Hasbro Third Quarter 2020
Financial Results Conference Call Management Remarks
October 26, 2020

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. 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 global Hasbro team did an excellent job delivering a strong third quarter, with revenues growth in toys, games and digital initiatives while live-action production begins to return.

- Consumer demand remained strong. Global point of sale for Hasbro brands was up mid-single digits, including double-digit gains in the U.S., U.K and Australia, among others. Overall point of sale grew despite declines in Latin America and Asia and some out of stocks in the Games category.
- Nearly all stores globally have been open and operating, with Latin America experiencing the most restrictions. Foot traffic in stores remains meaningfully lower, but ecomm continues to deliver, with 50% growth globally in the quarter. We also benefited from the reopening of Toy Specialty retailers in Europe.
- Production at our third-party factories is up and running, and supply is largely in line with demand. Where demand remains above trend, we are working to catch up.
- The restarting of live-action entertainment is gradually occurring, with some of our larger productions beginning late in the third quarter. As a result, deliveries were low but are set to improve in the fourth quarter and some revenue will move into 2021.

MAGIC: THE GATHERING delivered strong third quarter results and revenue was up double digits for the first nine months of the year. The release of *Double Masters* and *Zendikar Rising* drove the year-over-year gains in the quarter, including growth in analog and digital play. MAGIC: THE

GATHERING is providing its players connections and entertainment despite not all being able to gather to play.

That connection and entertainment continues to drive gaming demand broadly. Revenues grew for our gaming portfolio, and the overall gaming category - including MAGIC and MONOPOLY - was up 21%. Point of sale gains were limited by product availability as we worked to catch up on production.

Hasbro has an unparalleled position in gaming. We have the broadest portfolio, with the industry's best-known brands, reaching all demographics, across multiple genres. Importantly, we have invested to bring new games to the market over every period and every year. Our core games remained our best sellers, including MONOPOLY, JENGA, CONNECT 4, LIFE and OPERATION and we have new games to Bring Home The Fun this holiday. This includes a new game for the whole family in DEER PONG and new games like The Child inspired MONOPOLY and Super Mario Celebration MONOPOLY, among many others.

To further long-term growth, we are investing to drive digital gaming experiences for the Wizards of the Coast brands. *Magic: The Gathering Arena* will launch on mobile in early 2021, as we finetune the game this year. We also have *Spellslingers*, an all new digital game for the mobile-first generation, slated for next year and Tencent continues to lead the efforts to publish in China.

DUNGEONS AND DRAGONS continued to benefit from a strong release schedule and the quest for at home entertainment. Revenues for the brand were up more than 20% in the quarter and year to date. D&D digital is also ramping. *Baldur's Gate III* has released into Early Access on Steam to a strong reception and will be more broadly available next year. Also, in 2021, *Dark Alliance* from our own Tuque Games is planned for release.

D&D and MAGIC: THE GATHERING were among the brands on virtual display at our first ever Pulse Con. Pulse Con delivered to fans one-of-a-kind access to their favorite franchises, as well as interactive experiences with creative talent. It generated close to a billion social and media impressions. We unveiled new products across multiple franchises, hosted two days of panels and successfully fully-funded two Haslab campaigns – one for the *Star Wars* Vintage Collection

Razor Crest and one for the HEROQUEST Game System. If you missed it live, you can find the sessions online.

While the revenue for our HasLab projects will be recognized in future periods when we build and deliver the products, Hasbro's products for *Star Wars* delivered strong growth in the third quarter. Disney+ continued to drive engagement among kids and fans alike. Results were fueled by August shelf sets of our wide range of items for The Child as well as continued global strength in our fan business, particularly within our 40th Anniversary *Empire Strikes Back* product and our RETRO figures. This year, we also launched a *Star Wars: Galaxy's Edge* exclusive program designed to capture the parks' experience at retail.

Last year, on October 4, we executed on shelf events for *Star Wars*, in support of streaming and theatrical content, and for *Frozen 2*. We are up against those comps in 2020, but with new products and new streaming content for both properties we have a great line up for the holiday.

As this year developed, and entertainment plans shifted, our teams did a tremendous job of rebalancing our initiatives for the year. Reprioritizing factories, shifting marketing plans and partnering with our retailers around the world, they leveraged our portfolio's innovation for the holiday and ensured we have strong representation across demographics. These efforts include items like BABY ALIVE Baby Grows Up; FURREAL FRIENDS Mama Josie the Kangaroo; NERF Elite 2.0.; the PLAY-DOH Candy Delight Playset; and many more.

