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# EDITED TRANSCRIPT

MAT - Q2 2015 Mattel Inc Earnings Call

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**OVERVIEW:**

Co. reported 2Q15 adjusted EPS of \$0.01.



## CORPORATE PARTICIPANTS

**Martin Gilkes** *Mattel - VP Corporate Strategy & IR*

**Chris Sinclair** *Mattel - Chairman, CEO*

**Richard Dickson** *Mattel - President, COO*

**Kevin Farr** *Mattel - CFO*

## CONFERENCE CALL PARTICIPANTS

**Mike Swartz** *SunTrust Robinson Humphrey - Analyst*

**Eric Handler** *MKM Partners - Analyst*

**Drew Crum** *Stifel Nicolaus - Analyst*

**Taposh Bari** *Goldman Sachs - Analyst*

**Felicia Hendrix** *Barclays Capital - Analyst*

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

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

**Jaime Katz** *Morningstar - Analyst*

## PRESENTATION

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### Operator

Good day, ladies and gentlemen. Welcome to Mattel's second-quarter 2015 earnings conference call. (Operator Instructions). As a reminder, this conference call is being recorded.

I would like to turn the conference over to Martin Gilkes, Vice President, Investor Relations. You may begin.

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### Martin Gilkes - *Mattel - VP Corporate Strategy & IR*

Thank you, Operator, and good afternoon, everyone. Joining me today are Chris Sinclair, Mattel's Chairman and Chief Executive Officer; Richard Dickson, Mattel's President and Chief Operating Officer; and Kevin Farr, Mattel's Chief Financial Officer.

As you know, this afternoon we reported Mattel's second-quarter 2015 financial results. We will begin today's call with Chris, Richard, and Kevin providing commentary on our results, and then we will take your questions.

To help guide our discussion today, we have provided you with a slide presentation. Both our earnings release and slide presentation include non-GAAP financial measures. The information required by Regulation G regarding non-GAAP financial measures is included in these materials, and both documents are available in the investors section of our corporate website, [corporate.mattel.com](http://corporate.mattel.com).

Before we begin, I would like to remind you that certain statements made during the call may include forward-looking statements relating to the future performance of our overall business, brands, and product lines. These statements are based on currently available information and they are subject to a number of significant risks and uncertainties that could cause our actual results to differ materially from those projected in the forward-looking statements.

We describe some of these uncertainties in the risk factors section of our 2014 annual report on Form 10-K, our 2015 quarterly reports on Form 10-Q, in 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.



Now I would like to turn the call over to Chris.

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**Chris Sinclair** - *Mattel - Chairman, CEO*

Thanks, Martin, and good afternoon, everyone. I'd like to thank you for joining us today.

To begin with, I can report that we made some solid progress on a number of strategic and operational fronts in the second quarter as we continue to move quickly to put the Company back on track for growth and improved profitability. While it is still early in our turnaround, our overall second-quarter results were generally in line with our expectations.

In constant currency, worldwide gross sales were up by 1% in the quarter and are up 3% year to date. We also saw progress in our operating results, where we are managing our margins effectively and we are generating ample liquidity to fund our turnaround efforts and to maintain our \$0.38 a share quarterly dividend.

From a strategic perspective, we have continued to drive our culture change agenda. We have also made some solid progress against our six core priorities. Our emphasis continues to be on rebuilding our culture to embrace brand building, creativity, and innovation. And we streamlined our organization and made some incentive changes to encourage faster decision-making and more personal accountability. And early signs here continue to be positive.

We have also continued to make some progress strengthening our core brands, with good results on Hot Wheels, Thomas, and Ever After High; a solid quarter on American Girl; and improvements in restoring power and momentum on Barbie and Fisher-Price.

Further, we strengthened our Toy Box unit with some recently announced core licensing deals with Warner Bros. and DreamWorks and an important renewal within our Disney partnership. We also continue to broaden our innovation and invention pipeline.

In addition, we continue to execute better at retail and to better align our marketing and merchandising programs. And progress here can be seen with increased shelf-space productivity and improved inventories.

Encouragingly, our performance was also broadly balanced across geographies and we achieved some good gains in a number of developing and emerging countries, despite some difficult macroeconomic issues, with some noteworthy growth in China and in Russia.

And finally, we are very encouraged by our cost-improvement initiatives where we made some strong progress in both our global supply chain and our SG&A expenses. We have also begun to accelerate several broad initiatives targeting input and packaging costs.

As we reported earlier, we remain on track to deliver at the high end of our target cost-reduction range of \$250 million to \$300 million in gross savings by the end of next year.

So on balance as we exit the first half, we are continuing to move things forward and to see some real positives. And based on the results to date and our go-forward outlook, we do remain on track with our strategic priorities. We also remain on track to fund our turnaround initiatives fully, and we continue to be comfortable with our cash position and our commitment to the current dividend.

Now having said all of this, I want to assure you that we are not complacent and we recognize that we still have a lot to do to rebuild the business and to successfully navigate through a very competitive second half and an equally challenging set of economic headwinds. Our core brand and Toy Box slate is still a work in process. Stabilizing Monster High, fully rejuvenating Fisher-Price and Barbie, and restoring a vibrant licensing business will all take time. We also still have a lot of retail space to regain and merchandising to improve in the months ahead.

