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MAT.OQ - Q4 2020 Mattel Inc Earnings Call

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OVERVIEW:

Co. reported 2020 net sales of $4.584b, adjusted operating income of $448m and adjusted EPS of $0.54. 4Q20 net sales were $1.626b, adjusted operating income was $205m and adjusted EPS was $0.40. Expects 2021 net sales in constant currency to grow by mid-single-digit percentage.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Mattel, Inc. Fourth Quarter 2020 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

It is now my pleasure to introduce Vice President of Investor Relations, David Zbojniewicz.

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 2020 full year and fourth 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 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 margin; adjusted earnings and loss per share; earnings before interest, taxes, depreciation and amortization, or EBITDA; adjusted EBITDA; free cash flow; leverage ratio; and constant currency. Please note, going forward, references to revenues, sales, top line and other similar terms will be only in net sales terms.

We have also introduced a gross billings metric, which is directly comparable to the term gross sales that we used in prior quarters. This change has been made to clearly distinguish our revenue reported for GAAP purposes and the gross billings metric. Gross billings represent amounts invoiced to customers. It does not include the impact of sales adjustments such as trade discounts and other allowances. Mattel presents changes in gross billings as a metric for comparing its aggregate, categorical, brand and geographic results to highlight significant trends in Mattel's business. Changes in gross billings are discussed because while Mattel records the details of such sales adjustments in its financial accounting systems at the time of sale, such sales adjustments are generally not associated with categories, brands or individual products. Please also note that we 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.

In addition, please note that 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 is included in our earnings release and slide presentation, and both documents are also available in the Investors section of our corporate website.

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 2019 annual report on Form 10-K, our Q3 2020 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*

Thank you for joining Mattel's fourth quarter and full year 2020 earnings call. I hope that you and your families are staying healthy and safe. This was an exceptional quarter driven by strong consumer demand, capping an extraordinary year for Mattel. In the midst of a pandemic and very challenging market conditions, our results exceeded expectations with another major upswing in top line and a significant increase in profitability as we gained global market share and continued to transform Mattel into an IP-driven, high-performing toy company.

The fourth quarter and full year demonstrated the resilience of the toy industry and the priority that parents place on quality toys, trusted brands and purposeful play. At Mattel, we have been particularly proud to see children and families choosing our products again and again.

Here are some key highlights for the fourth quarter compared to prior year. Net sales grew 10% as reported and in constant currency, the highest fourth quarter growth rate in 15 years. Adjusted gross margin improved significantly and reached 51.4%, the 10th consecutive quarter of improvement on a year-over-year basis. Adjusted operating income increased 88% and adjusted EBITDA increased 53%.

In spite of a difficult first half, 2020 ended up being another milestone year for the company as we further advanced our transformation strategy. Here are some key highlights for the full year compared to 2019. Net sales grew by 2% as reported and by 3% in constant currency. This was the second consecutive year of growth in constant currency. Adjusted gross margin was 49.1%, an improvement of 420 basis points. Adjusted operating income was $448 million, the highest in 4 years, increasing more than 2.5x over last year. Adjusted EBITDA was $719 million, increasing by 59%. Free cash flow was $167 million, an improvement of $102 million. And we gained global market share for the full year per NPD.

Our momentum was driven by the quality and breadth of our product offering, enduring strength of our brands, highly efficient supply chain, world-class commercial capabilities and very effective demand creation in close collaboration with our retail partners. The continuous improvement in our performance puts us in a strong position from which we believe we can accelerate our growth.

Looking at the fourth quarter results in constant currency in more detail. For the second quarter in a row, we achieved double-digit growth, outpaced the industry and gained market share on a global basis. We achieved revenue growth in each of our 4 regions with particularly strong performance in North America and EMEA. Gross billings increased in 6 of the 7 categories with particularly strong gains in Dolls and Vehicles, notable growth in Infant, Toddler, and Preschool, and we also had a strong positive quarter for American Girl. Total company POS momentum remained strong throughout the quarter, increasing double digits and continuing to outpace billings. We also delivered continued strong growth in online retail and e-commerce as we accelerate our business in these channels. And our supply chain performed very well in fulfilling more of the extraordinary growth in consumer demand than expected.

Looking at the fourth quarter gross billings in constant currency by category. We delivered strong performance across the portfolio with growth across all categories where we are a global leader: Dolls, Vehicles and Infant, Toddler, and Preschool; and in 3 of the 4 categories where we are a challenger: Games, Building Sets and Other.

Dolls' category gross billings grew by 13% driven by continued strength in Barbie and growth in American Girl. POS remained strong, more than doubling our growth in billings. Barbie gross billings were up 18% as momentum in this power brand continued to be very strong. Barbie POS was up more than 30% driven by product innovation, cultural relevance and very effective demand creation. Per NPD, for both the fourth quarter and full year in 2020, Barbie was the #1 overall toy property globally. And the Barbie Dreamhouse was the #1 toy in the U.S. for both the fourth quarter and the full year. It is exciting to see Barbie go from strength to strength as this incredible flagship franchise continues to inspire consumers around the world.

