JAKKS PACIFIC INC
Form 10-Q
May 07, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2010

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______ to ______

Commission file number: 0-28104

JAKKS Pacific, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	95-4527222
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
22619 Pacific Coast Highway Malibu, California	90265
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (310) 456-7799

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
¨	x	¨	¨
		(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of the issuer's common stock is 27,901,076 as of May 7, 2010.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

INDEX TO QUARTERLY REPORT ON FORM 10-Q
Quarter Ended March 31, 2010

ITEMS IN FORM 10-Q

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. For example, statements included in this report regarding our financial position, business strategy and other plans and objectives for future operations, and assumptions and predictions about future product demand, supply, manufacturing, costs, marketing and pricing factors are all forward-looking statements. When we use words like "intend," "anticipate," "believe," "estimate," "plan", "expect" or words o similar import, we are making forward-looking statements. We believe that the assumptions and expectations reflected in such forward-looking statements are reasonable and are based on information available to us on the date hereof, but we cannot assure you that these assumptions and expectations will prove to have been correct or that we will take any action that we may presently be planning. We are not undertaking to publicly update or revise any forward-looking statement if we obtain new information or upon the occurrence of future events or otherwise.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	December 31, 2009 (*)	March 31, 2010 (Unaudited)
ASSETS		
Current assets		
Cash and cash equivalents	$ 254,837	$ 277,999
Marketable securities	202	204
Accounts receivable, net of allowances for uncollectible accounts of $2,005 and $2,136, respectively	129,930	59,236
Inventory	34,457	30,814
Income Tax receivable	35,015	42,200
Deferred income taxes	19,467	19,372
Prepaid expenses and other current assets	34,259	29,453
Total current assets	508,167	459,278
Property and equipment		
Office furniture and equipment	12,218	12,360
Molds and tooling	55,054	55,816
Leasehold improvements	6,540	6,831
Total	73,812	75,007
Less accumulated depreciation and amortization	52,598	54,914
Property and equipment, net	21,214	20,093
Deferred income taxes	53,502	56,326
Intangibles and other, net	40,604	38,645
Investment in video game Joint Venture	6,727	-
Goodwill, net	1,571	1,571
Trademarks, net	2,308	2,308
Total assets	$ 634,093	$ 578,221
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 37,613	$ 21,116
Accrued expenses	64,051	42,727
Reserve for sales returns and allowances	33,897	18,967
Capital lease obligation	155	73
Convertible senior notes	20,262	20,262
Total current liabilities	155,978	103,145
Convertible Senior Notes, Net	86,728	87,410
Other Liabilities	2,490	2,607
Income taxes payable	16,788	16,926
Total liabilities	261,984	210,088
Stockholders' equity		
Preferred stock, $.001 par value; 5,000,000 shares authorized; nil outstanding	—	—
Common stock, $.001 par value; 100,000,000 shares authorized; 27,638,769 and 27,895,569 shares issued and outstanding, respectively	28	28
Additional paid-in capital	303,474	304,654

Retained earnings	72,835	67,679
Accumulated comprehensive loss	(4,228)	(4,228)
Total stockholders' equity	372,109	368,133
Total liabilities and stockholders' equity	$ 634,093	$ 578,221

(*) Derived from audited financial statements
See notes to condensed consolidated financial statements.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Three Months Ended March 31, (Unaudited)	
	2009	2010
Net sales	$ 108,685	$ 77,345
Cost of sales	71,704	52,112
Gross profit	36,981	25,233
Selling, general and administrative expenses	54,554	38,861
Loss from operations	(17,573)	(13,628)
Profit from video game joint venture	2,896	-
Interest Income	179	57
Interest Expense, net of benefit	(1,267)	(1,197)
Loss before benefit for income taxes	(15,765)	(14,768)
Benefit for income taxes	(4,966)	(9,611)
Net Loss	$ (10,799)	$ (5,157)
Loss per share – basic	$ (0.40)	$ (0.19)
Loss per share – diluted	$ (0.40)	$ (0.19)

See notes to condensed consolidated financial statements.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Three Months Ended March 31, (Unaudited) 2009	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	$ (10,799)	$ (5,157)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	4,828	4,586
Share-based compensation expense	1,994	1,180
Loss (Gain) on disposal of property and equipment	6	(9)
Deferred income taxes	709	(2,729)
Changes in operating assets and liabilities:		
Accounts receivable	76,414	70,694
Inventory	8,782	3,643
Prepaid expenses and other current assets	(14,545)	4,806
Receivable from Joint Venture	(3,402)	6,727
Income tax receivable	79	(7,186)
Accounts payable	(35,127)	(16,497)
Accrued expenses	(24,611)	(21,324)
Income taxes payable	(6,938)	138
Reserve for sales returns and allowances	(4,374)	(14,930)
Other liabilities	111	117
Total adjustments	3,926	29,216
Net cash provided(used) by operating activities	(6,873)	24,059
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(4,191)	(1,250)
Change in other assets	342	437
Cash paid for net assets of business acquired	(11,679)	-
Net purchase of marketable securities	(3)	(2)
Net cash used in investing activities	(15,531)	(815)
CASH FLOWS FROM FINANCING ACTIVITIES		
Common stock repurchased	(1,389)	-
Increase/(decrease) in capital lease obligations	41	(82)
Net cash used in financing activities	(1,348)	(82)
Net increase (decrease) in cash and cash equivalents	(23,752)	23,162
Cash and cash equivalents, beginning of period	169,520	254,837
Cash and cash equivalents, end of period	$ 145,768	$ 277,999
Cash paid during the period for:		
Income taxes	$ 2,116	$ 400
Interest	$ 8	$ 3
Non cash investing and financing activity:		

In January 2009, two executive officers surrendered an aggregate of 74,836 shares of restricted stock at a value of $1.4 million to cover their income taxes due on the 2009 vesting of restricted shares granted to them in 2007 and 2008. This restricted stock was subsequently retired by the Company. Also in January 2009, an employee surrendered 551 shares of restricted stock at a value of $11,367 to cover his income taxes due on the December 31, 2008 vested shares.

See Notes 8 and 9 for additional supplemental information to the condensed consolidated statements of cash flows.

See notes to condensed consolidated financial statements.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
March 31, 2010

Note 1 — Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to prevent the information presented from being misleading. These financial statements should be read in conjunction with Management's Discussion and Analysis of financial condition and results of operations and the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K, which contains audited financial information for the three years in the period ended December 31, 2009.

The information provided in this report reflects all adjustments (consisting solely of normal recurring items) that are, in the opinion of management, necessary to present fairly the financial position and the results of operations for the periods presented. Interim results are not necessarily indicative of results to be expected for a full year.

Certain reclassifications have been made to prior year balances in order to conform to the current year presentation.

The condensed consolidated financial statements include the accounts of JAKKS Pacific, Inc. and its wholly-owned subsidiaries (collectively "the Company").

Note 2 — Business Segments, Geographic Data, Sales by Product Group, and Major Customers

The Company is a worldwide producer and marketer of children's toys and other consumer products, principally engaged in the design, development, production, marketing and distribution of its diverse portfolio. The Company's reportable segments are Traditional Toys, Craft/Activity/Writing Products, and Pet Products, each of which includes worldwide sales.

The Traditional Toys segment includes action figures, vehicles, playsets, plush products, dolls, accessories, pretend play products including Halloween costumes and accessories, dress-up costumes and accessories, electronic products, novelty toys, collectibles, construction toys, compounds, infant and pre-school toys, water toys, kites, and related products.

Craft/Activity/Writing Products include do-it-yourself kits, pens, pencils, stationery products, crayons, markers, paints, and other related craft and activity products.

Pet Products include pet toys, treats, apparel and related pet products.

Segment performance is measured at the operating income level. All sales are made to external customers, and general corporate expenses have been attributed to the various segments based on sales volumes. Segment assets are comprised of accounts receivable and inventories, net of applicable reserves and allowances, goodwill and other assets.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 2 — Business Segments, Geographic Data, Sales by Product Group, and Major Customers - (continued)

Results are not necessarily those that would be achieved were each segment an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts as of December 31, 2009 and March 31, 2010 and for the three months ended March 31, 2009 and 2010 are as follows (in thousands):

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010
Net Sales		
Traditional Toys	$ 97,592	$ 66,505
Craft/Activity/Writing Products	7,560	9,060
Pet Products	3,533	1,780
	$ 108,685	$ 77,345

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010
Operating Loss		
Traditional Toys	$ (15,780)	$ (11,718)
Craft/Activity/Writing Products	(1,222)	(1,596)
Pet Products	(571)	(314)
	$ (17,573)	$ (13,628)

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010
Depreciation and Amortization Expense		
Traditional Toys	$ 4,557	$ 3,424
Craft/Activity/Writing Products	179	1,075
Pet Products	92	87
	$ 4,828	$ 4,586

	December 31, 2009	March 31, 2010
Assets		
Traditional Toys	$ 565,516	$ 515,219
Craft/Activity/Writing Products	57,022	54,236
Pet Products	11,555	8,766
	$ 634,093	$ 578,221

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 2 — Business Segments, Geographic Data, Sales by Product Group, and Major Customers - (continued)

The following tables present information about the Company by geographic area as of December 31, 2009 and March 31, 2010 and for the three months ended March 31, 2009 and 2010 (in thousands):

	December 31, 2009	March 31, 2010
Long-lived Assets		
United States	$ 19,917	$ 18,951
Hong Kong	1,297	1,142
	$ 21,214	$ 20,093

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010
Net Sales by Geographic Area		
United States	$ 90,072	$ 64,475
Europe	6,137	5,158
Canada	4,404	3,126
Hong Kong	3,247	1,443
Other	4,825	3,143
	$ 108,685	$ 77,345

Major Customers

Net sales to major customers for the three months ended March 31, 2009 and 2010 were as follows (in thousands, except for percentages):

	Three Months Ended March 31, 2009		Three Months Ended March 31, 2010	
	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales
Wal-Mart	$ 35,546	32.7%	$ 19,398	25.1%
Target	15,696	14.4	9,827	12.7
Toys R Us	11,136	10.3	12,399	16.0
	$ 62,378	57.4%	$ 41,624	53.8%

No other customer accounted for more than 10% of the Company’s total net sales.

