Mattel Inc.

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Corporate Growth and the Financial Markets (komp)

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“I hereby certify that I am the author of this paper and that all the sources I have used therein have been reported.”

Conclusion

Financial results of company during 2011-2013 were growing, but the last period decline showed weakness of current strategy. Mattel Inc. is still take the first place in toy industry, moreover world financial crisis showed that company is quite tough and can restore lost positions. Forecast shows slow recovery to previous level in 2017, when company's sales would reach 2013-year level. Main factors or growth: buying of Mega Brands that compete in the same market segment as #2 in toy industry Lego; management that would revise company strategy or even replace it with that, which helped during crisis; after decline in sales of all brands in 2014 company should refresh product lines.

Introduction

Mattel Inc. is the world's largest toy manufacturer by revenues in 2014 with more than $6 bln. sales. Their main brands are Monster High, Barbie, Disney Princess, Hot Wheels, Fisher-price, and American Girl. Production of Mattel Inc. is sold worldwide. Mattel Inc. has several subsidiaries: Fisher-Price, Mega Brands, HIT Entertainment, and Playground Productions. Highest contribution in sales in 2014 has North America – 55% of sales, Europe was second market with 25%, Latin America contributes 13.5%, and lowest sales are in Asia Pacific 6.5%. Mega Brands was their last acquisition ended in 30 April 2014 for approximately $460 million. Main purpose of this purchase was to compete with second largest toy producer Lego ($4.5 bln. in 2014). Mega Brands produces construction toys that use same bricks as Lego, and proved legitimate reasons of their production in European Court of Justice earlier in 2010.

Chapter 1 – Industry & Sales

Question 1 Total revenue of global toy market was approximately $84 bln. in 2012, thus Mattel Inc. market share is about 7.5%. The market was strongly affected by world economic crisis during 2007-2009, and showed increase only in 2010 to $83bln from $79 bln revenues year earlier. Such figures show that industry depends on people's wealth, thus contractions are mostly the result of economic recession. In addition, producers face strong competition of digital games, which share grow instantly. World GDP growth rate in 2011 was 3.9% and its growth rate declined in 2014 to 3.3%, so growing of toy market should not be expected.

Source: Mattel Inc. annual reports; author's calculations.

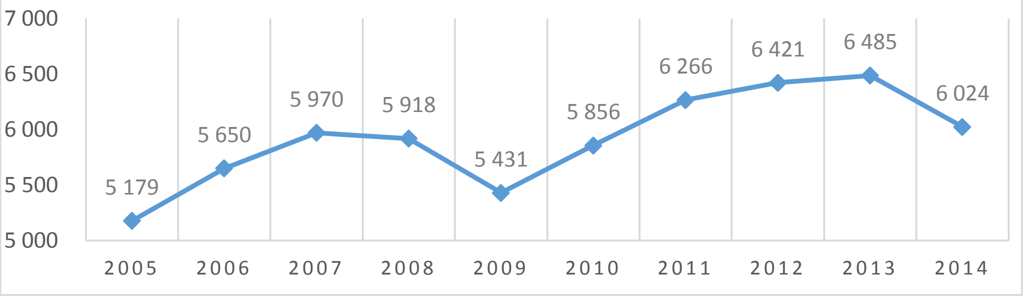

Fig 1.1 Revenue of Mattel Inc. 2005-2014

Mattel Inc. revenues keep pace with market showing better results before world economic crisis, declining during, and restoring positions after it. Average revenues growth rate for last 5 years was 2%, with highest results in 2010 and 2011 with 8% and 7% growth accordingly. Revenues growth slowed in 2012 (+2.5%) 2013 (+1%) and finally dropped in 2014 by 7%.

Historical data shows that periods from 2005-2009 and 2010-2014 look similar, but if reasoning of decrease during 2008-2009 is clear, year 2014 does not seem to be unsuccessful for world economy and toy industry.

