

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark one)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2022
- or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number: **0-28104**

JAKKS Pacific, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

95-4527222

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

2951 28th Street

Santa Monica, California

(Address of Principal Executive Offices)

90405

(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer

Non-accelerated filer

Emerging growth company

Accelerated filer

Smaller reporting company

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

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

Securities registered pursuant to Section 12(g) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock \$.001 Par Value	JAKK	The NASDAQ Global Select Market

The number of shares outstanding of the issuer's common stock is 9,587,806 as of May 10, 2022.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
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QUARTER ENDED MARCH 31, 2022
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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

Assets	March 31, 2022 (Unaudited)	December 31, 2021
Current assets		
Cash and cash equivalents	\$ 39,225	\$ 44,521
Restricted cash	—	811
Accounts receivable, net of allowance for doubtful accounts of \$2,576 and \$2,626 at March 31, 2022 and December 31, 2021, respectively	103,730	147,394
Inventory	85,306	83,954
Prepaid expenses and other assets	17,412	10,877
Total current assets	245,673	287,557
Property and equipment		
Office furniture and equipment	11,994	11,967
Molds and tooling	105,429	103,102
Leasehold improvements	6,866	6,876
Total	124,289	121,945
Less accumulated depreciation and amortization	110,345	108,796
Property and equipment, net	13,944	13,149
Operating lease right-of-use assets, net	17,089	16,950
Other long term assets	2,919	2,993
Intangible assets, net	761	1,015
Goodwill	35,083	35,083
Trademarks	300	300
Total assets	\$ 315,769	\$ 357,047
Liabilities, Preferred Stock and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 36,439	\$ 50,237
Payable to Meisheng (related party)	15,511	15,894
Accrued expenses	30,596	47,071
Reserve for sales returns and allowances	39,375	46,285
Income taxes payable	1,205	1,004
Short term operating lease liabilities	11,014	10,477
Short term debt, net	2,475	2,104
Total current liabilities	136,615	173,072
Long term operating lease liabilities	7,399	8,039
Debt, non-current portion, net of issuance costs and debt discounts	92,934	93,415
Preferred stock derivative liability	21,927	21,282
Income taxes payable	215	215
Deferred income taxes, net	51	51
Total liabilities	259,141	296,074
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; 200,000 shares issued and outstanding at March 31, 2022 and December 31, 2021	3,420	3,074
Stockholders' Equity		
Common stock, \$0.001 par value; 100,000,000 shares authorized; 9,587,806 and 9,520,817 shares issued and outstanding at March 31, 2022 and December 31, 2021, respectively	10	10
Additional paid-in capital	272,821	272,941
Accumulated deficit	(207,240)	(203,431)
Accumulated other comprehensive loss	(13,614)	(12,952)
Total JAKKS Pacific, Inc. stockholders' equity	51,977	56,568
Non-controlling interests	1,231	1,331
Total stockholders' equity	53,208	57,899
Total liabilities, preferred stock and stockholders' equity	\$ 315,769	\$ 357,047

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	(Unaudited)	
	2022	2021
Net sales	\$ 120,881	\$ 83,843
Cost of sales:		
Cost of goods	72,058	44,049
Royalty expense	17,690	12,511
Amortization of tools and molds	1,216	1,189
Cost of sales	90,964	57,749
Gross profit	29,917	26,094
Direct selling expenses	4,902	6,802
General and administrative expenses	25,153	21,411
Depreciation and amortization	596	604
Selling, general and administrative expenses	30,651	28,817
Loss from operations	(734)	(2,723)
Other income (expense), net	86	55
Change in fair value of preferred stock derivative liability	(645)	(7,375)
Change in fair value of convertible senior notes	—	(9,047)
Interest income	3	2
Interest expense	(2,202)	(4,875)
Loss before provision for income taxes	(3,492)	(23,963)
Provision for income taxes	417	88
Net loss	(3,909)	(24,051)
Net income (loss) attributable to non-controlling interests	(100)	35
Net loss attributable to JAKKS Pacific, Inc.	\$ (3,809)	\$ (24,086)
Net loss attributable to common stockholders	\$ (4,155)	\$ (24,412)
Loss per share - basic and diluted	\$ (0.43)	\$ (4.54)
Shares used in loss per share - basic and diluted	9,588	5,379
Comprehensive loss	\$ (4,571)	\$ (24,109)
Comprehensive loss attributable to JAKKS Pacific, Inc.	\$ (4,471)	\$ (24,144)

