Hasbro Fourth Quarter and Full-Year 2019
Financial Results Conference Call Management Remarks
February 11, 2020

Debbie Hancock, Hasbro, Senior 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 and presentation slides for today's call are posted 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 press 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.

These factors include those 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.

2019 was a pivotal year for Hasbro.

- We achieved our plan to profitably grow revenues, performing well in a dynamic retail and global trade environment. Hasbro revenues grew 5% absent FX and adjusted operating profit increased 12%. We ended the year with good momentum in many markets and across brands, which has carried forward to the start of 2020.
- We executed throughout the year as a more agile, modern and digitally driven company after re-designing our go-to-market strategy and commercial organization in 2018. The global teams delivered double-digit revenue and point of sale growth in pure-play Ecomm.
- Our channel strategy drove growth for the year including double-digit gains in the value channel, the fan channel and grocery and drug. We advanced our retail strategy and execution for online and omni-channel partners, ending with retail inventory of good quality and levels, as well as product designed specifically for these growing channels.
- We navigated the challenges and disruptions that arose in the global trade environment, implementing programs to meet revenue and margin goals during the important holiday season.

- We delivered compelling gaming experiences, led by the work of our teams at Wizards of the Coast. Our positive results to date have us on plan to double Wizards of the Coast revenues over five years, from 2018 to 2023.
    - MAGIC: THE GATHERING revenues increased more than 30% in the year, behind double-digit growth in tabletop play and a strong first year for *Magic: The Gathering Arena*.
    - DUNGEONS AND DRAGONS revenues grew for the sixth straight year, and we are meaningfully investing in both brands to drive engaging storytelling, while developing new digital games with high margin profitable growth longer-term. We look forward to sharing our 2020 new gaming plans for MAGIC and D&D on February 21st.
- MONOPOLY had double-digit revenue growth and grew in each region with new themes and relevant entertainment tie ins.
- We advanced our consumer products licensing business, growing revenues double-digits and expanding operating profit margin. We broadened our licensed brand portfolio and expanded our reach with original live events that drive consumer engagement. The team is actively working to leverage eOne's brands across global, multi-category licensing efforts and are already making great progress. We will share more about our plans at our upcoming investor meeting.

- We leveraged and created compelling entertainment to drive creativity across brands.
  - Partner Brand portfolio revenues grew 24% for the full year and 50% in the fourth quarter. Disney's *Frozen 2* and *Descendants 3,* Marvel's *Avengers* and *Spider-Man* franchises and *Star Wars* contributed to the gains for the year.
  - We added POWER RANGERS to our Hasbro owned portfolio, executing the brand across our Blueprint – in consumer products, entertainment and digital gaming. 2020 will be our first full year globally, and we will offer new expressions across product, gaming, story and experience.
  - TRANSFORMERS had its second highest non-movie year in its history fueled by growth of fan-oriented product and *Bumblebee* home entertainment; and
  - On December 30 we closed the acquisition of eOne, adding great global brands to our portfolio, and tremendous expertise and capabilities across film, tv and music. In addition to eOne's profitable business, we are poised to bring more Hasbro IP to audiences, fans and consumers globally while further developing Hasbro and eOne's cross platform storytelling. I am encouraged by the early days of our teams working together, and later this month we will share more about our new, stronger, Hasbro.

For the full year, the global Hasbro team delivered on our plan, reinventing our approach to commercial markets. Each major region grew revenues absent FX. The Entertainment, Licensing and Digital segment increased 22%, to $435 million or 9% of revenues, behind growth in digital gaming, entertainment and consumer products.

The U.S. ended the year with a strong fourth quarter performance including high single-digit revenue growth. Amid disruption from tariff uncertainty, the U.S. team worked closely with our retailers to preserve orders at risk ahead of the list 4B tariff implementation, which ultimately did not go into effect. Point of sale was positive for the quarter, as well as for the full year absent Toys“R”Us. We increased our investment in supply chain and logistics during the year to ensure revenue continuity, and to meet the increasing just-in-time inventory requirements of our retailers, which will remain a priority of our commercial and supply chain efforts going forward. Our teams, both Hasbro and our third-party providers, executed at a high level in the fourth quarter to meet the changing needs of our evolving retailer base. We view these improvements as sustainable in 2020.

