

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

MAT.OQ - Q3 2020 Mattel Inc Earnings Call

EVENT DATE/TIME: OCTOBER 22, 2020 / 9:00PM GMT

OVERVIEW:

Co. reported 3Q20 gross sales of \$1.818b, net sales of \$1.632b, adjusted operating income of \$401m and adjusted EPS of \$0.95. Expects 2020 gross sales in constant-currency to be flat to plus 1%.

CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

Felicia Rae Kantor Hendrix *Barclays Bank PLC, Research Division - MD & Senior Equity Research Analyst*

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

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

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

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

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

William Michael Reuter *BofA Merrill Lynch, Research Division - MD*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Mattel, Inc. Third 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 VP, 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 third quarter financial results. We will begin today's call with Ynon and Anthony providing commentary on our results, after which, we will provide some time for Ynon, Richard and Anthony to take your questions.

To help supplement our discussion today, we have provided you with a slide presentation. Our discussion, slide presentation and earnings release reference non-GAAP financial measures, including gross sales; adjusted gross profit and adjusted gross margin; adjusted other selling and administrative expenses; adjusted operating income and loss; adjusted earnings and loss per share; earnings before interest, taxes, depreciation and amortization or EBITDA; adjusted EBITDA; free cash flow; and constant currency.

Please note that the gross sales figures referenced on this call will be stated in constant currency. 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 described some of these uncertainties in the Risk Factors section of our 2019 annual report on Form 10-K, our Q2 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 Third Quarter 2020 Earnings Call. I hope that you and your families are staying healthy and safe. This was a very strong quarter for Mattel. We saw a major upswing in top line and a significant increase in profitability. We continue to make meaningful progress towards becoming an IP-driven, high-performing toy company. Here are some of the key highlights for the third quarter. Gross and net sales grew strongly versus prior year. Gross sales were \$1.8 billion, up 10% as reported and up 11% in constant currency. Net sales were \$1.6 billion, also up 10% as reported and up 11% in constant currency. Adjusted gross margin was 51%, a substantial improvement of 410 basis points.

This was the ninth consecutive quarter in which we improved adjusted gross margin on a year-over-year basis. Adjusted operating income grew strongly to \$401 million, up 131%, and adjusted EBITDA improved significantly to \$470 million, an increase of 90%.

The toy industry as a whole grew meaningfully and continues to demonstrate its resilience in challenging economic times. The industry is yet again proving to be a strategic category for retailers as parents continue to prioritize spend on their children and look for high-quality products at affordable price points. Mattel's growth outpaced the industry as we gained share in key markets around the world and achieved growth in each of our 4 regions. Our POS momentum remained strong throughout the quarter, with total company POS up double digits and outpacing sales. POS momentum has continued into October. A key highlight for the quarter was our growth in e-commerce, where we continued to see sales outpace other channels even as more stores reopened. E-commerce grew by approximately 50% versus prior year, and it now represents approximately 30% of our global POS as we expanded our listings and continued to drive performance in this important channel. Our supply chain is fully operational as we chase the extraordinary growth in consumer demand for our products.

Looking at our third quarter gross sales in constant currency by category. Our strong performance was driven by growth in our Dolls category, Action Figures, Building Sets, Games and Other category and Vehicles. This was partially offset by Infant, Toddler and Preschool.

Our Doll category gross sales grew by 24% year-over-year, driven primarily by Barbie and the newly launched Cave Club doll line. Barbie continued to perform exceptionally well and grew by a remarkable 30%. Gross sales increased across almost every segment, driven by a combination of great product, new innovation, cultural relevance and highly effective demand creation. POS growth rate in our Doll category outpaced shipments. Barbie POS was up more than 50%, which speaks to the strength and ongoing momentum of the franchise.

Per NPD, in the third quarter, Mattel was the #1 doll manufacturer in the U.S., Europe and Latin America and gained share in all 3 regions.

In the U.S., Barbie was the #1 toy property for 12 of 13 weeks in the quarter and finished the period as the #1 toy property overall, not just in dolls.

American Girl also improved substantially. Gross sales were down a mere 2% or \$1 million compared to a decline of 16% in the first half. This encouraging performance was in spite of COVID-19-related retail disruptions, including a large drop in overall tourist traffic to our flagship stores as well as the permanent closure of 4 of our retail stores this year. American Girl direct-to-consumer sales, however, doubled and almost fully

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 50% of sales.

Our Vehicles category gross sales were up 8% year-over-year, driven by the strong performance of Hot Wheels and Matchbox. Hot Wheels grew 9% with broad-based growth across segments, including Monster Trucks and Super Mario Kart. Hot Wheels also benefited from improved impulse purchases as retail stores reopened and foot traffic increased. POS growth in our Vehicles category was twice the rate of sales growth. Hot Wheels' POS was up double digits, reflecting the significant demand for this brand. Hot Wheels gained share in the third quarter in the U.S. and remains the #1 vehicles brand per NPD.

