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CORPORATE PARTICIPANTS

Joseph J. Euteneuer *Mattel, Inc. - CFO*
Whitney Steininger *Mattel, Inc. - Manager of IR*
Ynon Kreiz *Mattel, Inc. - Executive Chairman & CEO*

CONFERENCE CALL PARTICIPANTS

Arpine Kocharyan *UBS Investment Bank, Research Division - Director and Analyst*
Eric Owen Handler *MKM Partners LLC, Research Division - MD, Sector Head & Senior Analyst*
Felicia Rae Kantor Hendrix *Barclays Bank PLC, Research Division - MD & Senior Equity Research Analyst*
Frederick Charles Wightman *Citigroup Inc, Research Division - Senior Associate*
Gerrick Luke Johnson *BMO Capital Markets Equity Research - Senior Toys and Leisure Analyst*
Jaime M. Katz *Morningstar Inc., Research Division - Equity Analyst*
Michael Ng *Goldman Sachs Group Inc., Research Division - Research Analyst*
Timothy Andrew Conder *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for your patience. You've joined Mattel's Third Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference may be recorded. I would now like to turn the call over to your host, Ms. Whitney Steininger, with Investor Relations. Ma'am, you may begin.

Whitney Steininger ***Mattel, Inc. - Manager of 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 Joe Euteneuer, Mattel's Chief Financial Officer.

As you know, this afternoon, we reported Mattel's 2018 third 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 gross profit and adjusted gross margin; adjusted and other selling 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 described 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 third quarter earnings call. I'm happy to say we are on track with the execution of our strategy and have made meaningful progress towards restoring profitability, as we transform Mattel into an IP-driven, high-performing toy company.

During the third quarter, gross sales were down 6% as reported and 4% in constant currency, primarily due to a negative 3% impact from Toys "R" Us and a negative 3% impact from the slowdown in our China business. At the same time, gross sales in North America were up 6%, which is the highest sales growth we've had in this key market for 11 quarters.

Importantly, we have achieved profitability in the quarter as a result of savings realized from our Structural Simplification program, as well as a net benefit related to Toys "R" Us bankruptcy accounting. As a result, reported operating income was up 41% versus the same period last year, which is the first time in 8 quarters that we have posted year-over-year growth in operating income. These results were achieved in spite of increased inflation in the costs of raw materials and plant labor.

We are proud to say that we recaptured the position of the #1 global toy company in each of the last 4 months through September, according to NPD. We are also the #1 toy company in the U.S. and Latin America year-to-date through September.

We continued to make tangible progress in reshaping our organization. We are on track to achieve or exceed our $650 million savings target for Structural Simplification. In addition, we are actively exploring strategic alternatives for our manufacturing footprint as we move towards a capital-light model, which could lead to additional efficiencies over time.

We also have taken meaningful steps to drive future growth. This includes the creation of a new theatrical film division and a global franchise management organization, to capitalize on our iconic brands and IP. We saw particular strength in Barbie, Jurassic World and Games and are positioned well going into the holiday season.

In terms of performance by brand in the third quarter, Barbie continued its strong momentum with growth across all regions. Barbie gross sales were up 17% in constant currency. This makes the fourth consecutive quarter of strong year-over-year sales growth for the brand. POS continued to be strong and was up high single-digits.

Barbie sales in North America and International were up 22% and 11%, respectively in constant currency. Reinforcing these strong results, Barbie was the #1 global fashion doll property year-to-date through September, according to NPD. We expect to see continued momentum for Barbie in the fourth quarter and look forward to her 60th anniversary in 2019.

Hot Wheels POS continues to be up double digits and accelerated in the third quarter across all regions. However, gross sales were down 3% in constant currency versus 2017, which was the year that included sales in advance of the theatrical release of Star Wars: The Last Jedi and a Toys "R" Us exclusive product offering. While these factors will also impact the fourth quarter comparison, we expect them to be more than offset by growth in holiday sales of basic vehicles and track sets.

According to NPD, Hot Wheels continues to be the #1 property globally year-to-date in the vehicles supercategory through September, and we expect the brand to deliver strong growth in the fourth quarter and full year. Looking towards 2019, we are excited about the product pipeline, which includes breakthrough innovation which will be announced next year.

Fisher-Price and Thomas & Friends gross sales were down 10% in constant currency, which included a 4% impact from Toys "R" Us. POS in the quarter was down similarly due to the challenges in our China business, which we expect to continue into the fourth quarter, but was partially offset by positive POS results in Latin America.

