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MAT - Q3 2016 Mattel Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 reported EPS of \$0.68.



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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Mattel, Incorporated third-quarter 2016 earnings conference call.

(Operator Instructions)

As a reminder, this conference call 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. - Head of IR*

Thank you, Andrea, 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 third-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 selling and administrative expenses, adjusted operating income and loss, adjusted earnings and 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 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. Welcome, everybody. Thanks for joining us today. Now as usual, I will 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, and as Martin pointed out, we'll open things up at the end for any questions that you might have.

So let me begin by saying that in the quarter, we continued to make some very good progress across all of our strategic priorities. We were especially encouraged by the momentum of our top line where our positive consumer takeaway is aligning nicely with shipping. This increases our confidence as we get set for the holiday season and as we look to deliver on our challenging 2016 top-line objectives.

Also encouraging is the fact that our positive top-line results were very broad based. We continue to see real strength in our core brands with Barbie, Fisher-Price, Thomas, and Hot Wheels all growing, and the results also reflected a number of turnaround initiatives at American Girl, including the first full quarter of Wellie Wishers, the initial set of our expanded distribution strategy, and the signing of a new international licensing opportunity.

We also saw some excellent traction in our Toy Box with our Games and Entertainment properties and with MEGA brands. Our geographic performance was also broad based, and we continued to perform especially well in the priority of emerging markets like Russia and China, markets which are setting up extremely well for continued rapid growth.

Finally, I'd like to highlight the effectiveness of our commercial team, which is performing superbly and making some very real gains in space in merchandising and in building broader strategic partnerships with many of our key customers. So on balance, a lot of very good progress and performance which is helping to drive the top line.

Shifting to 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. We've been realizing some very significant supply chain savings and efficiencies. And despite some very aggressive targets, our efforts to streamline and prioritize SG&A spending are also progressing well.

As pointed out previously, the offsets of course continue to be negative foreign exchange and some unfavorable shifts in our brand mix, which have pressured our gross margins. We expect these factors will remain a challenge as we navigate through the balance of the year. Kevin is going to provide a little bit more perspective on this shortly. But to sum, up our third-quarter results provide some very solid momentum as we enter the holiday season, and they reflect encouraging progress across many fronts.

As we look ahead, the picture for the year is largely the same as what we have previously outlined. We have solid top-line momentum that's being aided by great customer support and well developed consumer programs. Additionally, foreign exchange should begin to moderate some, and we'll continue to push through cost savings to offset any mix effects. We'll also be working to achieve our aggressive SG&A cost targets.

Overall, I'd say that our strategies continue to gain 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, emerging market expansion, and our dividend.

While we always have to caution that we have a lot of work ahead with a critical quarter to still execute, I am proud of the progress that we have been making, and I remain very optimistic about the year and our future. Something we hope we'll shed a little bit more light on when we host our analyst day event early next month.



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

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

Thank you, Chris. As Chris mentioned, we are pleased with the quarterly results as we build solid momentum going into the important holiday season. Our work on core brand positioning, refreshed product and marketing, renewed licensing executions, and surgical retail execution globally is obviously paying off. Our third-quarter results clearly demonstrate significant progress on overcoming this year's revenue challenge with worldwide gross sales essentially flat at actual and up 1% in constant currency.

As you know, POS is the true barometer of a brand's success with shipping ultimately aligning to it over time. And our turnaround efforts focusing on consumer demand creation and better global commercial alignment are clearly gaining traction.

Excluding the impact of Disney Princess, global POS continues to be up mid-single digits for the quarter and year to date with solid results across the majority of our brands. And gross sales, excluding Disney Princess, are aligned to POS with sales in constant currency up low-double digits for the quarter and up high-single digits year to date.

Our third-quarter momentum is very broad based reflecting continuing and in some cases accelerating growth across a number of brands, licenses, and geographies. So, let me briefly touch on some specifics starting with our core brands, and let's start with Barbie which continues to exceed our expectations with global POS up in the high teens for the quarter and gross sales in constant currency up 17%. Year-to-date POS is up high-single digits with gross sales in constant currency up 14% reflecting increased retailer confidence in the brand as they restock and expand Barbie's shelf space.

Barbie is playing in an incredibly fast-moving, trend-based business which requires us to be nimble and act like a leader but think like a challenger. We knew going into this year that our Barbie strategies had to work almost perfectly, and so far they have. We're seeing very broad-based performance from the new styling and sculpts in our Fashionistas line to the I Can Be segment that exemplifies the brand's positioning and to our new Dreamtopia line that is capturing the imagination of younger girls.

Now orchestrating all of this simultaneously is quite an accomplishment, and we are particularly pleased with the significant turnaround in our international results. For the quarter, Barbie's international POS was up mid-teens and gross sales in constant currency are up 16%.

Fisher-Price with its renewed emphasis on early childhood development continues to grow with gross sales in constant currency up 8% for the quarter and up 7% year to date. Global POS remains solid with very strong POS internationally.