Reports of Mattel Inc. show that 7% declining is sales during 2014 did not have any specific reasons. Exchange rate impact was estimated as 2% of revenue decline, remaining 5% represent pure sales loses. Decreasing in sales is not equally distributed between markets: North America gross sales -5% y/y, international sales -7% y/y, including negative exchange rate impact of 4%. Distribution of gross sales by brands shows that company's main brands and Fisher-Price declined the most -10% y/y and -13% y/y accordingly. It means that company's product range is old and ineffective any more, thus it should be reworked. In addition, revenue of closest market chaser Lego increased by 13% y/y (including negative exchange rate impact of 1.9%) or $587 mln. These figures give the idea of direct squeezing out Mattel Inc. from the market by Lego.

Chapter 2 – Sources & Uses of funds

Question 2 and 2.1 Main sources of funds in 2013 (Appendix IV) were retained earnings (+$404 mln.), cash and equivalents (+$297 mln.). Main use of funds was treasury stock (+$296 mln.), other accrued expense (-$167 mln.) and total inventories (+$104 mln.). Increase in long-term debt by $500 mln. is a result of decrease in other debt statements: current portion of long-term debt and other long-term liabilities.

Main sources of funds in 2014 (Appendix III) were long-term debt (+$500 mln.), accounts receivable (+$167 mln.), cash and cash equivalents (+$67 mln.). Main use of funds were intangible assets (+$369 mln.), accumulated other comprehensive loss (+$179 mln.), property, plant and equipment (+$78 mln.). Intangible assets increased because Mattel Inc. acquired Mega Brands and because real asset value was less than nominal statement "Accumulated other comprehensive income (loss)" also increased. This purchase was financed by long-term debt financing.

Level of dividends in 2013 was $0.36 per share; company increased them from $0.31 because net income exceeded expectations. Mattel Inc. increased dividend to $0.38 per share in 2014 because they expected further growth. Expected level of dividends in 2015 is also $0.38 because net income decreased almost twice, thus company is not able to increase payout. In addition, company may not decrease dividends due to possible share price drop because dividends decreasing is a signal that company does not forecast future growth.

Question 2.2 Level of internal growth rate in 2013 was 6%; sustainable growth rate was 12.7%. Because dividend level is expected without changes in 2015, internal growth rate in 2014 was -0.2%; sustainable growth level was -0.5%. These negative figures are the result of plowback ratio decreasing to -3.2% from 43% in 2013 and is not representable.

Chapter 3 – Financial model

Question 3 and 3.1 For modeling future sales is used trend function, it showed that sales would increase in next 3 years (Appendix VI). Using logarithm type of trend line gives R-square at level of 61.4%; it is higher than linear trend that has R-square equaled 56.9%. For purposes of modeling, pure trend line formula does not fit because of relatively high error level that creates high difference between projected level in 2014 and real sales (Fig. 3.1). Projected figures show that in

2017 company’s sales would achieve $6390 mln. that almost matches sales in 2013. For use of modeling complex formula of trend line is replaced by 2% annual growth from 2014. Such substitution is supported by historical data of sales for 10 years that shows average growth rate of company was near 2%. Figure 3.1 shows that both forecasts by 2017 end up in one point.

Source: Mattel Inc. annual reports; author’s calculations.

