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MAT.OQ - Q2 2021 Mattel Inc Earnings Call

EVENT DATE/TIME: JULY 27, 2021 / 9:00PM GMT

OVERVIEW:

Co. reported 2Q21 reported net sales of $1.026b, adjusted operating income of positive $67m and adjusted EPS of positive $0.03. Expects full-year 2021 constant-currency net sales to grow 12-14%.

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PRESENTATION

Operator

Good day,and thank you for standing by. Welcome to the Mattel, Inc. Second 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 second 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 and loss and adjusted operating income loss margin; adjusted earnings and loss per share; 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.

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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.

We have 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 second quarter earnings release and slide presentation and will be reflected in our 2021 second 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 our Q1 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 to Mattel's Second Quarter 2021 Earnings Call. I hope that you and your families remain safe and healthy.

Mattel had another exceptional quarter as the company significantly improved profitability and accelerated top line growth. Consumer demand for our product was very strong. Mattel had market share gains across all regions in the second quarter per NPD. Key highlights for the second quarter as compared to the same period in the prior year are: net sales were up 40% as reported and 36% in constant currency; adjusted gross margin improved by 370 basis points and reached 47.5%, the 12th consecutive quarter of growing gross margin; and adjusted EBITDA was $131 million, more than 4x the same period last year.

Our tremendous momentum continued with strong double-digit growth in gross billings in each of our 4 regions, double-digit growth across the four reported categories and double-digit growth in our three power brands, Barbie, Hot Wheels and Fisher-Price and Thomas & Friends, as well as double-digit growth for American Girl. This is an exciting time for Mattel. Having successfully completed the heavy lifting of the transformation over the past three years, we are now in growth mode and establishing Mattel as an IP-driven, high-performing toy company.

Taking a broader look at this quarter. As part of our recent performance and continuous significant improvement across key metrics, gross billings grew double digits for the fourth quarter in a row. Total company POS grew double digits for the fourth quarter in a row, and we have achieved positive POS growth for the last five quarters. And global market share also grew for the fourth consecutive quarter according to NPD. Also, according to NPD, Mattel was the largest and fastest-growing of the top 5 toy manufacturers in the U.S. on a year-to-date basis.

Looking at performance by region in the second quarter per NPD. Mattel's growth exceeded the industry by 9 percentage points in the U.S., 11 percentage points in EMEA and 19 percentage points in Latin America.

With more brick-and-mortar stores open in most markets, consumers return to in-person shopping experiences, particularly in regions with lower e-commerce penetration. This is a benefit for Mattel given the breadth of our omnichannel presence, which includes more than 470,000 retail doors. As brick-and-mortar improved, e-commerce POS declined slightly but still represented more than 25% of our total POS, furthering the broad expansion in e-commerce in recent years and reaffirming our strategy to expand in the online retail and e-commerce space. According to NPD, Mattel was again the #1 Prime Day toy manufacturer in the U.S. with twice as many items in the top 20 industry-wide versus last year.

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While we saw strong growth in the quarter, we were also managing through global supply chain challenges and cost inflation. Our supply chain and commercial organizations were able to minimize the disruption and continue to work closely with our retail partners as we aim to meet the significant consumer demand for our products. We also had another quarter of strong cash generation, and we continue to improve our free cash flow conversion.

Looking at second quarter gross billings in constant currency by category versus prior year,it is clear that the Mattel playbook is working across the portfolio.

Dolls grew by an impressive 47%, with strong growth in Barbie, American Girl, Polly Pocket and Universal's Spirit, which launched in June. Dolls POS was strong, up double digits. Barbie continued its incredible performance, growing 41% with POS up double digits. Per NPD, Mattel's Dolls category gained 4.5 share points in the quarter, and Barbie was the #1 global dolls property in the second quarter and year-to-date. American Girl is becoming a playbook success story and now a growth driver for Mattel. American Girl increased 43%, the third consecutive quarter of growth and the second quarter of double-digit growth.

Vehicles increased significantly, up 62%, benefiting from a return to in-store impulse shopping. POS in the category was strong, up double digits. Hot Wheels grew 61%. According to NPD, Hot Wheels continued to build upon strength as the #1 vehicle globally in the second quarter and year-to-date. We are achieving great success in the relaunch of Matchbox as well as strong growth with Disney's CARS.

