A TRULY GREAT COMPANY, WITH THE VERY BEST PEOPLE, A COMPELLING UNDERLYING STRATEGY AND RESOURCES FOR SUSTAINABLE GROWTH.

# MATTEL, INC. 1999 ANNUAL REPORT

On the Cover:

Robotic Puppy, from Fisher-Price, is a puppy who actually listens and responds to his owner's voice with life-like actions, emotions and sounds. Jewel Girl Barbie features a belly button and also bends and twists with her new soft waist. Hot Wheels Stunt Track Driver CD-ROM was a top seller in 1999, providing kids with the ultimate in stunt driving excitement.  A new version of the game hits stores in 2000.

## LETTER TO SHAREHOLDERS

The bad news for 1999 unfortunately has overshadowed the good news. We are all painfully aware of the negative effect the acquisition of The Learning Company and its subsequent performance had on our results for 1999. These well-reported difficulties obscured the fundamentally strong performance of Mattel's core brands and sectors. In the seasonally important fourth quarter, core product sales were up 13 percent in the U.S. – Barbie grew by 11 percent and Fisher-Price by 14 percent. Mattel Entertainment was up 70 percent, Wheels recorded a worldwide sales increase of 6 percent and Pleasant Company achieved a 4 percent growth in sales. These solid performances represent a strong endorsement of Mattel's strategy, and serve as the underpinning for our optimism for the future. This gives us confidence that Mattel remains a truly great company, with the very best people, a compelling underlying strategy and resources for sustainable growth.

### OUR CORE BUSINESS: BRANDS AND MANAGEMENT

In February, the Board of Directors created the Office of the Chief Operating Officer comprised of the five presidents who are in charge of Mattel's brands: Adrienne Fontanella for Barbie and Girls' products; Matt Bousquette, Boys/Entertainment; Neil Friedman, Infant and Preschool including Fisher-Price; Bernard Stolar, Mattel Interactive; and Pleasant Rowland, Founder and President of Pleasant Company and creator of American Girl. We could not ask for five more talented individuals to lead the company's operations at this critical time.

Mattel's five business unit presidents include, *left to right:* Bernard Stolar, President, Mattel Interactive; Pleasant Rowland, President, Pleasant Company; Neil Friedman, President, Fisher-Price Brands; Matt Bousquette, President, Boys/Entertainment; and Adrienne Fontanella, President, Girls/Barbie.

## BARBIE AND GIRLS' PRODUCTS

At $1.5 billion in annual sales, Barbie remains the most successful toy of all time. The 11 percent increase we saw for domestic Barbie sales in the 1999 fourth quarter demonstrates the success of a complete repositioning of the brand, the benefits of which will be further seen in 2000. Everything from logotype to packaging to the look and feel of the dolls themselves has been renewed and freshened to be more relevant to today's girl.

All of this has been done under the direction of Adrienne Fontanella, who became President of the Girls' business in March 1999 and has infused new life into Barbie, creating fresh enthusiasm for this 41-year-old classic. Adrienne joined Mattel in 1996 with responsibility for Barbie licensing and tripled that business in three years while positioning Barbie as a lifestyle brand. New for this year, she has taken Barbie to the categories of activity toys and electronics, and has expanded the girls' business with new lines such as Diva Starz and Miracle Moves Baby.

### BOYS / ENTERTAINMENT

The Wheels category – which includes Hot Wheels, Matchbox and Tyco R/C – is our largest boys' business at more than $750 million in annual sales. Our Wheels business has more than tripled in the last three years under the leadership of Matt Bousquette, President of Boys/Entertainment. Matt rejoined Mattel in 1995, having served in boys' toys marketing in the 1980s.

He also leads our Entertainment category, which includes Nickelodeon, Disney, and our all-new Max Steel extreme sports action figure line tied to an animated series on Kids' WB! Mattel Entertainment capitalized on the box office success of Toy Story 2 in 1999, and Matt and his team brought home one of the most sought-after licenses of all time earlier this year when Warner Bros. Worldwide Consumer Products named Mattel the worldwide master toy licensee for Harry Potter. Toys based on the best-selling books will debut later this year, and a more extensive line will be introduced in 2001, timed for the release of the first Harry Potter movie.

## INFANT AND PRESCHOOL / FISHER-PRICE

The Fisher-Price brand, which has been a trusted household institution for generations, has a vitality and appeal to parents beyond anyone's expectations and remains the dominant preschool brand in the world at $1.6 billion in sales. Leading the strong momentum of this brand is Neil Friedman, who joined Tyco in 1995 from Universal Studios with 24 years of toy experience and came to Mattel with Tyco in 1997.

Neil's career accomplishments include the phenomenal success of such products as Tickle Me Elmo and Bounce Around Tigger, and this year's Fisher-Price line holds the same kind of promise. The new Fisher-Price Robotic Puppy, Let's Pretend Elmo and Ask Me More Eeyore will steal the hearts of children all around the world. New technology is evident throughout the Fisher-Price line, and most notably in the Intelli-Table, which results from a collaboration with Microsoft Corporation. This progressive early learning toy allows children to be exposed to computer applications away from the computer, and features motivating sounds, lights and activities that advance with a child from toddler to preschooler.

## PLEASANT COMPANY

Mattel's acquisition of Pleasant Company in July 1998 gave us a first-class business that has continued to grow. Internet sales accounted for $15 million of this growth, which helped us reach our goal of $60 million for company-wide Mattel Internet sales in 1999. Pleasant Company has also capitalized on innovative concepts such as the American Girl Place retail store.

Pleasant Rowland, founder of Pleasant Company, has been Vice Chairman of Mattel while continuing as President of Pleasant Company. The American Girl brand, a beloved favorite of girls somewhat older than those who play with Barbie, appeals to the sensibilities of girls of that age in a way no other doll product can do. In addition, Pleasant Company, through its successful catalog operation, has propelled Mattel forward in the world of direct-to-consumer marketing.

## MATTEL INTERACTIVE

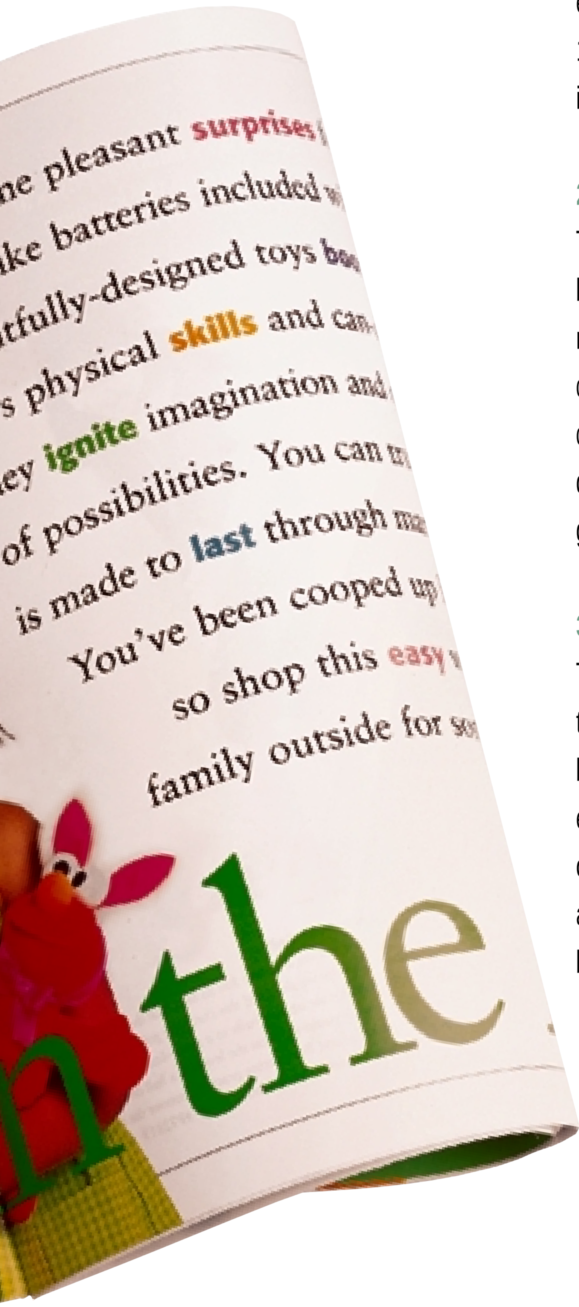
Our weaker than expected overall results in 1999 primarily reflected problems with The Learning Company. This acquisition, which was undertaken to support a still-persuasive e-commerce and interactive strategy, coincided with a slowdown in CD-ROM sales, leading to inventory problems and discounting, which resulted in an operating loss totaling approximately $206 million, pre-tax, before restructuring charges. Nevertheless, our Mattel Interactive division has good potential based upon its technology, its market position and its brands such as Reader Rabbit, Carmen Sandiego, The Oregon Trail and The Print Shop, along with traditional Mattel brands like Barbie, Hot Wheels, Matchbox, Fisher-Price and American Girl. In February, at the American International Toy Fair in New York, we debuted an extremely well-received range of

interactive products, including new IntelPlay introductions resulting from our partnership with Intel. As with last year's very successful QX3 Microscope, the Digital Movie Creator and Computer Sound Morpher will allow children to see and do things they've never done before.

We are very pleased to have Bernard Stolar heading Mattel Interactive. Bernie became part of the Mattel family in January of this year, with a solid background in establishing and transforming interactive brands. Having helped launch Dreamcast for Sega and Playstation for Sony, Bernie is the right leader to establish Mattel as a player in the interactive arena.

## STRATEGY

The growth strategy which Mattel has developed combines all of the company's strengths in order to cross-capitalize on our key attributes. Our strategy consists of three components.




### 1. Direct-to-Consumer: Catalogs and Internet

We are enhancing our direct communication with the consumer through catalogs and the Internet. Mattel's acquisition of Pleasant Company gave us unsurpassed expertise in direct-to-consumer marketing that is being applied to other Mattel brands. Last year we introduced a very successful Fisher-Price catalog and re-launched the Barbie Collector catalog, and there will be more catalogs to come in 2000.

As for the Internet, we have a Mattel shopping site that specializes in collector, customized, specialized and close-out product. But the real strength of our Internet strategy is in the individual sites linked through the main nexus of Mattel.com, where we are able to showcase our world renowned brands in ways that will also benefit the traditional retailer. The enthusiastic response to these brand sites is undeniable – Barbie.com, for instance, received 180 million hits this past December, and Hot Wheels.com had 78 million. The worldwide web is the perfect place to have a more direct relationship with the consumer.

### 2. Interactive

The second component of our strategy is to create a seamless connection between our valuable brands and new high quality, technologically sophisticated products. This approach predated our merger with The Learning Company, and we still regard this mission as sound and capable of creating a substantial contribution to our company's growth and profitability. Just as our purchase of Pleasant Company gave us resources that we have leveraged across brands to enhance direct marketing opportunities, so too we will be able to use the knowledge and resources gained from The Learning Company.

### 3. Mattel International

The third pillar of our strategic approach is related to Mattel International. Mattel is dedicated to becoming a truly global company. To this end, two years ago we unveiled Mattel's "market by market" approach to international growth, in which we adapt proactively to local tastes, economic conditions and pricing, rather than viewing the rest of the world as an extension of our U.S. strategy. Wheels was the first of our major categories to implement the new approach. Last year, Wheels sales grew 20 percent in international markets, and we expect to build further on that excellent start, applying this strategy to Barbie and Fisher-Price this year.

As you know, the board is stewarding the operations of the company while conducting the search for a new Chief Executive Officer. Bill Rollnick now serves as Chairman and Ron Loeb is acting CEO. We are working closely with John Vogelstein and Tully Friedman, who are the other members of the Executive Committee. The board's loyalty to Mattel is strong, based on its deep connections with the company, and it is committed to playing its part in this period of significant change. We are extremely fortunate to have in place the five members of the Office of the Chief Operating Officer to execute our strategy properly, as we search for a permanent Chief Executive Officer to whom these executives will report. We also have an outstanding new Chief Financial Officer, Kevin Farr, who brings his many years of experience as Corporate Controller to his new position and will play a key role in the future of the company.

We want to express our thanks to the other executives who are helping to position Mattel to take advantage of its solid underpinnings. In particular, we want to thank Ned Mansour, who has helped shepherd Mattel through this recent period of change and will leave the company at the end of March, and Joe Gandolfo, who has led our manufacturing organization for 10 years and will retire in April.

Strong brands, a strategic vision and the best people transformed Mattel from a dream 55 years ago to the $5.5 billion, Fortune 500 company it is today. The very same formula – terrific brands, a proven strategy, and effective implementation – will help the top toy, technology, entertainment, education and family products company to regain its luster, and to prosper for many years to come.

Ronald Loeb, Acting Chief Executive Officer, *left*; and William Rollnick, Chairman

Ronald M. Loeb
Acting Chief Executive Officer

William D. Rollnick
Chairman

March 17, 2000

## FIVE-YEAR FINANCIAL SUMMARY

Mattel, Inc. and Subsidiaries

| (In thousands, except per share and percentage information) | For the Year Ended December 31 (a) 1999 | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| **Operating Results:** | | | | | |
| Net sales | $5,514,950 | $5,621,207 | $5,455,547 | $5,064,860 | $4,708,452 |
| Gross profit | 2,601,040 | 2,913,303 | 2,819,660 | 2,590,078 | 2,292,309 |
| % of net sales | 47.2% | 51.8% | 51.7% | 51.1% | 48.7% |
| Operating profit (b) | 40,866 | 520,100 | 113,828 | 315,827 | 614,541 |
| % of net sales | 0.7% | 9.3% | 2.1% | 6.2% | 13.1% |
| Income (loss) before income taxes and extraordinary item | (110,743) | 391,632 | 1,216 | 188,898 | 506,243 |
| (Benefit) provision for income taxes | (28,370) | 185,579 | 179,327 | 166,936 | 197,246 |
| Income (loss) before extraordinary item | (82,373) | 206,053 | (178,111) | 21,962 | 308,997 |
| Extraordinary item - loss on early retirement of debt | – | – | (4,610) | – | – |
| Net income (loss) | (82,373) | 206,053 | (182,721) | 21,962 | 308,997 |
| **Income (Loss) Per Common Share (c):** | | | | | |
| Income (loss) before extraordinary item | | | | | |
| Basic | (0.21) | 0.51 | (0.51) | 0.04 | 0.88 |
| Diluted | (0.21) | 0.47 | (0.51) | 0.04 | 0.86 |
| Net income (loss) | | | | | |
| Basic | (0.21) | 0.51 | (0.52) | 0.04 | 0.88 |
| Diluted | (0.21) | 0.47 | (0.52) | 0.04 | 0.86 |
| **Dividends Declared Per Common Share (c)** | 0.35 | 0.31 | 0.27 | 0.24 | 0.19 |

| (In thousands) | As of Year End (a) 1999 | 1998 | 1997 | 1996 | 1995 |
|---|---|---|---|---|---|
| **Financial Position:** | | | | | |
| Cash and marketable securities | $ 275,024 | $ 469,213 | $ 883,903 | $ 811,284 | $ 715,440 |
| Accounts receivable, net | 1,270,005 | 1,150,051 | 1,253,343 | 1,033,066 | 926,626 |
| Inventories | 544,296 | 644,270 | 468,226 | 463,212 | 429,110 |
| Total assets | 5,127,022 | 5,147,385 | 4,512,843 | 4,607,008 | 4,394,801 |
| Short-term borrowings | 369,549 | 199,006 | 52,618 | 53,924 | 76,443 |
| Long-term liabilities | 1,346,811 | 1,333,548 | 1,110,722 | 1,121,350 | 1,266,079 |
| Stockholders' equity | 1,962,687 | 2,170,803 | 1,933,338 | 2,109,787 | 1,897,176 |

(a) Consolidated financial information for all periods presented has been restated retroactively for the effects of the May 1999 merger with The Learning Company, Inc. ("Learning Company"), accounted for as a pooling of interests. Consolidated financial information for 1995-1997 has been restated retroactively for the effects of the March 1997 merger with Tyco Toys, Inc. ("Tyco"), accounted for as a pooling of interests.

(b) Represents income from operations before interest expense and (benefit) provision for income taxes.

(c) Per share data reflect the retroactive effect of stock splits distributed to stockholders in March 1996 and January 1995, and the mergers with Learning Company and Tyco in 1999 and 1997, respectively.

## Cautionary Statement

Certain written and oral statements made or incorporated by reference from time to time by Mattel or its representatives in this Annual Report, other filings or reports with the Securities and Exchange Commission, press releases, conferences, or otherwise, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. 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, and forward-looking statements can be identified by the use of terminology such as "believe," "anticipate," "expect," "estimate," "may," "will," "should," "project," "continue," "plans," "aims," "intends," "likely," or other words or phrases of similar terminology. Management cautions you that forward-looking statements involve risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. In addition to the risk factors listed in Mattel's Annual Report on Form 10-K and other important factors detailed herein and from time to time in other reports filed by Mattel with the Securities and Exchange Commission, including Forms 8-K, 10-Q and 10-K, the following important factors could cause actual results to differ materially from those suggested by any forward-looking statements.

### Marketplace Risks

- Increased competitive pressure, both domestically and internationally, which may negatively affect the sales of Mattel's products
- Changes in public and consumer preferences, which may negatively affect Mattel's toy and consumer software business
- Significant changes in the play patterns of children, whereby they are increasingly attracted to more developmentally advanced products at younger ages, which may affect brand loyalty and the perceived value of and demand for Mattel's products
- Possible weaknesses in economic conditions, both domestically and internationally, which may negatively affect the sales of Mattel's products and the costs associated with manufacturing and distributing these products

### Financing Considerations

- Currency fluctuations, which may affect Mattel's reportable income
- Significant changes in interest rates, both domestically and internationally, which may negatively affect Mattel's cost of financing both its operations and investments
- Reductions in Mattel's credit ratings which may significantly increase the cost of satisfying Mattel's long-term capital needs

### Merger-Related Risk

- Continued difficulty integrating the operations of Learning Company into Mattel, which may prevent Mattel from realizing the expected benefitrs from the merger, such as cost savings, operating efficiencies, revenue enhancements or other synergies

### Other Risks

- Inability to successfully complete licensing and e-commerce deals in a timely fashion, which may reduce Mattel's ability to realize the full value of its intellectual property rights
- Development of new technologies, including the Internet, which may create new risks to Mattel's ability to protect its intellectual property rights
- Changes in laws or regulations, both domestically and internationally, including those affecting the Internet, consumer products or environmental activities or trade restrictions, which may lead to increased costs or interruption in normal business operations of Mattel
- Current and future litigation, governmental proceeding or environmental matters, which may lead to increased costs or interruption in normal business operations of Mattel
- Labor disputes, which may lead to increased costs or disruption of any of Mattel's operations

The risks included herein are not exhaustive. Other sections of this Annual Report may include additional factors which 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 risk factors emerge from time to time and it is not possible for management to predict all such risk 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 place undue reliance on forward-looking statements as a prediction of actual results.

## Summary

The following discussion should be read in conjunction with Mattel's consolidated financial statements and notes thereto, and the information included elsewhere herein. This discussion and the accompanying consolidated financial statements and notes thereto have been prepared to reflect the retroactive effect of Mattel's merger with Learning Company in May 1999. The merger was accounted for as a pooling of interests, which means that for accounting and financial reporting purposes and the discussion herein, the two companies are treated as if they have always been combined.

Mattel designs, manufactures, and markets a broad variety of family products on a worldwide basis through both sales to retailers and direct 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 which have historically had worldwide sustainable appeal. The recent acquisitions of Pleasant Company and Learning Company are part of Mattel's strategic plan to better position itself as a consumer products company that provides its core customers – children – with products that meet their preferences in an increasingly interactive and technology-driven world. The strategy has three components: first, Mattel is communicating with consumers more directly. Second, Mattel is combining its traditional and recently acquired brands with new technologies, including software, electronic games, interactive toys and new media. Through its integration of Learning Company and Mattel Media into the Mattel Interactive division, Mattel has one of the leading consumer software operations in the world. Mattel's joint venture with Intel is focused on producing high-technology, interactive toys that appeal to increasingly technology-oriented children and teenagers. Third, Mattel is implementing a "market by market" approach to Mattel International. Mattel intends to grow its international business by adapting products to local tastes, economic conditions and price requirements.

Mattel's portfolio of brands can be grouped in the following categories:

Girls - including Barbie® fashion dolls and accessories, collector dolls, Fashion Magic®, American Girl®, Cabbage Patch Kids® and Polly Pocket®
Infant and Preschool - including Fisher-Price®, Disney preschool and plush, Power Wheels®, Sesame Street®, See 'N Say®, Magna Doodle®, View-Master® and Blue's Clues®
Wheels - including Hot Wheels®, Matchbox®, Tyco® Electric Racing and Tyco® Radio Control
Entertainment - including Disney, Nickelodeon®, games and puzzles
Consumer Software - including Reader Rabbit®, Carmen Sandiego™, The Oregon Trail®, Myst® and The Print Shop®

## Results of Operations

The following is a percentage analysis of operating results for the past three years:

| | For the Year | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Net sales | 100.0% | 100.0% | 100.0% |
| Gross profit | 47.2% | 51.8% | 51.7% |
| Advertising and promotion expenses | 17.2 | 16.3 | 15.5 |
| Other selling and administrative expenses | 21.6 | 20.3 | 18.6 |
| Amortization of intangibles | 1.7 | 2.3 | 8.9 |
| Restructuring and other charges | 6.3 | 2.8 | 6.3 |
| Charge for incomplete technology | – | 1.0 | 0.4 |
| Other income, net | (0.3) | (0.2) | (0.1) |
| Operating profit | 0.7 | 9.3 | 2.1 |
| Interest expense | 2.7 | 2.3 | 2.1 |
| Income (loss) before income taxes and extraordinary item | (2.0)% | 7.0% | –% |

## 1999 Compared to 1998

### Consolidated Results

Net loss for 1999 was $82.4 million or $0.21 per diluted share as compared to net income of $206.1 million or $0.47 per diluted share in 1998. The 1999 results were negatively impacted by restructuring and other charges totaling $346.0 million, approximately $265 million after-tax or $0.64 per diluted share, related to the Mattel restructuring plan, the merger and integration of Learning Company, and other nonrecurring charges. Additionally, Mattel's 1999 results were negatively impacted by the results of operations of its Learning Company division, which reported a pre-tax loss of $205.5 million for the full year 1999. The 1998 results of operations were negatively impacted by nonrecurring charges, including an incomplete technology writeoff of $56.8 million related to the acquisition of Mindscape, Inc. in March 1998, restructuring and other charges of $113.3 million related to 1998 acquisitions and one-time charges of $44.0 million in connection with the voluntary recall of Power Wheels® ride-on vehicles and a Toys R Us-related antitrust litigation settlement. Total 1998 nonrecurring charges of approximately $163 million after-tax impacted the earnings by $0.39 per diluted share.

The negative results of the Learning Company division in 1999 were attributable to a number of factors. In 1999, Learning Company experienced a decrease in sales of CD-ROM products at retail and a higher proportion of sales of relatively lower priced and lower margin products. During the second half of 1999, Learning Company was in the process of revising its distribution channel arrangements. These changes in distribution terms combined with the general weakness in the CD-ROM market resulted in increased product returns. Significant price and promotional competition caused the Learning Company division to incur higher than anticipated price concessions and marketing expenses, including increased use of rebate programs, price protection and advertising. In addition, increased bad debt reserves of approximately $56 million, including $35 million related to one of Learning Company's major distributors, contributed to its operating loss.

In 2000, Mattel will attempt to improve the results of its Learning Company division by reducing the number of software products it develops and sells, decreasing the length of its software product development cycle and eliminating a number of its lower margin software titles. In addition, Mattel has implemented a more strict sales control policy with its distributors and retailers and plans to decrease the use of rebates to consumers and price and marketing concessions to distributors and retailers. Mattel intends to focus on areas where potential growth opportunities exist, including expansion of its interactive products to new platforms such as game consoles and the Internet, as well as increased sales in the international markets. Mattel also plans to continue its strategy of creating stand-alone on-line ventures utilizing Learning Company assets, such as Genealogy.com, LLC and GoodHome, LLC, in which Mattel retains an equity interest, and will consider strategic dispositions, licensing agreements and other similar transactions. In 1999 and 2000, Mattel replaced the senior management at its Learning Company division. There can be no assurance that the Learning Company division's results will improve as a result of Mattel's efforts.

