Hasbro Fourth Quarter and Full-Year 2018
Financial Results Conference Call Management Remarks
February 8, 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 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.

Informed by our proprietary global consumer insights and industry-leading brand-building capabilities, Hasbro's global teams worked to do more than just respond to a very disruptive market last year. In 2018, our teams actively managed through the year but also took strategic steps to drive long-term success in a rapidly changing environment.

Over the course of a 12-month period:

- We re-imagined and re-designed our go-to-market strategy and re-shaped our organization to become a more agile, modern and digitally-driven play and entertainment company.
- We meaningfully diversified our retail mix and grew online point of sale double digits, absent the impact of Toys"R"Us. We pivoted to a digital-first approach making Hasbro a complete e-comm partner. As a result, according to Edge Market Share, Hasbro was the #1 toy and game company on Amazon in the U.S. and Canada.
- We streamlined and focused our teams, cutting costs across the business. We identified greater savings than originally anticipated and now expect $70 to $80 million in gross savings by 2020 from our organizational actions. $50 to $55 million of these savings are expected this year after we reinvest.

- We further diversified our global sourcing efforts, reducing our risk and better managing our costs. We are on track to lower our Chinese manufacturing to 60% of total by the end of 2020;
- We invested in developing innovation across brands, price points and channels. We look forward to sharing many of these with you at Toy Fair.
- We purchased POWER RANGERS, adding a new entertainment brand to our global portfolio. We couldn't be more excited with how our original television series and line looks for 2019 and our retailers share our excitement.
- We grew MAGIC: THE GATHERING revenues behind positive tabletop performance as well as the move to open beta for our new digital initiative *Magic: The Gathering Arena*. *Arena* is poised for a successful launch this year, including a major new esports initiative. We are investing and innovating to make gaming a greater growth driver for Hasbro over the short- and long-term. You will hear more about our plans at our investor event next week.
- We successfully re-engaged families, kids and fans in the TRANSFORMERS franchise with our feature film *Bumblebee* and are charting a path forward across the blueprint in entertainment, gaming, publishing and merchandise for this valuable franchise.
- And we returned $559 million of excess cash to you, our shareholders, through our dividend and share repurchase. Today,

we announced the Board increased our quarterly dividend 8% to $0.68 per share. This represents the 15th dividend increase in 16 years.

While the 2018 industry headline was a major retailer bankruptcy, this event created a ripple which went deeper and magnified the impact of ongoing, underlying changes in the industry - including the rapid growth of online retail globally and a heightened focus by retailers on profit and inventory management. For Hasbro, in addition to losing hundreds of millions of dollars in revenue from Toys“R”Us, the liquidation of an additional hundreds of millions of dollars of their retail inventory sold into the market at large discounts was more impactful to 2018 than we, and industry experts, estimated. It is an unprecedented yet finite event.

Prior to its initial bankruptcy filing, Toys“R”Us was our third largest customer in the U.S., and our second largest customer in Europe and Asia-Pacific. In Europe, its bankruptcy added to a market already dealing with disintermediation across retail by online and omni-channel retailers as well as political and economic headwinds, notably in the UK. According to NPD, the European toy and game market declined 4% last year across the top six markets. As we discussed at the start of 2018, even before the European Toys“R”Us bankruptcy, reducing our European retail inventory was the top priority for our teams. Given the dynamic retail environment, it was a bigger negative impact than initially expected to both our top line and operating profit as the team executed this task. Retailers ended the year with significantly lower inventory, down approximately 27%. Our goal is to stabilize Europe this year and grow beyond 2019.

In the U.S., mass market retailers capitalized on the share opportunity in the toy and game category, but importantly also increased their focus on inventory management, implementing new behaviors and technologies this past holiday season. They ended the year with less Hasbro retail inventory than prior years. This is a trend we anticipate continuing. Including the loss of Toys“R”Us, Hasbro’s U.S. retail inventories were down approximately 24% last year. Point of sale in the U.S. and Canada, excluding Toys“R”Us, increased for the year and in the fourth quarter.

For the full year, Hasbro revenues declined 12% to $4.6 billion, including a 13% decline in the fourth quarter.

Several brands delivered positive performances. Franchise Brands MONOPOLY and MAGIC: THE GATHERING both grew revenues last year. DUNGEONS & DRAGONS delivered another record year within our Gaming portfolio. Our plans for an expanded universe of gaming behind D&D is taking shape in analog and digital game play.

