Hasbro Fourth Quarter and Full-Year 2020

Financial Results Conference Call Management Remarks

February 8, 2021

Debbie Hancock, Hasbro, Senior Vice President, Investor Relations:

Thank you and good morning everyone.

Joining me today 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. 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 and will be versus pro forma adjusted 2019 results. 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 met the distinct and unique challenges of 2020 with tremendous resilience and excellence. They leveraged the breadth of our portfolio, the global footprint of our business and the diverse and amazing talent in our Company to lead our organization through the year. I cannot say enough about the quality of the people that I have the honor to work with every day.

As consumers of all ages found themselves at home, they sought ways to connect and find joy. Hasbro is uniquely qualified to meet this need for every demographic. Our brands, toys, games and content are valuable as they bring happiness and enjoyment to so many in this unprecedented global environment.

After a very challenging June quarter, our performance improved in the second half of the year. Throughout the year we advanced our commercial and retailer programs and supply chain capabilities to meet consumer demand while managing expenses and cash. We grew Hasbro’s operating profit margin and finished the year with $1.45 billion in cash on our balance sheet.

We finished 2020 with growth in revenues and adjusted operating profit in the fourth quarter despite a tough comparison with successful theatrical releases a year ago. The 2020 holiday season was extended - starting earlier with strong consumer demand in October and November but seeing some challenges for key weeks in December. The period then ended with strong point of sales growth and this momentum has continued and accelerated into January. The comparison with Frozen was extremely challenging due to our success in December 2019. If we exclude Frozen from the data, Hasbro POS grew 4% for the fourth quarter across the G11. We also gained share and recorded the fastest point of sale growth on Amazon in the toy and game market in the U.S. and top European markets during the fourth quarter.

For the full year, we delivered $1.8 billion in gaming revenue, an increase of 15%. Franchise Brands MAGIC: THE GATHERING and MONOPOLY each had their best year ever; DUNGEONS AND DRAGONS did as well, and classic games like JENGA, OPERATION and CONNECT 4 – to name a few of many - had stellar years. Our Gaming business grew in all regions but Latin America. The result reflects the ability of our supply chain, marketing, and commercial teams to pivot and meet the demand of consumers as they changed their behaviors at pace.

Gaming has long been a priority investment category for Hasbro. Our brands and our teams lead this market, and we have clear growth plans in both face-to-face and digital gaming for the coming years. You will hear more from Chris Cocks, President, Wizards of the Coast, and Eric Nyman, Chief Consumer Officer, at our virtual investor event on February 25th.

To meet the high consumer demand in gaming and other categories, we leveraged our global retail network and investments in new channels. By year end, the team drove more than $1 billion in ecomm revenues, a 43% increase from last year and representing just under 30% of our global revenues. This translated to close to a ten-percentage point increase. Pure play and omni-channel retailers led this growth, and omni-channel made significant strides to double their ecomm revenue for the year. Our teams worked closely with retailers to expand their online offerings as many added click and collect to their capabilities during the year.

With channel support and innovative, tailored product, Hasbro also grew revenues with the fan channel last year. We augmented this with our own D2C capabilities, leveraging Hasbro Pulse to create authentic fan experiences. While Pulse is a small but growing piece of our revenue today, it is a unique experience that we are leveraging for continued growth and unmatched connections with the important fan community.

In addition to our global retail network, our global supply chain capabilities and our evolving geographic manufacturing supplier base were essential to meeting demand. Due to COVID and changing consumer behaviors, we had disruptions from production to logistics, but the team worked tirelessly to meet the demand and successfully execute the year. We added new ecomm capabilities and identified opportunities to further enhance these going forward. We continued to diversify our manufacturing, reducing our reliance on any one country, ending 2020 with approximately 55% of production in China.

To support new brand development and deeper brand engagement, we on-boarded the eOne team and their expansive capabilities in brands and storytelling. While live-action TV and film production were limited much of the year, we made substantial progress developing Hasbro IP for entertainment that we expect will lead to enhanced revenues and earnings power across multiple income streams.

After returning to live-action production in the third quarter, eOne revenues and profit increased versus 2019 for the last quarter of the year as deliveries resumed to our broadcast partners. Over the course of 2020 we completed production on 59 series across scripted and unscripted television and 5 feature films. With Covid-19 protocols in place, production continues around the world. While the near-term theatrical landscape remains uncertain, we see a path to its return, and the opportunities in streaming and linear now and into the future are clear and compelling for both viewership and merchandise.

The combination of Hasbro's portfolio and eOne's expertise is unlocking opportunity to expand our brands and launch new ones. This takes time and investment, but we have established a robust and deep slate and a roadmap to drive growth in our business for years to come.

