

JAKKS PACIFIC INC
Form 10-Q
November 09, 2011

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

FORM 10-Q

(Mark one)

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

For the quarterly period ended September 30, 2011

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
(State or Other Jurisdiction of Incorporation or Organization)

95-4527222
(I.R.S. Employer Identification No.)

22619 Pacific Coast Highway
Malibu, California
(Address of Principal Executive Offices)

90265
(Zip Code)

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

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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, 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 |
| <input type="checkbox"/> | <input checked="" type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

(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

The number of shares outstanding of the issuer's common stock is 25,980,731 as of November 8, 2011.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

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Quarter Ended September 30, 2011

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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 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.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

| Assets | December 31, 2010 (*) | September 30, 2011 (Unaudited) |
|---|------------------------------|--------------------------------------|
| Current assets | | |
| Cash and cash equivalents | \$ 278,346 | \$ 232,244 |
| Marketable securities | 207 | 212 |
| Accounts receivable, net of allowance for uncollectible accounts of \$2,778 and \$3,323, respectively | 122,476 | 239,680 |
| Inventory | 43,230 | 55,836 |
| Income tax receivable | 19,052 | 23,963 |
| Deferred income taxes | 23,576 | 16,475 |
| Prepaid expenses and other | 25,275 | 27,063 |
| Total current assets | 512,162 | 595,473 |
| Property and equipment | | |
| Office furniture and equipment | 12,127 | 12,484 |
| Molds and tooling | 57,103 | 62,866 |
| Leasehold improvements | 6,920 | 6,773 |
| Total | 76,150 | 82,123 |
| Less accumulated depreciation and amortization | 59,204 | 64,543 |
| Property and equipment, net | 16,946 | 17,580 |
| Deferred income taxes | 58,848 | 58,839 |
| Intangibles | 23,437 | 16,364 |
| Other long term assets | 12,643 | 8,239 |
| Investment in joint venture | 74 | 1,820 |
| Goodwill, net | 6,988 | 6,988 |
| Trademarks, net | 2,308 | 2,308 |
| Total assets | \$ 633,406 | \$ 707,611 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 35,886 | \$ 85,352 |
| Accrued expenses | 54,476 | 60,641 |
| Reserve for sales returns and allowances | 28,378 | 26,398 |
| Capital lease obligations | 27 | — |
| Income taxes payable | 6,143 | 21,716 |
| Total current liabilities | 124,910 | 194,107 |
| Convertible senior notes, net | 89,458 | 91,505 |
| Other liabilities | 1,625 | 1,571 |
| Income taxes payable | 5,005 | 4,712 |
| Total liabilities | 220,998 | 291,895 |
| Commitments and Contingencies | | |
| Stockholders' equity | | |
| Preferred shares, \$.001 par value; 5,000,000 shares authorized; nil outstanding | — | — |

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| | | |
|--|------------|------------|
| Common stock, \$.001 par value; 100,000,000 shares authorized; 27,610,952 and 25,969,274 shares issued, respectively; 27,319,624 and 25,969,274 shares outstanding, respectively | 28 | 26 |
| Additional paid-in capital | 302,425 | 274,066 |
| Treasury Stock at cost; 291,328 and nil shares, respectively | (5,641) | — |
| Retained earnings | 119,884 | 145,783 |
| Accumulated other comprehensive loss | (4,288) | (4,159) |
| Total stockholders' equity | 412,408 | 415,716 |
| Total liabilities and stockholders' equity | \$ 633,406 | \$ 707,611 |

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

JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

| | Three Months Ended September 30, (Unaudited) | | Nine Months Ended September 30, (Unaudited) | |
|---|--|------------|---|------------|
| | 2010 | 2011 | 2010 | 2011 |
| Net sales | \$ 348,677 | \$ 332,419 | \$ 549,277 | \$ 536,672 |
| Cost of sales | 237,720 | 226,749 | 369,858 | 361,639 |
| Gross profit | 110,957 | 105,670 | 179,419 | 175,033 |
| Selling, general and administrative expenses | 59,378 | 55,602 | 140,194 | 137,757 |
| Income from operations | 51,579 | 50,068 | 39,225 | 37,276 |
| Profit from video game joint venture | — | — | 6,000 | 6,000 |
| Equity in net loss of joint venture | — | (26) | — | (25) |
| Interest income | 99 | 102 | 251 | 329 |
| Interest expense, net | (1,547) | (2,063) | (5,751) | (6,128) |
| Income before provision for income taxes | 50,131 | 48,081 | 39,725 | 37,452 |
| Provision for income taxes | 9,771 | 13,256 | 1,547 | 8,962 |
| Net income | \$ 40,360 | \$ 34,825 | \$ 38,178 | \$ 28,490 |
| Income per share – basic | \$ 1.47 | \$ 1.32 | \$ 1.39 | \$ 1.06 |
| Income per share – diluted | \$ 1.23 | \$ 1.10 | \$ 1.22 | \$ 0.97 |

See notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

| | Nine Months Ended September 30, (Unaudited) | |
|---|---|-----------|
| | 2010 | 2011 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net Income | \$ 38,178 | \$ 28,490 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 22,809 | 20,614 |
| Share-based compensation expense | 3,616 | 1,547 |
| Loss (gain) on disposal of property and equipment | (35) | 18 |
| Deferred income taxes | (25,651) | 7,110 |
| Write-down of deferred offering costs | 495 | — |
| Equity in net loss of joint venture | — | 25 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (157,440) | (117,204) |
| Inventory | (26,002) | (12,606) |
| Prepaid expenses and other current assets | 7,302 | 1,934 |
| Receivable from joint venture | 6,727 | — |
| Income tax receivable | 35,015 | (4,911) |
| Accounts payable | 82,181 | 53,008 |
| Accrued expenses | 9,870 | 6,165 |
| Income taxes payable | 4,570 | 15,280 |
| Reserve for sales returns and allowances | (3,961) | (1,980) |
| Other liabilities | 478 | (54) |
| Total adjustments | (40,026) | (31,054) |
| Net cash used in operating activities | (1,848) | (2,564) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property and equipment | (9,614) | (11,621) |
| Change in other assets | 2,008 | 260 |
| Proceeds from sale of property and equipment | 67 | 26 |
| Investment in joint venture | — | (1,771) |
| Cash paid for net assets of business acquired | (1,875) | (3,542) |
| Net purchase of marketable securities | (4) | (5) |
| Net cash used in investing activities | (9,418) | (16,653) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Retirement of convertible notes | (20,262) | — |
| Proceeds from stock options exercised | — | 134 |
| Proceeds from warrants exercised | — | 1,135 |
| Common stock surrendered | (40) | (1,177) |
| Common stock repurchased | (4,554) | (24,359) |
| Dividends paid | - | (2,591) |
| Decrease in capital lease obligations | (122) | (27) |
| Net cash used in financing activities | (24,978) | (26,885) |
| Net decrease in cash and cash equivalents | (36,244) | (46,102) |

