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EDITED TRANSCRIPT

MAT.OQ - Q3 2021 Mattel Inc Earnings Call

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OVERVIEW:

Co. reported 3Q21 reported net sales of $1.762b, adjusted operating income of $401m, reported EPS of $2.29 and adjusted EPS of $0.84. Expects full-year 2021 constant-currency net sales to grow approx. 15%.

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CORPORATE PARTICIPANTS

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

David Zbojniewicz *Mattel, Inc. - Vice-President IR*

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

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

CONFERENCE CALL PARTICIPANTS

Alok Patel *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

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

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

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

Gerrick Luke Johnson *BMO Capital Markets Equity Research - Senior Toys and Leisure Analyst*

James Andrew Chartier *Monness, Crespi, Hardt & Co., Inc., Research Division - Security Analyst*

Michael Ng *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Stephanie Marie Schiller Wissink *Jefferies LLC, Research Division - Equity Analyst and MD*

Tami Zakaria *JPMorgan Chase & Co, Research Division - Analyst*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Mattel, Inc. Third Quarter 2021 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the call over to David Zbojniewicz, Vice President of Investor Relations. Please go ahead.

David Zbojniewicz - *Mattel, Inc. - Vice-President IR*

Thank you, operator, and good afternoon, everyone. Joining me today are Ynon Kreiz, Mattel's Chairman and Chief Executive Officer; Richard Dickson, Mattel's President and Chief Operating Officer; and Anthony DiSilvestro, Mattel's Chief Financial Officer. As you know, this afternoon, we reported Mattel's 2021 third quarter financial results. We will begin today's call with Ynon and Anthony providing commentary on our results. After which, we will provide some time for Ynon, Richard and Anthony to take your questions.

To help supplement our discussion today, we have provided you with a slide presentation. Our discussion, slide presentation and earnings release may reference non-GAAP financial measures including adjusted gross profit and adjusted gross margin; adjusted other selling and administrative expenses; adjusted operating income or loss; and adjusted operating income or loss margin; adjusted earnings or loss per share, from which we exclude the impact of a $510 million noncash tax benefit associated with releasing valuation allowances on deferred taxes; earnings before interest, taxes, depreciation and amortization, or EBITDA; adjusted EBITDA; free cash flow; free cash flow conversion; leverage ratio; and constant currency.

In addition, we present changes in gross billings, a key performance indicator. Please note that we may refer to gross billings as billings in our presentation and that gross billings figures referenced on this call will be stated in constant currency unless stated otherwise.

Our accompanying slide presentation can be viewed in sync with today's call when you access it through the Investors section of our corporate website, corporate.mattel.com. The information required by Regulation G regarding non-GAAP financial measures as well as information regarding our key performance indicator is included in our earnings release and slide presentation, and both documents are also available in the Investors section of our corporate website.

In the second quarter of 2021, we elected to revise prior periods for certain immaterial out-of-period adjustments, which do not require us to amend previous filings. These adjustments are reflected in our third quarter earnings release and slide presentation and will be reflected in our 2021 third quarter Form 10-Q. These adjustments will also be subsequently updated on the financial history section of our Investor Relations website at a later date.

Before we begin, I'd like to remind you that certain statements made during the call may include forward-looking statements related to the future performance of our business, brands, categories, and product lines. These statements are based on currently available information and assumptions, and they are subject to a number of significant risks and uncertainties that could cause our actual results to differ from those projected in the forward-looking statements, including risks and uncertainties associated with the COVID-19 pandemic. We describe some of these uncertainties in the Risk Factors section of our 2020 annual report on Form 10-K and on our Q2 2021 quarterly report on Form 10-Q, our earnings release and the presentation accompanying this call and other filings we make with the SEC from time to time as well as in other public statements. Mattel does not update forward-looking statements and expressly disclaims any obligation to do so except as required by law.

Now I'd like to turn the call over to Ynon.

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

Welcome, and thank you for joining Mattel's third quarter 2021 earnings call. Before we begin, on behalf of everyone at Mattel, I would like to take a moment to mourn the loss last week of one of the industry's great leaders, Brian Goldner. I had the pleasure of knowing Brian for over 25 years. He was passionate. He was an optimist. He operated with integrity and was a highly respected competitor. He would be greatly missed across our industry and, certainly, by many on this call today. Our thoughts are with his family and team at Hasbro.

Turning to the third quarter results. Mattel continued its strong performance despite ongoing global supply chain disruption, high inflation, and COVID-related lockdowns. The company exceeded expectations with strong consumer demand for our products.

