JAKKS PACIFIC INC
Form S-3/A
May 06, 2002

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As filed with the Securities and Exchange Commission on May 6, 2002

Registration No. 333-86800

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Pre-Effective Amendment No. 1
to

Form S-3

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

JAKKS Pacific, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**95-4527222**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

22619 Pacific Coast Highway, Malibu, California 90265, (310) 456-7799

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Jack Friedman

Chairman
JAKKS Pacific, Inc.
22619 Pacific Coast Highway
Malibu, California 90265
(310) 456-7799
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:

Murray L. Skala, Esq. **Feder, Kaszovitz, Isaacson, Weber,** **Skala, Bass & Rhine LLP** **750 Lexington Avenue** **New York, New York 10022-1200** **(212) 888-8200** **Fax: (212) 888-7776**	**Gordon M. Bava, Esq.** **Manatt, Phelps & Phillips, LLP** **11355 West Olympic Boulevard** **Los Angeles, California 90064** **(310) 312-4000** **Fax: (310) 312-4224**

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities To Be Registered	Amount to be Registered	Proposed Maximum Offering Price Per Unit(1)	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee
Common Stock, par value $.001 per share	4,025,000 Shares(2)	$19.95(3)	$80,298,750	$7,388

(1) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(c). Previously paid.

(2) Includes 525,000 shares of common stock, par value $.001 per share, which the underwriters have the option to purchase to cover over-allotments, if any.

(3) Pursuant to Rule 457(c), represents the average of the high and low sales prices of our common stock for April 22, 2002 as reported on the Nasdaq National Market System.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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SUBJECT TO COMPLETION, DATED MAY 6, 2002

PROSPECTUS

3,500,000 Shares

Common Stock

Of the 3,500,000 shares of common stock being offered, we are offering 3,000,000 shares and certain of our stockholders are offering 500,000 shares. Our common stock is traded on the Nasdaq National Market under the symbol JAKK. On May 1, 2002, the last reported sale price of our common stock was $18.98 per share.

Investing in our common stock involves risks. See Risk Factors beginning on page 7 of this prospectus to read about risks that you should consider before buying shares of our common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to us	$	$
Proceeds, before expenses, to the selling stockholders	$	$

We have granted the underwriters a 30-day option to purchase from us up to an aggregate of 525,000 additional shares of our common stock at the offering price, less the underwriting discount, to cover over-allotments, if any.

The underwriters are severally underwriting the shares being offered. The underwriters expect to deliver the shares against payment in New York, New York, on or about , 2002.

Bear, Stearns & Co. Inc. U.S. Bancorp Piper Jaffray

Advest, Inc.

The date of this Prospectus is , 2002.

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INSIDE FRONT COVER

Pictures or depictions of our products and our licensed and owned marks including Nickelodeon, WWF, Road Champs, Hello Kitty, Flying Colors, Go Fly A Kite, Funnoodle, Pentech, Toymax and Child Guidance.

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You should rely only on the information contained or incorporated in this prospectus. We, the selling stockholders and the underwriters have not authorized anyone to provide you with information different from that contained in this prospectus. We and the selling stockholders are offering to sell, and seeking offers to buy, shares of common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of our common stock. In this prospectus, references to the Company, JAKKS, we, us and our refer to JAKKS Pacific, Inc. and, where the context requires (such as when we discuss our business, operations, properties or products), our subsidiaries.

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Until , 2002 (25 days after the date of this prospectus), all dealers that buy, sell or trade these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus includes or incorporates by reference 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 prospectus 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 suc forward-looking statements are reasonable, 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 have disclosed certain important factors that could cause our actual results to differ materially from our current expectations under Risk Factors below and elsewhere in this prospectus. You should understand that forward-looking statements made in connection with this offering are necessarily qualified by these factors. We are not undertaking to publicly update or revise any forward-looking statement if we obtain information or upon the occurrence of future events or otherwise.

TRADEMARK AND LICENSING INFORMATION

We own or have rights to various trademarks and brand or trade names that we use in conjunction with the sale of our products. These include *World Wrestling Federation*®, *Nickelodeon*®, *Rugrats*® and *Hello Kitty*®, among others. We also refer in this prospectus to other trademarks or brand or trade names that are owned or licensed by other companies.

