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Hasbro's (HAS) CEO Brian Goldner on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-22-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $1.84 misses by $-0.36 | Revenue of $1.58B (0.35% Y/Y) misses by $-139.61M

Earning Call Audio

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Hasbro, Inc. (NASDAQ:HAS) Q3 2019 Earnings Conference Call October 22, 2019 8:00 AM ET

Company Participants

Debbie Hancock - SVP, IR

Brian Goldner - Chairman & CEO

Deb Thomas - CFO

Conference Call Participants

Steph Wissink - Jefferies

Mike Ng - Goldman Sachs

Tim Conder - Wells Fargo

Drew Crum - Stifel

Gerrick Johnson - BMO Capital Markets

Arpiné Kocharyan - UBS

Linda Bolton Weiser - D.A. Davison

Fred Wightman - Citi

Eric Handler - MKM Partners

Raymond Stochel - Consumer Edge

Priya Ohri-Gupta - Barclays

Operator

Good morning. Welcome to Hasbro's Third Quarter 2019 Earnings Conference Call. At this time, all parties will be in listen-only mode. [Operator Instructions]. Today's conference is being recorded. If you've any objections, you may disconnect at this time.

At this time, I'd like to turn the call over to Ms. Debbie Hancock, Senior Vice President of Investor Relations. Please go ahead.

Debbie Hancock

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?

Brian Goldner

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

The Hasbro team is making progress to accomplish our stated goal of returning to profitable growth this year in an environment where the trade conflict is having the short-term impact we have outlined throughout the year to our stakeholders. We are delivering innovation and creativity globally in gaming, across our Toy business and around the Brand Blueprint as we operate during a very dynamic quarter, and year.

We are actively developing our brands for success in analog and digital play and entertainment while investing for long-term profitable growth, including the September 26 launch of MAGIC: THE GATHERING Arena, our investments in Wizards gaming beyond Arena, and our announced plans to acquire Entertainment One.

We are doing this amid a very choppy environment where retailer order patterns have changed in response to potential tariffs, and our supply chain is being pushed to meet high levels of demand in condensed periods of time. We view these dynamic supply chain challenges as short-term, and we are positioning our business for growth in 2019 and over the long-term.

Overall revenues in the quarter grew 2% absent foreign exchange. Revenues were up in Asia and Latin America, including double-digit growth in China and Mexico. Europe remains on track with our plan to stabilize revenues and grow profit this year.

Global point-of-sale declined in the mid-single digits for the quarter, showing declines in July and August with improving trends in September and growth into October. Online point-of-sale continues to grow rapidly. We are the leading toy and game company year-to-date through August, across the G11 markets, according to NPD.

We posted revenue gains in MAGIC: THE GATHERING and DUNGEONS & DRAGONS, where only a small percentage of our sales is captured by NPD data, and we generated 20% revenue growth in the Entertainment, Licensing and Digital segment.

In the U.S., however, the threat and implementation of tariffs negatively impacted our quarterly results. For the third quarter, U.S. point-of-sale declined slightly, and retailers continued to lower inventory. With many of our holiday initiatives launching in early fourth quarter point-of-sale has improved in recent weeks and is up to start the quarter.

As you recall, since the administration began discussing tariffs, we have outlined the ripple effect they would have on our business. We've spoken about the changing order patterns in the U.S., whether or not tariffs are ultimately enacted.

In the third quarter, the threat of, and the implementation of tariffs in certain instances, impacted our shipments, and our ability to fully meet demand. Importantly, during Q3 alone we saw multiple different dates for the enactment of List 4 tariffs come and be delayed, now scheduled for December 15 and yet the prospect had our retailers cancel major direct import program orders and rewrite many of those orders as domestic shipments. The impact of the shift was that July and August total shipments were lower and September shipments were far higher than a year ago.

However, given the location of our inventory in Asia to satisfy direct import orders during July and August, we ultimately were unable to re-plan the orders and rewrite all of the orders from direct import to domestic orders all within the quarter.

We were also unable to ship all the orders, many of which came late in September, by the end of the quarter. Our supply chain team worked to rapidly respond as our domestic shipments increased to 59% of orders this year versus 51% of the U.S. and Canada segment this quarter last year.

We prioritized critically important launches like STAR WARS Triple Force Friday, Frozen 2, and NERF Ultra, all of which are off to very strong starts in line with, or ahead of our plans. To meet demand, we added air freight and shifted warehousing at an incremental expense to ensure shelves were stocked as the promotion builds for these initiatives.

We are working to catch up in the first weeks of the fourth quarter and, while early, we are seeing strong consumer demand for these new initiatives. We are working diligently to improve our approach to domestic shipments, and still face the prospect of more direct import cancellations and shifts to domestic orders as the December 15 List 4 date approaches for most of our product lines.

We've built a domestic supply chain that, like much of our approach to product manufacturing and distribution, is asset light. We have historically used a balance of customers' shipments and our own domestic shipments through third-party suppliers to manage our costs and make our supply chain most effective and cost efficient.

In this current environment, we've been transitioning and redesigning our U.S. supply chain at pace.

In addition, while the December 15 action will hit the majority of our products, List 3 tariffs enacted in September impacted some of our games during the third quarter. The direct import orders for these items were cancelled and we worked to get supporting domestic orders while also adjusting pricing to cover the tariff's impact and protect our gross margin.

As we have discussed previously, and experienced in both the second and third quarter, if we take no action the planned December 15 tariffs will curtail direct import shipments by retailers as they want product arriving on or after the 15th to be imported by Hasbro and demand fulfilled in the U.S.

The team is working on programs to help mitigate this impact as well as the impact on our consumers this holiday season, but we anticipate continued potential disruption in the fourth quarter.

Our teams are actively moving our strategic sourcing footprint and are on track to achieve our target of sourcing 50% for the U.S. out of China by year-end 2020. We are having good success identifying and building products in geographies including Vietnam, India, and others. Importantly, as a reminder, we are also sourcing 20% of our U.S. business from the U.S.

