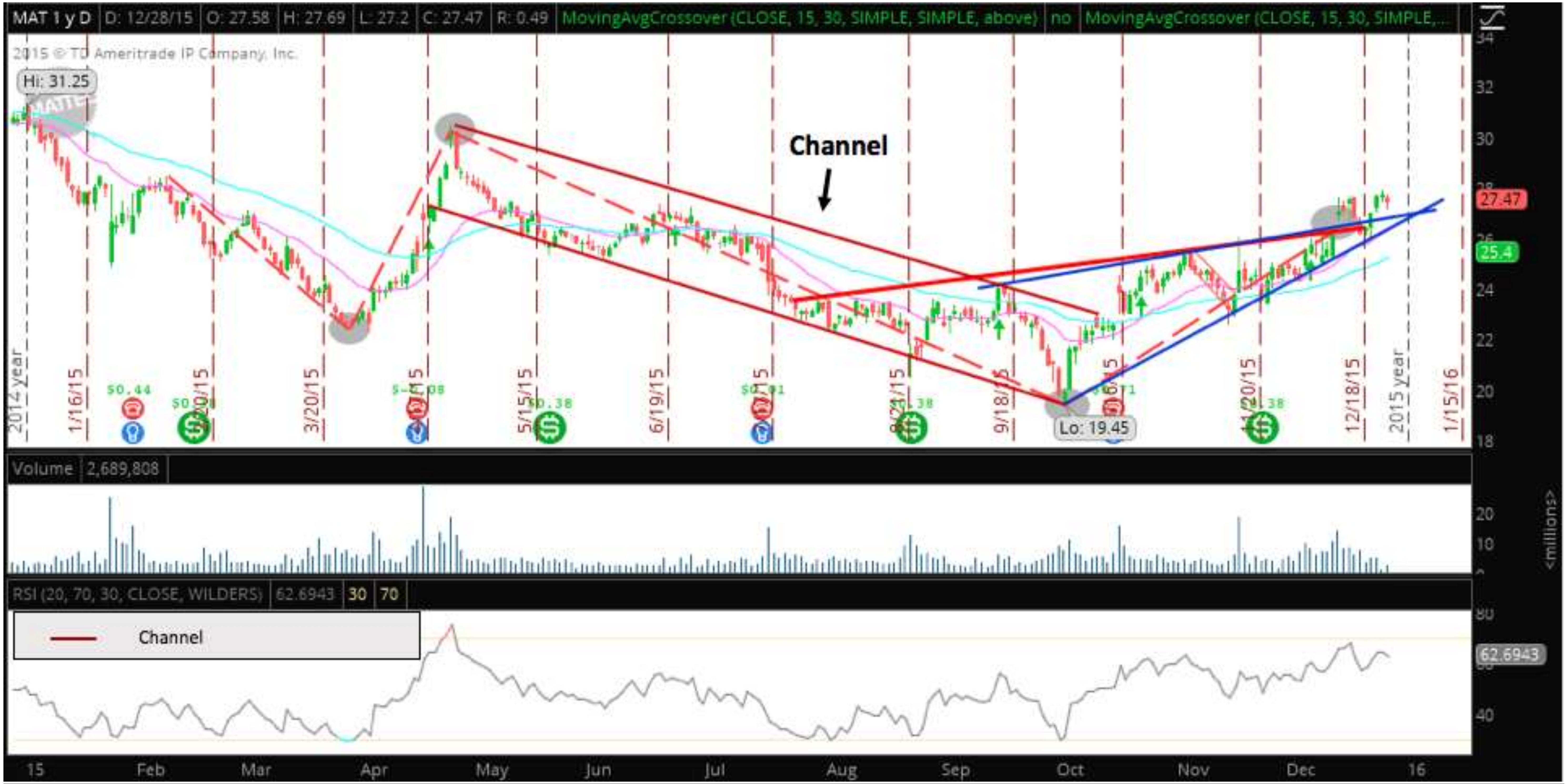


Diagram 1.0: Mattel's Daily Chart with Volume, Moving Averages and Channel

Chart Data By:

thinkorswim by TD Ameritrade

Diagram 2.0: Mattel's Daily Chart with Volume, Inverse Head-and-Shoulders, Flag, and Triangle

