THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MAT - Q2 2018 Mattel Inc Earnings Call

EVENT DATE/TIME: JULY 25, 2018 / 9:00PM GMT

OVERVIEW:

Co. reported 2Q18 results.

CORPORATE PARTICIPANTS

Whitney Steininger *Mattel, Inc. - Investor Relations*

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

Joseph J. Euteneuer *Mattel, Inc. - CFO*

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

CONFERENCE CALL PARTICIPANTS

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

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

Gregory R Badishkanian *Citigroup Inc, Research Division - MD and Senior Analyst*

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

Susan Kay Anderson *B. Riley FBR, Inc., Research Division - Analyst*

Timothy Andrew Conder *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, welcome to the Mattel, Inc. Second Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's call, Whitney Steininger. Ms. Steininger, you may begin.

Whitney Steininger - *Mattel, Inc. - Investor Relations*

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 Joe Euteneuer, Mattel's Chief Financial Officer.

As you know, this afternoon, we reported Mattel's 2018 second quarter financial results. We will begin today's call with Ynon and Joe providing commentary on our results, and then we will provide time for Ynon, Richard and Joe to take your questions.

To help guide our discussion today, we have provided you with a slide presentation. Our discussion and our slide presentation will reference non-GAAP financial measures such as gross sales; adjusted net sales; adjusted gross profit and adjusted gross margin; adjusted other selling and administrative expenses; adjusted operating income or loss; adjusted earnings or loss per share; earnings before interest, depreciation and amortization, or EBITDA; adjusted EBITDA; and constant currency.

Our earnings release also includes non-GAAP financial measures. The information required by Regulation G regarding non-GAAP financial measures is included in our earnings release and slide presentation, and both documents are available in the Investors section of our corporate website, corporate.mattel.com.

Before we begin, I'd like to remind you that certain statements made during the call may include forward-looking statements relating to the future performance of our 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 2017 annual report on Form 10-K, our 2018 quarterly report on Form 10-Q, our earnings release and the presentation accompanying this call, in other filings we make with the SEC from time to time as well as in our 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, everyone, for joining our second quarter earnings call. Mattel is a company with great potential. We see a lot of opportunities, but there's been a big discrepancy between our financial performance over the last few years and where the company should be. The industry is evolving, but the toy market is growing, and we should be able to reverse our own trends, given our strong standing and the quality of our assets.

With that said, we are in a turnaround, and as expected, had a challenging second quarter driven primarily by the Toys "R" Us liquidation. At the same time, we saw continued strong performance by Barbie and Hot Wheels, and we made substantial progress on our Structural Simplification program to restore profitability and improve productivity in the near term.

We're already seeing operational improvement as reflected by our inventory management, which has resulted in both lower owned and retail inventory. This positions us well for the holiday season.

On today's call, I will provide an overview of our second quarter performance and share some of the steps we are taking to transform Mattel into an IP-driven high-performing toy company.

I will also talk about steps we are taking to advance our strategy for long-term growth. Joe will then walk through the financials in more detail, and Richard will join us for Q&A.

Let me provide an overview of our second quarter performance. Worldwide gross sales in the quarter were down 11% as reported, which was in line with our expectations when considering the impact of Toys "R" Us and a tough comparison to last year's Cars 3 launch. This 11% decline included a negative 10% impact from Toys "R" Us and a negative 2% impact from a slowdown in our China business, which I will talk about shortly.

Regarding the outlook for Toys "R" Us, in particular, we now have more visibility into the potential for reabsorption by other retailers, which appears to be better than we initially anticipated. We are working in collaboration with other major retailers while taking market share and enhancing the shopping experience for consumers. While we still expect some impact to the top line in 2018, we're optimistic that the negative impact will subside by 2019. However, we expect this positive development to a full year outlook to be offset by new headwinds, including the recent strengthening of the U.S. dollar and challenges in China. If you net out the negative impact of Toys "R" Us, our year-over-year top line performance improved in the second quarter relative to the first quarter. As a result, we believe our underlying business is on the right trajectory, and we're making good progress towards stabilizing our revenues.

Gross margin and EBITDA in the second quarter were below our expectations. Although we have anticipated declines due to increase in raw material and distribution costs, there was additional pressure for foreign exchange headwinds and certain write-downs. Joe will provide further detail on the drivers of the decline in the second quarter and the impact to our full year gross margin outlook. Despite these headwinds, we continue to believe the business is capable of achieving our historical margin and profitability levels over time.

As we look at our performance from a brand perspective, I have been most impressed with the performance and consistency of Barbie and Hot Wheels. These two power brands are benefiting from purposeful programs, highly effective marketing and great execution, which are driving consumer demand. This is reflected in their strong worldwide sales and POS performance.

According to NPD, Barbie continue to gain market share as both the #1 property in the Fashion Dolls category globally and the #1 overall growth property in the same category. Similarly, per NPD, Hot Wheels continue to gain share as the #1 property in the vehicles category globally. We're very excited about the product development plan for next year, and we look forward to sharing more details in the future.