American Girl gross billings were up 9%. This was the first quarter of year-over-year growth in 4 years. This growth was achieved in spite of COVID-19 retail-related disruptions, including a large drop in overall tourist traffic to our flagship stores and the permanent closure of 4 retail stores. American Girl direct-to-consumer business continued to strengthen and more than compensated for the reduction in the retail business with growth in new customer activations, average order value and conversion rates. For the quarter, direct-to-consumer represented more than 75% of gross billings. These results are a significant achievement especially in a quarter that represents more than 50% of the brand's full year billings, which speaks to the successful progress of the turnaround of this iconic franchise as it continues to gain momentum.

Vehicles category gross billings also increased, up 12% for the quarter, driven by the strong performance of Hot Wheels and Matchbox. POS in the category remained strong, up double digits and aligned with billings. Hot Wheels gross billings were up 14% with broad-based growth across all product segments. Per NPD, Hot Wheels remained the #1 vehicles property globally in both the fourth quarter and the full year, and the Hot Wheels single assortment was the #1 toy sold globally in the full year. This was the third consecutive year of record gross billings for this power brand.

Infant, Toddler, and Preschool category gross billings were up 7% driven by an increase in Fisher-Price and Thomas & Friends. Fisher-Price Core was up 11% driven by growth in its Infant, Little People and Imaginext product segments. Fisher-Price Core POS was flat this quarter with positive POS in the Infant and BabyGear business. This was offset by a tough licensed entertainment POS comparison in our Preschool business. We remain on track with our turnaround strategy for this power brand and confident in its long-term growth prospects. Fisher-Price was again the #1 infant, toddler and preschool manufacturer in the U.S. and globally per NPD.

Gross billings for Action Figures, Building Sets, Games and Other, our challenger categories, grew 9% in the quarter driven by Games, Plush and Building Sets. Games achieved its eighth consecutive quarter of year-over-year growth. UNO continued to perform exceptionally well, remaining the #1 item based on units in the games and puzzles super category globally in 2020 per NPD. Games POS remained strong and was up double digits in the quarter.

Plush category, which was a white space for us only a year ago, continued to show strength driven by Star Wars. Our 11-inch Star Wars, The Child plush, was the #1 selling item in the plush super category in the U.S. in 2020 per NPD. We are pleased to expand on this new success in Plush with the recently announced line of Marvel plush items coming later this year.

Building Sets were up double digits in the quarter, a significant improvement compared to the first 9 months of the year, driven by strong POS and expanded distribution of MEGA, particularly in North America and EMEA. As expected, action figures declined due to the Toy Story 4 year-over-year comparison, although it remains a strong evergreen brand. The decline was partially offset by the Masters of the Universe collector toy line, which bodes well for the franchises relaunched this year. We also continue to see positive results with some of our key evergreen licenses, particularly Minecraft, Jurassic World and Minions.

Looking at gross billings by region in constant currency for the quarter. We achieved growth in each of our 4 regions for the second consecutive quarter despite COVID-19 disruption and local restrictions that impacted some locations. By the end of the fourth quarter, about 3% of all retail outlets that sell our products, representing approximately 5% of our revenue base, were closed. Strong POS performance for Mattel resulted in lower retail inventories year-over-year as we exited the quarter.

Looking at regional gross billings in constant currency and POS for the quarter. North America was up 13% and driven by broad-based strength across almost all categories. POS continued to be strong and was up slightly more than gross billings. Mattel continued to be the #1 manufacturer in the U.S. for the 27th consecutive year per NPD and gained market share in the fourth quarter and the full year. Mattel's year-over-year growth in the fourth quarter was 1.3x faster than the total U.S. industry's growth rate.

EMEA was up 12% driven by strong performance across all major markets and continued growth in e-commerce. POS was up double digits and aligned with gross billings. Mattel achieved year-over-year growth in gross billings in 7 out of the last 8 quarters. According to NPD, Mattel gained share in EMEA in 2020 and improved its rank from #3 in 2019 to #2 in 2020. Mattel's year-over-year growth was 5x faster than the toy industry's growth rate in the region.

Asia Pacific was up 8% driven by growth in Australia. POS was up low single digits in the quarter, an improving trend despite several markets experiencing COVID-19 restrictions and slow recoveries.

Latin America was up 3% driven by an improving retail market with store reopenings and increased food traffic. Mattel gained share in the quarter and the full year and expanded its #1 leadership position in the region per NPD.

E-commerce maintained its momentum and grew by more than 40% versus last year, representing about 36% of our global POS in the quarter. Per NPD, Mattel was the #1 manufacturer in the U.S. online for the fourth quarter and grew online share in the U.S. in the fourth quarter and the full year.

We have clearly made significant progress in our short to mid-term strategy to restore profitability and regain top line growth. Restoring profitability has been a key pillar in our short to mid-term strategy.

Looking at key profitability metrics since 2018. Adjusted gross margin has improved for 10 consecutive quarters year-over-year and over 1,100 basis points in the 3-year period. Adjusted EBITDA has improved by almost $600 million from $126 million in 2017 to $719 million in 2020 or more than 5.5x. We reshaped our operations and exited the year with over $1 billion in savings, primarily through our structural simplification and Capital Light cost savings programs, both key drivers in helping us make such significant progress on restoring profitability. This process yielded greater visibility and insights into our operations, and we have identified additional areas where we can further improve operations and drive greater productivity to accelerate growth and, at the same time, continue to reduce our cost base.

