

JAKKS PACIFIC INC  
Form 10-Q  
May 10, 2018

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

FORM 10-Q

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(Mark one)

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

For the quarterly period ended March 31, 2018  
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

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

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Delaware 95-4527222  
(State or Other Jurisdiction of Incorporation or Organization)(I.R.S. Employer Identification No.)

2951 28<sup>th</sup> Street 90405  
Santa Monica, California  
(Address of Principal Executive Offices)(Zip Code)

Registrant's Telephone Number, Including Area Code: (424) 268-9444

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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  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  No

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

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Large accelerated filer  
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company  
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the issuer's common stock is 29,169,913 as of May 10, 2018.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES  
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QUARTER ENDED MARCH 31, 2018  
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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 condensed consolidated 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 of 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.

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

JAKKS PACIFIC, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	March 31, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets		
Cash and cash equivalents	\$46,779	\$64,977
Accounts receivable, net of allowance for doubtful accounts of \$24,730 and \$10,940 at March 31, 2018 and December 31, 2017, respectively	93,928	142,457
Inventory	53,997	58,432
Prepaid expenses and other assets	20,812	16,803
Total current assets	215,516	282,669
Property and equipment		
Office furniture and equipment	15,171	15,043
Molds and tooling	116,920	115,378
Leasehold improvements	10,945	10,936
Total	143,036	141,357
Less accumulated depreciation and amortization	120,080	118,130
Property and equipment, net	22,956	23,227
Intangible assets, net	21,023	22,190
Other long term assets	18,504	6,579
Goodwill	35,592	35,384
Trademarks	300	300
Total assets	\$313,891	\$370,349
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$39,072	\$49,916
Accrued expenses	37,145	42,145
Reserve for sales returns and allowances	15,343	17,622
Short term debt	—	5,000
Convertible senior notes, net	21,119	21,075
Total current liabilities	112,679	135,758
Convertible senior notes, net	134,716	133,497
Other liabilities	4,426	4,537
Income taxes payable	1,327	1,261
Deferred income taxes, net	781	783
Total liabilities	253,929	275,836
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$.001 par value; 5,000,000 shares authorized; nil outstanding	—	—
Common stock, \$.001 par value; 100,000,000 shares authorized; 29,169,913 and 26,957,354 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	30	27

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Treasury stock, at cost; 3,112,840 shares	(24,000 )	(24,000 )
Additional paid-in capital	216,398	215,809
Accumulated deficit	(121,477)	(85,233 )
Accumulated other comprehensive loss	(12,009 )	(13,059 )
Total JAKKS Pacific, Inc. stockholders' equity	58,942	93,544
Non-controlling interests	1,020	969
Total stockholders' equity	59,962	94,513
Total liabilities and stockholders' equity	\$313,891	\$370,349

See accompanying notes to condensed consolidated financial statements.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except per share data)

	Three Months Ended March 31, (Unaudited)	
	2018	2017
Net sales	\$93,004	\$94,505
Cost of sales	70,045	64,484
Gross profit	22,959	30,021
Selling, general and administrative expenses	58,617	45,745
Loss from operations	(35,658)	(15,724)
Income from joint ventures	22	—
Other income	50	23
Change in fair value of convertible senior notes	(1,021 )	—
Interest income	14	4
Interest expense	(1,936 )	(2,932 )
Loss before benefit from income taxes	(38,529)	(18,629)
Benefit from income taxes	(2,336 )	(344 )
Net loss	(36,193)	(18,285)
Net income attributable to non-controlling interests	51	31
Net loss attributable to JAKKS Pacific, Inc.	\$(36,244)	\$(18,316)
Loss per share - basic and diluted	\$(1.57 )	\$(1.01 )
Shares used in loss per share - basic and diluted	23,100	18,104
Comprehensive loss	\$(35,143)	\$(17,754)
Comprehensive loss attributable to JAKKS Pacific, Inc.	\$(35,194)	\$(17,785)

See accompanying notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)

	Three Months Ended March 31, (Unaudited)	
	2018	2017
Cash flows from operating activities		
Net loss	\$(36,193)	\$(18,285)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,096	4,380
Write-off and amortization of debt issuance costs	242	837
Share-based compensation expense	676	748
Provision for doubtful accounts	13,794	(2 )
Change in fair value of convertible senior notes	1,021	—
Changes in operating assets and liabilities:		
Accounts receivable	34,735	75,108
Inventory	4,435	7,969
Prepaid expenses and other assets	(15,936)	(15,597)
Accounts payable	(9,934 )	(19,258)
Accrued expenses	(5,000 )	(20,001)
Reserve for sales returns and allowances	(2,279 )	(5,873 )
Income taxes payable	66	—
Other liabilities	(111 )	(95 )
Total adjustments	24,805	28,216
Net cash provided by (used in) operating activities	(11,388)	9,931
Cash flows from investing activities		
Purchases of property and equipment	(2,568 )	(4,367 )
Net cash used in investing activities	(2,568 )	(4,367 )
Cash flows from financing activities		
Repurchase of convertible senior notes	—	(24,052)
Repayment of credit facility borrowings	(5,000 )	—
Repurchase of common stock for employee tax withholding	(85 )	(12 )
Net cash used in financing activities	(5,085 )	(24,064)
Net decrease in cash and cash equivalents	(19,041)	(18,500)
Effect of foreign currency translation	843	468
Cash and cash equivalents, beginning of period	64,977	86,064
Cash and cash equivalents, end of period	\$46,779	\$68,032
Cash paid during the period for:		
Income taxes	\$331	\$221
Interest	\$485	\$2,039

As of March 31, 2018, there was \$4.3 million of property and equipment included in accounts payable. As of December 31, 2017, there was \$5.2 million of property and equipment included in accounts payable.

