

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2017

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: **0-28104**

**JAKKS Pacific, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**95-4527222**

(I.R.S. Employer Identification No.)

**2951 28<sup>th</sup> Street**

**Santa Monica, California**

(Address of Principal Executive Offices)

**90405**

(Zip Code)

Registrant's Telephone Number, Including Area Code: **(424) 268-9444**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares outstanding of the issuer's common stock is 26,987,430 as of August 9, 2017.

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
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**QUARTER ENDED JUNE 30, 2017**  
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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 consolidated financial position, business strategy and other plans and objectives for future operations, and assumptions and predictions about future product demand, supply, manufacturing, costs, marketing and pricing factors are all forward-looking statements. When we use words like “intend,” “anticipate,” “believe,” “estimate,” “plan,” “expect” or words of similar import, we are making forward-looking statements. We believe that the assumptions and expectations reflected in such forward-looking statements are reasonable and are based on information available to us on the date hereof, but we cannot assure you that these assumptions and expectations will prove to have been correct or that we will take any action that we may presently be planning. We are not undertaking to publicly update or revise any forward-looking statement if we obtain new information or upon the occurrence of future events or otherwise.

## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share amounts)

Assets	June 30, 2017	December 31, 2016
	(Unaudited)	
<b>Current assets</b>		
Cash and cash equivalents	\$ 64,098	\$ 86,064
Restricted cash	3,500	—
Accounts receivable, net of allowance for uncollectible accounts of \$5,138 and \$2,864 in 2017 and 2016, respectively	110,477	173,599
Inventory, net	81,220	75,435
Income taxes receivable	2,642	1,204
Prepaid expenses and other assets	27,480	17,077
Total current assets	289,417	353,379
<b>Property and equipment</b>		
Office furniture and equipment	14,771	14,345
Molds and tooling	109,894	103,128
Leasehold improvements	10,908	10,927
Total	135,573	128,400
Less accumulated depreciation and amortization	111,046	105,559
Property and equipment, net	24,527	22,841
Intangible assets, net	28,861	33,111
Other long term assets	2,490	2,156
Investment in DreamPlay LLC	7,000	7,000
Goodwill, net	43,475	43,208
Trademarks, net	2,608	2,608
Total assets	\$ 398,378	\$ 464,303
<b>Liabilities and Stockholders' Equity</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 67,003	\$ 51,741
Accrued expenses	22,390	38,645
Reserve for sales returns and allowances	9,056	16,424
Short term debt	—	10,000
Total current liabilities	98,449	116,810
Convertible senior notes, net of debt issuance costs of \$2,753 and \$3,858 in 2017 and 2016, respectively	152,975	203,007
Other liabilities	4,739	5,004
Income taxes payable	1,205	2,248
Deferred income taxes, net	2,034	2,034
Total liabilities	259,402	329,103
<b>Commitments and contingencies</b>		
<b>Stockholders' equity</b>		
Preferred stock, \$.001 par value; 5,000,000 shares authorized; nil outstanding	—	—
Common stock, \$.001 par value; 100,000,000 shares authorized; 26,987,430 and 19,376,773 shares issued and outstanding in 2017 and 2016, respectively	27	19
Treasury stock, at cost; 3,112,840 shares	(24,000)	(24,000)
Additional paid-in capital	213,898	177,624
Accumulated deficit	(37,206)	(2,148)
Accumulated other comprehensive loss	(14,741)	(17,207)
Total JAKKS Pacific, Inc. stockholders' equity	137,978	134,288
Non-controlling interests	998	912
Total stockholders' equity	138,976	135,200
Total liabilities and stockholders' equity	\$ 398,378	\$ 464,303

See accompanying notes to consolidated financial statements.

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
(In thousands, except per share data)

	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	2017	2016	2017	2016
Net sales	\$ 119,565	\$ 140,977	\$ 214,070	\$ 236,786
Cost of sales	85,846	96,177	150,330	160,803
Gross profit	33,719	44,800	63,740	75,983
Selling, general and administrative expenses	47,827	45,900	93,572	90,899
Loss from operations	(14,108)	(1,100)	(29,832)	(14,916)
Income from joint ventures	105	861	105	861
Other income	159	—	182	75
Interest income	10	18	14	34
Interest expense	(2,537)	(3,220)	(5,469)	(6,446)
Loss before provision for (benefit from) income taxes	(16,371)	(3,441)	(35,000)	(20,392)
Provision for (benefit from) income taxes	316	704	(28)	1,136
Net loss	(16,687)	(4,145)	(34,972)	(21,528)
Net income attributable to non-controlling interests	55	224	86	256
Net loss attributable to JAKKS Pacific, Inc.	\$ (16,742)	\$ (4,369)	\$ (35,058)	\$ (21,784)
Loss per share - basic and diluted	\$ (0.77)	\$ (0.27)	\$ (1.77)	\$ (1.30)
Shares used in loss per share	21,616	16,402	19,865	16,818
Comprehensive loss	\$ (14,752)	\$ (7,079)	\$ (32,506)	\$ (25,186)
Comprehensive loss attributable to JAKKS Pacific, Inc.	\$ (14,807)	\$ (7,303)	\$ (32,592)	\$ (25,442)

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<b>Six Months Ended June 30,</b>	
	<b>(Unaudited)</b>	
	<b>2017</b>	<b>2016</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (34,972)	\$ (21,528)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for doubtful accounts	2,893	—
Depreciation and amortization	10,113	8,692
Write-off and amortization of debt issuance costs	1,383	1,317
Share-based compensation expense	1,460	1,084
Gain on disposal of property and equipment	(23)	—
Gain on extinguishment of convertible senior notes	(114)	(69)
Deferred income taxes	—	4
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	60,229	30,495
Inventory	(5,785)	(10,924)
Income taxes receivable	(1,438)	573
Prepaid expenses and other assets	(10,898)	4,003
Accounts payable	15,322	32,330
Accrued expenses	(16,255)	(19,963)
Reserve for sales returns and allowances	(7,368)	(8,307)
Income taxes payable	(1,043)	985
Other liabilities	(265)	18
Total adjustments	48,211	40,238
Net cash provided by operating activities	13,239	18,710
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(7,611)	(6,110)
Proceeds from sale of property and equipment	24	—
Net cash used in investing activities	(7,587)	(6,110)
<b>Cash flows from financing activities</b>		
Repurchase of common stock	—	(11,941)
Repurchase of common stock for employee tax withholding	(12)	(844)
Repayment of credit facility borrowings	(10,000)	—
Repurchase of convertible senior notes	(35,614)	(2,626)
Proceeds from issuance of common stock	19,311	—
Net cash used in financing activities	(26,315)	(15,411)
Net decrease in cash and cash equivalents	(20,663)	(2,811)
Effect of foreign currency translation	2,197	(3,091)
Cash, cash equivalents, and restricted cash, beginning of period	86,064	102,528
Cash, cash equivalents, and restricted cash, end of period	\$ 67,598	\$ 96,626
Cash paid during the period for:		
Income taxes	\$ 1,598	\$ 23
Interest	\$ 4,793	\$ 4,899

See Notes 5, 6 and 9 for additional supplemental information to the consolidated statements of cash flows.

See accompanying notes to consolidated financial statements.

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**June 30, 2017**

**Note 1 — Basis of Presentation**

The accompanying unaudited interim consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to prevent the information presented from being misleading. These financial statements should be read in conjunction with Management’s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K, which contains audited financial information for the three years in the period ended December 31, 2016.

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, especially given seasonality, indicative of results to be expected for a full year.

The consolidated financial statements include the accounts of JAKKS Pacific, Inc. and its wholly-owned subsidiaries (collectively, “the Company”). The consolidated financial statements also include the accounts of DreamPlay Toys, LLC, a joint venture between JAKKS Pacific, Inc. and NantWorks LLC, JAKKS Meisheng Trading (Shanghai) Limited, a joint venture between JAKKS Pacific, Inc. and Meisheng Cultural & Creative Corp., Ltd., and JAKKS Meisheng Animation (HK) Limited, a joint venture between JAKKS Pacific, Inc. and Hong Kong Meisheng Cultural Company Limited.

Certain prior period amounts have been reclassified for consistency with the current period presentation.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers”, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is continuing to evaluate the effect that the adoption of this ASU will have on its consolidated financial statements and related disclosures, and has not yet selected a transition method. The Company is currently evaluating its business and contracts to determine any changes to accounting policies, processes or systems necessary to adopt the requirements of the new standard.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities”. The new guidance is intended to improve the recognition and measurement of financial instruments. The ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2017. The Company is currently assessing the potential impact of this ASU on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases”. ASU 2016-02 establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. A modified retrospective transition approach is required for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the impact of the pending adoption of this new standard on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.” The new guidance is intended to reduce diversity in practice in how transactions are classified in the statement of cash flows. This ASU is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this standard is not expected to have a material impact on the Company’s consolidated financial statements.