Our Infant, Toddler and Preschool category gross sales were down 5% year-over-year due to a decline in Fisher-Price Friends, as we continue to exit underperforming licenses, and a decline in Fisher-Price and Thomas & Friends. Fisher-Price core was down only 1%, which was a meaningful improvement compared to a 19% decline in the first half. These encouraging results were driven by growth in the Infant and Toddler segments, offset by the Toy Story 4 comparison in our Imaginext line. Category POS was up low single digits and continues to outpace shipping. Fisher-Price remains the #1 Infant/Toddler/Preschool manufacturer in the U.S. per NPD.

Gross sales for Action Figures, Building Sets, Games and Other, our challenger categories, together grew 14% year-over-year, driven by Games and Plush. Games achieved its seventh consecutive quarter of year-over-year growth. UNO continued to perform exceptionally well, remaining the #1 item in the Games and Puzzles category in the U.S. per NPD. Games POS remained strong and was up double digits in the quarter. Our Plush category continued to show strength with this year's launch of Star Wars: The Child. In the U.S., The Child was the #1 selling item in the Plush category in the third quarter and year-to-date per NPD.

Building Sets were down slightly, a significant improvement compared to the first half. We are encouraged by the double-digit POS growth in the quarter. As expected, Action Figures declined due to a Toy Story 4 year-over-year comparison. The decline was partially offset by Jurassic World, which was up in the third quarter and year-to-date in spite of being 2 years after the release of the movie as it continues to establish itself as an evergreen property. We also successfully introduced the Masters of the Universe collector toy line, with more to come in anticipation of the franchises relaunch next year.

In the U.S., we gained share in the Action Figures category in the third quarter, per NPD. Given the strength of our brands, we have accelerated our direct-to-consumer offering of collectors product to targeted segments of our consumers. We continue to leverage our capabilities in e-commerce and are looking to grow share and outpace the overall industry growth.

Looking at gross sales by region, in constant currency. We achieved growth in each of our 4 regions despite COVID-19 disruptions and local restrictions that impacted some locations. By the end of the third quarter, about 2% of all retail outlets that sell our products, representing about 1% of our revenue base, remain closed. While retailers were restocking the shelves, we still exited the third quarter with lower retail inventories year-over-year.

Looking at regional gross sales performance in constant currency for the quarter. North America was up 13%, driven by broad-based strength across almost all categories. POS was up more than 20%. Mattel was the #1 manufacturer in the third quarter in the U.S. and gained share throughout the quarter per NPD. EMEA was up 16%, driven by strong performance across all of our major markets and the continued shift to e-commerce. POS also accelerated and slightly outpaced sales growth. In Europe, Mattel grew at twice the rate of the industry and gained share throughout the quarter, per NPD. Asia Pacific was up 3%, driven by solid growth in Australia. POS was flat in the quarter compared to a double-digit decline in the first half as several markets continue to experience restrictions and slow recoveries. Latin America was up 3%, driven by an improving retail market with store re-openings and increased foot traffic. POS was up low single digits and in line with sales.

Our work over the past 2 years to develop a flexible and results-oriented organization continues to serve us well. While we faced significant disruptions in the first half of the year and some COVID-19 challenges still remained during the third quarter, we demonstrated our strong execution capabilities and the power of our brands. We have clearly made significant progress in our short- to midterm strategy to restore profitability and regain top line growth. And at the same time, we continued to advance our mid- to long-term strategy to capture the full value of our IP.

We recently announced a new film project based on Thomas & Friends. The film will be coproduced and directed by Marc Forster, the acclaimed filmmaker and Director of James Bond Quantum of Solace, Christopher Robin, and Finding Neverland, among others. We also recently greenlit 104 episodes and 2 specials for the Thomas & Friends television series. These shows will premiere in fall of 2021. Additionally, we announced Season 13 of Fireman Sam and greenlit Season 3 of Polly Pocket. Both shows will be distributed globally through broadcast television and streaming services. Production on our 2 Masters of the Universe animated series is ongoing, and we look forward to releasing them on Netflix next year. The successful introduction of the product line this year, combined with these animated series, will lead the groundwork for the holistic relaunch of this iconic franchise.

We continue to advance our digital gaming strategy with the launch of our Hot Wheels integration into World of Tanks on console and the upcoming launch of Hot Wheels Open World on Roblox. We also continue to see growing engagement in our existing digital games, including UNO, Phase 10, Scrabble, Barbie Dreamhouse, Hot Wheels and more.

Looking beyond the third quarter, based on the POS momentum we are seeing, the low retail inventories and the early start of the holiday shopping season, we expect gross sales to grow in the fourth quarter. We are working closely with our retail partners on the challenge of meeting the extraordinary growth in consumer demand heading into the holiday season.

