Hasbro Second Quarter 2019
Financial Results Conference Call Management Remarks
July 23, 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. Good morning everyone and thank you for joining us today.

The Hasbro team executed another good quarter, including revenue growth of 9% and operating profit gains of 47%. Revenues were up around our Brand Blueprint and across multiple regions, including growth in the U.S., Europe and Asia Pacific. Our commitment to *Creating the World's Best Play Experiences* through innovation and storytelling for our consumers, fans and audiences drove revenue gains of 6% and adjusted operating profit growth of 73% for the first six months of the year.

Behind a rich release slate and continued strength in digital gaming, MAGIC: THE GATHERING delivered an outstanding quarter and first half of the year. The War of the Spark set was extremely well received by players across formats, driving robust quarterly growth in tabletop and digital. Player engagement expanded, with global increases in total unique players and new players. This in turn drove an incremental increase in *Magic: The Gathering Arena* games played, with approximately 400 million played in the quarter and 1.1 billion since the game entered open beta in September of last year.

In addition, the Modern Horizons set release during the second quarter exceeded expectations and contributed to higher tabletop revenues during the quarter. This release timing was earlier in 2019 versus last year when a similar release occurred in the fourth quarter.

Importantly, Magic's second quarter performance was driven by growing engagement and monetization of tabletop and Arena, and through special releases like Modern Horizons that are launched once per year, this year in the second quarter.

The team also delivered initial shipments of the Core set 2020, which launched on July 12th in store and on Arena, further contributing to the above plan second quarter.

We are also investing to ensure the long-term success of MAGIC: THE GATHERING and *Arena*, with higher year-over-year spend to drive awareness and engagement and in support of an expanded event schedule. The team hosted a successful Mythic Championship played on *Arena* in June featuring 68 of the top Magic players who competed for a share of the $750,000 prize pool. Later this year, we are running several additional Mythic Championships for *Arena* and tabletop.

We are also increasing our development investment in future digital games and expertise across multiple properties that will come to market over the next several years. This includes new games for Magic, and for DUNGEONS & DRAGONS, which also grew revenues this quarter.

At retail, second quarter consumer takeaway was up mid-single digits excluding Toys"R"Us. This in part reflected the shift of Easter into the second quarter, but we are also seeing overall positive point of sale trends. In the U.S., point of sale was up double digits in the second quarter and up slightly through the first half. Global point of sale for the first half of the year declined mid-single digits, primarily due to Europe. In Europe, POS has picked up in recent weeks fueled by continued improvement in the underlying business, new initiatives such as NERF FORTNITE and growth in Marvel and MONOPOLY.

The U.S. team navigated a dynamic trade and inventory environment during the quarter. While no new material tariffs have been enacted on our products, we did incur incremental expenses to prepare for the potentiality of tariffs in the U.S. The team did an exhaustive amount of work and is extremely well prepared for what would be a very challenging and damaging impact if tariffs were implemented. Deb will speak in more detail about the implications.

Importantly, following a challenging 2018 we are recapturing share across a broad range of retailers. E-commerce has accelerated substantially, with both omni-channel and pureplay retailers driving revenue and point of sale growth significantly above the rest of the business. Last week, Hasbro brands delivered strong growth during Amazon's Prime Day event. In Amazon markets around the world, Games, PLAY-DOH and NERF were among the standout drivers.

We are leveraging online and digital to engage directly with consumers – launching two new HasLab projects this month through Hasbro Pulse and delivering innovative new shopping and social media experiences across geographies. This past weekend at San Diego Comic Con, we had a major show presence that we also shared with fans through social media “live” from the show floor with interviews, behind-the-scenes information, news around upcoming product and pre-order launches. Fans could purchase limited-edition products on-site as well as through Hasbro Pulse and select retailers. Hasbro’s investments in brand-driven storytelling uniquely positions us to monetize Content to Commerce experiences across online platforms.

In addition to ecomm growth, new retailers for Hasbro entered the category, or expanded their offering, over the past year and are supporting toys and games throughout the year. During the second quarter, new channels, including value, drug and grocery, as well as fan retailers, delivered higher revenues for Hasbro brands.

Our overall retail inventory declined in the quarter, as our mix of retailers and consumer purchasing behaviors shifts to channels which carry less weeks of inventory. Omnichannel retailers are moving toward online ecomm best practices for their physical store businesses. Profitability and carrying lower inventories remains a top priority for our global retailers, and we anticipate this will be an increasingly important factor in their purchasing decisions.