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**June 30, 2017**

In October 2016, the FASB issued ASU 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory.” The amendments in this ASU reduces the complexity in the accounting standards by allowing the recognition of current and deferred income taxes for an intra-entity asset transfer, other than inventory, when the transfer occurs. Historically, recognition of the income tax consequence was not recognized until the asset was sold to an outside party. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the impact of this ASU on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash”. The update requires that amounts generally described as restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The new standard will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. The Company early adopted this standard during the second quarter of 2017. Restricted cash is now included as a component of cash, cash equivalents, and restricted cash on the Company’s consolidated statements of cash flows. The inclusion of restricted cash increased the ending balance of the consolidated statements of cash flows by \$3.5 million and \$9.9 million for the six months ended June 30, 2017 and 2016, respectively.

In January 2017, the FASB issued ASU 2017-04, “Simplifying the Test for Goodwill Impairment”, which removes Step 2 from the goodwill impairment test. ASU 2017-04 will be effective for interim and annual reporting periods beginning after December 15, 2019. Early application is permitted after January 1, 2017. The Company is currently evaluating the impact of the adoption of ASU 2017-04 on its consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting”, which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of ASU 2017-09 on its consolidated financial statements.

**Note 2 — Business Segments, Geographic Data, and Sales by 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 of products. The Company has aligned its operating segments into three segments that reflect the management and operation of the business. The Company’s segments are (i) U.S. and Canada, (ii) International, and (iii) Halloween.

The U.S. and Canada segment includes action figures, vehicles, play sets, plush products, dolls, electronic products, construction toys, infant and pre-school toys, role play and everyday costume play, foot to floor ride-on vehicles, wagons, novelty toys, seasonal and outdoor products, kids’ indoor and outdoor furniture, and pet treats and related products, primarily within the United States and Canada.

Within the International segment, the Company markets and sells its toy products in markets outside of the U.S. and Canada, primarily in the European, Asia Pacific, and Latin and South American regions.

Within the Halloween segment, the Company markets and sells Halloween costumes and accessories and everyday costume play products, primarily in the U.S. and Canada.

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 upon relative sales volumes. Segment assets are primarily comprised of accounts receivable and inventories, net of applicable reserves and allowances, goodwill and other assets. Certain assets which are not tracked by operating segment and/or that benefit multiple operating segments have been allocated on the same basis.

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)  
**June 30, 2017**

Results are not necessarily those which would be achieved if each segment was an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts for the three and six months ended June 30, 2017 and 2016 and as of June 30, 2017 and December 31, 2016 are as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Net Sales</b>				
U.S. and Canada	\$ 70,140	\$ 89,737	\$ 141,052	\$ 161,939
International	17,500	19,953	37,442	40,121
Halloween	31,925	31,287	35,576	34,726
	<u>\$ 119,565</u>	<u>\$ 140,977</u>	<u>\$ 214,070</u>	<u>\$ 236,786</u>

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Income (Loss) from Operations</b>				
U.S. and Canada	\$ (9,519)	\$ 654	\$ (17,395)	\$ (7,899)
International	(1,479)	(344)	(3,251)	(2,505)
Halloween	(3,110)	(1,410)	(9,186)	(4,512)
	<u>\$ (14,108)</u>	<u>\$ (1,100)</u>	<u>\$ (29,832)</u>	<u>\$ (14,916)</u>

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Depreciation and Amortization Expense</b>				
U.S. and Canada	\$ 4,051	\$ 3,240	\$ 7,425	\$ 6,310
International	984	702	1,882	1,554
Halloween	698	714	806	828
	<u>\$ 5,733</u>	<u>\$ 4,656</u>	<u>\$ 10,113</u>	<u>\$ 8,692</u>

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
<b>Assets</b>		
U.S. and Canada	\$ 246,043	\$ 306,895
International	90,304	119,560
Halloween	62,031	37,848
	<u>\$ 398,378</u>	<u>\$ 464,303</u>

The following tables present information about the Company by geographic area as of June 30, 2017 and December 31, 2016 and for the three and six months ended June 30, 2017 and 2016 (in thousands):

	<b>June 30, 2017</b>	<b>December 31, 2016</b>
<b>Long-lived Assets</b>		
China	\$ 17,813	\$ 15,710
United States	6,272	6,587
Hong Kong	442	544
	<u>\$ 24,527</u>	<u>\$ 22,841</u>



**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)  
**June 30, 2017**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
<b>Net Sales by Customer Area</b>				
United States	\$ 99,070	\$ 115,216	\$ 168,630	\$ 186,184
Europe	10,337	11,410	22,897	24,165
Canada	2,580	5,053	7,024	9,703
Hong Kong	168	338	387	677
Other	7,410	8,960	15,132	16,057
	<u>\$ 119,565</u>	<u>\$ 140,977</u>	<u>\$ 214,070</u>	<u>\$ 236,786</u>

**Major Customers**

Net sales to major customers for the three and six months ended June 30, 2017 and 2016 were as follows (in thousands, except for percentages):

	<b>Three Months Ended June 30,</b>				<b>Six Months Ended June 30,</b>			
	<b>2017</b>		<b>2016</b>		<b>2017</b>		<b>2016</b>	
	<b>Amount</b>	<b>Percentage of Net Sales</b>	<b>Amount</b>	<b>Percentage of Net Sales</b>	<b>Amount</b>	<b>Percentage of Net Sales</b>	<b>Amount</b>	<b>Percentage of Net Sales</b>
Wal-Mart	\$ 19,391	16.2%	\$ 39,063	27.7%	\$ 42,643	19.9%	\$ 66,810	28.2%
Target	20,522	17.2	18,818	13.3	33,181	15.5	26,940	11.4
Toys 'R' Us	11,020	9.2	10,130	7.2	18,731	8.8	18,464	7.8
	<u>\$ 50,933</u>	<u>42.6%</u>	<u>\$ 68,011</u>	<u>48.2%</u>	<u>\$ 94,555</u>	<u>44.2%</u>	<u>\$ 112,214</u>	<u>47.4%</u>

At June 30, 2017 and December 31, 2016, the Company's three largest customers accounted for approximately 42.9% and 35.8%, 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.

**Note 3 — Inventory**

Inventory, which includes the ex-factory cost of goods, in-bound freight, duty and capitalized warehouse costs, is valued at the lower of cost (first-in, first-out) or net realizable value, net of inventory obsolescence reserve, and consists of the following (in thousands):

	<b>June 30,</b>	<b>December 31,</b>
	<b>2017</b>	<b>2016</b>
Raw materials	\$ 3,158	\$ 5,204
Finished goods	78,062	70,231
	<u>\$ 81,220</u>	<u>\$ 75,435</u>

During the first quarter of 2017, the Company adopted ASU 2015-11, "Simplifying the Measurement of Inventory (Topic 330)". The amendments, which apply to inventory that is measured using any method other than the last-in, first-out (LIFO) or retail inventory method, require that entities measure inventory at the lower of cost or net realizable value. ASU 2015-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016 and should be applied on a prospective basis. The adoption of ASU 2015-11 did not have a material impact on the Company's consolidated financial statements.

**JAKKS PACIFIC, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**June 30, 2017**

**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 upon terms, provided there are no uncertainties regarding customer acceptance, the sales price is fixed or determinable and collectability is reasonably assured and not contingent upon resale.

Generally, the Company does not allow product returns. It provides its customers a negotiated allowance for breakage or defects, 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 based upon historic return amounts and management estimates. The Company occasionally grants 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. Generally, these discounts range from 1% to 10% of gross sales, and are generally based upon product purchases or 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 \$9.1 million as of June 30, 2017, compared to \$16.4 million as of December 31, 2016. This decrease is primarily due to certain customers taking their annual allowances related to 2016 sales as well as allowances related to 2017 during 2017.

**Note 5 — Credit Facility**

In March 2014, the Company and its domestic subsidiaries entered into a secured credit facility with General Electric Capital Corporation ("GECC"). The loan agreement, as amended and subsequently assigned to Wells Fargo Bank, N.A. pursuant to its acquisition of GECC, provides for a \$75.0 million revolving credit facility subject to availability based on prescribed advance rates on certain accounts receivable and inventory (the "WF Loan Agreement"). The amounts outstanding under the credit facility are payable in full upon maturity of the facility on March 27, 2019, and the credit facility is secured by a security interest in favor of the lender covering a substantial amount of the assets of the Company. As of June 30, 2017, the amount of outstanding borrowings was nil and outstanding stand-by letters of credit totaled \$28.2 million which exceeded the borrowing base availability under the credit line by \$3.5 million and was funded by the Company resulting in restricted cash of \$3.5 million. Such funds will become unrestricted when and as the excess borrowing capacity under the credit line becomes positive. As of December 31, 2016, the amount of outstanding borrowings was \$10.0 million and outstanding stand-by letters of credit totaled \$28.2 million; the total excess borrowing capacity was \$12.1 million.

The Company's ability to borrow under the WF Loan Agreement is also subject to its ongoing compliance with certain financial covenants, including the maintenance by the Company of a fixed charge coverage ratio of at least 1.2:1.0 based on the trailing four fiscal quarters. As of June 30, 2017 and December 31, 2016, the Company was in compliance with the financial covenants under the WF Loan Agreement.

The Company may borrow funds at LIBOR or at a base rate, plus applicable margins of 225 basis point spread over LIBOR and 125 basis point spread on base rate loans. In addition to standard fees, the facility has a stand-by letter of credit fee of 225 basis points and an unused credit line fee, which ranges from 25 to 50 basis points. As of June 30, 2017 and December 31, 2016, the interest rate on the credit facility was approximately 3.04% and 3.01%, respectively.

