playing all year round

JAKKS Pacific inc.®

annual report **2002**

Playing All Year Round

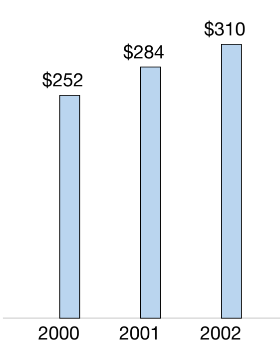
j f m a m j j a s o n d

JAKKS Pacific, Inc. is a multi-brand toy company that, since 1995, has been designing, developing, producing and marketing toys and related products that help children learn and have fun through play.

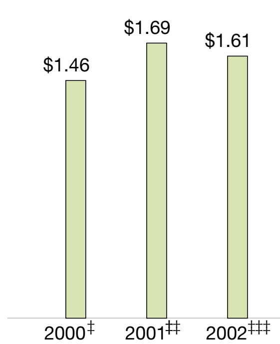
The Company has become the fourth largest U.S. player in the toys and leisure products sector through product development, licensing agreements and strategic acquisitions. We believe our growth strategy is unique and built upon a concerted effort to spread earnings across all four quarters. We have accomplished that by expanding and "counter-seasonalizing" our product lines; adding new retail outlets; and leveraging our product development and merchandising expertise on products with staying power.

We market our lines under various brand names, including Flying Colors®, Road Champs®, Remco®, Child Guidance®, Pentech®, Trendmasters®, Toymax®, Funnoodle® and Go Fly A Kite® and in multiple product categories, including Action Figures, Arts & Crafts Activity Kits, Stationery, Writing Instruments, Performance Kites, Water Toys, Sports Activity Toys, Vehicles, Infant/Pre-School, Plush and Dolls. The Company also participates in a joint venture with THQ Inc. that has exclusive worldwide rights to publish and market World Wrestling Entertainment™ video games.

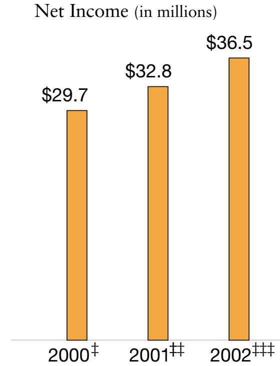
Net Sales (in millions)



EPS (in dollars)



Net Income (in millions)



‡ Excludes one-time charges of $0.9 million in connection with the restructuring of Flying Colors Toys, Inc. and $0.6 million in connection with the recall of one of our products.
‡‡ Excludes one-time charges of $5 million in connection with Kmart's bankruptcy filing and $1.2 million in connection with the restructuring of Pentech International, Inc.
‡‡‡ Excludes one-time charges of $4.5 million in connection with the restructuring of Toymax International, Inc. and $2.2 million in connection with the recall of one of our products.

To Our Stockholders:

In eight short years, JAKKS Pacific, Inc. has grown from a small, traditional toy company into the fourth largest U.S. player in our $31 billion industry. We realized this accomplishment by adhering to our visionary and strategic business plan and by leveraging the valuable lessons we have learned along the way.

As evidence of our abilities in both regards, we continued to grow in 2002. In the most challenging economic and retail environments in recent history, we extended our run of 27 quarters of year-over-year top-line growth. We improved our net sales and net income in 2002 (see graphs opposite), and we now have enjoyed a compounded annual growth rate of 75 percent over the past seven years. In comparison to our peer group, and the U.S. markets overall, we are proud of our performance in 2002, and our ability to weather the ups and downs of our industry.

This performance is also evident in the financial strength of our Company. At fiscal year-end, we reported $129.2 million in working capital, including $68.4 million in cash, and approximately $360.6 million in stockholders' equity. We are confident that our financial position will bolster our ability to execute our strategic plan even in challenging times.

In June 2003, we consummated a private offering of our Convertible Senior Notes, which provided us net proceeds of $94 million to allow us to continue to implement our growth strategies.

Traditionally, the third quarter, as we ready for the fourth quarter holiday season, is the most robust quarter in the toy industry. While the third quarter remains a strong quarter for us, we have successfully avoided the marked fluctuations of seasonality by diversifying our revenue stream across all quarters. This has been our stated goal since our inception. In 1995, third quarter revenues accounted for 48 percent of our total sales. In 2002, they represented 32 percent. We credit this shift to the core tenets of our business plan. Namely, we have grown the Company through acquisitions with complementary and evergreen product lines, as well as those with product lines that further diversified our portfolio of product offerings. We have strengthened our design teams across all brands and have cultivated strategic relationships with multiple third-party factories, which create efficiencies in our manufacturing process. We have identified and accessed larger distribution channels, and we have secured evergreen licenses that have increased both our sales and our profile within the toy industry.

By making JAKKS a player for all seasons, we have built the financial strength that enables us to further diversify our business.

Among our accomplishments in 2002 were two accretive additions to our Company. In October, we completed our purchase of Toymax International, Inc., a top industry competitor, adding recognized brands and product lines to our portfolio, including Go Fly A Kite®, Funnoodle®, Laser Challenge™, Creepy Crawlers®, TV Games™, karaoke machines and radio-controlled vehicles, among others. Following Toymax, we acquired the assets of Trendmasters in December. Among the privately held company's brands were The Storm™ brand of water guns, gliders and junior sports toys. We also acquired Trendmasters' seasonal products for Halloween, Christmas and Easter.

Possibly as important to us as the acquired assets is the added shelf space they give us for our existing and increasingly diversified product lines. For example, we are marketing our Nickelodeon Gak Splat™ junior sports line of outdoor products alongside The Storm™ water guns in stores nationwide, and selling Trendmasters seasonal items with our Flying Colors/Pentech office supplies in crafts specialty stores.

We further enhanced our portfolio of brands in 2002 with internal development projects as well. One example is our recognition of the growing popularity of the dissolvable, breath-freshening mint strips that took the adult market by storm. We seized the opportunity to create a more appropriate version for kids and, in January 2003, launched our breakthrough and proprietary Tongue Tape™. The product not only garners us presence in a burgeoning candy category but also positions JAKKS Pacific as the "first-to-market" pioneer in creating candy-flavored tongue strips marketed to kids. We believe we'll enjoy nice returns on our investment.

A key benefit of our growing reputation and profile has been our ability to secure important licenses. In December 2002 and February 2003, we were awarded three-year Master Toy Licenses for the Dragon Ball® franchise and Yu Yu Hakusho™—two top animé properties.

Under the agreement with FUNimation Products, Ltd., we are developing, manufacturing and distributing action figures, action figure accessories and vehicles based on the top Japanese animé franchise. These products join JAKKS' boys action division, where we anticipate our finely tuned design and merchandising experts will infuse new energy and innovations to maximize the potential for both lines.

Through our acquisitions and internal product development, JAKKS Pacific now offers more than 4,000 SKUs and our most robust and diversified product portfolio ever. With every acquisition, we use our industry experience to recognize the strong drivers for each brand and product category. We use our resources to strengthen the product lines through more effective branding, increased use of innovation and improved manufacturing capabilities. This know-how enables us to recognize and eliminate redundant or poor performers among the acquired lines.

Lastly, we are pleased to report that our international expansion also is proceeding as planned. In 2002 this segment increased 33 percent to represent $53.2 million or 17.2 percent of total net sales, and we anticipate continued growth in this initiative in the coming year.

Just a few short but exciting years after our initial launch in the U.S. toy market, we have made our mark both domestically and globally. We believe this proves that we are a sound company that is here to stay. We have become diversified by design, while being careful to remain focused. We take pride in producing toys and aligning ourselves with brands that have staying power. We continually enrich our product mix and targeted niches so no one product or season bears the burden of carrying any given quarter, and we take pride in working closely with retailers to ensure their continued support and partnership.

We are proud of what we have built and look forward to growing our company as we always have—through a proven business strategy that has spurred steady growth over the past eight years and solidified our standing as a year-round player in the children's toys and leisure products industry. Through all this, we continue to stay connected to our most important customer—children. We believe that there are no limits to the potential we can reach, just as there are no limits to a child's imagination—because that is what inspires us.

A tradition of innovation, a commitment to customers and a dedication to growing our business—it is not just our purpose, it is our passion. For the accomplishments of the past year and for our future opportunities, we thank all of our employees, partners, vendors and stockholders for your continued contributions and support.

Sincerely,

Stephen G. Berman
President and COO

Jack Friedman
Chairman and CEO

Spring

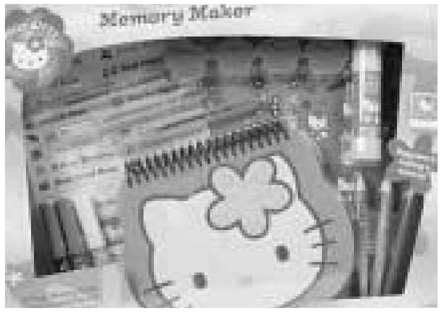
Cultivating Healthy, Sustainable Growth

From our initial start as a U.S. traditional children's toy company, JAKKS Pacific has grown into a diversified toy, writing instrument and leisure products force serving children and adults around the world. We imagine our growth resembling the progress of a seedling—a single twig that has blossomed into a strong, multi-branched oak.

Just as a tree has a predictable growth pattern, we have expanded our Company in calculated and manageable increments. To date, we have completed eleven acquisitions, each strategically selected to add capabilities, products, distribution channels, manufacturing capacities and/or revenues.

As an example, our 1999 acquisition of Flying Colors Toys® gave us seasoned employees who have made significant contributions to every department across the board. With the addition of Flying Colors, JAKKS became a leader in craft and activity toys—a brand new category for us and one that promised entrée into mature markets without the startup costs or risks associated with tackling a new sector from scratch.

It's Spring—a perfect time for golf with Goofy.



Following Flying Colors, we acquired Pentech®, a writing instruments company with nice synergies to the crafts market. In fact, by using pens from Pentech in the Flying Colors craft kits, we became our own supplier for our crafts business. As a result, we have saved on sourcing and development costs while delivering a higher quality product.

Both acquisitions gave us marked diversification, introduced us into significant new distribution channels and, we believe, positioned us securely in the back-to-school market.

Because we record sales when we ship to our customers, September school products boost our second quarter earnings—and help offset the toy industry's norm of predominantly third-quarter revenues. We were rewarded for our foresight and planning with a division that currently contributes 42 percent of total revenue, a division that we believe is always at the forefront of the craft and activity and writing instrument categories with an expansive source of innovative product lines.

Our subsequent acquisitions of Toymax®, a strong competitor, and Trendmasters®, another competitor with complementary and accretive products, afforded similar advantages. Specifically, they helped us truly round out our seasonal offerings with their strong outdoor lines, including Go Fly A Kite®, Funnoodle® and The Storm™ water guns, gliders and sports balls. We also gained footing in the electronics category with Singing Starz™ Video Karaoke Machine, the TV Games line of plug-and-play games, laser tag toys and radio-controlled cars.

We continue to look for potential acquisitions, keeping a keen eye on ways to expand our portfolio and market segments, strengthen our core competencies, offer cost efficiencies we could not implement as smoothly on our own or open up new avenues for profits. With a strong balance sheet and a recent infusion of over $94 million from our June 2003 Convertible Note Offering, we believe we are well-positioned to achieve our goal of $1 billion in sales in the next five years—a goal we believe we can reach through acquisitions and internal growth.

We are proud to feature children of JAKKS Pacific employees playing with our toys, writing instruments and leisure products throughout the seasons.

Products featured in the Spring section: WWE™ figure, Road Champs RXS® truck, Nick-tivities Gak Splat™ Racquet, Disney Jr. Sports Goofy Golf set, Dragon Ball Z® figure, Hello Kitty® Memory Maker, Nick-tivities SplatterDome™ and Switch 'Em Up SpongeBob SquarePants™.

Summer

Growing in New Directions with Revolutionary Ideas

If you believe a kid is a kid is a kid, you haven't been around one lately. Kids today are growing up in highly stimulated environments. They're smart and clever and always looking for the next new thing. At JAKKS, we realize that children will always enjoy a doll, an action figure or a ball. We also recognize that we need to take those toys to a new level to truly engage today's youth.