Chart Data By:

thinkorswim by TD Ameritrade

Prepared By:
Lynn Ho, Marcus Yip, Farrah Marilynn Yeo, and Neo Pok Chow
(31 December 2015)[#]

Background

Mattel, Inc. ("Mattel") is an American multinational toy manufacturing company founded in 1945 by Harold Matson and Elliot Handler. As one of the largest toy makers in the world, Mattel designs, manufactures, and markets a range of toy products worldwide. It offers a diverse range of products for families and children of all ages – dolls and accessories, vehicles and play sets, games and puzzles, media-driven products, and fashion-related toys. Mattel's products include, but are not limited to, Barbie and Polly Pocket dolls, Monster High and Winx Club dolls, Fisher-Price toys, Hot Wheels and Matchbox cars, American Girl dolls and books, WWE Wrestling, toys based on Walt Disney and Warner Bros. movies, and other licensed items. Mattel is renown for its success in the Toys and Games industry – it ranked #403 on the Fortune 500 in 2014. The company has presence in 40 countries and sells products in more than 150 nations. Mattel competes with several large toy companies, including Bandai, Hasbro, Jakks Pacific, and Lego. Headquartered in El Segundo, California, Mattel boasts a total workforce of over 31,000. It is listed on NASDAQ (NASDAQ: MAT) with an annual revenue of $6.02 billion in 2014. Chairman of the Board and Chief Executive Officer of Mattel, Inc. Christopher A. Sinclair has succeeded to the positions since January 2015 and April 2015 respectively.

Technical Analysis

After multiple earnings missed due to weak growth, shares of Mattel took a nosedive. Since its December 2013 highs of $48, the shares have lost 45% of their value to $26.

Since the start of the year, Mattel's shares followed a bearish trend continued from a high of $31.25 to a low of $19.45 at the start of October. A retracement can be observed thereafter.

Inverse Head-and-Shoulders

An inverse head-and-shoulders pattern was witnessed between mid-July to present. The head-and-shoulders pattern is one of the most reliable chart patterns. This reversal pattern generally occurs at the market tops and bottoms as sets of peaks and troughs, with the neckline as a level of support or resistance. As observed from the chart, the head was formed around early October and the shoulders were formed around mid-August and mid-November. The development of an inverse head-and-shoulders is an indication of a possible uptrend if the price breaks out from the neckline.

Flag

Additionally, a flag can be observed within the formation of the inverse head-and-shoulders. A flag is a quiet pause accompanied by a trend of declining volume that interrupts a sharp, almost vertical rise or decline. Once the flag formation is completed, price would break out in the same direction that it was moving in prior to the formation. Mattel's stock price consistently rose together with ascending volume from October to mid-October, indicating a bullish trend. A flag can be seen in the month of November – during early November, price declined from $25.32 to $23.20 together with falling volume; on 17th November, price surged to $24.71 as the volume exploded. The appearance of a flag indicates and further confirms a strong bullish trend.

20-day and 50-day Moving Averages

When paired together, the 20-day and 50-day MAs can signal a reversal of the current trend when a crossover occurs. This indicator is in favour of a bullish trend as the 20-day SMA is above the 50-day SMA. Furthermore, it seems like Mattel is forming a series of higher lows and higher highs, and possibly a triangle.

Price Target

If based merely on the aforementioned technical analysis, we would recommend to long Mattel, as there is still more upside to capitalize on with a price target of $30.

Fundamental Analysis

	2015 (Fiscal Year)	**2014** (Fiscal Year)	**2013** (Fiscal Year)
March			
Revenue (000')	922,749	946,177	995,606
EPS	-0.17	-0.03	0.11
Dividends	0.38	0.38	0.36
June			
Revenue (000')	988,152	1,062,000	1,169,000
EPS	-0.04	0.08	0.21
Dividends	0.38	0.38	0.36
September			
Revenue (000')	1,791,000	2,021,000	2,206,000
EPS	0.66	0.97	1.2
Dividends	0.38	0.38	0.36
December			
Revenue (000')		1,993,000	2,113,000
EPS		0.43	1.06
Dividends		0.38	0.38
Total[#]			
Revenue (000')	3,702,000	6,023,000	6,484,000
EPS	0.45	1.45	2.58
Dividends	1.14	1.52	1.46

Diagram 3.0: Summary of Key Fundamental Data

Mattel's strengths can be seen in multiple aspects – good cash flow from operations, expanding profit margins and a largely solid financial position with reasonable debt levels. However, we observe weaknesses in the midst of its strengths. This includes a generally disappointing performance in the stock itself, feeble growth in the company's earnings per share and deteriorating net income. Mattel booked its eighth consecutive quarter of falling sales as its last third-quarter earnings fell by 33%, including a significant decline for its iconic Barbie doll.