At December 31, 2009 and March 31, 2010, the Company’s three largest customers accounted for approximately 74.0% and 75.2%, respectively, of net accounts receivable. The concentration of the Company’s business with a relatively small number of customers may expose the Company to material adverse effects if one or more of its large customers were to experience financial difficulty. The Company performs ongoing credit evaluations of its top customers and maintains an allowance for potential credit losses.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 3 — Inventory

Inventory, which includes the ex-factory cost of goods, in-bound freight, duty and warehouse costs, is stated at the lower of cost (first-in, first-out) or market and consists of the following (in thousands):

	December 31, 2009	March 31, 2010
Raw materials	$ 6,995	$ 7,056
Finished goods	27,462	23,758
	$ 34,457	$ 30,814

Note 4 — Revenue Recognition and Reserve for Sales Returns and Allowances

Revenue is recognized upon the shipment of goods to customers or their agents, depending on terms, provided that there are no uncertainties regarding customer acceptance, the sales price is fixed or determinable, and collectability is reasonably assured and not contingent upon resale.

Generally, the Company does not allow product returns. It provides a negotiated allowance for breakage or defects to its customers, which is recorded when the related revenue is recognized. However, the Company does make occasional exceptions to this policy and consequently accrues a return allowance in gross sales based on historic return amounts and management estimates. The Company also will occasionally grant credits to facilitate markdowns and sales of slow moving merchandise. These credits are recorded as a reduction of gross sales at the time of occurrence.

The Company also participates in cooperative advertising arrangements with some customers, whereby it allows a discount from invoiced product amounts in exchange for customer purchased advertising that features the Company's products. Typically, these discounts range from 1% to 6% of gross sales, and are generally based on product purchases or on specific advertising campaigns. Such amounts are accrued when the related revenue is recognized or when the advertising campaign is initiated. These cooperative advertising arrangements are accounted for as direct selling expenses.

The Company's reserve for sales returns and allowances amounted to $33.9 million as of December 31, 2009, compared to $19.0 million as of March 31, 2010. This decrease was primarily due to certain customers taking their year-end allowances related to 2009 during 2010.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 5 — Convertible Senior Notes

In November 2009 the Company sold an aggregate of $100.0 million of 4.50% Convertible Senior Notes due 2014 (the “Notes”). The Notes are senior unsecured obligations of JAKKS, will pay interest semi-annually at a rate of 4.50% per annum and will mature on November 1, 2014. The conversion rate will initially be 63.2091 shares of JAKKS common stock per $1,000 principal amount of notes (equivalent to an initial conversion price of approximately $15.82 per share of common stock), subject to adjustment in certain circumstances. Prior to August 1, 2014, holders of the Notes may convert their Notes only upon specified events. Upon conversion, the Notes may be settled, at the Company’s election, in cash, shares of its common stock, or a combination of cash and shares of its common stock. Holders of the Notes may require the Company to repurchase for cash all or some of their Notes upon the occurrence of a fundamental change (as defined).

The Company used a portion of the net proceeds from the offering to repurchase $77.7 million of its 4.625% convertible senior notes due in 2023 and may repurchase the remaining $20.3 million of its 4.625% convertible senior notes in June 2010. In the event the Company is unable to or otherwise does not repurchase such Notes on satisfactory terms, it may use such proceeds for general corporate purposes.

In June 2003, the Company sold an aggregate of $98.0 million of 4.625% Convertible Senior Notes due June 15, 2023 of which $20.3 million remain outstanding. The notes may be converted into shares of the Company’s common stock at an initial conversion price of $20.00 per share, or 50 shares per note, subject to certain circumstances. The notes may be converted in each quarter subsequent to any quarter in which the closing price of the Company’s common stock is at or above a prescribed price for at least 20 trading days in the last 30 trading day period of the quarter. The prescribed price for the conversion trigger is $24.00 through June 30, 2010, and increases nominally each quarter thereafter. Cash interest is payable at an annual rate of 4.625% of the principal amount at issuance, from the issue date to June 15, 2010, payable on June 15 and December 15 of each year, commencing on December 15, 2003. After June 15, 2010, interest will accrue at the same rate on the outstanding notes. At maturity, the Company will redeem the notes at their accreted principal amount, which will be equal to $1,811.95 (181.195%) per $1,000 principal amount at issuance, unless redeemed or converted earlier. The notes were not convertible as of March 31, 2010 and are not convertible during the second quarter of 2010.

The Company may redeem the notes at its option in whole or in part beginning on June 15, 2010, at 100% of their accreted principal amount plus accrued and unpaid interest, if any, payable in cash. Holders of the notes may also require the Company to repurchase all or part of their notes on June 15, 2010, for cash, at a repurchase price of 100% of the principal amount per note plus accrued and unpaid interest, if any. Holders of the notes may also require the Company to repurchase all or part of their notes on June 15, 2013 and June 15, 2018 at a repurchase price of 100% of the accreted principal amount per note plus accrued and unpaid interest, if any. Any repurchases at June 15, 2013 and June 15, 2018 may be paid in cash, in shares of common stock or a combination of cash and shares of common stock.

Note 6 — Income Taxes

The Company’s income tax benefit of $9.6 million for the three months ended March 31, 2010 reflects an effective tax benefit of 65.1%. Included in the tax benefit of $9.6 million is a tax benefit of $4.9 million related to a reduction in tax reserves resulting from the effective settlement of tax audits of the Company’s 2003 through 2006 income tax returns. Absent this discrete tax benefit, the Company’s effective tax rate for the three months ended March 31, 2010 is 32.2%.

The Company’s tax benefit for the three months ended March 31, 2009 was $5.0 million and reflected an effective tax rate of 31.5%.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 7 — Loss Per Share

The following table is a reconciliation of the weighted average shares used in the computation of basic and diluted loss per share for the periods presented (in thousands, except per share data):

	Three Months Ended March 31,					
	2009			2010		
	Income / (Loss)	Weighted Average Shares	Per-Share	Income / (Loss)	Weighted Average Shares	Per-Share
Loss per share - basic						
Income available to common stockholders	$ (10,799)	27,194	$ (0.40)	$ (5,157)	27,393	$ (0.19)
Loss per share - diluted						
Income available to common stockholders plus assumed exercises and conversion	$ (10,799)	27,194	$ (0.40)	$ (5,157)	27,393	$ (0.19)

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 7 — Loss Per Share (continued)

Basic loss per share has been computed using the weighted average number of common shares outstanding. Diluted loss per share has been computed using the weighted average number of common shares and common share equivalents outstanding (which consist of warrants, options and convertible debt to the extent they are dilutive). For the three months ended March 31, 2010, the convertible notes interest and related common share equivalent of 7,334,010, diluted options and unvested restricted stock grants outstanding of 504,497 were excluded from the diluted loss per share calculation because they were anti-dilutive. Potentially dilutive stock options of 402,203 and 388,555 for the three months ended March 31, 2009 and 2010, respectively, were excluded from the computation of diluted loss per share as the average market price of the Company’s common stock did not exceed the weighted average exercise price of such options and to have included them would have been anti-dilutive. Potentially dilutive restricted stock of 421,179 and nil for the three months ended March 31, 2009 and 2010, respectively, were excluded from the computation of diluted loss per share as the average market price of the Company’s common stock did not exceed the weighted average exercise price of such options and to have included them would have been anti-dilutive.

Note 8 — Common Stock and Preferred Stock

The Company has 105,000,000 authorized shares of stock consisting of 100,000,000 shares of $.001 par value common stock and 5,000,000 shares of $.001 par value preferred stock.

In January 2010, the Company issued an aggregate of 240,000 shares of restricted stock at an aggregate value of approximately $2.9 million to two of its executive officers, which vest, subject to certain Company financial performance criteria, in January 2011, and an aggregate of 40,950 shares of restricted stock to its five non-employee directors, which vest in January 2011, at an aggregate value of approximately $0.5 million.

All issuances of common stock, including those issued pursuant to stock option and warrant exercises, restricted stock grants and acquisitions, are issued from the Company’s authorized but not issued and outstanding shares.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 9 — Business Combinations

The Company acquired the following entities to further enhance its existing product lines and to continue diversification into other toy categories and seasonal businesses:

In October 2008, the Company acquired substantially all of the assets of Tollytots Limited. The total initial consideration of $26.8 million consisted of $12.0 million in cash and the assumption of liabilities in the amount of $14.8 million, and resulted in goodwill of $4.1 million, of which $3.1 million has been determined to be impaired and was written off in the quarter ended June 30, 2009. In addition, the Company agreed to pay an earn-out of up to an aggregate amount of $5.0 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. In the first earn-out period ended December 31, 2009, no portion of the earn-out was earned. Tollytots is a leading designer and producer of licensed baby dolls and baby doll pretend play accessories based on well-known brands, and was included in its results of operations from the date of acquisition.

In October 2008, the Company acquired all of the stock of Kids Only, Inc. and a related Hong Kong company, Kids Only Limited (collectively, “Kids Only”). The total initial consideration of $23.8 million consisted of $20.4 million in cash and the assumption of liabilities in the amount of $3.4 million, and resulted in goodwill of $13.2 million, of which $12.7 million has been determined to be impaired and was written off in the quarter ended June 30, 2009. In addition, the Company agreed to pay an earn-out of up to an aggregate amount of $5.6 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. The first earn-out period ended September 30, 2009 and the full earn-out amount was earned for the first earn-out period earn-out agreement. Kids Only is a leading designer and producer of licensed indoor and outdoor kids’ furniture, and has an extensive portfolio which also includes baby dolls and accessories, room décor and a myriad of other children’s toy products, and was included in its results of operations from the date of acquisition. Pro forma results of operations are not provided since the amounts are not material to the consolidated results of operations.

In December 2008, the Company acquired certain assets of Disguise, Inc. and a related Hong Kong company, Disguise Limited (collectively, “Disguise”). The total initial consideration of $60.6 million consisted of $38.6 million in cash and the assumption of liabilities in the amount of $22.0 million, and resulted in goodwill of $30.6 million, all of which has been determined to be impaired and was written off in the quarter ended June 30, 2009. Disguise is a leading designer and producer of Halloween and everyday costume play and was included in our results of operations from the date of acquisition. Pro forma results of operations are not provided since the amounts are not material to the consolidated results of operations.

