

MATTEL INC /DE/
Form 10-Q
August 02, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the quarterly period ended June 30, 2006

**“ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

Commission File Number 001-05647

MATTEL, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of incorporation or organization)

95-1567322
(I.R.S. Employer Identification No.)

333 Continental Blvd.

El Segundo, CA 90245-5012

(Address of principal executive offices)

(310) 252-2000

(Registrant's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Number of shares outstanding of registrant's common stock, \$1.00 par value, as of July 28, 2006:

378,004,061 shares

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****MATTEL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

| (Unaudited; in thousands, except share data) | June 30, 2006 | June 30, 2005 | December 31, 2005 |
|--|---------------------|---------------------|----------------------|
| ASSETS | | | |
| Current Assets | | | |
| Cash and equivalents | \$ 625,050 | \$ 361,929 | \$ 997,734 |
| Accounts receivable, net | 743,701 | 692,408 | 760,643 |
| Inventories | 538,525 | 579,869 | 376,897 |
| Prepaid expenses and other current assets | 266,752 | 246,503 | 277,226 |
| Total current assets | 2,174,028 | 1,880,709 | 2,412,500 |
| Property, plant and equipment, net | 535,935 | 550,454 | 547,104 |
| Goodwill | 728,184 | 723,685 | 718,069 |
| Other noncurrent assets | 745,618 | 756,748 | 694,640 |
| Total Assets | \$ 4,183,765 | \$ 3,911,596 | \$ 4,372,313 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current Liabilities | | | |
| Short-term borrowings | \$ 33,391 | \$ 31,268 | \$ 117,994 |
| Current portion of long-term debt | 100,000 | 218,624 | 100,000 |
| Accounts payable | 295,340 | 276,237 | 265,936 |
| Accrued liabilities | 504,527 | 433,079 | 796,473 |
| Income taxes payable | 109,896 | 269,304 | 182,782 |
| Total current liabilities | 1,043,154 | 1,228,512 | 1,463,185 |
| Noncurrent Liabilities | | | |
| Long-term debt | 795,000 | 370,000 | 525,000 |
| Other | 291,779 | 242,069 | 282,395 |
| Total noncurrent liabilities | 1,086,779 | 612,069 | 807,395 |
| Stockholders' Equity | | | |
| Common stock \$1.00 par value, 1.0 billion shares authorized; 441.4 million shares issued | 441,369 | 441,369 | 441,369 |
| Additional paid-in capital | 1,588,879 | 1,590,201 | 1,589,281 |
| Treasury stock at cost; 61.2 million shares, 37.1 million shares and 52.8 million shares, respectively | (1,072,127) | (677,194) | (935,711) |
| Retained earnings | 1,377,372 | 1,005,808 | 1,309,822 |
| Accumulated other comprehensive loss | (281,661) | (289,169) | (303,028) |

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| | | | |
|---|---------------------|---------------------|---------------------|
| Total stockholders' equity | 2,053,832 | 2,071,015 | 2,101,733 |
| Total Liabilities and Stockholders' Equity | \$ 4,183,765 | \$ 3,911,596 | \$ 4,372,313 |

The accompanying notes are an integral part of these financial statements.

Table of Contents**MATTEL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS**

| (Unaudited; in thousands, except per share amounts) | For the Three Months Ended | | For the Six Months Ended | |
|--|----------------------------|------------------|--------------------------|------------------|
| | June 30, 2006 | June 30, 2005 | June 30, 2006 | June 30, 2005 |
| Net Sales | \$ 957,655 | \$ 886,823 | \$ 1,751,002 | \$ 1,669,943 |
| Cost of sales | 541,535 | 500,006 | 1,002,924 | 939,066 |
| Gross Profit | 416,120 | 386,817 | 748,078 | 730,877 |
| Advertising and promotion expenses | 100,554 | 93,116 | 189,407 | 180,825 |
| Other selling and administrative expenses | 265,655 | 265,176 | 540,751 | 515,998 |
| Operating Income | 49,911 | 28,525 | 17,920 | 34,054 |
| Interest expense | 16,078 | 19,655 | 31,281 | 37,202 |
| Interest (income) | (6,441) | (12,424) | (15,261) | (24,509) |
| Other non-operating (income), net | (2,080) | (4,712) | (3,959) | (13,593) |
| Income Before Income Taxes | 42,354 | 26,006 | 5,859 | 34,954 |
| Provision (benefit) for income taxes | 4,974 | 119,993 | (61,691) | 122,434 |
| Net Income (Loss) | \$ 37,380 | \$ (93,987) | \$ 67,550 | \$ (87,480) |
| Net Income (Loss) Per Common Share Basic | \$ 0.10 | \$ (0.23) | \$ 0.17 | \$ (0.21) |
| Weighted average number of common shares | 386,191 | 409,769 | 387,472 | 412,915 |
| Net Income (Loss) Per Common Share Diluted | \$ 0.10 | \$ (0.23) | \$ 0.17 | \$ (0.21) |
| Weighted average number of common and common equivalent shares | 388,777 | 409,769 | 390,026 | 412,915 |

The accompanying notes are an integral part of these financial statements.

Table of Contents**MATTEL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

| (Unaudited; in thousands) | For the Six Months Ended | |
|---|--------------------------|-------------|
| | June 30, | June 30, |
| | 2006 | 2005 |
| Cash Flows From Operating Activities: | | |
| Net income (loss) | \$ 67,550 | \$ (87,480) |
| Adjustments to reconcile net income (loss) to net cash flows used for operating activities: | | |
| Gain on sale of investments | | (17,119) |
| Net loss (gain) on disposal of other property, plant and equipment | 1,709 | (244) |
| Depreciation | 83,518 | 86,091 |
| Amortization | 1,940 | 2,237 |
| Deferred income taxes | (33,154) | 13,490 |
| Increase (decrease) from changes in assets and liabilities: | | |
| Accounts receivable | 28,689 | 53,320 |
| Inventories | (157,202) | (170,879) |
| Prepaid expenses and other current assets | 10,478 | 53,491 |
| Accounts payable, accrued liabilities and income taxes payable | (373,337) | (486,362) |
| Other, net | 11,890 | 2,375 |
| Net cash flows used for operating activities | (357,919) | (551,080) |
| Cash Flows From Investing Activities: | | |
| Purchases of tools, dies and molds | (31,730) | (35,319) |
| Purchases of other property, plant and equipment | (34,320) | (24,064) |
| Payment for businesses acquired | (695) | (995) |
| Proceeds from sale of investments | | 27,212 |
| Proceeds from disposal of other property, plant and equipment | 283 | 1,146 |
| Net cash flows used for investing activities | (66,462) | (32,020) |
| Cash Flows From Financing Activities: | | |
| Proceeds from short-term borrowings | 111,466 | 49,825 |
| Repayments of short-term borrowings | (195,990) | (47,894) |
| Proceeds from long-term borrowings | 298,356 | |
| Repayments of long-term borrowings | (30,000) | |
| Share repurchases | (155,633) | (230,744) |
| Proceeds from exercises of stock options | 14,991 | 28,408 |
| Other, net | 3,933 | (2,608) |
| Net cash flows from (used for) financing activities | 47,123 | (203,013) |
| Effect of Currency Exchange Rate Changes on Cash | 4,574 | (8,793) |
| Decrease in Cash and Equivalents | (372,684) | (794,906) |
| Cash and Equivalents at Beginning of Period | 997,734 | 1,156,835 |
| Cash and Equivalents at End of Period | \$ 625,050 | \$ 361,929 |

Supplemental Cash Flow Information:

Cash paid during the period for:

| | | |
|--|------------|------------|
| Income taxes, gross | \$ 116,515 | \$ 107,384 |
| Interest | 34,920 | 39,730 |
| Non-cash investing and financing activities: | | |
| Liability for equipment acquired | \$ 4,976 | \$ 443 |
| Asset write-downs | 450 | 878 |

The accompanying notes are an integral part of these financial statements.

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MATTEL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements and related disclosures have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, all adjustments, consisting of only those of a normal recurring nature, considered necessary for a fair presentation of the financial position and interim results of Mattel, Inc. and its subsidiaries (Mattel) as of and for the periods presented have been included. Because Mattel's business is seasonal, results for interim periods are not necessarily indicative of those that may be expected for a full year.

The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The financial information included herein should be read in conjunction with Mattel's consolidated financial statements and related notes in its 2005 Annual Report on Form 10-K.

2. Change in Accounting Principle

Prior to January 1, 2006, Mattel applied the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its employee stock compensation plans. All employee stock options were granted at or above the grant date market price. Accordingly, no compensation expense was recognized in the statements of operations for these employee stock options.

Effective January 1, 2006, Mattel adopted the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*, using the modified-prospective transition method. Accordingly, results for prior periods have not been restated and compensation cost in 2006 includes the portion of share-based payment awards attributable to employee service during the period for (i) grants made prior to January 1, 2006, but not previously included in the proforma expense disclosures in Mattel's financial statements, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, and (ii) grants made subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

Beginning January 1, 2006 and in connection with the adoption of SFAS No. 123(R), Mattel recognizes the cost of all new employee share-based payment awards on a straight-line attribution basis over their respective vesting periods, net of estimated forfeitures; whereas, prior to January 1, 2006, Mattel used the graded vesting attribution method prescribed by Financial Accounting Standards Board (FASB) Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. In accounting for the income tax benefits associated with employee exercises of share-based payments, Mattel has elected to adopt the alternative simplified method as permitted by FASB Staff Position (FSP) No. FAS 123(R)-3, *Accounting for the Tax Effects of Share-Based Payment Awards*. FSP No.

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FAS 123(R)-3 permits the adoption of either the transition guidance described in SFAS No. 123(R) or the alternative simplified method specified in the FSP to account for the income tax effects of share-based payment awards. In determining when additional tax benefits associated with

share-based payment exercises are recognized, Mattel follows the ordering of deductions of the tax law, which allows deductions for share-based payment exercises to be utilized before previously existing net operating loss carryforwards. In computing dilutive shares under the treasury stock method, Mattel does not reduce the tax benefit amount within the calculation for the amount of deferred tax assets that would have been recognized had Mattel previously expensed all share-based payment awards.

3. Accounts Receivable

Accounts receivable are shown net of allowances for doubtful accounts of \$20.3 million, \$30.2 million and \$24.6 million as of June 30, 2006, June 30, 2005 and December 31, 2005, respectively.

Table of Contents**4. Inventories**

Inventories include the following:

| <u>(In thousands)</u> | <u>June 30, 2006</u> | <u>June 30, 2005</u> | <u>December 31, 2005</u> |
|-----------------------------------|----------------------|----------------------|--------------------------|
| Raw materials and work in process | \$ 63,445 | \$ 61,983 | \$ 34,038 |
| Finished goods | 475,080 | 517,886 | 342,859 |
| | <u>\$ 538,525</u> | <u>\$ 579,869</u> | <u>\$ 376,897</u> |

5. Property, Plant and Equipment

Property, plant and equipment, net include the following:

| <u>(In thousands)</u> | <u>June 30, 2006</u> | <u>June 30, 2005</u> | <u>December 31, 2005</u> |
|--------------------------------|----------------------|----------------------|--------------------------|
| Land | \$ 29,042 | \$ 29,158 | \$ 29,125 |
| Buildings | 234,281 | 251,478 | 231,597 |
| Machinery and equipment | 755,404 | 711,957 | 736,041 |
| Tools, dies and molds | 566,188 | 595,754 | 557,133 |
| Capital leases | 23,271 | 23,271 | 23,271 |
| Leasehold improvements | 123,771 | 107,147 | 115,496 |
| | <u>1,731,957</u> | <u>1,718,765</u> | <u>1,692,663</u> |
| Less: accumulated depreciation | <u>(1,196,022)</u> | <u>(1,168,311)</u> | <u>(1,145,559)</u> |
| | <u>\$ 535,935</u> | <u>\$ 550,454</u> | <u>\$ 547,104</u> |

6. Goodwill

Goodwill is allocated to various reporting units, which are either at the operating segment level or one reporting level below the operating segment, for purposes of evaluating whether goodwill is impaired. Mattel's reporting units are: Mattel Girls Brands US, Mattel Boys Brands US, Fisher-Price Brands US, American Girl Brands and International. Mattel tests its goodwill for impairment annually in the third quarter, or whenever events or changes in circumstances indicate that the carrying value may not be recoverable, based on the fair value of the cash flows that the reporting units can be expected to generate in the future.

The change in the carrying amount of goodwill by reporting unit for the six months ended June 30, 2006 is shown below.

Brand-specific goodwill held by foreign subsidiaries is allocated to the US reporting units selling those brands, thereby causing foreign currency translation impact to the US reporting units.

| (In thousands) | December 31, 2005 | Impact of Currency Exchange Rate | June 30, 2006 |
|------------------------|-------------------|-------------------------------------|-------------------|
| | | Changes | |
| Mattel Girls Brands US | \$ 34,003 | \$ 2,285 | \$ 36,288 |
| Mattel Boys Brands US | 54,134 | 178 | 54,312 |
| Fisher-Price Brands US | 216,455 | 449 | 216,904 |
| American Girl Brands | 207,571 | | 207,571 |
| International | 205,906 | 7,203 | 213,109 |
| | <u>\$ 718,069</u> | <u>\$ 10,115</u> | <u>\$ 728,184</u> |

Table of Contents**7. Other Noncurrent Assets**

Other noncurrent assets include the following:

| (In thousands) | June 30, 2006 | June 30, 2005 | December 31, 2005 |
|-------------------------------|-------------------|-------------------|-------------------|
| Deferred income taxes | \$ 531,004 | \$ 561,266 | \$ 495,914 |
| Identifiable intangibles, net | 19,181 | 21,661 | 20,422 |
| Other | 195,433 | 173,821 | 178,304 |
| | <u>\$ 745,618</u> | <u>\$ 756,748</u> | <u>\$ 694,640</u> |

8. Accrued Liabilities

Accrued liabilities include the following:

| (In thousands) | June 30, 2006 | June 30, 2005 | December 31, 2005 |
|---|-------------------|-------------------|-------------------|
| Royalties | \$ 78,549 | \$ 54,704 | \$ 106,257 |
| Accounts receivable collections due to bank | 44,705 | 36,955 | 200,417 |
| Other | 381,273 | 341,420 | 489,799 |
| | <u>\$ 504,527</u> | <u>\$ 433,079</u> | <u>\$ 796,473</u> |

9. Long-term Debt

Long-term debt consists of the following:

| (In thousands) | June 30, 2006 | June 30, 2005 | December 31, 2005 |
|---|-------------------|-------------------|-------------------|
| Medium-term notes due May 2006 to November 2013 | \$ 370,000 | \$ 400,000 | \$ 400,000 |
| Senior notes due June 2009 to June 2011 | 300,000 | | |
| Term loan facility due December 2006 to December 2008 | 225,000 | | 225,000 |
| 6 1/8% senior notes due July 2005 | | 150,000 | |
| 10.15% mortgage note due November 2005 | | 38,624 | |
| | <u>895,000</u> | <u>588,624</u> | <u>625,000</u> |
| Less: current portion | <u>(100,000)</u> | <u>(218,624)</u> | <u>(100,000)</u> |
| | <u>\$ 795,000</u> | <u>\$ 370,000</u> | <u>\$ 525,000</u> |

In June 2006, Mattel issued \$100.0 million of unsecured floating rate senior notes (Floating Rate Senior Notes) due June 15, 2009 and \$200.0 million of unsecured 6.125% senior notes (6.125% Senior Notes) due June 15, 2011 (collectively Senior Notes). Interest on the Floating Rate Senior Notes is based on the three-month US Dollar London Interbank Offered Rate (LIBOR) plus 40 basis points with interest payable quarterly beginning September 15, 2006. Interest on the 6.125% Senior Notes is payable semi-annually beginning December 15, 2006. The 6.125% Senior Notes may be redeemed at any time at the option of Mattel at a redemption price equal to the greater of (i) the principal amount of the notes being redeemed plus accrued interest to the redemption date, and (ii) a make whole amount based on the yield of a comparable US Treasury security plus 20 basis points.