Mattel is also currently undertaking a comprehensive review of its entire interactive business to identify additional opportunities to improve operating productivity and realize costs savings. Following this review, Mattel expects to incur pre-tax reorganizational charges totaling approximately $75 million to $100 million in the first quarter of 2000. These charges are designed to streamline the infrastructure, product development cycle and operations of Mattel Interactive.

Net sales for 1999 were $5.5 billion, a decrease of 2% from $5.6 billion in 1998. Sales to customers within the US remained relatively flat and accounted for 72% and 71% of consolidated net sales in 1999 and 1998, respectively. Sales to customers outside the US were down 6%, including an unfavorable foreign exchange effect of approximately $22 million due to the generally stronger US dollar relative to 1998. At comparable foreign exchange rates, sales internationally declined by 4%, partially due to unfavorable industry-wide trends, especially the shift amongst European retailers to just-in-time inventory management. Mattel plans to grow its international business by adapting products to local tastes, economic conditions and price requirements. To accomplish this goal, Mattel continues to work on an extensive market-specific strategy aimed at improving sales of its core product lines in international markets. In addition, Mattel's September 1999 distribution agreement with Bandai Co. Ltd. ("Bandai"), the largest toy company in Japan, to distribute certain Mattel products in Japan is also part of Mattel's strategy for international growth and market penetration.

Sales in the Girls category decreased 3% largely due to declines in Barbie® and Cabbage Patch Kids® products, partially offset by incremental sales of American Girl® products resulting from the Pleasant Company acquisition. Pleasant Company was acquired in July 1998 and therefore the results of operations for 1998 only reflect six months of results. Sales in the Infant and Preschool category declined 3%, largely attributable to last year's success of Sesame Street® products, including 'Tickle Me Elmo' and decreased sales of Disney's Winnie the Pooh® products, partially offset by an increase in sales of core Fisher-Price® and Power Wheels® products. Sales in the Wheels category grew 6%, demonstrating continued strength in Hot Wheels®, Matchbox®, and Tyco® Radio Control. Sales in the Entertainment category, including Disney and Nickelodeon®, increased 11% largely due to this year's success of toys associated with Disney's feature motion picture ''Toy Story 2". Sales of Learning Company consumer software products decreased 8%, mainly due to a decrease in sales of CD-ROM products at retail and a higher proportion of sales of relatively lower priced and lower margin products. This decrease was partially offset by an increase in licensing revenues of approximately $50 million largely generated from licensing agreements, including Genealogy.com, LLC in the third quarter of 1999 and GoodHome, LLC in the second quarter of 1999. Mattel views e-commerce and licensing transactions to be a significant source of potential revenues for its Learning Company division and intends to continue to attempt to leverage the value of its Internet properties through joint ventures, licensing and other similar transactions.

Gross profit, as a percentage of net sales, was 47.2% in 1999, down from 51.8% in 1998, were largely due to lower profit margins at Learning Company. Excluding the Learning Company division, gross profit was 47.8% in 1999, down 1.6 percentage points from 1998 mainly due to overall change in product mix, higher ocean freight costs and slightly higher product costs due to strengthening currencies in countries where Mattel manufactures its products. As a percentage of net sales, advertising and promotion expenses increased nearly one percentage point to 17.2% mainly as a result of higher rebates offered to consumers on Learning Company products and increased marketing expenses incurred to promote certain Learning Company titles. Excluding the Learning Company division, advertising as a percentage of net sales was 15.4%, a decrease of 1.6 percentage points over 1998. Other selling and administrative expenses increased from 20.3% of net sales in 1998 to 21.6% of net sales in 1999, primarily due to increased Learning Company bad debt expense. Amortization of intangibles decreased by $37.8 million, mainly as a result of completed amortization of intangibles related to certain Learning Company acquisitions, partially offset by higher amortization resulting from 1998 acquisitions.

Interest expense increased $23.1 million, primarily due to increased short- and long-term borrowings to fund Learning Company's cash requirements and to finance Mattel's 1998 acquisitions.

### Business Segment Results

Mattel's reportable segments are separately managed business units and include Toy Marketing, Consumer Software and Operations. The Toy Marketing segment is divided on a geographic basis between domestic and international. The domestic Toy Marketing segment is further divided into USA Toys, US Fisher-Price/Tyco Preschool and Other. USA Toys principally sells products in the Girls, Entertainment and Wheels categories. US Fisher-Price/Tyco Preschool principally sells products in the Infant and Preschool categories. The Other segment principally sells specialty products in the Girls category. The International Toy Marketing segment sells products in all toy categories. The Consumer Software segment consists of educational, productivity and entertainment software products developed and sold by Learning Company on a worldwide basis. The Operations segment manufactures toy products, which are sold to the Toy Marketing segments. Additional financial information regarding Mattel's segments can be found in Note 8 to the consolidated financial statements.

The USA Toys segment sales reached $2.2 billion, consistent with 1998. This segment achieved these results through increased sales of Barbie®, Entertainment and Wheels products. The US Fisher-Price/Tyco Preschool segment sales grew by 4% mainly due to increased sales of core Fisher-Price® and Power Wheels® products, partially offset by lower sales of Tyco Preschool products as a result of last year's success of Sesame Street® products, including 'Tickle Me Elmo'. Sales in the Other segment increased by 24% due to incremental sales resulting from the July 1998 acquisition of Pleasant Company. The International Toy Marketing segment sales decrease of 7% was partially attributable to the unfavorable foreign exchange effect due to the generally stronger US dollar relative to 1998 and unfavorable industry-wide trends, especially the shift by European retailers to just-in-time inventory management. Mattel expects this trend to continue worldwide. By brand, the International Toy Marketing segment experienced lower sales of Barbie® and Infant and Preschool products, partially offset by sales increases in Wheels and Entertainment products. The Consumer Software segment sales decreased 8%, mainly due to a decrease in sales of CD-ROM products at retail and a higher proportion of sales of relatively lower priced and lower margin products.

Operating profit in the USA Toys and International Toy Marketing segments declined by 7% and 28%, respectively. The decline in operating profit in each of these segments was largely attributable to lower sales volume and unfavorable shift in product mix, partially offset by lower advertising costs. The US Fisher-Price/Tyco Preschool segment operating profit increased 8%, largely due to a favorable shift in product mix and lower advertising and overhead spending to support the Fisher-Price® product line. The Other segment operating profit declined by 73%, largely due to incremental amortization and overhead expenses resulting from the July 1998 acquisition of Pleasant Company. The Consumer Software segment realized an operating loss of $205.5 million in 1999 compared to a profit of $114.3 million in 1998. The negative results of the Learning Company division in 1999 were attributable to a number of factors. In 1999, Learning Company experienced a decrease in sales of CD-ROM products at retail and a higher proportion of sales of relatively lower priced and lower margin products. During the second half of 1999, Learning Company was in the process of revising its distribution channel arrangements. These changes in distribution terms combined with the general weakness in the CD-ROM market resulted in increased product returns. Significant price and promotional competition caused Learning Company to incur higher than anticipated price concessions and marketing expenses, including increased use of rebate programs, price protection and advertising. In addition, increased bad debt reserves of approximately $56 million, including $35 million related to one of Learning Company's major distributors, contributed to its operating loss.

## 1998 Compared to 1997

### Consolidated Results

Net income for 1998 was $206.1 million or $0.47 per diluted share as compared to a loss of $182.7 million or $0.52 per diluted share in 1997. Profitability for 1998 was negatively impacted by nonrecurring charges, including an incomplete technology writeoff of $56.8 million related to the acquisition of Mindscape, Inc. in March 1998, restructuring and other charges of $113.3 million related to 1998 acquisitions and one-time charges of $44.0 million in connection with the voluntary recall of Power Wheels® ride-on vehicles and a Toys R Us-related antitrust litigation settlement. Total 1998 nonrecurring charges of approximately $163 million after-tax impacted earnings by $0.39 per diluted share. Profitability for 1997 was impacted by restructuring and other charges of $343.6 million related to the Mattel restructuring plan, the merger and integration of Tyco, and other Learning Company merger charges. The 1997 results also included an incomplete technology writeoff of $20.3 million related to products being developed by Creative Wonders L.L.C., Parsons Technology Inc., and Living Books and an extraordinary charge of $4.6 million after-tax for the early retirement of debt assumed as part of the Tyco merger. Total 1997 nonrecurring charges of approximately $286.2 million after-tax impacted earnings by $0.77 per diluted share.

Net sales for 1998 reached $5.6 billion, an increase of 3% from $5.5 billion in 1997. Sales to customers within the US increased 6% and accounted for 71% and 69% of consolidated net sales in 1998 and 1997, respectively. Sales to customers outside the US were down 4%, including an unfavorable foreign exchange effect due to the generally stronger US dollar relative to 1997.

Sales in the Girls category decreased 4% largely due to a 14% decline in Barbie® products, as a result of high retail inventory levels entering 1998 and domestic toy retailers shift to a just-in-time buying pattern. As a result of the Pleasant Company acquisition in July 1998, the American Girl® brand contributed $213.2 million in sales, which helped to partially offset the decline in Barbie®. Sales in the Infant and Preschool category decreased 3%, largely attributable to declines in Sesame Street® and Fisher-Price® products, partially offset by an increase in Disney's Winnie the Pooh®. Sales in the Wheels category grew 21%, reflecting growth in both Hot Wheels® and Matchbox® vehicles and playsets. Sales in the Entertainment category, which includes

Disney and Nickelodeon®, increased 14% largely due to the 1998 introduction of toys associated with the feature motion pictures "A Bug's Life" and "The Rugrats Movie". Sales of Learning Company consumer software products increased 35%, mainly due to the acquisition of Mindscape, Inc. which added $188.1 million to 1998 sales, introduction of new software titles such as The ClueFinders™ 4th Grade Adventures, Arthur's® Computer Adventures, and upgraded products.

Gross profit as a percentage of net sales remained relatively constant at 51.8% compared to 51.7% in 1997. As a percentage of net sales, advertising and promotion expenses increased approximately one percentage point to 16.3%, and selling and administrative expenses increased 1.7 percentage points to 20.3%. Both ratios increased relative to 1997 as a result of unanticipated cutbacks in buying by domestic toy retailers due to a continuing shift by these retailers to just-in-time inventory management. To respond to such shifts, Mattel took appropriate actions to adjust its own shipping to more of a just-in-time pattern. As a result, toy products that would have previously been shipped in December of 1998 were shipped closer to the time that they were purchased by the consumer. Amortization of intangibles decreased by $357.5 million, mainly as a result of completed amortization of intangibles related to certain Learning Company acquisitions, partially offset by amortization resulting from the 1998 acquisitions of Pleasant Company, Sofsource, Inc., Bluebird Toys PLC ("Bluebird") and Mindscape, Inc.

Interest expense increased $15.9 million primarily due to increased short- and long-term borrowings to finance the 1998 acquisitions of Pleasant Company and Bluebird, partially offset by the repurchase of certain of the 5-1/2% Senior Notes of Learning Company.

Other income, net increased $8.3 million, mainly due to an $11.1 million gain realized on sale of investments.

### Business Segment Results

The USA Toys segment sales were down 5% in 1998 compared to 1997, largely due to lower sales of Barbie® products, as a result of high retail inventory levels entering 1998 and domestic toy retailers shift to a just-in-time buying pattern. This decrease was partially offset by increased sales of Wheels and Entertainment products. The US Fisher-Price/Tyco Preschool segment sales declined by 13% due to decreased sales of Sesame Street® and Fisher-Price® products. Sales in the Other segment increased to $256.1 million in 1998 from $58.3 million in 1997 due to American Girl® sales generated from the July 1998 acquisition of Pleasant Company. The International Toy Marketing segment sales decreased 1% due to lower sales of Barbie® products, partially offset by stronger sales of Wheels and Infant/Preschool products. Consumer Software segment sales increased 35%, mainly due to the acquisition of Mindscape, Inc. which added $188.1 million to 1998 net sales, introduction of new software titles such as The ClueFinders™ 4th Grade Adventures and Arthur's® Computer Adventures, and upgraded products.

Operating profit in the USA Toys and International Toy Marketing segments declined by 27% and 29%, respectively. The decline in operating profit in each of these segments was largely attributable to lower sales volume and unfavorable shift in product mix. The US Fisher-Price/Tyco Preschool segment operating profit increased 11%, driven by improved profitability in the Fisher-Price® product line, partially offset by unfavorable shift in product mix of Tyco Preschool products. The Other segment operating profit increased to $20.2 million in 1998 from $7.3 million in 1997 mainly due to the July 1998 acquisition of Pleasant Company. The Consumer Software segment realized profit of $114.3 million in 1998 compared to a loss of $312.5 million in 1997, largely due to increased sales and lower amortization.

## Income Taxes

The effective income tax rate for 1999 was 25.6%, favorably impacted by domestic losses incurred by Learning Company, and by income earned in foreign jurisdictions taxed at lower rates. This represents a substantial reduction from 1998 and 1997, during which the effective income tax rates were in excess of the US federal tax rate of 35%. The reduction in the tax rate is the result of a decrease in the amount of non-deductible items, particularly the writeoff of incomplete technology and other non-deductible expenses incurred in connection with business acquisitions, that unfavorably impacted the 1998 and 1997 tax rates.

Pre-tax losses from US operations as a percentage of the consolidated pre-tax income was less than the sales to US customers as a percentage of the consolidated gross sales. This difference results from operating losses, amortization of intangibles and corporate headquarters expenses incurred in the US that decreased US pre-tax income, and foreign profits related to sales ultimately made to US customers.

## Financial Position

Mattel's cash position was $275.0 million, compared to $469.2 million as of the end of 1998. Cash decreased $194.2 million primarily due to the payment of restructuring and integration costs related to the Learning Company merger, repayment of Learning Company's credit lines and the termination of Learning Company's receivable factoring facilities. Accounts receivable, net increased by $120.0 million to $1,270.0 million at year end 1999 principally due to the cancellation of Learning Company's receivable factoring facilities. Inventories decreased by $100.0 million to $544.3 million at year end 1999, reflecting Mattel's shift to just-in-time production and shipping programs, partially offset by higher Learning Company inventory. Prepaid expenses and other current assets decreased by $41.1 million to $330.7 million at year end 1999, primarily due to the reclassification of certain deferred income tax assets related to operating losses to noncurrent assets, partially offset by higher prepaid royalties and software development costs. Property, plant and equipment, net decreased $13.6 million to $749.5 million at year end 1999 largely due to asset writedowns related to the 1999 restructuring. Intangibles, net decreased $91.3 million to nearly $1.4 billion at year end 1999, mainly due to goodwill amortization. Other noncurrent assets increased by $299.9 million to $564.2 million at year end 1999, principally due to increased noncurrent deferred tax assets related to operating losses.

Short-term borrowings increased $170.5 million compared to 1998 year end, primarily due to the funding of Learning Company's cash requirements.

A summary of Mattel's capitalization is as follows:

| | As of Year End | | | |
|---|---|---|---|---|
| (In millions, except percentage information) | 1999 | | 1998 | |
| Senior notes | $ 601.0 | 18% | $ 601.0 | 17% |
| Medium-term notes | 540.5 | 17 | 540.5 | 16 |
| Other long-term debt obligations | 42.4 | 1 | 43.0 | 1 |
| Total long-term debt | 1,183.9 | 36 | 1,184.5 | 34 |
| Other long-term liabilities | 162.9 | 5 | 149.1 | 4 |
| Stockholders' equity | 1,962.7 | 59 | 2,170.8 | 62 |
| | $3,309.5 | 100% | $3,504.4 | 100% |

Total long-term debt remained approximately the same at year end 1999 compared to year end 1998. Although $301.0 million of the senior notes are maturing in 2000, they have been classified as long-term in the consolidated balance sheet at December 31, 1999 since management has the ability and intent to repay these obligations upon maturity with proceeds from the issuance of other long-term debt instruments. Despite the recent rating agency downgrades of Mattel's long-term debt, Mattel's long-term debt rating continues to be investment grade and the downgrades are not expected to impact Mattel's ability to access the capital markets to implement the refinancing. However, the rating agency downgrades will have a negative impact on the pricing spread over the Treasury rates and could cause Mattel to pay a slightly higher interest rate on the issued debt than it otherwise would have paid. Mattel expects to satisfy its future long-term capital needs through the retention of corporate earnings and the issuance of long-term debt instruments. In November 1998, Mattel filed its current universal shelf registration statement allowing it to issue up to $400.0 million of debt and equity securities, all of which was available to be issued as of December 31, 1999. Stockholders' equity of $2.0 billion at year end 1999 decreased $208.1 million from year end 1998, primarily due to dividend declarations on common and preferred stock, Mattel's net loss position due to restructuring and other nonrecurring charges, treasury stock purchases and unfavorable effect of currency translation adjustments, partially offset by cash received from exercise of employee stock options.

## Liquidity and Capital Resources

Mattel's primary sources of liquidity over the last three years have been cash on hand at the beginning of the year, cash flows generated from operations, long-term debt issuances and short-term seasonal borrowings. Operating activities generated cash flows of $58.6 million during 1999, compared to $571.7 million in 1998 and $503.4 million in 1997. The decrease in cash flows from operating activities in 1999 is largely due to the negative impact of Learning Company's results.

Mattel invested its cash flows during the last three years mainly in the acquisitions of Pleasant Company, Sofsource, Inc., Bluebird and Mindscape, Inc., additions to tooling in support of new products, and construction of new manufacturing facilities.

Mattel received cash flows from its short-term borrowings, which was primarily used to support operating activities. Mattel also received cash flows from the issuance of Senior Notes in 1998, and Medium-Term Notes and Softkey warrants in 1998 and 1997. Cash received from these debt issuances was used to fund the 1998 acquisitions of Pleasant Company, Mindscape, Inc. and Bluebird, to retire higher-cost debt and to support operating activities. In 1999, Mattel repaid $30.0 million of its Medium-Term Notes. In 1998, Mattel repaid the long-term debt and mortgage note assumed as part of the Pleasant Company acquisition. In 1997, Mattel redeemed the 10-1/8% Notes assumed as part of the acquisition of Tyco and repaid its 6-7/8% Senior Notes upon maturity. Cash was also spent during the last three years to purchase treasury stock to provide shares for issuance under Mattel's employee stock option plans and the exercise of outstanding warrants. In addition, over the last three years, Mattel has consistently increased its cash payments for dividends on its common stock. The payment of any dividends in the future is at the discretion of Mattel's board of directors.

## Seasonal Financing

Mattel expects to finance its seasonal working capital requirements for the coming year by using existing and internally generated cash, issuing commercial paper and selling certain trade receivables under its commited revolving credit facility and using various short-term bank lines of credit. Mattel's domestic committed unsecured credit facility provides up to a total of $1.0 billion in short-term borrowings from a commercial bank group. This facility provides for up to $700.0 million in advances and backup for commercial paper issuances, and up to an additional $300.0 million for nonrecourse purchases of certain trade accounts receivable by the bank group over the next three years. Under its domestic credit facility, Mattel is required to meet financial covenants for consolidated debt-to-capital and interest coverage. Currently Mattel is in compliance with such covenants.

Mattel is currently in the process of negotiating a 364 day, $400 million companion facility to its existing $1.0 billion credit facility, with essentially the same group of commercial banks. The terms and conditions of the companion facility will be similar to the existing $1.0 billion credit facility. Mattel expects to have the companion facility in place by the end of April 2000.

Mattel also expects to have approximately $370 million of individual short-term foreign credit lines with a number of banks available in 2000, which will be used as needed to finance seasonal working capital requirements of certain foreign affiliates.

## Business Combinations

Mattel and Learning Company completed the following business combinations during the last three years. Each transaction has been accounted for as a pooling of interests, which means the companies involved in the transaction are treated as if they had always been combined for accounting and financial reporting purposes.

In May 1999, Mattel completed its merger with Learning Company, after which Learning Company was merged with and into Mattel, with Mattel being the surviving corporation. Each share of Learning Company Series A Preferred Stock was then converted into 20 shares of Learning Company common stock immediately prior to the consummation of the merger. Pursuant to the merger agreement, each outstanding share of Learning Company common stock was converted into 1.2 shares of Mattel common stock upon consummation of the merger. As a result, approximately 126 million Mattel common shares were issued in exchange for all shares of Learning Company common stock outstanding as of the merger date. The outstanding share of Learning Company special voting stock was converted into one share of Mattel Special Voting Preferred Stock. Each outstanding exchangeable share of Learning Company's Canadian subsidiary, Softkey Software Products Inc., remains outstanding, but upon consummation of the merger became exchangeable for 1.2 shares of Mattel common stock.

In August 1998, Learning Company completed its merger with Broderbund Software, Inc. ("Broderbund"), a publisher and developer of consumer software for the home and school market. Under the merger agreement, each share of Broderbund common stock was converted into 0.80 shares of Learning Company common stock and resulted in the issuance of approximately 17 million shares of Learning Company common stock.

In March 1997, Mattel completed its merger with Tyco. Under the merger agreement, each Tyco common stockholder received 0.48876 shares of Mattel common stock for each share of Tyco common stock outstanding, which resulted in the issuance of approximately 17 million Mattel common shares. Tyco restricted stock units and stock options outstanding as of the merger date were exchanged for approximately 0.6 million Mattel common shares. In addition, each share of Tyco Series B and Series C preferred stock was converted into like Mattel preferred stock.

Learning Company also merged with Palladium Interactive, Inc. and P.F. Magic, Inc. in 1998 and TEC Direct, Inc., Microsystems Software, Inc., Skills Bank Corporation and Learning Company Services, Inc. in 1997, each of which were accounted for as poolings of interests. The consolidated financial statements have not been retroactively restated for the results of operations and financial position of these companies as the effect of each acqusition individually and in the aggregate on Learning Company's balance sheet and results of operations was less than three percent.

## Acquisitions

Mattel and Learning Company acquired the following companies during the years ended December 31, 1998 and 1997. Each of these acquisitions was accounted for using the purchase method of accounting. The results of operations of the acquired companies have been included in Mattel's consolidated financial statements from their respective dates of acquisition. Intercompany accounts and transactions between the acquired companies and Mattel, as applicable, have been eliminated.

| (In millions) | Month | Price | Method of Payment | (Assets)/ Liabilities Assumed | Intangibles | Incomplete Technology |
|---|---|---|---|---|---|---|
| **1998** | | | | | | |
| Pleasant Company | July | $715.0 | Cash | $(25.0) | $690.0 | $ – |
| Bluebird Toys PLC | June | 80.0 | Cash | (20.0) | 60.0 | – |
| Sofsource, Inc. | June | 45.0 | Stock | 6.7 | 36.8 | 14.9 |
| Mindscape, Inc. | March | 152.6 | Cash/stock | 6.4 | 119.0 | 40.0 |
| **1997** | | | | | | |
| Creative Wonders, L.L.C. | October | $ 37.8 | Cash | $ 7.3 | $ 44.0 | $ 1.1 |
| Parsons Technology | August | 31.0 | Cash | (11.7) | 9.3 | 10.0 |

The acquisition price includes investment advisor and other directly-related expenses as applicable. The portion of the purchase price allocated to incomplete technology was charged to expense in the year of acquisition.

Mattel also made other minor acquisitions during the last three years which were accounted for using the purchase method. These acquisitions resulted in the issuance of 0.4 million shares of common stock in the year ended December 31, 1997.

## New Venture

In the third quarter of 1999, Mattel executed stock purchase and distribution agreements with Bandai, the largest toy company in Japan. In the purchase agreement, Mattel acquired approximately five percent of the outstanding common stock of Bandai. The distribution agreements allow Bandai to distribute certain Mattel products in Japan, while Mattel was granted the right to distribute certain Bandai products in Latin America. Mattel and Bandai will discuss other distribution opportunities in the US on a case-by-case basis.

## Restructuring and Other Charges

In 1999 Mattel incurred restructuring and other nonrecurring charges totaling $346.0 million, approximately $265 million after-tax or $0.64 per diluted share.

During the first quarter of 1999, Mattel incurred a nonrecurring pre-tax charge of $3.9 million, largely related to the restructuring and integration of acquisitions made by its Learning Company division in the fourth quarter of 1998.