Key highlights for the third quarter as compared to last year are net sales grew 8% as reported and 7% in constant currency. This was the fifth consecutive quarter of year-over-year growth in net sales. Adjusted EBITDA was $463 million, essentially flat. And cash generation continued to improve with free cash flow for the trailing 12 months growing almost 2.5x to $320 million.

Looking at our performance in more detail. Gross billings, as reported, grew 8% versus the prior year and were up 18% versus the third quarter of 2019 pre-COVID. POS grew high-single digits with strength in North America, EMEA, and Latin America more than offsetting the impact of temporary retail closures in several countries in Asia Pacific.

Per The NPD Group, Mattel continued to outpace the industry with global market share gains for the fifth quarter in a row and all regions growing share in the third quarter. Also per NPD, looking at market share by region in the third quarter, Mattel gained 35 basis points in North America, 31 basis points in EMEA, 97 basis points in Latin America and 83 basis points in Australia.

Even as brick and mortar improved, e-commerce also grew and represented more than 25% of our total POS, in line with our strategy to expand in the online retail and e-commerce space.

Our supply chain and commercial organizations were successful in working through global supply chain disruption and closely collaborated with our retail partners in trying to meet consumer demand. The strong performance of our supply chain this year is attributable to our scale, expertise, and flexible model. We anticipated short supply and longer lead times and factor that into our planning with mitigating actions. For example, we expedited procurement of raw materials, pulled forward finished goods production to increase capacity, invested in additional tooling to dual source manufacturing of critical product lines, leveraged our diverse manufacturing footprint to optimize near-shoring of production contracted ocean freight capacity and rates in advance, and secured access to additional ports and shipping lanes. The Mattel playbook is driving consumer demand across multiple categories, and our portfolio strategy is delivering growth overall.

The fourth quarter is off to a good start. We expect to continue growing for the balance of the year, gain market share and have a strong holiday season. Our strength is foundational and broad-based. For the third time this year, we are raising guidance for both revenue and adjusted EBITDA for the full year in 2021 and believe we are well-positioned to achieve our goals in 2022 and 2023.

Turning to third quarter gross billings and POS in constant currency by category versus the prior year. Dolls gross billings was up 3% led by Barbie, Universal's Spirit, and Polly Pocket and aligned with POS. Barbie grew globally, up 3%, with POS up low-single digits. Gross billings was up 26% year-to-date. Per NPD, Dolls continued to gain market share globally, and Barbie remained the #1 Global Dolls property in the third quarter and year-to-date. For the full year, Barbie is expected to grow double digits.

American Girl was flat in the quarter and up 17% year-to-date. American Girl is showing strong results across key metrics and high consumer engagement as we enter the biggest quarter with approximately 50% of sales typically occurring in the fourth quarter. For the full year, we expect American Girl to grow high-single digits.

Vehicles grew 5% led by Hot Wheels. Category POS continued to be strong, up double digits. Hot Wheels gross billings grew 4% and was up 20% year-to-date. Global demand was robust across key segments with POS up double digits. According to NPD, Hot Wheels remains the #1 Vehicle property globally in the third quarter and year-to-date. Hot Wheels is on the road to achieve its fourth consecutive record year of sales.

Infant, Toddler, and Preschool declined 1% in the quarter and was up 8% year-to-date. Category POS was up low-single digits, with particularly strong demand in North America. Fisher-Price Core declined 1%, with POS up mid-single digits. Gross billings was up 9% year-to-date. For the full year, Fisher-Price and Thomas is expected to grow for the first time in five years as the brand's turnaround continues. Per NPD, Mattel continued to grow market share in the Infant, Toddler, and Preschool category, and Fisher-Price was the #1 Infant, Toddler, and Preschool property globally in the third quarter.

Action Figures, Building Sets, Games, and Other, our Challenger categories, together, grew 25%, with exceptional strength in Action Figures and strong growth in Building Sets and Other. POS was up double digits.

Action Figures continued to benefit from very strong demand with growth of more than 50% in the quarter and 76% year-to-date, driven primarily by Jurassic World, Masters of the Universe, and WWE. Building Sets also continued to grow with new offerings and greater distribution driving a double-digit increase for the quarter and 29% year-to-date. Games saw a mid-single digit decline as we lapped high comps a year ago in the search category. POS was up in the quarter led by UNO. And per NPD, UNO continued to be the #1 card game globally. Other, which includes Plush, was up 25%, with expanded products tied to Star Wars and new license offerings driving continued growth. For the full year, our Challenger categories together are expected to grow double digits.