The WF Loan Agreement also contains customary events of default, including a cross default provision and a change of control provision. In the event of a default, all of the obligations of the Company and its subsidiaries under the WF Loan Agreement may be declared immediately due and payable. For certain events of default relating to insolvency and receivership, all outstanding obligations become due and payable.

**Note 6 — Convertible Senior Notes**

In July 2013, the Company sold an aggregate of \$100.0 million principal amount of 4.25% Convertible Senior Notes due 2018 (the "2018 Notes"). The 2018 Notes are senior unsecured obligations of the Company paying interest semi-annually in arrears on August 1 and February 1 of each year at a rate of 4.25% per annum and will mature on August 1, 2018. The initial and still current conversion rate for the 2018 Notes is 114.3674 shares of JAKKS common stock per \$1,000 principal amount of notes, equivalent to an initial conversion price of approximately \$8.74 per share of common stock, subject to adjustment in certain events. Upon conversion, the 2018 Notes will be settled in shares of the Company's common stock. Holders of the 2018 Notes may require that the Company repurchase for cash all or some of their notes upon the occurrence of a fundamental change (as defined in the 2018 Notes). In 2016, the Company repurchased and retired an aggregate of approximately \$6.1 million principal amount of the 2018 Notes. In addition, approximately \$0.1 million of the unamortized debt issuance costs were written off and a nominal gain was recognized in conjunction with the retirement of the 2018 Notes. During the first quarter of 2017, the Company exchanged and retired \$39.1 million principal amount of the 2018 Notes at par for \$24.1 million in cash and approximately 2.9 million shares of its common stock. During the second quarter of 2017, the Company exchanged and retired \$12.0 million principal amount of the 2018 Notes at par for \$11.6 million in cash and 112,400 shares of its common stock. In addition, for the three months ended June 30, 2017, approximately \$0.1 million of the unamortized debt issuance costs were written off and a \$0.1 million gain was recognized in conjunction with the exchange and retirement of the 2018 Notes.

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In June 2014, the Company sold an aggregate of \$115.0 million principal amount of 4.875% Convertible Senior Notes due 2020 (the “2020 Notes”). The 2020 Notes are senior unsecured obligations of the Company paying interest semi-annually in arrears on June 1 and December 1 of each year at a rate of 4.875% per annum and will mature on June 1, 2020. The initial and still current conversion rate for the 2020 Notes is 103.7613 shares of the Company’s common stock per \$1,000 principal amount of notes, equivalent to an initial conversion price of approximately \$9.64 per share of common stock, subject to adjustment in certain events. Upon conversion, the 2020 Notes will be settled in shares of the Company’s common stock. Holders of the 2020 Notes may require that the Company repurchase for cash all or some of their notes upon the occurrence of a fundamental change (as defined in the 2020 Notes). In January 2016, the Company repurchased and retired an aggregate of \$2.0 million principal amount of the 2020 Notes. In addition, approximately \$0.1 million of the unamortized debt issuance costs were written off and a \$0.1 million gain was recognized in conjunction with the retirement of the 2020 Notes.

The fair value of the 2018 Notes as of June 30, 2017 and December 31, 2016 was approximately \$42.1 million and \$83.7 million, respectively, based upon the most recent quoted market price. The fair value of the 2020 Notes as of June 30, 2017 and December 31, 2016 was approximately \$98.0 million and \$89.3 million, respectively, based upon the most recent quoted market price. The fair value of the convertible senior notes is considered to be a Level 2 measurement on the fair value hierarchy.

Convertible senior notes consist of the following (in thousands):

	June 30, 2017			December 31, 2016		
	Principal Amount	Debt Issuance Costs	Net Amount	Principal Amount	Debt Issuance Costs	Net Amount
4.25% convertible senior notes (due 2018)	\$ 42,728	\$ 387	\$ 42,341	\$ 93,865	\$ 1,098	\$ 92,767
4.875% convertible senior notes (due 2020)	113,000	2,366	110,634	113,000	2,760	110,240
<b>Total</b>	<b>\$ 155,728</b>	<b>\$ 2,753</b>	<b>\$ 152,975</b>	<b>\$ 206,865</b>	<b>\$ 3,858</b>	<b>\$ 203,007</b>

Amortization expense classified as interest expense related to debt issuance costs was \$0.8 million and \$0.5 million for the three months ended June 30, 2017 and 2016, respectively, and \$1.1 million and \$1.1 million for the six months ended June 30, 2017 and 2016, respectively.

**Note 7 — Income Taxes**

The Company’s income tax expense of \$0.3 million for the three months ended June 30, 2017 reflects an effective tax rate of (1.9)%. The Company’s income tax expense of \$0.7 million for the three months ended June 30, 2016 reflects an effective tax rate of (20.5)%. The majority of the tax expense for the three months ended June 30, 2017 and 2016 relate to foreign income taxes.

The Company’s income tax benefit of \$27,603 for the six months ended June 30, 2017 reflects an effective tax rate of 0.1%. The Company’s income tax expense of \$1.1 million for the six months ended June 30, 2016 reflects an effective tax rate of (5.6)%. The majority of the tax benefit for the six months ended June 30, 2017 relates to favorable discrete items partially offset by foreign income taxes. The majority of the tax expense for the six months ended June 30, 2016 relates to foreign taxes.

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During the first quarter of 2017, the Company adopted ASU 2016-09, "Improvement to Employee Share-Based Payment Accounting," which simplifies several aspects of the accounting for share-based payments, including treatment of excess tax benefits and forfeitures, as well as consideration of minimum statutory tax withholding requirements. Under the new standard, all excess tax benefits and tax deficiencies will be recognized as income tax expense or benefit in the income statement as discrete items in the reporting period in which they occur. No discrete tax expense was recognized related to this during the second quarter of 2017.

**Note 8 — Loss Per Share**

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

	<b>Three Months Ended June 30,</b>					
	<b>2017</b>			<b>2016</b>		
	<b>Loss</b>	<b>Weighted Average Shares</b>	<b>Per-Share</b>	<b>Loss</b>	<b>Weighted Average Shares</b>	<b>Per-Share</b>
Loss per share — basic and diluted						
Net loss available to common stockholders	\$ (16,742)	21,616	\$ (0.77)	\$ (4,369)	16,402	\$ (0.27)

  

	<b>Six Months Ended June 30,</b>					
	<b>2017</b>			<b>2016</b>		
	<b>Loss</b>	<b>Weighted Average Shares</b>	<b>Per-Share</b>	<b>Loss</b>	<b>Weighted Average Shares</b>	<b>Per-Share</b>
Loss per share — basic and diluted						
Net loss available to common stockholders	\$ (35,058)	19,865	\$ (1.77)	\$ (21,784)	16,818	\$ (1.30)

Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated using the weighted average number of common shares and common share equivalents outstanding during the period (which consist of warrants, options, restricted stock awards, restricted stock units and convertible debt to the extent they are dilutive). The weighted average number of common shares outstanding excludes shares repurchased pursuant to a prepaid forward share repurchase agreement (see Note 9). Common share equivalents that could potentially dilute basic earnings per share in the future, which were excluded from the computation of diluted earnings per share due to being anti-dilutive, totaled 21,405,998 and 25,505,763 for the three months ended June 30, 2017 and 2016, respectively, and 22,160,979 and 25,285,744 for the six months ended June 30, 2017 and 2016, respectively.

**Note 9 — Common Stock and Preferred Stock**

In June 2014, the Company effectively repurchased 3,112,840 shares of its common stock for an aggregate amount of \$24.0 million pursuant to a prepaid forward share repurchase agreement entered into with Merrill Lynch International ("ML"). These repurchased shares are treated as retired for basic and diluted earnings per share purposes although they remain legally outstanding. The Company reflects the aggregate purchase price as a reduction to stockholders' equity classified as Treasury Stock. No shares have been delivered to the Company by ML as of June 30, 2017.

In June 2015, and as subsequently increased, the Board of Directors authorized the repurchase of an aggregate of \$35.0 million of the Company's outstanding common stock and/or convertible senior notes (collectively, "securities"). During 2015, the Company repurchased and retired 1,547,361 shares of its common stock at an aggregate value of \$13.2 million. During 2016, the Company repurchased and retired 1,766,284 shares of its common stock at an aggregate value of \$13.5 million, and also repurchased and retired \$2.0 million principal amount of its 2020 Notes at a cost of \$1.9 million and \$6.1 million principal amount of its 2018 Notes at a cost of \$6.1 million. As of December 31, 2016, the Company completed the repurchase authorization.

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In January 2016, the Company issued an aggregate of 449,120 shares of restricted stock at a value of approximately \$3.6 million to two executive officers, all of which were forfeited because certain company financial performance criteria and market conditions were not met. In addition, an aggregate of 62,710 shares of restricted stock at an aggregate value of approximately \$0.5 million were issued to its five non-employee directors, which vested in January 2017.

In March 2016, the Company issued an aggregate of 134,058 shares of restricted stock at a value of approximately \$0.9 million to an executive officer, all of which were forfeited because certain company financial performance criteria and market conditions were not met.

In October 2016, the Company issued an aggregate of 2,463 shares of restricted stock at a nominal value to a non-employee director, which vested on January 1, 2017.