Underlining Weaknesses

Mattel's performance not only reflected the drawback of a stronger U.S. dollar, but also the on going struggles as it embarks on a turnaround. Christopher Sinclair has been trying to boost morale at a company where the creative culture has struggled to come up with hit products in recent years and has also bungled basic retail execution during the holidays.

A major problem has been Barbie – one of Mattel's most profitable brands that has fallen on tough times as kids have gravitated to other dolls, like those based on the hit Disney movie Frozen. Barbie's overall sales fell 14% globally, its eighth straight quarter of a double-digit drop.

To make matters worse, Mattel took up over $160 million in debt last quarter. This debt, due within a year, was used to pay dividend before Mattel's cash starts coming in next quarter from retailers who bought its inventory for the holiday season. Furthermore, Mattel has sold over $2.8 million worth of stock in the last quarter. This is the third quarter in a row that Mattel has ditched buybacks in favour of diluting share value, and in turn, hurting EPS and increasing their dividend payment.

Long-Term Threats From Competitors

In recent years, toy makers have had ample opportunity to pad their bottom lines with licensing revenue. On this front, Hasbro has had more success than Mattel. It helps that it has a better movie tie-in line-up than Mattel – Hasbro owns the licensing rights to Star Wars, Transformers and Jurassic World, and those three franchises should deliver for years to come. The first Star Wars sequel hits theatres this year, with two more coming over the next few years. There are four more Transformers movies in the works, and a Jurassic World sequel tentatively scheduled for 2018. Of course, there is also an upcoming Frozen sequel.

Mattel has enjoyed the success of Disney's Frozen. Since the movie's release in 2013, Mattel has reaped the benefits with higher toy sales in the U.S.. Unfortunately, all good things must come to an end. On 1 January 2016, Mattel will relinquish the rights to dolls based on Anna, Elsa and other Disney Princesses. Instead, Hasbro, one of Mattel's rivals, has clinched these rights.

Movie tie-ins have been great revenue drivers, and Hasbro looks like it is set for a while. Mattel, on the other hand, is lacking. Mattel has recently sealed a long-term partnership with DHX Media Ltd. to jointly create video content tied to four established brands – Bob the Builder, Polly Pocket, Fireman Sam and Little People. This would open up the possibility to new merchandising and licensing opportunities. Then again, Mattel's strength was always in its line of Barbie products, but interest in that is starting to wane as the Disney princesses remain strong and alternate lines like Monster High gain popularity. Furthermore, even as Mattel has Man of Steel, that franchise is unlikely to move the needle significantly.

This suggests a closer look at the firms' dividends. Mattel and Hasbro retained similar dividend payout ratios as recent as last year where both were around 60%. Since then, they have diverged greatly. Hasbro now maintains a payout ratio under 50%, while Mattel's has skyrocketed to 170% on a trailing 12-month basis. On the surface, Mattel's 6% dividend looks like a better deal, but it's starting to reach the point of unsustainability. Hasbro's dividend, on the other hand, has a number of revenue drivers behind and looks secure.

Current Market Conditions

Besides technical and fundamental factors, market sentiment also affects stock prices. 2015 has been an eventful year with oil trading below US$35 a barrel and the first interest rate hike by the Federal Reserve in almost a decade. It is vital to analyse the economic factors that may affect Mattel's share price.

Firstly, Mattel relies on external financing to help fund its seasonal working capital needs. The increase in interest rates by the Federal Reserve could negatively affect Mattel's cost of financing. Any reduction in Mattel's credit ratings could also increase the cost of financing. Mattel may be hindered from obtaining, or incur additional costs to obtain, additional credit in tight credit markets. This could possibly reduce Mattel's profits and dividends. As a result, its share price may fall.