We continue to build strength in our baby business, especially in key international markets, and we're seeing a nice turnaround on our friends business driven by Nickelodeon. Hot Wheels, which is likely a concern for some of you this quarter given the Star Wars comp, continues to do well with gross sales in constant currency up 3% in the quarter and up 6% year to date. POS trends remain solid with global POS mid-single digits in the quarter and double digits year to date.

Thomas remains strong as we accelerate growth in international markets with global gross sales in constant currency up 6% in the quarter and up 3% year to date. POS remains particularly strong internationally.

And despite its impressive numbers as it does remain a top three fashion doll brand globally, we continue to have our challenges with Monster High. The new DVD that essentially kicks off the reboot of the brand came out recently and is being supported by product offerings that emphasize the core characters and the origin story. We're watching the performance of this brand closely during the holiday period.

And finally, American Girl, where we saw a solid turnaround in the quarter. While we did see solid results from our recent introduction of the Wellie Wishers line and the introduction of our latest historical character Melody, the third-quarter results really reflect the impact of our strategies to expand the brand's distribution. This includes the initial ship-in to support our new exclusive store within a store partnership with Toys R Us, our new retail execution at Kohl's, as well as a new franchise licensing agreement to expand the brand into the Middle East. We're very excited about



all of the strategies now in place to provide new ways for girls and their families to engage with the brand and look to see continued progress in the fourth quarter.

Briefly, moving on to the Toy Box. The key driver in the third quarter here is MEGA with gross sales in constant currency up 6% in the quarter and up 23% year to date, primarily driven by continued international expansion. Separately, continued success with our Warner Brothers DC Universe executions are evidenced by our DC Superhero Girls results and continuing strong demand for our Batman versus Superman products.

And the Toy Box organization has also been busy developing and recently sharing with our retail partners a number of exciting new products that will support the strong lineup of entertainment properties coming out next year, including Wonder Woman, Justice League, and additional content for DC Superhero Girls from Warner Brothers, Universal with Fast and Furious and Minions, and of course Disney with Cars 3.

The third-quarter results provide a glimpse into the power and breadth of our portfolio and how this organization, when properly aligned and given the right resources, can achieve great things. I continue to believe that our success this year will largely be a function of Mattel's ability to overcome a unique and significant revenue gap.

Yes, a number of headwinds remain but we are meeting these head on and moving forward with a lot more confidence and purpose. We will continue to build on our progress and create major new opportunities for growth in 2017 and beyond. I'm looking forward to continuing this discussion in a few weeks here at analyst day at Mattel, and 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. Overall, our third-quarter results met expectations with shipping better aligned with positive POS, which positions us well to execute the fourth quarter and deliver our challenging top-line objectives for the year. We continue to focus on managing the P&L, leveraging sales and POS momentum, and cost savings initiatives to help offset continued ForEx headwinds and short-term mix challenges.

Before going further, I want to remind everybody that unless otherwise noted, I'll be referring to gross sales in constant currency in order to provide better visibility to the underlying top-line trends. And in order to provide more transparency to the fundamentals of the business, I will also reference some adjusted financial results that exclude certain non-recurring 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.

So let's briefly get into some of the details. As Richard said, our third-quarter top-line results demonstrate significant progress. Third-quarter gross sales were up 1% in constant currency, and despite a significant Disney Princess comp, essentially flat on a reported basis. On a year-to-date basis, gross sales are now flat in constant currency and down 3% as reported.

We did see great sales acceleration in the quarter in our Asia-Pacific business. We also saw sequential improvement in our challenging Latin American business along with very strong growth in key emerging markets like China and Russia. And excluding Disney Princess, the underlying trends are even more compelling. Part of the revenue story is due to better commercial execution as we invest with our retail partners to turn the business around.

Sales adjustments were 9.1% in the quarter versus 9.6% in the prior year. Our reported gross margin in the third quarter came in as expected at 48.5%. Though ForEx represented less of a headwind than in the first half of the year, it was still the major driver of the year-on-year decline.

Unfavorable mix was also a headwind as our less accretive businesses continue to grow at a nice clip. We continue to partially offset these headwinds with strategic pricing and our successful cost savings initiatives.

Moving beyond gross margin, much like sales adjustments, our advertising rate was lower in the quarter as we move closer to 12% for the year. And we remain disciplined in SG&A with adjusted SG&A down approximately \$5.2 million or 2% year over year for the quarter. Year-to-date adjusted SG&A was down by \$48.3 million or 5%.

Our continuing efforts to aggressively reduce costs, particularly in SG&A, are reflected in quarterly results and are helping to offset the additional SG&A related to our recent technology acquisitions and increased incentive accrual in the quarter as year to date we are tracking to higher incentive payout as compared to the prior year. 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 Our Future cost savings program. We delivered approximately \$31.4 million in gross savings in Q3 and \$108.3 million year to date. Finally, adjusted EPS for the third quarter was \$0.70 per share or \$0.68 per share as reported.