See accompanying notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands)

Three Months Ended March 31, 2022
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	JAKKS Pacific, Inc. Stockholders' Equity (Deficit)	Non- Controlling Interests	Total Stockholders' Equity (Deficit)
Balance, December 31, 2021	\$ 10	\$ 272,941	\$ (203,431)	\$ (12,952)	\$ 56,568	\$ 1,331	\$ 57,899
Share-based compensation expense	—	870	—	—	870	—	870
Repurchase of common stock for employee tax withholding	—	(644)	—	—	(644)	—	(644)
Preferred stock accrued dividends	—	(346)	—	—	(346)	—	(346)
Net income (loss)	—	—	(3,809)	—	(3,809)	(100)	(3,909)
Foreign currency translation adjustment	—	—	—	(662)	(662)	—	(662)
Balance, March 31, 2022	<u>\$ 10</u>	<u>\$ 272,821</u>	<u>\$ (207,240)</u>	<u>\$ (13,614)</u>	<u>\$ 51,977</u>	<u>\$ 1,231</u>	<u>\$ 53,208</u>

Three Months Ended March 31, 2021
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	JAKKS Pacific, Inc. Stockholders' Equity (Deficit)	Non- Controlling Interests	Total Stockholders' Equity (Deficit)
Balance, December 31, 2020	\$ 6	\$ 221,590	\$ (197,423)	\$ (12,446)	\$ 11,727	\$ 1,211	\$ 12,938
Share-based compensation expense	—	382	—	—	382	—	382
Repurchase of common stock for employee tax withholding	—	(164)	—	—	(164)	—	(164)
Conversion of convertible senior notes	—	5,631	—	—	5,631	—	5,631
Preferred stock accrued dividends	—	(326)	—	—	(326)	—	(326)
Net income (loss)	—	—	(24,086)	—	(24,086)	35	(24,051)
Foreign currency translation adjustment	—	—	—	(58)	(58)	—	(58)
Balance, March 31, 2021	<u>\$ 6</u>	<u>\$ 227,113</u>	<u>\$ (221,509)</u>	<u>\$ (12,504)</u>	<u>\$ (6,894)</u>	<u>\$ 1,246</u>	<u>\$ (5,648)</u>

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	(Unaudited)	
	2022	2021
Cash flows from operating activities		
Net loss	\$ (3,909)	\$ (24,051)
Adjustments to reconcile net loss to net cash used in operating activities:		
Recovery of doubtful accounts	(39)	(772)
Depreciation and amortization	1,812	1,793
Payment-in-kind interest	—	925
Amortization of debt discount	94	719
Amortization of debt issuance costs	123	351
Share-based compensation expense	870	382
Gain on disposal of property and equipment	—	(55)
Change in fair value of convertible senior notes	—	9,047
Change in fair value of preferred stock derivative liability	645	7,375
Changes in operating assets and liabilities:		
Accounts receivable	43,703	23,369
Inventory	(1,352)	1,989
Prepaid expenses and other assets	(6,540)	(5,196)
Accounts payable and payable to Meisheng (related party)	(14,717)	(8,735)
Accrued expenses	(16,475)	(11,071)
Reserve for sales returns and allowances	(6,910)	(2,609)
Income taxes payable	201	(309)
Other liabilities	(242)	(113)
Total adjustments	1,173	17,090
Net cash used in operating activities	(2,736)	(6,961)
Cash flows from investing activities		
Purchases of property and equipment	(1,817)	(1,472)
Proceeds from sale of property and equipment	—	21
Net cash used in investing activities	(1,817)	(1,451)
Cash flows from financing activities		
Repurchase of common stock for employee tax withholding	(644)	(164)
Repayment of credit facility borrowings	(13,000)	—
Proceeds from credit facility borrowings	13,000	—
Repayment of 2021 BSP Term Loan	(248)	—
Net cash used in financing activities	(892)	(164)
Net decrease in cash, cash equivalents and restricted cash	(5,445)	(8,576)
Effect of foreign currency translation	(662)	(58)
Cash, cash equivalents and restricted cash, beginning of period	45,332	92,693
Cash, cash equivalents and restricted cash, end of period	\$ 39,225	\$ 84,059
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net	\$ 220	\$ 484
Cash paid for interest	\$ 1,967	\$ 5,118

