 47%, resulting in a full-year gross margin of 46.8%. Elevated sales adjustments, continued ForEx headwinds, and a slightly unfavorable shift in mix directly impacted the fourth quarter gross margin. Also, gross margin was lower since we fell a bit short of our strong internal shipping expectations.

We continued to partially offset these headwinds with strategic pricing and our successful cost savings programs.

As planned, advertising was lower in both absolute dollars and as a percentage of net sales in the fourth quarter and full year, which was consistent with our expectation of 11% to 13% for the full year.

We also remained disciplined with SG&A, as we continue to aggressively reduce cost while balancing strategic investments. For the quarter, adjusted SG&A was down approximately $58 million, or 14%, year over year. For the year, adjusted SG&A of $1.4 billion was down $106.2 million, or 7%.

The majority of the year-over-year SG&A savings came from our continuation of our cost saving programs. The balance of the savings related to our successful efforts to tightly manage our overhead spending. In addition, SG&A was lower due to lower incentive accrual, as we are a pay-for-performance Company. As a reminder, we set aggressive targets at the beginning of the year, including the full absorption of incremental overheads from our first quarter acquisitions of Fuhu and Sproutling, which were not contemplated when we set our original saving targets.

As I said earlier, we achieved savings at the high end of the $250 million to $300 million goal for our two-year "Funding the Future" cost savings program. We delivered approximately $34 million of gross savings in Q4 and $142 million for the full year.

Our tax rate for the full year was 22.4%, including discrete items. The tax rate was slightly higher than we projected at Analyst Day. The tax rate increase is primarily due to a change in the geographical mix of profits and since we fell short of our strong profit expectations.

Finally, adjusted EPS for the fourth quarter was $0.52 and $1.06 per share for the year, compared to the prior year of $0.65 and $1.27, respectively. Currency had a negative impact of $0.10 per share in the quarter and $0.31 for the year.

Now, turning to our balance sheet and cash flow, we ended the year with $680 million of net cash, which was below our expectations primarily due to higher working capital and lower operating results. We also continue to deploy capital in a disciplined manner to manage the business and reward shareholders. As expected, capital expenditures were up slightly, due to investments in tooling, plant automation, and the expansion of our die-cast carve capacity.

Dividends also remained our first priority after reinvesting in the business, with the Board declaring a first quarter dividend of $0.38 per share, which is flat compared to the first quarter of 2016.

Obviously, our 2016 results would require us to reset expectations. We'll provide greater detail to you on key top line and P&L drivers at Toy Fair.

What I can say is we still expect significant revenue momentum to be generated from a variety of areas, with continuing core brand momentum and incremental growth from our entertainment portfolio, which will be one of the strongest slates in years and includes Disney Cars 3, which we expect to generate incremental revenues of about $300 million-plus.

Additionally, we should see some top line benefit from the strategic accelerators Chris discussed at the Analyst Day.

However, the moderately high level of year-end retail inventories will likely reduce our revenues in the first quarter and have less than a 2% impact for the full year of 2017.

We also look to improve margins in 2017. We expect to see lower year-over-year sales adjustments. We look to expand gross margins by leveraging strategic pricing and a new supply chain cost savings initiatives. We'll continue to leverage advertising, especially given a higher concentration of licensed entertainment, and we will continue to tightly manage SG&A.

As discussed at our November Analyst Day, the path to our 15% to 20% operating margin target will not be achieved within a year. Clearly, our 2016 results have created additional challenges, and while we expect to rebuild margins in 2017, it is likely that we'll get back to our operating margin target range in a couple of years.

In terms of cash flow, we expect top line growth and margin expansion as well as disciplined working capital management to generate significant cash flow in 2017. We'll deploy the cash to invest in the business and support the dividend, which continues to be a priority, going forward.

In addition, we'll continue to evaluate strategic partnerships and M&A opportunities that would improve our growth trajectory.

As we look ahead, we remain committed to both the Company's long-term financial objectives, disciplined capital deployment priorities, and we'll use them as guides to manage the business, going forward.

With that, we'll now open the call to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Arpine Kocharyan, UBS Investment Bank.