In June 2006, Mattel entered into two interest rate swap agreements on the \$100.0 million Floating Rate Senior Notes, each in a notional amount of \$50.0 million, for the purpose of hedging the variability of cash flows in the interest payments due to fluctuations of the LIBOR benchmark interest rate. These cash flow hedges are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, whereby the hedges are reported in Mattel's consolidated balance sheets at fair value, with changes in the fair value of the hedges reflected in accumulated other comprehensive income. Under the terms of the agreements, Mattel will receive quarterly interest payments from the swap counterparties based on the three-month LIBOR plus 40 basis points and make semi-annual interest payments to the swap counterparties based on a fixed rate of 5.87125%. The three-month LIBOR rate used to determine interest payments under the interest rate swap agreements resets every three months, matching the variable interest on the Floating Rate Senior Notes. The agreements expire in June 2009.

Table of Contents**10. Comprehensive Income (Loss)**

The changes in the components of comprehensive income (loss), net of tax, are as follows:

| (In thousands) | For the Three Months Ended | | For the Six Months Ended | |
|--|----------------------------|---------------|--------------------------|---------------|
| | June 30, 2006 | June 30, 2005 | June 30, 2006 | June 30, 2005 |
| Net income (loss) | \$ 37,380 | \$ (93,987) | \$ 67,550 | \$ (87,480) |
| Currency translation adjustments | 21,623 | (15,309) | 31,989 | (35,337) |
| Minimum pension liability adjustments | | 651 | | 651 |
| Net unrealized gain (loss) on securities: | | | | |
| Unrealized holding gains (losses) | | 586 | | (1,484) |
| Reclassification adjustment for realized (gains) included in net income (loss) | | (3,264) | | (9,009) |
| | | (2,678) | | (10,493) |
| Net unrealized gain (loss) on derivative instruments: | | | | |
| Unrealized holding (losses) gains | (13,612) | 10,179 | (11,888) | 18,759 |
| Reclassification adjustment for realized losses included in net income (loss) | 2,021 | 3,117 | 1,266 | 7,079 |
| | (11,591) | 13,296 | (10,622) | 25,838 |
| | \$ 47,412 | \$ (98,027) | \$ 88,917 | \$ (106,821) |

The components of accumulated other comprehensive loss are as follows:

| (In thousands) | June 30, 2006 | June 30, 2005 | December 31, 2005 |
|--|---------------|---------------|-------------------|
| Currency translation adjustments | \$ (206,570) | \$ (235,129) | \$ (238,559) |
| Minimum pension liability adjustments | (68,715) | (60,821) | (68,715) |
| Net unrealized gain on securities | | 5,949 | |
| Net unrealized (loss) gain on derivative instruments | (6,376) | 832 | 4,246 |
| | \$ (281,661) | \$ (289,169) | \$ (303,028) |

Currency Translation Adjustments

Mattel's reporting currency is the US dollar. The translation of its results of operations and financial position of subsidiaries with non-US dollar functional currencies subjects Mattel to currency exchange rate fluctuations in its results of operations and financial position. Assets and

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liabilities of subsidiaries with non-US dollar functional currencies are translated into US dollars at fiscal period-end exchange rates. Income, expense and cash flow items are translated at weighted average exchange rates prevailing during the fiscal period. The resulting currency translation adjustments are recorded as a component of accumulated other comprehensive loss within stockholders' equity. Mattel's primary currency translation exposures were related to entities having functional currencies denominated in the Euro, British pound sterling and Mexican peso. For the six months ended June 30, 2006, currency translation adjustments resulted in a net gain of \$32.0 million, with gains from the strengthening of the Euro and British pound sterling, against the US dollar, partially offset by the weakening of the Mexican peso against the US dollar. For the six months ended June 30, 2005, currency translation adjustments resulted in a net loss of \$35.3 million, with losses from the weakening of the Euro and British pound sterling against the US dollar being partially offset by strengthening of the Mexican peso against the US dollar.

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Marketable Securities

As of June 30, 2006, Mattel held no marketable securities. Unrealized pre-tax gains of \$9.4 million (\$5.9 million net of tax) as of June 30, 2005 were deferred in accumulated other comprehensive loss related to marketable securities held.

During the second quarter of 2005, Mattel sold marketable securities for proceeds totaling \$8.6 million. For the six months ended June 30, 2005, proceeds from the sale of marketable securities totaled \$24.2 million. Pre-tax gains on sales of these securities totaling \$5.2 million, net of transaction costs, were recorded in other non-operating (income), net in the consolidated statements of operations for the three months ended June 30, 2005. Pre-tax gains totaling \$14.3 million, net of transaction costs, were recorded in other non-operating (income), net in the consolidated statements of operations for the six months ended June 30, 2005 from sales of marketable securities.

11. Income Taxes

In the normal course of business, Mattel is regularly audited by federal, state and foreign tax authorities. During the three months ended March 31, 2006, Mattel settled multiple ongoing audits by foreign tax authorities and as a result of the settlements, Mattel recognized income tax benefits of \$56.8 million during the first quarter of 2006. During the three months ended June 30, 2006, Mattel recognized income tax benefits of \$6.2 million primarily due to a settlement with a state tax authority for tax years 1997 and 1998.

On May 17, 2006, the Tax Increase Prevention and Reconciliation Act (the Tax Act) was signed into law. Management expects the Tax Act to lower Mattel's 2006 provision for income taxes by approximately 3 to 4 percentage points. The provision for income taxes for the three months ended June 30, 2006 was calculated based on the new lower expected tax rate for fiscal year 2006, and also included an appropriate net catch-up adjustment of \$1.6 million. This adjustment was necessary to appropriately adjust the tax provision for the six months ended June 30, 2006 to the lower expected annual tax rate. Future law changes by Congress or guidance from the Internal Revenue Service with respect to these new rules may further impact Mattel's estimates and could require further adjustments to future tax provisions. The impact of such future changes, if any, will be reflected in the financial reporting period in which any such change is enacted or becomes effective.

The consolidated statements of operations for the three and six months ended June 30, 2005 included a provision for income taxes of \$112.9 million for the total amount of earnings repatriated under the American Jobs Creation Act (the Jobs Act), which was signed into law on October 22, 2004. Among its various provisions, the Jobs Act created a temporary incentive for US corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. In the fourth quarter of 2005, management changed its estimate of the tax liability associated with the repatriated earnings to \$107.0 million and recorded the \$5.9 million adjustment to the provision for income taxes in that period.

12. Foreign Currency Transaction Gains and Losses

Currency exchange rate fluctuations may impact Mattel's results of operations and cash flows. Mattel's currency transaction exposures include gains and losses realized on unhedged inventory purchases and unhedged receivables and payables balances that are denominated in a currency other than the applicable functional currency. Gains and losses on unhedged inventory purchases and other transactions associated with operating activities are recorded in the components of operating income in the consolidated statements of operations. Gains and losses on unhedged intercompany loans and advances are recorded as a component of other non-operating (income), net in the consolidated statements of operations in the period in which the currency exchange rate changes. Inventory purchase transactions denominated in the Euro, British pound sterling, Mexican peso, Hong Kong dollar and Indonesian rupiah are the primary transactions that cause foreign currency transaction exposure

for Mattel.

Currency transaction (gains)/losses included in the consolidated statements of operations are as follows:

| (In thousands) | For the Three Months Ended | | For the Six Months Ended | |
|-----------------------------------|----------------------------|------------------|--------------------------|------------------|
| | June 30, 2006 | June 30, 2005 | June 30, 2006 | June 30, 2005 |
| Operating (income) | \$ (1,772) | \$ (13,190) | \$ (4,972) | \$ (26,265) |
| Other non-operating (income), net | (1,827) | 861 | (1,431) | 2,346 |
| Net transaction (gains) | \$ (3,599) | \$ (12,329) | \$ (6,403) | \$ (23,919) |

Table of Contents**13. Other Selling and Administrative Expenses**

Other selling and administrative expenses include the following:

| (In thousands) | For the Three Months Ended | | For the Six Months Ended | |
|--|----------------------------|-----------|--------------------------|-----------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2006 | 2005 | 2006 | 2005 |
| Research and development | \$ 40,590 | \$ 44,920 | \$ 79,771 | \$ 86,124 |
| Identifiable intangible asset amortization | 560 | 493 | 1,124 | 1,070 |

14. Earnings Per Share

Basic net income per common share is computed by dividing reported net income by the weighted average number of common shares outstanding during each period.

Diluted net income per common share is computed by dividing reported net income by the weighted average number of common shares and other common equivalent shares outstanding during each period. The calculation of common equivalent shares assumes the exercise of dilutive stock options, net of assumed treasury share repurchases at average market prices. Nonqualified stock options totaling 30.6 million shares were excluded from the calculation of diluted net income per common share for the three and six months ended June 30, 2006 because they were anti-dilutive. Diluted net (loss) per common share for the three and six months ended June 30, 2005 is the same as basic net (loss) per common share due to Mattel's net loss position for the three and six months ended June 30, 2005.

15. Employee Benefit Plans

Mattel and certain of its subsidiaries have qualified and nonqualified retirement plans covering substantially all employees of these companies, which are more fully described in Note 4 to the Consolidated Financial Statements in Mattel's 2005 Annual Report on Form 10-K.

A summary of the components of net periodic benefit cost for Mattel's defined benefit pension plans is as follows:

| (In thousands) | For the Three Months Ended | | For the Six Months Ended | |
|----------------|----------------------------|----------|--------------------------|----------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2006 | 2005 | 2006 | 2005 |
| Service cost | \$ 2,902 | \$ 2,538 | \$ 5,603 | \$ 4,869 |
| Interest cost | 5,738 | 6,135 | 11,339 | 11,552 |

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| | | | | |
|--------------------------------|-------------------|-------------------|-------------------|-------------------|
| Expected return on plan assets | (5,366) | (5,665) | (11,476) | (11,333) |
| Amortization of: | | | | |
| Prior service cost | 883 | 1,110 | 1,366 | 961 |
| Net actuarial loss | 1,716 | 2,499 | 4,503 | 4,838 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net benefit cost | \$ 5,873 | \$ 6,617 | \$ 11,335 | \$ 10,887 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

A summary of the components of net periodic benefit cost for Mattel's postretirement benefit plans is as follows:

| (In thousands) | For the Three Months Ended | | For the Six Months Ended | |
|--------------------|----------------------------|-------------------|--------------------------|-------------------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2006 | 2005 | 2006 | 2005 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Service cost | \$ 23 | \$ 32 | \$ 53 | \$ 64 |
| Interest cost | 565 | 803 | 1,345 | 1,606 |
| Amortization of: | | | | |
| Net actuarial loss | 68 | 384 | 459 | 768 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net benefit cost | \$ 656 | \$ 1,219 | \$ 1,857 | \$ 2,438 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

During the three and six months ended June 30, 2006, Mattel made cash contributions totaling approximately \$3 million and

\$6 million, respectively, to its defined benefit pension and postretirement benefit plans. Mattel expects to make cash contributions totaling approximately \$14 million to its defined benefit pension and postretirement benefit plans during 2006, including approximately \$11 million to cover benefit payments for its unfunded plans.

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16. Share-Based Payments

Mattel has various stock compensation plans, which are more fully described in Note 7 to the Consolidated Financial Statements in its 2005 Annual Report on Form 10-K. Under the Mattel, Inc. 2005 Equity Compensation Plan, Mattel has the ability to grant nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units (RSUs), dividend equivalent rights and shares of common stock to officers, employees, and other persons providing services to Mattel. Stock options expire no later than ten years from the date of grant and generally provide for vesting over a period of three years from the date of grant. Such stock options were granted with exercise prices at or above the fair market value of Mattel's common stock on the date of grant.

Effective January 1, 2006, Mattel adopted the fair value recognition provisions of SFAS No. 123(R) using the modified-prospective transition method. Prior to January 1, 2006, Mattel applied the recognition and measurement principles of APB Opinion No. 25, and related interpretations in accounting for its employee stock compensation plans. All employee stock options were granted at or above the grant date market price and, accordingly, no compensation expense was recognized in the consolidated statements of operations for these employee stock options. Instead, the amount of compensation expense that would have resulted if Mattel had applied the fair value recognition provisions of SFAS No. 123 was included as a proforma disclosure in the financial statement footnotes.

Prior to January 1, 2006, Mattel presented all benefits of tax deductions resulting from the exercise of share-based compensation as operating cash flows in the statements of cash flows. SFAS No. 123(R) requires the benefits of tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) be classified as financing cash flows. Excess tax benefits reflected as a financing cash inflow totaled \$0.1 million and \$0.8 million, respectively, during the three and six months ended June 30, 2006. Excess tax benefits reflected as an operating cash inflow totaled \$0.6 million and \$3.9 million, respectively, during the three and six months ended June 30, 2005.

On December 28, 2005, the Compensation Committee of the Board of Directors of Mattel approved the acceleration of vesting of options for approximately 12.4 million shares with an exercise price of \$16.09 or greater granted to employees other than Mattel's Chairman and Chief Executive Officer. Vesting was not accelerated for stock options held by any member of the Board of Directors. The primary purpose of the accelerated vesting was to avoid recognizing future compensation expense associated with the accelerated stock options under SFAS No. 123(R). Additionally, for financial reporting purposes, there may be other potential tax benefits derived from accelerating the vesting of stock options.

As of June 30, 2006, total unrecognized compensation cost related to unvested share-based payments totaled \$2.9 million and is expected to be recognized over a weighted-average period of 2.0 years.

