Hasbro Third Quarter 2014
Financial Results Conference Call Management Remarks
October 20, 2014

Debbie Hancock, Hasbro, Vice President, Investor Relations:

Thank you and good morning everyone.

Joining me this morning are Brian Goldner, Hasbro's President 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 quarterly performance and then we will take your questions.

Our third quarter earnings release was issued this morning and is available on our website. Additionally, presentation slides containing information covered in today's earnings release and call are also available on our site. The press release and presentation include information regarding Non-GAAP financial measures. 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. These forward-looking statements may include comments concerning our product and entertainment plans, anticipated product performance, business opportunities, plans and strategies, costs and cost savings initiative, financial goals and expectations for our future financial performance.

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. You should review such factors together with any forward looking statements made on today’s call.

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 President and CEO:

Thank you, Debbie. Good morning everyone and thank you for joining us today.

In the third quarter, we continued to execute our brand blueprint globally driving momentum in our Franchise Brands and key partner brands. We delivered growth in all regions, including the emerging markets where our investments are fueling continued double-digit growth and profitability gains. We took strategic steps to position us for long-term growth, including the addition of Disney Princess and Frozen to our Girls portfolio beginning in 2016. Finally, we continued to evolve and improve our content-led branded play strategy, and I will speak to this effort shortly.

Third quarter revenues increased 7%. We grew across all major operating segments of Hasbro, including a return to growth in the U.S. and Canada segment, and continued growth in the International and our Entertainment and Licensing segments.

Profitability increased – as adjusted operating profit in the quarter increased 9% and our operating profit margin was 19.4% of revenues.

Our focus on Hasbro Franchise Brands and key partner brands fueled these results. Franchise Brand revenues increased 36% in the third quarter. All seven Franchise Brands grew double-digits in the quarter. Additionally, point of sale at our top 5 U.S. retailers for Hasbro

Franchise Brands was up more than 30% in the quarter and year-to-date.

Let's highlight a few of these brands:

NERF continues to be the brand of choice. According to NPD, if we combined NERF and NERF REBELLE, it would be the second largest property in the U.S. year-to-date through August. NERF revenues grew in the Boys and Girls categories globally, including in both the U.S. and Canada and International segments, and point of sale was strong, growing double-digits in several markets.

MAGIC: THE GATHERING also grew globally, increasing in both the U.S. and Canada segment and International segment. The response to the July release of the Magic 2015 Core Set and September release of Khans of Tarkir positions the brand well into 2015. We believe there is tremendous future potential for MAGIC: THE GATHERING as it continues to grow around the world. We are investing in the brand, both in digital and analog play, through technology and storytelling.

Transformers: Age of Extinction delivered over 1 billion dollars at the global box office. This result, coupled with an innovative new line, drove strong year-over-year revenue gains in TRANSFORMERS. Through the first nine months of the year, TRANSFORMERS revenues are greater in international markets than in the U.S. and Canada segment, reflecting the mix of box office results and the global expansion of Hasbro. Overall, the brand is performing in line with the last movie year and we are well into development for the next installments of TRANSFORMERS content. This includes new television programming, as well as collaborating with the film makers on our next ideas to re-invent and re-imagine the TRANSFORMERS brand in movies.

Moving to Girls, the re-imagination of LITTLEST PET SHOP is at retail now. While still early on, initial consumer reaction and takeaway is encouraging.

MY LITTLE PONY revenues continued to grow, in toy and licensed merchandise, for both core MY LITTLE PONY and MY LITTLE PONY EQUESTRIA GIRLS. The second film, *MY LITTLE PONY EQUESTRIA GIRLS RAINBOW ROCKS,* launched in the U.S. on September 27th. The first box office weekend exceeded last year's box office by 37% and on a per theatre basis, ticket sales in the first three weeks grew an average of 19% in North America. The film will be distributed globally on networks around the world and in support of our all-screen strategy.

Our key partner brands contributed to revenue growth this past quarter, driven by our relationship with The Walt Disney Company.