Infant, Toddler and Preschool was up 12%, driven by Fisher-Price and Thomas & Friends power brand with growth across Little People, infant, newborn and Imaginext. Fisher-Price Core grew 15% with POS down low single digits due to the comparison to the high demand in baby gear last year when families went into quarantine. Per NPD, Fisher-Price continued to be the #1 Infant, Toddler and Preschool property globally and gained share. As expected, Power Wheels was down also due to the comparison to the high quarantine-related demand last year. Thomas & Friends was up 14%.

Action Figures, Building Sets, Games and Other, our challenger categories, together grew 28%. Action Figures was another success story with gross billings more than doubling, driven by Jurassic World, the relaunch of Masters of the Universe and WWE. Building Sets was up double digits, driven by MEGA Bloks and the continued success of Pokémon and Halo. Per NPD, Mattel grew global share in the Action Figures and Building Sets categories in the second quarter and year-to-date. Games declined double digits as we lapped high comps a year ago in this surge category. Per NPD, UNO remains the #1 card game globally. Plush grew double digits, driven by Mattel's product tied to Star Wars and an expanding range of other licensed offerings.

Mattel's performance exceeded expectations as our strategy to improve profitability and accelerate top line growth in the short term continued to show outstanding results on our path to establish Mattel as an IP-driven, high-performing toy company. The Optimizing for Growth program remains on track to deliver on the previously announced goal to achieve savings of $250 million by 2023.

Our strategy is driving growth across Mattel's three power brands as well as key flagship franchises, including American Girl, MEGA, Polly Pocket and UNO. We are leveraging our resources to relaunch iconic catalog IP, including Masters of the Universe, Matchbox and Monster High, where we see significant upside potential. We are also strengthening Mattel's standing as a partner of choice for the major entertainment companies, including Disney, Microsoft, Nickelodeon, Nintendo, Universal, Warner Bros. and WWE, and have licensing agreements for several highly anticipated properties in 2022 and beyond.

Looking at our mid- to long-term strategy. We continue to make progress towards capturing the full value of our IP. Mattel launched its first non-fungible tokens featuring three unique NFTs from the Hot Wheels NFT Garage series that were auctioned on the Mattel Creations collector platform. With the launch, we are creating a new way for innovation and artistry to converge in the toy space, and we'll continue to express our brands in the NFT format as we launch new creations throughout the year.

The animated Masters of the Universe: Revelation series was just released on Netflix last week. And a second series, He-Man and the Masters of the Universe, premieres in the fall. Barbie's next animated special, Big City Big Dreams, will launch on Netflix in September. Polly Pocket is being developed into a live-action motion picture in partnership with MGM, with Lena Dunham writing and directing and Lily Collins starring as Polly

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and also coproducing. This marks our 13th movie in development. We are happy to share that the new Barbie feature movie is greenlit and will go into production in 2022 for a targeted release in 2023. Greta Gerwig is now also confirmed to direct as well as write.

During the quarter, we evolved our citizenship strategy and goals and launched several key initiatives, including Mattel PlayBack, a new toy take-back program to recover and reuse materials from old Mattel toys for future Mattel products; Barbie Loves the Ocean, our first fashion doll line made from recycled, ocean-bound plastic; and the Fisher-Price Safe Start awareness campaign, engaging and educating parents and caregivers on important topics such as safety, health and development of babies and children.

As part of our diversity, equity and inclusion goals, we achieved 100% base pay equity for all employees performing similar work globally. Today, we announced Mattel has been recognized as a 2021 Great Place to Work by the Great Place to Work Institute. We will shortly be publishing a new citizenship report that expands on our strategy and goals in this important area.

The strength of the quarter and comprehensive top line growth is adding momentum to our transformation strategy. As was the case in the first quarter, there was some COVID-related year-over-year benefit this quarter, but we again outpaced the industry and believe our exceptional results are attributable to the strength of our brands and the quality of our execution. This is also evident when comparing this quarter to the second quarter in 2019 before COVID with net sales being higher by 19%.

Given our first half results and expectations for continued growth in the second half of the year, we are now raising our full year guidance for net sales growth in constant currency to be in the range of 12% to 14%. We're also raising our full year guidance for adjusted EBITDA to be between $875 million and $900 million.

As it relates to our stated goals beyond 2021, we are well positioned to achieve mid-single-digit net sales growth in constant currency in 2022 and in 2023 and an adjusted operating income margin in the mid-teens by 2023. With our strong momentum and positive outlook and taking into account what we know today, we expect to exceed $1 billion in adjusted EBITDA in 2022.