Table of Contents*Stock Options*

Mattel recognized compensation expense of \$0.5 million and \$1.1 million, respectively, for stock options during the three and six months ended June 30, 2006 as a component of other selling and administrative expenses. As discussed above, prior to January 1, 2006, no compensation expense was recognized in the statements of operations for stock options. Had compensation expense in 2005 for nonqualified stock options granted been determined based on their fair value at the grant date, consistent with the fair value method of accounting prescribed by SFAS No. 123, Mattel's net income and net income per common share for the three months and six months ended June 30, 2005 would have been adjusted as follows (amounts in thousands, except per share amounts):

| | For the Three | For the Six |
|---|---------------|---------------|
| | Months Ended | Months Ended |
| (In millions, except per share amounts) | June 30, 2005 | June 30, 2005 |
| <i>Net (loss)</i> | | |
| As reported | \$ (94.0) | \$ (87.5) |
| Pro forma compensation cost, net of tax | (5.8) | (12.5) |
| Pro forma net (loss) | \$ (99.8) | \$ (100.0) |
| <i>(Loss) per share</i> | | |
| Basic | | |
| As reported | \$ (0.23) | \$ (0.21) |
| Pro forma compensation cost, net of tax | (0.01) | (0.03) |
| Pro forma net (loss) per common share basic | \$ (0.24) | \$ (0.24) |
| Diluted | | |
| As reported | \$ (0.23) | \$ (0.21) |
| Pro forma compensation cost, net of tax | (0.01) | (0.03) |
| Pro forma net (loss) per common share diluted | \$ (0.24) | \$ (0.24) |

The fair value of options granted has been estimated using the Black-Scholes valuation model. The expected life of the options used in this calculation is the period of time the options are expected to be outstanding, and has been determined based on historical exercise experience. Expected stock price volatility is based on the historical volatility of Mattel's stock for a period approximating the expected life, the expected dividend yield is based on Mattel's historical annual dividend payout, and the

risk-free interest rate is based on the implied yield available on US Treasury zero-coupon issues. The fair value per option was lower in 2006 than in 2005 due primarily to a lower volatility factor and a shorter expected life. The shorter expected life was determined through a detailed study of historical exercise experience, and the shorter expected life impacted the period that was considered in developing other assumptions including volatility. The following weighted average assumptions were used in determining fair value for options granted:

| | During the Three Months Ended | During the Six Months Ended |
|----------------|-------------------------------|-----------------------------|
| (In thousands) | June 30, | June 30, June 30, |

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| | <u>2006</u> | <u>June 30, 2005</u> | <u>2006</u> | <u>2005</u> |
|--|-------------|--------------------------|-------------|-------------|
| Expected life (in years) | 4.87 | 7.39 | 4.87 | 6.79 |
| Risk-free interest rate | 4.12% | 3.99% | 4.12% | 3.93% |
| Volatility factor | 27.30% | 36.95% | 27.30% | 36.55% |
| Dividend yield | 2.41% | 1.23% | 2.41% | 1.28% |
| Weighted average fair value per granted option | \$ 4.48 | \$ 7.55 | \$ 4.48 | \$ 7.27 |

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The following is a summary of stock option information and weighted average exercise prices for Mattel's stock option plans during the six months ended June 30, 2006 (amounts in thousands, except average exercise price and average remaining life):

| | Number | Average Exercise Price | Average Remaining Life (in years) | Aggregate Intrinsic Value |
|--------------------------------------|---------|---------------------------|--|---------------------------------|
| Outstanding at January 1, 2006 | 47,851 | \$ 18.53 | | |
| Granted | 107 | 16.36 | | |
| Exercised | (952) | 15.12 | | |
| Forfeited | | | | |
| Canceled | (3,378) | 21.99 | | |
| Outstanding at June 30, 2006 | 43,628 | \$ 18.34 | 5.3 | \$ 55,343 |
| Exercisable at June 30, 2006 | 42,818 | \$ 18.34 | 5.5 | \$ 55,262 |
| Available for grant at June 30, 2006 | 42,963 | | | |

There were 50 million shares of common stock authorized for equity instrument awards under the 2005 Plan.

The intrinsic value of stock options is the amount by which the current market value of the underlying stock exceeds the exercise price of an option. The total intrinsic value of options exercised during the three and six months ended June 30, 2006 was \$0.4 million and \$2.3 million, respectively. The total intrinsic value of options exercised during the three and six months ended June 30, 2005 was \$1.7 million and \$11.8 million, respectively.

Mattel uses treasury shares purchased under its share repurchase program to satisfy stock option exercises. Cash received from stock options exercised during the three and six months ended June 30, 2006 was \$15.0 million and \$28.4 million, respectively, and the tax benefit for exercises during the three and six months ended June 30, 2006 was \$0.1 million and \$0.8 million, respectively.

Restricted Stock and Restricted Stock Units

Compensation expense recognized related to grants of restricted stock and RSUs to certain employees and non-employee Board members was \$0.2 million and \$0.3 million, respectively, for the three and six months ended June 30, 2006.

The following table summarizes the number and weighted average grant date fair value of Mattel's unvested restricted stock and RSUs as of June 30, 2006 (shares in thousands):

Weighted-average

| | Shares | grant date fair value |
|-----------------------------|--------|--------------------------|
| Unvested at January 1, 2006 | 220 | \$ 12.55 |
| Granted | 23 | 16.16 |
| Vested | (5) | 20.70 |
| Forfeited | | |
| | <hr/> | |
| Unvested at June 30, 2006 | 238 | \$ 12.72 |
| | <hr/> | |

17. Contingencies*Litigation Related to Carter Bryant and MGA Entertainment, Inc.*

In April 2004, Mattel filed a lawsuit in Los Angeles County Superior Court against Carter Bryant (Bryant), a former Mattel design employee. The suit alleges that Bryant aided and assisted a Mattel competitor, MGA Entertainment, Inc. (MGA), during the time he was employed by Mattel, in violation of his contractual and other duties to Mattel. In September 2004, Bryant asserted counterclaims against Mattel, including counterclaims in which Bryant seeks, as a putative class action representative, to invalidate Mattel's Confidential Information and Proprietary Inventions Agreements with its employees. In December 2004, MGA intervened as a party-defendant in Mattel's action against Bryant, asserting that its rights to the Bratz property are at stake in the litigation. Mattel's suit was removed to the United States District Court for the Central District of California.

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Separately, in November 2004, Bryant filed an action against Mattel in the United States District Court for the Central District of California. The action seeks a judicial declaration that Bryant's purported conveyance of rights in Bratz was proper and that he did not misappropriate Mattel property in creating Bratz.

In April 2005, MGA filed suit against Mattel in the United States District Court for the Central District of California. MGA's action alleges claims of trade dress infringement, trade dress dilution, false designation of origin, unfair competition and unjust enrichment. The suit alleges, among other things, that certain products, themes, packaging and/or television commercials in various Mattel product lines have infringed upon products, themes, packaging and/or television commercials for various MGA product lines, including Bratz. The complaint also asserts that various alleged Mattel acts with respect to unidentified retailers, distributors and licensees have damaged MGA and that various alleged acts by industry organizations, purportedly induced by Mattel, have damaged MGA. MGA's suit alleges that MGA has been damaged in an amount believed to reach or exceed tens of millions of dollars and further seeks punitive damages, disgorgement of Mattel's profits and injunctive relief. Mattel believes the claims by Bryant and MGA are without merit and intends to vigorously defend against them.

In June 2006, the three cases were consolidated in the United States District Court for the Central District of California. On July 17, 2006, the Court issued an order dismissing all claims that Bryant had asserted against Mattel, including Bryant's purported counterclaims to invalidate Mattel's Confidential Information and Proprietary Inventions Agreements with its employees, and Bryant's claims for declaratory relief. The Court, however, allowed Bryant the opportunity to correct the deficiencies in those claims. At this time Mattel does not know whether Bryant will try to correct those deficiencies and once again assert claims against Mattel.

18. Segment Information

Mattel's operating segments are separately managed business units and are divided on a geographic basis between domestic and international. On October 10, 2005, Mattel announced the consolidation of its domestic Mattel Girls & Boys Brands and Fisher-Price Brands divisions into one division. The creation of the Mattel Brands division, which resulted in the consolidation of some management and support functions, preserves the natural marketing and design groups that are empowered to create and market toys based on gender and age groups and is expected to more effectively and efficiently leverage Mattel's scale. These changes are consistent with Mattel's ongoing strategy to build brands, cut costs and develop people in a streamlined organization that is focused on scale, innovation and execution. There were no changes to Mattel's operating segments as a result of the consolidation.

Mattel's domestic operating segments include:

Mattel Girls & Boys Brands including Barbie® fashion dolls and accessories (Barbie®), Polly Pocket!Pixel Chix, Winx Club and Disney Classics (collectively Other Girls Brands), Hot WheelsMatchbox® and Tyco® R/C vehicles and playsets (collectively Wheels) and Batman CARS, Ice Age, Justice League, Superman, Yu-Gi-Oh! and games and puzzles (collectively Entertainment).

Fisher-Price Brands including Fisher-Price®, Little People®, Rescue Heroes®, BabyGear and View-Master® (collectively Core Fisher-Price®), Sesame Street®, Barney, Dora the Explorer, Winnie the Pooh, InteracTV and

See N Sa® (collectively Fisher-Price® Friends) and Power Wheels®.

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American Girl Brands including Just Like You (formerly referred to as American Girl Today®), the historical collection (formerly referred to as The American Girls Collection®) and Bitty Baby®. American Girl Brands products are sold directly to consumers and its children's publications are also sold to certain retailers.

Additionally, the International segment sells products in all toy categories, except American Girl Brands.

The tables below present information about revenues, income and assets by segment. Mattel does not include sales adjustments such as trade discounts and other allowances in the calculation of segment revenues (referred to as gross sales). Mattel records these adjustments in its financial accounting systems at the time of sale to each customer, but the adjustments are not allocated to individual products. For this reason, Mattel's chief operating decision maker uses gross sales by segment as one of the metrics to measure segment performance. Such sales adjustments are included in the determination of segment income from operations based on the adjustments recorded in the financial accounting systems. Segment income from operations represents operating income, while consolidated income from operations represents income from operations before income taxes as reported in the consolidated statements of operations. The corporate and other category includes costs not allocated to individual segments, including charges related to incentive compensation and corporate headquarters functions managed on a worldwide basis and the impact of changes in foreign currency rates on intercompany transactions.

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| (In thousands) | For the Three Months Ended | | For the Six Months Ended | |
|-----------------------------------|----------------------------|------------------|--------------------------|------------------|
| | June 30, 2006 | June 30, 2005 | June 30, 2006 | June 30, 2005 |
| Revenues | | | | |
| Domestic: | | | | |
| Mattel Girls & Boys Brands US | \$ 264,178 | \$ 249,048 | \$ 493,877 | \$ 486,985 |
| Fisher-Price Brands US | 231,614 | 223,725 | 431,254 | 392,943 |
| American Girl Brands | 61,639 | 58,803 | 123,507 | 126,433 |
| Total Domestic | 557,431 | 531,576 | 1,048,638 | 1,006,361 |
| International | 483,889 | 433,090 | 858,134 | 808,557 |
| Gross sales | 1,041,320 | 964,666 | 1,906,772 | 1,814,918 |
| Sales adjustments | (83,665) | (77,843) | (155,770) | (144,975) |
| Net sales | \$ 957,655 | \$ 886,823 | \$ 1,751,002 | \$ 1,669,943 |
| Income Before Income Taxes | | | | |
| Domestic: | | | | |
| Mattel Girls & Boys Brands US | \$ 34,380 | \$ 27,717 | \$ 47,787 | \$ 44,110 |
| Fisher-Price Brands US | 19,692 | 8,244 | 18,910 | 6,552 |
| American Girl Brands | 523 | 4,030 | 564 | 11,817 |
| Total Domestic | 54,595 | 39,991 | 67,261 | 62,479 |
| International | 34,764 | 13,372 | 40,204 | 23,073 |
| Corporate and other expense (a) | 89,359 | 53,363 | 107,465 | 85,552 |
| Operating income | 49,911 | 28,525 | 17,920 | 34,054 |
| Interest expense | 16,078 | 19,655 | 31,281 | 37,202 |
| Interest (income) | (6,441) | (12,424) | (15,261) | (24,509) |
| Other non-operating (income), net | (2,080) | (4,712) | (3,959) | (13,593) |
| Income before income taxes | \$ 42,354 | \$ 26,006 | \$ 5,859 | \$ 34,954 |

(a) For the three and six months ended June 30, 2006, corporate and other includes severance charges of \$2.2 million and \$15.2 million, respectively, primarily in connection with the streamlining of the Mattel Brands organization.

| (In thousands) | June 30, 2006 | June 30, 2005 | December 31, 2005 |
|-------------------------------|---------------|---------------|-------------------|
| Assets | | | |
| Domestic: | | | |
| Mattel Girls & Boys Brands US | \$ 258,020 | \$ 288,539 | \$ 255,817 |
| Fisher-Price Brands US | 244,651 | 239,431 | 188,076 |

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| | | | |
|-------------------------------------|--------------|--------------|--------------|
| American Girl Brands | 76,560 | 63,288 | 60,256 |
| | <hr/> | <hr/> | <hr/> |
| Total Domestic | 579,231 | 591,258 | 504,149 |
| International | 616,176 | 586,160 | 547,980 |
| | <hr/> | <hr/> | <hr/> |
| | 1,195,407 | 1,177,418 | 1,052,129 |
| Corporate and other | 86,819 | 94,859 | 85,411 |
| | <hr/> | <hr/> | <hr/> |
| Accounts receivable and inventories | \$ 1,282,226 | \$ 1,272,277 | \$ 1,137,540 |
| | <hr/> | <hr/> | <hr/> |

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Mattel sells a broad variety of toy products, which are grouped into three major categories: Mattel Girls & Boys Brands, Fisher-Price Brands and American Girl Brands. The table below presents worldwide revenues by category:

| (In thousands) | For the Three Months Ended | | For the Six Months Ended | |
|----------------------------|----------------------------|------------|--------------------------|--------------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2006 | 2005 | 2006 | 2005 |
| Worldwide Revenues | | | | |
| Mattel Girls & Boys Brands | \$ 609,627 | \$ 563,796 | \$ 1,102,834 | \$ 1,078,185 |
| Fisher-Price Brands | 365,717 | 337,270 | 672,955 | 601,654 |
| American Girl Brands | 61,639 | 58,803 | 123,507 | 126,433 |
| Other | 4,337 | 4,797 | 7,476 | 8,646 |
| Gross sales | 1,041,320 | 964,666 | 1,906,772 | 1,814,918 |
| Sales adjustments | (83,665) | (77,843) | (155,770) | (144,975) |
| Net sales | \$ 957,655 | \$ 886,823 | \$ 1,751,002 | \$ 1,669,943 |

19. New Accounting Pronouncement

In July 2006, the FASB issued Final Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 excludes income taxes from the scope of SFAS No. 5, *Accounting for Contingencies*. FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the consolidated balance sheets prior to the adoption of FIN 48 and the amounts reported after adoption are accounted for as a cumulative-effect adjustment to the beginning balance of retained earnings. Mattel is currently evaluating the effect that the adoption of FIN 48 will have on its results of operations and financial position.

20. Subsequent Event

On July 25, 2006, Mattel entered into an agreement to acquire Radica Games Limited (Radica) for approximately

\$230 million in cash. Radica manufactures and markets a diverse line of electronic entertainment products including electronic games carrying the Radica, 20Q® and Play TV® brand names and youth electronics carrying the Girl Tech® brand name. Under the Agreement and Plan of Amalgamation (the Amalgamation Agreement) between Radica and certain of Mattel's wholly owned subsidiaries, shareholders of Radica will receive \$11.55 in cash for each share of Radica common stock at the effective time of the amalgamation. Mattel, Inc. is a party to the Amalgamation Agreement solely as a guarantor of the obligations of its subsidiaries under the Amalgamation Agreement. Consummation of the transaction is subject to customary closing conditions, including, among other things, approval by 75% of Radica's shareholders voting on the amalgamation and certain regulatory approvals, including expiration or termination of any required waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and is expected to occur in the fourth quarter of 2006.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

MATTEL, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial information and related notes that appear in Part I of this Quarterly Report. Mattel's business is seasonal, and, therefore, results of operations are comparable only with corresponding periods.

Overview

Mattel designs, manufactures and markets a broad variety of toy products worldwide through sales to its customers and directly to consumers. Mattel's business is dependent in great part on its ability each year to redesign, restyle and extend existing core products and product lines, to design and develop innovative new products and product lines, and to successfully market those products and product lines. Mattel plans to continue to focus on its portfolio of traditional brands that have historically had worldwide appeal, to create new brands utilizing its knowledge of children's play patterns and to target customer and consumer preferences around the world.

