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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Ladies and gentlemen, good day. My name is Abby, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Mattel, Inc. Fourth Quarter and Full Year 2023 Earnings Conference Call. Today's conference is being recorded. (Operator Instructions)

Thank you, and I will now turn the conference over to Mr. David Zbojniewicz, Head of Investor Relations. You may begin.

David Zbojniewicz - *Mattel, Inc. - VP & Head of IR*

Thank you, operator, and good afternoon, everyone. Joining me today are Ynon Kreiz, Mattel's Chairman and Chief Executive Officer; and Anthony DiSilvestro, Mattel's Chief Financial Officer. As you know, this afternoon, we reported Mattel's 2023 fourth quarter and full year financial results. We will begin today's call with Ynon and Anthony providing commentary on our results, after which, we will provide some time for questions. To help supplement our discussion today, we have provided you with a slide presentation.

Our discussion, slide presentation and earnings release may reference non-GAAP financial measures, including adjusted gross profit and adjusted gross margin; adjusted other selling and administrative expenses; adjusted operating income or loss and adjusted operating income or loss margin; adjusted earnings per share; adjusted tax rate; earnings before interest, taxes, depreciation and amortization or EBITDA; adjusted EBITDA; free cash flow; free cash flow conversion; leverage ratio; net debt; and constant currency.

In addition, we present changes in gross billings a key performance indicator. Please note that we may refer to gross billings as billings in our presentation, and that gross billings figures referenced on this call will be stated in constant currency, unless stated otherwise. For today's presentation, references to POS and consumer demand exclude the impact related to our Russia business, given our decision to pause all shipments into Russia in 2022.

Our slide presentation can be viewed in sync with today's call when you access it through the Investors section of our corporate website, corporate.mattel.com. The information required by Regulation G regarding non-GAAP financial measures, as well as information regarding our key performance indicator, is included in our earnings release and slide presentation, and both documents are also available in the Investors section of our corporate website.

The preliminary financial results included in the press release and slide presentation represent the most current information available to management. The company's actual results, when disclosed in its Form 10-K, may differ from these preliminary results as a result of the completion of the company's financial closing procedures, final adjustments, completion of the review by the company's independent registered public accounting firm and other developments that may arise between now and the disclosures of the final results.

Before we begin, I'd like to caution you that certain statements made during the call are forward-looking, including statements related to the future performance of our business, brands, categories and product lines. Any statements we make about the future are, by their nature, uncertain. These statements are based on currently available information and assumptions, and they are subject to a number of significant risks and uncertainties that could cause our actual results to differ from those projected in the forward-looking statements.

We describe some of these uncertainties in the Risk Factors section of our 2022 Annual Report on Form 10-K, our Q3 2023 Quarterly Report on Form 10-Q, our earnings release and presentation and other filings we make with the SEC from time to time as well as in other public statements. Mattel does not update forward-looking statements and expressly disclaims any obligation to do so, except as required by law.

Now I'd like to turn the call over to Ynon.

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

Thank you for joining our fourth quarter and full year 2023 earnings call. 2023 was a milestone year for Mattel. We extended our leadership in our key toy categories and gained significant share overall, achieved extraordinary success with the Barbie movie and further strengthened our financial position.

Fourth quarter results saw meaningful sales growth and margin expansion. Consumer demand for our products increased, and we continued to outpace the industry. Full year sales were comparable to the prior year, with gross margin expansion and significant increase in cash flow. Execution on our toy strategy was strong, considering we entered 2023 with a challenging retail inventory headwind and faced a toy industry decline during the year.

We also made meaningful progress on our entertainment strategy across film, television, digital and publishing.

We achieved an investment-grade rating and resumed share repurchases for the first time since 2014. We ended 2023 with the strongest balance sheet we have had in years, with more resources to execute our strategy.

Looking at key financial metrics for the fourth quarter as compared to the same quarter in the prior year. Net sales increased 16% as reported or 14% in constant currency. Adjusted gross margin improved 570 basis points to 48.8%, and adjusted EBITDA increased 48% to $234 million. POS increased low single digits in the quarter as we worked closely with our retail partners to meet the demand for our product.

Looking at key financial metrics for the full year as compared to the prior year. Net sales were comparable or down 1% in constant currency, with growth in 3 or 4 regions. Adjusted gross margin improved 160 basis points to 47.5%. Adjusted EBITDA was $948 million, a decline of 2%. Free cash flow increased by $453 million to $709 million, and we ended the year with over $1.2 billion of cash after utilizing $203 million to repurchase shares. POS grew low single digits for the year and was up in 3 or 4 regions.

Per Circana, in the fourth quarter, Mattel gained share globally, driven by increases in Dolls and Vehicles as well as Games and Building Sets. For the full year, Mattel gained 70 basis points of share globally, driven by increases in Dolls and Vehicles as well as gains in Infant, Toddler and Preschool and Building Sets. Mattel was the #2 global toy company for the quarter and year, and the #1 toy company in the U.S. for the 30th consecutive year, where we achieved the largest annual share gain on record.

The global toy industry declined 7% in 2023 per Circana. That said, this followed extraordinary growth of 25% from 2019 to 2022, reaching an all-time high. It should be noted, the industry in 2023 was 17% higher than 2019 pre-pandemic and the third largest ever.

We are successfully executing our strategy to grow Mattel's IP-driven toy business and expand our entertainment offering.

