



MATTEL AND FUNKO

M&A Strategic Alternatives and Analysis



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Company Overview - Mattel

M&A Strategic Alternatives and Analysis



Company Overview

Overview: Mattel (Nasdaq: MAT) is a leading global toy company and the owner of a portfolio of iconic brands and partners with global entertainment companies to license other intellectual property. It has ranked as the #1 toy company in the US for 29 consecutive years, #2 in Europe, #1 in Latin America, and #2 in Australia.

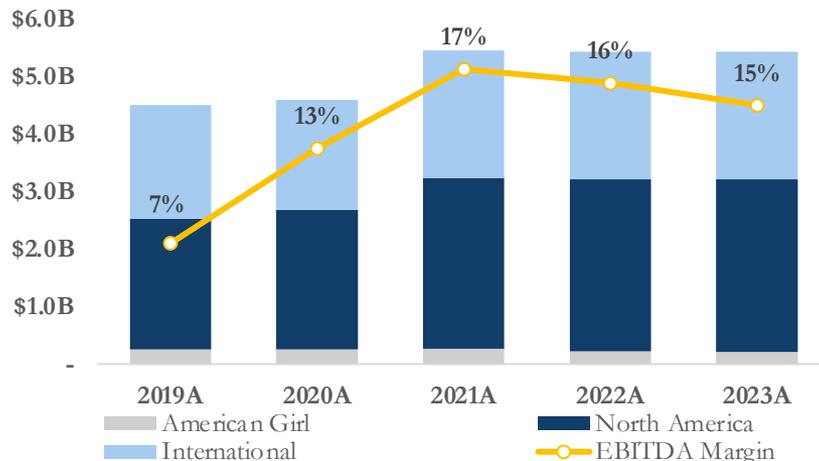
Current Strategy: The long-term strategy is to grow Mattel's Intellectual Property (IP)-driven toy collectibles business, with licensing partnerships for movies, TV shows, and more. In 2020, the company launched the Mattel Creations website, now hosting Barbie Signature, Hot Wheels, Skullector, and Disney collectibles sections, demonstrating Mattel's further expansion into IP-driven collectibles.

M&A Rationale: Riding the success of the Barbie movie, Mattel anticipates gaining a portion of ticket and streaming revenue as a production partner. The company has funds available to accelerate its topline growth and increase profitability through acquisitions. While Mattel has limited exposure in the Action Figures segment compared to competitors, it can leverage the popularity of Action Figures to grow its collectible business, and inorganic growth through M&A is one potential avenue.

Revenue Breakdown

Annual Sales (USD) by Operational Segment

2019 FY – 2023 FY



Current Market Data

Market Cap	\$6.8B	Revenue (FY2023)	\$5.4B
Enterprise Value	\$8.1B	EBITDA (FY2023)	\$816.7M
Share Price	\$17.8	Gross Profit Margin	47.5%
52 week-high	\$22.6	Debt/Capital	54.6%
52 week-low	\$15.4	P/E	32.1x
Cash	\$1.3B	Debt	\$2.6B

*Currency in USD 24/02/2024

Management Team

Chairman and Chief Executive Officer: Ynon Kreiz



- Mr. Kreiz has had extensive experience as a corporate leader in the media and entertainment industry. Prior to joining Mattel, he was Chairman and CEO of Maker Studios, a global leader in short-form video content and one of YouTube's largest multichannel networks. Maker Studios was acquired by The Walt Disney Company in 2014.

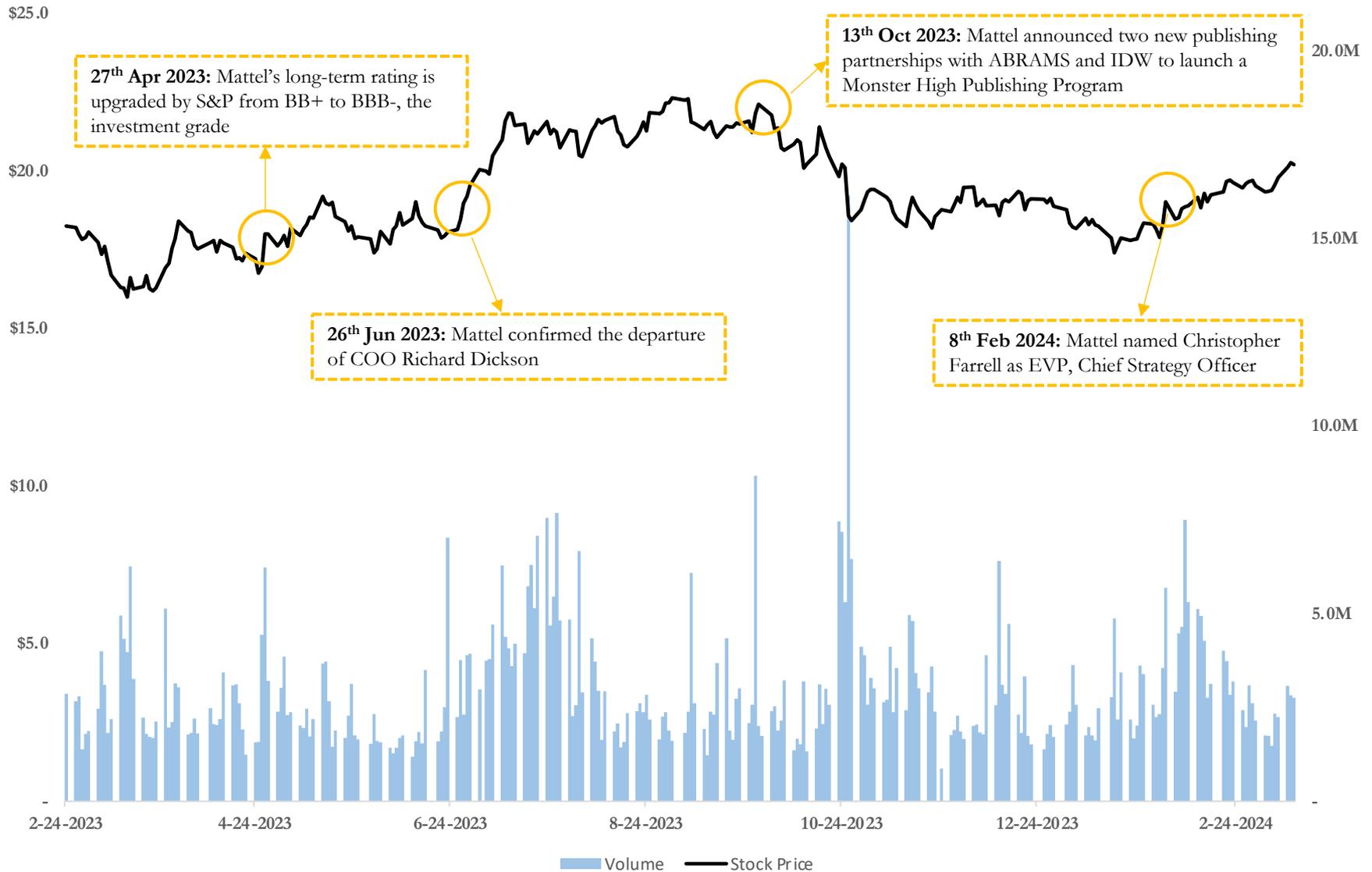
Chief Financial Officer: Anthony DiSilvestro