At the same time, as online retail grows rapidly and the mix of retailers evolves, retailers continue managing their business to carry lower retail inventories. U.S. retail inventories declined in the quarter mid-single-digits and European inventories were down more than 20% to meet the just in time needs of retailers, and we anticipate inventories will remain lower through the fourth quarter.

We have many new product lines launching in Q4 and more dynamic advertising support driving our innovative products and we are already seeing momentum in POS, and yet, we will likely not recapture all the revenues associated with canceled direct import orders in the third and fourth quarter. We have partnered with retailers to grow demand in a holiday season that has six fewer shopping days than last year.

During the third quarter, global retailers championed Hasbro's lines for Frozen Fan Fest and STAR WARS Triple Force Friday in support of the October 4th merchandising date. Partner Brand revenues increased 40% behind growth in these initiatives as well as Marvel product lines, including the Avengers and Spider-Man franchises, which continue to perform well.

The highly anticipated Disney's Frozen 2 is set to debut in many markets on late November. Hasbro is supporting this huge initiative with a complete line of fashion dolls, small dolls and playsets, including an iconic fashion doll castle which is already outselling our expectations.

STAR WARS Triple Force Friday featured meaningful pre-order activations tied to product reveals and launch initiatives planned by online retailers. We also created limited editions of some of our most popular fan items to drive foot traffic to retail on opening weekend.

Key retailers featured out of aisle placement of product and plan to continue to ramp support of the line as we move closer to the holidays.

We see the power of storytelling in our brands. TRANSFORMERS revenues were up on Bumblebee film-related revenue. Point-of-sale increased in the U.S. and revenues are up year-to-date, although shipments declined in the quarter with no feature film this year.

POWER RANGERS is off to a great start in the U.S. and several countries garnering high ratings for our new series and we're seeing early sales momentum.

Throughout nearly 10 years of storytelling, MY LITTLE PONY grew into a global lifestyle franchise with billions in retail sales. The series finale of Friendship is Magic aired earlier this month. While revenue has declined as this story line comes to an end, we see the potential to once again reimagine the brand and are investing in content and innovation. In partnership with Paramount, we are developing a MY LITTLE PONY animated feature for 2021.

We will seize upon our opportunity to leverage the talent we expect to onboard with the close of the acquisition of Entertainment One to chart the next great stories for Hasbro IP for kids, fans, and families around the world.

Storytelling also sits at the heart of MAGIC: THE GATHERING where the team delivered another quarter of revenue growth including the launch of Thrones of Eldraine and the live launch of MAGIC: THE GATHERING Arena in late September. As part of Arena’s launch, we are expanding marketing and promotional activity to reach new potential players. The game will be available at the Epic games storefront, connecting with a sizable global gaming audience in 2020 and beyond.

Given the shift in release timing, the fourth quarter will be a difficult comparison with last year for MAGIC, but we have delivered meaningful growth in the franchise in 2019 and are investing in new digital games and entertainment for future years. This also includes new gaming investments for DUNGEONS & DRAGONS which again grew revenues this quarter.

The team at Wizards of the Coast continues to do tremendous work advancing our capabilities and delivering exceptional experiences to our growing player and audience base.

Through both in-house development and with partners, the Wizards of the Coast team has close to a dozen games in development for delivery over the next five to six years. This includes Baldur’s Gate 3, a highly anticipated DUNGEONS & DRAGONS game we recently announced with our partner Larian.

Finally, the NERF team is delivering new innovation and experiences. While revenue and point-of-sale has not yet turned around this year, point-of-sale is improving following the global launch of Alpha Strike in August and the U.S. launch of Ultra in October.

According to NPD, the category is down through August in the G9, but NERF is gaining share, or was flat, every month since March, in part through the strength of our Fortnite line, where we are delivering more innovation this holiday, and in the under $20 dollar segment with the recent launch of Alpha Strike, where we are also gaining share.

Throughout the rest of this year you will see strong media support behind our key initiatives as well as more social media content.

In early October, in partnership with Kingsmen Creatives, we opened the world's first Nerf Action Xperience located in Singapore. The arena is designed to promote active play, which is the essence of NERF.

In the U.S. we are partnering with Kilburn Live on a new entertainment touring event, NERF Challenge. This all new attraction is debuting in Los Angeles at L.A. Live starting early December and brings the competitive fun of the NERF brand into an action-packed play experience.

In summary, we are continuing to make meaningful progress in a rapidly changing retail environment. Our team is redesigning our go to market efforts as the market shifts. We entered the fourth quarter with the initiatives to drive our business and look forward to 2020 and beyond as we bring more Hasbro owned story-led IP and gaming initiatives to global audiences, gamers and consumers.

I’ll now turn the call over to Deb. Deb?

Deb Thomas

Thank you, Brian and good morning everyone.

As the year progresses, our global teams continue to manage through a dynamic global trade and retail environment. We anticipate this continues throughout 2019 as retailers work to manage inventory, and we are working to mitigate the impact on consumers this holiday season.

This disruption is reflected in revenues, expenses, and in our underlying tax rate. However, within this environment, our teams are delivering an innovative slate across demographics and categories, including in digital gaming that we are supporting with robust marketing programs and continued investment in future gaming initiatives. We are delivering on the goals we set for the year of stabilizing Europe, launching MAGIC: THE GATHERING Arena and continuing to grow points of distribution.

Our financial position is strong and we ended the quarter with $1.1 billion in cash on our balance sheet.

Revenues are up slightly over a year ago and include a negative impact from foreign exchange of $20.5 million. Absent this impact, revenues grew 2%. If currency rates stay at similar levels to the end of Q3, we expect a similar negative impact of foreign exchange translation in the fourth quarter when compared with the fourth quarter of last year.