Now certainly ForEx is very much a drag in many of our important markets, so I do want to maintain an appropriate level of caution in framing where we are in our road to recovery. However, I can assure you we are very much in the game and we are committed to making progress. We believe we have an effective plan and we're moving rapidly across a number of fronts to rebuild and to strengthen our ability to compete and grow.

I continue to be impressed by the vibrancy of our industry and I am equally impressed by the resiliency and talent in our Company, a Company that is embracing change and, in my view, is very much up to the challenges and opportunities ahead.

Now I would like to turn it over to Richard, who is going to provide you a little bit more detail on some of the progress that we've made to date.



**Richard Dickson - Mattel - President, COO**

Thank you, Chris, and good afternoon, everyone.

We are making headway. The new Mattel that we have been shaping has begun to emerge. As Chris said, there is still a lot of work to be done, but we are confident that we have the ability and determination to restore the Company to a path of sustainable and profitable growth.

While we have been retooling the business overall, my priorities continue to be centered on revitalizing the iconic global brands which are the heartbeat of Mattel and on accelerating the work of our innovative Toy Box, the entrepreneurial business unit we created to drive invention and build the strongest pipeline of hit toys and licensed ventures in the category.

Today, I will focus on recent progress in those important areas. We continue working to give our brands strategic autonomy and resources they need to compete more effectively. Our new approach to global brand management is beginning to make an impact, and yes, we are making progress with Barbie. Our research shows that the brand's relevance and interest among girls has been improving as a result of more effective marketing and more exciting product.

In addition to diagnostics, which suggests the potential of the direction we are taking the brand, Barbie POS is up globally. We are seeing solid consumer takeaway in the US, where we have been able to better leverage the new marketing campaigns and do more extensive program integration with our largest retail partners.

The second wave of our Barbie Be Super brand strategy, emphasizing diversity with the new Fashionistas line, is proving to be a success. A comprehensive marketing program, including a music video, vlogging, social media, and PR, created tremendous buzz and momentum for the recent Fashionistas product launch, and the effectiveness of this program is inspiring new best practices for the brand.

Getting Barbie back on the trajectory we want will take time, but we are working hard to extend our domestic momentum on the brand to all key markets worldwide.

Monster High is a big, exciting brand that continues to have both great potential and significant challenges. Importantly, the brand concept continues to resonate with girls and we believe we can make it even more on trend and relevant. We have been doing a great deal to get the brand stabilized and refocused on its strengths. We are already seeing some promising early performance from key retailers in the new vinyl line and large-scale dolls we shared with you on the last call. There is much more work ahead here and there are important developments to come on this brand.

American Girl continues to improve in line with our strategy for refreshing each of the key components of the business. For example, in Q2 we launched the Truly Me personalized line to strengthen brand relevance and it's doing well. And just this month, we hit another important milestone in our international growth strategy for American Girl with the successful opening of our first store within a store in Mexico City, and its sales have been exceeding projections.

Our extensive work to restore power and momentum to the Fisher-Price business has two primary strategic priorities. The first is to strengthen the baby business, which represents about half of Fisher-Price and has historically been a momentum driver for the entire unit.

Here, we continue to see solid progress. In Q2, shipping for Fisher-Price Baby was up more than 10% in North America and internationally in constant currency. And we are seeing strong POS takeaway, particularly in the key international markets we have targeted for growth.

Second is to reestablish Fisher-Price as the premier brand in early childhood development, a focus for achievement-oriented millennial parents worldwide who are the brand's primary consumer. We have extensively reorganized Fisher-Price to meet this objective and we are investing in the discovery of breakthrough insights that enable us to capitalize on the significant opportunities we have identified for the brand.

Thomas & Friends had a strong first-half consumer takeaway and international market shipping, which validates our strategy to leverage the brand's untapped global potential, particularly in Brazil, Mexico, Russia, and China. We will be building on this momentum in the second half, aided by the international heavy-up of Thomas' 70th anniversary marketing initiatives in Q3 and Q4.

Hot Wheels continues to be a strong performer and we believe it represents a big opportunity in our portfolio. Not only does it have great potential to seamlessly integrate physical and digital, it has the strategic opportunity to evolve from simply cars and tracks to a greater system of purposeful play that parents will appreciate as much as kids will love.

These are opportunities we are working very hard to develop and exploit, laying the foundation for accelerated brand growth in 2016.



While our core brand portfolio regains its footing and begins to show important progress, we are concurrently building a formidable capability in the fast-paced, more entrepreneurial component of our industry, which is driven largely by hit toys, licensing, and partnerships.

We have created our Toy Box unit from the ground up to be a leader in this growing segment and are seeing important signs of progress here as well. One priority of our Toy Box strategy is to build a stronger licensing pipeline into the future by both acquiring and renewing important licenses. I will focus on that today.

We are determined to be the best in the business at retaining and growing the important relationships we already have. It is why we are particularly proud to announce the renewal of our partnership with Disney on the iconic Toy Story franchise, with the global rights for the blockbuster Toy Story 4 film in 2017. This renewal represents an encouraging new chapter in our partnership with Disney, a relationship we are determined to see become even more valuable to both partners.