Conversely, the strong IP potential of Fisher-Price, Thomas & Friends and American Girl is not being fully leveraged. We continue to believe in the power of these brands given the loyal fan base and historical strength. We have comprehensive plans in place for a turnaround and are confident we have the right teams in place that deeply understand each brand's consumers and their unique attributes and are implementing the right bespoke strategies to leverage the power of these brands.

In the second quarter, Fisher-Price was negatively impacted by both the year-over-year Toys "R" Us comparison, which made up nearly all of the decline, as well as the challenges we are currently facing in our China business. However, we are confident in our action plan and see early signs of improvement.

It's worth noting that according to NPD, Fisher-Price has been declining in the infant, toddler and preschool super categories, which is actually growing at a 5% CAGR. We still remain #1 in the category, which is the single largest category in the toy industry, and believe if we are successful in our turnaround plan, there is a lot of upside to capture.

Thomas & Friends will be building of its strong March debut on Nickelodeon with new refreshed content planned to air this September. We expect this to improve brand momentum and drive increased retailer and consumer interests. We look forward to providing a meaningful update when we report fourth quarter results.

And for American Girl, we are still in early phases of implementing the turnaround plan we discussed last quarter. I should note that the American Girl stores continue to generate positive cash flow, and the brand itself remains strong with very passionate fans. However, the strategy of pursuing growth through mass-market distribution channels, which took our focus away from the premium brand experience, was simply not correct. We're beginning to execute a turnaround plan to get this brand back on track, but it will take some time.

Moving to Toy Box. We continue to execute on our strategy to transform the business into a more stable and profitable innovation portfolio. As expected, Toy Box faced a tough comparison in the second quarter due to

last year's launch of Cars 3. However, this was partially offset by the successful launch of Jurassic World, which according to NPD, was the top growth property and a top 10 overall property in the U.S. for the second quarter.

We continue to emphasize the importance of our relationships with the key entertainment, retail and technology players. We are positioning Mattel as a trusted partner with strong execution capabilities at the highest level. I am actively involved in this on a day-to-day basis, and take it as an important priority. We are focused on growing and maximizing the profitability of our brand portfolio, also through our own creative capabilities and internal innovation. We are focused on being more consumer-centric to better identify category opportunities, so that we can more -- be more effective in picking winners.

As we look at our performance from a regional perspective, North America gross sales were down 13% as reported, which included a 19% negative impact from Toys "R" Us. International growth sales were down 5% as reported, driven by a slowdown in our China business, which accounted for essentially all of the decline in the International segment and global emerging markets.

In addition to the decline in China, there was also a negative 3% impact from Toys "R" Us. Setting aside these 2 issues, the International segment performed well and would have grown in the quarter. In addition, total Power Brands grew 5% as reported year-over-year.

While we expect to see China to be a headwind in 2018, we continue to see growth potential in the Chinese market and remain focused on building our position there to take full advantage of this market over the long term.

Latin America continues to perform well, and we see significant opportunity for improvement in Europe. We are focused on strengthening our operations and product offering in key European markets where we believe we can drive share and increase profitability.

Over the past 90 days, I've been intently focused on how we can accelerate our progress and better execute our transformation strategy. In the short to mid-term, we're implementing our strategy to transform Mattel from being a toy manufacturing company into an IP-driven high-performing toy company. Our first and foremost priority is to deliver on our structural simplification target of $650 million net savings exiting 2019. Our goal is to streamline the organization in order to rationalize our cost base, restore profitability and improve our efficiency and performance.

We're making good progress and are even looking into additional potential savings through the expanded scope of work in optimizing our manufacturing footprint. However, market volatility of raw material inflation and foreign exchange are now expected to be much higher than our initial projections and what we've experienced in recent years. We will keep you updated on these developments and the impact they may have on our profitability.

With regards to our progress, today, we announced the reduction of our global nonmanufacturing workforce by over 22%. As a result, we will remove more than 2,200 positions across the company globally. The vast majority of the reductions are from back-office and support functions. This significant action is a result of a comprehensive bottoms-up review, which involve all of the key leaders of the organization and is not merely about cost savings, but rather it is the start of a transformation in how we operate. Importantly, we have made a concerted effort to protect the revenue-generating and creative capabilities of the company.

As part of that process, we plan to realign resources towards high-growth areas that are essential to our future success, including design and development, content, global franchise management and commercial excellence. We will talk more about this in the weeks and months ahead.

We're taking another significant step as part of our Structural Simplification program by optimizing our manufacturing footprint and increasing the productivity of our plant infrastructure. We have decided to sell the real estate of our manufacturing plants located in Mexico and will be transitioning production over a period of time to other plants and outsourced partners. This action is an important step toward improving the utilization of our assets and reducing our overall fixed costs. We are conducting a thorough analysis of the remainder of our manufacturing footprint and are looking at a variety of options to increase efficiency and returns on capital. This is in addition to supporting our larger Structural Simplification efforts.

Given our commitment to safety, quality and timely delivery, we are pacing our progress very thoughtfully. That said, you should expect more updates on further optimization of our manufacturing footprint in the coming months. Joe will provide further detail on these actions as well as an update on the expected impact to our 2018 outlook to both gross margin and SG&A.