During the second quarter of 1999, Mattel completed its merger with Learning Company and finalized a previously announced plan of restructuring and integration. These actions, along with other one-time events, resulted in a nonrecurring pre-tax charge against operations of $345.0 million. In the fourth quarter of 1999, Mattel incurred an additional $23.5 million charge relating to its restructuring and integration plan and other one-time charges which had previously not met the requirement for accrual. In addition, Mattel reversed $26.4 million of the second quarter charge based on lower than anticipated costs and revisions to previous estimates. The impact of these new developments combined with the initial second quarter charge resulted in a full year nonrecurring charge of $342.1 million. Of the pre-tax restructuring and integration charges totaling $307.0 million, approximately $132 million was spent in 1999, $111 million is expected to be spent in 2000 and the remaining $64 million represents non-cash charges. Total cash outlay will be funded from existing cash balances and internally generated cash flows from operations.

The restructuring and integration plan, expected to be substantially complete by June 2000, provides for the consolidation and realignment of Mattel's operations. The plan was aimed at leveraging global resources in areas of manufacturing, marketing and distribution, eliminating duplicative functions worldwide and achieving improved operating efficiencies. The plan, which was designed to reduce product costs and overhead spending and recognize synergy savings, resulted in actual cost savings of approximately $40 million in 1999. Mattel expects savings of at least $350 million over the next three years. The realized cost savings for 1999 and beyond is lower than the previously estimated savings of approximately $50 million and $400 million, respectively, largely due to not realizing the revenue synergies with Learning Company. These savings are net of anticipated incremental integration-related spending of approximately $12 million. This incremental spending includes approximately $3 million for capital investment at existing manufacturing facilities as well as network consolidation, and charges for the relocation of employees and movement of equipment, employee transition/training, and manufacturing start-up costs.

The following are the major restructuring and integration initiatives:

- Consolidation of the Infant and Preschool businesses;
- Consolidation of the domestic and international back-office functions;
- Consolidation of direct marketing operations;
- Realignment of the North American sales force;
- Termination of various international distributor contracts; and
- Closure of three higher cost manufacturing facilities.

Components of the restructuring and other nonrecurring charges, including related adjustments, are as follows:

| (In millions) | Plan | Adjustments (Credits) | Adjustments Charges | Total Charges | Amounts Incurred | Balance Dec. 31, 1999 |
|---|---|---|---|---|---|---|
| Severance and other compensation | $108 | $ (13) | $18 | $113 | $ (30) | $ 83 |
| Distributor, license and other contract terminations | 57 | (2) | – | 55 | (45) | 10 |
| Writedown of assets | 42 | (2) | – | 40 | (40) | – |
| Lease termination costs | 22 | (4) | – | 18 | – | 18 |
| Total restructuring costs and asset writedowns | 229 | (21) | 18 | 226 | (115) | 111 |
| Merger-related transaction and other costs | 86 | (5) | – | 81 | (76) | 5 |
| Other nonrecurring charges | 30 | – | 5 | 35 | (16) | 19 |
| Total restructuring, asset writedowns and other charges | $345 | $(26) | $23 | $342 | $(207) | $135 |

In the fourth quarter of 1999, Mattel adjusted its restructuring and integration plan and other nonrecurring charges, resulting in a net reduction of approximately $3 million. The credits to the restructuring plan of approximately $26 million were mainly due to Mattel's recent decision not to close certain of its marketing offices and one of its manufacturing facilities. The remaining credits include other changes in estimates and lower than anticipated costs compared to the previous estimates for completed components of the plan. Approximately 900 employees will not be terminated as a result of these changes.

The fourth quarter restructuring charge of approximately $18 million relates to the termination of an additional 150 Learning Company employees at its domestic offices. This action was taken to further consolidate the operations of Learning Company's domestic offices. The fourth quarter other nonrecurring charge relates to a $4.0 million increase to the reserve for the October 1998 recall of Mattel's Power Wheels® vehicles and a $1.1 million additional charge related to the Toys R Us-related antitrust litigation settlement.

A description of the components of the restructuring and other nonrecurring charges is as follows:

Severance and other compensation costs relate to the termination of approximately 3,300 employees around the world. Approximately 2,300 of these employees are hourly workers located in certain of Mattel's manufacturing facilities, of which approximately 2,200 were employed in the manufacturing facility in Kuala Lumpur, which ceased operations in September 1999. The remainder of the work force reductions consist of downsizing sales and marketing groups in the US, Europe and Asia-Pacific regions as well as the elimination of duplicate administrative personnel following the consolidation of back-office functions, the majority of which are in Europe. As of December 31, 1999, approximately $30 million had been paid to nearly 2,700 terminated employees. Cash severance payments will extend beyond the completion of the workforce reductions due to the severance payment options available to affected employees.

Mattel terminated its sponsorship agreements related to certain attractions for a total cost of $37.5 million, inclusive of the writeoff of related capitalized costs. The cash portion of this charge was paid as of July 1999. Mattel also recognized a $17.5 million charge, mainly related to settlements for termination of certain foreign distributor agreements in conjunction with the realignment of its sales and distribution network.

Mattel's restructuring plan resulted in the impairment of certain long-lived assets related to the operations being closed. The sum of the undiscounted future cash flows of these assets was not sufficient to cover the carrying amount of these assets. As a result, these long-lived assets were written down to fair market value and will be depreciated over their remaining useful lives. Fair value of the impaired assets was determined by either third-party appraisals or past experience in disposing of similar assets. Buildings and, to the extent possible, equipment will be sold while the remainder of the impaired assets will be abandoned when taken out of service. Nearly all of the revenue-generating activities related to these assets will continue as a result of more effective utilization of other assets. A significant portion of the fixed asset writedowns is concentrated in the Operations and Learning Company segments. In addition, other asset writeoffs include approximately $10 million of goodwill related to a recently acquired software business, which was closed following the merger with Learning Company.

Lease termination costs include penalties imposed upon canceling existing leases and future obligations under long-term rental agreements at facilities being vacated following the merger and realignment.

Merger-related transaction costs consist of investment banking fees, legal, accounting and printing costs, registration fees and other costs recognized in connection with the merger. Also included in this amount are the contractual change of control payments arising from the merger. The majority of all merger-related transaction costs were paid during the second quarter of 1999.

Other nonrecurring charges principally include an additional $20.0 million related to the October 1998 recall of Mattel's Power Wheels® vehicles and $14.0 million for environmental remediation costs related to a manufacturing facility on a leased property in Beaverton, Oregon, based on the completion and approval of the remediation plan and feasibility study.

Mattel is currently undertaking a comprehensive review of its entire interactive business to identify additional opportunities to improve operating productivity and realize costs savings. Following this review, Mattel expects to incur pre-tax reorganizational charges totaling approximately $75 million to $100 million in the first quarter of 2000. These charges are designed to streamline the infrastructure, product development cycle and operations of Mattel Interactive. Additionally, compensation expense of approximately $50 million, including forgiveness of certain executive loans, will be incurred in the first quarter of 2000 related to the recent departure of certain senior executives.

## Litigation

### Power Wheels® Recall and Related Matters

On October 22, 1998, Mattel announced that Fisher-Price, in cooperation with the Consumer Product Safety Commission, would conduct a voluntary recall involving up to 10 million battery-powered Power Wheels® ride-on vehicles. The recall did not result from any serious injury, and involves the replacement of electronic components that may overheat, particularly when consumers make alterations to the product. The recall involves vehicles sold nationwide since 1984 under nearly 100 model names. Additionally, Fisher-Price has been notified by the Consumer Product Safety Commission that the Commission is considering whether Fisher-Price may be subject to a fine for delayed reporting of the facts underlying the recall.

In the third quarter of 1998, Mattel recognized a $38.0 million pre-tax charge related to the recall. During the second and fourth quarters of 1999, Mattel recognized additional pre-tax charges totaling $20.0 million related to the recall.

### Greenwald Litigation and Related Matters

On October 13, 1995, Michelle Greenwald filed a complaint (Case No. YC 025 008) against Mattel in Superior Court of the State of California, County of Los Angeles. Ms. Greenwald is a former employee whom Mattel terminated in July 1995. Her complaint sought $50 million in general and special damages, plus punitive damages, for breach of oral, written and implied contract, wrongful termination in violation of public policy and violation of California Labor Code Section 970. Ms. Greenwald claimed that her termination resulted from complaints she made to management concerning general allegations that Mattel did not account properly for sales and certain costs associated with sales and more specific allegations that Mattel failed to account properly for certain royalty obligations to The Walt Disney Company. On December 5, 1996, Mattel's motion for summary adjudication of Ms. Greenwald's public policy claim was granted. On March 7, 1997, Mattel filed a motion for summary judgment on the remaining causes of action. On December 9, 1997, Mattel's motion for summary judgment of Ms. Greenwald's remaining claims was granted. On February 4, 1998, Ms. Greenwald appealed from the dismissal of her suit. The appeal has been fully briefed, and a hearing took place on March 3, 2000. Mattel intends to continue to defend the action vigorously, including the appeal.

### Toys R Us and Related Matters

On October 2, 1997, the Attorney General of the State of New York filed in the United States District Court, Eastern District of New York (Case No. CV 97 5714), an action against Toys R Us, Mattel and certain other toy manufacturers alleging that the defendants had violated federal antitrust laws and entered into vertical and horizontal arrangements that had the effect of restricting sales to the warehouse clubs. The attorneys general from forty-three other states, the District of Columbia and the Commonwealth of Puerto Rico joined this action. Following the filing of the New York action, a series of private treble damage class actions under the federal antitrust laws were filed in various federal district courts. The parties later agreed to have these related actions transferred to the Eastern District of New York to be consolidated by the Judicial Panel on Multiple Litigation before Nina Gershon, United States District Judge. Private class actions were also filed in state courts in Alabama, California, and New Jersey, asserting claims under state antitrust law. These state court actions were coordinated with the federal court actions.

Subsequent mediation efforts resulted in a Settlement Agreement and Release as to Mattel, Inc., Fisher-Price, and Tyco, effective April 6, 1999. Pursuant to the terms of the Settlement Agreement and Release, Mattel agreed to make a cash payment and a toy contribution, both of which were made in the fourth quarter of 1999. As a result of a dispute between the parties as to the selection of the toys to be contributed, Mattel negotiated a Supplemental Toy Contribution Agreement and made a supplemental toy contribution in December 1999. Final Judgment and Order of Dismissal was entered by Judge Gershon on February 17, 2000 that effectively dismissed with prejudice the claims asserted by the state and private federal and state court plaintiffs, including the claims of any person represented in either a *parens patriae* or private class capacity.

### Litigation Related to Business Combination

On December 16, 21, and 23, 1998, several stockholders of the legal entity The Learning Company, Inc. that merged into Mattel ("Old Learning Company") filed six separate purported class action complaints in the Court of Chancery of the State of Delaware in and for New Castle County against Old Learning Company and Old Learning Company's board of directors for alleged breaches of fiduciary duties in connection with the May 1999 merger. The six complaints were consolidated. The consolidated complaint named Mattel as an additional defendant, claiming that Mattel aided and abetted the alleged breaches of fiduciary duty. On March 9, 2000, the plaintiffs filed a notice and order of dismissal dismissing the action without prejudice. Upon approval by the court, the consolidated action will be formally dismissed.

### Litigation Related to Learning Company Earnings Shortfall

Following Mattel's announcement on October 4, 1999 that it expected an earnings shortfall at its Learning Company division in the third quarter of 1999, several of Mattel's shareholders filed purported class action complaints in the United States District Court for the Central District of California, the United States District Court for the Southern District of New York and the United States District Court for Massachusetts naming Mattel and certain of its officers and directors as defendants. The complaints generally allege, among other things, that the defendants made false or misleading statements that artificially inflated the price of Mattel's common stock by overstating the revenues and net income of Mattel, including its Learning Company division, and by falsely representing that the May 1999 Learning Company acquisition would be immediately accretive to Mattel's 1999 and 2000 financial results.

Two of the purported class action complaints are brought on behalf of the former stockholders of Broderbund who acquired shares of Old Learning Company in exchange for their Broderbund common stock in connection with the Old Learning Company-Broderbund merger on August 31, 1998. Mattel has been named as a defendant as the successor-in-interest to Old Learning Company. The complaints generally allege that that the Old Learning Company-Broderbund Registration Statement on Form S-4 filed on or about July 14, 1998 in connection with the merger was materially false.

On November 23, 1999, Mattel (along with other defendants named in the federal securities lawsuits) filed a motion and brief before the Judicial Panel on Multidistrict Litigation seeking to transfer all of the federal actions to the United States District Court for the Central District of California for Coordinated or Consolidated Pretrial Proceedings. On March 3, 2000, the Judicial Panel on Multidistrict Litigation granted Mattel's motion.

In addition, a Mattel stockholder filed a derivative complaint on behalf and for the benefit of Mattel in the Superior Court of the State of California, County of Los Angeles. The complaint alleges that Mattel's directors breached their fiduciary duties, wasted corporate assets and grossly mismanaged Mattel in connection with Mattel's acquisition of Learning Company and seeks both monetary and injunctive relief. On February 10, 2000, the court sustained defendants' demurrer and dismissed the complaint with leave to amend.

Mattel believes the lawsuits are without merit and intends to defend them vigorously.

### Environmental

#### Fisher-Price

Fisher-Price has executed a consent order with the State of New York involving a remedial action/feasibility study for one of its manufacturing plants. Currently, Fisher-Price is negotiating an additional consent order which will outline the specific clean up strategy for the site. Mattel anticipates that the New York State Department of Environmental Quality will issue their Record of Decision in March 2000. The ultimate liability associated with this cleanup presently is estimated to be less than $1,425,000, approximately $1,030,500 of which has been incurred through December 31, 1999.

#### Beaverton, Oregon

Mattel operates a manufacturing facility on a leased property in Beaverton, Oregon that was acquired as part of the Tyco merger. In March 1998, samples of groundwater used by the facility for process water and drinking water disclosed elevated levels of certain chemicals, including trichloroethylene. Mattel immediately closed the water supply and self-reported the sample results to the Oregon Department of Environmental Quality and the Oregon Health Division. Mattel also implemented a community outreach program to employees, former employees and surrounding landowners.

In November 1998, Mattel and another potentially responsible party entered into a consent order with the Oregon Department of Environmental Quality to conduct a remedial investigation/feasibility study at the property, to propose an interim remedial action measure and to continue the community outreach program. In the second quarter of 1999, Mattel recorded a $14.0 million pre-tax charge for environmental remediation costs related to this property, based on the completion and approval of the remediation plan and feasibility study.

General

Mattel is also involved in various other litigation and legal matters, including claims related to intellectual property, product liability and labor, which Mattel is addressing or defending in the ordinary course of business. Management believes that any liability which may potentially result upon resolution of such matters will not have a material adverse effect on Mattel's business, financial condition or results of operations.

## 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. These arrangements include commitments for future inventory purchases and royalty payments. Certain of these commitments routinely contain provisions for guaranteed or minimum expenditures during the term of the contracts.

As of December 31, 1999, the Operations segment had outstanding commitments for 2000 purchases of inventory of approximately $92 million. Licensing and similar agreements with terms extending through 2007 contain provisions for future guaranteed minimum payments aggregating approximately $346 million.

## Foreign Currency Risk

Mattel's results of operations and cash flows can be impacted by exchange rate fluctuations. To limit the exposure associated with exchange rate movements, Mattel enters into foreign currency forward exchange and option contracts primarily to hedge its purchase of inventory, sales and other intercompany transactions denominated in foreign currencies. Mattel's results of operations can also be affected by the translation of foreign revenues and earnings into US dollars.

Market risk exposures exist with respect to the settlement of foreign currency transactions during the year because currency fluctuations cannot be predicted with certainty. Mattel seeks to mitigate its exposure to market risk by monitoring its currency exchange exposure for the year and partially or fully hedging such exposure. In addition, Mattel manages its exposure through the selection of currencies used for foreign borrowings and intercompany invoicing. Mattel does not trade in financial instruments for speculative purposes.

Mattel's foreign currency forward exchange contracts that were used to hedge firm foreign currency commitments as of December 31, 1999 and 1998 are shown in the following table.

These contracts generally mature within 18 months from the date of execution. Contracts outstanding at year-end mature during the next 13 months. All contracts are against the US dollar and are maintained by reporting units with a US dollar functional currency, with the exception of the Indonesian rupiah contracts that are maintained by an entity with a rupiah functional currency.

For the purchase of foreign currencies, fair value reflects the amount, based on dealer quotes, that Mattel would pay at maturity for contracts involving the same currencies and maturity dates, if they had been entered into as of year-end 1999 and 1998. For the sale of foreign currencies, fair value reflects the amount, based on dealer quotes, that Mattel would receive at maturity for contracts involving the same currencies and maturity dates, if they had been entered into as of year-end 1999 and 1998. The differences between the fair value and the contract amounts are expected to be fully offset by foreign currency exchange gains and losses on the underlying hedged transactions.

| | Buy | | | Sell | | |
|---|---|---|---|---|---|---|
| (In thousands of US dollars) | Contract Amount | Weighted Average Contract Rate | Fair Value | Contract Amount | Weighted Average Contract Rate | Fair Value |
| **1999** | | | | | | |
| Euro | $ 92,445 | 1.01 | $ 90,922 | $253,096 | 1.05 | $244,448 |
| British pounds sterling | 6,316 | 1.61 | 6,332 | 16,679 | 1.65 | 16,433 |
| Canadian dollar | 7,604 | 1.45 | 7,619 | 40,679 | .68 | 41,498 |
| Japanese yen | – | – | – | 19,412 | 116 | 19,557 |
| Australian dollar | – | – | – | 8,438 | .64 | 8,661 |
| Swiss franc | 14,893 | 1.58 | 14,798 | – | – | – |
| Indonesian rupiah | 19,455 | 7,676 | 20,998 | – | – | – |
| Singapore dollar | – | – | – | 4,066 | 1.68 | 4,091 |
| Thai bhat | 3,990 | 39.59 | 4,207 | – | – | – |
| | $144,703 | | $144,876 | $342,370 | | $334,688 |
| **1998** | | | | | | |
| German mark | $ 19,119 | 1.67 | $ 18,984 | $144,660 | 1.68 | $145,688 |
| Italian lira | 20,014 | 1,764.00 | 21,155 | 68,358 | 1,660.00 | 67,950 |
| Hong Kong dollar | 55,829 | 8.02 | 57,790 | – | – | – |
| French franc | 27,435 | 5.62 | 27,536 | 9,105 | 5.82 | 9,479 |
| British pounds sterling | 6,548 | 0.60 | 6,415 | 66,856 | 0.61 | 66,950 |
| Canadian dollar | 16,144 | 1.55 | 16,545 | 18,794 | 1.46 | 18,119 |
| Spanish peseta | 5,625 | 142.30 | 5,577 | 2,899 | 148.23 | 2,997 |
| Dutch guilder | 5,079 | 1.89 | 5,050 | 8,086 | 1.96 | 8,342 |
| Japanese yen | – | – | – | 12,501 | 116.00 | 12,759 |
| Australian dollar | 4,988 | 1.66 | 5,268 | 21,610 | 1.58 | 21,732 |
| Belgian franc | – | – | – | 11,641 | 35.46 | 11,871 |
| Swiss franc | 18,341 | 1.37 | 18,251 | – | – | – |
| Mexican peso | – | – | – | 22,000 | 10.02 | 21,956 |
| Indonesian rupiah | 10,000 | 15,720.50 | 19,183 | – | – | – |
| Singapore dollar | – | – | – | 3,962 | 1.64 | 3,943 |
| Brazilian real | – | – | – | 2,500 | 1.25 | 2,554 |
| | $189,122 | | $201,754 | $392,972 | | $394,340 |

### Manufacturing Risk
Mattel owns and operates manufacturing facilities and utilizes third-party manufacturers throughout Asia, primarily in China, Indonesia, Malaysia and Thailand. A risk of political instability and civil unrest exists in these countries, which could temporarily or permanently damage Mattel's manufacturing operations located there. Mattel's business, financial position and results of operations would be negatively impacted by a significant disruption to its manufacturing operations or suppliers.

### Effects of Inflation
Inflation rates in the US and in major foreign countries where Mattel does business have not had a significant impact on its results of operations or financial position during the three years ended December 31, 1999. The US Consumer Price Index increased 2.7% in 1999, 1.6% in 1998 and 1.7% in 1997. Mattel receives some protection from the impact of inflation from high turnover of inventories and its ability to pass on higher prices to consumers.

### Year 2000 Update
To address the year 2000 issue, in early 1998 Mattel established an in-house project team and initiated a comprehensive plan to assess, remediate and test Mattel's internal systems, hardware and processes, including key operational, manufacturing and financial systems. The plan also included steps to verify that all key third-party suppliers and customers were taking measures to ensure their own readiness and timely implementation. All phases of the year 2000 readiness plan were completed as scheduled. To date, Mattel has not experienced any year 2000 issues with its internal operating systems or with its third-party customers and suppliers. In addition, Mattel did not experience any loss in revenues due to the year 2000 issue.

All software products currently available for sale to consumers and under development are year 2000 compliant. However, several discontinued products sold in the past may not operate as intended on certain computers due to the year 2000 issue.

As of December 31, 1999, Mattel spent a total of approximately $13 million in connection with addressing the year 2000 issue. Any additional charges are expected to be minimal. These costs were largely due to the use of internal resources dedicated to achieving year 2000 compliance, and were charged to expense as incurred. All costs of addressing the year 2000 issue were funded from internally generated cash.

Although unlikely given that Mattel has not experienced any year 2000 issues to date, there can be no assurance that any future unforeseen year 2000 issues or year 2000 issues relating to possibly non-compliant software products will not materially adversely affect Mattel's results of operations, liquidity and financial position or adversely affect Mattel's relationships with customers, vendors or others.

### Euro Conversion
On January 1, 1999, a single currency called the euro was introduced in Europe. Eleven of the fifteen member countries of the European Union adopted the euro as their common legal currency on that date. Fixed conversion rates between these countries' existing currencies, ''legacy currencies", and the euro were established on that date. The legacy currencies are scheduled to remain legal tender in these participating countries through July 1, 2002. During the transition period, parties may settle transactions using the euro or a participating country's legacy currency.

Certain of Mattel's European facilities adopted the euro as their functional currency in 1999. The cost of system modifications to accommodate the euro was not material to Mattel's results of operations. Based on currently available information, the euro conversion has not had a material adverse impact on Mattel's business or financial condition.

### New Accounting Pronouncement
In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities.* This statement requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. It also requires that gains or losses resulting from changes in the values of those derivatives be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. Mattel is required to adopt this statement for its fiscal year beginning January 1, 2001. Management believes the adoption of this statement will not have a material impact on Mattel's consolidated financial position or results of operations.

## CONSOLIDATED BALANCE SHEETS

Mattel, Inc. and Subsidiaries

| (In thousands) | December 31, 1999 | December 31, 1998 |
|---|---|---|
| **Assets** | | |
| Current Assets | | |
| Cash and short-term investments | $ 275,024 | $ 469,213 |
| Accounts receivable, less allowances of $229.2 million at December 31, 1999 and $125.1 million at December 31, 1998 | 1,270,005 | 1,150,051 |
| Inventories | 544,296 | 644,270 |
| Prepaid expenses and other current assets | 330,702 | 371,772 |
| Total current assets | 2,420,027 | 2,635,306 |
| Property, Plant and Equipment | | |
| Land | 35,930 | 35,113 |
| Buildings | 276,880 | 271,580 |
| Machinery and equipment | 611,948 | 569,428 |
| Capitalized leases | 23,271 | 23,271 |
| Leasehold improvements | 84,333 | 98,400 |
| | 1,032,362 | 997,792 |
| Less: accumulated depreciation | 474,026 | 422,020 |
| | 558,336 | 575,772 |
| Tools, dies and molds, net | 191,158 | 187,349 |
| Property, plant and equipment, net | 749,494 | 763,121 |
| Other Noncurrent Assets | | |
| Intangibles, net | 1,393,315 | 1,484,634 |
| Other assets | 564,186 | 264,324 |
| | $5,127,022 | $5,147,385 |

The accompanying notes are an integral part of these statements.

