JAKKS PACIFIC INC
Form 10-Q
August 14, 2009

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

FORM 10-Q

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from ______ to ______

Commission file number: 0-28104

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

Delaware	95-4527222
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
22619 Pacific Coast Highway Malibu, California	90265
(Address of Principal Executive Offices)	(Zip Code)

Registrant’s telephone number, including area code: (310) 456-7799

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 x 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 o No ¨

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

Large accelerated filer	Accelerated filer	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company
x	o		¨

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

The number of shares outstanding of the issuer's common stock is 27,928,231 (as of August 13, 2009).

JAKKS PACIFIC, INC. AND SUBSIDIARIES

INDEX TO QUARTERLY REPORT ON FORM 10-Q
Quarter Ended June 30, 2009

ITEMS IN FORM 10-Q

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

This report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. For example, statements included in this report regarding our financial position, business strategy and other plans and objectives for future operations, and assumptions and predictions about future product demand, supply, manufacturing, costs, marketing and pricing factors are all forward-looking statements. When we use words like “intend,” “anticipate,” “believe,” “estimate,” “plan”, “expect” or words o similar import, we are making forward-looking statements. We believe that the assumptions and expectations reflected in such forward-looking statements are reasonable and are based on information available to us on the date hereof, but we cannot assure you that these assumptions and expectations will prove to have been correct or that we will take any action that we may presently be planning. We are not undertaking to publicly update or revise any forward-looking statement if we obtain new information or upon the occurrence of future events or otherwise.

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	December 31, 2008 (*)	June 30, 2009 (Unaudited)
ASSETS		
Current assets		
Cash and cash equivalents	$ 169,520	$ 122,406
Marketable securities	195	199
Accounts receivable, net of allowances for uncollectible accounts of $2,005 and $1,577, respectively	147,587	115,777
Inventory	87,944	76,563
Prepaid expenses and other current assets	29,670	28,629
Income tax receivable	22,288	41,120
Deferred income taxes	17,993	82,443
Total current assets	475,197	467,137
Property and equipment		
Office furniture and equipment	12,390	12,883
Molds and tooling	63,075	62,189
Leasehold improvements	5,947	6,185
Total	81,412	81,257
Less accumulated depreciation and amortization	52,914	51,280
Property and equipment, net	28,498	29,977
Investment in video game joint venture	53,184	34,683
Goodwill, net	427,693	—
Trademarks, net	10,491	2,308
Intangibles and other, net	33,061	49,607
Total assets	$ 1,028,124	$ 583,712
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 57,432	$ 66,490
Accrued expenses	61,780	42,489
Reserve for sales returns and allowances	23,317	15,793
Capital lease obligation	417	340
Income taxes payable	7,190	—
Convertible senior notes	—	98,000
Total current liabilities	150,136	223,112
Deferred income taxes	26,237	17,140
Income tax payable	4,686	4,686
Other liabilities	2,112	6,592
Convertible senior notes	98,000	—
Total liabilities	281,171	251,530
Stockholders' equity		
Preferred stock, $.001 par value; 5,000,000 shares authorized; nil outstanding	—	—
Common stock, $.001 par value; 100,000,000 shares authorized; 27,521,278 and 27,928,231 shares issued and outstanding, respectively	28	28
Additional paid-in capital	292,809	295,399

Retained earnings	458,345	40,984
Accumulated comprehensive loss	(4,229)	(4,229)
Total stockholders' equity	746,953	332,182
Total liabilities and stockholders' equity	$ 1,028,124	$ 583,712

(*) Derived from audited financial statements

See notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	2008 As Adjusted (Note 13)	2009	2008 As Adjusted (Note 13)	2009
Net sales	$ 145,291	$ 144,809	$ 276,226	$ 253,494
Cost of sales	92,366	150,885	174,804	222,589
Gross profit (loss)	52,925	(6,076)	101,422	30,905
Selling, general and administrative expenses	46,490	53,756	94,825	108,310
Write-down of intangible assets	—	8,221	—	8,221
Write-down of goodwill	—	407,125	—	407,125
Income (loss) from operations	6,435	(475,178)	6,597	(492,751)
Profit (loss) from video game joint venture	1,295	(22,901)	3,727	(20,005)
Interest Income	773	69	2,093	248
Interest Expense, net of benefit	(1,642)	(1,266)	(3,200)	(2,533)
Income (loss) before provision (benefit) for income taxes	6,861	(499,276)	9,217	(515,041)
Provision (benefit) for income taxes	2,091	(92,714)	2,857	(97,680)
Net income (loss)	$ 4,770	$ (406,562)	$ 6,360	$ (417,361)
Earnings (loss) per share – basic	$ 0.17	$ (14.96)	$ 0.23	$ (15.35)
Earnings (loss) per share – diluted	$ 0.17	$ (14.96)	$ 0.23	$ (15.35)

See notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Six Months Ended June 30, (Unaudited)	
	2008 As Adjusted (Note 13)	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ 6,360	$ (417,361)
Adjustments to reconcile net income (loss) to net cash used by operating activities:		
Depreciation and amortization	10,283	11,417
Share-based compensation expense	4,011	3,979
(Profit) loss from video game joint venture	(3,973)	18,332
Loss on disposal of property and equipment	43	2,341
Deferred income taxes	(90)	(73,547)
Write-down of intangible assets	—	8,221
Write-down of goodwill	—	407,125
Changes in operating assets and liabilities:		
Accounts receivable	72,005	31,810
Inventory	(8,115)	8,742
Prepaid expenses and other current assets	(14,479)	1,342
Income tax receivable	(8,919)	(18,832)
Accounts payable	866	9,058
Accrued expenses	(28,630)	(6,942)
Income taxes payable	(21,997)	(7,190)
Reserve for sales returns and allowances	(14,396)	(7,524)
Other liabilities	781	4,481
Total adjustments	(12,610)	392,813
Net cash used by operating activities	(6,250)	(24,548)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(12,776)	(10,912)
Change in other assets	125	2,068
Cash paid for net assets of business acquired	(14,993)	(12,253)
Net purchase of marketable securities	(2)	(4)
Net cash used by investing activities	(27,646)	(21,101)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from stock options exercised	2,831	—
Common stock surrendered	(2,968)	(1,389)
Common stock repurchased	(30,002)	—
Repayment of capital lease obligation	—	(76)
Net cash used in financing activities	(30,139)	(1,465)
Net decrease in cash and cash equivalents	(64,035)	(47,114)
Cash and cash equivalents, beginning of period	241,250	169,520
Cash and cash equivalents, end of period	$ 177,215	$ 122,406

Cash paid during the period for:				
Income taxes	$	36,877	$	2,224
Interest	$	2,341	$	2,281

Non cash investing and financing activity:

In January and March 2008, two executive officers surrendered an aggregate of 122,202 shares of restricted stock at a value of $3.0 million to cover their income taxes due on the 2008 vesting of restricted shares granted to them in 2006, 2007 and 2008. This restricted stock was subsequently retired by the Company.

In January 2009, two executive officers surrendered an aggregate of 74,836 shares of restricted stock at a value of $1.4 million to cover their income taxes due on the 2009 vesting of restricted shares granted to them in 2007 and 2008. This restricted stock was subsequently retired by the Company.

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

See notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
June 30, 2009

Note 1 — Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to prevent the information presented from being misleading. These financial statements should be read in conjunction with Management’s Discussion and Analysis of financial condition and results of operations and the financial statements and the notes thereto included in the Company’s Form 10-K, which contains audited financial information for the three years in the period ended December 31, 2008.

The information provided in this report reflects all adjustments (consisting solely of normal recurring items) that are, in the opinion of management, necessary to present fairly the financial position and the results of operations for the periods presented. Interim results are not necessarily indicative of results to be expected for a full year.

Certain reclassifications have been made to prior year balances in order to conform to the current year presentation.

The condensed consolidated financial statements include the accounts of JAKKS Pacific, Inc. and its wholly-owned subsidiaries (collectively “the Company”).

Note 2 — Business Segments, Geographic Data, Sales by Product Group, and Major Customers

The Company is a worldwide producer and marketer of children’s toys and other consumer products, principally engaged in the design, development, production, marketing and distribution of its diverse portfolio. The Company’s reportable segments are Traditional Toys, Craft/Activity/Writing Products, and Pet Products, each of which includes worldwide sales.

The Traditional Toys segment includes action figures, vehicles, playsets, plush products, dolls, accessories, pretend play products including Halloween costumes and accessories, dress-up costumes and accessories, electronic products, novelty toys, collectibles, construction toys, compounds, infant and pre-school toys, water toys, kites, and related products.