Revenues continued to grow in Marvel properties this past quarter. Supported by both film and animation, products based on The

Avengers and Spider-Man Franchises grew revenues in the quarter. Additionally, *Marvel's Guardians of the Galaxy* contributed to the quarter's year-over-year results.

Building on our relationship with The Walt Disney Company for Marvel and Star Wars, during the third quarter we established a new strategic merchandising relationship with Disney Consumer Products for the globally popular Disney Princess and Frozen properties. Through this new agreement, Hasbro will develop small and fashion dolls based on Disney Princess stories and characters as well as Frozen. Hasbro's line will be at retailers beginning in 2016.

Our design, development and marketing teams are truly excited to bring their expertise in girls and consumer-driven innovation to the future of Disney Princess and Frozen.

This new relationship is a terrific complement to the prolific boys' entertainment slate over the next several years, including film and television entertainment from Marvel and Lucasfilm, as well as the next theatrical installments of Hasbro's brands, G.I. JOE and TRANSFORMERS.

As I mentioned to start, we continue to evolve and improve our content-led branded play strategy.

To accelerate the progress and success of our joint venture television network, Discovery took a majority ownership position in the network during the third quarter, increasing its stake to 60%. On October 13th, Discovery Family debuted. Through our five-year partnership, The Hub Network has enjoyed solid ratings gains, subscriber and advertiser growth and is now profitable.

Discovery Family builds on the network's leadership in co-viewing, where kids and families watch together, and on the strengths of both Hasbro and Discovery, to enhance the value of the network for the audience and for our shareholders.

Furthering our all-screen content strategy, we are building our storytelling and omni-screen capabilities globally – reaching kids and families everywhere they are consuming content. Hasbro will continue to develop new programming in addition to our already rich programming library for Discovery Family and for networks and screens globally as we continue to build brands through storytelling.

In the first quarter 2015, we are launching the next installment of TRANSFORMERS television programming, *Transformers: Robots in Disguise*. The all new show will debut on Cartoon Network in the U.S., the top-rated primetime network for boys' ages 6-11 and 9-14.

Hasbro has developed tremendous expertise in producing animation. We are working with the world's best studios and we know how to produce top quality animation cost effectively. As our content strategy and all-screen strategy evolve, we are building upon our experience in animation and storytelling. In addition to television, there are select films where we are taking greater control of the process. We have two movies we are currently developing under our new film label, Allspark Pictures. These films are MY LITTLE PONY and JEM AND THE HOLOGRAMS.

Building on the global success of MY LITTLE PONY, we recently announced we are developing a MY LITTLE PONY animated feature. We've hired a great writer with strong credentials in animated film.

In addition, we are producing a JEM AND THE HOLOGRAMS live action feature directed by John Chu. The JEM AND THE HOLOGRAMS story was re-imagined from a Hasbro vault brand and inspired by the social-media driven lives of girls today. The film is scheduled for release on October 23, 2015, and will be distributed by Universal worldwide, with whom we co-financed the film.

We envision Allspark Pictures as a new way to make fresh and compelling movies, based on new and existing Hasbro brands, for audiences globally.

Given Halloween is upon us, on October 24 and in partnership with Universal, OUJIA will be out in theatres. This is an all-new spooky story that is true to the OUIJA brand and rated PG-13.

In closing, we’ve entered the holiday season well positioned, driving our brands through innovation and consumer-insights, supported by engaging marketing programs and strong retail execution around the world.

Now, I’d like to turn the call over to Deb.

Deb Thomas, Hasbro CFO

Thank you Brian and good morning everyone.

As Brian said, we had a good third quarter as we grew revenues in all regions and across our Franchise Brands. Hasbro's operating profit and operating profit margin increased. We've continued to invest in our business for long-term growth, adding a key new license beginning in 2016, while remaining focused on improving profitability and returning cash to our shareholders through our stock buyback program and dividend.

Before I review the quarter, I want to remind you of several items that impacted both this year's and last year's third quarters.