Now turning to the balance sheet and cash flow. We ended the first nine months of the year with \$297 million of cash, in line with our expectations and about equal to last year as we continue to tightly manage working capital. As expected, we did issue \$350 million of long-term debt in the quarter, which we will use to repay \$300 million of long-term debt maturing in November.

The additional funds will be used for general corporate purposes. The timing of the issuance is a reason why interest expense for the year will be slightly higher than last year. Not surprisingly, owned inventory on our balance sheet was up year over year as we positioned the business to deliver in the fourth quarter.

Finally, we continue to reward our shareholders by deploying capital in a disciplined manner and maintaining the dividend. As expected, capital expenditures were up slightly as we invest in incremental die-cast capacity to support growth in our Hot Wheels business and labor saving automation technologies. And dividends remain our first priority after reinvesting in the business with the Board declaring a fourth-quarter dividend of \$0.38 per share which is flat compared to the fourth quarter of 2015.

Looking ahead as Chris said, as we enter the fourth quarter, we don't see any significant changes to our full-year 2016 outlook. We have a lot of work to do to execute the fourth quarter and our focus remains on delivering operating profit by balancing our top-line and managing the middle of the P&L. As expected, the unfavorable impact of ForEx did lessen in the third quarter, which we believe will continue.

And given our third-quarter results, our revenue outlook has not changed. We've gained confidence with our results to date and believe we are well positioned to meet our challenging 2016 revenue objective of relatively flat net sales in constant currency.

At the same time, we will work hard to achieve a full-year gross margin of about 48.5%. This continues to be an important area of focus as we still face ForEx and mix headwinds but we do expect to be in the range of this target. It means that we need to achieve a fourth-quarter gross margin rate around 51%, which is a challenge, but well within the ranges we have achieved in the past. The sequential improvement in gross margin is supported by incremental volume, improved mix from stronger trends in our girls properties with American Girl, Barbie, and DC Superhero Girls, a smaller Disney Princess impact, and by incremental flow-through from our supply chain and other cost savings initiatives.

Now shifting to the other lines of our P&L, we'll continue to manage both advertising and SG&A to support achieving our operating profit goals. Specifically with advertising, we expect to continue to move to the midpoint of our 11% to 13% guidance. We also expect continued progress on SG&A likely finishing the year closer to the low end of our \$55 million to \$65 million savings range for adjusted SG&A. As a reminder, we set very aggressive targets here at the beginning of the year including the full absorption of incremental overheads from our first-quarter acquisitions of Sproutling and Fuhu, which were not contemplated when we set our original savings targets, and expected higher accrual for incentive compensation assuming we hit our performance targets.

So a lot of tightening and cutting on the cost front as we work hard to achieve a full-year adjusted SG&A of about \$1.4 billion. As an additional note on the P&L, I also wanted to remind you of our tax rate assumptions. While the year-to-date tax rate has been positively impacted by some discrete tax items, we still expect our full-year tax rate including discrete items to be around 21% for 2016 and beyond assuming no changes in current tax laws. Our tax rate including discrete items for the fourth quarter is expected to be about 24%. And finally, we expect our fourth-quarter diluted share count to be slightly above our third quarter of 344 million shares.



Turning to our balance sheet. We expect to end the year within our targeted range of \$800 million to \$1 billion in cash as we will continue to tightly manage our working capital. Looking beyond 2016, we expect to see ongoing brand momentum driven by the rollout of new initiatives, continuing tail winds related to our strategic investments in emerging markets, and benefits related to leveraging the technology acquisitions across our portfolio.

We'll also have a tailwind on top-line revenues from a much more robust entertainment slate including the Cars 3 movie in 2017. As previously stated, we remain diligent in our efforts to approach more normal operating margins of 15% to 20% in 2017 and beyond, and 2018 brings additional revenue and profit growth with tent poles like Toy Story 4 and Jurassic World in our entertainment lineup. I look forward to providing more details at analyst day in a few weeks.

In closing, let me repeat what Chris and Richard have already said. We are very pleased with the progress reflected by our year-to-date results, and while we still have a lot of work to do, we believe we are poised to deliver a solid holiday season and a solid year for our shareholders. We'll now open up the call to questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from the line of Greg Badishkanian with Citi.

Greg Badishkanian - Citigroup - Analyst

Great, thanks. It seems like you've had some pretty consistent POS in that what's called a positive mid-single-digit range excluding Disney. How should we think about fourth quarter and are there any issues that could derail that momentum?

Richard Dickson - Mattel, Inc. - President & COO

Hi, Greg. It's Richard. We're quite pleased obviously with the POS thus far this year, particularly on core brands. We're seeing more traction actually in the international markets accelerate as we had a good run this year in the US, and we continue to be quite confident in our go forward. The commercial group has done a brilliant job executing promotional space, additional advertising, online presence, as well as our own media strategies, which will amp up in the fourth quarter. So we think we're poised to continue the momentum and certainly recognize that this is where the ducks fly if you will, but we're excited about our programming being executed.