Craft/Activity/Writing Products include do-it-yourself kits, pens, pencils, stationery products, crayons, markers, paints, and other related craft and activity products.

Pet Products include pet toys, treats, apparel and related pet products.

Segment performance is measured at the operating income level. All sales are made to external customers, and general corporate expenses have been attributed to the various segments based on sales volumes. Segment assets are comprised of accounts receivable and inventories, net of applicable reserves and allowances, goodwill and other assets.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 2 — Business Segments, Geographic Data, Sales by Product Group, and Major Customers - (continued)

Results are not necessarily those that would be achieved were each segment an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts as of December 31, 2008 and June 30, 2009 and for the three and six months ended June 30, 2008 and 2009 are as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
Net Sales				
Traditional Toys	$ 131,127	$ 126,458	$ 250,645	$ 224,050
Craft/Activity/Writing Products	10,570	14,818	16,658	22,378
Pet Products	3,594	3,533	8,923	7,066
	$ 145,291	$ 144,809	$ 276,226	$ 253,494

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008 As Adjusted (Note 13)	2009	2008 As Adjusted (Note 13)	2009
Operating Income (Loss)				
Traditional Toys	$ 5,892	(373,944)	$ 6,133	$ (389,724)
Craft/Activity/Writing Products	405	(89,790)	363	(91,012)
Pet Products	138	(11,444)	101	(12,015)
	$ 6,435	(475,178)	$ 6,597	$ (492,751)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008 As Adjusted (Note 13)	2009	2008 As Adjusted (Note 13)	2009
Depreciation and Amortization Expense				
Traditional Toys	$ 5,163	$ 5,886	$ 9,655	10,444
Craft/Activity/Writing Products	276	573	493	751
Pet Products	43	130	135	222
	$ 5,482	$ 6,589	$ 10,283	$ 11,417

	December 31, 2008	June 30, 2009
Assets		
Traditional Toys	$ 877,606	$ 531,845
Craft/Activity/Writing Products	128,036	42,736
Pet Products	22,482	9,131
	$ 1,028,124	$ 583,712

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 2 — Business Segments, Geographic Data, Sales by Product Group, and Major Customers - (continued)

The following tables present information about the Company by geographic area as of December 31, 2008 and June 30, 2009 and for the three and six months ended June 30, 2008 and 2009 (in thousands):

	December 31, 2008	June 30, 2009
Long-lived Assets		
United States	$ 26,179	$ 27,722
Hong Kong	2,319	2,255
	$ 28,498	$ 29,977

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2009	2008	2009
Net Sales by Geographic Area				
United States	$ 112,783	$ 120,807	$ 220,252	210,879
Europe	9,713	6,152	16,442	12,288
Canada	4,377	5,563	9,288	9,968
Hong Kong	10,593	6,292	16,600	9,539
Other	7,825	5,995	13,644	10,820
	$ 145,291	$ 144,809	$ 276,226	$ 253,494

Major Customers

Net sales to major customers for the three and six months ended June 30, 2008 and 2009 were as follows (in thousands, except for percentages):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2008		2009		2008		2009	
	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales
Wal-Mart	$ 34,697	23.9%	$ 23,008	15.9%	$ 80,936	29.3%	$ 58,553	23.1%
Toys ‘R’ Us	9,942	6.8	14,698	10.1	22,321	8.1	25,834	10.2
Target	28,889	19.9	34,235	23.6	45,617	16.5	49,982	19.7
	$ 73,528	50.6%	$ 71,941	49.6%	$ 148,874	53.9%	$ 134,319	53.0%

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

At December 31, 2008 and June 30, 2009, the Company’s three largest customers accounted for approximately 74.0% and 50.1%, respectively, of net accounts receivable. The concentration of the Company’s business with a relatively small number of customers may expose the Company to material adverse effects if one or more of its large customers were to experience financial difficulty. The Company performs ongoing credit evaluations of its top customers and maintains an allowance for potential credit losses.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 3 — Inventory

Inventory, which includes the ex-factory cost of goods, in-bound freight, duty and warehouse costs, is stated at the lower of cost (first-in, first-out) or market and consists of the following (in thousands):

	December 31, 2008	June 30, 2009
Raw materials	$ 3,778	$ 4,001
Finished goods	84,166	72,562
	$ 87,944	$ 76,563

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

Revenue is recognized upon the shipment of goods to customers or their agents, depending on terms, provided that there are no uncertainties regarding customer acceptance, the sales price is fixed or determinable, and collectability is reasonably assured and not contingent upon resale.