The Mattel team continued to execute on our strategy to improve profitability and accelerate top line growth while also capturing the full value of our IP. While COVID drove industry-wide consumer demand for toys, it has also created significant headwinds and ongoing disruption in global supply chain and retail closures. The short capacity in global supply chain also caused significant inflation in ocean freight, which is impacting profitability. That said, Mattel continued to grow well ahead of the industry for the fifth consecutive quarter, increasing market share in all our core categories, two challenger categories, and all regions in the third quarter and year-to-date, per NPD. We believe that our growth can be mostly attributed to the strength of our brands, quality and breadth of our product, our world-class supply chain, global commercial capabilities, and very effective demand creation in close collaboration with our retail partners. Our restructured organization and Optimizing for Growth program, together with the pricing action announced last quarter, helped mitigate inflationary pressures.

As part of our growth strategy, we are also actively expanding our portfolio of licensed partnerships. We are excited to announce that we have renewed our decade-long partnership with WWE, which we expect will drive growth. We just announced an expansion of our relationship with Disney consumer products, games, and publishing for Disney and Pixar's eagerly anticipated movie Lightyear. This is the origin story of Toy Story's

Buzz Lightyear, and it is expected to be very toyetic. Mattel has the global licensing rights to develop the toy line for the franchise, which is expected to launch at retailers around the world beginning summer 2022.

We continue to make progress on our mid- to long-term strategy to capture the full value of our IP. Mattel Films is actively working on the development of the 13 live action projects announced to date, and Mattel Television has launched eight shows in 2021 with 13 more in production and over 30 in development. During the quarter, Mattel released exciting new content on Netflix, including Barbie, Polly Pocket, two Masters of the Universe series, as well as expanded global distribution for Thomas & Friends across more than 150 countries. Last week, Mattel launched Barbie Radio in partnership with iHeartMedia and Warner Music Group's Arts Music.

In online gaming, we launched the Hot Wheels Unleashed video game on all major consoles to widespread acclaim and announced the release of Mattel163's Skip-Bo mobile game launching next week. This is the third mobile game for Mattel163 joining our popular UNO and Phase 10 mobile games.

During the quarter, we advanced our role as a responsible corporate citizen with the publication of our new citizenship report, including updated environmental, social and governance strategy and goals. Last week, we announced that in 2020, we achieved 97% of recycled or FSC-certified content in the paper and wood fiber using our products and packaging, exceeding our goal of 95%. The Forestry Stewardship Council has honored Mattel with a 2021 Leadership Awards for Excellence. Mattel was also ranked among Forbes World's Best Employers and Best Employers for Women in 2021. We are proud and excited to make so much progress in this important area and continue to focus on our culture and employee well-being.

Given our results year-to-date, strong consumer demand, and expectations for continued growth in the fourth quarter with a strong holiday season, we are raising our full-year guidance. We now expect full-year net sales in constant currency to increase by approximately 15% and adjusted EBITDA to also increase and be in the range of $900 million to $925 million.

Beyond 2021, we reiterate our goals to grow net sales by mid-single digits in constant currency in 2022 and in 2023 and achieve an adjusted operating income margin in the mid-teens by 2023. We also reiterate our expectation to exceed $1 billion in adjusted EBITDA in 2022.

In closing, this was another strong quarter for Mattel with continued consumer demand for our products. We achieved growth and continued to gain market share in spite of significant and unprecedented exogenous challenges. The increased guidance puts Mattel on track to achieve its highest full year growth rate in decades.

The company is on a clear trajectory to improve profitability and accelerate top line growth. Our transformation strategy is working, and we are operating as an IP-driven, high-performing toy company. We remain focused on growing shareholder value and look forward to finishing the year on a high note with a strong holiday season.

Thank you. Anthony, over to you.

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

Thanks, Ynon. As you just heard, this was another strong quarter, with results exceeding expectations despite supply chain and COVID-related disruptions.

Taking a closer look at our results for the third quarter and compared to the prior year. Reported net sales were $1.762 billion compared to $1.636 billion an increase of 8%, reflecting the strength of our portfolio with gains primarily in North America and across most categories globally. Excluding the impact of currency translation, net sales increased 7%.