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PROSPECTUS SUMMARY

This summary highlights information more fully described elsewhere in this prospectus. Because it is a summary, it does not contain all the information that you should consider before buying shares of our common stock in this offering. You should read the entire prospectus, especially the Risk Factors section beginning on page 7, and our consolidated financial statements and the related notes incorporated by reference elsewhere in this prospectus, before deciding to invest in our common stock. Unless otherwise indicated, all information contained in this prospectus assumes that the underwriters will not exercise their over-allotment option.

JAKKS Pacific, Inc.

Our Business

We are a leading multi-line, multi-brand toy company that designs, develops, produces and markets toys and related products. We focus our business on acquiring or licensing well-recognized trademarks and brand names 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. Our products are typically simpler, lower-priced toys and accessories and include:

- Action figures and accessories including licensed characters, principally based on the *World Wrestling Federation,* and toy vehicles, including *Road Champs*® die-cast collectibles and *Remco*™ toy vehicles and role-play toys and accessories;

- Craft, activity and stationery products, including *Flying Colors*® activity sets, compounds, playsets and lunch boxes, and *Pentech*® writing instruments, stationery and activity products;

- *Child Guidance*® infant and pre-school electronic toys, toy foam puzzle mats and blocks, activity sets, outdoor products, plush toys and slumber bags; and

- Fashion and mini dolls and related accessories, including *Disney*® Princesses sold exclusively in The Disney Store.

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

- creating innovative products under established brand names;

- focusing our marketing efforts to enhance consumer recognition and retailer interest;

- linking them with our portfolio of evergreen brands;

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

- adding new features and improving the functionality of products in the line.

In addition to developing our proprietary brands and marks, we license marks such as *World Wrestling Federation, Nickelodeon, Rugrats, Blue s Clues*®, *Mickey Mouse*®, *Barney*®, *Sesame Street*®, *Winnie the Pooh*®, *Hello Kitty* and *Car and Driver*®. Licensing 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 marks, we have access to a far greater range of marks than would be available for purchase. We also license technology produced by unaffiliated inventors and product developers to improve the design and functionality of our products.

We have capitalized on our relationship with World Wrestling Federation Entertainment, Inc. (WWF) by obtaining an exclusive worldwide license for our joint venture with THQ Inc. (THQ), which develops, produces, manufactures and markets video games based on *World Wrestling Federation* characters and themes. Since the joint venture s first title release in 1999, it has released 11 new titles. We have received $27.5 million as our share of the joint venture s profit through March 31, 2002.

On March 11, 2002, we acquired a controlling interest in Toymax International, Inc. (Toymax), a developer and marketer of toys and related products, which added toy brand names such as *Laser Challenge*™ and *Creepy Crawlers*® to our brand portfolio. In addition, pool-related products branded under the name

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Funnoodle® and kites branded under the name *Go Fly a Kite*™ further diversified our portfolio with products popular in the spring and summer seasons.

Most of our current products are relatively simple and inexpensive. In 2001, approximately 70% of our revenue came from products priced below ten dollars at retail. We believe that these products have enduring appeal and are less subject to general economic conditions, toy product fads and trends, and changes in retail distribution channels. As of March 31, 2002, we had over 4,300 products and 19 product categories. In addition, the simplicity of these products enables us to choose among a wider range of manufacturers and affords us greater flexibility in product design, pricing and marketing. Our product development process typically takes from three to nine months from concept to production and shipment to our customers. We believe that many licensors and retailers recognize and reward our ability to bring product to market faster and more efficiently than many of our competitors.

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. The *Road Champs, Flying Colors* and *Pentech* products also are sold to smaller hobby shops, specialty retailers and corporate accounts, among others. Our five largest customers are Target, Kmart, Toys R Us, Wal-Mart, and Kay Bee Toys, which collectively accounted for approximately 54.7% of our net sales in 2001. We have over 10,000 other customers, none of which accounted for more than 2.0% of our net sales in 2001.

Our Growth Strategy

The successful execution of our growth strategy has resulted in increased revenues and earnings. From 1996 to 2001, our net sales, EBITDA and net income grew at a compound annual rate of 88.2%, 95.0% and 88.7%, respectively. In 2001, we generated net sales and EBITDA of $284.3 million and $44.1 million, respectively. Key elements of our growth strategy include:

Expand Core Products. We manage our existing and new brands through strong product development initiatives, including introducing new products, modifying existing products and extending existing product lines. Our product designers strive to develop new products or product lines to offer added technological, aesthetic and functional improvements to our product lines. In 2001, we expanded the use of real-scan technology in our action toys, which produces higher quality and better likenesses of the representative characters and vehicle parts. In addition, we introduced action figures with significantly greater ranges of motion, and expanded our electronic action figure recognition play sets.