As it relates to our Toy business, we made significant progress in scaling our portfolio, growing our franchise brands and advancing e-commerce and D2C. We successfully relaunched catalog IP and continued to strengthen our relationships with major entertainment partners and key retailers.

In 2023, Barbie was the #1 doll property globally, and #2 toy property overall. Hot Wheels gross billings achieved its sixth consecutive record year. Monster High was successfully relaunched globally and was the largest growth property in Dolls. Disney Princess and Frozen performance was strong in its first full year back at Mattel. Infant, Toddler, Preschool continued to optimize the portfolio with new product innovation and expanded its Little People Collector business. Mattel Creations, our D2C business serving adult fans, continue to grow, with user traffic up over 90%. And the company received an industry-leading 15 Toy of the Year nominations and 7 awards, including for design and marketing.

For our Entertainment business, this was a breakout year as we demonstrated the power of our IP and demand creation capabilities.

The Barbie movie was a cultural phenomenon, achieving the largest global box office in 2023, becoming Warner Bros. highest box office movie in its 100-year history and the industry's 14th largest box office of all time. The movie, its filmmakers and all-star cast, as well as the Barbie album have received multiple nominations and awards, highlighted by 8 Oscar nominations, including Best Picture. The Barbie album was honored on Sunday night with Grammy Awards for Compilation Soundtrack, Song of the Year and Best Song Written for Visual Media.

In addition to the fourteen live-action movies in development, we recently announced Mattel Films' first animated movie, Bob the Builder. Award-winning actor and recording artist, Anthony Ramos, will voice the title character; and coproduced with Oscar-winning Animation Studio, ShadowMachine and Jennifer Lopez' Nuyorican Productions. We also announced our partnership with Paramount Pictures to develop the American Girl live-action feature film.

Mattel Television Studios premiered 12 series and specials, including Monster High, Hot Wheels, Polly Pocket, Barbie, Thomas & Friends, Fireman Sam and Pictionary, as well as a Monster High movie sequel.

In Digital Gaming, Hot Wheels Unleashed 2 Turbocharged was released, and the first stand-alone Barbie game on Roblox was launched, achieving over 130 million visits since October. The Mattel163 joint venture grew its mobile gaming revenues to almost $200 million in 2023.

We also launched our own book publishing business, Mattel Press, with sales and distribution managed by Simon & Schuster.

We continue to improve operations and achieved $132 million of cost savings in 2023. We successfully concluded the Optimizing for Growth Program, which achieved total annualized savings of $343 million between 2021 and 2023, well beyond our initial target of $250 million and revised target of $300 million.

Today, we announced a new Optimizing for Profitable Growth Program that will target an additional $200 million of annualized savings between 2024 and 2026. The program's aim is to achieve further efficiencies and cost-saving opportunities that we believe can further improve our productivity, profitability and competitive position.

Aligned with our capital deployment strategy, Mattel's Board of Directors has approved a new $1 billion share repurchase authorization.

We were also pleased to announce earlier today that Julius Genachowski and Dawn Ostroff have joined Mattel's Board of Directors. Julius and Dawn are respected leaders who have extensive combined experience in media, entertainment and technology and bring expertise in finance, M&A and government regulation.

Todd Bradley and Ann Lewnes recently stepped down from the Board, and I would like to thank them for the many years of dedicated service. We are grateful for their support and guidance and playing an active role during their tenure.

We are also excited to welcome Chris Farrell, who recently joined the company as Chief Strategy Officer. Chris brings expertise in strategic planning, M&A, corporate development and investment banking in the consumer and retail sectors.

These additions will serve Mattel well as we execute our strategy, explore growth opportunities and enhance long-term shareholder value.

In terms of our expectations for the year, we believe we are well positioned competitively and will continue to outpace the industry and gain market share. We expect the toy industry to decline in 2024, although at a lesser rate than 2023. The anticipated decline is due to a lighter theatrical film slate and the impact of the shift in consumer spending patterns towards experiences and services, which we believe will moderate over the year.

Our 2024 plan emphasizes growth in profitability, gross margin expansion, and strong cash generation. With the benefit of a strong balance sheet and consistent with our capital allocation priorities, we intend to explore M&A and other corporate development opportunities as well as repurchase shares.

Some of the highlights for 2024 include Barbie's 65th anniversary celebration and related activations, as well as innovation in new segments and play patterns. Hot Wheels will expand its die-cast universe and benefit from a new animated series on Netflix. Fisher-Price will expand its core product lines, introduce an exciting new segment and extend its license entertainment offerings. And our Challenger categories will bring more innovative products to market. We look forward to sharing more details at our investor event in March, including our category strategies as well as power brands, Barbie, Hot Wheels and Fisher-Price.

In addition, we will continue to progress our entertainment strategy in film and television as well as digital and live experiences.

We expect Mattel's net sales in constant currency for the full year to be comparable to prior year and for adjusted EPS to grow double digit and be in the range of $1.35 to $1.45. Free cash flow is expected to be approximately $500 million.

We expect our full year POS to be comparable to 2023 and aim to outpace the toy industry and gain market share.

Beyond 2024, we believe toy industry trends will further improve and that the industry will return to growth and continue to grow over the long term. The fundamentals of the toy business are strong. Toys are an important part of consumers' lives, and retailers see the category as a strategic lever.