Greg Badishkanian - Citigroup - Analyst

And also, there was a press release put out very recently. Maybe, Richard, could you provide some more color on the Toy Box series and maybe that the opportunity for Mattel from a branding or a product sales perspective, what's the opportunity of that series for you?

Richard Dickson - Mattel, Inc. - President & COO

So, we were -- thank you for asking that question, actually. We're very excited about our partnership with ABC to launch what is going to be a new toy show television reality series called the Toy Box in partnership with ABC. It will be an exploration, frankly, of the trials, tribulations, and excitement around what it means to be a toy inventor and, frankly, the entertaining process that most of the world doesn't get to see of what it takes to actually



bring a creative idea to market. So we're really thrilled with the idea of the concept and certainly the details of the show will be revealed as the show gets launched in 2017.

We are at this point in MIPCOM working through our international distribution rollout of the show, and it will air in 2017 as a date will be announced soon. It also is a great opportunity for us to highlight that when we started the division called the Toy Box, we reiterated that it was about invention, creativity, and the idea of sort of a freeflow back to the origins of the Company, and I think the television show named Toy Box is going to do just that and it represents a new platform for us to find great new product and ideas around the world in an entertaining new way for the consumer and the Company.

Greg Badishkanian - *Citigroup - Analyst*

Good. Thank you.

Operator

Thank you. Our next question comes from the line of Arpine Kocharian with UBS Investment Bank.

Arpine Kocharian - *UBS Investment Bank - Analyst*

Thank you. Thanks very much. Richard, I wanted to address Barbie. This comes in above expectations in terms of sort of double-digit growth for the quarter. Just trying to understand how your customers are thinking about the brand heading into Q4. Are you seeing considerable shelf space increase? And then I have a follow-up question on DC Superheroes. If you were to size the opportunity for you in the back half of this year, could you -- anything you could give us in terms of quantifying what that brand could mean this year? And then I have a quick follow-up.

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

Sure, so the first question related to Barbie and the back half here, our shelf space gains in Barbie are commensurate with our performance. With POS and with performance comes additional space assuming you have the retail credibility and relationships to get that space, and we are quite pleased with the increments that we have in the back half, and with the momentum that we had continued to have all year, we're quite confident that we'll be able to maintain this great trend with the Barbie brand. As you also recall, international was a little slow to catch up to the US as we execute much of our program work in the US first, and we're seeing the buildup if you will in reaction of our programming product marketing in international that has had some terrific POS results, frankly, across the world. And we anticipate that that will also continue.

We're most pleased with the three segments that we've been talking about and marketing. The Fashionista collection, which of course has the new sculpts and shapes, the I Can Be segment, which of course is the career aspirational segment of the brand that we focus a lot of advertising to mom on, and as I mentioned Dreamtopia, a new segment to capture younger girls. Not only has the POS has been improved but also our brand equity scores have improved significantly, and in particular, with girls of younger moms -- of younger -- moms of younger girls between the ages of 2-5, we've seen the scores jump significantly as they have enjoyed much of the purposeful play messages that exemplify the brand's positioning statement, so that is the answer to your first question.

As it relates to DC Superhero Girls, we are thrilled with the early reads and in fact, it's shaping up to be one of the big fashion doll brands of the year. The programming in place, the content being rolled out, the additional marketing that Warner Brothers' DC is working on with Mattel ensures, if you will, the consistency of this important new girls franchise, and we believe that it will remain a top five brand fashion doll business for us in the future and we're really quite excited about it. In addition to that, as you know, Wonder Woman is coming out with a movie in the first half of 2017, and there's already a lot of build up around that brand and the implications of that for the entire collection, so we're quite bullish on it.



Arpine Kocharian - *UBS Investment Bank - Analyst*

That's great. Thank you. And then I have a question to the team. Wal-Mart is making some aggressive price investments to generate same-store growth. It seems like part of those dollar reinvestments are going to come from both suppliers and Wal-Mart. This is obviously your largest customer. As we look into 2017, could you frame what this could mean for the toy aisles and for Mattel perhaps? Thank you.

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

Arpine, it's Chris. Wal-Mart continues to be a stellar partner with us. We've been expanding space and merchandising. We're starting to do a lot of experiential things to test that out with them. We are frankly not seeing anything inordinate that's coming out in terms of your questions related to extra economic pressure or whatever. We're actually working quite well in trying to manage the line effectively for margins for both sides, so we have nothing but very good things to say about the partnership and how it's unfolding.

Arpine Kocharian - *UBS Investment Bank - Analyst*

Thank you.