Refer to Note 11 for information on the write-down of goodwill.

Note 10 — Joint Venture

The Company owned a fifty percent interest in a joint venture with THQ Inc. (“THQ”), which developed, published and distributed interactive entertainment software for the leading hardware game platforms in the home video game market. Pursuant to a Settlement Agreement and Mutual Release dated December 22, 2009, the joint venture was terminated on December 31, 2009 and THQ is obligated to pay the Company fixed payments of $6.0 million on each of June 30, 2010 and 2011 and $4.0 million on each of June 30, 2012 and 2013 which the Company will record as income on a cash basis when received (see Note 14).

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 10 — Joint Venture (continued)

As of December 31, 2009 and March 31, 2010, the balance of the investment in the video game joint venture includes the following components (in thousands):

	December 31 2009	March 31, 2010
Preferred return receivable	$ 6,727	$ -
Investment costs, net	—	-
	$ 6,727	$ -

Note 11 — Goodwill

The changes in the carrying amount of goodwill for the three months ended March 31, 2010 are as follows (in thousands):

	Traditional Toys
Balance at beginning of the period	$ 1,571
Adjustments to goodwill during the period	-
Balance at end of the period	$ 1,571

The Company applies a fair value-based impairment test to the net book value of goodwill and indefinite-lived intangible assets on an annual basis and, if certain events or circumstances indicate that an impairment loss may have been incurred, on an interim basis. The analysis of potential impairment of goodwill requires a two-step process. The first step is the estimation of fair value. If step one indicates that an impairment potentially exists, the second step is performed to measure the amount of impairment, if any. Goodwill impairment exists when the estimated fair value of goodwill is less than its carrying value.

During 2009, the Company reclassified $20.9 million from goodwill to intangibles and other assets for its Disguise acquisition. Furthermore, the Company increased goodwill for its Kids Only and Tollytots acquisitions by $0.3 million for acquisition related costs.

During the second quarter of 2009, the Company determined that the significant decline in its market capitalization was likely to be sustained and that an interim goodwill impairment test was required. As a result of such testing, the Company determined that $407.1 million, substantially of the goodwill related to previous acquisitions, including the acquisition of Disguise in December 2008, was impaired. This amount was charged to expense in Write-down of Goodwill in the second quarter of 2009.

At December 31, 2009, the Company recorded deferred tax liabilities related to the Tollytots and Kids Only acquisitions that resulted in Goodwill of $1.6 million.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 12 — Intangible Assets Other Than Goodwill

Intangible assets consist primarily of licenses, product lines, customer relationships, debt offering costs from the issuance of the Company's convertible senior notes and trademarks. Amortized intangible assets are included in the Intangibles and other, net, in the accompanying balance sheets. Trademarks are disclosed separately in the accompanying balance sheets. Intangible assets are as follows (in thousands, except for weighted useful lives):

		December 31, 2009			March 31, 2010		
	Weighted Useful Lives (Years)	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets:							
Acquired order backlog	.50	$ 2,393	$ (2,393)	$ —	$ 2,393	$ (2,393)	$ -
Licenses	4.84	85,788	(57,396)	28,392	85,788	(58,550)	27,238
Product lines	3.62	19,100	(18,285)	815	19,100	(18,290)	810
Customer relationships	5.32	6,296	(2,912)	3,384	6,296	(3,073)	3,223
Non-compete/Employment contracts	3.84	3,133	(2,823)	310	3,133	(2,855)	278
Debt offering costs	5.74	4,444	(372)	4,072	4,444	(565)	3,879
Total amortized intangible assets		121,154	(84,181)	36,973	121,154	(85,726)	35,428
Unamortized Intangible Assets:							
Trademarks		2,308		2,308	2,308		2,308
		$ 123,462	$ (84,181)	$ 39,281	$ 123,462	$ (85,726)	$ 37,736

Amortization expense related to limited life intangible assets was $1.6 million and $1.5 million for the three months ended March 31, 2009 and 2010, respectively.

As of June 30, 2009, the Company determined that the tradenames "Child Guidance" and "Play Along" and certain tradenames associated with its Craft and Activity product lines would either be discontinued, or were under-performing. Consequently, the intangible assets associated with these tradenames were written off to Write-down of Intangible Assets, resulting in a non-cash charge of $8.2 million.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 13 — Comprehensive Income (Loss)

The table below presents the components of the Company’s comprehensive loss for the three months ended March 31, 2009 and 2010 (in thousands):

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010
Net loss	$ (10,799)	$ (5,157)
Other comprehensive income (loss):		
Foreign currency translation adjustment	(7)	1
Comprehensive loss	$ (10,806)	$ (5,156)

Note 14— Litigation

On October 12, 2006, World Wrestling Entertainment, Inc. (“WWE”) commenced a lawsuit in Connecticut state court against THQ/JAKKS Pacific LLC, alleging that sales of WWE video games in Japan and other countries in Asia were not lawful (the “Connecticut Action”). The lawsuit sought, among other things, a declaration that WWE is entitled to terminate the video game license and monetary damages. In 2007, WWE filed an amended complaint in the Connecticut Action to add the principal part of the state law claims present in the action filed by WWE in the Southern District of New York (the “WWE Action”) to the Connecticut Action; the WWE Action was finally dismissed in 2009. THQ filed a cross-complaint that asserted claims by THQ and Mr. Farrell, THQ’s Chief Executive Officer, for indemnification from the Company in the event that WWE prevailed on its claims against THQ and Farrell and also asserted claims by THQ that the Company breached its fiduciary duties to THQ in connection with the videogame license between WWE and the THQ/JAKKS Pacific joint venture and sought equitable and legal relief, including substantial monetary and exemplary damages against the Company in connection with its claim. Thereafter, the WWE claims and the THQ cross-claims in the Connecticut Action were all dismissed with prejudice pursuant to settlement agreements that the Company entered into with WWE and THQ dated December 22, 2009 (the “Settlements”). The settlement agreement with THQ provides for payments to the Company in the aggregate amount of $20.0 million payable $6.0 million, $6.0 million, $4.0 million and $4.0 million in 2010, 2011, 2012 and 2013, respectively.

In November 2004, several purported class action lawsuits were filed in the United States District Court for the Southern District of New York (the “Class Actions”), alleging damages associated with the facts alleged in the WWE Action that was finally dismissed in 2009. A motion to dismiss the Class Actions was filed, was fully briefed and argument occurred on November 30, 2006. The motion was granted without prejudice to seeking leave to amend; such leave was granted to plaintiffs, an amended complaint was filed and briefing was completed with respect to a motion to dismiss, which was scheduled for argument in October 2008. That date was adjourned by the Court. The parties thereafter reached an agreement to settle this matter. In November 2009, a motion was filed by plaintiffs’ counsel for preliminary approval of this agreement, which provided for the matter to be settled for $3.9 million, without any admission of liability on the part of the Company, or its officers and directors. Three shareholder derivative actions pertaining to the WWE Action and the Class Actions were also filed against the Company, nominally, and against certain of the Company’s Board members (the “Derivative Actions”). The Derivative Actions seek to hold the individual defendants liable for damages allegedly caused to the Company by their actions, and, in one of the Derivative Actions, seeks restitution to the Company of profits, benefits and other compensation obtained by them. Agreement to resolve the Derivative Actions has been reached, but it is also subject to Court approval. A Company insurer has agreed to provide the $4.1 million that will be used to settle the Class Actions and the Derivative Actions.

The Company is a party to, and certain of its property is the subject of, various other pending claims and legal proceedings that routinely arise in the ordinary course of its business. The Company does not believe that any of these claims or proceedings will have a material effect on its business, financial condition or results of operations.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 15 — Share-Based Payments

The Company's 2002 Stock Award and Incentive Plan (the "Plan") provides for the awarding of stock options and restricted stock to employees, officers and non-employee directors. The Plan is more fully described in Notes 14 and 16 to the Consolidated Financial Statements in the Company's 2009 Annual Report on Form 10-K.

The following table summarizes the total share-based compensation expense and related tax benefits recognized for the three months ended March 31, 2009 and 2010 (in thousands):

	Three Months Ended March 31,			
	2009		2010	
Stock option compensation expense	$	109	$	39
Tax benefit related to stock option compensation	$	39	$	14
Restricted stock compensation expense	$	1,885	$	1,141
Tax benefit related to restricted stock compensation	$	718	$	431

Stock option activity pursuant to the Plan for three months ended March 31, 2010 is summarized as follows:

	Plan Stock Options (*)		
	Number of Shares	Weighted Average Exercise Price	
Outstanding, December 31, 2009	444,715	$	19.63
Granted	-	$	-
Exercised	-	$	-
Cancelled	(57,400)	$	21.20
Outstanding, March 31, 2010	387,315	$	19.39

* The stock option activity excludes 100,000 of fully vested warrants issued during 2003 with an initial exercise price of $11.35 per share, which expire August 14, 2013 and are outstanding at March 31, 2010.

Restricted stock award activity pursuant to the Plan for the three months ended March 31, 2010 is summarized as follows:

	Restricted Stock Awards	
	Number of Shares	Weighted Average Exercise Price

Outstanding, December 31, 2009	436,443	$	20.24
Awarded	280,950	$	12.12
Released	(178,526)	$	23.11
Forfeited	(24,150)	$	17.98
Outstanding, March 31, 2010	514,717	$	14.92

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read together with our Condensed Consolidated Financial Statements and Notes thereto which appear elsewhere herein.

Critical Accounting Policies and Estimates

The accompanying consolidated financial statements and supplementary information were prepared in accordance with accounting principles generally accepted in the United States of America. Significant accounting policies are discussed in Note 2 to the Consolidated Financial Statements set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009. Inherent in the application of many of these accounting policies is the need for management to make estimates and judgments in the determination of certain revenues, expenses, assets and liabilities. As such, materially different financial results can occur as circumstances change and additional information becomes known. The policies with the greatest potential effect on our results of operations and financial position include:

Allowance for Doubtful Accounts. Our allowance for doubtful accounts is based on management's assessment of the business environment, customers' financial condition, historical collection experience, accounts receivable aging, customer disputes and the collectability of specific customer accounts. If there were a deterioration of a major customer's creditworthiness, or actual defaults were higher than our historical experience, our estimates of the recoverability of amounts due to us could be overstated, which could have an adverse impact on our operating results. The allowance for doubtful accounts is also affected by the time at which uncollectible accounts receivable balances are actually written off.