- Prior to joining Mattel, Mr. DiSilvestro had nearly four decades of finance and leadership experience, most recently as Senior Vice President and Chief Financial Officer of Campbell Soup Company, from 2014 to 2019. In this position, he helped drive a return to growth and oversaw a successful transformation of the Campbell's cost structure.

1-Year Stock Price- Mattel

M&A Strategic Alternatives and Analysis



Company Overview

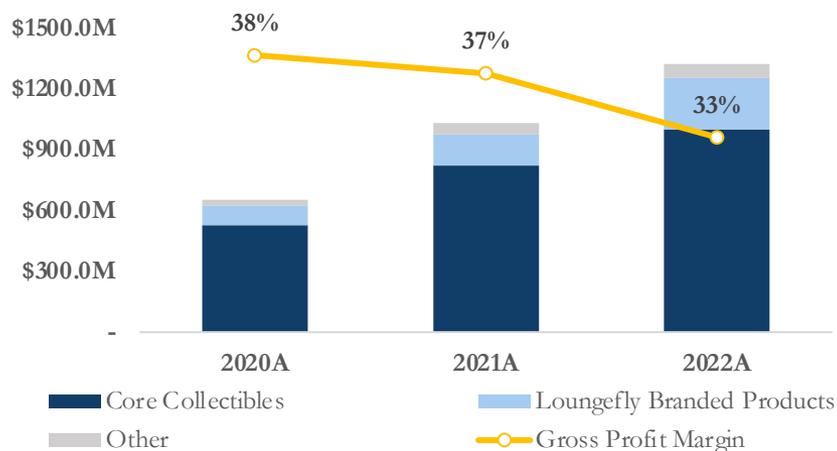
Overview: Funko (Nasdaq: FUNKO) has one of the industry's largest portfolios of licensed content spanning various product categories, including figures, plush, accessories, apparel, homewares, vinyl records, posters or digital NFT. Fueled by the growth of the pop culture industry, Funko's innovative product design and strategic market positioning have contributed to the establishment of protective moats.

Current Strategy: Funko aims to streamline its business by focusing on highly profitable products, particularly the evergreen product lines. In pursuit of long-term growth, Funko is actively advancing its DTC channel to enhance customer experience and expand its reach beyond the US and EMEA.

M&A Rationale: Funko experienced constant losses in the last fiscal year and incurred over \$30 million in inventory write-offs due to surplus stocks straining its fulfillment network and contributing to increased operating costs. The frequent turnover in the management team further undermines Funko's standing, prompting a negative outlook among investors and eroding confidence in the company.

Revenue Breakdown

Annual Sales (USD) by Operational Segment
2020 FY – 2022 FY



Current Market Data

Market Cap	\$352.8M	Revenue (LTM Q3)	\$1.1B
Enterprise Value	\$722.6M	EBITDA (LTM Q3)	(\$22.5M)
Share Price	\$7.0	EBITDA Margin	(2.0%)
52 week-high	\$13.4	Debt/Capital	61.7%
52 week-low	\$5.3	Inventory Turnover	3.7x
Cash	\$31.9M	Debt	\$391.3M

*Currency in USD 24/02/2024

Management Team



Interim Chief Executive Officer and Director: Michael Lunsford

- Appointed as Interim CEO in July 2023, He has served on the board of directors of Funko, Inc. since October 2018.
- Mr. Lunsford served as the chief executive officer of SK Planet, Inc., the U.S. e-commerce subsidiary of SK Telecom Co. Ltd. Prior to joining SK Planet, Mr. Lunsford held a number of positions at RealNetworks, Inc., from 2008 to 2013, including interim chief executive officer of RealNetworks.