For Mattel, we expect to grow sales and earnings in 2025 with the anticipated benefit of improving industry trends, innovation in toys, expansion of our entertainment offering and licensing partnerships as well as savings from our Optimizing for Profitable Growth Program.

In closing, 2023 was defined by our strong execution in both toys and entertainment. Consumer demand for our products continue to grow and meaningful market share gains demonstrated the strength of our portfolio as a whole. The breakout success of the award-winning Barbie movie was a showcase for our entertainment strategy and cultural relevance of our brands outside the toy aisle.

Mattel is in the strongest financial position it has been in years, with significant free cash flow generation, an optimization program and a new share repurchase authorization.

As we start a new year, we believe we are well positioned to continue the successful execution of our multiyear strategy to grow our IP-driven toy business and expand our entertainment offering and create long-term shareholder value.

Anthony will cover the financials in more detail.

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

Thanks, Ynon. As expected, we had a very strong fourth quarter, with double-digit top and bottom line growth compared to the prior year. Net sales of $1.621 billion increased 16% or 14% in constant currency. Adjusted gross margin increased 570 basis points to 48.8%. Adjusted operating income was $147 million, an increase of $68 million or 86%, primarily driven by sales growth and gross margin expansion partly offset by an incentive-driven increase in SG&A. Adjusted EPS was $0.29 compared to $0.18 a year ago, an increase of 61%. And adjusted EBITDA was $234 million, an increase of $76 million.

Looking at our full year performance. Net sales were flat or down 1%, excluding the positive impact of currency translation. Adjusted gross margin increased 160 basis points to 47.5%, benefiting from cost savings, pricing and the Barbie movie. Adjusted operating income was $641 million compared to $689 million in the prior year. Adjusted EPS was $1.23 compared to $1.25 last year. And adjusted EBITDA finished the year at $948 million compared to $968 million in the prior year.

Retailers ended the year with inventory down high single digits as measured in both dollars and weeks of supply. While they made significant progress in 2023, retailer inventories remain slightly elevated compared to historical norms.

Turning to gross billings in constant currency, beginning with the fourth quarter.

Gross billings increased 16%, with growth in our 3 leader categories, including double-digit growth in all 3 power brands, Barbie, Hot Wheels and Fisher-Price, as well as growth in our Challenger categories collectively. POS increased low single digits as we continued to outpace the industry and gain market share.

As previously discussed, shipping patterns have returned to historical trends with approximately 2/3 of annual gross billings in the second half, which has favorably impacted our fourth quarter gross billings performance in comparison to the prior year.

Dolls increased 27%, driven primarily by Barbie, Disney Princess and Frozen and Monster High. POS for the category increased low double digits. Barbie had a very strong finish to the year with fourth quarter growth of 24%, driven by toys and benefits associated with the movie.

Vehicles achieved another quarter of growth, increasing 15%, driven by a 16% increase in Hot Wheels, which benefited from die-cast cars and continued innovation across multiple segments. POS increased mid-single digits.

Infant, Toddler and Preschool increased by 7%, driven by double-digit growth in Fisher-Price. POS declined high single digits.

Challenger categories, in aggregate, increased by 1%, primarily driven by Games, partly offset by a decline in Action Figures. POS declined high single digits, primarily due to Action Figures.

Turning to the full year. Gross billings declined by 1%, primarily due to the negative impact of retailer inventory reductions and Russia, partly offset by the benefits from low single-digit POS growth and the very successful Barbie movie. Mattel outpaced the industry and gained 70 points of global market share per Circana.

Dolls increased 13%, in line with POS, driven by Disney Princess and Frozen, Monster High and Barbie, partly offset by a decline in American Girl. Barbie increased 2%. The total impact from our direct movie participation, movie-related toy sales and consumer products, generated more than $150 million in sales with a blended operating income margin of approximately 60%. POS was flat. Mattel outperformed the industry in the Dolls category and gained 750 basis points of market share for the full year per Circana.

Vehicles had another outstanding year growing 11%, in line with POS, driven by Hot Wheels die-cast and the successful extension of the brand into the skate and RC segments. Hot Wheels achieved its sixth consecutive record year. Mattel outpaced the industry in the Vehicles category, gained 280 basis points of market share, reaching its highest global market share on record per Circana.

Infant, Toddler and Preschool declined 12% due to Imaginext, wrapping theatrical times in the prior year, and Baby Gear, partly offset by Little People. POS declined high single digits. Despite the decline, Mattel outperformed the industry gained 10 basis points of market share and extended its #1 position within the category per Circana.

Challenger categories declined 25% due primarily to action figures comping a strong film slate in the prior year. POS declined low double digits. Building Sets and Games each grew gross billings for the year. Per Circana, Mattel gained market share in Building Sets for the full year.

Looking at our fourth quarter performance by region.

Growth was primarily driven by North America. Gross billings in North America increased 33%, benefiting from the return to historical shipping patterns. POS increased mid-single digits. EMEA grew 1% while POS was up mid-single digits, growing ahead of the market. Asia Pacific increased 6%, driven by growth in Australia and New Zealand. POS increased mid-single digits. Latin America increased 1% and POS was down mid-single digits due to softness in Brazil.

Looking at our full year performance on a regional basis.