That's why our sports balls are sticky, squishy and fun in durable new materials. It explains why our action figures have skin and limbs that feel real and our marker pens feature not only bright ink, but sparkles as well. These are but a few simple examples of how, throughout JAKKS, our employees are charged with maximizing our offerings—of making sure the long-lasting drivers of our portfolio continue to captivate the most challenging consumers in the world: children.

Nothing is more fun on a hot summer day than a dip in the pool with some Funnoodles®.

We're up to the task. We believe we've assembled the most creative, energetic, innovative and just plain fun teams of designers, merchandisers and brand managers in any industry.

Thanks to our acquisition history, our staff can incorporate features from other lines that make sense and exploit a wealth of knowledge and resources from within. Perhaps most important among our assets is our employees' ability to see and use synergies among divisions. As we grow, we are careful to take advantage of our acquired resources and experienced designers to enhance product lines, while striving to maximize our manufacturing capabilities to enhance products while keeping costs down.

For example, we've seen great, sustained success with our Flying Colors reusable compound Nickelodeon Goooze®. The slimy compound has been marketed in numerous formulations, including regular, glow, glitter, metallic, aromatherapy, stinky-scented gross-out formula and more. By sharing ideas and resources among divisions and across product categories, we have utilized the slimy compound to enhance the play-value of other toys. We created a cement dump truck from our Road Champs division with "real" cement; we included neon compounds in some WWE™ playsets to help recreate scenes from programming; and even have a soft-barreled pen line called Goooze FlexOGels™ with the compound inside the barrel.

In a related development, FUNimation recognized our skills in the boys' action area and challenged our design team to reinvigorate their products for the Dragon Ball franchise. As a result, our new Dragon Ball Z line will feature role-play with lights and sounds, new characters for the action figures, and a playset of the inside of a monster's body—complete with the goop and slime that the kids see on the show!

Products featured in the Summer section: Psychedelic Butterfly from Go Fly A Kite, Funnoodles, Constroodles™ and Soak-A-Noodles™, Disney Jr. Sports Super Elastic Bubble Bat, Dragon Ball Z® action figure, Nick-tivities Gak Splat™ football, and The Storm™ water guns.

Autumn

Hunting and Gathering New Opportunities

In our early years, JAKKS Pacific depended on the top five toy retailers for 67 percent of our sales. While we knew that having solid relationships with these retail giants was key to our success, we also believed that complete dependence limited our growth potential. As part of our diversification effort, we set out to increase our distribution networks.

We've made significant progress: today, those top five toy retailers, which include Wal*Mart, Target, KB Toys, Toys "R" Us and Kmart, account for 55 percent of our sales. Through acquisitions, we have gained entry into other retail channels including discount stores, club stores, office and school supply outlets, drug and grocery stores, sporting goods dealers and online merchants, and through our innovative product design, we've expanded our shelf space within these new distribution points, as well.

No need for boring brown bags—SpongeBob™ makes back-to-school much more fun.

Never satisfied, we have also pursued customer diversification through internal development efforts.

The most significant and recent example was our ability to turn someone else's big idea—mint strip breath fresheners for adults—into an appropriate and highly desirable candy product for children. With the introduction of Tongue Tape™ in January 2003, not only did we gain additional shelf space with our major retailers, we believe we've also opened the door on new opportunities with convenience and grocery stores across the country. We also proved our innovative capabilities in a highly competitive new market segment.

Beyond opening up new retail channels within the United States, we continue to pursue international opportunities. Through our 2001 acquisition of Kidz Biz Ltd., a leading United Kingdom toy distributor, we gained a foothold for expansion in Europe. Similarly, our agreement with Funtastic Limited expands existing opportunities for us to distribute our products in Australia and New Zealand. Despite volatile global markets in 2002, we made marked progress in our plans for international expansion—progress we believe will continue in the coming years.

As we evaluate and work to proactively identify new growth and diversification opportunities, accessing new retail channels will continue to be a key priority.

Products featured in the Autumn section: Tongue Tape™, Dora the Explorer™ Activity Suitcase, SpongeBob SquarePants™ lunchbox, The Storm™ plane, Creepy Crawlers® Bug Making Oven, Hello Kitty® cell phone, Fireworks® Glitterz® Pencils, UltraColor™ markers and a SpongeBob™ notepad.

NICKELODEON UltraColor FIREWORKS! FOCUS PENTECH®

Winter

Counting the Gifts of Our Labors

Among our most successful and lucrative endeavors toward diversification has been our pursuit of key licensing agreements. Beginning most notably with our World Wrestling Entertainment™ (WWE) action figures, we established ourselves as a viable partner in the development, manufacturing and merchandising of toys and games to capitalize on evergreen entertainment brands.

Such agreements provide us with products that have long-lasting, deep-seated appeal; remain especially compelling and engaging to our target customer groups; and enjoy the marketing expertise of their innovators—premier companies such as Nickelodeon, Disney, WWE and NASCAR. We continue to work closely with our licensors, committed to our joint and long-term success, and we've proven our capabilities so thoroughly that JAKKS now boasts relationships with major players in children's entertainment, sports marketing and many related industries.

Today we are working under a master toy agreement with World Wrestling Entertainment, and we have master activity licenses for Hello Kitty, Nickelodeon and Disney. In addition, we recently signed a master toy license for Nickelodeon's "The Fairly OddParents," currently the #2 television show among kids aged 2–11. This agreement, our first master toy deal with Nickelodeon, greatly expands our relationship with the children's

Silly games and scary stories in cozy slumber bags are the perfect remedy for a cold winter night.

Winter

cable network and, we believe, further demonstrates its confidence in our team. The new line will feature plush toys, dolls and accessories, play sets, role-play activities, handheld electronics, and novelty items.

We also recently signed a multi-category licensing agreement with FremantleMedia for American Idol™, one of the most successful reality shows on television. Targeting "tweens," our Flying Colors division launched a full line of fashion and beauty products based on the show in early 2003 and intends to introduce related stationery items such as portfolios, binders and writing instruments in time for back-to-school.

As evidenced by the successes of our top licensed properties, we are adept at maintaining the integrity and unique individuality of established brands while developing appropriate and innovative products their respective fan groups respond to.

Our lines extend product life cycles, too. For example, to keep our WWE fans excited about our products and hungering for more, we introduced action figures and accessories that take the Superstars out of the ring and into other settings. We created a line of off-road monster trucks with just as much style and attitude as their Superstar owners. We incorporated our molding compounds and other technology into the ring gear, play sets and accessories for added realism and play value, making our WWE product line more compelling to fans. Such enhancements have revived customers' imaginations and purchasing decisions.

Since 1999, we have released 14 World Wrestling Entertainment video games through our joint venture with THQ. Those titles have already generated $34.2 million in profit for JAKKS, and we look forward to the migration to Sony's PlayStation® 2, Microsoft's Xbox™, Nintendo Game Boy® Advance and other new platforms fueling profits through the end of the decade.

Products featured in the Winter pages include: Atari® TV Games™, SpongeBob SquarePants™, Dora the Explorer™ and Blue's Clues® slumber bags, Nick-tivities Skraaap™, NASCAR® 1:10 radio controlled vehicle, WWE® figure, Singing Starz™ Video Karaoke Machine, Strawberry Shortcake Tongue Tape™ and The Storm™ helicopter.

Significant Events

2002 ■ Toys "R" Us names JAKKS Pacific Vendor of the Year for 2001

■ JAKKS Pacific signs Master Activity Toy and Junior Sports Activity License with Disney

■ Michael Bianco promoted to Chief Merchandising Officer

■ JAKKS Pacific acquires controlling interest in Toymax International, Inc.

■ JAKKS Pacific raises $59.1 million in net proceeds in Secondary Public Offering

■ JAKKS Pacific receives 2002 LIMA International Licensing Excellence Award for best Corporate Licensee of the Year for its Nick-tivities line

■ Equalizer™ Radio Controlled Stunt Machine receives Oppenheim Toy Portfolio Gold Seal Award

■ *FORTUNE Magazine* names JAKKS Pacific to its list of 100 Fastest-Growing Companies—fourth consecutive year on list; JAKKS Pacific was one of only three companies to make the magazine's list of "Four Year All-Stars"

■ JAKKS Pacific completes acquisition of Toymax International, Inc.

■ *FORBES Magazine* names JAKKS Pacific to its list of 200 Best Small Companies in America—third year on list

■ JAKKS Pacific acquires assets of toymaker Trendmasters, Inc.

■ JAKKS Pacific signs Master Toy License for Dragon Ball® franchise

2003 ■ JAKKS Pacific launches new toy candy, Tongue Tape™

■ JAKKS Pacific signs a Multi-Category License for American Idol™

■ JAKKS Pacific signs Master Toy License for Nickelodeon's Fairly OddParents™

■ JAKKS Pacific signs Master Toy License for Yu Yu Hakusho™

■ JAKKS Pacific expands licensing agreement with Sanrio for the Hello Kitty® property to include multiple product categories

■ JAKKS Pacific signs licensing agreement with NASCAR® and Top Drivers

■ JAKKS Pacific receives net proceeds of more than $94 million from its private Convertible Senior Notes Offering

■ JAKKS Pacific acquires assets of P&M Color Workshop Holdings, Inc.

Selected Financial Data

You should read the financial data set forth below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes.

Year Ended December 31,	1998	1999	2000	2001	2002
(in thousands, except per share data)					
Consolidated Statement of Operations Data:					
Net sales	$85,253	$183,685	$252,288	$284,309	$310,016
Cost of sales	52,000	107,602	149,881	164,222	179,465
Gross profit	33,253	76,083	102,407	120,087	130,551
Selling, general and administrative expenses	24,007	51,154	80,435	89,575	91,848
Acquisition shut-down and product recall costs	—	—	1,469	1,214	6,718
Income from operations	9,246	24,929	20,503	29,298	31,985
Profit from joint venture	—	(3,605)	(15,906)	(6,675)	(8,004)
Interest, net	423	(1,588)	(3,833)	(2,057)	(1,141)
Other (income) expense, net	591	(182)	(92)	—	—
Income before provision for income taxes and minority interest	8,232	30,304	40,334	38,030	41,130
Provision for income taxes	1,857	8,334	11,697	9,797	9,049
Income before minority interest	6,375	21,970	28,637	28,233	32,081
Minority interest	—	—	—	—	810
Net income	$ 6,375	$ 21,970	$ 28,637	$ 28,233	$ 31,271
Basic earnings per share	$ 0.75	$ 1.55	$ 1.50	$ 1.55	$ 1.42
Weighted average shares outstanding	8,539	13,879	19,060	18,199	21,963
Diluted earnings per share	$ 0.59	$ 1.39	$ 1.41	$ 1.45	$ 1.37
Weighted average shares and equivalents outstanding	11,403	15,840	20,281	19,410	22,747

At December 31,	1998	1999	2000	2001	2002
(in thousands)					
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$12,452	$ 57,546	$ 29,275	$ 25,036	$ 68,413
Working capital	$13,736	$113,170	$ 86,897	$116,492	$129,183
Total assets	$58,736	$232,878	$248,722	$284,041	$408,810
Long-term debt, net of current portion	$ 5,940	$ 9	$ 1,000	$ 77	$ 60
Total stockholders' equity	$37,754	$187,501	$204,530	$244,403	$360,577

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors. You should read this section in conjunction with our consolidated financial statements and the related notes.

CRITICAL ACCOUNTING POLICIES

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 Footnote 2 to the Consolidated Financial Statements. 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 operation and financial position include:

The allowance for doubtful accounts is based on our assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. If there were a deterioration of a major customer's creditworthiness, or actual defaults were 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 revenue recognition policy is significant because our revenue is a key component of our results of operations. In addition, our revenue recognition determines the timing of certain expenses, such as commissions and royalties. We follow very specific and detailed guidelines in measuring revenues; however, certain judgments affect the application of our revenue policy. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter.