Today, we are announcing a new multiyear program called Optimizing for Growth, which will integrate the Capital Light program. The total benefit is expected to bring additional cost savings of $250 million by 2023. Anthony will share more detail on this in a moment. We believe the company is on solid ground to continue growing profitability in the coming years. Our goal is to achieve a mid-teen adjusted operating income margin by 2023. Having gone from a negative 4.2% in 2017 to a positive 9.8% in 2020, we believe we are on the right track. As it relates to 2021, we expect our adjusted EBITDA to be between $775 million to $800 million.

Regaining top line growth has also been a key pillar of our strategy, and we are very encouraged to have achieved the second year in a row of top line growth in constant currency after 5 years of consecutive decline. We are mindful of the continuing COVID-19 impact, market volatility and other macroeconomic risks and uncertainties. That said, we are entering the year with total company POS momentum continuing to be strong and low retail inventories and, therefore, expect to accelerate our top line growth in 2021 and achieve a mid-single-digit percentage increase in net sales in constant currency.

Looking beyond 2021, we are confident in the continued momentum of our Power Brands, the incredible pipeline of catalog IP and the strength of our entertainment partnerships, all fueled by innovation and cultural relevance. With that, our goal is to continue increasing market share and also grow our net sales by mid-single-digit percentages in constant currency in 2022 and 2023.

As it relates to our mid- to long-term strategy, we continue to make progress towards capturing the full value of our IP. We recently made exciting announcements with Mattel Films and Mattel Television, including an UNO live-action film in development with Grammy Award-nominated rapper Lil Yachty; an UNO game show in development with Propagate; a Whac-A-Mole game show in development with Fremantle based on the classic arcade game; and the Thomas & Friends: All Engines Go series to expand distribution with Cartoon Network and Netflix, both of which will air the show starting this fall and international distribution partners to be announced.

In closing, this was a banner quarter for the company with our best performance in years. 2020 was another milestone for Mattel, a year in which we grew both the top line and bottom line, gained global market share and continued to make significant progress in our transformation strategy. I could not be more proud of the work of the entire Mattel global team and the innovation, collaboration and execution that was demonstrated in an extremely tumultuous year. The momentum across the enterprise positions us well to accelerate our growth and make continued progress towards our goal to transform Mattel into an IP-driven, high-performing toy company. We remain committed to continued progress of our strategy and the creation of long-term shareholder value.

And now Anthony will cover the financials in more detail. Anthony, over to you.

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

Thanks, Ynon. We had another outstanding quarter, with the results exceeding expectations. Net sales increased double digits with broad-based gains across the portfolio, and we are pleased with the continued improvement in gross margin. Our structural simplification and Capital Light cost savings programs delivered $43 million of savings in the quarter and $193 million for the full year. And as Ynon mentioned, we are announcing the Optimizing For Growth program to further improve operations and drive greater productivity to accelerate growth and, at the same time, continue to reduce our cost base. This is expected to deliver, in aggregate, an additional $250 million of savings by 2023.

With a strong finish to the year and momentum into 2021, we are providing guidance for the new year, reflecting continued growth in both our top and bottom line. I'll now review our detailed results.

In the fourth quarter, we generated net sales of $1.626 billion, an increase of 10% versus the prior year. Adjusted gross margin increased by 250 basis points to 51.4% driven primarily by cost savings. On an adjusted basis, we generated $205 million of operating income, a $96 million increase year-over-year, driven by higher sales, gross margin gains and lower SG&A. EPS on an adjusted basis was $0.40 in the quarter, increasing 264% from 2019. And adjusted EBITDA grew by 53% to $284 million. As I said, just an outstanding quarter.

Commenting briefly on the full year performance, net sales increased by 2% to $4.584 billion, with second half performance more than offsetting declines in the first half. Excluding the negative impact of $54 million of currency translation, net sales in constant currency increased 3%. We are very pleased with gross margin performance. Adjusted gross margin, driven primarily by cost savings, increased by 420 basis points to 49.1%, the third consecutive year of significant improvement. Adjusted operating income increased 187% to $448 million, reflecting an adjusted OI margin in 2020 of 9.8%. Adjusted EPS is now positive, reaching $0.54 in 2020 compared to a loss of $0.30 in the prior year. And lastly, adjusted EBITDA increased by $266 million to $719 million, well ahead of expectations.

I'll continue my discussion of the fourth quarter with net sales by reporting segment. North America increased by 13% versus prior year, as reported and in constant currency, driven by growth in both the U.S. and Canada. International increased by 7% versus prior year as reported and 8% in constant currency driven by strong growth in EMEA and Asia Pacific as well as growth in Latin America where we extended our market-leading position. We are very pleased to see growth in American Girl as net sales increased by 12% on the strength of the direct-to-consumer business as we continue to execute the turnaround plan.

As Ynon mentioned, across our portfolio, the continued high growth of e-commerce was a key contributor to our success, representing 36% of total company POS in the quarter. In aggregate, net sales increased by 10%, both as reported and in constant currency, as currency translation had minimal impact on sales in the quarter.