Looking to the full year. With continued operational savings and margin expansion, we expect to see strong EBITDA growth. With that said, in spite of the positive outlook, we are mindful of the COVID-19 volatility and other macroeconomic uncertainties, which could negatively impact performance.

In closing, the third quarter represents a strong upswing compared to the first half as we were able to regain top line growth and exceed industry performance. We saw growth in every region in constant currency and broadly across our portfolio. Our supply chain continued to perform very well and worked in close partnership with our brand teams and commercial organizations. We achieved significant improvement in all key profitability metrics, including gross margin, operating income, EBITDA and free cash flow. There is strong demand for our product with POS outpacing shipments, and we expect continued growth through the rest of the year. We are also making significant progress on our strategy to capture the full value of our IP with 10 film projects already announced and numerous television projects in development or production, with more to come. We continue to demonstrate meaningful progress towards becoming an IP-driven, high-performing toy company. I could not be more proud of the work of the entire Mattel team. Every single employee deserves full credit for their commitment and contribution towards putting us back on a profitable growth trajectory. We remain focused on executing our strategy and the creation of long-term shareholder value.

And now Anthony DiSilvestro will cover the financials in more detail. As you know, this is Anthony's first earnings call as CFO. He has already made a real impact since joining the company in June. I'm sure you will all enjoy working with him. Anthony, over to you.

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Thanks, Ynon. We had an outstanding quarter with results exceeding our expectations, following a first half that was impacted by store closures and restrictions due to COVID-19. We are very pleased with the continuing improvements in gross margin, a key driver of our overall financial performance as we continue to benefit from our cost savings programs. Our cost savings programs, in aggregate, delivered \$37 million of savings in the quarter, bringing the year-to-date total to \$149 million. Cumulatively, we remain on track to exceed \$1 billion of savings exiting 2020.

Today, we will be providing 2020 guidance, reflecting our year-to-date performance and positive outlook for the fourth quarter, including the all-important holiday season.

I'll now review our detailed results.

In the third quarter, we generated gross sales of \$1.818 billion and net sales of \$1.632 billion, both increasing by 10% as reported and 11% in constant currency versus prior year. On an adjusted basis, we generated \$401 million of operating income, increasing by 131% year-over-year. This substantial increase reflects gains across the P&L, including higher sales, gross margin expansion, reductions in advertising, in part due to timing, and lower SG&A. Adjusted EPS in the quarter was \$0.95, 265% higher than the prior year. Adjusted EBITDA was up substantially, improving by \$222

million or 90% to \$470 million. This was driven by gains in operating income partly offset by lower depreciation as we've reduced our capital spending over the past few years.

Bridging our third quarter gross sales performance by reporting segment. North America increased by 13% in constant currency versus prior year. The increase was fueled by double-digit POS growth, which outpaced the industry as our teams, together with our retail and online partners, executed extremely well. International increased by 10% in constant currency versus prior year. This was driven by 16% growth in EMEA, benefiting from accelerated e-commerce growth, while Latin America and Asia Pacific each delivered 3% growth, a significant improvement from the first half as retail doors continued to reopen. American Girl gross sales declined 2% in the quarter as we continued to make progress on our strategy to rationalize our retail footprint and transition more of the business to DTC.

As Ynon mentioned, the continued high growth of e-commerce was a key contributor globally. Total company gross sales in constant currency increased 11%. Gross sales, as reported, increased 10%, including a 1-point negative impact from foreign currency translation, primarily due to the weakening of the Brazilian real and Mexican peso. We achieved continued improvement in gross margin. Compared to 2019, our third quarter adjusted gross margin increased by 410 basis points to 51%. This is the ninth consecutive quarter in which we improved adjusted gross margin on a year-over-year basis. Our cost savings programs contributed 150 basis points of adjusted gross margin expansion. We continued to achieve savings from our ongoing Capital Light program by rationalizing our manufacturing footprint and having successfully reduced our SKU count by over 30%. This 150-basis point gross margin expansion consisted of \$14 million of savings from the Structural Simplification program, which we completed at the end of last year and \$11 million of savings under the multiyear Capital Light program. Gross margin also benefited by 130 basis points from reduced royalties, reflecting lower sales of licensed products. Mix and Other contributed 110 basis points, driven primarily by the benefit of category mix, reflecting the above-average growth of Dolls and Games. And we experienced product cost deflation, adding 20 basis points to gross margin, driven by lower material prices, partly offset by increased conversion costs. On a year-to-date basis, adjusted gross margin was 47.8% compared to 42.9% for the same period last year as we make further progress on our goal to restore profitability.