Generally, the Company does not allow for product returns. It provides a negotiated allowance for breakage or defects to its customers, which is recorded when the related revenue is recognized. However, the Company does make occasional exceptions to this policy and consequently accrues a return allowance in gross sales based on historic return amounts and management estimates. The Company also will occasionally grant credits to facilitate markdowns and sales of slow moving merchandise. These credits are recorded as a reduction of gross sales at the time of occurrence.

The Company also participates in cooperative advertising arrangements with some customers, whereby it allows a discount from invoiced product amounts in exchange for customer purchased advertising that features the Company's products. Typically, these discounts range from 1% to 6% of gross sales, and are generally based on product purchases or on specific advertising campaigns. Such amounts are accrued when the related revenue is recognized or when the advertising campaign is initiated. These cooperative advertising arrangements are accounted for as direct selling expenses.

The Company's reserve for sales returns and allowances amounted to $23.3 million as of December 31, 2008, compared to $15.8 million as of June 30, 2009. This decrease was due primarily to certain customers taking their year-end allowances related to 2008 and current year allowances during 2009.

Note 5 — Convertible Senior Notes

In June 2003, the Company sold an aggregate of $98.0 million of 4.625% Convertible Senior Notes due June 15, 2023 and received net proceeds of approximately $94.4 million. The notes are convertible into shares of the Company's common stock at an initial conversion price of $20.00 per share, or 50 shares per note, subject to certain circumstances. The notes may be converted in each quarter subsequent to any quarter in which the closing price of the Company's common stock is at or above a prescribed price for at least 20 trading days in the last 30 trading day period of the quarter. The prescribed price for the conversion trigger is $24.00 through June 30, 2010, and increases nominally each quarter thereafter. Cash interest is payable at an annual rate of 4.625% of the principal amount at issuance, from the issue date to June 15, 2010, payable on June 15 and December 15 of each year. After June 15, 2010, interest will accrue on the outstanding notes until maturity. At maturity, the Company will redeem the notes at their accreted principal amount, which will be equal to $1,811.95 (181.195%) per $1,000 principal amount at issuance, unless redeemed or converted earlier. The notes were not convertible as of June 30, 2009 and are not convertible during the third quarter of 2009.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 5 — Convertible Senior Notes (continued)

The Company may redeem the notes at its option in whole or in part beginning on June 15, 2010, at 100% of their accreted principal amount plus accrued and unpaid interest, if any, payable in cash. Holders of the notes may also require the Company to repurchase all or part of their notes on June 15, 2010, for cash, at a repurchase price of 100% of the principal amount per note plus accrued and unpaid interest, if any. Accordingly, the notes have been reclassified as a short-term liability as of June, 30, 2009. Holders of the notes may also require the Company to repurchase all or part of their notes on June 15, 2013 and June 15, 2018 at a repurchase price of 100% of the accreted principal amount per note plus accrued and unpaid interest, if any, and may be paid in cash, in shares of common stock or a combination of cash and shares of common stock.

Note 6 — Income Taxes

The Company's income tax benefit, which includes federal, state and foreign income taxes, discrete items of goodwill and trademark impairment, and the THQ/Jakks joint venture settlement, was $97.7 million, or an effective tax benefit rate of 19.0% for the six months ended June 30, 2009. During the comparable period in 2008, the income tax provision was $2.9 million, or an effective tax provision rate of 31.0%. The impairment of goodwill and trademarks, totaling $64.5 million, and the THQ/Jakks joint venture settlement of $9.1 million, were reductions to the tax benefit rate realized. Exclusive of the discrete items, the second quarter 2009 effective tax benefit rate would be 31.8%, There were no discrete items in the second quarter of 2008.

As of June 30, 2009, the Company had net deferred tax assets of approximately $65.3 million for which an allowance of $0.9 million has been provided since, in the opinion of management, realization of the future benefit is uncertain.

Current interest on uncertain income tax liabilities is recognized as interest expense in the consolidated statement of operations. During the six months ended June 30, 2009, the Company recognized $0.1 million of current year interest expense.