In Europe, we executed our goal to stabilize revenues and improve profit. Full-year revenues grew 4% absent FX and operating profit increased more than 3 times, with room for future improvement. We enhanced our digital and online selling capabilities across the region to succeed in an environment where retailers carry less inventory and new channels are expanding. Amazon is our largest and fastest growing customer in the region. While the European region is not without its challenges, including continued retail disruption in several countries which contributed to a softer toy and game market, we grew revenue in Germany, Russia and Iberia, as well as a modest increase in the UK despite a down market. Point of sale declines moderated for the region during the fourth quarter, but POS was down absent Toys“R”Us for the full-year. Several brand launches occurred later here or will happen in 2020, such as NERF ULTRA and new PLAY-DOH offerings.

Latin America revenues were up slightly absent FX behind gains in Mexico, which offset disruptive unrest in several countries in the region. Asia Pacific revenue increased 7% absent FX, led by growth in Japan, China, India and Korea, where the fan economy is an important growth driver.

Our brand successes were led by innovation, new platforms and compelling stories. In addition to those I've already highlighted, PLAY-DOH revenues were up, driven by our popular Kitchen Creation play items and the roll out of five new compounds in the U.S., which will be distributed and marketed globally in 2020.

Hasbro's robust product line across price points for *Disney's Frozen 2* had a tremendous holiday and momentum continues into this year with the new home entertainment window beginning today. In partnership with the Walt Disney Company, the team created a highly innovative line to capture the imagination of our consumers with strength across price points. According to NPD, Hasbro's fourth quarter '19 sales across the G5 markets were the highest in the brand's history in the product categories where we have rights.

Star Wars benefited from the year-end theatrical release of *Star Wars: The Rise of Skywalker* and *The Mandalorian* airing on Disney+. *The Mandalorian* Black Series figure was one of the top sellers in the fourth quarter, and Hasbro leveraged the global phenomenon of The Child, affectionately called Baby Yoda, to drive pre-order sales across several new products which ship this year. Through new story and characters, young fans are increasingly engaging with *Star Wars* in major markets around the world. Finally, Hasbro's product for the Marvel franchises, including the *Avengers* and *Spider-Man*, had an outstanding year behind an extremely robust entertainment slate.

BEYBLADE leveraged new product, entertainment and digital integration for another year of revenue growth with good momentum to start the year.

For NERF, a very successful Fortnite line and a promising start with NERF ULTRA in the U.S. helped us gain share globally in the Blasters category in 2019, according to NPD. Performance improved throughout the year and the revenue and POS declines were modest in the fourth quarter. We will launch Ultra globally and have additional break frame product launching this year. We believe in the growth opportunity for this brand across product and experiences.

Our total Games category grew 6% for the year fueled by growth in MAGIC: THE GATHERING and MONOPOLY.

Higher revenues from DUNGEONS AND DRAGONS and several classic games titles did not offset declines in our Hasbro Gaming portfolio, including the contribution of new games launches and difficult comparisons to the prior year PIE FACE and SPEAK OUT sales. The team acted nimbly, reorienting marketing and retail campaigns mid-year to gain incremental space at retail for the holiday and will continue to drive original product, and impactful marketing across the business.

In closing, on the strength and diversity of our portfolio, we set a plan to profitably grow last year, and we delivered on that plan, including revenue and operating profit gains for the full year and the fourth quarter.

As we look to 2020, we are excited about the brand and entertainment opportunities the team is executing to deliver continued revenue and profit improvement. In early 2018, we set a target, that said if certain things broke right, Hasbro's 2020 business, without eOne, could look much like 2017 in terms of revenue and operating profit margin. We've made tremendous progress, and expect to continue to deliver profitable growth, but there are a few key factors which have changed over the period for Hasbro's business pre eOne. These include an approximate negative $160 million impact from foreign exchange; a decline in U.S. retail inventories alone of close to $200 million when you include the Toys"R"Us exit; and a toy and game industry that has not yet returned to growth. What will stand out in the market this year are our excellent brands across gaming, toys, and consumer products, with innovative product lines and an increasing array of compelling stories.