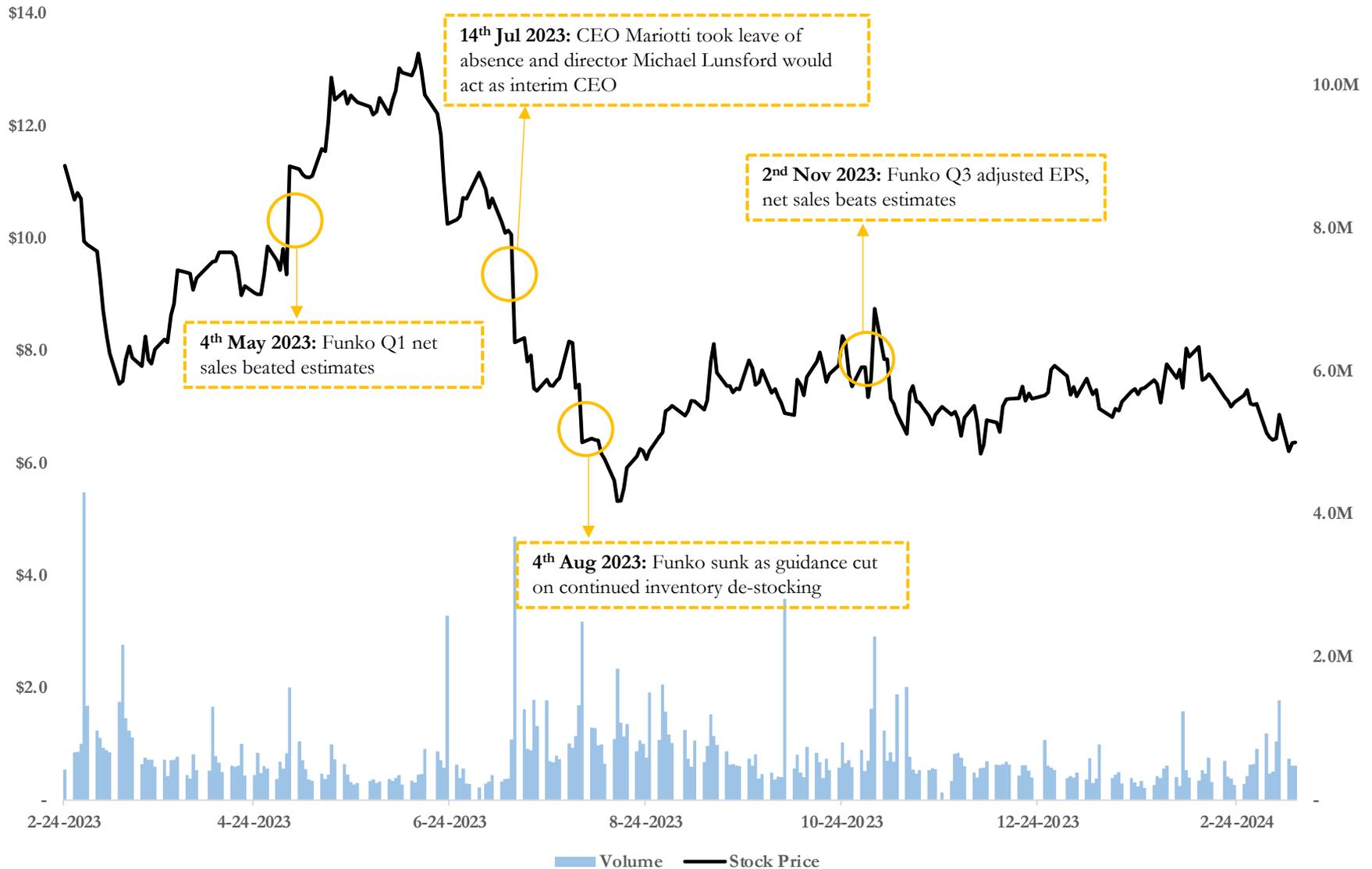


Chief Financial Officer & Chief Operating Officer: Steve Nave

- Prior to joining Funko, Mr. Nave served as the CEO of Bluestem Group from 2012 until 2018. Prior to his time with Bluestem Group, Mr. Nave held various executive positions as a member of the Launch Team of Walmart.com from 2000 until 2011, including Chief Financial Officer, Chief Operating Officer, and ultimately Chief Executive Officer.

1-Year Stock Price- Funko

M&A Strategic Alternatives and Analysis





Toy & Games Industry Overview

Segments: Based on the primary revenue-generating segments of Mattel and Funko, Mattel specializes primarily in Dolls & Stuffed Toys, while Funko focuses on Action Figures.

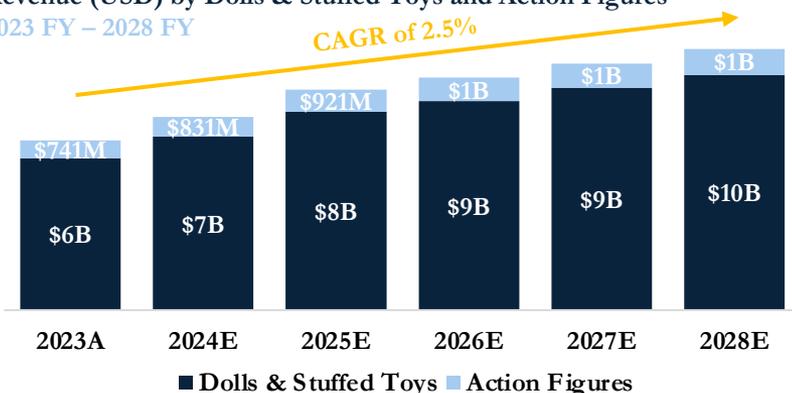
- **Dolls & Stuffed Toys:** Toys are designed to resemble human or animal figures, such as dolls, teddy bears, and plush toys.
- **Action Figures:** Poseable figurines or dolls represent characters from various media, including but not limited to movies, television shows, comics, video games, and anime.

