

JAKKS PACIFIC INC  
Form 10-K  
February 29, 2008

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

FORM 10-K

(Mark One)

T ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2007

£ 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  T

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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

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 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, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

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 February 28, 2008 of \$27.83) is \$768,963,995.

The number of shares outstanding of the registrant’s Common Stock, \$.001 par value (being the only class of its common stock), is 28,624,262 (as of February 28, 2008).

**Documents Incorporated by Reference**

None.

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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" or "expect," we are making forward-looking statements. We believe that the assumptions and expectations reflected in such 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 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. and its subsidiaries.

#### Company Overview

We are a leading multi-line, multi-brand toy company that designs, produces, markets and distributes toys and related products, writing instruments and related products, pet toys, consumables and related products, electronics and related products, 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. Our products are typically lower-priced toys and accessories, and include:

#### Traditional Toys

• Action figures and accessories, including licensed characters, principally based on *World Wrestling Entertainment*® (“WWE”), *The Chronicles of Narnia: Prince Caspian*™ and *Pokemon*® franchises;

- Toy vehicles, including *Road Champs*®, *RC Racers*™ and *MXS*® toy vehicles and accessories, as well as those based on Nascar®;

• Electronics products, including *Plug It In & Play TV Games*™, *EyeClops*™ *Bionic Eye* products, and *Laser Challenge*®, as well as others based on Disney® and Discovery Kids® brands;

• Role-play, dress-up and novelty products featuring entertainment and consumer products properties such as *Dirt Devil*®, *Subway*®, *Pizza Hut*® and *McDonalds*® pretend play products, *Disney Princess*®, *Hannah Montana*™, *Barbie*® and *Dora the Explorer*® playsets for girls and *Black & Decker*® and *Pirates of the Caribbean*™ playsets for boys;

• Infant and pre-school toys and plush toys featuring *Care Bears*®, *Barney*®, *The Wiggles*®, *Curious George*®, and slumber bags;

• Dolls including large, fashion and mini dolls and related accessories based on *Cabbage Patch Kids*®, *Hannah Montana*, *The Cheetah Girls*™, *Puppy in My Pocket and Friends*™, *Hairspray*™ the movie and *Disney Princess*® dolls and private label fashion dolls for other retailers;

• Seasonal and outdoor toys and leisure products, including *Go Fly A Kite*®, *Air Creations*®, and other kites, *Funnoodle*® pool toys, *The Storm*® water guns and *Fly Wheels*® *XPV*® and *Flight*™ vehicles; and

- Junior sports and toy paintball products, including *Gaksplat*® and *The Storm*.

Prior to 2007, we had accounted for seasonal and outdoor products as a separate category. During 2007, we restructured our internal operations and have consolidated this product group within the Traditional category. These products share key characteristics, including common management, distribution and marketing strategies. We have restated our prior segment reporting to reflect this change.

#### Craft, Activity and Writing Products

• Craft, activity and stationery products, including *Flying Colors*® activity sets, compounds, playsets and lunch boxes based on *Nickelodeon*®, *Dora the Explorer*, *Pokémon*, *The Littlest Petshop*® and others, and *Color Workshop*® craft products such as *Blopens*®, *Vivid Velvet*®, and *Pentech*® writing instruments, stationery and activity products, and non-licensed brands including *Girl Gourmet*™ and *The Spa Factory*™.

### **Pet Products**

• Pet products, including toys, consumables, beds, clothing and accessories, with licenses used in conjunction with these products, including *American Kennel Club*®, *The Cat Fanciers' Association*™, *Arm & Hammer*® and *The Humane Society of the United States*® brands, as well as entertainment properties, including *Disney* and *Snoop Dogg*®, and private label brands including *Totally My Pet*™.

We continually review the marketplace to identify and evaluate evergreen brands that we believe have the potential for significant growth. We endeavor to 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 evergreen portfolio of brands;
- adding new items to the branded product lines that we expect will enjoy greater popularity; and
- adding simple innovation and technology to make them more appealing to today's kids.

In addition to developing our proprietary brands and marks, licensing popular brands 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 obtained an exclusive worldwide license for our joint venture with THQ Inc. ("THQ"), which develops, publishes and distributes video games based on *WWE* characters and themes. Since the joint venture's first title release in 1999, it has released 35 new titles. We have recognized approximately \$93.3 million in profit from the joint venture through December 31, 2007. We and the joint venture are named as defendants in lawsuits commenced by *WWE*, pursuant to which *WWE* is seeking treble, punitive and other damages (including disgorgement of profits) in an undisclosed amount and a declaration that the video game license with the joint venture and an amendment to our toy licenses with *WWE* are void and unenforceable (see "Legal Proceedings").

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 account for approximately 19.3%, 14.5% and 14.1%, respectively, of our net sales in 2007. No other customer accounted for more than 10.0% of our net sales in 2007.

### **Our Growth Strategy**

The execution of our growth strategy has resulted in increased revenues and earnings. In 2006 and 2007, we generated net sales of \$765.4 million and \$857.1 million, respectively, and net income of \$72.4 million and \$89.0 million, respectively. Approximately 24.3% and 1.4% of our increased net sales in 2006 and 2007, respectively, were attributable to our acquisitions since 2005. 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 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. We use multiple methods including real-scan technology, articulated joints and a flexible rubberized coating to enhance the life-like feel of our action toys, and expanded to classic characters and special techniques such as vinyl figures. These innovations appeal to collectors and/or produce higher quality and better likenesses of the representative characters.
- **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 through the licensing of this category from our current licensors, such MTV Networks which owns *Nickelodeon*.

