Hasbro Fourth Quarter and Full-Year 2017
Financial Results Conference Call Management Remarks
February 7, 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 website. Additionally, presentation slides containing information covered in today's earnings release and call are also available on our site. The press release and presentation include information regarding Non-GAAP financial measures. 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.

In 2017, the Hasbro team delivered a strong year:

- We grew revenues 4% to a record $5.2 billion and captured the #1 position across the G11 markets for the full-year 2017, according to NPD and SIM.
- Consumer takeaway increased approximately 7% for the year, and we grew point of sale in all major regions and all brand portfolio categories.
- We continued investing in innovation at industry-leading levels delivering growth in Franchise Brands, Hasbro Gaming and Emerging Brands, while building capabilities across the Brand Blueprint.
- We delivered revenue and profit growth in the Entertainment and Licensing segment, led by strength in consumer products.
- We had two successful Franchise Brand theatrical events which drove incremental revenue in both TRANSFORMERS and MY LITTLE PONY.
- We added to our storytelling and content capabilities through an expansive, five-year agreement with Paramount, invested in our

animation studio, Boulder media, and enhanced our digital-first orientation.

- We maintained a high level of profitability, reporting a 15.6% operating profit margin.
- We invested in growing our business, while returning $427.0 million in cash to shareholders. Today, we announced our Board increased the dividend 11% to $0.63 per share, the 14th increase in 15 years.
- Importantly, we remained steadfast in our principles to operate with excellence. In 2017, Hasbro ranked #1 on the "100 Best Corporate Citizens List" by *CR Magazine*; we were recognized as a "World's Most Ethical Company" for the sixth consecutive year; and we ranked third on *Newsweek's* "Green Rankings."

The global Hasbro team's accomplishments in 2017 were meaningful, and we are excited about our opportunities in 2018 and beyond. Before I discuss the year more closely, let's review the fourth quarter including where our actual results fell short of the expectations we set in October.

Hasbro Franchise Brands sit at the center of our strategy and in the fourth quarter Franchise Brands revenues grew 11%. TRANSFORMERS, MAGIC: THE GATHERING, NERF, MY LITTLE PONY and MONOPOLY revenues increased.

For the quarter, point of sale increased in all categories other than Partner Brands. However, after ten months of strong consumer takeaway, the industry and our business slowed in November and December.

We've identified three significant factors:

First, we did not ship <u>or</u> sell through as much as we expected in support of the late fourth quarter release of *Star Wars: The Last Jedi*. As a result, Hasbro's STAR WARS revenues declined, and performed below expectations in the quarter and for the year. Historically, the brand would deliver a revenue surge in film years, and shrink the following year. Instead, we are seeing a pattern like other properties which have films every year, such as MARVEL, where STAR WARS should maintain a large, more sustainable year-in and year-out revenue level. Recognizing this and working with Disney, we can better plan our business with improved visibility, sustainability and profitability over the long term.

As the film has gained a wider audience, point of sale in early 2018 has significantly improved, and is up year to date including strong growth in online sales. We are working closely with Disney Consumer Products and Interactive Media to continue to drive innovative brand experiences over the coming years, and in the near term to leverage the upcoming home entertainment window for *The Last Jedi* and to ensure that retail is positioned to take new inventory in support of the May release of *Solo*: *A Star Wars Story.*

Going forward, merchandise on-shelf dates will be closer to movie promotional activity and premiere dates. Importantly, STAR WARS remains a tremendous property and opportunity – one in which Hasbro is deeply committed. In 2017, STAR WARS ranked as the #1 global property in the toy and game industry, according to NPD, and we look forward to driving this success for years to come.

Second, revenues declined 8% in Europe during the fourth quarter.

STAR WARS contributed to our European decline, but as we have discussed throughout 2017, the region was also affected by a weakening U.K. economy as Brexit negatively impacted consumer and retailer confidence. This impact was more severe than expected late in the year. During the weeks leading up to the holidays, retailers became increasingly risk averse as on-line grew dramatically and UK retailers focused on minimizing inventory and maintaining margins. Several U.K. retailers are cutting staff and stores, and profitability was impacted as we partnered with them to work through in-store inventory.