Moving down the P&L. Advertising expenses for the quarter totaled \$103 million, a decline of 40% compared to 2019. As anticipated, the year-over-year decrease in advertising was primarily due to lower spending in the quarter, reflecting a shift in timing to the fourth quarter as we plan to increase support for our products during the all-important holiday shopping season. We continue to proactively manage our SG&A expenses and have taken additional actions in 2020. Adjusted SG&A for the quarter was \$329 million compared to \$351 million in the prior year quarter, a decline of 6%. The decrease in SG&A was primarily driven by the benefits of the Structural Simplification program and additional cost savings actions taken in 2020.

We also had very strong bottom line performance in the quarter. Adjusted operating income grew from \$174 million to \$401 million, an increase of \$227 million or 131% compared to the prior year quarter. The increase in adjusted operating income was primarily driven by sales growth, gross margin expansion, lower advertising, in part due to timing, and lower SG&A.

Adjusted EBITDA was also up significantly, reflecting the gains in operating income. Adjusted EBITDA increased by \$222 million, or 90% to \$470 million.

Generating free cash flow is a key focus area for us. In the 9-month year-to-date period, Cash from Operations improved by \$80 million from a use of \$514 million in 2019 to a use of \$434 million in 2020, as a lower net loss was partly offset by higher seasonal working capital requirements. For the year-to-date period, depreciation and amortization decreased by \$36 million from \$186 million in 2019 to \$150 million in the current year as we've reduced capital spending levels over the years. Capital expenditures for the 9 months increased from \$76 million to \$90 million. We expect our full year capital expenditures to be in the range of \$125 million to \$150 million, which remains well below historical levels.

Free Cash Flow improved by \$65 million from a use of \$589 million last year to \$524 million in the current year. We believe it is important to begin communicating Free Cash Flow on a trailing 4-quarter basis, given the highly seasonal nature of our business.

On that basis, we generated positive Free Cash Flow of \$130 million over the last 4 quarters compared to \$74 million a year ago, an increase of \$56 million. The improvement in Free Cash Flow was driven by increased cash from operations, partly offset by an increase in capital expenditures.

Turning to the balance sheet. Accounts Receivable increased by \$35 million to \$1.326 billion due to the increase in gross sales. While the dollar value increased, days sales outstanding declined by 5 days, ending the quarter at 73 days as we tightly manage receivables. Owned inventory decreased by \$38 million to \$664 million. The reduction is primarily due to the increased demand for our products.

We ended the quarter with a cash balance of \$452 million, including \$400 million of short-term borrowings. This compares to a cash balance of \$218 million a year ago, with \$230 million of short-term borrowings. The increase of \$64 million in our cash balance, excluding short-term borrowings, is primarily driven by our trailing 4-quarter positive free cash flow.

With no debt maturities until March 2023 and the availability of a \$1.6 billion credit facility, liquidity is expected to be sufficient to effectively execute our strategy. Given our EBITDA growth trajectory, we expect our leverage ratio to continue to decline, and we intend to use excess free cash flow to reduce debt.

With one quarter to go in the year, and more visibility than we had in the early part of the COVID-19 disruption, we are providing sales and earnings guidance for 2020. We expect full year gross sales in constant currency to be between flat to plus 1% as our projected strong second half performance offsets the 13% decline in the first half. We anticipate our gross sales, as reported, to be negatively impacted by 1 to 2 percentage points due to currency translation. Our guidance for the full year gross sales in constant currency reflects mid-single-digit expected growth in the fourth quarter. As Ynon said, we are working closely with our retail partners on the challenge of meeting consumer demand heading into the holiday season. In addition, we are mindful of the COVID-19 volatility and other macroeconomic uncertainties, which could negatively impact performance.

Moving to profitability. We are increasing our guidance for adjusted gross margin, which we provided on our second quarter call. We now expect our adjusted gross margin to increase by 350 to 400 basis points to about 48.5% to 49% for the full year compared to last year's 44.9%. The improved gross margin outlook reflects better-than-expected manufacturing performance, lower-than-anticipated cost inflation and the benefit of favorable volume and mix. Advertising expense is expected to be near the midpoint of our previously communicated range of 11% to 13% of net sales.

On adjusted SG&A for the full year. We expect to generate the \$90 million of net SG&A cost savings previously discussed but expect it to be partly offset by above-target incentive compensation and currency translation, reflecting a U.S. dollar weaker than our initial expectations. Adjusted EBITDA savings from Structural Simplification are still expected to be \$92 million and we remain on track to deliver savings of \$50 million under our Capital Light program. Based on our year-to-date performance and outlook for the balance of the year, we expect full year adjusted EBITDA in the range of \$625 million to \$650 million compared to \$453 million in 2019. The strong forecasted growth in adjusted EBITDA reflects our ongoing progress to restore profitability and is driven by the benefit of our cost savings programs; improved supply chain performance, leveraging the benefit of our 30% SKU reduction; additional actions taken in 2020 to reduce SG&A; favorable product mix; and overall better execution across our organization.