The brand mix within revenue also had an impact on our expenses for the quarter, in addition to the impact on our supply chain from changing retailer shipping patterns. This resulted in operating profit margin of 18.9% for the quarter compared to 20% a year ago.

Within our segments, U.S. and Canada segment revenues declined 1.5%. Franchise Brand and Hasbro Gaming revenues declined in the quarter, while Partner Brand and Emerging Brand revenues grew. As Brian discussed earlier, the U.S. business was impacted by retailer cancelation of direct import orders in the quarter, and some of those orders were not re-written during the period. This had a particular impact on Hasbro Gaming, and represented most of the decline in the category for the quarter.

In franchise brands, MAGIC and MONOPOLY grew, with the remaining brands decline more than offsetting this growth. The largest decline in franchise brands was in NERF, as we positioned the brand for new innovation launching in North America early in the fourth quarter and globally thereafter.

In order to ensure we had inventory available domestically to meet on shelf dates for Frozen 2 and STAR WARS, we also prioritized our Partner Brands through our supply chain. In addition to products associated with those two brands, MARVEL properties also continue to perform well. As retailers focus on reducing inventory levels, retail inventory is down.

Due to the impact of the brand mix of revenues and the additional costs of warehousing and distribution in the U.S., the U.S. and Canada segment operating profit decreased 13% and operating profit margin was 21.6% compared to 24.5% a year ago. Favorable cost of sales was more than offset by higher royalty expense, freight, and warehousing costs, as well as intangible amortization associated with POWER RANGERS, which began selling in the segment in Q2 of this year.

International segment revenues were flat to a year ago including a negative $19.9 million impact from foreign exchange. Revenue declined in Europe and grew in Asia-Pacific and Latin America. Absent the impact of foreign exchange, segment revenues grew 4%. At constant FX rates, revenue in Europe was flat to a year ago, Latin America revenue increased 9%, and Asia-Pacific revenue increased 10%.

Within the segment, Partner and Emerging Brand revenues increased, while Franchise Brands and Hasbro Gaming categories declined.

International operating segment profit increased 1% to $67.2 million. Flat revenues and lower cost of sales were somewhat offset by increased royalty expense and intangible amortization.

Entertainment, Licensing and Digital segment revenues increased $19 million or 20% compared to the third quarter a year ago. Revenue growth was driven by MAGIC: THE GATHERING Arena and TRANSFORMERS: Bumblebee revenues.

Operating profit decreased to $24.6 million or 21.2% of net revenues, versus $37.1 million, or 38.3% of net revenues in 2018. The decline in operating profit was due to several factors. In the third quarter of last year, we signed a multi-year digital streaming agreement for Hasbro television programming. This typically happens every few years, and has a high pass through to operating profit. Additionally, this year, the segment had higher program production expense as we are receiving revenues and therefore amortizing production costs associated with the Bumblebee film.

Lastly, we continue to invest in digital gaming initiatives, including MAGIC: THE GATHERING Arena and future digital games. As we have discussed in prior quarters, we increased advertising and marketing expense in support of this launch. In addition, we continue to invest in the teams and development of new digital games we expect to launch in the future.

As a reminder when thinking about the fourth quarter, we had a major card set release for MAGIC in the second quarter of this year which occurred in the fourth quarter of last year and we began recognizing our first meaningful revenue associated with Arena last year in the fourth quarter.

Overall, operating profit for the quarter declined $16.1 million or 5%, to 18.9% of net revenues.

Cost of sales as a percentage of revenue decreased 195 basis points in the quarter. Favorable product brand mix from higher entertainment driven revenues, such as Frozen 2, MARVEL and STAR WARS, and a greater mix of Entertainment, Licensing and Digital revenues, including Arena, were somewhat offset by higher costs to bring inventory into the U.S. to sell domestically upon cancellation of direct import orders resulting from tariffs concerns.

Royalty expense increased in dollars and as a percentage of revenue on higher Partner Brand revenues. Based on our expectations for the full-year, we now anticipate royalties to be approximately 8.5% of revenues. Dependent on the level of shipments associated with Frozen 2 and STAR WARS which occur during the remainder of this year, royalty expense could exceed this amount.

Intangible amortization increased in the quarter, and we continue to expect full-year amortization of existing intangibles to be approximately $47 million.

Program production amortization increased as we are now receiving revenue and amortizing the costs associated with TRANSFORMERS: Bumblebee.

Given the timing of expected revenues, we now expect full-year program production cost amortization to be greater than historical levels but remain under 2% of total net revenues. Given a change in the expected timing of receipts on tax credits, we now expect full-year content spend of approximately $50 million to $60 million.

SD&A was up slightly in dollars and 10 basis points as a percentage of revenue over a year ago. Driving the increase are higher shipping and warehousing costs, primarily in the U.S., from higher costs on rerouting shipments to customers initially expected to be taken through direct import. This required moving inventory, into U.S. warehouses to ultimately ship domestically, as well as higher warehousing costs to store domestic U.S. inventory.

We also incurred higher costs associated with building our teams as we invest in digital gaming initiatives surrounding our Wizards of the Coast brands.

Finally, incentive-based compensation expense is higher than a year ago. These increased costs were largely offset by cost savings being achieved from our 2018 cost savings initiatives. Given the higher distribution and warehousing costs we are experiencing, we anticipate that full-year SD&A could be a similar percentage of revenue compared to adjusted full-year of 2018.

As Brian discussed, we continue to believe we will have full-year profitable growth in 2019 and we continue to take the steps to ensure we can grow operating profit margin over time.

Below operating profit other income expense decreased in the quarter, due primarily to losses associated with hedging the GBP purchase price for our proposed acquisition of eOne. Absent this $25.5 million loss, other income improved approximately $5.6 million. After taxes, this loss negatively impacted net earnings by $20.9 million, or $0.16 per share.

