Hasbro Second Quarter 2021

Financial Results Conference Call Management Remarks

July 26, 2021

Debbie Hancock, Hasbro, Senior Vice President, Investor Relations:

Thank you and good morning everyone.

Joining me today 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. 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.

The Hasbro team delivered an excellent second quarter, highlighting the power of our portfolio and the benefits of Supercharging Our Blueprint across Consumer Products, Wizards and Digital Gaming, and Entertainment. Each segment grew revenues <u>and</u> profit on an adjusted basis in the second quarter. Overall revenue was up 54% from last year and 9% higher compared to pro forma second quarter 2019. Demand for Hasbro brands, products and content remains strong. The team is executing extremely well to meet consumer, retailer and audience demand in a dynamic environment while driving significant profit and cash generation.

As communicated earlier this year, we are on track to grow revenues, adjusted earnings and adjusted EBITDA this year. This includes revenue growth in all segments to achieve double-digit revenue growth for Hasbro.

We also continue to believe we can reach an adjusted operating margin level approximately in line with last year's adjusted level of 15.1%. We delivered two quarters of excellent results so far, and given these results and favorable mix, year-to-date adjusted operating margin is 570 basis points higher versus last year's first half. We successfully established price increases that go into effect during the third quarter and provide an offset to the rising input and freight costs in the business. These supply chain pressures are meaningful, but given the strength in our business, the actions we have taken combined with our global footprint, we continue to believe we can meet our full-year targets. The team is doing tremendous work from manufacturing, to logistics, to partnering with our retailers to ensure there is product to meet demand. It is not easy, and we work through challenges every day. Deb will speak to this further.

Each brand category grew in the quarter, as did six of our seven Franchise Brands. MONOPOLY declined slightly versus a very robust quarter last year. Franchise Brands, Hasbro Gaming and

Emerging Brands were each up versus second quarter 2019. Partner Brands and the TV/Film/Entertainment categories were essentially flat with two years ago as theatrical releases and content production is returning.

Wizards generated a standout performance this quarter led by MAGIC: THE GATHERING. Demand for MAGIC is at all-time highs, including two record releases in the quarter: *Strixhave*n and *Modern Horizons 2*. As players begin to return to stores and play communities, we are seeing an uptick in sales on our back-list product as well. The high demand is tempered only by supply chain challenges as the collectible trading card space has seen significant demand for production capacity and materials.

The launch of *Magic: The Gathering Arena* on mobile exceeded our expectations and is attracting new *Arena* players. Hybrid players who engage on both desktop and mobile show increased engagement and spend.

Digital remains an important driver for our business and our overall digital portfolio is performing at record levels. We take a holistic approach and are pleased with the direction of our digital transformation. For DUNGEONS & DRAGONS, which grew in both analog and digital this past quarter, the launch of *Dark Alliance* did not meet our expectations, or that of our players. We will continue to invest in improving the game play and in downloadable content. *Dark Alliance* was a modest investment for us, and we do not anticipate any material effect to Wizards' results. We continue to invest robustly in digital.

Wizards is on track for another record year – and while much of that growth was front-half loaded, we expect growth in the second half of the year behind a positive third quarter release slate.

Turning to our Consumer Products business, each region grew toy and game revenues as did licensing which is beginning to recover. The strength of our brand portfolio more than offset the difficult comparison in games.

As expected, point of sale declined in the mid-single digits versus high-single digit growth last year which was led by the extraordinary growth in the games' category. Hasbro point of sale for toys this second quarter was up, while games was down. For the U.S., where we have the most comprehensive data, point of sale is up 10% when compared to 2019, with similar gains in both toy and games categories. The quarterly year-over-year comparisons are choppy, but the trajectory is positive.

Ecomm revenue, including omni-channel retailers, continued to grow in the mid-teens and physical shopping improved as most stores are open this year versus last. According to Profitero, Hasbro had the leading share of Prime Day toy and game sales in several countries. Channel growth was widespread with the largest growth in mass retailers, toy specialty and fan channels.

We have significant product launches backed by robust multi-channel marketing campaigns slated for the second half, including new NERF launches to continue driving the brand after successful Dinosquad and Hyper launches in the second quarter.

Hasbro's PEPPA PIG and PJ MASKS line will be on shelf in the coming weeks. With 100 new products, new entertainment and the support of Hasbro's global retail partners, these brands are poised to reach more families than ever.