Mattel's portfolio of brands and products are grouped in the following categories:

Mattel Girls & Boys Brands including Barbie® fashion dolls and accessories (Barbie®), Polly Pocket!Pixel Chix, Winx Club and Disney Classics (collectively Other Girls Brands), Hot WheelsMatchbox® and Tyco® R/C vehicles and playsets (collectively Wheels) and Batman®/AR, Ice Age, Justice League, Superman, Yu-Gi-Oh! and games and puzzles (collectively Entertainment).

Fisher-Price Brands including Fisher-Price®, Little People®, Rescue Heroes®, BabyGear and View-Master® (collectively Core Fisher-Price®), Sesame Street®, Barney, Dora the Explorer , Winnie the Pooh, InteracTVand See N Say® (collectively Fisher-Price® Friends) and Power Wheels®.

American Girl Brands including Just Like Youthe historical collection and Bitty Baby®. American Girl Brands products are sold directly to consumers and its children's publications are also sold to certain retailers.

On October 10, 2005, Mattel announced the consolidation of its domestic Mattel Girls & Boys Brands and Fisher-Price Brands divisions into one division. The creation of the Mattel Brands division, which resulted in the consolidation of some management and support functions, preserves the natural marketing and design groups that are empowered to create and market toys based on gender and age groups and is expected to more effectively and efficiently leverage Mattel's scale. These changes are consistent with Mattel's ongoing goals to enhance innovation and improve execution. In connection with this consolidation, Mattel executed an initiative in 2006 to streamline its workforce, primarily in El Segundo, California.

Management believes that the business environment for Mattel in 2006 will be similar to that of 2005. Mattel expects to continue facing challenges both domestically and internationally as certain retailers continue to rationalize stores and tightly manage inventory. Additionally, Mattel has experienced continued cost pressures in the areas of product costs, including oil-based resin and zinc, and employee-related costs. Management believes that Mattel will continue to encounter a challenging retail environment, along with cost pressures and the possibility of continued sales declines in the Barbie® brand.

Mattel's objective is to continue to create long-term shareholder value by generating strong cash flow and deploying it in a disciplined and opportunistic manner as outlined in Mattel's capital and investment framework. To achieve this objective, management has established three overarching goals. The first goal is to enhance innovation in order to reinvigorate the Barbie® brand, while maintaining growth in other core brands by continuing to develop popular toys. Additionally, Mattel plans to pursue additional licensing arrangements and strategic partnerships to extend its portfolio of brands into areas outside of traditional toys.

The second goal is to improve execution in areas including manufacturing, distribution and selling. In 2006, Mattel is continuing to focus on improving the efficiency of its supply chain using Lean supply chain initiatives. The objective of the Lean program is to improve the flow of processes, do more with less and focus on the value chain from beginning to end.

The third goal is to further capitalize on Mattel's scale advantage. For example, as the world's largest toy company, Mattel believes it can realize cost savings when making purchasing decisions based on a One Mattel philosophy.

Table of Contents**Results of Operations****Second Quarter***Consolidated Results*

Net sales for the second quarter of 2006 were \$957.7 million, an 8% increase as compared to \$886.8 million in 2005, with no impact from changes in currency exchange rates. Net income for the second quarter of 2006 was \$37.4 million, or \$0.10 per diluted share, as compared to a net loss for the second quarter of 2005 of \$94.0 million, or \$0.23 per diluted share. Net income for the second quarter of 2006 included a tax benefit of \$6.2 million, primarily related to a settlement with a state tax authority. The net loss for the second quarter of 2005 included income tax expense of \$112.9 million related to the repatriation of unremitted foreign earnings under the American Jobs Creation Act (the Jobs Act). Gross profit, as a percentage of net sales, declined slightly from 43.6% in 2005 to 43.5% in 2006. External cost pressures, sales mix and higher royalty costs negatively impacted gross profit, but were largely offset by price increases implemented in 2006 and supply chain savings. Advertising and promotion expenses in the second quarter of 2006 were flat as a percentage of net sales, as compared to the second quarter of 2005. Other selling and administrative expenses, as a percentage of net sales decreased from 29.9% for the second quarter of 2005 to 27.7% for the second quarter of 2006, as a result of savings related to the streamlining of the Mattel Brands organization, partially offset by higher costs related to the new

American Girl Place® retail store and higher employee-related costs. The net loss in the second quarter of 2005 was significantly impacted by the aforementioned income tax expense.

The following table provides a summary of Mattel's consolidated results for the second quarter of 2006 and 2005 (in millions, except percentage and basis point information):

| | For the Three Months Ended June 30, | | | | | |
|---|-------------------------------------|----------|----------|----------|------------------|------------------------------|
| | 2006 | | 2005 | | Year/Year Change | |
| | Amount | % of Net | Amount | % of Net | % | Basis Points of Net Sales |
| | | Sales | | Sales | | |
| Net sales | \$ 957.7 | 100.0% | \$ 886.8 | 100.0% | 8% | |
| Gross profit | \$ 416.1 | 43.5% | \$ 386.8 | 43.6% | 8% | (10) |
| Advertising and promotion expenses | 100.6 | 10.5 | 93.1 | 10.5 | 8% | |
| Other selling and administrative expenses | 265.6 | 27.7 | 265.2 | 29.9 | 0% | (220) |
| Operating income | 49.9 | 5.2 | 28.5 | 3.2 | | 200 |
| Interest expense | 16.1 | 1.7 | 19.6 | 2.2 | -18% | (50) |
| Interest (income) | (6.4) | -0.7 | (12.4) | -1.4 | -48% | 70 |
| Other non-operating (income), net | (2.2) | | (4.7) | | | |
| Income before income taxes | \$ 42.4 | 4.4% | \$ 26.0 | 2.9% | | 150 |

Sales

Net sales for the second quarter of 2006 were \$957.7 million, an 8% increase as compared to \$886.8 million in 2005, with no impact from changes in currency exchange rates. Gross sales within the US increased 5% as compared to 2005 and accounted for 53.5% of consolidated gross sales in 2006 as compared to 55.1% in 2005. In 2006, gross sales in international markets increased 12%, as compared to 2005, including favorable changes in currency exchange rates of 1 percentage point.

Worldwide gross sales of Mattel Girls & Boys Brands increased 8% in the second quarter of 2006 to \$609.6 million, with no impact from changes in currency exchange rates. Domestic gross sales of Mattel Girls & Boys Brands products increased 7% and international gross sales increased 9%, with no impact from changes in currency exchange rates. Worldwide gross sales for Barbie® declined 1% from 2005, with no impact from changes in currency exchange rates. Domestic gross sales of Barbie® increased 2%, primarily driven by sales of Barbie® Mermaidia and Barbie® Diaries. International gross sales of Barbie® declined 3%, including a

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1 percentage point benefit from changes in currency exchange rates. Worldwide gross sales of Other Girls Brands decreased 1%, including a 1 percentage point benefit from changes in currency exchange rates. The sales decrease for Other Girls Brands as compared to the second quarter of 2005 was the result of declining sales of product lines introduced in the prior year, including Furryville and Doggie DayCare, offset by strong sales of Pixel Chix and Polly Pocket!. Worldwide gross sales in the Wheels category declined 6%, with a 1 percentage point benefit from changes in currency exchange rates, primarily as a result of declines in Hot Wheels® and Tyco® R/C domestically, partially offset by growth in Hot Wheels® and Matchbox® internationally. Worldwide gross sales in the Entertainment category increased 38%, with no impact from changes in currency exchange rates, primarily driven by strong sales of CARS and Superman in the second quarter of 2006, which more than offset sales declines in Batman, as well as growth of Scene It? internationally and UNO® worldwide.

Worldwide gross sales of Fisher-Price Brands increased 8% in the second quarter of 2006 to \$365.7 million, with no impact from changes in currency exchange rates. Worldwide sales of Core Fisher-Price® increased 10%, including a 1 percentage point benefit from changes in currency exchange rates, primarily driven by continued strength in sales of newborn and BabyGear products. Worldwide gross sales of Fisher-Price® Friends increased 5% with no impact from changes in currency exchange rates, driven primarily by continued strength of Dora the Explorer and other Nickelodeon® properties.

American Girl Brands gross sales increased 5% in the second quarter of 2006 to \$61.6 million as compared to \$58.8 million in the second quarter of 2005. The increase was primarily driven by the opening of the American Girl Place® retail store in Los Angeles, California in April 2006.

Gross Profit

Gross profit, as a percentage of net sales, was 43.5% in the second quarter of 2006, as compared to 43.6% in the second quarter of 2005. External cost pressures, sales mix and higher royalty costs negatively impacted gross profit, as a percentage of net sales, but were largely offset by price increases and supply chain savings.

Advertising and Promotion Expenses

Advertising and promotion expenses were 10.5% of net sales in the second quarter of 2006, and flat with 2005 as a percentage of net sales.

Other Selling and Administrative Expenses

Other selling and administrative expenses were \$265.6 million, or 27.7% of net sales, in the second quarter of 2006, as compared to \$265.2 million, or 29.9% of net sales, in the second quarter of 2005. Other selling and administrative expenses increased in 2006, primarily driven by higher costs related to the new American Girl Place® retail store and higher employee-related costs, partially offset by savings related to the streamlining of the Mattel Brands organization.

Non-Operating Items

Interest expense decreased from \$19.6 million in the second quarter of 2005 to \$16.1 million in the second quarter of 2006, due to lower average borrowings, partially offset by higher interest rates. Interest (income) decreased from \$12.4 million in the second quarter of 2005 to \$6.4 million in the second quarter of 2006 due to lower average cash balances during the quarter, partially offset by higher interest rates. Other non-operating (income), net was \$2.2 million in the second quarter of 2006 as compared to \$4.7 million in the second quarter of 2005. Other non-operating (income), net included pre-tax gains on sales of marketable securities of \$5.2 million (\$3.3 million net of tax) in the second quarter of 2005.

As of June 30, 2006, Mattel held no marketable securities.

Business Segment Results

Mattel's reportable segments are separately managed business units and are divided on a geographic basis between domestic and international. The Domestic segment is further divided into Mattel Girls & Boys Brands US, Fisher-Price Brands US and American Girl Brands.

Table of Contents*Domestic Segment*

Mattel Girls & Boys Brands US gross sales increased 7% in the second quarter of 2006, as compared to the second quarter of 2005. Within this segment, Barbie® gross sales increased 2% and gross sales of Other Girls Brands decreased 16%. Gross sales in the Wheels category decreased 17% driven by sales declines in Hot Wheels® and Tyco® R/C products. Gross sales increased double digits in the Entertainment category, driven by strong sales of CARS and Superman in the second quarter of 2006, which more than offset sales declines in Batman. Mattel Girls & Boys Brands US segment income increased 24% to \$34.4 million in the second quarter of 2006, primarily due to increased sales volume.

Fisher-Price Brands US gross sales increased 4% in the second quarter of 2006, as compared to the second quarter of 2005, with strong sales growth of Core Fisher-Price® and Power Wheels® products. Fisher-Price Brands US segment income increased from

\$8.2 million in the second quarter of 2005 to \$19.7 million in the second quarter of 2006, due primarily to improved gross profit as a percentage of net sales, increased sales volume and lower other selling and administrative costs.

American Girl Brands gross sales increased 5% in the second quarter of 2006, as compared to the second quarter of 2005, primarily driven by the successful opening of the American Girl Place® retail store in Los Angeles, California. American Girl Brands segment income decreased from \$4.0 million in the second quarter of 2005 to \$0.5 million in the second quarter of 2006, primarily due to increased other selling and administrative costs associated with the opening of the American Girl Place® retail store in Los Angeles, California.

International Segment

The following table provides a summary of percentage changes in gross sales within the International segment for the second quarter of 2006 versus 2005:

| Non-US Regions: | % Change in Gross Sales | Impact of Change in Currency (in % pts) |
|----------------------------|------------------------------------|--|
| Europe | 4 | 1 |
| Latin America | 24 | 2 |
| Asia Pacific | 17 | (2) |
| Other | 15 | 7 |
| Total International | 12 | 1 |

International gross sales increased by 12% in the second quarter of 2006, as compared to the second quarter of 2005, including a 1 percentage point benefit from changes in currency exchange rates. Gross sales of Barbie® decreased 3%, including a 1 percentage point benefit from changes in currency exchange rates. Gross sales of Other Girls Brands increased double digits, primarily as a result of strong sales of Pixel Chix. Gross sales increased in the Wheels category, reflecting growth in Hot Wheels® and Matchbox®. Gross sales increased double digits in the Entertainment category, driven by sales of CARS and Superman, which more than offset sales declines of Batman. Fisher-Price Brands gross sales increased 18%, including a 1 percentage point benefit from changes in currency exchange rates, driven by strong sales in both Core

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Fisher-Price® and Fisher-Price® Friends. International segment income increased from \$13.4 million in the second quarter of 2005 to \$34.8 million in the second quarter of 2006, primarily due to increased sales volume.

Table of Contents**Results of Operations First Half***Consolidated Results*

Net sales for the first half of 2006 were \$1.75 billion, a 5% increase as compared to \$1.67 billion in 2005, with no impact from changes in currency exchange rates. Net income for the first half of 2006 was \$67.6 million, or \$0.17 per diluted share, as compared to a net loss of \$87.5 million, or \$0.21 per diluted share. Net income for the first half of 2006 was positively impacted by \$63.0 million of income tax benefits, primarily related to audit settlements with state and foreign tax authorities. The net loss for the first half of 2005 included income tax expense of \$112.9 million related to the repatriation of unremitted foreign earnings under the Jobs Act. Lower gross profit, as a percentage of net sales, and higher selling and administrative expenses partially offset these income tax benefits. Gross profit, as a percentage of net sales, declined from 43.8% in 2005 to 42.7% in 2006. External cost pressures, sales mix and higher royalty costs were the primary causes of the decline in gross profit. Other selling and administrative costs in the first half of 2006 included a \$15.2 million charge for severance primarily related to the streamlining of the Mattel Brands organization. The net loss in the first half of 2005 was significantly impacted by the aforementioned income tax expense.

The following table provides a summary of Mattel's consolidated results for the first half of 2006 and 2005 (in millions, except percentage and basis point information):

| | For the Six Months Ended June 30, | | | | | |
|---|-----------------------------------|----------|------------|----------|------------------|------------------------------|
| | 2006 | | 2005 | | Year/Year Change | |
| | Amount | % of Net | Amount | % of Net | % | Basis Points of Net Sales |
| | | Sales | | Sales | | |
| Net sales | \$ 1,751.0 | 100.0% | \$ 1,669.9 | 100.0% | 5% | |
| Gross profit | \$ 748.1 | 42.7% | \$ 730.8 | 43.8% | 2% | (110) |
| Advertising and promotion expenses | 189.4 | 10.8 | 180.8 | 10.8 | 5% | |
| Other selling and administrative expenses | 540.8 | 30.9 | 516.0 | 30.9 | 5% | |
| Operating (loss) income | 17.9 | 1.0 | 34.0 | 2.1 | | (110) |
| Interest expense | 31.3 | 1.8 | 37.2 | 2.2 | -16% | (40) |
| Interest (income) | (15.3) | -0.9 | (24.5) | -1.5 | 38% | 60 |
| Other non-operating (income), net | (4.0) | | (13.6) | | | |
| Income before income taxes | \$ 5.9 | 0.3% | \$ 34.9 | 2.1% | | (180) |

Sales

Net sales for the first half of 2006 were \$1.75 billion, a 5 percentage point increase as compared to \$1.67 billion in 2005, with no impact from changes in currency exchange rates. Gross sales within the US increased 4% as compared to 2005 and accounted for 55.0% of consolidated

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gross sales in 2006 as compared to 55.5% in 2005. In 2006, gross sales in international markets increased 6% as compared to 2005, including unfavorable changes in currency exchange rates of 2 percentage points.