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| | | | | |
|--|----|---------|----|----------|
| Cash and cash equivalents, beginning of period | | 254,837 | | 278,346 |
| Cash and cash equivalents, end of period | \$ | 218,593 | \$ | 232,244 |
| Cash paid (received) during the period for: | | | | |
| Income taxes | \$ | 3,542 | \$ | (8,471) |
| Interest | \$ | 2,630 | \$ | 2,250 |

Non cash investing and financing activity:

In January and February 2011, an executive officer surrendered an aggregate of 57,096 shares of restricted stock at a value of \$1.0 million to cover his income taxes due on the 2011 vesting of restricted shares granted to him in 2010 and 2011. This restricted stock was subsequently retired by the Company.

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

See notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

September 30, 2011

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, 2010.

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. In the fourth quarter of 2010, the Company re-aligned its products into two new categories to better reflect the operation of the business. The Company’s reportable segments are Traditional Toys and Electronics, and Role Play, Novelty and Seasonal Toys, each of which includes worldwide sales.

The Traditional Toys and Electronics segment includes action figures, vehicles, playsets, plush products, dolls, accessories, electronic products, construction toys, infant and pre-school toys, pet products and related products.

Role Play, Novelty and Seasonal Toys includes role play and dress-up products, Halloween and everyday costume play, novelty toys, seasonal and outdoor products, and indoor and outdoor kid’s furniture.

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.

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, 2010 and September 30, 2011 and for the three and nine months ended September 30, 2010 and 2011 are as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------------|-------------------------------------|------------|------------------------------------|------------|
| | 2010 | 2011 | 2010 | 2011 |
| Net Sales | | | | |
| Traditional Toys and Electronics | \$ 149,016 | \$ 163,199 | \$ 251,179 | \$ 269,096 |
| Role Play, Novelty and Seasonal Toys | 199,661 | 169,220 | 298,098 | 267,576 |
| | \$ 348,677 | \$ 332,419 | \$ 549,277 | \$ 536,672 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2010 | 2011 | 2010 | 2011 |
| Operating Income | | | | |
| Traditional Toys and Electronics | \$ 19,196 | \$ 28,012 | \$ 11,961 | \$ 19,796 |
| Role Play, Novelty and Seasonal Toys | 32,383 | 22,056 | 27,264 | 17,480 |
| | \$ 51,579 | \$ 50,068 | \$ 39,225 | \$ 37,276 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2010 | 2011 | 2010 | 2011 |
| Depreciation and Amortization Expense | | | | |
| Traditional Toys and Electronics | \$ 6,613 | \$ 6,314 | \$ 13,967 | \$ 13,218 |
| Role Play, Novelty and Seasonal Toys | 5,404 | 4,481 | 8,842 | 7,396 |
| | \$ 12,017 | \$ 10,795 | \$ 22,809 | \$ 20,614 |

| | December 31, 2010 | September 30, 2011 |
|--------------------------------------|----------------------|-----------------------|
| Assets | | |
| Traditional Toys and Electronics | \$ 252,107 | \$ 280,423 |
| Role Play, Novelty and Seasonal Toys | 381,299 | 427,188 |
| | \$ 633,406 | \$ 707,611 |

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, 2010 and September 30, 2011 and for the three and nine months ended September 30, 2010 and 2011 (in thousands):

| | December 31, 2010 | September 30, 2011 |
|-------------------|----------------------|-----------------------|
| Long-lived Assets | | |
| United States | \$ 16,023 | \$ 16,726 |
| Hong Kong | 923 | 854 |
| | \$ 16,946 | \$ 17,580 |

| Net Sales by Geographic Area | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|------------------------------|----------------------------------|------------|---------------------------------|------------|
| | 2010 | 2011 | 2010 | 2011 |
| United States | \$ 288,754 | \$ 276,955 | \$ 457,674 | \$ 444,188 |
| Europe | 29,644 | 23,132 | 41,697 | 37,944 |
| Canada | 18,593 | 17,603 | 25,782 | 24,450 |
| Hong Kong | 380 | 1,316 | 3,392 | 2,788 |
| Other | 11,306 | 13,413 | 20,732 | 27,302 |
| | \$ 348,677 | \$ 332,419 | \$ 549,277 | \$ 536,672 |

Major Customers

Net sales to major customers for the three and nine months ended September 30, 2010 and 2011 were as follows (in thousands, except for percentages):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | | Percentage of Net Sales | |
|----------|----------------------------------|----------------------------|---------------------------------|----------------------------|-------------------------------|----------------------------|
| | 2010 | 2011 | 2010 | 2011 | | |
| | Amount | Percentage of Net Sales | Amount | Percentage of Net Sales | Amount | Percentage of Net Sales |
| Wal-Mart | \$ 81,943 | 23.5% | \$ 93,227 | 28.0% | \$ 127,181 | 23.2% |
| Toys 'R' | | | | | | |
| Us | 45,958 | 13.2 | 38,877 | 11.7 | 66,977 | 12.2 |
| Target | 39,167 | 11.2 | 50,791 | 15.3 | 75,448 | 13.7 |
| | \$ 167,068 | 47.9% | \$ 182,895 | 55.0% | \$ 269,606 | 49.1% |
| | | | | | \$ 281,703 | 52.6% |

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

At December 31, 2010 and September 30, 2011, the Company's three largest customers accounted for approximately 52.5% and 51.7%, 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, 2010 | September 30, 2011 |
|----------------|----------------------|-----------------------|
| Raw materials | \$ 3,340 | \$ 4,059 |
| Finished goods | 39,890 | 51,777 |
| | \$ 43,230 | \$ 55,836 |

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 \$28.4 million as of December 31, 2010, compared to \$26.4 million as of September 30, 2011. This decrease was primarily due to certain customers taking their year-end allowances related to 2010 during 2011.