See Notes 5, 6 and 9 for additional supplemental information to the condensed consolidated statements of cash flows.

See accompanying notes to condensed consolidated financial statements.





JAKKS PACIFIC, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)  
March 31, 2018

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, 2017.

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, especially given seasonality, indicative of results to be expected for a full year.

The condensed consolidated financial statements include the accounts of JAKKS Pacific, Inc. and its wholly-owned subsidiaries (collectively, “the Company”). The condensed consolidated financial statements also include the accounts of DreamPlay Toys, LLC, a joint venture with NantWorks LLC, JAKKS Meisheng Trading (Shanghai) Limited, a joint venture with Meisheng Cultural & Creative Corp., Ltd., and JAKKS Meisheng Animation (HK) Limited, a joint venture with Hong Kong Meisheng Cultural Company Limited.

Certain prior period amounts have been reclassified for consistency with the current period presentation.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)”, which supersedes the revenue recognition requirements in ASC 605, (Topic 605), and most industry-specific guidance. Under the new model, recognition of revenue occurs when a customer obtains control of promised goods or services in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the new standard requires that reporting companies disclose the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU 2015-14, “Revenue from Contracts with Customers – Deferral of the Effective Date”, which defers the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, and interim periods therein. In 2016, the FASB issued ASU 2016-08, “Principal versus Agent Considerations (Reporting Revenue Gross versus Net)”, ASU 2016-10, “Identifying Performance Obligations and Licensing”, and ASU 2016-12, “Revenue from Contracts with Customers - Narrow-Scope Improvements and Practical Expedients”. Entities have the choice to adopt these updates using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a modified retrospective approach with the cumulative effect of these standards recognized at the date of the adoption.

On January 1, 2018, the Company adopted the new accounting standard ASC 606, (Topic 606), Revenue from Contracts with Customers and all the related amendments (“new revenue standard”) using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company’s historic accounting under ASC 605, (Topic 605).

There is no impact to the Company's condensed consolidated financial statements resulting from the adoption of Topic 606 as the timing and measurement of revenue remained consistent with Topic 605, although our approach to revenue recognition is now based on the transfer of control. Further, there is no difference in the amounts of the revenue and cost of sales reported in the Company's condensed consolidated statements of operations and comprehensive loss for the quarter ended March 31, 2018 that were recognized pursuant to Topic 606 and those that would have been reported pursuant to Topic 605.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). The new guidance is intended to improve the recognition and measurement of financial instruments. The ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2017. The adoption of this standard does not have an impact on the Company's condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)  
March 31, 2018

In February 2016, the FASB issued ASU 2016-02, "Leases". ASU 2016-02 establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact of the pending adoption of this new standard on its condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." The new guidance is intended to reduce diversity in practice in how transactions are classified in the statement of cash flows. This ASU is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this standard does not have an impact on the Company's condensed consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory." The amendments in this ASU reduces the complexity in the accounting standards by allowing the recognition of current and deferred income taxes for an intra-entity asset transfer, other than inventory, when the transfer occurs. Historically, recognition of the income tax consequence was not recognized until the asset was sold to an outside party. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this standard does not have an impact on the Company's condensed consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash". The update requires that amounts generally described as restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The new standard will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. The Company early adopted this standard during the second quarter of 2017. The adoption of this standard had a reclassification impact for the three month period ended March 31, 2017. The restricted cash as of March 31, 2017, in the amount of \$10.6 million, was previously classified as a financing activity related to borrowings exceeding the Company's borrowing base availability under the Wells Fargo credit facility. The increase to cash and cash equivalents was \$10.6 million.

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting", which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of this standard does not have an impact on the Company's condensed consolidated financial statements.

In January 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which gives entities the option to reclassify to retained earnings the tax effects resulting from the Act related to items in Accumulated Other

Comprehensive Income (“AOCI”) that the FASB refers to as having been stranded in AOCI. The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized in the period of adoption. The Company could adopt this guidance for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. The guidance, when adopted, will require new disclosures regarding a company’s accounting policy for releasing the tax effects in AOCI and permit the company the option to reclassify to retained earnings the tax effects resulting from the Act that are stranded in AOCI. The Company is not early adopting at this time and does not have plans to adopt this new guidance.

Note 2 — Business Segments, Geographic Data, and Sales by 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 of products. The Company has aligned its operating segments into three reporting segments that reflect the management and operation of the business. The Company’s segments are (i) U.S. and Canada, (ii) International, and (iii) Halloween.

The U.S. and Canada segment includes action figures, vehicles, play sets, plush products, dolls, electronic products, construction toys, infant and pre-school toys, role play and everyday costume play, foot to floor ride-on vehicles, wagons, novelty toys, seasonal and outdoor products, kids’ indoor and outdoor furniture, and related products.

JAKKS PACIFIC, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (unaudited)  
 March 31, 2018

Within the International segment, the Company markets and sells its toy products in markets outside of the U.S. and Canada, primarily in the European, Asia Pacific, and Latin American regions.

Within the Halloween segment, the Company markets and sells Halloween costumes and accessories and everyday costume play products, primarily in the U.S. and Canada.

Segment performance is measured at the operating income (loss) level. All sales are made to external customers and general corporate expenses have been attributed to the various segments based upon relative sales volumes. Segment assets are primarily comprised of accounts receivable and inventories, net of applicable reserves and allowances, goodwill and other assets. Certain assets which are not tracked by operating segment and/or that benefit multiple operating segments have been allocated on the same basis.