Our all new DC Superhero girls license with Warner Bros. not only represents a game-changing new segment, girls action figures, but also a state-of-the-art content-driven property. The characters, DC's female superheroes and super villains as teens, are at the heart of the girls' empowerment trend, something we know a great deal about.

Warner Bros. is putting a large amount of content behind this initiative and our products will be available in stores early 2016.

The latest collaboration in our strong ongoing partnership with Nickelodeon, Blaze and the Monster Machines, is already a breakthrough show. It has quickly risen to the number two ranking on all TV among boys 2 to 5 and the number one app on the kids & education charts, and, as a result, early toy sales are exceeding projections.

And in June, we announced yet another important new license, a partnership with DreamWorks Animation and their new on-trend mashup series Dinotrux. Content will soon begin to air on Netflix and our product will follow in 2016.

Toy Box is also leveraging entertainment partnerships to drive growth in the key construction segment of our MEGA Brands business. We are encouraged to see construction doing well, including important gains in the MEGA preschool business largely attributable to the continued success of our SpongeBob license, toys that tie into the big new Minions movie, and, coming next year, Teenage Mutant Ninja Turtles.

Taken as a whole, this represents a lot of solid progress across many important brands and our strategic priorities. Beyond what we are achieving in brand management, product innovation, and licensed entertainment, we are continuing to accelerate global development of our brands. There is much upside opportunity for us in emerging and developing markets and we're moving strategically to seize it. We continue to invest ahead of the growth in China and are seeing very strong results there. And we are encouraged by POS trends overseas.

We also continue to make progress, as Chris noted, on strengthening our retail relationships and our inventories in key markets to lay the groundwork for Q4.

Overall, we are a much more dynamic and purposeful Mattel than we were only a year ago, and the transformation underway in our strategic priorities and our culture, while neither easy nor painless, is beginning to shape a much more creative, aligned, and nimble organization.

We are laser focused on the strategic priorities Chris mentioned. We are confident in our plans to get Barbie and Fisher-Price back on track. We are encouraged by our recent success in building valuable strategic partnerships and focusing on continuing that success. We are determined to execute flawlessly at retail and we are committed to accelerating growth in emerging markets.

We are confident we will succeed because there is a renewed passion to lead among our talented people, and Mattel is beginning to feel more like the global leader with the heart of a challenger our founders first envisioned 70 years ago.

I look forward to sharing our progress with you in the quarters to come, and now I will turn the call over to Kevin Farr, Mattel's CFO.

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**Kevin Farr - Mattel - CFO**

Thank you, Richard, and good afternoon, everyone.

As Chris said, we continue to make solid progress on our strategic priorities and our overall second-quarter results were in line with our expectations.

As a reminder, to provide better visibility into the underlying business performance while we execute the turnaround, I will be discussing our results in constant currency and referring to adjusted financial measures that exclude certain items related to our acquisition of MEGA, as well as severance expense.



In constant currency, worldwide sales were up 1%, or down 6% as reported [**Clarification: worldwide gross sales**], as foreign-exchange translation continues to have a negative impact on revenues. Year to date, worldwide gross sales were up 3% in constant currency, or down 4% as reported. And our overall global POS, which was up low single digits, was roughly aligned with shipping, excluding MEGA, in both time periods.

From a brand perspective in constant currency, worldwide sales for Mattel Girls and Boys brands were down 3% in the quarter and down 1% year to date, driven by declines in Monster High, certain licensed entertainment properties, and Barbie, which was partially offset by growth in Hot Wheels, Disney Princess, and Minecraft.

Worldwide sales for Fisher-Price brands were up 9% in the quarter and up 7% year to date, driven by continued strength in our BabyCo business, which includes Baby Gear, newborn and infant toys, and Laugh & Learn, as well as Thomas, was up, too, which was partially offset by other Fisher-Price Friends properties.

American Girl continues to gradually improve, up 1% in the quarter and year to date, driven by the relaunch of our BeForever historical line late last year, as well as the beginnings of a refresh for the Truly Me product line.

On a global basis, MEGA shipping was \$65 million in the quarter and \$103 million year to date, as reported. The performance of the construction business was in line with our expectations for the first half of 2015.

We're building a solid foundation in 2015 to drive growth in the construction category on a global basis in terms of leveraging our brands, new licenses, and our global supply chain, as well as our marketing, distribution, and sales capabilities.

However, our arts and craft business was down as we de-emphasized nonstrategic, lower-margin product lines.

As Chris mentioned, our overall growth was fairly broad based across geographies in constant currency. Sales in the North American region were down 2% in the quarter, primarily due to lower sales of Monster High, but up 3% year to date, reflecting a much improved retail inventory position as we exited 2014.

Sales in our European region were up 4% in the quarter and down 1% year to date, driven by strong growth in Russia and other emerging Europe, which was partially offset by core brand softness in some western European markets. We also made good progress against our European retail inventory overhang in the quarter and expect to have clean retail inventories heading into the holiday season.