Gross billings in North America increased 1% with POS comparable to the prior year. Mattel outpaced the industry and gained 90 basis points of market share in North America, per Circana. EMEA declined 7%, including a negative 6 percentage point impact from Russia. POS, excluding Russia, increased high single digits. Mattel outpaced the industry and gained market share in EMEA, per Circana. Latin America increased 3%, in line with POS. Mattel gained market share and expanded its market leadership position in Latin America, per Circana. Asia Pacific increased 11%, while POS increased low single digits. Mattel outpaced the industry and gained market share in the region, per Circana.

Adjusted gross margin was 48.8% in the quarter, compared to 43.1% in the prior year, an increase of 570 basis points.

The significant increase in adjusted gross margin was driven by several factors. Cost deflation contributed 340 basis points; lower inventory management costs, primarily obsolescence and close-ups, added 150 basis points; savings from the Optimizing for Growth program added 130 basis points; favorable mix, primarily margin benefit related to the Barbie movie, added 70 basis points; and pricing, net of higher sales adjustments added 20 basis points. Going the other way, increased royalties and other factors had a negative impact of 140 basis points.

For the full year, adjusted gross margin increased by 160 basis points to 47.5%. The improvement was primarily driven by cost savings, the favorable mix impact associated with the Barbie movie, and pricing, partially offset by unfavorable fixed cost absorption due to lower production volume and other supply chain costs.

Moving down the P&L, in the fourth quarter, advertising expenses declined 3% to $234 million. During the fourth quarter, we shifted some of our support from advertising to promotions, which are reflected in higher sales adjustments. For the full year, advertising expense declined 2% to $525 million.

As expected, SG&A increased significantly due to incentive compensation. Adjusted SG&A in the fourth quarter increased by $127 million to $409 million, reflecting above-target incentive compensation. For the full year, adjusted SG&A increased $147 million due to incentive compensation and salary and market-related pay, partly offset by savings from the Optimizing for Growth program.

Adjusted operating income in the fourth quarter was $147 million, an increase of $68 million or 86% compared to the prior year. The increase was primarily driven by net sales growth and gross margin expansion, partly offset by higher SG&A. Adjusted EBITDA increased by $76 million to $234 million, driven by the same factors. Adjusted EPS increased 61% to $0.29.

For the year, adjusted operating income declined $47 million to $641 million, and adjusted EBITDA declined $21 million to $948 million. Adjusted EPS was $1.23 compared to $1.25 in the prior year. EPS performance benefited from higher interest income, a lower adjusted tax rate and a lower share count resulting from our share repurchase activity.

We generated very significant cash flow in 2023. Cash from operations almost doubled to $870 million compared to $443 million in the prior year, an increase of $427 million. The increase was primarily driven by improved working capital performance. Working capital was a source of funds in 2023, driven primarily by inventory reductions compared to a use of funds in the prior year.

Capital expenditures were $160 million compared to $187 million in the prior year and lower than our expectations, primarily due to the timing of expenditures on capacity additions. Free cash flow was $709 million compared to $256 million, an increase of $453 million. The increase was primarily driven by cash from operations and lower capital expenditures. As a percentage of adjusted EBITDA, free cash flow conversion was 75% compared to 26% in the prior year. During 2023, we utilized $203 million of cash to repurchase shares, fully utilizing the company's existing authorization.

Taking a look at the balance sheet. We meaningfully improved our financial position. We finished the year with a cash balance of $1.261 billion compared to $761 million in the prior year. The increase reflects our free cash flow performance for 2023, net of share repurchases.

Total debt was $2.330 billion, consistent with the prior year. Our debt portfolio is well positioned, with no scheduled maturities until 2026.

Accounts receivable increased by $222 million, in line with fourth quarter sales growth to $1.082 billion.

We made significant progress reducing owned inventory levels. Inventory at year-end was $572 million compared to $894 million in the prior year, a reduction of $322 million and a key contributor to free cash flow.

Consistent with our expectations, debt to adjusted EBITDA finished the year at 2.5x, excluding the benefit of our cash balance. This compares to 2.4x in the prior year.

Under our Optimizing for Growth program, we achieved cost savings of $46 million in the quarter and $132 million in the year. We have now completed this program. Under this program, we achieved total annualized savings of $343 million between 2021 and 2023, exceeding our initial target of $250 million and revised goal of $300 million.

We recognize the importance of managing our cost structure and continuing to expand margins as well as generating savings that can be reinvested in the business. Today, we are announcing a new 3-year program that we are calling Optimizing for Profitable Growth or OPG. The program's aim is to achieve efficiencies, leveraging our scale and cost savings opportunities within our global supply chain, including our manufacturing footprint that we believe can further improve productivity, profitability and our competitive position.

We are targeting $200 million of annualized savings between 2024 and 2026 under this new program, which includes the previously disclosed initiative to close a plant in China. In terms of the P&L, we anticipate approximately 70% of the expected savings to benefit cost of goods sold and the remaining 30% to benefit SG&A. Costs and investments to implement the program are estimated to be between $130 million to $170 million, which will be updated as the program advances.

We have a strong track record of achieving cost savings and are confident in our ability to execute this new program.

As Ynon said, we expect the toy industry to decline in 2024 and for Mattel to outpace the industry and continue to gain global market share.

For 2024, we expect net sales in constant currency to be comparable to the prior year, with growth in Vehicles, offset by a decline in Dolls as we wrap the benefits of the Barbie movie. We expect Infant, Toddler and Preschool as well as our Challenger categories collectively to be comparable to the prior year. With respect to the power brands, we expect Hot Wheels to grow, Fisher-Price to be comparable and for Barbie to decline.