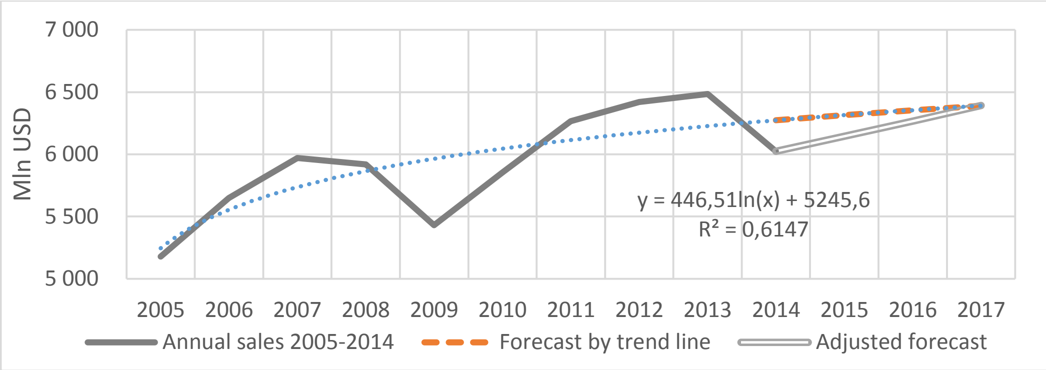

Fig. 3.1 Mattel Inc. annual sales 2005-20014, million USD.

Model of sales shows slow restoration to previous level; it is supplied by several facts. At first, Mattel Inc. purchased a company that operates in the same toy market segment as nearest competitor (Lego was probably one of the main factors for decrease in 2014). Mega Brands gross sales level in 2014 was $315 mln. (4.6% of total gross sales), this figure may increase because of finishing integration process. It results in lowering costs due to combination of sales channels and credit resources increasing, which may help in competition with Lego. Second important fact is that company already faced hard situation in near past. Historical data shows that company restored only after two years after sales fell in 2009. One of the key decisions that helped was lowering dividend level from $0.81 per share to $0.23, present situation looks less stable because dividends match income. However, dividend payments may increase by 4% annually after 2015 if the restoration is seen.

Question 3.2 and 3.3 Forecast of balance sheet and income statement main figures are made using trend lines of graphs (Appendix V) that show dependence from revenue changes historical data for 10 years, other, less important, forecasted using average level for 5-3 year periods.

“Cash and cash equivalents” is forecasted according to 3 year average level because drop under $950 mln. may be harmful for business; on the other hand increase more than $1200 mln. makes no sense due to high opportunity costs. “Other current assets” is the most influential statement in “Total current assets”, trend line shows 85% dependence from changes in sales level, and forecasted figures are adjusted on error level. Increase in both current assets statements result in “Total current asset” increase by 13% until 2017. “Property, Plant and Equipment” has no sustainable connection with changes in sales, forecast is based on average grow percent for 5 years at level 8%. No significant changes are forecasted in statement “Intangible Assets” for future periods because company recently purchased Mega Brands and there would be no additional earnings for new acquisitions. Changes in “Other long term assets” do not depend on changes in sales: forecast is made by 5-year average decrease 2% annually. “Total assets” will increase in 2017 on 8.4% or $565 mln. comparing to year 2014.

Statement “Total current liabilities” do not have significant connection with figures forecasted on historical basis of 5-year average changes. “Other long-term liabilities” have 55%

level of dependence on sales change, thus forecast was made using trend line equation adjusted on error; figures show moderate growth on 13.2% until 2017. “Long term debt” is used as plug and is not forecasted. Usage of debt financing instead of equity is supported by historic data: company used credit as a source for new assets. In addition, Mattel Inc. does not have many possibilities for equity financing because of relatively high dividend level established last year.

Historically tax rates of Mattel Inc. was dropping, mostly because cash that they earned in international market stayed there for taxation purposes, as a result in 2014 tax rate was 15% (marginal tax rate for corporations in USA is approximately 36%). Forecasted figures of taxation rate supplied by one idea that company would not change their taxation strategy. Pre-tax income forecasted with trend line formula, R-squared is 45%, error adjustment $208 mln. The statement forecast shows minor increase that matches similar sales growth. Forecast could be adjusted on amount of exchange rate possible loss, but its impact on sales is at level of 1-2% that is similar to error level and cannot be evaluated precisely. On the other hand, company would cut costs, thus effects negate each other. “Net income” forecast shows that company have possibility to increase dividends after 2015, if needed by 4% annually.

Table. 3.2

Mattel key figures for 2014, forecast 2015-2017.

