

MATTEL INC /DE/
Form 10-K
February 26, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

or

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

For the transition period from _____ to _____

Commission File Number 001-05647

MATTEL, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

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

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333 Continental Blvd.

El Segundo, CA 90245-5012

(Address of principal executive offices)

(310) 252-2000

(Registrant's telephone number)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$1.00 par value	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act:

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark whether the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K.

Indicate by check mark whether registrant is a large accelerated filer, accelerated filer or 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 registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

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The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant calculated using the market price as of the close of business June 30, 2006 was \$6,276,702,226.

Number of shares outstanding of registrant's common stock, \$1.00 par value, as of February 23, 2007:

393,171,940 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Mattel, Inc. 2007 Notice of Annual Meeting of Stockholders and Proxy Statement, to be filed with the Securities and Exchange Commission (SEC) within 120 days after the close of the registrant's fiscal year (incorporated into Parts II and III).

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PART I

Item 1. Business.

Mattel, Inc. (*Mattel*) designs, manufactures, and markets a broad variety of toy products worldwide through sales to its customers and directly to consumers. *Mattel*'s vision is to provide the world's premier toy brands today and tomorrow. Management has set six key company strategies: (i) improve execution of the existing toy business; (ii) globalize the brands; (iii) extend the brands into new areas; (iv) catch new trends, create new brands and enter new categories; (v) develop people; and (vi) improve productivity, simplify processes and maintain customer service levels.

Mattel believes its products are among the most widely recognized toy products in 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 Wheels*®, *Matchbox*® and *Tyco*® R/C vehicles and playsets (collectively *Wheels*) and *Batman*®, *ARS*, *Superman*, *Radica*® products, and games and puzzles (collectively *Entertainment*).

Fisher-Price Brands including *Fisher-Price*®, *Little People*®, *BabyGear* and *View-Master*® (collectively *Core Fisher-Price*®), *Sesame Street*®, *Dora the Explorer*, *Go-Diego-Go!*, *Winnie the Pooh*, *InteracTV* and *See 'N Say*® (collectively *Fisher-Price*® *Friends*) and *Power Wheels*®.

American Girl Brands including *Just Like You*®, the 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.

Mattel was incorporated in California in 1948 and reincorporated in Delaware in 1968. Its executive offices are located at 333 Continental Blvd., El Segundo, California 90245-5012, telephone number (310) 252-2000.

Business Segments

Mattel refers to *Mattel*, Inc. and its subsidiaries as a whole, unless the context requires otherwise. This narrative discussion applies to all segments except where otherwise stated. *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*.

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,

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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. The consolidation of these divisions did not change Mattel's operating segments.

Management believes that the business environment for Mattel for 2007 will be similar to that of 2006. Mattel expects to continue facing challenges both domestically and internationally as retailers continue to 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 sales declines in the Barbie® brand.

For additional information on Mattel's operating segment reporting, including revenues, segment income and assets, see Item 7 Management's Discussion and Analysis of Financial Condition and Results of

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Operations Results of Operations Operating Segment Results and Item 8 Financial Statements and Supplementary Data Note 10 to the Consolidated Financial Statements. For additional information regarding geographic areas, see Item 8 Financial Statements and Supplementary Data Note 10 to the Consolidated Financial Statements. For a discussion of the risks inherent in the foreign operations of Mattel, which affect each segment, see Item 1A Risk Factors Factors That May Affect Future Results.

Domestic Segment

The Domestic segment develops toys that it markets and sells through the Mattel Girls & Boys Brands US, Fisher-Price Brands US and American Girl Brands segments.

In the Mattel Girls & Boys Brands US segment, Barbie® includes brands such as Barbie® fashion dolls and accessories, My Scene, and Barbie® Collector. Polly Pocket!, Pixel Chix, Winx Club, and Disney Classics are included within Other Girls Brands. Wheels is comprised of Hot Wheels®, Matchbox®, and Tyco® R/C vehicles and playsets. Entertainment includes Batman, CARS, Justice League, MegaMan, Superman, Yu-Gi-Oh!, and Radica:® products, as well as games and puzzles.

In 2007, Mattel expects to introduce new products, including continuing to leverage content within its core brands. In the Mattel Girls Brands category, new product introductions include full-length animated launches of Barbie® in *Fairytopia III: Magic of the Rainbow* in spring 2007, and Barbie® as *The Island Princess* in fall 2007. Polly Pocket! will be expanding into new categories in 2007, with the introduction of Polly® Fliers and the Polly® Jet. In the Wheels category, Hot Wheels® will launch an all-new track set strategy, including new Flip N Go No Assembly sets. In the Entertainment category, Mattel will expand on the success of CARS and Scene It? brands, and introduce new products including toys and games from Disney's *Ratatouille* movie in summer 2007. Mattel's Radica:® products will expand on the success of 20Q and Girl Tech® brands with new releases, and add U.B. FUNKEYS, an all new platform in 2007.

The Fisher-Price Brands US segment includes Fisher-Price®, Little People®, Rescue Heroes®, BabyGear, View-Master®, Sesame Street®, Dora the Explorer, Go-Diego-Go!, Winnie the Pooh, InteracTV, See 'N Say®, and Power Wheels®. New product introductions for 2007 are expected to include the Smart Cycle, Digital Arts & Crafts Studio, Laugh & Learn Kitchen, Rainforest Bouncer, T.M.X. Friend Ernie, T.M.X. Friend Cookie Monster, Dora's Let's Get Ready VanityCan Play Guitar, and Diego's Mobile Rescue Unit.

The American Girl Brands segment is a direct marketer, children's publisher and retailer best known for its flagship line of historical dolls, books and accessories, as well as the Just Like You and Bitty Baby® brands. American Girl Brands also publishes best-selling Advice & Activity books and the award-winning *American Girl*® magazine. In January 2007, American Girl introduced Nicki, the newest Girl of the Year doll. In addition, American Girl is launching American Girl Boutique and Bistro, a new experiential retail concept, in Dallas, Texas and Atlanta, Georgia in mid-to-late 2007, and a new historical doll in September 2007. American Girl Brands products are sold only in the US and Canada.

International Segment

Products marketed by the International segment are generally the same as those developed and marketed by the Domestic segment, with the exception of American Girl Brands, although some are developed or adapted for particular international markets. Mattel's products are sold directly to retailers and wholesalers in most European, Latin American and Asian countries, and in Australia, Canada and New Zealand, and through agents and distributors in those countries where Mattel has no direct presence.

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Mattel's International segment revenue represented 44% of worldwide consolidated gross sales in 2006. Within the International segment, Mattel operates in four regions that generated the following gross sales during 2006 (in millions):

	<u>Amount</u>	<u>Percentage of International Gross Sales</u>
Europe	\$ 1,544.5	56%
Latin America	739.9	27
Asia Pacific	239.6	9
Other	215.0	8
	<u>\$ 2,739.0</u>	<u>100%</u>

No individual country within the International segment exceeded 6% of worldwide consolidated gross sales during 2006.

The strength of the US dollar relative to other currencies can significantly affect the revenues and profitability of Mattel's international operations. Mattel enters into foreign currency forward exchange and option contracts, primarily to hedge its purchase and sale of inventory and other intercompany transactions denominated in foreign currencies, to limit the effect of exchange rate fluctuations on its results of operations and cash flows. See Item 7A Quantitative and Qualitative Disclosures About Market Risk and Item 8 Financial Statements and Supplementary Data Note 8 to the Consolidated Financial Statements. For financial information by geographic area, see Item 8 Financial Statements and Supplementary Data Note 10 to the Consolidated Financial Statements.

Manufacturing and Materials

Mattel manufactures toy products for all segments in both company-owned facilities and through third-party manufacturers. Products are also purchased from unrelated entities that design, develop and manufacture those products. To provide greater flexibility in the manufacture and delivery of its products, and as part of a continuing effort to reduce manufacturing costs, Mattel has concentrated production of most of its core products in company-owned facilities and generally uses third-party manufacturers for the production of non-core products.

Mattel's principal manufacturing facilities are located in China, Indonesia, Thailand, Malaysia and Mexico. Mattel also utilizes third-party manufacturers to manufacture its products in the US, Mexico, Brazil, Asia, India, New Zealand, and Australia. To help avoid disruption of its product supply due to political instability, civil unrest, economic instability, changes in government policies and other risks, Mattel produces many of its key products in more than one facility. Mattel believes that the existing production capacity at its own and its third-party manufacturers' manufacturing facilities is sufficient to handle expected volume in the foreseeable future. See Item 1A Risk Factors Factors That May Affect Future Results.

Mattel bases its production schedules for toy products on customer orders and forecasts, taking into account historical trends, results of market research and current market information. Actual shipments of products ordered and order cancellation rates are affected by consumer acceptance of product lines, strength of competing products, marketing strategies of retailers, changes in buying patterns of both retailers and consumers, and overall economic conditions. Unexpected changes in these factors could result in a lack of product availability or excess inventory in a

particular product line.

The foreign countries in which most of Mattel's products are manufactured (principally China, Indonesia, Thailand, Malaysia and Mexico) all enjoy permanent normal trade relations (NTR) status under US tariff laws, which provides a favorable category of US import duties. China's NTR status became permanent in 2002,

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following enactment of a bill authorizing such status upon the country's accession to the World Trade Organization (WTO), which occurred in 2001. Membership in the WTO substantially reduces the possibility of China losing its NTR status, which would result in increased costs for Mattel and others in the toy industry.

All US duties on toys were completely eliminated upon implementation of the Uruguay Round WTO agreement in 1995. The European Union, Japan and Canada eliminated their tariffs on most toy categories through staged reductions that were completed by January 1, 2004. The primary toy tariffs still maintained by these countries are European Union and Japanese tariffs on dolls of 4.7% and 3.9%, respectively, and a Canadian tariff of 8.0% on children's wheeled vehicles.