Beginning in the first quarter of 2024, the American Girl business is being integrated into our North America commercial organization. As a result, American Girl will no longer be an operating segment.

Foreign currency translation is not expected to have a material impact on our top line performance based on current spot rates.

Adjusted gross margin is expected to increase from 47.5% in 2023 to a range of 48.5% to 49%. The forecasted improvement is primarily driven by savings from our OPG program and favorable fixed cost absorption from increased production levels, partly offset by wrapping the Barbie movie benefit.

We expect advertising and adjusted SG&A to remain relatively stable as a percent of net sales.

Adjusted EBITDA is expected to be in the range of $975 million to $1.025 billion compared to $948 million in the prior year.

Adjusted EPS is expected to grow double digits to a range of $1.35 to $1.45 compared to $1.23 in 2023.

The adjusted tax rate is expected to be 23% to 24% compared to the prior year rate of 23%.

Capital expenditures are expected to be in the range of $175 million to $200 million, and free cash flow is expected to be approximately $500 million.

As Ynon said, we are well positioned and expect to grow sales and earnings in 2025.

We are operating in a macroeconomic environment that may impact consumer demand. The guidance considers what the company is aware of today, but remains subject to market volatility, unexpected disruptions and other risks and uncertainties.

We have generated significant free cash flow and improved our financial position with a cash balance over $1.2 billion, achieved our targeted leverage ratio and an investment-grade rating. With our strong balance sheet and consistent with our stated capital allocation priorities, we are announcing a new multiyear share repurchase program with an authorization of $1 billion. This action reflects confidence in our strategy to grow sales, earnings, and cash flow, and create long-term shareholder value. We intend to fund repurchases with free cash flow.

In closing, we finished the year with a strong fourth quarter performance. For the year, we grew POS, gained market share and generated significant free cash flow. Looking ahead, we are launching a new cost savings program, expect to improve profitability in 2024, announced a new share repurchase program, and we'll continue to execute our strategy.

And now I will turn it over to the operator.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we will take our first question from James Hardiman with Citi.

James Lloyd Hardiman - *Citigroup Inc., Research Division - Director*

So I'm curious on the retail front. You talked about how retailers finished the year with absolute inventories and weeks on-hand down high single digits, but yet, it sounds like there's more work to be done. Maybe help us ideally quantify how much is left to go. What's the dollar value associated with that additional adjustment?

And then, maybe just qualitatively, I mean, obviously, there was a significant headwind last year, particularly the first half of last year with similar inventory reductions. I guess, net-net, should we be thinking about sort of this wholesale versus retail dynamic is a net headwind or a net tailwind for the year? And I guess, specifically, that first half period.

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

Sure. Let me address that. As we've discussed, we did -- ended the year 2023 with retail inventory elevated. And throughout the year, we worked with our retailers, and we've made significant progress. And as you pointed out, we ended the year with retail inventories down high single digits, both in dollars and weeks of supply.

That being said, right, and although we made significant progress, the levels at the end of 2023 and going into 2024 are slightly elevated. But the way to think about 2024 is that the impact year-on-year, as we wrap the significant retail inventory reductions in 2023, it actually is a tailwind, right, to our top line performance in 2024. So hopefully, that helps.

James Lloyd Hardiman - *Citigroup Inc., Research Division - Director*

It does. And I guess the keyword there is slightly elevated versus significantly elevated a year ago. Any idea, just ballpark, when we might get back to sort of a one-to-one relationship between wholesale and retail?

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

Yes, we would expect to work through the situation together with our retailers in 2024. And I think in terms of the other part of your question around cadence, we did see a return to more historical patterns in terms of first half, second half gross billings, 2/3 in the second half, 1/3 in the first half, and we would expect that to generally continue in terms of the cadence into 2024.

Operator

And we will take our next question from Eric Handler with ROTH MKM.

Eric Owen Handler - *ROTH MKM Partners, LLC, Research Division - MD*

Wondering if you could talk a little bit about Hot Wheels and sort of some of the growth that you're expecting from the segment in 2024. And sort of what's allowed that just to maintain such a strong growth cadence over the last 5 or 6 years?

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

Yes, Eric. So vehicles continued a very strong performance. It was up 15% in the quarter, 11% for the year, and POS was in line with that. We gained 280 basis points of market share. This is a very meaningful increase in our position. Hot Wheels within that grew 16% in the fourth quarter and 13% for the full year. And as we noted on the call, we achieved our sixth consecutive record year. And again, #1 in the Vehicles -- in the Vehicle category as a whole.

The growth was driven primarily by die-cast vehicles and new innovation, including the RC, for example, the skate segment and new launches of Hot Wheels RacerVerse in the fall. And we've continued to introduce new ways to play and engage with the brand. We also look to continue to leverage the core die-cast vehicle, serving both children and adult collectors. There's more content that will come out this year on Netflix.

And the success in our Vehicle category in general, and Hot Wheels specifically, really goes back to our playbook and how we're leveraging the strength of the brand, infusing innovation into the product and continuing to add more touch points for the consumers. And there's a movie currently in development with J.J. Abrams as a producer at Warner Bros. So we will continue to drive and elevate this incredible franchise, which has so much of a runway and opportunities ahead of it.