Major customers' accounts are monitored on an ongoing basis; more in depth reviews are performed based on changes in customer's financial condition and/or the level of credit being extended. When a significant event occurs, such as a bankruptcy filing by a specific customer, and on a quarterly basis, the allowance is reviewed for adequacy and the balance or accrual rate is adjusted to reflect current risk prospects.

Revenue Recognition. Our revenue recognition policy is to recognize revenue when persuasive evidence of an arrangement exists, title transfer has occurred (product shipment), the price is fixed or readily determinable, and collectability is probable. Sales are recorded net of sales returns and discounts, which are estimated at the time of shipment based upon historical data. JAKKS routinely enters into arrangements with its customers to provide sales incentives, support customer promotions, and provide allowances for returns and defective merchandise. Such programs are based primarily on customer purchases, customer performance of specified promotional activities, and other specified factors such as sales to consumers. Accruals for these programs are recorded as sales adjustments that reduce gross revenue in the period the related revenue is recognized.

Goodwill and other indefinite-lived intangible assets. Goodwill and indefinite-lived intangible assets are not amortized, but are tested for impairment at least annually at the reporting unit level.

Factors we consider important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and
- significant negative industry or economic trends.

Due to the subjective nature of the impairment analysis significant changes in the assumptions used to develop the estimate could materially affect the conclusion regarding the future cash flows necessary to support the valuation of long-lived assets, including goodwill. The valuation of goodwill involves a high degree of judgment and consists of a comparison of the fair value of a reporting unit with its book value. Based on the assumptions underlying the valuation, impairment is determined by estimating the fair value of a reporting unit and comparing that value to the reporting unit's book value. If the implied fair value is more than the book value of the reporting unit, an impairment loss is not indicated. If impairment exists, the fair value of the reporting unit is allocated to all of its assets and liabilities excluding goodwill, with the excess amount representing the fair value of goodwill. An impairment loss is measured as the amount by which the book value of the reporting unit's goodwill exceeds the estimated fair value of that goodwill.

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As of June 30, 2009, the Company determined that the significant decline in its market capitalization is likely to be sustained. The Company's market capitalization was not significantly affected by the substantial resolution of the WWE lawsuit, and the lower revenue expectations for 2009 versus 2008 were factors that indicated that an interim goodwill impairment test was required. As a result, the Company determined that $407.1 million, or all of the goodwill related to previous acquisitions, including the acquisition of Disguise in December 2008, was impaired. This amount is included in "Write-down of Goodwill" in the accompanying consolidated statements of operations.

As of June 30, 2009, the Company determined that the tradenames "Child Guidance" and "Play Along" and certain tradenames associated with our Craft and Activity product lines would either be discontinued, or were under performing. Consequently, the intangible assets associated with these tradenames were written off to "Write-down of Intangible Assets", resulting in a non-cash charge of $8.2 million.

Goodwill and Intangible assets amounted to $39.3 million as of March 31, 2010.

Reserve for Inventory Obsolescence. We value our inventory at the lower of cost or market. Based upon a consideration of quantities on hand, actual and projected sales volume, anticipated product selling prices and product lines planned to be discontinued, slow-moving and obsolete inventory is written down to its net realizable value.

Failure to accurately predict and respond to consumer demand could result in the Company under producing popular items or over producing less popular items. Furthermore, significant changes in demand for our products would impact management's estimates in establishing our inventory provision.

Management estimates are monitored on a quarterly basis and a further adjustment to reduce inventory to its net realizable value is recorded, as an increase to cost of sales, when deemed necessary under the lower of cost or market standard.

Income Allocation for Income Taxes. Our quarterly income tax provision and related income tax assets and liabilities are based on estimated annual income as allocated to the various tax jurisdictions based upon our transfer pricing study, US and foreign statutory income tax rates, and tax regulations and planning opportunities in the various jurisdictions in which the Company operates. Significant judgment is required in interpreting tax regulations in the US and foreign jurisdictions, and in evaluating worldwide uncertain tax positions. Actual results could differ materially from those judgments, and changes from such judgments could materially affect our consolidated financial statements.

Discrete Items for Income Taxes. A discrete tax benefit of $4.9 million was recognized during the three months ended March 31, 2010 related to a reduction in tax reserves resulting from the effective settlement of tax audits of the Company's 2003 through 2006 income tax returns.

Income taxes and interest and penalties related to income tax payable. We do not file a consolidated return with our foreign subsidiaries. We file federal and state returns and our foreign subsidiaries each file Hong Kong returns, as applicable. Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized as deductible temporary differences and operating loss and tax credit carry-forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Management employs a threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Tax benefits that are subject to challenge by tax authorities are analyzed and accounted for in the income tax provision.

We accrue a tax reserve for additional income taxes, which may become payable in future years as a result of audit adjustments by tax authorities. The reserve is based on management's assessment of all relevant information, and is periodically reviewed and adjusted as circumstances warrant. As of March 31, 2010, our income tax reserves are approximately $16.9 million and relate to the potential income tax audit adjustments, primarily in the areas of income allocation and transfer pricing.

Share-Based Compensation . We grant restricted stock and options to purchase our common stock to our employees (including officers) and non-employee directors under our 2002 Stock Award and Incentive Plan (the “Plan”), which incorporated the shares remaining under our Third Amended and Restated 1995 Stock Option Plan. The benefits provided under the Plan are share-based payments. We estimate the value of share-based awards on the date of grant using the Black-Scholes option-pricing model. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price, as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, cancellations, terminations, risk-free interest rates and expected dividends.

Recent Developments

In October 2008, we acquired substantially all of the assets of Tollytots Limited. The total initial consideration of $26.8 million consisted of $12.0 million in cash and the assumption of liabilities in the amount of $14.8 million, and resulted in goodwill of $4.1 million, of which $3.1 million has been determined to be impaired and was written off in the quarter ended June 30, 2009. In addition, we agreed to pay an earn-out of up to an aggregate amount of $5.0 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. In the first earn-out period ended December 31, 2009, no portion of the earn-out was earned. Tollytots is a leading designer and producer of licensed baby dolls and baby doll pretend play accessories based on well-known brands and was included in our results of operations from the date of acquisition.

In October 2008, we acquired substantially all of the stock of Kids Only, Inc. and a related Hong Kong company, Kids Only Limited (collectively, “Kids Only”). The total initial consideration of $23.8 million consisted of $20.4 million in cash and the assumption of liabilities in the amount of $3.4 million, and resulted in goodwill of $13.2 million, of which $12.7 million has been determined to be impaired and was written off in the quarter ended June 30, 2009. In addition, we agreed to pay an earn-out of up to an aggregate amount of $5.6 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. The first earn-out period ended September 30, 2009 and the full earn-out amount was earned for the first earn-out period. Kids Only is a leading designer and producer of licensed indoor and outdoor kids’ furniture, and has an extensive portfolio which also includes baby dolls and accessories, room décor and a myriad of other children’s toy products and was included in our results of operations from the date of acquisition.

In December 2008, we acquired certain assets of Disguise, Inc. and a related Hong Kong company, Disguise Limited (collectively, “Disguise”). The total initial consideration of $60.6 million consisted of $38.6 million in cash and the assumption of liabilities in the amount of $22.0 million, and resulted in goodwill of $30.6 million, all of which has been determined to be impaired and was written off in the quarter ended June 30, 2009. Disguise is a leading designer and producer of Halloween and everyday costume play and was included in our results of operations from the date of acquisition.

On November 10, 2009, we sold an aggregate of $100.0 million of 4.50% Convertible Senior Notes due 2014 (the “Notes”). The Notes are senior unsecured obligations of JAKKS, will pay interest semi-annually at a rate of 4.50% per annum and will mature on November 1, 2014. The conversion rate will initially be 63.2091 shares of our common stock per $1,000 principal amount of notes (equivalent to an initial conversion price of approximately $15.82 per share of common stock), subject to adjustment in certain circumstances. Prior to August 1, 2014, holders of the Notes may convert their Notes only upon specified events. Upon conversion, the Notes may be settled, at our election, in cash, shares of our common stock, or a combination of cash and shares of our common stock. Holders of the Notes may require us to repurchase for cash all or some of their Notes upon the occurrence of a fundamental change (as defined in the Notes). We used a portion of the net proceeds from the offering to repurchase $77.7 million of our

4.625% convertible senior notes due in 2023.

On December 22, 2009 we entered into a Settlement Agreement and Mutual Release pursuant to which our joint venture with THQ was terminated as of December 31, 2009 and we will receive fixed payments in the aggregate amount of $20.0 million from THQ payable $6.0 million on each of June 30, 2010 and 2011 and $4.0 million on each of June 30, 2012 and 2013 which we will record as income on a cash basis over the term.

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Results of Operations

The following unaudited table sets forth, for the periods indicated, certain statement of income data as a percentage of net sales.

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010
Net sales	100.0%	100.0%
Cost of sales	66.0	67.4
Gross profit	34.0	32.6
Selling, general and administrative expenses	50.2	50.2
Loss from operations	(16.2)	(17.6)
Profit from video game joint venture	2.7	-
Interest income	0.2	0.1
Interest expense, net of benefit	(1.2)	(1.5)
Loss before benefit for income taxes	(14.5)	(19.0)
Benefit for income taxes	(4.6)	(12.4)
Net Loss	(9.9)%	(6.6)%

The following unaudited table summarizes, for the periods indicated, certain income statement data by segment (in thousands).