The majority of Mattel's raw materials is available from numerous suppliers but may be subject to fluctuations in price.

Competition and Industry Background

Competition in the manufacture, marketing, and sale of toys is based primarily on quality, play value and price. Mattel offers a diverse range of products for children of all ages and families that includes, among others, toys for infants and preschoolers, girls' toys, boys' toys, youth electronics, hand-held and other games, puzzles, educational toys, media-driven products and fashion-related toys. The Mattel Girls & Boys Brands US and Fisher-Price Brands US segments compete with several large toy companies, including Bandai, Hasbro, Inc., Jakks Pacific, Leap Frog, Lego, MGA Entertainment, and VTech, many smaller toy companies and several manufacturers of video games and consumer electronics. American Girl Brands competes with companies that manufacture girls' toys and with children's book publishers and retailers. Mattel's International segment competes with global toy companies including Bandai, Hasbro, Lego, Tomy, and MGA Entertainment, and other national and regional toy companies and manufacturers of video games and consumer electronics. Foreign regions may include competitors who are strong in a particular toy line or geographical area, but do not compete with Mattel and other international toy companies worldwide.

Competition among the above companies is intensifying due to recent trends towards shorter life cycles for individual toy products, the phenomenon of children outgrowing toys at younger ages and an increasing use of high technology in toys. In addition, a small number of retailers account for an increasingly large number of toy sales, control the shelf space from which toys are viewed, and have direct contact with parents and children through in-store purchases, coupons, and print advertisements. Such retailers can and do promote their own private-label toys, facilitate the sale of competitors' toys, and allocate shelf space to one type of toys over another.

Seasonality

Mattel's business is highly seasonal, with consumers making a large percentage of all toy purchases during the traditional holiday season. A significant portion of Mattel's customers' purchasing occurs in the third and fourth quarters of Mattel's fiscal year in anticipation of such holiday buying. These seasonal purchasing patterns and requisite production lead times cause risk to Mattel's business associated with the underproduction of popular toys and the overproduction of toys that do not match consumer demand. Retailers are also attempting to manage their inventories more tightly in recent years, requiring Mattel to ship products closer to the time the retailers expect to sell the products to consumers. These factors 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. Additionally, as retailers manage their inventories, Mattel experiences cyclical ordering patterns for products and product lines that may cause its sales to vary significantly from period to period.

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In anticipation of retail sales in the traditional holiday season, Mattel significantly increases its production in advance of the peak selling period, resulting in a corresponding build-up of inventory levels in the first three

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quarters of its fiscal year. Seasonal shipping patterns result in significant peaks in the third and fourth quarters in the respective levels of inventories and accounts receivable, which result in seasonal working capital financing requirements. See Seasonal Financing.

Product Design and Development

Through its product design and development group, Mattel regularly refreshes, redesigns and extends existing toy product lines and develops innovative new toy product lines for all segments. Mattel believes its success is dependent on its ability to continue this activity effectively. See Item 1A Risk Factors Factors That May Affect Future Results. Product design and development activities are principally conducted by a group of professional designers and engineers employed by Mattel. During 2006, 2005 and 2004, Mattel spent \$173.5 million, \$182.0 million and \$171.3 million, respectively, in connection with the design and development of products, exclusive of royalty payments. See Item 8 Financial Statements and Supplementary Data Note 11 to the Consolidated Financial Statements.

Additionally, independent toy designers and developers bring concepts and products to Mattel and are generally paid a royalty on the net selling price of products licensed to Mattel. These independent toy designers may also create different products for other toy companies.

Advertising and Marketing

Mattel supports its product lines with extensive advertising and consumer promotions. Advertising takes place at varying levels throughout the year and peaks during the traditional holiday season. Advertising includes television and radio commercials, and magazine and newspaper advertisements. Promotions include in-store displays, sweepstakes, merchandising materials and major events focusing on products and tie-ins with various consumer products companies.

During 2006, 2005 and 2004, Mattel incurred \$651.0 million (11.5% of net sales), \$629.1 million (12.1% of net sales) and \$643.0 million (12.6% of net sales), respectively, on advertising and promotion.

Sales

Mattel's products are sold throughout the world. Products within the Domestic segment are sold directly to retailers, including discount and free-standing toy stores, chain stores, department stores, other retail outlets and, to a limited extent, wholesalers by Mattel Girls & Boys Brands US and Fisher-Price Brands US. Mattel also operates several small retail outlets, generally near or at its corporate headquarters and distribution centers as a service to its employees and as an outlet for its products. American Girl Brands products are sold directly to consumers and its children's publications are also sold to certain retailers. Mattel has three retail stores, American Girl Place® in Chicago, Illinois, New York, New York, and Los Angeles, California, each of which features children's products from the American Girl Brands segment. In April 2006, the third American Girl Place® retail store opened in Los Angeles, California. American Girl Brands also has a retail outlet in Oshkosh, Wisconsin that serves as an outlet for excess product. Products within the International segment are sold directly to retailers and wholesalers in Canada and most European, Asian and Latin American countries, and through agents and distributors in those countries where Mattel has no direct presence. Mattel also has retail outlets in Latin America and Europe as an outlet for its products. Additionally, Mattel sells certain of its products online through its website.

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During 2006, Mattel's three largest customers (Wal-Mart at \$1.1 billion, Toys R Us at \$0.8 billion and Target at \$0.5 billion) accounted for approximately 43% of worldwide consolidated net sales in the aggregate. Within countries in the International segment, there is also a concentration of sales to certain large customers that do not operate in the US. The customers and the degree of concentration vary depending upon the region or

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nation. See Item 1A Risk Factors Factors That May Affect Future Results and Item 8 Financial Statements and Supplementary Data Note 10 to the Consolidated Financial Statements.

Licenses and Distribution Agreements

Mattel has license agreements with third parties that permit Mattel to utilize the trademark, characters or inventions of the licensor in products that Mattel sells. A number of these licenses relate to product lines that are significant to Mattel's business and operations.

Mattel has entered into agreements to license entertainment properties from, among others, Disney Enterprises, Inc. (including Disney characters such as Winnie the Pooh and Disney Princesses, CARS from Pixar, and all Disney films and television properties for use in Mattel's DVD board games, such as Scene It?, sold in North America), Viacom International, Inc. relating to its Nickelodeon properties (including Dora the Explorer, Go-Diego-Go!, and SpongeBob SquarePants), Origin Products Limited relating to Polly Pocket!, Warner Bros. Consumer Products (including Batman, Superman, and Justice League), Sesame Workshop (relating to its Sesame Street® properties including Elmo).

Royalty expense during 2006, 2005 and 2004 was \$261.2 million, \$225.6 million and \$204.5 million, respectively. See Product Design and Development and Item 8 Financial Statements and Supplementary Data Note 9 to the Consolidated Financial Statements.

Mattel also licenses a number of its trademarks, characters and other property rights to others for use in connection with the sale of non-toy products that do not compete with Mattel's products. Mattel distributes some third-party finished products that are independently designed and manufactured.

Trademarks, Copyrights and Patents

Most of Mattel's products are sold under trademarks, trade names and copyrights, and a number of those products incorporate patented devices or designs. Trade names and trademarks are significant assets of Mattel in that they provide product recognition and acceptance worldwide.

Mattel customarily seeks patent, trademark or copyright protection covering its products, and it owns or has applications pending for US and foreign patents covering many of its products. A number of these trademarks and copyrights relate to product lines that are significant to Mattel's business and operations. Mattel believes its rights to these properties are adequately protected, but there can be no assurance that its rights can be successfully asserted in the future or will not be invalidated, circumvented or challenged.

Commitments

In the normal course of business, Mattel enters into contractual arrangements for future purchases of goods and services to ensure availability and timely delivery, and to obtain and protect Mattel's right to create and market certain products. Certain of these commitments routinely

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contain provisions for guaranteed or minimum expenditures during the term of the contracts. Current and future commitments for guaranteed payments reflect Mattel's focus on expanding its product lines through alliances with businesses in other industries.

As of December 31, 2006, Mattel had outstanding commitments for purchases of inventory, other assets and services totaling \$372.9 million in fiscal year 2007. Licensing and similar agreements with terms extending through 2011 contain provisions for future guaranteed minimum payments aggregating approximately \$135.0 million. See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Commitments and Item 8 Financial Statements and Supplementary Data Note 9 to the Consolidated Financial Statements.

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Backlog

Mattel ships products in accordance with delivery schedules specified by its customers, which usually request delivery within three months. In the toy industry, orders are subject to cancellation or change at any time prior to shipment. In recent years, a trend toward just-in-time inventory practices in the toy industry has resulted in fewer advance orders and therefore less backlog of orders. Mattel believes that the amount of backlog orders at any given time may not accurately indicate future sales.

Financial Instruments

Currency exchange rate fluctuations may impact Mattel's results of operations and cash flows. Mattel seeks to mitigate its exposure to market risk by monitoring its foreign 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. 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.

For additional information regarding foreign currency contracts, see International Segment above, Item 7A Quantitative and Qualitative Disclosures About Market Risk and Item 8 Financial Statements and Supplementary Data Note 8 to the Consolidated Financial Statements.

Seasonal Financing

Mattel maintains and periodically amends or replaces a \$1.3 billion 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 agreement in effect was amended and restated in March 2005 and the expiration date of the facility was extended to March 23, 2010. The other 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 each fiscal quarter and fiscal year in 2006. As of December 31, 2006, Mattel's consolidated debt-to-capital ratio, as calculated per the terms of the credit agreement, was 0.29 to 1 (compared to a maximum allowed of 0.50 to 1) and Mattel's interest coverage ratio was 11.72 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 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. On December 15, 2006, in addition to the required payment of \$50.0 million, MAPS prepaid an incremental \$125.0 million of the MAPS term loan facility. The remaining \$50.0 million principal amount, consisting of \$14.3 million due on December 15, 2007 and \$35.7 million due on December 9, 2008, was prepaid on January 16, 2007. As of

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December 31, 2006, there was no balance outstanding on the MAPS revolving loan facility. In connection with the MAPS facility, Mattel executed a

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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 December 31, 2006.

