Hasbro Third Quarter 2019
Financial Results Conference Call Management Remarks
October 22, 2019

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 and good morning everyone and thank you for joining us today.

The Hasbro team is making progress to accomplish our stated goal of returning to profitable growth this year in an environment where the trade conflict is having the short-term impact we have outlined throughout the year to our stakeholders. We are delivering innovation and creativity globally: in gaming, across our toy business and around the Brand Blueprint as we operate during a very dynamic quarter, and year. We are actively developing our brands for success in analog and digital play and entertainment while investing for long-term profitable growth, including the September 26 launch of *Magic: The Gathering Arena,* our investments in Wizards gaming beyond Arena, and our announced plans to acquire Entertainment One.

We are doing this amid a very choppy environment where retailer order patterns have changed in response to potential tariffs, and our supply chain is being pushed to meet high levels of demand in condensed periods of time. We view these dynamic supply chain challenges as short term, and we are positioning our business for growth in 2019 and over the long term.

Overall revenues in the quarter grew 2% absent foreign exchange. Revenues were up in Asia and Latin America, including double-digit growth in China and Mexico. Europe remains on track with our plan to stabilize revenues and grow profit this year. Global point of sale declined in the mid-single digits for the quarter, showing declines in July and August with improving trends in September and growth into October. Online point of sale continues to grow rapidly. We are the leading toy and game company year to date through August, across the G11 markets, according to NPD.

We posted revenue gains in MAGIC: THE GATHERING and DUNGEONS & DRAGONS, where only a small percentage of our sales is captured by NPD data, and we generated 20% revenue growth in the Entertainment, Licensing and Digital segment.

In the U.S., however, the threat and implementation of tariffs negatively impacted our quarterly results. For the third quarter, U.S. point of sale declined slightly, and retailers continued to lower inventory. With many of our holiday initiatives launching in early fourth quarter point of sale has improved in recent weeks and is up to start the quarter.

As you recall, since the administration began discussing tariffs, we have outlined the ripple effect they would have on our business. We've spoken about the changing order patterns in the U.S., whether or not tariffs are ultimately enacted. In the third quarter, the threat of, and the implementation of tariffs in certain instances, impacted our shipments, and our ability to fully meet demand. Importantly, during Q3 alone we saw multiple different dates for the enactment of list 4 tariffs come and be delayed, now scheduled for December 15, and yet the prospect had our retailers cancel major direct import program orders and rewrite many of those orders as domestic shipments. The impact of the shift was that July and August total shipments were lower and September shipments were far higher than a year ago. However, given the location of our inventory in Asia to satisfy direct import orders during July and August, we ultimately were unable to re-plan the orders and rewrite all of the orders from direct import to domestic orders all within the quarter.

We were also unable to ship all the orders, many of which came late in September, by the end of the quarter. Our supply chain team worked to rapidly respond as our domestic shipments increased to 59% of orders this year versus 51% of the U.S. and Canada segment this quarter last year.

We prioritized critically important launches like *Star Wars* Triple Force Friday, *Frozen 2*, and NERF Ultra, all of which are off to very strong starts - in line with, or ahead of our plans. To meet demand, we added air freight and shifted warehousing at an incremental expense to ensure shelves were stocked as the promotion builds for these initiatives.

We are working to catch up in the first weeks of the fourth quarter and, while early, we are seeing strong consumer demand for these new initiatives. We are working diligently to improve our approach to domestic shipments, and still face the prospect of more direct import cancellations and shifts to domestic orders as the December 15 list 4 date approaches for most of our product lines.

We've built a domestic supply chain that, like much of our approach to product manufacturing and distribution, is asset light. We have historically used a balance of customers' shipments and our own domestic shipments through third-party suppliers to manage our costs and make our supply chain most effective and cost efficient. In this current environment, we've been transitioning and redesigning our U.S. supply chain at pace.

In addition, while the December 15 action will hit the majority of our products, List 4 tariffs enacted in September impacted some of our games during the third quarter. The direct import orders for these items were cancelled and we worked to get supporting domestic orders while also adjusting pricing to cover the tariff's impact and protect our gross margin.

As we have discussed previously, and experienced in both the second and third quarter, if we take no action the planned December 15 tariffs will curtail direct import shipments by retailers as they want product arriving on or after the 15th to be imported by Hasbro and demand fulfilled in the U.S. The team is working on programs to help mitigate this impact as well as the impact on our consumers this holiday season, but we anticipate continued potential disruption in the fourth quarter.

Our teams are actively moving our strategic sourcing footprint and are on track to achieve our target of sourcing 50% for the U.S. out of China by year-end 2020. We are having good success identifying and building products in geographies including Vietnam, India, and others. Importantly, as a reminder we are also sourcing 20% of our U.S. business from the U.S.