Worldwide gross sales of Mattel Girls & Boys Brands increased 2% in the first half of 2006 to \$1.10 billion, including an unfavorable change in currency exchange rates of 1 percentage point. Domestic gross sales of Mattel Girls & Boys Brands products increased 2% and international gross sales increased 3%, including an unfavorable change in currency exchange rates of 1 percentage point. Worldwide gross sales for Barbie® declined 5% from 2005, including unfavorable changes in currency exchange rates of 2 percentage points. Domestic gross sales of Barbie® increased 1%, while International gross sales of Barbie® declined 8%, including an unfavorable change in currency exchange rates of 1 percentage point. Worldwide gross sales of Other Girls Brands increased 10%, including an unfavorable change in currency exchange rates of 1 percentage point. The sales growth for Other Girls Brands as compared to the first half of 2005 was driven by Pixel Chix, Winx Club and Polly Pocket!. Worldwide gross sales in the Wheels category declined 5%, with no impact from changes in currency exchange rates, driven by sales declines in Hot Wheels® and

Tyco® R/C products. Worldwide gross sales in the Entertainment category increased 15%, including an unfavorable change in currency exchange rates of 1 percentage point, primarily driven by strong sales of CARS and Superman, which more than offset sales declines in Batman.

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Worldwide gross sales of Fisher-Price Brands increased 12% in the first half of 2006 to \$673.0 million, with no impact from changes in currency exchange rates. Worldwide sales of Core Fisher-Price® increased 11%, with no impact from changes in currency exchange rates, primarily driven by continued growth in the BabyGear line and newborn products. Worldwide gross sales of

Fisher-Price® Friends grew 11%, including an unfavorable change in currency exchange rates of 1 percentage point, driven by continued strength of Dora the Explorer and increased sales of other Nickelodeon® properties. Power Wheels® gross sales also grew worldwide.

American Girl Brands gross sales decreased 2% in the first half of 2006 to \$123.5 million as compared to \$126.4 million in the first half of 2005. The decline was primarily driven by the strong sales of the 2005 Girl of the Year doll, Marisol, in the first half of 2005, offset by sales from the opening of the third American Girl Place® retail store in Los Angeles, California in April 2006.

Gross Profit

Gross profit, as a percentage of net sales, was 42.7% in the first half of 2006, as compared to 43.8% in the first half of 2005. The decrease in gross profit, as a percentage of net sales, resulted from the impact of sales mix, external cost pressures and higher royalty costs, partially offset by price increases and supply chain savings.

Advertising and Promotion Expenses

Advertising and promotion expenses were 10.8% of net sales in the first half of 2006, and flat with 2005 as a percentage of net sales.

Other Selling and Administrative Expenses

Other selling and administrative expenses were \$540.8 million, or 30.9% of net sales, in the first half of 2006 as compared to \$516.0 million, or 30.9% of net sales, in the first half of 2005. Other selling and administrative expenses increased in 2006, primarily due to the following:

Higher employee-related costs;

\$15.2 million of severance charges, primarily related to the streamlining of the Mattel Brands organization, offset by cost savings; and

Costs associated with the American Girl Place® retail store in Los Angeles, California that opened in April 2006.

Non-Operating Items

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Interest expense decreased from \$37.2 million in the first half of 2005 to \$31.3 million in the first half of 2006, due to lower average borrowings, partially offset by higher interest rates. Interest (income) decreased from \$24.5 million in the first half of 2005 to

\$15.3 million in the first half of 2006, due to lower average cash balances, partially offset by higher interest rates. Other non-operating (income), net was \$4.0 million in the first half of 2006 as compared to \$13.6 million in the first half of 2005, which was mainly comprised of gains from the sale of marketable securities in 2005.

Business Segment Results

Mattel's reportable segments are separately managed business units and are divided on a geographic basis between domestic and international. The Domestic segment is further divided into Mattel Girls & Boys Brands US, Fisher-Price Brands US and American Girl Brands.

Domestic Segment

Mattel Girls & Boys Brands US gross sales increased 2% in the first half of 2006, as compared to the first half of 2005. Within this segment, Barbie® gross sales increased 1% and sales of Other Girls Brands decreased 6%. Gross sales in the Wheels category decreased double digits. Sales growth in the Entertainment category increased double digits, driven by sales of CARS and Superman, which more than offset sales declines in Batman. Mattel Girls & Boys Brands US segment income increased 8% to \$47.8 million in the first half of 2006, primarily due to increased sales volume and improved gross profit, as a percentage of net sales.

Fisher-Price Brands US gross sales increased 10% in the first half of 2006, as compared to the first half of 2005, with strong sales growth of Core Fisher-Price®, Fisher-Price® Friends and Power Wheels® products. Fisher-Price Brands US segment income increased from \$6.6 million in the first half of 2005 to \$18.9 million in the first half of 2006, primarily driven by increased sales volume.

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American Girl Brands gross sales decreased 2% in the first half of 2006, as compared to the first half of 2005, primarily driven by strong sales of the 2005 Girl of the Year doll, Marisol in the first half of 2005, partially offset by the April 2006 opening of the

American Girl Place® retail store in Los Angeles, California. American Girl Brands segment income decreased from \$11.8 million in the first half of 2005 to \$0.6 million in the first half of 2006, primarily due to decreased sales volume and increased other selling and administrative costs associated with the opening of the American Girl Place® retail store in Los Angeles, California.

International Segment

The following table provides a summary of percentage changes in gross sales within the International segment for the first half of 2006 versus 2005:

| | % Change in Gross Sales | Impact of Change in Currency (in % pts) |
|----------------------------|----------------------------|---|
| Non-US Regions: | | |
| Europe | (1) | (3) |
| Latin America | 19 | 3 |
| Asia Pacific | 10 | (2) |
| Other | 25 | 7 |
| Total International | 6 | (2) |

International gross sales increased 6% in the first half of 2006, as compared to the first half of 2005, including unfavorable changes in currency exchange rates of 2 percentage points. Gross sales of Barbie® decreased 8%, including an unfavorable change in currency exchange rates of 1 percentage point. Gross sales of Other Girls Brands increased double digits, primarily as a result of higher sales of Pixel Chix, Winx Club, and Polly Pocket!. Gross sales increased 5% in the Wheels category, including an unfavorable change in currency rates of 1 percentage point, reflecting growth in Hot Wheels® and Matchbox®. Gross sales increased in the Entertainment category, driven by strong sales of CARS, Ice Age and Superman properties. Fisher-Price Brands gross sales increased 16%, including an unfavorable change in currency exchange rates of 1 percentage point, driven by strong sales in both Core Fisher-Price® and Fisher-Price® Friends. International segment income increased from \$23.1 million in the first half of 2005 to \$40.2 million in the first half of 2006 primarily due to increased sales volume.

Income Taxes

In the normal course of business, Mattel is regularly audited by federal, state and foreign tax authorities. During the three months ended March 31, 2006, Mattel settled multiple ongoing audits by foreign tax authorities and as a result of the settlements, Mattel recognized income tax benefits of \$56.8 million during the first quarter of 2006. During the three months ended June 30, 2006, Mattel recognized income tax benefits of \$6.2 million primarily due to a settlement with a state tax authority for tax years 1997 and 1998.

On May 17, 2006, the Tax Increase Prevention and Reconciliation Act (the Tax Act) was signed into law. Management expects the Tax Act to lower Mattel's 2006 provision for income taxes by approximately 3 to 4 percentage points. The provision for income taxes for the three months

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ended June 30, 2006 was calculated based on the new lower expected tax rate for fiscal year 2006, and also included an appropriate net catch-up adjustment of \$1.6 million. This adjustment was necessary to appropriately adjust the tax provision for the six months ended June 30, 2006 to the lower expected annual tax rate. Future law changes by Congress or guidance from the Internal Revenue Service with respect to these new rules may further impact Mattel's estimates and could require further adjustments to future tax provisions. The impact of such future changes, if any, will be reflected in the financial reporting period in which any such change is enacted or becomes effective.

The consolidated statements of operations for the three and six months ended June 30, 2005 included a provision for income taxes of \$112.9 million for the total amount of earnings repatriated under the American Jobs Creation Act (the Jobs Act), which was signed into law on October 22, 2004. Among its various provisions, the Jobs Act created a temporary incentive for US corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. In the fourth quarter of 2005, management changed its estimate of the tax liability associated with the repatriated earnings to \$107.0 million and recorded the \$5.9 million adjustment to the provision for income taxes in that period.

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Liquidity and Capital Resources

Mattel's primary sources of liquidity are its cash balances and access to short-term borrowing facilities. Cash flows from operations could be negatively impacted by decreased demand for Mattel's products, which could result from factors such as adverse economic conditions and changes in public and consumer preferences, or by increased costs associated with manufacturing and distribution of products or shortages in raw materials or component parts. Additionally, Mattel's ability to issue long-term debt and obtain seasonal financing could be adversely affected by factors such as an inability to meet its debt covenant requirements, which include maintaining consolidated debt-to-capital and interest coverage ratios, or a deterioration of Mattel's credit ratings. Mattel's ability to conduct its operations could be negatively impacted should these or other adverse conditions affect its primary sources of liquidity.

Capital and Investment Framework

To guide future capital deployment decisions, with a goal of maximizing shareholder value, Mattel's Board of Directors in 2003 established the following capital and investment framework:

To maintain approximately \$800 million to \$1 billion in year-end cash available to fund a substantial portion of seasonal working capital;

To maintain a year-end debt-to-capital ratio of about 25%;

To invest approximately \$180 million to \$200 million in capital expenditures annually to maintain and grow the business;

To make strategic acquisitions consistent with Mattel's vision of providing the world's premier toy brands today and tomorrow; and

To return excess funds to shareholders through dividends and share repurchases.

Over the long-term, assuming cash flows from operating activities remain strong, Mattel plans to use its free cash flows to invest in strategic acquisitions and to return funds to shareholders through cash dividends and, depending on market conditions, share repurchases. However, the ability to implement successfully the capital deployment plan is directly dependent on Mattel's ability to generate strong cash flows from operating activities. There is no assurance that Mattel will continue to generate strong cash flows from operating activities or achieve its targeted goals from investing activities.

On July 25, 2006, Mattel entered into an agreement to acquire Radica Games Limited (Radica) for approximately \$230 million in cash. Consummation of the transaction is subject to customary closing conditions, including, among other things, approval by 75% of Radica's shareholders voting on the amalgamation and certain regulatory approvals, including expiration or termination of any required waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, and is expected to occur in the fourth quarter of 2006.

Operating Activities

Cash flows used for operating activities were \$357.9 million in the first half of 2006, as compared to \$551.1 million in the first half of 2005. The decrease in cash flows used for operating activities was primarily due to a decrease in the use of cash for working capital requirements in 2006, primarily as a result of lower net tax payments in 2006 and changes in the amount and timing of other payable payments.

Investing Activities

Cash flows used for investing activities in the first half of 2006 increased \$34.5 million to \$66.5 million, as compared to \$32.0 million in the first half of 2005, mainly due to proceeds received from the sale of investments in 2005, an increase in other property, plant and equipment purchases in 2006, primarily related to the construction of the new American Girl Place® in Los Angeles, California and investment in Mattel's long-term information technology strategy.

Financing Activities

Cash flows from financing activities in the first half of 2006 were \$47.1 million, as compared to cash flow used for financing activities of \$203.0 million in the first half of 2005. The increase in cash flows from financing activities was primarily due to the issuance of \$300.0 million of senior notes in June 2006 and lower share repurchases, partially offset by the repayment of \$100.0 million on the foreign revolving loan facility in June 2006 and repayment of \$30.0 million of medium-term notes in May 2006.

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Mattel maintains and periodically amends or replaces a domestic unsecured committed revolving credit facility with a commercial bank group that is used as the primary source of financing for the seasonal working capital requirements of its domestic subsidiaries. The current agreement was amended and restated in March 2005 and expires on March 23, 2010. The terms and conditions of the amended and restated facility are substantially similar to those contained in the previous facility. Interest is charged at various rates selected by Mattel, ranging from market commercial paper rates to the bank reference rate. The domestic unsecured committed revolving credit facility contains a variety of covenants, including financial covenants that require Mattel to maintain certain consolidated debt-to-capital and interest coverage ratios. Specifically, Mattel is required to meet these financial covenant ratios at the end of each fiscal quarter and fiscal year, using the formulae specified in the credit agreement to calculate the ratios. Mattel was in compliance with such covenants at the end of the second quarter of 2006. As of June 30, 2006, Mattel's consolidated debt-to-capital ratio, as calculated per the terms of the credit agreement, was 0.33 to 1 (compared to a maximum allowed of 0.60 to 1) and Mattel's interest coverage ratio was 12.27 to 1 (compared to a minimum allowed of 3.50 to 1).

On December 9, 2005, Mattel, Mattel Asia Pacific Sourcing Limited ("MAPS"), a wholly-owned subsidiary of Mattel, Bank of America, N.A., as a lender and administrative agent, and other financial institutions executed a credit agreement (the "MAPS facility") which provides for (i) a term loan facility of \$225.0 million consisting of a term loan advanced to MAPS in the original principal amount of \$225.0 million, with \$50.0 million of such amount to be repaid by MAPS on each of December 15, 2006 and December 15, 2007, and the remaining aggregate principal amount of \$125.0 million to be repaid on December 9, 2008 and (ii) a revolving loan facility consisting of revolving loans advanced to MAPS in the maximum aggregate principal amount at any time outstanding of \$100.0 million, with a maturity date of December 9, 2008. Interest is charged at various rates selected by Mattel based on Eurodollar rates or bank reference rates. In connection with the MAPS facility, Mattel executed a Continuing Guaranty Agreement pursuant to which Mattel unconditionally guaranteed the obligations of MAPS arising pursuant to the MAPS facility. The MAPS facility contains a variety of covenants, including financial covenants that require Mattel to maintain certain consolidated debt-to-capital and interest coverage ratios at the end of each fiscal quarter and fiscal year, using the formulae specified and ratios allowed in the MAPS facility to calculate the ratios. The formulae specified in the MAPS facility are the same as those required by the domestic unsecured committed revolving credit facility. Mattel was in compliance with such covenants at June 30, 2006.

The domestic unsecured committed revolving credit facility and the MAPS facility are material agreements and failure to comply with the financial covenant ratios may result in an event of default under the terms of the facilities. If Mattel defaulted under the terms of the domestic unsecured committed revolving credit facility or the MAPS facility, its ability to meet its seasonal financing requirements could be adversely affected.

To finance seasonal working capital requirements of certain foreign subsidiaries, Mattel avails itself of individual short-term credit lines with a number of banks. Mattel expects to extend these credit lines throughout 2006.

In June 2006, Mattel issued \$100.0 million of unsecured floating rate senior notes ("Floating Rate Senior Notes") due June 15, 2009 and \$200.0 million of unsecured 6.125% senior notes ("6.125% Senior Notes") due June 15, 2011 (collectively "Senior Notes"). Interest on the Floating Rate Senior Notes is based on the three-month US Dollar London Interbank Offered Rate ("LIBOR") plus 40 basis points with interest payable quarterly beginning September 15, 2006. Interest on the 6.125% Senior Notes is payable semi-annually beginning December 15, 2006. The 6.125% Senior Notes may be redeemed at any time at the option of Mattel at a redemption price equal to the greater of (i) the principal amount of the notes being redeemed plus accrued interest to the redemption date, and (ii) a "make whole" amount based on the yield of a comparable US Treasury security plus 20 basis points.