With 2019's good performance and investments in future growth drivers as a backdrop, over the past year we took major steps to create the Hasbro of the future. We have built profitable revenue streams across consumer products, including toys and games; in gaming led by our efforts at Wizards of the Coast; and in entertainment, which we bolstered with the acquisition of eOne and are making great progress to achieve the synergies we outlined around our combination.

On February 21 we will speak in more detail about the opportunity for Hasbro executing an evolved Blueprint strategy.

As we focus on unlocking the value from the eOne acquisition and de-levering over the coming years, we remain committed to investing in our business for growth and maintaining our dividend. The Board has declared our next quarterly dividend of $0.68 per share to be paid in May. I would like to now turn the call over to Deb to speak to the financial performance and strength of Hasbro.

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

2019 was a good - and important - year for Hasbro. We delivered on our goal of profitable growth, we managed through a challenging trade environment and we undertook, financed and, at the beginning of fiscal 2020, closed the eOne acquisition. Our teams worked extremely hard to ensure we executed at a high level this holiday, to drive fourth quarter and full-year revenue and profit growth while also diversifying our supply chain and completing a major acquisition.

2019 revenues excluding foreign exchange increased 5%. Operating profit margin adjusted for eOne acquisition related expenses increased to 14.2%, and full-year adjusted EPS was $4.08 per share.

We generated $653.1 million in operating cash flow during the year and returned $398 million to shareholders. In support of the eOne acquisition, during the fourth quarter, we raised $3.3 billion in net proceeds from our equity and debt offerings, which is included in our year-end cash balance of $4.6 billion. Excluding these financing activities, our year-end cash balance is in line with 2018. During our first fiscal quarter of 2020, with the deal close, we borrowed $1 billion of a term loan to round out our eOne financing, and paid $3.8 billion for eOne shares as well as approximately $830 million to redeem their outstanding notes and revolving credit facility.

We are so pleased that eOne is now part of our team.

Overall, Hasbro's revenue grew at actual and constant rates, and on an as reported and adjusted basis, operating profit increased.

Looking at our segments, U.S. and Canada segment revenue grew 3% for the year, with growth in Partner and Emerging Brands. Underlying profit was essentially flat, as we absorbed higher royalty costs in support of strong Partner Brand growth; higher intangible amortization associated with POWER RANGERS; and higher shipping and warehousing costs from carrying more domestic inventory and managing an increasingly just-in-time retail network. Retail inventories were up slightly in the U.S at year end, behind growth in Partner and Emerging Brand inventories.

International segment revenues grew 4% absent an unfavorable FX impact. Partner Brands revenue grew, and, absent FX, Emerging Brands were up. Following significant reductions in 2018 retail inventory levels, they remain in good shape internationally. Operating profit for the segment more than doubled, as retail inventories were at much improved levels, allowances declined, operating costs came down and revenues grew.

Entertainment, Licensing and Digital segment revenues increased 22% with growth in digital gaming - led by *Magic: The Gathering Arena*; in revenues from the *Bumblebee* film; and in consumer products licensing. Adjusted operating profit and profit margin declined as we invest in digital gaming initiatives, including *Magic: The Gathering Arena* and future MAGIC and DUNGEONS AND DRAGONS digital games. In addition, we recorded lower streaming television revenues and had higher program amortization associated with the *Bumblebee* film. Despite the near-term margin impact of investments, the segment margin of 22.9% remains meaningfully accretive to our corporate average.

Overall cost of sales as a percentage of revenue improved 200 basis points for the year. We had forecasted and delivered improvement based on lower retail inventory in Europe which drove a meaningful decline in allowances and closeouts. In addition, we benefited from favorable product mix from higher Entertainment, Licensing and Digital revenues, higher entertainment driven toy and game revenues, such as *Frozen 2*, Marvel and *Star Wars*, and a greater mix of MAGIC: THE GATHERING. This was partially offset by higher costs to bring inventory into the U.S.