In January and February 2017, the Company issued an aggregate of 873,787 shares of restricted stock at a value of approximately \$4.5 million to two executive officers, which vest, subject to certain company financial performance criteria and market conditions, over a three year period. In addition, an aggregate of 94,102 shares of restricted stock at an aggregate value of approximately \$0.5 million were issued to its five non-employee directors, which vest in January 2018.

In January and February 2017, the Company issued an aggregate of 2,865,000 shares of its common stock at a value of \$15.1 million to holders of its 2018 convertible senior notes as partial consideration for the exchange at par of \$39.1 million principal amount of such notes.

In March 2017, the Company entered into an agreement to issue 3,660,891 shares of its common stock at an aggregate price of \$19.3 million to a Hong Kong affiliate of its China joint venture partner. After their shareholder and China regulatory approval, the transaction closed on April 27, 2017. Upon the closing, the Company added a representative of Meisheng as a non-employee director and issued 13,319 shares of restricted stock at a value of \$0.1 million, which vest in January 2018.

In June 2017, the Company issued an aggregate of 112,400 shares of its common stock at a value of approximately \$0.4 million to holders of its 2018 convertible senior notes as partial consideration for the exchange at par of \$11.6 million principal amount of such notes.

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.

**Note 10 — Joint Ventures**

The Company owns a fifty percent interest in a joint venture ("Pacific Animation Partners") with the U.S. entertainment subsidiary of a leading Japanese advertising and animation production company. The joint venture was created to develop and produce a boys' animated television show, which it licensed worldwide for television broadcast as well as consumer products. The Company produced toys based upon the television program under a license from the joint venture which also licensed certain other merchandising rights to third parties. The Company is responsible for fifty percent of the operating expenses of the joint venture. The Company's investment is being accounted for using the equity method. The joint venture completed and delivered 65 episodes of the show, which began airing in February 2012, and has since ceased production of the television show. For the three and six months ended June 30, 2017 and 2016, the Company recognized nil and \$0.7 million of income for funds related to operations of the joint venture.

As of June 30, 2017 and December 31, 2016, the balance of the investment in the Pacific Animation Partners joint venture is nil.

For the three and six months ended June 30, 2017 and 2016, respectively, the Company recognized \$0.1 million and \$0.2 million of income for funds received related to a former video game joint venture in partial settlement of amounts owed to the Company when our joint venture partner was liquidated pursuant to their 2012 bankruptcy filing.

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In September 2012, the Company entered into a joint venture (“DreamPlay Toys”) with NantWorks LLC (“NantWorks”) in which it owns a fifty percent interest. Pursuant to the operating agreement of DreamPlay Toys, the Company paid to NantWorks cash in the amount of \$8.0 million and issued NantWorks a warrant to purchase 1.5 million shares of the Company’s common stock at a value of \$7.0 million in exchange for the exclusive right to arrange for the provision of the NantWorks recognition technology platform for toy products. The Company has classified these rights as an intangible asset, which is being amortized over the anticipated revenue stream from the exploitation of these rights. The joint venture entered into a Toy Services Agreement, as amended, with a current expiration date of October 1, 2018, to develop and produce toys utilizing recognition technologies owned by NantWorks. Pursuant to the terms of the amended Toy Services Agreement, NantWorks is entitled to receive a renewal fee of \$0.4 million per year and a preferred return based upon net sales of DreamPlay Toys product sales and third-party license fees. The Company retains the financial risk of the joint venture and is responsible for the day-to-day operations, including development, sales and distribution, for which it is entitled to receive any remaining profit or is responsible for any losses. The results of operations of the joint venture are consolidated with the Company’s results. Sales of DreamPlay Toys products commenced in the third quarter of 2013. The owner of NantWorks beneficially owns more than 10% of the Company’s outstanding common stock, which includes 1.5 million shares underlying out-of-the-money stock warrants.

In addition, in 2012, the Company invested \$7.0 million in cash in exchange for a five percent economic interest in a related entity, DreamPlay LLC, which will exploit the recognition technologies in non-toy consumer product categories. NantWorks has the right to repurchase the Company’s interest for \$7.0 million. The Company has classified this investment as a long term asset on its balance sheet. The Company’s investment is being accounted for using the cost method. As of June 30, 2017, the Company determined the value of this investment will be realized and that no impairment has occurred.

In November 2014, the Company entered into a joint venture with Meisheng Cultural & Creative Corp., Ltd., for the purpose of providing certain JAKKS licensed and non-licensed toys and consumer products to agreed-upon territories of the People’s Republic of China. The joint venture includes a subsidiary in the Shanghai Free Trade Zone that sells, distributes and markets these products, which include dolls, plush, role play products, action figures, costumes, seasonal items, technology and app-enhanced toys, based on top entertainment licenses and JAKKS’ own proprietary brands. The Company owns fifty-one percent of the joint venture and consolidates the joint venture since control rests with the Company. The non-controlling interest’s share of the income from the joint venture for the three months ended June 30, 2017 and 2016 was income of \$55,000 and \$224,000, respectively, and for the six months ended June 30, 2017 and 2016 was income of \$86,000 and \$256,000, respectively.

In October 2016, the Company entered into a joint venture with Hong Kong Meisheng Cultural Company Limited, a Hong Kong-based subsidiary of Meisheng (“HK Meisheng”), for the purpose of creating and developing original, multiplatform content for children including new short-form series and original shows. JAKKS and HK Meisheng each own fifty percent of the joint venture and will jointly own the content. JAKKS will retain merchandising rights for kids’ consumer products in all markets except China, which Meisheng will oversee through the Company’s existing distribution joint venture. During the three and six months ended June 30, 2017, minimal expenses were incurred and the non-controlling interest’s share of the losses from the joint venture for the three and six months ended June 30, 2017 was immaterial. As of April 27, 2017, Hong Kong Meisheng Cultural Company Limited beneficially owns more than 10% of the Company’s outstanding common stock.

**Note 11 — Goodwill**

The changes to the carrying amount of goodwill as of June 30, 2017 are summarized as follows (in thousands):

	<b>Total</b>
Balance, December 31, 2016	\$ 43,208
Adjustments to goodwill for foreign currency translation	267
Balance, June 30, 2017	\$ 43,475

The Company applies a fair value-based impairment test to the carrying 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 the first step indicates that a potential impairment 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. Based on the Company’s April 1 assessment, it determined that the fair values of its reporting units were not less than the carrying amounts. No goodwill impairment was determined to have occurred during the six months ended June 30, 2017.

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**Note 12 — Intangible Assets Other Than Goodwill**

Intangible assets other than goodwill consist primarily of licenses, product lines, customer relationships and trademarks. Amortized intangible assets are included in intangibles in the accompanying balance sheets. Trademarks are disclosed separately in the accompanying balance sheets. Intangible assets as of June 30, 2017 and December 31, 2016 include the following (in thousands, except for weighted useful lives):

	Weighted Useful Lives (Years)	June 30, 2017			December 31, 2016		
		Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets:							
Licenses	5.81	\$ 20,130	\$ (17,833)	\$ 2,297	\$ 20,130	\$ (17,248)	\$ 2,882
Product lines	7.50	50,093	(23,807)	26,286	50,093	(20,634)	29,459
Customer relationships	4.90	3,152	(2,927)	225	3,152	(2,755)	397
Trade names	5.00	3,000	(2,950)	50	3,000	(2,650)	350
Non-compete agreements	5.00	200	(197)	3	200	(177)	23
Total amortized intangible assets		<u>\$ 76,575</u>	<u>\$ (47,714)</u>	<u>\$ 28,861</u>	<u>\$ 76,575</u>	<u>\$ (43,464)</u>	<u>\$ 33,111</u>
Unamortized Intangible Assets:							
Trademarks		<u>\$ 2,608</u>	<u>\$ —</u>	<u>\$ 2,608</u>	<u>\$ 2,608</u>	<u>\$ —</u>	<u>\$ 2,608</u>

**Note 13 — Comprehensive Loss**

The table below presents the components of the Company's comprehensive loss for the three and six months ended June 30, 2017 and 2016 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
<b>Net Loss</b>	\$ (16,687)	\$ (4,145)	\$ (34,972)	\$ (21,528)
Other comprehensive income (loss):				
Foreign currency translation adjustment	1,935	(2,934)	2,466	(3,658)
Comprehensive loss	(14,752)	(7,079)	(32,506)	(25,186)
Less: Comprehensive income attributable to non-controlling interests	55	224	86	256
Comprehensive loss attributable to JAKKS Pacific, Inc.	<u>\$ (14,807)</u>	<u>\$ (7,303)</u>	<u>\$ (32,592)</u>	<u>\$ (25,442)</u>

**Note 14 — Litigation**

The Company is a party to, and certain of its property is the subject of, various pending claims and legal proceedings that routinely arise in the ordinary course of its business, but the Company does not believe that any of these claims or proceedings will have a material effect on its business, financial condition or results of operations.

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**Note 15 — Share-Based Payments**

The Company's 2002 Stock Award and Incentive Plan (the "Plan"), as amended, provides for the awarding of stock options and restricted stock to employees, officers and non-employee directors. Under the Plan, the Company grants directors, certain officers and other key employees restricted common stock, with vesting contingent upon completion of specified service periods ranging from one to five years. The Company also grants certain officers performance-based awards, with vesting contingent upon the Company's achievement of specified financial goals. The Plan is more fully described in Notes 15 and 17 to the Consolidated Financial Statements in the Company's 2016 Annual Report on Form 10-K.