In the mid- to long term, we plan to capture the full value of our IP through content initiatives, including both film and television as well as franchise management in areas such as consumer products, content distribution, gaming and live events. It is fair to say that historically, we have looked at content as more of a marketing and promotional tool rather than a profit-generating business. Going forward, given the strength of our IP and depth of our library on the one hand and the proliferation of distribution platforms and the demand for quality content on the other hand, we believe we can turn this into a revenue driver and profit engine. We believe similar opportunities exist to expand our presence in gaming, live events and more. We are already in the process of realigning resources and bringing onboard the leadership capabilities required to succeed in these areas.

Overall, I'm very focused on amplifying the creativity of this company. Innovation is the heart of Mattel. It is essential for our transformation plan to protect and leverage our world-class creative capabilities and match that with an efficient operating structure.

Another important priority is the expansion of our capabilities in online retail. We have been evolving and advancing the way we sell our products given the change in the global retail environment and the shift to e-commerce. Our progress has established a strong foundation, and we believe given the strength of our brands, there's a lot more value to capture.

In the first quarter, Mattel continued to be the #1 toy manufacturer in e-commerce sales in the U.S., according to NPD. We still have to accelerate our channel segmentation strategy and capabilities, so our consumers can engage with our iconic brands and products in customized and optimized ways. This is an area of focus for me and as a company, we will be increasing our investment in this important area. I look forward to providing updates in future quarters.

In addition to all of the changes we are making across the company to strengthen our positioning for the future, our board is also undergoing a transformation to ensure it has the right capabilities and expertise. At our 2018 Annual Meeting, our board added 2 new independent directors: Todd Bradley, a veteran of HP; and Soren Laursen, who spent more than 20 years as a senior executive at LEGO. Together, these two new directors bring added expertise in areas that are core to our business, including marketing, restructuring, retail, supply chain, technology and digital. The board remains committed to continued refreshment, and we are encouraged by the diversity and leadership experience of the individuals that are in the recruitment process. We expect to have more news for you on this front in the coming weeks.

In closing, we have made significant progress on our transformation strategy in the past 90 days and are sharply focused on executing our plan to increase long-term shareholder value. While we are seeing some early signs of success, we clearly have more work to do. This is a multiyear effort, but we have the right team, the right assets and the right strategy in place to achieve our goals. I look forward to providing more updates in the coming months ahead.

I will now turn the call over to Joe to walk through our second quarter performance in more detail.

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Thank you, Ynon, and good afternoon, everyone. Today, I'll provide more detail on the important actions we've taken related to Structural Simplification, and then walk you through the financial results.

During the second quarter, we remained focused on execution and are pleased to report that our 2-year $650 million Structural Simplification program is on track. We have made significant progress in the first half of the year, including our most recent announcements on the important actions taken with regards to our organizational structure and our manufacturing footprint.

During the second quarter, we completed our comprehensive review of the organization and today, announced an extensive restructuring, reducing the global nonmanufacturing workforce by over 22%. As Ynon said, these reductions are weighted most heavily towards back office and support functions.

While changes like this are not easy, this was a necessary action taken to realign our cost base with the top line and restructure the organization to better support the execution of our going-forward strategy. This specific action is expected to result in full year run rate SG&A savings of approximately $150 million, with 1/3 expected to be realized in 2018. In aggregate, our actions to date are expected to result in full year run rate SG&A savings of approximately $270 million.

We estimate the severance costs related to this action to be approximately $75 million, with $27 million expensed in the second quarter and expect the balance to be expensed in the second half of the year. At this point, we are ahead of schedule with our SG&A-related Structural Simplification actions. As a result, we are updating our outlook for adjusted SG&A from slightly higher than last year to now being slightly lower than last year.

As it relates to cost of goods sold and the reassessment of our manufacturing footprint and supply chain, we have expanded the scope and are in the process of a thorough analysis. Given the expanded scope, some of the cost of goods sold savings we initially expected to benefit 2018 will now shift into 2019, impacting our full year 2018 gross margin outlook.

Our analysis to date has led to today's announcement of our decision to sell the real estate of our manufacturing plants located in Mexico. This is a first step that will help simplify our manufacturing footprint, reduce our asset base and increase the utilization of our remaining manufacturing footprint. We will provide more detail closer to the completion of a transaction, but this action is expected to be beneficial to our cost structure. Additionally, we will continue to evaluate our remaining

manufacturing footprint and are looking at a variety of options to support our larger Structural Simplification efforts. These actions, combined with the actions taken previously, bring the exiting 2018 run rate cost savings to $500 million out of the total $650 million targeted run rate exiting 2019.

Moving onto our second quarter performance. We were in line with our expectations for the topline, despite the impact of the Toys "R" Us liquidation and a tough comparison to last year's Cars 3 launch. As Ynon said, second quarter worldwide gross sales were down 11% year-over-year, driven primarily by the negative 10% impact from Toys "R" Us and a negative 2% impact from the slowdown in our China business.

Worldwide POS for Mattel was up low single digits and roughly flat, excluding the benefit of the Toys "R" Us discounting that took place in the quarter.