Looking ahead for Fisher-Price, we have already received very positive feedback from customers on our new 2019 product line, which was developed under the brand leadership brought on board earlier this year.

Thomas & Friends' new TV series was launched on Nick Jr. in the U.S. in September, airing daily and available on demand. The new content also launched in the U.K. and has been well received, with viewership growth of 44% over the previous period. This should provide momentum for the brand as we enter the fourth quarter and beyond.

As expected, American Girl gross sales continued to decline, down 31% in constant currency. Despite the decline, increasing Net Promoter Scores indicate that brand health remains strong with the existing consumer base. We will be executing retail activations and live events in the fourth quarter with a 40-city theatrical touring program to help promote new consumer acquisition. As I discussed last quarter, this brand is in a multi-year turnaround, and we expect to dedicate 2019 to making the fixes necessary to deliver improved performance thereafter.

Toy Box Owned Brands gross sales were up 2% in constant currency in the quarter. We have seen promising success from the Polly Pocket launch in the U.S. and Europe. Momentum from Polly and other brands have returned sales in our total Girls portfolio to positive growth for the first time in 5 years.

Games also performed well in the quarter, with gross sales up 20% year-over-year in constant currency, benefiting from the continued success of the UNO brand, including ongoing momentum for DOS. Year-to-date through September, UNO is the #1 selling game in the games and puzzles supercategory in the U.S., according to NPD.

Turning to Toy Box Partner Brands, gross sales were down 15% in constant currency when compared to 2017, which benefited from the theatrical release of Cars 3, partially offset by the initial sales of Jurassic World in 2018. Our success with Jurassic World has been largely driven by the creation of a toy line with action figures that are in- scale with other categories such as vehicles and drones for a more immersive play experience.

Universal recently stated that our collaboration with Jurassic was, and I quote, "One of the most compelling toy lines ever developed, driving toy sales results for the brand to new heights."

Looking ahead, we are excited for the release of Toy Story 4 in 2019, which will serve as one of our biggest tentpole properties next year.

We are working hard to position Mattel as the partner of choice for all of our partners by delivering innovative product, and strong, global execution.

We also made good progress when it comes to our local execution in the various regions around the world. We are the #1 toy company in the U.S. and Latin America year-to-date through September, according to NPD. Having maintained our strong position there, we are now turning our focus to improving our performance in Europe and Global Emerging Markets, including China in particular.

Looking at the regions in more detail, North America gross sales were up 6%, driven primarily by strong Barbie and Jurassic World sales, even with the negative impact from Toys "R" Us. This is the highest growth we have had in this key market since fourth quarter 2015.

Given the magnitude of the Toys "R" Us disruption expected in the fourth quarter this year, gross sales are likely to decline. Yet, we are very proud of the progress we are making in the largest and most competitive toy market in the world.

International gross sales were down 11% in constant currency, including the 6% negative impact in China, which accounted for essentially all of the decline in Global Emerging Markets. As I mentioned last quarter, we are seeing a slowdown in our China business and expect this to persist for the remainder of 2018. Our team on the ground is managing through inventory at retail amidst a softening market and we are taking action to mitigate the decline. We are reassessing our approach and continue to aim for long-term growth in the Chinese market.

Europe represents our next big opportunity geographically to improve performance given the size of the market and the strength of our brands. Europe was down 10% in constant currency, mainly due to the Cars 3 comparison and declines in Fisher-Price and Thomas. We are currently implementing a growth plan to improve our positioning while enhancing productivity and efficiency. This includes building out our e-commerce capabilities and expanding our presence with value retailers.

To accelerate our strategy in Europe, we have appointed our board member, Soren Laursen, as Executive Director. Many of you may be familiar with Soren's background as a long-standing senior executive at LEGO and, most recently, the CEO of TOP-TOY, the largest retailer of toys and children's product in the Nordic region. We believe Soren will add significant value to Mattel in this expanded role.

We have continued to do well in Latin America, with gross sales up 1% in constant currency, in spite of the 2% impact from the Cars 3 comparison in 2017. Gross sales as reported were down 8% due to the significant foreign exchange impact in Brazil. We have a strong leadership team driving our strategy in Latin America, which positions us well for continued success.

I will now provide an overview of the primary elements of our strategy. We see two sets of opportunities. In the short-to-mid-term, our priorities are to fix the core business by continuing to reshape operations, grow Power Brands and expand our brand portfolio. In the mid-to-long-term, we are looking to capture the full value of our IP through franchise management and develop our online retail and e-commerce capabilities.