Our new collectibles lines, LOST KITTIES and YELLIES, along with POWER RANGERS licensing revenue in the second half of the year, contributed to growth in Emerging Brands.

Global point of sale for Franchise Brands, Emerging Brands and our gaming category, including MONOPOLY, was up for the year and the fourth quarter excluding Toys“R”Us in both periods.

Given their strong representation at Toys“R”Us, certain brands and categories were disproportionately impacted by its bankruptcy and liquidation. NERF is one example of a brand that due to its performance and innovation received larger shelf space at the retailer. In addition, increased competition, principally at lower price points, contributed to a decline in NERF revenues last year. Nerf remains by far the industry leader and we are building on Hasbro’s long-standing reputation for innovation, performance, accuracy and safety. Beginning with our new Gamer series, NERF FORTNITE and NERF OVERWATCH, we are entering a new innovation cycle for the brand that will deliver compelling product across price points in 2019, 2020 and beyond. We’ll share more about our plans at Toy Fair but given the competitive nature of the industry we will be waiting to share some initiatives and plans closer to their launch dates.

Within Partner Brand’s, Hasbro’s MARVEL portfolio and BEYBLADE delivered very strong performances behind innovative product and great entertainment. After an outstanding box office and merchandise year, Marvel’s 2019 theatrical line up is impressive and includes a diverse portfolio led by Marvel Studios’ *Captain Marvel* in March and *Avengers: End Game* in April; as well as Columbia Pictures’ *Spider-Man: Far From Home* in July.

These strong Partner Brand performances were offset by declines in STAR WARS, DISNEY PRINCESS, FROZEN and TROLLS – each of which has significant new entertainment for 2019 or 2020. The Walt Disney company continues to set the standard for tremendous stories with highly merchandisable content and 2019 is poised to be another amazing year. In addition to the robust Marvel slate, Hasbro will be delivering innovation and marketing programs to engage kids and fans in the Star Wars franchise throughout the year. Coming soon for the franchise is *The Mandalorian*, an all-new live action television series from executive producer Jon Favreau on Disney's upcoming streaming service, Disney+; the opening of a major new theme park land, Galaxy's Edge, in both Anaheim and Orlando; and *Star Wars: Episode IX* which debuts in theatres December of this year, with its impact reaching across both 2019 and 2020.

The Disney Princess franchise will benefit from new entertainment, including the live action *Aladdin* film in theatres this May. The highly anticipated theatrical release, Disney Animation's *Frozen 2*, is set to debut Thanksgiving 2019, and will be a factor in both 2019 and 2020. Hasbro is supporting the film with a complete line of fashion and small dolls, playsets, castles, PLAY-DOH products and games.

In addition, Trolls will release all new theatrical entertainment in 2020.

Throughout 2018, the Hasbro team worked in real time to use our industry-leading capabilities as well as adding new capabilities to drive share recapture from the Toys“R”Us bankruptcy and liquidation. While in the short term we didn’t achieve all the share recapture we were driving for given the higher than anticipated impact of the Toys“R”Us stores’ liquidation, we did create share shifts and new channel opportunities that will benefit us in 2019 and beyond. Importantly, by lowering retail inventories and having tremendous new brand initiatives, we have laid the groundwork that will enable us to stabilize Europe, while making plans to return Hasbro to growth this year.

Our growth plan is multi-faceted and is based on our ability to grow our brands, deliver compelling new gaming experiences across all formats, create engaging entertainment, and expand our consumer products, while fueling our digital commerce with digital marketing leveraging a right-sized expense model. As a result, we are well positioned to grow Hasbro this year and beyond.

Next week at Toy Fair, Deb, John and our amazing teams will dive deeper into our plans and brand initiatives. We hope you will join us.

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

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

Following several years of growing Hasbro's revenues and earnings, our global teams faced significant challenges in 2018. According to NPD, the toy industry declined for the first time since 2009, decreasing 2% across the G11 markets for the year and 6% in the fourth quarter. The bankruptcy of Toys“R”Us was the most impactful event to our business. In addition, several other retailers around the world closed their doors and, as Brian spoke to, several implemented new approaches to managing inventory which decreased their late fourth quarter re-order levels versus historical patterns. In Europe, throughout the year, our teams diligently lowered retail inventory levels to reposition the business going forward. This European activity meaningfully impacted the revenue and profitability of our International segment and was nearly as impactful as Toys“R”Us to our overall business.

Our investments in brands, gaming and content drove growth in higher margin initiatives including MONOPOLY, MAGIC: THE GATHERING, DUNGEONS AND DRAGONS and ENTERTAINMENT AND LICENSING. We continue to invest to expand our portfolio across channels and categories.