Results are not necessarily those which would be achieved if each segment was an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts for the three months ended March 31, 2018 and 2017 and as of March 31, 2018 and December 31, 2017 are as follows (in thousands):

	Three Months Ended March 31, 2018      2017	
Net Sales		
U.S. and Canada	\$70,535	\$70,912
International	17,299	19,942
Halloween	5,170	3,651
	\$93,004	\$94,505

	Three Months Ended March 31, 2018      2017	
Loss from Operations		
U.S. and Canada	\$(22,979)	\$(7,876 )
International	(6,939 )	(1,772 )
Halloween	(5,740 )	(6,076 )
	\$(35,658)	\$(15,724)

	Three Months Ended March 31, 2018      2017	
Depreciation and Amortization Expense		
U.S. and Canada	\$2,416	\$3,374
International	581	898

Halloween	99	108
	\$3,096	\$4,380

	March 31, 2018	December 31, 2017
Assets		
U.S. and Canada	\$ 199,711	\$ 229,505
International	91,764	106,255
Halloween	22,416	34,589
	\$313,891	\$ 370,349

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JAKKS PACIFIC, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)  
March 31, 2018

The following tables present information about the Company by geographic area as of March 31, 2018 and December 31, 2017 and for the three months ended March 31, 2018 and 2017 (in thousands):

	March 31, 2018	December 31, 2017
Long-lived Assets		
China	\$17,229	\$17,194
United States	5,504	5,755
Hong Kong	223	278
	\$22,956	\$23,227

	Three Months Ended March 31, 2018		2017	
Net Sales by Customer Area				
United States	\$71,373	\$69,560		
Europe	8,629	12,560		
Canada	3,761	4,444		
Hong Kong	227	219		
Other	9,014	7,722		
	\$93,004	\$94,505		

#### Major Customers

Net sales to major customers for the three months ended March 31, 2018 and 2017 were as follows (in thousands, except for percentages):

	Three Months Ended March 31, 2018		2017	
	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales
Wal-Mart	\$24,758	26.6 %	\$26,370	27.9 %
Target	15,312	16.5	12,671	13.4
Toys "R" Us	10,625	11.4	13,260	14.0
	\$50,695	54.5 %	\$52,301	55.3 %

At March 31, 2018 and December 31, 2017, the Company's three largest customers accounted for approximately 58.4% and 60.6%, respectively, of the Company's gross 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.

On March 15, 2018, Toys “R” Us (“TRU”) filed a motion to conduct an orderly wind down of its operations in the U.S. and commence store closing sales at all 735 U.S. stores. The total worldwide pre and post-petition gross accounts receivable balance as of March 31, 2018 is \$35.1 million. In April 2018, the Company collected \$12.0 million from its insurance carrier and \$0.6 million from TRU, resulting in a net receivable from TRU of \$22.5 million. The \$22.5 million net receivable balance has been fully reserved by the Company as of March 31, 2018.

At March 31, 2018 and December 31, 2017, the Company's TRU consolidated accounts receivable balance represented 29.4% and 26.4%, respectively, of the Company's gross accounts receivable.



JAKKS PACIFIC, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (unaudited)  
 March 31, 2018

Note 3 — Inventory

Inventory, which includes the ex-factory cost of goods, in-bound freight, duty and capitalized warehouse costs, is valued at the lower of cost (first-in, first-out) or net realizable value, net of inventory obsolescence reserve, and consists of the following (in thousands):

	March 31, 2018	December 31, 2017
Raw materials	\$1,594	\$ 1,596
Finished goods	52,403	56,836
	\$53,997	\$ 58,432

During the first quarter of 2017, the Company adopted ASU 2015-11, “Simplifying the Measurement of Inventory (Topic 330)”. The amendments, which apply to inventory that is measured using any method other than the last-in, first-out (LIFO) or retail inventory method, require that entities measure inventory at the lower of cost or net realizable value. ASU 2015-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016 and should be applied on a prospective basis. The adoption of ASU 2015-11 did not have an impact to the Company’s condensed consolidated financial statements.

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

The Company’s contracts with customers only include one performance obligation (i.e., sale of the Company’s products). Revenue is recognized in the gross amount at a point in time when delivery is completed and control of the promised goods is transferred to the customers. Revenue is measured as the amount of consideration the Company expects to be entitled to in exchange for those goods. The Company’s contracts do not involve financing elements as payment terms with customers are less than one year. Further, because revenue is recognized at the point in time goods are sold to customers, there are no contract assets or contract liability balances.

The Company disaggregates its revenues from contracts with customers by reporting segment: U.S. and Canada, International, and Halloween. The Company further disaggregates revenues by major geographic region. See Note 2, Business Segments, Geographic Data, and Sales by Major Customers, for further information.

The Company offers various discounts, pricing concessions, and other allowances to customers, all of which are considered in determining the transaction price. Certain discounts and allowances are fixed and determinable at the time of sale and are recorded at the time of sale as a reduction to revenue. Other discounts and allowances can vary and are determined at management’s discretion (variable consideration). Specifically, the Company occasionally grants discretionary credits to facilitate markdowns and sales of slow moving merchandise, and consequently accrues an allowance based on historic credits and management estimates. Further, while the Company generally does not allow product returns, the Company does make occasional exceptions to this policy, and consequently records a sales return allowance based upon historic return amounts and management estimates. These allowances (variable consideration) are estimated using the expected value method and are recorded at the time of sale as a reduction to revenue. The Company adjusts its estimate of variable consideration at least quarterly or when facts and circumstances used in the estimation process may change. The variable consideration is not constrained as the Company has sufficient history on the related estimates and does not believe there is a risk of significant revenue reversal.