Our underlying tax rate, absent discrete events, was 18.2%, compared to an underlying rate of 17.6% last year. During the third quarter of 2018, we also recorded a $17.3 million tax benefit, or $0.14 per share, related to our interpretation of U.S. tax reform guidance that was released during that quarter. Based on the shifting mix of our business, primarily in the U.S., 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 responses to potential tariffs.

For the third quarter, reported earnings per share was $1.67. Adjusted earnings per share, excluding the $0.16 FX hedging loss, was $1.84.

Operating cash flow over the past 12 months totaled $860.8 million and we had $1.1 billion in cash at the end of the quarter.

During the third quarter we returned $87.4 million to shareholders, including $85.9 million in dividends and we repurchased $1.5 million in common stock. Year-to-date repurchases total $60.1 million. As a result of our planned acquisition of eOne, which Brian will speak more to in a moment; we anticipate suspending our share repurchase program as we focus our cash flows on reducing leverage arising in the transaction.

Hasbro's balance sheet remains strong. Both our debt to EBITDA and EBITDA to interest ratios at 2.0 and 9.8, respectively, remain within our targets.

Receivables increased 2% and days sales outstanding were 82 days. Excluding the impact of foreign exchange, receivables increased 4% in part due to the shift away from U.S. retailers use of direct import orders.

Hasbro owned inventory decreased $21.8 million, or 4%, most significantly in Europe and Latin America. This decrease was partially offset by growth in U.S. and Canada owned inventory as we have previously discussed. Absent the impact of FX, inventory decreased 1%.

Retail inventories declined in the U.S. and internationally, notably in Europe.

In a rapidly changing retail environment, and an uncertain trade situation, we are addressing these changes and adjusting our business on a real time basis. At the same time, we are investing to strengthen our brands and expand our revenue and profit drivers through investments in digital gaming and in entertainment. We are delivering innovation across the portfolio, working with new retailers and introducing new ways to experience our brands, all positioning us to profitably grow in 2019 and going forward.

I would now like to turn the call back to Brian to give an update on the eOne acquisition.

Brian Goldner

Thank you, Deb.

Before we take your questions, I want to update you on the progress of our acquisition of Entertainment One. Last week, the shareholders of eOne overwhelmingly approved the acquisition. We are delighted with their support. We have received regulatory approvals in two of the four jurisdictions where it is required, the U.S. and Germany, with Canada and the UK outstanding. We continue to expect to close the transaction during the fourth quarter. We also continue to expect to finance the transaction with the proceeds of debt financing at approximately $1 billion to $1.25 billion in cash from equity financing. The strategic opportunity to bring onboard the brands, capabilities and talent from eOne is compelling to our long-term prospects as a leading global play and entertainment company and we look forward to sharing more about our plans after the close.

Deb and I are now happy to take your questions.

Question-and-Answer Session

Operator

Thank you. At this time we will be conducting a question-and-answer session. [Operator Instructions].

Thank you. And our first question is coming from the line of Steph Wissink with Jefferies. Please proceed with your question.

Steph Wissink

Thanks. Good morning everyone. Brian, I wanted to just follow-up on your comments regarding shipment timing, because that seems to be the gap to everyone's expectations today. Can you walk us through an illustration of what you observed in your quarter, it sounds like the quarter was extremely backend weighted, should we assume that the fourth quarter is also going to be frontend weighted then as you catch up on some of the outstanding shipments to meet demand? So that's kind of framework for one question. And then I'm wondering if you can just help us appreciate within your supply chain, where are the greatest constraints, is it in getting goods into the U.S. meaning shipper or container capacity and getting things through the port, which is why you were forced to air freight? Or is it more on the 3PL warehouse and logistics side just getting access to enough space to hold the inventory and to sell domestic? Thank you.

Brian Goldner

Well, thanks. Thanks for the question. Let me try to summarize in a couple of ways because you're right, in an environment like this one, without the trade conflict, our growth in the quarter could have been more consistent with our year-to-date results. There are a number of regions and brands that grew revenues and our overall revenue was impacted by the disruption that was caused by the threatened implementation of tariffs.

We do use this asset light model that relies on the balance of our domestic shipments coming from a 3PL supplier provider, and then our customers direct import orders.

So let me give you an example as you ask. A retailer would place an order let's say in August for direct import, so sales and product ownership, the transfers that would occur in Asia. Then when the tariff is announced for goods arriving after September 1, they cancel that order, and they shift it to a domestic order where they take ownership in the U.S. This happened multiple times in the quarter as the rolling tariffs or potentiality of enactment of tariffs.

As a result, we needed to rewrite the order from a domestic or a direct import order to a domestic order, as they have different terms, and then we need to ensure that the inventory is available in the U.S. because of the original order required inventory in Asia. And then we need to fulfill the order in the United States. So given those number of shifts and nearly 10 percentage point increase of domestic orders as a percent of U.S. and Canada in the third quarter, we didn't meet all the demand during the quarter. So the impact of the shift was that July and August total shipments were lower and September shipments were far higher than a year-ago.

We believe that we could meet all the demand in September, but the really the timing of new orders in many in instances was just too late. We did incur some incremental shipping and warehousing expense including some air freight, which also impacted our margin. We've been catching up in the fourth quarter. But we also are still looking at a potential December 15 date for the enactment of tariffs. The team is working in real time to come up with and we have new plans around ways to in 2020 and beyond deal with the balance between our domestic shipments and our direct import shipments.

But we've been working to redesign in real time, our domestic shipping plan. And we really have a number of new initiatives coming for the fourth quarter we're very excited about a lots of new innovation we've seen early results in NERF Ultra. We're seeing the early results on Disney's Frozen 2 and on STAR WARS and a raft of other brand initiatives. But the results in Q3 were primarily related to the timing of the potential enactment of tariffs. And the way we've gone to market historically.