Fiscal Period	2014	2015	2016	2017
Cash And Cash Equivalents	972	1 116	1 116	1 116
Other Current Assets	2 214	2 302	2 392	2 483
Total Current Assets	**3 186**	**3 418**	**3 508**	**3 599**
Property, Plant and Equipment	738	797	861	930
Intangible Assets	2 133	2 133	2 133	2 133
Other Long Term Assets	665	652	639	626
Total Assets	**6 722**	**7 000**	**7 140**	**7 287**
Total Current Liabilities	1 089	1 165	1 247	1 334
Long-Term Debt (PLUG)	2 100	2 261	2 267	2 263
Other Long-Term Liabilities	584	609	635	661
Total Liabilities	**3 773**	**4 036**	**4 149**	**4 258**
Total Equity (PLUG)	2 949	2 964	2 991	3 029
Total Equity and Liabilities	**6 722**	**7 000**	**7 140**	**7 287**
Revenues forecast by trend	6 024	6 316	6 355	6 391
Revenues adjusted forecast	**6 024**	**6 144**	**6 267**	**6 393**
Pre-Tax Income	587	624	662	700
Tax Provision	-88	-94	-99	-105
Tax Rate %	15	15	15	15
Net Income	**499**	**530**	**562**	**595**
Dividents	515	515	536	557
Retained Earnings	-16	15	27	38

Source: Annual report, author’s calculations

Sources

1. http://news.mattel.com – annual reports of company
2. http://www.statista.com/ - toy industry data
3. http://www.imf.org/ - world GDP growth data

Appendix I. Balance sheet of company for 2005-2014

Fiscal Period	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cash And Cash Equivalents	998	1 206	901	618	1 117	1 281	1 369	1 336	1 039	972
Accounts Receivable	761	944	991	874	749	1 146	1 247	1 227	1 260	1 093
Total Inventories	377	383	429	486	356	464	487	465	569	562
Other Current Assets	277	318	272	410	333	336	341	529	510	559
Total Current Assets	2 413	2 850	2 593	2 387	2 555	3 227	3 444	3 557	3 378	3 186
Gross Property, Plant and Equipment	1 693	1 716	1 820	1 753	1 823	1 876	1 986	2 133	2 239	2 395
Accumulated Depreciation	-1 146	-1 180	-1 301	-1 217	-1 318	-1 391	-1 462	-1 540	-1 580	-1 657
Property, Plant and Equipment	547	537	519	536	505	485	524	593	659	738
Intangible Assets	718	916	1 045	1 052	828	1 038	822	1 787	1 765	2 133
Other Long Term Assets	695	653	649	700	893	669	882	590	638	665
Total Assets	4 372	4 956	4 805	4 675	4 781	5 418	5 672	6 527	6 440	6 722
Accounts Payable	266	376	441	422	351	406	335	385	375	430
Total Tax Payable				39	40	120	27	114	28	19
Other Accrued Expense	796	980	713	649	618	263	619	807	640	640
Accounts Payable & Accrued Expense	1 062	1 356	1 154	1 110	1 009	790	981	1 306	1 043	1 089
Current Portion of Long-Term Debt	218	64	399	150	52	250	58	410	4	
Other Current Liabilities	183	162	17			311	0			
Total Current Liabilities	1 463	1 583	1 570	1 260	1 061	1 350	1 039	1 716	1 047	1 089
Long-Term Debt	525	636	550	750	700	950	1 500	1 100	1 600	2 100
NonCurrent Deferred Liabilities				133						
Other Long-Term Liabilities	282	305	378	415	489	489	522	644	541	584
Total Liabilities	2 271	2 523	2 499	2 558	2 250	2 789	3 061	3 460	3 188	3 773
Common Stock	441	441	441	441	441	441	441	441	441	441
Retained Earnings	1 310	1 652	1 977	2 086	2 340	2 721	3 168	3 515	3 919	3 896
Accumulated other comprehensive income (loss)	-303	-277	-176	-431	-380	-359	-447	-464	-443	-622
Additional Paid-In Capital	1 589	1 613	1 635	1 642	1 685	1 706	1 690	1 728	1 784	1 767
Treasury Stock	-936	-997	-1 572	-1 621	-1 555	-1 881	-2 243	-2 153	-2 449	-2 533
Total Equity	2 102	2 433	2 307	2 117	2 531	2 629	2 611	3 067	3 252	2 949
Total Equity and Liabilities	4 373	4 956	4 806	4 675	4 781	5 418	5 672	6 527	6 440	6 722