Mattel has delivered an outstanding quarter. In spite of the pandemic, we have continued 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'm very much looking forward to partnering with Ynon and the entire team as we continue to transform Mattel into an IP-driven, high-performing toy company.

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 Michael Ng with Goldman Sachs.

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

Congratulations on the great quarter. And I just have 2 questions. First, there were a few theatrical shifts in the quarter. Minions got pushed out, for instance, and it didn't really show up in your results at all. But I was wondering if you could talk about the impact of theatrical shifts and discuss some of the key partner brand initiatives that you have for this year and next. And then I just have a quick follow-up.

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

Yes. Michael, thank you. As you noted, theatrical releases have been shifted away from this year to next. This, while had some impact on us overall, didn't change the very strong performance we expect to have in the second half of the year and see growth in the fourth quarter. With that said, we do expect performance to be positively impact next year -- impacted next year with the additional releases theatrically. And there's actually a pretty strong slate of movies that we expect, such as Minions, Spirit, Jurassic World 3, Fast & Furious, Top Gun, all at this point, expected to show next year. So this, in addition to our own strong portfolio of brands and products, bodes well for us in 2021.

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

Great, thank you. And I just had a follow-up question on the guidance. Can you talk about some of the assumptions in the 4Q growth outlook of mid-single digits, particularly, given the 10% growth in 3Q? Did 3Q benefit from an outsized amount of retail inventory restocking? Is there anything in particular you'd call out?

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

Just to say that we are seeing a significant upswing in revenues with our top line now forecasted to be up high single-digit in the second half versus a double-digit decline in the first half. We do expect an improved second half, but we did not anticipate such a strong upswing in such a short time when we entered peak production and planned our inventory. POS remains strong, and there is continuing demand for our product. And while our supply chain is fully operational, we are chasing extraordinary growth in demand. We gave you guidance, and we do expect to meet our gross sales guidance, but we cannot be certain we will fully meet the surge in consumer demand. We continue to work closely with our retail partners on the challenge of meeting the strong demand heading into the holiday season.

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Just to add to that. We did see the restocking of retailer inventories. This is the typical seasonal build that we see in the third quarter. But we did end the quarter below last year's levels. And when you consider the strong POS, our weeks of supply are also down at the end of the third quarter.

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

Yes, good add. Thank you.

Operator

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

It sounds like supply chain is good, but can we go into more detail there? We've been hearing about difficulties getting containers, for instance. So how is that supply chain? How are your factories in Asia? And then also, how are your retailers? There may be some retailer bottlenecks that we have been hearing about as well? So if you can go through all that.

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

Yes. Our supply chain is fully operational. And as I said, we, at this point, chase the extraordinary growth in consumer demand for our product. And we work closely with our retail partners on the challenge of meeting the demand heading into the season. This is not impacted by COVID. This is literally all about surge, surge in demand. As far as retail closure, as we noted in the prepared remarks, at this point, 2% of stores that sell our product are closed, representing about 1% of our revenue base. In North America and Europe, the retail is 100% open. Lat Am is about 2% closed and Asia Pacific about 7% closed.

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

Okay. So none of your retail partners is having any problem flowing goods? They're all pretty pleased?

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

Yes. The retail partners are doing a great job, really chasing as well demand. We've done -- together, we worked hard to fulfill the demand. They're doing an excellent job in offering multichannel offering -- omnichannel solutions for shoppers, and we expect that this will remain an important category for them, a strategic category for them heading into the holiday season.

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

Yes. And my last one, some big Barbie play sets were really good sellers over the summer. Board and busters offering kids activities while they're at home. Do you believe this has pulled sales from fourth quarter when those products would have traditionally been sold?

So -- yes, especially on those Barbie Dreamhouses, there were a lot of those sold, I think, in July.

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

Yes, we do not believe there was a pull forward as it relates to shipment or consumer demand. The -- in the third quarter, some restocking did occur, but retail inventories are still down in absolute dollars and down significantly in weeks of supply. So as it relates to consumer demand, our own internal shopper research shows that the vast majority of parents plan to spend the same or more on holiday toy purchases throughout the fourth quarter.

Operator

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

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

Could you actually quantify where retail inventories are? I know you said in your prepared remarks that, that number was down year-over-year at the end of the quarter. And if you have that number for North America as well as internationally, that would be most helpful. And then I have a quick follow-up.

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. We don't have the specific number, but let me give you some additional context on retailer inventories. And going back to the beginning of 2020, we came into the year with retailer inventories higher than the prior year. And then as we talked about at the end of Q2, we talked about retailer inventories being down versus the prior year. And then as I said earlier, there was the seasonal build in the third quarter of retailer inventories. But at the end of the quarter, we're still down a little bit versus the prior year, not as much as we were at the end of the second quarter. But when you consider the weeks of supply, given the high growth of POS, the weeks of supply are down rather significantly.