The following table summarizes the total share-based compensation expense and related tax benefits recognized for the three and six months ended June 30, 2017 and 2016 (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Restricted stock compensation expense	\$ 712	\$ 461	\$ 1,460	\$ 1,084
Tax benefit related to restricted stock compensation	—	—	—	—

No stock options were outstanding as of December 31, 2016 and there has been no stock option activity pursuant to the Plan for the six months ended June 30, 2017.

Restricted stock award activity pursuant to the Plan for the six months ended June 30, 2017 is summarized as follows:

	<b>Restricted Stock Awards</b>	
	<b>Number of Shares</b>	<b>Weight Average Grant Fair Value</b>
Outstanding, December 31, 2016	196,453	\$ 7.01
Awarded	981,208	5.15
Released	(67,544)	8.33
Forfeited	(7,715)	5.22
Outstanding, June 30, 2017	<u>1,102,402</u>	<u>5.28</u>

As of June 30, 2017, there was \$3.6 million of total unrecognized compensation cost related to non-vested restricted stock awards, which is expected to be recognized over a weighted-average period of 5.2 years.

The Company granted Restricted Stock Units ("RSUs") to certain non-executive personnel during the first quarter of 2017. RSUs are not treated in the same manner as Restricted Stock Awards ("RSAs") as the Company does not issue the shares until the vest timing. Vesting of RSUs is predicated upon meeting certain criteria related to service, performance and/or market based conditions.

Restricted stock unit activity pursuant to the Plan for the six months ended June 30, 2017 is summarized as follows:

	<b>Restricted Stock Units</b>	
	<b>Number of Shares</b>	<b>Weight Average Grant Fair Value</b>
Outstanding, December 31, 2016	—	\$ —
Awarded	1,001,206	5.15
Released	—	—
Forfeited	(37,864)	5.15
Outstanding, June 30, 2017	<u>963,342</u>	<u>5.15</u>

As of June 30, 2017, there was \$3.9 million of total unrecognized compensation cost related to non-vested restricted stock units, which is expected to be recognized over a weighted-average period of 6.4 years.



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**Note 16 — Subsequent Event**

In August 2017, the Company agreed with Oasis Management and Oasis Investments II Master Fund Ltd., the holder of \$21.6 million face amount of its 4.25% Convertible Senior Notes due in 2018, to extend the maturity date of these notes to November 2020 and reduce the interest rate to 3.25% per annum, among other things. The agreement is subject to the negotiation and conclusion of a definitive agreement for the modification and final approval by the other members of the Company's Board of Directors and Oasis' Investment Committee. After such modification the balance of the face amount of the 2018 Notes will be reduced to approximately \$21.2 million.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read together with our Consolidated Financial Statements and Notes thereto, which appear elsewhere herein.

### Critical Accounting Policies and Estimates

The accompanying consolidated financial statements and supplementary information were prepared in accordance with accounting principles generally accepted in the United States of America. Significant accounting policies are discussed in Note 2 to the Consolidated Financial Statements set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016. Inherent in the application of many of these accounting policies is the need for management to make estimates and judgments in the determination of certain revenues, expenses, assets and liabilities. As such, materially different financial results can occur as circumstances change and additional information becomes known. The policies with the greatest potential effect on our results of operations and financial position include:

**Allowance for Doubtful Accounts.** Our allowance for doubtful accounts is based upon management's assessment of the business environment, customers' financial condition, historical collection experience, accounts receivable aging, customer disputes and the collectability of specific customer accounts. If there were a deterioration of a major customer's creditworthiness, or actual defaults higher than our historical experience, our estimates of the recoverability of amounts due to us could be overstated, which could have an adverse impact on our operating results. Our allowance for doubtful accounts is also affected by the time at which uncollectible accounts receivable balances are actually written off.

Major customers' accounts are monitored on an ongoing basis; more in-depth reviews are performed based upon changes in a customer's financial condition and/or the level of credit being extended. When a significant event occurs, such as a bankruptcy filing by a specific customer, and on a quarterly basis, the allowance is reviewed for adequacy and the balance or accrual rate is adjusted to reflect current risk prospects.

**Revenue Recognition.** Our revenue recognition policy is to recognize revenue when persuasive evidence of an arrangement exists, title transfer has occurred (product shipment), the price is fixed or readily determinable and collectability is probable. Sales are recorded net of sales returns and discounts, which are estimated at the time of shipment based upon historical data. We routinely enter into arrangements with our customers to provide sales incentives and support customer promotions and we provide allowances for returns and defective merchandise. Such programs are primarily based upon customer purchases, customer performance of specified promotional activities and other specified factors such as sales to consumers. Accruals for these programs are recorded as sales adjustments that reduce gross revenue in the period in which the related revenue is recognized.

**Goodwill and other indefinite-lived intangible assets.** Goodwill and indefinite-lived intangible assets are not amortized, but are tested for impairment at least annually at the reporting unit level.

Factors we consider important that could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and
- significant negative industry or economic trends.

Due to the subjective nature of the impairment analysis, significant changes in the assumptions used to develop the estimate could materially affect the conclusion regarding the future cash flows necessary to support the valuation of long-lived assets, including goodwill. The valuation of goodwill involves a high degree of judgment. Based upon the assumptions underlying the valuation, impairment is determined by estimating the fair value of a reporting unit and comparing that value to the reporting unit's book value. If the implied fair value is more than the book value of the reporting unit, an impairment loss is not indicated. If impairment exists, the fair value of the reporting unit is allocated to all of its assets and liabilities excluding goodwill, with the excess amount representing the fair value of goodwill. An impairment loss is measured as the amount by which the book value of the reporting unit's goodwill exceeds the estimated fair value of that goodwill.

Goodwill (net), Trademarks (net) and Intangible assets (net) amounted to \$74.9 million as of June 30, 2017 and \$78.9 million as of December 31, 2016.

**Reserve for Inventory Obsolescence.** We value our inventory at the lower of cost or net realizable value. Based upon a consideration of quantities on hand, actual and projected sales volume, anticipated product selling prices and product lines planned to be discontinued, slow-moving and obsolete inventory is written down to its net realizable value.

Failure to accurately predict and respond to consumer demand could result in us under-producing popular items or over-producing less popular items. Furthermore, significant changes in demand for our products would impact management's estimates in establishing our inventory provision.

Management's estimates are monitored on a quarterly basis, and a further adjustment to reduce inventory to its net realizable value is recorded as an increase to cost of sales when deemed necessary under the lower of cost or net realizable value standard.

**Discrete Items for Income Taxes.** ASU 2016-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. No discrete expense was recorded in the three months ended June 30, 2017 related to this. During the three and six months ended June 30, 2017, a discrete tax benefit of \$115,000 related to return to provision adjustments for foreign jurisdictions and favorable audit settlements were recognized. During the comparable period in 2016, a discrete tax expense of \$127,000 related to the additional tax assessment on the Hong Kong income tax audits for the tax year 2010/2011 was recognized.

**Income taxes and interest and penalties related to income tax payable.** We do not file a consolidated return for our foreign subsidiaries. We file federal and state returns and our foreign subsidiaries each file returns as required. Deferred taxes are provided on an asset and liability method, whereby deferred tax assets are recognized as deductible temporary differences and operating loss and tax credit carry-forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Management employs a threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Tax benefits that are subject to challenge by tax authorities are analyzed and accounted for in the income tax provision.

We accrue a tax reserve for additional income taxes, which may become payable in future years as a result of audit adjustments by tax authorities. The reserve is based upon management's assessment of all relevant information and is periodically reviewed and adjusted as circumstances warrant. As of June 30, 2017 and December 31, 2016, our income tax reserves were approximately \$1.2 million and \$2.3 million, respectively. The \$1.2 million balance primarily relates to the potential tax settlement in Hong Kong and adjustments in the area of withholding taxes. Our income tax reserves are accounted for in income taxes payable.

**Share-Based Compensation.** We grant restricted stock awards to our employees (including officers) and to non-employee directors under our 2002 Stock Award and Incentive Plan (the "Plan"), as amended. The benefits provided under the Plan are share-based payments. We amortize over a requisite service period, the net total deferred restricted stock expense based upon the fair value of the stock on the date of the grants. In certain instances, the service period may differ from the period in which each award will vest. Additionally, certain groups of grants are subject to an expected forfeiture rate calculation.