Appendix II. Income statement of company for 2005-2014

Fiscal Period	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Revenue	5 179	5 650	5 970	5 918	5 431	5 856	6 266	6 421	6 485	6 024
Cost of Goods Sold	2 806	3 038	3 193	3 234	2 716	2 901	3 120	3 012	3 006	3 023
Gross Profit	2 373	2 612	2 777	2 684	2 715	2 955	3 146	3 409	3 479	3 001
Gross Margin %	46	46	47	45	50	50	50	53	54	50
Selling, General, & Admin. Expense	1 708	1 883	2 047	2 143	1 984	2 053	2 105	2 388	2 311	2 347
Advertising	629	651	709	719	610	647	699	718	750	733
Research & Development	--	--	--	--	--	--	--	--	--	--
Other Operating Expense	-629	-651	-709	-719	-610	-647	-699	-718	-750	-733
Operating Income	665	729	730	542	731	902	1 041	1 021	1 168	654
Operating Margin %	13	13	12	9	13	15	17	16	18	11
Interest Income	34	30	33	25	8	8	8	7	6	7
Interest Expense	-76	-80	-71	-82	-72	-65	-75	-89	-79	-79
Other Income (Expense)	30	4	11	3	-7	1	-3	6	4	5
Pre-Tax Income	652	684	703	488	660	847	971	945	1 099	587
Tax Provision	-235	-91	-103	-108	-131	-162	-202	-169	-195	-88
Tax Rate %	36	13	15	22	20	19	21	18	18	15
Net Income (Continuing Operations)	417	593	600	380	529	685	769	776	904	499
Net Income (Discontinued Operations)	--	--	--	--	--	--	--	--	--	--
Net Income	417	593	600	380	529	685	769	776	904	499
Net Margin %	8	10	10	6	10	12	12	12	14	8
Preferred dividends	--	--	--	--	--	--	--	--	--	--
EPS (Basic)	1	2	2	1	1	2	2	2	3	1
EPS (Diluted)	1	2	2	1	1	2	2	2	3	1
Shares Outstanding (Diluted)	411	386	391	363	362	365	348	346	348	341
Depreciation, Depletion and Amortization	175	172	172	172	170	166	161	174	196	249
EBITDA	904	936	946	742	902	1 077	1 207	1 208	1 374	915

Appendix III. Sources and uses of funds 2014-2013

Fiscal Period	2014	2013	diff	diff,%
Cash And Cash Equivalents	972	1 039	-67	-6.45%
Accounts Receivable	1 093	1 260	-167	-13.25%
Total Inventories	562	569	-7	-1.23%
Other Current Assets	559	510	49	9.61%
Total Current Assets	**3 186**	**3 378**	**-192**	**-5.68%**
Gross Property, Plant and Equipment	2 395	2 240	155	6.92%
Accumulated Depreciation	-1 657	-1 580	-77	4.87%
Property, Plant and Equipment	**738**	**660**	**78**	**11.82%**
Intangible Assets	**2 133**	**1 764**	**369**	**20.92%**
Other Long Term Assets	**665**	**638**	**27**	**4.23%**
Total Assets	6 722	6 440	282	4.38%
Accounts Payable	430	375	55	14.67%
Total Tax Payable	19	28	-9	-32.14%
Other Accrued Expense	640	640	0	0.00%
Current Portion of Long-Term Debt		4	-4	-100.00%
Total Current Liabilities	**1 089**	**1 047**	**42**	**4.01%**
Long-Term Debt	**2 100**	**1 600**	**500**	**31.25%**
Other Long-Term Liabilities	**584**	**541**	**43**	**7.95%**
Total Liabilities	**3 773**	**3 188**	**585**	**18.35%**
Common Stock	441	441	0	0.00%
Retained Earnings	3 896	3 919	-23	-0.59%
Accumulated other comprehensive income (loss)	-622	-443	-179	40.41%
Additional Paid-In Capital	1 767	1 784	-17	-0.95%
Treasury Stock	-2 533	-2 449	-84	3.43%
Total Equity	**2 949**	**3 252**	**-303**	**-9.32%**
Total Equity and Liabilities	6 722	6 440	282	4.38%