Adjusted gross margin was 47.8%, declining 280 basis points due to the impact of cost inflation partly offset by the benefit of pricing and cost savings. Adjusted operating income was $401 million compared to $397 million, an improvement of $4 million. On an as-reported basis, EPS was $2.29 per share, including a $510 million noncash tax benefit associated with releasing our valuation allowances on deferred tax assets, reflecting improvements in profitability and future outlook. Adjusted EPS was $0.84 compared to $0.94. The year-over-year comparison is impacted by lower tax rate in the prior year. And adjusted EBITDA was $463 million compared to $465 million. Overall, strong results for the quarter as top line growth and the benefits from our cost savings program and pricing actions offset the impact of cost inflation.

Gross billings increased by 7% in constant currency in the quarter with global POS increasing high-single digits. POS growth outpaced the industry. And per NPD, we again achieved market share gains in each of our four regions.

Looking at gross billings in constant currency by region. North America was up 11% with POS increasing high-single digits driven by growth across the portfolio. EMEA was up 3% with POS increasing high-single digits. Latin America increased 8% with POS increasing by double digits as we further expanded our leadership position in the region. In Asia Pacific, gross billings declined 22% and POS declined roughly half that rate, reflecting the impact of temporary retail closures in several key markets.

At the end of the third quarter, except for the Asia Pacific region, all of the retail outlets that sell our products were open. In the Asia Pacific region, 4% of stores representing 7% of our revenues were closed and together with lower retail traffic, more negatively impacted results. Overall, we delivered growth above expectations despite the impact of supply chain disruption.

Adjusted gross margin declined by 280 basis points to 47.8%. Here is a breakdown of the key drivers. As anticipated, cost inflation had a significant impact of 350 basis points due primarily to increases in materials and logistics. Other factors, including mix, had a negative impact of 140 basis points. And foreign exchange had a negative impact of 70 basis points. On the positive side, pricing had a positive impact of 110 basis points. As we've discussed, we began implementing incremental pricing actions during the third quarter.

The scale benefit driven by our top line growth contributed 90 basis points. Cost savings contributed 80 basis points. In the quarter, Optimizing for Growth delivered $14 million of savings within cost of goods sold.

Moving down the P&L. Advertising expenses were $118 million, an increase of 15%, as we continue to drive demand creation to support POS. Adjusted SG&A expenses were $324 million, a decline of 2%, primarily driven by benefits from our cost savings programs and lower incentive compensation expense.

Adjusted operating income increased 1% to $401 million. The increase was driven by top line growth and lower SG&A, partly offset by a decline in gross margin and higher advertising expenses. Adjusted EBITDA declined by $2 million or less than 1% to $463 million in the quarter and is up 58% year-to-date.

We continue to meaningfully improve our cash flow generation. Cash from operations year-to-date improved by $186 million to a seasonal use of $256 million driven primarily by gains in net income adjusted for the noncash impact of the release of the valuation allowances. Free cash flow year-to-date improved by $153 million driven by gains in cash from operations, partly offset by an increase in capital expenditures of $33 million to support future growth. On a trailing 12-month basis, we continue to make significant progress in improving cash generation. Free cash flow was $320 million, an improvement of $191 million from the prior year driven by higher cash from operations slightly offset by an increase in capital expenditures. As you'll see on the balance sheet, free cash flow has been used to reduce long-term debt.

On a trailing 12-month basis, we converted 33% of our adjusted EBITDA into free cash flow compared to 21% in the prior year. We believe we are well positioned to continue our positive cash flow trends through the fourth quarter and beyond.

Taking a look at our balance sheet. We finished the quarter with a cash balance of $149 million, short-term borrowings of $128 million and long-term debt of $2.57 billion. On a net basis, this compares very favorably to the year-ago quarter in which we had cash of $452 million, short-term borrowings of $400 million and long-term debt of $2.853 billion. The improvement in our net debt position was primarily driven by our free cash flow generation over the trailing 12 months.

The reduction in long-term debt reflects our redemption early in the third quarter of the remaining $275 million principal amount of 6.75% notes due 2025. The incremental debt reduction will lower annualized interest expense by $19 million, which is in addition to the $40 million annualized benefit from the refinancing transaction completed earlier in the year. We continue to expect as reported interest expense to be approximately $255 million for 2021, including $102 million of onetime costs associated with the redemption of the 6.75% notes.

Accounts receivable increased by $112 million to $1.438 billion in line with sales growth. We ended the quarter with an inventory balance of $854 million, up $174 million versus the prior year, primarily due to cost inflation and increases to support future growth. The inflation impact on inventories will negatively impact gross margin in the fourth quarter and into 2022.