As part of reshaping operations, our first and foremost priority is to deliver on our Structural Simplification target of $650 million of run-rate savings exiting 2019. We are on track to achieve or exceed this savings target.

We are seeing good momentum in product and marketing innovation and we are increasing focus on efficiency and performance, as well as the quality and consistency of our execution. We are also proceeding with the reassessment of our manufacturing footprint and supply chain, as we discussed last quarter. We are considering strategic alternatives for our manufacturing footprint and expect to advance towards a capital-light model during 2019.

The second phase of our strategy is driven by Mattel's ownership of one of the strongest catalogues of kids and family entertainment franchises in the world. Our vast and diverse portfolio of hundreds of intellectual properties reaches beyond any one category or genre. Yet, we have commercialized only a small portion of it. With that in mind, we plan to capture the full value of our IP in highly accretive business verticals, including film and television, digital gaming, live events, music and consumer products. These have been historically under-leveraged and we believe there is transformative value to be created if executed well. To achieve this, we have brought on board world-class leadership capabilities to execute and set us up for success.

We are excited about the potential to unlock the value of our IP on the big screen. We have recently announced the creation of Mattel Films and the appointment of Robbie Brenner as Executive Producer to lead this new opportunity. We are constructing a capital-light business model, with plans to collaborate with other partners in the industry and we do not anticipate taking on financial risk.

We have already received significant interest in our film division from some of the world's leading distributors, filmmakers, producers and talent. At this stage, we can't be specific about timing of film releases, but it will be worth waiting for.

We also recently announced the launch of a Global Franchise Management organization. This team, led by Janet Hsu as Chief Franchise Management Officer, will complement our core toy business and extend Mattel's brands to new, significant commercial areas.

In conclusion, our turnaround plan is starting to show tangible results. While there is still a lot more work to do, we are confident in our strategy and the progress we are making. We delivered 6% growth in North America and recaptured the #1 position in the U.S. year-to-date through September, according to NPD. Also, per NPD, we recaptured our position as the #1 toy company globally in each of the last 4 months through September. The toy industry is expected to continue to grow on a global basis through 2022 according to Euromonitor, and we intend to accelerate our own pace and increase market share.

We delivered meaningful improvement in bottom line performance. This is in spite of increased inflation and costs of raw materials and plant labor, as well as the Toys "R" Us disruption. And we expect to deliver further improvement in profitability in the fourth quarter. As we head into next year, our focus will be on driving top line performance and continued growth in profitability.

Looking into 2020 and beyond, we believe the capabilities we are putting in place will position us well to accelerate growth and capture the full value of our IP. We are in a multi-year turnaround and execution will take time. However, given the quality of our assets and the strength of our team, I'm confident that we will be able to execute on our strategy and increase long-term shareholder value.

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

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

Thank you Ynon, and good afternoon everyone. Today I'll begin by walking you through the financial results and updated outlook for the full year. Then I'll provide an update on our strategic investments and our continued progress against Structural Simplification.

We are starting to see demonstrated improvement in our performance as a result of our continued strong execution.

As Ynon mentioned, gross sales in the quarter were down 4% year-over-year in constant currency, driven by a negative 3% impact from Toys "R" Us and a negative 3% impact from the slowdown in our China business. As expected, POS from Mattel was down mid-to-high-single-digits for the quarter as consumers began transitioning from Toys "R" Us to other retailers. Our performance was roughly in-line with the industry and, as Ynon said, we recaptured the #1 global toy manufacturer position in each of the last 4 months through September, according to NPD.

In looking at the full year, we said back at Toy Fair in February that we would be working to stabilize the top line in 2018. While we've made meaningful progress, especially in North America, there have been a number of developments throughout the year that have had a negative impact on our full year outlook, including the impact of Toys "R" Us, a 3% foreign exchange headwind, and a 3% negative impact from challenges in our China business. We expect the impact of these developments to result in a full year topline decline similar to prior year.

Despite these headwinds on the topline, I am pleased to report that our third quarter performance reflected significant improvement in our profitability as we continue to realize the benefits of the actions taken toward Structural Simplification.

In the third quarter, our adjusted gross margin was 43% of net sales, up from 41.5% in the third quarter of 2017. The improvement was primarily driven by the $63 million benefit from Structural Simplification; last year's Toys "R" Us revenue reversal of $43 million, which did not include a corresponding reversal of the cost of goods sold; favorability in freight and logistics costs associated with bringing in-house a previously outsourced distribution facility; and price increases in select international markets. These were partially offset by a negative 300 basis point impact from inflation in the cost of raw materials and plant labor. Consistent with the second quarter, we remain confident that our second half gross margin will be in the low 40s and continue to expect full year gross margin to be in the high 30s.