To finance seasonal working capital requirements of certain foreign subsidiaries, Mattel avails itself of individual short-term credit lines with a number of banks. As of December 31, 2006, foreign credit lines totaled approximately \$200 million, a portion of which are used to support letters of credit. Mattel expects to extend the majority of these credit lines throughout 2007.

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, or (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 Statement of Financial Accounting Standards (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 loss. Under the terms of the agreements, Mattel receives quarterly interest payments from the swap counterparties based on the three-month LIBOR plus 40 basis points and makes 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, which corresponds with the maturity of the Floating Rate Senior Notes.

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. In March 2006, this same credit rating agency reduced Mattel's long-term credit rating to BBB- and changed the outlook from negative to stable. 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 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 2007, amounts available under its domestic unsecured committed revolving credit facility, the MAPS facility, and its foreign credit lines will be adequate to meet its seasonal financing requirements in 2007. As of December 31, 2006, Mattel had available incremental borrowing resources totaling approximately \$1.3 billion under its domestic unsecured committed revolving credit facility, the MAPS facility and foreign credit lines.

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

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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.

Sales of receivables pursuant to the domestic receivables sale facility occur periodically, generally quarterly. The receivables are sold by Mattel Sales Corp. and Fisher-Price, Inc. to Mattel Factoring for a purchase price equal to the nominal amount of the receivables sold. Mattel Factoring then sells such receivables to the bank group at a slight discount, and Mattel acts as a servicer for such receivables. Mattel has designated Mattel Sales Corp. and Fisher-Price, Inc. as sub-servicers, as permitted by the facility. Mattel's appointment as a servicer is subject to termination events that are customary for such transactions. The domestic receivables sales facility is also subject to conditions to funding, representations and warranties, undertakings and early termination events that are customary for transactions of this nature. Mattel retains a servicing interest in the receivables sold under this facility.

Until the Master Agreement was terminated on February 9, 2007, Mattel International Holdings B.V., a company incorporated in the Netherlands (the Depositor), Mattel France, a company incorporated in France (Mattel France), and Mattel GmbH, a company incorporated in Germany (Mattel Germany), each of which is a subsidiary of Mattel, and Societe Generale Bank Nederland N.V. (SGBN), were parties to a Master Agreement for the Transfer of Receivables that established a Euro 150 million European trade receivables facility (the European trade receivables facility), pursuant to which Mattel France and Mattel Germany sold trade receivables to SGBN. The European trade receivables facility was subject to conditions to funding, representations and warranties, undertakings and early termination events that were customary for transactions of this nature.

Sales of receivables pursuant to the European trade receivables facility occurred monthly, with the last such sale occurring on January 10, 2007. The receivables were sold by Mattel France and Mattel Germany directly to SGBN for a purchase price equal to the nominal amount of the receivables sold. As a result, no Mattel subsidiary was used as a special purpose entity in connection with these transactions. A portion of the purchase price was funded by SGBN and a portion by a deposit provided by the Depositor. The amount of the deposit was reset on each date on which new receivables were sold. During the 12-month period ending December 31, 2006, the deposit was, on average, equal to about 51% of the aggregate notional amount of sold receivables outstanding during such period.

As with the domestic receivables facility, each sale of accounts receivable was recorded in Mattel's consolidated balance sheet at the time of such sale. Under the European trade receivables facility, the outstanding amount of receivables sold could not exceed Euro 60 million from February 1 through July 31 of each year and could not exceed Euro 150 million at all other times.

Each of Mattel France and Mattel Germany was appointed to service the receivables sold by it to SGBN. No servicing fees were paid by SGBN for such services. The appointment of each of Mattel France and Mattel Germany to act as servicer was subject to termination events that were customary for transactions of this nature.

Mattel France and Mattel Germany were obligated to pay certain fees to the Depositor in consideration of the Depositor providing the deposit to SGBN. During the 12-month period ending December 31, 2006, fees paid

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by Mattel France and Mattel Germany to the Depositor were, on average, approximately 0.11% of the aggregate notional amount of sold receivables outstanding during such period.

In November 2006, the commitment termination date for the European trade receivables facility was extended until February 28, 2007. However, effective on February 9, 2007, the Depositor, Mattel France and Mattel Germany terminated the European trade receivable facility with SGBN. The Company determined the facility was no longer necessary based on projected international cash flows and seasonal financing needs.

Government Regulations and Environmental Quality

Mattel's toy products sold in the US are subject to the provisions of the Consumer Product Safety Act and the Federal Hazardous Substances Act, and may also be subject to the requirements of the Flammable Fabrics Act or the Food, Drug and Cosmetics Act, and the regulations promulgated pursuant to such statutes. The Consumer Product Safety Act and the Federal Hazardous Substances Act enable the Consumer Product Safety Commission (CPSC) to exclude from the market consumer products that fail to comply with applicable product safety regulations or otherwise create a substantial risk of injury, as well as articles that contain excessive amounts of a banned hazardous substance. The CPSC may also require the recall and repurchase or repair of articles that are banned. Similar laws exist in some states and cities and in many international markets.

Mattel maintains a quality control program to ensure compliance with various US federal, state and applicable foreign product safety requirements. Notwithstanding the foregoing, there can be no assurance that all of Mattel's products are or will be free from defects or are hazard-free. A product recall could have a material adverse effect on Mattel's results of operations and financial condition, depending on the product affected by the recall and the extent of the recall efforts required. A product recall could also negatively affect Mattel's reputation and the sales of other Mattel products. See Item 1A Risk Factors Factors That May Affect Future Results.

Mattel's advertising is subject to the Federal Trade Commission Act, The Children's Television Act of 1990, the rules and regulations promulgated by the Federal Trade Commission and the Federal Communications Commission as well as laws of certain countries that regulate advertising and advertising to children. In addition, Mattel's websites that are directed towards children are subject to The Children's Online Privacy Protection Act of 1998. Mattel is subject to various other federal, state and local laws and regulations applicable to its business. Mattel believes that it is in substantial compliance with these laws and regulations.

Mattel's operations are from time to time the subject of investigations, conferences, discussions and negotiations with various federal, state and local environmental agencies with respect to the discharge or cleanup of hazardous waste and compliance by those operations with environmental laws and regulations. See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Environmental and Item 8 Financial Statements and Supplementary Data Note 9 to the Consolidated Financial Statements Environmental.

Employees

The total number of persons employed by Mattel and its subsidiaries at any one time varies because of the seasonal nature of its manufacturing operations. At December 31, 2006, Mattel's total number of employees was approximately 32,000.

Table of Contents**Executive Officers of the Registrant**

The current executive officers of Mattel, all of whom are appointed annually by and serve at the pleasure of the Board of Directors, are as follows:

Name	Age	Position	Executive Officer Since
Robert A. Eckert	52	Chairman of the Board and Chief Executive Officer	2000
Ellen L. Brothers	51	Executive Vice President of Mattel and President, American Girl	2003
Thomas A. Debrowski	56	Executive Vice President, Worldwide Operations	2000
Kevin M. Farr	49	Chief Financial Officer	1996
Neil B. Friedman	59	President, Mattel Brands	1999
Alan Kaye	53	Senior Vice President, Human Resources	2000
Robert Normile	47	Senior Vice President, General Counsel and Secretary	1999
Michael A. Salop	42	Senior Vice President, External Affairs and Treasurer	2005
Bryan Stockton	53	Executive Vice President, International	2000
H. Scott Topham	46	Senior Vice President and Corporate Controller	2004

Mr. Eckert has been Chairman of the Board and Chief Executive Officer since May 2000. He was formerly President and Chief Executive Officer of Kraft Foods, Inc., the largest packaged food company in North America, from October 1997 until May 2000. From 1995 to 1997, Mr. Eckert was Group Vice President of Kraft Foods, Inc. From 1993 to 1995, Mr. Eckert was President of the Oscar Mayer foods division of Kraft Foods, Inc. Mr. Eckert worked for Kraft Foods, Inc. for 23 years prior to joining Mattel.

Ms. Brothers has been Executive Vice President of Mattel and President, American Girl since July 2000. From November 1998 to July 2000, she was Senior Vice President of Operations, Pleasant Company (which merged with and into Mattel on December 31, 2003, followed immediately on January 1, 2004, by an asset transfer to Mattel's subsidiary American Girl). From January 1997 to November 1998, she was Vice President of the Catalogue Division, Pleasant Company. She joined Pleasant Company in 1995, prior to its acquisition by Mattel in July 1998, as Vice President of Catalogue Marketing.

Mr. Debrowski has been Executive Vice President, Worldwide Operations, since November 2000. From February 1992 until November 2000, he was Senior Vice President-Operations and a director of The Pillsbury Company. From September 1991 until February 1992, he was Vice President of Operations for the Baked Goods Division of The Pillsbury Company. Prior to that, he served as Vice President and Director of Grocery Operations for Kraft U.S.A.

Mr. Farr has been Chief Financial Officer since February 2000. From September 1996 to February 2000, he was Senior Vice President and Corporate Controller. From June 1993 to September 1996, he served as Vice President, Tax. Prior to that, he served as Senior Director, Tax from August 1992 to June 1993.

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Mr. Friedman has been President, Mattel Brands (which includes Mattel Girls & Boys Brands US and Fisher-Price Brands US) since October 2005. From March 1999 to October 2005, he was President, Fisher-Price Brands. From August 1995 to March 1999, he was President, Tyco Preschool. For more than five years prior to that time, he was President of MCA/Universal Merchandising, Senior Vice President-Sales, Marketing and

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Design of Just Toys, Vice President and General Manager of Baby Care for Gerber Products, Executive Vice President and Chief Operating Officer of Lionel Leisure, Inc., and President of Aviva/Hasbro.