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 principal amount of 4.50% Convertible Senior Notes due 2014 (the “Notes”). The Notes, which are senior unsecured obligations of the Company, pay cash interest semi-annually at a rate of 4.50% per annum and will mature on November 1, 2014. The initial conversion rate is 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. As a result of the cash dividend of \$0.10 per share declared by the Board of Directors payable October 3, 2011, the new conversion rate will be 63.5950 shares of JAKKS common stock per \$1,000 principal amount of notes (or approximately \$15.72 per share). 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).

In accordance with ASC 470-20, “Debt with Conversion and Other Options,” the Company allocated \$13.7 million of the \$100.0 million principal amount of the Notes to the equity component, which represents a discount to the debt and is being amortized to interest expense through November 1, 2014. Interest expense associated with the amortization of the equity component was \$0.7 million and \$0.7 million in the three months ended September 30, 2010 and 2011, respectively, and \$2.0 million and \$2.0 million for the nine months ended September 30, 2010 and 2011, respectively.

Note 6 — Income Taxes

The Company’s income tax expense of \$9.0 million for the nine months ended September 30, 2011 reflects an effective tax rate of 23.9%. Included in the tax expense of \$9.0 million is a tax benefit of \$1.3 million related to a reduction in tax reserves resulting from closed statutes and an adjustment to record various outstanding state tax refunds. The Company’s income tax expense of \$1.5 million for the nine months ended September 30, 2010 reflected an effective tax expense rate of 3.9%. Included in the tax expense of \$1.5 million was a tax benefit of \$11.1 million primarily 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, the receipt of a refund of tax resulting from the tax audits of the Company’s 2003 through 2009 income tax returns and an adjustment related to transfer pricing. Absent this discrete tax benefit, the Company’s effective tax rate for the nine months ended September 30, 2010 would be 31.8%.

The Company’s income tax expense of \$13.3 million for the three months ended September 30, 2011 reflects an effective tax rate of 27.6%. The Company’s income tax expense for the three months ended September 30, 2010 was \$9.8 million and reflects an effective tax rate of 19.5%.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 7 — Earnings Per Share

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

| | Three Months Ended September 30, | | | | | |
|---|----------------------------------|---------------------------------------|-----------|-----------|---------------------------------------|-----------|
| | Income | 2010 Weighted Average Shares | Per-Share | Income | 2011 Weighted Average Shares | Per-Share |
| Earnings per share – basic | | | | | | |
| Income available to common stockholders | \$ 40,360 | 27,379 | \$ 1.47 | \$ 34,825 | 26,476 | \$ 1.32 |
| Effect of dilutive securities: | | | | | | |
| Convertible senior notes | 1,289 | 6,321 | | 1,289 | 6,329 | |
| Options and warrants | | 31 | | | 11 | |
| Unvested restricted stock grants | | 243 | | | 106 | |
| Earnings per share – diluted | | | | | | |
| Income available to common stockholders plus assumed exercises and conversion | \$ 41,649 | 33,974 | \$ 1.23 | \$ 36,114 | 32,922 | \$ 1.10 |

| | Nine Months Ended September 30, | | | | | |
|---|---------------------------------|---------------------------------------|-----------|-----------|---------------------------------------|-----------|
| | Income | 2010 Weighted Average Shares | Per-Share | Income | 2011 Weighted Average Shares | Per-Share |
| Earnings per share – basic | | | | | | |
| Income available to common stockholders | \$ 38,178 | 27,388 | \$ 1.39 | \$ 28,490 | 26,858 | \$ 1.06 |
| Effect of dilutive securities: | | | | | | |
| Convertible senior notes | 4,145 | 6,940 | | 3,867 | 6,323 | |
| Options and warrants | | 25 | | | 26 | |
| Unvested restricted stock grants | | 238 | | | 98 | |
| Earnings per share – diluted | | | | | | |
| Income available to common stockholders plus assumed exercises and conversion | \$ 42,323 | 34,591 | \$ 1.22 | \$ 32,357 | 33,305 | \$ 0.97 |

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 7 — Earnings Per Share (continued)

Basic earnings per share has been computed using the weighted average number of common shares outstanding. Diluted earnings 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). Potentially dilutive stock options of 283,156 and 144,665 for the three months ended September 30, 2010 and 2011, respectively, were excluded from the computation of diluted earnings 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 stock options of 317,293 and 180,034 for the nine months ended September 30, 2010 and 2011, respectively, were excluded from the computation of diluted earnings 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 2011, the Company issued 27,442 shares of restricted stock at a value of \$0.5 million to an executive officer, which vest, subject to certain company financial performance criteria, over a six year period beginning in February 2012. In addition, an aggregate of 26,480 shares of restricted stock was issued to its five non-employee directors, which vest in January 2012, at an aggregate value of approximately \$0.5 million. In February 2011, the Company issued an aggregate of 65,363 shares of restricted stock at a value of \$1.2 million to certain employees including an executive officer, which vest over a three-year period beginning in December 2011. In addition, the company issued 18,238 shares of restricted stock at a value of \$0.3 million to an executive officer, which vest, subject to certain company financial performance criteria, over a six year period beginning in February 2011. In March 2011, the Company cancelled an aggregate of 5,000 shares of restricted stock due to the termination of an employee and the refusal of a grant by a current employee. During the first quarter of 2011, an executive officer surrendered an aggregate of 57,096 shares of restricted stock at a value of \$1.0 million to cover income taxes on the 2011 vesting of his restricted shares.

In April 2011, the Company issued 5,500 shares of common stock on the exercise of options at a value of \$73,480. Also, in April 2011, the Company cancelled an aggregate of 19,362 shares of restricted stock due to the termination of two employees. In May 2011, the Company issued 4,500 shares of common stock on the exercise of options at a value of \$60,120. In June 2011, the Company cancelled 13,013 shares of restricted stock due to the termination of an employee.

In August 2011, certain employees surrendered an aggregate of 7,868 shares of restricted stock at a value of \$136,588 to cover their income taxes due on the 2011 vesting of the restricted shares granted to them in 2006. Also, in August 2011, the Company cancelled an aggregate of 15,229 shares of restricted stock due to the termination of two employees. During the third quarter of 2011, the Company repurchased the remaining 1,206,300 shares of authorized common stock available for repurchase at a value of \$19.3 million. These shares represented approximately 4.4% of the Company's outstanding shares of common stock at the time of repurchase, and were retired by the Company during the third quarter of 2011.