## New Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers", which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). We are continuing to evaluate the effect that the adoption of this ASU will have on our consolidated financial statements and related disclosures, and have not yet selected a transition method. We are currently evaluating our business and contracts to determine any changes to accounting policies, processes or systems necessary to adopt the requirements of the new standard.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities". The new guidance is intended to improve the recognition and measurement of financial instruments. The ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2017. We are currently assessing the potential impact of this ASU on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Leases”. ASU 2016-02 establishes a right-of-use (“ROU”) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. A modified retrospective transition approach is required for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. We are currently evaluating the impact of the pending adoption of this new standard on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments.” The new guidance is intended to reduce diversity in practice in how transactions are classified in the statement of cash flows. This ASU is effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this standard is not expected to have a material impact on our consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory.” The amendments in this ASU reduces the complexity in the accounting standards by allowing the recognition of current and deferred income taxes for an intra-entity asset transfer, other than inventory, when the transfer occurs. Historically, recognition of the income tax consequence was not recognized until the asset was sold to an outside party. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early adoption is permitted. We are currently evaluating the impact of this ASU on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash”. The update requires that amounts generally described as restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The new standard will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. We early adopted this standard during the second quarter of 2017. Restricted cash is now included as a component of cash, cash equivalents, and restricted cash on our consolidated statements of cash flows. The inclusion of restricted cash increased the ending balance of the consolidated statements of cash flows by \$3.5 million and \$9.9 million for the six months ended June 30, 2017 and 2016, respectively.

In January 2017, the FASB issued ASU 2017-04, “Simplifying the Test for Goodwill Impairment”, which removes Step 2 from the goodwill impairment test. ASU 2017-04 will be effective for interim and annual reporting periods beginning after December 15, 2019. Early application is permitted after January 1, 2017. We are currently evaluating the impact of the adoption of ASU 2017-04 on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting”, which clarifies when to account for a change to the terms or conditions of a share-based payment award as a modification. Under the new guidance, modification accounting is required only if the fair value, vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We are currently evaluating the impact of the adoption of ASU 2017-09 on our consolidated financial statements.

## Results of Operations

The following unaudited table sets forth, for the periods indicated, certain statement of income data as a percentage of net sales.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	71.8	68.2	70.2	67.9
Gross profit	28.2	31.8	29.8	32.1
Selling, general and administrative expenses	40.0	32.6	43.7	38.4
Loss from operations	(11.8)	(0.8)	(13.9)	(6.3)
Income from joint ventures	0.1	0.6	—	0.4
Other income	0.1	—	0.1	—
Interest income	—	—	—	—
Interest expense	(2.1)	(2.2)	(2.6)	(2.7)
Loss before provision for (benefit from) income taxes	(13.7)	(2.4)	(16.4)	(8.6)
Provision for (benefit from) income taxes	0.3	0.5	—	0.5
Net loss	(14.0)	(2.9)	(16.4)	(9.1)
Net income attributable to non-controlling interests	—	0.2	—	0.1
Net loss attributable to JAKKS Pacific, Inc.	(14.0)%	(3.1)%	(16.4)%	(9.2)%

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
<b>Net Sales</b>				
U.S. and Canada	\$ 70,140	\$ 89,737	\$ 141,052	\$ 161,939
International	17,500	19,953	37,442	40,121
Halloween	31,925	31,287	35,576	34,726
	<u>119,565</u>	<u>140,977</u>	<u>214,070</u>	<u>236,786</u>
<b>Cost of Sales</b>				
U.S. and Canada	50,115	58,520	97,742	107,260
International	11,782	13,657	24,390	27,554
Halloween	23,949	24,000	28,198	25,989
	<u>85,846</u>	<u>96,177</u>	<u>150,330</u>	<u>160,803</u>
<b>Gross Profit</b>				
U.S. and Canada	20,025	31,217	43,310	54,679
International	5,718	6,296	13,052	12,567
Halloween	7,976	7,287	7,378	8,737
	<u>\$ 33,719</u>	<u>\$ 44,800</u>	<u>\$ 63,740</u>	<u>\$ 75,983</u>

**Comparison of the Three Months Ended June 30, 2017 and 2016**

Net Sales

*U.S. and Canada.* Net sales of our U.S. and Canada segment were \$70.1 million for the three months ended June 30, 2017 compared to \$89.7 million for the prior year period, representing a decrease of \$19.6 million, or 21.9%. The decrease in net sales was primarily due to a decrease in unit sales of our Disney Tsum Tsum line of collectibles, Disney Frozen line of toddler dolls, XPV line of radio controlled vehicles, and our seasonal products, partially offset by an increase in unit sales of Beauty and the Beast and Moana products, which were not sold in the prior year period.

*International.* Net sales of our International segment were \$17.5 million for the three months ended June 30, 2017 compared to \$20.0 million for the prior year period, representing a decrease of \$2.5 million, or 12.5%. The decrease in net sales was primarily driven by declines in unit sales of our Disney Frozen line of toddler dolls, Sofia the First, Star Wars, and Warcraft products, partially offset by an increase in unit sales of Beauty and the Beast, Moana, and Elena of Avalor products, which were not sold in the prior year period.

*Halloween.* Net sales of our Halloween segment were \$31.9 million for the three months ended June 30, 2017 compared to \$31.3 million for the prior year period, representing an increase of \$0.6 million, or 1.9%. The increase in net sales was primarily driven by a shift in product mix to higher priced products.

Cost of Sales

*U.S. and Canada.* Cost of sales of our U.S. and Canada segment was \$50.1 million, or 71.5% of related net sales for the three months ended June 30, 2017 compared to \$58.5 million, or 65.2% of related net sales for the prior year period, representing a decrease of \$8.4 million, or 14.4%. The decrease in dollars is due to lower overall unit sales in 2017. The increase as a percentage of net sales, year over year, is primarily due to a higher average royalty rate resulting from a shift in product mix as well as an increase in depreciation of molds and tools.

*International.* Cost of sales of our International segment was \$11.8 million, or 67.4% of related net sales for the three months ended June 30, 2017 compared to \$13.7 million, or 68.5% of related net sales for the prior year period, representing a decrease of \$1.9 million, or 13.9%. The decrease in dollars is due to lower overall unit sales in 2017. The decrease as a percentage of net sales, year-over-year, is primarily due to a shift in product mix.

*Halloween.* Cost of sales of our Halloween segment was \$23.9 million, or 74.9% of related net sales for the three months ended June 30, 2017 compared to \$24.0 million, or 76.7% of related net sales for the prior year period, representing a decrease of \$0.1 million, or 0.4%. The decrease in dollars is due to lower overall unit sales in 2017. The decrease as a percentage of net sales, year-over-year, is primarily due to a shift in product mix to lower margin products.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$47.8 million for the three months ended June 30, 2017 compared to \$45.9 million for the prior year period constituting 40.0% and 32.6% of net sales, respectively. Selling, general and administrative expenses increased by \$1.9 million from the prior year period primarily due to a non-cash bad debt charge of \$2.3 million in 2017.

#### Income from joint ventures

We recognized \$0.1 million of income for funds received in the three months ended in June 30, 2017 related to our former video game joint venture in partial settlement of amounts owed to the Company when our joint venture partner was liquidated pursuant to their 2012 bankruptcy filing. It is not known if any additional funds will be received by us. We recognized \$0.7 million of income for funds received in the three months ended June 30, 2016 related to Pacific Animation Partners and \$0.2 million of income for funds received in the three months ended June 30, 2016 related to our former video game joint venture in partial settlement of amounts owed to the Company when our joint venture partner was liquidated pursuant to their 2012 bankruptcy filing.

#### Interest Expense

Interest expense was \$2.5 million in the three months ended June 30, 2017, as compared to \$3.2 million in the prior year period. In the three months ended June 30, 2017, we booked interest expense of \$2.5 million related to our convertible senior notes payable due in 2018 and 2020. In the three months ended June 30, 2016, we booked interest expense of \$2.9 million related to our convertible senior notes payable due in 2018 and 2020 and \$0.3 million related to our revolving credit facility. The decrease in 2017 is the result of lower average debt balances in 2017 due to debt repurchases and retirements in 2017 and 2016.

#### Provision for Income Taxes

Our income tax expense, which includes federal, state and foreign income taxes and discrete items, was \$0.3 million, or an effective tax rate of (1.9)%, for the three months ended June 30, 2017. During the comparable period in 2016, our income tax expense was \$0.7 million, or an effective tax rate of (20.5%).

### **Comparison of the Six Months Ended June 30, 2017 and 2016**

#### Net Sales

*U.S. and Canada.* Net sales of our U.S. and Canada segment were \$141.1 million for the six months ended June 30, 2017 compared to \$161.9 million for the prior year period, representing a decrease of \$20.8 million, or 12.8%. The decrease in net sales was primarily due to a decrease in unit sales of our Disney Tsum Tsum line of collectibles, Disney Frozen line of toddler dolls, XPV line of radio controlled vehicles, and our seasonal products, partially offset by an increase in unit sales of Beauty and the Beast and Moana products, which were not sold in the prior year period.

*International.* Net sales of our International segment were \$37.4 million for the six months ended June 30, 2017 compared to \$40.1 million for the prior year period, representing a decrease of \$2.7 million, or 6.7%. The decrease in net sales was primarily driven by declines in unit sales of our Disney Frozen line of toddler dolls and Star Wars products, partially offset by an increase in unit sales of Smurfs<sup>TM</sup>, Beauty and the Beast, and Moana products, which were not sold in the prior year period.

*Halloween.* Net sales of our Halloween segment were \$35.6 million for the six months ended June 30, 2017 compared to \$34.7 million for the prior year period, representing an increase of \$0.9 million, or 2.6%. The increase in net sales was driven by shift in product mix to higher priced products.