Arpine Kocharyan - *UBS - Analyst*

Chris, Richard, Kevin, a little bit surprising today. But most importantly, what I'm having a hard time understanding is the disconnect between very strong POS -- your Q4 POS is above expectations -- yet, a very disappointing bottom line result. If you could perhaps --? And I appreciate your detailed explanation on the cadence of what happened in the quarter, but if you could just give a little bit of more detail helping investors understand strong POS versus such a sort of panic promotional activity that happened industry wide in the last -- initially in December?

Was it just driven by not seeing the traction you were expecting to see in the first two, three weeks of December, and then it came out to be more than you expected? Or, the holiday season, over all? Given that you're up mid-single digits on very tough comps year over year, which is even slightly ahead of industry, what happened there? If you could just explain it a little bit more?

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

Arpine, it's Chris. Let me take a crack at it. I think Richard sort of gave you a little bit of the perspective, but if you stand back and look at what happened in the industry in Q4, it slowed fairly significantly and it showed growth of a little under 3% when it had been running over 6% as we led into the quarter.

October and November were moderate growth months, but a little below the expectations, I think, which is what started to create some stress at retail. Then, as we rolled into the first three weeks of December, the category actually went down precipitously, and it was down about 7% for those three weeks. And I think that's when the retail environment became extremely turbulent. We had enormous pressure put back on shipping expectations and forecasts.

And I think we were faced with: Do you react and try to get shipping in and protect that and get your product in for the consumers? Or, do you take it on the chin? And we went through a fairly careful diagnosis of where are we better off and concluded we needed to get product on the shelves and protect the POS momentum.

And that's sort of what happened, and it actually wasn't just the US. The trends in Europe and some of the other developed markets were very, very similar. If you go to NPD, you'll find they tracked actually quite close to what we tracked here. So, it was a fairly broad-based set of circumstances that we were confronting.

The market rebounded dramatically on Christmas week and actually sold about 20% of the quarter sales on that week alone, which is well above what even the historic late sales have been. And that's what basically saved the trends in terms of POS, over all.

But frankly, by then it was too late for the retailers and for all of us. And the good news is that it helped absorb some of the inventory. But the bad news is it came too late to truly affect any further shipments. And also, the discounting had already been sort of heavily underway.

So, unfortunately, it was a fairly ugly end to the end. But as we exit, I think the message was we felt pretty good about protecting our POS. We feel pretty good about where our inventories are, broadly. And now, we just have to kind of move back on and get focused on sort of the 2017 agenda.

Arpine Kocharyan - *UBS - Analyst*

Thank you. I appreciate that. Is there a way to sort of give investors a little bit more clarity on how much of the strong sort of POS was driven by that discounting versus sort of underlying trends and a consumer that dramatically shifted towards the end of the holiday season, which was again very dramatic when you look at the industry data?

And then, I have a quick follow-up question, actually.

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

I can give you sort of my broad sense of it, is that if you looked at the discounting trends for the industry in that period of time, they were pretty precipitous across the board. So, it wasn't a case of us being out there as sort of a solo discounter and propping up our position.

It was basically trying to be competitive in that environment. And if anything, our level of discounting year on year was not as precipitous as the rest of the industry, certainly in the US numbers where we have visibility. So, it clearly was a category issue that was occurring, and I think in that context I think we were as competitive as we could be, but certainly not out of line with what was going on.

Arpine Kocharyan - *UBS - Analyst*

That's very helpful. Thank you. And then, in terms of looking into 2017, you guys have previously given a mid-single-digit top line guidance. Obviously, you'll update at Toy Fair probably in a little bit more detail, but do you have any updates to that guidance?

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

I think we're still in that boxcar, Arpine. So, obviously, you're resetting the base here on a lot of dimensions, but that's what we're working through right now and we'll share with you at Toy Fair. But we still feel very good about sort of the fundamentals underneath and the entertainment properties that we talked about. And certainly, our emerging market focus on China should be quite positive this year.

Arpine Kocharyan - *UBS - Analyst*

Thank you.

Operator

Tim Conder, Wells Fargo Securities.

Tim Conder - *Wells Fargo Securities - Analyst*

Just to follow on a little bit on the prior question here. I think you had said previously regarding 2017 top line outlook -- and granted, Chris, what you just said, that the base bar has been lowered here -- but I think previously you had said somewhere up between mid- and high-single digits. And then, Kevin, in your comment you said you see 2017 being impacted less than 2% for a full year.