Sales in our Latin America region were down 3% in the quarter and up 1% year to date in constant currency, with growth in our two largest markets, Mexico and Brazil, being offset by several smaller countries that faced very difficult macroeconomic environments.

Sales in our Asia-Pacific region were up 22% in the quarter and up 20% year to date in constant currency, driven by fairly broad-based growth, which was led by China.

Looking at the P&L, we continue to invest in retail promotions and strategic pricing to improve topline momentum. And our adjusted gross margin remained solid at 47.9% in the quarter, up 70 basis points versus 47.2% in 2014. Our adjusted gross margin was 48.3% on a year-to-date basis, which was down 60 basis points versus 48.9% in the prior year.

As it relates to the key drivers of gross margin in the quarter and year to date, our price increases and our cost-savings initiatives were offset by a higher product related cost. Year-to-date adjusted gross margins were negatively impacted by mix, primarily related to the acquisition of MEGA, and our overall basket of product related cost is roughly consistent with our forecast as we enter peak production.

Finally, the currency impact of the timing of inventory movement and hedging gains had a positive effect on our gross margin rate in the quarter and year to date. We continue to anticipate a negative impact in the second half of 2015 related to foreign currency, including the year-over-year impact on intercompany sales of inventory from the significant strengthening of the US dollar.

Our advertising rate remains higher, reflecting our investments to support key core brands throughout the year, including additional spending in China and Russia, where we are investing ahead of growth and saw acceleration in growth in shipments and POS.

SG&A was down versus the prior year in absolute dollars on both a reported and adjusted basis as we continue to streamline our organization to facilitate faster decision-making. Importantly, with MEGA in the base business for two months in 2014 [**Clarification: Q2 2014**], the impact of our cost-saving initiatives is becoming more apparent. And we continue to execute aggressively on our Funding Our Future cost-savings programs where we delivered \$29 million in overall gross savings in the quarter and \$48 million year to date, which was split roughly even between gross margin and SG&A/Other.



We are on track to deliver \$125 million of gross savings in 2015, weighted to the second half, and remain committed to delivering at the high end of our two-year target of \$250 million to \$300 million.

In the quarter, our adjusted operating profit was \$23 million and \$8 million year to date. Adjusted EPS for the quarter was \$0.01, and year to date, it was a negative \$0.07 per share.

Now let's review our POS and shipping performance by core brand in more detail. I will focus my remarks on the first half, which we believe provides the best indication of underlying trends by including Easter in both time periods.

Overall, global POS was up low single digits, with international POS up mid-single digits and US POS down slightly. While very early in the year, we are encouraged to see continued positive global POS for all of our core brands, with the exception of Monster High.

For the first half, Barbie POS was up slightly on a global basis, with double-digit gains in the US partially offset by a mid-single digit decline in international markets.

Worldwide shipping for Barbie was down 8% in constant currency year to date, with North America down 6% and international down 9%. We believe US POS trends were aided by a better retail inventory situation and our ability to integrate our new brand campaigns more quickly in this market. We were pleased to see the continued improvement in Barbie, particularly in the US, and we expect to see shipments and POS more closely aligned as the year progresses as retailers buy what is selling.

International POS is still impacted by Frozen, the slower rollout of our new brand campaigns, and less clearance activity in 2015 in Latin America. Overall, international POS and shipping for Barbie are relatively aligned.

As it relates to our high school franchises, Monster High POS and shipping remain challenged as we continue to work to stabilize the business. And Ever After High continued to gain traction in most existing international markets, with global POS and shipping both up in the quarter in constant currency.

Global POS for total Fisher-Price brands, including Thomas, was up mid-single digits, driven by positive POS for the baby business in the US and, importantly, double-digit gains in international markets. Global shipping for Fisher-Price brands were up 7% in constant currency, with North America up 5% and international up 9%.

For Thomas, we continue to see solid gains for POS and shipments in both the US and international markets in constant currency and we saw similarly strong trends for Hot Wheels.

Turning to the balance sheet, our balance sheet continues to be strong. Our owned inventory was down about \$30 million year over year and, consistent with our expectations, we ended the quarter with about \$300 million of cash on our balance sheet as we continue to tightly manage our seasonal working capital needs and reduce our owned inventory levels.

Our second-quarter results also reflect our ongoing commitment to disciplined capital deployment. As Chris said, dividends remain our first priority after reinvesting in the business and the Board declared a third-quarter dividend of \$0.38 per share, which is flat compared to the third quarter of 2014. As we continue to execute aggressive cost-reduction initiatives, we believe we can make the investments necessary to grow our business while continuing our current dividend.

Clearly, as we have done historically, we will evaluate capital deployment priorities quarterly with the Board.

Looking forward, we continue to monitor the currency markets and macroeconomic outlook closely, especially given the recent economic events in the eurozone. Overall, based upon our year-to-date financial results, we continue to believe the 2015 outlook that we provided in last quarter's investment call remains achievable.

In closing, while we recognize we have got a lot of work to do, we continue to see signs of stabilization of revenues and POS on an underlying basis, as well as improving financial performance across the P&L in the first half of 2015. We are pleased that our turnaround remains on track.