At the same time, as online retail grows rapidly and the mix of retailers evolves, retailers continue managing their business to carry lower retail inventories. U.S. retail inventories declined in in the quarter mid-single digits and European inventories were down more than 20% to meet the just in time needs of retailers, and we anticipate inventories will remain lower through the fourth quarter.

We have many new product lines launching in Q4 and more dynamic advertising support driving our innovative products and we are already seeing momentum in POS, and yet, we will likely not recapture all the revenues associated with canceled direct import orders in the third and fourth quarter. We have partnered with retailers to grow demand in a holiday season that has six fewer shopping days than last year.

During the third quarter, global retailers championed Hasbro’s lines for *Frozen* Fan Fest and STAR WARS Triple Force Friday in support of the October 4th merchandising date. Partner Brand revenues increased 40% behind growth in these initiatives as well as Marvel product lines, including the *Avengers* and *Spider-Man* franchises, which continue to perform well.

The highly anticipated *Disney’s Frozen 2* is set to debut in many markets in late November. Hasbro is supporting this huge initiative with a complete line of fashion dolls, small dolls and playsets, including an iconic fashion doll castle which is already outselling our expectations.

Star Wars Triple Force Friday featured meaningful pre-order activations tied to product reveals and launch initiatives planned by online retailers. We also created limited editions of some of our most popular fan items to drive foot traffic to retail on opening weekend. Key retailers featured out of aisle placement of product and plan to continue to ramp support of the line as we move closer to the holidays.

We see the power of storytelling in our brands. TRANSFORMERS revenues were up on *Bumblebee* film-related revenue. Point of sale increased in the U.S. and revenues are up year-to-date, although shipments declined in the quarter with no feature film this year.

POWER RANGERS is off to a great start in the U.S. and several countries garnering high ratings for our new series and we're seeing early sales momentum.

Throughout nearly ten-years of storytelling, MY LITTLE PONY grew into a global lifestyle franchise with billions in retail sales. The series finale of *Friendship is Magic* aired earlier this month. While revenue has declined as this story line comes to an end, we see the potential to once again reimagine the brand and are investing in content and innovation. In partnership with Paramount, we are developing a MY LITTLE PONY animated feature for 2021.

We will seize upon our opportunity to leverage the talent we expect to onboard with the close of the acquisition of Entertainment One to chart the next great stories for Hasbro IP for kids, fans, and families around the world.

Storytelling also sits at the heart of MAGIC: THE GATHERING where the team delivered another quarter of revenue growth including the launch of Thrones of Eldraine and the live launch of *Magic: The Gathering Arena* in late September. As part of Arena's launch, we are expanding marketing and promotional activity to reach new potential players. The game will be available at the Epic games storefront, connecting with a sizable global gaming audience in 2020 and beyond.

Given the shift in release timing, the fourth quarter will be a difficult comparison with last year for Magic, but we have delivered meaningful growth in the franchise in 2019 and are investing in new digital games and entertainment for future years. This also includes new gaming investments for DUNGEONS & DRAGONS which again grew revenues this quarter. The team at Wizards of the Coast continues to do tremendous work advancing our capabilities and delivering exceptional experiences to our growing player and audience base.

Through both in-house development and with partners, the Wizards of the Coast team has close to a dozen games in development for delivery over the next 5 to 6 years. This includes Baldur's Gate 3, a highly anticipated DUNGEONS & DRAGONS game we recently announced with our partner Larian.

Finally, the NERF team is delivering new innovation and experiences. While revenue and point of sale has not yet turned around this year, point of sale is improving following the global launch of Alpha Strike in August and the U.S. launch of Ultra in October.

According to NPD, the category is down through August in the G9, but NERF is gaining share, or was flat, every month since March, in part through the strength of our Fortnite line - where we are delivering more innovation this holiday - and in the under $20 dollar segment with the recent launch of Alpha Strike, where we are also gaining share. Throughout the rest of this year you will see strong media support behind our key initiatives as well as more social media content.

In early October, in partnership with Kingsmen Creatives, we opened the world's first Nerf Action Xperience located in Singapore. The arena is designed to promote active play, which is the essence of NERF. In the U.S. we are partnering with Kilburn Live on a new entertainment touring event – NERF Challenge. This all new attraction is debuting in Los Angeles at L.A. Live starting early December and brings the competitive fun of the NERF brand into an action-packed play experience.

In summary, we are continuing to make meaningful progress in a rapidly changing retail environment. Our team is redesigning our go to market efforts - as the market shifts. We entered the fourth quarter with the initiatives to drive our business and look forward to 2020 and beyond as we bring more Hasbro owned, story-led IP and gaming initiatives to global audiences, gamers and consumers.

I’ll now turn the call over to Deb.

