Third Quarter 2023
Financial Results Conference Call Management Remarks
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Debbie Hancock, Senior Vice President, Investor Relations

Thank you and good morning, everyone.

Joining me today are Chris Cocks, Hasbro's chief executive officer, and Gina Goetter, Hasbro's chief financial officer. Today, we will begin with Chris and Gina 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.

Today's guidance assumes we retain the non-core entertainment film and TV business, notwithstanding our recently announced agreement with Lionsgate to sell this business. That transaction is subject to customary closing conditions.

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 Chris Cocks.

Chris Cocks, Hasbro CEO

Thanks Debbie and good morning.

A year ago, we outlined a strategy to grow share in key categories with our core toy and game franchises. We called it "Fewer, Bigger, Better": drive savings and investment capacity through operational excellence and build new growth for the Company across games, direct to consumer and licensing. We also announced our intention to refocus on what has traditionally made us great, the business of play. This required making tough choices including some significant divestitures. The goal of this plan, Blueprint 2.0, was a more focused, profitable and higher growth Hasbro built on a portfolio of some of the most valuable brands in the toy and games industry.

We've made progress against this framework, including impressive growth in Wizards and Digital, continued momentum in direct to consumer and share gains in key categories, but as our Q3 results show, particularly in our Consumer Products segment, more needs to be done. This morning we will talk about progress on each pillar and add a special emphasis on a key part of our plan, returning Consumer Products (CP) to growth.

Let's start with **Refocusing on Play.**

Play is what makes our brands great and our Company healthy. The sale of eOne Film and TV, which continues to be on track for an end of year close, will simplify our operating model and refocus Hasbro on our core mission. Moving forward, our entertainment efforts will be franchise-led and asset-lite focused on driving toy and game sales with support from world class content partners. We have over 30 projects in development from blockbuster movies like the upcoming *Transformers One* with Paramount to an animated MAGIC series with Netflix to digital-first IP development like our new YouTube series, *Oddpaws*. The margin and simplification benefits of refocusing on play will grow over time as our teams build innovative, next generation toys and games reinforced by cost-effective and partner-led content.

Next, operational excellence, where we are making solid progress but need to accelerate flow through.

Our cost savings initiatives have already exceeded our 2023 savings target of $150 million. This year we anticipate total gross savings of approximately $200 million, dollars we are using to fund short-term inventory reductions and product promotions in a toy market facing headwinds and to invest long-term in new consumer insight capabilities and our growth initiatives.

Importantly, our Supply Chain team is reinventing itself. In a time where inflation is up over 4%, our logistics and production costs are down mid-single digits. Supply Chain alone is driving approximately $100 million of the full year's expected savings, and we see more opportunities ahead to enhance our gross margins while improving the quality and competitiveness of our toys and games. For instance, we will be releasing a new version of JENGA. It will be of comparable quality, but lower cost and higher margin, all based on a fresh design for cost model. We are replicating this up and down our line.

Our revamped Supply Chain is helping us get smarter on inventory management. Through Q3, Hasbro's total inventory is down 27% year-over-year, with a 34% reduction in our CP business. We anticipate we will end the year with inventories 20-25% below 2022 levels. This should enable us to improve cash flow and lower our allowances in the quarters to come.

Given the headwinds facing our Consumer Products segment, the flow through to the bottom line on these initiatives has not materialized as quickly as anticipated so we plan to accelerate our efforts heading into 2024. We expect to achieve our 2025 goal of $250-$300 million in gross cost savings earlier than expected and will use these incremental savings and healthier inventory position to flow more cash directly to the bottom line, particularly in CP.

Next, our growth initiatives which are broadly on track.

Wizards of the Coast and Digital Gaming is up 11% year to date. MAGIC: THE GATHERING is delighting tens of millions of fans with new concepts like *Universes Beyond* which combine MAGIC with fan-favorite IP like *Lord of the Rings* and *Dr. Who*. *Universes Beyond* is a long term, multi-property strategy that is already delivering collector excitement and new player growth. Last week we announced a new collaboration with the beloved video game series *Fallout* and saw preorders climb to #1 in the Toy and Games charts over the weekend on Amazon. And on Monday we expanded our partnership with The Walt Disney Company with the announcement of a multi-set MAGIC and Marvel collaboration. Expect more exciting news and previews in the quarters to come.