Mr. Kaye has been Senior Vice President, Human Resources since July 1997. From June 1996 to June 1997 he was President, Texas Division of Kaufman and Broad Homes, a home building company. From June 1991 to June 1996, he served as Senior Vice President, Human Resources for Kaufman and Broad Homes. Prior to that, he worked for two years with the Hay Group, a compensation consulting firm and for 12 years with IBM in various human resources positions.

Mr. Normile has been Senior Vice President, General Counsel and Secretary since March 1999. He served as Vice President, Associate General Counsel and Secretary from August 1994 to March 1999. From June 1992 to August 1994, he served as Assistant General Counsel. Prior to that, he was associated with the law firms of Latham & Watkins LLP and Sullivan & Cromwell LLP.

Mr. Salop has been Senior Vice President, External Affairs and Treasurer since September 2005. He served as Senior Vice President, Strategic Opportunities from May 2004 through September 2005 and Senior Vice President, Corporate Strategic Planning from February 2003 through May 2004. From July 2000 to February 2003 he was Senior Vice President, Finance Europe and from August 1998 through July 2000 he was Vice President, Finance American Girl. Prior to that, he served in various financial roles after joining Mattel in 1990.

Mr. Stockton has been Executive Vice President, International since February 2003. He served as Executive Vice President, Business Planning and Development from November 2000 until February 2003. From April 1998 until November 2000, he was President and Chief Executive Officer of Basic Vegetable Products, the largest manufacturer of vegetable ingredients in the world. For more than 20 years prior to that, he was employed by Kraft Foods, Inc., the largest packaged food company in North America, and was President of Kraft North American Food Service from August 1996 to March 1998.

Mr. Topham has been Senior Vice President and Corporate Controller since September 2005. He served as Senior Vice President and Treasurer from March 2005 to August 2005 and as Vice President and Treasurer from March 2004 to March 2005. Prior to that, he served as Vice President and Assistant Controller from May 2001 to March 2004. From August 2000 to May 2001, he served as Vice President and Treasurer of Premier Practice Management, Inc. From June 1999 to August 2000, he served as Division Vice President of Dataworks, Inc., a specialized publishing company. Prior to that, he spent eight years with Total Petroleum (North America) Ltd., most recently as Vice President of Human Resources.

Available Information

Mattel files its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) with the SEC. The public may read and copy any materials that Mattel files with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet website that contains reports, proxy and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>.

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Mattel's Internet website address is <http://www.mattel.com>. Mattel makes available on its Internet website, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after such materials are electronically filed with, or furnished to, the SEC.

Table of Contents**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 Annual Report on Form 10-K, 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; integration of Radica Games Limited; 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, or other similar words or phrases. Except for historical matters, the matters discussed in this Annual Report on Form 10-K 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 consumer 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. Significant, sudden shifts in demand are caused by hit toys and trends, which are often unpredictable. Mattel offers a diverse range of products for children of all ages and families that includes, among others, toys for infants and preschoolers, girls' toys, boys' toys, youth electronics, hand-held and other games, puzzles, educational toys, media-driven products and fashion-related toys. Mattel competes domestically and internationally with a wide range of large and small manufacturers, marketers and sellers of toys, video games, consumer electronics and other play products, as well as retailers, which means that Mattel's market position is always at risk. Mattel's ability to maintain its current product sales, and increase its product sales or establish product sales with new, innovative toys, will depend on Mattel's ability to satisfy play preferences, enhance existing products, develop and introduce new products, and achieve market acceptance of these products. Competition is intensifying due to recent 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. 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.

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Mattel's business is susceptible to changes in popular culture, media, fashion, and technology. Misperceptions of trends in popular culture, media and movies, fashion, or technology can negatively affect Mattel's sales.

Successful movies and characters in children's literature affect play preferences, and many toys depend on media-based intellectual property licenses. Media-based licenses can cause a line of toys to gain immediate success among children, parents, or families. Trends in media, movies, and children's characters change swiftly and contribute to the transience and uncertainty of play preferences. Mattel responds to such trends and developments by modifying, refreshing, extending, and expanding its product offerings on an annual basis. If Mattel does not accurately anticipate trends in popular culture, movies, media, fashion, or technology, its products may not be accepted by children, parents, or families and could negatively affect Mattel's sales.

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.

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.

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.

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A small number of customers account for a large share of Mattel's net sales. In 2006, Mattel's three largest customers, Wal-Mart, Toys 'R Us and Target, in the aggregate, accounted for approximately 43% of net sales, and its ten largest customers, in the aggregate, accounted for approximately 52% of net sales. The concentration

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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, favor competitors or new entrants, or increase their direct competition with Mattel by expanding their private-label business. 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 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.

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.

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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 and information, including its trademarks, trade names, copyrights, patents and trade secrets in the US and around the world, as well as its customer, employee and consumer data. 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.

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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 offer new innovative toys, 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 investment of capital and 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.

Mattel depends on key personnel and may not be able to hire, retain and integrate sufficient qualified personnel to maintain and expand its business.

Mattel's future success depends partly on the continued contribution of key executives, designers, technical, sales, marketing, manufacturing and administrative personnel. The loss of services of any of Mattel's key personnel could harm Mattel's business. Recruiting and retaining skilled personnel is costly and highly competitive. If Mattel fails to retain, hire, train and integrate qualified employees and contractors, Mattel will not be able to maintain and expand Mattel's business.

Mattel is subject to various laws and government regulations, violation of which could subject it to sanctions. In addition, changes in such 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. While Mattel takes all the steps it believes are necessary to comply with these laws and regulations, there can be no assurance that Mattel will be in compliance in the future. Failure to comply could result in monetary liabilities and other sanctions which could have a negative impact on Mattel's business, financial condition and results of operations. In addition, 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

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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. There can also 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. Further, Mattel cannot be certain that key talented individuals at these acquired companies will continue to work for Mattel after the acquisition or that they will continue to develop popular and profitable products or services. 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 Annual Report on Form 10-K 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 Annual Report on Form 10-K 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.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Mattel owns its corporate headquarters in El Segundo, California, consisting of approximately 335,000 square feet, and an adjacent office building consisting of approximately 55,000 square feet. Mattel also leases buildings in El Segundo consisting of approximately 327,000 square feet. All segments use these facilities. Mattel's Fisher-Price subsidiary owns its headquarters facilities in East Aurora, New York, consisting of approximately 535,000 square feet, which is used by the Fisher-Price Brands US segment and for corporate support functions. American Girl Brands owns its headquarters facilities in Middleton, Wisconsin, consisting of approximately 180,000 square feet, a warehouse in Middleton, consisting of approximately 215,000 square feet, and distribution facilities in Middleton, DeForest and Wilmot, Wisconsin, consisting of a total of approximately 948,000 square feet, all of which are used by the American Girl Brands segment.

Mattel maintains leased sales offices in California, Illinois, Minnesota, New York, and Arkansas and leased warehouse and distribution facilities in California, New Jersey and Texas, all of which are used by the Domestic segment. Mattel has leased retail and related office space in Chicago, Illinois, New York, New York and Los Angeles, California for its American Girl Place® stores, leased retail space in Oshkosh, Wisconsin, which are used by the American Girl Brands segment, and Pomona, California which is used by Mattel Brands. Mattel also has leased office space in Florida, which is used by the International segment, and California, Massachusetts, and Texas, which are used by Radica Games Limited (Radica). Mattel leases a computer facility in Phoenix, Arizona used by all segments. Internationally, Mattel has offices and/or warehouse space in Argentina, Australia, Austria, Belgium, Bermuda, Brazil, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Denmark, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Italy, Japan, Korea, Macau, Mexico, The Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Puerto Rico, Romania, Singapore, South Korea, Spain, Switzerland, Taiwan, Turkey, the United Kingdom and Venezuela which are leased (with the exception of office space in Chile, certain warehouse space in France, and office and warehouse space in Hong Kong, that is

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owned by Mattel) and used by the International segment. Mattel's principal manufacturing facilities are located in China, Indonesia, Thailand, Malaysia and Mexico. See Manufacturing and Materials.

For leases that are scheduled to expire during the next twelve months, Mattel may negotiate new lease agreements, renew existing lease agreements or utilize alternate facilities. See Item 8 Financial Statements and Supplementary Data Note 9 to the Consolidated Financial Statements. Mattel believes that its owned and leased facilities, in general, are suitable and adequate for its present and currently foreseeable needs.

Item 3. Legal Proceedings.

See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations Litigation and Item 8 Financial Statements and Supplementary Data Note 9 to the Consolidated Financial Statements.

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

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

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PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

For information regarding the markets in which Mattel's common stock, par value \$1.00 per share, is traded, see the cover page hereof. For information regarding the high and low closing prices of Mattel's common stock for the last two calendar years, see Item 8 Financial Statements and Supplementary Data Note 13 to the Consolidated Financial Statements.

Holder of Record

As of February 23, 2007, Mattel had approximately 40,000 holders of record of its common stock.

Dividends

In 2006, 2005 and 2004, Mattel paid a dividend per share of \$0.65, \$0.50 and \$0.45, respectively, to holders of its common stock. The board of directors declared the dividend in November, and Mattel paid the dividend in December of each year. The payment of dividends on common stock is at the discretion of Mattel's Board of Directors and is subject to customary limitations.

Securities Authorized for Issuance under Equity Compensation Plans

The information regarding Mattel's equity compensation plans is incorporated herein by reference to Mattel's 2007 Notice of Annual Meeting of Stockholders and Proxy Statement.