Within the Vehicles category, just to say, Matchbox also performed well. Disney Pixar Cars continue to show that it's an evergreen brand under our management, with double-digit growth in the fourth quarter. And all in all, we're in a great place and expect to continue to see growth in '24 and beyond.

Eric Owen Handler - *ROTH MKM Partners, LLC, Research Division - MD*

Great. And then, Anthony, just a quick question on free cash flow. So you're expecting about $200 million of lower free cash flow in 2024. EBITDA is expected to grow. Is there some type of working capital issue that's sort of causing the lower free cash flow number? Or maybe you could walk us through that.

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

Sure. I wouldn't call it an issue per se. I think the way to look at it is, it was outstanding performance in 2023, over $700 million of free cash flow at 75% conversion from EBITDA. And the key driver of that is, I would say, an outsized reduction in our inventory levels, right? So we've been working on this for quite some time and have seen sequential improvements over, I would say, the last 6 quarters. And ended the year with inventories down $322 million or 36%, and that's having a significant impact on our free cash flow performance in 2023. In terms of 2024, I would characterize the $500 million as a strong, well, cash flow and about a 50% EBITDA conversion based on the midpoint of the guidance. So we feel good about 2023, especially, and we feel good about the expected level in 2024.

Operator

And we will take our next question from Linda Bolton-Weiser with D.A. Davidson.

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

I was wondering if you could give us some more information on the cadence of the $200 million of cost savings over the next few years. Is it weighted more toward one year or another? And then how much in cost savings are you figuring into your guidance for 2024?

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

Sure. To answer the last part, first, Linda, we expect about $60 million of savings from the program in 2024. I would say, in terms of cadence, I would think kind of an even distribution over the next 3 years. So as we talked, targeting $200 million by the third year, again, coming equally. And in terms of P&L distribution, about 70% coming out of cost of goods sold and 30% out of SG&A.

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

Okay. And then, can you comment -- I mean there's been some commentary made out there about the fact that you should do something more dramatic with your Fisher-Price business and American Girl. And now you're announcing that American Girl will sort of be integrated. Maybe you can just explain what are the benefits of integrating that American Girl into the North American organization.

And then also, I mean, I do think that American Girl has had some trouble in general with growth in the last couple of years. So it seems to me that doing something with that business is more of a stand-alone -- I kind of don't think you're going to get rid of Fisher-Price. That would just be my guess, but maybe you could just comment on these businesses.

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

Thank you, Linda. Without commenting specifically about any one brand, we believe we have a very strong portfolio. We always evaluate our portfolio to position the company for growth, in line with our strategy to create long-term shareholder value. And you obviously assume that whatever we announced today has been in play for a while, and these are things that we take our time to consider and analyze.

As it relates to American Girl, it's a valued asset within our portfolio, with significant -- a significant fan base and a really, really good product. We continue to progress our strategy to optimize the retail footprint and consumer omnichannel experience. We saw improvement in sales trends in the fourth quarter. We opened a new L.A. flagship store, and all 3 flagship stores achieved same-store sales growth for the year.

We recently announced the American Girl movie in partnership with Paramount, and just announced today our latest collaboration with Disney Princess and Frozen. So the brand is very much thriving with a lot of activity. And the -- moving American Girl to be part of the commercial organization is about helping us leverage our direct-to-consumer capabilities and drive demand, as we did so well with Mattel Creations.

We think the issue -- the product is great. We're looking to strengthen the commercial model and believe that within our -- within our North America organization, we have very strong capabilities as it relates to the direct to consumer. We are very confident in the long-term value of American Girl and continue to always evaluate our portfolio and position the company for long-term growth.

Operator

We will take our next question from Arpine Kocharyan with UBS.

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

I apologize. You mentioned M&A as a potential use of capital. Could you just comment what would that look like for you in terms of criteria for acquisition? If you could just update us what those criteria would look like, that would be great.

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

Yes, Arpine, and thank you. We talked about our M&A approach before. Consistent with our capital allocation strategy, we are going to, first of all, when it comes to deploying capital, first of all, it's about organic growth and maintaining our investment-grade rating with a leverage ratio between 2x and 2.5x debt to adjusted EBITDA. Now with our strong balance sheet and significant cash balance, we have the flexibility to look at more opportunities to grow the business, and this is M&A and share repurchases.

As it relates to M&A, the criteria is going to look for opportunities that are strategic, that are accretive, that will help us improve our growth profile and create economic value for our shareholders. And the terminology we used in the past, the way we said is that we are looking to do things that will be obvious to our investors. We're going to be smart, methodical. We worked very hard to put the company on a very strong financial footing as we are today. And we will make sure that we will not change that if we do an M&A or pursue external opportunities for growth.

Operator

We will take our next question from Jim Chartier with Monness, Crespi, Hardt.

James Andrew Chartier - *Monness, Crespi, Hardt & Co., Inc., Research Division - Security Analyst*

Anthony, the deflation is a big driver of gross margin in fourth quarter. Can you just kind of walk through the drivers of that? And then how does that play into the gross margin outlook for 2024?

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

Sure. As you saw in our bridge, we increased gross margin 570 basis points in the fourth quarter and 340 of that was deflation. So we did see deflation in both logistics, primarily ocean freight, as well as on our resin cost, and that's coming through in the P&L in the fourth quarter. I mean, together with lower inventory management costs and cost savings and favorable mix, we feel really good about where we ended on gross margin. As I look to the full year, right, inflation was a slight benefit, primarily driven again by ocean freight and resin.