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

Okay. That's very helpful. And then, Ynon, you mentioned October retail momentum has held up, should we assume you continue to see double-digit increase in POS into October?

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

We gave you guidance for the quarter. And what I can say in addition to that, the POS momentum is strong. It remains strong throughout the quarter, with total company POS up double digit, as we said, outpacing sales. The good news is that there is strong demand for the product. And at this point, it remains ahead of sales. And all of this, we believe, will be -- will point to a strong season for us.

Operator

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

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

So a very impressive quarter, congrats to the team. I just have 2 quick questions. One is, historically, if you look at the fourth quarter sales versus the third quarter, usually the fourth quarter is bigger in dollar amount versus the third quarter, but it seems like you're guiding the fourth quarter to be similar to the third quarter this time around. So is that conservatism? Or there is something specific that's driving that outlook for the fourth quarter?

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

Yes. Tami, thank you for the question. As I said, this is not about change in demand. Demand is still strong. At this point, it's about being able to fulfill the demand. This is why we say we are chasing this extraordinary surge in -- that we see in demand. When you consider that we went from a double-digit decline in the first half to a double-digit growth in the third quarter and a high single-digit growth overall in the second half, at this point, it's all about being able to fulfill this very strong, extraordinary growth in demand.

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

Got it. Got it. That's super helpful. And then another quick one is, for the Thomas & Friends movie that you just announced, are you planning to coproduce that movie? Meaning if there's upside to the movie revenues, will you be sharing in that economics? Or it's just going to be more like a product-driven revenues?

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

Well, we haven't disclosed the terms of the distribution of the movie and in other words, the commercial arrangements about the movie. This is a development deal with Marc Forster. We have different types of relationships and agreements with different studios. And directionally, we always

expect to have economic upside in our movies. This is not -- none of our movies are purely about a licensing deal. We do get paid, but we also retain upside in the economic success of our projects.

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*

We'd like to isolate 2 areas if we could. The first is on A&P. I think you mentioned that your expectations for the year are right around the midpoint of that 11% to 13% range, which would imply a pretty significant step-up in Q4. So our question is: Have you already committed to that amount? Or is that kind of banking the value in case you need it?

Particularly, I just want to reconcile that with your comments on demand outstripping supply. And then really quickly, Ynon, on e-comm because that seems to really stand out both for American Girl and for the total company being almost 1/3 of your business now. So can you talk a little bit about what a higher percentage of e-comm penetration might mean to the timing of revenues, the scope of your advertising and promotions? Anything that we should be thinking about in terms of that channel shift?

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

Yes. I'll start with the advertising question and give you a little bit of context. If you go back to the beginning of the year, we did say we expect a shift of advertising to the back half, and that's turning out to be more of a shift between Q3 to Q4 as well. Don't want to get into too much specifics for competitive reasons. But let me say that some of that shift is due to year-on-year timing, and some of it is the result of aligning our spend with consumer shopping behavior. As you pointed out, we also said, for 2020, we expect to be near the midpoint of the 11% to 13% of net sales range. And as you do the math, you will see that's a pretty significant increase in our fourth quarter spending, as we support our products during the holiday shopping season, when consumers are making those purchase decisions. And I would also say that most of that spend is largely committed at this point.

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

Yes. And Steph, I'll take the e-comm question. So as we said in the prepared remarks, we are seeing very strong growth for us in e-commerce and online retail, more than 50% growth, now representing 30% of our global POS. In the case of American Girl, DTC more than doubled, now represents more than 50% of sales. So clearly, a very important part of the business. As it relates to our economics, what we are seeing is a high propensity of online shopping among consumers. And at the same time, traditional retailers are doing really good work in evolving in that direction, offering more solutions to shoppers. So this is really about being at the front of the curve of responding to change in consumer behavior and being able to meet demand wherever consumers are. We haven't broken out the economics, change in margin and things of that nature. But I would say that as the future becomes more about online shopping and online retail, our ability to be at the front of it is going to be very important for growth. It is part of our strategy. As you know, it's always been on that one page that we have. What did change is the timing of it. We are accelerating the execution of this part of the strategy given the importance of this channel.

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

I'm trying to do the math on the EBITDA and what would be implied for the fourth quarter. It looks like your implied guidance is just slightly lower than where the street is. So I was wondering if there's any way you can quantify the increase in incentive comp. Or what the year-over-year increase in incentive comp would be? Or if there's any other factors that are affecting the SG&A in fourth quarter?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. I'll take that. You've done your math right. On a full year basis, we're going from \$453 million to \$625 million to \$650 million on adjusted EBITDA, and that implies a smaller growth in the fourth quarter. I would tell you, the biggest change is actually in the advertising line. When you go through the math I just talked about, the midpoint of 11% to 13% against where we are year-to-date implies a very significant increase in advertising. And that shift, right between the first 3 quarters and the last explains most of that delta in terms of growth in EBITDA compared to the prior year. Specifically, around SG&A, as we said in our remarks, we do expect to generate the \$90 million of net SG&A savings that we talked about before. But sitting here today, our expectations and guidance for the full year is above our original expectations. So we're accruing to above-target incentive compensation. Don't want to quantify that yet. It's all based on forecast and estimates, so it's a little bit premature for us to do that. But again, the biggest factor is that shift in advertising.

