

JAKKS PACIFIC INC
Form 10-K
March 16, 2015
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

- ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2014
- TRANSITION REPORT UNDER 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

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.001 par value per share	Nasdaq Global Select

Securities registered pursuant to Section 12(g) of the Exchange Act:

Title of Class

Common Stock, \$.001 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 of the Act.
Yes No

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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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of “large accelerated filer,” “large 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
(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 aggregate market value of the voting and non-voting common equity (the only such common equity being Common Stock, \$.001 par value per share) held by non-affiliates of the registrant (computed by reference to the closing sale price of the Common Stock on June 30, 2014 of \$7.74) is \$175,132,771.

The number of shares outstanding of the registrant’s Common Stock, \$.001 par value (being the only class of its common stock), is 23,280,790 as of March 13, 2015.

Documents Incorporated by Reference

None.

JAKKS PACIFIC, INC.

INDEX TO ANNUAL REPORT ON FORM 10-K

For the Fiscal Year ended December 31, 2014

Items in Form 10-K

	Page
PART I	
<u>Item 1.</u> <u>Business</u>	2
<u>Item 1A.</u> <u>Risk Factors</u>	11
Item 1B. Unresolved Staff Comments	None
<u>Item 2.</u> <u>Properties</u>	16
<u>Item 3.</u> <u>Legal Proceedings</u>	17
<u>Item 4.</u> <u>Mine Safety Disclosures</u>	18
PART II	
<u>Item 5.</u> <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	19
<u>Item 6.</u> <u>Selected Financial Data</u>	22
<u>Item 7.</u> <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 7A.</u> <u>Quantitative and Qualitative Disclosures About Market Risk</u>	35
<u>Item 8.</u> <u>Financial Statements and Supplementary Data</u>	37
Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	None
<u>Item 9A.</u> <u>Controls and Procedures</u>	73
Item 9B. Other Information	None
PART III	
<u>Item 10.</u> <u>Directors, Executive Officers and Corporate Governance</u>	75
<u>Item 11.</u> <u>Executive Compensation</u>	78
<u>Item 12.</u> <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	93
<u>Item 13.</u> <u>Certain Relationships and Related Transactions, and Director Independence</u>	95
<u>Item 14.</u> <u>Principal Accountant Fees and Services</u>	95
PART IV	
<u>Item 15.</u> <u>Exhibits and Financial Statement Schedules</u>	97
<u>Signatures</u>	99
Certifications	

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” or “expect,” we are making forward-looking statements. We believe that the assumptions and expectations reflected in such forward-looking statements are reasonable, based upon 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 have disclosed certain important factors that could cause our actual results to differ

materially from our current expectations elsewhere in this report. You should understand that forward-looking statements made in this report are necessarily qualified by these factors. We are not undertaking to publicly update or revise any forward-looking statement if we obtain new information or upon the occurrence of future events or otherwise.

PART I

Item 1. Business

In this report, “JAKKS,” the “Company,” “we,” “us” and “our” refer to JAKKS Pacific, Inc., its subsidiaries and our majority owned joint venture.

Company Overview

We are a leading multi-line, multi-brand toy company that designs, produces, markets and distributes toys and related products, pet toys, consumables and related products, electronics and related products, kids indoor and outdoor furniture, and other consumer products. We focus our business on acquiring or licensing well-recognized trademarks and brand names, most with long product histories (“evergreen brands”). We seek to acquire these evergreen brands because we believe they are less subject to market fads or trends. We also develop proprietary products marketed under our own trademarks and brand names, and have historically acquired complementary businesses to further grow our portfolio. For accounting purposes, our products can be divided into two segments: (i) traditional toys and electronics and (ii) role play, novelty and seasonal toys. Segment information with respect to revenues, assets and profits or losses attributable to each segment is contained in Note 3 to the audited consolidated financial statements contained below in Item 8. Our products include:

Traditional Toys and Electronics

Action figures and accessories, including licensed characters, principally based on Batman, Star Wars, and Nintendo® franchises;

Toy vehicles, including Road Champs®, Fly Wheels® and MXS® toy vehicles and accessories;

Electronics products, including Spy Net® spy products, Plug It In & Play TV Games™ video games based on Disney® brands, and Duck Commander, and other popular brands;

Dolls and accessories, including small dolls, large dolls, fashion dolls and baby dolls based on licenses, including Disney Frozen, Disney Princess®, Disney Fairies®, Cabbage Patch Kids®, and Graco® plush, infant, and pre-school toys based on PBS’s Daniel Tiger’s Neighborhood;

Private label products as “exclusives” for a myriad of retail customers in many product categories;

Foot-to-floor ride-on toys based on Fisher Price®, Kawasaki®, and DC Comics®, inflatable environments, tents and wagons; and

Pet products, including toys, consumables, and accessories, branded JAKKS Pets® and American Classics™, some of which also feature licenses, including Kong.