Enter New Product Categories. We will continue to use our extensive experience in the toy and other industries to evaluate products and licenses in new product categories and to develop additional product lines. We have entered the plush toy category through the licensing of *Pound Puppies*®, as well as through the creation of our own *Limbo Legs*™, and expanded into slumber bags through the licensing of this category from our current licensors, such as MTV Networks, Inc. (Nickelodeon).

Pursue Strategic Acquisitions. We intend to supplement our internal growth rate with selected strategic acquisitions. Since our inception in 1995, we have successfully completed and integrated nine acquisitions of companies and trademarks. These include our acquisitions of Justin Products, Road Champs, *Remco, Child Guidance,* Berk, Flying Colors, Pentech, Kidz Biz and most recently, our controlling interest in Toymax. We will continue focusing our acquisition strategy on businesses or brands that have compatible product lines and offer valuable trademarks or brands.

Acquire Additional Character and Product Licenses. We have acquired the rights to use many familiar corporate, trade and brand names and logos from third parties that we use with our primary trademarks and brands. Currently, we have license agreements with the WWF, 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 product developers.

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Expand International Sales. We believe that foreign markets, especially Europe, Australia, Canada, Latin America and Asia, offer us significant growth opportunities. In 2001, our sales generated outside the United States grew 78% to approximately $40.0 million, or 14.1% of total sales. We intend to continue to expand our international sales by capitalizing on our experience and our relationships with foreign distributors and retailers. Our recent expansion efforts included entering into a distribution agreement with Funtastic Ltd., an Australia based toy distributor. In addition, in December 2001, we acquired Kidz Biz for its distribution channels in the United Kingdom and surrounding territories. We expect both initiatives to contribute to our continued international growth in 2002.

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

Industry Overview

According to the Toy Industry Association, Inc. (TIA), the leading toy industry trade group, total retail sales of toys, excluding video games, in the United States, were approximately $25.0 billion in 2001. Sales by domestic toy manufacturers to foreign customers exceeded $5.0 billion in 2001. In the United States video game segment, total retail sales of video game software were approximately $9.4 billion in 2001.

Recent Developments

On March 11, 2002, we purchased 8,100,065 shares of common stock of Toymax, a developer and marketer of toys and related products, from four of its stockholders for approximately $24.3 million in cash and 646,384 shares of our common stock. Previously, between December 2, 2001 and February 4, 2002, we purchased 132,754 shares of Toymax common stock on the open market for an aggregate purchase price of approximately $0.2 million. As a result of these transactions, we own approximately 66.8% of the outstanding shares of Toymax common stock.

We intend to purchase the remaining shares of Toymax common stock in a merger transaction by the end of the second quarter of 2002, at which point Toymax will become our wholly owned subsidiary. We currently estimate that the consideration payable to acquire the remaining shares of Toymax common stock will consist of approximately $11.8 million in cash and approximately 312,500 shares of our common stock.

Toymax has an established portfolio of brand names and products including innovative and technologically advanced toys such as *Laser Challenge* and *Creepy Crawlers* activities brands, *Mighty Mo s*® electronic vehicles and radio-controlled vehicles and robots, as well as pool and water toys and accessories and other outdoor products under the *Funnoodle* brand and kites, banners, *WindWheels*™, weathervanes and wind chimes under the *Go Fly a Kite* brand. These brand names and products further diversify and complement our existing brand names and products. We also expect to benefit from efficiencies generated by lowering our combined operating expenses. In addition, the *Funnoodle* and *Go Fly a Kite* products have significant sales through the spring and summer season.

We recently reported our financial results for the quarter ended March 31, 2002. Net sales for the first quarter of 2002 totaled $59.9 million, as compared to $60.0 million for the first quarter of the prior year. Excluding a one-time restructuring charge of $6.6 million related to our acquisitions of Kidz Biz and Toymax, net income for the first quarter of 2002 increased 16.1% to $7.0 million, or $0.35 per diluted share, compared to net income of $6.0 million, or $0.32 per diluted share, in 2001. Net income, including the one-time charge, was $2.2 million or $0.11 per diluted share. Additional information is included in our Quarterly Report on Form 10-Q for the period ended March 31, 2002, which is incorporated by reference in this prospectus.