Power Brands worldwide gross sales were down 2% in constant currency in the quarter, including the negative 11% impact from Toys "R" Us. Barbie and Hot Wheels maintained their momentum, continuing to deliver strong performance. More specifically, Barbie worldwide gross sales were up 12% in constant currency in the second quarter despite the negative 11% impact of Toys "R" Us. This is the third consecutive quarter of strong year-over-year sales growth for the brand. Worldwide POS continue to be strong in the quarter and was up similarly with and without the benefit of the Toys "R" Us discounting.

Barbie sales in North America were up 2% in constant currency despite a negative 23% impact of Toys "R" Us. International sales were up 20% in constant currency, including a negative 2% impact of Toys "R" Us.

Hot Wheels worldwide gross sales were up 22% in constant currency, despite a negative 10% impact of Toys "R" Us. This is the second consecutive quarter of double-digit year-over-year sales growth for the brand. Worldwide POS continued to be strong in the quarter and was up double digits, both with and without the benefit of the Toys "R" Us discounting.

Fisher-Price and Thomas & Friends worldwide gross sales were down 15% in constant currency, which included a negative 14% impact from Toys "R" Us. Worldwide POS in the quarter, without the benefit of Toys "R" Us discounting, was down mid-single digits. As expected, worldwide gross sales for American Girl were down 33% in constant currency in the second quarter.

As Ynon said, we are focused on executing the turnaround plans for Fisher-Price, Thomas & Friends and American Girl and believe there is significant value to be recaptured, given the historical strength and loyal fan base of these franchises.

Toy Box worldwide gross sales were down 23% in constant currency in the second quarter, in line with expectations, primarily driven by the tough comparison to last year's Cars 3 launch and the negative 10% impact from Toys "R" Us. The decline was partially offset by the successful launch of our Jurassic World toy line, which is performing very well.

In the second quarter, our reported gross margin was 30.1% of net sales, down from 41% in the second quarter of 2017. Our adjusted gross margin was 30.4% of net sales, down from 41% in the second quarter of 2017. As expected, and consistent with what we shared in Q1, two key drivers of the second quarter decline were continued raw materials inflation and freight and logistics costs associated with bringing in-house, a previously outsourced distribution facility. These drove approximately 1/3 of the year-over-year gross margin decline and are expected to be partially mitigated in the second half of the year.

Another driver of the decline relates to obsolescence expense, primarily for additional discontinued products, making up roughly 1/5 of the year-over-year gross margin decline. Since Q2 is a seasonally small quarter, these write-offs have a relatively large impact on the gross margin percentage for the quarter, but are not expected to have a material impact on our full year gross margin outlook. We remain confident that on a full year basis, year-over-year obsolescence will be significantly favorable versus last year.

Increased sales adjustments make up approximately 1/5 of the year-over-year gross margin decline and are primarily related to country and customer mix. Our second quarter sales adjustment rate was in line with first quarter, and we expect a similar rate for the full year 2018.

The balance of the year-over-year decline was primarily due to unfavorable foreign exchange in the period as a result of the appreciation of the U.S. dollar against most major currencies and the negative impact of scale. As expected, since a portion of our cost of goods sold are fixed, the year-over-year revenue decline has had a negative impact as those fixed costs are spread over less revenue.

In the second half, we expect a significant sequential improvement in gross margin, as we realize the benefit of scale given the seasonality of our business. Our fixed costs will be spread over a much larger sales volume in the second half of the year. For context, the second half benefit of scale in 2018 is expected to contribute approximately half of the sequential margin improvement compared to the first half of the year.

Other expected drivers of sequential margin improvement in the second half of the year include: cost savings from Structural Simplification actions taken in the first half of the year; lower obsolescence expected in the second half of the year, given the quality of our inventory; and lower freight and distribution costs related to our previously outsourced distribution facility that were fully transitioned in-house and operational again by the end of the second quarter.

In aggregate, these drivers of sequential margin improvement are expected to lead to a second half gross margin in the low 40s. While we expect the sequential margin improvement to be significant, we are revising our full year gross margin outlook to reflect our latest view of the cost of goods sold component of Structural Simplification, continued raw material inflation and the unfavorable impact of foreign currency, assuming currencies remain at current levels for the balance of the year. Given these factors, we now expect full gross margin to be in the high 30s.

Despite the change of our 2018 gross margin expectation, we remain on track to achieve our initially targeted Structural Simplification savings exiting 2019.

In the second quarter, our advertising rate was 9.8%, which was flat year-over-year. We continue to expect our full year advertising rate to return to our historical range of 11% to 13% of net sales as we benefit from Structural Simplification savings of $30 million to $40 million.

In the second quarter, our reported SG&A was $360 million, up $7 million year-over-year, which included $48 million of severance and restructuring costs. Second quarter adjusted SG&A of $315 million was down $30 million compared to prior year. This year-over-year decrease was primarily driven by cost savings from Structural Simplification and lower incentive and equity compensation.

Given the significant progress made on Structural Simplification, we now expect adjusted SG&A for the full year to be down slightly compared to 2017.