In October 2010, the Company's Board of Directors authorized it to repurchase up to \$30.0 million of its common stock. As of December 31, 2010, 291,328 shares at a value of \$5.6 million were repurchased and held in Treasury, and during the first quarter of 2011, an additional 274,005 shares at a value of \$5.1 million were repurchased. All such shares totaling 565,333 shares represented approximately 2.0% of the Company's outstanding shares of common stock at the time of repurchase, and were retired by the Company during the first quarter of 2011.

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.

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 two earn-out periods ended December 31, 2009 and 2010, nil and \$1.7 million, respectively, 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, 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. In the first two earn-out periods ended September 30, 2009 and 2010 the full earn-out amounts of \$1.9 million each were earned. 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 decor and a myriad of other children’s toy products, and was included in its results of operations from the date of acquisition.

During the first quarter of, 2011, an aggregate of \$3.5 million of earn-out was paid in connection with the Tollytots and Kids Only acquisitions.

Note 10 — Joint Ventures

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 in the aggregate amount of \$20.0 million payable \$6.0 million on each of June 30, 2010 (payment received in June 2010) and 2011 (payment received in June 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.

The Company owns a fifty percent interest in a joint venture 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 intends to license worldwide for television broadcast as well as consumer products. The joint venture has already licensed the right to the Company to develop and market toys based on the television

program and certain other merchandising rights to third-parties. The Company is responsible for fifty percent of the operating expenses of the joint venture and for twenty-five percent of the production costs of the television show. The joint venture has approved the production of 52 episodes of the show for which the Company is responsible for an aggregate of approximately \$3.4 million. Production has commenced on the first 26 episodes for which the Company has paid an aggregate amount of approximately \$1.7 million in 2011. The Company's investment is being accounted for using the equity method. For the three and nine months ended September 30, 2011, the Company recognized a loss of \$25,787 and \$24,869, respectively, from the joint venture. Operations of the joint venture commenced in the fourth quarter of 2010. Accordingly, there was no activity in the three and nine months ended September 30, 2010.

As of December 31, 2010 and September, 2011, the balance of the investment in the joint venture includes the following components (in thousands):

| | December 31, 2010 | | September 30, 2011 | |
|---------------------------------|----------------------|------|-----------------------|-------|
| Capital Contributions | \$ | 130 | \$ | 1,901 |
| Equity in cumulative net (loss) | | (56) | | (81) |
| Investment in joint venture | \$ | 74 | \$ | 1,820 |

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 11 — Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2011 are as follows (in thousands):

| | Traditional Toys and Electronics | Role Play, Novelty and Seasonal Toys | Total |
|---|--|---|----------|
| Balance at beginning of the period | \$ 2,445 | \$ 4,543 | \$ 6,988 |
| Adjustments to goodwill during the period | — | — | — |
| Balance, September 30, 2011 | \$ 2,445 | \$ 4,543 | \$ 6,988 |

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.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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 balance sheets. Trademarks are disclosed separately in the accompanying balance sheets. Debt offering costs from the issuance of the Company's convertible senior notes are included in the accompanying balance sheets. Intangible assets and debt issuance costs are as follows (in thousands, except for weighted useful lives):

| | Weighted Useful Lives (Years) | December 31, 2010 | | | September 30, 2011 | | |
|-----------------------------------|--|-----------------------------|-----------------------------|---------------|-----------------------------|-----------------------------|---------------|
| | | 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 | (65,435) | 20,353 | 85,788 | (71,512) | 14,276 |
| Product lines | 3.62 | 19,100 | (18,592) | 508 | 19,100 | (18,720) | 380 |
| Customer relationships | 5.32 | 6,296 | (3,902) | 2,394 | 6,296 | (4,673) | 1,623 |
| Non-compete/Employment contracts | 3.84 | 3,133 | (2,951) | 182 | 3,133 | (3,048) | 85 |
| Total amortized intangible assets | | 116,710 | (93,273) | 23,437 | 116,710 | (100,346) | 16,364 |
| Deferred Costs: | | | | | | | |
| Debt issuance costs | 5.00 | 3,678 | (856) | 2,822 | 3,678 | (1,407) | 2,271 |
| Unamortized Intangible Assets: | | | | | | | |
| Trademarks | indefinite | 2,308 | — | 2,308 | 2,308 | — | 2,308 |
| | | \$ 122,696 | \$ (94,129) | \$ 28,567 | \$ 122,696 | \$ 101,753 | \$ 20,943 |

Amortization expense related to limited life intangible assets and debt offering costs was \$4.4 million and \$4.0 million for the three months ended September 30, 2010 and 2011, respectively, and \$8.5 million and \$7.6 million for the nine months ended September 30, 2010 and 2011, respectively.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 13 — Comprehensive Income

The table below presents the components of the Company's comprehensive income for the three and nine months ended September 30, 2010 and 2011 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|-----------|---------------------------------|-----------|
| | 2010 | 2011 | 2010 | 2011 |
| Net Income | \$ 40,360 | \$ 34,825 | \$ 38,178 | \$ 28,490 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustment | 5 | 166 | (27) | 129 |
| Comprehensive income | \$ 40,365 | \$ 34,991 | \$ 38,151 | \$ 28,619 |

Note 14— Litigation

In January 2011, Nouveau Model and Talent Management (“Nouveau”) instituted an action against Jakks and Disguise (together, “the Company”) in Superior Court of the State of California, Los Angeles, captioned Nouveau v. Disguise, et al., SC 111112. The Complaint stated causes of action for statutory misappropriation of publicity (Civ. Code §3344), common law misappropriation of publicity, unjust enrichment and breach of contract, and sought unspecified damages relating to the Company's alleged improper and unauthorized use of the likenesses of models used in the promotion of the Company's products. In June 2011, the Company filed a demurrer and motion to strike and, in response, Nouveau filed a first amended complaint (“FAC”). The Company filed a demurrer and motion to strike with respect to the FAC, which is scheduled to be heard in January 2012. Discovery is proceeding. We believe that the claims in the FAC are without merit and we intend to defend vigorously against them. However, because this action is in its preliminary stage, we cannot assure you as to the outcome of the action, nor can we estimate the range of our potential losses.