Note 7 — Earnings Per Share

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

	Three Months Ended June 30,					
	2008 As Adjusted (Note 13)			2009		
	Income	Weighted Average Shares	Per-Share	Income / (Loss)	Weighted Average Shares	Per-Share
Earnings (loss) per share - basic						
Income available to common stockholders	$ 4,770	27,288	$ 0.17	$ (406,562)	27,175	$ (14.96)
Effect of dilutive securities:						
Convertible senior notes	737	4,900		—	—	

Options and warrants		—	198				—	—		
Unvested restricted stock grants		—	208				—	—		
Earnings (loss) per share - diluted										
Income available to common stockholders plus assumed exercises and conversion	$	5,507	32,594	$	0.17	$	(406,562)	27,175	$	(14.96)

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JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 7 — Earnings Per Share (continued)

	Six Months Ended June 30,					
	2008 As Adjusted (Note 13)			2009		
	Income	Weighted Average Shares	Per-Share	Income / (Loss)	Weighted Average Shares	Per-Share
Earnings (loss) per share - basic						
Income available to common stockholders	$ 6,360	27,677	$ 0.23	$ (417,361)	27,187	$ (15.35)
Effect of dilutive securities:						
Options and warrants	—	225		—	—	
Unvested restricted stock grants	—	175		—	—	
Earnings (loss) per share - diluted						
Income available to common stockholders plus assumed exercises and conversion	$ 6,360	28,077	$ 0.23	$ (417,361)	27,187	$ (15.35)

Basic earnings per share has been computed using the weighted average number of common shares outstanding. Diluted earnings per share has been computed using the weighted average number of common shares and common share equivalents outstanding (which consist of warrants, options and convertible debt to the extent they are dilutive). For the three months ended June 30, 2009 and the six months ended June 30, 2008 and 2009, the convertible notes interest and related common share equivalent of 4,900,000 were excluded from the diluted earnings per share calculation because they were anti-dilutive. For the three and six months ended June 30, 2009, the diluted options and warrants of 15,027 and 30,279, respectively, and unvested restricted stock grants outstanding of 209,692 and 174,331, respectively, were excluded from the diluted earnings per share calculation because they were anti-dilutive. Potentially dilutive stock options of nil for the three and six months ended June 30, 2008, respectively, were excluded from the computation of diluted earning per share as the average market price of the Company's common stock did not exceed the weighted average exercise price of such options and to have included them would have been anti-dilutive.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 8 — Common Stock and Preferred Stock

The Company has 105,000,000 authorized shares of stock consisting of 100,000,000 shares of $.001 par value common stock and 5,000,000 shares of $.001 par value preferred stock.

In January 2009, the Company issued an aggregate of 240,000 shares of restricted stock at an aggregate value of approximately $5.0 million to two of its executive officers, which vest, subject to certain Company financial performance criteria, in January 2010, an aggregate of 30,340 shares of restricted stock to its five non-employee directors, which vest in January 2010, at an aggregate value of approximately $0.6 million, and an aggregate of 206,500 shares of restricted stock to its employees at an aggregate value of approximately $3.8 million, which vest over a five-year period. Additionally, 74,836 shares of restricted stock previously received by two executive officers were surrendered at a value of $1.4 million to cover their income taxes due on the 2009 vesting of the restricted stock granted to them in 2007 and 2008. This restricted stock was subsequently retired by the Company. Also, in January 2009, an employee surrendered 551 shares of restricted stock at a value of $11,367 to cover his income taxes due on the December 31, 2008 vested shares. In February 2009, the Company issued 3,000 shares of restricted stock at a value of approximately $0.05 million to an employee, which vest over a five-year period. In June 2009, the Company issued 2,500 shares of restricted stock at a value of approximately $0.03 million to an employee, which vest over a five-year period.