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

And Linda, let me just add that the EBITDA guidance that we gave is \$50 million higher than the guidance we gave before the disruption, which we pulled. So coming back and upgrading that number by \$50 million, after such a strong -- such negative first half tells you a story, a story of a very strong performance in the second half overall.

Operator

And our next question comes from the line of William Reuter with Bank of America.

William Michael Reuter - BofA Merrill Lynch, Research Division - MD

In your -- one of your first slides of the presentation, you talked about the industry as a whole growing meaningfully and Mattel growing ahead of that. It's based on your internal numbers. What do you think that the toy industry did grow at? And I'm wondering, as a whole, the industry growth, what do you attribute this to. And I guess, how much of it may be related to COVID in some way?

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

Yes. Look, the industry as a whole did grow meaningfully and continue to demonstrate its resilience even in challenging economic times. We see that parents continue to prioritize spend on their children and look for high-quality products at affordable price points. The industry is a strategic category for retailers. It drives foot traffic, even though, there's not a lot of foot traffic in stores, but it definitely increases engagement and an important category for them. The retail partners themselves have done a really good job adapting to the new current environment, and we expect them to continue to drive shopping among consumers, especially as we head into the season. While we believe some of the growth that we see in the industry is because of COVID, it's important to note that the toy industry has been growing historically and was projected to grow before COVID. We always point to a Euromonitor research that forecast growth of 4.9% on a global basis through 2024. This is actually expected to be driven by the Dolls category, which is meant to grow at about 10% per year, which is a good thing for Mattel. And I would note that within these dynamics, we expect to continue to outpace the industry growth and continue to perform above industry averages.

William Michael Reuter - BofA Merrill Lynch, Research Division - MD

That was a very wholesome answer and helpful. Just one more question. Given your credit metrics have improved so much, do you have a leverage target at this point? Or are you thinking about hoping or trying to achieve an investment-grade credit rating?

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. So a couple of things on that front. First, we are very pleased with our free cash flow performance. We talked about the last 4 quarters being a positive \$130 million. And our intent is to pay down debt going forward to improve our leverage ratio. If you combine that with the adjusted EBITDA performance and the trajectory we expect our leverage will continue to decline and improve over time. And we are targeting an investment-grade rating. I don't -- can't give a date for that, but directionally, that's where we're headed. If you look at some of the metrics, on a trailing 4-quarter basis, we ended the third quarter debt to adjusted EBITDA at 5.3x, and that compares to 6.9x, same period 12 months ago. So significant improvement, and we expect that to continue to improve as we head towards investment grade.

Operator

And our next question comes from the line of David Beckel with Berenberg Capital Markets.

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

I have 2, if I could. The first one is with regards to gross margin for next year. I was curious to what extent should we expect certain areas of outperformance this year from things like royalties and mix to reverse next year. And then I have a quick follow-up.

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. So not prepared to give guidance for 2021 at this point. But needless to say, we're very pleased with the performance on gross margin, the fact that we're going to be up 350 to 400 basis points this year to a range of about 48.5% to 49%. As you go back in time, 2017, that gross margin was just around 38%, so significant improvement. And that's really the result of all the great work the company has done around cost savings, both Structural Simplification and the Capital Light program. Now the Capital Light program is a multiyear program, addressing our plant footprint, reducing SKUs by over 30%, other productivity measures. We do expect that to continue to contribute into 2021. I don't have a number for you yet. And we will also look for other opportunities and efficiencies to further improve our gross margin.

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

Great. That's helpful. And second question is around e-commerce, and specifically direct-to-consumer. You called out Masters of the Universe and collector sets as a partial driver of sales this year. I was wondering if you could expand on that and just shed some light on the extent to which that forms or is a broader e-commerce and direct-to-consumer strategy that you expect to roll out in the future.

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

Yes, David, it's too early to talk about that, to provide specific detail. But as I mentioned before, online retail and e-commerce and DTC, especially is an important part of our strategy, and we'll be able to share with you more down the road as we make further progress.

Operator

And our next question comes from the line of Felicia Hendrix with Barclays.

Felicia Rae Kantor Hendrix - Barclays Bank PLC, Research Division - MD & Senior Equity Research Analyst

So Ynon, you guys have had now a nice string of reporting upside in the quarters. And I do think everyone appreciates your conservatism. But it would be helpful to know what the biggest surprise was in terms of biggest delta, I would say, between your outlook and then what you reported. And I think you touched on it very early in this call in Michael's question, but maybe if you could help peel back those layers a little bit more. And then as you look to the end of the year, kind of on the same lines, what do you think the biggest drivers of potential upside could be?