The fourth quarter is unfolding in multiple stages, kicking off successfully earlier this month with Prime Day and major initiatives from our largest Omni-channel retail partners. Hasbro lines sold very well during this period. Our teams are working in concert with our retailers to drive and fulfill demand this holiday season. They are doing an excellent job managing this dynamic environment, driving the business forward for this year and beyond. Importantly, they have positioned us for what we believe should be a good holiday season for Hasbro.

In entertainment, the last few quarters have been difficult given the inability to get on set and produce much of the live-action content we planned for the year; however, the integration is progressing well and we have been able to make more progress than planned in the development of future projects. We recently announced that producer and director Jonathan Entwistle has come on board to shepherd new film and television adaptations of POWER RANGERS. eOne will develop and produce the projects with Entwistle set to direct. We also launched a competitive cooking show based on CANDYLAND, hosted by Kristin Chenowith. You can see that series beginning November 15th on the Food Network.

Looking ahead, some revenue originally planned for 2020 will shift into 2021. Both from eOne projects and from theatrical releases which were originally slated for this year. During 2020, we continued to advance in ecomm and focused the teams on our highest priorities for the near term and for long-term growth. COVID-19 remains a reality in our markets around the world, and we are closely monitoring developments to ensure we can execute while keeping the safety of our employees and communities a top priority.

I'll now turn the call over to Deb.

Deb Thomas, Hasbro CFO

Thank you, Brian and good morning everyone.

Our teams delivered a very good third quarter in a difficult environment. The results reflected growing consumer demand for Hasbro brands; an improved operating environment as third-party factories, warehouses and retail stores were mostly open; and excellent execution by our teams, including strong cash collections and cost management.

My discussion today will be versus pro forma adjusted 2019 earnings. The third quarter 2020 adjusted results exclude after tax amounts of $19.6 million of purchased intangible amortization and $4.7 million of acquisition and related expenses associated with the eOne acquisition, and $13.7 million of incremental tax expense related to a change in the U.K. tax code.

We ended the quarter with one of our highest ever third quarter cash balances and delivered an additional 230 basis points on adjusted operating profit margin for the quarter from both favorable product mix and cost savings.

We continued to have $1.5 billion available under our revolving credit facility, should we need it, and we remain well within our financial covenants. The team drove strong cash collections and Q3 DSO decreased to 74 days from 83 days last year, and 96 days in the second quarter.

As live-action production has been limited, our cash spend on content this year is now targeted to be at the lower end of our prior $450 to $550 million range for the full year. Due to the timing of this return to production, certain deliveries expected in the fourth quarter 2020 will move to 2021, shifting expected revenue. We currently expect next year to have a more normalized cash spend level as production and deliveries are slated to improve from the lower 2020 levels.

Our Capital Expenditures year to date are in line with 2019 and are now expected to be slightly below the $145 to $155 million we targeted for this year. This amount includes the capitalization of digital gaming development relating to games to be launched in future years, some of which Brian spoke to, as well as several others for 2022 and beyond.

Hasbro owned inventory is down 7% absent FX as demand remains strong. Retail inventory declined, led by the U.S., reflecting the shift to ecomm and higher consumer takeaway. In Latin America we continue to work through inventory we began the year with. Our goal is to reduce excess inventory by year end to position us to stabilize the region's performance next year.

Our integration with eOne remains on track and we continue to target synergies of $130 million by year-end 2022. This includes 2020 cost savings of at least $20 million, before one-time expenses – recognizing the eOne business, like the overall Hasbro business, is not operating to our original plan due to COVID-19. Synergies are planned to increase in 2021 as we begin to insource toys and games for eOne properties and recognize more of the benefit of cost savings.

For the quarter, revenues were down 4% reflecting growth in toys, games and digital initiatives offset by a decline in entertainment.

In the U.S. and Canada segment, revenues grew 9% behind growth in Franchise Brands, led by MAGIC: THE GATHERING, Emerging Brands and Hasbro Gaming. Gaming supply was catching up to demand during the quarter. Partner Brands declined behind good growth in *Star Wars* but a decline in Marvel and *Frozen* revenues. Point of sale for the segment grew double digits and retail inventory declined double digits. Ecomm revenues grew more than 50%.

Segment operating profit grew and operating profit margin expanded 530 basis points. This gain was the result of revenue growth, favorable product mix – including growth in MAGIC: THE GATHERING – and inventory cost management.