We achieved continued improvement in gross margin. Compared to 2019, the fourth quarter adjusted gross margin increased by 250 basis points to 51.4%. Together, our cost savings programs contributed 220 basis points to the year-over-year increase. For the quarter, Capital Light and the recently completed structural simplification program delivered savings of $24 million and $11 million, respectively. Gross margin also benefited by 120 basis points from reduced royalties, reflecting lower sales of licensed products. Mix and Other contributed 50 basis points driven by favorable category mix, reflecting the above-average growth of Dolls and Games. Foreign exchange was a 90 basis point headwind to gross margin as input costs were negatively impacted mainly by weaker currency rates, including the Mexican peso and Brazilian real. Lastly, product cost inflation had a negative impact of 40 basis points in the quarter driven by higher rates in logistics and plant labor, bringing the fourth quarter adjusted gross margin to 51.4%.

Moving down the P&L. Advertising expenses for the quarter totaled $278 million, an increase of 22% compared to 2019. As expected, the increase in advertising reflects a timing shift to the fourth quarter, which we previously discussed. Adjusted SG&A expenses declined by 8% to $353 million driven by lower incentive compensation due to timing and the benefits of the structural simplification program and additional cost savings actions taken in 2020.

We had another quarter of very strong bottom line performance. Adjusted operating income grew from $109 million to $205 million, an increase of $96 million. The increase was driven by higher sales, gross margin expansion and lower SG&A, partly offset by increased advertising. Reflecting the gains in operating income, our adjusted EBITDA also increased significantly, up $99 million to $284 million.

As I've stated before, generating free cash flow is a key focus area for us. Cash from operations increased from $181 million in 2019 to $289 million in 2020, an increase of $108 million. The primary driver of the increase was a gain in the net income line as we went from a loss of $214 million in 2019 to a positive net income of $127 million in 2020, a positive swing of $341 million. This was partly offset by the use of $151 million in working capital and other in 2020. The increase in working capital reflects a sales-driven increase in accounts receivable, which will bode well for cash generation heading into 2021. Our inventory levels are also higher as we prepare for and anticipated strong start to 2021. Moving down to free cash flow, with capital expenditures similar year-on-year, free cash flow more than doubled, increasing by $102 million from $65 million in 2019 to $167 million in 2020.

Turning to the balance sheet. We ended the fourth quarter with a cash balance of $762 million compared to $630 million a year ago with essentially no short-term borrowings. The $132 million increase in cash is primarily driven by our 2020 positive free cash flow, which I just discussed. In line with our double-digit increase in fourth quarter sales, accounts receivable balance increased by $98 billion to $1.034 billion. We continue to effectively manage accounts receivable as our year-end 2020 day sales outstanding is consistent with last year at 57 days. As I mentioned, our inventories are slightly higher, reflecting the positive momentum entering the first quarter. And our debt-to-adjusted EBITDA ratio improved, declining from 6.4x in 2019 to 4.0x at the end of 2020.

As Ynon discussed, we have made significant progress in restoring profitability. This chart illustrates our progress on 3 important metrics. Since 2017, adjusted operating income has steadily improved from a negative $203 million in 2017, turning positive in 2019 and advancing to $448 million in 2020. Our cost savings over the last 3 years, which exceeded $1 billion in savings, was a primary driver of this performance. Gains in operating income are reflected in the adjusted operating income margin, which finished 2020 at 9.8%. While we've made significant progress, we believe there is further opportunity to improve our margin, and I will discuss our plans in a moment. Lastly, on adjusted EPS, a critical metric that includes interest and taxes, we improved from a loss of $1.20 in 2017 to a positive $0.54 per share in 2020.

I want to share with you 2 more important metrics. The first is free cash flow, which has steadily improved over the last 3 years. From negative $325 million in 2017, free cash flow returned to positive $65 million in 2019 and increased to $167 million in 2020. Going forward, we will be focused on converting an increasing percentage of EBITDA into free cash flow. And as previously stated, we intend to utilize excess free cash flow to reduce debt in the near term. Driven primarily by the growth in adjusted EBITDA, our leverage ratio of debt-to-adjusted EBITDA has improved significantly. From a high of 25x in 2017, we ended 2020 with a leverage ratio of just 4x. Given our expectations for future EBITDA growth and the utilization of excess free cash flow to reduce debt, we expect our leverage ratio to continue to improve as we work our way back towards an investment-grade rating.

The new Optimizing for Growth program is designed to further improve operations and drive greater productivity to accelerate growth and, at the same time, continue to reduce our cost base. This new program will integrate our Capital Light program going forward with several new opportunities that leverage our scale and streamline key processes. Under the program, we expect to achieve an additional $250 million of savings by 2023, with the first $75 million benefiting 2021. In terms of the P&L, we anticipate approximately 50% of the expected savings to benefit cost of goods sold, 40% to benefit SG&A and the remaining 10% to impact advertising and promotion. We also expect that the majority of the savings will contribute to operating margin expansion. Currently, we estimate the cash cost and investment to implement the program to be in the range of $100 million to $125 million, which we will update as we advance the program.

As it relates to Capital Light, this past January, we completed the divestiture of Mattel's arts, crafts and stationery business, including the associated manufacturing plant. The business was included in the MEGA acquisition in 2014. This divestiture allows us to exit a noncore business and further reduce our plant footprint as we advance our Capital Light strategy.