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2010
Net Sales		
Traditional Toys	$97,592	$66,505
Craft/Activity/Writing Products	7,560	9,060
Pet Products	3,533	1,780
	108,685	77,345
Cost of Sales		
Traditional Toys	63,207	44,810
Craft/Activity/Writing Products	5,207	5,938
Pet Products	3,290	1,364
	71,704	52,112
Gross Profit		
Traditional Toys	34,385	21,695
Craft/Activity/Writing Products	2,353	3,122
Pet Products	243	416
	$36,981	$25,233

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Comparison of the Three Months Ended March 31, 2010 and 2009

Net Sales

Traditional Toys. Net sales of our Traditional Toys segment were $66.5 million in the three months ended March 31, 2010, compared to $97.6 million in the prior year period, representing a decrease of $31.3 million, or 28.8%. The decrease in net sales was primarily due to lower unit sales of our WWE®, Pokémon® and Smurfs® toys, Hannah Montana® dolls, dress-up and electronics, and other JAKKS products, including EyeClops® electronics, Graco® dolls and accessories, In My Pocket & Friends™ and Discovery Kids® toys, Nascar® vehicles and JAKKS™ dolls. This was offset in part by increases in unit sales of some products, including UFC action figures, Bella Sara®, Club Penguin™ and Hello Kitty® toys, Cabbage Patch Kids® dolls, Road Champs vehicles, and Lucky BeeBee™ activities.

Craft/Activity/Writing Product. Net sales of our Craft/Activity/Writing Products were $9.1 million in the three months ended March 31, 2010 , compared to $7.6 million in the prior year period, representing an increase of $1.5 million, or 19.8%. The increase in net sales was primarily due to increases in unit sales of our activity items, offset in part by decreases in unit sales of Spa Factory™ activity toys.

Pet Products. Net sales of our Pet Products were $1.7 million in the three months ended March 31, 2010, compared to $3.5 million in the prior year period, representing a decrease of $1.8 million, or 49.6%. The decrease is mainly attributable to the less available shelf space for pet products at some of our major customer retail stores, and lower unit sales of consumable pet products. Sales of pet products were led by our AKC® licensed line of products.

Cost of Sales

Traditional Toys. Cost of sales of our Traditional Toys segment was $44.8 million, or 67.4% of related net sales, for the three months ended March 31, 2010, compared to $63.2 million, or 64.8% of related net sales, in the prior year period, representing a decrease of $18.4 million, or 29.4%. The dollar decrease is due to lower sales. The increase in cost of sales as a percentage of net sales is primarily due to a change in the product mix and higher royalty costs partially offset by lower depreciation of molds and tooling.

Craft/Activity/Writing Products. Cost of sales of our Craft/Activity/Writing Products segment was $5.9 million, or 65.5% of related net sales, in 2009, compared to $5.2 million, or 68.9% of related net sales, in the prior year period, representing an increase of $0.7 million, or 14.0%. The $0.7 million increase was primarily driven by higher sales volume. Product costs as a percentage of net sales decreased primarily due to the mix of the product and lower royalty expense. Royalty expense decreased by $0.4 million or 26.7% as a percentage of net sales due to a non recurring royalty expense in the first three months of 2009.

Pet Product. Cost of sales of our Pet products was $1.4 million, or 76.6% of related net sales, for the three months ended March 31, 2010, compared to $3.3 million, or 93.1% of related net sales, in the prior period, representing a decrease of $1.9 million, or 58.5%. This decrease primarily consisted of a decrease in product costs of $1.8 million, due to the mix of product and non-recurring closeout discounts in the three months ended March 31, 2009. Product costs as a percentage of net sales decreased primarily due to non-recurring closeout discounts in the three months ended March 31, 2009. Royalty expense decreased by $0.2 million on lower sales volumes and increased as a percentage of sales due to changes in the product mix.

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Selling, General and Administrative Expenses

Selling, general and administrative expenses were $38.9 million in the three months ended March 31, 2010 and $54.6 million in the prior year period, constituting 50.2% and 50.2% of net sales, respectively. Selling, general and administrative expenses decreased $15.7 million from the prior year period primarily due to the favorable effect of cost controls and restructuring initiatives, coupled with the effect of lower sales on certain volume-sensitive expenses specifically, product development ($4.7 million), salary and benefits ($3.6 million), direct selling costs ($2.5 million), rent ($1.2 million), marketing ($1.0 million), legal ($0.7 million), stock compensation ($0.7 million), outside services and temporary labor ($0.7 million) and commissions ($0.6 million), partially offset by increased bad debt expense ($0.4 million) and bonus expense ($0.6 million).

Write-down of Intangible Assets

As of June 30, 2009, we determined that the tradenames “Child Guidance,” “Play Along” and certain tradenames associated with our Crafts and Activities product lines would either be discontinued, or were under-performing. Consequently, the intangible assets associated with these tradenames were written off to “Write-down of Intangible Assets”, resulting in a non-cash charge of $8.2 million. During the third quarter of 2008, the Company discontinued the use of the “Toymax” and “Trendmaster” tradenames on products and market these products under the JAKKS Pacific trademark. Consequently, the intangible assets associated with these tradenames were written off to “Write-down of Intangible Assets”, resulting in a charge of $3.5 million. Also, the Company adjusted the value of the Child Guidance trademark to reflect lower sales expectations for this tradename, resulting in a charge to “Write-down of Intangible Assets” of $5.6 million.

Write-down of Goodwill

As of June 30, 2009, we determined that the significant decline in our market capitalization was likely to be sustained and that an interim goodwill impairment test was required. As a result of such testing, we determined that $407.1 million, or all of the goodwill related to previous acquisitions, including the acquisition of Disguise in December 2008, was impaired. This amount was charged to expense in “Write-down of Goodwill” during the second quarter of 2009.

Profit from Video Game Joint Venture

We did not incur any income from our video game joint venture in 2010, as compared to profit of $2.9 million in 2009. Pursuant to a Settlement Agreement and Mutual Release dated December 22, 2009, the joint venture was terminated on December 31, 2009 and we will receive fixed payments in the aggregate amount of $20.0 million from THQ payable $6.0 million on each of June 30, 2010 and 2011 and $4.0 million on each of June 30, 2012 and 2013 which we will record as income on a cash basis over the term (see “Legal Proceedings”).

Interest Income

Interest income in the three months ended March 31, 2010 was $0.1 million, as compared to $0.2 million in the three months ended March 31, 2009. The decrease is due to lower interest rates during 2010 compared to 2009.

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Interest Expense

Interest expense was $1.2 million in the three months ended March 31, 2010, as compared to $1.3 million in the prior period. In the three months ended March 31, 2010, we booked interest expense of $2.2 million related to our convertible senior notes payable, offset in part by a net benefit of $1.0 million related to uncertain tax positions taken or expected to be taken in a tax return and net interest expense of $0.1 million related to uncertain tax positions taken or expected to be taken in a tax return. In the three months ended March 31, 2009, we booked interest expense of $1.1 million related to our convertible senior notes payable and net interest expense of $0.1 million related to uncertain tax positions taken or expected to be taken in a tax return.

Provision for Income Taxes

Our income tax benefit, which includes federal, state and foreign income taxes, and discrete items, was $9.6 million, or an effective tax rate benefit of 65.1% for the three months ended March 31, 2010. During the comparable period in 2009, the income tax expense was $5.0 million, or an effective tax provision rate of 31.5%.

The income tax benefit for the three months ended March 31, 2010 included a discrete benefit of $4.9 million related to a reduction in tax reserves resulting from the effective settlement of tax audits of the Company’s 2003 through 2006 income tax returns (see Note 6 of the Notes to Condensed Consolidated Financial Statements, supra.). Exclusive of the discrete items, the March 31, 2010 effective tax provision rate would be 32.2%.

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Seasonality and Backlog

The retail toy industry is inherently seasonal. Generally, our sales have been highest during the third and fourth quarters, and collections for those sales have been highest during the succeeding fourth and first fiscal quarters. Our working capital needs have been highest during the third and fourth quarters.

While we have taken steps to level sales over the entire year, sales are expected to remain heavily influenced by the seasonality of our toy and Halloween products. The result of these seasonal patterns is that operating results and demand for working capital may vary significantly by quarter. Orders placed with us for shipment are cancelable until the date of shipment. The combination of seasonal demand and the potential for order cancellation makes accurate forecasting of future sales difficult and causes us to believe that backlog may not be an accurate indicator of our future sales. Similarly, financial results for a particular quarter may not be indicative of results for the entire year.

Liquidity and Capital Resources

As of March 31, 2010, we had working capital of $356.1 million, compared to $352.1 million as of December 31, 2009. The increase was primarily attributable to seasonally accounts receivable, inventory and prepaid expense balances offset partially by lower accrued expenses and accounts payable balances.

Operating activities provided net cash of $24.1 million in the first three months of 2010, as compared to a net cash use of $6.9 million in the prior year period. Net cash was provided primarily from receipt of payments for outstanding receivables. Our accounts receivable turnover as measured by days sales for the quarter outstanding in accounts receivable was 69 days as of March 31, 2010, an increase from 59 days as of March 31, 2009. Other than open purchase orders issued in the normal course of business, we have no obligations to purchase finished goods from our manufacturers. As of March 31, 2010, we had cash and cash equivalents of $278.0 million.

Our investing activities used net cash of $0.8 million in the three months ended March 31, 2010, as compared to $15.5 million in the prior year period, consisting primarily of cash paid for the purchase of office furniture and equipment and molds and tooling of $1.3 million used in the manufacture of our products, offset in part by the change in other assets of $0.4 million. As part of our strategy to develop and market new products, we have entered into various character and product licenses with royalties generally ranging from 1% to 14% payable on net sales of such products. As of March 31, 2010, these agreements required future aggregate minimum guarantees of $84.7 million, exclusive of $58.8 million in advances already paid. Of this $84.7 million future minimum guarantee, $59.4 million is due over the next twelve months.

Our financing activities used net cash of $0.1 million in 2009, consisting of payments for capital leases.

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In October 2008, we acquired substantially all of the assets of Tollytots Limited. The total initial consideration of $26.8 million consisted of $12.0 million in cash and the assumption of liabilities in the amount of $14.8 million, and resulted in goodwill of $4.1 million, of which $3.1 million has been determined to be impaired and was written off in the quarter ended June 30, 2009. In addition, we agreed to pay an earn-out of up to an aggregate amount of $5.0 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. In the first earn-out period ended December 31, 2009, no portion of the earn-out was earned. Tollytots is a leading designer and producer of licensed baby dolls and baby doll pretend play accessories based on well-known brands and was included in our results of operations from the date of acquisition.