In June 2006, Mattel entered into two interest rate swap agreements on the \$100.0 million Floating Rate Senior Notes, each in a notional amount of \$50.0 million, for the purpose of hedging the variability of cash flows in the interest payments due to fluctuations of the LIBOR benchmark

interest rate. These cash flow hedges are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, whereby the hedges are reported in Mattel's consolidated balance sheets at fair value, with changes in the fair value of the hedges reflected in accumulated other comprehensive income. Under the terms of the agreements, Mattel will receive quarterly interest payments from the swap counterparties based on the three-month LIBOR plus 40 basis points and make semi-annual interest payments to the swap counterparties based on a fixed rate of 5.87125%. The three-month LIBOR rate used to determine interest payments under the interest rate swap agreements resets every three months, matching the variable interest on the Floating Rate Senior Notes. The agreements expire in June 2009.

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In October 2005, a major credit rating agency maintained its long-term rating for Mattel at BBB but changed its long-term outlook to negative and reduced its short-term rating to A-3. Also in October 2005, another major credit rating agency maintained its long-term rating for Mattel at Baa2, but changed its long-term outlook to negative. In March 2006, one of those credit rating agencies reduced Mattel's long-term credit rating to BBB- and changed the outlook from negative to stable. In May 2006, another major credit rating agency reduced Mattel's long-term credit rating to BBB. Management does not expect these actions to have a significant impact on Mattel's ability to obtain financing or to have a significant negative impact on Mattel's liquidity or results of operations.

Mattel believes its cash on hand at the beginning of 2006, amounts available under its domestic unsecured committed revolving credit facility, the MAPS facility, its uncommitted money market facility, the proceeds from the issuance of the \$300.0 million of Senior Notes in June 2006 and its foreign credit lines will be adequate to meet its seasonal financing requirements in 2006.

Mattel sells certain domestic and foreign trade receivables as one of its means for financing its seasonal working capital requirements. Mattel has a \$300.0 million domestic receivables sales facility that is a sub-facility of Mattel's domestic unsecured committed revolving credit facility. The outstanding amount of receivables sold under the domestic receivables facility may not exceed \$300.0 million at any given time, and the amount available to be borrowed under the credit facility is reduced to the extent of any such outstanding receivables sold. Under the domestic receivables facility, certain trade receivables are sold to a group of banks, which currently include, among others, Bank of America, N.A., as administrative agent, Citicorp USA, Inc. and Barclays Bank PLC, as co-syndication agents, and Societe Generale and BNP Paribas, as co-documentation agents. Pursuant to the domestic receivables facility, Mattel Sales Corp. and Fisher-Price, Inc. (which are wholly-owned subsidiaries of Mattel) can sell eligible trade receivables from Wal-Mart and Target to Mattel Factoring, Inc. (Mattel Factoring), a Delaware corporation and wholly-owned, consolidated subsidiary of Mattel. Mattel Factoring is a special purpose entity whose activities are limited to purchasing and selling receivables under this facility. Pursuant to the terms of the domestic receivables facility and simultaneous with each receivables purchase, Mattel Factoring sells those receivables to the bank group. Mattel records the transaction, reflecting cash proceeds and sale of accounts receivable in its consolidated balance sheet, at the time of the sale of the receivables to the bank group.

Mattel International Holdings B.V., a company incorporated in the Netherlands, Mattel France S.A.S., a company incorporated in France, and Mattel GmbH, a company incorporated in Germany, each of which is a subsidiary of Mattel, and Societe Generale Bank Nederland N.V. are parties to a Master Agreement for the Transfer of Receivables establishing a Euro 150 million European trade receivables facility, pursuant to which Mattel France S.A.S. and Mattel GmbH may sell trade receivables to Societe Generale Bank Nederland N.V. As with the domestic receivables facility, each sale of accounts receivable is recorded in Mattel's consolidated balance sheet at the time of such sale. No Mattel subsidiary is used as a special purpose entity in connection with these transactions. Under the European trade receivables facility, the outstanding amount of receivables sold may not exceed Euro 60 million from February 1 through July 31 of each year and may not exceed Euro 150 million at all other times. Pursuant to a letter agreement between Societe Generale Bank Nederland N.V. and Mattel International Holdings B.V., Mattel France S.A.S. and Mattel GmbH effective June 23, 2006, the commitment termination date for the European trade receivables facility was extended to

November 30, 2006.

The outstanding amounts of accounts receivable that have been sold under these facilities and other factoring arrangements, net of collections from customers, have been excluded from Mattel's consolidated balance sheets and are summarized as follows:

| (In millions) | June 30, 2006 | June 30, 2005 | December 31, 2005 |
|-------------------------------|---------------|---------------|-------------------|
| Receivables sold pursuant to: | | | |
| Domestic receivables facility | \$ 51.3 | \$ 59.2 | \$ 251.4 |
| European receivables facility | 64.2 | 50.4 | 95.9 |
| Other factoring arrangements | 13.7 | 10.7 | 95.8 |

| | | | |
|--|-----------------|-----------------|-----------------|
| | <u>\$ 129.2</u> | <u>\$ 120.3</u> | <u>\$ 443.1</u> |
|--|-----------------|-----------------|-----------------|

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Mattel's cash and equivalents at June 30, 2006 decreased \$372.7 million to \$625.1 million, as compared to year-end 2005, primarily due to the payment of various year-end 2005 accrued liability balances, repayment of \$100.0 million on the MAPS revolving loan facility and repurchase of \$155.6 million of treasury shares in 2006, partially offset by proceeds from the issuance of \$300.0 million of Senior Notes in June 2006 and the collection of year-end 2005 accounts receivable balances in 2006. Accounts receivable, net decreased \$16.9 million to \$743.7 million at June 30, 2006, as compared to year-end 2005 due to the seasonality of sales and collections.

The current portion of long-term debt decreased \$118.6 million to \$100.0 million at June 30, 2006, as compared to \$218.6 million at June 30, 2005, primarily due to the repayment of \$150.0 million of 6 1/8% senior notes in the third quarter of 2005, repayment of the \$38.6 million mortgage note in the fourth quarter of 2005 and repayment of \$30.0 million of medium-term notes in May 2006, partially offset by the reclassification from long-term debt to current portion of long-term debt of \$20.0 million of medium-term notes maturing in September 2006, \$50.0 million related to the MAPS term loan maturing in December 2006 and \$30.0 million of medium-term notes maturing in May 2007. Accounts payable and accrued liabilities decreased \$262.5 million since year-end 2005 to \$799.9 million at June 30, 2006, mainly due to the payment of various year-end 2005 accrued liability balances, including receivables collections due to bank related to the European receivables facility, incentive compensation, advertising and royalty obligations.

A summary of Mattel's capitalization is as follows:

| (In millions, except percentage information) | June 30, 2006 | | June 30, 2005 | | December 31, 2005 | |
|--|---------------|------|---------------|------|-------------------|------|
| Medium-term notes | \$ 320.0 | 10% | \$ 370.0 | 14% | \$ 350.0 | 12% |
| Senior notes | 300.0 | 10 | | | | |
| Term loan facility | 175.0 | 6 | | | 175.0 | 6 |
| Total long-term debt | 795.0 | 26 | 370.0 | 14 | 525.0 | 18 |
| Other long-term liabilities | 291.8 | 9 | 242.1 | 9 | 282.4 | 10 |
| Stockholders' equity | 2,053.8 | 65 | 2,071.0 | 77 | 2,101.7 | 72 |
| | \$ 3,140.6 | 100% | \$ 2,683.1 | 100% | \$ 2,909.1 | 100% |

Total long-term debt increased \$425.0 million at June 30, 2006, as compared to June 30, 2005 due to borrowings under the MAPS term loan facility (of which \$175.0 million is classified as long-term at June 30, 2006) and \$300.0 million of Senior Notes borrowings (all of which is classified as long-term at June 30, 2006), partially offset by the reclassification of \$50.0 million of medium-term notes maturing in the next twelve months to current portion of long-term debt. Mattel expects to satisfy its future long-term capital needs through the generation of corporate earnings and issuance of long-term debt instruments. Stockholders' equity of \$2.1 billion, decreased \$17.2 million since June 30, 2005, primarily as a result of the share repurchases during 2005 and 2006 and payment of the annual dividend in the fourth quarter of 2005, offset by net income from operations.

Mattel's debt-to-capital ratio, including short-term borrowings and current portion of long-term debt, increased from 23.0% at June 30, 2005 to 31.1% at June 30, 2006. Mattel's objective is to continue to maintain a year-end debt-to-capital ratio of approximately 25%.

Litigation

See Part II, Item 1 – Legal Proceedings.

Application of Critical Accounting Policies

Mattel's critical accounting policies are included in its Annual Report on Form 10-K for the year ended December 31, 2005 and have not changed, except for Mattel's accounting for share-based payments in connection with the January 1, 2006 adoption of Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*.

Share-Based Payments

Prior to January 1, 2006, Mattel applied the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its employee stock compensation plans. All employee stock options were granted at or above the grant date market price and, accordingly, no compensation expense was recognized in the consolidated statements of operations for these employee stock options. Instead, the amount of compensation expense that would have resulted if Mattel had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, was included as a proforma disclosure in the financial statement footnotes.

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Effective January 1, 2006, Mattel adopted the fair value recognition provisions of SFAS No. 123(R) using the modified-prospective transition method. Accordingly, results for prior periods have not been restated and compensation cost in 2006 includes the portion of share-based payment awards attributable to employee service during the period for (i) grants made prior to January 1, 2006, but not previously included in the proforma expense disclosures in Mattel's financial statements, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (ii) grants made subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

Beginning January 1, 2006 and in connection with the adoption of SFAS No. 123(R), Mattel recognizes the cost of all new employee share-based payment awards on a straight-line attribution basis over their respective vesting periods, net of estimated forfeitures; whereas, prior to January 1, 2006, Mattel used the graded vesting attribution method prescribed by Financial Accounting Standards Board (FASB) Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. In accounting for the income tax benefits associated with employee exercises of share-based payments, Mattel has elected to adopt the alternative simplified method as permitted by FASB Staff Position (FSP) No. FAS 123(R)-3, *Accounting for the Tax Effects of Share-Based Payment Awards*. FSP No. FAS 123(R)-3 permits the adoption of either the transition guidance described in SFAS No. 123(R) or the alternative simplified method specified in the FSP to account for the income tax effects of share-based payment awards. In determining when additional tax benefits associated with share-based payment exercises are recognized, Mattel follows the ordering of deductions of the tax law, which allows deductions for share-based payment exercises to be utilized before previously existing net operating loss carryforwards. In computing dilutive shares under the treasury stock method, Mattel does not reduce the tax benefit amount within the calculation for the amount of deferred tax assets that would have been recognized had Mattel previously expensed all share-based payment awards.

Determining the fair value of share-based awards at the grant date requires judgment, including estimating the expected term that stock options will be outstanding prior to exercise, the associated volatility and the expected dividends. The fair value of options granted has been estimated using the Black-Scholes valuation model. The expected life of the options used in this calculation is the period of time the options are expected to be outstanding and has been determined based on historical exercise experience. Expected stock price volatility is based on the historical volatility of Mattel's stock for a period approximating the expected life, the expected dividend yield is based on Mattel's historical annual dividend payout, and the risk-free interest rate is based on the implied yield available on US Treasury zero-coupon issues. Judgment is also required in estimating the amount of share-based awards that will be forfeited prior to vesting.

The following weighted average assumptions were used in determining fair value for options granted:

| (In thousands) | During the Three Months Ended | | During the Six Months Ended | |
|--|-------------------------------|----------|-----------------------------|----------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2006 | 2005 | 2006 | 2005 |
| Expected life (in years) | 4.87 | 7.39 | 4.87 | 6.79 |
| Risk-free interest rate | 4.12% | 3.99% | 4.12% | 3.93% |
| Volatility factor | 27.30% | 36.95% | 27.30% | 36.55% |
| Dividend yield | 2.41% | 1.23% | 2.41% | 1.28% |
| Weighted average fair value per granted option | \$ 4.48 | \$ 7.55 | \$ 4.48 | \$ 7.27 |

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The fair value per option was lower in 2006 than in 2005 due primarily to a lower volatility factor and a shorter expected life. The shorter expected life was determined through a detailed study of historical exercise experience, and the shorter expected life impacted the period that was considered in developing other assumptions including volatility. The following table summarizes the sensitivity of valuation assumptions within the calculation of stock option fair values, if all other assumptions are held constant:

| | Increase in Assumption Factor | Increase (Decrease) in Fair Value (in % pts) |
|--------------------------|--|---|
| Expected life (in years) | 1 year | 7.8 |
| Risk-free interest rate | 1% | 7.4 |
| Volatility factor | 1% | 2.9 |
| Dividend yield | 1% | (11.6) |

| | (Decrease) in Assumption Factor | Increase (Decrease) in Fair Value (in % pts) |
|--------------------------|--|---|
| Expected life (in years) | (1) year | (9.4) |
| Risk-free interest rate | (1)% | (7.1) |
| Volatility factor | (1)% | (2.9) |
| Dividend yield | (1)% | 12.7 |

On December 28, 2005, the Compensation Committee of the Board of Directors of Mattel approved the acceleration of vesting of options for approximately 12.4 million shares with an exercise price of \$16.09 or greater granted to employees other than Mattel's Chairman and Chief Executive Officer. Vesting was not accelerated for stock options held by any member of the Board of Directors. The primary purpose of the accelerated vesting was to avoid recognizing future compensation expense associated with the accelerated stock options under SFAS No. 123(R). Additionally, for financial reporting purposes, there may be other potential tax benefits derived from accelerating the vesting of stock options. Due to the acceleration of vesting in 2005, future share-based payment grants are expected to impact Mattel's statements of operations more significantly than in the current period. For those future grants, different valuation assumptions, or actual forfeitures differing significantly from estimated forfeitures, could have a material effect on Mattel's future financial statements. Additionally, Mattel is evaluating the types of share-based payment awards it grants to employees and different types of share-based payment awards may be granted in the future.

Mattel recognized compensation expense of \$0.5 million and \$1.1 million, respectively, for stock options during the three and six months ended June 30, 2006 as a component of other selling and administrative expenses. As of June 30, 2006, total unrecognized compensation cost related to unvested share-based payments totaled \$2.9 million and is expected to be recognized over a weighted-average period of 2.0 years.

New Accounting Pronouncement

In July 2006, the FASB issued Final Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet

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before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN 48 excludes income taxes from the scope of SFAS No. 5, *Accounting for Contingencies*. FIN 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the consolidated balance sheets prior to the adoption of FIN 48 and the amounts reported after adoption are accounted for as a cumulative-effect adjustment to the beginning balance of retained earnings. Mattel is currently evaluating the effect that the adoption of FIN 48 will have on its results of operations and financial position.