In the third quarter, our advertising rate was 11.5%, which was flat year-over-year. For the full year, we continue to expect our 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 third quarter, our reported SG&A was $326 million, down $55 million or 15% year-over-year, which included severance and restructuring costs of $26 million.

Our third quarter adjusted SG&A of $300 million was down $50 million or 14% compared to the prior year. This year-over-year improvement was primarily driven by cost savings of $55 million from Structural Simplification and approximately $13 million of Toys "R" Us bad debt recoveries.

Looking ahead, we continue to expect adjusted SG&A for the full year to be slightly better than the prior year, in dollars.

Adjusted operating income in the quarter was $153 million, up $36 million or 31% compared to the prior year, driven by the $119 million of savings realized from our Structural Simplification cost savings program, as well as the net benefit of last year's Toys "R" Us revenue reversal of $43 million and the $13 million of Toys "R" Us bad debt recoveries, partially offset by inflation in the cost of raw materials and plant labor, as I previously mentioned.

Now let me give you an update on taxes. Our income tax expense was $66 million in the third quarter and $71 million year-to-date. Our overall 2018 effective tax rate may vary significantly from quarter-to-quarter due to the level and mix of income or losses in our foreign jurisdictions and due to the full valuation allowance on our U.S. deferred tax assets.

As a result of the valuation allowance, in the third quarter of 2018, we did not recognize an income tax benefit for any U.S. losses since we released the valuation allowance to cover the related expenses but recorded an income tax expense on our net foreign income in certain jurisdictions. Additionally, we had previously expected to pay cash taxes of $100 million in 2018, similar to the prior year. We now expect cash taxes for the full year to be $60 million to $80 million, excluding any actions related to Structural Simplification.

With regards to the Tax Act, in the third quarter, we recorded a provisional tax of $9 million associated with the deemed repatriation of accumulated foreign earnings. Additionally, in order to enhance Mattel's access to foreign earnings, we changed our indefinite reinvestment assertion on a portion of our foreign earnings and recorded a tax expense of $15 million related to this change.

Assuming no changes in tax laws and excluding discrete tax items, Mattel anticipates that our fourth quarter tax expense should be less than $30 million based on our current projections.

Moving to the balance sheet, we ended the third quarter with a cash balance of $209 million. During the first nine months, our working capital improved $552 million, primarily driven by accounts receivable improvement of $193 million, or 13% year-over-year, half of which was driven by lower sales and the other half by improved collections. This improvement resulted in a five-day reduction in our days sales outstanding.

As it relates to the recently announced Sears bankruptcy, Sears represented less than 1% of our overall revenues last year, and our exposure is insignificant as we have closely managed the account for some time. Additionally, owned inventory improved $264 million or 27% year-over-year, as a result of our continued efforts to tightly manage our inventory by better aligning the timing of production with consumer demand.

Moving to the statement of cash flows, cash flows used for operations was $731 million year-to-date, which was an improvement compared to prior year usage of $740 million driven by lower working capital usage offset by a higher net loss excluding non-cash charges of approximately $266 million.

The primary driver of investing activities was capital expenditures, which were $111 million year-to-date, down 53% year-over-year due to reductions in tooling and plant capital expenditures.

We originally expected capital expenditures to be down $100 million or 33% versus the prior year. Based on year-to-date spend, we are confident that we will exceed that goal.

We will continue to tightly manage working capital as we approach the 2018 holiday season. We also continue to monitor our capital structure and remain confident that we have sufficient liquidity to run our business efficiently and we have no debt maturities until October 2020.

Turning to our strategic investments, after a comprehensive review, we remain committed to our investment strategy. While we originally expected investment spend to be $85 million for both 2018 and 2019, with the leadership transition, we took time to reassess and reprioritize. We now expect the spend to be more heavily weighted toward 2019. We expect our 2018 spend to be approximately $60 million and have spent $27 million year-to-date on initiatives including our IT transformation, American Girl turnaround, other brand growth opportunities, as well as our international strategy. We plan to provide more visibility into our plans for 2019 in the coming months.

With regards to Mattel Films, as Ynon said, we are constructing a capital-light business model and we do not anticipate taking on financial risk.

Now let me provide an update on our Structural Simplification cost-savings program. We continue to be on track to achieve or exceed our $650 million targeted run rate exiting 2019. We are pleased to report that we achieved approximately $120 million of savings in the quarter, and year-to-date savings of approximately $160 million. Our year-to-date severance and restructuring cost related to Structural Simplification are $104 million.