D&D is expanding into a digitally driven multimedia franchise*. Baldur's Gate III*, the new videogame from Larian Studios based on D&D's 5th Edition, is one of the best-selling games of 2023 and one of the highest rated videogames of all time with metacritic reviews equivalent to mega franchises like *Grand Theft Auto* and *The Legend of Zelda*.

Our success in digital isn't just contained to the world of core gaming. *Monopoly Go!* from our partners at Scopely is the number one mobile game launch of 2023. Combined, Hasbro expects to generate in excess of $90 million in licensed revenue from these two properties this year with a multi-year long tail anticipated. These were long term, thoughtful partnerships. Each game was signed pre 2018 and we have several more of these kinds of projects in the pipeline, including new games from our own internal studios which we will be sharing more about in the coming months.

Our direct-to-consumer business is up 57% year-to-date. Hasbro Pulse, is a modest sized platform today but is scaling rapidly giving us new avenues to delight fans and learn from our consumers. We are excited to continue to grow our direct initiatives behind brands like Star Wars, Marvel, TRANSFORMERS, MAGIC, GI JOE, D&D and POWER RANGERS – one of the best line ups of IP in the collectibles space.

And we continue to scale our industry-leading licensing business across an array of brands and categories from PEPPA PIG to TRANSFORMERS; education to location-based entertainment.

Next, growing share in key categories.

In Q3, we grew share in 4 of 5 of our key categories: Preschool, Action, Blasters, and Arts & Crafts. Driving this, we have several brands that are performing well. In Gaming, MAGIC and D&D are having record years. MONOPOLY is back to growth, recently reclaiming the title of the top selling board game brand. New innovation like TWISTER AIR is driving genre expansion in board games. TRANSFORMERS POS is up over 30% YoY and PLAY-DOH is showing solid gains. GI JOE continues to be a fan favorite and growth driver for our Pulse business. And FURBY is off to a strong start – one of the hottest new toy introductions of the holiday. But we have challenges in other brands that weigh on our results, particularly in our Consumer Products business.

Let's now turn to how we will return this key segment back to growth.

We went into 2023 expecting a Toy category down low-single digits for the year. We expected Hasbro performance to be broadly in line with market minus our exited licenses and businesses. Year-to-date, our POS is roughly in line with category, however, market performance has been more challenging than planned. Our internal POS system shows total point of sale down -8% through Q3, roughly equivalent to our view of the total Toy market, or -4% when accounting for exited licenses. We saw the category soften during Q3 to -10%, again roughly equivalent to our view of the market, or -5% when accounting for discontinued licenses.

Our share is up in our core categories. Our work on operational efficiency means our performance versus market is the best it's been in several years. But we are facing headwinds. In any market scenario, we think this holiday will be late breaking and heavily deal reliant, so we are taking the necessary steps to position our portfolio for continued share growth, exiting the year with momentum for our brands and assuring our inventory health is back to historical norms. Our guidance is based on a cautious outlook, but we are prepared to take advantage of any opportunities presented.

We are investing in Q4 to drive continued share momentum, including maintaining our advertising and promotion budgets at competitive levels and working with retail partners to excite consumers with compelling deals. We are accelerating our cost savings initiatives to reduce overheard and see nearer term flow through in operating margins. And we continue to invest in product innovation behind a new leadership team in Toy that will expand us into new play patterns, price points and market opportunities in the months ahead.

Our long-term capital priorities guide our decision making for these nearer term decisions: invest to grow the business, pay down our debt, maintain a healthy balance sheet and return cash to shareholders via our category leading dividend. Consistent with these priorities, we are investing to ensure our Toy business exits the year with healthy inventories, continued share momentum and a clear runway for new product introductions in 2024.

Wrapping up, our results in Q3 show we are making progress across many of our key initiatives but that we also have more to do, particularly in returning Consumer Products to growth. Hasbro's strength is the diversity of our brands across both Toy and Game. Our Wizards and Digital business continues to demonstrate impressive growth with smart bets coming to fruition this year and lots to be excited about in the years to come. We are likewise investing in Toy to strengthen this business for the long term. A healthy toy business is a healthy Hasbro.

I'd now like to turn over the call to Gina Goetter, our Chief Financial Officer, to share more about our detailed results and an update on guidance.

Gina Goetter, Hasbro CFO

Thanks Chris and good morning, everyone.

The Hasbro team continues to make progress in transforming our Company – building a world-class gaming business, streamlining, and improving the profitability of our consumer products and strengthening our balance sheet.