In January 2008, the Company issued an aggregate of 240,000 shares of restricted stock at an aggregate value of approximately $5.7 million to two of its executive officers, which vested 50% in each of January 2009 and 2010 and an aggregate of 25,340 shares of restricted stock to its five non-employee directors, which vest in January 2009, at an aggregate value of approximately $0.6 million. In February 2008, the Company issued an aggregate of 41,134 shares of restricted stock as 2007 bonus compensation to two of its executive officers, which vested immediately, at an aggregate value of approximately $1.0 million. In February 2008, the Company issued 3,593 shares of restricted stock as 2007 bonus compensation at a value of approximately $0.1 million to an executive officer, which vests 50% on each of March 1, 2009 and 2010. During the six months ended June 30, 2008, the Company also issued 208,871 shares of common stock on the exercise of options at a value of $2.8 million, and 122,202 shares of restricted stock previously received by two executive officers were surrendered at a value of $3.0 million to cover their income taxes due on the 2008 vesting of the restricted shares granted to them in 2006, 2007 and 2008. This surrendered restricted stock was subsequently retired by the Company. The Company granted and issued an aggregate of 20,000 shares of restricted stock to an employee at an aggregate value of approximately $0.5 million. In February 2008, the Company's Board of Directors authorized it to repurchase up to $30.0 million of its common stock. In April and May 2008, the Company repurchased an aggregate of 1,259,300 shares of its common stock at an average price of $23.82 per share for a total cost of $30.0 million. The repurchased stock represented approximately 4.4% of the Company's then outstanding shares of common stock at the time of the repurchase and was subsequently retired by the Company.

All issuances of common stock, including those issued pursuant to stock option and warrant exercises, restricted stock grants and acquisitions, are issued from the Company's authorized but not issued and outstanding shares.

JAKKS PACIFIC, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 9 — Business Combinations

The Company acquired the following entities to further enhance its existing product lines and to continue diversification into other toy categories and seasonal businesses:

In October 2008, the Company acquired substantially all of the assets of Tollytots Limited. The total initial consideration of $25.7 million consisted of $12.0 million in cash and the assumption of liabilities in the amount of $13.7 million, and resulted in goodwill of $3.1 million. In addition, the Company agreed to pay an earn-out of up to an aggregate amount of $5.0 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. Tollytots is a leading designer and producer of licensed baby dolls and baby doll pretend play accessories based on well-known brands, and was included in its results of operations from the date of acquisition. Pro forma results of operations are not provided since the amounts are not material to the consolidated results of operations.

In October 2008, the Company acquired all of the stock of Kids Only, Inc. and a related Hong Kong company, Kids Only Limited (collectively, “Kids Only”). The total initial consideration of $23.3 million consisted of $20.4 million in cash and the assumption of liabilities in the amount of $2.9 million, and resulted in goodwill of $12.7 million. In addition, the Company agreed to pay an earn-out of up to an aggregate amount of $5.6 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. Kids Only is a leading designer and producer of licensed indoor and outdoor kids’ furniture, and has an extensive portfolio which also includes baby dolls and accessories, room décor and a myriad of other children’s toy products, and was included in its results of operations from the date of acquisition. Pro forma results of operations are not provided since the amounts are not material to the consolidated results of operations.

In December 2008, the Company acquired certain assets of Disguise, Inc. and a related Hong Kong company, Disguise Limited (collectively, “Disguise”). The total initial consideration of $60.6 million consisted of $38.6 million in cash and the assumption of liabilities in the amount of $22.0 million, and resulted in goodwill of $30.6 million. The Company has not finalized its purchase price allocation for Disguise and has engaged a third party to perform studies and valuations of the estimated fair value of assets and liabilities assumed. Disguise is a leading designer and producer of Halloween and everyday costume play and was included in our results of operations from the date of acquisition. Pro forma results of operations are not provided since the amounts are not material to the consolidated results of operations.

Refer to Note 11 for information on the write-down of goodwill.

Note 10 — Joint Venture

The Company owns a fifty percent interest in a joint venture with THQ Inc. (“THQ”) which develops, publishes and distributes interactive entertainment software for the leading hardware game platforms in the home video game market. The joint venture has entered into a license agreement with an initial license period expiring December 31, 2009 and a renewal period at the option of the joint venture expiring December 31, 2014 under which it acquired the exclusive worldwide right to publish video games based on the WWE franchise on all hardware platforms. The Company’s investment is accounted for using the cost method due to the financial and operating structure of the venture and its lack of significant influence over the joint venture. The Company’s basis consists primarily of organizational costs, license costs and recoupable advances and is being amortized over the term of the initial license period. The joint venture agreement provides for the Company to receive guaranteed preferred returns through June 30, 2006 at varying rates of the joint venture's net sales depending on the cumulative unit sales and platform of each particular game. The preferred return is accrued in the quarter in which the licensed games are sold and the preferred return is earned. The preferred return was subject to change after June 30, 2006 and was to be set for the distribution period beginning July 1, 2006 and ending December 31, 2009 (the "Next Distribution Period"). The agreement provides that the parties will negotiate in good faith and agree to the preferred return not less than 180 days prior to the start of the Next Distribution Period. It further provides that if the parties are unable to agree on a preferred return, the preferred return will be determined by arbitration. The parties did not reach an agreement with respect to the preferred return for the Next Distribution Period and the preferred return for the Next Distribution Period was determined through arbitration (see Note 17). On July 24, 2009 a decision was rendered by the arbitrator setting the preferred return rate at 6 %. Based on this lower rate, an adjustment in the amount of $22.5 million was made and an estimated receivable of $34.5 million for the cumulative preferred return for the period from July 1, 2006 to June 30, 2009 has been accrued as of June 30, 2009. As of December 31, 2008 and June 30, 2009, the balance of the investment in the video game joint venture includes the following components (in thousands):