We are also re-launching MY LITTLE PONY in the third quarter. There is an all-new cast of ponies and product in support of the September Netflix premiere of the CGI movie, *My Little Pony: A New Generation*. We will further support the franchise with additional series and specials in coming periods.

Audiences are returning to theatres, and we are supporting several feature films including, in partnership with Paramount, *Snake Eyes: GI Joe Origins,* that premiered this past weekend; Marvel Studios' *Black Widow,* that released earlier this month; as well as Marvel Studios' *Spider-Man: No Way Home;* and Sony's *Ghostbusters: Afterlife*.

Entertainment is the catalyst the unlocks the next level of value in our portfolio. eOne is in production. Television, both scripted and unscripted, led the growth this quarter along with Family Brands revenue from content sales and YouTube advertising. Our Entertainment business grew significantly in the quarter, and we continue to target a similar level of revenue for the segment this year versus 2019, absent the second half of the year Music revenues.

In television, *Cruel Summer* premiered to very high ratings on Freeform and was picked up by the network for a second season. ABC renewed *The Rookie* for a fourth season, and we have commenced production. Apple TV+ bought worldwide rights to our production of *Come From Away* which is in post-production for release this fall. Additional film releases to come include *Clifford the Big Red Dog* with Paramount and *Stillwater*, directed by Tom McCarthy and starring Matt Damon. In unscripted TV, our slate remains robust with close to 40 active productions for Canada, the U.S. and U.K.

The eOne team continues to develop and move into production Hasbro IP. Of the more than 200 projects in development across TV, film and animation, more than 30 Hasbro brands are being developed. Among the many active projects, we are in production on the *Dungeons & Dragons* live-action feature to premiere in 2023 and we began principal photography with Paramount on the live-action *Transformers: Rise of the Beasts* coming June 2022.

Hasbro is well positioned for the coming quarters and years with the industry's best brand portfolio backed by unmatched capabilities in consumer products, gaming and entertainment. Our global team of Hasbro employees and partners continues exceeding expectations to execute and deliver outstanding results during these dynamic times.

I will now turn the call over to Deb. Deb.

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

The second quarter was another very good quarter for Hasbro. The team executed at a high level to drive revenue growth, profit and margin improvement, manage a complex supply chain, while reducing debt and delivering a strong balance sheet.

Revenues were up significantly versus last year, but importantly also up compared to the second quarter of 2019 which did not have an impact from Covid. Each segment grew revenues and profits on an adjusted basis year-over-year. As Brian said, we are tracking to our full-year goals and our outlook is in line with our prior guidance.

The strength of our balance sheet and the sale of the Music business, which was completed early in the third quarter, enabled us to pay off $250 million of long-term debt prior to quarter end and another $100 million in July. Through today, we have retired $650 million of debt this year, and are evaluating incremental opportunities for further reductions.

At quarter end, cash on hand was $1.2 billion and we are making good progress toward our goal of returning to our target of 2.0-2.5X debt to EBITDA and maintaining our investment grade rating.

Receivables declined further in the quarter. DSOs were 60 days, a reduction of 37 days compared to Q2 2020 and down 24 days from pro forma Q2 2019. These are the lowest levels of DSOs in a very long time. This improvement is the result of higher sales combined with improved collections and excellent work between the commercial and treasury teams across our business.

Inventory decreased versus second quarter last year when sell into retailers was limited. Inventory remains below 2019 levels and of good quality. Retail inventory increased in markets where we were understocked last year, including the U.S. and Europe, and we continue to reduce our levels in certain markets like Latin America, which is helping improve profit in that region year-over-year.

My discussion will be based on adjusted results which exclude several items outlined in our release today, including a $101.8 million charge related to the loss on eOne Music assets held for sale and related pre-tax transaction costs of $9.5 million.

Within our segments, Consumer Products revenue grew 33% behind gains in Franchise Brands, Emerging Brands and Partner Brands. While overall Hasbro Gaming grew, in the segment it declined compared to the strong demand last year. Revenue grew in each geographic region. Licensed consumer products revenue increased again this quarter behind Franchise and entertainment-backed Brands as licensed categories and the retail environment are improving. Foreign exchange had a favorable $19.1 million impact on the segment.

Operating profit for the segment increased $63.1 million. Similar to the first quarter, the higher revenue was partially offset by increases in royalties from Partner Brand growth, higher advertising to drive the business throughout the year and increased freight costs. Profit was up throughout the segment, with North America, Europe and Latin America contributing the most to profit improvements.