So, was that reference point up mid- to high-single digits for year-over-year growth and now you're saying that range comes off less than 2%? Is that the proper way we should hear what you're saying?

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

I think that's probably a fair way to look at it, Tim. We're still confident that we're somewhere in the mid to the up-middle range of growth. But we do have to work off a little bit of inventory in some pockets. That's probably more of a first quarter issue, but obviously it affects full year.

Tim Conder - *Wells Fargo Securities - Analyst*

Right. And I think yourselves and the industry -- yourselves and a major competitor -- had pretty good sell-through last year in Q4, and then you refilled the shelves in Q1. So, you've got kind of the combination of difficult Q1 comps paired with now you've got to pull down some inventory. So, Q1 won't look all that great. But in the whole scheme of things, it's obviously not that important to the full year. Fair?

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

Yes, totally fair. And I would point out we have a fairly big push in Q2 with Cars. So, hopefully that gets trajectories back where they should be.

Tim Conder - *Wells Fargo Securities - Analyst*

Perfect segue into the next question. So, Kevin, you said over $300 million on an incremental basis, one. I think previously you guys had thrown out $350 million. So, just to clarify that?

And then, the incremental -- again, just to make sure we're all on the same understanding here -- that's incremental above what you already did in Cars this year? Or, is that $300 million collective in Cars -- or $350 million -- year over year?

Kevin Farr - *Mattel, Inc. - CFO*

It's off the base currently of 2016. So, it's bigger than just $300 million. And the $350 million to $300 million really is ForEx. As we convert it from a standard to US dollars and the changes in foreign exchange rates post elections, that turns into $300-plus million.

Tim Conder - *Wells Fargo Securities - Analyst*

Okay. Okay. Okay. And then, on the operating margin commentary, I think you -- again, the goal was to approach the low end -- I think was the language you used -- of that 15% to 20% in 2017. And now, you're saying a couple of years. Should we say that's maybe been pushed out a year? Should we look to 2018? Directionally, is that reasonable?

Kevin Farr - *Mattel, Inc. - CFO*

Well, I think what I said in my comments, in my prepared comments, was a couple of years. So, I think prior to that we would say it was 2018, but I think it's more like 2019 now.

Tim Conder - *Wells Fargo Securities - Analyst*

Okay. Okay. And last question. I know this is a little bit of the elephant in the room with the recent announcement. So, I'll put it out there. Should we anticipate that the current management on this call and the new CEO who has been named that that now constitutes the go-forward -- nothing's permanent forever, but for the foreseeable future -- management team outlook?

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

Yes, I think I touched on that, Tim. That's the team. And we have -- I think you've seen a bunch of them at Analyst Day -- we have a very strong team underneath. So, all of that is tracking, and Richard and Kevin are still in the chair. And I will be somewhat involved, I assure you.

Tim Conder - *Wells Fargo Securities - Analyst*

Okay. It seems like a good complementary assembly of talents. Okay. Well, thank you, gentlemen. Appreciate it.

Operator

Greg Badishkanian, Citi.

Greg Badishkanian - *Citi - Analyst*

So, do you think you'll end Q1 with normalized inventory levels? And then, how much do you think the accelerated sales adjustments in Q1, how much will that impact Q1, if at all? And if you think that will continue into second quarter, assuming you have too high inventories entering into the second quarter? So, when will this kind of discontinue, in terms of the promotions, discounts, et cetera?

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

Greg, I think I would expect we'd be in pretty decent shape on inventory as we get through the first quarter, and it's really in pockets. So, this is not a horrendous issue at this point.

But as far as the allowances and discounting, I think we expect that to kind of be back to normalized levels at this point. And remember, a lot of that is actually being used not for pure discounting; it was to help accelerate some shipments. And so, I think that's sort of reached sort of a balance point with the major retailers. And I'd say most of them are fairly comfortable with where they're at right now, and the exit POS certainly helped everybody.

Kevin Farr - *Mattel, Inc. - CFO*

And I'd just like to add on. Sales were below expectations, but our owned inventory is of good quality. We've got mostly good brand POS momentum exiting the year. And we'll work through the extra inventory quickly, and I don't think we have to discount it.

Greg Badishkanian - *Citi - Analyst*

Okay. All right. And which of those categories were the cleanest versus the heaviest? I think I know, but maybe you can just state that for me? (multiple speakers)

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

I think our core brands are really in pretty decent shape. Barbie looks solid, obviously as you'd expect. I think Hot Wheels is in good position.

