Kalekem Cleophas, Paul Hwang, Julie Landy, Naomi Rodriguez, Nihar Shendye - 29 April 2014

Hasbro and Mattel Financial Statement Analysis

Hasbro, Inc. and Mattel, Inc. are two of the most recognized toy companies in the U.S. They operate in the toys & games industry, where competition is fierce and abundant and economic success depends on following market trends. Toy companies must embrace innovation in order to set themselves apart from their competition. Mattel, deemed the #1 toy manufacturer on the globe by Hoover's, offers famous brands such as Barbie and Fisher-Price Toys ("Mattel, Inc"). Hasbro Inc, deemed #2, offers the classic Play-doh and Milton Bradley games ("Hasbro, Inc"). Top competitors in the industry include JAKKS Pacific, Inc. and LEGO.

Interpretation of significant changes in financial statements

The most significant change in Hasbro's income statement — despite it being a small monetary amount — is in the amortization of intangibles expense. As shown in the trend income statement, this amount increased by 67% between 2011 and 2013, and as shown by the common-size income statement, this figure almost doubled in terms of percentage of sales. This increase reflects an increase among expenses, as shown particularly by the common-size income statement, which reflects that, relative to sales, all but one expense (advertising) has increased since 2011. This general increase in relative expense costs has had a detrimental effect on the net income, which is down 30% in pure figures and from 9% to 7% relative to sales.

There was a significant spike in cash and cash equivalents in 2012, likely due in part to the corresponding spike in short-term borrowings in the same year, particularly since sales were down in 2012 from 2011. Cash and cash equivalents returned to their pre-2012 value (around $650,000) in 2013, probably largely because the company paid back a significant portion of their short-term borrowings in 2013. This is a relatively normal business activity, and therefore is not cause for concern.

Ratios

The current ratio calculates a company's ability to pay short-term liabilities with short-term assets (Libby 458). For the last two years, Hasbro has demonstrated an overall better use of short-term assets to pay for short-term liabilities. Both companies had ratios over 2.0 at one point, meaning they used their funds inefficiently. Hasbro has become the stronger company by improving its management techniques over time, increasing efficiency. The managers have control over their short-term debt, which will, in turn maximize returns for their shareholders.

The quick ratio measures a company's quick assets against its current liabilities, which demonstrates a company's ability to quickly settle their current liabilities (Libby 458). What constitutes a good quick ratio is largely dependent on industry benchmarks. The ratio rises as quick assets (in relation to current liabilities) increase. Hasbro's quick ratio has decreased from 1.96 to 1.30 between 2012 and 2013, whereas Mattel's has increased from 1.49 to 2.20 in the same time. It seems that Mattel is using its quick assets less effectively; they have more than twice as much cash and cash equivalents as they do current liabilities, so they should be using that cash to invest in the company. Therefore, Hasbro has the stronger quick ratio.

The gross profit percentage measures a company's ability to charge premium prices and produce goods and services at low costs. All other things equal, a higher gross profit results in higher net income (Libby 284). Hasbro's gross profit/margin has not changed for the last two years because the changes in the net sales and cost of goods sold are almost the same. For Mattel, the gross margin for the last two years has seen a slight increase from 0.53 to 0.54. The increase in gross margin was as a result of Mattel's increase of net sales in 2013 and a decline in the cost of goods sold. Mattel demonstrates a stronger ratio.

Profit margin measures how much of every sales dollar generated during the period is profit (Libby 182). Hasbro's profit margin had a 12.5% decrease from 2012 to 2013. This decrease was due to an increase in expenses which eventually increased the costs, reducing the net revenues/ income. Mattel however did a better job of controlling its sales and costs, making its profit ratio increase about 16.7%. This indicates higher efficiency in the management of sales and expenses by Mattel.

Operating margin determines how much money a company is making in profit from its operating activities (Libby 182). Hasbro's operating margin decreased by 15.4%. This decrease was a result of high operating expenses witnessed in 2013. These expenses decreased the net operating profit which lowered the ratio. Mattel, however, has realized more profit from its operating activities, increasing from 0.16 to 0.18. This increase in Mattel's profit margin was a result of the lower expenses realized in 2013 in comparison to prior years. The lower operating costs increased the operating income, increasing the company's operating margin. Mattel performs better in terms of realizing profit from its operating activities.

The asset turnover ratio measures the sales generated per dollar of assets (Libby 127). Hasbro's asset turnover decreased from 0.97 to 0.94. The decrease in the ratio was due to an increase in Hasbro's assets in the year 2013. This indicates that Hasbro was less effective in using its assets to generate sales. Mattel's asset turnover ratio also decreased from 1.05 to 1.00. This decrease in the ratio was due to significant increase of total assets in 2013, which also increased average assets. Compared to Mattel, Hasbro has better management of its assets to generate sales.