With a strong second half and positive momentum, we are providing 2021 guidance reflecting our expectation for continued growth. Our guidance is subject to COVID-19 impact, market volatility and other macroeconomic risks and uncertainties.

On the top line, we expect net sales in constant currency to grow by a mid-single-digit percentage, primarily driven by Dolls, Vehicles and Action Figures categories as well as improving performance in the Infant, Toddler, and Preschool and Building Sets categories.

In terms of phasing, we are comping an unprecedented year in which we saw a double-digit decline in the first half followed by double-digit growth in the second half. With that, we expect strong sales gains in the first half of 2021 and will face challenging comparisons in the second half.

Following a 3-year period in which adjusted gross margin expanded by 1,100 basis points, we expect adjusted gross margin to decline by 50 to 100 basis points in 2021 to a range of 48.1% to 48.6% as we are facing a high level of inflation in cost of goods sold. In aggregate, we expect cost inflation to have a negative impact on gross margin of approximately 200 basis points.

We expect continued growth of adjusted EBITDA, which is forecasted to be in the range of $775 million to $800 million as our business continues its upward trajectory and improved performance. This assumes a slight decrease in depreciation and amortization as we have reduced our capital expenditures relative to historical levels.

With respect to capital expenditures, in 2021, we expect spending between $125 million and $150 million, which includes investments related to the Optimizing for Growth program. As Ynon mentioned, looking ahead, our goal is to continue growing net sales in constant currency by mid-single-digit percentages in 2022 and 2023 and to achieve an adjusted operating income margin in the mid-teens by 2023.

In closing, Mattel delivered another outstanding quarter, and we are very pleased with our performance for the full year. In spite of the challenges in 2020, we continue to make meaningful progress towards our strategy to restore profitability and regain top line growth. We believe we are well positioned to maintain this momentum.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Tami Zakaria with JPMorgan.

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

Congrats on excellent results. I just wanted to -- my first question is around the mid-teens operating margin guide by 2023. Can you help us understand the breakdown between gross margin and SG&A contributions to get to that level?

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

Yes, I'll take that. Tami, it's Anthony. So as we said, we have a goal here to expand our adjusted operating income margin to the mid-teens by 2023, and a key driver of that is going to be our Optimizing for Growth program. And as we've disclosed that program, we've given an allocation of how that will impact the P&L, so about 50% COGS, 40% SG&A and the remaining 10% coming through the advertising and promotion line. We're not giving specifics around gross margin, but it is our expectation that the combination of pricing and Optimizing for Growth will more than exceed the impact of cost inflation over time and an expanding gross margin will contribute to that OI goal.

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

Got it. And my follow-up question is around the mid-single-digit net sales growth expectation until 2023. Again, could you help us understand what's driving that, meaning which brands? And do you expect international growth to sort of be above that? Basically, what's supporting that mid-single-digit sales growth expectation?

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

Tami, it's Ynon. So we were -- we provided our goals -- this is different from the guidance we gave for '21. But directionally, when we look at the quality and breadth of our product, the enduring strength of our brands, the efficient supply chain that we now have and call a competitive advantage, the world-class commercial capabilities and how we work in close collaboration with retail partners and looking at the momentum we have, we feel confident to share with you our goal and believe we will make it.

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

Understood. One last quick one from me, from a modeling perspective, how should we think about the tax rate for 2021?

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

Yes. So Tami, we're not providing specific guidance around the tax line. But I don't think it would be meaningfully different than where we've been in the recent past.

Operator

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

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

I was wondering if you could talk about retail inventory situation globally. The bigger question is, as you look at the rest of the year, outside of current POS trends, which still won't be comping sort of pandemic-related boost, what is your outlook on whether the industry can grow and where Mattel fits in, in terms of taking share? I guess I'm trying to understand better why is the mid-single-digit growth the right number for you for shipment given sort of really depleted inventories and strong film slate and easier shipment comps in the first half of the year. And then I have a quick follow-up.

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

Yes, so let me comment on the retail inventory situation. As you may recall, we did start 2020 with retail inventory slightly elevated. And then as we progressed through 2020, we achieved double-digit POS growth, which outpaced our 3% gross billings growth in constant currency. And therefore, we ended 2020 with retail inventories down mid-single-digit percentages in terms of dollars. And when you look at and incorporate the increased POS, which has continued into 2021, our weeks of supply are actually down double digits. And looking ahead into '21, that should bode well for our sales outlook as we enter 2021.

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

That's very helpful. And my question on kind of what's your view on the industry, perhaps a question for Ynon, do you actually think the industry can overcome these tough comps and grow? And then I have a quick follow-up.

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

Yes. So there's no question that the COVID lockdown drove strong consumer demand for toys across the board as parents spend more money in 2020 on quality product and trusted brands and consumers adopted to the new norm with particularly strong performance in certain surge categories, including outdoors, games and puzzles and building sets. 2020 ended up seeing extraordinary growth for the industry, which again proved its resilience, highlighted the importance of play and continued to be a strategic category for retailers.