I think construction was a little bit challenged, and that's probably where some of the inventory is and, frankly, that was probably the most competitive category as we went into December. So, there, we're a little bit long, but I think we've got good programming in place.

Greg Badishkanian - *Citi - Analyst*

Perfect. Thank you very much.

Operator

Felicia Hendrix, Barclays.

Felicia Hendrix - *Barclays - Analyst*

First, I kind of have been confused throughout -- I was confused throughout December kind of watching the NPD data come in. And I understand there was a shift with Hanukkah which kind of threw things, but globally that might not have been as much of an impact.

So, I'm just wondering if you could discuss why you think the toy industry was weaker than expected in December? And then, also, how can we be confident that there isn't a broader toy industry issue here? So, how can we be confident that things can recover in 2017?

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

Good question, Felicia. Let me take a crack, and Richard can jump on it if he'd like. Some of this is -- a lot of this is empirical; some of it's a little bit anecdotal.

But clearly, Star Wars and the overlap of Star Wars was a huge factor in the slowdown as we got into the quarter, and it showed up dramatically on Star Wars related products. I think anecdotally -- and we can't actually get this data -- but we think a lot of foot traffic was brought in in the prior year through things like Star Wars.

We also had a lot of strong industry drivers in 2015. I don't think the slate was nearly as strong in 2016. So, that contributed to it, things like Shopkins and Minions and so forth last year. If you look at the core drivers this year, there weren't many big ones that were drawing in traffic. So, part of the interpretation is that.

And then, I think just the continued trend of shifting later into the December month has been an ongoing phenomenon, but hard to say why it was so dramatic this year. The two extra days of selling at Christmas may have had something to do with it. Clearly, that's where it showed up in POS.

And we think the shift in e-commerce strength was another factor.

Our view is there's not something fundamental going on, because if you sort of look at where we exited on POS for the year, 5% growth for the toy industry is still pretty robust. So, we're going to continue to dig and look at that and, obviously, it's something we need to get smarter about. But I think that's probably about the best we can articulate at this point. Hanukkah was a factor here, certainly, but not everywhere.

Felicia Hendrix - *Barclays - Analyst*

Okay.

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

I would just add to Chris' comments that, complementing the industry that we're in, it continues to reinvent itself and put very good scores on the board in terms of growth. I think there were several years where the question of traditional toys was in play, based on the evolution of technology.

And I think what you've seen -- and, certainly, our efforts of using technology to enable innovation through play and toy is taking shape. There were some incredible hits in the industry. Certainly, we had some, but, over all, the industry had some great hits, complemented by real new innovation.

I think even in our portfolio, entertainment-driven properties, despite the fact that people might be critical of a Superman v. Batman box office, we did spectacular with action figures. And certainly, introducing a new girls brand with DC Super Hero Girls was well received by the market.

And last but not least -- and I can't say it enough -- we have these incredible core assets that cross generations and have been with us for many, many years. And to see Barbie, Hot Wheels, and Fisher-Price all post the kind of resurgence in growth that they did this year leads us to believe in great spades that we are in a good industry and, certainly, innovation prevails.

Felicia Hendrix - *Barclays - Analyst*

Thanks. And for the e-commerce, how much did you guys distribute through e-commerce this holiday period versus last holiday period?

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

I don't think we have published that number, but it was up substantially for us. And it's probably -- I guess I can say -- probably in the high teens as a percentage of our mix.

Felicia Hendrix - *Barclays - Analyst*

Do you know what it is for the industry, over all?

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

I think our performance we feel was probably a little bit stronger on the -- certainly in the US. But I can't give you measures in some of the other markets.

Felicia Hendrix - *Barclays - Analyst*

Okay.

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

We saw a pretty -- it was sort of a low-digit growth throughout the year with the real spike, obviously, toward the end there in the last several days, but not necessarily disproportionate from its historical trend.

Felicia Hendrix - *Barclays - Analyst*

And industry wide, was there a big change, do you think?

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

In e-commerce?

Felicia Hendrix - *Barclays - Analyst*

Yes.

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

We do think it shifted positively, the e-commerce, definitely. But again, off that base, it's not enough to offset what was happening at brick and mortar.