For the year, NPD estimates the UK toy and game market declined 3% and we estimate the EU5 markets declined slightly.

Across the European region, Ecommerce is growing rapidly, representing an even bigger piece of the market during the holiday, and disrupting traditional retailers' business models. We've invested in a global omni-channel strategy to make Hasbro brands available everywhere consumers shop. We are working through inventory carry over in Europe, and anticipate we will face headwinds while we address these changing market dynamics during the year, particularly in the first half.

Third, our outlook for the fourth quarter reflected a higher level of uncertainty due to the September Toys"R"Us bankruptcy. This uncertainty materialized, and our business with Toys"R"Us was impacted in the quarter about as we expected. We continue to partner with Toys"R"Us to support their turnaround, while managing our risk and inventory.

We estimate less than half the stores in their announced closures directly affect our initial plans, but we also expect Toys"R"Us to streamline inventory at remaining stores. Much of this impact will be felt in the first two quarters of the year. We anticipate during 2018, that we will right size our business with Toys"R"Us while leveraging our omni-channel model to ensure product is available throughout our retailer network to meet consumer demand. The development of our omni-channel product and channel strategy is aligned with where retailers are expanding, notably in emerging markets in Asia and Russia, and also in growing channels in developed economies.

Despite the slower end to the year, our Brand Blueprint strategy is working.

Franchise Brands grew 10% in 2017 - behind growth in TRANSFORMERS, NERF, MONOPOLY and MY LITTLE PONY. Each brand activates the blueprint differently, but the result is consistent: deeper consumer engagement, innovative brand and product experiences and increasingly expansive opportunities for our portfolio.

NERF posted its fifth consecutive year of double-digit growth and was the #1 toy and game property in the U.S., according to NPD. We are delivering innovation that's breakframe, and performance in our products that is unparalled—as we say, it's Nerf or nothing.

TRANSFORMERS and MY LITTLE PONY both leveraged multiple content platforms including theatrical releases, animation on broadcast and streaming sites and digital content to drive growth. TRANSFORMERS revenue grew strong double-digits, and storytelling delivered strong engagement based on compelling insights around the blueprint for both brands. We'll talk more about storytelling and its continued importance in brand building at Toy Fair next week.

MONOPOLY had a strong year – including a successful token madness promotion and product, as well as MONOPOLY GAMER which introduced beloved Nintendo characters to the MONOPOLY game.

MAGIC: THE GATHERING finished the year strong, as revenue grew in the fourth quarter, but full-year revenue declined slightly. Our investments and activities for long-term growth are taking hold, including a successful closed beta for our new digital initiative, MAGIC: THE GATHERING ARENA.

As gaming platforms and audiences continue to expand globally, we have increased our focus on gaming. In 2017, Hasbro Gaming revenues increased 10%. Our tremendous heritage of gaming expertise is a strategic differentiator which uniquely positions us to capitalize on the dynamic opportunity in gaming, across demographics and platforms. Our new innovative social games capture the fun in gaming. Kids, adults and families are playing games. While many gaming brands contributed to growth for the year, Dungeons and Dragons was particularly successful. We also grew digital gaming revenues; and we launched new gaming experiences such as DROPMIX.

Emerging Brands revenue grew 2% as BABY ALIVE continued to perform at a high level. FURREAL FRIENDS also had a great year, including Tyler the Tiger which was a top toy over the holiday period.

While several partner brands grew in 2017, overall Partner Brand revenues declined 10%. BEYBLADE delivered a strong first year and both MARVEL and SESAME STREET posted higher revenues. TROLLS full-year revenue was down, but came close to 2016's movie year sales, which began during Q4 last year.

The softness in the Partner Brand category came primarily from STAR WARS, as we discussed, and to a lesser extent DISNEY FROZEN as it is one year further removed from the movie year. DISNEY PRINCESS revenues declined slightly while full-year point of sale increased substantially, driven by the introduction of new properties.

Looking forward, both in 2018 and beyond, we are positioned to leverage our industry-leading investment in innovation and drive new brand experiences across our brand portfolio.