We assess the impairment of long-lived assets and goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which 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.

When we determine that the carrying value of long-lived assets and goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. Net long-lived assets and goodwill amounted to $222.0 million as of December 31, 2002.

RECENT DEVELOPMENTS

On March 11, 2002, we purchased a controlling interest in Toymax. On October 25, 2002, we completed that acquisition by acquiring the remaining outstanding common shares. The total purchase price of approximately $62.2 million consisted of 1,166,360 shares of our common stock, 598,697 stock options and approximately $41.0 million in cash and resulted in additional goodwill of $64.9 million. Our results of operations have included Toymax from March 12, 2002, however for the period March 12, 2002 through October 25, 2002 the minority interest's share of Toymax's earnings were excluded.

On November 27, 2002, we purchased certain product lines, assets and assumed certain liabilities from Trendmasters. The total purchase price of approximately $19.0 million consisted of all cash and resulted in goodwill of $26.2 million. Our results of operations have included Trendmasters from the date of acquisition.

RESULTS OF OPERATION

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

Years Ended December 31,	1998	1999	2000	2001	2002
Net sales	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of sales	61.0	58.6	59.4	57.8	57.9
Gross profit	39.0	41.4	40.6	42.2	42.1
Selling, general and administrative expenses	28.2	27.8	31.9	31.5	29.6
Acquisition shut-down and product recall costs	—	—	0.5	0.4	2.2
Income from operations	10.8	13.6	8.2	10.3	10.3
Profit from joint venture	—	(2.0)	(6.3)	(2.3)	(2.6)
Interest, net	0.4	(0.9)	(1.5)	(0.7)	(0.4)
Other (income) expense, net	0.7	—	—	—	—
Income before income taxes and minority interest	9.7	16.5	16.0	13.3	13.3
Provision for income taxes	2.2	4.5	4.6	3.4	2.9
Income before minority interest	7.5	12.0	11.4	9.9	10.4
Minority interest	—	—	—	—	0.3
Net income	7.5%	12.0%	11.4%	9.9%	10.1%

YEARS ENDED DECEMBER 31, 2002 AND 2001

Net Sales. Net sales increased $25.7 million, or 9.0%, to $310.0 million in 2002 from $284.3 million in 2001. The growth in net sales was due primarily to the addition of the Toymax products and continuing growth in sales of our Flying Colors and Doll products which was offset in part by a decrease in sales of our Wheels division, consisting primarily of our Road Champs die-cast toy and collectible vehicles with its extreme sports products.

Gross Profit. Gross profit increased $10.5 million, or 8.7%, to $130.6 million in 2002, or 42.1% of net sales, from $120.1 million, or 42.2% of net sales, in 2001. The overall increase in gross profit was attributable to the increase in net sales. Gross profit margin was compatible to last year as lower margins for Toymax products were offset by the decrease in royalty expense as a percentage of net sales due to changes in the product mix resulting from the sale of more products with lower royalty rates or proprietary products with no royalties.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $91.8 million in 2002 and $89.6 million in 2001, constituting 29.6% and 31.5% of net sales, respectively. The overall increase of $2.2 million in such costs was due to costs incurred in support of our Kidz Biz and Toymax acquisitions and increased media buys, offset in part by a decrease in Goodwill amortization expense based on the implementation of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." The decrease as a percentage of net sales is primarily attributable to the relative fixed nature of certain expenses with a concurrent increase in net sales. We produced and aired television commercials in support of several of our products, including World Wrestling Entertainment action figures and Flying Colors products, in 2001 and 2002. From time to time, we may increase our advertising efforts, if we deem it appropriate for particular products.

Acquisition Shut-down and Recall Costs. Acquisition shut-down costs in 2002 relate to shut-down costs, including lease termination, fixed asset abandonment and other costs, of certain operations of Toymax and Kidz Biz. Such costs in 2001 relate to shut-down costs of certain operations of Pentech, acquired in 2000. Operations impacted by these shut-downs were sales, design, distribution and administration. The integration of Pentech was completed in 2001 and the integration of Toymax and Kidz Biz was completed in 2002. In 2002, we accrued $2.2 million for the recall of one of our products.

The components of the acquisition shut-down and recall costs are as follows:

	Accrued Balance December 31, 2001	Accrual	Actual	Accrued Balance December 31, 2002
Lease abandonment costs	$ —	$3,723,481	$(1,413,681)	$2,309,800
Fixed asset write-off	—	260,142	(260,142)	—
Other	—	558,995	(558,995)	—
Recall	—	2,175,087	(2,175,087)	—
Total acquisition shut-down and recall costs	$ —	$6,717,705	$(4,407,905)	$2,309,800

Profit from Joint Venture. Profit from joint venture increased by $1.3 million in 2002 due to the joint venture having sales of only carryover titles in 2001 compared to releasing a new Microsoft Xbox title in addition to having sales of carryover titles in 2002. New releases typically generate higher unit sales resulting in higher overall sales as compared to carryover titles. Profit from the joint venture contributed significantly to our pre-tax profit, representing 17.6% of pre-tax income in 2001 and 19.5% in 2002. We expect to continue to receive a preferred return over the remaining term of the license agreement ending December 31, 2009, although we cannot predict with certainty what levels of return will be achieved and, in any case, we anticipate substantial fluctuations in the amount of the preferred return distributed to us from year to year.

Interest, Net. Interest income decreased in 2002 compared to 2001 in spite of higher average cash balances due to lower interest rates.

Provision for Income Taxes. Provision for income taxes included Federal, state and foreign income taxes in 2001 and 2002, at effective tax rates of 25.8% in 2001 and 22% in 2002, benefiting from a flat 16.5% Hong Kong Corporation Tax on our income arising in, or derived from, Hong Kong. The decrease in the current year effective rate net results primarily from certain permanently non-taxable items in addition to a continued shift in profits to more favorable tax jurisdictions. As of December 31, 2002, we had net deferred tax assets of approximately $3.9 million for which no allowance has been provided since, in the opinion of management, realization of the future benefit is probable. In making this determination, management considered all available evidence, both positive and negative, as well as the weight and importance given to such evidence.

YEARS ENDED DECEMBER 31, 2001 AND 2000

Net Sales. Net sales increased $32.0 million, or 12.7%, to $284.3 million in 2001 from $252.3 million in 2000. The growth in net sales was due primarily to the continuing growth in sales of our Flying Colors products and an increase in sales of our World Wrestling Entertainment wrestling products, as well as the addition of Pentech products, which began contributing to operations in August 2000, and the introduction of our products based on the Battlebots television show though offset by a decrease in sales of our Doll products and our Wheels products, consisting primarily of our Road Champs die-cast toy and collectible vehicles including BXS die-cast bicycle, MXS die-cast motorcycles and other extreme sports products.

Gross Profit. Gross profit increased $17.7 million, or 17.3%, to $120.1 million in 2001, or 42.2% of net sales, from $102.4 million, or 40.6% of net sales, in 2000. The overall increase in gross profit was attributable to the increase in net sales and the increase in the gross profit margin. The increase in gross profit margin of 1.6% of net sales is primarily attributable to the decrease in royalty expense as a percentage of net sales due to changes in the product mix and lower product costs, which was partially offset by an increase in amortization expense relating to molds and tools used in the manufacture of our products.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $89.6 million in 2001 and $80.4 million in 2000, constituting 31.5% and 31.9% of net sales, respectively. The overall increase of $9.2 million in such costs in 2001 was due in large part to a $5.0 million dollar reserve on accounts receivable relating to the Chapter 11 bankruptcy filing of Kmart, which was filed in January of 2002, and the increase in net sales with its proportionate impact on variable selling costs such as freight and shipping related expenses, sales commissions, cooperative advertising and travel expenses, among others. The decrease as a percentage of net sales is primarily attributable to the fixed nature of certain of these expenses with a concurrent increase in net sales. We produced and aired television commercials in support of several of our products, including World Wrestling Entertainment action figures, Road Champs extreme sports products and Flying Colors products in 2000 and 2001. From time to time, we may increase our advertising efforts, if we deem it is appropriate for particular products.

Acquisition Shut-down and Other Costs. Acquisition shut-down and other costs in 2001 relate to shut-down costs, including lease termination, relocation and consulting fees and expenses, of certain operations of Pentech, acquired in 2000, and such costs in 2000 relate to shut-down costs, including lease termination, relocation, and consulting fees and expenses of certain operations of Flying Colors, acquired in 1999. Operations impacted by both shut-downs were sales, design, distribution, and administration. Total Pentech costs are comprised of $0.3 million relating to lease terminations and abandonments, $0.2 million in consulting fees and expenses incurred to facilitate the integration, $0.4 million relating to relocation expense, and $0.1 million relating to the abandonments of other assets. Twenty-one Pentech employees received severance totaling $0.4 million, that was accrued in the fourth quarter of 2000 and was fully paid out by June 30, 2001. The integration of Pentech was substantially completed in the second quarter of 2001 and related costs are expected to be nominal in future quarters. In 2000, total Flying Colors costs is comprised of $0.2 million relating to lease terminations and abandonments and $0.3 million relating to relocation expense. The integration of Flying Colors was completed in 2000. Additionally, 2000 includes $0.6 million relating to the recall of one of our products.

Profit from Joint Venture. Profit from our joint venture with THQ decreased in 2001 due to a decrease in our preferred return resulting from fewer releases of *World Wrestling Entertainment* video games by our joint venture in 2001 than in 2000. In 2001, the joint venture released two Nintendo GameBoy titles, which have lower unit sales and sales prices than the other game platforms, and one Sony PlayStation 2 title along with modest carryover sales of titles released in 2000 and earlier, as compared to 2000, in which the joint venture released a total of four new titles consisting of two Sony PlayStation titles, one Nintendo 64 title and one Sega Dreamcast title in addition to strong carryover sales of the two 1999 releases. Profit from the joint venture contributed significantly to our pre-tax profit, representing 39.4% of pre-tax income in 2000 and 17.6% in 2001. Through June 30, 2006, we are entitled to receive a guaranteed preferred return at varying rates of net sales of the video games depending on the cumulative unit sales and platform of each particular game, and after June 30, 2006, the amount of the preferred return is subject to renegotiation between THQ and us. The minimum preferred return to be distributed to us by the joint venture during each of the years in the period ending December 31, 2003 is $2.6 million per year. We expect our aggregate return over the remaining term of the license agreement ending December 31, 2009 to be significantly in excess of this amount, although we cannot predict with certainty that expected levels of return will be achieved and, in any case, we anticipate substantial fluctuations in the amount of the preferred return distributed to us from year to year.

Interest, Net. Interest income decreased in 2001 due to lower average cash balances during 2001 than in 2000 as a result of significant disbursements made in the third and fourth quarters of 2000 related to the acquisition of Pentech and the repurchase by the Company of its common stock. Interest expense was nominal in 2000 and 2001.

Provision for Income Taxes. Provision for income taxes included Federal, state and foreign income taxes in 2000 and 2001, at effective tax rates of 29% in 2000 and 25.8% in 2001, benefiting from a flat 16.5% Hong Kong Corporation Tax on our income arising in, or derived from, Hong Kong. As of December 31, 2001, we had deferred tax assets of approximately $0.4 million for which no allowance has been provided since, in the opinion of management, realization of the future benefit is probable. In making this determination, management considered all available evidence, both positive and negative, as well as the weight and importance given to such evidence.

QUARTERLY FLUCTUATIONS AND SEASONALITY

We have experienced significant quarterly fluctuations in operating results and anticipate these fluctuations in the future. The operating results for any quarter are not necessarily indicative of results for any future period. Our first quarter is typically expected to be the least profitable as a result of lower net sales but substantially similar fixed operating expenses. This is consistent with the performance of many companies in the toy industry.

The following table presents our unaudited quarterly results for the years indicated. The seasonality of our business is reflected in this quarterly presentation.