Consolidated results for 1998 have been restated retroactively for the effects of the May 1999 merger with Learning Company, accounted for as a pooling of interests. See Note 7.

| (In thousands, except per share data) | December 31, 1999 | December 31, 1998 |
|---|---|---|
| **Liabilities And Stockholders' Equity** | | |
| Current Liabilities | | |
| Short-term borrowings | $ 369,549 | $ 199,006 |
| Current portion of long-term liabilities | 3,173 | 33,666 |
| Accounts payable | 360,609 | 362,467 |
| Accrued liabilities | 825,874 | 748,837 |
| Income taxes payable | 258,319 | 299,058 |
| Total current liabilities | 1,817,524 | 1,643,034 |
| Long-Term Liabilities | | |
| 6-3/4% senior notes, due 2000 | 100,000 | 100,000 |
| 5-1/2% senior notes, due 2000 | 200,955 | 200,955 |
| 6% senior notes, due 2003 | 150,000 | 150,000 |
| 6-1/8% senior notes, due 2005 | 150,000 | 150,000 |
| Medium-term notes | 540,500 | 540,500 |
| Mortgage note | 42,380 | 43,007 |
| Other | 162,976 | 149,086 |
| Total long-term liabilities | 1,346,811 | 1,333,548 |
| Stockholders' Equity | | |
| Preferred stock, Series A $0.01 par value, $200.00 liquidation preference per share, 750.0 thousand shares authorized, issued and outstanding at December 31, 1998 | – | 8 |
| Preferred stock, Series C $1.00 par value, $125.00 liquidation preference per share, 772.8 thousand shares authorized; 771.9 thousand shares issued and outstanding at December 31, 1998 | – | 772 |
| Special voting preferred stock $1.00 par value, $10.00 liquidation preference per share, one share authorized, issued and outstanding, representing the voting rights of 3.2 million and 5.2 million outstanding exchangeable shares at December 31, 1999 and 1998, respectively | – | – |
| Common stock $1.00 par value, 1.0 billion shares authorized; 433.6 million shares and 405.1 million shares issued in 1999 and 1998, respectively | 433,563 | 405,114 |
| Additional paid-in capital | 1,728,954 | 1,845,222 |
| Deferred compensation | – | (12,265) |
| Treasury stock at cost; 12.0 million shares and 14.3 million shares in 1999 and 1998, respectively | (361,825) | (495,347) |
| Retained earnings | 401,642 | 625,197 |
| Accumulated other comprehensive loss | (239,647) | (197,898) |
| Total stockholders' equity | 1,962,687 | 2,170,803 |
| | $5,127,022 | $5,147,385 |

Commitments and Contingencies (See accompanying notes.)

The accompanying notes are an integral part of these statements.

Consolidated results for 1998 have been restated retroactively for the effects of the May 1999 merger with Learning Company, accounted for as a pooling of interests. See Note 7.

## CONSOLIDATED STATEMENTS OF OPERATIONS

M a t t e l ,  I n c .  a n d  S u b s i d i a r i e s

| (In thousands, except per share amounts) | For the Year 1999 | 1998 | 1997 |
|---|---|---|---|
| **Net Sales** | $5,514,950 | $5,621,207 | $5,455,547 |
| Cost of sales | 2,913,910 | 2,707,904 | 2,635,887 |
| **Gross Profit** | 2,601,040 | 2,913,303 | 2,819,660 |
| Advertising and promotion expenses | 945,955 | 917,665 | 846,448 |
| Other selling and administrative expenses | 1,190,915 | 1,144,801 | 1,013,091 |
| Restructuring and other charges | 345,996 | 157,314 | 343,606 |
| Amortization of intangibles | 91,847 | 129,689 | 487,199 |
| Charge for incomplete technology | – | 56,826 | 20,300 |
| Interest expense | 151,609 | 128,468 | 112,612 |
| Other income, net | (14,539) | (13,092) | (4,812) |
| **Income (Loss) Before Income Taxes and Extraordinary Item** | (110,743) | 391,632 | 1,216 |
| (Benefit) provision for income taxes | (28,370) | 185,579 | 179,327 |
| **Income (Loss) Before Extraordinary Item** | (82,373) | 206,053 | (178,111) |
| Extraordinary item - loss on early retirement of debt | – | – | (4,610) |
| **Net Income (Loss)** | (82,373) | 206,053 | (182,721) |
| Preferred stock dividend requirements | 3,980 | 7,960 | 10,505 |
| **Net Income (Loss) Applicable to Common Shares** | $ (86,353) | $ 198,093 | $ (193,226) |
| **Basic Income (Loss) Per Common Share** | | | |
| Income (loss) before extraordinary item | $ (0.21) | $ 0.51 | $ (0.51) |
| Extraordinary item - loss on early retirement of debt | – | – | (0.01) |
| Net income (loss) | $ (0.21) | $ 0.51 | $ (0.52) |
| Weighted average number of common shares | 414,186 | 390,210 | 369,870 |
| **Diluted Income (Loss) Per Common Share** | | | |
| Income (loss) before extraordinary item | $ (0.21) | $ 0.47 | $ (0.51) |
| Extraordinary item - loss on early retirement of debt | – | – | (0.01) |
| Net income (loss) | $ (0.21) | $ 0.47 | $ (0.52) |
| Weighted average number of common and common equivalent shares | 414,186 | 421,707 | 369,870 |
| **Dividends Declared Per Common Share** | $ 0.35 | $ 0.31 | $ 0.27 |

The accompanying notes are an integral part of these statements.

Consolidated results for all periods presented have been restated retroactively for the effects of the May 1999 merger with Learning Company, accounted for as a pooling of interests. See Note 7.

Consolidated results for 1997 have been restated retroactively for the effects of the March 1997 merger with Tyco, accounted for as a pooling of interests. See Note 7.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Mattel, Inc. and Subsidiaries

| (In thousands) | For the Year 1999 | 1998 | 1997 |
|---|---|---|---|
| **Cash Flows From Operating Activities:** | | | |
| Net (loss) income | $ (82,373) | $ 206,053 | $(182,721) |
| Adjustments to reconcile net (loss) income to net cash flows from operating activities: | | | |
| Noncash restructuring and integration charges | 63,700 | 32,380 | 115,559 |
| Depreciation | 199,830 | 179,135 | 164,060 |
| Amortization | 98,769 | 133,549 | 489,937 |
| Charge for incomplete technology | – | 56,826 | 32,467 |
| Loss on early retirement of debt, net of tax | – | – | 4,610 |
| Increase (decrease) from changes in assets and liabilities: | | | |
| Accounts receivable | (167,052) | 141,583 | (247,406) |
| Inventories | 82,077 | (61,508) | (48,923) |
| Prepaid expenses and other current assets | (84,636) | (26,873) | (127,595) |
| Accounts payable, accrued liabilities and income taxes payable | (42,263) | (104,275) | 253,729 |
| Deferred income taxes | (7,151) | (999) | 64,015 |
| Other, net | (2,315) | 15,793 | (14,344) |
| Net cash flows from operating activities | 58,586 | 571,664 | 503,388 |
| **Cash Flows From Investing Activities:** | | | |
| Purchases of tools, dies and molds | (107,017) | (114,387) | (96,006) |
| Purchases of other property, plant and equipment | (104,572) | (162,132) | (136,439) |
| Payment for acquisitions, net of cash acquired | (5,863) | (938,647) | (115,231) |
| Proceeds from sale of business and other property, plant and equipment | 10,033 | 18,667 | 31,484 |
| Investment in other long-term assets | (70,671) | (10,783) | (7,816) |
| Other, net | (612) | (1,484) | 566 |
| Net cash flows used for investing activities | (278,702) | (1,208,766) | (323,442) |
| **Cash Flows From Financing Activities:** | | | |
| Short-term borrowings, net | 179,595 | 131,810 | 3,193 |
| Proceeds from issuance of notes | – | 350,000 | 310,000 |
| Proceeds from issuance of Softkey warrants | – | 134,346 | 57,462 |
| Payments of long-term debt | (30,254) | (106,421) | (265,499) |
| Exercise of stock options including related tax benefit | 81,291 | 170,233 | 72,290 |
| Purchase of treasury stock | (75,507) | (351,093) | (242,505) |
| Sale of treasury stock | – | – | 71,248 |
| Issuance of preferred stock | – | – | (10,701) |
| Payment of dividends on common and preferred stock | (125,673) | (97,970) | (84,537) |
| Other, net | (670) | (6,968) | (1,083) |
| Net cash flows from (used) for financing activities | 28,782 | 223,937 | (90,132) |
| **Effect of Exchange Rate Changes on Cash** | (2,855) | (1,525) | (17,195) |
| **(Decrease) Increase in Cash and Short-term Investments** | (194,189) | (414,690) | 72,619 |
| **Cash and Short-term Investments at Beginning of Year** | 469,213 | 883,903 | 811,284 |
| **Cash and Short-term Investments at End of Year** | $ 275,024 | $ 469,213 | $ 883,903 |

The accompanying notes are an integral part of these statements.

Consolidated results for all periods presented have been restated retroactively for the effects of the May 1999 merger with Learning Company, accounted for as a pooling of interests. See Note 7.

Consolidated results for 1997 have been restated retroactively for the effects of the March 1997 merger with Tyco, accounted for as a pooling of interests. See Note 7.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Mattel, Inc. and Subsidiaries

| (In thousands) | Preferred Stock | Common Stock | Additional Paid-In Capital | Treasury Stock | Deferred Compensation | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 1996** | $ 827 | $369,190 | $1,233,753 | $(215,999) | $ – | $ 820,024 | $ (98,008) | $2,109,787 |
| Comprehensive (loss): | | | | | | | | |
| Net (loss) | | | | | | (182,721) | | (182,721) |
| Unrealized gain on securities | | | | | | | 719 | 719 |
| Currency translation adjustments | | | | | | | (113,177) | (113,177) |
| Comprehensive (loss) | | | | | | (182,721) | (112,458) | (295,179) |
| Net income of Broderbund for the three months ended November 30, 1996 not included in results of operations | | | | | | 8,895 | | 8,895 |
| Purchase of treasury stock | | (480) | (14,094) | (227,932) | | | | (242,506) |
| Issuance of treasury stock | | | (45,486) | 158,511 | | | | 113,025 |
| Exercise of stock options | | 2,135 | 36,655 | | | | | 38,790 |
| Shares issued for acquisitions | | 4,362 | 13,591 | | | (6,193) | | 11,760 |
| Issuance of Series A Preferred Stock | 8 | | 202,025 | | | | | 202,033 |
| Issuance of Softkey warrants | | | 57,462 | | | | | 57,462 |
| Conversion of 7% Notes | | 893 | 15,141 | | | | | 16,034 |
| Conversion of preferred stock | (55) | 2,761 | (2,706) | | | | | – |
| Conversion of exchangeable shares | | 88 | (88) | | | | | – |
| Shares issued under employee stock purchase plan | | 62 | 1,208 | | | | | 1,270 |
| Dividends declared on common stock | | | | | | (77,528) | | (77,528) |
| Dividends declared on preferred stock | | | | | | (10,505) | | (10,505) |
| **Balance, December 31, 1997** | 780 | 379,011 | 1,497,461 | (285,420) | – | 551,972 | (210,466) | 1,933,338 |
| Comprehensive income: | | | | | | | | |
| Net income | | | | | | 206,053 | | 206,053 |
| Unrealized gain on securities | | | | | | | 10,249 | 10,249 |
| Currency translation adjustments | | | | | | | 2,319 | 2,319 |
| Comprehensive income | | | | | | 206,053 | 12,568 | 218,621 |
| Net income of Broderbund for the month ended December 31, 1997 not included in results of operations | | | | | | 209 | | 209 |
| Purchase of treasury stock | | | | (351,393) | | | | (351,393) |
| Issuance of treasury stock | | | (65,210) | 141,466 | | | | 76,256 |
| Exercise of stock options | | 4,682 | 76,749 | | | | | 81,431 |
| Shares issued for acquisitions | | 5,503 | 111,011 | | | (34,646) | | 81,868 |
| Issuance of Softkey warrants | | | 134,346 | | | | | 134,346 |
| Conversion of exchangeable shares | | 10,900 | (10,900) | | | | | – |
| Conversion of 5-1/2% Notes | | 4,122 | 88,880 | | | | | 93,002 |
| Issuance of nonvested stock | | 840 | 12,071 | | (12,265) | | | 646 |
| Shares issued under employee stock purchase plan | | 56 | 814 | | | | | 870 |
| Dividends declared on common stock | | | | | | (90,431) | | (90,431) |
| Dividends declared on preferred stock | | | | | | (7,960) | | (7,960) |
| **Balance, December 31, 1998** | 780 | 405,114 | 1,845,222 | (495,347) | (12,265) | 625,197 | (197,898) | 2,170,803 |
| Comprehensive (loss): | | | | | | | | |
| Net (loss) | | | | | | (82,373) | | (82,373) |
| Unrealized gain on securities: | | | | | | | | |
| Unrealized holding gains | | | | | | | 3,184 | 3,184 |
| Less: reclassification adjustment for realized gains included in net (loss) | | | | | | | (11,143) | (11,143) |
| Currency translation adjustments | | | | | | | (33,790) | (33,790) |
| Comprehensive (loss) | | | | | | (82,373) | (41,749) | (124,122) |
| Conversion of Series A Preferred Stock | (8) | 18,000 | (17,992) | | | | | – |
| Redemption of Series C Preferred Stock | (772) | 6,382 | (51,834) | 46,224 | | | | – |
| Purchase of treasury stock | | | | (75,507) | | | | (75,507) |
| Issuance of treasury stock | | | (87,300) | 134,977 | | | | 47,677 |
| Exercise of stock options | | 1,447 | 28,018 | | | | | 29,465 |
| Shares issued for acquisitions | | 241 | 5,306 | | | | | 5,547 |
| Conversion of exchangeable shares | | 2,342 | (2,342) | | | | | – |
| Shares issued under employee stock purchase plan | | 37 | 719 | | | | | 756 |
| Tax adjustment related to 1987 quasi-reorganization | | | 33,400 | | | | | 33,400 |
| Exercise of warrants | | | (24,243) | 27,828 | | | | 3,585 |
| Nonvested stock activity | | | | | 12,265 | | | 12,265 |
| Dividends declared on common stock | | | | | | (137,202) | | (137,202) |
| Dividends declared on preferred stock | | | | | | (3,980) | | (3,980) |
| **Balance, December 31, 1999** | $ – | $433,563 | $1,728,954 | $(361,825) | $ – | $ 401,642 | $(239,647) | $1,962,687 |

The accompanying notes are an integral part of these statements.

Consolidated results for all periods presented have been restated retroactively for the effects of the May 1999 merger with Learning Company, accounted for as a pooling of interests. See Note 7.

Consolidated results for December 31, 1996 have been restated retroactively for the effects of the March 1997 merger with Tyco, accounted for as a pooling of interests. See Note 7.

## Note 1 - Summary of Significant Accounting Policies

### Principles of Consolidation and Basis of Preparation

The consolidated financial statements include the accounts of Mattel, Inc. and its subsidiaries ("Mattel"). All significant intercompany accounts and transactions have been eliminated in consolidation, and certain amounts in the financial statements for prior years have been reclassified to conform with the current year presentation. Investments in joint ventures and other companies are accounted for by the equity method or cost basis depending upon the level of the investment and / or Mattel's ability to exercise influence over operating and financial policies. Financial data for all periods presented reflect the retroactive effect of the merger, accounted for as a pooling of interests, with Learning Company consummated in May 1999 (see Note 7). Financial data for 1997 reflect the retroactive effect of the merger, accounted for as a pooling of interests, with Tyco consummated in March 1997 (see Note 7).

Preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### Foreign Currency Translation

Assets and liabilities of foreign subsidiaries are translated into US dollars at fiscal year-end exchange rates. Income, expense and cash flow items are translated at weighted average exchange rates prevailing during the fiscal year. The resulting currency translation adjustments are recorded as a component of other comprehensive income (loss) within stockholders' equity.

### Cash and Short-Term Investments

Cash includes cash equivalents, which are highly liquid investments with maturities of three months or less when purchased. Because of the short maturities of these instruments, the carrying amount is a reasonable estimate of fair value.

### Marketable Securities

Marketable securities, comprised principally of investments in private and publicly-traded securities, are stated at market value and classified as securities available-for-sale. Unrealized gains or losses are reported as a component of other comprehensive income (loss) within stockholders' equity until realized. Quoted market prices, which approximated cost as of the balance sheet dates, are reasonable estimates of the portfolio's fair value. These marketable securities, which had a cost basis of $2.1 million and $2.7 million as of December 31, 1999 and 1998, respectively, are shown in the consolidated balance sheets as part of other assets.

### Inventories

Inventories, net of an allowance for excess quantities and obsolescence, are stated at the lower of cost or market. Cost is determined by the first-in, first-out method.

### Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over estimated useful lives of 10 to 40 years for buildings, 3 to 10 years for machinery and equipment, and 10 to 20 years, not to exceed the lease term, for leasehold improvements. Tools, dies and molds are amortized using the straight-line method over three years.

### Intangibles and Long-Lived Assets

Intangible assets consist of the excess of purchase price over the fair value of net assets acquired in purchase acquisitions, and the cost of acquired patents and trademarks. Intangible assets are amortized using the straight-line method over periods ranging from 2 to 40 years. Accumulated amortization was $1,327.8 million and $1,236.8 million as of December 31, 1999 and 1998, respectively.

The carrying value of fixed and intangible assets is periodically reviewed to identify and assess any impairment by evaluating the operating performance and future undiscounted cash flows of the underlying assets.

### Revenue Recognition

Revenue from the sale of toy products is recognized upon shipment. Accruals for customer discounts and rebates, and defective returns are recorded as the related revenues are recognized.

Revenue from the sale of software products is recognized upon shipment, provided that no significant obligations remain outstanding and collection of the receivable is probable. Costs related to insignificant post shipment obligations are accrued when revenue is recognized for the sale of the related products. Allowances for good returns are provided at the time of sale and allowances for price protection are provided at the time of commitment and are charged against revenues. The allowances for good returns and doubtful accounts are developed based on an evaluation of historical and expected sales experience and by channel of distribution, and are based on information available as of the reporting date. To the extent the future market, sell-through experience, customer mix, channels of distribution, product pricing and general economic and competitive conditions change, the estimated reserves required for returns and allowances may also change. Revenues from royalty and licensing arrangements are recognized as earned based upon performance or product shipments.

### Advertising and Promotion Costs

Costs of media advertising are expensed the first time the advertising takes place, except for direct-response advertising, which is capitalized and amortized over its expected period of future benefits. Direct-response advertising consists primarily of catalogue production and mailing costs that are generally amortized within three months from the date catalogues are mailed. Advertising costs associated with customer benefit programs are accrued as the related revenues are recognized. Costs related to various end-user coupon rebate programs are expensed at the time sales are made and are estimated based on the expected coupon redemption rate on a product-by-product basis and are adjusted to actual at the end of each reporting period.

### Software Development Costs

Costs for new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. Once technological feasibility is established, software development costs are capitalized until the related product is launched. Capitalized software development costs are amortized on a product-by-product basis using the straight-line method over the estimated economic life of the product, which is generally twelve months from when the product is launched, which approximates the ratio that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product. As of December 31, 1999 and 1998, Mattel had net capitalized software development costs of $73.1 million and $24.3 million, respectively, which are included in the consolidated balance sheets as part of other current assets. Amortization of software development costs included in cost of goods sold was $64.3 million, $20.2 million and $12.1 million for the years ended December 31, 1999, 1998 and 1997, respectively.

### Stock-Based Compensation

Mattel has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation.* Accordingly, no compensation cost has been recognized in the results of operations for nonqualified stock options granted under Mattel's plans as such options are granted at not less than the quoted market price of Mattel's common stock on the date of grant.

### Income Taxes

Mattel accounts for certain income and expense items differently for financial reporting and income tax purposes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, applying enacted statutory tax rates in effect for the year in which the differences are expected to reverse.

### Income and Dividends Per Common Share

Share and per share data for all periods presented in these financial statements reflect the retroactive effects of the May 1999 Learning Company merger. The 1997 share and per share data presented in these financial statements reflect the retroactive effects of the March 1997 Tyco merger.

In the 1997 fourth quarter, Mattel adopted Statement of Financial Accounting Standards No. 128, *Earnings per Share.* Accordingly, data for 1997 have been restated to present basic and diluted income (loss) per common share.

Basic income (loss) per common share is computed by dividing earnings available to common stockholders by the weighted average number of common shares and common shares obtainable upon the exchange of the exchangeable shares of Mattel's Canadian subsidiary, Softkey Software Products Inc., outstanding during each period. Earnings available to common stockholders represent reported net income (loss) less preferred stock dividend requirements.

Diluted income (loss) per common share is computed by dividing diluted earnings available to common stockholders by the weighted average number of common shares, common shares obtainable upon the exchange of the exchangeable shares of Mattel's Canadian subsidiary, Softkey Software Products Inc., and other common equivalent shares outstanding during each period. The calculation of common equivalent shares assumes the exercise of dilutive stock options and warrants, net of assumed treasury share repurchases at average market prices, and conversion of dilutive preferred stock and convertible debt, as applicable.

A reconciliation of earnings available to common stockholders and diluted earnings available to common stockholders and the related weighted average shares for the years ended December 31 follows (in thousands):

| | 1999 | | 1998 | | 1997 | |
|---|---|---|---|---|---|---|
| | Earnings | Shares | Earnings | Shares | Earnings | Shares |
| Income (loss) before extraordinary item | $(82,373) | | $206,053 | | $(178,111) | |
| Extraordinary item - loss on early retirement of debt | – | | – | | (4,610) | |
| Net income (loss) | (82,373) | | 206,053 | | (182,721) | |
| Less: preferred stock dividend requirements | (3,980) | | (7,960) | | (10,505) | |
| Earnings available to common stockholders | $(86,353) | 414,186 | $198,093 | 390,210 | $(193,226) | 369,870 |
| Dilutive securities: | | | | | | |
| Dilutive stock options | | | | 8,685 | | |
| Warrants | | | | 4,812 | | |
| Preferred stock | | | | 18,000 | | |
| Diluted earnings available to common stockholders | $(86,353) | 414,186 | $198,093 | 421,707 | $(193,226) | 369,870 |

Premium price stock options totaling 16.9 million, other nonqualified stock options totaling 23.2 million, convertible debt, preferred stock and warrants were excluded from the calculation of diluted earnings per share in 1999 because they were anti-dilutive. Premium price options totaling 18.7 million, Series C preferred stock and convertible debt were excluded from the calculation of diluted earnings per share in 1998 because they were anti-dilutive. Convertible debt, preferred stock and warrants were excluded from the calculation of diluted earnings per share in 1997 because they were anti-dilutive.

### Foreign Currency Contracts

Mattel enters into foreign currency forward exchange and option contracts primarily as hedges of inventory purchases, sales and other intercompany transactions denominated in foreign currencies to limit the effect of exchange rate fluctuations on its results of operations and cash flows. Mattel does not enter into contracts for speculative purposes. Gains and losses related to firm commitments, which qualify for hedge accounting, are deferred and are recognized in the results of operations, balance sheet, and statement of cash flows as part of the underlying transaction. Contracts that do not qualify for hedge accounting are marked to market with gains and losses recognized in the results of operations currently. If a derivative previously designated as a hedge of a foreign currency commitment is terminated prior to the transaction date of the related commitment, the resultant gain or loss is recognized at the time of maturity of the original contract as a component of other income, net.

