Hasbro Second Quarter 2018
Financial Results Conference Call Management Remarks
July 23, 2018

Debbie Hancock, Hasbro, Vice President, Investor Relations:

Thank you and good morning everyone.

Joining me this morning are Brian Goldner, Hasbro's Chairman and Chief Executive Officer, and Deb Thomas, Hasbro's Chief Financial Officer. Today, we will begin with Brian and Deb providing commentary on the Company's performance and then we will take your questions.

Our earnings release was issued this morning and is available on our investor website. Additionally, presentation slides containing information covered in today's earnings release and call are also available on our investor website.

The press release and presentation include information regarding Non-GAAP adjustments and Non-GAAP financial measures. Our call today will discuss certain Adjusted measures, which exclude these Non-GAAP Adjustments. A reconciliation of GAAP to non-GAAP measures is included in the release and presentation.

Please note that whenever we discuss earnings per share or EPS, we are referring to earnings per diluted share.

Before we begin, I would like to remind you that during this call and the question and answer session that follows, members of Hasbro management may make forward-looking statements concerning management's expectations, goals, objectives and similar matters.

There are many factors that could cause actual results or events to differ materially from the anticipated results or other expectations expressed in these forward-looking statements.

Some of those factors are set forth in our annual report on form 10-K, our most recent 10-Q, in today's press release and in our other public disclosures.

We undertake no obligation to update any forward-looking statements made today to reflect events or circumstances occurring after the date of this call.

I would now like to introduce Brian Goldner.

Brian Goldner, Hasbro Chairman and CEO:

Thank you, Debbie. Good morning everyone and thank you for joining us today.

2018 is unfolding as expected as our teams manage the liquidation of Toys“R”Us in many markets and address the rapidly evolving European retail landscape. As anticipated, revenues were down in the quarter, reflecting both lower Toys“R”Us revenues and the impact of its liquidation on the marketplace.

Importantly, consumer takeaway remains positive and retailer inventories declined. We were ranked #1 in the G11 markets every month in 2018 through May, according to NPD, and we are investing to deliver break-frame innovation, compelling entertainment and a modern commercial organization. We’ve also maintained good operating margins despite expense deleverage resulting from lower revenues.

In addition to investing back in our business, we’ve returned excess cash to our shareholders this year, with an 11% increase in our quarterly dividend and the repurchase of approximately $113 million of Hasbro shares through the first two quarters. We anticipate repurchasing additional shares opportunistically throughout the second half of the year, which will take our total purchases beyond the $150 million target we previously communicated.

With Toys“R”Us out of the U.S. market, retailers are executing meaningful plans to capitalize on the opportunity. This includes expansion at existing retailers, significant online programs as well as new retailers delivering on unique consumer offerings. As we said before, we don't expect to recapture all of the lost revenues in 2018, but by 2019 we should have moved beyond Toys"R"Us.

In Europe, our team is effectively addressing the evolving retail environment, which is characterized by a rapid growth in online purchases and the changing dynamic of brick and mortar retailing. The closing of Toys"R"Us in most markets, coupled with additional retailer bankruptcies and ongoing retail challenges, is impacting our European business and the industry in Europe this year. In fact, according to NPD, toy and game sales in Europe are down through May. We also began 2018 with too much inventory at retail in a number of brands. These factors created a near-term situation which we anticipate will take through the remainder of 2018 to resolve. We accelerated our investment to create a modern commercial organization in Europe, with the right cost base for this new omni-channel marketplace.

Our Brand Blueprint enables us to capitalize on this converged retail consumer behavior by delivering content-to-commerce, digital marketing and innovative product offerings across all channels of retail. Online point of sale for Hasbro products continues to grow at a rate several times faster than overall retail.

We've established a global online team to ensure that we are investing in the analytics, supply chain and consumer programs which drive profitable growth. We are investing in digital media and marketing to develop direct to consumer engagement around the world. We are also creating online exclusive products and programs to support many of our retailers including Walmart and Target, and retail events such as JD.Com's JD day, Amazon's Prime Day and the 11/11 Alibaba Singles Day.