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

QUESTION AND ANSWER

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**Operator**

(Operator Instructions). Mike Swartz, SunTrust.



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**Mike Swartz - SunTrust Robinson Humphrey - Analyst**

I just wanted to touch on Barbie real quick, and it sounds like POS has started to turn, and I think Richard had made some commentary just about getting that brand back on track. Is there any timeline we should be thinking about? Is that back half of this year, going into 2016, because I think a lot of what we have heard and what is out there is just that the competitive environment in dolls is getting a little more -- or stiffer and stiffer as we go through 2015?

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**Richard Dickson - Mattel - President, COO**

Hi, Mike, it's Richard. I think we are pleased, as I mentioned, with the progress that we are making on the brand and I think most evident with our US performance in the first half, POS all indicating great momentum, but we are going into a very competitive second half.

Now we are poised in a better place than we have been in a while, and certainly all the research and indicators that we have in terms of girl consumer interest in the brand is back in the right trajectory. There is obviously a lot of interest in the programming that we have for the back half. We are continuing on a daily basis to beef up that programming, in line with the competitive landscape that we have, and we are encouraged with early signs of momentum based on the first half.

We continue to re-emphasize internationally all the programs that we have. We are working very hard around the world to continue to execute against the new creative and we will continue to slug it out on a daily basis.

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**Mike Swartz - SunTrust Robinson Humphrey - Analyst**

Thanks for the color. And then, if I can just ask one more for Kevin. I think you mentioned in the first half you had a benefit from just the impact of, I guess, timing of inventory from FX. Is that right? And then, as we think about the back half of the year, how much of a flip do we see as that turns to the negative?

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**Kevin Farr - Mattel - CFO**

Yes, I think as we looked at the first half of the year, we are impacted by ForEx in absolute dollars, but when you look at it at a rate perspective, the change in strengthening of the US dollar impacted sales more because you use the current rates of translation.

And with regard to inventories, we're really seeing inventories flow through from a couple of quarters ago when they were purchased by our foreign subsidiaries, and those subsidiaries, both with respect to the translation they used, was not as weak as it is today, as well as our hedging related to that was better than the rates today.

So we saw a benefit from a rate perspective, but as we look forward, we do expect that the rate with respect to -- we have given a forecast of 4% to 6% on the topline for the full year due to translation. We expect that to mitigate as we get to the second half of the year because we are down minus 7 at this point in translation for the first half.

And then with regard to gross margins, we expect that impact to be higher because the fact that the translation is going to occur when the dollar already strengthened in the first half of this year, as well as our hedging in the back half of the year isn't at the rates that we were at earlier in the year.

So we should see an impact of 30% to 35% -- \$0.35 per share on EPS in the back half of the year [**Clarification: \$0.30 to \$0.35 per share**]. And year to date, that impact is only about \$0.02 a share.

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**Mike Swartz - SunTrust Robinson Humphrey - Analyst**

Okay, great. Thank you so much for the color.

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**Operator**

Eric Handler, MKM Partners.





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**Eric Handler - MKM Partners - Analyst**

Yes, thanks very much for taking the question. When I look at your Fisher-Price business, this was the first time since the fourth quarter of 2012 that you actually had an up quarter, and I believe back then you had the benefit of the acquisition of HIT Entertainment. So, do you think we have turned the corner here where you can be -- you can show several quarters in a row of positive growth at Fisher-Price or is there something that specifically helped Q2?

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**Richard Dickson - Mattel - President, COO**

Across the board, we are seeing some early signs and good positive results from many of the initiatives that we have been working on in the Fisher-Price brand for quite some time. Mainly, I would say there has been an incredible amount of innovation in our product, new aesthetics on Baby Gear, as well as new marketing campaigns that have been tested and arguably some of the most effective work that the brand has done in several years.

I think it's a combination of many things. As we see product being more embraced, retailers get more excited about the pricing strategies and retail execution that we have had recently, and, again, the marketing initiatives that the brand has done are starting to really take shape. So we are encouraged with the momentum that we are building with Fisher-Price, but this is a long-term strategy, obviously, with lots of hurdles ahead, but we are encouraged with the early signs in many parts of the brand.

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**Chris Sinclair - Mattel - Chairman, CEO**

One thing to amplify, Eric, when you look at Fisher-Price's performance, a lot of the things Richard talked about clearly driving it, but we're also seeing enormous traction in emerging markets and we would certainly expect that to continue and build.

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**Eric Handler - MKM Partners - Analyst**

Great, thanks a lot.

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**Operator**

Drew Crum, Stifel.

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**Drew Crum - Stifel Nicolaus - Analyst**

So 26% growth for Wheels at constant currency, was there anything there specific that drove that growth? How much impact did the Marvel and Star Wars licenses have on performance and was that something we should expect to continue in the second half?

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**Chris Sinclair - Mattel - Chairman, CEO**

Probably you want to take that up. Hot Wheels, right?

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**Richard Dickson - Mattel - President, COO**

Our licensing initiatives with Hot Wheels has really helped drive additional sales in the Hot Wheels brand. Notably, though, to recognize that our basic car business is also healthy and growing.