Operator

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

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

Thank you. Just wanted to continue on a little bit, the Barbie International component. Richard, if you alluded to that the international just in general lagged the US as far as you guys looking at wholesale versus retail, and international, correct me if I'm wrong, is 60%, 65% of Barbie. So we're seeing that disproportionately reflected and driving that wholesale. Is that part of the dynamic also here?

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

No, not quite actually. Well, at the percentages you've got right but the catch up in international was really just a function of the ability for us to execute programs a little bit faster in the US. As you recall, again, the three segments that we've really been concentrating on have been Fashionista, which had an early rollout in the US with significant PR and marketing out at which point the international markets have lagged. The I Can Be segment, which had an enormous amount of mom directed marketing, if you recall. That piece of communication rolled out in the US earlier and now is rolling out significantly around the world.

And the last piece, which is Dreamtopia, which is gaining more and more distribution, if you will, from a content perspective in international and getting traction. So all of it has been really timed around programming, and I think that what you're seeing is just the rest of the world catch up to what was the beginning of the trend in the US and now we see a really complete picture of great global momentum for the brand overall.

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

Tim, just a little bit of a follow-up, too, on that. If you look at the numbers, we've actually reached pretty nice equilibrium on Barbie now in the third quarter, and it's being frankly driven by a snapback both in North America and international. So last year, as you know, we were kind of out of balance the other way. I think it's come back, and actually the third quarter was pretty much on the number for POS and shipping in both sets of geographies.

Tim Conder - Wells Fargo Securities, LLC - Analyst

Okay, very helpful. Thank you. Any comment, gentlemen, early on here with American Girl POS? Wellie Wishers is the first full quarter, and then anything very early on here with Toys R Us and Kohl's?

Chris Sinclair - Mattel, Inc. - Chairman & CEO

Tim, I'll take a stab at this, and Richard can jump in. But look, it is early days. I think we're feeling very good about the take on Wellies. That looks like it is helping to build the base. The distribution build has just frankly started through late September in the TRU and Kohl's. Early reads, by the way, certainly very positive on both fronts, but I think a lot will play out over the coming next couple of months. We start the content with Amazon as you know next week, and I think the distribution will be in full force by this month. So right now, a lot of it's kind of a buildup but the underlying business seems to have picked up with the addition of Wellie Wishers.

Tim Conder - Wells Fargo Securities, LLC - Analyst

Okay. Okay. And then more so, Kevin, or whoever wants to take this. As we look to 2017, you've given us some goals that you guys early on are still targeting. That really hasn't changed since the beginning of the year, but if we had to sort of parse between gross margin and SG&A and given that you're going to have the Wonder Woman, given you're going to have Cars 3, would it be fair to say that maybe you'll get a little more leverage on SG&A relative to gross margin as we -- if we look at what's really going to be driving 2017 operating margins on a year-over-year basis 2017 versus 2016?

Kevin Farr - Mattel, Inc. - CFO

Yes, I think that's fair. I think the incremental sales, we've talked about Cars having incremental \$350 million. That will give a scale both on gross margins and SG&A, but I think also with regard to the cost cutting, we're going to continue to lean in to our supply chain as well as into SG&A but I think your conclusion is in the ballpark, yes.

Tim Conder - Wells Fargo Securities, LLC - Analyst

Gentlemen, thank you, and congratulations.

Chris Sinclair - Mattel, Inc. - Chairman & CEO

Thanks, Tim.

Operator

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

Felicia Hendrix - Barclays Capital - Analyst

Hi. Thanks for taking my question. For my first question, I apologize if you already said this but I don't remember hearing it. So did you mention what US point of sales was in the quarter?



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

I think we did for North America.

Felicia Hendrix - *Barclays Capital - Analyst*

I know you said global.

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

It should be in the document, isn't it? But I can tell you the North American number if you exclude Disney Princess, it's up 2%, North America, and down modestly with Disney Princess in there.

Felicia Hendrix - *Barclays Capital - Analyst*

Okay, thank you. So just sticking on the topic of gross margins, and Kevin, you kind of gave color and we could have backed into what you need to be for the fourth quarter and you kind of highlighted that it's challenging. But just given all of the inputs, the puts and takes to get to that number for the fourth quarter taking into consideration there's challenging, I was just wondering how comfortable are you with your full-year gross margin outlook, like what could go wrong.

Kevin Farr - *Mattel, Inc. - CFO*

Yes, I think with regard to we don't control things like ForEx, and there's a lot of moving pieces like mix but when we look at it we feel pretty confident with regard to the 48.5% target, and we're working hard to achieve that and it's difficult to predict but we are working on a lot of the moving pieces including ForEx, mix, and incremental revenues, and we also expect to improve mix from our girls properties, American Girl, Barbie, and Disney or DC Superheroes. There is going to be a smaller impact from Disney Princess, and then we do see incremental flow through from our supply chain and other cost savings initiatives.