#### Cost of Sales

*U.S. and Canada.* Cost of sales of our U.S. and Canada segment was \$97.7 million, or 69.2% of related net sales for the six months ended June 30, 2017 compared to \$107.3 million, or 66.3% of related net sales for the prior year period, representing a decrease of \$9.6 million, or 8.9%. The decrease in dollars is due to lower overall unit sales in 2017. The increase as a percentage of net sales, year-over-year, is primarily due to a shift in product mix and an increase in depreciation of molds and tools.

*International.* Cost of sales of our International segment was \$24.4 million, or 65.2% of related net sales for the six months ended June 30, 2017 compared to \$27.6 million, or 68.8% of related net sales for the prior year period, representing a decrease of \$3.2 million, or 11.6%. The decrease in dollars is due to lower overall unit sales in 2017. The decrease as a percentage of net sales, year-over-year, is due to a shift in product mix.

*Halloween.* Cost of sales of our Halloween segment was \$28.2 million, or 79.2% of related net sales for the six months ended June 30, 2017 compared to \$26.0 million, or 74.9% of related net sales for the prior year period, representing an increase of \$2.2 million, or 8.5%. The increase in dollars is due to higher overall unit sales in 2017. The increase as a percentage of net sales, year-over-year, is due to the lower net sales due to increased customer allowances and a shift in product mix.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$93.6 million for the six months ended June 30, 2017 compared to \$90.9 million for the prior year period constituting 43.7% and 38.4% of net sales, respectively. Selling, general and administrative expenses increased by \$2.7 million from the prior year period primarily due to a non-cash bad debt charge of \$2.3 million in 2017, incremental overhead related to our C'est Moi youth makeup and skincare product line, and our Studio JP animation initiative.

#### Income from joint ventures

We recognized \$0.1 million of income for funds received in the six months ended in June 30, 2017 related to our former video game joint venture in partial settlement of amounts owed to the Company when our joint venture partner was liquidated pursuant to their 2012 bankruptcy filing. It is not known if any additional funds will be received by us. We recognized \$0.7 million of income for funds received in the six months ended June 30, 2016 related to Pacific Animation Partners and \$0.2 million of income for funds received in the six months ended June 30, 2016 related to our former video game joint venture in partial settlement of amounts owed to the Company when our joint venture partner was liquidated pursuant to their 2012 bankruptcy filing.

#### Interest Expense

Interest expense was \$5.5 million in the six months ended June 30, 2017, as compared to \$6.4 million in the prior year period. In the six months ended June 30, 2017, we booked interest expense of \$5.3 million related to our convertible senior notes payable due in 2018 and 2020 and \$0.2 million related to our revolving credit facility. In the six months ended June 30, 2016, we booked interest expense of \$6.0 million related to our convertible senior notes payable due in 2018 and 2020 and \$0.4 million related to our revolving credit facility. The decrease in 2017 is the result of lower average debt balances in 2017 due to debt repurchases and retirements in 2017 and 2016.

#### Provision for (Benefit From) Income Taxes

Our income tax benefit, which includes federal, state and foreign income taxes and discrete items, was \$27,603, or an effective tax rate of 0.1%, for the six months ended June 30, 2017. During the comparable period in 2016, our income tax expense was \$1.1 million, or an effective tax rate of (5.6%).

#### Seasonality and Backlog

The retail toy industry is inherently seasonal. Generally, our sales have been highest during the third and fourth quarters, and collections for those sales have been highest during the succeeding fourth and first quarters. Our working capital needs have been highest during the third and fourth quarters.

While we have taken steps to level sales over the entire year, sales are expected to remain heavily influenced by the seasonality of our toy and Halloween products. The result of these seasonal patterns is that operating results and the demand for working capital may vary significantly by quarter. Orders placed with us are generally cancelable until the date of shipment. The combination of seasonal demand and the potential for order cancellation makes accurate forecasting of future sales difficult and causes us to believe that backlog may not be an accurate indicator of our future sales. Similarly, financial results for a particular quarter may not be indicative of results for the entire year.

#### Liquidity and Capital Resources

As of June 30, 2017, we had working capital of \$191.0 million, compared to \$236.6 million as of December 31, 2016. The decrease was primarily attributable to the exchange and retirement of convertible senior notes, the net loss and lower accounts receivable, partially offset by proceeds from the issuance of common stock to a Hong Kong affiliate of our China joint venture partner during the second quarter of 2017, an increase in prepaid expenses and repayment of credit facility borrowings.

Operating activities provided net cash of \$13.2 million in the six months ended June 30, 2017, as compared to providing net cash of \$18.7 million in the prior year period. Net cash was primarily impacted by a decrease in accounts receivable, partially offset by an increase in prepaid expenses. Our accounts receivable turnover as measured by days sales for the quarter outstanding in accounts receivable was 84 days as of June 30, 2017, compared to 86 days as of June 30, 2016. Other than open purchase orders issued in the normal course of business, we have no obligations to purchase finished goods from our manufacturers. As of June 30, 2017, we had cash and cash equivalents of \$64.1 million and restricted cash of \$3.5 million.

Our investing activities used net cash of \$7.6 million in the six months ended June 30, 2017, as compared to using net cash of \$6.1 million in the prior year period, consisting of cash paid for the purchase of molds and tooling used in the manufacture of our products. As part of our strategy to develop and market new products, we have entered into various character and product licenses with royalties generally ranging from 1% to 20% payable on net sales of such products. As of June 30, 2017, these agreements required future aggregate minimum guarantees of \$69.6 million, exclusive of \$26.2 million in advances already paid. Of this \$69.6 million future minimum guarantee, \$46.3 million is due over the next twelve months.

Our financing activities used net cash of \$26.3 million in the six months ended June 30, 2017, as compared to using net cash of \$15.4 million in the prior year period, primarily consisting of the cash portion of \$35.6 million in the exchange of \$51.1 million principal amount of our 2018 convertible senior notes, partially offset by the issuance of approximately 3.7 million shares of common stock for cash in the amount of \$19.3 million.

In March 2014, we and our domestic subsidiaries entered into a secured credit facility with General Electric Capital Corporation (“GECC”). The loan agreement, as amended and assigned to Wells Fargo Bank, N.A. pursuant to its acquisition of GECC (the “WF Loan Agreement”), provides for a \$75.0 million revolving credit facility subject to availability based on prescribed advance rates on certain accounts receivable and inventory. The amounts outstanding under the WF Loan Agreement are payable in full upon maturity of the credit facility on March 27, 2019, and the credit facility is secured by a security interest in favor of the lender covering a substantial amount of the assets of the Company. As of June 30, 2017, the amount of outstanding borrowings was nil and outstanding stand-by letters of credit totaled \$28.2 million which exceeded the borrowing base availability under the credit line by \$3.5 million and was funded by the Company resulting in restricted cash of \$3.5 million. Such funds will become unrestricted when and as the excess borrowing capacity under the credit line becomes positive.

In July 2013, we sold an aggregate of \$100.0 million principal amount of 4.25% Convertible Senior Notes due 2018 (the “2018 Notes”). The 2018 Notes are senior unsecured obligations of the Company paying interest semi-annually in arrears on August 1 and February 1 of each year at a rate of 4.25% per annum and will mature on August 1, 2018. The initial and still current conversion rate for the 2018 Notes is 114.3674 shares of our common stock per \$1,000 principal amount of notes, equivalent to an initial conversion price of approximately \$8.74 per share of common stock, subject to adjustment in certain events. Upon conversion, the 2018 Notes will be settled in shares of the Company’s common stock. Holders of the 2018 Notes may require us to repurchase for cash all or some of their notes upon the occurrence of a fundamental change (as defined in the 2018 Notes). We used \$61.0 million of the approximate \$96.0 million in net proceeds from the offering to repurchase at par and retire \$61.0 million principal amount of then outstanding. In 2016, the Company repurchased and retired an aggregate of approximately \$6.1 million principal amount of the 2018 Notes. During the first quarter of 2017, the Company exchanged at par and retired \$39.1 million principal amount of the 2018 Notes for \$24.1 million in cash and approximately 2.9 million shares of its common stock. During the second quarter of 2017, the Company exchanged and retired \$12.0 million principal amount of the 2018 Notes at par for \$11.6 million in cash and 112,400 shares of its common stock.

In June 2014, the Company sold an aggregate of \$115.0 million principal amount of 4.875% Convertible Senior Notes due 2020 (the “2020 Notes”). The 2020 Notes are senior unsecured obligations of the Company paying interest semi-annually in arrears on June 1 and December 1 of each year at a rate of 4.875% per annum and will mature on June 1, 2020. The initial and still current conversion rate for the 2020 Notes is 103.7613 shares of our common stock per \$1,000 principal amount of notes, equivalent to an initial conversion price of approximately \$9.64 per share of common stock, subject to adjustment in certain events. Upon conversion, the 2020 Notes will be settled in shares of the Company’s common stock. Holders of the 2020 Notes may require us to repurchase for cash all or some of their notes upon the occurrence of a fundamental change (as defined in the 2020 Notes). The Company received net proceeds of approximately \$110.4 million from the offering of which \$24.0 million was used to repurchase 3.1 million shares of the Company’s common stock under a prepaid forward purchase contract and \$39.0 million was used to redeem the remaining principal amount of then outstanding notes. In 2016, the Company repurchased and retired \$2.0 million principal amount of the 2020 Notes.