Secondly, Mattel's stock is greatly exposed to market risk as Mattel is closely correlated to S&P500 index (beta of 1.2). Given any downturn faced by the market, Mattel's share will take an equal beating. Amidst the general pessimistic market outlook, it is possible that such negative macroeconomic factors could reduce consumers' spending on Mattel's products. Deterioration of global economic conditions could potentially have an adverse effect on Mattel's liquidity and capital resources, including increasing Mattel's cost of capital, or otherwise adversely affect Mattel's business and financial results.

In 2014, Mattel's net sales to international customers comprised 47% of its total consolidated net sales. The strength of the U.S. dollar relative to other currencies can significantly affect the revenues and profitability of Mattel's international operations. The strengthening of the dollar might pose a problem to Mattel's international sales. To mitigate its exposure to market risk, Mattel enters into foreign currency forward exchange contracts. This strategy primarily hedges its purchase and sale of inventory and other transactions denominated in foreign currencies, to limit the impact of exchange rate fluctuations on its results of operations and cash flows.

Thirdly, consumer preferences are continuously changing. Significant or sudden shifts in demand caused by "hit" toys and trends, which are often unpredictable, could have a material impact. Delving further into the current trend in the industry, we see that many children have been moving away from traditional toys and games at a younger age. As a result, traditional toy companies now also face competition from entertainment offerings of other companies, such as makers of video games and consumer electronic products. Also, Mattel's business is very seasonal and depends on sales during the relatively brief holiday season, which puts heavy emphasis on efficient production and inventory management. 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.

Lastly, political developments, such as the threat of terrorist activities could adversely impact Mattel, its personnel and facilities, its customers and suppliers, retail and financial markets, and general economic conditions. With the recent rise in terrorism-related attacks, uncertainty reigns. As markets detest uncertainty, the reaction of markets to a terrorist attack is initially invariably downward. But markets have proved to be relatively resilient to such attacks in the past. Nonetheless, the indirect costs of terrorism can be large as they affect the economy in the medium term by undermining consumer and investor confidence. A more lasting effect could come from the economic impact of fearful consumers and tighter borders.

Conclusion

Regardless of fourth quarter results for Mattel, its dividend has to be cut in the near future. It's unhealthy for Mattel to borrow to fund their daily operations and to pay its dividend. Moreover, with rising interest rates and Mattel's declining credit rating, debt financing would be much more expensive. Currently, Mattel is rated Baa1 by Moody's and BBB by S&P – any further debt issuance could lead to junk status.

We unanimously believe that fundamental analysis poses a greater significance in determining our position on the stock. Competition-wise, we believe that Mattel does not have a unique selling proposition to have an edge over their rival Hasbro. Furthermore, we observe existing drawbacks and imminent vulnerability to the company – decline sales of Mattel's major products, bleak future prospect, stiff competition faced, increased cost of financing, and negative economic outlook. Hence, taking into account both technical analysis and fundamental analysis, we recommend a sell on Mattel at the price range of $29-$30 and a take profit at $20.

Options Alternatives

Incorporating options into one's trading can be a strategic way to trade. Options, with their versatility, are instruments that investors can utilize to reduce their cost basis and increase their probability of profit (POP).

With regard to the case in point, for every 100 shares of MAT shorted, an investor can sell a FEB 16 expiration 24 strike Put option with 53 Days to Expiration (DTE) to collect a $0.45 credit. Since each options contract is written on 100 shares of the underlying asset (Mattel), the investor stands to gain a maximum profit of $45 ($0.45 x 100 = $45).

What happens when stock price < strike price at expiration?

If the stock price is below the option's strike price at expiration, the option seller will be assigned 100 shares which neutralizes the short 100 shares initially in the portfolio, leaving him with net zero shares. The $0.45 collected is the reduction in cost basis from the trade. When the cost basis is reduced, the breakeven point shifts in favour of the trader and that increases the POP. (For simplicity of illustration, commission to the brokerage is omitted.)