Our third quarter results demonstrate the growth potential across our diversified gaming portfolio offset by the tough macro environment across Toys and Entertainment. Despite market headwinds, we are growing share in the categories where we compete and are beginning to see the benefits of our cost savings initiatives play through the P&L.

Total Hasbro revenue of $1.5 billion was down 10% versus last year. Wizards of the Coast and Digital Gaming revenue increased 40% behind strong contributions from *Baldur's Gate III*, *Monopoly Go!* and MAGIC: THE GATHERING. Consumer Products declined 18% due to macro category trends and planned business exits; excluding these exits the segment finished down 12%. The Entertainment Segment declined 42% due to the writer & actor strike impact.

Adjusted operating profit of $343 million increased 27% versus last year. The increase was the result of favorable product mix, most notably high-margin digital game revenues, as well as lower royalty & operating expenses.

Adjusted earnings per share of $1.64 increased 15% versus last year reflecting the higher operating profit partially offset by incremental interest expense and an unfavorable tax rate impact.

The adjusted results exclude $512 million of cumulative pre-tax impact associated with the loss on assets held for sale and to a lesser extent, one-time charges for the Operational Excellence program.

Looking at our brand performance, our Franchise Brands grew 8% in the quarter and were flat year-to-date. These brands represent our biggest and most profitable brands and are just over 60% of our revenue.

Within Franchise Brands we delivered significant Q3 revenue growth across gaming including DUNGEONS & DRAGONS, HASBRO GAMING and MAGIC.

Partner brands declined year-over-year after strong performance from Marvel and Star Wars in 2022. Partnerships like we have with The Walt Disney Company remain a key priority for us and we expect results to improve in the quarters ahead as we expand our partner brand lines and categories, like our just announced collaboration with Marvel and MAGIC.

Turning to operating margin, third quarter adjusted operating margin of 22.8% was 6.7 margin points higher than last year.

The profit impact from the volume decline in Consumer Products was offset by favorable mix growth in licensed digital gaming and MAGIC. Supply chain cost savings outpaced inflation and delivered 1.9 points of margin growth. Operating expenses also contributed 1.4 points behind labor and lower royalty expense for exited licenses. Lower advertising spend contributed 1.7 margin points of improvement as we align spend to current demand. That said, we will continue to invest in advertising and marketing to drive sales this holiday season. Finally, lower entertainment deliveries resulted in a decline in program amortization expense that contributed 1.5 points of margin.

Our transformation activities are delivering real savings in our P&L. Having begun these programs last year, we have a strong start on resetting the cost base for the Company and the savings are helping us navigate a softer toy market. Year-to-date we have accumulated $62 million of gross cost savings within supply chain and an additional $92 million of gross savings within operating expense. The combined $154 million of gross cost savings this year are more than offsetting supply chain cost inflation and allowing us to reinvest in the business, and partially defray the higher cost to move through inventory. Cumulatively, since we began the savings program last year, we have reduced our cost base and delivered gross savings of $174 million. This progress puts us on track to meet our long-term gross savings goals earlier than expected and we will be doubling down as we continue to focus on streamlining our operations and improving the profitability within Toys.

We continue to make progress in lowering inventory levels. We reduced total owned inventory 27% versus prior year, primarily driven by a 34% reduction in the Consumer Products segment inventory. From a retail inventory perspective, their inventory was down 18% year-over-year, but up sequentially versus last quarter as they set for the holiday season. As we look to the balance of the year, we remain focused on ensuring we have a clean start to 2024 both in owned and retail inventory levels and will continue remaining agile and taking actions to stay in sync with broader category momentum.

Looking more closely at segment performance within the quarter, Wizards segment revenue increased 40 percent versus last year. 23 points of the growth was led by licensed digital gaming revenue from *BG3* and to a lesser extent, *Monopoly Go!* The revenue for *Baldur's Gate* is realized along with unit sales, whereas in the near-term *Monopoly Go!* has a straight-line revenue recognition based on the total multi-year contract minimum guarantee. Tabletop revenue, which includes both MAGIC and D&D, added 14 points of growth driven by timing releases including an incremental MAGIC release in this quarter versus last year.

The growth in high margin licensed digital gaming drove a 99% increase in total segment operating profit versus last year and expanded operating profit margin by 14.3 percentage points.

Turning to the Consumer Products segment, the overall Toy category was down 8% in the quarter, according to Circana, versus 6% through the first part of the year. Despite the category headwinds, we gained share in four of our five key categories, including Action Figures, Arts & Crafts, Preschool and Blasters.