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

As the year progresses, our global teams continue to manage through a dynamic global trade and retail environment. We anticipate this continues throughout 2019 as retailers work to manage inventory, and we are working to mitigate the impact on consumers this holiday season. This disruption is reflected in revenues, expenses and in our underlying tax rate. However, within this environment, our teams are delivering an innovative slate across demographics and categories, including in digital gaming, that we are supporting with robust marketing programs and continued investment in future gaming initiatives. We are delivering on the goals we set for the year of stabilizing Europe, launching *Magic: The Gathering Arena* and continuing to grow points of distribution. Our financial position is strong and we ended the quarter with $1.1 billion in cash on our balance sheet.

Revenues are up slightly over a year ago and include a negative impact from foreign exchange of $20.5 million. Absent this impact, revenues grew 2%. If currency rates stay at similar levels to the end of Q3, we expect a similar negative impact of foreign exchange translation in the fourth quarter when compared with the fourth quarter of last year. The brand mix within revenue also had an impact on our expenses for the quarter, in addition to the impact on our supply chain from changing retailer shipping patterns. This resulted in operating profit margin of 18.9% for the quarter compared to 20.0% a year ago.

Within our segments, U.S. and Canada segment revenues declined 1.5%. Franchise Brand and Hasbro Gaming revenues declined in the quarter, while Partner Brand and Emerging Brand revenues grew. As Brian discussed earlier, the U.S. business was impacted by retailer cancelation of Direct Import orders in the quarter, and some of those orders were not re-written during the period. This had a particular impact on Hasbro Gaming, and represented most of the decline in the category for the quarter. In Franchise Brands, MAGIC and MONOPOLY grew, with the remaining brands decline more than offsetting this growth. The largest decline in Franchise Brands was in NERF, as we positioned the brand for new innovation launching in North America early in the fourth quarter and globally thereafter.

In order to ensure we had inventory available domestically to meet on shelf dates for *Frozen 2* and *Star Wars*, we also prioritized our Partner Brands through our supply chain. In addition to products associated with those two brands, MARVEL properties also continue to perform well. As retailers focus on reducing inventory levels, retail inventory is down.

Due to the impact of the brand mix of revenues and the additional costs of warehousing and distribution in the U.S., the U.S. and Canada segment operating profit decreased 13% and operating profit margin was 21.6% compared to 24.5% a year ago. Favorable cost of sales was more than offset by higher royalty expense, freight and warehousing costs, as well as intangible amortization associated with POWER RANGERS, which began selling in the segment in Q2 of this year.

International segment revenues were flat to a year ago including a negative $19.9 million impact from foreign exchange. Revenue declined in Europe and grew in Asia Pacific and Latin America. Absent the impact of foreign exchange, segment revenues grew 4%. At constant FX rates, revenue in Europe was flat to a year ago, Latin America revenue increased 9% and Asia Pacific revenue increased 10%. Within the segment, Partner and Emerging Brand revenues increased, while Franchise Brands and Hasbro Gaming categories declined.

International operating segment profit increased 1% to $67.2 million. Flat revenues and lower cost of sales were somewhat offset by increased royalty expense and intangible amortization.

Entertainment, Licensing and Digital segment revenues increased $19 million or 20% compared to the third quarter a year ago. Revenue growth was driven by *Magic: The Gathering Arena* and *Transformers: Bumblebee* revenues.

Operating profit decreased to $24.6 million, or 21.2% of net revenues, versus $37.1 million, or 38.3% of net revenues in 2018. The decline in operating profit was due to several factors. In the third quarter of last year, we signed a multi-year digital streaming agreement for Hasbro television programming. This typically happens every few years, and has a high pass through to operating profit. Additionally, this year, the segment had higher program production expense as we are receiving revenues and therefore amortizing production costs associated with the *Bumblebee* film. Lastly, we continue to invest in digital gaming initiatives, including *Magic: The Gathering Arena* and future digital games. As we have discussed in prior quarters, we increased advertising and marketing expense in support of this launch. In addition, we continue to invest in the teams and development of new digital games we expect to launch in the future. As a reminder when thinking about the fourth quarter, we had a major card set release for Magic in the second quarter of this year which occurred in the fourth quarter of last year and we began recognizing our first meaningful revenue associated with Arena last year in the fourth quarter.

Overall, operating profit for the quarter declined $16.1 million or 5%, to 18.9% of net revenues.

Cost of sales as a percentage of revenue decreased 195 basis points in the quarter. Favorable product brand mix from higher entertainment driven revenues, such as *Frozen 2*, MARVEL and *Star Wars*, and a greater mix of Entertainment, Licensing and Digital revenues, including

Arena, were somewhat offset by higher costs to bring inventory into the U.S. to sell domestically upon cancellation of Direct Import orders resulting from tariffs concerns.

Royalty expense increased in dollars and as a percentage of revenue on higher Partner Brand revenues. Based on our expectations for the full year, we now anticipate royalties to be approximately 8.5% of revenues. Dependent on the level of shipments associated with *Frozen 2* and *Star Wars* which occur during the remainder of this year, royalty expense could exceed this amount.