And as we turn to 2024, we do expect 100 to 150 basis points of gross margin expansion. And the two primary drivers are actually savings from our Optimizing for Profitable Growth Program as well as fixed cost absorption benefits as we resume normal production levels following the pullback in 2023. And those will be partly offset as we wrap some of the Barbie movie-related benefits.

We don't expect inflation/deflation to have a material impact in 2024. Although we do expect to see favorability in ocean freight, we do see a headwind on wages and salaries within our cost of goods sold line. And then in terms of phasing, probably some deflation in the first half and that reversing in the second half.

James Andrew Chartier - *Monness, Crespi, Hardt & Co., Inc., Research Division - Security Analyst*

And then you highlighted Mattel163 growth in the year. Could you just kind of walk through that business, what is kind of the growth going forward for that business? And then I noticed that the equity income line was actually down for the quarter and year despite the revenues growing for that business. So just curious why the profitability is lower?

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

Yes. So we have been very successful with our Mattel163 business. Sales grew to almost $200 million in 2023 inside of the joint venture with -- behind the success between UNO, Phase 10 and Skip-Bo. The reason on the P&L that our earnings from equity affiliates is down slightly is that we are making investments in that business, both marketing current games and development costs around innovating around future games.

Operator

And we will take our next question from Stephen Laszczyk with Goldman Sachs.

Stephen Neild Laszczyk - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

For Ynon or maybe Anthony, on Barbie, could you perhaps impact some of the underlying assumptions in your outlook for the brand in '24? I think you mentioned that you expect sales to be down year-over-year. I appreciate that there is the $150 million revenue hard comp from the movie last year. But maybe adjusting for that, to what degree do you expect to see any sustained momentum from the brand in 2024?

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

Yes. Stephen, the Barbie had a very strong finish for the year, with the fourth quarter growing 24%, and this was across the brand, toys and the benefits associated with the movie. The movie continue to play very well. It was a cultural phenomenon. It lifted the brand. It brought in the audience. And it played well also with adults, and especially with collectors.

Within that, the Barbie Dreamhouse had an excellent year as well. And Barbie, as a whole, continued to gain share and perform very strongly. A lot of it was due -- was related to the movie. It was the benefit of the movie, but not only. It's just the strength and the cultural resonance of the brand. And we did a lot of work around that to make sure we capture the moment and build on that.

In '24, we will be celebrating Barbie's 65th anniversary, with a lot of activations around that and more product that will celebrate the brand's past and future. We are looking to leverage the broader audience to launch new products, especially for adult collectors, and trying to reach and engage pop culture fans and also reach all the kids and brought in the audience after the movie's success.

We also expect to see shelf space expansion in the second half and more customized product line that we will support with a unique system of play that we will talk more about in our March investor presentation. And separately from that, there will also be content on Netflix that will continue to play -- offer the drumbeat of the content engagement with fans around the brand.

Operator

And we will take our next question from Christopher Horvers with JPMorgan.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So as you think about -- I have 2 questions. So first, as you think about like the excess inventory that is in the market, can you talk about where you're seeing that in terms of what categories?

And then as a follow-up, as you think about the prospect for your cost deflating, do retailers typically try to go and recapture some of that in terms of better pricing or better margins? And is it your expectation that are you planning for these current freight rates to sort of stay intact at these levels into the back half of the year?

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

Yes. As it comes to the retail inventory levels, as we said, they are slightly elevated. I think slightly is the key word there, and I can't point you to any specific category or any geographic region where we have the issue. It's not that significant. As we said, we made significant headways in bringing down retail inventory levels in 2023. And in fact, as we wrap it, it's going to be a tailwind in 2024.

As it relates to your other question, if you go back in time, we have experienced significant cost inflation over the last several years. And it isn't until the second half of 2023 that we actually saw some deflation come through. And so in terms of working with our retailers, we will manage the situation accordingly. We don't plan for any broad-based pricing changes in 2024, and again, work closely with our retailers on this front.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Got it. And then just in terms of the -- how you're planning for freight rates. Obviously, there's a lot of noise in the world, and ocean freight rates are up globally, not like they were, certainly, in 2021. But I guess, how are you planning for freight rates? And is that -- are you expecting them to remain elevated through the back half of the year when a lot of the shipments start churning through? Or how do you manage that sort of contracting versus spot process?

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

Yes. This is a situation, obviously, we're monitoring very closely. I would say, to date, it has not had a material impact. And we've made some assumptions around ocean freight declining in 2024 versus 2023. But like I said, we'll continue to watch what's happening.

Operator

We will take our next question from Megan Alexander with Morgan Stanley.

Megan Christine Alexander - *Morgan Stanley, Research Division - VP*

I wanted to go back to James' question at the beginning and just your comments on lapping the destock being a tailwind this year. You're guiding to flat sales. You quantified $125 million of Barbie-related movie sales. So if you have to kind of -- if we assume you give that back this year, that more or less implies underlying, call it, low single-digit sales growth. You're talking POS expectation, I think, is flat.

So is that, call it, 2% benefit the tailwind from lapping the destocking? And just from a timing perspective, you're saying we're back to more historical shipping patterns, the -- but retailer inventory is slightly elevated. So do we see that 2 points in the first half, just given the lap? Or is it more of a back-half opportunity?