Overall Consumer Product segment revenue was down 18% versus last year. Looking at the key drivers for the quarter, 6 points of the revenue decline was driven by planned license exits. Another 12 points of decline was driven by Toy and Game volume given the broad category trends. 2 points of decline came from pricing & mix driven by additional close-out costs as we worked through higher inventory levels. FX had a favorable 2-point impact on the segment.

The segment adjusted operating margin declined 1.4 margin points primarily driven by unfavorable mix and higher inventory obsolescence and close-out costs.

Turning to the Entertainment Segment, in the quarter, revenue declined 42% primarily as a result of the writers' and actors' strikes. Partially offsetting this was 53% revenue growth in Family Brands driven by content sales primarily for PEPPA PIG and POWER RANGERS.

Adjusted operating profit increased 37% and margin expanded 3.8 margin points to 6.6% due to the exited businesses, lower program amortization, and operating expenses.

The eOne Film and TV asset to be sold has delivered approximately $400 million of revenue year-to-date, which is down approximately 20% versus last year. Full-year earnings are expected to be break even to a modest loss. We've received the expected regulatory approvals for the sale of eOne Film and TV and remain on track to close the deal by the end of the year.

Wrapping up with Hasbro, Inc., we delivered $335 million of operating cash year-to-date, which is $73 million ahead of last year driven by working capital improvements led by the reduction in inventory, combined with lower production costs within the Entertainment Segment. Our cash and cash equivalents of $186 million does not include approximately $70 million of cash recorded in assets held for sale – the substantial majority of which we expect to stay with Hasbro upon the close of the transaction. Including this, it brings our cash on hand to approximately $250 million, up from $217 million in Q2 2023.

Through Q3, we repaid $107 million of long-term debt and spent $160 million on capital expenditures led by investments in Wizards of the Coast for future digital gaming releases. And we've returned $291 million of capital to our shareholders via dividends.

In the quarter we booked a 23.2% adjusted underlying tax rate, which compares to 19.9% last year. The higher rate continues to be the result of our Film and TV losses and a shift in the geographical mix of income.

Turning to our 2023 guidance, the impact of the broader Toy category declines has had a change on our Consumer Products and total Hasbro outlook. Based on this we now expect:

- **Total Hasbro Inc revenue to be down 13 - 15%.** As we look at the three primary Segments, this guidance now assumes that the Consumer Products business will be down mid- to high-teens. Based on the category trend in Q3, we are planning for modest improvement in Q4 as we begin to lap the market declines from last year. We believe that Retailers will remain cautious with their inventory positions, which will have an impact on typical holiday order patterns. We continue to expect that Wizards of the Coast will deliver high-single digit revenue growth behind the strong performance within Digital games and solid performance on MAGIC. The majority of the revenue from *BG3* was realized in Q3; we expect a modest positive contribution to revenue from the game in Q4 as it will continue to be recorded in line with unit sales. *Monopoly Go!* Q4 revenue will be consistent with Q3 given the accounting methodology. As Chris said, in total we expect the aggregate contribution from these two licensed games to be more than $90 million for the full year. And finally, for Entertainment we continue to expect revenue declines of 25% to 30% which incorporates the impact of the writers' and actors' strikes on production deliveries in the back half of the year. Minus these assets held for sale, we expect total Company revenue declines of 8 - 11% for the year.

- **Adjusted Operating Margin is now expected to be between 13 and 13.5 percent.** This guidance reflects the impact of the CP revenue call-down and includes additional one-time costs to clear aged inventory on Hasbro's balance sheet, continue share momentum and reset the foundation heading into next year. This margin guidance includes a step-up in the in-year gross cost savings from our transformation efforts to $200 million and as we look to 2024, we expect to continue accelerating our savings efforts to improve the profitability across Toys and Games.

- Given the revenue call-down we now expect 2023 adjusted EBITDA of $900-$950 million. And, based on this current forecast we expect to generate $500-$600 million of operating cash flow.

- From a capital allocation standpoint, our priorities are to invest behind the business, pay down debt and return excess cash to shareholders via dividends. We remain committed to our dividend strategy and advancing our progress towards achieving an overall 2 to 2.5x long-term leverage target.

As I said earlier, we are making good progress on our transformation and the work we've done to date has us positioned to build on our gaming leadership and strengthen our toy business. We believe the Toy market will stabilize and return to growth; our near-term focus is on executing the holiday season, resetting the cost base, removing complexity, and sharpening the innovation pipeline for 2024 and 2025.

Chris and I will now take your questions.