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Note 10 — Joint Venture (continued)

	December 31, 2008	June 30, 2009
Preferred return receivable	$ 52,845	$ 34,514
Investment costs, net	339	169
	$ 53,184	$ 34,683

The Company's joint venture partner retains the financial risk of the joint venture and is responsible for the day-to-day operations, including development, sales and distribution, for which they are entitled to any remaining profits. During the three months ended June 30, 2008 and 2009, the Company earned a profit of $1.3 million and incurred a loss of $22.9 million, respectively, from the joint venture. During the six months ended June 30, 2008 and 2009, the Company earned a profit of $3.7 million and incurred a loss of $20.0 million, respectively, from the joint venture. The losses in 2009 were due to the reduction from approximately $56.2 million to approximately $33.7 million in the accrual of the receivable from the joint venture that resulted from the arbitration setting the preferred return rate at 6%, instead of the 10% rate that had been accrued.

Note 11 — Goodwill

The changes in the carrying amount of goodwill for the six months ended June 30, 2009 are as follows (in thousands):

	Traditional Toys	Craft/Activity/ Writing Products	Pet Products	Total
Balance at beginning of the period	$ 335,083	$ 82,826	$ 9,784	$ 427,693
Adjustments to goodwill during the period	(20,568)	—	—	(20,568)
Write-down of goodwill	(314,515)	(82,826)	(9,784)	(407,125)
Balance at end of the period	$ —	$ —	$ —	$ —

During the six months ended June 30, 2009, the Company reclassified $21.0 million from goodwill to intangibles and other assets for its Disguise acquisition. The Company is in the process of finalizing its purchase price allocation for its Disguise Acquisition and is working with a third party to perform studies and valuations to the estimated fair value of assets and liabilities assumed. Furthermore, the Company paid out an additional working capital adjustment of $0.9 million for its Disguise acquisition.

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), the Company applies a fair value-based impairment test to the net book value of goodwill and indefinite-lived intangible assets on an annual basis and, if certain events or circumstances indicate that an impairment loss may have been incurred, on an interim basis. The analysis of potential impairment of goodwill requires a two-step process. The first step is the estimation of fair value. If step one indicates that an impairment potentially exists, the second step is performed to measure the amount of impairment, if any. Goodwill impairment exists when the estimated fair value of goodwill is less than its carrying value.

During the three months ended June 30, 2009, the Company determined that the significant decline in its market capitalization is likely to be sustained. The Company's market capitalization was not significantly affected by the dismissals subject to appeal of the WWE lawsuit, and the lower revenue expectations for 2009 versus 2008 which indicated that an interim goodwill impairment test was required under SFAS 142. As a result, the Company determined that $407.1 million, or all of the goodwill related to previous acquisitions, including the acquisition of Disguise in December 2008, was impaired in accordance with SFAS 142. This amount is included in “Write-down of Goodwill” in the accompanying condensed consolidated statements of operations.

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Note 12 — Intangible Assets Other Than Goodwill

Intangible assets consist primarily of licenses, product lines, customer relationships, debt offering costs from the issuance of the Company’s convertible senior notes and trademarks. Amortized intangible assets are included in the Intangibles and other, net, in the accompanying balance sheets. Trademarks are disclosed separately in the accompanying balance sheets. Intangible assets are as follows (in thousands, except for weighted useful lives):

		December 31, 2008			June 30, 2009		
	Weighted Useful Lives (Years)	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets:							
Acquired order backlog	0.50	$ 2,393	$ (2,165)	$			