Wizards of the Coast and Digital Gaming segment revenues increased 118% in the quarter. MAGIC: THE GATHERING and DUNGEONS & DRAGONS contributed to this growth. Foreign exchange had a favorable $7.2 million impact. With the higher revenues, operating profit grew, increasing $118.8 million and 780 basis points in operating margin. The increased revenue more than offset higher expenses to support new game launches, including investing in future games, advertising and marketing to support game launches, and depreciation related to capitalized game development. We have said previously, that based on release schedules, we expected the second quarter to be the largest for this business and the team outperformed our expectations. Based on the release schedule for the remainder of the year, we continue to expect a record revenue year for Wizards with operating margins closer to 2019 levels.

Entertainment segment revenues grew 47%, with growth in scripted and unscripted television, animated content and YouTube revenues. Foreign exchange had a favorable $8.8 million impact in the quarter. These results have us on the path to reaching 2019 levels of revenue, excluding the music business over the second half of the year given it will no longer be in our results. Adjusted operating profit was up, but margin declined with higher expenses as eOne returns to more normal levels of operation.

Our cash spend on content across scripted and unscripted live action, animated TV and film is planned to be in the range of $675 million to $750 million for the full year. Through the second quarter, we have spent approximately $308 million of that plan.

Looking at our overall Hasbro P&L, robust revenue growth and favorable mix drove significant improvement in operating profit dollars and a 1,060 basis point increase in adjusted operating profit margin to 16.0% for the quarter. Adjusted EBITDA more than doubled in the quarter versus last year.

Gross margin, including cost of sales and program amortization, increased 80 basis points from growth across the business, including high gross margin revenues from Wizards of the Coast.

Cost of sales increased in dollars on the higher revenues but declined as a percent of revenues reflecting the favorable mix of Wizards revenue and improved profit in the Consumer Products business.

While other factors positively influenced gross margin, freight and input costs are significantly higher this year than last. One example is ocean freight costs where we are projecting, on average, that costs will be more than 4 times higher this year versus last.

As Brian mentioned, we are implementing price increases during the third quarter, that should be fully realized by the fourth quarter. We expect this to offset the rising costs in freight and commodities we continue to see across the business.

We are also working to ensure product availability during the holiday season. We may experience some shifts in delivery dates and timing of revenue, but we are leveraging our global footprint and scale to meet demand. This includes sourcing more products earlier out of multiple countries, increasing the number of ocean carriers we work with and utilizing more ports to expedite the delivery of our product from their origin to their destination points, along with many other tactics to manage through anticipated port congestion and ocean capacity constraints expected in the second half of the year.

Program amortization increased in the quarter, reflecting the higher Entertainment deliveries. This is expected to be in the range of 9 to 10% of revenues for the full-year 2021.

We continue to expect gross margin to decline slightly for the full year.

Product development increased $29 million, led by investments in future analog and digital games at Wizards. As a percentage of revenue, this declined 20 basis points.

Advertising expense increased $33 million to support new digital game launches along with higher support of our toy and game business as planned for this year versus last. This line also declined as percentage of revenue, by 40 basis points.

Reflecting the sale of the music business, we now expect intangible amortization related to the eOne acquisition to be approximately $86 million for the full-year 2021, or approximately $20 million in each of the third and fourth quarters. As a reminder, we exclude this expense in adjusted earnings and EPS.

SD&A reflects higher expenses as the business returns to pre-Covid levels, with higher levels of marketing and sales expense, increased depreciation associated with capitalized digital games, increased compensation and higher freight costs. Despite these higher expenses, SD&A declined as a percentage of revenue by 540 basis points.

The underlying tax rate in the quarter was 23.2%, compared to 20.6% last year. The higher rate is due to the mix of income, but we expect the full-year underlying rate to remain at approximately 21%, excluding the amortization of the eOne acquisition intangible. The all-in GAAP effective tax rate in the quarter was mainly driven by two discrete events including the impact of the Music sale and the remeasurement of our U.K. net deferred tax liability. This was offset by a benefit resulting from tax planning and normal discrete items.

Our second quarter showcased the benefit of our deep portfolio of brands and capabilities, backed by a tremendous team and solid execution. For the remainder of the year, we will be delivering tremendous innovation and a robust content slate while navigating the global supply environment to deliver a successful holiday season.

Brian and I are now happy to take your questions.