Our leverage ratio continues to improve meaningfully. We ended the quarter with a debt to adjusted EBITDA ratio of 2.8x compared to 5.3x a year ago. As we've stated, we remain focused on strengthening the balance sheet and utilizing excess free cash flow to reduce debt and returning to investment-grade metrics, which will provide flexibility to consider other capital allocation strategies in the future.

We continue to make good progress on our Optimizing for Growth program, generating $20 million of savings in the quarter and $69 million year-to-date. We expect to achieve savings of approximately $80 million to $90 million in 2021 and are on track to achieve our total targeted savings of $250 million by 2023, a key driver towards our mid-teens adjusted operating income margin goal by 2023.

As Ynon stated, we are increasing our 2021 net sales in constant currency and adjusted EBITDA guidance relative to the guidance we provided last quarter. We now expect net sales to increase by approximately 15% in constant currency, up from our prior guidance range of 12% to 14%. Full year net sales growth, reflecting the strength of our portfolio, is expected to be driven by Dolls, Vehicles, Action Figures, Infant, Toddler, Preschool, and Building Sets categories. We also forecast full year growth in our three power brands, Barbie, Hot Wheels and Fisher-Price and Thomas as well as American Girl. This net sales guidance reflects our expectation for continued growth in the fourth quarter.

Guidance for gross margin has not changed. We continue to expect adjusted gross margin to decline to a range of 47.6% to 48.1%. The gross margin guidance is impacted by cost inflation, partly offset by savings from our Optimizing for Growth program and pricing actions, including those that we're implementing in the second half. We are increasing guidance for adjusted EBITDA by $25 million to a range of $900 million to $925 million.

As we did last quarter, we are providing guidance for tax expense. On an as reported basis, we now forecast tax expense to be a net benefit in the range of $390 million to $400 million, including the benefit of releasing the valuation allowances and the impact of other tax-related adjustments.

Forecasted capital expenditures are still expected to be approximately $150 million to $175 million, including capacity additions to support growth. The guidance takes into account the anticipated supply chain disruption that we are aware of today but is still subject to any unexpected supply chain disruption, market volatility and other macroeconomic risks and uncertainties.

Looking beyond 2021. We are well positioned to achieve our goals of mid-single-digit net sales growth in constant currency in 2022 and 2023, and an adjusted operating income margin in the mid-teens by 2023 as well as exceed $1 billion in adjusted EBITDA in 2022. We look forward to providing guidance for 2022 on our fourth quarter earnings call.

In closing, this was another strong quarter for Mattel. We are very pleased with our overall financial performance and remain focused on growing shareholder value.

I will now hand it over to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

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

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

So congratulations on the Lightyear license. I'm guessing that was separate from the Toy Story deal. Do you still have an overall Toy Story license? And if we could go back to the last Toy Story movie, I seem to remember expectations of revenue something in excess of $200 million of retail sales. Is that still -- do you think that's a good starting point for Lightyear?

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

Eric, this agreement is separate from what we've done to date. We are not providing specific guidance for this particular partnership. But as we said in the prepared remarks, it is expected to be a very toyetic movie. So it's a meaningful addition to our portfolio.

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

And Eric, it's Richard. We still maintain the origin story of the original Toy Story movies, of which we continue to market and sell products against.

Operator

Your next question comes from the line of Tami Zakaria with JPMorgan Chase.

Tami Zakaria - *JPMorgan Chase & Co, Research Division - Analyst*

So could you provide any color on the POS trends you're seeing quarter-to-date given you're lapping Amazon Prime Day from last year?

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

Sure. This is Anthony. Look, we are off to a strong start in the fourth quarter and look ahead to a strong holiday season.

Tami Zakaria - *JPMorgan Chase & Co, Research Division - Analyst*

Got it. That's helpful. If I could ask one more follow-up. I think Fisher-Price POS was up about mid-single digit in the quarter, but it seems like shipments were down about 1 point. Can you help us understand the gap there?

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

Sure. It's Richard. Despite a decline in gross billings for the first quarter, the POS, as mentioned, remains strong. We grew our market share per NPD. The segments of growth were really Little People, Infant, Newborn, and Imaginext. We saw growth in North America, and the decline in gross billings was primarily attributed to Asia Pacific because of COVID lockdowns. NPD also mentions as well that Fisher-Price is the #1 i=Infant, Toddler, Preschool property globally in the third quarter as well as year-to-date, and we expect growth in the category for 2021.

Operator

Your next question comes from the line of Steph Wissink with Jefferies.