Taking a macro view, the industry as a whole is expected to grow in the coming years. Euromonitor has increased their industry forecast again and now estimates a growth rate of 5.4% CAGR over the next five years through 2025. Within this environment, we believe we will outpace the industry and continue to grow our market share.

In closing, this was another exceptional quarter for the company. Our strength is foundational and broad-based, and we believe we are in the strongest position we have been in many years to improve profitability and accelerate top line growth. Mattel is on a growth trajectory. Our multiyear transformation strategy is working, and we are establishing Mattel as an IP-driven, high-performing toy company.

I would like to thank the entire Mattel organization for their outstanding results and our team's ability to drive world-class innovation and creativity across the portfolio. We remain focused on growing long-term shareholder value.

And now I'm happy to turn it over to Anthony to discuss Mattel's financial results. Thank you. Anthony, over to you.

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

Thanks, Ynon. As you just heard, Mattel continued its strong comprehensive performance.

Taking a closer look at our second quarter results relative to the same period in the prior year. Reported net sales were $1.26 billion compared to $732 million, an increase of 40%, driven by strength across the portfolio. On a constant currency basis, net sales increased by 36%. Adjusted gross margin was 47.5%, increasing 370 basis points as the scale benefit of the very strong top line growth more than offset the negative impact of cost inflation.

Adjusted operating income was a positive $67 million compared to a loss of $28 million, an improvement of $94 million. Adjusted EPS was a positive $0.03 compared to a loss of $0.26, an improvement of $0.29. And adjusted EBITDA increased by $102 million or 353% to $131 million.

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Overall, another outstanding quarter with results exceeding expectations. We continue to improve our cash flow performance. And early in the third quarter, we redeemed through a call option the remaining $275 million 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 in the first quarter. As a result, we now expect as-reported interest expense to be approximately $255 million for 2021, including $102 million of one-time costs associated with the redemption of the 6.75% notes.

Looking at gross billings by region. For the fourth consecutive quarter, we achieved growth in each of our four regions in constant currency with strong double-digit growth this quarter. Gross billings outpaced POS growth, reflecting store re-openings and some inventory restocking by retailers after last year's retail shutdowns. Retailer inventory levels increased by double digits in dollars and by mid-single digits in weeks of supply, reflecting the strong POS growth. POS growth outpaced the industry with strong consumer demand across the portfolio.

North America was up 29% with POS increasing high single digits. EMEA was up 54% with POS increasing double digits. Latin America increased 48%, driven by strong performance across markets as stores reopened. POS increased double digits. Asia Pacific increased 29%, driven by growth in Australia, Japan and Southeast Asia. POS increased low single digits.

At the end of the second quarter, 1% of all retail outlets that sell our products, representing 1% of our revenues, were closed. Although almost all stores were open, store traffic continues to be negatively impacted by travel and other local restrictions. In North America and EMEA, all retail outlets were open at the end of the quarter. In Latin America, 1% of stores, representing 5% of our revenues, were closed, while in Asia Pacific, 2% of stores were closed, representing 5% of revenues.

During the quarter, we did experience supply chain disruptions, including shipping container shortages that were exacerbated by a temporary port shutdown in China and temporary plant shutdowns in Asia related to COVID-19 restrictions. These challenges, however, did not have a material impact on our results in the quarter. Adjusted gross margin increased by 370 basis points to 47.5%.

Here is a breakdown of the key drivers. Scale benefit driven by high sales growth contributed 330 basis points. Cost savings contributed 220 basis points. In the quarter, optimizing for growth delivered $21 million of savings within cost of goods sold. Mix and other had a favorable impact of 170 basis points, primarily driven by category and sales mix and lower inventory obsolescence expenses. Cost inflation had a negative impact of 220 basis points, driven by increases in materials and logistics. Foreign exchange, primarily in Latin America, had a negative impact of 120 basis points.

Moving down to P&L. Advertising expenses were $88 million, an increase of 47%, in line with revenue growth. Adjusted SG&A expenses increased by 16% to $333 million, driven by above-target incentive compensation expense expected this year given our strong results, while the prior year included onetime savings related to COVID-19.

We had another quarter of significant improvement in profitability. Adjusted operating income improved by $94 million from a negative $28 million to a positive $67 million. The increase was driven by sales growth and higher adjusted gross margin despite higher inflation, partly offset by increases in advertising and adjusted SG&A. Reflecting the improvement in operating income, our adjusted EBITDA increased by $102 million to $131 million in the quarter.