We established a global channels team focused on the opportunity beyond mass retail, toy specialty and online. Activating across new channels begins with product development to create the right brands, products and price points for each channel and retailer, supported by the best retail partnerships and executions. We have made significant progress in the U.S. over the past few years, and this is the roadmap our regions are following and executing locally.

In 2018, consumer takeaway is up for Hasbro Franchise Brands, Hasbro Gaming and Partner Brands.

During the quarter, we acquired POWER RANGERS, further enhancing our story-led brand portfolio. We see tremendous opportunity to expand this iconic property with a broader, more innovative line; which we will further develop both geographically and more deeply across retailers; while executing around Hasbro's Brand Blueprint, including consumer products, digital gaming and multi-screen content. Our line will be in the North American market in Spring 2019 and will then roll out around the world. 2019 will be a transition year as retailers sell through the prior product. By 2020, the team will be well on its way to fully activating POWER RANGERS across the entire blueprint.

Hasbro's gaming portfolio is one of our biggest long-term opportunities. In the second quarter, our total gaming category revenues, including MAGIC: THE GATHERING and MONOPOLY, grew 14%, with growth in both of these Franchise Brands as well as growth in DUNGEONS AND DRAGONS, DUEL MASTERS, JENGA and DON'T STEP IN IT. Point of sale increased in the quarter and through the first six months.

Hasbro is uniquely positioned to grow in face-to-face gaming, with our Wizards of the Coast portfolio and in digital gaming. MAGIC: THE GATHERING had a strong second quarter driven by growth in *Dominaria*, released earlier this quarter, as well as a double-digit increase in new players year-over-year. DUNGEONS AND DRAGONS continues to deliver revenue growth, as fans re-engage with this brand and it attracts new players.

MONOPOLY grew behind consumer-insight driven innovation, including the all new Cheaters Edition. In the second half of this year, we will further support the property with several new launches.

In 2018, there are several new games based on social insights, including DON'T LOSE YOUR COOL, CHOW CROWN and CONNECT 4 SHOTS.

This quarter, we've taken this social listening and fast-to-market approach beyond games with the successful launch of LOST KITTIES and LOCK STARS within our Emerging Brands portfolio.

In our Franchise Brand Portfolio, in addition to our games brands, BABY ALIVE revenues increased in the quarter.

Our second annual NERF Fest is starting now. After a successful debut last year, we've made this a global marketing and retail event taking place in 37 different markets featuring 7 new innovative blasters. In addition, we recently announced the highly-anticipated NERF LASER OPS PRO.

We continue to execute our multi-screen content strategy for TRANSFORMERS, with new product innovations supporting each of our unique stories. In addition to our feature film *TRANSFORMERS BUMBLEBEE* coming in December, we have a new kid-targeted animated series, *Transformers Cyberverse*, this Fall airing on Cartoon Network. We also continue with our fan-targeted *Power of the Prime* series and preschool targeted *Rescue Bots* series with all new content and product innovation. Our animation studio is producing both the *TRANSFORMERS CYBERVERSE* and *RESCUE BOTS* series.

Paramount and Hasbro's Allspark Pictures are exploring dates for future films in support of the TRANSFORMERS franchise. The shift from 2019 to a later date was driven by the final timing of the *Bumblebee* film's theatrical release this December and the home entertainment window which takes place in 2019.

Our Partner Brands also benefited from multi-screen entertainment, with both BEYBLADE and the MARVEL Portfolio delivering revenue growth and strong point of sale gains.

Hasbro's Marvel toy lines saw extremely positive results behind *Avengers: Infinity War* as well as continued robust sales for *Black Panther* merchandise. In addition, *Deadpool, Ant-Man & The Wasp, Venom* and *Spider-Man: Into the Spider-Verse* are being supported by robust product lines and strong retail and marketing programs.

STAR WARS revenue grew slightly in the quarter. In the U.S., point of sale was positive. Our product line for *Solo: A Star Wars Story* was well received by consumers as was our fan-focused Black Series and new Vintage Collection. Outside the U.S., we are successfully selling through carry-forward inventory.