Stephanie Marie Schiller Wissink - *Jefferies LLC, Research Division - Equity Analyst and MD*

Anthony, I think this one might be best for you, but it's a question related to pricing. I think if I jotted it down correctly, you said about 110 basis points of benefit in the third quarter. How should we think about the benefit you expect to see in the fourth quarter? And I think you also mentioned that you expect margins to be down again. So just trying to reconcile benefits from price, both in sales guidance and margins. And then anything you want to help us think through in terms of '22, just the anniversarying of those price increases and how that should factor into our gross margin bridge for '22?

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

Sure. As we said in the remarks, pricing did have a benefit of 110 basis points in Q3, but that does not yet reflect all the incremental pricing actions that we're implementing in the second half. So we should have a greater pricing benefit in Q4. That being said, our gross margin guidance implies a decline of about 300 basis points of gross margin in Q4. Obviously, the biggest driver of that is cost inflation, which we expect to partly offset with the pricing actions we're implementing as well as continued savings from our Optimizing for Growth program.

It's a little early to talk about 2022, and we look forward to providing guidance for '22 on our fourth quarter earnings call. And lastly, I'll just add, I mean, as Ynon stated in the remarks, we do expect to exceed $1 billion of adjusted EBITDA in 2022.

Stephanie Marie Schiller Wissink - *Jefferies LLC, Research Division - Equity Analyst and MD*

Okay. What are you assuming in your sales guidance for the benefits of price in the fourth quarter?

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

We're not going to get specific on the magnitude of the pricing action for competitive reasons, but we are implementing those pricing actions. It's going well. We haven't seen any negative response in terms of consumer purchases, so we'll continue to implement those programs.

Operator

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

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

This is Arpine. You're probably very well aware there's a considerable concern among investors regarding supply chain disruption and what it could mean for the holiday season and primarily, what risks it poses for the first half of the year. Could you spend a few minutes going over the types of contingency measures you have taken to sort of mitigate any unanticipated disruption? And also, if you could detail what percentage of your volume you expect to go through direct import programs in Q4, if you have a sense at this point, which I'm hoping you do.

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

Yes. Arpine, during the third quarter, our supply chain and commercial organizations were very successful in working through global supply chain disruptions. And it's not that we were not impacted, but we did anticipate short supply and longer lead times and factor that into our planning and took very specific mitigating actions. A few -- some of the examples we talk about is how we expedited procurement of raw materials. We pulled forward finished goods production to increase capacity. We invested in more tooling in order to dual source manufacturing of very specific product lines where we expected shortage. We leveraged our scale, our diverse manufacturing footprint to optimize near-shoring of production.

We also contracted ocean freight capacity and rates in advance and secured access to additional ports and shipping lanes, which appears obvious in hindsight, but we were ahead of the game. And this is really where our scale, expertise, and flexible supply chain, the -- all the work we've done over the last 3 years is working to our advantage. And with that, we are ready for a strong holiday season and do what we can to meet the strong demand for our product.

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

And to the second part of your question, we don't really expect to see any material change in the mix of trade and direct import going ahead.

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

Would you say that could be as much as north of 40% of your volume? Could you just like breakdown? I know during the tariff period -- tariff disruption, it could have been as low as 35% and above. But could you kind of give a sense of what that -- where that percentage stands?

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

Yes, Arpine, we're not going to get into that level of detail for competitive reasons.

Operator

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

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

Talk about your experience with Masters of the Universe in terms of product sales. Anything separate from any content revenue recognized from Netflix? And what would be the next marker for this brand? And then I have a follow-up for Anthony.

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

Sure. We're incredibly pleased with the progress and momentum, not only with Masters of the Universe but the entire Action Figure category. I mean we've been consistently growing share in this category all of 2021. We are particularly excited about Masters of the Universe. The relaunch has been going incredibly well. Product is performing. Content is working. During the quarter, we released two series, which we have part two actually of Masters of the Universe revelation that's premiering on Netflix next month.

Our performance in Action Figures really is a great example of the successful execution of our category structure. We've been applying this methodology across our portfolio to existing properties like WWE, Jurassic and Minecraft, and it's really showing up on the scoreboards.

2021, it's been a phenomenal year for Action Figures, of course, with the excitement with Masters of the Universe as Mattel IP, but 2022 is going to be even bigger and better, Jurassic World, Minions. We just renewed our license with WWE. And of course, the expansion of Disney Pixar's Lightyear, we're incredibly excited about the category. And certainly, Masters of the Universe is a prized performed property.