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. Generally, these allowances range from 2% to 10% of gross sales, and are generally based upon product purchases or specific advertising campaigns. Such allowances are accrued when the related revenue is recognized. These cooperative advertising arrangements provide a distinct benefit and fair value, and are accounted for as direct selling expenses.

Sales commissions are expensed when incurred as the related revenue is recognized at a point in time and therefore the amortization period is less than one year. As a result these costs are recorded as direct selling expenses, as incurred.

Shipping and handling activities are considered part of the Company's obligation to transfer the products and therefore are recorded as direct selling expenses, as incurred.

The Company's reserve for sales returns and allowances amounted to \$15.3 million as of March 31, 2018, compared to \$17.6 million as of December 31, 2017. This decrease was primarily due to certain customers taking their annual allowances related to 2017 sales.

JAKKS PACIFIC, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (unaudited)  
 March 31, 2018

Note 5 — Credit Facility

In March 2014, the Company and its domestic subsidiaries entered into a secured credit facility with General Electric Capital Corporation (“GECC”). The loan agreement, as amended and subsequently assigned to Wells Fargo Bank, N.A. pursuant to its acquisition of GECC, provides for a \$75.0 million revolving credit facility subject to availability based on prescribed advance rates on certain domestic accounts receivable and inventory (the “WF Loan Agreement”). The amounts outstanding under the credit facility, as amended, are payable in full upon maturity of the facility on March 27, 2019, except that the credit facility will mature on June 15, 2018 if we do not refinance or extend the maturity of the Convertible Senior Notes that mature in 2018, provided that any such refinancing or extension shall have a maturity date that is no sooner than six months after the stated maturity of the facility (i.e., on or about September 27, 2019). The credit facility is secured by a security interest in favor of the lender covering a substantial amount of the assets of the Company. As of March 31, 2018, there were no outstanding borrowings and the amount of outstanding stand-by letters of credit totaled \$13.7 million; the total excess availability under the facility was \$10.0 million. As of December 31, 2017, the amount of outstanding borrowings was \$5.0 million and outstanding stand-by letters of credit totaled \$20.0 million; the total excess availability under the facility was \$14.1 million.

The Company’s ability to borrow under the WF Loan Agreement is also subject to its ongoing compliance with certain financial covenants, including the maintenance by the Company of a fixed charge coverage ratio of at least 1.25:1.0 based on the trailing four fiscal quarters in the event minimum excess availability of \$10.0 million under the facility is not maintained. As of March 31, 2018 and December 31, 2017, the Company was in compliance with the financial covenants under the WF Loan Agreement.

The Company may borrow funds at LIBOR or at a Base Rate, plus applicable margins of 225 basis point spread over LIBOR and 125 basis point spread on Base Rate loans. The Base Rate is the highest of (i) the Federal Funds Rate plus a margin of 0.50%, (ii) the rate last quoted by The Wall Street Journal as the “Prime Rate,” or (iii) the sum of a LIBOR rate plus 1.00%. In addition to standard fees, the facility has an unused credit line fee, which ranges from 25 to 50 basis points. As of March 31, 2018 and December 31, 2017, the weighted average interest rate on the credit facility was approximately 3.79%.

The WF Loan Agreement also contains customary events of default, including a cross default provision and a change of control provision. In the event of a default, all of the obligations of the Company and its subsidiaries under the WF Loan Agreement may be declared immediately due and payable. For certain events of default relating to insolvency and receivership, all outstanding obligations become due and payable.

Note 6 — Convertible Senior Notes

Convertible senior notes consist of the following (in thousands):

	March 31, 2018			December 31, 2017		
	Principal/ Fair Value	Debt Issuance Costs	Net Amount	Principal/ Fair Value	Debt Issuance Costs	Net Amount
3.25% convertible senior notes (due 2020) *	\$23,490	\$	\$23,490	\$22,469	\$	\$22,469
4.25% convertible senior notes (due 2018)	21,178	59	21,119	21,178	103	21,075

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4.875% convertible senior notes (due 2020)	113,000	1,774	111,226	113,000	1,972	111,028
Total convertible senior notes, net of debt issuance costs	\$157,668	\$1,833	\$155,835	\$156,647	\$2,075	\$154,572

\* The amount presented for the 3.25% 2020 convertible senior notes within the table represents the fair value as of March 31, 2018. The principal amount of these notes is \$21.5 million.

Amortization expense classified as interest expense related to debt issuance costs was \$0.2 million and \$0.3 million for the three months ended March 31, 2018 and 2017, respectively.

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In July 2013, the Company sold an aggregate of \$100.0 million principal amount of 4.25% Convertible Senior Notes due 2018 (the “2018 Notes”). The 2018 Notes are senior unsecured obligations of the Company paying interest semi-annually in arrears on August 1 and February 1 of each year at a rate of 4.25% per annum and will mature on August 1, 2018. The initial and still current conversion rate for the 2018 Notes is 114.3674 shares of the Company’s common stock per \$1,000 principal amount of notes, equivalent to an initial conversion price of approximately \$8.74 per share of common stock, subject to adjustment in certain events. Upon conversion, the 2018 Notes will be settled in shares of the Company’s common stock. Holders of the 2018 Notes may require that the Company repurchase for cash all or some of their notes upon the occurrence of a fundamental change (as defined in the 2018 Notes). In 2016, the Company repurchased and retired an aggregate of approximately \$6.1 million principal amount of the 2018 Notes. In addition, approximately \$0.1 million of the unamortized debt issuance costs were written off and a nominal gain was recognized in conjunction with the retirement of the 2018 Notes. During the first quarter of 2017, the Company exchanged and retired \$39.1 million principal amount of the 2018 Notes at par for \$24.1 million in cash and approximately 2.9 million shares of its common stock. During the second quarter of 2017, the Company exchanged and retired \$12.0 million principal amount of the 2018 Notes at par for \$11.6 million in cash and 112,400 shares of its common stock, and approximately \$0.1 million of the unamortized debt issuance costs were written off and a \$0.1 million gain was recognized in conjunction with the exchange and retirement of the 2018 Notes.