Distribution Channels: The Toy & Games Industry includes online and offline sales channels and encompasses spending by both consumers (B2C) and enterprises (B2B).

- **Retail Stores:** Toys are sold through various retail channels, including specialty toy stores, department stores, and big-box retailers.
- **E-commerce:** Online platforms play an increasingly significant role in toy sales, with companies selling directly through their websites or third-party e-commerce platforms.

Key Industry Metrics

Revenue (USD) by Dolls & Stuffed Toys and Action Figures
2023 FY – 2028 FY



2024E Toy Industry Total Revenue of \$42.5B

Key Industry Trends

A shift in demographics of toy buyers: The audience buying toys now is no longer limited to kids. Older enthusiasts with their own money for their own special occasion, are becoming buyers of toy collectibles. Unlike traditional gift-buying events such as birthdays or holidays, they are purchasing items as an expression of their love for a particular fandom.

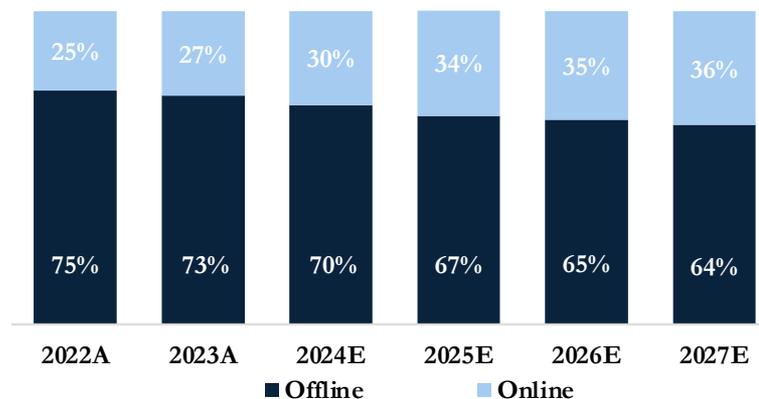
Increasing demand of collectibles business: Nostalgic value attached to collectibles resonates with a broader audience, fostering demand. Also, the integration of collectibles into pop culture has amplified their visibility, attracting new enthusiasts.

Popularity of licensing and franchises: Toys based on popular movie franchises, TV shows, and video games continued to be popular. Licensing agreements with entertainment companies were a common strategy for toy manufacturers.

Direct-to-Consumer (DTC) sales surge: With the rise of e-commerce and the challenge of sustaining profitability amid high inflation rates, many toy companies were exploring or expanding their direct-to-consumer sales channels. This includes selling toys directly through their websites or other online platforms.

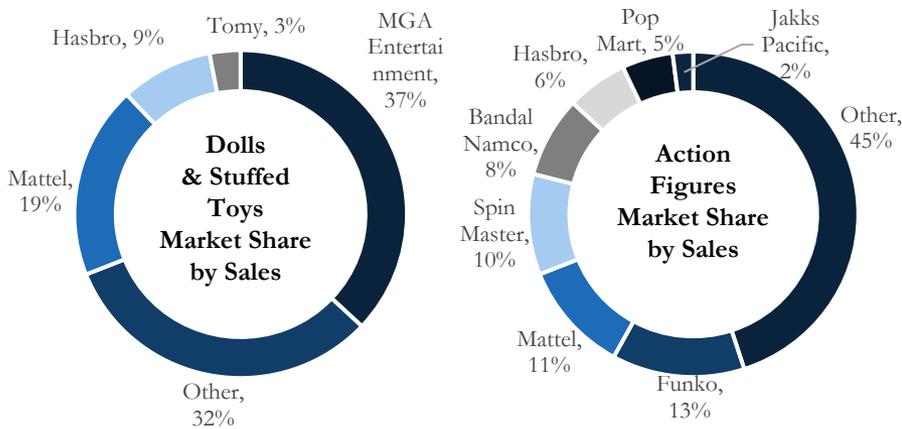
Sales Channel Change

Total Sales(%) by Online and Offline Channels
2022 FY – 2027 FY





Competitive Landscape by Revenue (FY2023)

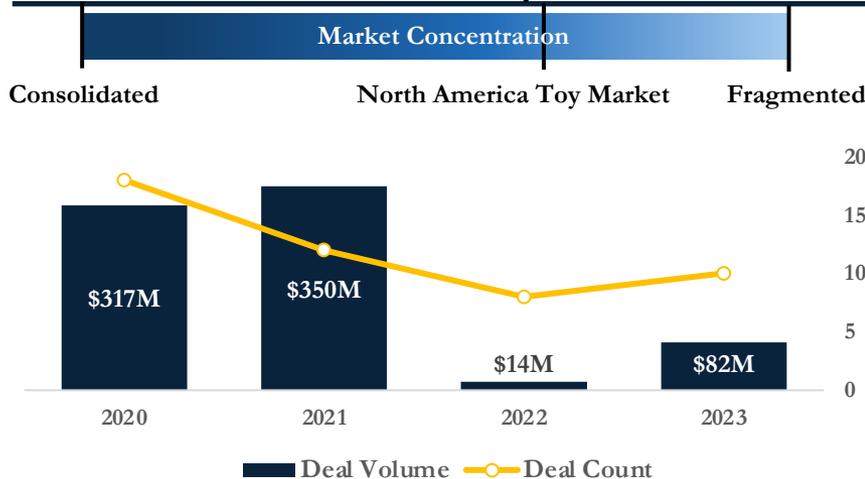


Competitive Landscape by Brand Value (FY2023)

In the world's top 10 most valuable brands, Mattel owns three brands: Fisher-Price, Barbie, and Hot Wheels, while Funko owns Pop!