In the third quarter of this year we restructured our investment in the Hub Network joint venture – reducing our ownership to 40% of the network. In connection with this restructuring, we recorded a pre-tax charge of $11.6 million, or $0.06 per diluted share, in the third quarter 2014. This net charge is primarily related to the costs associated with recording the fair value of a put/call option exercisable at the end of 2021 that Hasbro and Discovery entered into related to this transaction.

In last year's third quarter, there were a number of factors impacting our reported earnings. These included a pre-tax charge of $75.5

million, or $0.50 cents per diluted share, related to an adverse arbitration award; a pre-tax charge of $4.1 million, or $0.03 per diluted share, associated with restructuring and partial pension settlement charges; and a $23.6 million, or $0.18 per diluted share, favorable tax adjustment.

We have included a reconciliation to reported amounts in today's release. During the rest of my discussion of our business, I will exclude these items as they do not speak to the underlying performance of Hasbro.

Looking at our segments,

Third quarter revenues in the U.S. and Canada segment increased 4%. Revenues in both the Boys and Games categories grew in the quarter, partially offset by declines in the Girls and Preschool categories. The Girls category decline was primarily the result of an expected decline in FURBY. The Preschool decline was primarily due to the challenging comparisons within Sesame Street, which included a difficult comparison with Big Hugs Elmo in last year's results.

Overall in the U.S., we had positive point of sale trends at our top 5 retailers and our inventory at retail was down slightly at quarter end. At the same time, retailers are expanding inventory to support our growing brands. Point of sale was up in Canada as well.

Segment operating profit in the U.S. and Canada increased 16% in the quarter, reflecting the higher revenue levels, favorable mix and improved expense leverage in the quarter despite being partially offset by a challenging environment in Canada. We also continued to invest in our business including support of key initiatives such as MAGIC: THE GATHERING.

In the International segment, third quarter revenues increased 11%, with 7% growth in Europe, 24% growth in Latin America and 11% growth in Asia Pacific. Foreign exchange had a negative $9.7 million impact on revenue for the segment in the quarter.

Internationally, the Boys, Girls and Preschool categories all grew and more than offset a decline in the Games category. Within the Girls category, FURBY revenues declined, but not as significantly as in the U.S. and Canada, as non-English speaking markets are in their first year of FURBY BOOM.

Operating profit increased 10% in the International segment, on higher revenues which were slightly offset by higher expenses related to supporting our expanding international and emerging markets business.

Entertainment and Licensing segment revenues grew 10%, fueled primarily by lifestyle licensing revenues for Hasbro Franchise Brands, including MY LITTLE PONY and TRANSFORMERS.

The Entertainment and Licensing segment operating profit declined to $493,000 in the quarter. The benefit of higher licensing revenue was offset by lower television and digital streaming revenue as well as the acceleration of programming costs associated with KAIJUDO programming. We decided to exit this brand and therefore had lower future revenues to amortize production costs against. While KAIJUDO'S retailer and player community continued to grow into August, it did not meet our expectations and KAIJUDO'S Vortex card set, which released on August 29, was the game's final paper trading card game release.

Looking at our overall expenses and profitability, operating profit dollars and margin increased in the third quarter on higher revenue levels, partially offset by continued investments in growing our business for the long term.

Cost of sales as a percentage of revenue in the quarter declined. This decline continues to reflect growth in entertainment properties, including TRANSFORMERS and MARVEL properties, as well as higher Entertainment and Licensing revenues.

As entertainment-backed revenues grew, royalty expense also increased. In the third quarter, royalties increased to 6.6% of revenues versus 6.3% last year. Through the first nine months, royalties as a percentage of revenues are equal to our five year average of 7.3%. We continue to believe the full-year will be around this average.

Product development was 4.0% of revenues, a decrease of 2% year-over-year. In the third quarter of last year, we had higher product development expenses due to the write-off of early film development for movies which had not yet moved to production.

Our investment in innovation remains paramount to driving the future growth of Hasbro. In addition to our ongoing focus on innovation, in the fourth quarter 2014 we have begun investing in developing product for the Disney Princess and Frozen properties. Our investment for this exciting new line will ramp up in 2015, ahead of revenues.