In August 2017, the Company agreed with Oasis Management and Oasis Investments II Master Fund Ltd., the holder of approximately \$21.5 million face amount of its 4.25% Convertible Senior Notes due in 2018, to extend the maturity date of these notes to November 1, 2020. In addition, the interest rate was reduced to 3.25% per annum and the conversion rate was increased to 328.0302 shares of the Company’s common stock per \$1,000 principal amount of notes, among other things. After execution of a definitive agreement for the modification and final approval by the other members of the Company’s Board of Directors and Oasis’ Investment Committee the transaction closed on November 7, 2017. In connection with this transaction, the Company recognized a loss on extinguishment of the debt of approximately \$0.6 million. Further, the Company elected to measure and present the new debt held by Oasis at fair value using Level 3 inputs and as a result, recognized a loss of \$1.0 million for the three months ended March 31, 2018 related to changes in the fair value of the 3.25% 2020 Notes. At March 31, 2018 and December 31, 2017, the 3.25% 2020 Notes had a fair value of approximately \$23.5 million and \$22.5 million, respectively. The Company evaluated its credit risk as of March 31, 2018, and determined that there was no change from December 31, 2017.

In June 2014, the Company sold an aggregate of \$115.0 million principal amount of 4.875% Convertible Senior Notes due 2020 (the “2020 Notes”). The 2020 Notes are senior unsecured obligations of the Company paying interest semi-annually in arrears on June 1 and December 1 of each year at a rate of 4.875% per annum and will mature on June 1, 2020. The initial and still current conversion rate for the 2020 Notes is 103.7613 shares of the Company’s common stock per \$1,000 principal amount of notes, equivalent to an initial conversion price of approximately \$9.64 per share of common stock, subject to adjustment in certain events. Upon conversion, the 2020 Notes will be settled in shares of the Company’s common stock. Holders of the 2020 Notes may require that the Company repurchase for cash all or some of their notes upon the occurrence of a fundamental change (as defined in the 2020 Notes). In January 2016, the Company repurchased and retired an aggregate of \$2.0 million principal amount of the 2020 Notes. In addition, approximately \$0.1 million of the unamortized debt issuance costs were written off and a \$0.1 million gain was recognized in conjunction with the retirement of the 2020 Notes.

Note 7 — Income Taxes

The Company's income tax benefit of \$2.3 million for the three months ended March 31, 2018 reflects an effective tax rate of 6.1%. The Company's income tax benefit of \$0.3 million for the three months ended March 31, 2017 reflects an effective tax rate of 1.8%. The majority of the tax benefit for the three months ended March 31, 2018 relates to foreign income taxes partially offset by discrete items. The majority of the tax benefit for the three months ended March 31, 2017 relates to foreign income taxes partially offset by the U.S. alternative minimum tax.

The Tax Cuts and Jobs Act was enacted on December 22, 2017. The Act reduces the U.S. federal corporate income tax rate from 35% to 21%, and requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. Due to the timing of the enactment and the complexity involved in applying the provisions of the Act, we made reasonable estimates of the effects and recorded provisional amounts in our financial statements as of December 31, 2017. As we collect and prepare necessary data, and interpret the Act and any additional guidance issued by the U.S. Treasury Department, the Internal Revenue Service (IRS), and other standard-setting bodies, we may make adjustments to the provisional amounts. Those adjustments may materially affect our provision for income taxes and effective tax rate in the period in which the adjustments are made. No adjustments were made in the first quarter of 2018 as the provisional amounts as of December 31, 2017 remain reasonable. We will continue to make and refine our calculations as additional analysis is completed in 2018.

The Act subjects a U.S. shareholder to tax on Global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred as a period expense only. Given the complexity of the GILTI provisions, we are still evaluating the effects of the GILTI provisions and have not yet determined our accounting policy. At March 31, 2018, because we are still evaluating the GILTI provisions and our analysis of future taxable income that is subject to GILTI, we have included GILTI related to current-year operations only. The GILTI provision does not impact the 2018 first quarter tax expense due to the fully valued tax attributes carryforward.

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Note 8 — Loss Per Share

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

	Three Months Ended March 31, 2018			2017		
	Loss	Weighted Average Shares	Per-Share	Loss	Weighted Average Shares	Per-Share
Loss per share — basic and diluted						
Net loss available to common stockholders	\$(36,244)	23,100	\$ (1.57 )	\$(18,316)	18,104	\$ (1.01 )

Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated using the weighted average number of common shares and common share equivalents outstanding during the period (which consist of warrants, options, restricted stock awards, restricted stock units and convertible debt to the extent they are dilutive). The weighted average number of common shares outstanding excludes shares repurchased pursuant to a prepaid forward share repurchase agreement associated with the issuance of the Convertible Senior Notes due 2020. Common share equivalents that could potentially dilute basic earnings per share in the future, which were excluded from the computation of diluted earnings per share due to being anti-dilutive, totaled approximately 24,917,528 and 22,969,239 for the three months ended March 31, 2018 and 2017, respectively.