M&A Activity



Inorganic Growth and Consolidation of Brands

Target	Acquirer	Deal Size	Rationale
MEGA	MATTEL	\$50M April 2018	Entering strategic categories: construction building sets and arts & crafts
GUND	SPIN MASTER	\$79.1M March 2018	Expanding into the infant toy and specialty gift categories
D&D BEYOND	Hasbro	\$146.3M April 2022	Strengthening the existing products for world-class tabletop and digital play
Melissa & Doug	SPIN MASTER	\$950M October 2023	Bringing complementary capabilities in early childhood toys by adding wooden toys

Conclusion: The toy industry faces challenges such as a low CAGR of 2.5%, a fragmented market, and intense competition, making organic growth exceptionally difficult. Consequently, M&A plays a crucial role in stimulating the expansion of company product offerings and market shares.



Mattel Rationale

Horizontal Integration: Mattel captures the second-largest market share (11%) in the action figures market, with Funko holding the largest market share (13%). Considering the fragmented market, the market shares between companies are very close, making consolidation and mergers necessary. Since they have similar client targets and production materials, horizontal integration can achieve economic scale and increase Mattel's market shares in action figures.

Portfolio Diversification: Mattel's Action Figures portfolio designs figures based on existing IPs from famous movies and games, which tends to attract more male buyers. Funko's Pop! Vinyl figures are a rare example that have many female buyers, and Funko's Pop! Yourself even allows buyers to create personalized figures for themselves.

DTC Channel Enhancement: To adapt to changing client needs and the boom of e-commerce, selling toys directly through company websites or online platforms will become the main distribution channel. Funko's direct-to-consumer (DTC) channel, including the Funko Fun Club and Mobile App, can provide guidance to Mattel in achieving its strategy for advancing e-commerce and DTC channels.

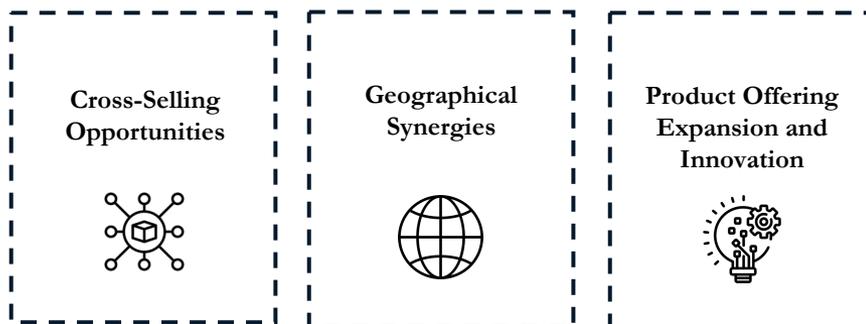
Funko Rationale

International Market Expansion: Funko is aiming to expand beyond the US and continue to grow its EMEA business because it heavily relies on its US business, which constitutes over 70% of its sales and is exposed to geographical risks. Mattel's solid presence in the US, Latin America, and EMEA can provide Funko with mature distribution channels and leverage Mattel's branding power.

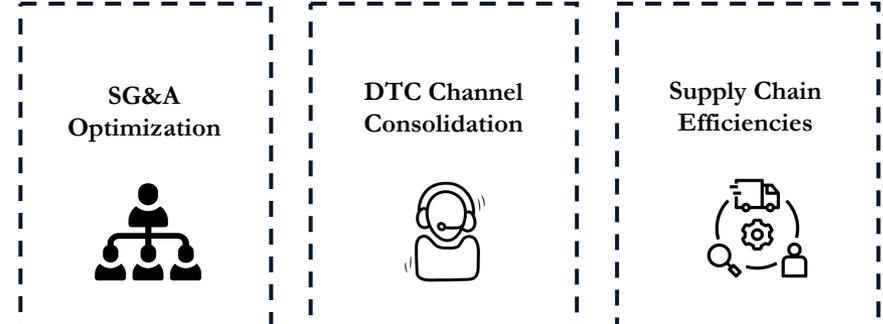
Content Alignment: Funko enters into licensing agreements with many franchises such as Star Wars, Disney Pixar, WWE, and Jurassic World highly overlap with Mattel's. If acquired by Mattel, Funko could potentially reduce royalty rates through shared licensing agreements. This could further enhance its profitability, allowing Funko to leverage not only Mattel's licensed partnerships but also Mattel's proprietary IPs for designing products.

Inventory Issue: Funko is troubled by the increasing fulfillment expenses and has resorted to destroying inventory in good condition. Funko needs to find a partner with a larger inventory capacity and strong distribution channels to help sell the excess inventory, and Mattel perfectly satisfies these characteristics.