Table of Contents**Non-GAAP Financial Measure**

In this Quarterly Report on Form 10-Q, Mattel includes a non-GAAP financial measure, gross sales, which it uses to analyze its continuing operations and to monitor, assess and identify meaningful trends in its operating and financial performance. Net sales, as reported in the consolidated statements of operations, include the impact of sales adjustments, such as trade discounts and other allowances. Gross sales represent sales to customers, excluding the impact of sales adjustments. Consistent with its segment reporting, Mattel presents changes in gross sales as a metric for comparing its aggregate, business unit, brand and geographic results to highlight significant trends in Mattel's business. Changes in gross sales are discussed because, while Mattel records the detail of such sales adjustments in its financial accounting systems at the time of sale, such sales adjustments are generally not associated with individual products, making net sales less meaningful. A reconciliation of gross sales to the most directly comparable GAAP financial measure, net sales, is as follows:

| | For the Three Months Ended | | For the Six Months Ended | |
|----------------------------|----------------------------|------------|--------------------------|--------------|
| | June 30, | June 30, | June 30, | June 30, |
| | 2006 | 2005 | 2006 | 2005 |
| (In thousands) | | | | |
| Worldwide Revenues | | | | |
| Mattel Girls & Boys Brands | \$ 609,627 | \$ 563,796 | \$ 1,102,834 | \$ 1,078,185 |
| Fisher-Price Brands | 365,717 | 337,270 | 672,955 | 601,654 |
| American Girl Brands | 61,639 | 58,803 | 123,507 | 126,433 |
| Other | 4,337 | 4,797 | 7,476 | 8,646 |
| Gross sales | 1,041,320 | 964,666 | 1,906,772 | 1,814,918 |
| Sales adjustments | (83,665) | (77,843) | (155,770) | (144,975) |
| Net sales | \$ 957,655 | \$ 886,823 | \$ 1,751,002 | \$ 1,669,943 |

Item 3. Quantitative and Qualitative Disclosures About Market Risk.*Foreign Currency Exchange Rate Risk*

Currency exchange rate fluctuations may impact Mattel's results of operations and cash flows. Inventory purchase transactions denominated in the Euro, British pound sterling, Mexican peso, Hong Kong dollar and Indonesian rupiah were the primary transactions that cause currency transaction exposure for Mattel. Mattel seeks to mitigate its exposure to market risk by monitoring its currency transaction exposure for the year and partially hedging such exposure using foreign currency forward exchange and option contracts primarily to hedge its purchase and sale of inventory, and other intercompany transactions denominated in foreign currencies. These contracts generally have maturity dates of up to 18 months. For those intercompany receivables and payables that are not hedged, the transaction gains or losses are recorded in the consolidated statement of operations in the period in which the exchange rate changes as part of operating income or other non-operating (income), net based on the nature of the underlying transaction. Transaction gains or losses on intercompany inventory transactions are recorded in the consolidated statement of operations in the period in which the inventory is sold to customers. In addition, Mattel manages its exposure to currency exchange rate fluctuations through the selection of currencies used for international borrowings. Mattel does not trade in financial instruments for speculative purposes.

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Mattel's financial position is also impacted by currency exchange rate fluctuations on translation of its net investment in subsidiaries with non-US dollar functional currencies. Assets and liabilities of subsidiaries with non-US dollar functional currencies are translated into US dollars at fiscal period-end exchange rates. Income, expense and cash flow items are translated at weighted average exchange rates prevailing during the fiscal period. The resulting currency translation adjustments are recorded as a component of accumulated other comprehensive loss within stockholders' equity. Mattel's primary currency translation exposures were related to its net investment in entities having functional currencies denominated in the Euro, British pound sterling and Mexican peso.

Interest Rate Risk

In June 2006, Mattel issued \$100.0 million of unsecured Floating Rate Senior Notes due June 15, 2009. Interest on the Floating Rate Senior Notes is based on the three-month US Dollar LIBOR plus 40 basis points with interest payable quarterly beginning September 15, 2006.

In June 2006, Mattel entered into two interest rate swap agreements on the \$100.0 million Floating Rate Senior Notes, each in a notional amount of \$50.0 million, for the purpose of hedging the variability of cash flows in the interest payments due to fluctuations of the LIBOR benchmark interest rate. These cash flow hedges are accounted for under SFAS No. 133, whereby the hedges are reported in Mattel's consolidated balance sheets at fair value, with changes in the fair value of the hedges reflected in

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accumulated other comprehensive income. Under the terms of the agreements, Mattel will receive quarterly interest payments from the swap counterparties based on the three-month LIBOR plus 40 basis points and make semi-annual interest payments to the swap counterparties based on a fixed rate of 5.87125%. The three-month LIBOR rate used to determine interest payments under the interest rate swap agreements resets every three months, matching the variable interest on the Floating Rate Senior Notes. The agreements expire in June 2009.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

As of June 30, 2006, Mattel's disclosure controls and procedures were evaluated to provide reasonable assurance that information required to be disclosed by Mattel in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to management, as appropriate, in a timely manner that would alert them to material information relating to Mattel that would be required to be included in Mattel's periodic reports and to provide reasonable assurance that such information was recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Based on this evaluation, Robert A. Eckert, Mattel's principal executive officer, and Kevin M. Farr, Mattel's principal financial officer, concluded that these disclosure controls and procedures were effective as of June 30, 2006.

Changes in Internal Control Over Financial Reporting

Mattel made no change to its internal control over financial reporting or in other factors that materially affected, or were reasonably likely to have materially affected, its internal control over financial reporting during the quarter ended June 30, 2006.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

Litigation Related to Carter Bryant and MGA Entertainment, Inc.

In April 2004, Mattel filed a lawsuit in Los Angeles County Superior Court against Carter Bryant (Bryant), a former Mattel design employee. The suit alleges that Bryant aided and assisted a Mattel competitor, MGA Entertainment, Inc. (MGA), during the time he was employed by Mattel, in violation of his contractual and other duties to Mattel. In September 2004, Bryant asserted counterclaims against Mattel, including counterclaims in which Bryant seeks, as a putative class action representative, to invalidate Mattel's Confidential Information and Proprietary Inventions Agreements with its employees. In December 2004, MGA intervened as a party-defendant in Mattel's action against Bryant, asserting that its rights to the Bratz property are at stake in the litigation. Mattel's suit was removed to the United States District Court for the Central District of California.

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Separately, in November 2004, Bryant filed an action against Mattel in the United States District Court for the Central District of California. The action seeks a judicial declaration that Bryant's purported conveyance of rights in Bratz was proper and that he did not misappropriate Mattel property in creating Bratz.

In April 2005, MGA filed suit against Mattel in the United States District Court for the Central District of California. MGA's action alleges claims of trade dress infringement, trade dress dilution, false designation of origin, unfair competition and unjust enrichment. The suit alleges, among other things, that certain products, themes, packaging and/or television commercials in various Mattel product lines have infringed upon products, themes, packaging and/or television commercials for various MGA product lines, including Bratz. The complaint also asserts that various alleged Mattel acts with respect to unidentified retailers, distributors and licensees have damaged MGA and that various alleged acts by industry organizations, purportedly induced by Mattel, have damaged MGA. MGA's suit alleges that MGA has been damaged in an amount believed to reach or exceed tens of millions of dollars and further seeks punitive damages, disgorgement of Mattel's profits and injunctive relief. Mattel believes the claims by Bryant and MGA are without merit and intends to vigorously defend against them.

In June 2006, the three cases were consolidated in the United States District Court for the Central District of California. On July 17, 2006, the Court issued an order dismissing all claims that Bryant had asserted against Mattel, including Bryant's purported counterclaims to invalidate Mattel's Confidential Information and Proprietary Inventions Agreements with its employees, and Bryant's claims for declaratory relief. The Court, however, allowed Bryant the opportunity to correct the deficiencies in those claims. At this time Mattel does not know whether Bryant will try to correct those deficiencies and once again assert claims against Mattel.

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Item 1A. Risk Factors.

Factors That May Affect Future Results

(Cautionary Statement Under the Private Securities Litigation Reform Act of 1995)

Certain written and oral statements made or incorporated by reference from time to time by Mattel or its representatives in this Quarterly Report on Form 10-Q, other filings or reports filed with the SEC, press releases, conferences, or otherwise, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and may include, but are not limited to, statements about: sales and inventory levels; brand and customer management programs; increased competition; initiatives to promote revenue growth; globalization initiatives; restructuring and financial realignment plans; special charges and other non-recurring charges; initiatives aimed at anticipated cost savings; initiatives to invigorate the Barbie® brand, enhance innovation, improve the execution of the core business, leverage scale, extend brands, catch new trends, create new brands and enter new categories, develop people, improve productivity, simplify processes, maintain customer service levels and improve supply chain; operating efficiencies; capital and investment framework (including statements about free cash flow, seasonal working capital, debt-to-total capital ratios, capital expenditures, strategic acquisitions, dividends and share repurchases); cost pressures and increases; advertising and promotion spending; profitability; price increases, retail store openings and the impact of recent organizational changes. Mattel is including this Cautionary Statement to make applicable and take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any such forward-looking statements. Forward-looking statements include any statement that may predict, forecast, indicate, or imply future results, performance, or achievements. Forward-looking statements can be identified by the use of terminology such as believe, anticipate, expect, estimate, may, will, should, project, continue, plans, aims, intends, like, or phrases. Except for historical matters, the matters discussed in this Quarterly Report on Form 10-Q and other statements or filings made by Mattel from time-to-time may be forward-looking statements. Management cautions you that forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the forward-looking statements. In addition to the important factors detailed herein and from time-to-time in other reports filed by Mattel with the SEC, including Forms 8-K, 10-Q and 10-K, the following important factors could cause actual results to differ materially from past results or those suggested by any forward-looking statements.

If Mattel does not successfully satisfy consumer preferences, enhance existing products, develop and introduce new products and achieve market acceptance of those products, Mattel's results of operations may be adversely affected.

Mattel's business and operating results depend largely upon the appeal of its toy products. Consumer preferences, particularly among end users of Mattel's products—children—are continuously changing. The toy industry experiences significant, sudden shifts in demand caused by hit toys and trends, which are often unpredictable. Mattel competes with many other toy companies, both large and small, which means that Mattel's market position is always at risk. Mattel's ability to maintain its current category share, and increase its category share or establish category share in new product categories, will depend on Mattel's ability to satisfy consumer preferences, enhance existing products, develop and introduce new products, and achieve market acceptance of these products. In recent years, there have been trends towards shorter life cycles for individual toy products, the phenomenon of children outgrowing toys at younger ages and an increasing use of more sophisticated technology in toys. As a result, Mattel must also compete with many other companies, including the makers of video games and consumer electronic products, to meet the entertainment demands of older children. If Mattel does not successfully meet the challenges outlined above in a timely and cost-effective manner, demand for its products could decrease and Mattel's revenues, profitability and results of operations may be adversely affected.

Mattel's business is seasonal and therefore its operating results will depend, in large part, on sales during the relatively brief traditional holiday season. Improved inventory management by retailers resulting in shorter lead times for production and possible shipping disruptions during peak demand times may affect Mattel's ability to deliver its products in time to meet retailer demands.

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Mattel's business is subject to risks associated with the underproduction of popular toys and the overproduction of toys that do not match consumer demand. Sales of toy products at retail are seasonal, with a majority of retail sales occurring during the period from September through December. As a result, Mattel's operating results will depend, in large part, on sales during the relatively brief traditional holiday season. Retailers are attempting to manage their inventories better, requiring Mattel to ship products closer to the time the retailers expect to sell the products to consumers. This in turn results in shorter lead times for production. Management believes that the increase in last minute shopping during the holiday season and the popularity of gift cards (which often result in purchases after the holiday season) may negatively impact customer re-orders during the holiday season. Shipping disruptions limiting the availability of ships or containers in Asia during peak demand times may affect Mattel's ability to deliver its products in time to meet retailer demand. These factors may decrease sales or increase the risk that Mattel may not be able to meet demand for certain products at peak demand times, or that Mattel's own inventory levels may be adversely impacted by the need to pre-build products before orders are placed.

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Uncertainty and adverse changes in the general economic conditions of markets in which Mattel participates may negatively affect Mattel's business.

Current and future conditions in the economy have an inherent degree of uncertainty. As a result, it is difficult to estimate the level of growth or contraction for the economy as a whole. It is even more difficult to estimate growth or contraction in various parts, sectors and regions of the economy, including the many different markets in which Mattel participates. Because all components of Mattel's budgeting and forecasting are dependent upon estimates of growth or contraction in the markets it serves and demand for its products, the prevailing economic uncertainties render estimates of future income and expenditures very difficult to make. Adverse changes may occur as a result of soft global or regional economic conditions, rising oil prices, wavering consumer confidence, unemployment, declines in stock markets or other factors affecting economic conditions generally. These changes may negatively affect the sales of Mattel's products, increase exposure to losses from bad debts, or increase costs associated with manufacturing and distributing products.

The concentration of Mattel's business with a small retail customer base that makes no binding long-term commitments means that economic difficulties or changes in the purchasing policies of its major customers could have a significant impact on Mattel's business and operating results.

A small number of customers account for a large share of Mattel's net sales. In 2005, Mattel's three largest customers, Wal-Mart, Toys 'R Us and Target, in the aggregate, accounted for approximately 45% of net sales, and its ten largest customers, in the aggregate, accounted for approximately 54% of net sales. The concentration of Mattel's business with a relatively small number of customers may expose Mattel to a material adverse effect if one or more of Mattel's large customers were to significantly reduce purchases for any reason. Customers make no binding long-term commitments to Mattel regarding purchase volumes and make all purchases by delivering one-time purchase orders. Any customer could reduce its overall purchases of Mattel's products, reduce the number and variety of Mattel's products that it carries and the shelf space allotted for Mattel's products, or otherwise seek to materially change the terms of the business relationship at any time. Any such change could significantly harm Mattel's business and operating results.

The production and sale of private-label toys by Mattel's retail customers may result in lower purchases of Mattel-branded products by those retail customers.

In recent years, consumer goods companies generally, including those in the toy business, have experienced the phenomenon of retail customers developing their own private-label products that directly compete with the products of traditional manufacturers. Some retail chains that are customers of Mattel sell private-label toys designed, manufactured and branded by the retailers themselves. These toys may be sold at prices lower than comparable toys sold by Mattel, and may result in lower purchases of Mattel-branded products by these retailers. In some cases, retailers who sell these private-label toys are larger than Mattel and may have substantially more resources than Mattel.

Liquidity problems or bankruptcy of Mattel's key customers could increase Mattel's exposure to losses from bad debts and could have a material adverse effect on Mattel's business, financial condition and results of operations.

Many of Mattel's key customers are mass-market retailers. The mass-market retail channel in the US has experienced significant shifts in market share among competitors in recent years, causing some large retailers to experience liquidity problems. From 2001 through early 2004, four large customers of Mattel filed for bankruptcy. In addition, Mattel's sales to customers are typically made on credit without collateral. There is a risk that customers will not pay, or that payment may be delayed, because of bankruptcy or other factors beyond the control of Mattel, which could increase Mattel's exposure to losses from bad debts. In addition, if these or other customers were to cease doing business as a result of

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bankruptcy, or significantly reduce the number of stores operated, it could have a material adverse effect on Mattel's business, financial condition and results of operations.

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A reduction or interruption in the delivery of raw materials, parts and components from its suppliers or a significant increase in the price of supplies could negatively impact the gross profit margins realized by Mattel on the sale of its products or result in lower sales.

Mattel's ability to meet customer demand depends, in part, on its ability to obtain timely and adequate delivery of materials, parts and components from its suppliers and internal manufacturing capacity. Mattel has experienced shortages in the past, including raw materials and components. Although Mattel works closely with suppliers to avoid these types of shortages, there can be no assurance that Mattel will not encounter these problems in the future. A reduction or interruption in supplies or a significant increase in the price of one or more supplies, such as fuel and resin (which is an oil-based product) expenses, could have a material adverse effect on Mattel's business. Cost increases, whether resulting from shortages of materials or otherwise, including but not limited to rising costs of materials, transportation, services and labor (including but not limited to wages, expenses related to employee health plans and insurance), could impact the profit margins realized by Mattel on the sale of its products. Because of market conditions, timing of pricing decisions and other factors, there can be no assurance that Mattel will be able to offset any of these increased costs by adjusting the prices of its products. Increases in prices of Mattel's products could result in lower sales.