As of March 31, 2022, there was \$3.3 million of property and equipment purchases included in accounts payable. As of March 31, 2021, there was \$1.7 million of property and equipment purchases included in accounts payable.

See Notes 1, 5, 6 and 9 for additional supplemental information to the condensed consolidated statements of cash flows.

See accompanying notes to condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
March 31, 2022

Note 1 — Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to prevent the information presented from being misleading. These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K, which contains audited financial information for the three years in the period ended December 31, 2021.

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

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

Effective July 9, 2020, the Company completed a 1 for 10 reverse stock split of its \$0.001 par value common stock reducing the issued and outstanding shares of common stock from 42,395,782 to 4,239,578 (“Reverse Stock Split”). The Reverse Stock Split did not cause an adjustment to the par value or the authorized shares of the common stock. All share and per share amounts in the financial statements and notes thereto have been retroactively adjusted for all periods presented to give effect to the Reverse Stock Split, including reclassifying an amount equal to the reduction in par value of common stock to additional paid-in capital. The primary reason for implementing the Reverse Stock Split was to regain compliance with the minimum bid price requirement of The NASDAQ Stock Market LLC (“Nasdaq”). On July 31, 2020, the Company was notified by Nasdaq that it had regained compliance with the Nasdaq listing requirements.

In June 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-13, “Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” which require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The new standard was initially effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. In November 2019, the FASB issued ASU 2019-10 which deferred the effective date of ASU 2016-13 by three years for Smaller Reporting Companies. As a result, the effective date for the standard is fiscal years beginning after December 15, 2022, and interim periods therein, and early adoption is permitted. The Company is currently evaluating the impact of the adoption of ASU 2016-13 on its condensed consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, “Simplifying the Accounting for Income Taxes,” which simplifies the accounting for income taxes related to the approach for intra-period tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax assets for investments. The guidance also reduces complexity in certain areas, including the accounting for transactions that result in a step-up in the tax basis of goodwill and allocating taxes to members of a consolidated group. This new standard is effective for the Company for fiscal years beginning January 1, 2021, with early adoption permitted. The adoption of this standard did not have a material impact on the Company’s condensed consolidated financial statements.

In March 2020, the FASB issued ASU 2020-04, “Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” In January 2021, the FASB issued ASU 2021-01, “Reference Rate Reform (Topic 848): Scope.” The ASUs provide temporary optional expedients and exceptions for applying U.S. GAAP to contracts, hedging relationships, and other transactions, for a limited period of time, to ease the potential burden of recognizing the effects of reference rate reform on financial reporting. The amendments in ASU 2020-04 apply to contracts, hedging relationships and other transactions that reference the London Inter-Bank Offered Rate (“LIBOR”) or another reference rate expected to be discontinued due to the global transition away from LIBOR and certain other interbank offered rates. The new standard is effective for the Company for fiscal years beginning after December 15, 2022, including interim periods within these fiscal years, with early adoption permitted. The Company is currently evaluating the impact that the adoption of this new guidance will have on its condensed consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
March 31, 2022