In October 2008, we acquired substantially all of the stock of Kids Only, Inc. and a related Hong Kong company, Kids Only Limited (collectively, “Kids Only”). The total initial consideration of $23.5 million consisted of $20.4 million in cash and the assumption of liabilities in the amount of $3.4 million, and resulted in goodwill of $13.2 million, of which $12.7 million has been determined to be impaired and was written off in the quarter ended June 30, 2009. In addition, we agreed to pay an earn-out of up to an aggregate amount of $5.6 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. The first earn-out period ended September 30, 2009 and the full earn-out amount was earned for the first earn-out period. Kids Only is a leading designer and producer of licensed indoor and outdoor kids’ furniture, and has an extensive portfolio which also includes baby dolls and accessories, room décor and a myriad of other children’s toy products and was included in our results of operations from the date of acquisition.

In December 2008, we acquired certain assets of Disguise, Inc. and a related Hong Kong company, Disguise Limited (collectively, “Disguise”). The total initial consideration of $60.6 million consisted of $38.6 million in cash and the assumption of liabilities in the amount of $22.0 million, and resulted in goodwill of $30.6 million, all of which has been determined to be impaired and was written off in the quarter ended June 30, 2009. Disguise is a leading designer and producer of Halloween and everyday costume play and was included in our results of operations from the date of acquisition.

In November 2009, we sold an aggregate of $100.0 million of 4.50% Convertible Senior Notes due 2014 (the “Notes”). The Notes are senior unsecured obligations of JAKKS, will pay interest semi-annually at a rate of 4.50% per annum and will mature on November 1, 2014. The conversion rate will initially be 63.2091 shares of our common stock per $1,000 principal amount of notes (equivalent to an initial conversion price of approximately $15.82 per share of common stock), subject to adjustment in certain circumstances. Prior to August 1, 2014, holders of the Notes may convert their Notes only upon specified events. Upon conversion, the Notes may be settled, at our election, in cash, shares of our common stock, or a combination of cash and shares of our common stock. Holders of the Notes may require us to repurchase for cash all or some of their Notes upon the occurrence of a fundamental change (as defined in the Notes). We used a portion of the net proceeds from the offering to repurchase $77.7 million of our 4.625% convertible senior notes due in 2023.

In June 2003, we sold an aggregate of $98.0 million of 4.625% Convertible Senior Notes due June 15, 2023, of which $20.3 million remain outstanding. The notes may be converted into shares of our common stock at an initial conversion price of $20.00 per share, or 50 shares per note, subject to certain circumstances. The notes may be converted in each quarter subsequent to any quarter in which the closing price of our common stock is at or above a prescribed price for at least 20 trading days in the last 30 trading day period of the quarter. The prescribed price for the conversion trigger is $24.00 through June 30, 2010, and increases nominally each quarter thereafter. Cash interest is payable at an annual rate of 4.625% of the principal amount at issuance, from the issue date to June 15, 2010, payable on June 15 and December 15 of each year, commencing on December 15, 2003. After June 15, 2010, interest will accrue at the same rate on the outstanding notes until maturity. At maturity, we will redeem the notes at their accreted principal amount, which will be equal to $1,811.95 (181.195%) per $1,000 principal amount at issuance, unless redeemed or converted earlier. The notes were not convertible as of March 31, 2010 and are not convertible during the second quarter of 2010.

We may redeem the notes at our option in whole or in part beginning on June 15, 2010, at 100% of their accreted principal amount plus accrued and unpaid interest, if any, payable in cash. Holders of the notes may also require us to repurchase all or part of their notes on June 15, 2010, for cash, at a repurchase price of 100% of the principal amount per note plus accrued and unpaid interest, if any. Holders of the notes may also require us to repurchase all or part of their notes on June 15, 2013 and June 15, 2018 at a repurchase price of 100% of the accreted principal amount per note plus accrued and unpaid interest, if any. Any repurchases at June 15, 2013 and June 15, 2018 may be paid in cash, in shares of common stock or a combination of cash and shares of common stock.

We believe that our cash flows from operations and cash and cash equivalents will be sufficient to meet our working capital and capital expenditure requirements and provide us with adequate liquidity to meet our anticipated operating needs for at least the next 12 months. Although operating activities are expected to provide cash, to the extent we grow significantly in the future, our operating and investing activities may use cash and, consequently, this growth may require us to obtain additional sources of financing. There can be no assurance that any necessary additional financing will be available to us on commercially reasonable terms, if at all. We intend to finance our long-term liquidity requirements out of net cash provided by operations and net cash and cash equivalents. As of March 31, 2010, we do not have any off-balance sheet arrangements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and rates. We are exposed to market risk in the areas of changes in United States and international borrowing rates and changes in foreign currency exchange rates. In addition, we are exposed to market risk in certain geographic areas that have experienced or remain vulnerable to an economic downturn, such as China. We purchase substantially all of our inventory from companies in China, and, therefore, we are subject to the risk that such suppliers will be unable to provide inventory at competitive prices. While we believe that, if such an event were to occur we would be able to find alternative sources of inventory at competitive prices, we cannot assure you that we would be able to do so. These exposures are directly related to our normal operating and funding activities. Historically, we have not used derivative instruments or engaged in hedging activities to minimize our market risk.

Interest Rate Risk

In June 2003, we issued convertible senior notes payable of $98.0 million with a fixed interest rate of 4.625% per annum, of which $20.3 million remain outstanding as of March 31, 2010. In November 2009, we issued convertible senior notes payable of $100.0 million with a fixed interest rate of 4.50% per annum, which remain outstanding as of March 31, 2010. Accordingly, we are not generally subject to any direct risk of loss arising from changes in interest rates.

Foreign Currency Risk

We have wholly-owned subsidiaries in Hong Kong, China, Canada, and the United Kingdom. Sales made by the Hong Kong subsidiaries are denominated in U.S. dollars. However, purchases of inventory are typically denominated in Hong Kong dollars and local operating expenses are denominated in the local currency of the subsidiary, thereby creating exposure to changes in exchange rates. Changes in the local currency/U.S. dollar exchange rates may positively or negatively affect our operating results. We do not believe that near-term changes in these exchange rates, if any, will result in a material effect on our future earnings, fair values or cash flows, and therefore, we have chosen not to enter into foreign currency hedging transactions. We cannot assure you that this approach will be successful, especially in the event of a significant and sudden change in the value of the Hong Kong dollar or Chinese Yuan relative to the U.S. dollar. We incorporated a subsidiary in the United Kingdom in late 2008 and have limited operations and, therefore, we have a nominal currency translation risk at this time.

Item 4. Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Report, have concluded that as of that date, our disclosure controls and procedures were effective. There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Exchange Act Rule 13a-15(d) that occurred during the period covered by this Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II
OTHER INFORMATION

Item 1. Legal Proceedings

On October 12, 2006, World Wrestling Entertainment, Inc. ("WWE") commenced a lawsuit in Connecticut state court against THQ/JAKKS Pacific LLC, alleging that sales of WWE video games in Japan and other countries in Asia were not lawful (the "Connecticut Action"). The lawsuit sought, among other things, a declaration that WWE is entitled to terminate the video game license and monetary damages. In 2007, WWE filed an amended complaint in the Connecticut Action to add the principal part of the state law claims present in the action filed by WWE in the Southern District of New York (the "WWE Action") to the Connecticut Action; the WWE Action was finally dismissed in 2009. THQ filed a cross-complaint that asserted claims by THQ and Mr. Farrell, THQ's Chief Executive Officer, for indemnification from the Company in the event that WWE prevailed on its claims against THQ and Farrell and also asserted claims by THQ that the Company breached its fiduciary duties to THQ in connection with the videogame license between WWE and the THQ/JAKKS Pacific joint venture and sought equitable and legal relief, including substantial monetary and exemplary damages against the Company in connection with its claim. Thereafter, the WWE claims and the THQ cross-claims in the Connecticut Action were all dismissed with prejudice pursuant to settlement agreements that the Company entered into with WWE and THQ dated December 22, 2009 (the "Settlements").

In November 2004, several purported class action lawsuits were filed in the United States District Court for the Southern District of New York: (1) Garcia v. JAKKS Pacific, Inc. et al., Civil Action No. 04-8807 (filed on November 5, 2004), (2) Jonco Investors, LLC v. JAKKS Pacific, Inc. et al., Civil Action No. 04-9021 (filed on November 16, 2004), (3) Kahn v. JAKKS Pacific, Inc. et al., Civil Action No. 04-8910 (filed on November 10, 2004), (4) Quantum Equities L.L.C. v. JAKKS Pacific, Inc. et al., Civil Action No. 04-8877 (filed on November 9, 2004), and (5) Irvine v. JAKKS Pacific, Inc. et al., Civil Action No. 04-9078 (filed on November 16, 2004) (the "Class Actions"). The complaints in the Class Actions alleged that defendants issued positive statements concerning increasing sales of our WWE licensed products which were false and misleading because the WWE licenses had allegedly been obtained through a pattern of commercial bribery, our relationship with the WWE was being negatively impacted by the WWE's contentions and there was an increased risk that the WWE would either seek modification or nullification of the licensing agreements with us. Plaintiffs also alleged that we misleadingly failed to disclose the alleged fact that the WWE licenses were obtained through an unlawful bribery scheme. The plaintiffs in the Class Actions were described as purchasers of our common stock, who purchased from as early as October 26, 1999 to as late as October 19, 2004. The Class Actions sought compensatory and other damages in an undisclosed amount, alleging violations of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder by each of the defendants (namely the Company and Messrs. Friedman, Berman and Bennett), and violations of Section 20(a) of the Exchange Act by Messrs. Friedman, Berman and Bennett. On January 25, 2005, the Court consolidated the Class Actions under the caption In re JAKKS Pacific, Inc. Shareholders Class Action Litigation, Civil Action No. 04-8807. On May 11, 2005, the Court appointed co-lead counsels and provided until July 11, 2005 for an amended complaint to be filed; and a briefing schedule thereafter with respect to a motion to dismiss. The motion to dismiss was fully briefed and argument occurred on November 30, 2006. The motion was granted in January 2008 to the extent that the Class Actions were dismissed without prejudice to plaintiffs' right to seek leave to file an amended complaint based on statements that the WWE licenses were obtained from the WWE as a result of the long-term relationship with WWE. A motion seeking leave to file an amended complaint was granted and an amended complaint filed. Briefing was completed with respect to a motion to dismiss that was scheduled for argument in October 2008. The Court adjourned the argument date. The parties notified the Court that an agreement to resolve this action was reached. In November 2009, a motion was filed by plaintiffs' counsel for preliminary approval of this agreement, which provides for the matter to be settled for $3.9 million, without any admission of liability on the part of the Company, or its officers and directors.