In Europe, our turnaround is well under way and we delivered growth in both revenue and profit in the quarter. Retail inventory is significantly improved and declined further. Despite ongoing economic uncertainty in the region, the team is successfully executing its plan and Europe revenues and profits are up over the first half of the year. With much of the year ahead of us, we continue to expect to stabilize revenues and improve profit for the full-year 2019.

Over the first half of the year, global revenues increased for several Franchise Brands including PLAY-DOH, MONOPOLY and TRANSFORMERS. We also launched POWER RANGERS in North America, with international markets to rollout through this year. Point of sale is up on these brands, as well as for BABY ALIVE. NERF POS turned positive in the second quarter with the success of NERF FORTNITE which is now rolling out internationally, and we have new NERF products hitting the market throughout the second half and in some geographies next year.

Within our Partner Brand portfolio, Hasbro toys and games for Marvel's *Avengers: End Game* and *Spider-Man* franchises, along with innovation in Hasbro's preschool line of *Marvel Super Hero Adventures* and new Mega Mighties 10-inch figures, delivered revenue growth in the quarter. As we look to the fourth quarter, retailers have strong plans for the October 4th launch of Hasbro product for both *Frozen 2* and *Star Wars: The Rise of Skywalker.*

Our team is ready for the most important quarters of the year. We are driving revenues around amazing innovation and storytelling, and - as this management team has done in the past - we are investing for future profitable growth. Following a strong first half, our view of the year has not changed, and we believe we are well positioned to deliver profitable growth for the full-year 2019.

I’d like to now turn the call over to Deb.

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

Our second quarter results reflect the outstanding execution of our entire global team, producing strong quarterly revenue and profit gains in a very dynamic environment. Revenue growth came from several brands but was led by MAGIC: THE GATHERING. Given a robust release schedule which was more heavily weighted to the first half of this year versus last, and the positive momentum in the brand, we forecasted a strong first half for Magic, and it came in ahead of our expectations.

Magic's revenue growth was further supported by growth in other Franchise Brands: MONOPOLY and PLAY-DOH; the launch of POWER RANGERS and also Hasbro products from the Marvel brand, notably in support of *Avengers: End Game* and *Spider-Man: Far From Home*. The quarter's higher revenues and favorable mix contributed to a 250-basis point increase in gross margin. Combined with our cost savings activities and ongoing cost management, we delivered a 330-basis point increase in operating profit margin to 13.0%.

During the quarter, we successfully settled our U.S. pension plan liability and recorded a pre-tax charge of $110.8 million within the other expense line. Due primarily to the performance of our investments prior to the settlement of this liability, this charge was less than the $140 to $150 million estimate we provided at Toy Fair. The $0.11 per share we reported for the second quarter included a $0.68 per share charge for the pension settlement. Excluding the charge, adjusted EPS was $0.78 per share.

After generating $741.5 million in operating cash flow over the trailing twelve-month period, we ended the quarter with $1.2 billion in cash. Our inventory is in a good position, both in the quality and level of inventory, declining $45.5 million year-over-year.

Within our segments, revenues in the U.S. and Canada segment increased 14%. Franchise Brand revenues increased, led by MAGIC: THE GATHERING, along with PLAY-DOH, TRANSFORMERS and MONOPOLY. Partner Brands, behind Marvel growth, and Emerging Brands, including the POWER RANGERS launch, increased revenues, while Hasbro Gaming declined. Retail inventory at quarter end was down slightly and of good quality. As Brian spoke to, retailers are focused on running their business with less inventory than they have had in the past and we expect this will continue to influence retailers' buying decisions this holiday season.

Operating profit for the segment increased 46% to $106.6 million. The increase was driven by revenue growth, led by MAGIC: THE GATHERING, and was only partially offset by higher intangible asset amortization expense associated with POWER RANGERS and higher warehousing expense. Warehousing expense included bringing more product into the country than planned to position ourselves ahead of potential tariffs. As a result, our U.S. on hand inventory also increased.

As Brian mentioned, the team did a tremendous job this quarter assessing and acting on the potential implementation of tariffs. It is an extremely complex issue with far reaching implications within the business. While no tariffs on our products have been enacted in the U.S. at this point, I would like to review how this could impact the business, namely on the price of product, inventory, our tax rate, the cadence of revenues and manufacturing footprint.

A tariff increases the price to bring our product into the country. This would be born by the importer, which is primarily Hasbro. We would pass this increase on to the customer through higher prices on the tariffed items. We notified our retailers of this plan during the quarter. Given the status of tariff implementation, no price changes were enacted.