Note 9 — Common Stock and Preferred Stock

In January and February 2017, the Company issued an aggregate of 873,787 shares of restricted stock at a value of approximately \$4.5 million to two executive officers, which vest, subject to certain company financial performance criteria and market conditions, over a three year period. In addition, an aggregate of 94,102 shares of restricted stock at an aggregate value of approximately \$0.5 million were issued to its five non-employee directors, which vested in January 2018.

In January and February 2017, the Company issued an aggregate of 2,865,000 shares of its common stock at a value of \$15.1 million to holders of its 2018 convertible senior notes as partial consideration for the exchange at par of \$39.1 million principal amount of such notes.

In March 2017, the Company entered into an agreement to issue 3,660,891 shares of its common stock at an aggregate price of \$19.3 million to a Hong Kong affiliate of its China joint venture partner. After their shareholder and China regulatory approval, the transaction closed on April 27, 2017. Upon the closing, the Company added a representative of Meisheng as a non-employee director and issued 13,319 shares of restricted stock at a value of \$0.1 million, which vested in January 2018.

In June 2017, the Company issued an aggregate of 112,400 shares of its common stock at a value of approximately \$0.4 million to holders of its 2018 convertible senior notes as partial consideration for the exchange at par of \$11.6 million principal amount of such notes.

In January 2018, the Company issued an aggregate of 1,914,894 shares of restricted stock at a value of approximately \$4.5 million to two executive officers, which vest, subject to certain company financial performance criteria and market conditions, over a three year period. In addition, an aggregate of 249,480 shares of restricted stock at an aggregate value of approximately \$0.6 million were issued to its six non-employee directors, which vest in January 2019.

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.

No dividend was declared or paid in the first quarter of 2018 and in 2017.



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Note 10 — Joint Ventures

The Company owns a fifty percent interest in a joint venture (“Pacific Animation Partners”) with the U.S. entertainment subsidiary of a leading Japanese advertising and animation production company. The joint venture was created to develop and produce a boys’ animated television show, which it licensed worldwide for television broadcast as well as consumer products. The Company produced toys based upon the television program under a license from the joint venture which also licensed certain other merchandising rights to third parties. The joint venture completed and delivered 65 episodes of the show, which began airing in February 2012, and has since ceased production of the television show. For the three months ended March 31, 2018 and 2017, the Company recognized income from the joint venture of \$22,000 and nil, respectively.

As of March 31, 2018 and December 31, 2017, the balance of the investment in the Pacific Animation Partners joint venture is nil.

In September 2012, the Company entered into a joint venture (“DreamPlay Toys”) with NantWorks LLC (“NantWorks”) in which it owns a fifty percent interest. Pursuant to the operating agreement of DreamPlay Toys, the Company paid to NantWorks cash in the amount of \$8.0 million and issued NantWorks a warrant to purchase 1.5 million shares of the Company’s common stock at a value of \$7.0 million in exchange for the exclusive right to arrange for the provision of the NantWorks recognition technology platform for toy products. The Company had classified these rights as an intangible asset, which was being amortized over the anticipated revenue stream from the exploitation of these rights. However, the Company has abandoned the use of the technology in connection with its toy products and no future sales are anticipated, and the Company recorded an impairment charge to income of \$2.9 million to write off the remaining unamortized technology rights during the third quarter of 2017. The Company retains the financial risk of the joint venture and is responsible for the day-to-day operations, which are expected to be nominal in future periods. The results of operations of the joint venture are consolidated with the Company’s results.

In addition, in 2012, the Company invested \$7.0 million in cash in exchange for a five percent economic interest in a related entity, DreamPlay, LLC, that was expected to monetize the exploitation of the recognition technologies in non-toy consumer product categories. Adoption of the technology has been inadequate to establish a commercially viable market for the technology. NantWorks has the right to repurchase the Company’s interest for \$7.0 million, but the Company does not anticipate that NantWorks will do so. As of September 30, 2017, the Company determined the value of this investment will not be realized and that full impairment of the value had occurred. Accordingly, the Company recorded an impairment charge of \$7.0 million during the quarter ended September 30, 2017.

In November 2014, the Company entered into a joint venture with Meisheng Culture & Creative Corp., for the purpose of providing certain JAKKS licensed and non-licensed toys and consumer products to agreed-upon territories of the People’s Republic of China. The joint venture includes a subsidiary in the Shanghai Free Trade Zone that sells, distributes and markets these products, which include dolls, plush, role play products, action figures, costumes, seasonal items, technology and app-enhanced toys, based on entertainment licenses and JAKKS’ own proprietary brands. The Company owns fifty-one percent of the joint venture and consolidates the joint venture since control rests with the Company. The non-controlling interest’s share of the income from the joint venture for the three months ended March 31, 2018 and 2017 was income of \$51,000 and \$31,000, respectively.

In October 2016, the Company entered into a joint venture with Hong Kong Meisheng Cultural Company Limited, a Hong Kong-based subsidiary of Meisheng (“HK Meisheng”), for the purpose of creating and developing original,

multiplatform content for children including new short-form series and original shows. JAKKS and HK Meisheng each own fifty percent of the joint venture and will jointly own the content. JAKKS will retain merchandising rights for kids' consumer products in all markets except China, which Meisheng will oversee through the Company's existing distribution joint venture. The non-controlling interest's share of the loss from the joint venture for three months ended March 31, 2018 and 2017 was nil. As of April 27, 2017, Hong Kong Meisheng Cultural Company Limited beneficially owns more than 10% of the Company's outstanding common stock.