On December 2, 2004, a shareholder derivative action was filed in the Southern District of New York by Freeport Partner, LLC against us, nominally, and against Messrs. Friedman, Berman and Bennett, Freeport Partners v. Friedman, et al., Civil Action No. 04-9441 (the “Derivative Action”). The Derivative Action seeks to hold the individual defendants liable for damages allegedly caused to us by their actions and in particular to hold them liable on a contribution theory with respect to any liability we incur in connection with the Class Actions. On or about February 10, 2005, a second shareholder derivative action was filed in the Southern District of New York by David Oppenheim against us, nominally, and against Messrs. Friedman, Berman, Bennett, Blatte, Glick, Miller and Skala, Civil Action 05-2046 (the “Second Derivative Action”). The Second Derivative Action seeks to hold the individual defendants liable for damages allegedly caused to us by their actions as a result of alleged breaches of their fiduciary duties. On or about March 16, 2005, a third shareholder derivative action was filed. It is captioned Warr v. Friedman, Berman, Bennett, Blatte, Glick, Miller, Skala, and JAKKS (as a nominal defendant), and it was filed in the Superior Court of California, Los Angeles County (the “Third Derivative Action”). The Third Derivative Action seeks to hold the individual defendants liable for (1) damages allegedly caused to us by their alleged breaches of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment; and (2) restitution to us of profits, benefits and other compensation obtained by them. Agreement to resolve the Derivative Actions has been reached, but it is also subject to Court approval. A Company insurer has agreed to provide the $4.1 million that will be used to settle the Class Action and the Derivative Actions.

We are a party to, and certain of our property is the subject of, various other pending claims and legal proceedings that routinely arise in the ordinary course of our business, but we do not believe that any of these claims or proceedings will have a material effect on our business, financial condition or results of operations.

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Item 1A. Risk Factors

From time to time, including in this Quarterly Report on Form 10-Q, we publish forward-looking statements, as disclosed in our Disclosure Regarding Forward-Looking Statements beginning immediately following the Table of Contents of this Report. We note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed or anticipated in our forward-looking statements. The factors listed below are the risks and uncertainties that may arise and that may be detailed from time to time in our public announcements and our filings with the Securities and Exchange Commission, such as on Forms 8-K, 10-Q and 10-K. We undertake no obligation to make any revisions to the forward-looking statements contained in this Report to reflect events or circumstances occurring after the date of the filing of this report.

Our inability to redesign, restyle and extend our existing core products and product lines as consumer preferences evolve, and to develop, introduce and gain customer acceptance of new products and product lines, may materially and adversely impact our business, financial condition and results of operations.

Our business and operating results depend largely upon the appeal of our products. Our continued success in the toy industry will depend on our ability to redesign, restyle and extend our existing core products and product lines as consumer preferences evolve, and to develop, introduce and gain customer acceptance of new products and product lines. Several trends in recent years have presented challenges for the toy industry, including:

- Age Compression: The phenomenon of children outgrowing toys at younger ages, particularly in favor of interactive and high technology products;
- Increasing use of technology;
- Shorter life cycles for individual products; and
- Higher consumer expectations for product quality, functionality and value.

We cannot assure you that:

- our current products will continue to be popular with consumers;
- the product lines or products that we introduce will achieve any significant degree of market acceptance; or
- the life cycles of our products will be sufficient to permit us to recover licensing, design, manufacturing, marketing and other costs associated with those products.

Our failure to achieve any or all of the foregoing benchmarks may cause the infrastructure of our operations to fail, thereby adversely affecting our business, financial condition and results of operations.

The failure of our character-related and theme-related products to become and/or remain popular with children may materially and adversely impact our business, financial condition and results of operations.

The success of many of our character-related and theme-related products depends on the popularity of characters in movies, television programs, live wrestling exhibitions, auto racing events and other media. We cannot assure you that:

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media associated with our character-related and theme-related product lines will be released at the times we expect or will be successful;

the success of media associated with our existing character-related and theme-related product lines will result in substantial promotional value to our products;

we will be successful in renewing licenses upon expiration on terms that are favorable to us; or

we will be successful in obtaining licenses to produce new character-related and theme-related products in the future.

Our failure to achieve any or all of the foregoing benchmarks may cause the infrastructure of our operations to fail, thereby adversely affecting our business, financial condition and results of operations.

There are risks associated with our license agreements.

Our current licenses require us to pay minimum royalties

Sales of products under trademarks or trade or brand names licensed from others account for substantially all of our net sales. Product licenses allow us to capitalize on characters, designs, concepts and inventions owned by others or developed by toy inventors and designers. Our license agreements generally require us to make specified minimum royalty payments, even if we fail to sell a sufficient number of units to cover these amounts. In addition, under certain of our license agreements, if we fail to achieve certain prescribed sales targets, we may be unable to retain or renew these licenses.

Some of our licenses are restricted as to use

Under the majority of our license agreements the licensors have the right to review and approve our use of their licensed products, designs or materials before we may make any sales. If a licensor refuses to permit our use of any licensed property in the way we propose, or if their review process is delayed, our development or sale of new products could be impeded.

New licenses are difficult and expensive to obtain

Our continued success will depend substantially on our ability to obtain additional licenses. Intensive competition exists for desirable licenses in our industry. We cannot assure you that we will be able to secure or renew significant licenses on terms acceptable to us. In addition, as we add licenses, the need to fund additional royalty advances and guaranteed minimum royalty payments may strain our cash resources.

A limited number of licensors account for a large portion of our net sales

We derive a significant portion of our net sales from a limited number of licensors. If one or more of these licensors were to terminate or fail to renew our license or not grant us new licenses, our business, financial condition and results of operations could be adversely affected.

The toy industry is highly competitive and our inability to compete effectively may materially and adversely impact our business, financial condition and results of operations.

The toy industry is highly competitive. Globally, certain of our competitors have financial and strategic advantages over us, including:

- greater financial resources;
- larger sales, marketing and product development departments;
- stronger name recognition;
- longer operating histories; and
- greater economies of scale.

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In addition, the toy industry has no significant barriers to entry. Competition is based primarily on the ability to design and develop new toys, to procure licenses for popular characters and trademarks and to successfully market products. Many of our competitors offer similar products or alternatives to our products. Our competitors have obtained and are likely to continue to obtain licenses that overlap our licenses with respect to products, geographic areas and markets. We cannot assure you that we will be able to obtain adequate shelf space in retail stores to support our existing products or to expand our products and product lines or that we will be able to continue to compete effectively against current and future competitors.

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We may not be able to sustain or manage our growth, which may prevent us from continuing to increase our net revenues.

We have experienced rapid growth in our product lines resulting in higher net sales over the last nine years, which was achieved through acquisitions of businesses, products and licenses. For example, revenues associated with companies we acquired since 2008 were approximately $169.0 million and $11.0 million, for the year ended December 31, 2009 and the three months ended March 31, 2010, respectively, representing 21.0% and 14.3% of our total revenues for those periods. As a result, comparing our period-to-period operating results may not be meaningful and results of operations from prior periods may not be indicative of future results. We cannot assure you that we will continue to experience growth in, or maintain our present level of, net sales.

Our growth strategy calls for us to continuously develop and diversify our toy business by acquiring other companies, entering into additional license agreements, refining our product lines and expanding into international markets, which will place additional demands on our management, operational capacity and financial resources and systems. The increased demand on management may necessitate our recruitment and retention of qualified management personnel. We cannot assure you that we will be able to recruit and retain qualified personnel or expand and manage our operations effectively and profitably. To effectively manage future growth, we must continue to expand our operational, financial and management information systems and to train, motivate and manage our work force. There can be no assurance that our operational, financial and management information systems will be adequate to support our future operations. Failure to expand our operational, financial and management information systems or to train, motivate or manage employees could have a material adverse effect on our business, financial condition and results of operations.

In addition, implementation of our growth strategy is subject to risks beyond our control, including competition, market acceptance of new products, changes in economic conditions, our ability to obtain or renew licenses with commercially reasonable terms and our ability to finance increased levels of accounts receivable and inventory necessary to support our sales growth, if any. Accordingly, we cannot assure you that our growth strategy will continue to be implemented successfully.

If we are unable to acquire and integrate companies and new product lines successfully, we will be unable to implement a significant component of our growth strategy.

Our growth strategy depends in part upon our ability to acquire companies and new product lines. Revenues associated with our acquisitions since 2008 represented approximately 21.0% and 14.3% of our total revenues for the year ended December 31, 2009 and the three months ended March 31, 2010, respectively. Future acquisitions will succeed only if we can effectively assess characteristics of potential target companies and product lines, such as:

- attractiveness of products;
- suitability of distribution channels;
- management ability;
- financial condition and results of operations; and
- the degree to which acquired operations can be integrated with our operations.

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We cannot assure you that we can identify attractive acquisition candidates or negotiate acceptable acquisition terms, and our failure to do so may adversely affect our results of operations and our ability to sustain growth. Our acquisition strategy involves a number of risks, each of which could adversely affect our operating results, including:

- difficulties in integrating acquired businesses or product lines, assimilating new facilities and personnel and harmonizing diverse business strategies and methods of operation;
- diversion of management attention from operation of our existing business;
- loss of key personnel from acquired companies; and
- failure of an acquired business to achieve targeted financial results.

A limited number of customers account for a large portion of our net sales, so that if one or more of our major customers were to experience difficulties in fulfilling their obligations to us, cease doing business with us, significantly reduce the amount of their purchases from us or return substantial amounts of our products, it could have a material adverse effect on our business, financial condition and results of operations.