Now let me give you an update on taxes. Our income tax expense was $6.9 million in the second quarter and $4.3 million year-to-date. Our overall 2018 effective tax rate may vary significantly from quarter-to-quarter due to, first, the level and mix of income or losses in our foreign jurisdictions; second, the fact that we have a full valuation allowance on our U.S. deferred tax assets.

In the U.S., during periods of taxable loss, we would record no income tax benefit, and during periods of income, we would record no income tax expense as the valuation allowance is released to cover the related expenses.

In the second quarter of 2018, we provided no income tax benefit for any U.S. losses and recorded an income tax benefit on our net foreign losses in jurisdictions with no valuation allowance. Additionally, in 2018, we expect the cash we pay for taxes to be similar to the prior year, excluding any actions related to Structural Simplification.

We are still finalizing our estimate of the mandatory repatriation tax under the Tax Act today. We continue to believe the cash tax impact of repatriation is not expected to be material to our annual cash flows because we will use foreign tax credits and deferred tax assets that we have on our balance sheet to offset the cash tax payments.

Moving to the balance sheet. We ended the second quarter with a cash balance of $229 million. Net cash is favorable compared to last year due to the combination of the debt issuances, the suspension of the dividend and the improvement in working capital.

During the second quarter, our working capital improved by $223 million, primarily due to accounts receivable improvement of $138 million or 15% year-over-year as a result of lower sales and a reduction in our days sales outstanding and owned inventory improvement of $221 million or 24% year-over-year as a result of our continued efforts to tightly manage our inventory. With owned inventory down 24% and retail inventory down similarly, we believe we are well positioned as we approach the all-important holiday season.

Moving to the statement of cash flows. Cash flows used for operations was $557 million year-to-date, which was an increase compared to the prior year usage of $549 million, driven by a higher net loss, partially offset by proactive management of working capital. Primary driver of investing activities was capital expenditures, which were $78 million year-to-date, down 48% year-over-year, driven primarily by reductions in tooling and plant capital expenditures. Our spend is still aligned with our commitment to reduce full year capital expenditures to about $200 million.

Our year-to-date financing activities include a debt repayment of $250 million in the first quarter, the proactively financing of the $500 million of debt due in May 2019 and the $80 million drawdown on our credit facility. As a result of these financing activities, our next debt maturity is now October 2020. We have sufficient liquidity, and we will continue to tightly manage working capital as we approach the 2018 holiday season.

In closing, I am pleased with our progress as we continue to execute against our strategy. Although two quarters do not make a trend, we are starting to see positive momentum on our top line while remaining focused on Structural Simplification. We are still on track to achieve $650 million in cost savings exiting 2019 as a result of the accelerated progress made to date in SG&A, despite some of the cost of goods sold savings shifting into 2019. With the increasing visibility into the potential Toys "R" Us reabsorption by other retailers, we feel comfortable with current inventory levels, and we believe we are well positioned for the second half of the year.

Thank you for your time, and we'll now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Michael Ng of Goldman Sachs.

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

I just had a follow-up on the comments about the transition from a manufacturing company to an IP owner. First, the real estate that you're selling in Mexico, what was produced in those factories? And then as a follow-up to that, is it fair to assume that you expect fixed cost leverage to be reduced as you sell some of your manufacturing capabilities?

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Okay. As far as what was produced, there was a lot of the Fisher-Price stuff and the baby gear type of things. And the second question?

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

Do you expect your long-term fixed cost leverage to be reduced as you sell some of the factories?

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Well, yes, the whole goal of this is to eliminate fixed costs and increase the profitability and the gross margins as a result of those actions, so yes.

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

Okay. And then second, could you talk a little bit about what you're seeing in terms of the retailer demand absorption? I think you mentioned it's occurring a little bit better than expected. I was just wondering if you can give some examples of some retailers who may be expanding shelf space and what you're seeing there.

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

Yes, well, we can't get into specifics but I can tell you that there's clear demand. We're seeing all of the major retailers stepping in and capturing and taking share. Our approach to this is that we don't think kids will consume less toys or be less interested in our brands because Toys "R" Us is out of business. And you have to remember that the industry is still growing, so there is demand and the retailers are stepping in and we're in active conversations with them -- with all of them. And as we said in the prepared statement that we do expect the Toys "R" Us situation to subside over the course of 2019 and '18, and we move beyond that in 2019.

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

Great. And just lastly, you didn't mention the revenue outlook that you guys had for '18, the book end of flat to down $300 million. Is that still the case?

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Yes. Well, I'll give you the book end. In the last quarter, that said worst case, we will be down $300 million. But the fact of the matter is that we are getting this positive feedback from all of the retailers, whether it's Walmart or Target or Amazon, so that will make that $300 million last. We will be better than that, that number.

Operator

Our next question comes from the line of Tim Conder of Wells Fargo Securities.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Maybe just a little more color, gentlemen, however you may want to answer this on your manufacturing footprint. At this point, where do you see the mix of manufacturing owned versus sourced by year-end '19 or '20?