In closing, our teams are working to develop multi-year growth plans with our retailers and we affirm our objective of delivering long-term profitable growth. Our brands have good momentum and are supported with meaningful innovation, storytelling and marketing programs slated for the remainder of the year. As we look beyond 2018, we expect to return to growth. 2019 is setting up to be a great year with engaging storytelling and multi-screen content along with new brand innovation and a robust entertainment slate, including the launch of POWER RANGERS.

I would now like to turn the call over to Deb.

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

Overall the Hasbro teams delivered a good quarter despite challenges in the market. Revenues and profits continued to be negatively impacted by the liquidation of Toys“R”Us, both in terms of lower revenues and the carry on effect of steep discounts on the market. While the biggest revenue impact is in the U.S., Toys“R”Us effected many markets around the world. The retailer closed in major markets such as the U.K. and Australia and created ongoing uncertainty in other countries as potential acquirers have been or are in process of being secured. These countries include Canada; Germany, Austria and Switzerland; and in Asia, where the sale process is ongoing.

Hasbro’s diverse product portfolio helped offset the margin impact of lower revenues. Growth in gaming brands, such as MAGIC: THE GATHERING, MONOPOLY, DUNGEONS AND DRAGONS and DUEL MASTERS combined with higher revenues in the Entertainment and Licensing segment positively impacted margins and helped to partially offset the deleverage we had on fixed expenses in the quarter.

Throughout this short-term disruption, our strong balance sheet has allowed us to continue investing for future long-term growth while also returning cash to shareholders.

We ended the quarter with $1.2 billion in cash. This reflects cash payments of approximately $155 million for POWER RANGERS and the return of approximately $260 million to our shareholders through our dividend and share repurchases this year.

Within our segments, the U.S. and Canada segment revenues declined 7% with lower revenues in all brand portfolio categories. Retail inventory is down and point of sale increased, both with and without the impact of Toys“R”Us.

U.S. and Canada segment operating profit declined in line with the revenue decline, to $76.2 million, or 16.6% of revenues. This was a 10-basis point improvement versus second quarter last year in operating profit margin. Favorable product mix offset the deleveraging of expenses from lower revenues.

International segment revenues declined 11% including a favorable $2.6 million dollar impact from foreign exchange. Revenue declined in each region during the quarter.

In Europe, in addition to the loss of Toys“R”Us in most markets, our teams are clearing through carry-forward retail inventory. Changing retail dynamics in developed and emerging markets are also impacting our decisions around extending credit. Both factors negatively impacted revenue this quarter, and we expect that they will have a continued impact for the remainder of 2018. Retail inventories are down meaningfully since the start of the year, but there is more work to be done. Currency had a favorable $6.2 million dollar impact on European revenues.

In Latin America, the political and economic environment disrupted the quarter. Currency devaluation had a negative $5.5 million dollar impact, notably in Mexico and Argentina, and Brazil dealt with a trucking strike which made the delivery of goods difficult. We are still catching up. Despite these challenges, revenues grew 2% absent Foreign Exchange and point of sale was up in the quarter.

In Asia Pacific, we were cautious with how we shipped to Toys“R”Us Asia, but we continue working with them. In Australia the retailer shut down in June. This region also faced difficult comparisons with last year’s TRANSFORMERS movie, as this franchise has a very strong heritage in Asia. Currency had a favorable $2.0 million dollar revenue impact in the region.

The International segment reported operating profit of $173,000. The lower operating profit was primarily the result of lower revenues which were unable to absorb fixed costs. We continue to look to right-size our cost structure in-line with the changing retail landscape.

Entertainment and Licensing segment revenues increased 26%. As was the case last quarter, the adoption of the new revenue recognition standard impacts when we record revenues from our licensees. In addition to the ongoing success in our licensing and entertainment businesses, the adoption of this standard contributed to the segment's higher revenues.

The segment's operating profit increased 64%.