Steph Wissink

Brian, should we model your own brands and to improve as a rate in the fourth quarter, I'm just trying to make sure I'm understanding what you're saying because it sounds like you prioritize franchise which makes sense. But should we assume that the rate of decline in your own brands in the Q3 will get much worse or will get better in Q4?

Brian Goldner

Yes, the two brands -- the two brand areas that were most impacted by the direct imports first, Deb noted is that our games business was directly impacted. And remember, some of our games were actually tariffs as part of List 3 tariff. So we're now in a tariff environment on those games. We took pricing in the quarter to offset the impact of those tariffs and those direct import shipments were impacted.

The brand that's most associated with direct import and remember Q3 is our highest quarter for direct imports is the NERF brand. So that clearly was a brand that was impacted.

Having said that, if you look at our overall brands, we did note that in the fourth quarter, we do have a tough comparison on MAGIC. MAGIC has grown substantially throughout the year. In fact, our plan to grow MAGIC over the next five years is really well underway. And yet in the fourth quarter, we have some tough comps versus a year-ago where we had a major card release.

So I think overall, we have a lot of brand initiatives around Hasbro's brands. We have a lot of new innovation coming into the market. We have a very big fourth quarter lined up for our partners between Disney's Frozen, STAR WARS, and the continuation in the strength of Marvel. And so I'd say it's a bit more of a balance, but we also noted that we probably have a bit higher royalties in the fourth quarter as well.

Operator

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The next question is from the line of Mike Ng with Goldman Sachs. Please proceed with your question.

Mike Ng

Hi, thanks for the question. I just want to talk a little bit about the moving parts around royalty expenses. I think you guys said that in the shift to the direct import program, you were prioritizing partner brands like STAR WARS and Frozen this year. So as we think about 2020, should we expect a decline in royalty expense as the mix of partner brands normalize? And could you give us a sense of what you expect the mix of partner brands to be this year? Thanks.

Deb Thomas

Yes, I think that, good morning, Michael. The -- as we look to 2020 while we usually give guidance about the upcoming year at Toy Fair and we will do so again, really the strength of our partner brands that we're seeing right now at Retail, with Frozen 2 and STAR WARS just coming out and launching initially with mostly the fan base in STAR WARS coming out on October 4, for Triple Force Friday, very exciting. We see that as we've previously spoken about really continuing into 2020.

So in a year where we have major movie releases coming so late in the year, we tend to see the benefit of that continuing into the next year. And I think we continue to believe that as we sit here today, as well as being excited about things, like, the Marvel Properties coming next year and our own Snake Eyes, as well as some other properties that we have coming from an entertainment standpoint.

So as I sit here today, I would think our royalty expense might be a bit higher than it's been historically. But perhaps you're seeing the impact of much of it coming late in the year, this year. When we look to our own brands for 2020, we're very excited about those as well.

Operator

The next question is from the line of Tim Conder with Wells Fargo. Please proceed with your question.

Tim Conder

Thank you. Just to circle back to the what seems like the primary focus here the tariffs and direct import dynamic. Granted, that won't fully anniversary to a degree until Q3 next year. But given things that kick in December and how you're scrambling and doing the best you can obviously under difficult circumstances here. Do you see that adjusting by Q1 or Q2? I guess is question number one. And then on the Canadian and UK approval, I know you're anticipating closer here the deal in Q4, but any update on timing of that, Brian? Thank you.

Brian Goldner

Sure. Look, we expect to still close eOne deal in Q4 of this year. And that's the timing we have two of the four regulatory authorities having approved and we're very happy to have the shareholder vote and support and behind us.

As we look at the business going forward, we feel like we have a number of strong initiatives coming into the fourth quarter this year. We have been addressing our supply chain and the balance between the DI and our domestic shipments. As we go forward, the team is already working with our retailers on new ways, new techniques, and new programs that we can get a great balance using our asset light model, but picking up on new ways to bring product into the U.S. using the strength of our biggest retailers who tend to also be our biggest direct importers and then continue to drive our business with our own domestic shipments, so finding that balance.

I would expect in early 2020, we could get back to that balance and also recognize that we would like to see the tariff environment abate and to mitigate. And we would hope to continue great dialogue with the administration to see that occur. We continue to lead our strategic sourcing footprint outside of China to be below 50% at year-end 2020 and we will continue to source in great other geographies like Vietnam and India.

And so again, it's a dynamic environment. But the underlying strength of our business is apparent. The underlying strength of our brands is -- is being presented to our customers and our consumers. We have great partner brands as well as own franchise brands and gaming initiatives and it's been obfuscated by this tariff environment.

Operator

The next question is from the line of Drew Crum with Stifel. Please proceed with your question.

Drew Crum

Okay, thanks. Good morning, everyone. Deb, can you remind us what your expectations are for ad spend during the year. I think the original guidance was around 10% and as net revenue and the rate of growth has been a little bit slower relative to our model, given some of the initiatives you guys outlined at the beginning of the year. So just looking for an update there? And then, Brian, can you remind us its importance to MAGIC: THE GATHERING and MAGIC: THE Arena is that an important markets for the King. Thanks.

Deb Thomas

Sure. Well, let me take the advertising questions. And if you don't mind, Brian first, Drew we do continue to expect our advertising kind of in line with our initial guidance and just under -- just as around that 10%, or, just under that that 10% range, and much of that was, as we said, kind of gearing we had some specific expense gearing up around the launch of MAGIC. So it launched very late in the quarter and you'll continue to see us advertising and marketing heavily around that in the fourth quarter now that we're in open launch.

Drew Crum

Okay, got it.

Brian Goldner

Yes. And then if you look at Wizards overall in our strategy, we said that we believe we could double the size of the Wizards of the Coast business over the next five years, as we've accomplished over the past five years. And this year's growth puts us on pace to achieve this objective. And yet, the storytelling cadence of the card releases has it's up against the tough comparison from last year's fourth quarter.