Recent Sales of Unregistered Securities

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

Issuer Purchases of Equity Securities

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The Board of Directors approved an increase to the share repurchase program of an additional \$250.0 million in November 2003 and, at that time, there were share repurchase authorizations that had not been executed totaling \$5.6 million. During 2004, Mattel repurchased 14.7 million shares at a cost of \$255.1 million. In 2005, the Board of Directors approved the repurchase of an additional \$500.0 million of Mattel's common stock. During 2005, Mattel repurchased 28.9 million shares at a cost of \$500.4 million. In January 2006, the Board of Directors authorized Mattel to increase its share repurchase program by an additional \$250.0 million. During 2006, Mattel repurchased 11.8 million shares at a cost of \$192.7 million. At December 31, 2006, share repurchase authorizations of \$57.3 million had not been executed. Repurchases take place from time to time, depending on market conditions. Mattel's share repurchase program has no expiration date.

During the fourth quarter of 2006, Mattel did not repurchase any shares of its common stock in the open market.

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	For the Year Ended December 31,				
	2006	2005	2004	2003	2002
(In thousands, except per share and percentage information)					
Operating Results:					
Net sales (a)	\$ 5,650,156	\$ 5,179,016	\$ 5,102,786	\$ 4,960,100	\$ 4,885,340
Gross profit	2,611,793	2,372,868	2,410,725	2,429,483	2,360,987
% of net sales	46.2%	45.8%	47.2%	49.0%	48.3%
Operating income	728,818	664,529	730,817	785,710	733,541
% of net sales	12.9%	12.8%	14.3%	15.8%	15.0%
Income before income taxes	683,756	652,049	696,254	740,854	621,497
Provision for income taxes (b)	90,829	235,030	123,531	203,222	166,455
Income from continuing operations	592,927	417,019	572,723	537,632	455,042
Gain from discontinued operations, net of tax (c)					27,253
Cumulative effect of change in accounting principle, net of tax (d)					(252,194)
Net income	\$ 592,927	\$ 417,019	\$ 572,723	\$ 537,632	\$ 230,101
Net Income Per Common Share Basic:					
Income from continuing operations	\$ 1.55	\$ 1.02	\$ 1.37	\$ 1.23	\$ 1.04
Gain from discontinued operations (c)					0.06
Cumulative effect of change in accounting principle (d)					(0.58)
Net income per common share basic	1.55	1.02	1.37	1.23	0.52
Net Income Per Common Share Diluted:					
Income from continuing operations	1.53	1.01	1.35	1.22	1.03
Gain from discontinued operations (c)					0.06
Cumulative effect of change in accounting principle (d)					(0.57)
Net income per common share diluted	1.53	1.01	1.35	1.22	0.52
Dividends Declared Per Common Share	\$ 0.65	\$ 0.50	\$ 0.45	\$ 0.40	\$ 0.05

	December 31,				
	2006	2005	2004	2003	2002
(In thousands)					
Financial Position:					
Total assets	\$ 4,955,884	\$ 4,372,313	\$ 4,756,492	\$ 4,510,950	\$ 4,459,659
Noncurrent liabilities	940,390	807,395	643,509	826,983	832,194
Stockholders' equity	2,432,974	2,101,733	2,385,812	2,216,221	1,978,712

(a) Effective October 1, 2003, close out sales previously classified as a reduction of cost of sales are now classified as net sales in Mattel's consolidated statements of operations. Close out sales for the fourth quarter of 2003, totaling \$19.2 million, were included in reported net sales. This change in classification had no impact on gross profit, operating income, net income, net income per common share, balance sheets or cash flows.

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The following table provides the quantification of total close out sales by year (in thousands):

<i>For the Year Ended</i>	
<i>2003</i>	<i>2002</i>
\$57,328	\$112,673

- (b) The provision for income taxes in 2006 was positively impacted by the Tax Increase Prevention and Reconciliation Act (the Tax Act) passed in May 2006, and income tax benefits of \$63.0 million related to tax settlements of ongoing audits with foreign tax authorities and a settlement with a state tax authority for tax years 1997 and 1998. The provision for income taxes in 2005 was negatively impacted by incremental tax expense of \$107.0 million, resulting from Mattel's decision to repatriate \$2.4 billion in previously unremitted foreign earnings under the American Jobs Creation Act (the Jobs Act), partially offset by \$38.6 million of tax benefit primarily relating to audit settlements with certain tax authorities in both the US and abroad. The provision for income taxes in 2004 was positively impacted by a \$65.1 million tax benefit related to an audit settlement with the US Internal Revenue Service (IRS).
- (c) The Consumer Software segment, which was comprised primarily of The Learning Company, Inc. (Learning Company), was reported as a discontinued operation effective March 31, 2000, and the consolidated financial statements were reclassified to segregate the operating results of the Consumer Software segment. In 2002, Gores Technology Group completed the sale and liquidation of non-cash proceeds related to the sales of the education and productivity divisions of the former Learning Company, Mattel received \$43.3 million in cash proceeds from Gores Technology Group and recognized a gain on the disposal of discontinued operations of \$27.3 million, net of taxes of \$16.0 million, in the consolidated statement of operations in 2002.
- (d) The cumulative effect of change in accounting principle, net of tax, in 2002, relates to the adoption of SFAS No. 142, Goodwill and Other Intangible Assets, and an impairment of goodwill upon adoption.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the consolidated financial statements and the related notes. See Item 8 Financial Statements and Supplementary Data.

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:

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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 Wheels®, Matchbox® and Tyco® R/C vehicles and playsets (collectively Wheels) and Batman®, ARS, Superman, Radica:® products, and games and puzzles (collectively Entertainment).

Fisher-Price Brands including Fisher-Price®, Little People®, BabyGear and View-Master® (collectively Core Fisher-Price®), Sesame Street®, Dora the Explorer, Go-Diego-Go!, Winnie the Pooh, InteracTV and See N Say® (collectively Fisher-Price® Friends) and Power Wheels®.

American Girl Brands including Just Like You® the 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.

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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. The consolidation of these divisions did not change Mattel's operating segments.

Management believes that the business environment for Mattel in 2007 will be similar to that of 2006. Mattel expects to continue facing challenges both domestically and internationally as retailers continue to 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 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.

Results of Operations

2006 Compared to 2005

Consolidated Results

Net sales for 2006 were \$5.65 billion, a 9% increase compared to \$5.18 billion in 2005, including a 1 percentage point benefit from changes in currency exchange rates. Net income for 2006 was \$592.9 million, or \$1.53 per diluted share, as compared to net income of \$417.0 million, or \$1.01 per diluted share, for 2005.

Gross profit, as a percentage of net sales, increased to 46.2% in 2006 from 45.8% in 2005. The increase in gross profit was driven by price increases and savings from supply chain initiatives, which were partially offset by unfavorable mix, external cost pressures and higher royalty costs.

Income before income taxes as a percentage of net sales declined to 12.1% in 2006 from 12.6% in 2005. Contributing to this decline were higher selling and administrative expenses as a percentage of net sales and lower other non-operating income, partially offset by higher gross margins and lower advertising expenses as a percentage of net sales. Higher selling and administrative expenses were primarily attributed to increased incentive compensation accruals, stock-based compensation including a pre-tax charge of \$19.3 million for prior

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period unintentional stock option accounting errors (see Item 8 Financial Statements and Supplementary Data Note 7 to the Consolidated Financial Statements), costs associated with the opening of the third American Girl Place® retail store in April 2006 and the acquisition of Radica in October 2006, partially offset by savings related to the streamlining of the Mattel Brands organization. Other non-operating (income), net in 2005 included gains from the sale of marketable securities of \$25.8 million. There were no gains or losses from the sale of marketable securities in 2006.

Net income in 2006 was positively impacted by the Tax Act passed in May, and income tax benefits of \$63.0 million related to settlements of multiple ongoing audits by foreign tax authorities and a settlement with a state tax authority for tax years 1997 and 1998. Net income in 2005 was negatively impacted by incremental tax expense of \$107.0 million, resulting from Mattel's decision to repatriate \$2.4 billion in previously unremitted foreign earnings under The American Jobs Creation Act (the Jobs Act), partially offset by \$38.6 million of tax benefits primarily relating to audit settlements with certain tax authorities in both the US and abroad.

Shares repurchased under Mattel's share repurchase program resulted in a benefit to Mattel's earnings per share in 2006 when compared to 2005, by reducing the average number of common shares outstanding. Since inception of the share repurchase program in July 2003, Mattel has repurchased 68.1 million shares, representing 15% of common shares outstanding.

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

	For the Year					
	2006		2005		Year/Year Change	
	Amount	% of Net Sales	Amount	% of Net Sales	%	Basis Points of Net Sales
Net sales	\$ 5,650.2	100.0%	\$ 5,179.0	100.0%	9%	
Gross profit	\$ 2,611.8	46.2%	\$ 2,372.9	45.8%	10%	40
Advertising and promotion expenses	651.0	11.5	629.1	12.1	3%	(60)
Other selling and administrative expenses	1,232.0	21.8	1,079.3	20.8	14%	100
Operating income	728.8	12.9	664.5	12.8	10%	10
Interest expense	79.9	1.4	76.5	1.5	4%	(10)
Interest (income)	(30.5)	0.5	(34.2)	0.7	11%	20
Other non-operating (income), net	(4.4)		(29.8)			
Income before income taxes	\$ 683.8	12.1%	\$ 652.0	12.6%	5%	(50)

Sales

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Net sales for 2006 were \$5.65 billion, a 9% increase compared to \$5.18 billion in 2005, including a 1 percentage point benefit from changes in currency exchange rates. Gross sales within the US increased 8% from 2005 and accounted for 56% of consolidated gross sales in 2006 and 2005. In 2006, gross sales in international markets increased 11% compared to 2005, including a 2 percentage point benefit from changes in currency exchange rates.