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

Yes. So let me try to unpack the top line guidance a bit for 2024. As we said, comparable in constant currency. And from a category perspective, Vehicles, up; Infant, Toddler, Preschool and Challenger categories, flat; and Dolls, down. The other way to look at it is in the context here, as Ynon said, we do expect the industry to decline, but not to the extent it did in 2023.

Against that backdrop, we expect our POS to be flat, which implies significant and continuing share gains. And then there's a plus and a minus, right? The plus is, we're going to wrap the inventory reduction in 2023. That's a tailwind to 2024, but that's being offset by the wrap related to the benefits associated with the Barbie movie. So there's several pluses and minuses in there, and hopefully, that helps, Megan.

Megan Christine Alexander - *Morgan Stanley, Research Division - VP*

Okay. I guess, just anything on the timing, we know that $125 million was more so the third quarter. I guess, just your sales were down significantly in the first half of last year. So is it -- but you said more normal. So is it flat over the year? I guess, like is it -- can you help us a little bit on timing?

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

Yes, sure. I think in the context of our $5 billion of sales, as I said earlier, we do expect kind of a return to historical patterns in terms of shipments. So we don't really see any material change in the cadence between 2023 and 2024.

Megan Christine Alexander - *Morgan Stanley, Research Division - VP*

Okay. And then I think just on the cost savings. I think you said 70% kind of in cost of goods. Can you help us unpack maybe how much of that just this year is related to the closing of the China manufacturing plan? And then maybe can you just spend some time expanding on the other things you're doing that's driving the $200 million of savings.

I guess you've taken out a lot of costs over the last couple of years. So I'm just trying to understand maybe how much is pure cost takeout versus maybe more productivity-type efficiencies.

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

Yes. Sure. As you suggested, look, we have a strong track record of identifying and executing against our cost savings commitments. And as we announced today, we're launching this Optimizing for Profitable Growth Program. It's a combination of looking for and achieving efficiencies, which really leveraged our global scale, as well as cost-saving opportunities within our supply chain, including our manufacturing footprint.

So we did talk about taking out one of our China plants. That's not going to impact 2024, that's more later, given the time horizon. But we have a number of productivity initiatives planned for our supply chain as well as optimizing our geographic sourcing on product, which is going to help in 2024. So we expect about $60 million total from the program in 2024. Again, a combination of cost of goods sold and SG&A, and very confident in our ability to achieve that.

Operator

We will take our final question from Drew Crum with Stifel.

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

Ynon, a couple of years ago, you suggested that Dolls would be the fastest or one of the fastest-growing segments of the toy industry on a global basis. As you enter a new year, what is your updated view on the category and Mattel's positioning? Any catalysts on the horizon we can look forward to as it relates to your business? And then I have a follow-up.

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

Yes, thanks, Drew. Yes, we couldn't be happier with our performance in the Dolls category. And we're going to have a lot more to share with you at our Investor Day. There's a pretty deep analysis, a lot of exciting innovation, and we'll break it down by each of our key brands. We do expect -- just to give you a bit of a preview, we do expect the category to be down in 2024. But over time, it's a healthy category. It's competitive. It's driven by innovation.

And within that, we expect to continue to gain share, with a very strong portfolio of some of the strongest brands in the industry that we are managing with -- as part of our portfolio strategy, with each of our key brands having its own lane, with its own clear purpose and methodology. And Lisa McKnight, our Chief Brand Officer, will talk about that in more detail at our presentation in March.

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

Okay. Perfect. And then maybe for Anthony, can you remind us what percentage of manufacturing is sourced from China, I guess, before and after the closure of the plant?

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

I'm sorry, Drew. I'm going to answer that one again, in case we were on mute. So the question was, what's the percent of product out of China? We're at about 50%, plus or minus. We have a very diversified manufacturing footprint, both on our own facilities as well as third-party. And once we close that plant in China, that will come down a bit from there going forward.

Operator

And ladies and gentlemen, that is all the time we have for questions today. I will now turn the call back to Chairman and CEO, Mr. Ynon Kreiz, for closing remarks.

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

Thank you, operator, and thank you, everyone, for your questions today. In conclusion, this was a very strong fourth quarter for the company, with double-digit growth, both at the top line and bottom line, and continued margin expansion. We ended the year with the strongest balance sheet we've had in years, putting us in an excellent position to continue to execute our strategy.

As we look to 2024, we believe we are very well positioned competitively, and we'll continue to outpace the industry and gain market share. And we talked today about 2 important programs that we put in place for the -- one is for the $1 billion of share repurchase and the other one is the Optimizing for Profitable Growth Program of $200 million savings over the next 3 years.

So we look forward to discussing more about our strategy and our road map for the year and beyond at our investor presentation in March. So please look out for more details about that. We'll have a lot more to share with you then. And now I'll turn the call back over to Dave.

David Zbojniewicz - *Mattel, Inc. - VP & Head of IR*

Thank you, Ynon, and thank you, everyone, for joining the call today. The replay of this call will be available via webcast beginning at about 8:30 p.m. Eastern Time today. The webcast link can be found in the Events and Presentations section of our Investors section of our corporate website, corporate.mattel.com. Thank you for participating on today's call.

Operator

And ladies and gentlemen, this concludes today's conference call, and we thank you for your participation.