So we have leveraged licensing and, as we have initiated with our strategic priorities, partnerships as a way to infuse relevance, pop culture relevance, and additional incremental business for the brand.

We obviously are very excited about Star Wars and being part of the momentum that that property will have and enjoying some great Hot Wheels momentum in partnership with Star Wars, as well as our other licensed initiatives within Hot Wheels are starting to really show the power of strategic partnerships when leveraging a big platform brand like Hot Wheels.



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**Chris Sinclair** - *Mattel - Chairman, CEO*

Yes, and I think we're also seeing more traction with Hot Wheels in emerging markets like China.

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**Drew Crum** - *Stifel Nicolaus - Analyst*

Got it, okay. And just one more for me, guys. I think you acknowledged some lost shelf space in the fall of last year and with your spring line this year. What are your expectations for the second half of this year? Any additional detail or color you can provide there would be helpful. Thanks.

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**Chris Sinclair** - *Mattel - Chairman, CEO*

I am sorry. We had a hard time hearing on that, Drew, but I guess you're talking about shelf space, right?

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**Drew Crum** - *Stifel Nicolaus - Analyst*

Yes, shelf space, correct.

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**Chris Sinclair** - *Mattel - Chairman, CEO*

Look, I think we have talked about this before, but we lost quite a bit of space between last fall and the spring sets. That's largely in the numbers we are contending with. That's been some of the issues on managing inventory and shipments that we have been dealing with.

We think we probably have a little bit more to go in spots for the fourth quarter, but we have put in place a lot of activity to get secondaries to build our promotional inventories and things like that, and our shelf productivities and retailer profit turns have been excellent the last few months. So we are selling hard to make sure we don't see any more slippage, and hopefully we can offset with our secondaries any remaining space loss. But I think we are beginning to at least staunch that issue and turn the tide a little bit.

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**Kevin Farr** - *Mattel - CFO*

And I think, Drew, as I mentioned in the first-quarter investor call, we really have reflected in our plan for the year higher sales adjustments than our average rate historically, and that was really put in place to combat that shelf-space loss by having the ability to do out-of-aisle displays and do more promotions, so those are one of the things, along with we put more advertising dollars. We have said, look, we're going to be at the high end of the range of advertising so we can advertise and promote more to support that additional space productivity.

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**Drew Crum** - *Stifel Nicolaus - Analyst*

Got it. Okay, thanks, guys.

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**Operator**

Taposh Bari, Goldman Sachs.

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**Taposh Bari** - *Goldman Sachs - Analyst*

I had a question on MEGA. Surprised by the revenue number there. It seems like there is some strategic lower-margin cleanup happening there. If you can just help size up that part of the business, it looks like MEGA was doing about \$350 million LTM since you acquired it. How much of that piece is going away as part of the strategic initiative?



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**Chris Sinclair - Mattel - Chairman, CEO**

I'll take this one. Look, MEGA, actually you have to disaggregate it a bit, but there's a few things going on. One, there is no doubt we had some integration issues and some delays in startup, particularly in Europe, for some labor reasons and so forth. So we got off to a little bit of a slow start there.

We have also been focusing heavily on the core construction part of the business and de-emphasizing a little bit the arts and crafts piece, which what you are really seeing in the results right now is the arts and crafts is what has been pulling things down a bit and construction is actually performing quite well.

Certainly as we have gotten through the integration issues, I would tell you the last six weeks we have had very positive momentum on MEGA, and if you look at the licensed properties and activity we have coming forward in the next six months, we are actually feeling very good about that business, a lot of optimism going forward. But we are going to continue to do some cleanup on the arts and crafts business.

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**Kevin Farr - Mattel - CFO**

Yes, I think one of the things we are really excited about now is the success of Minions movie, which is a license that we have, and I think also in the back half of the year Halo is launching their latest game, so we have also got that from a tailwind in the back half of the year.

And then, obviously, we are very excited about next year trajectory from Teenage Mutant Ninja Turtles, so making good progress, as well as we are launching Monster High on that platform here in the fall.

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**Taposh Bari - Goldman Sachs - Analyst**

Great, and then just two more and I will pass it along. One, Kevin, for you, can you quantify the impact that the FX timing and inventory receipt timing and hedging, et cetera, had on second-quarter gross margins?

And then, the second question is just related to the Disney revenue piece. First, congrats on renewing the Pixar license or the Toy Story license, but on the actual Princess loss next year, you have given us some parameters around what that business has done in the past, but can you give us some sense on what the margin is related to that or what the incremental margin is on that, whatever it is, the revenue piece ultimately is, just to size up the earnings hole?

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**Kevin Farr - Mattel - CFO**

Yes, I think as I said for the first half of the year in absolute dollar terms, ForEx was a hit to gross margins. As a percentage of the rate, I am not going to get in the details of that, but it was the driver of the increase in the quarter, offset by higher royalties.

And then with regard to the Disney Princess, I'll just, hey, it's a good margin business. It's higher on average than our average overall rate.

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**Taposh Bari - Goldman Sachs - Analyst**

Okay, thank you.

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**Operator**

Felicia Hendrix, Barclays.