Our teams are also on track to launch Hasbro developed, marketed, and distributed toy and game lines for the leading preschool brands PEPPA PIG and PJ MASKS later this year. To further support our portfolio, we have fully integrated our consumer products organizations to drive immersive brand experiences across categories. With Hasbro's global retailer reach and brand category expertise, as well as retailers in the licensed consumer products space reopening and operating, we are expanding these brands. This is further enhanced by Hasbro IP, like MY LITTLE PONY, which has been reinvented under the eOne Family Brands team leadership and is relaunching later this year. The eOne team will share more on our progress and plans at our event on February 25th.

2020 showcased how story and character executed via streaming platforms drives merchandise. Hasbro's Star Wars product revenues grew nearly 70% last year, despite it being the first year without a theatrical release since 2014. This growth was driven by the strength of the Disney+ global roll out of *The Mandalorian*. All regions grew versus prior year with the strongest growth in Europe, North America and Australia. The Child products were a significant driver of the business, including The Child Animatronic Edition, our signature holiday item, and the #1 item in the Plush category in North America and several other markets in the fourth quarter, according to NPD. The success of this line helped Hasbro achieve the #1 position in the Plush Supercategory across the G11 for 2020.

Even without the Child items, Hasbro's Star Wars lines grew significantly behind increasing fan engagement globally in Black Series and The Vintage collection; a reemergence of our kids' business fueled by lightsabers and our new vehicle line, Mission Fleet; and a resurgence in casual, pop culture fans in Star Wars overall.

Hasbro's commercial and brand teams are executing meaningful global merchandise programs for streaming properties and supporting significant future partner brand initiatives, including with Disney+ for Star Wars, Marvel and Disney Princess and Frozen, as well as Hasbro-led streaming initiatives for our portfolio from children through to adults.

At the center of everything we did last year, and in every year, is our community of Hasbro employees and stakeholders. 2020 reminded us that living our purpose and values is imperative to continuing our legacy as a responsible corporate citizen. To drive this forward, we recently appointed Kathrin Belliveau, a long-standing Hasbro leader in our CSR practice, as our first Chief Purpose Officer. I strongly believe Hasbro has both the opportunity and responsibility to lead as a corporate citizen across all aspects of our business.

As we look to the coming year, we continue to see consumers and retailers turning to our categories and Hasbro. We have amazing new lines, coupled with planned increases in theatrical, television and streaming entertainment, to drive the business. Investments in innovation and new growth drivers, including digital gaming and entertainment, will come to market. We believe we will grow in 2021 as we will continue navigating through COVID-19 while leveraging our unparalleled portfolio of brands and capabilities in consumer products, gaming and entertainment.

I will now turn the call over to Deb.

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

The Hasbro team did amazing work in 2020, delivering a good year, prioritizing the health and safety of our employees and our communities while navigating retail and supply chain disruptions. The team never lost focus on strengthening an already solid balance sheet while managing the business for profit and cash generation in the near term and investing for future growth.

On a full year revenue decline of 8%, operating profit declined only 1% and operating profit margin increased 110 basis points to 15.1%. A strong fourth quarter aided this full-year result, as operating profit margin grew 480 basis points on 4% revenue growth in the final period of the year.

I am particularly proud of the work we did to manage working capital. Hasbro generated $976 million in operating cash flow last year, ending 2020 with $1.45 billion in cash. We paid part of our term loan earlier than anticipated and reduced $123 million of this long-term debt. We are progressing in paying down our debt and remain headed toward returning to our targeted 2 to 2.5X Debt to Ebitda.

We also returned $373 million in quarterly dividends during the year. Combined with today's notice of the May dividend payment, the board has already declared the first two quarterly payments for this year.

Throughout 2020, our treasury and commercial teams worked hand in hand supporting global retailers as their businesses changed without warning, in some instances to meet rising demand and others to manage shutdowns. DSOs declined 17 days on a pro forma basis to 74, reflecting both strong collections and a geographic shift in customer base to those with shorter terms.

Consumer demand and inventory management drove inventory down 11% with lower positions in all regions, led by the U.S. Days sales in inventory were down 38 days year-over-year. Retail inventory at year end was of good quality and level, increasing slightly in the U.S. as supply continued to improve, while declining in most other markets. Importantly, retailers were well positioned to meet the strong uptick in demand this January in major markets like the U.S. and Europe.

With live action tv and film production limited, this activity returned during the third quarter. As a result, our full-year 2020 cash spend on content was $439 million, slightly below the expected low end. As production has returned, and we manage COVID-19 protocols to safely keep them up and running, our cash spend on content across scripted and unscripted live action, animated tv and film in 2021 is planned to be in the range of $675 million to $750 million.

While managing a rapidly changing business environment, the Hasbro and eOne teams made significant progress toward both the business and financial goals of our integration. Brian spoke to much of the business progress, which contributed to approximately $30 million of cost savings.

This is ahead of the plan we shared at toy fair last year and puts us well on our way to our goal of $130 million in synergies by the end of 2022. This is just the beginning of unlocking incremental revenue and profit from the acquisition, as we further develop existing brands and launch new ones to extend the reach and value of our consumer products, gaming and entertainment initiatives.