Retailers have the option to take ownership of inventory in the U.S. or directly from our contract manufacturing locations, known as Direct Import. In 2018, 35% of our U.S. and Canada revenues were delivered through Direct Import. Tariffs would essentially eliminate this program for items being produced in China. In fact, in the second quarter some retailers briefly paused direct import orders, and all are watching it closely. As a result, we expect to see direct import orders decline as a percent of the total this year. While we can build other programs over time, in the near-term Hasbro would be the primary importer. This increases shipping and warehousing costs and would impact the mix of income and expenses, and ultimately our tax rate.

This would also mean product ownership is passed to the retailer later, impacting the cadence of revenues between quarters. For example, in the fourth quarter, retailers place some direct import orders for first quarter on shelf dates. Instead they would take this product in the U.S. during the first quarter itself. While this would level out over time, it would have an impact in the initial period on fourth quarter shipments.

Finally, as we've discussed in the past, as part of our risk management program, we have been diversifying our manufacturing footprint for several years. During the quarter, we increased our resources invested in this program to accelerate our plans further and as a result have taken on more costs. China will continue to be an important part of our global supply network. Last year, 67% of the product we sold in the U.S. came from China and we believe we can get to approximately 50% by year end 2020. We also source 20% of products sold in the U.S. from U.S. manufacturers.

We have done the work and are prepared to address tariffs if they happen but continue to believe they would be very disruptive to our business and consumers in the near term.

Moving to the International segment, revenues declined 1%, including a negative $20.1 million impact from foreign exchange. Excluding FX, revenues increased 5% in the segment, behind growth in Europe and Asia Pacific. Latin America declined 1% excluding FX. Led by Europe, retail and on-hand inventories in the segment continued to decline.

Revenues grew in Franchise Brands, led by MAGIC: THE GATHERING, and Emerging Brands behind POWER RANGERS. Partner Brand revenues were flat but increased absent FX in the quarter with growth in Marvel. Hasbro Gaming revenues were down.

The International segment increased operating profit to $14.6 million. The profit improvement resulted from favorable mix, driven by growth in MAGIC: THE GATHERING, and our continued focus on cost management.

Entertainment, Licensing and Digital segment revenues grew 28% to $96.5 million. Digital gaming, primarily *Magic: The Gathering Arena,* and to a lesser extent, consumer product licensing drove the revenue growth.

Operating profit in the segment declined to $7.9 million due to higher program production expense and increased investments in digital gaming marketing and future game development. As we have discussed, we continue investing in future gaming initiatives to drive long-term profitable revenue growth, particularly in our MAGIC: THE GATHERING and DUNGEONS & DRAGONS brands. We anticipate full-year program production amortization to be in the range of 1.0 to 1.5% of total company revenues, down from the first half rate of 1.8%.

Looking at the balance of the year for the segment, I'd remind you we signed a multi-year digital streaming agreement for Hasbro television programming during the third quarter of 2018. Also, Arena entered open beta in September 2018, and we recorded our first meaningful revenues for the game in the fourth quarter of last year.

Overall, Hasbro operating profit improved to $128.3 million, or 13.0% of revenues. Higher revenues and the improved gross margin I spoke to earlier contributed to this improvement, along with the favorable impact of our cost savings activities and a continued focus on cost management. This improvement was partially offset by factors I have already discussed, most notably investments in digital gaming, higher program production expense and higher intangible asset amortization.

Turning to our results below operating profit:

Other expense of $100.2 million includes the $110.8 million pre-tax charge for settling our U.S. pension plan liability. Excluding this charge, other income was $10.6 million and increased primarily due to foreign currency transaction gains this year versus loss last year.

Our underlying tax rate for the quarter was 18.3% versus 17.4% last year. 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 response to potential tariffs.

Our financial strength is evident in our strong balance sheet and cash flow, including quarter end cash position of $1.2 billion, lower inventories and DSOs flat to last year at 74 days.

Brian and I have spoken today about the timing of revenues and expenses as we enter our largest revenue and profit quarters of the year. We recognize that our retailers are focused on increasing profit and carrying lower inventory levels, while driving their point of sale. We know and have communicated that we are investing and managing incremental expenses – both planned and unplanned as discussed – that we will be absorbing. This also includes higher planned incentive compensation given our outlook for this year versus a year ago. That being said, we continue to expect to return to profitable growth in 2019. Our teams have executed an excellent start to the year, and we are excited to deliver on the many amazing brand and entertainment initiatives coming this holiday season while continuing to invest for future growth.

We will now open the call for questions.