Felicia Hendrix - *Barclays - Analyst*

And then, the high teens, the increase that you had this year, was that off of like a really easy comp for 2015 over --?

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

No. No. No. Actually, I was giving you percentage of the mix, at that number. We probably did a little better than that, Felicia. And we were comping a big number last year in terms of growth.

Felicia Hendrix - *Barclays - Analyst*

Okay. And then, earlier in your comments you said that the issue was industry wide, but your level of discounting wasn't as bad as the industry, over all. Was that --? I just want to make sure I heard that right.

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

I would say -- I don't want to cast too much on the competition. But it was clear that the full industry was discounting quite heavily and maybe a little more precipitously in some cases.

Felicia Hendrix - *Barclays - Analyst*

Okay. And then, can we just --? I'm getting all of these incoming questions about your sales adjustments are up. There was discounting, which was clear. You explained that well. I think everybody gets that. But then, where there's confusion is talking about the POS. So, if you're discounting and there's promotions, wouldn't that benefit your POS? So, how do we think about it in a clean way?

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

I think that's what I was trying to articulate earlier. Clearly, discounting, whether it's through what we're supporting or through retail or whatever, would have an impact on POS. All I would point to is in this environment where it was so pervasive everywhere, I think it's probably more a case of holding your own, would be the way I would phrase it.

Felicia Hendrix - *Barclays - Analyst*

Okay. That's helpful. Final question, just on the dividend. Mattel has definitely gone through harder times and maintained a dividend and came out of that fine. But just wondering how the Board stays comfortable with the current level of the dividend when the chances of covering the dividend has just been potentially pushed out?

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

We've taken a pretty hard look at 2017 and with the expectation of growth in the business and a lot tougher management on working capital, inventory, and things like that. I think we feel at this point reasonably comfortable, Felicia, that we're okay there. And we always reevaluate, but at this point I think we're quite comfortable.

Kevin Farr - *Mattel, Inc. - CFO*

I think the other thing that we've taken into consideration is due to the timing of Cars 3 shipments, we project higher customer collections in the second half of the year, which should result in improved cash flow. And as Chris said, we are going to actively manage inventories. They're higher than our average for five years, and we think we've got an opportunity, really due to investments in IT systems, to really manage that down in 2017.

Felicia Hendrix - *Barclays - Analyst*

Okay. Okay. Thanks.

Operator

Gerrick Johnson, BMO Capital Markets.

Gerrick Johnson - *BMO Capital Markets - Analyst*

Gift cards. They seem to be a bigger portion of holiday sales each year. Can you talk about POS in January and if the shift, say, to gift cards may have pulled some POS into the first quarter from the fourth?

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

I'm not sure I would have that data right now, Gerrick.

Kevin Farr - *Mattel, Inc. - CFO*

I think you could say the last week of December was very strong. So, I assume some of that related to using gift cards. And whether that went into January, we don't have that information at this point in time.

Gerrick Johnson - *BMO Capital Markets - Analyst*

All right. Thank you.

Operator

Linda Bolton-Weiser, B. Riley.

Linda Bolton-Weiser - *B. Riley Caris - Analyst*

I had a question on Barbie, first. It seems that when you talk about the strong POS of, like, Hot Wheels and Barbie, the shipments in of Wheels, the numbers that you're showing, seem to better match the POS numbers that you're quoting. But Barbie, there seems to be a bigger disconnect.

So, is there something about the POS data that you're not -- would Barbie POS be positive and as strong as you're saying in every period? Or, you said in the last month and the last six weeks. But maybe in the last two weeks of the year Barbie POS faltered? Or, is there anything to help us understand better why Barbie seems to be a little bit more of a disconnect?

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

It's Richard. First off, it's important to note that as we close the year of 2016, Barbie POS globally is up double digits and shipping commensurate with that, high-single digits. So, clearly, a successful year for Barbie.

Again, it remains number one global girls property in the world; number three, over all.

And when you look at it, its POS is aligned with shipping. What you do see is -- and you'll recall -- Barbie had a very strong first three quarters and, in fact, in the third quarter shipping actually was higher than POS. And while it was part of the progress of a consistent growth that Barbie had, it did fill the shelves. Retailers were excited about it. And we benefited from that.

Unfortunately, as the industry slowed and retailers delayed the overall additional shipments, that included Barbie. And so, to some extent she was a victim of the same thing that we're talking about in relation to the category, and the volatility that happened at retail increased promotional efforts and, ultimately, delayed shipping.