Intangible amortization increased in the quarter, and we continue to expect full year amortization of existing intangibles to be approximately $47 million.

Program production amortization increased as we are now receiving revenue and amortizing the costs associated with *Transformers: Bumblebee*. Given the timing of expected revenues, we now expect full-year program production cost amortization to be greater than historical levels but remain under 2.0% of total net revenues. Given a change in the expected timing of receipts on tax credits, we now expect full-year content spend of approximately $50-60 million.

SD&A was up slightly in dollars and 10 basis points as a percentage of revenue over a year ago. Driving the increase are higher shipping and warehousing costs, primarily in the U.S., from higher costs on rerouting shipments to customers initially expected to be taken through direct import. This required moving inventory, into U.S. warehouses to ultimately ship domestically, as well as higher warehousing costs to store domestic U.S. inventory. We also incurred higher costs associated with building our teams as we invest in digital gaming initiatives surrounding our Wizards of the Coast brands. Finally, incentive-based compensation expense is higher than a year ago. These increased costs were largely offset by cost savings being achieved from our 2018 cost savings initiatives. Given the higher distribution and warehousing costs we are experiencing, we anticipate that full-year SD&A could be a similar percentage of revenue compared to adjusted full-year of 2018.

As Brian discussed, we continue to believe we will have full-year profitable growth in 2019 and we continue to take the steps to ensure we can grow operating profit margin over time.

Below operating profit:

Other income (expense) decreased in the quarter, due primarily to losses associated with hedging the GBP purchase price for our proposed acquisition of eOne. Absent this $25.5 million loss, other income improved approximately $5.6 million. After taxes, this loss negatively impacted net earnings by $20.9 million, or ($0.16) per share.

Our underlying tax rate, absent discrete events, was 18.2%, compared to an underlying rate of 17.6% last year. During the third quarter of 2018, we also recorded a $17.3 million tax benefit, or $0.14 per share, related to our interpretation of U.S. tax reform guidance that was released during that quarter. Based on the shifting mix of our business, primarily in the U.S., we believe the full-year tax rate will trend to the middle to high end of our guided 17.5% to 19% range and could potentially go slightly above the high end due to our customers' and our own responses to potential tariffs.

For the third quarter, reported earnings per share was $1.67. Adjusted earnings per share, excluding the $0.16 FX hedging loss, was $1.84.

Operating cash flow over the past twelve months totaled $860.8 million and we had $1.1 billion in cash at the end of the quarter.

During the third quarter we returned $87.4 million to shareholders, including $85.9 million in dividends and we repurchased $1.5 million in common stock. Year-to-date repurchases total $60.1 million. As a result of our planned acquisition of eOne, which Brian will speak more to in a moment, we anticipate suspending our share repurchase program as we focus our cash flows on reducing leverage arising in the transaction.

Hasbro's balance sheet remains strong. Both our Debt to EBITDA and EBITDA to Interest ratios at 2.0 and 9.8, respectively, remain within our targets.

Receivables increased 2% and days sales outstanding were 82 days. Excluding the impact of foreign exchange, receivables increased 4% in part due to the shift away from U.S. retailers use of direct import orders.

Hasbro owned inventory decreased $21.8 million, or 4%, most significantly in Europe and Latin America. This decrease was partially offset by growth in U.S. and Canada owned inventory as we have previously discussed. Absent the impact of FX, inventory decreased 1%. Retail inventories declined in the U.S. and internationally, notably in Europe.

In a rapidly changing retail environment, and an uncertain trade situation, we are addressing these changes and adjusting our business on a real time basis. At the same time, we are investing to strengthen our brands and expand our revenue and profit drivers through investments in digital gaming and in entertainment. We are delivering innovation across the portfolio, working with new retailers and introducing new ways to experience our brands - all positioning us to profitably grow in 2019 and going forward.

I would now like to turn the call back to Brian to give an update on the eOne acquisition.

Brian Goldner, Hasbro Chairman and CEO:

Thank you, Deb. Before we take your questions, I want to update you on the progress of our acquisition of Entertainment One. Last week, the shareholders of eOne overwhelmingly approved the acquisition. We are delighted with their support. We have received regulatory approvals in two of the four jurisdictions where it is required, the U.S. and Germany, with Canada and the UK outstanding. We continue to expect to close the transaction during the fourth quarter. We also continue to expect to finance the transaction with the proceeds of debt financing and approximately $1.0 billion to $1.25 billion in cash from equity financing. The strategic opportunity to bring onboard the brands, capabilities and talent from eOne is compelling to our long-term prospects as a leading global play and entertainment company and we look forward to sharing more about our plans after the close.

Deb and I are now happy to take your questions.