We are excited about where Hasbro is today – the progress we are making in our brands and our organization is unlocking future opportunities for our stakeholders. Across Hasbro, the brands where we have invested to execute the full Brand Blueprint are the ones that are producing extraordinary results and building value for our shareholders. As we look ahead, the Hasbro team is delivering on the promise of what our differentiated, story-led and digital-first strategy offers to consumers, audiences and customers and we look forward to sharing more with you on February 16th at our Investor Event at Toy Fair.

I will now turn the call over to Deb.

Deb Thomas, Hasbro CFO

Q4 & FY 2017 Earnings Conference Call

Deb Thomas

Thank you, Brian and good morning everyone.

2017 was a record year for Hasbro. The investments we have made over the last 10 years continue to bear fruit. Overall Hasbro revenues grew 4%. Our Franchise Brands, utilizing the full blueprint, grew 10%; Hasbro Gaming grew 10%; many emerging brands benefited from innovation and the category grew 2%. Several of our Partner Brands grew, but the category declined 10%. Much of this decline directly impacted our fourth quarter, which had revenues lower than we expected.

As Brian discussed, after 10 months of very strong performance in both sales to our customers and sell through to consumers, the months of November and December slowed significantly for the industry and for us, and we did not achieve the objectives we had set for the fourth quarter. Despite this, our operating profit margin for the full year was 15.6%, and strong capital management continued to positively contribute to fourth quarter earnings as it had throughout the year.

In the fourth quarter our finance organization assessed the global tax environment which provided opportunities to utilize tax assets and reevaluate our current and historical tax reserves. This exercise contributed to an increase in underlying earnings per share for both the quarter and the year. Similar to other U.S. multinationals, we recorded a provisional charge related to U.S. tax reform in the fourth quarter. As these new laws are clarified and additional guidance is provided in 2018, this amount is likely to be further adjusted; however, we anticipate a sustainable benefit to our effective tax rate in the future and our access to global cash that will enable us to further invest in our business for long-term growth.

Our cash position ended the year stronger than ever, and our directors have voted an 11% increase to our quarterly dividend.

In the U.S. and Canada segment, revenues grew 5% for the year. Franchise Brands, Hasbro Gaming and Emerging Brands increased, while Partner Brands declined. Point of sale increased in the high single digits for the year, with only Partner Brands declining slightly. Retail inventory is overall in good shape; however, we are working through carry over inventory in select brands to begin 2018.

Operating profit in the U.S. and Canada segment declined 2% and operating profit margin was 19.0%. The year-over-year decline was primarily driven by the mix of revenue, increased advertising and higher bad debt expense related to the Toys“R”Us bankruptcy filing in the third quarter of 2017.

International segment revenues increased 2%, including a favorable $75.3 million dollar impact from foreign exchange.

Within the International segment, Franchise Brand and Hasbro Gaming revenue growth offset a decline in Partner Brand and Emerging Brand revenues.

Revenues increased in Latin America and Asia Pacific, while Europe declined 2%. Point of sale increased in all three regions, although Europe slowed late in the year.

Operating profit in the International segment declined 22%, to $228.7 million, or 10.2% of net revenues. The decline in operating profit was driven by higher sales allowances and unfavorable product mix, as well as higher advertising. In addition, as we indicated earlier in the year, lower gains on FX hedges negatively impacted gross margins.

Entertainment and Licensing segment revenues increased 8%. Consumer products, digital gaming and Boulder Media contributed to the revenue growth.

The segment's operating profit increased to $96.4 million or 33.8% of revenues as we gained leverage in our consumer products and digital gaming businesses.

Overall, Hasbro operating profit margin was essentially flat, declining 10 basis points to 15.6% versus our reported operating profit margin last year. Despite lower than expected revenues, our teams focused on prudent cost management and delivered good operating profit margin for the year.

Cost of sales increased to 39.0% of revenues. The 100-basis point increase resulted from higher sales allowances and higher levels of close out sales, incremental tooling expense as well as less favorable hedges. Growth in higher margin revenues partially offset this impact.