- ***Pursue Strategic Acquisitions.*** We intend to supplement our internal growth with selected strategic acquisitions. Most recently, in June 2005, we acquired the assets of Pet Pal Corp. which expanded our offerings and distribution into pet toy, treats and related products, and in February 2006, we acquired the business of Creative Designs International, Ltd., a leading manufacturer of girls' dress-up and role-play toys. 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, among others, we have license agreements with *WWE*, *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.

- **Expand International Sales.** We believe that foreign markets, especially Europe, Australia, Canada, Latin America and Asia, offer us significant growth opportunities. In 2007, our sales generated outside the United States were approximately \$126.1 million, or 14.7% of total net sales. We intend to continue to expand our international sales by capitalizing on our experience and our relationships with foreign distributors and retailers. We expect these initiatives to continue to contribute to our international growth in 2008.
- **Capitalize On Our Operating Efficiencies.** We believe that our current infrastructure and operating model can accommodate significant 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 12). For example, our growth strategy 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 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. 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.

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.

### **Recent Acquisitions**

In February 2006, we acquired substantially all of the assets of Creative Designs International, Ltd. and a related Hong Kong company, Arbor Toys Company Limited (collectively, “Creative Designs”). The total initial consideration of \$111.1 million consisted of cash paid at closing in the amount of \$101.7 million, the issuance of 150,000 shares of our common stock valued at approximately \$3.3 million and the assumption of liabilities in the amount of \$6.1 million, and resulted in the recording of goodwill in the amount of \$53.6 million. Goodwill represents anticipated synergies to be gained via the combination of Creative Designs with us. In addition, we agreed to pay an earn-out of up to an aggregate of \$20.0 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. For the years ended December 31, 2006 and 2007, \$6.9 million and \$6.7 million, respectively, of the earn-out was earned and recorded as goodwill. Creative Designs is a leading designer and producer of dress-up and role-play toys. This acquisition expands our product offerings in the girls role-play and dress-up area and brings new product development and

marketing talent to us. Our results of operations have included Creative Designs from the date of acquisition.

**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 \$22.1 billion in 2007. 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. In the United States video game segment, total retail sales of video game software were approximately \$17.9 billion in 2007.

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 on a few dominant toy companies. Retailer concentration also enables us to ship products, manage account relationships and track retail sales 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 14% of net sales, and some may require minimum guarantees and advances. Our principal products include:

### **Traditional Toys**

#### ***Electronics Products***

Our electronic products category includes our *Plug It In & Play TV Games*, *EyeClops™ Bionic Eye* products and *Laser Challenge®* product lines. Our current *Plug It In & Play TV Games* titles include licenses from *Namco®*, *Disney*, *Marvel®* and *Nickelodeon*, and feature such games as *SpongeBob SquarePants®*, *Dora the Explorer*, *Disney Princess®*, *Ms. Pac-Man®* and *Pac-Man®*.

We regularly release new *Plug It In & Play TV Games* titles for the pre-school and leisure gamer segments including *Wheel of Fortune®*, *Deal or No Deal®*, *Jeopardy®*, *Sesame Street®* and *Thomas the Tank™*.

#### ***Wheels Division Products***

- *Toy and activity vehicles*

Our toy vehicle line includes toy and activity vehicles and other toys. We also produce radio controlled vehicles. Our toy vehicle line is comprised of an assortment of rugged die-cast and plastic vehicles that range in size from four-and three-quarter inch to big-wheeled seventeen inch vehicles. The breadth of the line is extensive, with themes ranging from emergency, fire, farm and construction, to racing and jungle adventure.

- *Road Champs® die-cast collectible and toy vehicles*

The *Road Champs* product line consists of highly detailed, die-cast replicas of new and classic cars, trucks, motorcycles, emergency vehicles and service vehicles, primarily in 1/43 scale (including police cars, fire trucks and ambulances), buses and aircraft. Through licenses, we produce replicas of well-known vehicles including those from *Ford®*, *Chevrolet®* and *Porsche®*. We believe that these licenses increase the perceived value of the products and enhance their marketability.

- *Extreme sports die-cast collectibles and toy vehicles and action figures*

Our extreme sports offerings include our *MXS* line of motorcycles with riders, off-road vehicles, personal watercraft, surfboards and skateboards, which are sold individually and with playsets and accessories.

#### ***Action Figures and Accessories***

We have an extensive toy license with the WWE pursuant to which we have the right, until December 31, 2009, to develop and market a full line of toy products based on the popular *WWE* professional wrestlers. These wrestlers

perform throughout the year at live events that attract large crowds, many of which are broadcast on free and cable television, including pay-per-view specials. We launched this product line in 1996 with various series of 6 inch articulated action figures that have movable body parts. We continually expand and enhance this product line by using technology in the development and in the products themselves. The 6 inch figures currently make up a substantial portion of our overall *WWE* line, which has since grown to include many other new products including playsets. Our strategy has been to release new figures and accessories frequently and to offer many exclusive programs to our retail partners to keep the line fresh and relevant to *WWE*'s television programming, and to retain the interest of the consumers.

We also develop, manufacture and distribute other action figures and action figure accessories including those based on the animated series *Pokemon*, and the Disney feature film *The Chronicles of Narnia: Prince Caspian*.

***Role-play and Dress-up Products***

Our line of role-play and dress-up products features entertainment and consumer products properties such as *Disney Princess*, *Hannah Montana* and *Dora the Explorer* for girls and *Black & Decker* and *Pirates of the Caribbean* for boys. These products generated a significant amount of sales in 2007, and we expect that level of sales to continue in 2008.

***Infant and Pre-school Toys***

Our pre-school toys include plush and electronic toys based on *Care Bears*, *The Wiggles*, *Barney* licenses and more, some branded under *Child Guidance*® and others under *Play Along*®. In 2007, we also introduced new pre-school foam play products called *Gorilla Blocks*™.