The ROE is useful for comparing the profitability of a company to that of other firms in the same industry (Libby 702). The decrease from 0.23 in 2012 to 0.18 in 2013, for Hasbro indicates that there was a decrease in profitability. An increase from 0.27 to 0.29 indicates an increase in profitability for Mattel, making them the stronger company. Mattel’s largest customers include “Wal-Mart at $1.2 billion, Toys “R” Us at $0.7 billion and Target at $0.5 billion” (Mattel Annual Report 8).

ROA tells us what earnings were generated from invested capital (Libby 250). A decrease in ROA for Hasbro, from 0.08 to 0.07 indicates a decrease in these earnings. An increase for Mattel from 0.13 to 0.14 indicates an increase in these earnings.

Financial leverage is the degree to which a company uses fixed-income securities such as debt and preferred equity (“Complete Guide to Corporate Finance”). The more debt financing a company uses, the higher its financial leverage. A decrease in financial leverage, from 2.89 to 2.74 indicates less debt financing for Hasbro. A decrease from 2.15 to 2.05 indicates the same for Mattel.

Accounts receivable turnover is calculated using net credit sales and trade receivables (Libby 292). Hasbro and Mattel sell mostly to retailers, meaning most of their sales are on credit. From this, we can assume that total accounts receivable is equal to trade receivables. Mattel has a higher ratio for both years, revealing that the company collects cash about five times per year. Hasbro only collects three times per year. Mattel is the stronger company in terms of credit-granting and collections.

Days in accounts receivable is calculated by dividing 365 by the accounts receivable turnover ratio. The ratio reveals the average amount of days it takes to collect payments, which should not exceed 1.5 times the terms of credit granting (Libby 460). A high ratio would imply that the company needs to be more strict about its collections. Hasbro collects in 92-94 days. Mattel collects in only 70 days. This is in agreement with the accounts receivable turnover ratio: Mattel is the stronger company.

The inventory turnover ratio is a representation of the amount of times in a year a company's inventory was acquired and sold, measuring liquidity and general efficiency (Libby 347). Hasbro's inventory turnover ratio decreased from 5.14 to 5.03; Mattel's decreased from 6.33 to 5.81. Both of these decreases suggest a decrease in liquidity and efficiency. Sometimes, an inventory turnover ratio can be too high, but in the toys and games industry, merchandise changes more often than in other industries, requiring a higher inventory turnover. Mattel maintains the higher inventory turnover ratio, which indicates higher efficiency.

The days in inventory is calculated by dividing 365 by the inventory turnover ratio, so it is inversely correlated to the inventory turnover ratio (Libby 347). Hasbro's days in inventory has increased from about 71 to about 73; Mattel's has increased from about 58 to about 63. These increases are congruent with the decreases in the inventory turnover ratio showed: Both companies are likely becoming less efficient, but Mattel seems to be more efficient than Hasbro.

The accounts payable turnover ratio is a representation for how many times a year the company pays for its inventory (Libby 460). Hasbro's accounts payable turnover decreased from about 12 to about 10; Mattel's decreased slightly from 8.30 to 8.18. Relating this to their relative inventory turnover ratios, they both pay for their inventory more quickly than they sell their inventory, which is generally a negative. Mattel is the stronger company.

The days in accounts payable is inversely correlated to the accounts payable turnover (Libby 460). Hasbro's days in accounts payable increased from about 30 to about 36; Mattel's increased from 44 to 45. The days in accounts payable shows that accounts payable is settled more quickly than inventory is sold, which is unfavorable, but Mattel is stronger than Hasbro.

The cash conversion cycle calculates the period of time it takes a company to receive resource inputs and convert them to cash flows ("Cash Conversion Cycle"). Mattel's low ratio suggests better liquidity, with money moving quickly through inventory, accounts payable, and accounts receivable. Businesses with high ratios may have to resort to lowering prices in order to get rid of inventory. Mattel's lower cash conversion cycle implies better management of assets and liabilities, making them the stronger company.

The allowance for doubtful accounts to accounts receivable ratio deals with a company's projected credit collections/uncollectibles. A higher ratio suggests that there is a greater risk to the company for a larger amount of write-offs. For both Hasbro and Mattel, allowance for doubtful accounts have decreased over the last two years, but Mattel's has decreased to below Hasbro's. Even though there were not any large fluctuations in accounts receivable for either company, Mattel managed to reduce the uncollectibility on its credit sales.