The Company is also 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.

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 2010 Annual Report on Form 10-K.

The following table summarizes the total share-based compensation expense and related tax benefits recognized for the three and nine months ended September 30, 2010 and 2011 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|--------|---------------------------------|----------|
| | 2010 | 2011 | 2010 | 2011 |
| Stock option compensation expense | \$ | \$ — | \$ (224) | \$ — |
| Tax benefit related to stock option compensation | \$ | \$ | \$ (82) | \$ |
| Restricted stock compensation expense | \$ 1,526 | \$ 429 | \$ 3,840 | \$ 1,547 |
| Tax benefit related to restricted stock compensation | \$ 575 | \$ 145 | \$ 1,447 | \$ 558 |

Stock option activity pursuant to the Plan for nine months ended September 30, 2011 is summarized as follows:

| | Plan Stock Options (*) | |
|---------------------------------|------------------------|---------------------------------|
| | Number of Shares | Weighted Average Exercise Price |
| Outstanding, December 31, 2010 | 318,265 | \$ 19.23 |
| Granted | — | \$ — |
| Exercised | (10,000) | \$ 13.36 |
| Cancelled | (118,100) | \$ 20.02 |
| Outstanding, September 30, 2011 | 190,165 | \$ 19.04 |

* The stock option activity excludes 100,000 underlying fully vested warrants issued in 2003 with an exercise price of \$11.35 per share, which were exercised in full on March 10, 2011. There are no warrants outstanding as of September 30, 2011.

Restricted stock award activity pursuant to the Plan for the nine months ended September 30, 2011 is summarized as follows:

| | Restricted Stock Awards | |
|--|-------------------------|------------------------------|
| | Number of Shares | Weighted Average Grant Price |

| | | | |
|---------------------------------|------------|----|-------|
| Outstanding, December 31, 2010 | 324,635 | \$ | 14.99 |
| Awarded | 137,523 | \$ | 18.29 |
| Released | (200,911) | \$ | 13.10 |
| Forfeited | (51,104) | \$ | 18.33 |
| Outstanding, September 30, 2011 | 210,143 | \$ | 18.15 |

Note 16 — Subsequent Events

On October 14, 2011, the Company acquired Moose Mountain Toymakers Limited (“Moose Mountain”). The purchase price for Moose Mountain was approximately \$16.0 million in cash, subject to an upward or downward adjustment based on the level of Moose Mountain’s net working capital as of the closing date of the acquisition and a contingent payment based on future sales performance of the Moose Mountain products. The purchase price for the acquisition of Moose Mountain was funded from existing cash.

Moose Mountain’s core business is developing, manufacturing, marketing and distributing foot to floor ride on and other toys.

On September 13, 2011 the Company received an unsolicited letter from Oaktree Capital Management L.P. (“Oaktree”) expressing a non-binding indication of interest in acquiring the Company for \$20 per share, subject to due diligence and Oaktree’s ability to raise the necessary debt financing. Oaktree had initially contacted the Company in March 2011 regarding an earlier non-binding and highly conditional indication of interest in acquiring the Company. With the advice and assistance of its independent financial advisors and special counsel, the Board of Directors of the Company reviewed and analyzed the terms of Oaktree’s indication of interest. After several Board meetings, a meeting between the Company and Oaktree attended by its independent financial advisors and special counsel, and other communications, in July of 2011 the Company’s Board unanimously determined that pursuing Oaktree’s initial indication of interest would not be in the best interests of the Company and its shareholders. The Board communicated its conclusion to Oaktree in July 2011. The Company heard nothing further from Oaktree until it received the September 13, 2011 letter, which Oaktree simultaneously made public. Once again, after a thorough review with the advice and assistance of its independent financial advisors and special counsel, the Company’s Board unanimously determined that Oaktree’s highly conditional and non-binding indication of interest was inadequate and not in the best interests of the Company and its stockholders. On October 5, 2011 the Board sent a letter to Oaktree conveying its determination.

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, 2010. 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 was 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. We routinely enter into arrangements with our 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.

Goodwill and Intangible assets amounted to \$25.7 million as of September 30, 2011, and \$32.7 million as of December 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 \$1.3 million was recognized during the nine months ended September 30, 2011 related to a reduction in tax reserves resulting from closed statutes and an adjustment to record various outstanding state tax refunds. In the nine months ended September 30, 2010, the Company recognized a discrete tax benefit of \$11.1 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, the receipt of a refund of tax resulting from the tax audits of the Company's 2003 through 2009 income tax returns and an adjustment related to transfer pricing.

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 September 30, 2011, our income tax reserves are approximately \$4.7 million and relate to the potential income tax audit adjustments, primarily in the areas of fixed asset depreciation in Hong Kong and ongoing state audits. As of September 30, 2010, our income tax reserves were approximately \$16.4 million and relate to the potential income tax audit adjustments, primarily in the areas of expense

recognition and state taxes.

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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

On September 13, 2011 the Company received an unsolicited letter from Oaktree Capital Management L.P. (“Oaktree”) expressing a non-binding indication of interest in acquiring the Company for \$20 per share, subject to due diligence and Oaktree’s ability to raise the necessary debt financing. Oaktree had initially contacted the Company in March 2011 regarding an earlier non-binding and highly conditional indication of interest in acquiring the Company. With the advice and assistance of its independent financial advisors and special counsel, the Board of Directors of the Company reviewed and analyzed the terms of Oaktree’s indication of interest. After several Board meetings, a meeting between the Company and Oaktree attended by its independent financial advisors and special counsel, and other communications, in July of 2011 the Company’s Board unanimously determined that pursuing Oaktree’s initial indication of interest would not be in the best interests of the Company and its shareholders. The Board communicated its conclusion to Oaktree in July 2011. The Company heard nothing further from Oaktree until it received the September 13, 2011 letter, which Oaktree simultaneously made public. Once again, after a thorough review with the advice and assistance of its independent financial advisors and special counsel, the Company’s Board unanimously determined that Oaktree’s highly conditional and non-binding indication of interest was inadequate and not in the best interests of the Company and its stockholders. On October 5, 2011 the Board sent a letter to Oaktree conveying its determination.