We continue to meaningfully improve our cash flow generation. Cash from operations year-to-date improved by $225 million to a seasonal use of $241 million, driven primarily by improvements in the net income line. Free cash flow year-to-date improved by $207 million as gains in cash from operations were slightly offset by increased capital expenditures.

Looking at cash flow performance over the trailing 12 months. We are making great progress. Cash from operations increased by $400 million to $510 million. The increase was driven by gains in net income partly offset by higher working capital usage. On a trailing 12-month basis, free cash flow was $374 million compared to a negative $10 million a year ago, an improvement of $384 million.

On a trailing 12-month basis, we converted 39% of our adjusted EBITDA into free cash flow compared to a negative 3% a year ago. We again generated sequential improvement in this key metric after ending the first quarter of 2021 with a free cash flow conversion of 36%.

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We believe we are well positioned to continue our positive cash flow momentum through the balance of 2021 and beyond. We ended the second quarter with a cash balance of $385 million and essentially no short-term borrowings. This compares very favorably to the year-ago quarter in which we had a cash balance of $462 million and short-term borrowings of $400 million. The improvement in cash less short-term borrowings of $323 million was primarily driven by our significant free cash flow generation over the trailing 12 months.

Accounts receivable increased by $134 million to $784 million, reflecting the strong sales growth. We continue to effectively manage our receivables and finished the quarter with a days sales outstanding of 69 days, 11 days below the prior year. We ended the second quarter with an inventory balance of $818 million, up $90 million versus the prior year, primarily due to cost inflation, which will negatively impact gross margin in the second half and as we build inventories to support growth.

We continue to make significant progress on reducing leverage. Our debt to adjusted EBITDA ratio improved meaningfully, declining to just 3x at the end of the second quarter compared to 8.4x a year ago. Early in the third quarter, we redeemed the remaining $275 million of 6.75% notes due in 2025. We remain focused on continuing to pay down debt and returning to investment-grade metrics, which will provide flexibility to consider other shareholder value-creating opportunities in the future.

We are making very good progress on our Optimizing for Growth program, generating $49 million of savings year-to-date. We continue to expect savings of approximately $80 million to $90 million in 2021 and are confident we will achieve our total targeted savings of $250 million by 2023.

As Ynon stated, we are increasing our 2021 net sales and adjusted EBITDA guidance relative to the guidance we provided last quarter. We now forecast net sales for the full year to increase by 12% to 14% in constant currency, almost doubling the growth rate of our prior guidance. Full year net sales growth is expected to be driven by Dolls, Vehicles, Action Figures, Infant, Toddler, Preschool and Building Sets categories. We also expect growth in our 3 power brands, Barbie, Hot Wheels and Fisher-Price and Thomas, as well as American Girl. Our net sales guidance means that we expect growth in the second half.

Guidance for gross margin has not changed since last quarter. We continue to expect adjusted gross margin to decline to a range of 47.6% to 48.1%. Within gross margin, we now expect a slightly higher negative impact from cost inflation than we previously guided due to further increases in ocean freight. This will be partly offset by cost savings and upcoming pricing actions in many of our key markets. The pricing actions will be implemented in the second half of the year.

With that, we are increasing guidance for adjusted EBITDA by $75 million to a range of $875 million to $900 million. Given the forecasted increase in profitability, we are providing guidance for tax expense, which we expect to be in the range of $90 million to $105 million for the year, excluding any unusual items.

Forecasted capital expenditures are now expected to be approximately $150 million to $175 million, above our previous guidance of $125 million to $150 million as we invest in expanding capacity to support future growth. The new guidance takes into account all of the anticipated supply chain disruptions that we are aware of today but is still subject to COVID-19-related impacts, including new unexpected supply chain disruptions, market volatility and other macroeconomic risks and uncertainties.

As Ynon said, beyond 2021, we are well positioned to achieve our goals of mid-single-digit net sales growth in constant currency in 2022 and in 2023 and an adjusted operating income margin in the mid-teens by 2023. With our strong momentum and positive outlook and taking into account what we know today, we expect to exceed $1 billion in adjusted EBITDA in 2022. We look forward to providing more detail at the beginning of next year.