Role Play, Novelty and Seasonal Toys

Role play, dress-up, pretend play and novelty products for boys and girls based on well-known brands and entertainment properties such as Disney Frozen, Black & Decker®, McDonald’s®, Dirt Devil®, Disney Princess®, Disney Fairies® and Dora the Explorer®, as well as those based on our own proprietary brands;

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Indoor and outdoor kids' furniture, activity trays and tables and room décor; kiddie pools, seasonal and outdoor products, including those based on Crayola®, Disney® characters and more, and Funnoodle® pool floats;

Halloween and everyday costumes for all ages based on licensed and proprietary non-licensed brands, including Spiderman®, Iron Man, Toy Story®, Sesame Street®, Power Rangers®, Hasbro® brands and Disney's Frozen, Disney Princess®, and related Halloween accessories; and

Junior sports and outdoor activity toys including Skyball® hyper-charged balls and sport sets and Wave Hoops® toy hoops marketed under our Maui Toys brand.

We continually review the marketplace to identify and evaluate popular and evergreen brands and product categories that we believe have the potential for growth. We endeavor to generate growth within these lines by:

creating innovative products under our established licenses and brand names;

adding new items to the branded product lines that we expect will enjoy greater popularity;

infusing innovation and technology when appropriate to make them more appealing to today's kids; and

focusing our marketing efforts to enhance consumer recognition and retailer interest.

Our Business Strategy

In addition to developing our own proprietary brands and marks, licensing popular trademarks enables us to use these high-profile marks at a lower cost than we would incur if we purchased these marks or developed comparable marks on our own. By licensing trademarks, we have access to a far greater range of marks than would be available for purchase. We also license technology developed by unaffiliated inventors and product developers to enhance the design and functionality of our products.

We sell our products through our in-house sales staff and independent sales representatives to toy and mass-market retail chain stores, department stores, office supply stores, drug and grocery store chains, club stores, toy specialty stores and wholesalers. Our three largest customers are Wal-Mart, Target and Toys 'R' Us, which accounted for approximately 20.5%, 15.3% and 11.6%, respectively, of our net sales in 2014. No other customer accounted for more than 10.0% of our net sales in 2014.

Our Growth Strategy

In 2013 and 2014, we generated net sales of \$632.9 million and \$810.1 million, respectively, and net loss of \$53.9 million in 2013 and net income of \$21.5 million in 2014. Approximately 47.2% and 52.1% of our net sales in 2013 and 2014, respectively, were attributable to our acquisitions since 2008. Key elements of our growth strategy include:

Expand Core Products. We manage our existing and new brands through strategic product development initiatives, including introducing new products, modifying existing products and extending existing product lines to maximize their longevity. Our marketing teams and product designers strive to develop new products or product lines to offer added technological, aesthetic and functional improvements to our extensive portfolio.

Enter New Product Categories. We use our extensive experience in the toy and other consumer product industries to evaluate products and licenses in new product categories and to develop additional product lines. We began marketing licensed classic video games for simple plug-in use with television sets and expanded into several related categories by infusing additional technologies such as motion gaming and through the licensing of this category from our current licensors, such as Disney® and MTV Networks which owns Nickelodeon®.

Pursue Strategic Acquisitions. We supplement our internal growth with selected strategic acquisitions. In July 2012 we acquired the business of Maui, Inc., an Ohio corporation, and A.S. Design Limited, a related Hong Kong corporation (collectively, "Maui"). Maui is a leading manufacturer and distributor of spring and summer activity toys and impulse toys. We will continue focusing our acquisition strategy on businesses or brands that we believe have compatible product lines and/or offer valuable trademarks or brands.

Acquire Additional Character and Product Licenses. We have acquired the rights to use many familiar brand and character names and logos from third parties that we use with our primary trademarks and brands. Currently, among others, we have license agreements with Nickelodeon®, Disney®, and Warner Bros.®, as well as with the licensors of the many popular licensed children's characters previously mentioned, among others. We intend to continue to pursue new licenses from these entertainment and media companies and other licensors. We also intend to continue to purchase additional inventions and product concepts through our existing network of inventors and product developers.