Our three largest customers accounted for 53.8% and 55.6% of our net sales for the three months ended March 31, 2010 and the year ended December 31, 2009, respectively. Except for outstanding purchase orders for specific products, we do not have written contracts with or commitments from any of our customers. A substantial reduction in or termination of orders from any of our largest customers could adversely affect our business, financial condition and results of operations. In addition, pressure by large customers seeking price reductions, financial incentives, changes in other terms of sale or for us to bear the risks and the cost of carrying inventory also could adversely affect our business, financial condition and results of operations. If one or more of our major customers were to experience difficulties in fulfilling their obligations to us, cease doing business with us, significantly reduce the amount of their purchases from us or return substantial amounts of our products, it could have a material adverse effect on our business, financial condition and results of operations. In addition, the bankruptcy or other lack of success of one or more of our significant retailers could negatively impact our revenues and bad debt expense.

We depend on our key personnel and any loss or interruption of either of their services could adversely affect our business, financial condition and results of operations.

Our success is largely dependent upon the experience and continued services of Stephen G. Berman, our President and Chief Executive Officer. We cannot assure you that we would be able to find an appropriate replacement for Mr. Berman if the need should arise, and any loss or interruption of Mr. Berman's services could adversely affect our business, financial condition and results of operations.

We depend on third-party manufacturers, and if our relationship with any of them is harmed or if they independently encounter difficulties in their manufacturing processes, we could experience product defects, production delays, cost overruns or the inability to fulfill orders on a timely basis, any of which could adversely affect our business, financial condition and results of operations.

We depend on many third-party manufacturers who develop, provide and use the tools, dies and molds that we own to manufacture our products. However, we have limited control over the manufacturing processes themselves. As a result, any difficulties encountered by the third-party manufacturers that result in product defects, production delays, cost overruns or the inability to fulfill orders on a timely basis could adversely affect our business, financial condition and results of operations.

We do not have long-term contracts with our third-party manufacturers. Although we believe we could secure other third-party manufacturers to produce our products, our operations would be adversely affected if we lost our relationship with any of our current suppliers or if our current suppliers' operations or sea or air transportation with our overseas manufacturers were disrupted or terminated even for a relatively short period of time. Our tools, dies and molds are located at the facilities of our third-party manufacturers.

Although we do not purchase the raw materials used to manufacture our products, we are potentially subject to variations in the prices we pay our third-party manufacturers for products, depending on what they pay for their raw materials.

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We have substantial sales and manufacturing operations outside of the United States subjecting us to risks common to international operations.

We sell products and operate facilities in numerous countries outside the United States. For the three months ended March 31, 2010 and the year ended December 31, 2009 sales to our international customers comprised approximately 16.6% and 16.5%, respectively, of our net sales. We expect our sales to international customers to account for a greater portion of our revenues in future fiscal periods. Additionally, we utilize third-party manufacturers located principally in China which are subject to the risks normally associated with international operations, including:

- currency conversion risks and currency fluctuations;
- limitations, including taxes, on the repatriation of earnings;
- political instability, civil unrest and economic instability;
- greater difficulty enforcing intellectual property rights and weaker laws protecting such rights;
- complications in complying with laws in varying jurisdictions and changes in governmental policies;
- greater difficulty and expenses associated with recovering from natural disasters;
- transportation delays and interruptions;
- the potential imposition of tariffs; and
- the pricing of intercompany transactions may be challenged by taxing authorities in both Hong Kong and the United States, with potential increases in income taxes.

Our reliance on external sources of manufacturing can be shifted, over a period of time, to alternative sources of supply, should such changes be necessary. However, if we were prevented from obtaining products or components for a material portion of our product line due to medical, political, labor or other factors beyond our control, our operations would be disrupted while alternative sources of products were secured. Also, the imposition of trade sanctions by the United States against a class of products imported by us from, or the loss of "normal trade relations" status by China, could significantly increase our cost of products imported from that nation. Because of the importance of our international sales and international sourcing of manufacturing to our business, our financial condition and results of operations could be significantly and adversely affected if any of the risks described above were to occur.

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Our business is subject to extensive government regulation and any violation by us of such regulations could result in product liability claims, loss of sales, diversion of resources, damage to our reputation, increased warranty costs or removal of our products from the market, and we cannot assure you that our product liability insurance for the foregoing will be sufficient.

Our business is subject to various laws, including the Federal Hazardous Substances Act, the Consumer Product Safety Act, the Flammable Fabrics Act and the rules and regulations promulgated under these acts. These statutes are administered by the Consumer Products Safety Commission ("CPSC"), which has the authority to remove from the market products that are found to be defective and present a substantial hazard or risk of serious injury or death. The CPSC can require a manufacturer to recall, repair or replace these products under certain circumstances. We cannot assure you that defects in our products will not be alleged or found. Any such allegations or findings could result in:

- product liability claims;
- loss of sales;
- diversion of resources;
- damage to our reputation;
- increased warranty and insurance costs; and
- removal of our products from the market.

Any of these results may adversely affect our business, financial condition and results of operations. There can be no assurance that our product liability insurance will be sufficient to avoid or limit our loss in the event of an adverse outcome of any product liability claim.

We depend on our proprietary rights, and our inability to safeguard and maintain the same, or claims of third parties that we have violated their intellectual property rights, could have a material adverse effect on our business, financial condition and results of operations.

We rely on trademark, copyright and trade secret protection, nondisclosure agreements and licensing arrangements to establish, protect and enforce our proprietary rights in our products. The laws of certain foreign countries may not protect intellectual property rights to the same extent or in the same manner as the laws of the United States. We cannot assure you that we or our licensors will be able to successfully safeguard and maintain our proprietary rights. Further, certain parties have commenced legal proceedings or made claims against us based on our alleged patent infringement, misappropriation of trade secrets or other violations of their intellectual property rights. We cannot assure you that other parties will not assert intellectual property claims against us in the future. These claims could divert our attention from operating our business or result in unanticipated legal and other costs, which could adversely affect our business, financial condition and results of operations.

Market conditions and other third-party conduct could negatively impact our margins and implementation of other business initiatives.

Economic conditions, such as rising fuel prices, increased competition and decreased consumer confidence, may adversely impact our margins. Such a weakened economic and business climate could create uncertainty and adversely affect our sales and profitability. Other conditions, such as the unavailability of electronics components, may impede our ability to manufacture, source and ship new and continuing products on a timely basis. Significant and sustained increases in the price of oil could adversely impact the cost of the raw materials used in the manufacture of our products, such as plastic.

We may not have the funds necessary to purchase our outstanding convertible senior notes upon a fundamental change or other purchase date, as required by the indenture governing the notes.

On June 15, 2010, June 15, 2013 and June 15, 2018, holders of our convertible senior notes may require us to purchase their notes, which repurchase may be made for cash. In addition, holders may also require us to purchase their notes for cash upon the occurrence of certain fundamental changes in our board composition or ownership structure, if we liquidate or dissolve under certain circumstances or if our common stock ceases being quoted on an established over-the-counter trading market in the United States. If we do not have, or have access to, sufficient funds to repurchase the notes, then we could be forced into bankruptcy. In fact, we expect that we would require third-party financing, but we cannot assure you that we would be able to obtain that financing on favorable terms or at all.

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We have a history of making acquisitions which resulted in material amounts of goodwill. Any future acquisitions may also result in material amounts of goodwill which, if it becomes impaired, would result in a reduction in our net income.

Goodwill is the amount by which the cost of an acquisition exceeds the fair value of the net assets we acquire. Current accounting standards require that goodwill no longer be amortized but instead be periodically evaluated for impairment based on the fair value of the reporting unit. On June 30, 2009, we recognized an impairment of our goodwill, for a non-cash charge to income of $407.1 million. Any goodwill associated with future acquisitions is subject to the same impairment risk.

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Item 6. Exhibits

Number	Description
3.1	Amended and Restated Certificate of Incorporation of the Company(1)
3.2.1	By-Laws of the Company(2)
3.2.2	Amendment to By-Laws of the Company(3)
4.1	Indenture, dated as of September 9, 2003, by and between the Registrant and Wells Fargo Bank, N.A.(4)
4.2	Form of 4.625% ConveForm of 4.625% Convertible Senior Note(4)
4.3	Indenture, dated November 10, 2009, by and between the Registrant and Wells Fargo Bank, N.A. (5)
4.4	Form of 4.5% Senior Convertible Note (5)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer(6)
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer(6)
32.1	Section 1350 Certification of Chief Executive Officer(6)
32.2	Section 1350 Certification of Chief Financial Officer(6)

(1) Filed previously as Appendix 2 to the Company's Schedule 14A Proxy Statement filed August 23, 2002 and incorporated herein by reference.

(2) Filed previously as an exhibit to the Company's Registration Statement on Form SB-2 (Reg. No. 333-2048-LA), effective May 1, 1996, and incorporated herein by reference.

(3) Filed previously as an exhibit to the Company's Registration Statement on Form SB-2 (Reg. No. 333-22583), effective May 1, 1997, and incorporated herein by reference.

(4) Filed previously as an exhibit to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003, filed on August 14, 2003, and incorporated herein by reference.

(5) Filed previously as an exhibit to the Company's Current Report on Form 8-K, filed on November 10, 2009, and incorporated herein by reference.

(6) Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

JAKKS PACIFIC, INC.

Date: May 7, 2010	By:	/s/ JOEL M. BENNETT Joel M. Bennett Executive Vice President and Chief Financial Officer (Duly Authorized Officer and Principal Financial Officer)

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EXHIBIT INDEX

Number	Description
3.1	Amended and Restated Certificate of Incorporation of the Company(1)
3.2.1	By-Laws of the Company(2)
3.2.2	Amendment to By-Laws of the Company(3)
4.1	Indenture, dated as of September 9, 2003, by and between the Registrant and Wells Fargo Bank, N.A.(4)
4.2	Form of 4.625% ConveForm of 4.625% Convertible Senior Note(4)
4.3	Indenture, dated November 10, 2009, by and between the Registrant and Wells Fargo Bank, N.A. (5)
4.4	Form of 4.5% Senior Convertible Note (5)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer(6)
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer(6)
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