In August 2020, the FASB issued ASU 2020-06, “Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity.” The new guidance eliminates two of the three models in ASC 470-20, which required entities to account for beneficial conversion features and cash conversion features in equity, separately from the host convertible debt or preferred stock. As a result, only conversion features accounted for under the substantial premium model in ASC 470-20 and those that require bifurcation in accordance with ASC 815-15 will be accounted for separately. In addition, the amendments in ASU 2020-06 eliminate some of the requirements in ASC 815-40 related to equity classification. The amendments in ASU 2020-06 further revised the guidance in ASC 260, Earnings Per Share (“EPS”), to address how convertible instruments are accounted for in calculating diluted EPS, and require enhanced disclosures about the terms of convertible instruments and contracts in an entity’s own equity. The new standard is effective for the Company for fiscal years beginning after December 15, 2023, including interim periods within these fiscal years, with early adoption permitted. The Company is currently evaluating the impact that the adoption of this new guidance will have on its condensed consolidated financial statements.

In November 2021, the FASB issued ASU 2021-10, “Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance.” ASU 2021-10 requires annual disclosures that are expected to increase the transparency of transactions involving government grants, including (1) the types of transactions, (2) the accounting for those transactions and (3) the effect of those transactions on an entity’s financial statements. The provisions of ASU 2021-10 are effective for fiscal years beginning after December 31, 2021, with early adoption permitted. The Company adopted ASU 2021-10 during the fiscal period December 31, 2021. (Note 5 – Debt and Note 18 –Prepaid Expenses and Other Assets, for disclosures related to government assistance received by the Company).

Liquidity

On January 30, 2020, the World Health Organization (“WHO”) announced a global health emergency because of a new strain of coronavirus originating in Wuhan, China (the “COVID-19 outbreak”) and the risks to the international community as the virus spreads globally beyond its point of origin. In March 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally.

The global pandemic continues to be an unpredictable macro event impacting the world at large and by extension, the market for JAKKS products as well as its operations. The Company has navigated the pandemic to date and has expectations of wider vaccinations and reduced pandemic restrictions on mobility and social interactions in the quarters to follow. As such, it is uncertain as to the full magnitude that the pandemic will have on the Company’s financial condition, liquidity, and future results of operations. Management is actively monitoring the global situation and the resulting impact on its financial condition, liquidity, operations, suppliers, industry, and workforce. Given the daily evolution of the COVID-19 outbreak and the global responses to curb its spread, the Company is unable to estimate effects of the COVID-19 outbreak on its future results of operations, financial condition, and liquidity.

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief and Economic Security Act (“CARES Act”). The CARES Act, among other things, includes provisions relating to refundable payroll tax credits, deferment of employer-side social security payments, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations and technical corrections to tax depreciation methods for qualified improvement property. On December 27, 2020, President Trump signed into law the Consolidated Appropriations Act of 2021 (“CAA”), which includes many tax and health components, as well as CARES Act extensions and modifications. The Company continues to monitor and explore any relevant government assistance programs that could support either cash liquidity or operating results in the short-medium term.

On April 23, 2020, the Small Business Administration issued new guidance that questioned whether a public company with substantial market value and access to capital markets would qualify to participate in the Paycheck Protection Program (“PPP”). Subsequently, on April 28, 2020, the Secretary of the Treasury and Small Business Administrator announced that the government will review all PPP loans of more than \$2.0 million for which the borrower applies for forgiveness. If the Company were to be audited and receive an adverse finding in such audit, the Company could be required to return the full amount of the loan, which could reduce its liquidity, and potentially subject it to fines and penalties.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
March 31, 2022

On June 12, 2020, the Company received a \$6.2 million loan under the PPP within the CARES Act (the "PPP Loan"). The PPP Loan maturity date was June 2, 2022 and was subject to the CARES Act terms which included, among other terms, an interest rate of 1.00% per annum and monthly installment payments of \$261,275 commencing on September 27, 2021. The PPP Loan allowed for prepayment at any time prior to maturity with no prepayment penalties. The PPP Loan was subject to events of default and other provisions customary for a loan of this type. The application for the loan required the Company to, in good faith, certify that the current economic uncertainty made the loan request necessary to support the ongoing operations of the Company. This certification further required the Company to take into account its current business activity and its ability to access other sources of liquidity sufficient to support ongoing operations in a manner that is not significantly detrimental to the business. A PPP Loan may be forgiven, partially or in full, if certain conditions are met, principally based on having been disbursed for permissible purposes and maintaining certain average levels of employment and payroll as required by the CARES Act. The forgiveness of the loan was also dependent on the Company having initially qualified for the loan.