In closing, this was another outstanding quarter for Mattel. We have strong momentum and are pleased to raise guidance as we improve profitability and accelerate top line growth. Beyond the P&L, we are strengthening the balance sheet and making our way back to investment-grade credit metrics. On a personal note, having just completed my first year at Mattel, I cannot be more excited to be where we are and part of a winning team.

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

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Drew Crum with Stifel.

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

POS strong, up double digits, would seem to have lagged, however, the shipment growth that you reported. When would you expect the 2 to align? Or asked differently, what are your expectations for POS growth in the second half?

And then I think separately for Anthony, the free cash flow conversion over the last 12 months at 39%, is that a good number to use for 2021 against your adjusted EBITDA guidance? Or should we assume something higher or different?

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

Okay. Let me address the conversion question first. First, let me say we are very pleased with our free cash flow conversion performance, 39% trailing 12 months and in the second quarter. And that's up from 35% in the first quarter. It's up from 23% for 2020. So we continue to make progress. And as we look ahead, our aim is to continue to improve our free cash flow conversion for several reasons.

One is we'll continue to utilize our free cash flow to reduce debt, which will benefit interest expense. Our cash tax situation is such that we have certain tax attributes that will minimize cash taxes in the near term, and we'll continue to manage capital expenditures appropriately. So for those reasons, we expect this metric to continue to improve over time.

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

On the POS, Drew, the second quarter gross billings outpaced POS growth, reflecting store re-openings and some inventory restocking by retailers after last year's retail shutdowns. Retailer inventory levels increased by double digit in dollars and by mid-single digit in weeks of supply, reflecting the strong POS growth. POS quarter-to-date remains strong. This is the third quarter. We expect growth in the second half of the year, as we said, and are off to a good start in the third quarter.

And just taking a bit of a further look just heading towards the holiday season, we feel great about brand momentum and retail promotional plans for the holiday season, but too early to provide POS projections for that.

Operator

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

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

I was just wondering if you could expand a little bit about your comments about the holiday. How do you expect that to play out? Are there any things that you're doing to get ahead of any supply chain concerns?

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

Yes. Too early to talk about the holiday in detail. But as I said, we do feel very good about our brand momentum and all the plans we have in place right now. We do expect to grow market share and continue to outperform the industry. Our supply chain is a competitive advantage, and we feel that we have the capabilities, the scale to continue to meet together, to work collaboratively with the retail partners to meet the strong consumer demand for our product.

Taking that in combination with our expectation for growth in the second half, we do expect strong growth for the year. We're effectively doubling our guidance right after -- a quarter after we provided 6% to 8% guide in Q1, we're now raising it, effectively doubling the growth expectation. So that should tell you that we do expect to end the year strongly, even with the disruptions that may come our way from -- in relation to COVID.

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

Great. And as a follow-up, I was just wondering if you could talk a little bit more about Wheels and Vehicles. Obviously, an incredibly strong category and brand in the quarter. You did talk a little bit about the strength in impulse shopping as well as the relaunch of Matchbox. Are these sustained tailwinds we might be able to see in the back half?

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

Yes. Thanks, Michael. We delivered, as you can see, extraordinary growth in Vehicles this quarter. I mean gross billings up 61% and growth across all regions. The growth primarily was in our core diecast business. We grew strong double digits in that segment and also incredible growth in Mario Kart, which is a great, strong license for us, as well as Monster Trucks and Hot Wheels City.

As we continue to drive the Vehicle category as its leader, we've talked to you about Matchbox as well and certainly Disney/Pixar Cars rounding out what is the leading Vehicle category in the industry. We're very, very excited about the upcoming innovation that we have as well as content, Legends Tour with Hot Wheels on special events, and we'll continue to accelerate growth in this category.

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, this question is probably best suited for you. It's just related to the middle of the P&L. If I take your gross margin guidance and then drop down to your EBITDA guidance, wondering if you can help us think about advertising and promotion as a percentage of sales and the selling and administrative. It would just imply that you're going to be down quite sharply in dollars. I just want to understand a little bit about brand support and then where you expect some of the savings to be realized in the selling and administrative area?

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

Yes, sure. Let me address that question in the context of our Q2 and then talk about the second half. So SG&A was up a little bit in the second quarter, driven by 2 drivers. One is above-target incentive compensation given our revised outlook for the year. And we're wrapping some onetime benefits last year related to COVID-19.

Advertising was up pretty significantly. Again, that's primarily in line with sales. And I would expect as you look at the second half of the year, right, for advertising as a percent of sales to be fairly consistent relative to the prior year and track with sales.