Expand International Sales. We believe that foreign markets, especially Europe, Australia, Canada, Latin America and Asia, offer us significant growth opportunities. In 2014, our sales generated outside the United States were approximately \$156.6 million, or 19.3% of total net sales. We intend to continue to expand our international sales and in 2014 opened sales offices and expanded distribution agreements in Latin America and China to capitalize on our experience and our relationships with foreign distributors and retailers. We expect these initiatives to contribute to our international growth in 2015.

Capitalize On Our Operating Efficiencies. We believe that our current infrastructure and operating model can accommodate growth without a proportionate increase in our operating and administrative expenses, thereby increasing our operating margins.

The execution of our growth strategy, however, is subject to several risks and uncertainties and we cannot assure you that we will continue to experience growth in, or maintain our present level of net sales (see "Risk Factors," beginning on page 11). For example, our growth strategy will place additional demands upon our management, operational capacity and financial resources and systems. The increased demand upon management may necessitate our recruitment and retention of additional 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. While we believe that our operational, financial and management information systems will be adequate to support our future growth, no assurance can be given they will be adequate without significant investment in our infrastructure. 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.

Moreover, 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 on commercially reasonable terms and our ability to finance increased levels of accounts receivable and inventory necessary to support our sales growth, if any.

Furthermore, 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.

Finally, 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.

Industry Overview

According to Toy Industry Association, Inc., the leading toy industry trade group, the United States is the world's largest toy market, followed by Japan and Western Europe. Total retail sales of toys, excluding video games, in the United States, were approximately \$18.1 billion in 2014. We believe the two largest United States toy companies, Mattel and Hasbro, collectively hold a dominant share of the domestic non-video toy market. In addition, hundreds of smaller companies compete in the design and development of new toys, the procurement of character and product licenses, and the improvement and expansion of previously introduced products and product lines.

Over the past few years, the toy industry has experienced substantial consolidation among both toy companies and toy retailers. We believe that the ongoing consolidation of toy companies provides us with increased growth opportunities due to retailers' desire to not be entirely dependent upon a few dominant toy companies. Retailer concentration also enables us to ship products, manage account relationships and track point of sale information more effectively and efficiently.

Products

We focus our business on acquiring or licensing well-recognized trademarks or brand names, and we seek to acquire evergreen brands which are less subject to market fads or trends. Generally, our license agreements for products and concepts call for royalties ranging from 1% to 16% of net sales, and some may require minimum guarantees and advances. Our principal products include:

Traditional Toys and Electronics

Electronics Products

Our electronic products category includes our Plug It In & Play TV Games®, SpyNet Spy products and Laser Challenge® product lines. Our current Plug It In & Play TV Games® titles, geared to the pre-school and leisure gamer segments, include licenses from Namco®, Disney, Marvel® and Nickelodeon®, and feature such games as SpongeBob SquarePants®, Duck Commander®, Walking Dead®, Dora the Explorer®, Disney Princess®, Ms. Pac-Man® and Pac-Man®.

In 2014, we launched our Hero Portal™ video games with collectible figurines that interact with an all-in-one video console featuring Teenage Mutant Ninja Turtles and DC Universe among other brands.

Wheels Products

Motorized and plastic toy vehicles and accessories.

Our extreme sports offerings include our MXS line of motorcycles with generic and well-known riders and other vehicles include off-road vehicles and skateboards, which are sold individually and with playsets and accessories. In 2012, we launched our proprietary line of motorized trains and track sets under the brand Power Trains, and in 2015, we will expand the product line to include buildings, automobiles and freeways under the Power City™ brand.

Action Figures and Accessories

We currently develop, manufacture and distribute other action figures and action figure accessories including those based on the animated series El Chavo®, Star Wars®, and Batman®, capitalizing on the expertise we built in the action figure category.

In 2014, we expanded our line of big figures featuring our 31” figures including Superman®, Power Rangers® and Star Wars® to include an assortment of 20” figures as well as 48” Teenage Mutant Ninja Turtles figures.

Dolls

Dolls and accessories include small dolls, large dolls, fashion dolls and baby dolls based on licenses, including Disney's Frozen, Disney Princess®, Disney Fairies®, Cabbage Patch Kids® and Graco®, including an extensive line of baby doll accessories that emulate real baby products that mothers today use; plush, infant and pre-school toys, and private label fashion dolls for other retailers and sold to Disney Stores and Disney Parks and Resorts.

In 2013, we launched miWorld®, a line of mall-based playhouse elements featuring Claire's, Skechers and O.P.I. among others which incorporates DreamPlay technology adding a virtual experience to a physical toy and expanded the product line to include additional retail brands and released an update of the app.