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**Felicia Hendrix - Barclays Capital - Analyst**

So in your prepared remarks and in the Q&A, you all called out the Barbie POS plus shipment imbalance. I was just wondering if you could talk about any other lines that face similar imbalance, and where do you stand in getting closer there?



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**Chris Sinclair** - *Mattel - Chairman, CEO*

There aren't too many of the other businesses that have quite the same imbalance. We still have some issues on the Highs, which are dropping on inventory faster -- or shipments, I should say, faster than POS, but a lot of that is related to cleaning up inventory in places like Europe.

Barbie has probably been the most pronounced in terms of a mismatch, but part of that, if I can explain it a little, is related to what we measure in POS and what we actually include in shipments. DVD sales and consumer product sales are reflected in shipments. Those are actually the bigger part of the imbalance than the core Barbie business, which is actually tracking quite well in terms of shipments and POS.

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**Felicia Hendrix** - *Barclays Capital - Analyst*

Okay, thanks. And then, could we just talk about -- so American Girl improved sequentially. Just given the two stores that opened at the end of this year, and then you had Nashville open at the end of May, I would have thought it would have done a little bit better. So maybe you could talk a bit about what is happening at American Girl?

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**Richard Dickson** - *Mattel - President, COO*

We have been working, obviously, to drive some refreshes, the launch -- relaunch of our BeForever historical line late last year, as well as the newly refreshed Truly Me line, which is the largest piece of the business. All of these are showing signs of improvement.

The new retail stores are meeting and exceeding expectations, and obviously, I mentioned the successful launch and expansion of our first store within a store in Mexico City.

We recently rebranded our My AG line to Truly Me, and so there has been a lot of really great refresh work that we are starting to see the results. The new product line in the market is beginning to show improvement and that's, frankly, been the objective that we are starting to see pronounced.

That said, we have more work to do to reinforce American Girl's point of differentiation, personalization, even our in-store experience. All of that is top of mind and worked on by the brand. We will have more news to come throughout the year on this one.

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**Felicia Hendrix** - *Barclays Capital - Analyst*

Great, thank you. And then just, Kevin, for my final question, I just want to -- on the balance sheet, so in the quarter your cash balance was \$300 million, and seasonally in the third quarter, the cash typically goes down. So I was just wondering if you could talk about your comfort with the cash balances, because if you look at recent history you are at the lower end of the range where you have been.

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**Kevin Farr** - *Mattel - CFO*

Yes, I think we are comfortable at the \$300 million level. That is actually a little bit better than our plan, so we are tracking ahead. And we're also tracking ahead on the usage of cash flow. So we are very comfortable at this point where we stand on cash.

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**Felicia Hendrix** - *Barclays Capital - Analyst*

Okay, great. Thank you.

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**Operator**

Tim Conder, Wells Fargo.



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

Just a couple of clarifications, just wanted to make sure that I heard properly. From a broad global channel inventory perspective, you continue to expect to have that cleaned up by the end of the third quarter. And then would you also -- if I am interpreting your commentary right, we should expect a wholesale trough here in Barbie in the second or third quarter? Is that correct?

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**Chris Sinclair** - Mattel - Chairman, CEO

I don't know if I quite understood your second question, Tim. Can you try that again on the trough on Barbie?

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

Yes, I mean, if we look at the way Barbie is trending with the wholesale trends, should we expect that maybe still it would be negative, but -- on a year-over-year basis, but potentially less negative here going forward. So maybe we are seeing the trough, the inflection point at that wholesale level?

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**Chris Sinclair** - Mattel - Chairman, CEO

Yes, I got you. The answer to that question is yes. We do think it is going to start to align better and we should start to see that mitigate. And the first question, remind me.

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

Oh, cleanup of the broad channel pockets of inventories.

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**Chris Sinclair** - Mattel - Chairman, CEO

Yes, sorry. No, I think we are feeling we are getting that pretty well under control, Tim. Europe still has some issues, but I think we are working through those, so we should be okay. I think Latin America has done a pretty good job of cleaning things up.

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

Okay. And then on the Funding The Future, Kevin, you have given some good guidance here on the gross savings and some historical perspective. Of that 1-1/4 this year largely weighted, as you said, to the back half and then [250] by the end of 2016, any color or commentary you can say about what we should expect from a net number perspective?

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**Kevin Farr** - Mattel - CFO

Well, again, I think I'm not going to give you a net number perspective, but I think you have got the couple of components. We have laid out in 2014 what the integration and acquisition charges are for MEGA, and then I think the other thing we have laid out is severance in 2014. And we expect severance -- last year, it was \$51 million. It is likely that severance is going to be above that number next year -- or this year, I'm sorry.

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

In 2015, okay. Okay. Okay, and then expect that to decline in 2016?

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**Kevin Farr** - Mattel - CFO



Yes.

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

Okay, okay. Lastly, you have talked about some key hires that you have done over the last six months. How do you feel at this point about the team that is assembled? Are you pretty well done, have the team set across the organization?

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**Chris Sinclair** - *Mattel - Chairman, CEO*

Actually, Tim, I think we have said before we have made some key hires. We have obviously reorganized and put people in different positions, but we still have a number of active searches going on right now, which we will probably have more to talk about in the coming months.