## Note 2 - Income Taxes

Consolidated pre-tax income (loss) consists of the following (in thousands):

| | For the Year | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| US operations | $(388,382) | $ (25,271) | $(373,836) |
| Foreign operations | 277,639 | 416,903 | 375,052 |
| | $(110,743) | $391,632 | $ 1,216 |

The (benefit) provision for current and deferred income taxes consists of the following (in thousands):

| | For the Year | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Current | | | |
| Federal | $ 9,816 | $ 61,434 | $101,916 |
| State | 7,400 | 6,500 | 24,796 |
| Foreign | 59,400 | 110,300 | 82,628 |
| | 76,616 | 178,234 | 209,340 |
| Deferred | | | |
| Federal | (121,506) | 18,179 | (26,335) |
| State | 3,420 | 2,366 | 1,587 |
| Foreign | 13,100 | (13,200) | (7,962) |
| | (104,986) | 7,345 | (32,710) |
| (Benefit) provision including extraordinary item | (28,370) | 185,579 | 176,630 |
| Benefit allocated to extraordinary item | – | – | 2,697 |
| Total (benefit) provision for income taxes | $ (28,370) | $185,579 | $179,327 |

Deferred income taxes are provided principally for net operating loss carryforwards, certain reserves, depreciation, employee compensation-related expenses, acquired technology, and certain other expenses that are recognized in different years for financial statement and income tax purposes. Mattel's deferred income tax assets (liabilities) were comprised of the following (in thousands):

| | As of Year End | |
|---|---|---|
| | 1999 | 1998 |
| Operating loss and tax credit carryforwards | $ 426,836 | $ 254,770 |
| Sales allowances and inventory reserves | 118,729 | 122,178 |
| Deferred compensation | 40,372 | 37,022 |
| Excess of tax basis over book basis | 22,142 | 21,917 |
| Restructuring and integration charges | 68,091 | 23,030 |
| Postretirement benefits | 12,790 | 12,842 |
| Acquired technology | 9,181 | 6,170 |
| Other | 48,858 | 42,000 |
| Gross deferred income tax assets | 746,999 | 519,929 |
| Excess of book basis over tax basis | (37,800) | (30,851) |
| Retirement benefits | (19,933) | (15,570) |
| Deferred intangible assets | (54,791) | (20,329) |
| Other | (26,407) | (9,159) |
| Gross deferred income tax liabilities | (138,931) | (75,909) |
| Deferred income tax asset valuation allowances | (234,206) | (175,144) |
| Net deferred income tax assets | $ 373,862 | $ 268,876 |

Management considered all available evidence and determined that a valuation allowance of $234.2 million was required as of December 31, 1999 for certain tax credit and net operating loss carryforwards that would likely expire prior to their utilization. However, management feels it is more likely than not that Mattel will generate sufficient taxable income in the appropriate carryforward periods to realize the benefit of the remaining net deferred tax assets of $373.9 million.

Differences between the (benefit) provision for income taxes at the US federal statutory income tax rate and the (benefit) provision in the consolidated statements of operations were as follows (in thousands):

| | For the Year | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| (Benefit) provision at federal statutory rates | $(38,760) | $136,927 | $ 426 |
| Increase (decrease) resulting from: | | | |
| Losses without income tax benefit | 33,553 | 1,821 | 1,468 |
| Foreign earnings taxed at different rates, including withholding taxes | (63,616) | (34,221) | (40,803) |
| State and local taxes, net of federal benefit | 6,165 | 5,763 | 17,149 |
| Non-deductible amortization, merger and restructuring charges | 29,391 | 65,493 | 139,363 |
| Effect of change in valuation allowance | – | (8,766) | 50,679 |
| Other | 4,897 | 18,562 | 11,045 |
| Total (benefit) provision for income taxes | $(28,370) | $185,579 | $179,327 |

Appropriate US and foreign income taxes have been provided for earnings of foreign subsidiary companies that are expected to be remitted in the near future. The cumulative amount of undistributed earnings of foreign subsidiaries that Mattel intends to permanently invest and upon which no deferred US income taxes have been provided is $1.4 billion at December 31, 1999. The additional US income tax on the unremitted foreign earnings, if repatriated, would be offset in whole or in part by foreign tax credits.

As of December 31, 1999, Mattel has US net operating loss carryforwards totaling $740.2 million and credit carryforwards of $53.4 million for federal income tax purposes. The net operating loss carryforwards expire during the years 2000 to 2019, while $49.2 million of the tax credits expire during the years 2000 to 2010 with the remainder having no expiration date. Utilization of these loss and credit carryforwards are subject to annual limitations, and Mattel has established a valuation allowance for the carryforwards which are not expected to be utilized. The goodwill recorded in connection with Tyco's 1991 acquisition of Matchbox and Learning Company's 1998 acquisition of Mindscape, Inc. have been reduced by the tax effect of the portion of the net operating losses which Mattel expects to utilize.

Certain foreign subsidiaries have net operating loss carryforwards totaling $219.6 million ($135.4 million with no expiration date, $82.5 million expiring during the years 2000 to 2004, and $1.7 million expiring after 2004).

Generally accepted accounting principles require that tax benefits related to the exercise by employees of nonqualified stock options be credited to additional paid-in capital. In 1999, 1998 and 1997, nonqualified stock options exercised resulted in credits to additional paid-in capital totaling $15.0 million, $38.7 million and $20.2 million, respectively.

The Internal Revenue Service has completed its examination of the Mattel, Inc. federal income tax returns through December 31, 1994.

## Note 3 - Employee Benefits

Mattel and certain of its subsidiaries have retirement plans covering substantially all employees of these companies. Expense related to these plans totaled $18.6 million, $20.0 million and $19.0 million in 1999, 1998 and 1997, respectively.

### Pension Plans

Mattel provides defined benefit pension plans, which satisfy the requirements of the Employee Retirement Income Security Act of 1974 ("ERISA"). With the exception of the Fisher-Price Pension Plan, activity related to Mattel's pension plans, including those of foreign affiliates, was not significant during any year.

The components of net pension income for the Fisher-Price Pension Plan, based upon a December valuation date for the year ended December 31, 1999 and an October valuation date for the years ended December 31, 1998 and 1997, are detailed below (in thousands):

| | For the Period Ended | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Service cost | $ 2,829 | $ 2,508 | $ 2,594 |
| Interest cost | 14,655 | 10,929 | 10,327 |
| Expected return on plan assets | (27,237) | (18,949) | (16,163) |
| Amortization of: | | | |
| Unrecognized prior service cost | 88 | 108 | 134 |
| Unrecognized net asset | (1,284) | (2,569) | (2,569) |
| Plan amendment loss (gain) | 1,386 | 1,154 | (826) |
| Net pension income | $ (9,563) | $ (6,819) | $ (6,503) |

Reconciliation of the funded status of Fisher-Price's domestic pension plan to the related prepaid asset included in the consolidated balance sheets is as follows (in thousands):

| | As of Year End | |
|---|---|---|
| | 1999 | 1998 |
| Funded status of the plan | $ 65,401 | $41,335 |
| Unrecognized net gain | (19,551) | (4,438) |
| Unrecognized prior service cost | 692 | 1,366 |
| Unrecognized net transition asset | – | (1,285) |
| Prepaid pension asset | $ 46,542 | $36,978 |

Reconciliation of the assets and liabilities of Fisher-Price's domestic pension plan are as follows (in thousands):

| | As of Year End | |
|---|---|---|
| | 1999 | 1998 |
| **Change in Plan Assets** | | |
| Plan assets at fair value, beginning of year | $197,912 | $202,887 |
| Actual return on plan assets | 35,588 | 2,793 |
| Benefits paid | (10,707) | (7,768) |
| Plan assets at fair value, end of year | $222,793 | $197,912 |
| **Change in Projected Benefit Obligation** | | |
| Projected benefit obligation, beginning of year | $156,577 | $142,078 |
| Service cost | 2,829 | 2,508 |
| Interest cost | 14,655 | 10,929 |
| Plan amendments | 2,003 | 1,154 |
| Actuarial (gain) loss | (7,965) | 7,676 |
| Benefits paid | (10,707) | (7,768) |
| Projected benefit obligation, end of year | $157,392 | $156,577 |

| | For the Period Ended | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| **Assumptions:** | | | |
| Weighted average discount rate | 8.00% | 7.50% | 7.75% |
| Rate of future compensation increases | 4.00% | 4.00% | 4.00% |
| Long-term rate of return on plan assets | 11.00% | 11.00% | 11.00% |

During 1999, Mattel applied for a determination letter from the Internal Revenue Service related to its planned conversion of the Fisher-Price Pension Plan from a career-average plan to a cash balance plan. As of December 31, 1999, the proposed cash balance plan is under review by the Internal Revenue Service.

### Other Retirement Plans

Domestic employees are eligible to participate in 401(k) savings plans sponsored by Mattel or its subsidiaries, which are defined contribution plans satisfying ERISA requirements. Mattel also maintains unfunded supplemental executive retirement plans which are nonqualified defined benefit plans covering certain key executives. For 1999, 1998 and 1997, the accumulated and vested benefit obligations and related expenses of these plans were not significant.

### Deferred Compensation and Excess Benefit Plans

Mattel provides a deferred compensation plan which permits certain officers and key employees to elect to defer portions of their compensation. The deferred compensation plan, together with certain contributions made by Mattel and employees to an excess benefit plan, earn various rates of return. The liability for these plans as of December 31, 1999 and 1998 was $65.1 million and $47.8 million, respectively. Mattel's contribution to these plans and the related administrative expense were not significant to the results of operations during any year.

Mattel has purchased group trust-owned life insurance contracts designed to assist in funding these programs. The cash surrender value of these policies, valued at $55.7 million and $40.7 million as of December 31, 1999 and 1998, respectively, are held in an irrevocable rabbi trust which is included in other assets in the consolidated balance sheets.

### Postretirement Benefits

Fisher-Price has an unfunded postretirement health insurance plan covering certain eligible domestic employees hired prior to January 1, 1993. Details of the expense for the Fisher-Price plan recognized in the consolidated statements of operations for the years ended December 31, 1999, 1998 and 1997 are as follows (in thousands):

| | For the Year | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Service cost | $ 224 | $ 218 | $ 284 |
| Interest cost | 2,531 | 2,416 | 2,465 |
| Net postretirement benefit cost | $2,755 | $2,634 | $2,749 |

Amounts included in the consolidated balance sheets for this plan are as follows (in thousands):

| | As of Year End | |
|---|---|---|
| | 1999 | 1998 |
| Current retirees | $29,988 | $25,140 |
| Fully eligible active employees | 3,013 | 4,222 |
| Other active employees | 4,162 | 4,239 |
| Accumulated postretirement benefit obligation | 37,163 | 33,601 |
| Unrecognized net loss | (6,254) | (1,716) |
| Accrued postretirement benefit liability | $30,909 | $31,885 |

Reconciliation of the liabilities of Fisher-Price's postretirement health insurance plan are as follows (in thousands):

| | As of Year End | |
|---|---|---|
| | 1999 | 1998 |
| **Change in Accumulated Postretirement Benefit Obligation** | | |
| Accumulated postretirement benefit obligation, beginning of year | $33,601 | $33,315 |
| Service cost | 224 | 218 |
| Interest cost | 2,531 | 2,416 |
| Actuarial loss | 4,538 | 503 |
| Benefits paid, net of participant contributions | (3,731) | (2,851) |
| Accumulated postretirement benefit obligation, end of year | $37,163 | $33,601 |

The discount rates used in determining the accumulated postretirement benefit obligation were 8.00% for 1999, 7.50% for 1998 and 7.75% for 1997. For all participants, the health care cost trend rate for expected claim costs was assumed to be 5.50% in 1999 and remaining constant thereafter. A one percentage point increase or decrease in the assumed health care cost trend rate for each future year would have the following effect on the accumulated postretirement benefit obligation and the service and interest cost recognized as of and for the year ended December 31, 1999 (in thousands):

| | One Percentage Point | |
|---|---|---|
| | Increase | Decrease |
| Accumulated postretirement benefit obligation | $3,729 | $(3,188) |
| Service and interest cost | 284 | (239) |

Domestic employees of Mattel participate in a contributory postretirement benefit plan. The ongoing costs and obligations associated with the Mattel, Inc. plan are not significant to the financial position and results of operations during any year.

### Incentive Awards

In June 1999, the stockholders approved the Amended and Restated Mattel Long-Term Incentive Plan ("Amended and Restated LTIP"). The Amended and Restated LTIP is a three-year plan available to certain key executives of Mattel, Inc. Awards are based upon the financial performance of Mattel over a three-year period and are paid in the quarter following the end of the three-year measurement period. No expense was recorded in 1999 for awards under the Amended and Restated LTIP. Amounts charged to operating expense in 1998 and 1997 under the 1996 - 1998 LTIP were $10.8 million and $13.8 million, respectively.

Mattel also has annual incentive compensation plans for officers and key employees based on Mattel's performance and subject to certain approvals of the Compensation/Options Committee of the board of directors. No expense was recorded in 1999 for awards under these plans. For the years ended December 31, 1998 and 1997, $11.7 million and $23.2 million, respectively, were charged to operating expense for awards under these plans. For the year ended December 31, 1999, $22.0 million was charged to operating expense related to a special award. This special broad-based employee award was approved by Mattel's board of directors and was designed to provide a competitive compensation level to retain and motivate employees of Mattel.

Prior to the May 1999 merger, Learning Company maintained the 1990 Long-Term Equity Incentive Plan for certain senior executives. Under this plan, 0.8 million shares of nonvested stock were issued during 1998. The aggregate fair market value of the nonvested stock was being amortized to compensation expense over the restriction period. At the time of the 1999 merger, the nonvested stock became fully vested as a result of change of control provisions and the remaining unamortized amount of $12.3 million was charged to operating expense in 1999.

Prior to the March 1997 merger, Tyco had a Long-Term Incentive Plan for certain senior executives, under which Tyco awarded Restricted Stock Units ("RSU"). The aggregate fair market value of the RSUs was being amortized to compensation expense by Tyco over the restriction period. At the time of the 1997 merger, the RSUs were converted into approximately 244 thousand shares of Mattel common stock which approximated the fair value of the RSUs on the merger consummation date and the remaining unamortized amount of $5.1 million was charged to operating expense.

## Note 4 – Seasonal Financing and Long-Term Debt

### Seasonal Financing

Mattel maintains and periodically amends or replaces an unsecured committed revolving credit agreement with a commercial bank group that is used as the primary source of financing the seasonal working capital requirements of its domestic and certain foreign affiliates. The agreement in effect during 1999 consisted of a committed unsecured facility providing a total of up to $1.0 billion in seasonal financing (a five-year facility that expires in 2003). Within the facility, up to $700.0 million was a standard revolving credit line available for advances and backup for commercial paper issuances. Interest was charged at various rates selected by Mattel, ranging from market commercial paper rates to the bank reference rate. The remaining $300.0 million was available for nonrecourse purchases of certain trade accounts receivable of Mattel by the commercial bank group providing the credit line. The agreement required Mattel to meet financial covenants for consolidated debt-to-capital and interest coverage and Mattel was in compliance with such covenants during 1999. This agreement will continue to be in effect during 2000. In addition, Mattel avails itself of uncommitted domestic facilities provided by certain banks to issue short-term money market loans.

To meet seasonal borrowing requirements of certain foreign affiliates, Mattel negotiates individual financing arrangements, generally with the same group of banks that provided credit in the prior year. Foreign credit lines total approximately $370 million, a portion of which is used to support letters of credit. Mattel expects to extend these credit lines throughout 2000 and believes available amounts will be adequate to meet its seasonal financing requirements. Mattel also enters into agreements with banks of its foreign affiliates for nonrecourse sales of certain of its foreign subsidiary receivables.

TLC Multimedia Inc., a wholly-owned subsidiary of Learning Company, had a revolving line of credit, of which $40.0 million was outstanding as of December 31, 1998. Learning Company was also party to a receivables purchase agreement for nonrecourse sales of certain domestic trade accounts receivable, of which $75.0 million was utilized as of December 31, 1998. Learning Company had a European accounts receivable facility for sales with recourse of certain European trade accounts receivable of up to $25.0 million, which was fully utilized as of December 31, 1998. Upon consummation of the May 1999 merger, all outstanding borrowings under the revolving line of credit and the European accounts receivable facility were repaid and the revolving line of credit and the domestic and European accounts receivable facilities were terminated by Mattel.

Interest rates charged on Mattel's working capital credit lines are adjusted on a periodic basis; therefore, the carrying amounts of such obligations are a reasonable approximation of their fair value. Information relating to Mattel's domestic and foreign credit lines and other short-term borrowings is summarized as follows (in thousands):

| | For the Year | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| Balance at end of year | | | |
| Domestic | $ 293,744 | $ 119,175 | $ 35,150 |
| Foreign | 75,805 | 79,831 | 17,468 |
| Maximum amount outstanding | | | |
| Domestic | $1,207,000 | $1,076,600 | $558,000 |
| Foreign | 117,000 | 141,000 | 67,000 |
| Average borrowing | | | |
| Domestic | $ 573,100 | $ 400,800 | $178,000 |
| Foreign | 40,000 | 58,000 | 40,000 |
| Weighted average interest rate on average borrowing | | | |
| Domestic (computed daily) | 5.5% | 5.6% | 5.7% |
| Foreign (computed monthly) | 33.0% | 20.3% | 11.9% |

### 6-3/4% Senior Notes

In May 1993, Mattel issued $100.0 million aggregate principal amount of 6-3/4% Senior Notes maturing May 15, 2000. Interest is payable semiannually on the fifteenth day of May and November. At December 31, 1999 and 1998, the bid prices for the 6-3/4% Senior Notes, as provided by one of the underwriters, were $999.40 and $1,014.00, respectively, based on a par value of $1,000.00. As of December 31, 1999, the 6-3/4% Senior Notes are classified in the consolidated balance sheets as a long-term liability because management has the ability and intent to repay this obligation upon maturity with proceeds from the issuance of other long-term debt instruments.

### 5-1/2% Senior Convertible Notes ("5-1/2% Notes")

In October 1995, Learning Company issued $350.0 million aggregate principal amount of 5-1/2% Notes maturing November 1, 2000. Interest is payable semiannually on the first day of May and November. The 5-1/2% Notes are convertible at the option of the holders into common stock at $53.00 per share. The terms of the 5-1/2% Notes provide for early redemption at the option of the issuer, in whole or in part, at any time on or after November 2, 1998 at redemption prices equal to 102.2% of the principal amount reducing annually to 100% by November 1, 2000. During the years ended December 31, 1998 and 1997, Learning Company repurchased $6.0 million and $28.0 million, respectively, of 5-1/2% Notes. In June 1998, Learning Company repurchased $96.7 million of 5-1/2% Notes in exchange for issuance of 4.1 million shares of common stock. At December 31, 1999 and 1998, the bid prices for the 5-1/2% Notes, as provided by one of the underwriters, were $980.00 and $985.00, respectively, based on a par value of $1,000.00. As of December 31, 1999, the 5-1/2% Senior Notes are classified in the consolidated balance sheets as a long-term liability because management has the ability and intent to repay this obligation upon maturity with proceeds from the issuance of other long-term debt instruments.

Mattel assumed Learning Company's obligations related to the 5-1/2% Notes upon consummation of the May 1999 merger. As a result, the 5-1/2% Notes are now convertible at the option of the holders into a number of shares of Mattel common stock determined by dividing the principal amount of the notes to be converted by the $53.00 conversion price and multiplying the resulting number by 1.2.

In December 1995, Tribune Company made an investment in Learning Company in the form of $150.0 million aggregate principal amount of 5-1/2% Notes. These notes were sold by Tribune Company during 1997 in a private transaction to an investor group prior to the issuance by Learning Company of 750.0 thousand shares of Series A Convertible Participating Preferred Stock ("Series A Preferred Stock") and were surrendered by the investor group for the shares of the Series A Preferred Stock.

### 6% and 6-1/8% Senior Notes

In July 1998, Mattel issued $300.0 million aggregate principal amount of senior notes, $150.0 million of which were 6% Senior Notes maturing July 15, 2003 and $150.0 million of which were 6-1/8% Senior Notes maturing July 15, 2005. Interest is payable semiannually on the fifteenth day of January and July. At December 31, 1999 and 1998, the bid prices for the 6% and 6-1/8% Senior Notes, as provided by one of the underwriters, were $929.20 and $1,004.40, respectively, for the 6% Senior Notes and $884.60 and $998.65, respectively, for the 6-1/8% Senior Notes, based on a par value of $1,000.00.

### Medium-Term Notes ("MT Notes")

During the 1994 third quarter, Mattel commenced a program for the issuance of debt and equity securities under various shelf registration statements. In November 1998, Mattel filed its current universal shelf registration statement allowing the issuance of up to $400.0 million of debt and equity securities, all of which was available to be issued as of December 31, 1999. The following is a summary of MT Notes currently outstanding (in millions, except bid prices):

| Year Issued | Amount | Maturity Date | Rate (a) | Bid Price (b) 1999 | Bid Price (b) 1998 |
|---|---|---|---|---|---|
| 1994 | $ 50.5 | 12/01-12/04 | 8.48%-8.55% | $1,008.57-$991.65 | $1,052.61-$1,112.70 |
| 1995 | 130.0 | 04/02-05/07 | 7.01%-7.65% | 937.40 - 963.78 | 1,043.20 - 1,051.34 |
| 1997 | 310.0 | 11/04-07/12 | 6.70%-7.49% | 867.40 - 912.10 | 1,021.59 - 1,073.45 |
| 1998 | 50.0 | 11/13 | 6.50%-6.61% | 777.50 - 786.30 | 990.52 - 1,000.85 |

(a) Interest is payable semiannually at fixed rates on the fifteenth day of May and November.
(b) Based on a par value of $1,000.00.

### Mortgage Note

In 1990, Mattel borrowed $45.0 million under a mortgage agreement collateralized by its headquarters office facility in El Segundo, California. Interest accrues at 10.15% and monthly principal and interest payments are due through December 2005. The fair value of the original mortgage note, estimated by discounting future cash flows at interest rates currently available for debt with the same credit rating, similar terms and maturity date, was approximately $46 million and $51 million at December 31, 1999 and 1998, respectively.

### 7% Convertible Subordinated Notes ("7% Notes")

Upon consummation of the March 1997 merger, Mattel assumed Tyco's $16.0 million obligation related to the 7% Notes. On September 10, 1997, the holder converted all of the 7% Notes into 892.7 thousand shares of Mattel common stock.

### 10-1/8% Senior Subordinated Notes ("10-1/8% Notes")

Upon consummation of the March 1997 merger, Mattel assumed Tyco's $126.5 million obligation related to the 10-1/8% Notes. On August 15, 1997, Mattel exercised its option and redeemed the 10-1/8% Notes at 103.797% of par together with accrued interest. In the third quarter of 1997, Mattel recognized a pre-tax extraordinary loss of $7.3 million, and a related income tax benefit of $2.7 million, as a result of the early retirement.

### 6-7/8% Senior Notes

Mattel's $100.0 million of 6-7/8% Senior Notes issued in August 1992 were repaid upon maturity on August 1, 1997.

### Scheduled Maturities

The aggregate amounts of long-term debt and other obligations maturing in the next five years are as follows (in thousands):

| | Senior Notes | MT Notes | Mortgage Note | Other | Total |
|---|---|---|---|---|---|
| 2000 | $301,000 | $ – | $600 | $2,500 | $304,100 |
| 2001 | – | 30,500 | 700 | 500 | 31,700 |
| 2002 | – | 30,000 | 800 | 200 | 31,000 |
| 2003 | 150,000 | 30,000 | 800 | 200 | 181,000 |
| 2004 | – | 50,000 | 900 | 200 | 51,100 |

## Note 5 – Stockholders' Equity

### Preference Stock and Preference Share Purchase Rights

Mattel is authorized to issue 20.0 million shares of $0.01 par value preference stock, of which none is currently outstanding. There are 2.0 million shares of $0.01 par value preference stock designated as Series E Junior Participating Preference Stock in connection with a distribution of Preference Share Purchase Rights (the "Rights") to Mattel's common stockholders. The Rights may be exercised by their holders to purchase shares of Mattel's Series E Junior Participating Preference Stock upon the occurrence of a change of control as defined in the rights agreement. The Rights will expire on February 17, 2002, unless the agreement is further extended or the Rights are earlier redeemed or exchanged by Mattel.

### Preferred Stock

Mattel is authorized to issue 3.0 million shares of $1.00 par value preferred stock, of which 771.9 thousand shares were outstanding as of December 31, 1998.

#### Series A Preferred Stock

During 1997, Learning Company issued 750.0 thousand shares of Series A Preferred Stock to an investor group in exchange for $150.0 million of 5-1/2% Notes. Just prior to the consummation of the May 1999 merger, each share of Series A Preferred Stock was converted into 20 shares of Learning Company common stock, and the resale restrictions expired.

An extraordinary loss of approximately $61 million was recognized upon conversion of the 5-1/2% Notes into the Series A Preferred Stock due to the appreciation of the underlying common stock between the date the conversion agreement was signed and the date the preferred stock was issued. The resulting income tax benefit related to the extraordinary loss was also estimated to be approximately $61 million. As a result, the extraordinary loss, net of tax, was determined to be immaterial and was not disclosed as a separate item in the consolidated statement of operations for the year ended December 31, 1997.