Pet Products

We entered the Pet Products category with our acquisition of Pet Pal, whose products include pet toys, treats, beds, clothes and related pet products. These products are marketed under JAKKS Pets® and our own proprietary brand of assorted pet products under the brand American Classics® as well as licenses including Kong® and numerous other entertainment and consumer product properties.

Role Play, Novelty & Seasonal

Role Play and Dress-up Products

Our line of role play and dress-up products for boys and girls features entertainment and consumer products properties such as Disney's Frozen, Disney Princess®, Disney Fairies®, Dora the Explorer®, and Black & Decker®. These products generated a significant amount of sales in 2013 and 2014.

Seasonal/ Outdoor Products

We have a wide range of seasonal toys and outdoor and leisure products including our recently acquired Maui line of proprietary products including Sky Ball and Wave Hoop among other outdoor toys. Our Funnoodle® pool toys include the basic Funnoodle pool floats and a variety of other pool toys.

Indoor and Outdoor Kids' Furniture

We produce an extensive array of licensed indoor and outdoor kids' furniture and activity tables, and room decor. Our licensed portfolio includes character licenses, including Crayola®, Disney Princess®, Toy Story®, Mickey Mouse®, Dora the Explorer®, and others. Products include children's puzzle furniture, tables and chairs to activity sets, trays, stools and a line of licensed molded kiddie pools, among others.

Halloween and Everyday Costume Play

We produce an expansive and innovative line of Halloween costumes and accessories which includes a wide range of non-licensed Halloween costumes such as horror, pirates, historical figures and aliens to animals, vampires, angels and more, as well as popular licensed characters from top intellectual property owners including Disney®, Hasbro®, Marvel®, Sesame Workshop®, Mattel®, and many others.

DreamPlay Technology

In September 2012, we formed a joint venture with NantWorks LLC called DreamPlay Toys LLC to exploit their patented recognition technologies in conjunction with toy and consumer products. In 2013, we launched two lines of toy products which utilize the technologies to enhance the play pattern of the toys as well as enhance the in-store experience of the consumer. The first product line was based on Disney's Little Mermaid followed by our propriety concept, miWorld®. Both product lines were accompanied by a software application which brings the toy products to life adding a rich virtual experience to a physical experience. In 2014, we released updates to these apps as well as launched several other toys with application based product lines.

Sales, Marketing and Distribution

We sell all of our products through our own in-house sales staff and independent sales representatives to toy and mass-market retail chain stores, department stores, office supply stores, drug and grocery store chains, club stores, toy specialty stores and wholesalers. Our three largest customers are Wal-Mart, Target, and Toys ‘R’ Us, which accounted for approximately 47.8% of our net sales in 2013 and 47.4% of our net sales in 2014. With the JAKKS Pets® product line, we distribute pet products to key pet supply retailers Petco and PetSmart in addition to many other pet retailers and our existing customers. We generally sell products to our customers pursuant to letters of credit or, in some cases, on open account with payment terms typically varying from 30 to 90 days. From time to time, we allow our customers credits against future purchases from us in order to facilitate their retail markdown and sales of slow-moving inventory. We also sell our products through e-commerce sites, including Toysrus.com and Amazon.com.

We contract the manufacture of most of our products to unaffiliated manufacturers located in The People’s Republic of China (“China”). We sell the finished products on a letter of credit basis or on open account to our customers, many of whom take title to the goods in Hong Kong or China. These methods allow us to reduce certain operating costs and working capital requirements. A portion of our sales originate in the United States, so we hold certain inventory in our warehouses and fulfillment facilities. To date, a significant portion of all of our sales has been to domestic customers. We intend to continue expanding distribution of our products into foreign territories and, accordingly, we have:

entered into a joint venture in China,

engaged representatives to oversee sales in certain foreign territories,

engaged distributors in certain foreign territories,

established direct relationships with retailers in certain foreign territories,

opened sales offices in Europe,

opened sales offices and a distribution center in Canada, and

expanded in-house resources dedicated to product development and marketing of our lines.

Outside of the United States, we currently sell our products primarily in Europe, Australia, Canada, Latin America and Asia. Sales of our products abroad accounted for approximately \$108.7 million, or 17.2% of our net sales, in 2013 and approximately \$156.6 million, or 19.3% of our net sales, in 2014. We believe that foreign markets present an attractive opportunity, and we plan to intensify our marketing efforts and further expand our distribution channels abroad.

We establish reserves for sales allowances, including promotional allowances and allowances for anticipated defective product returns, at the time of shipment. The reserves are determined as a percentage of net sales based upon either historical experience or upon estimates or programs agreed upon by our customers and us.