	2000				2001				2002			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(in thousands, except per share data)												
Net sales	$50,782	$50,578	$91,838	$59,090	$59,962	$70,141	$92,768	$61,438	$59,895	$78,992	$102,640	$68,489
As a % of full year	20.1%	20.1%	36.4%	23.4%	21.1%	24.7%	32.6%	21.6%	19.3%	25.5%	33.1%	22.1%
Gross profit	$20,104	$21,748	$37,672	$22,883	$24,468	$32,609	$39,056	$23,953	$26,470	$35,192	$ 41,812	$27,077
As a % of full year	19.7%	21.2%	36.8%	22.3%	20.4%	27.2%	32.5%	19.9%	20.3%	27.0%	32.0%	20.7%
As a % of net sales	39.6%	43.0%	41.0%	38.7%	40.8%	46.5%	42.1%	39.0%	44.2%	44.6%	40.7%	39.5%
Income (loss) from operations	$ 3,552	$ 6,095	$11,201	$ (345)	$ 7,267	$ 8,879	$14,562	$ (1,410)	$ 1,420	$ 9,912	$ 18,895	$ 1,758
As a % of full year	17.3%	29.8%	54.6%	(1.7)%	24.8%	30.3%	49.7%	(4.8)%	4.4%	31.0%	59.1%	5.5%
As a % of net sales	7.0%	12.1%	12.2%	(0.6)%	12.7%	12.1%	15.7%	(2.3)%	2.4%	12.5%	18.4%	2.6%
Income before income taxes and minority interest	$ 9,715	$ 8,877	$13,615	$ 8,127	$ 8,480	$ 9,478	$15,250	$ 4,822	$ 2,985	$10,849	$ 19,944	$ 7,352
As a % of net sales	19.1%	17.6%	14.8%	13.8%	14.1%	13.5%	16.4%	7.8%	5.0%	13.7%	19.4%	10.7%
Net income	$ 6,603	$ 6,237	$ 9,769	$ 6,028	$ 6,021	$ 6,873	$10,949	$ 4,390	$ 2,156	$ 7,832	$ 13,954	$ 7,329
As a % of net sales	13.0%	12.3%	10.6%	10.2%	10.0%	9.8%	11.8%	7.1%	3.6%	9.9%	13.6%	10.7%
Diluted earnings per share	$ 0.32	$ 0.31	$ 0.48	$ 0.32	$ 0.32	$ 0.36	$ 0.56	$ 0.22	$ 0.11	$ 0.36	$ 0.58	$ 0.30
Weighted average shares and equivalents outstanding	20,374	20,371	20,330	18,621	18,920	19,259	19,586	19,763	20,236	21,953	24,059	24,800

During the second quarter of 2000, we recorded a charge which impacted operating income by approximately $1.4 million relating to the recall of one of our products.

During the fourth quarter of 2001, we recorded a charge of $5.0 million to bad debt impacting operating income relating to the bankruptcy filing of one of our customers, Kmart.

During the first quarter of 2002, we recorded a charge which impacted operating income by approximately $6.6 million relating to the restructuring of Toymax and Kidz Biz.

During the second quarter of 2002, we recorded a charge which impacted operating income by approximately $1.5 million relating to the recall of one of our products.

During the fourth quarter of 2002, we reversed $2.1 million of the restructuring charge recorded in the first quarter of 2002 and recorded an additional charge of approximately $0.7 million relating to the recall of one of our products, the net of which favorably impacted operating income by approximately $1.4 million. In addition, our effective tax rate for the year 2002 was reduced from 26% to 22%.

RECENT ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). The objective of SFAS 143 is to establish an accounting standard for the recognition and measurement of an asset retirement obligation on certain long-lived assets. The retirement obligation must be one that results from the acquisition, construction or normal operation of a long-lived asset. SFAS 143 requires the legal obligation associated with the retirement of a tangible long-lived asset to be recognized at fair value as a liability when incurred, and the cost to be capitalized by increasing the carrying amount of the related long-lived asset. SFAS 143 will be effective for the Company's fiscal year beginning January 1, 2003. The adoption of this statement will have no material impact on the consolidated financial statements.

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 144 supersedes Statements of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS 121") and retains the basic requirements of SFAS 121 regarding when and how to measure an impairment loss. SFAS 144 provides additional implementation guidance on accounting for an impairment loss. SFAS 144 is effective for all fiscal years beginning after December 15, 2001. The Company adopted SFAS 144 beginning in fiscal 2002, the adoption of which did not have a material effect on the Company's financial position or results of operations.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, "Rescission of Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Correction" ("SFAS 145"). SFAS 145 eliminates extraordinary accounting treatment for reporting gains or losses on debt extinguishments, and amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of this SFAS are effective for fiscal years beginning after May 15, 2002; however, early application of SFAS 145 is encouraged. Debt extinguishments reported as extraordinary items prior to scheduled or early adoption of this SFAS would be reclassified to other income in most cases following adoption.

The Company is currently evaluating the impact of the adoption of SFAS 145 would have on its consolidated results of operations subject to the evaluation in accordance with APB 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions."

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), which changes the accounting for costs such as lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity initiated after December 31, 2002. The standard requires companies to recognize the fair value of costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan.

The Company anticipates that the adoption of SFAS 146 will not have a material effect on the Company's financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2002, we had working capital of $129.2 million, as compared to $116.5 million as of December 31, 2001. This increase was primarily attributable to the receipt of net proceeds from the sale of our common stock and from operating activities offset in part by disbursements relating to the acquisitions of Toymax and Trendmasters.

Operating activities provided net cash of $66.2 million including the sale of marketable securities of $37.1 million in the year ended December 31, 2002 as compared to $13.4 million, net of the purchase of marketable securities of $23.5 million, in 2001. Net cash was provided primarily by net income and non-cash charges, such as depreciation and amortization, the forgiveness of an officer note receivable and minority interest, as well as decreases in prepaid expenses and other current operating assets, the sale of marketable securities and increases in the reserve for sales returns and allowances, income taxes payable and deferred income taxes, which were offset in part by a non-cash benefit consisting of earned compensation from stock option grants, increases in the preferred return from THQ joint venture, accounts receivable, inventory, advanced royalty payments and decreases in accounts payable and accrued expenses. As of December 31, 2002, we had cash and cash equivalents of $68.4 million and no marketable securities.

Operating activities provided net cash of $13.4 million, net of the purchase of marketable securities of $23.5 million, in the year ended December 31, 2001 as compared to $30.0 million, including the sale of marketable securities of $25.7 million, in 2000. Net cash was provided primarily by net income and non-cash charges, such as depreciation and amortization and recognition of compensation expense from stock option grants, as well as the increases in accrued expenses and deferred income taxes and decrease in the preferred return due from the joint venture, which were offset in part by increases in accounts receivable and inventory and decreases in the reserve for sales returns and allowances and income taxes payable. As of December 31, 2001, we had cash and cash equivalents of $25.0 million and marketable securities of $37.1 million.

Our investing activities used cash of $87.8 million in the year ended December 31, 2002, as compared to $19.4 million in 2001, consisting primarily of the purchase of office furniture and equipment and molds and tooling used in the manufacture of our products, the goodwill acquired in the acquisitions of Toymax and Trendmasters, the $4.5 million in goodwill relating to the final earn-out for Flying Colors, and the increase in other assets, partially offset by the repayment of notes receivable from officers. In 2001, our investing activities consisted primarily of the purchase of molds and tooling used in the manufacture of our products, the goodwill acquired in the acquisitions of Kidz Biz Ltd. and Kidz Biz Far East, plus the $4.5 million in goodwill relating to the 2001 earn-out for Flying Colors, partially offset by the repayment of notes receivable from officers. As part of our strategy to develop and market new products, we have entered into various character and product licenses with royalties ranging from 1% to 12% payable on net sales of such products. As of December 31, 2002, these agreements required future aggregate minimum guarantees of $19.4 million, exclusive of $2.9 million in advances already paid.

Our investing activities used net cash of $19.4 million in the year ended December 31, 2001, as compared to $47.9 million in 2000, consisting primarily of the purchase of molds and tooling used in the manufacture of our products in 2001 and 2000, and goodwill acquired in the acquisitions of Kidz Biz Ltd. and Kidz Biz Far East in 2001 and Pentech in 2000. As part of our strategy to develop and market new products, we have entered into various character and product licenses with royalties ranging from 1% to 12% payable on net sales of such products. As of December 31, 2001, these agreements required future aggregate minimum guarantees of $11.5 million, exclusive of $2.0 million in advances already paid.

Our financing activities provided net cash of $64.9 million in the year ended December 31, 2002, as compared to $1.8 million in 2001. In 2002, cash was primarily provided from the sale of our common stock and from the exercise of stock options and warrants, partially offset by the repayment of long-term debt. In 2001, cash was primarily provided from the exercise of stock options and warrants, partially offset by the repayment of debt assumed in the acquisition of Pentech.

Our financing activities provided net cash of $1.8 million in the year ended December 31, 2001, compared to having used cash of $10.4 million in 2000. In 2000, we used cash primarily to repurchase 1,493,600 shares of our common stock for a total of $12.9 million, while cash was provided by the exercise of stock options and warrants and the assumption of debt related to the acquisition of Pentech. Net cash provided in 2001 consisted primarily of proceeds from the exercise of stock options and warrants, offset by the repayment of debt assumed in the acquisition of Pentech.

During 2002, we acquired all the outstanding common shares of Toymax for cash of approximately $41.0 million and 1,166,360 shares of our common stock and paid off approximately $12.3 million of indebtedness. In November 2002, we acquired certain assets of Trendmasters for approximately $19.0 million and paid off approximately $3.7 million of indebtedness in cash.

The following is a summary of our significant contractual cash obligations for the periods indicated that existed as of December 31, 2002 and is based on information appearing in the notes to the consolidated financial statements:

	2003	2004	2005	2006	2007	Thereafter	Total
Long-term debt	$ 17,805	$ 19,036	$ 20,350	$ 20,297	$ —	$ —	$ 77,488
Operating leases	4,707,091	4,601,158	3,967,662	3,905,415	3,490,756	1,292,900	21,964,982
Minimum guaranteed license/royalty payments	4,202,692	1,829,063	4,538,335	1,040,000	1,040,000	6,731,000	19,381,090
Employment contracts	4,887,867	4,114,997	3,201,000	2,855,000	2,930,000	4,410,000	22,398,864
Total contractual cash obligations	$13,815,455	$10,564,254	$11,727,347	$7,820,712	$7,460,756	$12,433,900	$63,822,424

In May and June 2002, we received an aggregate of $59.1 million in net proceeds from the sale of 3,525,000 shares of our common stock in an under-written public offering. These proceeds, which we invested temporarily in marketable securities and cash equivalents, were applied to our product acquisition, development, working capital and general corporate needs.

In December 2001, we acquired all of the outstanding capital stock of Kidz Biz Limited, a United Kingdom company, and an affiliated Hong Kong company, Kidz Biz Far East Limited, for an aggregate purchase price of approximately $12.4 million. Total consideration was paid on the closing of the transaction in cash in the amount of $6.4 million and the issuance of 308,992 shares of our common stock at a value of $6.0 million. In addition, we agreed to pay an earn-out for each of 2002, 2003, 2004 and 2005, based on the year-over-year increase in Kidz Biz sales, payable by delivery of up to 25,749 shares of our common stock. In 2002, nothing was earned.

In October 1999, we acquired Flying Colors Toys for approximately $34.7 million in cash for the stock and paid off approximately $17.6 million of indebtedness. In addition, we also paid an earn-out of up to $4.5 million in each of the three 12-month periods following the closing because the gross profit of Flying Colors products achieved certain targeted levels during these periods.

In October 2001, we secured a syndicated line of credit totaling $50.0 million with a consortium of banks led by Bank of America, N.A. ("Line of Credit"). The Line of Credit will be available for future acquisitions and working capital and is secured by a lien on substantially all of our assets and contains customary financial and non-financial covenants which require us to maintain a minimum net worth and limit our ability to incur additional indebtedness, pay cash dividends or make distributions, sell assets and enter into certain mergers or acquisitions. We are required to not have any outstanding borrowings in excess of $30.0 million for a period of at least 30 consecutive days during the first fiscal quarter of each year of the agreement. Amounts outstanding under this facility bear interest at 0.25% plus the greater of the Prime Rate or the Federal Funds Rate plus 0.5%, subject to adjustment based on certain financial ratios. As of December 31, 2002, we had no outstanding borrowings.