As the related revenues will not start to be recognized until 2016, we expect this investment to result in higher product development expense as a percent of revenues, with our product development spend at the high end, or slightly above, our previously communicated target of product development spending of 4.5% to 5.0% of revenues. In future years, as we begin to recognize revenues we expect to return to this more normalized range.

In the third quarter, intangible amortization declined slightly year-over-year as some of our assets have become fully amortized.

Program production cost amortization increased $6 million in the quarter primarily due to the write-off of television programming I referenced earlier. As Brian discussed, content development is fundamental to our strategy going forward and we will continue to invest in content supporting our brands.

SD&A declined slightly as a percentage of quarterly revenues reflecting the impact of higher revenues. These expenses reflect continued investments in our business, including international operations and MAGIC: THE GATHERING.

Turning to our results below operating profit for the quarter:

Excluding the impact of our restructured investment in the Hub Network we mentioned earlier, other expense was $4.2 million compared to $1.6 million in 2013. This includes a $6.2 million loss from foreign exchange versus a slight gain in 2013.

We also recorded our 50% share in the Hub Network in this line. In the third quarter, this improved to a profit of $1.9 million versus a loss of $91,000 last year. In future periods, this line will reflect our 40% share of the Discovery Family channel.

As I mentioned, we recorded a charge primarily associated with recording the fair value of a put/call option that the Company and Discovery entered into relating to this transaction, as well as certain other items, including our share of restructuring charges. We anticipate there could be further expenses associated with restructuring the network in the fourth quarter of 2014 as Discovery Family channel plans are finalized.

The third quarter underlying tax rate increased to 27.8% versus 26.5% in the third quarter 2013. We expect our full-year underlying tax rate to be in the range of 27% to 28% reflecting higher anticipated earnings in the United States.

For the third quarter, average diluted shares were 128.7 million shares compared to 131.8 million last year. The actual amount of shares outstanding at the end of the third quarter 2014 was 126.2 million.

Diluted earnings per share, absent charges, in the third quarter 2014 were $1.46 versus $1.31 in 2013.

At quarter end, cash totaled $452.2 million reflecting our higher level of share repurchases.

In the third quarter, we returned $179.2 million to shareholders: $54.7 million in cash dividends and $124.5 million in share repurchases. At quarter-end, $183.6 million remained available in our current share repurchase authorization. In the first nine months of the year, we have repurchased 6.4 million shares, returning $341.3 million to shareholders.

Receivables at quarter end increased 8% versus 2013 and compared to a 7% increase in revenues. DSOs were 80 days in both 2014 and 2013.

Inventories increased $52.0 million versus last year. Inventory to support our emerging markets growth was the biggest component of this increase. Year-over-year inventories were also up in developed economies to support anticipated higher revenue levels in 2014. Versus the second quarter, inventory increased slightly, by $6 million.

Additionally, our inventory at retail is well positioned to support the fourth quarter across the major markets where we are able to track these levels. As I mentioned, retail inventory declined slightly in the U.S., but increased in many of the brands with strong point of sale trends. Outside the U.S., inventory is up in some markets but also well positioned to support the holiday season.

With three quarters behind us, the full success of our year will be determined by how consumers embrace our products this holiday season. We are well positioned with innovative brands, inventory in all of our key locations and strong marketing programs to capitalize on the holiday season.

Before we take your questions, I'd like to turn the call back over to Brian for a few additional remarks.

Brian Goldner, Hasbro President and CEO:

Thank you, Deb.

I want to take a moment and recognize David Hargreaves, Hasbro's Chief Strategy Officer. Many of you know David personally. Last week he announced that after 32 years, he will be retiring from Hasbro in February.

David's stewardship, vision and business acumen have been instrumental in our success today as a branded play company. There is no question Hasbro would not be where it is today without David's leadership. His legacy will be defined by his tireless work ethic, his belief that Hasbro comes first, and his competitive drive to ensure Hasbro's success is sustainable for generations to come. For me personally, he has been a trusted partner and advisor. Please join me in thanking David for his dedication and all of the significant contributions to Hasbro, and wishing him all the best as he begins this exciting new chapter in his life.

Deb and I are now happy to take your questions.