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 | | | | Nine Months Ended | | | |
|--|--------------------|---|---------------|---|-------------------|---|---------------|---|
| | September 30, | | September 30, | | September 30, | | September 30, | |
| | 2010 | | 2011 | | 2010 | | 2011 | |
| Net sales | 100.0 | % | 100.0 | % | 100.0 | % | 100.0 | % |
| Cost of sales | 68.2 | | 68.2 | | 67.3 | | 67.4 | |
| Gross profit | 31.8 | | 31.8 | | 32.7 | | 32.6 | |
| Selling, general and administrative expenses | 17.0 | | 16.7 | | 25.5 | | 25.7 | |
| Income from operations | 14.8 | | 15.1 | | 7.2 | | 6.9 | |
| Profit from video game joint venture | | | | | 1.1 | | 1.1 | |
| Equity in net loss of joint venture | | | | | | | | |
| Interest income | | | | | | | 0.1 | |
| Interest expense, net | (0.4 |) | (0.6 |) | (1.0 |) | (1.1 |) |
| Income before provision for income taxes | 14.4 | | 14.5 | | 7.3 | | 7.0 | |
| Provision for income taxes | 2.8 | | 4.0 | | 0.3 | | 1.7 | |
| Net Income | 11.6 | % | 10.5 | % | 7.0 | % | 5.3 | % |

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

| | Three Months Ended | | Nine Months Ended | |
|--------------------------------------|--------------------|------------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2010 | 2011 | 2010 | 2011 |
| Net Sales | | | | |
| Traditional Toys and Electronics | \$ 149,016 | \$ 163,199 | \$ 251,179 | \$ 269,096 |
| Role Play, Novelty and Seasonal Toys | 199,661 | 169,220 | 298,098 | 267,576 |
| | 348,677 | 332,419 | 549,277 | 536,672 |
| Cost of Sales | | | | |
| Traditional Toys and Electronics | 103,546 | 106,646 | 169,664 | 178,364 |
| Role Play, Novelty and Seasonal Toys | 134,174 | 120,103 | 200,194 | 183,275 |
| | 237,720 | 226,749 | 369,858 | 361,639 |
| Gross Profit | | | | |
| Traditional Toys and Electronics | 45,471 | 56,553 | 81,515 | 90,732 |
| Role Play, Novelty and Seasonal Toys | 65,486 | 49,117 | 97,904 | 84,301 |
| | \$ 110,957 | \$ 105,670 | \$ 179,419 | \$ 175,033 |

Comparison of the Three Months Ended September 30, 2011 and 2010

Net Sales

Traditional Toys and Electronics. Net sales of our Traditional Toys and Electronics segment were \$163.2 million in the three months ended September 30, 2011, compared to \$149.0 million in the prior year period, representing an increase of \$14.2 million, or 9.5%. The increase in net sales was primarily due to higher unit sales of our Cabbage Patch Kids® dolls, Pokémon® action figures and accessories, large baby dolls and accessories based on Disney Princess® characters, Pirates of the Caribbean® action figures and accessories, Real Steel™ action figures and Smurfs® plush and play sets. This was offset in part by decreases in unit sales of some products, including UFC™ action figures, dolls based on Disney Fairies®, and Disney Princess & Me dolls and accessories.

Role Play, Novelty and Seasonal Toys. Net sales of our Role Play, Novelty and Seasonal Toys were \$169.2 million in the three months ended September 30, 2011, compared to \$199.7 million in the prior year period, representing a decrease of \$30.5 million, or 15.3%. The decrease in net sales was primarily due to decreases in unit sales of our Halloween costumes and accessories, offset in part by increases in unit sales of our kids outdoor furniture and activity tables.

Cost of Sales

Traditional Toys and Electronics. Cost of sales of our Traditional Toys and Electronics segment was \$106.6 million, or 65.3% of related net sales, for the three months ended September 30, 2011, compared to \$103.5 million, or 69.5% of related net sales, in the prior year period, representing an increase of \$3.1 million, or 3.0%. The dollar increase in cost of sales is driven by an increase of \$4.1 million in royalty expense. The increase in royalty expense is due to changes in product mix from products with lower royalty rates or proprietary brands with no royalty rates to products with higher royalty rates. Depreciation of molds and tools in the segment decreased by \$0.8 million due to the reduction of the number of SKU's in our product lines.

Role Play, Novelty and Seasonal Toys. Cost of sales of our Role Play, Novelty and Seasonal Toys segment was \$120.1 million, or 71.0% of related net sales, in 2011, compared to \$134.2 million, or 67.2% of related net sales, in the prior year period representing a decrease of \$14.1 million, or 10.5%. Product costs decreased by \$12.4 million but, however, increased as a percentage of sales due to higher costs on the lower volume of purchases. Royalty expense increased by \$1.8 million and increased as a percentage of sales due to changes in product mix from products with lower royalty rates or proprietary brands with no royalty rates to products with higher royalty rates. Our depreciation of molds and tools in the segment are comparable year over year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$55.6 million in the three months ended September 30, 2011 and \$59.4 million in the prior year period, constituting 16.7% and 17.0% of net sales, respectively. Selling, general and administrative expenses decreased \$3.8 million from the prior year period primarily due to a decrease of direct selling costs (\$2.7 million), product development costs (\$0.6 million), stock based compensation (\$1.1 million), bonus expense (\$3.1 million) and amortization of intangible assets (\$0.4 million), offset in part by legal and financial advising fees related to the unsolicited indication of interest to acquire the Company (\$0.7 million), salary expenses (\$2.6 million), and rent expense (\$0.6 million). Selling, general and administrative expenses have decreased as a percentage of sales due to the lower sales volume as well as lower non-variable expenses.

Profit from Video Game Joint Venture

Pursuant to a Settlement Agreement and Mutual Release dated December 22, 2009, the video game joint venture was terminated on December 31, 2009. In each of June, 2010 and 2011, we received a fixed payment from THQ in the amount of \$6.0 million, which was recognized as income during the respective quarter. Additionally, we are due to receive future payments in the amount of \$4.0 million on each of June 30, 2012 and 2013 which we will record as income on a cash basis over the term.

Other Expense

Our equity in the net income/(loss) from our animation joint venture is charged to other expense. Operations of the joint venture commenced in the fourth quarter of 2010. Accordingly, there was no activity in the three months ended September 30, 2010. There was nominal activity in the three months ended September 30, 2011.