We believe that our cash flows from operations, cash and cash equivalents on hand and the availability under our credit facility will be sufficient to meet our working capital and capital expenditure requirements and provide us with adequate liquidity to meet our anticipated operating needs for at least the next 12 months. Although operating activities are expected to provide cash, to the extent we grow significantly in the future and due to the seasonality of our business, our operating and investing activities may use cash and, consequently, this growth may require us to obtain additional sources of financing. There can be no assurance that any necessary additional financing will be available to us on commercially reasonable terms, if at all. As of June 30, 2017 and December 31, 2016, we held cash and short term investments held by our foreign subsidiaries of \$60.9 million and \$72.2 million, respectively. Although a significant portion of our cash is held by our foreign subsidiaries off-shore, we intend to finance our long-term liquidity requirements out of net cash provided by operations and net cash and cash equivalents and availability under our credit facility. As of June 30, 2017, we do not have any off-balance sheet arrangements.



### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

#### **Interest Rate Risk**

We issued \$100.0 million principal amount of convertible senior notes with a fixed interest rate of 4.25% per annum in July 2013 and \$115.0 million principal amount of convertible senior notes with a fixed interest rate of 4.875% per annum in June 2014, of which \$42.7 million and \$113.0 million, respectively, remain outstanding as of June 30, 2017. Accordingly, we are not generally subject to any direct risk of loss arising from changes in interest rates on these issuances.

Our exposure to market risk includes interest rate fluctuations in connection with our revolving credit facility (see Note 5 - Credit Facility in the accompanying notes to the consolidated financial statements for additional information). Borrowings under the credit facility bear interest at a variable rate based on Prime Lending Rate or LIBOR Rate at the option of the Company. For Prime Lending Rate loans, the interest rate is equal to the highest of (i) the Federal Funds Rate plus a margin of 0.50%, (ii) the rate last quoted by The Wall Street Journal as the "Prime Rate," or (iii) the sum of a LIBOR rate plus 1.00%, plus a margin of 2.25%. For LIBOR rate loans, the interest rate is equal to a LIBOR rate plus a margin of 2.25%. Borrowings under the credit facility are therefore subject to risk based upon prevailing market interest rates. Interest rate risk may result from many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors that are beyond our control. During the six months ended June 30, 2017, the maximum amount borrowed under the facility was \$20.0 million and the average amount of borrowings outstanding was \$7.7 million. As of June 30, 2017, the amount of total borrowings outstanding was nil. If the prevailing market interest rates relative to these borrowings increased by 10%, our interest expense during the period ended June 30, 2017 would have increased by less than \$0.1 million.

#### **Foreign Currency Risk**

We have wholly-owned subsidiaries in Hong Kong, China, the United Kingdom, Germany, France, Spain, Canada and Mexico. Sales are generally made by these operations on FOB China or Hong Kong terms and are denominated in U.S. dollars. However, purchases of inventory and Hong Kong operating expenses are typically denominated in Hong Kong dollars and local operating expenses in the United Kingdom, Germany, France, Spain, Canada, Mexico and China are denominated in local currency, thereby creating exposure to changes in exchange rates. Changes in the U.S. dollar exchange rates may positively or negatively affect our gross margins, operating income and retained earnings. The exchange rate of the Hong Kong dollar to the U.S. dollar has been fixed by the Hong Kong government since 1983 at HK\$7.80 to US\$1.00 and, accordingly, has not represented a currency exchange risk to the U.S. dollar. We do not believe that near-term changes in these exchange rates, if any, will result in a material effect on our future earnings, fair values or cash flows. Therefore, we have chosen not to enter into foreign currency hedging transactions. We cannot assure you that this approach will be successful, especially in the event of a significant and sudden change in the value of these foreign currencies.

### **Item 4. Controls and Procedures**

Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Report, have concluded that as of that date, our disclosure controls and procedures were effective. There has been no change in our internal control over financial reporting identified in connection with the evaluation required by Exchange Act Rule 13a-15(d) that occurred during the period covered by this Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

We are a party to, and certain of our property is the subject of, various pending claims and legal proceedings that routinely arise in the ordinary course of our business, but we do not believe that any of these claims or proceedings will have a material effect on our business, financial condition or results of operations.

### Item 1A. Risk Factors

There have been no material changes to the risk factors disclosed under Part I, Item 1A “Risk Factors” in the Company’s 2016 Annual Report on Form 10-K.

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

#### Issuer Purchases of Equity Securities

During the second quarter of 2017, the Company did not purchase any of its common stock.

#### Issuer Unregistered Sale of Equity Securities

During the second quarter of 2017, the Company issued 3,660,891 unregistered shares of its common stock at an aggregate price of \$19.3 million to a Hong Kong affiliate of its China joint venture partner.

### Item 6. Exhibits

<u>Number</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation of the Company (1)
3.2	Amended and Restated By-Laws of the Company (2)
4.1	Indenture dated July 24, 2013 by and between the Registrant and Wells Fargo Bank, N.A (3)
4.2	Form of 4.25% Senior Convertible Note (3)
4.3	Credit Agreement dated as of March 27, 2014 by and among Registrant and its US wholly-owned subsidiaries and General Electric Capital Corporation (4)
4.4	Revolving Loan Note dated March 27, 2014 by Registrant and its US wholly-owned subsidiaries in favor of General Electric Capital Corporation (4)
4.5	Indenture dated June 9, 2014 by and between the Registrant and Wells Fargo Bank, N.A (5)
4.6	Form of 4.875% Senior Convertible Note (5)
4.7	Fourth Amendment to Credit Agreement dated as of June 5, 2015 among Registrant and its US wholly-owned subsidiaries and General Electric Capital Corporation (6)
10.1	Equity Purchase Agreement dated as of March 15, 2017 between Registrant and Hong Kong Meisheng Cultural Company Limited. (7)
10.2	Registration Rights Agreement dated as of April 27, 2017 between Registrant and Hong Kong Meisheng Cultural Company Limited. (7)
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer (8)
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer (8)
32.1	Section 1350 Certification of Chief Executive Officer (8)
32.2	Section 1350 Certification of Chief Financial Officer (8)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Filed previously as Appendix 2 to the Company's Schedule 14A Proxy Statement filed August 23, 2002 and incorporated herein by reference.
  - (2) Filed previously as an exhibit to the Company's Current Report on Form 8-K filed October 21, 2011 and incorporated herein by reference.
  - (3) Filed previously as an exhibit to the Company's Current Report on Form 8-K filed July 24, 2013 and incorporated herein by reference.
  - (4) Filed previously as an exhibit to the Company's Current Report on Form 8-K filed April 2, 2014 and incorporated herein by reference.
  - (5) Filed previously as an exhibit to the Company's Current Report on Form 8-K filed June 9, 2014 and incorporated herein by reference.
  - (6) Filed previously as an exhibit to the Company's Current Report on Form 8-K filed June 16, 2015 and incorporated herein by reference.
  - (7) Filed previously as an exhibit to the Company's Current Report on Form 8-K filed March 16, 2017 and incorporated herein by reference.
  - (8) Filed herewith.
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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

JAKKS PACIFIC, INC.

Date: August 9, 2017

By:           /s/ JOEL M. BENNETT            
Joel M. Bennett  
Executive Vice President and Chief Financial Officer  
(Duly Authorized Officer and Principal Financial  
Officer)

**Item 6. Exhibits**

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- (7) Filed previously as an exhibit to the Company's Current Report on Form 8-K filed March 16, 2017 and incorporated herein by reference.
- (8) Filed herewith.
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**CERTIFICATIONS**

I, Stephen G. Berman, Chief Executive Officer, certify that:

I have reviewed this quarterly report on Form 10-Q of JAKKS Pacific, Inc. (“Company”);

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this quarterly report;

The Company’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and

d) disclosed in this quarterly report any change in the Company’s internal control over financial reporting that occurred during the Company’s most recent fiscal quarter (the Company’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and

The Company’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the Audit Committee of the Company’s board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

By: \_\_\_\_\_  
 /s/ Stephen G. Berman  
 Stephen G. Berman  
 Chief Executive Officer

Date: August 9, 2017

**CERTIFICATIONS**

I, Joel M. Bennett, Chief Financial Officer, certify that:

I have reviewed this quarterly report on Form 10-Q of JAKKS Pacific, Inc. ("Company");

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this quarterly report;

The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and

d) disclosed in this quarterly report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and

The Company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the Audit Committee of the Company's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

By: \_\_\_\_\_  
 /s/ Joel M. Bennett  
 Joel M. Bennett  
 Chief Financial Officer

Date: August 9, 2017

## Written Statement of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. Section 1350, the undersigned officer of JAKKS Pacific, Inc. (“Registrant”) hereby certifies that the Registrant’s Quarterly Report on Form 10-Q for the three months ended June 30, 2017 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Stephen G. Berman

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Stephen G. Berman  
*Chief Executive Officer*

Date: August 9, 2017



## Written Statement of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

Pursuant to 18 U.S.C. Section 1350, the undersigned officer of JAKKS Pacific, Inc. (“Registrant”) hereby certifies that the Registrant’s Quarterly Report on Form 10-Q for the three months ended June 30, 2017 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Joel M. Bennett

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Joel M. Bennett  
*Chief Financial Officer*

Date: August 9, 2017