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

We are not at this stage committed to any particular scenario. We are in the middle of analyzing our manufacturing footprint, and we see opportunities clearly. We took the first step that was easy to execute, but we're being thoughtful about the way we approach this process because we need to remain committed to quality, safety, timely delivery. We can't afford to miss any holiday shopping demand, and therefore, we're taking, as I said, the thoughtful approach to this. But at the same time, we are moving pretty rapidly. We're taking a very comprehensive view across the entire footprint and also the supply chain as a whole, not just our own factories. And as a result, as we said, we expect to -- we said that there is a potential for even further savings above the target of $650 million.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Okay. Okay. Joe, my apologies, just if you could repeat the Barbie POS on a global basis?

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Barbie POS?

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Yes.

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

Yes, I got this. On Barbie POS on a global basis, we're up 21% for the year. And for the quarter, we were also up double digit.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Okay, and that's inclusive of Toys "R" Us?

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

That's inclusive of Toys "R" Us. Actually, ex Toys "R" Us, we were up over 20%.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

And that's in the quarter?

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

Yes, in the quarter.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Got it. Okay. And then how would you, Joe, frame the age of the company inventories and channel inventories at this point? You talked about a little more obsolescence but again, that's a -- there can be optics viewed here given the first half is always a small piece of the full year. But just a little comment on the company age, quality of the inventories and then what you see in the channel.

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Yes. We're very well positioned on an inventory basis. We took all those actions at year-end, and we do have -- we worked down a lot of the obsolescence that we took at year-end, so that's been going really well in our inventory levels both at the retail level and in-house are -- we feel very, very comfortable with it as we move into the holiday season. So we're -- it's mid-teens inventories. So we did -- we've done very well.

Operator

Our next question comes from the line of Arpine Kocharyan of UBS.

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

I want to go back to margins for a second, Joe. So now it's revised to high 30s. That would imply back half margins of up more than 42%, give or take. When your top line is down at least mid-single digits and would increase sort of freight costs in the back half and raw materials, how do you maintain flat margins? I guess, could you give us some of the puts and takes of -- I understand seasonally, it's a stronger quarters ahead, but how do you keep margins flat when you have declining top line?

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Yes. I mean, look, the realities are in the script, we talked about how the mid- to low 40s that you're talking about, 42, give or take, half of it comes just as a result of just math. 2/3 of your revenue comes in the back half of the year versus you only have 1/3 in the first half of the year. Then it's the corrective actions we've taken. So you take the Pennsylvania distribution plant that we spent the first half of the year getting up and running by the end of June. We're going to gain the benefits of that on the back half of the year. From a raw material standpoint, the comps are a lot easier in the back half of the year than they were in the first half of the year. You have all of the Structural Simplification efforts that we've put in place, the benefits of the labor takedowns, the reduction of labor overhead in the manufacturing plants we booked earlier in the year. And then the fact is we'll have less write-downs and obsolescence because we worked so hard to get that done at the end of '17 and then clean it up here in the first half of the year, so you can get positioned well for the back half of the year. So we feel pretty confident about the back half of the year being into those that low 40%. And we used the first half of the year to sort of get things cleaned up and then a position. So that as we exit 2018, we are on a great positive runway, including the top line.

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

Okay. And then I have a broader set of strategy question to Ynon. It seems like you guys are moving forward with SG&A reduction and full speed. But I would imagine that cutting SG&A is sort of the easier part of this equation, right? Making sure that, that doesn't disrupt top line is the tougher part in any turnaround. I guess, what are you doing today to protect top line for the back half outside of just the Toys "R" Us? What are some of the drivers outside of the channel disruption that would make investors comfortable that you can -- or top line might not fall off the cliff?

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

Yes. So as we said, the majority of the reductions came from back-office and support functions. We definitely were very mindful of maintaining the revenue-generating and part of the company and the creative capabilities. And in fact, we've been building up capacity, especially in areas such as franchise management and other revenue-generating opportunities that we've identified, and you will see more on that in the coming weeks. Now the company is very -- is in a very strong position creatively, and we're seeing good momentum. We are seeing good momentum in many parts across the organization. The Toys "R" Us is what it is, it's a market factor. We took a hit, but it doesn't change the fundamental quality of the IP that we own and the capabilities in the company. Barbie and Hot Wheels are great case studies. The -- you see what happens when you have the right leadership, the right strategy, strong assets. And that defies even an impact like Toys "R" Us. We will not wait to do the same across all of the other brands and the company as a whole. And in terms of taking -- the way we're thinking about it, it's really a 2-step approach. Step one is getting on top of our manufacturing infrastructure and the cost base. We are looking to, as we said, we want to stabilize revenue decline first and foremost and restore profitability. Once we do that now -- then we turn into growing top line, investing in other areas such as franchise management and content. I said earlier before the Q&A that taking content is one example. For us, up until now was pretty much a marketing and promotional tool, and it's an area where we lost money. Going forward, this should be a profit engine not just a great way to promote our brands. So there are a lot of areas that we see where we can turn things around both on the cost side and on the revenue side, but I also want to remind us, remind you, remind everyone, it will take time. This is a turnaround process, and we've got to do things in the right order. Step one is cost. Step two, revenue.