Both analog and digital are performing very strongly. And then we're also working on person, first-party and third-party games and they're progressing really well. In 2020, we're going to have several new games to talk about with you.

As we look at the TCG, we're seeing growth in unique players. We're also seeing growth in games played. As we get into Q1 of 2020, there's a new gathering and new card release that returns to Theros which is a fan favorite, and a launch of a new standard legal set called Theros Beyond Death. So we're excited about the card games that gets back up and pace -- on pace for first quarter 2020.

As we look at MAGIC Arena, we ended the Open Beta with over 1.5 billion games played, with the game seeing significant year-over-year growth in every quarter since the start of our closed beta in December of 2017.

Our streaming growth is up over 100% with over 65,000 streamers streaming the game in Open Beta. We're one of the best reviewed Free to Play Games released in 2019. And it's very exciting to see a Metacritic score of 82 which is really on par with some of the best games in the industry. The launch weekend saw the game featured in the top 10 games streamed on Twitch. And again we've had and want to thank no more than three-and-a-half million participants that have been in our beta for making Arena really the most successful MAGIC digital game in the 25-year history. So we're really well on our way, we also have making progress to be on the Epic Games storefront for 2020 and we'll expand our audience.

We're developing a Mac OS version of the game, but we're also making progress with our mobile MAGIC game that's currently in test market and we'll have more news for you on that shortly into 2020.

So, again, we feel very good about the portfolio of games that we're bringing for the Wizards of the Coast brands and for MAGIC: THE GATHERING.

Operator

The next question is from the line of Gerrick Johnson with BMO Capital Markets. Please proceed with your question.

Gerrick Johnson

Hey, good morning. So List 4-301 I think it was announced back in May. So we knew this impact was coming on our last call in July. The conversation here sounds a little bit like there's you were caught off guard a little bit in some regards. So what changed since we talked about this in July? What's different from how you're originally planning and what's going on right now?

Brian Goldner

Yes, the three different communications also happened during the third quarter because the tariffs continue to get push back throughout the third quarter. And there were different proclamations around where the tariffs would occur. So the teams continue to gear up recognize that you're talking about in the third quarter, a year ago, about 50% of our sales were direct imports. So it's a big business for us in the third quarter, and we use that balance between that in our 3PL supply in the U.S. for domestic.

Given it continued to get pushed back, we were canceling orders in Asia, moving the inventory to the U.S. And the biggest difference versus our expectations for the quarter was what went on in September, and that we were unable to get all the products domestically through our supply chain, with the DI orders having come down or being cancelled. And that's really the difference maker of the quarter.

And as we head into Q4, we obviously prioritized around the earliest launches, and we have product in market, we're seeing really good results. But it was just the fact that we were short of either getting matched inventory, meaning inventory that comes in from Asia that's now available domestically that we can then put to a domestic retailer in time to meet an order or the actual domestic supply chain.

Gerrick Johnson

Okay, okay, that makes sense. But you mentioned that some orders were cancelled or not rewritten. So what are those products and what was not rewritten of the orders that were cancelled?

Brian Goldner

Brian Goldner

Yes, Deb talked a bit about it, there was and as you recall, there's a List 3. Some of our games that are more off the board games were part of List 3. So the tariffs were enacted, those DI orders were cancelled. And then we began to get some additional supporting orders for those games, but it came much later to come into the fourth quarter a bit. But we also had to take pricing across a number of dimensions to again support our gross margin around those games. As we said, we would, once the tariffs were enacted on certain products that are in our portfolio. So that was a process that went on for during Q3 as well.

Operator

The next question is coming from the line of Arpiné Kocharyan with UBS. Please proceed with your question.

Arpiné Kocharyan

Thank you very much. So as retailers' right size their direct import programs and also given the need that Hasbro need to hold more inventory into Q4. Also we have Entertainment's plate rich Q4, I'm trying to understand why inventory is down on balance sheet entering the quarter?

Deb Thomas

Hey Arpiné, it’s Deb. I'll take that. It's actually, so there is a couple of things. We've been working hard on reducing inventory in several locations. And it's -- we haven't actually talked about the fact that we have stabilized our European business actually and our international business was up in the quarter absent FX.

So FX is the -- is a big factor of why inventory is down. So as we think about it, it is up in the U.S. as we moved more inventory here domestically in order to be able to ship what we need to ship domestically versus direct import with what we're seeing in these trends now that we've been talking about, but it is down in our European business primarily and also in Latin America, it's up a little bit in Asia, just because where our business is growing there. But FX is probably the biggest reason why it's down overall.

Arpiné Kocharyan

Arpine Kocharyan

Okay. And then quick follow-up with Brian, I know it's still early on. But are there potentially parts of the eOne business that Hasbro could opportunistically divest over time, if you look at the business today?

Brian Goldner

We're very excited about bringing on board the brands, the capabilities and the personnel. And we are actively meeting one another and beginning to share what each business is all about. And I'd say, we'd like to close on our deal. And then we'll begin to look in earnest about the strongest and best and biggest growth drivers.

But it's very exciting to look at the prospects of the two companies together and how we can continue to drive even more of our owned IP to drive value for our shareholder across multiple dimensions of the Brand Blueprint. And we have a number of great brand initiatives coming this year for the holidays and we feel like in the future we'll have even more owned IP in the marketplace that will support our toys, games, and consumer products business as well as location based entertainment. So we'll close the deal and then we'll be able to give you a broader perspective.

Operator

Our next question comes from the line of Linda Bolton Weiser with D.A. Davison. Please proceed with your question.

Linda Bolton Weiser

Hi, so, could you talk about the price increases you did take already and if you are sensing any in the data, any kind of demand reduction in terms of volume demand by consumers in reaction to the pricing? And also can you comment on the different comments that the retailers have been making with regard to pricing related to the tariffs because I think Walmart has been openly saying that consumers are going to face higher prices, whereas Target actually said that they're not going to accept any more price increases related to tariffs. So can you talk about the whole-- the whole pricing situation? Thanks.