Revenue Synergy



Cost Synergy



Cash Flow Forecast

	Fiscal Year Ending December 31					
	2022A	2023E	2024E	2025E	2026E	2027E
Revenue	\$1322.7	\$1489.0	\$1712.3	\$1969.2	\$2264.5	\$2604.2
<i>Annual Growth (%)</i>		13%	15%	15%	15%	15%
EBITDA	\$35.7	\$119.1	\$137.0	\$157.5	\$181.2	\$208.3
<i>Margin (%)</i>	3%	8%	8%	8%	8%	8%
EBIT	-\$11.9	\$81.0	\$82.3	\$111.8	\$129.7	\$141.6
<i>Margin (%)</i>	-1%	5%	5%	6%	6%	5%
Less: Tax expense	17.8	(0.9)	(1.2)	(1.5)	(1.9)	(2.3)
Add: Depreciation and amortization	47.7	38.2	36.2	34.4	32.7	31.1
Less: Capital expenditures	(59.1)	(33.4)	(31.7)	(30.1)	(28.6)	(27.2)
Less: Change in net working capital	(88.1)	(67.4)	(72.2)	(83.0)	(95.5)	(109.8)
Unlevered Free Cash Flow	-\$93.7	\$17.4	\$31.9	\$42.8	\$55.1	\$69.0

Assumption

- Revenue growth is fueled by industry-wide action figure expansion, and Funko's leading position is set to yield stabilized returns at 15%, lower than the previous high-growth stage.
- Increasing margins derived from improved efficiency in workforce, property commitments, and SG&A requirements, recovering from constant loss in 2022
- FCF discounted at a 11% WACC
- Capex maintained at lower levels than historical, largely driven by streamlined operations and equipment purchase

Perpetuity Growth & Exit Multiple Method

Perpetuity Growth Method		Exit Multiple Method	
Perpetuity Growth Rate	2.5%	Terminal EV/EBITDA Multiple	7.4x
PV Sum of Unlevered FCF	211.1	PV Sum of Unlevered FCF	211.1
Terminal Value	586.1	Terminal Value	967.6
Enterprise Value	797.2	Enterprise Value	1,178.7
Add: Cash	31.9	Add: Cash	31.9
Less: Debt	277.5	Less: Debt	277.5
Less: Other EV adjustments	-	Less: Other EV adjustments	-
Equity Value	551.6	Equity Value	933.1
Shares Outstanding	47.6	Shares Outstanding	47.6
Implied Share Price	\$11.6	Implied Share Price	\$19.6
Current Price	\$6.9	Current Price	\$6.9
Implied Price	\$11.6	Implied Price	\$19.6
Total Return	68.8%	Total Return	185.5%

Sensitivity Analysis

		WACC				
		12.00%	11.50%	11.00%	10.50%	10.00%
Perpetuity Growth Rate	-					
	1.5%	\$ 8.63	\$ 9.40	\$ 10.26	\$ 11.22	\$ 12.28
	2.0%	\$ 9.15	\$ 9.99	\$ 10.93	\$ 11.98	\$ 13.16
	2.5%	\$ 9.73	\$ 10.65	\$ 11.67	\$ 12.83	\$ 14.14
	3.0%	\$ 10.37	\$ 11.38	\$ 12.51	\$ 13.80	\$ 15.27
3.5%	\$ 11.09	\$ 12.20	\$ 13.46	\$ 14.91	\$ 16.57	
Terminal EV/EBITDA Multiple	-					
	5.0 x	\$ 13.02	\$ 13.42	\$ 13.82	\$ 14.23	\$ 14.66
	6.0 x	\$ 15.80	\$ 16.25	\$ 16.73	\$ 17.21	\$ 17.71
	7.0 x	\$ 18.57	\$ 19.09	\$ 19.63	\$ 20.19	\$ 20.76
	8.0 x	\$ 21.34	\$ 21.93	\$ 22.54	\$ 23.17	\$ 23.81
	9.0 x	\$ 24.12	\$ 24.77	\$ 25.45	\$ 26.14	\$ 26.86

Accretion/ Dilution Analysis

M&A Strategic Alternatives and Analysis



Sources and Uses

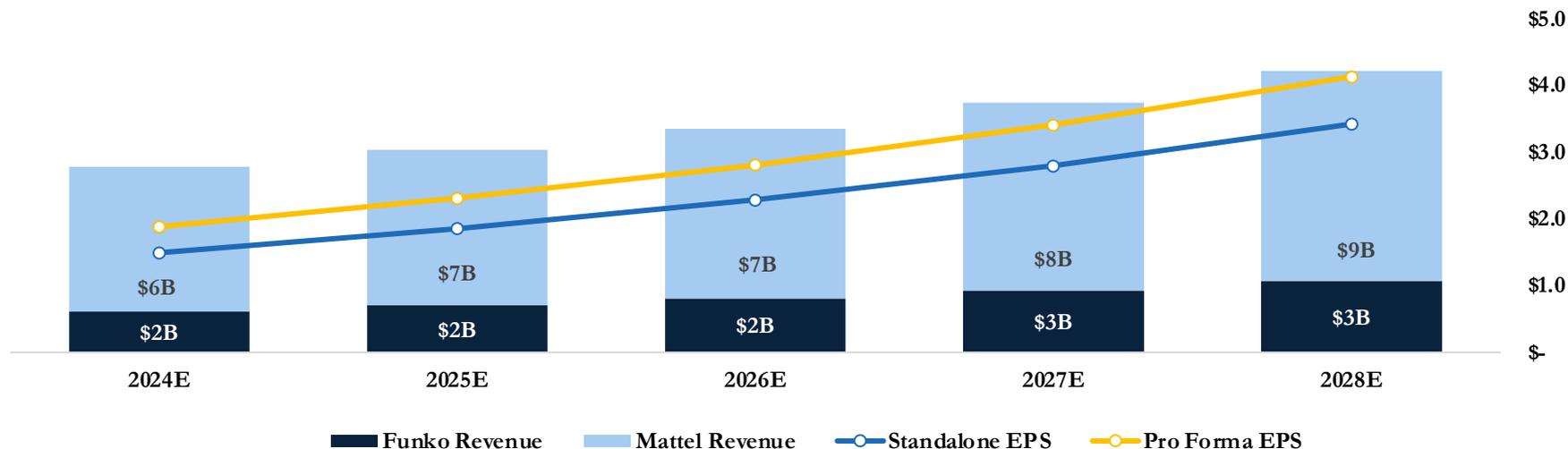
Deal Structure	50% Equity	50% Cash
Sources of Fund		
	Amount	% of Total
Debt Issued to Acquire Target	144.07	33.4%
Cash used to Acquire Target	75.49	17.5%
Value of Stock Issues to Target Shareholders	212.43	49.2%
Total Sources	431.99	100%
Uses of Fund		
	Amount	% of Total
Stock to Target	212.43	49.2%
Cash to Target	212.43	49.2%
Deal Fees	4.25	1.0%
Finance Fees	2.88	0.7%
Total Uses	431.99	100%