The demand driven by COVID, however, is difficult to quantify as the industry was projected to grow even before the pandemic. That said, when we look at our overall performance, our market share gains, the significant increase in profitability, that's been driven by the hard work of the organization. And many of the actions we took before the pandemic to reshape and simplify our operations as part of our turnaround strategy are now contributing to our strong performance overall. So we didn't just ride the wave, we outpaced the industry, we gained share on a global basis in the third quarter, in the fourth quarter and the full year.

Now we believe that the categories where we are a global leader: Dolls, Vehicles and Infant, Toddler, and Preschool will continue to perform well, and we expect to grow and increase our overall market share. With that, we expect that the surge categories that benefited from the pandemic mostly will be more challenged: outdoor, games and puzzles and building sets. Beyond '21, we believe strongly in the long-term growth prospects of the industry. We're seeing the strong fundamentals, and we believe we are well positioned to capture this growth.

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

That's very helpful. And I have one more quick clarification question. What does the cadence of that cash spend look like to help you get to that cost savings of $250 million? Particularly as it relates to this year, it seems like $75 million of that cost savings are hitting the P&L this year. But what is cash expense offset? And I understand that cash expense and what hits the P&L could be different. Is it more 2021 skewed? Does that mean run rate EBITDA coming out of the year would be higher than $800 million if I were to think about that spend that won't be really recurring in forward years?

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

Yes, if you're referring to the cash implementation costs of about $100 million to $125 million, I think we're not going to get into too much detail, but I think it's reasonable to assume kind of pro rata over the 3-year period.

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

Okay. That's very helpful, and great quarter.

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

Thank you.

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

Thank you, Arpine.

Operator

And our next question comes from the line of Eric Handler with MKM Partners.

Eric Owen Handler - *MKM Partners LLC, Research Division - MD, Sector Head & Senior Analyst*

Anthony, if you get to your planned $775 million to $800 million of adjusted EBITDA this year, what kind of free cash flow conversion do you think you could achieve off of that?

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

So Eric, it's Anthony. So as we said in our remarks, our focus going forward is on increasing the conversion of EBITDA to free cash flow, and we think we're well positioned to do that. Obviously, we'll get the growth in EBITDA up to the $775 million to $800 million range, improving free cash flow. We are well positioned with respect to working capital. So we saw a $150 million increase in 2020. Most of that was sales driven accounts receivable, which is really kind of timing. So that bodes well for improving the conversion in 2021. So we're confident we'll be able to improve our free cash flow generation in 2021 over 2020. And as we've talked about, our expectation is to utilize our excess free cash flow to reduce debt in the near term and continue to improve our leverage ratio. As I've said, we're down to 4x debt to adjusted EBITDA. And we would expect that to improve going forward as well.

Eric Owen Handler - *MKM Partners LLC, Research Division - MD, Sector Head & Senior Analyst*

And you said you want to achieve an investment-grade credit rating. What target leverage do you need to achieve to get there? And once you get there, are -- dividend buybacks, are those back on the table?

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

Yes, I think it's premature to talk about the next evolution of capital allocation. As I said, our focus on the short term is improving our leverage ratio, getting ourselves and working our way back towards investment grade. That means that debt-to-EBITDA in that kind of that 2x, 2.5x range, and that's what we're focused on.

Operator

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

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

I just have 2. First, could you just talk about some of the key theatrical toy property licenses you have for 2021? I know there are some Pixar movies and, obviously, Minions, I think, is also supposed to come in '21. And then the second question, just a comment as it relates to top line growth for '21, strong first half, tough comps in the second half. Will we see growth in second half, albeit more muted? Or could second half actually be down?

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

Yes, Michael, the current slate that we have includes great properties, including Spirit, Minions, Fast & Furious, Top Gun: Maverick as well as HALO, Minecraft and the Tokyo Olympics. Now we all know that the entertainment slate remains fluid, and there is still movement around the timing of releases and distribution models. But from our perspective, we are not as dependent as other companies on these properties because the vast majority of our business is driven by our own brands and our own intellectual properties.

Now we do have very strong relationships with all major entertainment companies, and we look to continue to strengthen our position as a partner of choice. And to the extent there is a shift in the release calendar, we will still benefit from those releases when they do come out. That said, we're not dependent on that. And we did factor our outlook on these properties in the EBITDA guidance that we provided. If you look at our results for the fourth quarter and the full year, our best performance in years, it shows you the strength and quality of the product that we had with very little entertainment properties in 2020.

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

And just to comment on the phasing, as we said, we're wrapping double-digit declines followed by double-digit growth. So we do expect to see strong sales gains in the first half, more challenging comps in the second half and, most importantly, right, achieving our guidance of mid-single-digit growth for the full year.

Operator

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

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

I may have a couple of tactical questions. The first is, on your comments, Anthony, about gross margins and the inflation that you're embedding in 2021, I'm curious, with the momentum in your business, why you wouldn't have the power to take some price. So maybe talk a little bit about how you're feeling about your brands and the pricing within their competitive sets and if you feel like you do have the potential opportunity to take some price to offset some of that inflation.

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

Yes, let me first just kind of reiterate the comment on the inflation. It is in both materials driven by resin and in logistics driven by ocean freight, and it came on pretty quickly. In terms of our brands, we feel great about our brands. We're not going to talk about specific pricing action, but our belief is that, over time, that combination of pricing and cost reductions coming out of our Optimizing for Growth program will more than offset cost inflation in the long term and contribute to margin expansion.