We obtain, directly, or through our sales representatives, orders for our products from our customers and arrange for the manufacture of these products as discussed below. Cancellations generally are made in writing, and we take appropriate steps to notify our manufacturers of these cancellations. We may incur costs or other losses as a result of cancellations.

We maintain a full-time sales and marketing staff, many of whom make on-site visits to customers for the purpose of showing product and soliciting orders for products. We also retain a number of independent sales representatives to sell and promote our products, both domestically and internationally. Together with retailers, we occasionally test the consumer acceptance of new products in selected markets before committing resources to large-scale production.

We publicize and advertise our products in trade and consumer magazines and other publications, market our products at international, national and regional toy and other specialty trade shows, conventions and exhibitions and carry on cooperative advertising programs with toy and mass market retailers and other customers which include the use of print and television ads and in-store displays. We also produce and broadcast television commercials for several of our product lines, if we expect that the resulting increase in our net sales will justify the relatively high cost of television advertising.

Product Development

Each of our product lines has an in-house manager responsible for product development. The in-house manager identifies and evaluates inventor products and concepts and other opportunities to enhance or expand existing product lines or to enter new product categories. In addition, we create proprietary products to fully exploit our concept and character licenses. Although we have the capability to create and develop products from inception to production, we also use third-parties to provide a portion of the sculpting, sample making, illustration and package design required for our products in order to accommodate our increasing product innovations and introductions. Typically, the development process takes from three to nine months from concept to production and shipment to our customers.

We employ a staff of designers for all of our product lines. We occasionally acquire our other product concepts from unaffiliated third parties. If we accept and develop a third party's concept for new toys, we generally pay a royalty on the sale of the toys developed from this concept, and may, on an individual basis, as well as some of our DreamPlay apps, guarantee a minimum royalty. In addition, we engage third-party developers to program our line of Plug it in & Play TV Games. Royalties payable to inventors and developers generally range from 1% to 5% of the wholesale sales price for each unit of a product sold by us. We believe that utilizing experienced third-party inventors gives us access to a wide range of development talent. We currently work with numerous toy inventors and designers for the development of new products and the enhancement of existing products.

Safety testing of our products is done at the manufacturers' facilities by quality control personnel employed by us or by independent third-party contractors engaged by us. Safety testing is designed to meet or exceed regulations imposed by federal and state, as well as applicable international governmental authorities, our retail partners, licensors and the

Toy Industry Association. We also closely monitor quality assurance procedures for our products for safety purposes. In addition, independent laboratories engaged by some of our larger customers and licensors test certain of our products.

Manufacturing and Supplies

Most of our products are currently produced by overseas third-party manufacturers, which we choose on the basis of quality, reliability and price. Consistent with industry practice, the use of third-party manufacturers enables us to avoid incurring fixed manufacturing costs, while maximizing flexibility, capacity and production technology. Substantially all of the manufacturing services performed overseas for us are paid for on open account with the manufacturers. To date, we have not experienced any material delays in the delivery of our products; however, delivery schedules are subject to various factors beyond our control, and any delays in the future could adversely affect our sales. Currently, we have ongoing relationships with over eighty different manufacturers. We believe that alternative sources of supply are available to us although we cannot be assured that we can obtain adequate supplies of manufactured products.

Although we do not conduct the day-to-day manufacturing of our products, we are extensively involved in the design of the product prototype and production tools, dyes and molds for our products and we seek to ensure quality control by actively reviewing the production process and testing the products produced by our manufacturers. We employ quality control inspectors who rotate among our manufacturers' factories to monitor the production of substantially all of our products.

The principal raw materials used in the production and sale of our toy products are plastics, zinc alloy, plush, printed fabrics, paper products and electronic components, all of which are currently available at reasonable prices from a variety of sources. Although we do not manufacture our products, we own the majority of the tools, dyes and molds used in the manufacturing process, and these are transferable among manufacturers if we choose to employ alternative manufacturers. Tools, dyes and molds represent a substantial portion of our property and equipment with a net book value of \$8.6 million in 2013 and \$8.8 million in 2014; substantially all of these assets are located in China.

Trademarks and Copyrights

Most of our products are produced and sold under trademarks owned by or licensed to us. We typically register our properties, and seek protection under the trademark, copyright and patent laws of the United States and other countries where our products are produced or sold. These intellectual property rights can be significant assets. Accordingly, while we believe we are sufficiently protected, the loss of some of these rights could have an adverse effect on our business, financial condition and results of operations.