Transaction Structuring

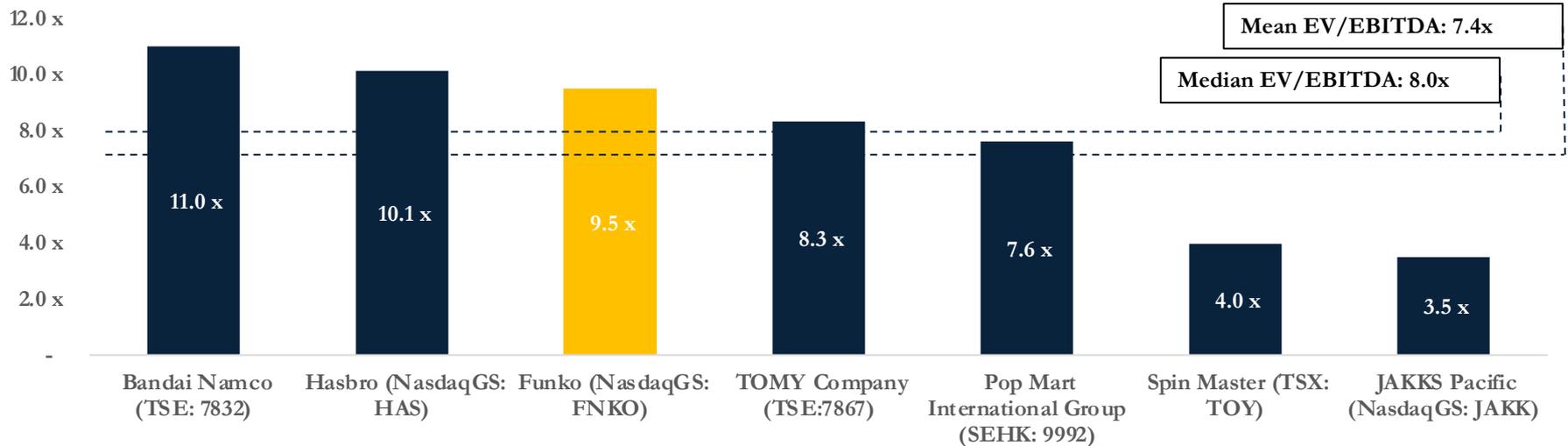
Purchase Premium: Assuming an offer price of \$8.92, reflecting a 30% premium on Funko's closing price as of January 26, 2024. The premium is determined based on considerations from DCF and Comparable Company Analysis, as most precedent transactions involve private-to-public deals with limited disclosed information about premiums. Due to Funko's recent unsatisfactory financial performance leading to a price drop, the anticipated purchase premium is expected to be lower.

Recommended Financing & Financing Justification: It is recommended that Mattel fund the transaction with 50% equity and 50% cash. Although the current high-interest rate environment may pose some challenges, the lower cost of debt compared to stock and the anticipated recovery in interest rates in the next couple of years still makes new debt issuance attractive. Mattel can also leverage its excess cash reserves and elevated share price. Lastly, a significant portion of stock financing in the transaction shifts part of the risk onto Funko shareholders while allowing them to realize the upside of becoming a toy conglomerate.

Standalone vs. Combined Entity Performance



Comparable Company Analysis



	Entertainment						
Equity Value	\$13.3B	\$6.6B	\$356.9M	\$1.5B	\$3.2B	\$2.6B	\$350.5M
Enterprise Value	\$11.8B	\$10.3B	\$726.6M	\$1.3B	\$2.6B	\$2.0B	\$286.3B
Revenue (2024E)	\$7.0B	\$4.5B	\$1.1B	\$1.4B	\$1.1B	\$2.4B	\$728.7M
EBITDA (2024E)	\$1.1B	\$1.0B	\$75.7M	\$157.6M	\$344.2M	\$487.7M	\$72.6M

Due to **management forecast issues and inventory excess**, Funko is currently experiencing historically **low profitability** and is trading at a premium of 9.5x EV/EBITDA in 2024. However, its 0.6x EV/Revenue multiples indicate **undervaluation** compared to its peers in terms of revenue-generating ability.



Horizontal Integration

Alternative: Implement horizontal integration to expand the product portfolio and strengthen the Direct-to-Consumer (DTC) channel.

Recommendation: While Mattel maintains a strong position in Dolls & Stuffed Toys, the competition in Toys for Toddlers & Kids and Construction Sets & Models remains intense, with these two segments being the largest in the entire toy market. Therefore, it is recommended that Mattel consider acquiring companies in these segments: Spin Master, Basic Fun!, and MGA.

Potential Acquirers:



Opinion: This horizontal integration can diversify Mattel's portfolio and increase its market share in major segments of the toy market. However, there is still a concern of whether the newly added brands can align with Mattel's current targeted client base.

Co-Branding through Licensing Agreement

Alternative: Enter into licensing agreement with another major toy company to co-develop branded toys and games.