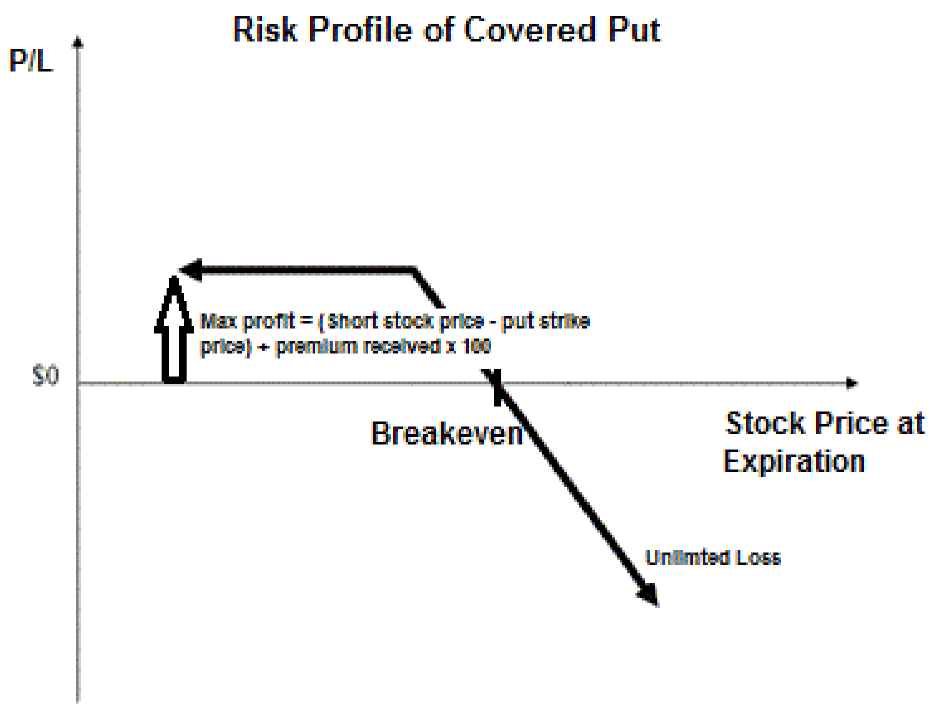


Diagram 4.0: Risk Profile of Covered Put

What happens when stock price > strike price at expiration?

However, if the stock price is above the strike price at expiration, the $0.45 credit received will simply reduce the cost basis without the seller being assigned 100 shares of the stock. Therefore, the aforementioned selling of options can be done periodically when the option expires to constantly generate theta decay from the premium received in order to reduce the cost basis.