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

Okay. That's helpful. And then on the Optimizing for Growth, the $720 million was your exit EBITDA rate for 2020. The guidance at $775 million to $800 million would include that $75 million of savings. So maybe help us think through the bridge. And what's happening to the underlying business ex the savings to be kind of flattish or up only modestly on a mid-single-digit rate of growth?

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

Yes, so let me comment on that. I think the way to think about our EBITDA guidance, the $775 million to $800 million, which is growth of 8% to 11%, there's really 3 factors: the first is mid-single-digit top line growth with strong flow-through through the EBITDA; the $75 million of expected savings from the Optimizing for Growth program, and that's going to hit across the P&L, and those 2 more than offsetting the impact of cost inflation on gross margin; and as I said before, that cost inflation, in and of itself, has about a 200 basis point negative impact. So those 3 things really get you to the EBITDA guidance.

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

Okay. That's great. And then, Ynon, if I could, just one real quick question on ad spend because it was up pretty sharply in the fourth quarter as you had planned. Anything you learned from how you allocated advertising by quarter, by brand, by channel, by digital versus legacy that you're going to carry forward into your programs and your plans for '21, '22 and '23?

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

Yes. We generally continue to adjust, improve and strengthen how we think about demand creation. We did move strategically certain spending to Q4 to align better with the POS patterns that we saw coming into the fourth quarter and heading into 2021. And we will continue to adjust our advertising budget as we shift more spend towards digital platforms and focus on reaching more consumers wherever they are and be more productive and more effective in our reach.

Operator

And our 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*

Ynon, first, you came close to answering Arpine's question about your outlook for the industry. I asked Brian yesterday, so it's only fair I ask you as well, if you can give us what you think that number would be in terms of U.S. and worldwide growth. That's first. And second, if Richard is around, 3 straight years of Barbie shipment growth. I think it's about 5 years of POS growth. And these kind of trends are usually pretty cyclical to last maybe 3 to 5 years. So based on history, perhaps Barbie should be peaking right about now. So do you anticipate growth in Barbie in '21? And should we be concerned about the beginning of a down cycle?

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

Yes. So Gerrick, when you look under the hood of the industry as a whole, there was a different level of performance by category. By far, the main growth of the entire industry was driven by the 3 surge categories I mentioned earlier: outdoors, games and puzzles and building sets. And they -- we believe that these categories will have more of a challenge in 2021 just simply given comping such a strong year. The categories where we're strong, Dolls, Vehicles and Infant, Toddler, and Preschool, were less impacted by COVID. And to some degree, our performance kind of doesn't tell the full story because we just outperformed so strongly. But those categories were not -- didn't benefit from the surge related to COVID as much as the other categories I mentioned.

So with that, you will see we will have a different performance by category. Hard to tell where the industry as a whole will land, but we believe the categories where we're a global leader will continue to perform well. And within that environment, we expect to increase our overall market share.

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

Gerrick, it's Richard, and I'll take the next question proudly. And I appreciate the history that you have with the brand. But clearly, Barbie has been gaining more and more momentum over the last several years. Certainly, we had a spectacular quarter. We grew double digits in the quarter and for the year, and that's with POS growing more than 30%. We ended, as you know, as the #1 overall toy property globally, which speaks to the strength of the brand. We're confident in the momentum that we have moving into '21.

There's great strong activations planned throughout the year. We have 2 new animated movie launches on Netflix where we're extending characters like Chelsea, Barbie's sister. We have new fashion segments like Barbie Extra. And Ken turned 60, and you know we know how to do an anniversary program. We'll also continue with surprising pop culture milestone moments, which we've become incredibly well-known for to maximize the current momentum. And look, as the category leader in this high-growth dolls category, we've got incredibly exciting new content, digital engagement and we see significant power and opportunity for the expansion and the growth of Barbie.

And it goes to say, without taking anything away from Barbie's tremendous success, and you've been tracking this and we certainly are enjoying the momentum, this is really a story about the success of the overall Mattel playbook. Barbie is based on the same approach, the same methodology, capabilities that we've been applying across the portfolio: brand purpose, the values of each brand, design-led innovation, cultural relevance and executional excellence. And our category structure and centralized D&D organization, which we talked a lot about over the last couple of years, is filled with extraordinary talent who work across the portfolio, leveraging skill sets and creativity across all brands. The foundation that Barbie has been rebuilt on is strong. The growth trajectory, we feel very confident about. And in fact, we look forward to sharing a lot more detail with you at the upcoming analyst presentation.

Operator

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

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

So with your directional guidance for Infant/Toddler/Preschool, do you expect to grow Fisher-Price in 2021? Core has been better than Friends. Does that dynamic continue this year? And I guess asked differently, when does Friends stop being a headwind? And then separately, you gave us some numbers for e-commerce in the quarter. Where did it end up for 2020? And can you remind us the impact it has on margin relative to a bricks-and-mortar retailer?