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I mean the other drivers, if you think about our adjusted EBITDA for the second half, we do expect to be down slightly. And that's a combination of our gross margin being down, driven by an accelerated impact of cost inflation. We ended the second quarter with some inflation impact on the balance sheet, and that will come through the P&L in the second half. But we're looking to offset a good piece of that, right, with savings from our Optimizing for Growth program and some incremental pricing actions that we are now taking in the marketplace that will be implemented in the second half.

And just lastly, I think the way to think about our performance is really on a full year basis. If you take our EBITDA guidance of $875 million to $900 million, that represents growth of 24% to 27%, which is about 2x our top line expectation of 12% to 14%.

Operator

Your next question comes from the line of Arpiné Kocharyan with UBS Investment Research.

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

So you mentioned exceeding $1 billion in adjusted EBITDA in '22. It seems like that is based on kind of mid-single-digit growth on top of double-digit growth in top line this year. Could you go through the puts and takes maybe, Ynon, of what's driving that? And I'm asking for really sort of big picture because top line growing at a double-digit rate this year is a pretty tough comp to offset, whether it's the entertainment calendar, new launches picking up like Monster High, Jurassic World. You've done incredibly well with that license. Just if you could break down what you think could drive that would be helpful. And then I have a very quick follow-up.

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

Yes, sure, Arpiné. So we're saying exceed the $1 billion EBITDA. This is more directional. We're not saying exactly $1 billion EBITDA. We're saying we will exceed it just to give you a sense of where we are heading. And we didn't provide a breakdown. We'll obviously give a much more detailed guidance at the start of the year.

But if you look at the growth drivers for the company for next year and beyond, we actually have several exciting opportunities and growth engines starting with the power brands that are doing so well right now, Barbie and Hot Wheels that are just growing at a tremendous pace. You see strong performance from flagship franchises like UNO, Polly Pocket, Monster Trucks and even the new white space like Plush.

You are seeing very positive momentum with the turnaround brands that are now growing and becoming growth drivers for the company, American Girl, Fisher-Price, Thomas & Friends and MEGA. There's also the 3 new catalog IP that we are relaunching, Masters of the Universe, Monster High and Matchbox, that have such incredible potential with a built-in fan base and obviously the expanding partnerships that we have with the entertainment companies.

So this is just in the core business before you talk about new innovation, e-commerce or the IP strategy. So there are a lot of growth drivers, a lot of opportunities ahead of us. And tracking the momentum we are seeing, we're very confident in saying that we will exceed $1 billion of EBITDA in 2022.

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

That's very helpful. And then a quick follow-up on -- are you able to share the extent of pricing action that you have taken to mitigate some of the cost pressures? And when they take full effect, I would appreciate any detail there in some of our conversations with the trade we picked up. And you were from 8% to 10% in some core brands that were very, very surprising to us. So any detail you could provide there would be very helpful.

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

Yes. We're not providing a specific breakdown, but the pricing actions will be implemented in the second half of the year. They were not -- you didn't see any impact in the second quarter obviously. And it is our expectation that the combination of pricing and our Optimizing for Growth savings will more than exceed the impact of cost inflation over time.

Operator

Your next question comes from the line of Linda Bolton-Weiser with D.A. Davidson.

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

I was wondering if you could talk about the timing of when you might make decisions given your improved cash flow regarding potential dividend or share repurchase. Just kind of the rough timing of when you might be talking more about that.

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

Yes, sure. I can address that. I think first and foremost, we feel really good about our recent performance with respect to cash flow. We are growing our EBITDA. We are converting a higher percentage of that into free cash flow. We're using that free cash flow in the near term to reduce debt, as evidenced by the redemption of the remaining $275 million of the 6.75% in the third quarter. Both that EBITDA improvement and the free cash flow to reduce debt is resulting in improving credit metrics.

So we're down to 3.0x debt to adjusted EBITDA as of the end of the second quarter, and we're making our way back towards those investment-grade metrics. And when we get there, this will provide us good flexibility to consider other shareholder value-creating opportunities in the future. I don't have specifics to share with you, but we are well on our way.

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

Great. And then I think you mentioned in your commentary that you view supply chain as a competitive advantage. I mean is that -- can you elaborate on that? Is that just referring to the idea that you actually own a fair number of your own plants? And can you update us on your manufacturing footprint reduction and kind of where you are in that process?