Worldwide gross sales of Mattel Girls & Boys Brands increased 9% to \$3.42 billion in 2006 compared to 2005, including fourth quarter sales of Radica:® products and a 1 percentage point benefit from changes in currency exchange rates. Domestic gross sales increased 10% and international gross sales increased 8%, including a 2 percentage point benefit from changes in currency exchange rates. Worldwide gross sales of Barbie® were flat, including a 1 percentage point benefit from changes in currency exchange rates. Domestic gross sales of Barbie® increased 3% and international gross sales of Barbie® decreased 2%, including a 2 percentage point benefit from changes in currency exchange rates. Worldwide gross sales of Other Girls Brands

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increased 11% from 2005, including a 1 percentage point benefit from changes in currency exchange rates, primarily driven by strong sales of Polly Pocket! and Pixel Chix worldwide and the continued success of Winx Club in international markets.

Worldwide gross sales in the Wheels category decreased 1% compared to 2005, including a 1 percentage point benefit from changes in currency exchange rates. Strong sales of Hot Wheels® and Matchbox® products internationally were more than offset by Hot Wheels® sales declines in the US and Tyco® R/C sales declines worldwide. Worldwide gross sales in the Entertainment category, which includes games and puzzles and Radica:® products, increased by 34% compared to 2005, with no impact from changes in currency exchange rates. Excluding Radica:® products, worldwide gross sales increases in the Entertainment category, were driven by the worldwide success of CARS and Superman products, which more than offset worldwide sales declines of Batman and Yu-Gi-Oh! products.

Worldwide gross sales of Fisher-Price Brands increased 12% to \$2.27 billion in 2006 compared to 2005, including a 1 percentage point benefit from changes in currency exchange rates. Domestic gross sales increased 8%, while international gross sales increased 20%, including a benefit of 2 percentage point benefit from changes in currency exchange rates. Worldwide gross sales of Core Fisher-Price® increased 11% compared to 2005, including a 1 percentage point benefit from changes in currency exchange rates, primarily driven by the worldwide success of BabyGear and infant and newborn products. Worldwide gross sales of Fisher-Price® Friends increased 19% compared to 2005, including a 1 percentage point benefit from changes in currency exchange rates, driven by several Nickelodeon properties including Go-Diego-Go!, Dora the Explorer, and The Backyardigans and T.M.X Elmo from Sesame Street®.

Gross sales of American Girl Brands increased 1% to \$440.0 million in 2006 compared to 2005, driven by the American Girl Place® retail stores, including American Girl®'s third store which opened in Los Angeles, California in April 2006. Growth in the retail stores was partially offset by a decline in the catalog business.

Cost of Sales

Cost of sales increased by \$232.2 million, or 8%, from \$2.81 billion in 2005 to \$3.04 billion in 2006, as compared to a 9% increase in net sales. On an overall basis, cost of sales increased primarily due to increased sales volume. Within cost of sales, product costs increased by \$204.9 million, or 9%, from \$2.21 billion in 2005 to \$2.42 billion in 2006, which was primarily driven by increased sales volume and higher external cost pressures, partially offset by cost savings realized from supply chain efficiency initiatives. Royalty expense increased by \$35.6 million, or 16%, from \$225.6 million in 2005 to \$261.2 million in 2006, and is reflective of higher sales of licensed products in 2006. Freight and logistics expenses decreased by \$8.2 million, or 2%, from \$365.5 million in 2005 to \$357.3 million in 2006. The decrease in freight and logistics expenses was primarily due to supply chain savings and distribution center efficiency initiatives, including strategies to shorten customer shipping distances, partially offset by increased sales volume.

Gross Profit

Gross profit, as a percentage of net sales, was 46.2% in 2006 compared to 45.8% in 2005. The increase in gross profit was driven by price increases and supply chain savings, which were partially offset by higher external cost pressures and unfavorable product mix, including higher royalty costs for licensed products.

Advertising and Promotion Expenses

Advertising and promotion expenses were 11.5% of net sales in 2006, compared to 12.1% in 2005 due primarily to overall higher sales volume and greater leverage in advertising spending. Mattel expects advertising spending levels for 2007 to be fairly consistent with its 11%-13% historical range to support its plan to invest in the business to drive long-term performance.

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Other Selling and Administrative Expenses

Other selling and administrative expenses were \$1.23 billion in 2006, or 21.8% of net sales, compared to \$1.08 billion in 2005, or 20.8% of net sales. The increase in other selling and administrative expenses in 2006 is primarily attributable to an \$86.3 million increase in incentive compensation accruals, an increase of \$27.3 million in stock-based compensation, including a pre-tax charge of \$19.3 million for prior period unintentional stock option accounting errors (see Item 8 Financial Statements and Supplementary Data Note 7 to the Consolidated Financial Statements), costs associated with the third American Girl Place[®] retail store, and additional selling and administrative expenses for Radica (acquired in October 2006), partially offset by savings related to the 2006 streamlining of the Mattel Brands organization.

Non-Operating Items

Interest expense was \$79.9 million in 2006 compared to \$76.5 million in 2005 due to higher average long-term borrowings and higher short-term interest rates, partially offset by lower average short-term borrowings. Interest income decreased from \$34.2 million in 2005 to \$30.5 million in 2006 due to lower average invested cash balances. Other non-operating (income), net was \$4.3 million compared to \$29.8 million in 2005. Other non-operating income in 2005 included gains from the sale of marketable securities of \$25.8 million. There were no gains or losses from the sale of marketable securities in 2006.

As of December 31, 2006 and 2005, Mattel held no marketable securities.

Provision for Income Taxes

Net income in 2006 was positively impacted by the Tax Act passed in May 2006, and income tax benefits of \$63.0 million related to settlements of ongoing audits with foreign tax authorities and a settlement with a state tax authority for tax years 1997 and 1998, which were recorded in the first two quarters of 2006. Net income in 2005 was negatively impacted by incremental tax expense of \$107.0 million, resulting from Mattel's decision to repatriate \$2.4 billion in previously unremitted foreign earnings under the Jobs Act, partially offset by \$38.6 million of tax benefits primarily relating to audit settlements with certain tax authorities in both the US and abroad.

Operating Segment Results

Mattel's operating 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. Operating segment results should be read in conjunction with Item 8 Financial Statements and Supplementary Data Note 10 to the Consolidated Financial Statements.

Domestic Segment

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Mattel Girls & Boys Brands US gross sales increased 10% in 2006 compared to 2005. Within this segment, gross sales of Barbie® increased 3% and gross sales of Other Girls Brands decreased 5%. Gross sales in the Wheels category decreased 9% driven by sales declines in Hot Wheels® and Tyco® R/C product lines. Gross sales in the Entertainment category, which includes games and puzzles and Radica:® products, increased 61% driven by the success of CARS and Superman products and Radica:® products, which more than offset sales declines in Batman and Yu-Gi-Oh!. Mattel Girls & Boys Brands US segment income increased 29% to \$267.2 million in 2006, primarily due to higher sales volume and improved gross profit, partially offset by higher other selling and administrative expenses. The increase in gross profit is due to higher sales volume, including Radica:® products, price increases and supply chain savings, partially offset by external cost pressures and unfavorable mix.

Fisher-Price Brands US gross sales increased 8%, reflecting an increase in sales of Core Fisher Price® and Fisher Price® Friends products. Sale increases in Core Fisher Price® products reflected strong sales of

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BabyGear and infant and newborn products. Sales increases in Fisher-Price® Friends were driven by several Nickelodeon properties including Go-Diego-Go!, Dora the Explorer, and The Backyardigans and Sesame Street®. Fisher-Price Brands US segment income increased 25% to \$216.1 million in 2006, primarily due to higher sales volume and improved gross profit resulting from price increases and favorable product mix, partially offset by higher external cost pressures.

American Girl Brands gross sales increased 1% from the prior year. American Girl Brands segment income decreased from \$106.2 million to \$97.0 million in 2006, primarily driven by higher other selling and administrative expenses associated with the American Girl Place® retail store in Los Angeles which opened in 2006.

International Segment

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

Non-US Regions:	% Change in Gross Sales	Impact of Change in Currency Rates (in % pts)
Europe	9	2
Latin America	15	1
Asia Pacific	10	
Other	12	4
Total International	11	2

International gross sales increased 11% in 2006 compared to 2005, including a 2 percentage point benefit from changes in currency exchange rates. Gross sales of Barbie® decreased 2%, including a 2 percentage point benefit from changes in currency exchange rates. Gross sales of Other Girls Brands increased 26%, including a 3 percentage point benefit from changes in currency exchange rates, primarily driven by increased sales of Polly Pocket!, Pixel Chix and Winx Club. Gross sales in the Wheels category grew by 7%, including a 2 percentage point benefit from changes in currency exchange rates, mainly driven by the success of Hot Wheels® and Matchbox® products, partially offset by Tyco® R/C sales declines. Gross sales in the Entertainment category increased by 15%, mainly due to strong sales in CARS and Superman products, which more than offset decline in sales of Batman and Yu-Gi-Oh! products. Fisher-Price Brands gross sales increased 20%, including a 2 percentage point benefit from changes in currency exchange rates, due to increased sales of Core Fisher-Price® products, primarily infant and newborn and BabyGear products and growth in Fisher-Price® Friends, mainly Dora the Explorer and Go-Diego-Go! properties, and T.M.X. Elmo from Sesame Street®. International segment income increased 33% to \$419.1 million in 2006, as a result of an increase in sales volume, improved gross profit and benefits from changes in currency exchange rates. Improved gross profit resulted from price increases, partially offset by external cost pressures, unfavorable product mix, and higher royalty costs.

2005 Compared to 2004*Consolidated Results*

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Net sales for 2005 were \$5.18 billion, a 1% increase compared to \$5.10 billion in 2004, including a 1 percentage point benefit from changes in currency exchange rates. Net income for 2005 was \$417.0 million, or \$1.01 per diluted share, as compared to net income of \$572.7 million, or \$1.35 per diluted share, for 2004.