The debt-to-equity ratio provides information about how much capital a company receives from its owners versus its creditors. A high ratio suggests that the company relies heavily on creditor funds. (Libby 712) Neither company's ratio is too high, which implies that both Mattel and Hasbro have a good capital structure. Relying too much on debt could result in bankruptcy if sales do not exceed these liabilities. Mattel demonstrates better capital structure by receiving more funds from owners than creditors, which is less risky, making it the stronger company.

The times interest earned ratio is largely used by creditors to determine a company's ability to pay its interest, based on its net income before interest and taxes. A higher ratio is generally better, meaning net income is higher in relation to the interest expense. (Libby 712) Hasbro's ratio decreased from 4.97 to 3.33; Mattel's increased from 10.64 to 14.00. Mattel's times interest earned ratio is significantly higher than Hasbro's, meaning that creditors will be more willing to invest in Mattel because it has greater security.

The dividend payout ratio reveals total dividends paid to stockholders, in relation to total net income (Libby 713). Hasbro's ratio decreases in 2013 while Mattel is consistent. The growth rate is calculated using the return on equity and dividend payout ratios. Mattel has the higher growth rate for last two years, and both companies were generally consistent in their numbers. This formula takes into consideration steady income versus reinvestment for possible future earnings, assuming the company has a net income. The decrease in dividends and net income implies that Hasbro did poorly in 2013 in comparison to 2012. Mattel has continued to perform well while increasing both its net income and dividends for last two years. Mattel is growing at a consistent, higher rate than Hasbro.

Inventory Cost Flow Assumptions

In considering inventory purchases, Mattel and Hasbro must take into account customer preferences (current and future), past trends, and research into the market. Companies in the toys and games industry must keep up with current trends and produce toys and games that are in high demand in order to maximize profits. Seasonality is an important concept when considering inventory purchases, with high sales during the winter holidays. Hasbro uses the first-in, first out method of inventory valuation. This method makes the assumption that the first inventory purchased will also be the first inventory sold, so the remaining inventory at the end of the period is that which was purchased the most recently. Inventory is stated at lower of cost or market (Hasbro Annual Report 57).

Mattel also employs the FIFO inventory cost flow method. There is no purpose in delaying the sale of inventory (Mattel Annual Report 70). This method leads to lower taxes as the price of inventory decreases. Mattel inventory is stated at lower of cost or market. Recently, Mattel has improved its purchasing strategies, buying inventory closer to the holiday season in order to follow customer demand and lessen inventory insufficiency (15-16).

Depreciation Methods

Hasbro predominantly uses the straight-line depreciation method, specifically in their amortizable intangibles and the majority of the plant, property and equipment. However, some of the property, plant and equipment is most useful at the beginning of its life, and for these items, the accelerated method is used (Hasbro Annual Report 57).

Mattel employs the straight-line method for the depreciation of their property, plant, and equipment. Additionally, they designate a usefulness over time estimate for each asset, which is monitored every few years in order to maintain accuracy. For all buildings, they anticipate ten to thirty years. For all equipment, they estimate three to ten years. For all leasehold improvements, ten to twenty years. For items such as tools, dies, and molds, Mattel uses the straight-line methods over a period of three years (Mattel Annual Report 71).

Additional liabilities

Mattel's and Hasbro's liabilities include short-term borrowings, long-term debt, accounts payable, income taxes payable, accrued liabilities and other liabilities. The short-term and long-term borrowings are made from domestic and foreign banks. For December 2013 and 2012, Mattel had foreign short-term bank loans outstanding of $4.3 million and $9.8 million respectively. But, "as of December 31, 2013 and 2012, Mattel had no borrowings outstanding under the credit facility" (Mattel Annual Report 80). Mattel is able to reduce its yearly liabilities through its "cash flow from operating activities, net proceeds from the issuance of long-term borrowings and proceeds from the exercise of stock options" (42). Mattel also maintains a deferred compensation plan that permits certain officers and key employees to elect portions of their compensation. The liability for these plans, as of December 31, 2013 and 2012 was $68 million and $59 million respectively, and is included in "other liabilities" in the consolidated balance sheet. Mattel therefore includes their major liabilities in its consolidated balance sheets. Liabilities not included in the balance sheet are insignificant. Some outside factors which may increase Mattel's liabilities include adverse global economic conditions which change consumer preferences. This would make it more difficult for a company to collect enough cash from its operating activities, reducing the ability to settle their major liabilities. Hasbro may also face difficulties in settling its debts during economic downturns that "negatively impact the retail and credit markets, or that otherwise damage the financial health" of the retail customers, which eventually harm the business's financial performance (Hasbro Annual Report 16).