Note 11 — Goodwill

The changes to the carrying amount of goodwill as of March 31, 2018 are summarized as follows (in thousands):

	Total
Balance, December 31, 2017	\$35,384
Adjustments to goodwill for foreign currency translation	208
Balance, March 31, 2018	\$35,592

The Company applies a fair value-based impairment test to the carrying value of goodwill and indefinite-lived intangible assets on an annual basis and, on an interim basis, if certain events or circumstances indicate that an impairment loss may have been incurred. Goodwill impairment exists when the estimated fair value of goodwill is less than its carrying value. Based on several factors that occurred during the quarter ended March 31, 2018, the Company determined the fair value of its reporting units should be retested for potential impairment. As a result of the retesting performed, no goodwill impairment was determined to have occurred for the three months ended March 31, 2018.

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Note 12 — Intangible Assets Other Than Goodwill

Intangible assets other than goodwill consist primarily of licenses, product lines, customer relationships and trademarks. Amortized intangible assets are included in intangibles in the accompanying condensed consolidated balance sheets. Trademarks are disclosed separately in the accompanying condensed consolidated balance sheets. Intangible assets as of March 31, 2018 and December 31, 2017 include the following (in thousands, except for weighted useful lives):

	Weighted Useful Lives (Years)	March 31, 2018			December 31, 2017		
		Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets:							
Licenses	5.81	\$20,130	\$ (18,900 )	\$1,230	\$20,130	\$ (18,620 )	\$1,510
Product lines	10.36	33,858	(14,065 )	19,793	33,858	(13,178 )	20,680
Customer relationships	4.90	3,152	(3,152 )	—	3,152	(3,152 )	—
Trade names	5.00	3,000	(3,000 )	—	3,000	(3,000 )	—
Non-compete agreements	5.00	200	(200 )	—	200	(200 )	—
Total amortized intangible assets		\$60,340	\$ (39,317 )	\$21,023	\$60,340	\$ (38,150 )	\$22,190
Unamortized Intangible Assets:							
Trademarks		\$300	\$ —	\$300	\$300	\$ —	\$300

Note 13 — Comprehensive Loss

The table below presents the components of the Company's comprehensive loss for the three months ended March 31, 2018 and 2017 (in thousands):

	Three Months Ended March 31,	
	2018	2017
Net Loss	\$(36,193)	\$(18,285)
Other comprehensive income:		
Foreign currency translation adjustment	1,050	531
Comprehensive loss	(35,143)	(17,754)
Less: Comprehensive income attributable to non-controlling interests	51	31
Comprehensive loss attributable to JAKKS Pacific, Inc.	\$(35,194)	\$(17,785)

Note 14 — Litigation

The Company is a party to, and certain of its property is the subject of, various pending claims and legal proceedings that routinely arise in the ordinary course of its business, but 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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Note 15 — Share-Based Payments

The Company's 2002 Stock Award and Incentive Plan (the "Plan"), as amended, provides for the awarding of stock options, restricted stock and restricted stock units to certain key employees, executive officers and non-employee directors. Current awards under the Plan include grants to directors, executive officers and certain key employees of restricted stock awards and units, with vesting contingent upon (a) the completion of specified service periods ranging from one to five years and/or (b) meeting certain financial performance and/or market-based metrics. Unlike the restricted stock awards, the shares for the restricted stock units are not issued until they vest. The Plan is more fully described in Notes 15 and 17 to the Condensed Consolidated Financial Statements in the Company's 2017 Annual Report on Form 10-K.

The following table summarizes the total share-based compensation expense and the related tax benefits recognized for the three months ended March 31, 2018 and 2017 (in thousands):

	Three Months Ended March 31, 2018 2017	
Restricted stock compensation expense	\$676	\$748
Tax benefit related to restricted stock compensation	—	—

Restricted Stock Awards

Restricted stock award activity (including those with performance-based vesting criteria) for the three months ended March 31, 2018 is summarized as follows:

	Restricted Stock Awards	Weighted Average Grant Fair Value
	Number of Shares	
Outstanding, December 31, 2017	981,208	\$ 5.15
Awarded	2,164,374	2.35
Released	(194,800 )	5.14
Forfeited	—	—
Outstanding, March 31, 2018	2,950,782	3.10

As of March 31, 2018, there was \$4.4 million of total unrecognized compensation cost related to non-vested restricted stock awards, which is expected to be recognized over a weighted-average period of 2.73 years.

Restricted Stock Units

Restricted stock unit activity (including those with performance-based vesting criteria) for the three months ended March 31, 2018 is summarized as follows:

	Restricted Stock Units	Weighted Average Grant Fair Value
	Number of Shares	
Outstanding, December 31, 2017	959,192	\$ 5.15
Awarded	—	—
Released	(125,290)	5.15
Forfeited	(79,831 )	5.15
Outstanding, March 31, 2018	754,071	5.15

As of March 31, 2018, there was \$1.8 million of total unrecognized compensation cost related to non-vested restricted stock units, which is expected to be recognized over a weighted-average period of 2.3 years.

#### Stock Options

There has been no stock option activity pursuant to the Plan since December 31, 2015.