Felicia Hendrix - *Barclays Capital - Analyst*

Okay, helpful, thanks. And then just getting to American Girl, I was just trying to understand how the branded on kind of an apples-to-apples basis so ex-Wellie Wishers and ex the new distribution initiatives.

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

Probably just modestly better than it had been trending before you put all of the incremental stuff in there would be a fair way to think about it, Felicia.

Felicia Hendrix - *Barclays Capital - Analyst*

Okay, and --.

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

Some of the Wellie impact is kind of hard to separate out how much is cannibalization but I think that's probably a fair way to look at the thing.



Felicia Hendrix - *Barclays Capital - Analyst*

Okay, and then just finally, and I'm sure you're probably going to talk about this more in your investor day, but I was wondering if you could just give us a road map for the improvement in Monster High. I know it's something you guys have been working on since the transition, but can you just kind of help us understand how to think about that going forward a bit?

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

Sure, Felicia. It's Richard. We've been very transparent in our efforts to get this brand back on the right track, and as I've mentioned many times, our encouragement is really based on engagement that we see with girls having with the brand and, frankly, new consumers coming into the franchise. We have significant web traffic, increasing content viewership, and great brand loyalty. Despite our POS challenges, it still is one of the top fashion doll brands in the world and we are still trying to find that base business. There are a lot of success stories within that mix of business. The Monster High minis are doing very well and some of the new product that we're featuring out is also doing well. There's as I mentioned the DVD, which is the origin story that has refreshed packaging and content that is also included this year.

We recently announced a partnership with Lady Gaga. We're coming out with a new Zomby Gaga and partnered with her to feature a new character within the Monster High franchise. There's actually going to be a music video associated with that character that will debut on Nickelodeon. There's an increased amount of media associated with that piece of content as well as other forms of new engagement that we're pretty confident on. We're taking our best swings at sort of reviving this business. So when you come out here, we'll certainly give you more detail on product and marketing and hopefully share some continued improved results on the franchise.

Felicia Hendrix - *Barclays Capital - Analyst*

Great. That's very helpful. Thank you.

Operator

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

Gerrick Johnson - *BMO Capital Markets - Analyst*

Good afternoon. I have two questions here. First, ForEx impact on gross margin and basis points, please, if you could provide that. And second, are you gaining share? Is your POS keeping up with overall industry growth? The POS is good, but how strong is the industry right now?

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

Let me take the share one, and I'll let Kevin take the margin one. But if you strip out Disney Princess and look at our base performance, we are I would say holding and in some cases gaining share.

Kevin Farr - *Mattel, Inc. - CFO*

And on your second question regarding the gross margin impact of ForEx, the negative impact of ForEx on the year-over-year gross margin rate was about 130 basis points for the quarter, which was significantly less than what we saw in the first half of the year.



Gerrick Johnson - *BMO Capital Markets - Analyst*

Great. Thank you very much.

Operator

Thank you. Our next question comes from the line of Trevor Young with Jefferies.

Trevor Young - *Jefferies & Co. - Analyst*

Hi. Thanks for taking my question. Just to expand on an earlier question actually, could you provide some detail around when you began to ship into Toys R Us and Kohl's for American Girl? Was it midway through the quarter or was it just strictly September after the press release?

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

No, it was September, and probably the back half of September for most of the set up.

Trevor Young - *Jefferies & Co. - Analyst*

Okay, great, and then shifting to free cash flow. It looks like free cash flow year to date hasn't been as strong as last year primarily driven by working capital. Is that mostly on the AR side of things?

Kevin Farr - *Mattel, Inc. - CFO*

It's a little bit on the AR side as well as the inventory. Inventory is up about \$40 million, and again, we continue to work on tightly managing working capital and our accounts payable is actually up, too. So overall, working capital is up but again, we've got a plan as we get through the fourth quarter to tightly manage that and hit our \$800 million to \$1 billion year-end cash targets.

Trevor Young - *Jefferies & Co. - Analyst*

Okay. So kind of performing in line with your expectation so far?

Kevin Farr - *Mattel, Inc. - CFO*

Yes, we're pretty much in line with where we expected to be given that we started the year with \$80 million less in cash. We did have a write-down of cash related to Venezuela devaluation, and again, all that is on track to deliver \$800 million to \$1 billion in cash at year end.

Trevor Young - *Jefferies & Co. - Analyst*

Great. Thanks so much.

Operator

Thank you. Our next question comes from the line of Linda Bolton Weiser with B. Riley.

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

Thanks. So just to stick on the working capital topic, thinking about next year with your higher earnings that we're expecting for next year, you should have better cash flow unless the higher revenue growth is going to require more working capital investment. And then so can you just comment on kind of just in a very rough way what you generally expect on that? And then secondly, can you talk about how you think about prioritizing share repurchase potentially next year versus dividend increase? Thanks.

