

Mossberg's Investor Digest

Best Idea Profile

Mattel (NYSE: MAT)

DESCRIPTION:

Headquartered in El Segundo, CA; Mattel is the largest toy company in the world with approximately 20% of the U.S. toy market. It's toy brands include Fisher Price, Barbie, Matchbox, and Hotwheels (among others) with 80%+ of its product portfolio geared to young children from birth to 9 years old. The company generates approximately 50% of its sales outside of the United States.

KEY INVESTMENT CONSIDERATIONS:

Toy sales tend to outperform other categories during a recession – During 4Q08, toy sales declined 5%, versus 5% decline in electronics, 7% decline in apparel, 13% decline in furniture and 24% decline in automobiles. While Mattel and the rest of the toy industry will surely face a weak consumer this peak selling season, parents are more likely to cut back on their own purchases than deny their children new toys at during the holidays.

The big toy companies will take share from the smaller ones – The toy market is fragmented with the top 8 players commanding only 56% of the toy market. In the current economic environment, the largest toy companies will take share from the smaller ones. With less brand and pricing power, smaller toy companies are struggling. Anecdotally, KB toys recently filed for Chapter 11, closing 600 of its 1,200 stores. The loss of a significant customer can be devastating for smaller, less diverse toy companies. In addition, nearly 1,000 toy exporters shut their doors in southern China last year. All this means less competition for Mattel.

Competitive moat increases pricing power – According to The NPD Group, Mattel had 21% of the U.S. toy market. This compares to 35% for the next 7 largest companies combined. Its size and brand power allow Mattel to have more control over pricing when compared to other, smaller toy companies. According to NPD, Mattel's price points increased 8.5% during 2008 and the company has recently implemented another round of price increases.

- **Branding** – At 50 years old, Barbie is the most popular doll in the world.
- **Less dependent on big three toy retailers** – Wal-Mart, Toys "R" Us, and Target control about 2/3 of the U.S. retail toy market. These are big players with significant power to drive pricing from toy vendors. However, only 38% of MAT's sales come from these three vendors, significantly less than the other toy vendors.

Longer-term favorable macro trends – Recent U.S. birth rates were the highest they have been in four decades. Mattel may be the best positioned toy company to capitalize on this trend due to its focus on young children.

Bottom line should grow much faster than the top – During 2009 and 2010 the company is putting in place costs savings initiatives designed to provide sustainable cost savings of \$180 million to \$200 million per year. To put this into perspective, that is 3 to 3 ½ percentage points of margin improvement at current sales levels.

VALUATION:

With efficiencies of scale, leading market share and brand power, Mattel has a great business that requires limited capital investment (with the exception of working capital) and has produced return on equity in the high teens to mid 20' since 2001. Trading at just 7.8x EV/ EBITDA, this appears to be a bargain price. While it is unlikely that the valuation multiple will expand much in the near term due to expected weakness in top line performance, profitability should actually grow this year due to cost cutting initiatives. Its competitive position should allow Mattel to grow faster than its peers coming out of the bottom of the cycle. The dividend appears to be in good shape, so you can collect a nice 4.9% yield while you wait.

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Investment Data (as of 7/10/09)

Recent Price	\$15.19
52-Week Range	10.36 - 21.95
Fiscal Year End	December
Dividend	\$0.75
Yield	4.9%
Shares Outstanding	358 MM
Average Trading Volume (3 mos)	3 MM
Market Capitalization	5.5 B
Cash	400 MM
Long Term Debt	900 MM
Enterprise Value (EV)	6.0 B
LT Debt/ Equity	0.4
BV/ Share	2.97
TTM Revenue	5.8 B
P/ Revenue	0.9x
TTM EPS (non-GAAP)	1.03
P/ EPS	14.7x
TTM EBITDA	767 MM
EV/ TTM EBITDA	7.8x

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