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Note 16 — Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based upon these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market-corroborated, or unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based upon observable inputs used in the valuation techniques, the Company is required to provide information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values into three broad levels as follows:

- Level 1: Valuations for assets and liabilities traded in active markets from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third-party pricing services for identical or similar assets or liabilities.
- Level 3: Valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

In instances where the determination of the fair value measurement is based upon inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based upon the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The following table summarizes our financial assets measured at fair value on a recurring basis as of March 31, 2018 (in thousands):

	Carrying Amount as of March 31, 2018	Fair Value Measurements As of March 31, 2018		
		Level 1	Level 2	Level 3
Cash equivalents	\$8,169	\$8,169	\$	—\$—
3.25% Convertible senior notes due in 2020	23,490	—	—	23,490

  

	Carrying Amount as of	Fair Value Measurements As of December 31, 2017	
		Level 1	Level 3

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	December 31, 2017		Level 2
Cash equivalents	\$ 13,718	\$ 13,718	\$ —
3.25% Convertible senior notes due in 2020	22,469	—	— 22,469

The following table provides a reconciliation of the beginning and ending balances of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	2018
Balance at January 1, 2018	\$22,469
Change in fair value	1,021
Balance at March 31, 2018	\$23,490

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Note 17 — Liquidity

As of March 31, 2018 and December 31, 2017, the Company held cash and cash equivalents of \$46.8 million and \$65.0 million, respectively. Cash and cash equivalents held outside of the United States in various foreign subsidiaries totaled \$39.7 million and \$52.8 million as of March 31, 2018 and December 31, 2017, respectively. The cash and cash equivalent balances in foreign subsidiaries have been fully taxed in the U.S. in connection with the Tax Cuts and Jobs Act, and would not be subject to additional U.S. tax should such amounts be repatriated in the form of dividends or deemed distributions. Any such repatriation may result in foreign withholding taxes, which would not be significant as of March 31, 2018.

The Company's primary sources of working capital are cash flows from operations and borrowings under its credit facility (see Note 5).

Typically, cash flows from operations are impacted by the effect on sales of (1) the appeal of the Company's products, (2) the success of its licensed brands, (3) the highly competitive conditions existing in the toy industry, (4) dependency on a limited set of large customers, and (5) general economic conditions. A downturn in any single factor or a combination of factors could have a material adverse impact upon the Company's ability to generate sufficient cash flows to operate the business. In addition, the Company's business and liquidity are dependent to a significant degree on its vendors and their financial health, as well as the ability to accurately forecast the demand for products. The loss of a key vendor, or material changes in support by them, or a significant variance in actual demand compared to the forecast, can have a material adverse impact on the Company's cash flows and business. Given the conditions in the toy industry environment in general, vendors, including licensors, may seek further assurances or take actions to protect against non-payment of amounts due them. Changes in this area could have a material adverse impact on the Company's liquidity.

Cash and cash equivalents, projected cash flow from operations and borrowings under the Company's credit facility should be sufficient to meet working capital and capital expenditure requirements, and allow the repayment of the Company's indebtedness in 2018, for the next 12 months with certain mitigating plans described herein. The Company is currently in the process of negotiating to amend its credit facility to allow for certain foreign accounts receivable to be included in the borrowing base calculation to improve the liquidity position. The Company is also in the process of negotiating a term loan with another bank under which the amount advanced would be based on certain types of inventory. These two transactions would provide the Company with additional working capital after the 2018 convertible notes of \$21.2 million are effectively repaid on or about June 15, 2018 as a result of the springing maturity provision included in its credit facility. The Company cannot make assurances that it will be able to close the aforementioned two transactions or that it will have the financial resources required to obtain, or that the conditions of the capital markets will support, any future debt or equity financings. In addition, the Company's ability to fund operations and retire or refinance the 2018 convertible notes is dependent on a number of factors, some of which are beyond its control, including the Company's future operating performance and the factors mentioned above and included in "Risk Factors" in Item 1A of this Form 10-Q. If the Company is unable to amend its credit facility to increase the borrowing base, close the contemplated term loan, refinance the 2018 convertible notes or secure another source of capital on commercially reasonable terms, it may be required to take additional measures, such as reorganizing its cost structure and adjusting inventory purchases and/or payment terms with suppliers, which could have a material adverse impact on its revenues and business.



## 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 condensed 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 Condensed Consolidated Financial Statements set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017. 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 upon 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 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. Our allowance for doubtful accounts is also affected by the time at which doubtful accounts receivable balances are actually written off.

Major customers' accounts are monitored on an ongoing basis; more in-depth reviews are performed based upon changes in a 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.** Revenue is recognized upon the shipment of goods to customers or their agents, depending upon terms, provided that control of the goods has transferred.

Generally, we do not allow product returns. We provide our customers a negotiated allowance for breakage or defects, which is recorded when the related revenue is recognized. However, we do make occasional exceptions to this policy and consequently accrue a return allowance based upon historic return amounts and management estimates. We 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 the sale.

**Fair value measurements.** Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, we use various methods including market, income and cost approaches. Based upon these approaches, we often utilize certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market-corroborated, or unobservable inputs. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based upon observable inputs used in the valuation techniques, we are required to provide information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values into three broad levels as follows:

Level 1: Valuations for assets and liabilities traded in active markets from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third-party pricing services for identical or similar assets or liabilities.

Level 3: Valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

In instances where the determination of the fair value measurement is based upon inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based upon the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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The following table summarizes our financial assets measured at fair value on a recurring basis as of March 31, 2018 (in thousands):

	Carrying Amount as of March 31, 2018	Fair Value Measurements As of March 31, 2018		
		Level 1	Level 2	Level 3
Cash equivalents	\$8,169	\$8,169	\$	—\$—
3.25% Convertible senior notes due in 2020	23,490	—	—	23,490

Carrying Amount as of	Fair Value Measurements As of December 31, 2017