Operator

Our next question comes from the line of Felicia Hendrix of Barclays.

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

Ynon or Joe, I was just wondering, can you just explain to us exactly what happened in China. I think, Ynon, in your prepared remarks, you said it was going to be discussed later. And I'm not sure, Joe, you actually really kind of went through that.

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

Yes, let me give you the short version. We were basically overly optimistic in our own projections for Q1. And there was -- we ended up with more inventory that we expected, and now we are basically absorbing it. We still see demand. We -- the market is healthy, and we remain positive on the Chinese market. In the way we see it, it was a one-off literally driven by the wrong forecasts for Q1.

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

So I think -- look, we have a kind of a before and now scenario going on here. So but I think before, there was the Chinese market was kind of being looked at as like this real kind of place to grow the Fisher-Price and kind of be leader in the developmental toy arena with young moms and that sort of thing. I mean, is that still a strategy? Is that an area where you had too much inventory? Can you may be can just talk about the China strategy going forward?

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

Yes. The -- again, as you said, there was an outlook in the past how we view the Chinese market. And as I said, we remain positive on this market. But the way we look at the international market right now is in -- is we're taking a view on the entire market, all of the geographies because we also see, for example, opportunities in Europe, even in mature Europe where we see opportunities for growth. We actually did well in the second quarter. We had our single digit, mid-single-digit decline in Europe, and we believe we can also find opportunities there. So I'm taking a more, a broader approach to the international market. Given my background, I feel very good in terms of where we are internationally. And we're not singling out China as one market where we see potential. We're going after the whole market, and we'll come back with more updates on that. But it's fair to say that we see opportunities in developing markets as well as mature markets internationally.

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

Okay, that's helpful. And Joe, can we just talk for a second about this 2,200 headcount reduction? I think I heard you -- it sounds like it's a bit shy of a quarter of your back office. Can you help us just understand a bit more what these functions were? It was such a big number and it was just a ton of redundancies. Are you automating a bunch of stuff? I'm just trying to understand kind of this part of your business and that kind of reduction and if you're cutting into bone or there was just so much fat. Can you give us some perspective?

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Yes, no. So look, it's a combination of everything you said. It's about getting -- I think you've heard me commented on the earlier phone calls about the lack of automation here, so we're making a big push to get more and more automated, which caused us to become far more efficient. The other thing is I think we're just -- we're looking at (inaudible) processes that we have and streamline and to get rid of the excess staff so that we can operate more efficiently and create more profitability. So -- and I believe that.

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

Look, the way we think about this reduction, this is not simply about cost savings. We are transforming the way we operate. And there were systems and processes that have been in place for a long time in the company that are simply no longer needed or there are better ways to affect them. So this -- and I guess, it goes back to an earlier question about how we're going to manage the company given these changes. So I can tell you that this was a process where we involved leaders across the organization and spent a lot of time on to make sure that we are doing the right thing, that we're not throwing the baby with the water, that we're not leaving the company with gaps and handicaps in any area, even though we took it largely out of support functions and back office, even that is important. You want a healthy, robust company that can support itself. So we took -- while you can say -- and it is significant approach into restructuring and kicked off this process with a real action, we did it very methodically. This was developed and planned for. And we think, if anything, it will make us more efficient, more robust, more effective, better performing. It's not about cutting into the bone and weakening the company. We believe it will make us stronger even in the short term, let alone longer term.

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

Okay, that's helpful. Final question is you guys -- you shipped a lot of on your kind of core product, Barbie and Hot Wheels in the quarter. One risk certainly is that people, kind of throughout the Toys "R" Us liquidation, have taken discounted product that they bought there and kind of putting them in their closets and waiting throughout the year for birthdays and Christmas and that sort of thing. So as you were shipping into that, there's a potential risk that in the second half of the year, people might buy less. So just wondering what you think about those -- that thesis?

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

It's Richard. It's pretty difficult to quantify the impact of pantry loading, essentially consumers buying now to save later. What we can see is based on some NPD publications that they've suggested that fourth quarter sales should be only slightly impacted by the liquidation. We're working really closely, obviously, with our retail partners who are incredibly aggressive and excited about the market shop opportunities to grow their business.

Operator

Our next question comes from the line of Susan Anderson of B. Riley, FBR.

Susan Kay Anderson - *B. Riley FBR, Inc., Research Division - Analyst*

I was just wondering if you could give us a little bit of an update just on American Girl and thoughts around timing on that turnaround strategy and getting product out of the mass market. It looks like sales were down a little bit more this quarter versus the past 5, so just trying to figure out also when you would expect the brand to stabilize?

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

Look, we -- this brand is in turnaround, and we are taking a very proactive approach to getting on top of it. The brand remain strong and vibrant. And there's still many passionate fans out there, but we just had the wrong strategy, and it took us a little bit to realize what exactly was the root cause of this issue. We believe we understand what it is, and we are getting very active on it. So it will take time. It's probably likely a lot of them are more challenged brands in terms of where it is, but the value is still there. And we -- and it kind of goes back to what I said earlier about the discrepancy between the quality and the strength of a brand relative to its financial performance. So we will do what we have to do. It might take some time, but we are very -- we're strong believers in the potential, and we'll update you as we go forward. It might not be -- it's not a quarter or a next quarter issue. It will take time. But the brand is strong. The fans are out there, and we are going to fix it.