Royalty expense decreased 40 basis points to 7.8% of revenue from lower Partner Brand product sales.

Our investment in product development remained significant but did not change materially in dollars or as a percent of revenue. Innovative brand experiences remain core to our strategy and we continue investing at rates higher than our major competitors.

Program production amortization was essentially flat year over year. Amortization of our investment in the MY LITTLE PONY movie began in the fourth quarter, offset by lower amortization of television programming.

SD&A at 21.6% of revenue increased slightly from 21.5% in 2016, excluding the $32.9 million dollar goodwill impairment charge. The increase includes third quarter bad debt expense associated with Toys“R”Us, higher depreciation as well as an unfavorable impact of foreign exchange. We received some benefit from lower stock compensation and bonus expense and we closely managed discretionary expenses.

Turning to our results below operating profit:

Other income was $74.1 million versus $1.8 million last year. This included higher interest income as we generated better returns on higher levels of invested cash. We also realized a $19.9 million gain due to a change in the value of a long-term liability due to lower corporate tax rates associated with U.S. tax reform. In addition, in 2016 we recorded foreign currency losses of $32.9 million. In 2017, this was a gain of $1.3 million.

Our underlying tax rate, absent the impact of tax reform, was 19.9%. The reduction from our previously guided rate reflects the favorable impact of tax planning and the reevaluation of current reserves. This benefit to our underlying tax rate is sustainable into the future. Our effective tax rate for the year, absent the impact of U.S. tax reform, was 9.5%. This includes discrete items, such as the benefit from our adoption of the new accounting standard governing stock compensation and the fourth quarter reassessment of historical tax reserves and audit settlements.

We anticipate U.S. tax reform will lower our overall underlying tax rate and we will discuss this further at our Investor Event at Toy Fair. In the fourth quarter, we recognized a net charge of $296.5 million related to U.S. tax reform. This net amount included a provisional charge of $316.4 million recognized in income tax expense, and the gain of $19.9 million I referenced earlier in other income. The tax charge includes an estimate for the one-time repatriation tax liability and adjustments to the Company’s deferred tax assets and liabilities to reflect a lower corporate tax rate that takes effect in 2018. As I said earlier, this number could change as there is clarification to the new law.

Adjusted earnings per share, absent the impact of U.S. tax reform, was $5.46. On a reported basis, including the $2.33 per share impact resulting from U.S. tax reform, net earnings were $3.12 per share.

Our year-end balance sheet is strong and we generated $724.4 million in operating cash flow, ending the year with $1.58 billion in cash.

We paid out $277.0 million in dividends and repurchased $150.0 million worth of common stock. In 2018, the Board has increased the quarterly dividend 11% and we have $178 million remaining in our current share repurchase authorization.

We have a long-standing commitment to deploy capital for the best long-term return. This includes investing in our business, rewarding our employees for their contributions to our success and returning excess cash to shareholders. We will continue to review our capital strategies as we gain better visibility to the ultimate impact of tax reform.

Receivables increased 7% and days sales outstanding increased 6 days to 79 days, including two days related to the timing of collecting Toys“R”Us receivables. The remaining increase was related to the timing of collections and foreign exchange. Absent the impact of foreign exchange translation, receivables increased in line with constant currency revenue growth.

Inventories increased 12%. Absent foreign exchange, inventories were up 5%, with half of this increase due to new markets we entered during 2017. Our overall inventory at Hasbro is in good condition and associated with growing brands. With respect to retail inventory, our commercial teams in most markets collaborated to sell through and clear inventory heading into 2018. We continue to work through higher than desired retail inventory levels, primarily in Europe, as we begin the year.

The teams addressed significant issues in 2017 including the Toys“R”Us bankruptcy, a shifting retail landscape, the implementation of tax reform and a slower than expected holiday season. While the last two months of the year were below our expectations, our strength through most of the year combined with our strong financial discipline delivered a very good year. We continue to execute our strategy with excellence, and we are excited about our product lines, innovation and offerings in 2018 and beyond. We look forward to sharing these with you at our Toy Fair Investor Event on February 16th.

We will now open the call up for questions.