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

And then my follow-up for Anthony. The updated guidance for '21 would imply an adjusted EBIT margin in the low teens range. If my math is correct, kind of 13%, 14%-ish. Does that suggest you're pacing ahead of your goal for the mid-teens threshold by fiscal '23? And does it cause you to rethink that goal with perhaps something higher?

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

Yes. So we are making great progress against our goal of an adjusted mid-teens OI margin by 2023. I'm not going to sit and tell you we're ahead of that. But with the success we're seeing on our Optimizing for Growth program, the scale benefit we're getting from our higher top line, we are well on our way. And I think when we get to our fourth quarter call, we'll be able to provide more specific 2022 guidance then.

Operator

Your next question comes from the line of Gerrick Johnson with BMO Capital Markets.

Gerrick Luke Johnson - *BMO Capital Markets Equity Research - Senior Toys and Leisure Analyst*

I want to talk about gaming for a second. Your Hot Wheels Unleashed game came out to great reviews, which is really cool. Just wondering about the economics of that and if that could be material to you guys and then other digital initiatives behind that like UNO mobile and others.

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

Gerrick, we're not providing specific by project, but the message here is that we are growing our digital gaming activity. It is a strategic priority for us as part of our mid- to long-term strategy to capture the full value of our IP. Given the strength of our catalog, we believe there is significant opportunity for us to grow in digital gaming, increase brand engagement and capture more opportunities outside of the toy aisles. So yes, with that, it was very -- out with very positive reviews.

We also launched another game as part of Mattel163, our mobile gaming platform. This is the third game to come out on our own mobile gaming platform. And with that, you will see additional activity in digital experiences, not just gaming but also NFT and other digital opportunities.

Operator

Your next question comes from the line of Mike Ng with Goldman Sachs.

Michael Ng - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

I just wanted to follow up on an earlier question about supply chain issues. Could you just give us a status update about where some of the biggest supply chain challenges are today and how those challenges may have evolved over the last couple of months? And then separately -- and you talked a little bit about the flexible supply chain as a mitigant. How important is it to own your manufacturing facilities to actually be able to navigate through these supply chain challenges?

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

Right. Michael, so look, the -- I'll start with the second question in that we do believe that owning our own manufacturing, especially in relation to dolls and diecast where we have so much scale. That gives us a competitive advantage in terms of cost, quality and service. We do have the ability to design for -- to do -- to have a strategy -- design for manufacturing, principle to drive down cost, improve quality, increase speed to market and all in all, allowed us to perform so well in control and -- be in control of a key part of the chain.

In terms of challenges, what type of challenges we're seeing? Look, it does -- it's not different from what you're reading and what everyone sees in terms of logistics, short supply on distribution capacity. But as we said earlier, given our scale, given our expertise and how we evolved our supply chain platform to be more nimble, more flexible, be able to mobilize resources and shift manufacturing and distribution where needed, we were able to manage with the disruption. And again, I want to say this is not that we were not impacted. But even with that, we were able to grow our business, capture market share and position the company for growth in the fourth quarter and the holiday season.

Michael Ng - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

And if I could ask a follow-up question on Richard's comments regarding Action Figures. Obviously, a tremendous amount of strength in the quarter, up 50%. Was that primarily Masters of the Universe? I know you mentioned Jurassic World as well. I was just wondering if there was a specific content catalyst or something that you would call out for Jurassic World that drove a lot of strength. And how should we think about Action Figures growth from here on out?

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

Yes. As I mentioned, and very specifically, I think this is really about a portfolio strategy. I mean, clearly, we've got a great portfolio of brands, and the growth is really comprehensive. Jurassic has certainly been a successful partnership for us, and we continue to see great growth. As we mentioned, WWE has been a partner of ours for over a decade. So we're very excited about the renewal, and we've got lots of great plans ahead.

As we look forward, and we recognize our extension with the Disney partnership with Lightyear, we're clearly looking at a continued growth in the category. I mean, as you can see, it's already been a great year for Action Figures. I mentioned as well we've been consistently gaining market share in 2021, and 2022 is going to be an even bigger year. Masters specifically is a great story in relation to our overall strategy, taking IP, unlocking the value, creating a franchise plan, working with content partners, driving toy product, both for adult as well as kid with a consumer product component, and we're really starting to get traction in that strategy. So overall, Action Figures is definitely an exciting category for us.