In February 2003, our Board of Directors approved a buyback of up to $20 million of our common stock. As of March 27, 2003, we repurchased 330,000 shares of our common stock for a total of approximately $3.4 million.

We believe that our cash flows from operations, cash and cash equivalents on hand and the availability under the Line of Credit 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, 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.

EXCHANGE RATES

Sales from our United States and Hong Kong operations are denominated in U.S. dollars and our manufacturing costs are denominated in either U.S. or Hong Kong dollars. Domestic sales from our United Kingdom operations and operating expenses of all of our operations are denominated in local currency, thereby creating exposure to changes in exchange rates. Changes in the Hong Kong dollar or British pound/U.S. dollar exchange rate 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 cannot assure you that the exchange rate between the United States and Hong Kong currencies will continue to be fixed or that exchange rate fluctuations between the United States and Hong Kong and United Kingdom currencies will not have a material adverse effect on our business, financial condition or results of operations.

Consolidated Balance Sheets

December 31,	2001	2002
ASSETS		
Current assets		
Cash and cash equivalents	$ 25,036,203	$ 68,412,826
Marketable securities	37,119,071	—
Accounts receivable, net of allowance for uncollectible accounts of $7,273,497 and $6,781,324 for 2001 and 2002, respectively	52,888,452	56,195,578
Inventory, net of reserves of $2,590,099 and $4,782,021 for 2001 and 2002, respectively	32,023,960	38,009,747
Prepaid expenses and other	4,735,059	3,547,179
Income taxes receivable	—	2,205,882
Advanced royalty payments	1,991,788	2,863,099
Notes receivable—officers	—	1,113,000
Deferred income taxes	—	4,445,658
Total current assets	153,794,533	176,792,969
Property and equipment		
Office furniture and equipment	5,305,212	5,932,385
Molds and tooling	26,355,861	31,068,888
Leasehold improvements	1,854,501	2,463,875
Total	33,515,574	39,465,148
Less accumulated depreciation and amortization	17,762,905	24,639,593
Property and equipment, net	15,752,669	14,825,555
Notes receivable—officers	2,224,000	—
Intangibles and other, net	2,945,075	8,169,168
Investment in joint venture	7,893,312	8,118,645
Goodwill, net	89,863,415	189,335,933
Trademarks, net	11,567,679	11,567,679
Total assets	$284,040,683	$408,809,949
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 12,692,826	$ 8,994,469
Accrued expenses	18,068,725	19,394,014
Reserve for sales returns and allowances	4,952,879	13,579,368
Current portion of long-term debt	17,582	17,805
Income taxes payable	1,570,973	5,624,532
Total current liabilities	37,302,985	47,610,188
Long-term debt, net of current portion	77,488	59,683
Deferred income taxes	2,256,817	562,948
Total liabilities	39,637,290	48,232,819
Commitments and contingencies		
Stockholders' equity		
Preferred shares, $.001 par value; 5,000,000 shares authorized; nil outstanding	—	—
Common stock, $.001 par value; 100,000,000 shares authorized; 20,320,354 and 24,472,884 shares issued, respectively	20,320	24,473
Additional paid-in capital	168,114,819	240,101,458
Treasury stock, at cost, 1,493,600 and nil shares, respectively	(12,911,483)	—
Retained earnings	89,179,737	120,451,199
Total stockholders' equity	244,403,393	360,577,130
Total liabilities and stockholders' equity	$284,040,683	$408,809,949

See notes to consolidated financial statements.

Consolidated Statements of Operations

Years Ended December 31,	2000	2001	2002
Net sales	$252,287,943	$284,309,021	$310,016,208
Cost of sales	149,880,804	164,222,261	179,465,227
Gross profit	102,407,139	120,086,760	130,550,981
Selling, general and administrative expenses	80,434,872	89,574,503	91,848,674
Acquisition shut-down and product recall costs	1,468,798	1,214,101	6,717,705
Income from operations	20,503,469	29,298,156	31,984,602
Profit from joint venture	(15,905,860)	(6,675,428)	(8,003,925)
Interest, net	(3,833,359)	(2,056,526)	(1,141,191)
Other income, net	(91,670)	—	—
Income before provision for income taxes and minority interest	40,334,358	38,030,110	41,129,718
Provision for income taxes	11,696,963	9,797,209	9,048,538
Income before minority interest	28,637,395	28,232,901	32,081,180
Minority interest	—	—	809,718
Net income	$ 28,637,395	$ 28,232,901	$ 31,271,462
Basic earnings per share	$ 1.50	$ 1.55	$ 1.42
Diluted earnings per share	$ 1.41	$ 1.45	$ 1.37

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

	Common Stock Number of Shares	Common Stock Amount	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Total Stockholders' Equity
BALANCE, DECEMBER 31, 1999	19,272,692	$19,273	$155,172,781	$ —	$ 32,309,441	$187,501,495
Exercise of options and warrants	212,890	212	1,171,031	—	—	1,171,243
Earned compensation for fully vested stock options	—	—	131,531	—	—	131,531
Repurchase of common stock	(1,493,600)	—	—	(12,911,483)	—	(12,911,483)
Net income	—	—	—	—	28,637,395	28,637,395
BALANCE, DECEMBER 31, 2000	17,991,982	19,485	156,475,343	(12,911,483)	60,946,836	204,530,181
Exercise of options and warrants	525,780	526	3,069,219	—	—	3,069,745
Earned compensation for fully vested stock options	—	—	2,570,566	—	—	2,570,566
Issuances of common shares for Kidz Biz	308,992	309	5,999,691	—	—	6,000,000
Net income	—	—	—	—	28,232,901	28,232,901
BALANCE, DECEMBER 31, 2001	18,826,754	20,320	168,114,819	(12,911,483)	89,179,737	244,403,393
Exercise of options and warrants	954,770	955	5,882,976	—	—	5,883,931
Earned compensation for fully vested stock options	—	—	(1,308,365)	—	—	(1,308,365)
Retirement of treasury stock	—	(1,494)	(12,909,989)	12,911,483	—	—
Fair value of outstanding stock options in acquisition	—	—	3,150,961	—	—	3,150,961
Issuance of common stock for cash	3,525,000	3,525	59,090,980	—	—	59,094,505
Issuance of common stock for Toymax	1,166,360	1,167	18,080,076	—	—	18,081,243
Net income	—	—	—	—	31,271,462	31,271,462
BALANCE, DECEMBER 31, 2002	24,472,884	$24,473	$240,101,458	$ —	$120,451,199	$360,577,130

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years Ended December 31,	2000	2001	2002
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 28,637,395	$ 28,232,901	$ 31,271,462
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	9,272,917	12,219,545	9,193,328
Earned compensation from stock option grants	131,531	2,570,566	(1,308,365)
Investment in joint venture	(6,100,020)	2,977,201	(225,333)
Loss on disposal of property and equipment	—	15,668	—
Forgiveness of officer note receivable	—	—	285,000
Minority interest	—	—	809,718
Changes in operating assets and liabilities			
Sale (purchase) of marketable securities	25,716,032	(23,501,159)	37,119,071
Accounts receivable	(9,028,796)	(5,834,753)	(3,307,126)
Inventory	(10,671,318)	(1,489,134)	(10,996,095)
Advanced royalty payments	(1,357,789)	503,239	(871,311)
Prepaid expenses and other	(4,037,788)	920,421	1,377,841
Accounts payable	4,656,864	(1,926,693)	(3,698,357)
Accrued expenses	(3,317,215)	5,529,435	(9,534,539)
Income taxes payable	4,411,429	(6,052,382)	7,056,041
Reserve for sales returns and allowances	(8,764,770)	(1,600,352)	8,626,489
Deferred income taxes	442,983	800,000	431,667
Total adjustments	1,354,060	(14,868,398)	34,958,029
Net cash provided by operating activities	29,991,455	13,364,503	66,229,491
CASH FLOWS FROM INVESTING ACTIVITIES			
Property and equipment	(13,787,805)	(4,971,185)	(6,593,600)
Other assets	(1,134,864)	(1,230,664)	(1,658,539)
Investment in joint venture	—	(1,112,154)	—
Cash paid for net assets	(30,535,848)	(12,280,536)	(80,409,951)
Notes receivable—officers	(2,450,000)	226,000	861,000
Net cash used by investing activities	(47,908,517)	(19,368,539)	(87,801,090)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from sale of common stock	—	—	59,094,505
Repurchase of common stock	(12,911,483)	—	—
Proceeds from debt	1,500,000	95,070	—
Proceeds from stock options and warrants exercised	1,171,243	3,069,745	5,883,931
Repayments of debt	(113,680)	(1,400,000)	(30,214)
Net cash provided (used) by financing activities	(10,353,920)	1,764,815	64,948,222
Net increase (decrease) in cash and cash equivalents	(28,270,982)	(4,239,221)	43,376,623
Cash and cash equivalents, beginning of year	57,546,406	29,275,424	25,036,203
Cash and cash equivalents, end of year	$ 29,275,424	$ 25,036,203	$ 68,412,826
Cash paid during the period for:			
Interest	$ 189,630	$ 118,144	$ 80,312
Income taxes	$ 8,600,895	$ 14,007,578	$ 3,235,095

See note 17 for additional supplemental information to consolidated statements of cash flows.

See notes to consolidated financial statements.

NOTE 1—PRINCIPAL INDUSTRY

JAKKS Pacific, Inc. (the "Company") is engaged in the development, production and marketing of toys and related products, some of which are based on highly-recognized entertainment properties and character licenses. The Company commenced its primary business operations in July 1995 through the purchase of substantially all of the assets of a Hong Kong toy company. The Company markets its product lines domestically and internationally.

The Company was incorporated under the laws of the State of Delaware in January 1995.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation. The consolidated financial statements include accounts of the Company and its wholly-owned subsidiaries. In consolidation, all significant inter-company balances and transactions are eliminated.

Cash and cash equivalents. The Company considers all highly liquid assets, having an original maturity of less than three months, to be cash equivalents. The Company maintains its cash in bank deposits which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

Use of estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual future results could differ from those estimates.

Revenue recognition. Revenue is recognized upon the shipment of goods to customers. Provisions for estimated returns, defective products, markdowns and other allowances are made at the time of sale.

Inventory. Inventory, which includes the ex-factory cost of goods and in-bound freight, is valued at the lower of cost (first-in, first-out) or market and consists of the following:

December 31,	2001	2002
Deposits	$ 82,793	$ 20,185
Raw materials	236,206	586,244
Finished goods	31,704,961	37,403,318
	$32,023,960	$38,009,747

Marketable securities. Marketable securities have been categorized as trading and as a result are stated at fair value, with unrealized holding gains and losses included in earnings. At December 31, 2001 and 2002, such gains and losses were not material.

Fair value of financial instruments. The Company's cash and cash equivalents, accounts receivable and notes payable represent financial instruments. The carrying value of these financial instruments is a reasonable approximation of fair value.

Property and equipment. Property and equipment are stated at cost and are being depreciated using the straight-line method over their estimated useful lives as follows:

Office equipment	5 years
Furniture and fixtures	5–7 years
Molds and tooling	2–4 years
Leasehold improvements	Shorter of length of lease or 10 years

Shipping and handling costs. The consolidated financial statements reflect, for all periods presented, the adoption of the classification or disclosure requirements pursuant to Emerging Issues Task Force ("EITF") 00-10, "Accounting for Shipping and Handling Fees and Costs," which was effective in the fourth quarter of fiscal 2000. Consistent with EITF 00-10, the Company has historically classified income from freight charges to customers in "Net sales." The Company classifies shipping and handling costs in "Selling, general and administrative expenses." Such costs amounted to approximately $8,127,000 in 2000, $11,940,000 in 2001 and $8,135,000 in 2002.