Interest Income

Interest income in the three months ended September 30, 2011 was \$0.1 million, comparable to \$0.1 million in the three months ended September 30, 2010.

Interest Expense

Interest expense was \$2.1 million in the three months ended September 30, 2011, as compared to \$1.5 million in the prior period. In the three months ended September 30, 2011, we booked interest expense of \$2.0 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. In the three months ended September 30, 2010, we booked interest expense of \$2.0 million related to our convertible senior notes payable and net interest expense of \$0.2 million related to uncertain tax positions taken or expected to be taken in a tax return.

Provision for Income Taxes

Our income tax expense, which includes federal, state and foreign income taxes, and discrete items, was \$13.3 million, or an effective tax rate of 27.6% for the three months ended September 30, 2011. During the comparable period in 2010, the income tax expense was \$9.8 million, or an effective tax provision rate of 19.5%.

Comparison of the Nine Months Ended September 30, 2011 and 2010

Net Sales

Traditional Toys and Electronics. Net sales of our Traditional Toys and Electronics segment were \$269.1 million in the nine months ended September 30, 2011, compared to \$251.2 million in the prior year period, representing an increase of \$17.9 million, or 7.1%. The increase in net sales was primarily due to higher unit sales of our Pokémon® action figures and play sets, large baby dolls and accessories based on Disney Princess® characters, and Pirates of the Caribbean® action figures and accessories, Real Steel™ action figures, and Cabbage Patch Kids® dolls. This was offset in part by lower unit sales of our UFC™ action figures, dolls based on Disney Fairies®, and electronics based on the Spy Net™ and Ultimotion™ brands.

Role Play, Novelty and Seasonal Toys. Net sales of our Role Play, Novelty and Seasonal Toys were \$267.6 million in the nine months ended September 30, 2011, compared to \$298.1 million in the prior year period, representing a decrease of \$30.5 million, or 10.2%. Net sales decreased year over year due to lower unit sales in our role play and dress up items based on Disney Fairies® and Barbie® and lower unit sales in our Halloween costumes, offset in part by higher unit sales of our kids outdoor furniture and activity tables.

Cost of Sales

Traditional Toys and Electronics. Cost of sales of our Traditional Toys and Electronics segment was \$178.4 million, or 66.3% of related net sales, for the nine months ended September 30, 2011, compared to \$169.7 million, or 67.6% of related net sales, in the prior year period, representing an increase of \$8.7 million, or 5.1%. The dollar increase consists of an increase of product costs of \$2.4 million, which is in line with the higher volume of sales. Royalty expense increased by \$7.5 million and increased as a percentage of sales due to changes in product mix from products with lower royalty rates or proprietary brands with no royalty rates to products with higher royalty rates. Our depreciation of molds and tools decreased by \$1.2 million primarily due to decreased purchases in molds and tools related to the reduction of SKU's in our product lines.

Role Play, Novelty and Seasonal Toys. Cost of sales of our Role Play, Novelty and Seasonal Toys segment was \$183.3 million, or 68.5% of related net sales, in 2011, compared to \$200.2 million, or 67.2% of related net sales, in the prior year period, representing a decrease of \$16.9 million, or 8.4%. The dollar decrease consists of decrease in product costs of \$13.5 million which is primarily due to lower sales volume. Royalty expense decreased by \$3.7 million due to the lower sales volume. Depreciation of molds and tools is comparable year over year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$137.8 million in the nine months ended September 30, 2011 and \$140.2 million in the prior year period, constituting 25.7% and 25.5% of net sales, respectively. Selling, general and administrative expenses decreased \$2.4 million from the prior year period primarily due to decreases of direct selling costs (\$1.5 million), bonus expense (\$4.4 million) stock based compensation (\$2.3 million) offset in part by an increase in legal expense (\$1.0 million), legal and financial advising fees related to the unsolicited indication of interest to acquire the Company (\$1.8 million), salary and payroll taxes (\$0.9 million), 401K match (\$0.9 million) and product development costs (\$1.3 million). Selling, general and administrative expenses are comparable year over year as a percentage of sales.

Profit from Video Game Joint Venture

Pursuant to a Settlement Agreement and Mutual Release dated December 22, 2009, the video game joint venture was terminated on December 31, 2009. In each of June 2010 and 2011, we received a fixed payment from THQ in the amount of \$6.0 million, which was recognized as income during the respective quarter. Additionally, we will receive future payments in the amount of \$4.0 million on each of June 30, 2012 and 2013 which we will record as income on a cash basis over the term

Other Expense

Our equity in the net income/(loss) from our animation joint venture is charged to other expense. Operations of the joint venture commenced in the fourth quarter of 2010. Accordingly, there was no activity in the nine months ended September 30, 2010. There was nominal activity in the nine months ended September 30, 2011.

Interest Income

Interest income in the nine months ended September 30, 2011 was \$0.3 million, comparable to \$0.3 million in the nine months ended September 30, 2010.

Interest Expense

Interest expense was \$6.1 million in 2011, as compared to \$5.8 million in 2010. In 2011, we booked interest expense of \$6.0 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. In 2010, we booked interest expense of \$6.9 million related to our convertible senior notes payable offset in part by a net benefit of \$0.6 million related to uncertain tax positions taken or expected to be taken in a tax return.

Provision for Income Taxes

Our income tax expense, which includes federal, state and foreign income taxes, and discrete items, was \$9.0 million, or an effective tax rate of 23.9% for the nine months ended September 30, 2011. During the comparable period in 2010, the income tax expense was \$1.5 million, or an effective tax rate of 3.9%.

The income tax benefit for the nine months ended September 30, 2011 included a discrete benefit of \$1.3 million related to a reduction in tax reserves resulting from closed statutes and an adjustment to record various outstanding state tax refunds. (see Note 6 of the Notes to Condensed Consolidated Financial Statements, supra.). Exclusive of the discrete items, the September 30, 2011 effective tax provision rate would be 27.3%.

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 September 30, 2011, we had working capital of \$401.4 million, compared to \$387.3 million as of December 31, 2010. The increase was primarily attributable to seasonably high accounts receivable and inventory balances offset partially by higher accrued expenses and accounts payable balances and the repurchase of shares of the Company's common stock

Operating activities used net cash of \$2.6 million in the first nine months of 2011, as compared to using net cash of \$1.8 million in the prior year period. Net cash was used primarily for the purchase of inventory. Our accounts receivable turnover as measured by days sales for the quarter outstanding in accounts receivable was 66 days as of September 30, 2011, a decrease from 76 days as of September 30, 2010. 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 September 30, 2011, we had cash and cash equivalents of \$232.2 million.