I can tell you the growth of the brand, over all, has been broad-based. Between the younger girl introduction of Dreamtopia, which was a segment that we went after; the reignite fashion piece of the business, with Fashionista, with different ethnicities and scale; and, ultimately, the prominent I Can Be segment, which is ultimately the marketing platform, all performed really up to and, in some cases, beyond our expectations.

Space has been commensurate with our POS growth, and we saw additional space this year, and we see additional space coming up for 2017. And we are, frankly, very confident in our plans for Barbie in 2017 and beyond, maximizing the momentum that we currently have.

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

I guess I'd just step back and say if you look at the full year, POS and shipping are aligned and it's high-single digits.

Linda Bolton-Weiser - *B. Riley Caris - Analyst*

Okay. Thank you. That's helpful. And then, just getting back to the questioning on online sales, I recently read in a British publication that 36% of toy sales in the UK were online. So, that's quite a bit higher than what we're seeing in the US. So, first of all, can you explain why that is?

And secondly, as the US switches more or shifts even more toward online, how do you think about that sharing responsibility with the retailer? So, if the retailer needs to work harder to be more effective in bricks and mortar, how do you share that cost with them? So, in other words, this holiday season you decided to help them. But how do you think about that in the future? It's not your responsibility. You're not the retailer; you're the supplier. So, maybe you could just kind of talk about that as a longer-term issue?

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

It's Richard. I can't speak to the UK stat that you mentioned. What we can tell you is -- and I think it's fairly well known -- we continue to see the shift into online activity and, in particular, as we mentioned, it had a positive trend the whole year, with a specific spike in the last few weeks and even more specific few days.

What we also do very closely is work with our retailers on their own sites as well as their stores and align the strategies, the product, the pricing, and the promotion to complement. And that will just simply continue.

And we will continue to not only align around them, but specifically build programs and marketing that go after that opportunity while, honestly, driving experiential activity and reasons to, essentially, drive traffic into stores. So, we are traveling down two lanes and, frankly, both are opportunities: we need to enhance retail experiences and create a reason to go to stores, and we also need to continue to build robust programs and marketing that drive the continued trend of people shopping online.

Linda Bolton-Weiser - *B. Riley Caris - Analyst*

Okay. Thank you very much.

Operator

Steph Wissink, Piper Jaffray.

Steph Wissink - *Piper Jaffray - Analyst*

Just a follow-up question on Margo's appointment. Chris, if you could talk a little bit more about how you expect to leverage her tech background? Just some of the enthusiasm around some of her experience?

And then, as it relates to the dividend, I'm curious around some of the capital commitments and how you're thinking about capital flexibility, particularly if you do expect to lean a little bit more into technology, and how to fund some of that innovation?

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

We'll have more time, I guess, Steph, when we see you back at Toy Fair, and Margo will be joining us, actually, on the Analyst Day that we have. So, you'll get a better read on Margo's strengths.

But first and foremost, she is an enormously talented leader and a good strategic leader, which was one of the things we were quite interested in.

Secondly, obviously, her capabilities in the digital world and technology world are extremely important to some of the things that we've started to talk about, whether it's connected toys or CRM or partnerships with some of the online players around the world. I think she'll be pretty instrumental in that. And as you know, we've made some investments in technology. We're kind of working our way into it, but I think she can help us prioritize, streamline, and accelerate those.

So, I think she'll have a huge impact there, but I think she's a keen strategist and brand builder, and so forth. So, I think we'll see benefits on a lot of fronts.

Steph Wissink - *Piper Jaffray - Analyst*

Okay. And then, just one follow, if I could? It hasn't been asked, and I'm curious about the border tax, if there's been any contingency planning kind of behind the scenes? If you can give us an update on internal discussions around what might be your options if that does go into effect?

Kevin Farr - *Mattel, Inc. - CFO*

I think the discussions have been pretty high level so far with regard to that particular tax. So, it's a little early to speculate. My thought process is it looks like, to me, that it would be more appropriate to raise or increase import duties, which currently in the US there aren't any.

So, from a short-term perspective, I don't think there's much we can do, because all of our manufacturing facilities are outside the US. But I think longer term, we're looking at those factories. And we've been doing a lot with regard to automation to take costs out and take people out. And I think over time, if in fact there's a big toll charge to get into the US with imported products, then we have to relook at our manufacturing base and adjust accordingly.