#### Series C Mandatorily Convertible Redeemable Preferred Stock ("Series C Preferred Stock")

During 1996, Tyco sold 772.8 thousand shares of Series C Preferred Stock. Each share of Series C Preferred Stock was converted into like Mattel preferred stock as a result of the March 1997 merger. Series C Depositary Shares ("Depositary Shares"), each representing one twenty-fifth of a share of Series C Preferred Stock, totaling 19.3 million shares, were sold by the depositary as part of the above offering. Each Depositary Share was converted into a like Mattel depositary share as a result of the March 1997 merger. On July 1, 1999, all outstanding shares of Series C Preferred Stock (and the related Depositary Shares) were converted by the holders into 7.7 million shares of Mattel common stock pursuant to terms of the certificate of designations.

#### Series B Voting Convertible Exchangeable Preferred Stock ("Series B Preferred Stock")

During 1994, Tyco sold 47.6 thousand shares of Series B Preferred Stock to a private investment group. Each share of Series B Preferred Stock was converted into like Mattel preferred stock as a result of the March 1997 merger. On December 2, 1997, all outstanding shares of Series B Preferred Stock were converted by the holders into 2.8 million shares of Mattel common stock.

### Special Voting Preferred Stock

Mattel is authorized to issue one share of $1.00 par value Special Voting Preferred Stock, which was issued in exchange for one share of Learning Company special voting stock in connection with the May 1999 merger. The par value and liquidation preference of the Special Voting Preferred Stock are $1.00 and $10.00 per share, respectively. The Special Voting Preferred Stock has a number of votes equal to the number of outstanding exchangeable shares which are not owned by Mattel, its subsidiaries or any entity controlled by Mattel. The Special Voting Preferred Stock votes together with the holders of Mattel's common stock as a single class on all matters on which the holders of Mattel's common stock may vote. No dividends are paid on the Special Voting Preferred Stock. The Special Voting Preferred Stock will be redeemed for $10.00 on February 4, 2005, the redemption date for the exchangeable shares, unless the board of directors of Mattel's subsidiary, Softkey Software Products Inc., extends or accelerates the redemption date.

### Common Stock

In May 1998, the stockholders of Mattel approved an amendment to Mattel's Restated Certificate of Incorporation that increased the number of shares of authorized common stock from 600.0 million to 1.0 billion in order to accommodate issuance of common stock in connection with possible future mergers and other financing transactions, future stock dividends or splits, future awards pursuant to Mattel's stock option plans, warrant exercises, and other general corporate purposes.

### Exchangeable Shares and Related Softkey Warrants

As of December 31, 1999 and 1998, there were 3.2 million and 5.2 million outstanding exchangeable shares, respectively, which were not owned by Mattel, its subsidiaries or any entity controlled by Mattel. As a result of the May 1999 merger, each exchangeable share is convertible at the option of the holder, without additional payment, for the right to receive 1.2 shares of Mattel common stock until February 4, 2005. On that date, any exchangeable shares not previously converted will be redeemed at the current market price of Mattel's common stock multiplied by 1.2. The redemption price will be paid in the form of Mattel common stock, plus cash equal to any unpaid dividends. The board of directors of Mattel's subsidiary, Softkey Software Products Inc., may extend the automatic redemption date at its option and able shares is less than 0.5 million. Holders of exchangeable shares are entitled to receive dividends declared on Mattel's common stock multiplied by 1.2 as if the exchangeable shares had been converted into common stock. Holders of exchangeable shares vote their shares through the Special Voting Preferred Stock at the rate of 1.2 votes per exchangeable share on all matters on which the holders of Mattel's common stock may vote. As a result of the 1999 merger, each exchangeable share will include the right to acquire exchangeable shares under a rights agreement issued by Softkey Software Products Inc. These rights have an economically equivalent value to the Rights attached to Mattel's common stock.

During the years ended December 31, 1999, 1998 and 1997, 1.9 million, 9.1 million and 0.1 million exchangeable shares, respectively, were converted by the holders into common stock at the rate of 1.2 common shares per exchangeable share.

In 1997 and 1998, Mattel's Canadian subsidiary, Softkey Software Products Inc., issued 4.1 million and 8.7 million warrants in private placements in Canada for net proceeds of $57.5 million and $134.3 million, respectively. Each warrant was subsequently exchanged in accordance with its provisions into one exchangeable share without additional payment during 1998.

### Stock Compensation Plans

#### Mattel Stock Option Plans

In 1996, the stockholders of Mattel approved the Mattel 1996 Stock Option Plan. Under this plan, incentive stock options, nonqualified stock options, stock appreciation rights, nonvested stock awards, and shares of common stock may be granted to officers, key employees, and other persons providing services to Mattel. In addition, nonqualified stock options may be granted to members of Mattel's board of directors who are not employees of Mattel.

Generally, options are exercisable contingent upon the grantees' continued employment with Mattel. Nonqualified stock options are granted at not less than 100% of the fair market value of Mattel's common stock on the date of grant, generally vest at the rate of 25% per year of service, and usually expire within ten years from the date of grant. The 1996 Stock Option Plan provides that up to 1.5% of Mattel's outstanding common stock as of the first day of each calendar year will be available for awards under the plan. Grants made to individual participants cannot exceed 1.0 million shares in any single calendar year. On February 4, 1999, Mattel's board of directors approved an amendment to the 1996 Stock Option Plan authorizing an additional 6.0 million shares for grant in connection with new employees of businesses acquired by Mattel. The aggregate number of shares of common stock available for grant under the 1996 Stock Option Plan may not exceed 50.0 million shares. This plan expires on December 31, 2005. Mattel's previous plans, the 1982 and 1990 Stock Option Plans, expired on April 14, 1992 and December 31, 1996, respectively. All outstanding awards under these plans continue to be exercisable under the terms of their respective grant agreements.

In November 1999, the Compensation/Options Committee of Mattel's board of directors approved the Mattel 1999 Stock Option Plan. Under this plan, nonqualified stock options, stock appreciation rights and nonvested stock awards may be granted to key employees who are not officers, directors or consultants of Mattel. Generally, options are exercisable contingent upon the grantee's continued employment with Mattel. Nonqualified stock options are granted at not less than 100% of the fair market value of Mattel's common stock on the date of grant, and expire within ten years from the date of grant. Options granted under the 1999 Stock Option Plan vest on a schedule determined by the Compensation/Options Committee. Grants made in 1999 vest over three years at six month intervals, at a rate of 10% for each six-month period during the first year and at a rate of 20% per six-month period thereafter. Grants made to individual participants cannot exceed 1.0 million shares in any single calendar year. The aggregate number of shares of common stock available for grant under the 1999 Stock Option Plan may not exceed 12.8 million shares. This plan expires on December 31, 2009.

The fair value of Mattel options granted has been estimated using the Black-Scholes pricing model. The expected life of these options used in this calculation has been determined using historical exercise patterns. The following weighted average assumptions were used in determining fair value:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Expected life (in years) | 3.90 | 3.60 | 3.40 |
| Risk-free interest rate | 6.34% | 4.61% | 5.69% |
| Volatility factor | 18.46% | 15.80% | 17.40% |
| Dividend yield | 0.84% | 0.83% | 0.86% |

The weighted average fair value of Mattel options granted during 1999, 1998 and 1997 were $4.85, $7.32 and $4.86, respectively.

The following is a summary of stock option information and weighted average exercise prices for Mattel's stock option plans during the year (options in thousands):

| | 1999 | | 1998 | | 1997 | |
|---|---|---|---|---|---|---|
| | Number | Price | Number | Price | Number | Price |
| Outstanding at January 1 | 16,075 | $27.02 | 17,307 | $21.73 | 13,310 | $18.05 |
| Options granted | 18,208 | 20.45 | 3,680 | 41.66 | 7,443 | 25.79 |
| Options exercised | (201) | 20.93 | (4,284) | 17.80 | (2,807) | 14.89 |
| Options canceled | (1,872) | 28.14 | (628) | 29.79 | (639) | 22.44 |
| Outstanding at December 31 | 32,210 | $23.28 | 16,075 | $27.02 | 17,307 | $21.73 |
| Exercisable at December 31 | 10,813 | $23.89 | 5,645 | $20.48 | 5,999 | $16.29 |
| Available for grant at December 31 | 9,234 | | 2,358 | | 1,072 | |

The following table summarizes information about the weighted average remaining contractual life (in years) and the weighted average exercise prices for Mattel stock options outstanding as of December 31, 1999 (options in thousands):

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Price Ranges | Number | Remaining Life | Price | Number | Price |
| $ 4.69 to $13.56 | 389 | 5.20 | $11.59 | 259 | $10.77 |
| 13.69 to 13.69 | 7,010 | 9.84 | 13.69 | – | – |
| 14.00 to 22.40 | 3,090 | 4.65 | 16.17 | 2,990 | 16.05 |
| 22.50 to 22.50 | 3,816 | 9.04 | 22.50 | 1 | 22.50 |
| 22.56 to 25.63 | 3,125 | 6.76 | 24.47 | 1,811 | 24.57 |
| 25.75 to 25.75 | 5,063 | 7.11 | 25.75 | 3,162 | 25.75 |
| 25.94 to 26.25 | 592 | 6.93 | 26.15 | 507 | 26.14 |
| 26.38 to 26.38 | 5,440 | 9.42 | 26.38 | 947 | 26.38 |
| 26.50 to 41.38 | 826 | 7.64 | 33.37 | 410 | 31.40 |
| 42.00 to 42.00 | 2,859 | 8.10 | 42.00 | 726 | 42.00 |
| $ 4.69 to $42.00 | 32,210 | 8.13 | $23.28 | 10,813 | $23.89 |

Prior to the March 1997 merger, Tyco had various incentive and nonqualified stock option plans that provided benefits for eligible participants. Effective with the 1997 merger, all stock options previously granted and outstanding under these plans were exchanged for approximately 363 thousand Mattel common shares, which approximated the fair value of the options as of the merger consummation date.

Mattel 1997 Premium Price Stock Option Plan

In November 1997, the Compensation/Options Committee of the board of directors approved the Mattel, Inc. 1997 Premium Price Stock Option Plan, which was subsequently approved by Mattel's stockholders at the May 1998 meeting. Under this plan, premium price options may be granted to officers and other key employees of Mattel. Grants made to individual participants cannot exceed 4.5 million shares in any three consecutive calendar years. Grants under the 1997 Premium Price Stock Option Plan in 1997 were intended to replace annual grants under the 1996 Stock Option Plan until the end of 2000.

The exercise price of premium price options is calculated at 25% and 33-1/3% above Mattel's six-month average stock price prior to the date of grant. Options are forfeited unless Mattel's common stock price reaches the premium exercise price within two years from the date of grant for options with a 25% premium price and within three years from the date of grant for options with a 33-1/3% premium price. Options granted under the plan may not be exercised for three years and expire five years from the date of grant. Each option includes a Tandem Limited Stock Appreciation Right which gives the holder the right to receive cash, shares of common stock or any combination of cash and common stock upon the occurrence of a change of control as defined in the plan. On February 4, 1999, Mattel's board of directors approved an amendment to the 1997 Premium Price Stock Option Plan authorizing an additional 3.0 million shares for grant in connection with new employees of businesses acquired by Mattel, bringing the aggregate number of shares of common stock available for grant under this plan to 24.0 million. This plan expires on December 31, 2002.

The following is a summary of stock option information and weighted average exercise prices for premium price options during the year (options in thousands):

| | 1999 | | 1998 | | 1997 | |
|---|---|---|---|---|---|---|
| | Number | Price | Number | Price | Number | Price |
| Outstanding at January 1 | 18,661 | $44.04 | 17,661 | $43.58 | – | |
| Options granted | 3,420 | 35.00 | 1,000 | 52.15 | 17,661 | $43.58 |
| Options exercised | – | | – | | – | |
| Options canceled | (5,139) | 39.71 | – | | – | |
| Outstanding at December 31 | 16,942 | $43.53 | 18,661 | $44.04 | 17,661 | $43.58 |
| Exercisable at December 31 | – | | – | | – | |
| Available for grant at December 31 | 7,058 | | 2,339 | | 3,339 | |

The fair value of premium price options granted has been estimated using the Black-Scholes pricing model. The following assumptions were used in determining fair value:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Expected life (in years) | 5.00 | 5.00 | 5.00 |
| Risk-free interest rate | 5.16% | 5.80% | 6.33% |
| Volatility factor | 39.90% | 25.50% | 24.10% |
| Dividend yield | 0.89% | 0.83% | 0.86% |

The fair value of options granted during 1999, 1998 and 1997 was $5.37, $5.10 and $4.79 for 25% premium price options and $5.48, $4.92 and $4.86 for 33-1/3% premium price options, respectively.

The following table summarizes information about the remaining contractual life (in years) and the exercise prices for premium price options outstanding as of December 31, 1999 (options in thousands):

| Options Outstanding | | |
|---|---|---|
| Number | Remaining Life | Price |
| 660 | 4.25 | $35.24 |
| 660 | 4.25 | 37.59 |
| 7,364 | 2.85 | 42.31 |
| 7,258 | 2.85 | 44.87 |
| 500 | 3.54 | 50.46 |
| 500 | 3.54 | 53.83 |
| 16,942 | | $43.53 |

Learning Company Stock Option Plans

Prior to the May 1999 merger, Learning Company and its subsidiaries had various incentive and nonqualified stock option plans that provided benefits for eligible employees and non-employee directors. Effective with the 1999 merger, each outstanding option under these plans was converted into an option to purchase 1.2 shares of Mattel common stock. The exercise price of such options was adjusted by dividing the Learning Company option price by 1.2. Other than options granted under some plans assumed by Learning Company in connection with recent acquisitions, all Learning Company stock options vested and became fully exercisable as a result of the 1999 merger.

The fair value of Learning Company options granted prior to the 1999 merger, and during the years ended 1998 and 1997 has been estimated using the Black-Scholes pricing model. The expected life of these options used in this calculation has been determined using historical exercise patterns. The following weighted average assumptions were used in determining fair value:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Expected life (in years) | 4.00 | 6.00 | 4.00 |
| Risk-free interest rate | 6.35% | 5.13% | 6.00% |
| Volatility factor | 51.00% | 68.00% | 75.00% |
| Dividend yield | – | – | – |

The weighted average fair value of Learning Company options granted prior to the 1999 merger, and during the years ended 1998 and 1997 were $9.83, $10.14 and $8.81, respectively.

The following is a summary of stock option information and weighted average exercise prices for Learning Company's stock option plans during the year (options in thousands):

| | 1999 | | 1998 | | 1997 | |
|---|---|---|---|---|---|---|
| | Number | Price | Number | Price | Number | Price |
| Outstanding at January 1 | 17,626 | $14.30 | 16,396 | $14.43 | 14,694 | $18.63 |
| Options assumed in acquisitions | – | – | – | – | 860 | 3.98 |
| Options granted | 1,415 | 21.12 | 8,979 | 15.29 | 9,695 | 11.12 |
| Options exercised | (5,278) | 10.99 | (4,660) | 8.77 | (1,489) | 7.43 |
| Options canceled | (3,083) | 15.94 | (3,089) | 21.70 | (7,364) | 16.12 |
| Outstanding at December 31 | 10,680 | $16.19 | 17,626 | $14.30 | 16,396 | $14.43 |
| Exercisable at December 31 | 9,473 | $15.41 | 6,602 | $15.04 | 7,154 | $13.05 |
| Available for grant at December 31 | – | | 4,709 | | 3,270 | |

The following table summarizes information about the weighted average remaining contractual life (in years) and the weighted average exercise prices for Learning Company stock options outstanding as of December 31, 1999 (options in thousands):

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Price Ranges | Number | Remaining Life | Price | Number | Price |
| $ 0.58 to $ 5.63 | 232 | 6.87 | $ 3.90 | 222 | $ 3.90 |
| 6.54 to 12.92 | 2,026 | 7.54 | 10.87 | 2,016 | 10.88 |
| 12.97 to 23.49 | 7,361 | 7.32 | 15.89 | 6,479 | 15.34 |
| 24.06 to 34.51 | 1,025 | 7.14 | 29.38 | 727 | 29.55 |
| 79.92 to 79.92 | 36 | 0.83 | 79.92 | 29 | 79.92 |
| $ 0.58 to $79.92 | 10,680 | 7.31 | $16.19 | 9,473 | $15.41 |

In March 1997, in order to provide a competitive employment environment for staff retention and hiring, Learning Company instituted an option exchange program under which certain employees (other than employee directors) with options exercisable at $8.67 per share or higher were given the opportunity to exchange such options for options with an exercise price of $8.67 per share. A total of 4.4 million options were exchanged and have been included in the canceled and granted totals for the year ended December 31, 1997.

Compensation Cost

Mattel, Tyco and Learning Company each adopted the disclosure-only provisions of SFAS No. 123. Accordingly, no compensation cost has been recognized in the results of operations for nonqualified stock options granted under these plans during the years ended December 31, 1999, 1998 and 1997. Had compensation cost for nonqualified stock options been determined based on their fair value at the date of grant consistent with the method of accounting prescribed by SFAS No. 123, Mattel's net income (loss) and earnings per share would have been adjusted as follows (amounts in millions except per share data):

| | For the Year Ended | | |
|---|---|---|---|
| | 1999 | 1998 | 1997 |
| **Net income (loss)** | | | |
| As reported | $(82.4) | $206.1 | $(182.7) |
| Stock option plans | (30.1) | (67.1) | (38.6) |
| Premium price stock option plan | (20.1) | (21.1) | – |
| Pro forma income (loss) | $(132.6) | $117.9 | $(221.3) |
| **Income (loss) per share** | | | |
| Basic | | | |
| As reported | $(0.21) | $ 0.51 | $ (0.52) |
| Stock option and premium price option plans | (0.12) | (0.17) | (0.11) |
| Pro forma basic income (loss) | $(0.33) | $ 0.34 | $ (0.63) |
| Diluted | | | |
| As reported | $(0.21) | $ 0.47 | $ (0.52) |
| Stock option and premium price option plans | (0.12) | (0.16) | (0.11) |
| Pro forma diluted income (loss) | $(0.33) | $ 0.31 | $ (0.63) |

The pro forma effect on Mattel's 1998 and 1997 net income is not indicative of the pro forma effect in future years, because it does not take into consideration the pro forma expense related to grants made prior to 1995.

Stock Subscription Warrants

In December 1999, 751.4 thousand warrants were exercised for an equal number of common shares by the holder in accordance with the terms of the warrant agreement. In June 1999, 114.2 thousand common shares were issued to a warrant holder in a cashless exercise in accordance with the terms of the warrant agreement. As of December 31, 1999, all stock subscription warrants previously outstanding had been exercised.

### Disney Warrant

In 1996, Mattel entered into a licensing agreement with Disney Enterprises, Inc. Pursuant to this agreement, Mattel issued Disney a warrant to purchase 3.0 million shares of Mattel's common stock at an exercise price of $27.375 per share. This warrant expires no later than April 2, 2004. The warrant's fair value of $26.4 million was determined using the Black-Scholes pricing model, assuming an expected life of eight years, a dividend yield of 0.88%, a risk-free interest rate of 6.17%, and a volatility factor of 27.60%.

The fair value of the warrant is amortized as a component of royalty expense when the related properties are introduced over the period the related revenues are recognized. During 1999, 1998 and 1997, $5.6 million, $3.2 million and $1.1 million, respectively, was recognized in the results of operations related to this warrant.

### Learning Company Employee Stock Purchase Plan

In December 1997, Learning Company stockholders approved the 1997 Employee Stock Purchase Plan, which provided certain eligible employees with the opportunity to purchase shares of common stock at a price of 85% of the price listed on the New York Stock Exchange at various specified purchase dates. The plan met the criteria established in SFAS No. 123 for noncompensatory employee stock purchase plans and therefore, no compensation expense was recorded in connection with this plan. During the years ended December 31, 1999 and 1998, approximately 37 thousand and 56 thousand shares, respectively, were purchased by employees under this plan. As a result of the May 1999 merger, the 1997 Employee Stock Purchase Plan was terminated.

Prior to their merger with Learning Company, Broderbund also had an employee stock purchase plan. During the year ended December 31, 1997, approximately 62 thousand shares were purchased by employees under this plan. As a result of the merger with Learning Company, the Broderbund employee stock purchase plan was terminated.

### Common Stock Repurchase Plan

Mattel's common stock repurchase plan, initiated in May 1990, provides for the repurchase of common shares to fund Mattel's stock option plans. The number of shares to be repurchased is authorized on an annual basis by the board of directors based upon anticipated reissuance needs. During 1999, 1998, and 1997, Mattel repurchased 4.0 million, 9.7 million, and 6.5 million shares, respectively.

### Dividends and Capital Transactions

A regular quarterly cash dividend has been declared by the Mattel board of directors on Mattel's common stock since the second quarter of 1990. The board of directors increased the quarterly cash dividend from $0.08 per common share to $0.09 per common share in the second quarter of 1999. Learning Company did not pay dividends on its common stock during 1999 prior to the May merger and during the years ended December 31, 1998 and 1997.

## Note 6 - Commitments and Contingencies

### Leases

Mattel routinely enters into noncancelable lease agreements for premises and equipment used in the normal course of business. The following table shows the future minimum obligations under lease commitments in effect at December 31, 1999 (in thousands):

| | Capitalized Leases | Operating Leases |
|---|---|---|
| 2000 | $ 300 | $ 49,000 |
| 2001 | 300 | 37,800 |
| 2002 | 300 | 20,500 |
| 2003 | 300 | 15,100 |
| 2004 | 300 | 13,900 |
| Thereafter | 9,200 | 10,300 |
| | $10,700(a) | $146,600 |

(a) Includes $8.4 million of imputed interest.

Rental expense under operating leases amounted to $75.2 million, $66.6 million and $71.5 million for 1999, 1998 and 1997, respectively, net of sublease income of $0.6 million, $0.5 million and $0.3 million in 1999, 1998 and 1997, respectively.

### Commitments

In the normal course of business, Mattel enters into contractual arrangements to obtain and protect Mattel's right to create and market certain products and for future purchases of goods and services to ensure availability and timely delivery. Such arrangements include royalty payments pursuant to licensing agreements and commitments for future inventory purchases. Certain of these commitments routinely contain provisions for guaranteed or minimum expenditures during the terms 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.

The largest commitment involves Mattel's agreements with The Walt Disney Company and Disney Enterprises, Inc. The licensing agreement with The Walt Disney Company, which contains annual minimum royalty guarantees, permits Mattel to use the Disney name and certain characters on preschool and infant products through September 2002.

The agreement with Disney Enterprises, Inc. grants Mattel exclusive worldwide rights (with certain exceptions) to produce toys based on all children-oriented Disney television and film properties introduced. This agreement spans three years, with Mattel having the right for up to two additional years to market merchandise from film properties produced during the second and third years. The initial term of the agreement may be renewed for an additional three-year period upon mutual consent. This agreement contains minimum royalty guarantees that are contingent upon the number and nature of the properties introduced by Disney. Commitments for 2000 introductions are expected to approximate $10 million payable over a three-year period. Pursuant to the agreement, Mattel issued Disney a stock warrant, valued at $26.4 million, to purchase 3.0 million shares of Mattel's common stock.

In January 2000, Mattel and Warner Bros. Worldwide Consumer Products signed a licensing agreement making Mattel the worldwide master toy licensee for the literary characters from the Harry Potter books published by J.K. Rowling as well as for feature film and television properties developed by Warner Bros. Pictures featuring the Harry Potter characters. Mattel's worldwide toy licensing agreement involves the first two Harry Potter books and theatrical films. This agreement contains minimum royalty guarantees and has a term of four years, provided that the second theatrical film is released prior to January 1, 2003. If the second theatrical film is released subsequent to January 1, 2003, the agreement will be extended to a date twelve months after the release of the second theatrical film. Pursuant to the agreement, Mattel issued

Warner Bros. Consumer Products a stock warrant to purchase 3.0 millions shares of Mattel's common stock. This warrant became fully vested and exercisable upon signing of the licensing agreement.

Licensing and related agreements provide for terms extending from 2000 through 2007 and contain provisions for future minimum payments as shown in the following table (in thousands):

| | Minimum Payments |
|---|---|
| 2000 | $134,000 |
| 2001 | 104,000 |
| 2002 | 69,000 |
| 2003 | 15,000 |
| 2004 | 18,000 |
| Thereafter | 6,000 |
| | $346,000 |

Royalty expense for the years ended December 31, 1999, 1998 and 1997 was $308.6 million, $234.2 million and $225.8 million, respectively.

As of December 31, 1999, Mattel had outstanding commitments for 2000 purchases of inventory of approximately $92 million.