Uses of funds

	2014	2013	diff
Intangible Assets	2 133	1 764	369
Accumulated other comprehensive income (loss)	-622	-443	179
Property, Plant and Equipment	738	660	78
Treasury Stock	-2 533	-2 449	84
Other Current Assets	559	510	49
Other Long Term Assets	665	638	27
Retained Earnings	3 896	3 919	23
Additional Paid-In Capital	1 767	1 784	17
Total Tax Payable	19	28	9
Current Portion of Long-Term Debt		4	4
TOTAL			**839**

Sources of funds

	2014	2013	diff
Long-Term Debt	2 100	1 600	500
Accounts Receivable	1 093	1 260	167
Cash And Cash Equivalents	972	1 039	67
Accounts Payable	430	375	55
Other Long-Term Liabilities	584	541	43
Total Inventories	562	569	7
TOTAL			**839**

Appendix IV. Sources and uses of funds 2013-2012

Fiscal Period	2013	2012	diff	diff,%
Cash And Cash Equivalents	1 039	1 336	-297	-22.2%
Accounts Receivable	1 260	1 227	33	2.7%
Total Inventories	569	465	104	22.4%
Other Current Assets	510	529	-19	-3.6%
Total Current Assets	**3 378**	**3 557**	**-179**	**-5.0%**
Gross Property, Plant and Equipment	2 239	2 133	106	5.0%
Accumulated Depreciation	-1 580	-1 540	-40	2.6%
Property, Plant and Equipment	**659**	**593**	**66**	**11.1%**
Intangible Assets	**1 765**	**1 787**	**-22**	**-1.2%**
Other Long Term Assets	**638**	**590**	**48**	**8.1%**
Total Assets	6 440	6 527	-87	-1.3%
Accounts Payable	375	385	-10	-2.6%
Total Tax Payable	28	114	-86	-75.4%
Other Accrued Expense	640	807	-167	-20.7%
Current Portion of Long-Term Debt	4	410	-406	-99.0%
Total Current Liabilities	**1 047**	**1 716**	**-669**	**-39.0%**
Long-Term Debt	**1 600**	**1 100**	**500**	**45.5%**
Other Long-Term Liabilities	**541**	**644**	**-103**	**-16.0%**
Total Liabilities	3 188	3 460	-272	-7.9%
Common Stock	441	441	0	0.0%
Retained Earnings	3 919	3 515	404	11.5%
Accumulated other comprehensive income	-443	-464	21	-4.5%
Additional Paid-In Capital	1 784	1 728	56	3.2%
Treasury Stock	-2 449	-2 153	-296	13.7%
Total Equity	3 252	3 067	185	6.0%
Total Equity and Liabilities	6 440	6 527	-87	-1.3%

Uses of funds

	2013	2012	diff
Current Portion of Long-Term Debt	4	410	406
Treasury Stock	-2 449	-2 153	296
Other Accrued Expense	640	807	167
Total Inventories	569	465	104
Other Long-Term Liabilities	541	644	103
Total Tax Payable	28	114	86
Property, Plant and Equipment	659	593	66
Other Long Term Assets	638	590	48
Accounts Receivable	1 260	1 227	33
Accounts Payable	375	385	10
TOTAL			**1 319**