We are taking steps to right size our expense base and align behind our highest priority initiatives.

As discussed earlier, and detailed in the reconciliations to the earnings release, we incurred certain charges in 2018 related to organizational changes, the Toys“R”Us bankruptcy, and asset impairments, which totaled $267 million. Excluding these charges operating profit margin was 13.1%. Lower revenues coupled with higher costs to clear inventory were the primary drivers of the decline. We reduced operating expenses but lost leverage. Most of the savings from our actions will be delivered in 2019 and beyond, and we will begin to drive increases in our operating profit margin.

Our cash generation is in line with our targets and we ended with $1.2 billion in cash. During the year, we returned $559.4 million to our shareholders, an increase of approximately $131 million versus the prior year, and the Board voted to increase the quarterly dividend 8% this year. Investing in the business remains our top capital priority. We made important investments last year in brand innovation and acquisition, digital gaming capabilities, organizational change and talent, storytelling and content capabilities, as well as in our supply chain all to drive long-term profitable growth.

Within our segments, the U.S. and Canada segment revenues declined 10% for the year, and 9% in the fourth quarter. The segment was negatively impacted by the loss of Toys“R”Us revenues, the impact of its liquidation on the U.S. market and by retailer efforts to more tightly manage inventory this holiday season. Our revenues across brand portfolio categories declined. Excluding Toys“R”Us, point of sale increased for the year and across all four brand portfolio categories, including Franchise Brands, Partner Brands, Hasbro Gaming and Emerging Brands. Between the loss of Toys“R”Us and the steps mass market retailers took to manage inventory during the holiday, retail inventories are down significantly at year end.

Operating profit in the U.S. and Canada segment declined 25% as reported. Adjusted segment operating profit, excluding the $46 million of Toys“R”Us-related charges, declined 16% and represented 17.6% of revenues versus 19.0% in 2017. Lower revenues drove the decline, along with a higher mix of close out sales in the year.

International segment revenues declined 17%, including an unfavorable $41.7 million impact of foreign exchange. On a constant currency basis, full-year revenues declined in Europe and Asia Pacific but were flat in Latin America. Emerging Brand revenues increased, but the remaining three Brand Portfolio categories declined.

Europe revenues declined 24% for the year, or $335.0 Million. $9.0 million of the decline was related to foreign exchange. Our efforts to clear retail inventory and the bankruptcy of several toy specialty retailers last year were the primary factors in the decline. Toys“R”Us was most impactful, but Ludendo in France and Top-Toy in the Nordics also closed. While we expect continued consumer and retailer challenges in Europe, our goal is to stabilize the business in 2019, positioning it to return to growth in future years.

In Latin America, revenues declined 6% including a negative $31.2 million impact of foreign exchange. Excluding the currency impact, the region was flat year-over-year led by revenue gains in Mexico. Point of sale increased for the region despite ongoing political and economic instability.

Asia Pacific revenues were down 5%, including a $1.6 million negative foreign exchange impact. Australia’s decline was most impactful to the region as it was hurt by the closing of Toys“R”Us as well as retailers inventory management. Revenue increased across the Asian countries, led by our new office in India. China was flat year-over-year despite a tough comparison with 2017’s *Transformers: The Last Knight* movie merchandise. After premiering last month, *Bumblebee* has earned over $167 million at the Chinese box office.

Within Europe and Latin America, macroeconomic factors and retailer health continue to impact our decisions around extending credit to certain retailers. While this has resulted in an improvement in our DSO, it also has impacted our revenues in the near term.

Operating profit in the International segment declined 79%, excluding $8 million of Toys“R”Us related charges. As was the case throughout 2018, lower revenues combined with higher costs to clear inventory drove the decline in operating profit. We have taken steps to lower our fixed cost base, notably in Europe, and to better align with our business priorities and the skill sets required to grow Hasbro in 2019 and beyond.

Entertainment and Licensing segment revenues increased 5% for the year due to changes in revenue recognition and a multi-year digital streaming agreement for Hasbro television programming. Our Consumer Products business was negatively impacted by difficult movie year comparisons, as both the *My Little Pony* movie and *Transformers: The Last Knight* were in theatres during 2017, as well as the loss of Toys“R”Us. The adoption of the new revenue recognition standard contributed to higher revenues in the segment on a full-year basis as revenue from multi-year agreements are now recognized ratably across the license term. As we had outlined throughout 2018, this new revenue recognition also resulted in less revenue recognized in the fourth quarter due to more being recognized earlier in the year.