Gross profit, as a percentage of net sales, declined from 47.2% in 2004 to 45.8% in 2005. Higher external cost pressures, higher sales of lower margin products, including the impact of sales mix, and higher royalty costs

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were the primary drivers for the decline in gross profit, partially offset by a moderate price increase implemented in January 2005 and favorable changes in currency exchange rates.

Income before income taxes declined as a percentage of net sales in 2005 compared to 2004. Contributing to this decline were overall lower gross margins, higher selling, general and administrative costs due to upward cost pressures for employee-related expenses and ongoing investments in growth strategies including new product design and expansion of our American Girl Place[®] retail stores, partially offset by lower incentive compensation, lower advertising expenses and favorable changes in currency exchange rates. Income before income taxes in 2004 was negatively impacted by a pre-tax charge of \$16.2 million, primarily related to the elimination of approximately 285 positions as a result of headcount reductions, and integration of the Matchbox[®] and Tyco[®] R/C business into the Hot Wheels[®] business in California, partially offset by net favorable legal settlements.

Net income in 2005 was negatively impacted by incremental tax expense of \$107.0 million resulting from Mattel's decision to repatriate \$2.4 billion in previously unremitted foreign earnings under the Jobs Act, partially offset by \$38.6 million of tax benefit primarily relating to audit settlements with certain tax authorities in both the US and abroad. Net income in 2004 was positively impacted by a \$65.1 million tax benefit related to an audit settlement with the IRS.

Shares repurchased under Mattel's share repurchase program resulted in a benefit to Mattel's earnings per share in 2005 when compared to 2004, by reducing the average number of common shares outstanding.

The following table provides a summary of Mattel's consolidated results for 2005 and 2004 (in millions, except percentage and basis point information):

	For the Year					
	2005		2004		Year/Year Change	
	Amount	% of Net Sales	Amount	% of Net Sales	%	Basis Points of Net Sales
Net sales	\$ 5,179.0	100.0%	\$ 5,102.8	100.0%	1%	
Gross profit	\$ 2,372.9	45.8%	\$ 2,410.7	47.2%	2%	(140)
Advertising and promotion expenses	629.1	12.1	643.0	12.6	2%	(50)
Other selling and administrative expenses	1,079.3	20.8	1,036.9	20.3	4%	50
Operating income	664.5	12.8	730.8	14.3	9%	(150)
Interest expense	76.5	1.5	77.8	1.5	2%	
Interest (income)	(34.2)	0.7	(19.7)	0.4	74%	(30)
Other non-operating (income), net	(29.8)		(23.5)			
Income before income taxes	\$ 652.0	12.6%	\$ 696.2	13.6%	6%	(100)

Sales

Net sales for 2005 were \$5.18 billion, a 1% increase compared to \$5.10 billion in 2004, including a 1 percentage point benefit from changes in currency exchange rates. Gross sales within the US decreased 2% from 2004 and accounted for 56% of consolidated gross sales in 2005 compared to 58% in 2004. In 2005, gross sales in international markets increased 5% compared to 2004, including a 1 percentage point benefit from changes in currency exchange rates.

Worldwide gross sales of Mattel Girls & Boys Brands decreased 3% to \$3.14 billion in 2005 compared to 2004, including a 1 percentage point benefit from changes in currency exchange rates. Domestic gross sales decreased 10% and international gross sales increased 3%, including a 1 percentage point benefit from changes in currency exchange rates. Worldwide gross sales of Barbie® decreased 13% from 2004, including a

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1 percentage point benefit from changes in currency exchange rates. Domestic gross sales of Barbie® decreased 21% and international gross sales of Barbie® decreased 7%, including a 1 percentage point benefit from changes in currency exchange rates. Worldwide gross sales of Other Girls Brands increased 25% from 2004, including a 1 percentage point benefit from changes in currency exchange rates, primarily driven by sales of Disney Princesses, Pound Puppies and Pixel Chix worldwide, and Winx Club in international markets. Worldwide gross sales in the Wheels category decreased 1% compared to 2004, including a 2 percentage point benefit from changes in currency exchange rates. International gross sales increases in the Hot Wheels® and Tyco® R/C product lines were more than offset by sales declines in the US. Worldwide gross sales in the Entertainment category were flat with the prior year, including a 2 percentage point benefit from changes in currency exchange rates. In the Entertainment category, growth in worldwide sales of Batman products was partially offset by sales declines in Yu-Gi-Oh! and Harry Potter worldwide, and JuiceBox in the US.

Worldwide gross sales of Fisher-Price Brands increased 5% to \$2.02 billion in 2005 compared to 2004, with no impact from changes in currency exchange rates. Domestic gross sales increased 3%, while international gross sales grew low double digits. Worldwide gross sales of Core Fisher-Price® increased 1% compared to 2004, with no impact from changes in currency exchange rates, primarily driven by infant products and continued growth in the BabyGear line internationally. Worldwide gross sales of Fisher-Price® Friends increased 18% compared to 2004, with no impact from changes in currency exchange rates, mainly attributable to the continued strength of the Dora the Explorer property.

Gross sales of American Girl Brands increased 15% to \$436.1 million in 2005 compared 2004, primarily due to continued strong performance of the American Girl Place® retail stores and the direct channels, driven by the success of the Marisol doll and book from the Just Like You contemporary line, and doll and book products related to the American Girl® live-action, made-for-TV movies.

Cost of Sales

Cost of sales increased by \$114.1 million, or 4%, from \$2.69 billion in 2004 to \$2.81 billion in 2005, as compared to a 1% increase in net sales. On an overall basis, cost of sales increased primarily due to increased sales volume, external cost pressures, and higher royalty costs for licensed products. Within cost of sales, product costs increased by \$74.7 million, or 3%, from \$2.14 billion in 2004 to \$2.21 billion in 2005, which was primarily driven by increased sales volume and external cost pressures. Royalty expense increased by \$21.1 million, or 10%, from \$204.5 million in 2004 to \$225.6 million in 2005, and is reflective of higher sales of licensed products in 2005. Freight and logistics expenses increased by \$18.2 million, or 5%, from \$347.3 million in 2004 to \$365.5 million in 2005, which was primarily driven by increased sales volume and external cost pressures.

Gross Profit

Gross profit, as a percentage of net sales, was 45.8% in 2005 compared to 47.2% in 2004. The decrease in gross profit, as a percentage of net sales, resulted from higher external cost pressures, higher sales of lower margin products, including the impact of sales mix, and higher royalty costs. These factors were partially offset by favorable changes in currency exchange rates and a moderate price increase implemented in January 2005.

Advertising and Promotion Expenses

Advertising and promotion expenses were 12.1% of net sales in 2005, compared to 12.6% in 2004.

Other Selling and Administrative Expenses

Other selling and administrative expenses were \$1.08 billion in 2005, or 20.8% of net sales, compared to \$1.04 billion in 2004, or 20.3% of net sales. Other selling and administrative expenses increased in 2005, primarily due to the following:

Higher external cost pressures and employee-related costs;

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Investments in growth initiatives including new product design and development and higher overhead costs in 2005 associated with the third American Girl Place[®] retail store that opened in April 2006; and

Net favorable legal settlements in 2004 that did not recur in 2005.

The consolidation of its Mattel Girls & Boys Brands US and Fisher-Price Brands US divisions into one division included the elimination of executive-level positions and resulted in severance charges totaling \$7.1 million in 2005, of which \$6.1 million resulted from the elimination of the position of president of the Mattel Girls & Boys Brands US division. The overall increase in other selling and administrative expenses was partially offset by a \$16.2 million charge for severance in 2004 related to the elimination of approximately 285 positions, resulting from headcount reductions and the relocation of the Matchbox[®] and Tyco[®] R/C brands from New Jersey to California and lower incentive compensation in 2005.

Non-Operating Items

Interest expense decreased from \$77.8 million in 2004 to \$76.5 million in 2005 due to lower average debt in 2005, partially offset by higher average short-term borrowing rates. Interest income increased from \$19.7 million in 2004 to \$34.2 million in 2005, primarily as a result of higher interest rates. Other non-operating (income), net was \$29.8 million in 2005, comprised mainly of a \$25.8 million gain from the sale of marketable securities. Other non-operating (income), net was \$23.5 million in 2004, comprised mainly of a \$22.1 million gain from the sale of marketable securities.

As of December 31, 2005, Mattel held no marketable securities. As of December 31, 2004, the pre-tax unrealized gains on marketable securities held by Mattel were \$26.1 million (\$16.4 million after-tax).

Provision for Income Taxes

Net income in 2005 was negatively impacted by incremental tax expense of \$107.0 million, resulting from Mattel's decision to repatriate \$2.4 billion in previously unremitted foreign earnings under the Jobs Act and was positively impacted by \$38.6 million of tax benefit primarily relating to audit settlements with certain tax authorities in both the US and abroad. Net income in 2004 was positively impacted by a \$65.1 million tax benefit related to an audit settlement with the IRS.

Operating Segment Results

Mattel's operating 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. Operating Segment Results should be read in conjunction with Item 8 Financial Statements and Supplementary Data Note 10 to the Consolidated Financial Statements.

Domestic Segment

Mattel Girls & Boys Brands US gross sales decreased 10% in 2005 compared to 2004. Within this segment, gross sales of Barbie® declined 21% and gross sales of Other Girls Brands increased double-digits, primarily driven by increased sales of Disney Princesses, Pound Puppies and Pixel Chix. Gross sales in the Wheels category decreased 8% driven by sales declines in all the Wheels brands. Gross sales in the Entertainment category decreased double digits, primarily driven by sales declines in Yu-Gi-Oh! and JuiceBox which offset strong sales of Batman products. Mattel Girls & Boys Brands US segment income decreased 37% to \$206.5 million in 2005, primarily due to lower sales volume and a decline in gross profit resulting from increased sales of lower margin products, including the impact of sales mix, increased royalty costs and ongoing external cost pressures.