Looking at our performance, our fourth quarter revenue and operating profit growth is discussed in our earnings release and presentation today. I will focus my commentary on the full-year 2020 and provide an outlook for certain items for 2021.

In the U.S. and Canada segment, revenues grew 4% and operating profit increased 30%, or 420 basis points, due to gains in Franchise Brands, led by MAGIC: THE GATHERING, and Hasbro Gaming. Operating profit increased on favorable product mix partially offset by higher freight costs for increased domestic shipments in the U.S. and higher product development and other costs at Wizards of the Coast to support future game launches. At our investor event, Chris Cocks will share more details about Wizards' plans in this area.

International segment revenue and operating profit declined, primarily due to declines in Latin America and Asia. European revenues were flat. Hasbro Gaming revenue increased, as did MAGIC: THE GATHERING. The International segment operating profit declined as result of the lower revenues partially offset by lower spending, most notably in advertising and marketing, as well as lower royalties. As we discussed throughout the year, Latin America was challenging. The toy and game market declined, retailers were closed, ecomm is underdeveloped, and we reduced our inventory at retail. This impacted 2020 revenue and margins, and we are now better positioned to stabilize the business and drive profit improvement this year.

Entertainment, Licensing and Digital segment revenue declined led by entertainment as compared to 2019, which included the *Transformers Bumblebee* film revenue, as well as declines in licensed consumer products. Operating profit increased behind growth in higher margin licensed digital gaming and cost savings.

eOne segment revenue declined from proforma 2019 due to both lower TV and Film revenue from COVID-19 related live-action production and theater shutdowns, as well as lower Family Brand revenue from retail disruption. Operating profit for the eOne segment decreased due to the decline in revenues, partially offset by lower advertising and royalty expense.

For Hasbro overall,

Gross margin, including cost of sales and program amortization, increased 140 basis points. Product mix, led by Wizards of the Coast and gaming, resulted in a slightly lower cost of sales as a percentage of revenue. This combined with the reduction in program amortization drove the improvement. To better help you understand the components of cost of sales, we included the 2020 breakdown in our earnings presentation today.

The improvements were partially offset by additional markdowns in Latin American and Asia to reduce inventory levels at retail. For 2021, we anticipate cost of sales to decline as a percentage of revenue, but this is expected to be more than offset by a return to more normal levels of program amortization, in the 9 to 10% range.

Royalties were down slightly as percentage of revenue, reflecting mix. We anticipate several theatrical launches in addition to streaming content and innovation across our lines to support our Partner Brand portfolio, but in 2021 it is expected to decrease slightly as a percentage of the total.

Advertising in 2020 was lower than historical levels, reflecting both the decision to not advertise during periods when consumers were unable to shop and lower theatrical and entertainment events which would traditionally have P&A support from eOne. In 2021, we anticipate more normal levels of activity and ad spend to be in the 8 to 9% of revenue range.

Intangible amortization, excluding acquisition amortization for eOne, came in at the forecasted $47 million and is planned to decline to approximately $32 million in the coming year as certain property rights are now fully amortized.

For 2020, SD&A totaled 22.8% of revenues up from 21%. We took aggressive cost saving actions which lowered spending meaningfully, but this overall decline was offset by higher costs, in part, resulting from the pandemic, namely in freight and in bad debt, as well as depreciation and investments at Wizards for gaming development. In 2021, some of the spending will return. SD&A dollars should increase but is expected to decrease slightly as a percentage of revenue.

We are closely watching the freight environment, which impacts both cost of sales and SD&A. We have been able to meet demand despite challenges in shipping and port congestion, but the cost of doing so is increasing and does not appear to be reversing, at least not in the next few months.

As we pay down debt, including the $300 million note due in May, interest expense should decline to approximately $188 million from $201 million.

For 2020, our underlying tax rate, absent intangible amortization associated with the eOne acquisition, one-time charges and ordinary discrete items, is 21%. The fourth quarter underlying tax rate was 18%, which includes ordinary discrete tax benefits of roughly 6%. The discrete benefit in the quarter was primarily due to tax planning associated with the eOne integration and other on-going planning.

Based on currently enacted tax law, we expect our underlying tax rate for 2021 to be approximately 21% excluding expected further integration charges and the amortization of the eOne acquisition intangible.

As we look ahead, the last year has reinforced the core tenants of Hasbro's advantage – the value of brands and play, of connecting and competing through gaming, the enjoyment from watching and sharing a story, and our desire to make everyone's life better in all that we do. The investments we made to drive these businesses – in innovation, in digital gaming talent and development, in our entertainment studio, in ecomm and our supply chain – were instrumental in our ability to operate. We shared with you today a view to 2021, but it is important to recognize that we continue to operate through a pandemic, where things are at times unpredictable and don't develop as we expect. We have great confidence in our teams, in our brands, our gaming launches, and in our entertainment planned for the coming year to grow revenue and earnings. We are looking forward to sharing more about our long-term plans at our investor event on February 25.

Brian and I are now happy to take your questions.