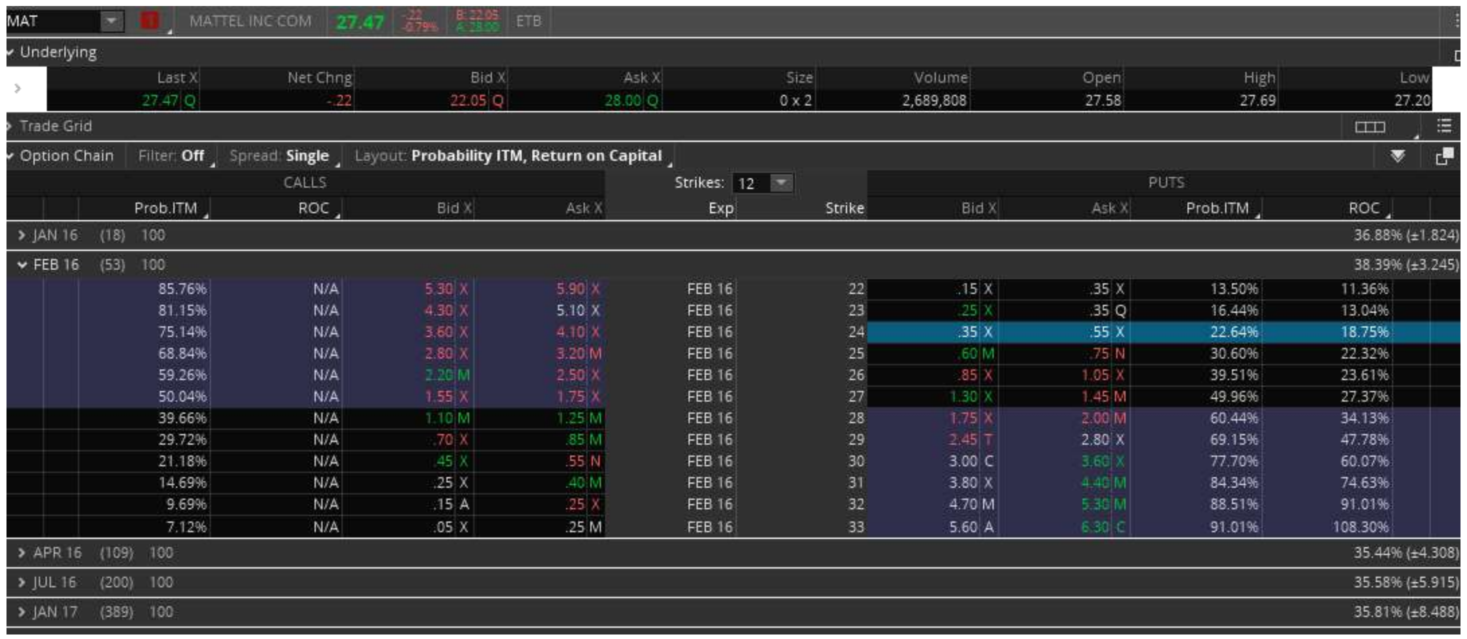
Trade off

Surely with everything good there is a trade-off. The only "downside" to this Covered Put strategy, is that the profit is capped at the price one shorted the stock at to the price of the put strike price plus the premium received, compared to the unlimited profit that one can get from simply selling the put.

Max profit = (Short stock price - put strike price) + premium received x 100

Then again, the aforementioned "downside" is in fact the best-case scenario of the Covered Put strategy – maximum profit is reached and the trade can be closed out to free up capital for the investor to utilize.

Additionally, traders should not overlook the time aspect of a trade. They could focus on maximizing the Return On Capital (ROC) per day in order to improve their trade returns. The short put in the Covered Put trade example offers 18.75% ROC over 53 days which amounts to 0.35% ROC/day. An advantage of selling options is allowing time to work in your favour. The said short put provides an average of $0.85 theta decay/day. The put has 22.64% probability of expiring in the money (PITM), which also means that it has 77.36% probability of expiring out of the money (POTM). Therefore, the probability of collecting the premium received without getting assigned 100 shares of MAT is 77.36%.



MAT | MATTEL INC COM | 27.47 | -.22 -0.79% | B: 22.05 A: 28.00 | ETB

Underlying

Last X	Net Chng	Bid X	Ask X	Size	Volume	Open	High	Low
27.47 Q	-.22	22.05 Q	28.00 Q	0 x 2	2,689,808	27.58	27.69	27.20

Trade Grid

Option Chain Filter: Off Spread: Single Layout: Probability ITM, Return on Capital

Strikes: 12

CALLS						PUTS			
Prob.ITM	ROC	Bid X	Ask X	Exp	Strike	Bid X	Ask X	Prob.ITM	ROC
JAN 16 (18) 100									36.88% (±1.824)
FEB 16 (53) 100									38.39% (±3.245)
85.76%	N/A	5.30 X	5.90 X	FEB 16	22	.15 X	.35 X	13.50%	11.36%
81.15%	N/A	4.30 X	5.10 X	FEB 16	23	.25 X	.35 Q	16.44%	13.04%
75.14%	N/A	3.60 X	4.10 X	FEB 16	24	.35 X	.55 X	22.64%	18.75%
68.84%	N/A	2.80 X	3.20 M	FEB 16	25	.60 M	.75 N	30.60%	22.32%
59.26%	N/A	2.20 M	2.50 X	FEB 16	26	.85 X	1.05 X	39.51%	23.61%
50.04%	N/A	1.55 X	1.75 X	FEB 16	27	1.30 X	1.45 M	49.96%	27.37%
39.66%	N/A	1.10 M	1.25 M	FEB 16	28	1.75 X	2.00 M	60.44%	34.13%
29.72%	N/A	.70 X	.85 M	FEB 16	29	2.45 T	2.80 X	69.15%	47.78%
21.18%	N/A	.45 X	.55 N	FEB 16	30	3.00 C	3.60 X	77.70%	60.07%
14.69%	N/A	.25 X	.40 M	FEB 16	31	3.80 X	4.40 M	84.34%	74.63%
9.69%	N/A	.15 A	.25 X	FEB 16	32	4.70 M	5.30 M	88.51%	91.01%
7.12%	N/A	.05 X	.25 M	FEB 16	33	5.60 A	6.30 C	91.01%	108.30%
APR 16 (109) 100									35.44% (±4.308)
JUL 16 (200) 100									35.58% (±5.915)
JAN 17 (389) 100									35.81% (±8.488)

Diagram 5.0: Overview of Mattel's Options Chain Sheet