Susan Kay Anderson - *B. Riley FBR, Inc., Research Division - Analyst*

Okay. Got it. And then on Jurassic World, so it sounds like that's been pretty successful. I guess, how is -- how did that trend so far versus your expectations? And I think the last quarter you said you had expected third quarter to be the bigger quarter for the product. So should we expect sales to even accelerate from where they have been in second quarter?

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

I'll start with the context of Jurassic, but we've been extremely pleased with the Jurassic business. It's the hottest action figure brand out there. Our teams collectively with Universal are working really well and hard together to maximize the opportunity. Clearly, a terrific theatrical release aligned our teams with Universal, and the execution has been really beyond our expectations.

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

It points to another thing, another important part of what we're doing is we're now working really hard to position Mattel as a great partner. We are treating third-party IP as if it's our own. And Jurassic World was one of the first franchises where -- that we approached with that in mind under a new leadership and have done extremely well. They knocked the ball out of the park. We've worked in close collaboration with Universal, so we can't claim all of the credit. But clearly, on the toy line, distribution marketing, we've done a terrific job. And this is really a start of a new day in terms of the way Mattel works with third-party partners, and you will see success with the other brands that we will have in the future.

Operator

Our last question comes from the line of Greg Badishkanian of Citigroup.

Gregory R Badishkanian - *Citigroup Inc, Research Division - MD and Senior Analyst*

So with respect to overall POS, excluding Toys "R" Us in the U.S. and then if you could also break out international.

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

Sure. Richard, you want to take that?

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

Yes. So on our core brands, we were up 2%; and total brands, we were up 2%. Our total core brands extremely successful performance as we've indicated with Barbie and Hot Wheels. And important to note also ex TRU, Fisher-Price and Thomas was also flat. So again, a clear performance against core brand. And within the Toy Box portfolio, obviously, the switch with Cars and Jurassic has had a hit in the context of that segment for us, but in our own brands within Toy Box also performed very strongly ex TRU also up single digit.

Gregory R Badishkanian - *Citigroup Inc, Research Division - MD and Senior Analyst*

And when would you expect your shipment growth to match the POS growth? When is that going to be fully aligned, would you say?

Joseph J. Euteneuer - *Mattel, Inc. - CFO*

I think as you go into the second half of the year, I mean, we've worked really hard to get our inventory levels right, I was just trying -- with the issue. But yes, I think the back half of the year.

Gregory R Badishkanian - *Citigroup Inc, Research Division - MD and Senior Analyst*

All right. And then Ynon, you mentioned you're treating third-party IP like your own. So are there some very significant opportunities to win additional contract -- contracts over the next 18 months?

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

We're working on it. We're working on it. Look, I mean, historically, we were very internally focused literally because of the strength of our IP. So you say, why go anywhere else, but this is not mutually exclusive. We clearly have very strong generational IP with a very deep and wide catalog. In fact, probably one of the strongest catalogs out there. But that does not mean we cannot work with third parties and do a great job with that. I want to take this and extend the answer a little bit and say that we're now transitioning to become an IP-driven company. And what that means is that our job is to take great IP and build it into commercial enterprises. We are -- the opportunity is beyond making great toys, even though the toy -- being a toy company is a great business to be at. So we're very proud of that, and we can capture a lot of value. If not -- if we do nothing, just reorganize the company and transform the way we operate, there's a lot of value to recapture just with that alone. But we're not looking to stop there. If you think as an IP-driven company, you can take great franchises to many different directions and turn this company into something a lot bigger than was ever imagined. So to do that, you got to do it with your own IP and we have a lot to play with. You can do it with new IPs that you developed in-house, but there's no reason not to work in collaboration with IPs that we don't have. And while you don't -- because you don't know and it's clearly the economics are somewhat different, but if you take it as an add-on or you don't take it as a mutually exclusive opportunity, it's -- it comes on top. So we feel that we are heading in the right direction. As I said earlier, we're seeing early signs of success, but it will take time to do that. And we've got to prioritize the areas where we take action. We're moving as fast as possible without weakening the company. We want to remain competitive because the company is still a going concern, very active, vibrant player in the toy industry. So while we are restructuring our own company, we're looking to maintain growth and momentum, and you've got to do it at the same time. But we feel very good about where we are, and we're positive and confident as we head to the second half of the year.

Operator

Thank you. This concludes today's Q&A session. I would now like to turn the call back over to Whitney Steininger for any closing remarks. Ma'am?

Whitney Steininger - *Mattel, Inc. - Investor Relations*

Thank you. There will be a replay of this call available via webcast and audio beginning at 8:30 p.m. Eastern time today. The webcast link can be found on our Investor page. Or for an audio replay, please dial (404) 537-3406. The passcode is 4398245. Thank you for participating in today's call.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program, and you may now disconnect. Have a great day.