As we discussed last quarter, royalty expense grew to 8.8% of revenues for the year on higher Partner Brand revenues including strong *Frozen 2* and *Star Wars* shipments in the fourth quarter.

Advertising declined $26 million for the year, including a decrease of $46 million in the fourth quarter, which was in part due to higher entertainment-backed revenues which require lower advertising investments. When viewed together, our royalty and advertising expense in 2019 increased 30 basis points from prior year. We are also driving greater efficiency in our advertising, reaching more consumers through lower cost, more effective platforms including social media.

Program production amortization increased as expected, coming in at 1.8% of full-year revenues reflecting the revenue timing and amortization of *Transformers: Bumblebee*.

SD&A declined to 21.6% of revenues, excluding eOne transaction expenses. The benefit of our cost savings initiatives and favorable foreign exchange were partly offset by higher investments in digital gaming, increased compensation expense and additional warehousing costs. Our team did a good job prioritizing and managing expenses in the fourth quarter.

Below operating profit:

Interest expense reflected $10.7 million from bonds issued to fund the eOne acquisition. Reflecting this financing, for 2020, we estimate interest expense to be approximately $210 million.

2019 other income includes a $111 million settlement charge associated with the termination of our U.S. pension plan earlier in the year. There are also several items associated with the eOne acquisition. These include a full-year gain of $114 million associated with hedging the British Pound purchase price. In the fourth quarter, this equaled a gain of $140 million pre-tax. The fourth quarter and full year also included $20.6 million of financing transaction fees, primarily associated with the bridge facility. With the financing complete, the bridge facility has been terminated. Excluding these eOne acquisition-related items, adjusted other income totaled $60.4 million for 2019 and $23.3 million for the fourth quarter, which includes approximately $6 million of interest income associated with higher cash balances ahead of the closing.

Our underlying adjusted tax rate, absent discrete events, was 17.0%, compared to an underlying 18.3% last year. Based on our customer's reaction to pending tariffs, we had forecasted the tax rate to be at the high end of our previously guided range. However, the teams worked with retailers during the quarter to preserve direct import orders from China and ultimately List 4B tariffs were not implemented. As a result, the buying practices were closer to historical levels than expected, and direct import orders declined only 3 percentage points of the total. That trend, along with sales exceeding expectations in certain foreign jurisdictions, changed our mix of income and resulted in a more favorable tax rate. The 12.4% GAAP effective tax rate includes the favorable tax impact of the pension termination as well as certain items associated with the eOne transaction.

Moving to the balance sheet, given the fourth quarter entertainment releases and the later timing of direct import orders due to tariff uncertainty, our shipments and collections came later in the year. As a result, receivables increased 19% and days sales outstanding increased 12 days to 90 days. The impact of FX on the receivables balance was less than $1 million. Receivables are of good quality and by the end of January, we collected nearly $550 million of the year-end balance.

Our teams navigated the past twelve months extremely well, as we executed major brand campaigns, met the needs of a changing retail landscape, dealt with a disruptive trade environment and completed a major acquisition. Our combined organization is becoming one. We are about six weeks into our work together with eOne and we look forward to sharing more with you regarding our view to 2020 and beyond at Toy Fair.

In closing, I'd like to comment on the coronavirus. Our thoughts are with those impacted by the outbreak. There is disruption to our supply chain and commercial operations in China as travel is limited and employees and factory workers have been delayed in returning to work.

The impact to our business to date is small, but it is challenging to quantify the potential magnitude at this time, as it will depend on how long it takes to contain the outbreak. If it takes a significant period of time to control, there could be a larger impact on our business. We are rescheduling any China-based direct import shipments and production missed during the past week and we are monitoring the situation closely to determine how quickly our manufacturing partners can resume full production levels and catch up on the missed activity.

This is a lower revenue and factory production period for us, and we are working to protect the flow of goods. We have a cross functional team working to identify and mitigate the impact to Hasbro. We have identified priority items with launch dates in the coming weeks and months as part of our contingency plans and will work to recapture any lost productivity in the near term to meet demand throughout the year.

Now, Brian and I are happy to take your questions.