But clearly, we have, I think, flagged in the past we have some more marketing talent we are looking at. We are certainly working on content and e-commerce and a number of other areas. So no, we are not done with recruiting at this point.

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

Okay, thank you.

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**Operator**

Linda Bolton Weiser, B. Riley.

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

You gave quite a bit of commentary on Barbie POS. I think you said it was up double digit in the US in the first half. Can you give just a little bit more and tell us was it actually better, like an acceleration of growth in the second quarter or about the same or a little slower growth in terms of POS in the US for Barbie?

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**Kevin Farr** - *Mattel - CFO*

Linda, I think it's challenging because in 2015, Easter was in the first quarter, and in 2014, Easter was in the second quarter, so as we look at POS, it is better to look at it from the perspective, particularly in the US, on the first-half basis. And we did see it being up double digits in the first half for Barbie.

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

Okay. And then just on the gross margin, you said input costs were higher or product-related costs. Can you give a little more color on -- are you actually experiencing lower resin costs year over year? And what about other commodity inputs? And then, also, I would expect labor costs are probably up, but can you give a little more color on the actual commodities and labor?

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**Kevin Farr** - *Mattel - CFO*

Yes, I think commodities, we are seeing lower resin costs, but we do see other input costs outside of resins being impacted as a challenge.

But the biggest issue is labor cost, direct labor cost, and that has gone up double digits. And again, that's why we are very focused in on our systemic cost-savings initiatives, particularly with regard to automation to try to take direct labor out. And we are progressing on that. I think year to date we have taken out about 2,500 of the 3,000 people that we had targeted for this year, so we are making progress there.

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**Chris Sinclair** - *Mattel - Chairman, CEO*



Linda, just one clarification on resin worth noting, too. That came down a lot slower than we would have anticipated and primarily in Asia resin. That started to turn finally, but we didn't get a lot of help on resin even coming through the first half. That should get a little better as we go forward.

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**Kevin Farr - Mattel - CFO**

And I think, as I stated, I think our overall basket of costs are about what we expected them to be, so when you look at the fact we take a mid-single digit price increase, right now we're pretty comfortable that's going to be reflective in what our expected costs are in the second half of the year during our peak season.

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

Thank you.

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**Martin Gilkes - Mattel - VP Corporate Strategy & IR**

Operator, we have time for one last call or one last question.

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**Operator**

Jaime Katz, Morningstar.

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**Jaime Katz - Morningstar - Analyst**

Thanks for squeezing me in. I have just a quick question on speed to market. You guys had mentioned it and I am curious how the organizational changes that you have made have impacted that, and maybe how you think about where inventory turns go? Do they stay the same and you have more frequent product launches or is there room to make significant impact in that metric?

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**Richard Dickson - Mattel - President, COO**

We have been working very closely with the global supply chain and putting stealth efforts into streamlining product development processes, ranking and prioritizing within our brands, as well as Toy Box, particular products that we want to fast track. There are specific initiatives with names for these initiatives that are now being executed.

It is early days, but the results of these initiatives are proving incredibly effective and, frankly, inspiring the organization overall to believe that we can really change the paradigm of the way that the -- certainly the product development process works overall with additional speed to market that is, frankly, to some extent, price of entry today in terms of what consumer expectations are.

So we are encouraged with the early signs. We believe that this will only get better and more effective as time moves on.

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**Kevin Farr - Mattel - CFO**

And I would just add, I think it's a huge opportunity for us with regard to our global supply chain. We are very focused on cutting down lead times, materials, and just about every aspect of shortening the time from ideation to getting it to the store shelves, we are working on it in some form or fashion.

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**Jaime Katz - Morningstar - Analyst**

Are you guys utilizing the Quirky relationship for that in some way, shape, or form that maybe is a lot larger than we think?



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**Richard Dickson - Mattel - President, COO**

We are very active on a day-to-day basis leveraging the Quirky relationship, and I think we will probably in the coming calls have more updates in terms of the results, some of which speak to speed to market and product development, new ideation, and certain challenges that we have given the Quirky community, all of which is active and, frankly, quite exciting and I think we will have some news to share as calls come in.

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**Jaime Katz - Morningstar - Analyst**

Thanks.

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**Chris Sinclair - Mattel - Chairman, CEO**

Thanks. Okay, are we done now, Martin?

Listen, thank you very much, everybody, for joining us. I know that Kevin is going to be available for some follow-up discussions with some of you, and we look forward to following up in the coming months. Thanks again.

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**Martin Gilkes - Mattel - VP Corporate Strategy & IR**

There will be a replay (multiple speakers). Go ahead.

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**Operator**

Go ahead.

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**Martin Gilkes - Mattel - VP Corporate Strategy & IR**

There will be a replay of this call available beginning at 8 PM Eastern time today. The number to call for the replay is 404-537-3406 and the passcode is 67921610. Thank you for participating in today's call.

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**Operator**

Ladies and gentlemen, thank you for participating in today's conference. That does conclude today's program. You may all disconnect. Have a great day, everyone.

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