As Ynon stated, we are making good progress in exploring strategic alternatives for our manufacturing footprint as we move toward a capital-light model, which could lead to additional efficiencies over time.

In closing, I am pleased with our progress as we continue to execute against our strategy in spite of the short-term industry disruption related to Toys "R" Us. We are clearly seeing the benefits of Structural Simplification materializing in the P&L. We remain focused on value creation for our shareholders through our comprehensive actions to restore profitability and to stabilize the topline.

Thank you for your time today, and we will now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Eric Handler of MKM Partners.

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

Joe, just a couple of questions for you here. First, when you say you expect revenue for the full year to be down similar to last year, so that's about 10% on a net adjusted sales basis, are you talking gross sales? Are you talking after the sales adjustments on that line?

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

I was talking gross sales.

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

You're talking gross sales. And then how would you then think about the adjustments line -- the sales adjustments line?

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

I didn't provide any guidance on that. I wanted to just give you the topline and the bottom line. It is a line we continue to work hard on, but remember, the majority of that money is going to happen here in the fourth quarter. So...

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

Got it. And then, one other quick question for you. With regards to the movie business. So given that you don't expect to take any financial risk, does that mean you expect to get any equity participation in these films? And if you do, how exactly is that going to work?

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

Let me answer on the film side. This is Ynon. We intend to receive different forms of participation. It's a combination of cash for the rights as well as royalties in back-end upside in the movie. This is without taking on financial risk. And the driver, the reason we can receive good terms, is because the IP is such high-quality and is such high demand. So without risking capital, we intend to still have meaningful participation in the upside in the event of success.

Operator

Our next question comes from the line of Gerrick Johnson of BMO Capital Partners.

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

I've got a couple here. First, on the Chinese part, is this slowdown in macro a Chinese issue or is this a more micro Mattel issue?

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

It is more of our own issue. This is a self-inflicted situation related to a miscalculation of forecast and mismatch in the supply versus demand. This will have an impact of 3% on the topline for the full year. And our team on the ground is managing through inventory at retail and taking action to mitigate the decline. I should say that we do have great partnerships in place in China between Alibaba, Fosun, Babytree, NetEase and are continuing to engage with them to differentiate ourselves in the market and still see potential growth in China going forward. So it is a local issue. It's a 2019 issue and we hope to work through it going forward.

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

Okay. And how about shipments from China? Are those containers getting through the ports okay? Or is there any slowdown because of the tariff issue and inspection of containers?

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

None at all. We are fine.

Operator

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

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

I wanted to talk about margins. It seems like high 30s gross margin guidance is still your guidance. And given year-to-date performance, that would imply Q4 has to be up definitely more than 800, 900 points to meet that guidance. Could you just go over some of the puts and takes? There was a lot of SKU rationalization last year that was margin disruptive and some distribution center issues. But still on a declining top line, that seems aggressive. So if you could just go through puts and takes. And then, I have a follow-up on China.

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

Yes, sure. Remember, you have 2 big things. One is fourth quarter is your biggest quarter. So obviously, you have scale. And then, the second thing, if you remember last year, I had a big write-off in the fourth quarter. So from a year-over-year basis, I'm getting the benefit of the write-off that I had last year that I don't have -- or not anticipating this year. And then, you have the benefits from Structural Simplification. You have the benefits from the TRU sales reversal, which is a last year issue. You have the benefits that I have been talking for the past 2 quarters of the Pennsylvania distribution facility that's online and achieving the savings and operating it the way we want, after we've gone through 2.5 quarters of problems with us. So that's up and running great. And then, we do have a little bit of price increases in selected places. And then, it's just offset by the inflation that I discussed. So yes, we feel pretty good about -- we feel great about where we are and are confident in the numbers we put out there.

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

So would you say, by my calculation, that at least sort of half of that potentially 800, 900 basis points of margin, would you say that's about right in terms of impact what's really truly one-off?

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

Yes, if you remember last quarter, I did say that part of the benefits we were going to get in the back half of the year were going to be mathematical in the sense there's stuff that happened in last year that aren't repeating this year, and obsolescence is one and the TRU issue is the second one. So yes, a portion of it is mathematics and other portion is real execution on our part to improve our profitability.

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

Okay. And then I have a quick follow-up on China. I'm sorry, I'm still sort of not understanding it because 3% of topline is $165 million. That to my knowledge, represents more than half of your China business. It's not -- it doesn't seem like it's a slowdown. It seems like it's a significant, significant decline because the base of that business could not have been more than $500 million. Could you just go over the scale of that decline?