Kevin Farr - *Mattel, Inc. - CFO*

Yes, I think with regard to cash flow next year, we expect to have cash flow next year that's greater than 2016 as we have incremental revenues and as we approach more normal operating profit margins, so that should exceed the amount that we have to pay the dividends. And then with respect to prioritizing that excess cash flow on share repurchases or other investments in the business, I think again we'll be looking at that at the time we generate the cash and look at what the best alternative is with regard to investing in emerging markets or investing in buying other brands or actually investing in ourselves and buying back our shares.

So we'll make that determination when we get to 2017. That said, I think when you look at increasing the dividend, I think we're really looking to get back into overtime which we think will grow into it that 50% to 60% dividend payout ratio and get our yield back more in line with the best S&P 500 consumer goods companies.

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

Thanks, and then can I ask, a few Christmases ago when you had some misexecution across the Company, one of the issues was that you didn't anticipate the shifting to online sales from bricks and mortar and you didn't strategize correctly and you spent too much on bricks and mortar investment. I think Richard touched on that but what are the specific things you've done to make sure that you are prepared for that continued shift to online purchases of toys?

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

Yes, Linda, I'm not quite sure where the comment was that we over invested in brick and mortar but we've been pretty aggressive for the last year and a half here building up our eCommerce capabilities starting with our own sites as well as setting strategic partnerships with the major operators out there. We've hired some terrific folks in that arena. We're doing I think a stellar job with people like Amazon with some of the big players in China starting to move around with some of our omnichannel folks in Europe and places like that. So I think we're actually doing a great job on the eCommerce side to be honest with you, and we've continued to invest obviously heavily with our brick and mortar customers on building out the business there. We're working with them on their omnichannel efforts as well, so I think we're feeling pretty balanced about it at this point, and I don't think we're feeling we're under or over investing at this stage.

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

Okay, thanks very much.

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

Okay, Linda.

Operator

Thank you. Our next question comes from the line of Mike Swartz with SunTrust.

Mike Swartz - SunTrust Robinson Humphrey - Analyst

Hi, good afternoon, guys. Just wanted to follow up on Monster High. Just maybe from looking at it from another perspective I guess. I'm sorry, not Monster High, American Girl. And just some of the distribution gains there, how should we think about just the shape of the year now that you do have a part of that business going through wholesale and some retail partners? And then secondly, how do you ensure from a cannibalization standpoint that you have your fixed cost structure around your direct or store model in the right place?

Richard Dickson - Mattel, Inc. - President & COO

So our expectations as we've said for American Girl will be a rebound on the core business in the fourth quarter. As we've said, much of the surgical rework of the brand in relation to price architecture, product, marketing, and even in store execution services, and so fourth, really should start to take hold in the back six weeks, eight weeks of the year. Wellie Wishers certainly is a major new introduction on the brand at a price point in particular and a fresh aesthetic appealing to a younger girl. We can't necessarily guarantee that there won't be cannibalization. We're studying the brand and its performance very carefully. At this point, we're pretty pleased with it and we anticipate that we'll continue to get some traction.

As Chris mentioned, a lot of the marketing and new content that we're launching with American Girl is yet to be seen. In fact, this week we've got episodes for Wellie Wishers, Melody, the Girl of the Year character is going to come out the beginning of next week I believe. At the end of November, we have Mary Ellen, which is also another character that Amazon is going to be featuring so we anticipate that sort of in the next couple months, we'll see a nice rebound if you will on the overall franchise. And early days on our brand extension reads but we continue to be pretty excited and pleased not only from a volume perspective but frankly exposing the brand to new audiences in new ways through these partners that have been carefully crafted strategically with the brand group and our retail partners. So we'll have a lot more to update you on the results of course and perhaps when you're out here, we can give you more detail on that at analyst day.

Mike Swartz - SunTrust Robinson Humphrey - Analyst

Thanks Richard, and maybe for Kevin. It looks like you haven't changed your full-year expectations. It gave me a lot of help but most people are looking for. So would that imply that sales in the fourth quarter would be down year over year, and if that's the case, I guess why would that be the case if you have the momentum you have on the POS side of the business?

Kevin Farr - Mattel, Inc. - CFO

Yes, I think what we stated is we expect incremental revenues in the fourth quarter, a little bit higher than historically, too, relative to the third quarter. So that's I think what we've stated here a couple times.

Mike Swartz - SunTrust Robinson Humphrey - Analyst

Okay, thank you.

Operator

Thank you. Our next question comes from the line of Eric Handler with MKM Partners.

Eric Handler - MKM Partners - Analyst

Yes, thanks for taking my question. Two questions for you. First, can you talk about your licensing business a little bit in the sense of how significant is it at this point? How much growth are we seeing year over year, and how high you think you could get with this business? And then secondly, a

number of entertainment publications have listed a Barbie movie for May of next year through Sony, and just wondering. It's been very quiet in terms of everything other than the script. Wondered if you could give some comments on that.