Our Corporate Information

We were formed as a Delaware corporation in 1995. Our principal executive offices are located at 22619 Pacific Coast Highway, Malibu, California 90265. Our telephone number is (310) 456-7799. Our Internet website address is www.jakkspacific.com. The contents of our website are not part of this prospectus.

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THE OFFERING

Common stock offered by us	3,000,000 shares
Common stock offered by the selling stockholders	500,000 shares(1)
Common stock outstanding after this offering	23,018,865 shares(2)(3)
Use of proceeds received by us	To purchase the remaining shares of Toymax, to finance potential acquisitions of companies, product lines, brands and licenses, to fund product development and for working capital and general corporate purposes. We will not receive any proceeds from the sale of our common stock by the selling stockholders pursuant to this prospectus.
Risk Factors	An investment in our common stock involves a high degree of risk. See Risk Factors.
Nasdaq National Market symbol	JAKK

(1) Includes 350,078 shares of common stock issuable upon the exercise of stock options.

(2) Assumes the sale of all of the shares offered hereby. Includes 350,078 shares to be sold by selling stockholders which will be issued upon the exercise of options. Does not include 1,395,735 shares reserved by us for issuance upon exercise of all stock options included in our Third Amended and Restated 1995 Employee Stock Option Plan, all of which have already been granted at prices ranging from $3.00 to $26.00 and expiring at various times from October 7, 2002 to January 1, 2012.

(3) If all the over-allotment shares are sold, we would issue an additional 525,000 shares, so that 23,543,865 shares would be outstanding after this offering.

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SUMMARY CONSOLIDATED FINANCIAL DATA

The following summary consolidated financial data have been derived from our audited and unaudited consolidated financial statements, which are incorporated by reference in this prospectus. You should read the financial data set forth below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and notes incorporated by reference in this prospectus.

	Year Ended December 31,					Three Months Ended March 31,	
	1997	1998	1999	2000	2001	2001	2002
	(in thousands, except per share data)						
Consolidated Statement of Operations Data:							
Net sales	$41,945	$85,253	$183,685	$252,288	$284,309	$59,962	$59,895
Cost of sales	25,875	52,000	107,602	149,881	164,222	35,494	33,425
Gross profit	16,070	33,253	76,083	102,407	120,087	24,468	26,470
Income from operations	4,175	9,246	24,929	20,503	29,298(1)	7,267	1,419(2)
(Profit)/loss from joint venture			(3,605)	(15,906)	(6,675)	(728)	(1,297)
Net income	$ 2,786	$ 6,375	$ 21,970	$ 28,637	$ 28,233(1)	$ 6,021	$ 2,156(2)
Diluted earnings per share	$ 0.35	$ 0.59	$ 1.39	$ 1.41	$ 1.45(1)	$ 0.32	$ 0.11(2)
Weighted average shares and equivalents outstanding diluted	9,103	11,403	15,840	20,281	19,410	18,920	20,236

	As of December 31,					As of March 31,	
	1997	1998	1999	2000	2001	2002l	As 2002ted(3)
	(in thousands)						
Consolidated Balance Sheet Data:							
Cash and cash equivalents	$ 2,536	$12,452	$ 57,546	$ 29,275	$ 25,036	$ 14,937	$ 70,500
Marketable securities			39,334	13,618	37,119	16,706	16,706
Working capital	3,368	13,736	113,170	86,897	116,487	82,006	137,569
Total assets	43,605	58,736	232,878	248,722	284,041	330,704	386,267
Total long-term debt	6,000	5,940	9	1,000	73	76	76
Total stockholders equity	25,959	37,754	187,501	204,530	244,403	260,890	316,453

	Year Ended December 31,				
	1997	**1998**	**1999**	**2000**	**2001(1)**
	(in thousands, except for percentages)				
Other Financial Data:					
EBITDA(4)	$6,161	$12,993	$29,575	$31,377	$44,104
EBITDA growth	293.7%	110.9%	127.6%	6.1%	40.6%
Net sales growth	248.0%	103.2%	115.5%	37.3%	12.7%
Net income growth	136.1%	128.8%	244.6%	30.3%	(1.4)%
EBITDA margin	14.7%	15.2%	16.1%	12.4%	15.5%
Gross profit margin	38.3%	39.0%	41.4%	40.6%	42.2%
Net income margin	6.6%	7.5%	12.0%	11.4%	9.9%

(1) Results reflect a one-time charge of $5.0 million relating to the bankruptcy filing of Kmart.