Advertising. Production costs of commercials and programming are charged to operations in the year during which the production is first aired. The costs of other advertising, promotion and marketing programs are charged to operations in the year incurred. Advertising expense for the years ended December 31, 2000, 2001 and 2002, was approximately $14,416,000, $11,026,000 and $12,697,000, respectively.

Income taxes. The Company does not file a consolidated return with its foreign subsidiaries. The Company files Federal and state returns and its foreign subsidiaries each file Hong Kong returns. Deferred taxes are provided on a liability method whereby deferred tax assets are recognized as deductible temporary differences and operating loss and tax credit carryforwards 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 basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion 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.

Translation of foreign currencies. Monetary assets and liabilities denominated in Hong Kong dollars or British pounds sterling are translated into United States dollars at the rate of exchange ruling at the balance sheet date. Transactions during the period are translated at the rates ruling at the dates of the transactions.

Profits and losses resulting from the above translation policy are recognized in the consolidated statements of operations.

Accounting for the impairment of long-lived assets. Long-lived assets, which include property and equipment, goodwill and intangible assets other than goodwill, are evaluated for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through the estimated undiscounted future cash flows from the use of these assets. When any such impairment exists, the related assets will be written down to fair value.

Goodwill and other intangible assets. In July 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" (SFAS 141) and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). SFAS 141 is effective for business combinations initiated after June 30, 2001. SFAS 141 requires that all business combinations completed after its adoption be accounted for under the purchase method of accounting and establishes specific criteria for the recognition of intangible assets separately from goodwill. SFAS 142 was effective for the Company on January 1, 2002 and primarily addresses the accounting for goodwill and intangible assets subsequent to their acquisition. With the adoption of SFAS 142, goodwill and other intangible assets are no longer amortized and are tested for impairment at least annually at the reporting unit level. As of December 31, 2002, there was no impairment to the underlying value of goodwill or intangible assets other than goodwill.

The effect of adoption of SFAS 142 on the reported net income for the current and comparative prior period is as follows:

For the Year Ended December 31,	2000	2001	2002
Reported net income	$28,637,395	$28,232,901	$31,271,462
Add back: Amortization of goodwill and other intangibles, net of tax effect	1,591,578	2,578,676	—
Net income, as adjusted	$30,228,973	$30,811,577	$31,271,462
Earnings per share—basic:			
Reported net income	$ 1.50	$ 1.55	$ 1.42
Add back: Amortization of goodwill and other intangibles, net of tax effect	0.08	0.14	—
	$ 1.58	$ 1.69	$ 1.42
Earnings per share—diluted:			
Reported net income	$ 1.41	$ 1.45	$ 1.37
Add back: Amortization of goodwill and other intangibles, net of tax effect	0.08	0.13	—
Net income, as adjusted	$ 1.49	$ 1.58	$ 1.37

Goodwill represents the excess purchase price paid over the fair market value of the assets of acquired toy companies. In fiscal 2002, the Company began to write off goodwill and certain intangible assets on an impairment basis where losses in value are recorded when and as material impairment has occurred in the underlying assets. Accumulated amortization of goodwill at December 31, 2001 and 2002 totaled $6,577,121.

The carrying value of goodwill is based on management's current assessment of recoverability. Management evaluates recoverability using both objective and subjective factors. Objective factors include management's best estimates of projected future earnings and cash flows and analysis of recent sales and earnings trends. Subjective factors include competitive analysis and the Company's strategic focus.

Intangible assets other than goodwill consist of product technology rights and trademarks. Intangible assets are amortized on a straight-line basis, over five to thirty years, the estimated economic lives of the related assets. Accumulated amortization as of December 31, 2001 and 2002 was $1,961,113 and $2,910,386, respectively.

Stock option plans. In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure an Amendment of FASB Statement No. 123" (SFAS 148). SFAS 148 Statement amends Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of that Statement to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. Finally, SFAS 148 amends APB Opinion No. 28, "Interim Financial Reporting," to require disclosure about those effects in interim financial information.

At December 31, 2002, the Company has stock-based employee compensation plans, which are described more fully in Note 14. The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. However, certain options had been repriced resulting in compensation adjustments, which have been reflected in net income. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123, to stock-based employee compensation.

In 2000, 2001 and 2002 the fair value of each employee option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used: risk-free rate of interest of 6%, 6% and 4%, respectively; dividend yield of 0%; with volatility of 94%, 91% and 87% respectively; and expected lives of five years.

Year Ended December 31,	2000	2001	2002
Net Income, as reported	$28,637,395	$28,232,901	$31,271,462
Add (Deduct): Stock-based employee compensation expense (income) included in reported net income	131,531	2,570,566	(1,308,365)
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards net of related tax effects	(1,806,108)	(1,498,495)	(2,034,284)
Pro forma net income	$26,962,818	$29,304,972	$27,928,813
Earnings per share:			
Basic—as reported	$ 1.50	$ 1.55	$ 1.42
Basic—pro forma	$ 1.41	$ 1.61	$ 1.27
Diluted—as reported	$ 1.41	$ 1.45	$ 1.37
Diluted—pro forma	$ 1.33	$ 1.51	$ 1.23

Earnings per share. The following table is a reconciliation of the weighted average shares used in the computation of basic and diluted earnings per share for the periods presented:

2000	Income	Weighted Average Shares	Per Share
Basic EPS			
Income available to common stockholders	$28,637,395	19,059,544	$1.50
Effect of dilutive securities			
Options and warrants	—	1,221,931	
Diluted EPS			
Income available to common stockholders plus assumed exercises	$28,637,395	20,281,475	$1.41

2001	Income	Weighted Average Shares	Per Share
Basic EPS			
Income available to common stockholders	$28,232,901	18,199,108	$1.55
Effect of dilutive securities			
Options and warrants	—	1,210,817	
Diluted EPS			
Income available to common stockholders plus assumed exercises	$28,232,901	19,409,925	$1.45

2002	Income	Weighted Average Shares	Per Share
Basic EPS			
Income available to common stockholders	$31,271,462	21,962,807	$1.42
Effect of dilutive securities			
Options and warrants	—	783,700	
Diluted EPS			
Income available to common stockholders plus assumed exercises	$31,271,462	22,746,507	$1.37

Recent accounting standards. In June 2001, the FASB issued Statement No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143). The objective of SFAS 143 is to establish an accounting standard for the recognition and measurement of an asset retirement obligation on certain long-lived assets. The retirement obligation must be one that results from the acquisition, construction or normal operation of a long-lived asset. SFAS 143 requires the legal obligation associated with the retirement of a tangible long-lived asset to be recognized at fair value as a liability when incurred, and the cost to be capitalized by increasing the carrying amount of the related long-lived asset. SFAS 143 will be effective for the Company's fiscal year beginning January 1, 2003. The adoption of this statement will have no material impact on the consolidated financial statements.

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (SFAS 144). SFAS 144 supersedes SFAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of” (“Statement 121”) and retains the basic requirements of SFAS 121 regarding when and how to measure an impairment loss. SFAS 144 provides additional implementation guidance on accounting for an impairment loss. SFAS 144 is effective for all fiscal years beginning after December 15, 2001. The Company adopted SFAS 144 beginning in fiscal 2002, the adoption of which did not have a material effect on the Company’s financial position or results of operations.

In April 2002, the FASB issued Statement No. 145, “Rescission of Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Correction” (SFAS 145). SFAS 145 eliminates extraordinary accounting treatment for reporting gains or losses on debt extinguishments, and amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. The provisions of this SFAS are effective for fiscal years beginning after May 15, 2002; however, early application of SFAS 145 is encouraged. Debt extinguishments reported as extraordinary items prior to scheduled or early adoption of this SFAS would be reclassified to other income in most cases following adoption.

The Company is currently evaluating the impact the adoption of SFAS 145 would have on its consolidated results of operations subject to the evaluation in accordance with APB 30, “Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions.”

In June 2002, the FASB issued Statement No. 146, “Accounting for Costs Associated with Exit or Disposal Activities” (SFAS 146), which changes the accounting for costs such as lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity initiated after December 31, 2002. The standard requires companies to recognize the fair value of costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan.

The Company anticipates that the adoption of SFAS 146 will not have a material effect on the Company’s financial position or results of operations.

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

NOTE 3—BUSINESS SEGMENTS AND GEOGRAPHIC DATA

JAKKS Pacific is a worldwide producer and marketer of children’s toys and related products, principally engaged in the design, development, production and marketing of traditional toys, including boys action figures, vehicles and playsets, craft and activity products, writing instruments, compounds, girls toys, and infant and preschool toys. The Company’s reportable segments are North America Toys, International and Other.

The North America Toys segment, which includes the United States and Canada, and the International toy segment, which includes sales to non-North American markets, include the design, development, production and marketing of children’s toys and related products. The Company also has an additional segment classified as Other, which sells various products to the specialty markets in the United States.

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 North America Toy segment, which is a dominant segment. Segment assets are comprised of accounts receivable and inventories, net of applicable reserves and allowances.

The accounting policies of the segments are described in Note 2.

Results are not necessarily those that would be achieved were each segment an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts for the three years ended December 31, 2000, 2001 and 2002 are as follows:

Year Ended December 31,	2000	2001	2002
Net Sales			
North America Toys	$235,136,139	$250,627,160	$263,313,848
International	15,567,118	32,870,718	46,250,930
Other	1,584,686	811,143	451,430
	$252,287,943	$284,309,021	$310,016,208

Year Ended December 31,	2000	2001	2002
Operating Income			
North America Toys	$ 19,109,540	$ 25,827,227	$ 27,166,108
International	1,265,141	3,387,340	4,771,919
Other	128,788	83,589	46,575
	$ 20,503,469	$ 29,298,156	$ 31,984,602

December 31,	2001	2002
Assets		
North America Toys	$250,523,882	$347,488,457
International	33,119,144	60,912,682
Other	397,657	408,810
	$284,040,683	$408,809,949

The following tables present information about the Company by geographic area as of and for the three years ended December 31, 2002:

December 31,	2000	2001	2002
Long-lived Assets			
United States	$ 92,737,874	$ 93,154,559	$161,596,858
Hong Kong	13,705,700	24,556,935	612,710
Europe	—	497,381	59,745,654
	$106,443,574	$118,208,875	$221,955,222

Year Ended December 31,	2000	2001	2002
Net Sales by Geographic Area			
United States	$229,792,943	$244,317,186	$256,798,941
Europe	8,323,132	29,029,659	39,414,011
Canada	6,133,948	7,121,117	6,966,338
Hong Kong	5,397,135	—	323,527
Other	2,640,785	3,841,239	6,513,391
	$252,287,943	$284,309,021	$310,016,208

NOTE 4—ACQUISITIONS AND JOINT VENTURE

The Company owns a fifty percent interest in a joint venture with a company that develops, publishes and distributes interactive entertainment software for the leading hardware game platforms in the home video game market. The joint venture has entered into a license agreement under which it acquired the exclusive worldwide right to publish video games on all hardware platforms. The Company's investment is accounted for using the cost method due to the financial and operating structure of the venture and our lack of control over the joint venture. The Company's basis consists primarily of organizational costs and recoupable advances. The joint venture agreement provides for the Company to receive guaranteed preferred returns through June 30, 2006, subject to annual minimum payments of $2,600,000 through December 31, 2003, at varying rates of the joint venture's net sales depending on the cumulative unit sales and platform of each particular game. For periods after June 30, 2006, the amount of the preferred return will be subject to renegotiation between the parties. The preferred return is accrued in the quarter in which the licensed games are sold and the preferred return is earned. The Company's joint venture partner retains the financial risk of the joint venture and is responsible for the day-to-day operations, including development, sales and distribution, for which they are entitled to any remaining profits. During 2000, 2001 and 2002, the Company earned $15,905,860, $6,675,428 and $8,003,925, respectively, in profit from the joint venture.