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

I mean, look, we have not given out specific numbers in regards to China individually. I mean, look, the realities are in China, it's very simple. It's a market that even though you see press headlines that the market is slowing, it still has great growth as a market. And what's happened to us is something that was self-inflicted, where somebody overestimated that demand, and therefore, we're supplying to an overestimated demand and now we're having to work through those issues. That said, it's helped that it's corrected and we move on. Right now we can take advantage of the high-growth opportunity in China.

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

Okay. And then, I have a one quick one. It seems like industry sales softened significantly into the third quarter. As you look at the retail picture not just from Mattel but your competitors and kind of the Toys "R" Us situation and what retailers are doing, what is your explaining on what's happening at such demand level outside of Toys "R" Us? Given that the rest of the consumer picture seems okay, do you feel like it's toys sales being pulled forward a bit into the first half of the year and that's having a bit of impact? Why do you think toys retail slowed down significantly into Q3?

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

Well, there's no denial that the Toys "R" Us liquidation had an impact on the U.S. market specifically. But to put it in context, the Toys "R" Us situation is a very specific situation to Toys "R" Us. This is not a reflection on the rest of the industry, and do not confuse that. Based on the research that we see, take Euromonitor research for example that was established in May this year, they project that the industry would grow to 2022 at 4.7% CAGR. And this is based on a study they have done in 32 countries, making up about 80% of the global toy industry. So we do expect the disruption in 2018. But we -- that impact will subside during 2019 and beyond. And as it relates to this year, what we see are all the other retailers moving in and picking up the demand for toys and catering for customers -- sorry, consumers who are looking to buy product. Now fundamentally speaking, the fact that one retailer is out of business doesn't mean that consumers will change what they do, what they consume and the toys they like. Now the market will realign over time. And based on what we know, we expect growth to continue in the industry.

Operator

Our next question comes from the line of Mike Ng of Goldman Sachs.

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

I just have a few if I could. In North America I think you said you expect the 4Q revenue to decline year-over-year because of the impact of Toys "R" Us. I just wanted to understand this a little bit better in the context of the very strong 3Q North America growth despite 400 basis point headwind from Toys "R" Us. Does this imply that the headwind from Toys "R" Us is increasing in 4Q versus 3Q? Or is the underlying growth in North America slowing down?

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

Yes. Q4 will have the greatest impact year-on-year from Toys "R" Us.

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

Okay. And then, I was wondering if you could just comment on the 300 basis point headwind from Toys "R" Us in the quarter on the topline. Is that a gross or a net number? Said differently, Toys "R" Us was 8% of revenue last year. Does that mean that you recaptured the majority of the lost Toys "R" Us revenue?

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

So you're talking about on the topline? Yes, as far as recapturing, we haven't really estimated -- it's hard to estimate what recapturing really is if you think about Walmart or Target. It's hard to estimate what the impact of recapturing really is.

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

Okay. And then I was just wondering if you could comment on your owned inventories, which were down fairly substantially in the quarter. Do you feel like those inventories are in a good place to fulfill demand going forward? And could you just comment on the health of what you believe retail inventory of Mattel's products are?

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

Look, at the -- we are very focused on managing our inventory very tightly and making sure it's aligned with demand and the production output. We are in a healthy place now. We are very cognizant of legacy issues and supply chain challenges we had in the past, and we are very focused on fixing it going forward. This -- when we talk about reshaping operations, which is part of the -- is a key pillar in our strategy, this is a big part of that component to make sure that we are on top of our own production capabilities, that we optimize pricing, that we deliver product on time, that our distribution is up -- is on par with our expectations. And all of that takes a lot of heavy lifting, but we are making good progress and feel that we are in a healthy place now.

Operator

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

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

I just wanted to get, and I apologize if I missed this during your earlier comments. I got disconnected there for a little bit. But China-U.S. war. What do you view as you or the industry's risk to that? There was some commentary earlier in the week by a competitor from that perspective. But I wanted to hear your thoughts. And then, just to sort of stay on the channel inventories. It seemed like exiting Q2, you felt very good with the exception of China, and you've already commented about how -- the issue you have by the end of the year. Just to make sure everything else at this point, do you feel good about the channel inventories or are there some pockets where you may be seeing some things that need to be addressed?