Brian Goldner

Sure. Well, the tariffs have been enacted now on List 3 products, which includes some of our games, and I would focus you again on kind of face-to-face games that are kind of non-traditional board games like games like Bop-It. And what we've done is looked at a portfolio approach to pricing. So we really look across our portfolio of games, we have many new games launching. And again, we're looking at critical price points. We're looking at demand and price elasticity, spending a lot of time to ensure the consumer gets the great games that they want, that they're able to participate fully in the broad array of our games and portfolio of our games.

And so being thoughtful about how we take pricing, but we are taking pricing to protect our gross margin. Thus far we have communicated the intention to take pricing on List 3 and have on List 4, we are actively communicating but if the December 15 tariffs were to go into effect, we would take pricing to again protect our gross margin and those price increases would be passed along to consumers. And, again, we'll use a combination of product and portfolio approach to get pricing for our products ensure we still hit critical price points, and really trying to give the consumer a great holiday.

We don't see tariffs being enacted two weeks before Christmas is giving the consumer the optimal holiday season. And we're hoping through engaged dialogue with the administration that we can mitigate any impact and/or preclude that from happening.

Linda Bolton Weiser

Thanks. And then if I could have a second question. You talked about your difficulty in getting the product over here to be able to fulfill the domestic orders, but yet, end demand for the toys will or will not be there Christmas, we're assuming it will be there because you have strong popular product. So is the supply chain constraint, just something that pushes over demand fulfillment into the first quarter or early part of 2020 such that consumers will still want the product and you make it carry over demand into the early part of the year. Is that something that's possible?

Brian Goldner

Well, I think you've hit on something really important as we think about some of the initiatives that are launching in Q4. Let's just take three, three initiatives. You look at Disney's Frozen 2, STAR WARS and NERF Ultra. These are three initiatives that we absolutely believe will have even more impact in 2020 than they'll have in 2019. So we're very excited about the launch. We're very excited about what's been happening since October 4 in the marketplace. We're seeing very strong demand for each of those initiatives. And yet, will satisfy even more demand coming through the holidays as millions and millions of people around the world get to enjoy that entertainment or get to begin to enjoy NERF Ultra. Right now, Ultra is only in the U.S. is a launch and we wish we had even more product and are racing to get product out to more markets around the world.

We're already seeing that several of our products are in hot demand and are selling incredibly well. Our Frozen Castle is a great hot seller. And again, it's selling ahead of our demand. And so you're right, there'll be a big impact into 2020. We have a lot of new initiatives coming in 2020 and a number of other new entertainment initiatives as well as brand initiatives. Year-to-date, we have four brands that are up, MONOPOLY, MAGIC, TRANSFORMERS, and PLAY-DOH. So we do have brands that are selling quite well, we had some puts and takes in the third quarter.

Many of those elements or issues were related to the just the supplying of product that we've talked about. We do view this tariff environment as short-term in nature and certainly disruptive. But we also view 2020 -- 2019 holiday and 2020 as an opportunity to grow our business. We have great initiatives, great marketing, and teams on the field who are actively redesigning our path to the marketplace. And we believe we'll be in a very good position coming into 2020.

Operator

Our next question is from the line of Greg Badishkanian with Citi. Please proceed with your question.

Fred Wightman

Hey guys, good morning. It’s actually Fred Wightman on for Greg. I think it'd be really helpful just given all the noise from a timing and a tariff perspective. How should we think about potentially getting back to those 2017 revenue and operating targets next year? Is that something that's still on the table? Or is sort of everything that you're seeing in the market today change that target?

Brian Goldner

I think that in many ways, we continue to track towards that idea. We said that if things few things broke right 2020 could look like 2017. Obviously, the tariff and tariff environment has created some short-term disruption to our growth trajectory. But if you look year-to-date having grown 5% absent FX, that's that mid-single-digit growth, we've talked to you about getting back on track remembering that we were just coming through Toys R Us. We certainly are seeing the acceleration in our gaming business particularly in Wizards of the Coast, we have a number of new initiatives coming for 2020 and yet, in overall, we saw that in September, overall retail sales were down a bit.

So we just feel that we have what it takes to be successful for the long-term. We believe that we will be back on track with the kind of growth trajectory we created from 2012 to 2017 that 5% CAGR in revenues and double-digit net earnings CAGR that we can get back there. And that given some of these short-term issues, 2020 is possible and we just need, as we've said, from the very beginning, a few things to break right for us in order to accomplish that objective.

Operator

Thank you. The next question is from the line of Eric Handler with MKM Partners. Please proceed with your question.

Eric Handler

Yes. Good morning, and thanks for the question. Brian, I wondered, if you could talk a little bit about the fundamentals of eOne, when eOne reached the end of its last fiscal year, you talked about for its, the family -- the family kids business, they expected to see strong revenue and EBITDA growth in its current fiscal year fiscal 2020. The company has in recent weeks come out with Q1 statement and the first half of the year statement saying revenue in that segment is flat year-over-year and margins have contracted a little bit. So wonder if you could provide some perspective of first, is that business -- was that business always expected to be backend weighted. Has anything changed in with the core of that business and what's in and what you expected to see when you first took a look at the books?

Brian Goldner

Yes, we feel very good about multiple aspects of the eOne business, the family and brands business clearly, there's a perennial star in Tampa and we feel that together the teams can do even a better job into the future as we take on more of the toys and games business as they continue to reinvent, reimagine the storytelling. And we do more of the licensing in-house. We see an opportunity again with PJ Masks as it goes forward. Ricky Zoom is just getting launched around the world. And so again, that's a very, very exciting new prospect; they have a number of new original IPs in development that they intend to launch.

And then they -- also when they recently spoke, they were not full-year results, so not all the interim periods were the same. So I think that that was just to try to get some correspondence or communication out to shareholders in advance of our potential close in Q4 this year.