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

Sure. Look, we do expect to see continuing improvement in Fisher-Price Core and with Thomas. In the fourth quarter, Fisher-Price Core was up a strong 11%, and it was driven by growth in its Infant, Little People and Imaginext product segments. We are encouraged by the performance, the first positive quarter, frankly, since 2016. And as we look to 2021, we have incredible new innovation across product segments. To your point, Fisher-Price Friends will no longer be a headwind as we've exited most of the underperforming licensed properties. We remain on track focused on our turnaround strategy and continue to be confident in its long-term growth prospects.

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

Drew, responding to the question on e-commerce, this was another star performer for us, a big driver of our business. We grew in the fourth quarter by 40% and for the full year by 50%, currently representing 1/3 of our global POS. We ended the year as the #1 manufacturer in e-commerce in the

U.S. in the fourth quarter, and we grew our e-commerce share in the U.S. both in the fourth quarter and the full year. I talk about the U.S. because that's the only market where we have specific measurement, but that's a good proxy for our performance in the rest of the world.

Operator

And our 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*

So when you think about your long-term operating margin target, I guess, back -- historically, your peak was about 18%, but that was a little bit of a rarefied environment where you had outsized doll positioning when Monster High was growing. So is 18% possible out in the future? Or do you need to add some additional major doll franchises to get there? And on the subject of dolls, can you talk a little bit about Cave Club dolls? We saw a fair amount of shelf space at Walmart. Is that a significant line? And do you see some opportunity for that line?

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

Linda, at this stage, we're giving goals only to 2023 and feel confident enough to share with you our goals. We haven't given more information beyond that. Mid-teen operating income margin at this point is a good reference for 2023.

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

Look, and Linda, also, we're really pleased with the performance of the overall doll category. As you know, we manage it as a portfolio. Cave Club was a successful launch. Frankly, in a challenging time period, we achieved all the objectives we had for the brand globally. We continue to believe in launching new brands. Cave Club will have a good another year as well as we have Polly Pocket, which has been continuing to grow. We've got several regional brands as well like Enchantimals that had a strong performance. So as we look at the doll category overall, we expect to continue to see growth with, of course, Barbie leading the way.

Operator

Our last question comes from the line of David Beckel with Berenberg Capital.

David James Beckel - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Two questions for you guys. First one around the film slate, I'm just curious to navigate your thoughts on -- I assume you're in pretty regular dialogue with your film studio partners, how the change in film studio economics that's been experienced throughout this pandemic has affected the time line of the projects that you currently have planned going forward. And relatedly, to what extent is your sort of mid-single-digit growth outlook dependent on the release of those movies. And then second question, a little bit quicker, I just want to take another stab at dimensionalizing sales growth for next year. Given the depleted status of inventory, I'm wondering if you can maybe quantify the extent to which mid-single-digit sales is comprised of an inventory rebuild.

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

Okay. David, so the industry is still finding its way within the restrictions imposed by the pandemic, but I have to say, productions are ramping. People are doing a good job with the right protections and safety protocols. So we expect that to gradually resume and get into more normal cadence but not completely done, obviously, given the expected impact of COVID. We -- that will, to some degree, impact release schedule. But all of this is moving and hard to see where things would land.

As it relates to our plans, it hasn't really impacted our production calendar directly because we haven't been -- we haven't gone into production. But in the meantime, we continue to make a lot of progress on our projects. As you know, we just announced our 11th motion picture target -- sorry, film. We've been doing a lot of work on scripts, casting, budgeting and production plans and seeing continued interest and a lot of excitement around the -- all of our projects. There's more coming. There's more coming that we haven't announced yet. The pipeline is building. We're also making great progress on the television side with numerous shows in production and more in development and expect that to continue to build.

This -- none of that is factored into our margin guidance that we provided. That margin is solely driven by the toy side of the business. So as we always say, capturing value from our intellectual property is part of our mid- to long-term strategy. These projects do take time given the scale and the ambition, and we're going about them the right way. But given the level of interest, the quality of partners, the strength of these properties, we remain very excited about what this can mean for us in the mid- to long term.

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

To the second part of your question around sales guidance for 2021, while we do expect inventory replenishment to have some impact, the vast majority of our growth will be driven by the POS performance across our portfolio.

Operator

That is all the time we have today for questions. I will now turn the call back over to Chairman and CEO, Ynon Kreiz, for any closing remarks.

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

Thank you, operator. As I said, I could not be more proud of the entire Mattel global team, not only for their resilience and execution in the face of a pandemic and such challenging market conditions this year but also for stepping up as a responsible corporate citizen, leveraging our resources to support consumers, customers, business partners and the communities where we live, work and play.

It's important to say that the fourth quarter was our best performance in years, but this is not just about the quarter or the year but a multiyear turnaround that is tracking very well, which puts us in a strong position to continue to increase profitability and accelerate growth in 2021 and beyond.

We look forward to sharing with you more detail on our ongoing progress to become an IP-driven, high-performing toy company at our virtual Analyst Day on February 24. And we thank you for your time and interest. I will now turn the call back to Dave to provide the replay details. Thank you.

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 Investors page. Or for an audio replay, please dial (404) 537-3406. The passcode is 4894534. Thank you for participating in today's call.

Operator

Ladies and gentlemen, thank you for participating in today's conference call. Thank you for participating, and you may now disconnect.