(2) Results reflect one-time restructuring charges of $6.6 million relating to our acquisitions of Kidz Biz and Toymax.

(3) The adjusted balance sheet gives effect to receipt of the net proceeds from our sale of shares of our common stock in this offering at an assumed offering price of $18.98 per share, after we deduct the underwriting discount and pay the expenses associated with this offering and the receipt of the option price from the selling stockholders of $2,354,754 upon the exercise of options to purchase 350,078 shares that are being sold in this offering.

(4) EBITDA is defined as earnings from continuing operations before interest and income taxes, net of nonrecurring items, plus depreciation and amortization of long-term assets. EBITDA does not include our profit from the joint venture with THQ in the amounts of $3.6 million, $15.9 million and $6.7 million in the years ended 1999, 2000 and 2001, respectively. EBITDA is generally regarded as providing useful information regarding a company s financial performance, but it is not a measure of financial performance under generally accepted accounting principles. EBITDA should not be considered an alternative to measures of operating performance as determined in accordance with generally accepted accounting principles, including net income as a measure of our operating results and cash flows as a measure of our liquidity. Additionally, EBITDA is not calculated identically by all companies, therefore, our calculation of EBITDA may not be comparable to other similarly titled measures of other companies.

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RISK FACTORS

An investment in our securities involves a high degree of risk. You should carefully consider the following risk factors in conjunction with the other information contained and incorporated by reference in this prospectus before purchasing our securities. If any of the risks discussed in this prospectus actually occur, our business, operating results, cash flows, prospects or financial condition could be materially adversely affected. This may cause the market price of our securities to decline and could cause you to lose all or part of your investment.

We Are Subject to Changing Consumer Preferences and New Product Introductions

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:

- 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.

We Are Subject to Changing Popularity of Our Products

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 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.

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 some of our license agreements, including WWF and Nickelodeon, 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

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.

Our Video Game Joint Venture with THQ Is Subject to Numerous Risks and Uncertainties

In addition to the risks relating to us and the toy industry, our joint venture with THQ faces the following risks:

- The joint venture depends entirely on a single license, which gives the venture exclusive worldwide rights to produce and market video games based on World Wrestling Federation characters and themes. The popularity of professional wrestling, in general, and the World Wrestling Federation, in particular, is subject to changing consumer tastes and demands. The relative popularity of professional wrestling has fluctuated significantly in recent years. A decline in the popularity of the World Wrestling Federation could adversely affect the joint venture s and our business, financial condition and results of operations.

- The joint venture relies on hardware manufacturers and THQ s non-exclusive licenses with them for the right to publish titles for their platforms and for the manufacture of the joint venture s titles. If

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THQ s manufacturing licenses were to terminate and the joint venture could not otherwise obtain these licenses from other manufacturers, the joint venture would be unable to publish additional titles for these manufacturers platforms, which would materially adversely affect the joint venture s and our business, financial condition and results of operations.

The software industry has experienced periods of significant growth in consumer interest, followed by periods in which growth has substantially declined. The joint venture s sales of software titles depend, among other factors, on the popularity and unit sales of platforms generally, as well as on the relative popularity and unit sales of various platforms. The relative popularity of certain platforms has fluctuated significantly in recent years. An unexpected decline in the popularity of a particular platform can be expected to have a material adverse affect on consumer demand for titles released or to be released by the joint venture for such platforms.

The joint venture s failure to timely develop titles for new platforms that achieve significant market acceptance, to maintain net sales that are commensurate with product development costs or to maintain compatibility between its personal computer CD-ROM titles and the related hardware and operating systems would adversely affect the joint venture s and our business, financial condition and results of operations.

In general, THQ controls the day-to-day operations of the joint venture and all of its product development and production operations. Accordingly, the joint venture relies exclusively on THQ to manage these operations effectively. THQ s failure to effectively manage the joint venture would have a material adverse effect on the joint venture s and our business and results of operations.

We May Not Be Able To Sustain or Manage Our Rapid Growth

We have experienced rapid growth in net sales, operating income and net income over the last five years. 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 or net income.

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 on 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.

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We Need To Be Able To Acquire and Integrate Companies and New Product Lines Successfully

Our growth strategy depends in part upon our ability to acquire companies and new product lines. 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 b