In October 1999, the Company acquired all of the stock of Flying Colors Toys, Inc. ("Flying Colors") for $52,879,182 in cash paid at closing. Contingent consideration paid included an earn-out of $4,500,000 in each of the three 12-month periods following the closing, because gross profit of Flying Colors branded products achieved certain prescribed levels in each of such periods. Of the $4,500,000 earned in 2000, the amount of $464,938 was deemed to be compensation and has been expensed in 2000. The remaining balance of $4,035,062 and the 2001 and 2002 earn-outs have been recorded as goodwill.

In December 2001, the Company acquired all the outstanding stock of Kidz Biz Ltd., a United Kingdom company, and Kidz Biz Far East Limited, a Hong Kong corporation, collectively ("Kidz Biz"), for an aggregate purchase price of approximately $12.4 million, which was paid by the issuance of 308,992 shares of the Company's common stock at a value of $6.0 million and cash of $6.4 million. Both the United Kingdom and Hong Kong based companies are distributors of toys and related products in the United Kingdom, Ireland and the Channel Islands.

The Company acquired the following entities to further enhance its existing product lines and to continue diversification into other seasonal business.

On March 11, 2002, the Company purchased a controlling interest in Toymax International, Inc. ("Toymax"). On October 25, 2002, we completed that acquisition by acquiring the remaining outstanding common shares in a merger transaction. The total purchase price of approximately $62.2 million consisted of 1,166,360 shares of the Company's common stock, 598,697 options and approximately $41.0 million in cash. Results of operations have included Toymax from March 12, 2002; however, for the period from March 12, 2002 through October 25, 2002, the minority interest's share of Toymax's earnings were excluded.

On November 27, 2002, the Company purchased certain product lines, assets and assumed certain specific liabilities from Trendmasters, Inc. ("Trendmasters"). The total purchase price of approximately $19.0 million consisted of all cash. Results of operations have included Trendmasters from the date of acquisition.

The total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed as set forth in the following table:

	Kidz Biz	Toymax	Trendmasters	Total
Condensed balance sheet:				
Current assets	$ 8,254,974	$ 26,856,685	$ 20,158	$ 35,131,817
Property and equipment, net	503,294	1,672,614	1,488,318	3,664,226
Other assets	—	11,751,594	—	11,751,594
Current liabilities	(15,042,928)	(42,999,773)	(8,713,143)	(66,755,844)
Goodwill	18,684,660	64,923,989	26,230,167	109,838,816
Total	$ 12,400,000	$ 62,205,109	$19,025,500	$ 93,630,609

Goodwill related to Kidz Biz and Trendmasters is not expected to be deductible for tax purposes, however, approximately $12.7 million of the Toymax goodwill is expected to be deductible for tax purposes.

The following unaudited pro forma information represents the Company's consolidated results of operations as if the acquisitions of Kidz Biz, Toymax and Trendmasters had occurred on January 1, 2001 and after giving effect to certain adjustments including the elimination of certain general and administrative expenses and other income and expense items not attributable to ongoing operations, interest expense, and related tax effects. Such pro forma information does not purport to be indicative of operating results that would have been reported had the acquisitions of Kids Biz, Toymax and Trendmasters occurred on January 1, 2001 or future operating results.

Year Ended December 31,	2001	2002
Net Sales	$483,941,432	$375,008,126
Net income	$ 23,529,672	$ 25,457,352
Basic earnings per share	$ 1.16	$ 1.11
Weighted average shares outstanding	20,273,181	22,998,347
Diluted earnings per share	$ 1.10	$ 1.07
Weighted average shares and equivalents outstanding	21,483,998	23,782,047

NOTE 5—CONCENTRATION OF CREDIT RISK

Financial instruments that subject the Company to concentration of credit risk are cash and cash equivalents and accounts receivable. Cash equivalents consist principally of short-term money market funds. These instruments are short-term in nature and bear minimal risk. To date, the Company has not experienced losses on these instruments.

The Company performs ongoing credit evaluations of its customers' financial condition, but does not require collateral to support domestic customer accounts receivables. Most goods shipped FOB Hong Kong or China are sold on irrevocable letter of credit basis.

NOTE 6—ACCRUED EXPENSES

Accrued expenses consist of the following:

	2001	2002
Bonuses	$ 2,381,698	$ 2,124,000
Royalties and sales commissions	4,787,099	3,972,753
Hong Kong subsidiaries accruals	6,193,354	2,900,611
Other	4,706,574	10,396,650
	$18,068,725	$19,394,014

NOTE 7—RELATED PARTY TRANSACTIONS

A director of the Company is a partner in the law firm that acts as counsel to the Company. The Company incurred legal fees and expenses to the law firm in the amount of approximately $975,000 in 2000, $1,129,000 in 2001 and $2,653,000 in 2002.

As of December 31, 2002, there were two notes receivable from officers totaling $1,113,000 issued at interest rates of 6.5% each, with interest payable on each April 28 and October 28 of each year, and principal payable at a maturity date of April 28, 2003. Additionally, there was a third note receivable from an officer for $250,000 issued at an interest rate of 7.0%, with interest and principal payable at a maturity date of May 12, 2002, except that all indebtedness under the loan was forgiven on May 12, 2002, pursuant to this officer's employment agreement because employment continued through such date.

NOTE 8—LONG-TERM DEBT

Long-term debt consists of the following:

	2001	2002
Loan payable, due in 60 monthly payments with the final payment due December 4, 2006, with interest at 6.7% per annum	$95,070	$77,488
Less current portion of long-term debt	17,582	17,805
Long-term debt, net of current portion	$77,488	$59,683

The following is a schedule of payments for the loan payable:

2003	$17,805
2004	19,036
2005	20,350
2006	20,297
	$77,488

NOTE 9—INCOME TAXES

The Company does not file a consolidated return with its foreign subsidiaries. The Company files Federal and state returns and its foreign subsidiaries file Hong Kong and United Kingdom returns. Income taxes reflected in the accompanying consolidated statements of operations are comprised of the following:

Year Ended December 31,	2000	2001	2002
Federal	$ 4,979,188	$2,595,989	$2,241,028
State and local	1,112,798	1,064,843	270,465
Foreign	5,161,994	5,336,377	6,105,378
	11,253,980	8,997,209	8,616,871
Deferred	442,983	800,000	431,667
	$11,696,963	$9,797,209	$9,048,538

The components of deferred tax assets/(liabilities) are as follows:

	2001	2002
Net deferred tax assets/(liabilities):		
Current:		
Reserve for sales allowances and possible losses	$ 495,787	$ 2,012,524
Accrued expenses	(495,787)	1,848,700
Other	—	584,434
	—	4,445,658
Long-Term:		
Undistributed earnings	(5,084,165)	(11,024,165)
Property and equipment	(2,441,471)	(1,564,268)
Other	801,945	1,570,124
Federal net operating loss carryforwards	4,466,874	9,666,608
State net operating loss carryforwards	—	788,753
	(2,256,817)	(562,948)
Total net deferred tax assets/(liabilities)	$(2,256,817)	$ 3,882,710

Income tax expense varies from the U.S. Federal statutory rate. The following reconciliation shows the significant differences in the tax at statutory and effective rates:

	2000	2001	2002
Federal income tax expense	35%	35%	35%
State income tax expense, net of Federal tax effect	1.8	1.8	0.4
Effect of differences in U.S. and foreign statutory rates	(14.8)	(16.7)	(15.3)
Other	7.0	5.9	1.9
	29%	26%	22%

Deferred taxes result from temporary differences between tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. The temporary differences result from costs required to be capitalized for tax purposes by the U.S. Internal Revenue Code ("IRC"), and certain items accrued for financial reporting purposes in the year incurred but not deductible for tax purposes until paid.

As of December 31, 2002, the Company has Federal and state net operating loss carryforwards of $27.6 million and $43 million, respectively, expiring through 2023. These carryforwards resulted from the acquisitions of Pentech and Toymax; the utilization of these losses to offset future income is limited under IRC§382. The Company's management concluded that a deferred tax asset valuation allowance was not necessary.

The components of income before provision for income taxes and minority interest are as follows:

	2000	2001	2002
Domestic	$ 8,480,038	$ 4,677,721	$ 3,537,593
Foreign	31,854,320	33,352,389	37,592,125
	$40,334,358	$38,030,110	$41,129,718

NOTE 10—CREDIT FACILITY

On October 12, 2001, the Company entered into a Loan Agreement with a consortium of banks led by Bank of America, N.A. This agreement expires on October 12, 2004 and permits the Company to borrow (and maintain obligations under outstanding letters of credit) up to an aggregate of $50,000,000. Available borrowings under the facility are determined by applying specified advance rates to eligible domestic accounts receivable and inventory.

The Company is required to not have any outstanding borrowings in excess of $30,000,000 for a period of at least 30 consecutive days during the first fiscal quarter of each year of the agreement.

This Credit facility is secured by a lien on substantially all of the Company's assets and contains customary financial and non-financial covenants which limit the ability to incur additional indebtedness, pay dividends or make other distributions, sell assets and enter into certain mergers or acquisitions. Amounts outstanding under this credit facility bears interest at 0.25% plus the greater of the Prime Rate or Federal Funds Rate plus 0.5%, and is subject to change based on certain financial ratios. As of December 31, 2002, the Company has no outstanding borrowings.

NOTE 11—LEASES

The Company leases office, warehouse and showroom facilities and certain equipment under operating leases. Rent expense for the years ended December 31, 2000, 2001 and 2002 totaled $769,070, $2,495,390 and $3,957,712, respectively. The following is a schedule of minimum annual lease payments.

2003	$ 4,707,091
2004	4,601,158
2005	3,967,662
2006	3,905,415
2007	3,490,756
Thereafter	1,292,900
	$21,964,982

NOTE 12—COMMON STOCK AND PREFERRED STOCK

The Company has 105,000,000 authorized shares of stock consisting of 100,000,000 shares of $.001 par value common stock and 5,000,000 shares of $.001 par value preferred stock. At the Company's annual meeting on September 27, 2002, its Stockholders approved increases in our authorized shares from 25,000,000 shares of common stock and 1,000,000 shares of preferred stock.

During 2002, the Company issued 954,770 shares of common stock on the exercise of options and warrants for a total of $5,883,931, 1,166,360 shares of common stock at a value of $18,081,243 in connection with the Toymax acquisition and 3,525,000 shares of common stock in connection with an underwritten public offering for net proceeds of approximately $59.1 million.

Warrant activity is summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding, December 31, 1999	293,132	$5.92
Exercised	(36,777)	5.79
Outstanding, December 31, 2000	256,355	5.94
Exercised	(82,118)	4.48
Canceled	(7,362)	5.63
Outstanding, December 31, 2001	166,875	6.67
Exercised	(166,875)	6.67
Outstanding, December 31, 2002	—	$ —

During 2001, the Company issued 525,780 shares of common stock on exercise of options and warrants for a total of $3,069,745 and 308,992 shares of common stock at a value of $6,000,000 in connection with the Kidz Biz acquisition.

During 2000, the Company issued 212,890 shares of common stock on exercise of options and warrants for a total of $1,171,243. The Company repurchased 1,493,600 shares of common stock for a total of $12,911,483 and retired such stock in 2002.

NOTE 13—COMMITMENTS

The Company has entered into various license agreements whereby the Company may use certain characters and properties in conjunction with its products. Such license agreements call for royalties to be paid at 1.0% to 14.0% of net sales with minimum guarantees and advance payments. Additionally, under two separate licenses, the Company has committed to spend 12.5% of related net sales up to $1,000,000 and 5.0% of related net sales on advertising per year on such licenses.

Future annual minimum royalty guarantees as of December 31, 2002 are as follows:

2003	$ 4,202,692
2004	1,829,063
2005	4,538,335
2006	1,040,000
2007	1,040,000
Thereafter	6,731,000
	$19,381,090

The Company has entered into various employment agreements with certain executives expiring through June 2009. At December 31, 2002, the aggregate minimum guaranteed amounts under those agreements amount to $22.4 million.