The segment’s operating profit as reported was $17.3 million. The segment’s adjusted operating profit margin, excluding impairment charges, was 34.7% versus 33.8% in 2017.

During the fourth quarter, we performed our annual goodwill impairment tests, including for Backflip Studios. Mobile gaming is a dynamic market and the team modified its long-term plan to succeed in this space. This included organizational changes and the pacing of launch dates for games in development, as well as bringing in development partners for future releases. Our long-term plan also provides for investments in advertising and the right in-house capabilities to succeed. As a result of the changes to Backflip's long-term plan, we concluded the associated goodwill was impaired and we recorded a pre-tax non-cash impairment charge of $86.3 million in the fourth quarter.

Overall, Hasbro operating profit margin declined year-over-year. The team is very focused on managing costs and improving our margin in 2019 and beyond. As part of these efforts, we incurred $89.3 million in pre-tax severance costs last year and anticipate delivering $70 to $80 million of gross annualized savings by 2020. We plan to reinvest $10 to $15 million this year to bring on board relevant skill sets and talent.

Moving on to costs, on an as reported basis, cost of sales increased to 40.4% of revenues from 39.0% in 2017. The 140-basis point increase resulted from higher levels of close out sales, higher obsolescence reserves to end the year and lower gains on FX hedges. Growth in higher margin revenues, including MAGIC: THE GATHERING and the Entertainment and Licensing segment, partially offset this impact.

We invested in innovation, spending 5.4% of revenues on product development. We are looking forward to sharing with you many of these new initiatives at Toy Fair, but also in future years as our investments are focused several years out. The lower dollar amount in 2018 was driven by the capitalization of certain *Magic: The Gathering Arena* costs versus 2017 when they were expensed.

Program production amortization increased to 1.0% of revenues reflecting the delivery of a multi-year streaming deal for Hasbro television content and amortization of our investment in the MY LITTLE PONY movie.

As reported SD&A included $257 million of charges related to the items discussed earlier. Excluding these charges, SD&A decreased by an approximate $94 million in 2018. Stock compensation and bonus expense declined. This was partially offset by higher shipping and warehousing costs in the U.S. and higher bad debt provisions in Europe.

Turning to our results below operating profit:

Other income, net was $30.2 million versus $74.1 million last year. While many factors contributed to the change, the three primary drivers were as follows: In 2017 we realized a $19.9 million gain due to a change in the value of a long-term liability due to U.S. tax reform. In addition, we had $10.8 million of foreign currency losses in 2018 versus a $1.3 million gain in 2017. Also, due to accounting standard changes beginning in 2018, pension expense for our frozen plans is now recognized in this line and totaled $5.8 million.

Our underlying tax rate was 18.3% versus 19.9% last year. The impact from tax reform changes to the U.S. tax code was offset by a significant change in the mix of where the Company earned its profits, mainly the result of lower European revenues. Our effective tax rate for the year absent the impact of U.S tax reform and the Non-GAAP charges was 9.1% compared to 9.5% in 2017. This includes discrete items such as the benefit of tax planning, reassessment of historical tax reserves, accounting standard governing stock compensation and audit settlements.

Adjusted earnings per share, excluding $268 million of after-tax charges, was $3.85. On a reported basis, including the $2.11 of charges, net earnings were $1.74 per share.

Our year-end balance sheet remains strong. We generated $646.0 million in operating cash flow during the year and today we announced that the board declared an 8% quarterly dividend increase payable in May.

Receivables decreased 15% and were down 12% excluding the impact of foreign exchange. Days sales outstanding decreased 2 days to 78 days.

Hasbro-owned inventories increased 2% at year end and were up 7% excluding the impact of foreign exchange. Inventory levels declined internationally, led by Europe, but increased in the U.S. and in the new Hasbro-operated markets of India and Japan. The quality of our inventory is good, and we began 2019 with significantly lower retail inventory in several major markets, including the U.S. and Europe.

The global team managed through a very disruptive year, working closely with our retailers, engaging directly with our consumers and aligning around our growth plan. We have a solid financial foundation upon which we are operating and investing which affords us the ability to take actions for the long-term, while also pivoting our near-term behaviors to reflect a rapidly changing global market. Our teams have tremendous innovation and strategic plans for this and future years, and we look forward to sharing more of those with you on Friday, February 15 at our NY Toy Fair Investor Event.

We will now open the call up for questions.