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

Okay. Let me start and take the tariff question first. We are being very watchful. This is something that will impact the entire toy industry. The Toy Industry Association of America reported recently that 85% of all toys sold in the U.S. are imported from China. In our case, it is actually less than 2/3, so we are somewhat in a better position. And actually, I should say, I should point out an important advantage is that Hot Wheels and Barbie products, the majority of Hot Wheels and Barbie products, are not manufactured in China, so there's no threat in the majority of that business. Our job is to desire an organization that is flexible and can respond to headwinds and challenges like tariffs in China, and this is part of our plan to move towards a capital-light model that will give us more flexibility as we are looking to optimize our supply chain across the world.

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

Yes. And in regard to your second question, you've seen that our inventory is down. Across the board, we had everybody focused on making sure that inventory is healthy, not only at the retailer but at our levels, too. So it is one of our, a #1 focus that we take -- we want to make sure that our retailers are taken care of along with ourselves and we're servicing them properly.

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

Okay. And then, to circle back to the third quarter retail slowness. Would you believe that the -- or is the majority of that due to the comparables of Toys "R" Us? Or again, I just want to make sure there's nothing else that you're seeing either domestically or Europe that could be influencing that.

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

Yes. I think yes. If you think about it, the Toys "R" Us liquidation ran till the end of June. So now that that's behind us, we're now focused on the back half of the year. And in the fourth quarter, you can have that negative comparison because obviously, the bulk of historic Toys "R" Us sales were in the fourth quarter. But yes, there's nothing that we think is going to affect the business. Our growth there, we think, is going to be pretty healthy.

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

Okay. And lastly, Joe, however you want -- or Ynon, however you want to answer this question. Just sort of walking through some math that we had, what you reported, now you've updated. Even though the top line is going to be a little bit lighter, directionally on an adjusted EBITDA basis, do you feel comfortable that something north of $200 million is within the ballpark just sort of the benchmark guidepost here for '18?

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

Yes. We haven't given any -- we haven't provided any guidance on the EBITDA number. Look, you can pretty easily get to a number that you can get comfortable with, but we haven't given any specific guidance at this time.

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***

Joe, can you just -- in the -- in your financials now, it looks like you are taking out the Toys "R" Us adjustment. So can you just walk us through the decision there?

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

Yes. That decision was through our discussions with the SEC that they preferred that we did not do the math for you and that we provided the raw numbers and let you do the math on your own. So we're just complying with a comment letter that they had, that you can see is up on the policy. You can see it. That was the reason for the change.

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

Okay. And then -- okay, and this is for both of you, Ynon and Joe. Maybe I'm a little bit confused, but I'm just trying to reconcile the implied fourth quarter revenue guidance. So based on what you said and what you've reported this year, it looks like the revenues will be down about 13%, which means that you're shipping 13% less year-over-year in the fourth quarter. But you kind of did better in the third quarter. So which, I mean, it was still down, but it wasn't -- it was down. So I'm just trying to understand. I think it's kind of to -- the retail inventories crushed back for that. I just want to understand the cadence here.

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

Actually, it's really just that there's a bigger impact last year in Toys "R" Us in the fourth quarter versus the third quarter. That's all it is. Our inventories, everything else, were fine. We're going into the fourth quarter strong. We've got great relationships with everybody. We're working it hard. We're feeling very good internally about what's going on and carrying forward. That's the issue.

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

And I guess, maybe I'll ask it another way. I mean, for a lot of us who model, and you've seen all the sell-side models through the fourth -- or for the year, but inclusive of the fourth quarter, it's a little bit of a surprise to us. But since you guys don't give guidance, I mean, is that fourth quarter implied guidance now in line with perhaps what you were thinking last quarter or with your overall plan? Or is it more than you expected?

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

Yes, no. The interesting thing is that part of the reason we gave the topline guidance is to get everyone's models adjusted because internally, we feel very, very good about the numbers. And the fact of the matter is Toys "R" Us impact in the third quarter was low single-digits, and in the fourth quarter, it will be double digits. So that's the issue.

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

Okay. And then just finally, on American Girl. I mean, I know some of the -- the problem is that you guys are kind of working through some decisions that were made from the prior management team. So how long do you think it will take for you to work through all the third-party channel stuff?

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

So we've decided that we are -- obviously, we're hard at work at American Girl. This will be a multi-year turnaround. The focus of the turnaround, as you know, is obviously on the omnichannel experience that we have, catalogue, e-commerce in our own stores; evaluating our price value equation; enhancing customer relationships through improved data management and CRM; and most importantly as well, modernizing the brand's content, which with new talent in the organization and the new partnerships that we've established in the content arena, we're very confident that we're going to be able to address that quickly. So when to watch? Absolutely, we are working feverishly on dragging the turnaround of that brand. Despite all of the challenges, Net Promoter Scores remained high. Loyalty remained high. Our conversion of the customers we do have is very impressive. And so we still are very confident in the DNA of the brand, and we will work hard to turn that around.