Recommendation: Co-branding is a good choice for Mattel and the cooperating toy company, and licensing is the most agile way to make it happen. Given the fragmented toy industry, co-brandings can leverage each of the two parties to maximize the branding power of the counterparty. Both parties can retain unique stables of properties that will pack more punch and gain wider distribution and awareness when combined.

Potential Partners:



Opinion: The collaboration can enhance the visibility and awareness of Mattel's products, especially if the partner company has a stronger brand presence. However, differences in marketing strategies, target audiences, or product quality standards may lead to conflicts between the two companies.

Vertical Integration

Alternative: Pursue vertical integration, in response to industry trends, to stay at the forefront of both physical and digital entertainment for kids of all ages.

Recommendation: Acquiring a reading application developer for improving childhood literacy, such as Homer, allows Mattel to continue its ed-tech initiative focused on the future of play. Additionally, buying Unleashed Brands Group, a platform operator that provides physical play scenes through franchising for kids, can further integrate Mattel's toy image into the physical entertainment experience for children.

Potential Target Companies:



Opinion: Given Mattel's current strategy and ambition to develop ed-tech related products combined with its owned toy brands, it is more likely to acquire Homer than Unleashed Brands Group. Mattel also needs to consider technological integration with its current ed-tech platform to generate more synergies.

Spin-Off

Alternative: Spin off the most profitable business line of the target to maximize synergies.

Recommendation: Funko has a diverse business portfolio, encompassing figures, clothing, board games, vinyl records, art prints, etc. However, its Pop! brand stands out as the most valuable within the entire product portfolio. This brand primarily consists of action figures licensed from movies, TV shows, games, and more. Mattel could consider acquiring this specific segment from Funko, as it serves as the core revenue and profit generator, complementing Mattel's figures product mix.

Likelihood: Given the dominant position of the figures segment in Funko, it is highly unlikely that Funko would choose to sell only this part; they may also request a high deal price. In this case, Mattel might opt to acquire the entire company instead.

Risks and Mitigants

M&A Strategic Alternatives and Analysis

Risks

Mitigation Strategies

Risk Matrix

1 Failed Cultural Integration

Having made substantial acquisitions in the past and successfully managed the global operation of acquired brands and products, Mattel is well-positioned for large-scale endeavors. The company can conduct a comprehensive cultural due diligence pre-acquisition, establish clear expectations, and provide regular updates to employees to minimize uncertainty in the post-acquisition phase.

2 Opposition from Shareholders

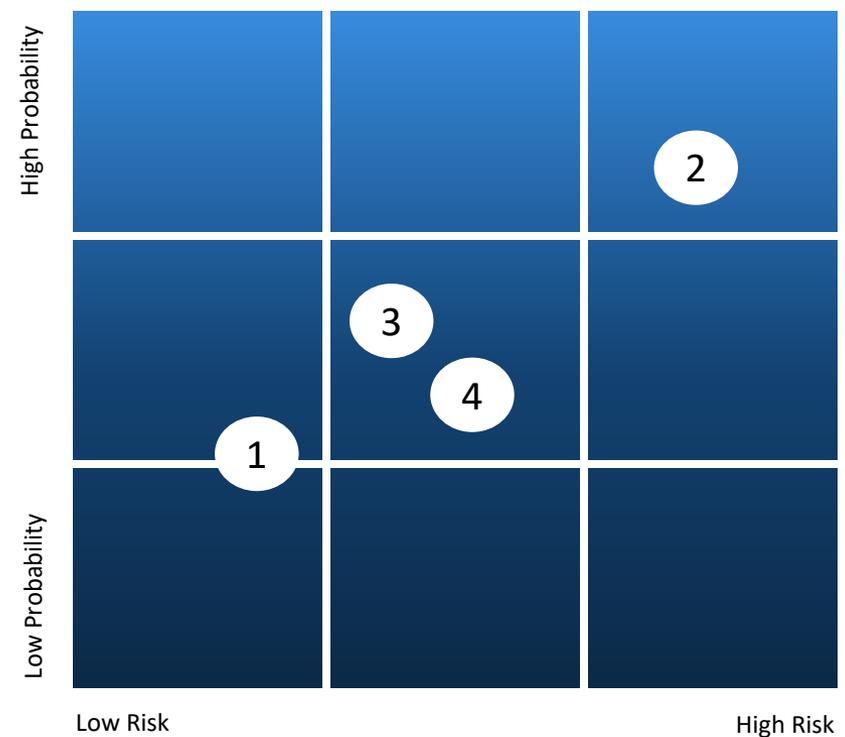
The transaction is funded through new stock issuance, which may dilute the ownership of Mattel's existing shareholders and could be a concern for them. It is essential to clearly outline the potential benefits and increased shareholder value arising from the acquisition and emphasize how this strategic move enhances the overall financial health of the company.

3 Dilutive Transaction

Funko is currently operating with a negative net income, attributed to its financial performance falling short of estimates and issues of trust in management. There is a possibility that Mattel may experience a dilutive transaction, but synergies are expected to be realized over time as Funko's excess inventory is resolved and margins steadily recover, reaching nearly 19% by 2028.

4 Loss of Key Licences

Mattel should prioritize securing long-term and strategic licensing agreements with key partners for both itself and Funko. This involves engaging in proactive license renewal negotiations well in advance. After acquisition, a comprehensive evaluation of the combined license portfolio is necessary. Identify any redundancies or excessive reliance on specific licenses and make necessary adjustments to the product portfolio.



The primary risk for Mattel lies in **potential opposition from current shareholders**, a key factor for the success of the acquisition. However, leveraging the experience gained from **past successful M&A transactions and maintaining open communication with shareholders** can effectively mitigate the risk of opposition.