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

Sure, Linda. So we, as you know, restructured supply chain and made several changes, not just how we make product but the entire process and setup. We simplified the operation. We closed 4 plants. We reduced the number of items that we make, those -- the items that were not productive, and overall turned our supply chain to be a real driver not just in, again, cost reduction but actually driving our top line and helping us grow the business.

The -- in spite of the disruption in the second quarter, and there were disruptions, we had no material impact on our results. And this is because of our capabilities, our scale and how we run our supply chain. We expect that to continue to improve and get even better. And we believe that this is one of the advantages that we have over any other player in the industry. It is a combination of some of the factories that we own as well as how we work with third-party suppliers and other vendors.

But on the whole, we view supply chain as a business partner. It's not a cost center. It's not a service center. It's a business partner to the rest of the organization and is really making a difference and a positive impact on the overall enterprise.

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Operator

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

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

Great. My questions are similarly along the lines of what Linda was asking, but I was hoping you could talk a little bit more about the tactics, the specific tactics maybe you've been using to mitigate some of the shipping challenges and what you plan to do when we get to a heavy shipping season upcoming here. And similarly, your diversified manufacturing base across geographies, do you have built-in redundancies to mitigate geographic risk? And -- yes, we'll leave it at that. So how are you doing it? That's the question.

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

Look, the -- I'll give you a couple of examples. When it came to -- hi, Gerrick, sorry, I should have said hi first. But in terms of container shortage, we've been managing through that for multiple quarters now. And given our scale and relationships with suppliers, we've been able to minimize that impact.

There were temporary plant shutdowns that we've experienced with some intermittent cases over the past year due to COVID-related disruptions, and we were able to manage through that as well. We have the ability to leverage resources and mobilize resources where needed with the ability to restart plants quickly. And given the geographic diversity of our manufacturing footprint, we've been able to minimize the impact.

And another dimension would be labor shortage. Same thing. We've been able to mitigate for that for multiple quarters now by mobilizing resources and leverage capabilities where we have them given that we work in multiple places and again -- and own some factories with -- that operate at a very high level of productivity.

So this is just to give you a bit of a feel. I should say that we still foresee continuing supply chain challenges for the rest of the year, but we have factored them into our plans. And the new guidance does take into account all of the anticipated supply chain disruptions that we are aware of today. Of course, there could be still unanticipated supply chain challenges, and it's hard to tell what the future may hold, but we have proven that we have the ability to manage through major disruptions given our scale and capabilities, as was the case during the pandemic last year. And with all of the expected disruptions that we are anticipating, we still expect to grow a healthy double-digit 12% to 14% in net sales for the year.

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

Okay. And can I ask Richard a question?

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

Of course.

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

Sure, Gerrick. I'm right here.

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

Richard, so your reaction to Masters of the Universe: Revelation. You are #6 on Netflix. I think it was #2 for kids. Are there any metrics you could share in terms of viewers? And how was the performance versus your expectations?

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

Well, Gerrick, first off, we were actually #1 in ranking on the kids' series in the U.S. in its first weekend.

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

Sorry about that.

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

Yes. It's favorable for us. And we were also a top 5 series on Netflix in 20 markets. We were top 10 in 55 markets. Those include ranking #4 in the U.S., #1 in Brazil, #2 in Germany. All of this in the first weekend. We're really very, very pleased with the beginning of this and excited about the continuation of the momentum on Masters of the Universe in a variety of different ways.

Action Figures has been a great success story for us overall. We talked about gross billings more than doubling, innovation with Jurassic and WWE, but really very, very happy with the relaunch of Masters. And as we move forward, we're also looking forward to the next series as well that will start in the fall. He-Man and Masters of the Universe premiers in the fall, and that's actually geared towards kids. So, so far, so good and momentum building.

Operator

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

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

My first question is, are you seeing any benefit in your POS from the Child Tax Credit payments that started hitting accounts from mid-July?

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

Tami, yes, we do believe the credit are having a positive impact on consumer demand. This is, by the way, in some cases, also happening in other countries. That said, the toy industry proved its resilience yet again in the second quarter not because of those stimulus checks but just given the fundamentals of the category, the importance of physical play. And it continues to be a strategic category for retailers.

So it's great to see a positive impact, but we're not dependent on that. The industry is not dependent on that. And the healthy fundamentals of the toy industry as a whole is very much strong and in a good place.