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

Yes. Thank you, Felicia. You've been following the company, and you know that we've done a lot over the last couple of years. And many of the actions that we took before the pandemic to reshape and simplify our operations as part of our turnaround strategy are definitely working. Our brands and our products resonate very well with consumers, and our partnership with retailers in driving demand is working very well.

And when you ask about surprise, we did expect growth. As we've said in the second quarter, we said that we expect growth. But clearly, this surge and incredible momentum we have, both top line and bottom line, is very strong. The quality of the numbers, the fact that we grew in every region and broadly across the entire portfolio, seeing such strong growth in profitability, all of this is very strong. And as it happens, this was actually the highest quarterly growth for Mattel in the past 10 years, of any quarter, not just third quarter, of any quarter. This was the highest growth for Mattel in any quarter in the last 10 years. And when you add that to the continuous improvement in gross margin, 9 quarters in a row, where we continue to improve gross margin on a year-over-year basis with such strong momentum, all of that is -- speaks to the progress we are making. I can't sit here and tell you that it's exactly as we planned. It's fair to say, it's ahead of our expectations. And we are not slowing down. We keep up the momentum. We focus on execution, and it's great to see the results coming in.

Felicia Rae Kantor Hendrix - Barclays Bank PLC, Research Division - MD & Senior Equity Research Analyst

Yes. I get all that. I guess what I'm just wondering is like what -- because that you -- you knew before. So what I'm trying to understand is like was it the restocking that was faster than expected, were there certain products that just had a stronger kind of take in retail. I mean was there anything kind of that was -- what was specifically kind of different? Because I think what we're all trying to do is kind of gauge fourth quarter. And certainly, there's some conservatism built in there as well.

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

I wouldn't say we're not -- I'm not trying to avoid the question. It's, in a way, a tale of 2 halves for the year. We did have a challenging first half. And obviously, we've done -- we've seen very strong momentum in the third quarter and expect that to continue in the fourth quarter. The performance was broad-based. I literally can't sit and just point to one part of the company. Dolls, as a whole category, grew 24%; Vehicles, Hot Wheels was up 9%. Even our challenger categories were up 14%. Our growth in the U.S. was 1.4x the industry's growth rate. We were #1 in the region in the third quarter. In Europe, we grew at twice the rate of the industry and gained share throughout the quarter, per NPDP. So you look at our categories, you look at our regions, the company as a whole is performing very strongly. And together with the momentum we're seeing in the market, partly driven by what retailers are doing themselves, very strong demand from consumers. All of this comes together to these numbers.

Anthony P. DiSilvestro - Mattel, Inc. - CFO

Yes. I would just add to that. As you look to the fourth quarter, there's a couple of factors at play. One is the continued POS growth. The other is our supply chain ability to supply. And that's what Ynon was talking about in terms of we can't be certain that we could fully meet that surge. So that's the other factor as we look ahead in the near term.

Felicia Rae Kantor Hendrix - Barclays Bank PLC, Research Division - MD & Senior Equity Research Analyst

Okay. And just very quickly, on Fisher-Price. Just do you expect to see kind of more of a positive momentum in the fourth quarter. Right now, you're lagging in North America. But just wondering that -- and how long it would take to work through some of the underperforming brands that you mentioned in the deck?

Richard Dickson - Mattel, Inc. - President & COO

Yes. It's Richard, Felicia. Yes, we've been very encouraged with the progress that we're making on Fisher-Price. We've been seeing consistent POS growth for the last 2 consecutive quarters. It's been driven by new innovation, great new compelling products. And Mattel led by Fisher-Price is still the #1 leader in the Infant/Toddler/Preschool category, continuing to be this incredibly valued brand by parents and trust, which is such an important attribute today more than ever. So you'll see a lot more progress on Fisher-Price, but we're really encouraged with the last 2 quarters of positive POS.

Operator

Thank you. That is all the time we have for Q&A. So with that, I will turn the call back over to Chairman and CEO, Ynon Kreiz, for closing remarks.

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

Thank you, operator, and thank you, everyone, for your questions. This was a very strong quarter for us. We continue to make meaningful progress towards becoming an IP-driven, high-performing toy company. I would not say that the COVID disruption and volatility is over and that macroeconomic uncertainties do not remain, but seeing such strong growth in top line and even more so on the bottom line in the midst of a pandemic is another clear sign that our turnaround is working. We believe there is more to come. And as always, we remain focused on creating long-term shareholder value.

We hope that you and your families are healthy and safe. And now I will return the call back to Dave to provide the replay details. Thank you.

David Zbojnowicz - 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 3348954. Thank you for participating in today's call.

Operator

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

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2020, Refinitiv. All Rights Reserved.