Major sources and uses of cash.

The largest source of cash (inflow) for companies comes from operating activities. For the years 2013, 2012, and 2011, Mattel's largest sources of cash came from net income. Share-based compensation was another large source of cash. In 2013 and 2011, deferred income taxes accounts were one of the largest sources of cash for Mattel; in 2012 there is an outflow of cash in this category. In 2012, there is cash inflow from accounts receivable, inventories, and accounts payable accrued liabilities, and income tax payable for Mattel; in 2013 and 2011 there is cash outflow in these categories (Mattel Annual Report 78). For Hasbro, for the years 2013, 2012, and 2011, net earnings, depreciation of plant and equipment, and amortization of intangibles represent the largest cash inflows (Hasbro Annual Report 57).

The largest outflow of cash for these companies comes from investing and financing activities. For all three years (2013, 2011, and 2012), purchase of tools, dies, and molds, and purchase of other property, plant, and equipment represent one of the largest outflows of cash for investing activities, for Mattel. For 2012, payment for acquisition, net of cash acquired was the largest cash outflow for investing activities in all three years, for Mattel. For financing activities, payments of long-term borrowings, share repurchases, and payment of dividends on common stock was the largest outflow for all three years, for Mattel (Mattel Annual Report 86). For investing activities, for all three years, additions to property, plant, and equipment, and for 2013 and 2011, investments are acquisitions, net of cash required are the largest outflows of cash, for Hasbro. For financing activities, purchases of common stock and dividends paid are the largest outflows of cash for all three years, for Hasbro (Hasbro Annual Report 67).

Audit reports analysis

The seven essential parts of a standard unqualified audit report are the title, addressee, introductory paragraph, scope paragraph, opinion paragraph, name of auditor (CPA firm), and date of report. The auditing report of Hasbro is reflective of standard unqualified audit reports and it follows the standard in orderly manner. In contrast, Mattel's auditing report shows slight departure from the standard. Mattel addresses the opinion regarding the financial statements preceding introductory paragraph; it expresses the auditor's opinion in regard to the fairness of the financial statements based upon evidence obtained through the audit before stating "which financial statements are covered by the report, that the statements are the responsibility of management, and that the auditor has a responsibility to express an opinion." This slight change in the format is favorable to some extent because the SEC can see the opinion of the independent accounting firm before they check to see what the auditors have included and evaluated in the financial statements ("AU Section 150").

$50,000 to invest in one company

After analyzing Hasbro Inc and Mattel Inc, paying special attention to their ratios, business practices/strategies, and recent major changes in their financial statements, a $50,000 investment to Mattel, Inc would be a better investment. This choice will result in higher returns. This company demonstrates effective financial management, which exceeds that of Hasbro, allowing for nearly all of Mattel's ratios to demonstrate better performance as a company in the toys and games industry. We foresee more growth in the future, as well as continued innovation and cost reduction.

Works Cited

"AU Section 150." Public Company Accounting Oversight Board. N.p., n.d. Web. 25 Apr. 2014.

Bushman, Melissa. "The Standard Unqualified Audit Report." Yahoo Contributor Network. N.p., n.d. Web. 25 Apr. 2014.

"Cash Conversion Cycle (CCC) Definition | Investopedia." *Investopedia*. N.p., n.d. Web. 18 Apr. 2014.

"Complete Guide to Corporate Finance | Investopedia." *Investopedia.* N.p., n.d. Web. 20 Apr. 2014.

"Dividend Payout Ratio." Finance Formulas. N.p., n.d. Web. 25 Apr. 2014.

Hasbro, Inc. 2013 10-K Report. Hasbro Incorporated, 2013. Web. 10 Apr. 2014.

Hasbro, Inc. 2013 Annual Report. Hasbro Incorporated, 2013. Web. 10 Apr. 2014.

"Hasbro, Inc. Company Information." *Hoover's Inc*. N.p., n.d. Web. 20 Apr. 2014.

Libby, Robert, Patricia A. Libby, and Daniel G. Short. *Financial Accounting*. New York: McGraw-Hill/Irwin, 2011. Print.

Mattel, Inc. 2013 10-K Report. Mattel Incorporated, 2013. Web. 10 Apr. 2014.

Mattel, Inc. 2013 Annual Report. Mattel Incorporated, 2013. Web. 10 Apr. 2014.

"Mattel, Inc. Company Information." *Hoover's Inc*. N.p., n.d. Web. 20 Apr. 2014.

"Ratios and Formulas in Customer Financial Analysis." Ratios and Formulas in Customer Financial Analysis. Credit Research Foundation, 1999. Web. 25 Apr. 2014.