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

Got it. That's super helpful. So I think that's a perfect segue to my second question. I think your updated full year guidance, revenue guidance sort of embeds like a 1 percentage growth in the back half, if I -- my back-of-the-envelope math is correct. So is that expectation not conservative given the 2-year stacks you've been holding in the first half and then you have stimulus money coming in. And there's a lot of momentum in your brand. So why is the back half expectation not better than what you just guided to?

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

Tami, it's Anthony. Let me comment on that. I think first and foremost, our guidance -- with our guidance, we do expect growth in the second half of 2021. And I think it's important to remember, that's on top of the double-digit growth in the second half of last year. We're off to a good start to the second half, and we've seen strong POS growth. As Ynon said, we feel really good about our brand momentum and our promotional plans for the holiday season and expect to grow market share and continue to outperform the industry.

And in the broader context of the full year, I mean, our net sales growth guidance in constant currency is now 12% to 14%. So strong double digits, right? And we're wrapping a year that had some anomalies around the quarterly phasing with double-digit declines in the first half of 2020 followed by double-digit increases in the second.

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

And Tami, I would just add that we don't manage the company quarter-by-quarter but take a full year view as part of our long-range outlook. And while the first half growth is higher than the second half, the expected full year performance is very strong and clearly points to a growth trajectory. And that's how we are thinking about the momentum.

Operator

Your next question comes from the line of Shawn Collins with Citigroup.

Shawn Michael Collins - *Citigroup Inc., Research Division - VP*

My question is sort of a follow-up on the relaunch of the Masters of the Universe on Netflix this weekend. I certainly watched it, and I enjoyed it greatly. And I wanted to ask if you could talk about the rollout of the associated toys such as He-Man, Skeletor, Teela in stores. I think Target is a key partner in this effort, but any color would be interesting.

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

Well, we have -- first of all, thank you for watching and appreciating it. We're excited about it as well. And there are toys in the marketplace with all of our major retail partners, including, of course, as you mentioned, Target, Walmart and a variety of other places that you can find Action Figures, playsets and other licensed products associated with the property. As we continue to gain momentum and as our fall product rolls out, you'll see more and more product and lots of excitement around innovative ways that we will be merchandising as well as retail promotions to support the content.

Operator

Your last question comes from the line of Greg Badishkanian with Wolfe Research.

Frederick Charles Wightman - *Wolfe Research, LLC - Research Analyst*

It's Fred Wightman on for Greg. Just quickly, could you dig into the gross margin guidance staying unchanged despite the higher top line outlook? You mentioned some higher cost inflation. I think you talked about 300 basis points of headwinds from transportation and resins previously. Where is that figure now? And why wouldn't we expect to see at least some benefit from the incremental pricing that you touched on, too?

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

Yes, I can take that one. Let me address that. Our full year guidance, as I said, for gross margin has not changed since the last quarter. We continue to expect to be in that range of 47.6% to 48.1%. And I think it's important to remember that the first half gross margin benefited from a significant fixed cost absorption benefit, which we do not expect will continue into the second half. Within gross margin, what's changed is we now expect a slightly higher negative impact from cost inflation than we previously guided, and that's due to ocean freight.

And also, we expect that inflation to impact our second half results much more than the first half, driven by a couple of factors. One is the inflation rate has trended upward as we enter the peak production season. And also, as I mentioned earlier, our existing inventory at the end of the second quarter on the balance sheet did have a higher level of inflation inside of it, and that will come through the P&L in the second half. And against that, the inflation impact will be partly offset by cost savings.

We're making great progress on our Optimizing for Growth program. And we'll also benefit from the upcoming pricing actions across a number of our key markets that we're implementing in the second half of the year. And again, as I said earlier, despite the inflation impact on gross margin, we continue to improve profitability with adjusted EBITDA expected to grow at 2x the rate of our top line.

Operator

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

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

Thank you, operator. This is another exciting time for Mattel. We exceeded expectations with another exceptional quarter and strong consumer demand for our product. We significantly outperformed the industry and grew market share in each region per NPD. As we heard today, the Mattel playbook is working across the portfolio. We believe we are in the strongest position we have been in many years to improve profitability and accelerate top line growth as we establish Mattel as an IP-driven, high-performing toy company. We appreciate your interest, and thank you for following our story.

And now I will turn the call 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 in our Investor page. Or for an audio replay, please dial 1 (404) 537-3406. The passcode is 3897244. Thank you for participating in today's call.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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