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

And Michael, I just want to build off on what Richard said in talking about the portfolio and how we run our Action Figures. This is really how we run the entire company. When we shifted to the category structure, the opportunity was to grow our business across all the full portfolio at scale. And the way you do that is through the category management strategy.

If you look at our performance year-to-date, while -- we outgrew the industry growth rate by 1.7x. So this is not just growth relative to our own performance last year. But by industry standard, we grew -- where the industry grew in the third quarter by 6.4%, we actually grew by 11.5%, so well ahead of the industry. And a lot of it is driven by our strategy -- portfolio strategy but of course, execution across the enterprise, including strong performance by our supply chain as well as our commercial organization. And this is where the entire company is working hand in hand to follow our strategy, and you're seeing the results in the numbers.

Operator

Your next question comes from the line of Alok Patel with Berenberg Capital Markets.

Alok Patel - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

So I noted in Q1 that you guys said resin and freight was approximately 15% of COGS. What -- where does that stand today in Q3? And I think you guys also said you were expecting 35% inflation in those two items. What are your expectations for inflation going forward?

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

Yes. I'll take that. Things have gone a little bit worse on the inflation front. We made some adjustments in our Q2 guidance. So those two items, resin, and ocean freight, as you said, they're somewhere around 15% to 20% of our cost base. And our latest estimate is that, on a combined basis, they're increasing by a rate of 50%. So it's a little bit higher than the 35% we talked about earlier. And...

Alok Patel - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Okay. And I had a quick -- go ahead.

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

No. I was just going to add that on a year-to-date basis, we've successfully offset all of that inflation in our gross margin through a combination of pricing, savings from our cost savings program as well as the scale benefit associated with our top line growth.

Alok Patel - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Okay. Great. That actually was going to be my follow-up. I guess one more question. Are you guys taking on any hedging activities to mitigate some of the impact on the margins from these costs?

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

Yes. We have a pretty robust program across a number of commodities through a combination of advanced purchases and through financial hedges, right, to basically lock in for a period of time. So we're delaying the impact, and that gives us some time to make adjustments such as the pricing actions that we're taking in the second half.

Operator

And your last question comes from the line of Jim Chartier with Monness, Crespi, Hardt.

James Andrew Chartier - *Monness, Crespi, Hardt & Co., Inc., Research Division - Security Analyst*

It looks like on the balance sheet, the inventory is pretty well positioned, up over 20% on a two-year basis, which is stronger than your sales growth on a two-year. So just curious how much of that is in transit and maybe delivered late. And then what does your inventory look like at retail at the end of third quarter? And where do you expect it will end the year?

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

Yes. I think there's two parts to the question. Yes, our inventories are up on the balance sheet year-over-year. I think it's about $174 million, and there's two drivers of that. One is the cost inflation I just talked about, and the other part is increases to support future growth.

In terms of retailer inventories, we ended the quarter with retailer inventory levels up mid-single digits in dollars compared to last year but down low to mid-single digits when you look at weeks of supply and when you factor in the recent increases in POS. I think net-net, we believe we are well positioned as we head into the fourth quarter and the holiday season and are working closely with our retail partners.

Operator

That concludes our question-and-answer session for today. I will now turn the call back to our Chairman and CEO, Ynon Kreiz, for final comments.

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

Thank you, operator. Just to say in summary that our third quarter performance shows that we are operating as an IP-driven, high-performing toy company. You are seeing it in the numbers. You're seeing it in the results. And while the industry as a whole has been growing strongly, we have been gaining market share for five consecutive quarters.

There is strong demand for our product. We are entering the fourth quarter with great momentum and are off to a good start towards a strong holiday season. We continue to successfully navigate global supply chain disruption. That -- it is what the industry is facing as a whole. But we are on track to achieve our highest full year growth rate in decades, having just raised our guidance for the third time this year.

We are clearly executing on our strategy to improve profitability and accelerate top line growth and appreciate you following our journey. Thank you for your time. We appreciate all the questions and the interest in Mattel, and we'll be happy to answer more questions off-line. And I'll turn it back to Dave. Thank you, Dave.

David Zbojniewicz - *Mattel, Inc. - Vice-President IR*

Thank you, Ynon, and thank you, everyone, for joining the call today. The replay of this call will be available via webcast and audio beginning at 8:30 p.m. Eastern Time today. The webcast link can be found on our Investor page, or for an audio replay, please dial (404) 537-3406. The passcode is 6941839. Thank you for participating in today's call.

Operator

And this concludes today's conference call. Thank you for participating. You may now disconnect.