Operator

Our next question comes from the line of Greg Badishkanian of Citi.

Frederick Charles Wightman ***Citigroup Inc, Research Division - Senior Associate***

It's actually Fred Wightman on for Greg. If we look at that $160 million in cost savings year-to-date, can you just walk through the bigger buckets of the bridge of the $500 million that you are expecting by the end of the year?

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

Oh, you mean as far as where it's coming from?

Frederick Charles Wightman ***Citigroup Inc, Research Division - Senior Associate***

Yes, please.

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

Yes. So you're going to have roughly $200 million is going to come out of cost of goods sold. You'll have the $30 million to $40 million that we're going to get in advertising here in the fourth quarter. And then the balance will come out of SG&A. A number of actions have already been taken. You saw the 22% reduction in workforce. You've heard us talk about all of the initiatives we have at the manufacturing plants. And you heard Ynon talk about this, this isn't about expense takeouts, it's about reorganizing and becoming a far more efficient organization. And all of those things, they are multiple projects contributing to getting to that exiting ramp.

Frederick Charles Wightman ***Citigroup Inc, Research Division - Senior Associate***

Great. And if we look at the strategic roadmap slide, one of the short-to-mid-term goals talks about expanding the brand portfolio. Is that something that you think is likely to come from acquisitions? Is that something that you guys think you can develop internally? Is that talking about licensing? How are you thinking about that?

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

Yes. This is a combination of 3 components. The first is leveraging our own library, more of the dormant brands that we haven't commercialized in full. And as we noted in the prepared comments, we have hybrids of those, so there's a huge portfolio that we can commercialize. Then, you have the brands that we do not know that exist yet. These are the other brands that that we will create as we're looking to drive and innovate and create the next big brands for the industry. So these components are Mattel Owned Brands. And the third dimension are licensed brands. This is where we are looking to position Mattel as the partner of choice for the big -- the other media platforms around the world, especially the entertainment companies that own the big movie franchises. It is fair to say that we lost a few key licenses along the way, and we intend to go back and compete for them in a matter of a front-footed way. We've done, as a case in point, a great job with Jurassic World, which exceeded everybody's expectations. And we are looking to collaborate with other partners going forward.

Operator

Our next question comes from the line of Jaime Katz of MorningStar.

Jaime M. Katz ***Morningstar Inc., Research Division - Equity Analyst***

I'm curious about the working capital metrics that you guys have had improving on the balance sheet. And you've made some pretty strides at unlocking some value there in the last quarter. And I'm just wondering what you guys expect going forward, particularly on the receivables side maybe as you move to some smaller retailers, which could provide a headwind on that line.

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

Sure. No, we still expect to manage receivables very tightly. We would think that receivables should be down along with inventory going down here into the fourth quarter. So we feel pretty good about our positioning and the effort going on across the company to really manage those two balances very tightly.

Jaime M. Katz ***Morningstar Inc., Research Division - Equity Analyst***

Okay. And then, you guys have made some key hires for the commercial organization. Are there any priorities you guys would like to share with us that might help us think about, if there's a way to squeeze some cost savings out of that side of the business?

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

This is less about cost savings and much more about addressing highly accretive business verticals, where we have incredible potential to commercialize our library. I think I just want to put things in perspective because when we talk about our portfolio, this catalogue spans girls, boys, infants and preschool demographics. We have dolls and vehicles, action figures, construction, games, from learning and development, superheroes, spies, space explorers, princesses, you name it. So we have so much opportunity around our own catalogue that has not been commercialized that it's going to be mostly about cadence and the way we progress our efforts on that front. We did talk about the film. And as we said before, there are a few big projects in the works. We're not ready to announce anything at this time, but it is in motion. And we're also looking at the other verticals that are highly accretive businesses in and of themselves. Historically, we have done things in those areas, but it was mostly about marketing and promotion. Our approach now is about commercializing these areas as verticals -- as successful verticals in and of themselves. And that's where we see the potential, and you should expect more to come in that area.

Operator

At this time, I'd like to turn the call back over to Whitney Steininger for any closing remarks. Ma'am?

Whitney Steininger ***Mattel, Inc. - Manager of IR***

Thank you, Latif. Thank you, everyone, for joining the call today. A replay of this call will be available via webcast and the 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 31878885. Thank you for participating in today's call.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day. You may disconnect at this time.