Unfavorable resolution of pending and future litigation matters and disputes could have a material adverse effect on Mattel's financial condition.

Mattel is involved in a number of litigation matters. An unfavorable resolution of pending litigation could have a material adverse effect on Mattel's financial condition. Litigation may result in substantial costs and expenses and significantly divert the attention of Mattel's management regardless of the outcome. There can be no assurance that Mattel will be able to achieve a favorable settlement of pending litigation or obtain a favorable resolution of litigation if it is not settled. In addition, current and future litigation, governmental proceedings, labor disputes or environmental matters could lead to increased costs or interruptions of the normal business operations of Mattel.

Recalls, post-manufacture repairs of Mattel products, product liability claims, absence or cost of insurance, and associated administrative costs could harm Mattel's reputation, increase costs or reduce sales.

Mattel is subject to regulation by the Consumer Product Safety Commission and similar state and international regulatory authorities, and its products could be subject to involuntary recalls and other actions by these authorities. Concerns about product safety may lead Mattel to voluntarily recall selected products. Mattel has experienced, and in the future may experience, defects or errors in products after their production and sale to customers. These defects or errors could result in the rejection of Mattel's products by customers, damage to its reputation, lost sales, diverted development resources and increased customer service and support costs, any of which could harm Mattel's business. Individuals could sustain injuries from Mattel's products, and Mattel may be subject to claims or lawsuits resulting from these injuries. There is a risk that these claims or liabilities may exceed, or fall outside the scope of, Mattel's insurance coverage. Moreover, Mattel may be unable to obtain adequate liability insurance in the future. Recalls, post-manufacture repairs of Mattel products, absence or cost of insurance, and administrative costs associated with recalls could harm Mattel's reputation, increase costs or reduce sales.

Failure by Mattel to protect its proprietary intellectual property and information could have a material adverse effect on Mattel's business, financial condition and results of operations.

The value of Mattel's business depends to a large degree on its ability to protect its intellectual property, including its trademarks, trade names, copyrights, patents and trade secrets in the US and around the world. Any failure by Mattel to protect its proprietary intellectual property and information, including any successful challenge to Mattel's ownership of its intellectual property or material infringements of its intellectual

property, could have a material adverse effect on Mattel's business, financial condition and results of operations.

Political developments, including trade relations, and the threat or occurrence of war or terrorist activities could materially impact Mattel, its personnel and facilities, its customers and suppliers, retail and financial markets, and general economic conditions.

Mattel's business is worldwide in scope, including operations in 42 countries. The deterioration of the political situation in a country in which Mattel has significant sales or operations, or the breakdown of trade relations between the US and a foreign country in which Mattel has significant manufacturing facilities or other operations, could adversely affect Mattel's business, financial condition and results of operations. For example, a change in trade status for China could result in a substantial increase in the import duty of toys manufactured in China and imported into the US. In addition, the occurrence of war or hostilities between countries or threat of terrorist activities, and the responses to and results of these activities, could materially impact Mattel, its personnel and facilities, its customers and suppliers, retail and financial markets, and general economic conditions.

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Disruptions in Mattel's manufacturing operations due to political instability, civil unrest, SARS, avian flu or other diseases could negatively impact Mattel's business, financial position and results of operations.

Mattel owns and operates manufacturing facilities and utilizes third-party manufacturers throughout Asia, primarily in China, Indonesia, Malaysia and Thailand. The risk of political instability and civil unrest exists in certain of these countries, which could temporarily or permanently damage Mattel's manufacturing operations located there. In the past, outbreaks of SARS have been significantly concentrated in Asia, particularly in Hong Kong, and in the Guangdong province of China, where many of Mattel's manufacturing facilities and third-party manufacturers are located. The design, development and manufacture of Mattel's products could suffer if a significant number of Mattel's employees or the employees of its third-party manufacturers or their suppliers contract SARS, avian flu or other communicable diseases, or otherwise are unable to fulfill their responsibilities. Mattel has developed contingency plans designed to help mitigate the impact of disruptions in its manufacturing operations. Mattel's business, financial position and results of operations could be negatively impacted by a significant disruption to its manufacturing operations or suppliers.

Earthquakes or other catastrophic events out of our control may damage Mattel's facilities or those of its contractors and harm Mattel's results of operations.

Mattel has significant operations, including its corporate headquarters, near major earthquake faults in Southern California. Southern California has experienced earthquakes, wildfires and other natural disasters in recent years. A catastrophic event where Mattel has important operations, such as an earthquake, tsunami, flood, typhoon, fire or other natural or manmade disaster, could disrupt Mattel's operations or those of its contractors and impair production or distribution of its products, damage inventory, interrupt critical functions or otherwise affect business negatively, harming Mattel's results of operations.

Significant changes in currency exchange rates could have a material adverse effect on Mattel's business and results of operations.

Mattel's net investment in its foreign subsidiaries and its results of operations and cash flows are subject to changes in currency exchange rates and regulations. Mattel seeks to mitigate the exposure of its results of operations to fluctuations in currency exchange rates by partially hedging this exposure using foreign currency forward exchange and option contracts. These contracts are primarily used to hedge Mattel's purchase and sale of inventory, and other intercompany transactions denominated in foreign currencies. Government action may restrict Mattel's ability to transfer capital across borders and may also impact the fluctuation of currencies in the countries where Mattel conducts business or has invested capital. Significant changes in currency exchange rates, reductions in Mattel's ability to transfer its capital across borders, and changes in government-fixed currency exchange rates, including the Chinese yuan, could have a material adverse effect on Mattel's business and results of operations.

Increases in interest rates, reduction of Mattel's credit ratings or the inability of Mattel to meet the debt covenant coverage requirements in its credit facilities could negatively impact Mattel's ability to conduct its operations.

Increases in interest rates, both domestically and internationally, could negatively affect Mattel's cost of financing both its operations and investments. Any reduction in Mattel's credit ratings could increase the cost of obtaining financing. Additionally, Mattel's ability to issue long-term debt and obtain seasonal financing could be adversely affected by factors such as an inability to meet its debt covenant requirements, which include maintaining consolidated debt-to-capital and interest coverage ratios. Mattel's ability to conduct its operations could be negatively impacted should these or other adverse conditions affect its primary sources of liquidity.

Mattel's failure to successfully market or advertise its products could have a material adverse effect on Mattel's business, financial condition and results of operations.

Mattel's products are marketed worldwide through a diverse spectrum of advertising and promotional programs. Mattel's ability to sell products is dependent in part upon the success of these programs. If Mattel does not successfully market its products or if media or other advertising or promotional costs increase, these factors could have a material adverse effect on Mattel's business, financial condition and results of operations.

Failure to successfully implement new initiatives could have a material adverse effect on Mattel's business, financial condition and results of operations.

Mattel has announced initiatives to improve the execution of its core business, globalize and extend Mattel's brands, catch new trends, create new brands and enter new categories, develop people, improve productivity, simplify processes, maintain customer service levels, as well as new initiatives designed to drive sales growth, manage costs and improve its supply chain. These initiatives involve complex decision making as well as extensive and intensive execution, and the success of these initiatives is not assured. Failure to successfully implement any of these initiatives could have a material adverse effect on Mattel's business, financial condition and results of operations.

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Changes in laws or regulations may lead to increased costs, changes in Mattel's effective tax rate, or the interruption of normal business operations that would negatively impact Mattel's financial condition and results of operations.

Mattel operates in a highly regulated environment in the US and international markets. US federal, state and local governmental entities and foreign governments regulate many aspects of Mattel's business, including its products and the importation and exportation of its products. These regulations may include accounting standards, taxation requirements (including changes in applicable income tax rates, new tax laws and revised tax law interpretations), trade restrictions, regulations regarding financial matters, environmental regulations, advertising directed toward children, safety and other administrative and regulatory restrictions. Changes in laws or regulations may lead to increased costs, changes in Mattel's effective tax rate, or the interruption of normal business operations that would negatively impact its financial condition and results of operations.

Mattel may engage in acquisitions, mergers or dispositions, which may affect the profit, revenues, profit margins, debt-to-capital ratio, capital expenditures or other aspects of Mattel's business. In addition, Mattel has certain anti-takeover provisions in its by-laws that may make it more difficult for a third party to acquire Mattel without its consent, which may adversely affect Mattel's stock price.

Mattel may engage in acquisitions, mergers or dispositions, which may affect the profit, revenues, profit margins, debt-to-capital ratio, capital expenditures, or other aspects of Mattel's business. There can be no assurance that Mattel will be able to identify suitable acquisition targets or merger partners or that, if identified, it will be able to acquire these targets on acceptable terms or agree to terms with merger partners. Additionally, there can be no assurance that Mattel will be successful in integrating any acquired company into its overall operations, or that any such acquired company will operate profitably or will not otherwise adversely impact Mattel's results of operations. In addition, Mattel has certain anti-takeover provisions in its bylaws that may make it more difficult for a third party to acquire Mattel without its consent, which may adversely affect Mattel's stock price.

If any of the risks and uncertainties described in the cautionary factors listed above actually occurs, Mattel's business, financial condition and results of operations could be materially and adversely affected. The factors listed above are not exhaustive. Other sections of this Quarterly Report on Form 10-Q include additional factors that could materially and adversely impact Mattel's business, financial condition and results of operations. Moreover, Mattel operates in a very competitive and rapidly changing environment. New factors emerge from time to time and it is not possible for management to predict the impact of all of these factors on Mattel's business, financial condition or results of operations or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not rely on forward-looking statements as a prediction of actual results. Any or all of the forward-looking statements contained in this Quarterly Report on Form 10-Q and any other public statement made by Mattel or its representatives may turn out to be wrong. Mattel expressly disclaims any obligation to update or revise any forward-looking statements, whether as a result of new developments or otherwise.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Recent Sales of Unregistered Securities

During the second quarter of 2006, Mattel did not sell any unregistered securities.

Issuer Purchases of Equity Securities

This table provides certain information with respect to Mattel's purchases of its common stock during the second quarter of 2006:

| Period | Total Number of Shares (or Units) Purchased | Average Price Paid per Share (or Unit) | Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs |
|---------------------------|---|---|---|--|
| April 1 - 30 | | | | |
| Repurchase program (1) | | \$ | | \$ 250,000,000 |
| Employee transactions (2) | | | N/A | N/A |
| May 1 - 31 | | | | |
| Repurchase program (1) | 5,730,424 | 16.26 | 5,730,424 | 156,814,093 |
| Employee transactions (2) | | | N/A | N/A |
| June 1 - 30 | | | | |
| Repurchase program (1) | 3,660,000 | 16.43 | 3,660,000 | 96,682,885 |
| Employee transactions (2) | | | N/A | N/A |
| Total | | | | |
| Repurchase program (1) | 9,390,424 | \$ 16.33 | 9,390,424 | \$ 96,682,885 |
| Employee transactions (2) | | \$ | N/A | N/A |

(1) In January 2006, the Board of Directors authorized Mattel to increase its share repurchase program by an additional \$250.0 million. Repurchases will take place from time to time, depending on market conditions. Mattel's share repurchase program has no expiration date.

(2) During the second quarter of 2006, there were no sales of restricted shares for employee tax withholding obligations that occur upon vesting.

N/A Not applicable.

Item 3. Defaults Upon Senior Securities.

None.

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Item 4. Submission of Matters to a Vote of Security Holders.

The Annual Meeting of Stockholders of Mattel was held on May 11, 2006. Proxies for the meeting were solicited pursuant to Regulation 14A of the Securities Exchange Act of 1934 and there was no solicitation in opposition to that of management. All of the nominees for director listed in the proxy statement were elected pursuant to the process described in the proxy statement, with the number of votes cast as follows:

| Name of Nominee | Votes FOR | Votes Withheld From This Nominee | Votes Withheld From All Nominees |
|-------------------------|-------------|-------------------------------------|-------------------------------------|
| Eugene P. Beard | 341,852,257 | 4,117,228 | 145,605 |
| Michael J. Dolan | 321,607,065 | 24,362,420 | 145,605 |
| Robert A. Eckert | 340,998,440 | 4,971,045 | 145,605 |
| Tully M. Friedman | 331,459,114 | 14,510,371 | 145,605 |
| Dominic Ng | 342,700,265 | 3,269,220 | 145,605 |
| Dr. Andrea L. Rich | 342,651,837 | 3,317,648 | 145,605 |
| Ronald L. Sargent | 265,526,634 | 80,442,851 | 145,605 |
| Christopher A. Sinclair | 342,320,552 | 3,648,933 | 145,605 |
| G. Craig Sullivan | 342,675,608 | 3,293,877 | 145,605 |
| John L. Vogelstein | 339,049,039 | 6,920,446 | 145,605 |
| Kathy Brittain White | 342,107,994 | 3,861,491 | 145,605 |

The proposal to ratify the selection of PricewaterhouseCoopers LLP as Mattel's independent registered public accounting firm for the year ending December 31, 2006, was approved by the following vote:

| Shares Voted FOR | Shares Voted AGAINST | Shares ABSTAINING | Broker NON-VOTE |
|------------------|-------------------------|----------------------|-----------------|
| 336,466,325 | 7,492,836 | 2,155,929 | |

A stockholder proposal regarding separating the roles of CEO and Board Chair was approved by the following vote:

| Shares Voted FOR | Shares Voted AGAINST | Shares ABSTAINING | Broker NON-VOTE |
|------------------|-------------------------|----------------------|-----------------|
| 156,775,864 | 150,176,466 | 2,310,109 | 36,852,651 |

A stockholder proposal regarding certain reports by the Board of Directors was defeated by the following vote:

| Shares Voted FOR | Shares Voted AGAINST | Shares ABSTAINING | Broker NON-VOTE |
|------------------|-------------------------|----------------------|-----------------|
| 16,896,505 | 233,642,959 | 58,722,975 | 36,852,651 |

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A stockholder proposal regarding pay-for-superior-performance was defeated by the following vote:

| <u>Shares Voted FOR</u> | <u>Shares Voted AGAINST</u> | <u>Shares ABSTAINING</u> | <u>Broker NON-VOTE</u> |
|-------------------------|-----------------------------|--------------------------|------------------------|
| 145,336,311 | 161,613,893 | 2,312,235 | 36,852,651 |

Item 5. Other Information.

None.

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Item 6. Exhibits.

| Exhibit No. | Exhibit Description |
|--------------------|---|
| 11.0* | Computation of Income per Common and Common Equivalent Share |
| 12.0* | Computation of Earnings to Fixed Charges |
| 31.0* | Certification of Principal Executive Officer dated August 2, 2006 pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.1* | Certification of Principal Financial Officer dated August 2, 2006 pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.0** | Certification of Principal Executive Officer and Principal Financial Officer dated August 2, 2006 pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ¹ |
| 99.0* | Form of Grant Agreement for Initial Grants to Outside Directors of Restricted Stock Units with Dividend Equivalent Rights under the Mattel, Inc. 2005 Equity Compensation Plan |

* *Filed herewith.*

** *Furnished herewith.*

¹ *This exhibit should not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934.*

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934 as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MATTEL, INC.
Registrant

Date: As of August 2, 2006

By: _____
H. Scott Topham
Senior Vice President and Corporate Controller (Duly
authorized officer and chief accounting officer)