But short term, 90% of the toys are manufactured in China, and it's going to impact the entire industry. So, I think shorter term there's not much we can do about that; longer term, I think we would react to it.

Steph Wissink - *Piper Jaffray - Analyst*

Final one for us is just regarding pricing. I think you had an advantage in 2016, and it sounds like in 2017 you expect a bit of an advantage, as well. Maybe talk a little bit about what categories you're expecting to take some price? And if we should look for overall pricing to lift on some of your core businesses?

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

I don't think we would probably comment on that, Steph, but we carefully look at it every year, and right now we're taking a renewed hard look at it. So, we will be probably finding areas to price strategically. But that would be about all I'd say at this point.

Kevin Farr - *Mattel, Inc. - CFO*

Strategically, I think we look to make sure we price for value, and that's what we would look at if we are taking a price increase, to make sure we keep the consumer value equation correct. So, we will be looking at it on an SKU-by-SKU basis.

Steph Wissink - *Piper Jaffray - Analyst*

Thanks, guys. Very helpful.

Martin Gilkes - *Mattel, Inc. - VP, Corporate Strategy & IR*

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

Operator

Drew Crum, Stifel.

Drew Crum - *Stifel Nicolaus & Co. - Analyst*

I wonder if you guys would be willing to comment on the quarterly cadence of improvement you're anticipating for gross margin as you go through 2017, given the excess inventory that you're dealing with at the beginning of the year? And any comments you have on the outlook for input costs, going into 2017?

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

I don't think we're in a position where we'd be giving any cadence on margins, Drew, but maybe we'll have more to talk about when we see you in a couple of weeks.

I would say on the input cost side there is a little bit of stress right now on resin and packaging and things like that, which we've been dealing with and I think have game plans to offset. On the good news side, there's currency devaluation that's affecting labor. So, I think on balance we're still pretty comfortable with where we are on our manufacturing conversion front.

Drew Crum - *Stifel Nicolaus & Co. - Analyst*

Got it. And then, just one last question. You made a comment that you felt like you had one of the strongest lineups of entertainment properties in years. And obviously, you have Cars 3. Aside from that, what else are you excited about as you think about the portfolio of entertainment IP that you have this year?

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

Our continued partnership with Warner Bros. is one to really compliment. We had a spectacular year with them, not only with Batman v. Superman, but also DC Super Hero Girls. Those brands continue into the next several years with theatricals. Wonder Woman is actually going to be this spring. Justice League is on the docket, as well, which is in our portfolio.

Cars 3, of course we've talked about it and we'll continue to talk about it, but we're incredibly excited about that business in 2017. There are a multitude of other really exciting properties, as well: Fast and Furious from Universal is coming at us, and Nickelodeon continues to have great success in some of their preschool brands.

Without getting into the list that I'm excited to take you through at Toy Fair, what's also really important to note is that we have great pipeline for 2018, as well. Toy Story is on the docket [Correction: Toy Story 4 is slated for 2019], as well as Jurassic, which is an incredible franchise that we are anticipating a great degree of excitement and innovation.

So, I'll share more details around our pipeline for 2017, 2018, and even further down the road, but we are quite confident that this lineup is one of the best ones that we've had in many, many years.

Kevin Farr - *Mattel, Inc. - CFO*

And just to go back to input costs, we are seeing inflation in things like resins and, as Chris said, paper as well as labor in China. So, those things are headwinds. We're trying to work very hard on supply chain initiatives to offset as much of that as we can.

Drew Crum - *Stifel Nicolaus & Co. - Analyst*

And Kevin, the pricing increases you anticipate taking this year, that's enough to offset some of those inflationary pressures?

Kevin Farr - *Mattel, Inc. - CFO*

Yes.

Drew Crum - *Stifel Nicolaus & Co. - Analyst*

Okay. Thanks, guys.

Martin Gilkes - *Mattel, Inc. - VP, Corporate Strategy & IR*

Thank you, all, for joining us today. There will be a replay of this call available beginning at 9:00 p.m. Eastern time. The number to call for the replay is (404) 537-3406, and the passcode is 43079679. Thanks, again.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may all disconnect, and have a wonderful day.