Scources of funds

	2013	2012	diff
Long-Term Debt	1 600	1 100	500
Retained Earnings	3 919	3 515	404
Cash And Cash Equivalents	1 039	1 336	297
Additional Paid-In Capital	1 784	1 728	56
Intangible Assets	1 765	1 787	22
Accumulated other comprehensive income (loss)	-443	-464	21
Other Current Assets	510	529	19
TOTAL			**1 319**

Appendix V. Connection of company's figures and revenues

Source: Mattel annual report, author's calculations

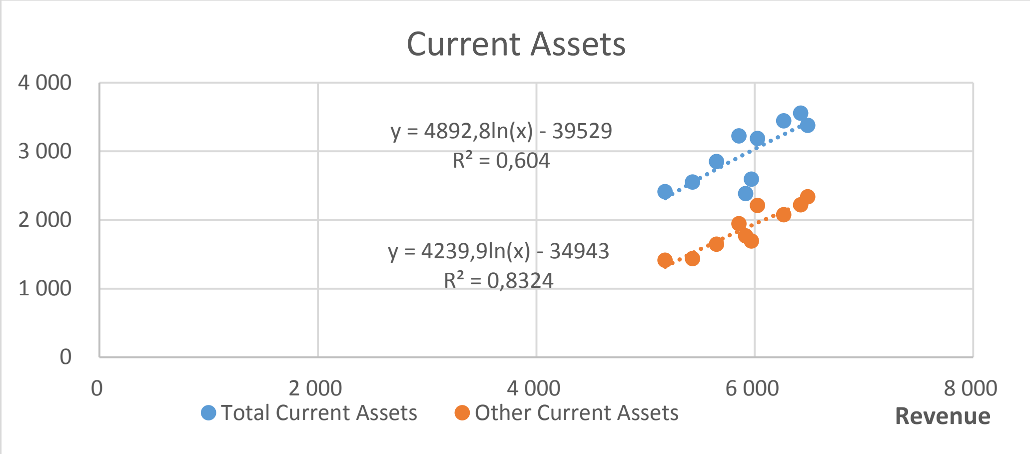

Figure V.1 Historical connection of Other current assets, Total current assets and revenue.

Source: Mattel annual report, author's calculations

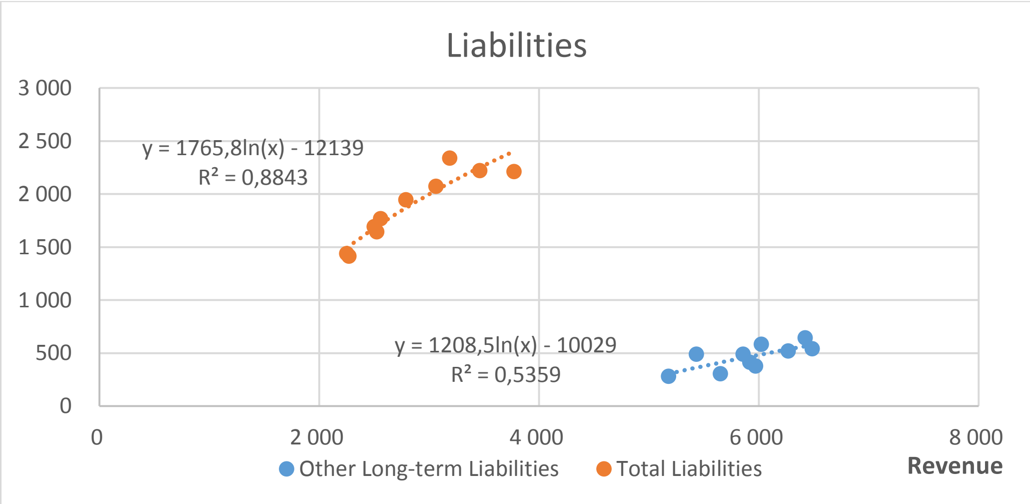

Figure V.2 Historical connection of Other Long-term liabilities, Total liabilities assets and revenue.