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Fisher-Price Brands US gross sales increased 3%, reflecting an increase in sales of Fisher-Price® Friends, driven by the continued success of the Dora the Explorer property. Sales increases in Fisher-Price® Friends were partially offset by a decrease in sales of Power Wheels® and a decrease in sales of Core Fisher Price® products, which included strong sales of infant and BabyGear lines. Fisher-Price Brands US segment income was \$173.0 million in 2005, which was flat compared to 2004, primarily due to higher sales volume offset by higher employee-related costs, additional investment in product design and development, and ongoing external cost pressures.

American Girl Brands gross sales increased 15%, primarily as a result of the continued strong performance of the American Girl Place® retail stores and the direct channels, driven by the success of the Marisol doll and book from the Just Like You contemporary line, and doll and book products related to the American Girl® live-action, made-for-TV movies. American Girl Brands segment income increased 37% to \$106.2 million in 2005, driven by higher sales volume, improved gross profit, and tight management of costs.

International Segment

The following table provides a summary of percentage changes in gross sales within the International segment in 2005 versus 2004:

Non-US Regions:	% Change in Gross Sales	Impact of Change in Currency Rates (in % pts)
Europe		(1)
Latin America	23	8
Asia Pacific	7	2
Other	(3)	5
Total International	5	1

International gross sales increased 5% in 2005 compared to 2004, including a 1 percentage point benefit from changes in currency exchange rates. Gross sales of Barbie® decreased 7%, including a 1 percentage point benefit from changes in currency exchange rates and gross sales of Other Girls Brands increased double-digits, including a 2 percentage point benefit from changes in currency exchange rates, primarily driven by increased sales of Disney Princesses, Pound Puppies and Winx Club. Gross sales in the Wheels category grew by mid single-digits in 2005 compared to 2004, mainly due to growth in sales of Hot Wheels® products. Gross sales in the Entertainment category increased by double-digits in 2005 compared to 2004, primarily due to strong sales in the male-action properties including Batman, Robots and MegaMan, partially offset by declines in Harry Potter and Yu-Gi-Oh! properties. Fisher-Price Brands gross sales increased 11%, including a 1 percentage point benefit from changes in currency exchange rates, due to strong growth in Core Fisher-Price® products, primarily infant and BabyGear lines, and Fisher-Price® Friends, mainly Dora the Explorer properties. International segment income increased 6% to \$316.2 million in 2005, as a result of an increase in sales volume, benefits from changes in currency exchange rates and a modest price increase, partially offset by increased external cost pressures, higher employee-related costs and investments in emerging international markets.

Income Taxes

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Mattel's effective tax rate on income before income taxes in 2006 was 13.3% compared to 36.0% in 2005. The 2006 income tax provision includes a tax benefit \$63.0 million related to settlements with foreign and state taxing authorities. Of the total benefit recorded, \$57.5 million represents refunds of previously paid taxes, recorded as an expense in previous years. These refunds were recorded as a reduction to income tax expense in the period the refunds were received by Mattel. The balance of the tax benefit recorded in 2006 was a net reduction to total income tax reserves resulting from tax settlements with foreign and state tax authorities. The

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2006 income tax provision was also positively impacted by approximately \$37 million as a result of the Tax Act passed in May 2006.

The 2005 income tax provision includes estimated US federal and state taxes of \$107.0 million related to Mattel's repatriation of \$2.4 billion in qualifying dividends from Mattel's foreign subsidiaries pursuant to the Jobs Act. The 2005 effective tax rate also includes a tax benefit of \$38.6 million primarily related to audit settlements reached with certain tax authorities in both the US and abroad. In 2005, the IRS completed its examination of Mattel's US federal income tax returns through 2003.

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.

Operating Activities

Cash flows generated from operating activities were \$875.9 million during 2006, compared to \$466.7 million in 2005 and \$570.4 million in 2004. The increase in cash flows from operating activities in 2006 from 2005 was primarily the result of higher net income and lower working capital, mainly due to higher levels of accounts payable and accrued expenses due primarily to higher incentive accruals, and the timing of vendor payments, partially offset by higher accounts receivable at December 31, 2006. The decrease in cash flows from operating activities in 2005 from 2004 was primarily due to lower net income and a change in working capital

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requirements, mainly due to payments made in 2005 related to year-end 2004 accruals to vendors and foreign tax authorities.

Investing Activities

On October 3, 2006, Mattel completed its acquisition of Radica for net cash paid of \$196.4 million, which includes the purchase price and acquisition costs of \$235.1 million, net of cash acquired of \$38.7 million. Mattel's acquisition of Radica is intended to maximize and combine the core competencies of each company, as well as provide growth opportunities internationally and for existing brands like Barbie®, Hot Wheels®, and Fisher-Price®. See Item 8 Financial Statements and Supplementary Data Note 12 to the Consolidated Financial Statements.

Cash flows used for investing activities were \$314.8 million during 2006, primarily due to the acquisition of Radica, investments in tooling to support existing and new products and Mattel's long-term information technology strategy, partially offset by proceeds from the sale of property, plant and equipment. Cash flows used for investing activities were higher in 2006 as compared to 2005 due to the Radica acquisition and lower proceeds from the sale of investments. Cash flows used for investing activities were lower in 2005 as compared to 2004 due to higher proceeds from the sale of investments and lower payments for business acquired in 2005, partially offset by higher investments in other property, plant and equipment in 2005 as a result of investment in Mattel's long-term information technology strategy and spending associated with the construction of the new American Girl Place® in Los Angeles. In 2004, Mattel used cash flows for investing activities of \$108.1 million. Capital expenditures were partially offset by proceeds from the sale of investments and property, plant and equipment, primarily related to the disposal of property in Mexico that was no longer needed when manufacturing operations in Mexico were combined as part of the financial realignment plan.

Financing Activities

Cash flows used for financing activities decreased to \$374.1 million in 2006 from \$537.3 million in 2005 as a result of lower share repurchases, higher proceeds from the exercise of stock options, and the issuance of \$300.0 million of Senior Notes in June 2006, which were partially offset by higher payments on short-term borrowings, the repayment of \$175.0 million of the MAPS term loan facility in December 2006 and \$50.0 million of Medium-term notes in May and September 2006 and increased dividend payments. Cash flows used for financing activities increased \$71.0 million to \$537.3 million in 2005 compared to 2004, primarily due to the repayment of \$150.0 million of 6 1/8% senior notes in July 2005 and the 10.15% mortgage note for \$39.1 million in November 2005 upon maturity, higher dividends paid and an increase in share repurchases in 2005, partially offset by \$225.0 million of proceeds from the MAPS term loan facility and \$100.0 million under the MAPS revolving loan facility.

The Board of Directors approved an increase to the share repurchase program of an additional \$250.0 million in November 2003 and, at that time, there were share repurchase authorizations that had not been executed totaling \$5.6 million. During 2004, Mattel repurchased 14.7 million shares at a cost of \$255.1 million. In 2005, the Board of Directors approved the repurchase of an additional \$500.0 million of Mattel's common stock. During 2005, Mattel repurchased 28.9 million shares at a cost of \$500.4 million, of which \$487.1 million was paid during 2005. In January 2006, the Board of Directors authorized Mattel to increase its share repurchase program by an additional \$250.0 million. During 2006, Mattel repurchased 11.8 million shares at a cost of \$192.7 million. The total amount paid for share repurchases in 2006 was \$205.9 million. At December 31, 2006, share repurchase authorizations of \$57.3 million had not been executed. Repurchases take place from time to time, depending on market conditions. Mattel's share repurchase program has no expiration date.

In 2006, 2005 and 2004, Mattel paid a \$0.65 per share, \$0.50 per share, and \$0.45 per share dividend to holders of its common stock, respectively. The Board of Directors declared the dividend in November, and

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Mattel paid the dividend in December of each year. The dividend payments were \$249.5 million, \$200.5 million, and \$186.9 million in 2006, 2005 and 2004, respectively.

Seasonal Financing

Mattel maintains and periodically amends or replaces a \$1.3 billion 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 agreement in effect was amended and restated in March 2005 and the expiration date of the facility was extended to March 23, 2010. The other 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 each fiscal quarter and fiscal year in 2006. As of December 31, 2006, Mattel's consolidated debt-to-capital ratio, as calculated per the terms of the credit agreement, was 0.29 to 1 (compared to a maximum allowed of 0.50 to 1) and Mattel's interest coverage ratio was 11.72 to 1 (compared to a minimum allowed of 3.50 to 1).

On December 9, 2005, Mattel, 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 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. On December 15, 2006, in addition to the required payment of \$50.0 million, MAPS prepaid an incremental \$125.0 million of the MAPS term loan facility. The remaining \$50.0 million principal amount, consisting of \$14.3 million due on December 15, 2007 and \$35.7 million due on December 9, 2008, was prepaid on January 16, 2007. As of December 31, 2006, there was no balance outstanding on the MAPS revolving loan facility. 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 December 31, 2006.

To finance seasonal working capital requirements of certain foreign subsidiaries, Mattel avails itself of individual short-term credit lines with a number of banks. As of December 31, 2006, foreign credit lines totaled approximately \$200 million, a portion of which are used to support letters of credit. Mattel expects to extend the majority of these credit lines throughout 2007.

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

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interest to the redemption date, or (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 loss. Under the terms of the agreements, Mattel receives quarterly interest payments from the swap counterparties based on the three-month LIBOR plus 40 basis points and makes 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, which corresponds with the maturity of the Floating Rate Senior Notes.

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. In March 2006, this same credit rating agency reduced Mattel's long-term credit rating to BBB- and changed the outlook from negative to stable. 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 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 2007, amounts available under its domestic unsecured committed revolving credit facility, the MAPS facility, and its foreign credit lines will be adequate to meet its seasonal financing requirements in 2007. As of December 31, 2006, Mattel had available incremental borrowing resources totaling approximately \$1.3 billion under its domestic unsecured committed revolving credit facility, the MAPS facility and foreign credit lines.