Eric Handler

Okay, so overall, for you nothing is at least on the near-term perspective. I fully understand the long-term perspective, the long-term view, but nothing has changed at least on the near term, fundamental basis with them?

Brian Goldner

No, not at all. No, we feel very enthusiastic about coming together with eOne.

Operator

Thank you. The next question is from the line of Raymond Stochel with Consumer Edge. Please proceed with your question.

Raymond Stochel

Great, thanks for taking my question. Can you talk about NERF innovation both out the strike and Ultra as far as the timing, just an update on the timing there? And then where do you think you're trending for year-end for NERF overall within hopefully the context of what you're seeing this holiday in terms of competition?

Brian Goldner

Yes, so overall, for NERF the team has brought forward a lot of new innovation and in the fourth quarter will have 10 new blasters across the NERF business, so they brought a lot of new innovation to the business and into the category. Clearly Fortnite has been a strong performer and yet they have new innovation coming now, there's new form factors also coming within the Fortnite part of the business.

We've seen our share of growth for NERF overall, we've seen our share in under $20 grow with Alpha Strike. And we're now with the launch of Ultra in the U.S. seeing U.S. POS up for the first time in several quarters. So we believe we're on the right track as we get more innovation at volume, at scale, to not only grow the NERF business, but once again grow the category as we've been the leader in really inventing and reinventing this category over time.

As we get into 2020, there's a number of new innovations that are coming clearly Ultra scale gets out to more countries globally. We have new innovations coming across other platforms for NERF. And we're also bringing that experiential part of NERF to bear around the world between our agents, first location based experience and then something here in the United States that I spoke to.

So again feel very good about NERF in the long-term prospects. Obviously, some interruption of that in the quarter because of the way a lot of NERF direct import business gets done. But where we have new innovation, we are seeing the growth in POS and very happy NERF Nation where we bring the product to the market.

Raymond Stochel

Got it, thanks. And then a follow-up would be on some incremental details around guidance. So, royalties, sort of at least higher than what we were contemplating could be different maybe than what you all were contemplating or what Street was contemplating. And also SG&A sort of flat as a percent of sales. So are those two things driven by I guess royalties, one higher partner brands, brand sales, and we may have thought prior in SG&A such as the incremental warehousing and supply chain? Or are we having an issue on both of those line items, which is just lower overall expected revenues? And maybe we had been thinking prior for the full-year?

Deb Thomas

I think on the royalties, we wanted to make sure we put that new guidance out there because it actually is exceeding our guidance that we've previously provided. And that has to do with the way the mix of our partner brands are playing out with our franchise brands and frankly exceeding our originally expected demand from what we're seeing right now. So that's really royalties. And that's why we wanted to update you when we know we saw this trend developing.

From an SG&A standpoint, we are getting the cost savings that we anticipated, we still expect that we'll get the $50 million in cost savings, just being masked a bit by higher shipping and warehousing costs and also within that line a big piece of that is the investment we're making in growing our Wizards of the Coast brands as we think about adding the teams to do the game development, you've got some amortization of previously capitalized games that are going through that admin line.

So you're seeing that there this year, we really think it's primarily that that shipping in warehousing that's impacting us. And that's hitting -- that’s hitting that line that that will keep the comps about the same to adjusted SG&A because we had some unusual charges that went through that line item last year as well.

So overall, we're getting the cost savings, we believe we'll get the cost savings next year, we need to work on these factors that are hitting us in the quarter. But we continue to work to reduce costs in that line, but make the appropriate investments to keep investing in our future because as Brian said, our goal has been to grow the Wizards of the Coast brands, we think we can double them like we did in the last five years and the next five and that just requires investments. So we won't take our foot off the gas on those investments and we'll continue looking at different ways to save money to pay for those investments as we go forward.

Operator

Thank you. The next question is from the line of Priya Ohri-Gupta with Barclays. Please proceed with your question.

Priya Ohri-Gupta

Thank you so much for the question. First I would just like to ask about, how you're thinking about the importance of trying to maintain access to your two commercial paper market as you consider the funding mix for eOne. And then just as a follow-up, again, on the funding mix, are you considering also incorporating any sort of Sterling or even Euro borrowings in addition to dollars? Thank you.

Deb Thomas

So good morning, and thanks for asking question. For us, it's a great question. It's important for us to maintain access to the commercial paper markets and we stated it's our intent to be an investment grade company, we think in addition to giving us access to commercial paper and affording us with the appropriate available liquidity to keep investing in our business to grow in the long-term, that's very important to us.

So we will prioritize paying down our debt to get back to our leverage targets, two to two-and-a-half times and greater than eight as we look at debt-to-EBITDA and EBITDA to interest. But it is important to us to maintain that. That being said, we did end the quarter with $1 billion of cash on our balance sheet. In the last 12 months, we've generated about $860 million of cash flow. So we do generate a lot of cash.

As we look at the transaction, we have hedged a portion of the transaction knowing that we will need pounds to pay it and we saw that running to our P&L this quarter, and we're looking at the various borrowings that we could do to actually pay for the transaction in various currencies as well.

Priya Ohri-Gupta

And no further sort of delineation between how your liquidity needs could be affected, if you were to say, falter Tier 3 CP access versus Tier 2 would that impair your borrowing ability at all?

Deb Thomas

Well, we look at our borrowing ability, it's pretty strong, but it also get -- affords us at the rates we're at, and being an investment grade company and with the ratings we get from our rating agencies, that it is something we can afford go forward while we continue to invest in our business.

Operator

Thank you. We've reached the end of the question-and-answer session. And I will now turn the call over to Debbie Hancock for closing remarks.

Debbie Hancock

Thank you, Robin. Thank you everyone for joining the call today. The replay will be available on our website in approximately two hours. Additionally, management's prepared remarks will be posted on our website following this call. Thank you.

Operator

Thank you. This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.