Overall, Hasbro operating profit margin declined 60 basis points. As we enter the most important half of our year, absent charges associated with Toys"R"Us and organizational changes, full-year operating profit margin could approach last year's levels. Most importantly, we continue to see profit improvement opportunity in 2019 and beyond.

Cost of sales declined 50 basis points. Favorable product mix from higher revenues in gaming brands such as MAGIC: THE GATHERING, as well as Entertainment and Licensing revenues, partially offset the impact of lower overall revenues. We expect the loss of Toys"R"Us combined with continued pressure of higher retail inventories primarily in Europe, to have a short-term impact on our gross margin for the full-year 2018; however, we believe that over the next few years, there is nothing prohibiting us from returning to a 62% gross margin.

Royalty expense declined in dollars and as a percentage of revenue on lower Partner Brand revenues.

Intangible amortization was down year-over-year and included approximately $1 million associated with the acquisition of POWER RANGERS. We anticipate approximately $10 million in incremental amortization expense in the second half of 2018 due to the acquisition, and approximately $21 million in 2019. As Brian indicated, in 2019 we will begin to record revenue associated with our line for this brand.

Program production amortization increased as we are amortizing *MY LITTLE PONY: THE MOVIE* production expense, in addition to television programming. During the second quarter, we began contributing to financing films under our arrangement with Paramount, funding part of the production costs for *Bumblebee*. We will not begin amortizing any production costs in relation to this contribution until 2019.

SD&A increased as a percentage of revenue, primarily due to higher freight and warehousing expenses. The higher freight costs are mainly caused by new trucking regulations and driver shortages in the U.S., and the warehousing expense is the result of higher inventories at our warehouses.

Below operating profit:

Other income declined in the quarter, largely due to a greater loss on foreign exchange this year versus last.

Our underlying tax rate, absent discrete events, was 17.4%, compared to an underlying rate of 24.7% last year and 19.9% for the full-year 2017. The lower rate reflects the benefit of U.S tax reform. We believe our full-year underlying tax rate will be at the high end of our previously communicated range of 15% to 17%. There were no tax reform updates this quarter although we continue to expect additional guidance on tax reform that will require consideration and interpretation going forward.

For the second quarter, earnings per share was $0.48.

In mid-June, we closed on our acquisition of POWER RANGERS and other entertainment assets from Saban Properties. At closing, we paid approximately $155 million in cash and issued approximately 3.1 million shares of common stock to Saban. We have remaining cash payments of $100 million due in 2019. Due to the timing of when the shares were issued, they had very little impact on our share count for earnings per share in the quarter, but will impact shares outstanding going forward. During the second quarter we repurchased $74.1 million in common stock, bringing our year-to-date repurchases to $112.9 million. We expect to continue opportunistically repurchasing shares in the open market, and now expect to exceed our previously communicated target of $150 million for the year. Our full-year repurchases could offset the shares issued in connection with the POWER RANGERS acquisition, depending on market conditions. Actual shares outstanding at quarter end were 127.5 million and $565.1 million remained available in our current share repurchase authorizations.

Hasbro's balance sheet remains strong. Both our debt to ebitda and ebitda to interest ratios at 2.0 and 9.1, respectively, are favorable to our targets.

Receivables decreased 13% and days sales outstanding decreased to 74 days. Excluding the impact of foreign exchange, receivables declined 10%.

While Hasbro revenues were down, point of sale increased and retail inventory of Hasbro product declined during the quarter.

Our owned inventory increased, primarily in the U.S., to support greater retailer activation in the second half of the year. Foreign exchange decreased the inventory value by $12.5 million.

In Europe, inventory is down at retail and at Hasbro.

We are through the first half of the year, which is the period when we anticipated the greatest disruption to our business. Now the real work begins. Our teams around the world are executing the biggest quarters of our year, including the holiday season. We are collaborating with retailers to activate our joint plans in the important toy and game categories, not just for a successful 2018, but for many years to come. Our teams will be focused on managing costs in a year where we have lost a significant customer and face geographic challenges. At the same time, we are strategically investing to ensure we have the brands, entertainment and skill sets to be successful for years to come.

We will now open the call up for questions.