In June 2021, the Company filed its application for forgiveness of the entirety of its PPP loan. On September 10, 2021, the full amount of the PPP Loan was forgiven.

The CARES Act also provided an employee retention credit ("ERC") which was a refundable tax credit against certain employment taxes of up to \$5,000 per employee for eligible employers. The credit is equal to 50% of qualified wages paid to employees during a quarter, capped at \$10,000 of qualified wages through year end. The Company became eligible for the credit beginning on March 16, 2020.

The CAA extended and expanded the availability of the ERC through June 30, 2021. Subsequently, the American Rescue Plan Act of 2021 ("ARP"), enacted on March 11, 2021, extended and expanded the availability of the ERC through December 31, 2021, however, certain provisions apply only after December 31, 2020. This new legislation amended the employee retention credit to be equal to 70% of qualified wages paid to employees after December 31, 2020, and before January 1, 2022. During calendar year 2021, a maximum of \$10,000 in qualified wages for each employee per qualifying calendar quarter may be counted in determining the 70% credit. Therefore, the maximum tax credit that can be claimed by an eligible employer is \$7,000 per employee per qualifying calendar quarter of 2021. The Company will qualify for the employee retention credit for quarters where the Company's operations were partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19. During the three months ended March 31, 2021, the Company recorded \$1.9 million related to the ERC as an offset within selling, general and administrative expenses on the Company's condensed consolidated statements of operations and within prepaid expenses and other assets on the Company's condensed consolidated balance sheet (See Note 18 – Prepaid Expenses and Other Assets).

As of March 31, 2022 and December 31, 2021, the Company held cash and cash equivalents, including restricted cash, of \$39.2 million and \$45.3 million, respectively. Cash, and cash equivalents, including restricted cash held outside of the United States in various foreign subsidiaries totaled \$33.3 million and \$30.7 million as of March 31, 2022 and December 31, 2021, respectively. The cash and cash equivalents, including restricted cash balances in the Company's foreign subsidiaries have either been fully taxed in the U.S. or tax has been accounted for in connection with the Tax Cuts and Jobs Act, or may be eligible for a full foreign dividends received deduction under such Act, and thus would not be subject to additional U.S. tax should such amounts be repatriated in the form of dividends or deemed distributions. Any such repatriation may result in foreign withholding taxes, which the Company expects would not be significant as of March 31, 2022.

The Company's primary sources of working capital are cash flows from operations and borrowings under its credit facility (see Note 6 - Credit Facilities).

Typically, cash flows from operations are impacted by the effect on sales of (1) the appeal of the Company's products, (2) the success of its licensed brands in motivating consumer purchase of related merchandise, (3) the highly competitive conditions existing in the toy industry and in securing commercially-attractive licenses, (4) dependency on a limited set of large customers, and (5) general economic conditions. A downturn in any single factor or a combination of factors could have a material adverse impact upon the Company's ability to generate sufficient cash flows to operate the business. In addition, the Company's business and liquidity are dependent to a significant degree on its vendors and their financial health, as well as the ability to accurately forecast the demand for products. The loss of a key vendor, or material changes in support by them, or a significant variance in actual demand compared to the forecast, can have a material adverse impact on the Company's cash flows and business.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
March 31, 2022