Source: Mattel annual report, author's calculations

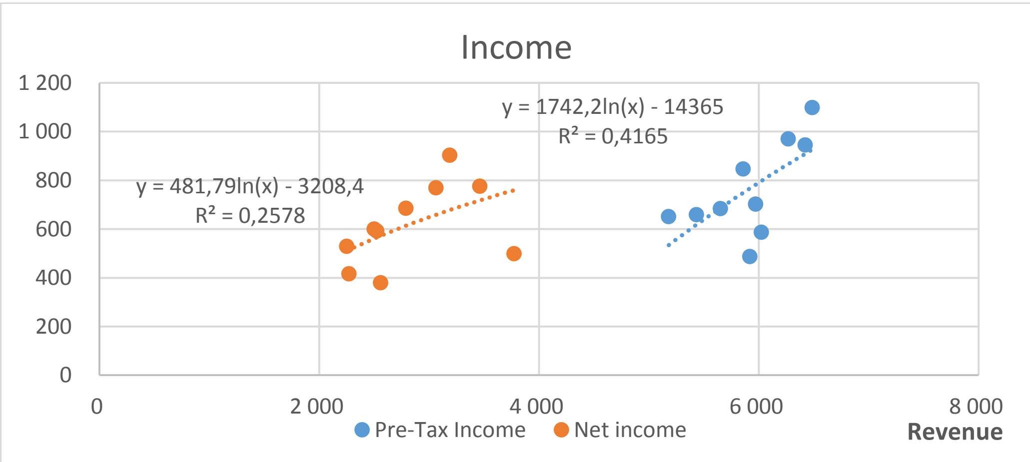

Figure V.3 Historical connection of Pre-tax income, Net income and revenue.

Appendix VI. Company financial model 2015-2017

Fiscal Period	2014	2015	2016	2017	2017/14 diff,%	Forecast description
Cash And Cash Equivalents	972	1 116	1 116	1 116	14.8%	Average level last 3 years, flat
Other Current Assets	2 214	2 302	2 392	2 483	12.1%	Trend formula, R=85%, $263 error
Total Current Assets	3 186	3 418	3 508	3 599	13.0%	
Property, Plant and Equipment	738	797	861	930	26.0%	Average growth rate for 5 y 8%
Intangible Assets	2 133	2 133	2 133	2 133	0.0%	flat
Other Long Term Assets	665	652	639	626	-5.9%	Average growth rate for 5 y -2%
Total Assets	6 722	7 000	7 140	7 287	8.4%	
Total Current Liabilities	1 089	1 165	1 247	1 334	22.5%	Average growth rate for 5y 7%
Long-Term Debt (PLUG)	2 100	2 261	2 267	2 263	7.8%	
Other Long-Term Liabilities	584	609	635	661	13.2%	Trend formula, R=55%, error 98
Total Liabilities	3 773	4 036	4 149	4 258	12.9%	
Total Equity (PLUG)	2 949	2 964	2 991	3 029	2.7%	
Total Equity and Liabilities	6 722	7 000	7 140	7 287	8.4%	
Revenues By trend	6 024	6 316	6 355	6 391	6.1%	
Revenues by %%	6 024	6 144	6 267	6 393	6.1%	
Pre-Tax Income	587	624	662	700	19.3%	Trend formula, R=45%, error 208
Tax Provision	-88	-94	-99	-105	19.3%	
Tax Rate %	15	15	15	15	0.0%	
Net Income	499	530	562	595	19.3%	
Dividents	515	515	536	557	8.2%	No sufficient trend R=1%, 2014/2013 4% growth rate.
Retained Earnings	-16	15	27	38	-338.2%	

Source: Mattel annual reports author's calculations