### Foreign Currency Contracts

To limit the exposure associated with exchange rate movements, Mattel enters into foreign currency forward exchange and option contracts primarily as hedges of inventory purchases, sales and other intercompany transactions denominated in foreign currencies. These contracts generally have maturity dates of up to 18 months. Gains or losses related to firm commitments, which qualify for hedge accounting, are deferred and are recognized in the results of operations as part of the underlying transaction. Contracts that do not qualify for hedge accounting are marked to market with gains and losses recognized in the results of operations. Had Mattel not entered into hedges to limit the effect of exchange rate fluctuations on results of operations and cash flows, 1999 pre-tax income would have been reduced by approximately $16 million.

As of December 31, 1999 and 1998, Mattel held the following contracts to sell foreign currencies (in thousands):

| | 1999 | | 1998 | |
|---|---|---|---|---|
| | Amount | Fair Value | Amount | Fair Value |
| Forwards | $342,370 | $334,688 | $392,972 | $394,340 |

Fair value for forwards reflects the amount, based on dealer quotes, Mattel would receive at maturity for contracts involving the same currencies and maturity dates, if they had been entered into as of year-end 1999 and 1998, respectively.

As of December 31, 1999 and 1998, Mattel held $144.7 million and $189.1 million, respectively, of foreign currency forward exchange contracts to purchase foreign currencies. The fair value of these contracts was $144.9 million and $201.8 million as of December 31, 1999 and 1998, respectively. Fair value reflects the amount, based on dealer quotes, Mattel would pay at maturity for contracts involving the same currencies and maturity dates, if they had been entered into as of year-end 1999 and 1998, respectively.

The following table summarizes Mattel's foreign currency contracts by major currency as of December 31, 1999 and 1998 (in thousands of US dollars):

| | 1999 | | 1998 | |
|---|---|---|---|---|
| | Buy | Sell | Buy | Sell |
| US dollar | $342,370 | $144,703 | $392,972 | $189,122 |
| Euro | 92,445 | 253,096 | – | – |
| British pounds sterling | 6,316 | 16,679 | 6,548 | 66,856 |
| Canadian dollar | 7,604 | 40,679 | 16,144 | 18,794 |
| Indonesian rupiah | 19,455 | – | 10,000 | – |
| Japanese yen | – | 19,412 | – | 12,501 |
| Swiss franc | 14,893 | – | 18,341 | – |
| Australian dollar | – | 8,438 | 4,988 | 21,610 |
| Hong Kong dollar | – | – | 55,829 | – |
| French franc | – | – | 27,435 | 9,105 |
| Italian lira | – | – | 20,014 | 68,358 |
| German mark | – | – | 19,119 | 144,660 |
| Spanish peseta | – | – | 5,625 | 2,899 |
| Dutch guilder | – | – | 5,079 | 8,086 |
| Mexican peso | – | – | – | 22,000 |
| Belgian franc | – | – | – | 11,641 |
| Other (under $5,000) | 3,990 | 4,066 | – | 6,462 |
| | $487,073 | $487,073 | $582,094 | $582,094 |

In order to minimize the risk of counterparty non-performance, Mattel executes its foreign currency forward exchange and option contracts with financial institutions believed to be credit-worthy, generally those that provide Mattel with its working capital lines of credit.

Market risk exposures exist with respect to the settlement of foreign currency transactions during the year because currency fluctuations cannot be predicted with certainty. Mattel seeks to mitigate its exposure to market risk by monitoring its currency exchange exposure for the year and partially or fully hedging such exposure. In addition, Mattel manages its exposure through the selection of currencies used for international borrowings and intercompany invoicing. Mattel does not trade in financial instruments for speculative purposes.

### Litigation

#### Power Wheels® Recall and Related Matters

On October 22, 1998, Mattel announced that Fisher-Price, in cooperation with the Consumer Product Safety Commission, would conduct a voluntary recall involving up to 10 million battery-powered Power Wheels® ride-on vehicles. The recall did not result from any serious injury, and involves the replacement of electronic components that may overheat, particularly when consumers make alterations to the product. The recall involves vehicles sold nationwide since 1984 under nearly 100 model names. Additionally, Fisher-Price has been notified by the Consumer Product Safety Commission that the Commission is considering whether Fisher-Price may be subject to a fine for delayed reporting of the facts underlying the recall.

In the third quarter of 1998, Mattel recognized a $38.0 million pre-tax charge related to the recall. During the second and fourth quarters of 1999, Mattel recognized additional pre-tax charges totaling $20.0 million related to the recall.

#### Greenwald Litigation and Related Matters

On October 13, 1995, Michelle Greenwald filed a complaint (Case No. YC 025 008) against Mattel in Superior Court of the State of California, County of Los Angeles. Ms. Greenwald is a former employee whom Mattel terminated in July 1995. Her complaint sought $50 million in general and special damages, plus punitive damages, for breach of oral, written and implied contract, wrongful termination in violation of public policy and violation of California Labor Code Section 970. Ms. Greenwald claimed that her termination resulted from complaints she made to management concerning general allegations that Mattel did not account properly for sales and certain costs associated with sales and more specific allegations that Mattel failed to account properly for certain royalty obligations to The Walt Disney Company. On December 5, 1996, Mattel's motion for summary adjudication of Ms. Greenwald's public policy claim was granted. On March 7, 1997, Mattel filed a motion for summary judgment on the remaining causes of action. On December 9, 1997, Mattel's motion for summary judgment of Ms. Greenwald's remaining claims was granted. On February 4, 1998, Ms. Greenwald appealed from the dismissal of her suit. The appeal has been fully briefed, and a hearing took place on March 3, 2000. Mattel intends to continue to defend the action vigorously, including the appeal.

Toys R Us and Related Matters

On October 2, 1997, the Attorney General of the State of New York filed in the United States District Court, Eastern District of New York (Case No. CV 97 5714), an action against Toys R Us, Mattel and certain other toy manufacturers alleging that the defendants had violated federal antitrust laws and entered into vertical and horizontal arrangements that had the effect of restricting sales to the warehouse clubs. The attorneys general from forty-three other states, the District of Columbia and the Commonwealth of Puerto Rico joined this action. Following the filing of the New York action, a series of private treble damage class actions under the federal antitrust laws were filed in various federal district courts. The parties later agreed to have these related actions transferred to the Eastern District of New York to be consolidated by the Judicial Panel on Multiple Litigation before Nina Gershon, United States District Judge. Private class actions were also filed in state courts in Alabama, California, and New Jersey, asserting claims under state antitrust law. These state court actions were coordinated with the federal court actions.

Subsequent mediation efforts resulted in a Settlement Agreement and Release as to Mattel, Inc., Fisher-Price, and Tyco, effective April 6, 1999. Pursuant to the terms of the Settlement Agreement and Release, Mattel agreed to make a cash payment and a toy contribution, both of which were made in the fourth quarter of 1999. As a result of a dispute between the parties as to the selection of the toys to be contributed, Mattel negotiated a Supplemental Toy Contribution Agreement and made a supplemental toy contribution in December 1999. Final Judgment and Order of Dismissal was entered by Judge Gershon on February 17, 2000 that effectively dismissed with prejudice the claims asserted by the state and private federal and state court plaintiffs, including the claims of any person represented in either a *parens patriae* or private class capacity.

Litigation Related to Business Combination

On December 16, 21, and 23, 1998, several stockholders of the legal entity The Learning Company, Inc. that merged into Mattel (''Old Learning Company'') filed six separate purported class action complaints in the Court of Chancery of the State of Delaware in and for New Castle County against Old Learning Company and Old Learning Company's board of directors for alleged breaches of fiduciary duties in connection with the May 1999 merger. The six complaints were consolidated. The consolidated complaint named Mattel as an additional defendant, claiming that Mattel aided and abetted the alleged breaches of fiduciary duty. On March 9, 2000, the plaintiffs filed a notice and order of dismissal dismissing the action without prejudice. Upon approval by the court, the consolidated action will be formally dismissed.

Litigation Related to Learning Company Earnings Shortfall

Following Mattel's announcement on October 4, 1999 that it expected an earnings shortfall at its Learning Company division in the third quarter of 1999, several of Mattel's stockholders filed purported class action complaints in the United States District Court for the Central District of California, the United States District Court for the Southern District of New York and the United States District Court for Massachusetts naming Mattel and certain of its officers and directors as defendants. The complaints generally allege, among other things, that the defendants made false or misleading statements that artificially inflated the price of Mattel's common stock by overstating the revenues and net income of Mattel, including its Learning Company division, and by falsely representing that the May 1999 Learning Company acquisition would be immediately accretive to Mattel's 1999 and 2000 financial results.

Two of the purported class action complaints are brought on behalf of the former stockholders of Broderbund who acquired shares of Old Learning Company in exchange for their Broderbund common stock in connection with the Old Learning Company-Broderbund merger on August 31, 1998. Mattel has been named as a defendant as the successor-in-interest to Old Learning Company. The complaints generally allege that that the Old Learning Company-Broderbund Registration Statement on Form S-4 filed on or about July 14, 1998 in connection with the merger was materially false.

On November 23, 1999, Mattel (along with other defendants named in the federal securities lawsuits) filed a motion and brief before the Judicial Panel on Multidistrict Litigation seeking to transfer all of the federal actions to the United States District Court for the Central District of California for Coordinated or Consolidated Pretrial Proceedings. On March 3, 2000, the Judicial Panel on Multidistrict Litigation granted Mattel's motion.

In addition, a Mattel stockholder filed a derivative complaint on behalf and for the benefit of Mattel in the Superior Court of the State of California, County of Los Angeles. The complaint alleges that Mattel's directors breached their fiduciary duties, wasted corporate assets and grossly mismanaged Mattel in connection with Mattel's acquisition of Learning Company and seeks both monetary and injunctive relief. On February 10, 2000, the court sustained defendants' demurrer and dismissed the complaint with leave to amend.

Mattel believes the lawsuits are without merit and intends to defend them vigorously.

Environmental

Fisher-Price has executed a consent order with the State of New York involving a remedial action / feasibility study for one of its manufacturing plants. Currently, Fisher-Price is negotiating an additional consent order which will outline the specific clean up strategy for the site. Mattel anticipates that the New York State Department of Environmental Quality will issue their Record of Decision in March 2000. The ultimate liability associated with this cleanup presently is estimated to be less than $1,425,000, approximately $1,030,500 of which has been incurred through December 31, 1999.

Mattel operates a manufacturing facility on a leased property in Beaverton, Oregon that was acquired as part of the Tyco merger. In March 1998, samples of groundwater used by the facility for process water and drinking water disclosed elevated levels of certain chemicals, including trichloroethylene. Mattel immediately closed the water supply and self-reported the sample results to the Oregon Department of Environmental Quality and the Oregon Health Division. Mattel also implemented a community outreach program to employees, former employees and surrounding landowners.

In November 1998, Mattel and another potentially responsible party entered into a consent order with the Oregon Department of Environmental Quality to conduct a remedial investigation/feasibility study at the property, to propose an interim remedial action measure and to continue the community outreach program. In the second quarter of 1999, Mattel recorded a $14.0 million pre-tax charge for environmental remediation costs related to this property, based on the completion and approval of the remediation plan and feasibility study.

General

Mattel is also involved in various other litigation and legal matters, including claims related to intellectual property, product liability and labor, which Mattel is addressing or defending in the ordinary course of business. Management believes that any liability which may potentially result upon resolution of such matters will not have a material adverse effect on Mattel's business, financial condition or results of operations.

## Note 7 - Acquisitions and Nonrecurring Items

### Business Combination with Learning Company

In May 1999, Mattel completed its merger with Learning Company, after which Learning Company was merged with and into Mattel, with Mattel being the surviving corporation. Each share of Learning Company Series A Preferred Stock was converted into 20 shares of Learning Company common stock immediately prior to the consummation of the merger. Pursuant to the merger agreement, each outstanding share of Learning Company common stock was then converted into 1.2 shares of Mattel common stock upon consummation of the merger. As a result, approximately 126 million Mattel common shares were issued in exchange for all shares of Learning Company common stock outstanding as of the merger date. The outstanding share of Learning Company special voting stock was converted into one share of Mattel Special Voting Preferred Stock. Each outstanding exchangeable share of Learning Company's Canadian subsidiary, Softkey Software Products Inc., remains outstanding, but upon consummation of the merger became exchangeable for 1.2 shares of Mattel common stock.

This transaction has been accounted for as a pooling of interests, and accordingly, financial information for periods prior to the merger reflect the retroactive restatement of the companies' combined financial position and operating results. For periods preceding the merger, there were no material intercompany transactions which required elimination from the combined consolidated results of operations and there were no adjustments necessary to conform the accounting practices of the two companies.

Selected financial information for the combining entities included in the consolidated statements of operations for the three years ended December 31, 1999 is shown below. Although the merger was effective on May 13, 1999, interim financial information for the combining companies was not available as of that date; therefore, information for and as of March 31, 1999 has been presented.

| (In thousands) | March 31, 1999 | Dec. 31, 1998 | Dec. 31, 1997 |
|---|---|---|---|
| **Net sales** | | | |
| Mattel | $692,116 | $4,781,892 | $4,834,616 |
| Learning Company | 186,843 | 839,315 | 620,931 |
| Combined | $878,959 | $5,621,207 | $5,455,547 |
| **Net income (loss)** | | | |
| Mattel | $ (17,856) | $ 332,264 | $ 285,184 |
| Learning Company (a)(b) | 22,905 | (126,211) | (467,905) |
| Combined | $ 5,049 | $ 206,053 | $ (182,721) |

(a) The (benefit) provision for income taxes has been adjusted by $(0.6) million, $20.9 million and $(27.0) million in 1999, 1998 and 1997, respectively, to reflect the reduction of valuation allowances established in Learning Company's historical financial statements resulting in the recognition of estimated benefits of net operating losses incurred by Learning Company.

(b) Net loss in 1997 has been decreased by $9.0 million to reflect the reduction in the purchase price paid by Learning Company when it acquired the Former Learning Company and the corresponding decrease in goodwill amortization.

### Other Business Combinations

In August 1998, Learning Company completed its merger with Broderbund, a publisher and developer of consumer software for the home and school market. The stock-for-stock transaction was approved by the stockholders of Broderbund, after which Broderbund became a wholly-owned subsidiary of Learning Company. Under the merger agreement, each outstanding share of Broderbund common stock was converted into 0.80 shares of Learning Company common stock and resulted in the issuance of approximately 17 million shares of Learning Company common stock.

This transaction was accounted for as a pooling of interests, and accordingly, financial information for periods prior to the merger reflect the retroactive restatement of the companies' combined financial position and operating results. The consolidated statement of stockholders' equity for the year ended December 31, 1998 has been adjusted to include Broderbund's unrealized gain on securities of $0.5 million (included in comprehensive income) and net income of $0.2 million for the month ended December 31, 1997. Broderbund's net sales and operating expenses for the month ended December 31, 1997 were $28.7 million and $28.0 million, respectively. The consolidated statements of operations, cash flows and stockholders' equity for the year ended December 31, 1997 have been combined with those of Broderbund for the twelve-month period ended November 30, 1997. The consolidated statement of stockholders' equity for the year ended December 31, 1997 has been adjusted to include Broderbund's net income of $8.9 million for the period from September 1, 1996 through November 30, 1996.

In March 1997, Mattel completed its merger with Tyco, accounted for as a pooling of interests. Under the merger agreement, each outstanding share of Tyco common stock was converted into 0.48876 Mattel common shares and resulted in the issuance of approximately 17 million Mattel common shares. Tyco restricted stock units and stock options outstanding as of the merger date were exchanged for approximately 0.6 million Mattel common shares. In addition, each share of Tyco Series B and Series C Preferred Stock was converted into like Mattel preferred stock. Financial information for periods prior to the merger reflect the retroactive restatement of the companies' combined financial position and operating results.

Learning Company also merged with Palladium Interactive, Inc. and P.F. Magic, Inc. in 1998 and TEC Direct, Inc., Microsystems Software, Inc., Skills Bank Corporation and Learning Services Inc. in 1997, each of which were accounted for as poolings of interests. The consolidated financial statements have not been retroactively restated for the results of operations and financial position of these companies as the effect of each acquisition individually and in the aggregate on Learning Company's balance sheet and results of operations was less than three percent. The consolidated statements of stockholders' equity for the years ended December 31, 1998 and 1997 have been adjusted to include the historical results of operations of the acquired companies of $34.6 million and $6.2 million, respectively. A total of 1.6 million and 3.8 million common shares were issued in the years ended December 31, 1998 and 1997, respectively, as a result of these mergers.

### Acquisitions

Mattel acquired the following companies during the years ended December 31, 1998 and 1997. Each of these acquisitions were accounted for using the purchase method of accounting. The results of operations of the acquired companies have been included in Mattel's consolidated financial statements from their respective dates of acquisition. Intercompany accounts and transactions between the acquired companies and Mattel, as applicable, have been eliminated.

| (In millions) | Month | Price | Method of Payment | (Assets)/ Liabilities Assumed | Intangibles | Incomplete Technology |
|---|---|---|---|---|---|---|
| **1998** | | | | | | |
| Pleasant Company | July | $715.0 | Cash | $(25.0) | $690.0 | $ – |
| Bluebird Toys PLC | June | 80.0 | Cash | (20.0) | 60.0 | – |
| Sofsource, Inc. | June | 45.0 | Stock | 6.7 | 36.8 | 14.9 |
| Mindscape, Inc. | March | 152.6 | Cash/stock | 6.4 | 119.0 | 40.0 |
| **1997** | | | | | | |
| Creative Wonders, L.L.C. | October | $ 37.8 | Cash | $ 7.3 | $ 44.0 | $ 1.1 |
| Parsons Technology | August | 31.0 | Cash | (11.7) | 9.3 | 10.0 |

The acquisition price includes investment advisor and other directly-related expenses, as applicable. The portion of the purchase price allocated to incomplete technology was charged to expense in the year of acquisition.

Mattel also made other minor acquisitions during the last three years, which were accounted for using the purchase method. These acquisitions resulted in the issuance of 0.4 million shares of common stock in the year ended December 31, 1997.

### Pro Forma Effect of 1998 Acquisitions

The unaudited pro forma results of operations for 1998 acquisitions accounted for using the purchase method of accounting are as follows:

| (In thousands, except per share data) | Mattel | Acquired Companies | Pro Forma Combined |
|---|---|---|---|
| **1998** | | | |
| Net sales | $5,621,207 | $103,862 | $5,725,069 |
| Income before extraordinary item | 206,053 | (102,175) | 103,878 |
| Net income | 206,053 | (102,175) | 103,878 |
| Basic income per share | 0.51 | | 0.24 |
| Diluted income per share | 0.47 | | 0.22 |
| **1997** | | | |
| Net sales | $5,455,547 | $550,659 | $6,006,206 |
| Loss before extraordinary item | (178,111) | (61,827) | (239,938) |
| Net loss | (182,721) | (61,827) | (244,548) |
| Basic loss per share | | | |
| Loss before extraordinary item | (0.51) | | (0.65) |
| Net loss | (0.52) | | (0.66) |
| Diluted loss per share | | | |
| Loss before extraordinary item | (0.51) | | (0.65) |
| Net loss | (0.52) | | (0.66) |

The amounts shown for acquired companies assumes that Mattel's 1998 acquisitions occurred on January 1, 1997. These unaudited pro forma results of operations have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred on the date indicated, or which may result in the future. Pro forma adjustments have been made to reflect the amortization of intangible assets and goodwill capitalized as a result of the acquisitions, incremental interest expense that would have been incurred as a result of financing the acquisition of Pleasant Company as of January 1, 1997, and elimination of intercompany sales and margins related to the acquisition of Bluebird.

### Restructuring and Other Charges

In 1999, Mattel incurred restructuring and other nonrecurring charges totaling $346.0 million, approximately $265 million after-tax or $0.64 per diluted share.

During the first quarter of 1999, Mattel incurred a nonrecurring pre-tax charge of $3.9 million, largely related to the restructuring and integration of acquisitions made by its Learning Company division in the fourth quarter of 1998.

During the second quarter of 1999, Mattel completed its merger with Learning Company and finalized a previously announced plan of restructuring and integration. These actions, along with other one-time events, resulted in a nonrecurring pre-tax charge against operations of $345.0 million. In the fourth quarter of 1999, Mattel incurred an additional $23.5 million charge relating to its restructuring and integration plan and other one-time charges which had previously not met the requirement for accrual. In addition, Mattel reversed $26.4 million of the second quarter charge based on lower than anticipated costs and revisions to previous estimates. The impact of these new developments combined with the initial second quarter charge resulted in a full year nonrecurring charge of $342.1 million. Of the total pre-tax charges, approximately $278 million represents cash expenditures.

The restructuring and integration plan, expected to be substantially complete by June 2000, provides for the consolidation and realignment of Mattel's operations. The plan was aimed at leveraging global resources in areas of manufacturing, marketing and distribution, eliminating duplicative functions worldwide and achieving improved operating efficiencies. The following are the major restructuring and integration initiatives:

– Consolidation of the Infant and Preschool businesses;
– Consolidation of the domestic and international back-office functions;
– Consolidation of direct marketing operations;
– Realignment of the North American sales force;
– Termination of various international distributor contracts; and
– Closure of three higher cost manufacturing facilities.

Components of the restructuring and other nonrecurring charges, including related adjustments, are as follows:

| | | Adjustments | | | | Balance |
|---|---|---|---|---|---|---|
| (In millions) | Plan | (Credits) | Charges | Total Charges | Amounts Incurred | Dec. 31, 1999 |
| Severance and other compensation | $108 | $(13) | $18 | $113 | $ (30) | $ 83 |
| Distributor, license and other contract terminations | 57 | (2) | – | 55 | (45) | 10 |
| Writedown of assets | 42 | (2) | – | 40 | (40) | – |
| Lease termination costs | 22 | (4) | – | 18 | – | 18 |
| Total restructuring costs and asset writedowns | 229 | (21) | 18 | 226 | (115) | 111 |
| Merger-related transaction and other costs | 86 | (5) | – | 81 | (76) | 5 |
| Other nonrecurring charges | 30 | – | 5 | 35 | (16) | 19 |
| Total restructuring, asset writedowns and other charges | $345 | $(26) | $23 | $342 | $(207) | $135 |

In the fourth quarter of 1999, Mattel adjusted its restructuring and integration plan and other nonrecurring charges, resulting in a net reduction of approximately $3 million. The credits to the restructuring plan of approximately $26 million were mainly due to Mattel's recent decision not to close certain of its marketing offices and one of its manufacturing facilities. The remaining credits include other changes in estimates and lower than anticipated costs compared to the previous estimates for completed components of the plan. Approximately 900 employees will not be terminated as a result of these changes.

The fourth quarter restructuring charge of approximately $18 million relates to the termination of an additional 150 Learning Company employees at its domestic offices. This action was taken to further consolidate the operations of Learning Company's domestic offices. The fourth quarter other nonrecurring charge relates to a $4.0 million increase to the reserve for the October 1998 recall of Mattel's Power Wheels® vehicles and a $1.1 million additional charge related to the Toys R Us-related antitrust litigation settlement.

A description of the components of the restructuring charges is as follows:

Severance and other compensation costs relate to the termination of approximately 3,300 employees around the world. Approximately 2,300 of these employees are hourly workers located in certain of Mattel's manufacturing facilities, of which approximately 2,200 were employed in the manufacturing facility in Kuala Lumpur, which ceased operations in September 1999. The remainder of the work force reductions consists of downsizing sales and marketing groups in the US, Europe and Asia-Pacific regions as well as the elimination of duplicate administrative personnel following the consolidation of back-office functions, the majority of which are in Europe. As of December 31, 1999, approximately $30 million had been paid to nearly 2,700 terminated employees. Cash severance payments will extend beyond the completion of the workforce reductions due to the severance payment options available to affected employees.

Mattel terminated its sponsorship agreements related to certain attractions for a total cost of $37.5 million, inclusive of the writeoff of related capitalized costs. The cash portion of this charge was paid as of July 1999. Mattel also recognized a $17.5 million charge, mainly related to settlements for termination of certain foreign distributor agreements in conjunction with the realignment of its sales and distribution network.