Our investing activities used net cash of \$16.7 million in the nine months ended September 30, 2011, as compared to \$9.4 million in the prior year period, consisting primarily of cash paid for the purchase of office furniture and equipment and molds and tooling of \$11.6 million used in the manufacture of our products, the Kids Only earn-out of \$1.9 million, and the Tollytots earn-out of \$1.7 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 September 30, 2011, these agreements required future aggregate minimum guarantees of \$89.7 million, exclusive of \$38.7 million in advances already paid. Of this \$89.7 million future minimum guarantee, \$45.2 million is due over the next twelve months.

Our financing activities used net cash of \$26.9 million in the nine months ended September 30, 2011, as compared to \$25.0 million in the prior year period, consisting primarily of cash paid for the repurchase of our common stock.

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 two earn-out periods ended December 31, 2009 and 2010, nil and \$1.7 million, respectively, 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 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. In the first two earn-out periods ended September 30, 2009 and 2010 the full earn-out amounts of \$1.9 million each were earned. 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 decor and a myriad of other children's toy products, and was included in our results of operations from the date of acquisition.

During the first quarter of 2011, an aggregate of \$3.6 million of earn-out was paid in connection with the Tollytots and Kids Only acquisitions.

In November 2009, we sold an aggregate principal amount of \$100.0 million of 4.50% Convertible Senior Notes due 2014 (the "Notes"). The Notes, which are senior unsecured obligations the Company, pay interest semi-annually at a rate of 4.50% per annum and mature on November 1, 2014. The initial conversion rate is 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. As a result of the cash dividend of \$0.10 per share declared by the Board of Directors payable October 3, 2011, the new conversion rate will be 63.5950 shares of JAKKS common stock per \$1,000 principal amount of notes (or approximately \$15.72 per share). 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 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 September 30, 2011, we do not have any off-balance sheet arrangements.

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 November 2009, we issued convertible senior notes payable of \$100.0 million principal amount with a fixed interest rate of 4.50% per annum, which remain outstanding as of September 30, 2011. 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, Spain, France 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. Our subsidiaries in the United Kingdom, Spain and France 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.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

In January 2011, Nouveau Model and Talent Management (“Nouveau”) instituted an action against Jakks and Disguise (together, “the Company”) in Superior Court of the State of California, Los Angeles, captioned Nouveau v. Disguise, et al., SC 111112. The Complaint stated causes of action for statutory misappropriation of publicity (Civ. Code §3344), common law misappropriation of publicity, unjust enrichment and breach of contract, and sought unspecified damages relating to the Company’s alleged improper and unauthorized use of the likenesses of models used in the promotion of the Company’s products. In June 2011, the Company filed a demurrer and motion to strike and, in response, Nouveau filed a first amended complaint (“FAC”). The Company filed a demurrer and motion to strike with respect to the FAC, which is scheduled to be heard in January 2012. Discovery is proceeding. We believe that the claims in the FAC are without merit and we intend to defend vigorously against them. However, because this action is in its preliminary stage, we cannot assure you as to the outcome of the action, nor can we estimate the range of our potential losses.

We are also 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.

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:

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.

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.

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 \$207.0 million and \$183.1 million, for the year ended December 31, 2010 and the nine months ended September 30, 2011, respectively, representing 27.7% and 34.1% 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 27.7% and 34.1% of our total revenues for the year ended December 31, 2010 and the nine months ended September 30, 2011, 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.

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 52.6% and 53.4% of our net sales for the nine months ended September 30, 2011 and the year ended December 31, 2010, 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.

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 nine months ended September 30, 2011 and the year ended December 31, 2010 sales to our international customers comprised approximately 17.2% and 15.2%, 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.

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, as required by the indenture governing the notes.

Our \$100.0 million principal amount of 4.50% convertible senior notes mature on November 1, 2014. Holders of these notes may require us to purchase all or some of 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.

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 not be amortized but instead be periodically evaluated for impairment based on the fair value of the reporting unit. In the second quarter of 2009, we recognized an impairment of our goodwill, for a non-cash charge to income of \$407.1 million. Goodwill currently on our books and any goodwill associated with future acquisitions are subject to the same impairment risk.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

In October 2010, the Company's Board of Directors authorized it to repurchase up to \$30.0 million of its common stock. As of December 31, 2010, 291,328 shares at a value of \$5.6 million were repurchased and held in Treasury, and during the first quarter of 2011, an additional 274,005 shares at a value of \$5.1 million were repurchased. All such shares totaling 565,333 shares represented approximately 2.0% of the Company's outstanding shares of common stock at the time of repurchase, and were retired by the Company during the first quarter of 2011. During August and September 2011, the Company completed the repurchase authorization with the purchase of 1,206,300 shares of common stock at an aggregate value of \$19.3 million, or average price of \$16.01 per share. All such shares represented approximately 4.4% of the Company's outstanding shares of common stock at the time of the repurchase, and were retired by the Company during the third quarter of 2011.

| Month | No. of Shares Repurchased | Average Price Per Share Repurchased | Total \$ Spent on Repurchases |
|-----------|---------------------------|--|----------------------------------|
| August | 969,500 | \$15.89 | \$15,400,916.00 |
| September | 236,800 | \$16.50 | \$ 3,907,717.90 |

Item 6. Exhibits

| Number | Description |
|----------|--|
| 3.1 | Amended and Restated Certificate of Incorporation of the Company(1) |
| 3.2 | Amended and Restated By-Laws of the Company(2) |
| 4.3 | Indenture, dated November 10, 2009, by and between the Registrant and Wells Fargo Bank, N.A. (3) |
| 4.4 | Form of 4.50% Senior Convertible Note (3) |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer(4) |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer(4) |
| 32.1 | Section 1350 Certification of Chief Executive Officer(4) |
| 32.2 | Section 1350 Certification of Chief Financial Officer(4) |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase |

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- (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 Current Report on Form 8-K filed on October 21, 2011, and incorporated herein by reference.
- (3) 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.
- (4) Filed herewith.

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

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: November 9, 2011

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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