NOTE 14—STOCK OPTION PLANS

Under its Third Amended and Restated 1995 Stock Option Plan ("the Plan"), the Company has reserved 3,725,000 shares of its common stock for issuance upon exercise of options granted under the Plan. And, under the 2002 Stock Award and Incentive Plan (the "2002 Plan"), the Company has reserved 2,300,000 shares of its common stock. Under the plans, employees (including officers), non-employee directors and independent consultants may be granted options to purchase shares of common stock.

As of December 31, 2002, 1,688,262 shares were available for future grant. Additional shares may become available to the extent that options presently outstanding under the Plan terminate or expire unexercised. Stock option activity pursuant to the Plans is summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding, December 31, 1999	2,138,318	$11.70
Granted	2,036,497	10.49
Exercised	(91,177)	6.88
Canceled	(1,880,898)	15.82
Outstanding, December 31, 2000	2,202,740	7.15
Granted	724,125	15.73
Exercised	(427,536)	6.21
Canceled	(185,773)	7.98
Outstanding, December 31, 2001	2,313,556	9.97
Granted	1,124,197	11.06
Exercised	(787,836)	6.71
Canceled	(42,030)	15.00
Outstanding, December 31, 2002	2,607,887	$11.35

During 2002, the Company issued 598,697 options in connection with the Toymax acquisition. Stock option activity outside of the Plans is summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding, December 31, 1999	101,062	$3.69
Exercised	(84,936)	3.96
Outstanding, December 31, 2000	16,126	2.24
Exercised	(16,126)	2.24
Outstanding, December 31, 2001 and 2002	—	$ —

The weighted average fair value of options granted to employees in 2000, 2001 and 2002 was $7.23, $16.24 and $10.65 per share, respectively.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2002:

	Outstanding			Exercisable	
Option Price Range	Number of Shares	Weighted Average Life	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$2.24–$20.57	2,607,887	4.28 years	$11.35	974,007	$9.34

NOTE 15—EMPLOYEE PENSION PLAN

The Company sponsors for its U.S. employees, a defined contribution plan under Section 401(k) of the Internal Revenue Code. The plan provides that employees may defer up to 15.0% of annual compensation, and that the Company will make a matching contribution equal to 50.0% of each employee's deferral, up to 5.0% of compensation. Company matching contributions, which vest equally over a five-year period, totaled $212,212, $216,038 and $268,086 for 2000, 2001 and 2002, respectively.

NOTE 16—MAJOR CUSTOMERS

Net sales to major customers, which are part of our North America Toys segment, were approximately as follows:

2000		2001		2002	
Amount	Percentage	Amount	Percentage	Amount	Percentage
$ 43,505,000	17.2%	$ 44,646,000	15.7%	$ 46,396,000	15.0%
36,321,000	14.4	36,024,000	12.7	41,506,000	13.4
30,481,000	12.1	34,319,000	12.1	34,773,000	11.2
27,338,000	10.8	20,972,000	7.4	34,018,000	11.0
21,875,000	8.7	19,425,000	6.8	16,077,000	5.1
$159,520,000	63.2%	$155,386,000	54.7%	$172,770,000	55.7%

NOTE 17—SUPPLEMENTAL INFORMATION TO CONSOLIDATED STATEMENTS OF CASH FLOWS

In 2002, 1,166,360 shares of common stock valued at $18.1 million and 598,697 options valued at $3.2 million were issued in connection with the acquisition of Toymax (Note 4).

In 2001, 308,992 shares of common stock valued at $6,000,000 were issued in connection with the acquisition of Kidz Biz (Note 4).

NOTE 18—SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Selected unaudited quarterly financial data for the years 2001 and 2002 are summarized below:

	2001				2002			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(in thousands, except per share data)								
Net sales	$59,962	$70,141	$92,768	$61,438	$59,895	$78,992	$102,640	$68,489
Gross profit	$24,468	$32,609	$39,056	$23,953	$26,470	$35,192	$ 41,812	$27,077
Income (loss) from operations	$ 7,267	$ 8,879	$14,562	$ (1,410)	$ 1,420	$ 9,912	$ 18,895	$ 1,758
Income before income taxes and minority interest	$ 8,480	$ 9,478	$15,250	$ 4,822	$ 2,985	$10,849	$ 19,944	$ 7,352
Net income	$ 6,021	$ 6,873	$10,949	$ 4,390	$ 2,156	$ 7,832	$ 13,954	$ 7,329
Basic earnings per share	$ 0.33	$ 0.38	$ 0.60	$ 0.24	$ 0.11	$ 0.37	$ 0.59	$ 0.30
Weighted average shares outstanding	18,008	18,048	18,273	18,463	19,017	20,985	23,586	24,178
Diluted earnings per share	$ 0.32	$ 0.36	$ 0.56	$ 0.22	$ 0.11	$ 0.36	$ 0.58	$ 0.30
Weighted average shares and equivalents outstanding	18,920	19,259	19,586	19,763	20,236	21,953	24,059	24,800

During the second quarter of 2000, the Company recorded a charge which impacted operating income by approximately $1.4 million relating to the recall of one of our products.

During the fourth quarter of 2001, the Company recorded a charge of $5.0 million to bad debt impacting operating income relating to the bankruptcy filing of one of its customers, Kmart.

During the first quarter of 2002, the Company recorded a charge which impacted operating income by approximately $6.6 million relating to the restructuring of Toymax and Kidz Biz.

During the second quarter of 2002, the Company recorded a charge which impacted operating income by approximately $1.4 million relating to the recall of one of its products.

During the fourth quarter of 2002, the Company reversed $2.1 million of the restructuring charge recorded in the first quarter of 2002 and recorded an additional charge of approximately $0.7 million relating to the recall of one of its products, the net of which favorably impacted operating income by approximately $1.5 million. In addition, the Company's effective tax rate for the year 2002 was reduced from 26.0% to 22.0%.

NOTE 19—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.

NOTE 20—SUBSEQUENT EVENTS

In February 2003, the Company's Board of Directors approved a buyback of up to $20.0 million of the Company's common stock. As of March 27, 2003, the Company repurchased 330,000 shares of its common stock for a total of approximately $3.4 million.

Schedule II—Valuation and Qualifying Accounts

Years Ended December 31, 2002, 2001 and 2000

Allowances are deducted from the assets to which they apply, except for sales returns and allowances.

	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
Year ended December 31, 2000:					
Allowance for:					
Uncollectible accounts	$ 1,887,374	$ 2,270,611	$2,773,744 (a)	$ 3,920,027	$ 3,011,702
Reserve for potential product obsolescence	2,942,606	1,318,730	4,095,771 (b)	1,035,470	7,321,637
Reserve for sales returns and allowances	15,318,001	17,296,039	1,360,000 (c)	27,420,809	6,553,231
	$20,147,981	$20,885,380	$8,229,515	$32,376,306	$16,886,570
Year ended December 31, 2001:					
Allowance for:					
Uncollectible accounts	$ 3,011,702	$ 6,320,940	$ —	$ 2,059,145	$ 7,273,497
Reserve for potential product obsolescence	7,321,637	1,039,005	—	5,770,543	2,590,099
Reserve for sales returns and allowances	6,553,231	25,190,259	—	26,790,611	4,952,879
	$16,886,570	$32,550,204	$ —	$34,620,299	$14,816,475
Year ended December 31, 2002:					
Allowance for:					
Uncollectible accounts	$ 7,273,497	$ 2,372,524	$ —	$ 2,864,697	$ 6,781,324
Reserve for potential product obsolescence	2,590,099	4,084,591	—	1,892,669	4,782,021
Reserve for sales returns and allowances	4,952,879	31,916,660	7,500,000 (d)	30,790,171	13,579,368
	$14,816,475	$38,373,775	$7,500,000	$35,547,537	$25,142,713

(a) Obligations assumed in conjunction with the acquisitions of Flying Colors and Pentech.

(b) Fair market value adjustment for inventory acquired in connection with the acquisition of Pentech.

(c) Obligation assumed in conjunction with the acquisition of Pentech.

(d) Obligations assumed in conjunction with the asset acquisitions of Trendmasters and Dragon Ball Franchise.

Independent Auditors' Report

The Stockholders
JAKKS Pacific, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of JAKKS Pacific, Inc. and Subsidiaries as of December 31, 2001 and 2002, and the related consolidated statements of operations, stockholders' equity and cash flows and the financial statement schedule for each of the three years in the period ended December 31, 2002. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements and schedule referred to above present fairly, in all material respects, the financial position of JAKKS Pacific, Inc. and Subsidiaries as of December 31, 2001 and 2002, and the results of their operations and cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 2 to these consolidated financial statements, the Company changed its method of accounting for the amortization of goodwill and other intangible assets in accordance with guidance provided by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," in 2002.

PKF

PKF
Certified Public Accountants
A Professional Corporation
Los Angeles, California
February 10, 2003, except for Note 20,
for which the date is March 27, 2003

Board of Directors

Jack Friedman
Chairman and
Chief Executive Officer
JAKKS Pacific, Inc.

Stephen G. Berman
President, Secretary and
Chief Operating Officer
JAKKS Pacific, Inc.

David C. Blatte
Partner
Catterton Partners

Robert E. Glick
Apparel Manufacturing Executive

Michael G. Miller
Advertising Executive

Murray L. Skala
Partner
Feder, Kaszovitz, Isaacson, Weber, Skala, Bass & Rhine LLP

Corporate Officers

Jack Friedman
Chief Executive Officer

Stephen G. Berman
President and
Chief Operating Officer

Joel M. Bennett
Executive Vice President and
Chief Financial Officer

Michael L. Bianco, Jr.
Executive Vice President and
Chief Merchandising Officer

Corporate Information

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Fax: 909-594-2179

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Corporate Information

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Investor Relations
Integrated Corporate Relations, Inc.
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Long Beach, CA 90806
Tel: 562-256-7049
Fax: 562-256-7052

Transfer Agent
U.S. Stock Transfer Corp.
1745 Gardena Avenue
2nd Floor
Glendale, CA 91204

Stock Exchange Listing
Common stock trading on the Nasdaq National Market® under the symbol "JAKK." As of June 12, 2003, there were approximately 117 holders of record and approximately 9,384 beneficial owners of the Company's common stock. The Company has not paid cash dividends and does not anticipate paying cash dividends in the foreseeable future.

Annual Report
A copy of the Company's annual report on Form 10-K, as filed with the Securities and Exchange Commission, will be furnished to stockholders and interested investors free of charge upon written request to the Company, Attention: Corporate Secretary, 22619 Pacific Coast Highway, Suite 250, Malibu, CA 90265.

Annual Meeting
The Annual Meeting of Stockholders will be held on Thursday, August 14, 2003, at 9:00 A.M. PDT at Sherwood Country Club, 320 West Stafford Road, Thousand Oaks, CA 91361.

Common Stock Price Data

2001	High	Low
First Quarter	$15.00	$ 8.00
Second Quarter	19.44	8.78
Third Quarter	21.80	12.60
Fourth Quarter	25.38	12.44
2002		
First Quarter	$23.70	$15.85
Second Quarter	23.49	15.91
Third Quarter	17.76	9.57
Fourth Quarter	16.63	9.30
2003		
First Quarter	$14.49	$ 9.50

Forward-Looking Statements
This annual report contains forward-looking statements that are subject to the safe harbor created by Section 27a of the federal securities law, including, among others, statements relating to sales growth, political support for education, acceptance of our products and new product introductions. Such statements are subject to substantial risks and uncertainties. Actual events or results may differ materially as a result of many factors, including but not limited to: the extent of acceptance and purchase of the Company's products by target customers; the extent of educators' acceptance of technology, accountability and standardized testing; political trends; seasonality and sales cycles in the Company's markets; competition; availability of funding available to schools; the Company's ability to continue to demonstrate the efficacy of its products, which depends on how the programs are administered, the demography of participants and other factors; the Company's ability to retain key personnel; pricing pressures; obstacles or delays in product development; and other risks detailed in the Company's SEC reports, including the Company's reports on Form 10-K and 10-Q.

Designed by Curran & Connors, Inc. / www.curran-connors.com

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