International segment revenues were down 7%, excluding the impact of foreign currency. European revenues grew 4%, excluding FX, but both Latin America and Asia Pacific revenues declined. Hasbro Gaming revenues were flat absent FX and the other brand portfolio categories declined. Ecomm revenues grew approximately 40%.

Segment operating profit was down due to lower revenues, but operating profit margin improved 40 basis points on favorable mix, including growth in MAGIC: THE GATHERING, lower advertising spend and cost management initiatives.

In the Entertainment, Licensing and Digital segment, revenues declined due to lower film revenue versus last year, when we first recorded *Bumblebee*, offset in part by higher digital gaming revenues. For consumer products, revenue and profit held up well in the quarter. As we look ahead, the fourth quarter in part reflects licensee sales from the third quarter. It is a bigger quarter for the category and retailers are being very cautious with inventory management given store closures and lower sales in licensed categories. This also had an impact on Family Brands in the eOne segment.

Despite the decline in net revenues, operating profit and operating profit margin increased due to increased revenue from high profit digital licensing and decreased advertising costs versus the 2019 initial launch of *Magic: The Gathering Arena*.

For eOne, the segment's performance was hampered by the timing of live-action production restarts in the TV and film business and lower digital content advertising revenues. The segment reported a small adjusted operating loss due to these lower revenues.

For Hasbro overall,

Gross margin increased 180 basis points, including both cost of sales and program cost amortization, driven by favorable product mix and inventory cost management.

Program amortization is expected to be more in line with last year's levels as a percentage of revenue for the fourth quarter.

Advertising declined to 7.7% of revenues on lower spend at eOne due to the lack of theatrical releases as well as lower advertising within the commercial business. Given the expected shift of digital gaming launches from Q4 to Q1 2021, advertising is expected to be at similar levels as a percentage of revenue in Q4.

While SD&A declined in dollars it was up as a percentage of revenues. Cost savings are having a favorable impact, but freight expense was up on the higher domestic U.S. and European orders, as well as the alignment of accounting for certain eOne expenses in the current year versus last. We expect fourth quarter to be more in line with last year's level as a percent of revenues.

The underlying tax rate for the quarter was 19.8% compared to 18.2% last year. The rate is driven by the change in geographic mix of income and the impact of the eOne acquisition. As I mentioned to start, during the quarter we recorded incremental tax expense, which increased our effective rate to 26.5%. This expense was related to the U.K. Finance Act of 2020 enacted during the quarter that maintained the U.K. corporate income tax at 19% instead of the previously enacted reduction to 17%. This resulted in the remeasurement of our U.K. net deferred tax liability, driving the rate higher.

In closing, the team has continued to do an outstanding job and I could not be prouder of them. We are set up for a good holiday season leveraging our broad portfolio, including strength in games, customer relationships and ecomm expertise backed by strong execution of the team. We are watching the development of COVID-19 infections in various markets around the world, but so far, retail has remained accessible to customers – including through ecommerce. We are leveraging our global manufacturing partners to have supply to meet demand, and eOne is back in production with more deliveries anticipated in the fourth quarter and some shifting into 2021.

We feel good about next year and our opportunity to execute successfully with innovative products, robust entertainment and strong execution from our global teams. We have invested to ensure Hasbro is best positioned to drive profitable revenue growth around our blueprint. As we look to the next stage of our Company, we have pivoted to create not only more entertainment based on our brands, but more profitable entertainment. We have over thirty Hasbro properties in development with eOne across various platforms, which drive high-margin revenue streams – in entertainment, consumer products and digital gaming. Combined with revenue growth from our core toy and game business and the pipeline of digital games in development we are set up well for delivering improved profits and cash flow for the long term.

I will now turn back to Brian for some closing remarks before we take your questions.

Brian Goldner, Hasbro Chairman and CEO

Thank you, Deb. I want to take a minute and recognize John Frascotti. Earlier this month, we announced that John has decided to retire after 13 years with Hasbro when his existing contract ends in March of 2021.

John has been an important part of our senior management team since 2008, and a loyal colleague, mentor and friend to so many of us over the years. In addition to the leadership roles he has held, John has always been a champion for our culture, our purpose and our values. He embodies the idea of servant leadership and his impact on our Company will be felt long after he departs.

John leaves big shoes to fill, but I am extremely confident in the leadership of our Company and the strength of our teams to lead Hasbro into the future.

Deb and I are now happy to take your questions.