Mattel's restructuring plan resulted in the impairment of certain long-lived assets related to the operations being closed. The sum of the undiscounted future cash flows of these assets was not sufficient to cover the carrying amount of these assets. As a result, these long-lived assets were written down to fair market value and will be depreciated over their remaining useful lives. Fair value of the impaired assets was determined by either third-party appraisals or past experience in disposing of similar assets. Buildings and, to the extent possible, equipment will be sold while the remainder of the impaired assets will be abandoned when taken out of service. Nearly all of the revenue-generating activities related to these assets will continue as a result of more effective utilization of other assets. A significant portion of the fixed asset writedowns is concentrated in the Operations and Learning Company segments. In addition, other asset writeoffs include approximately $10 million of goodwill related to a recently acquired software business, which was closed following the merger with Learning Company.

Lease termination costs include penalties imposed upon canceling existing leases and future obligations under long-term rental agreements at facilities being vacated following the merger and realignment.

Merger-related transaction costs consist of investment banking fees, legal, accounting and printing costs, registration fees and other costs recognized in connection with the merger. Also included in this amount is the contractual change of control payments arising from the merger. The majority of all merger-related transaction costs were paid during the second quarter of 1999.

In 1998 Learning Company incurred restructuring charges related to the integration of the business operations of Broderbund and Mindscape, Inc. as a result of their respective acquisitions.

In 1997 Mattel incurred restructuring and integration charges related to the integration of the business operations of Tyco as a result of its acquisition and further restructuring of the business operations of Mattel. In 1997 Learning Company also incurred charges related to the integration of the business operations of Creative Wonders, L.L.C., Learning Services, Inc., Skills Bank Corporation, Microsystems Software, Inc. and TEC Direct, Inc. as a result of their respective acquisitions.

### Other Nonrecurring Charges

In the third quarter of 1998, Mattel recognized a $38.0 million pre-tax charge related to a voluntary recall of certain Power Wheels® ride-on vehicles. During the second and fourth quarters of 1999, Mattel recognized an additional pre-tax charge totaling $20.0 million related to the recall.

In the second quarter of 1999, Mattel recorded a $14.0 million pre-tax charge for environmental remediation costs related to a manufacturing facility on a leased property in Beaverton, Oregon, based on the completion and approval of the remediation plan and feasibility study.

In the fourth quarter of 1998, Mattel recognized a $6.0 million pre-tax charge related to the settlement of the Toys R Us-related antitrust litigation. In the fourth quarter of 1999, Mattel recognized an additional $1.1 million in connection with this matter. Mattel made all required cash and toy contributions during the fourth quarter of 1999.

### Charge for Incomplete Technology

The charge for incomplete technology for the years ended December 31, 1998 and 1997 relates to products being developed by acquired companies at the time of their acquisitions. In each case, Learning Company believed such products had not yet reached technological feasibility, had no future alternative use as of the date of acquisition, and required additional development to complete the software technology and products. In order to develop the acquired incomplete technology into commercially viable products, Learning Company was required to complete the development of proprietary code, development of the artistic and graphic works, and design of the remaining storyboards. During the two year period ended December 31, 1999, Learning Company spent a total of approximately $25 million to complete the development of acquired incomplete technology related to 1998 acquisitions. In order to complete the development of acquired incomplete technology, Learning Company spent approximately $0.5 million in 1998 related to 1997 acquisitions.

## Note 8 - Segment Information

In the 1998 fourth quarter, Mattel adopted Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*. This statement supersedes Statement of Financial Accounting Standards No. 14, *Financial Reporting for Segments of a Business Enterprise*, replacing the "industry segment" approach with the "management" approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of Mattel's reportable segments. This statement requires disclosure of certain information by reportable segment, geographic area and major customer.

The tables below present information about segment revenues, operating profit and assets. Mattel's reportable segments are separately managed business units and include toy marketing, toy manufacturing, and consumer software sales and development. The Toy Marketing segment is divided on a geographic basis between domestic and international. The domestic Toy Marketing segment is further divided into USA Toys, US Fisher-Price/Tyco Preschool and Other. USA Toys principally sells products in the Girls, Entertainment and Wheels categories. US Fisher-Price/Tyco Preschool principally sells products in the Infant and Preschool categories. The Other segment principally sells specialty products in the Girls category. The International Toy Marketing segment sells products in all toy categories. The Consumer Software segment consists of educational, productivity and entertainment software products developed and sold by Learning Company on a worldwide basis. The Operations segment manufactures toy products, which are sold to the Toy Marketing segments based on intercompany transfer prices. Such prices are based on manufacturing costs plus a profit margin. Segment revenues do not include sales adjustments such as trade discounts and other allowances. However, such adjustments are included in the determination of segment profit from operations. Segment profit from operations represents income before restructuring and other charges, interest expense, and provision for income taxes. The consolidated total profit from operations presented in the following tables represents income before income taxes and extraordinary item as reported in the consolidated statements of operations. The segment assets are comprised of accounts receivable and inventories, net of applicable reserves and allowances.

| (In thousands) | For the Year 1999 | 1998 | 1997 |
|---|---|---|---|
| **Revenues** | | | |
| Toy Marketing | | | |
| USA Toys | $ 2,199,329 | $ 2,207,018 | $ 2,330,658 |
| US Fisher-Price / Tyco Preschool | 941,208 | 902,018 | 1,030,906 |
| Other | 316,902 | 256,089 | 58,330 |
| International | 1,596,449 | 1,712,509 | 1,733,605 |
| Learning Company | 770,488 | 839,315 | 620,931 |
| Operations | 1,426,167 | 1,488,502 | 1,554,047 |
| Segment total | 7,250,543 | 7,405,451 | 7,328,477 |
| Elimination of intersegment sales | (1,426,167) | (1,486,320) | (1,552,029) |
| Sales adjustments | (309,426) | (297,924) | (320,901) |
| Net sales | $ 5,514,950 | $ 5,621,207 | $ 5,455,547 |
| **Operating Profit (Loss)** | | | |
| Toy Marketing | | | |
| USA Toys | $322,755 | $ 348,142 | $ 478,579 |
| US Fisher-Price / Tyco Preschool | 105,519 | 97,813 | 87,742 |
| Other | 5,433 | 20,235 | 7,300 |
| International | 112,222 | 156,207 | 218,659 |
| Learning Company | (205,472) | 114,344 | (312,478) |
| Operations | 223,952 | 151,905 | 144,058 |
| Segment total | 564,409 | 888,646 | 623,860 |
| Restructuring and other charges | (345,996) | (157,314) | (343,606) |
| Charge for incomplete technology | – | (56,826) | (20,300) |
| Interest expense | (151,609) | (128,468) | (112,612) |
| Corporate and other | (177,547) | (154,406) | (146,126) |
| Income (loss) before income taxes | $(110,743) | $ 391,632 | $ 1,216 |
| **Depreciation / Amortization (a)** | | | |
| Toy Marketing | | | |
| USA Toys | $ 75,745 | $ 61,510 | $ 51,358 |
| US Fisher-Price / Tyco Preschool | 38,673 | 41,376 | 43,926 |
| Other | 27,912 | 14,071 | – |
| International | 52,366 | 49,234 | 45,024 |
| Learning Company | 51,820 | 97,779 | 464,086 |
| Operations | 28,859 | 25,629 | 32,145 |
| Segment total | 275,375 | 289,599 | 636,539 |
| Corporate and other | 23,224 | 23,085 | 17,458 |
| Depreciation and amortization | $298,599 | $312,684 | $653,997 |

(a) Included in depreciation and amortization are charges for tooling. Such charges are allocated among segments based on a percentage of relative sales.

| (In thousands) | As of Year End 1999 | 1998 | 1997 |
|---|---|---|---|
| **Assets** | | | |
| Toy Marketing | | | |
| USA Toys | $ 570,892 | $ 571,976 | $ 588,154 |
| US Fisher-Price / Tyco Preschool | 230,237 | 279,773 | 337,680 |
| Other | 96,538 | 71,575 | – |
| International | 566,203 | 602,063 | 538,099 |
| Learning Company | 302,818 | 226,913 | 201,309 |
| Operations | 60,796 | 88,613 | 73,048 |
| Segment total | 1,827,484 | 1,840,913 | 1,738,290 |
| Corporate and other | (13,183) | (46,592) | (16,721) |
| Accounts receivable and inventories, net | $1,814,301 | $1,794,321 | $1,721,569 |

The Toy Marketing segments sell a broad variety of children's toy products, which are grouped into four major categories: Girls, Infant and Preschool, Entertainment and Wheels. Learning Company is a leading publisher of consumer software for the personal computer. The table below presents revenues from external customers by category:

| (In thousands) | For the Year 1999 | 1998 | 1997 |
|---|---|---|---|
| Girls | $2,082,841 | $2,136,354 | $2,217,400 |
| Infant and Preschool | 1,635,286 | 1,684,196 | 1,739,900 |
| Wheels | 759,813 | 714,506 | 590,700 |
| Entertainment | 531,540 | 479,891 | 421,700 |
| Other | 44,408 | 64,869 | 185,817 |
| | 5,053,888 | 5,079,816 | 5,155,517 |
| Sales adjustments | (309,426) | (297,924) | (320,901) |
| Toy category | 4,744,462 | 4,781,892 | 4,834,616 |
| Learning Company | 770,488 | 839,315 | 620,931 |
| Consolidated total | $5,514,950 | $5,621,207 | $5,455,547 |

The tables below present information by geographic area. Revenues are attributed to countries based on location of customer. Long-lived assets principally include net property, plant and equipment, and goodwill.

| (In thousands) | For the Year 1999 | 1998 | 1997 |
|---|---|---|---|
| **Net Sales** | | | |
| United States | $3,983,217 | $3,998,823 | $3,770,540 |
| International | 1,531,733 | 1,622,384 | 1,685,007 |
| Consolidated total | $5,514,950 | $5,621,207 | $5,455,547 |

| (In thousands) | As of Year End 1999 | 1998 | 1997 |
|---|---|---|---|
| **Long-Lived Assets** | | | |
| United States | $1,477,202 | $1,580,625 | $ 770,147 |
| International | 675,202 | 635,238 | 518,198 |
| | 2,152,404 | 2,215,863 | 1,288,345 |
| Corporate and other | 257,786 | 245,985 | 229,625 |
| Consolidated total | $2,410,190 | $2,461,848 | $1,517,970 |

Credit is granted to customers on an unsecured basis, and generally provides for extended payment terms, which result in a substantial portion of trade receivables being collected during the latter half of the year. Mattel's two largest customers accounted for the following percentage of consolidated net sales and net accounts receivable:

| | 1999 | 1998 | 1997 |
|---|---|---|---|
| Worldwide sales for the year ended | 33% | 28% | 30% |
| Accounts receivable as of December 31 | 27% | 26% | 36% |

## Note 9 - Quarterly Financial Information (Unaudited)

| (In thousands, except per share amounts) | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| **Year Ended December 31, 1999 (a)** | | | | |
| Net sales | $878,959 | $1,040,154 | $1,825,247 | $1,770,590 |
| Gross profit | 438,497 | 512,501 | 867,286 | 782,756 |
| Advertising and promotion expenses | 116,759 | 136,475 | 296,436 | 396,285 |
| Other selling and administrative expenses | 259,494 | 245,134 | 331,934 | 354,353 |
| Amortization of intangibles | 23,009 | 19,419 | 22,765 | 26,654 |
| Restructuring and other charges (b) | 3,889 | 345,000 | – | (2,893) |
| Other income, net | (4,038) | (3,961) | (846) | (5,694) |
| Income (loss) before income taxes | 10,254 | (261,880) | 175,978 | (35,095) |
| Net income (loss) | 5,049 | (204,334) | 135,333 | (18,421) |
| Preferred stock dividend requirements | (1,990) | (1,990) | – | – |
| Net income (loss) applicable to common shares | 3,059 | (206,324) | 135,333 | (18,421) |
| Basic income (loss) per common share: | | | | |
| Net income (loss) | $ 0.01 | $ (0.50) | $ 0.32 | $ (0.04) |
| Weighted average number of common shares | 396,480 | 409,040 | 425,148 | 425,680 |
| Diluted income (loss) per common share: | | | | |
| Net income (loss) | $ 0.01 | $ (0.50) | $ 0.32 | $ (0.04) |
| Weighted average number of common and common equivalent shares | 422,264 | 409,040 | 429,455 | 425,680 |
| Dividends declared per common share | $ 0.08 | $ 0.09 | $ 0.09 | $ 0.09 |
| Common stock market price: | | | | |
| High | $ 27.81 | $ 29.00 | $ 26.69 | $ 16.88 |
| Low | 21.50 | 22.88 | 19.00 | 11.81 |
| **Year Ended December 31, 1998 (a)** | | | | |
| Net sales | $884,500 | $1,033,509 | $1,884,843 | $1,818,355 |
| Gross profit | 439,888 | 509,240 | 996,090 | 968,085 |
| Advertising and promotion expenses | 119,175 | 135,030 | 281,726 | 381,734 |
| Other selling and administrative expenses | 242,092 | 263,402 | 278,059 | 361,248 |
| Amortization of intangibles | 49,600 | 33,091 | 20,674 | 26,324 |
| Charge for incomplete technology (c) | 40,000 | 16,826 | – | – |
| Restructuring and other charges (d) | 15,230 | 20,887 | 97,088 | 24,109 |
| Other (income) expense, net (e) | (2,147) | (7,922) | 8,870 | (11,893) |
| Income (loss) before income taxes | (47,156) | 29,757 | 267,327 | 141,704 |
| Net income (loss) | (55,957) | 4,578 | 168,734 | 88,698 |
| Preferred stock dividend requirements | (1,990) | (1,990) | (1,990) | (1,990) |
| Net income (loss) applicable to common shares | (57,947) | 2,588 | 166,744 | 86,708 |
| Basic income (loss) per common share: | | | | |
| Net income (loss) | $ (0.15) | $ 0.01 | $ 0.42 | $ 0.22 |
| Weighted average number of common shares | 376,364 | 384,596 | 399,218 | 397,237 |
| Diluted income (loss) per common share: | | | | |
| Net income (loss) | $ (0.15) | $ 0.01 | $ 0.39 | $ 0.20 |
| Weighted average number of common and common equivalent shares | 376,364 | 423,407 | 435,123 | 424,296 |
| Dividends declared per common share | $ 0.07 | $ 0.08 | $ 0.08 | $ 0.08 |
| Common stock market price: | | | | |
| High | $ 45.63 | $ 43.63 | $ 42.31 | $ 39.63 |
| Low | 35.63 | 36.00 | 28.00 | 21.69 |

(a) Financial information for first quarter 1999 and full year 1998 has been restated retroactively for the effects of the May 1999 merger with Learning Company, accounted for as a pooling of interests.

(b) Represents integration and restructuring charges in the second quarter of 1999 related to the Learning Company merger, and other nonrecurring charges. The nonrecurring credit for the fourth quarter of 1999 represents net adjustments made to the restructuring and nonrecurring charges recorded in the second quarter of 1999.

(c) Primarily represents the writeoff of products being developed by Mindscape, Inc. and Sofsource, Inc. that had not reached technological feasibility as of the dates of their acquisitions in the first and second quarters of 1998, respectively. These products had no alternative future use and additional development costs would have been required to complete the software technology.

(d) Includes restructuring charges in the third quarter related to the merger with Broderbund, a nonrecurring charge in the third quarter related to a voluntary recall of certain Power Wheels® ride-on vehicles, and a one-time charge in the fourth quarter in connection with the Toys R Us-related antitrust litigation settlement.

(e) Includes unrealized foreign currency exchange losses in the third quarter that were partially recovered in the fourth quarter.

## Note 10 - Supplemental Financial Information

| (In thousands) | As of Year End 1999 | 1998 |
|---|---|---|
| **Inventories include the following:** | | |
| Raw materials and work in process | $ 48,569 | $ 48,473 |
| Finished goods | 495,727 | 595,797 |
| | $ 544,296 | $ 644,270 |
| **Prepaid expenses and other current assets include the following:** | | |
| Deferred income taxes | $ 91,545 | $ 215,370 |
| Other | 239,157 | 156,402 |
| | $ 330,702 | $ 371,772 |
| **Intangibles, net include the following:** | | |
| Goodwill | $1,274,643 | $1,335,183 |
| Other | 118,672 | 149,451 |
| | $1,393,315 | $1,484,634 |
| **Other assets include the following:** | | |
| Deferred income taxes | $ 296,805 | $ 55,342 |
| Other | 267,381 | 208,982 |
| | $ 564,186 | $ 264,324 |
| **Short-term borrowings include the following:** | | |
| Notes payable | $ 121,805 | $ 121,006 |
| Commercial paper | 247,744 | 78,000 |
| | $ 369,549 | $ 199,006 |
| **Accrued liabilities include the following:** | | |
| Advertising and promotion | $ 186,558 | $ 164,543 |
| Restructuring and other charges | 170,845 | 85,623 |
| Royalties | 109,399 | 112,839 |
| Other | 359,072 | 385,832 |
| | $ 825,874 | $ 748,837 |

| (In thousands) | For the Year 1999 | 1998 | 1997 |
|---|---|---|---|
| **Selling and administrative expenses include the following:** | | | |
| Research and development | $207,664 | $274,820 | $246,337 |
| **Supplemental disclosure of cash flow information:** | | | |
| Cash paid during the year for: | | | |
| Interest | $147,530 | $124,087 | $124,234 |
| Income taxes | 79,099 | 102,163 | 113,496 |
| Noncash investing and financing activities: | | | |
| Common stock issued for acquisitions: | | | |
| Settlement of earn-out agreements | $ 5,547 | $ 5,572 | $ 2,023 |
| Sofsource, Inc. | – | 45,000 | – |
| Mindscape, Inc. | – | 30,000 | – |
| Other | – | – | 7,321 |
| Conversion of 5-1/2% Notes | – | 96,695 | 202,033 |
| Conversion of 7% Notes | – | – | 16,034 |
| Increase in paid-in capital due to value of in-the-money employee stock options acquired in connection with acquisitions | – | – | 2,969 |

## Note 11 - New Accounting Pronouncement

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities.* This statement requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. It also requires that gains or losses resulting from changes in the values of those derivatives be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. Mattel is required to adopt this statement for its fiscal year beginning January 1, 2001. Management believes the adoption of this statement will not have a material impact on Mattel's consolidated financial position or results of operations.

## MANAGEMENT REPORT ON RESPONSIBILITY FOR FINANCIAL REPORTING

Management is responsible for the preparation of Mattel's consolidated financial statements and the related financial and nonfinancial information appearing in this annual report. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States and, in the opinion of management, present fairly Mattel's financial position, results of operations and cash flows. The financial statements necessarily contain some amounts that are based on the best estimates and judgments of management.

Mattel maintains accounting and internal control systems which management believes are adequate to provide reasonable assurance, in relation to reasonable cost, as to the integrity and reliability of the financial statements and as to protection of assets from unauthorized use or disposition. The selection and training of qualified personnel, the establishment and communication of accounting and administrative policies and procedures, and a program of internal audit are important elements of these control systems.

Mattel's internal auditors are directed to examine the adequacy and effectiveness of Mattel's system of internal accounting, administrative and operational controls. They conduct formal and systematic reviews to determine that operations are adequately controlled and to assure that assets are effectively safeguarded.

The board of directors has appointed an audit committee, composed entirely of nonemployee directors. The committee meets regularly with financial management, internal auditors and the independent accountants to review accounting control, auditing and financial reporting matters.

PricewaterhouseCoopers LLP, independent accountants, have been retained to audit Mattel's consolidated financial statements. They conduct a review of internal accounting controls to the extent required by auditing standards generally accepted in the United States and perform such tests and related procedures as they deem necessary to arrive at an opinion on the fairness of the financial statements.

Kevin M. Farr

Kevin M. Farr
Chief Financial Officer

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of Mattel, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Mattel, Inc. and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of Mattel's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Los Angeles, California
February 2, 2000

## DIRECTORS AND OFFICERS



### Board of Directors

William D. Rollnick (1) (2) (3)
Chairman of the Board, Mattel, Inc.
Retired Chairman, Genstar Rental Electronics, Inc.

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Tully M. Friedman (1) (6)
Chairman and Chief Executive Officer,
Friedman Fleischer & Lowe, LLC

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Mattel, Inc.

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Ned Mansour (6)
President, Mattel, Inc.

Andrea L. Rich (3) (6)
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Los Angeles County Museum of Art

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Pleasant Company

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Chairman and Chief Executive Officer,
Caribiner International

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Ralph V. Whitworth
Managing Member,
Relational Investors, LLC

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(2) Member, Compensation/Options Committee
John L. Vogelstein, Chairman
(3) Member, Audit Committee
William D. Rollnick, Chairman
(4) Member, Pension Committee
Christopher A. Sinclair, Chairman
(5) Member, Foundation Committee
Dr. Harold Brown, Chairman
(6) Member, Nominations/Corporate Governance Committee
Ronald M. Loeb, Chairman

### Corporate Officers

Ronald M. Loeb
Acting Chief Executive Officer

Pleasant T. Rowland
Vice Chairman, Mattel, Inc. and President,
Pleasant Company

Ned Mansour
President, Mattel, Inc.

Joseph C. Gandolfo
President, Worldwide Manufacturing Operations

Kevin M. Farr
Chief Financial Officer

Alan Kaye
Senior Vice President, Human Resources

Robert Normile
Senior Vice President, General Counsel and Secretary

William Stavro
Senior Vice President and Treasurer

### Business Unit Executives

Matthew C. Bousquette
President, Boys/Entertainment

Adrienne Fontanella
President, Girls/Barbie

Neil B. Friedman
President, Fisher-Price Brands

Bernard Stolar
President, Mattel Interactive

## CORPORATE INFORMATION



**Transfer Agent and Registrar**
Mattel, Inc. Common Stock
BankBoston, N.A.
c/o EquiServe Limited Partnership

Exchangeable Non-Voting Shares of Softkey Software Products Inc.
CIBC Mellon Trust Company

**Note Trustees**
Mattel, Inc. 6-3/4% Senior Notes due May 15, 2000
Mattel, Inc. 6% Senior Notes due July 15, 2003
Mattel, Inc. 6-1/8% Senior Notes due July 15, 2005
Mattel, Inc. Medium-Term Notes
Chase Manhattan Bank and Trust Company National Association
101 California Street, Suite 2725
San Francisco, California 94111

Softkey International Inc. 5-1/2% Senior Convertible/Exchangeable Notes due 2000
State Street Bank and Trust Company
Global Investor Services Group
Corporate Trust
P.O. Box 778
Boston, Massachusetts 02102-0778

**Stock Exchange Listings**
Mattel, Inc. Common Stock
Mattel, Inc. Preference Share Purchase Rights
New York Stock Exchange and Pacific Exchange, Inc.

Exchangeable Non-Voting Shares of Softkey Software Products Inc.
Toronto Stock Exchange

**Stockholder Administration**
Inquiries relating to stockholder accounting records, stock transfer, dividends (including dividend reinvestment) and direct stock purchase for Mattel, Inc. Common Stock should be directed to:
BankBoston, N.A.
c/o EquiServe Limited Partnership
P.O. Box 8040
Boston, Massachusetts 02266-8040
Telephone numbers:
888-909-9922 (dividend reinvestment and direct stock purchase plan enrollment only)
800-730-4001 (all other stockholder inquiries)
Website: www.equiserve.com

Inquiries relating to stockholder accounting records, stock transfer and dividends for Softkey Exchangeable shares should be directed to:
CIBC Mellon Trust Company
P.O. Box 7010
Adelaide Street Postal Station
Toronto, Ontario M5C 2W9
Canada
Telephone numbers:
416-643-5500
800-387-0825 (for use in U.S. only)

**Common Stockholders**
As of March 6, 2000, there were approximately 52,000 holders of record of Mattel, Inc. Common Stock.

**Annual Meeting**
The Annual Meeting of Stockholders will be held June 7, 2000 at 10:00 a.m. at the Manhattan Beach Marriott, Manhattan Beach, California.

**Form 10-K**
Mattel's Annual Report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 1999 is available upon request by writing to the Secretary of the Company, 333 Continental Boulevard, El Segundo, California 90245-5012.

**Trademark Legends**
Barbie, Fisher-Price, American Girl, Mattel Interactive, Diva Starz, Miracle Moves Baby, Hot Wheels, Matchbox, Tyco, Max Steel, Intelli-Table, The Learning Company, Reader Rabbit, Carmen Sandiego, The Oregon Trail, The Print Shop and QX3 are trademarks of Mattel, Inc.

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