

Buy Mattel (NASDAQ: MAT) before its earnings release (ER) on April 27, 2022

- From the brink of bankruptcy, MAT has staged an impressive comeback, and its growth is accelerating
- However, the strength of its revenue (REV) and earnings per share (EPS) growth has not yet been fully recognized
- Macro uncertainty and market volatility further depressed investor sentiment, pressuring MAT share price
- A quick analysis suggests that it is likely MAT will beat Q1FY22 consensus, and affirm its FY22 and FY23 guidance
- At a 25% discount to the market, and with an elevated short interest, MAT is likely to rally at a positive surprise

Our trade

- Long April 29 23 calls, target share price gain of 10% before call expiration

Situation

Back from the brink, growth picked up steam, headwinds in FY22, expectation modest, sentiment negative

- MAT share price declined 80% from its 2016 high to March 2020 low; a new CEO took over in April, 2018
- A turnaround since 2018 has returned MAT to health, with REV growth and margin expansion picking up momentum
 - Leverage ratio declined from 25.0 to 2.6 and EPS rose from -\$1.20 (2017) to \$1.30 (2021)
 - REV growth of (1%, 3%, 18%) and adjusted operating margin of (3.4%, 9.6% 14.0%) in FY19, 20, 21, respectively
- Despite growth momentum, uncertainty depressed sentiment, keeping expectations modest and short interest high
 - War, inflation, rate hike, economic slowdown, persist global covid disruptions and lockdowns dampen sentiment
 - Investors also worried that demand pull forward will reduce sales, and cost inflation depress margins in FY22, 23
 - Consensus FY22 and FY23 REV growth and EPS, at (6.8%, 7.5%) and (\$1.45, \$1.85), are below MAT guidance
 - Short interest of MAT stood at 23.5 million as of March 31, at a short ratio of 10.5

Analysis

Negativity overblown, momentum sustainable, financials strong, valuation low, positive surprise likely

- War impact limited – MAT confirmed that Russia and Ukraine combined account for less than 2% of REV
- Consensus calls for a contained war, probability of a recession below 40%, market to end 2022 higher
- Numerous growth initiatives, gaining market shares, and likely continue to gain shares from competitors
 - Launching space exploration Barbie, 12 global entrepreneur dolls, and non-fungible tokens (NFTs)
 - New license of Frozen, Princesses, Troll, Santiago of the Sea, et al., from Disney, Universal, and Nickelodeon
 - Film/TV programming/gaming for Barbie, Monster High, and other existing brands and new franchises
 - MAT has been gaining market shares, with planned growth for 2022 and 2023, the trend is likely to continue
 - May soon add M&A as a growth driver, given a leverage ratio of 2.6 and 2021 EBITDA of \$1bn and growing
- At \$22.90 and consensus FY23 EPS of \$1.85, MAT has a forward PE (FPE) of 12.5, compared to FPE of 17 for S&P500
- Consensus estimate conservative, a Q1 beat and guidance affirmation amid uncertainty would be a positive surprise
 - A quick guesstimate suggests FY22 and FY23 sales growth above 10%, higher than consensus and MAT guide
 - Historical global toy sales growth tracks inflation. MAT and industry FY21 sales grew at 18% and 9%
 - Normalized MAT FY21 sales growth 16% YoY (7% inflation + 9% outperformance)
 - Normalized MAT FY22 sales growth 14% YoY (6% inflation + 8% outperformance, to be conservative)
 - FY21 YoY pulled 2% demand forward, FY22 residual YoY sales growth 12%, or 10% after war impact
 - MAT FY22 YoY sales growth likely to be higher, due to higher growth in NFTs/films/TV programs/games
 - Similar analysis suggests that MAT FY23 growth should be above 10% vs. consensus estimate of 7.5%
 - MAT beat EPS estimate 4 times in a row over the last 4 earnings reports by an average of 80%
 - MAT guided 9% FY22 and 5%-10% FY23 sales growth, higher than consensus but still likely conservative
 - Consensus FY22 and FY23 EPS conservative
 - Labor/material/freight cost inflation priced in, MAT confirmed FY22 and FY23 guide multiple times
 - A higher sales at the same margin guided - FY22 and FY23 EPS likely will be higher as well

Conclusion

- MAT likely to rally at a positive surprise; sufficient safety margin to buy at current price, around \$22.90

Disclaimer

- For information sharing only. See www.traderoryan.com/disclaimer for details