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

Okay. Eric. I'll take the question and my friends here can fill in as they wish. From a licensing perspective, there's really two components to our licensing business. There's certainly the licensing in business, right, which is the Disneys, Universals, Nickelodeons of the world where we make and manufacture and market their toys associated with their properties, and as we've reiterated, that has been a big strategic focus for us to regain relevance in that community, and I think it's evidenced by the recent awards, if you will, of some of those properties mentioned. So we're very, very bullish around our renewed relationships in the entertainment community and then some extending to Microsoft and other forms of partnership that we're getting really pronounced in. And I would say we're projecting significant growth over the next several years in that space.

Then, of course, there's the licensing out business or better known as consumer products where we've over the years enjoyed some great business out of our own brands being licensed out. That business, frankly, is a little bit of a catch-up, if you will, to the core toy business and in particular, the Barbie licensing business, which has generally been a pretty large engine for us of great revenue, margin, and profit, is in catch-up mode, and as we see the brand gain more and more traction and relevance, particularly on the core side, we anticipate and see the traction not too far behind on the Barbie licensing front.

I will say one of the challenges of course we have had in consumer products has been Monster High, and that's been certainly a challenge for us as well, although there's some pretty terrific categories out there that maintain traction and continuity, and we are doing a lot more work in that space as well. Generally speaking, again, during our time of year at Mattel if you join us, we'll certainly add a lot more color to the consumer products business and the strategies that we have moving forward.

Eric Handler - *MKM Partners - Analyst*

Okay, just as a quick follow-up to that before the Barbie movie question, from what you're seeing this year from Barbie, from Thomas, and the other head entertainment properties, how much of the growth has been from the consumer products businesses? Is it pretty negligible or is this something that's really starting to grow significantly?

Kevin Farr - *Mattel, Inc. - CFO*

Yes, I think that it's really being driven by the toy business.

Eric Handler - *MKM Partners - Analyst*

Great.

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

On the last piece which was the Barbie movie question, I think perhaps why you're not hearing anything is because we don't have anything to share as of yet. We continue to work closely with the creative partners at Sony and various other experts in the industry, if you will, to craft what we believe should be an epic Barbie story. When we have further information around what that is and when the release date will be for that movie, we will certainly be excited to share that, but at this point there's no news.



Eric Handler - MKM Partners - Analyst

Thank you.

Martin Gilkes - Mattel, Inc. - Head of IR

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

Operator

Absolutely. Our last question comes from the line of Drew Crum with Stifel.

Drew Crum - Stifel Nicolaus - Analyst

Okay, thanks. Good afternoon, everyone. So, Kevin, can you remind us how Cars and the theatrical release year impacts some of your own vehicle brands like Hot Wheels? And then separately, just a progress update on Brazil. It looks like Latin America was less bad in the third quarter relative to year to date, so is that a function of Brazil getting a little bit better or is it just the overall strength that you're seeing in Mexico? Thanks.

Richard Dickson - Mattel, Inc. - President & COO

Well Drew, I'll start the chat and then Chris can chime in. Do you guys want to take this one?

Chris Sinclair - Mattel, Inc. - Chairman & CEO

Go ahead.

Richard Dickson - Mattel, Inc. - President & COO

Okay, so sorry. The first question associated with Cars. So generally speaking, we see obviously the whole vehicle category driven by a content film like Cars. Hot Wheels in particular has currently great momentum as you know, and the extension of that particular franchise using licenses to drive its relevance has been very successful. We've got some great licenses within Hot Wheels that continue to fuel and drive growth that we anticipate will continue to keep that brand and in that world pretty fresh and exciting. Cars really will bring a lot of attention to the vehicle category generally speaking. It will grow the entire category itself. It will certainly be the dominant voice in the vehicle category, but there's a lot of great brands in vehicles today. Blaze and the Monster Machine from Nickelodeon addresses a younger audience for vehicles, and certainly we have Hot Wheels and now we'll have Cars. So we're really looking at it as a category leader anticipating that the category itself will grow significantly and certainly Cars will be the leader of that trend.

Chris Sinclair - Mattel, Inc. - Chairman & CEO

Drew, let me quickly just hit on your question on Latin America. It's really kind of a combined story. Brazil has gotten a little better. Obviously, the foreign exchange has improved which has helped, and I think some of our programming is stronger at this point, so Brazil is doing a bit better but still challenged. But the rest of the southern cone and Mexico are performing extremely well, so given the scale, they are more than compensating for any of the weakness we still have in Brazil, but essentially all elements are looking better than they did.

Drew Crum - *Stifel Nicolaus - Analyst*

Okay, great. Thanks, guys.

Operator

Thank you. This concludes today's Q&A session. I would now like to turn the call back over to Martin Gilkes for any closing remarks.

Martin Gilkes - *Mattel, Inc. - Head of IR*

Thanks again, everybody, for joining. 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 82398434. Thanks again for participating in today's call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program and you may now disconnect. Everyone have a great day.

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