On June 2, 2021, the Company and certain of its subsidiaries, as borrowers, entered into a Credit Agreement (the “JPMorgan ABL Credit Agreement”), with JPMorgan Chase Bank, N.A., as agent and lender for a \$67,500,000 senior secured revolving credit facility (the “JPMorgan ABL Facility”). The JPMorgan ABL Credit Agreement replaced the Company’s existing asset-based revolving credit agreement, dated as of March 27, 2014 (the “Wells Fargo ABL Facility,” formerly known as the “Amended ABL Facility” in prior filings), with General Electric Capital Corporation, since assigned to Wells Fargo Bank, National Association. The Company pays a commitment fee (0.25% - 0.375%) based on the unused portion of the revolving credit facility. Any amounts borrowed under the JPMorgan ABL Facility will bear interest at either (i) Eurodollar spread plus 1.50% - 2.00% (determined by reference to an excess availability pricing grid) or (ii) Alternate Base Rate plus 0.50% - 1.00% (determined by reference to an excess availability pricing grid and base rate subject to a 1.00% floor). The JPMorgan ABL Facility matures in June 2026.

The JPMorgan ABL Credit Agreement contains negative covenants that, subject to certain exceptions, limit the ability of the Company and its subsidiaries to, among other things, incur additional indebtedness, make restricted payments, pledge their assets as security, make investments, loans, advances, guarantees and acquisitions, undergo fundamental changes and enter into transactions with affiliates. Under certain circumstances the Company is also subject to a springing fixed charge coverage ratio covenant of not less than 1.1 to 1.0, as described in more detail in the JPMorgan ABL Credit Agreement.

The JPMorgan ABL Credit Agreement contains events of default that are customary for a facility of this nature, including (subject in certain cases to grace periods and thresholds) nonpayment of principal, interest, fees or other amounts, material inaccuracy of representations and warranties, violation of covenants, cross-default to certain other existing indebtedness, bankruptcy or insolvency events, certain judgment defaults, loss of liens or guarantees and a change of control as specified in the JPMorgan ABL Credit Agreement. If an event of default occurs, the commitments of the lenders to lend under the JPMorgan ABL Credit Agreement may be terminated and the maturity of the amounts owed may be accelerated.

The obligations under the JPMorgan ABL Credit Agreement are guaranteed by the Company, the subsidiary borrowers thereunder and certain of the other existing and future direct and indirect subsidiaries of the Company and are secured by substantially all of the assets of the Company, the subsidiary borrowers thereunder and such other subsidiary guarantors, in each case, subject to certain exceptions and permitted liens.

On June 2, 2021, the Company and certain of its subsidiaries, as borrowers, entered into a First Lien Term Loan Facility Credit Agreement (the “2021 BSP Term Loan Agreement”) with Benefit Street Partners L.L.C., as Sole Lead Arranger, and BSP Agency, LLC, as agent, for a \$99.0 million first-lien secured term loan (the “Initial Term Loan”) and a \$19.0 million delayed draw term loan (the “Delayed Draw Term Loan” and collectively, the “2021 BSP Term Loan”). Net proceeds from the issuance of the 2021 BSP Term Loan, after deduction of \$2.2 million in closing fees and \$0.5 million of other administrative fees paid directly to the lenders, totaled \$96.3 million. These fees are being amortized over the life of the 2021 BSP Term Loan on a straight-line basis which approximates the effective interest method. Proceeds from the Initial Term Loan, together with available cash from the Company, were used to repay the Company’s existing term loan (the “2019 Recap Term Loan,” formerly known as the “New Term Loan” in prior filings) under the agreement dated as of August 9, 2019 with Cortland Capital Market Services LLC, as agent for certain investor parties. The Delayed Draw Term Loan provision was secured to redeem any of the Company’s outstanding 2023 Convertible Senior Notes (the “New Oasis Notes” or “3.25% convertible senior notes due 2023”), upon its maturity, which, upon repayment of the 2019 Recap Term Loan, accelerated to no later than 91 days from the repayment of the 2019 Recap Term Loan, or September 1, 2021. On July 29, 2021 the Company terminated its Delayed Draw Term Loan option as it determined it had sufficient liquidity to fund any outstanding convertible senior notes that remained upon maturity.

Amounts outstanding under the 2021 BSP Term Loan will bear interest at either (i) LIBOR plus 6.50% - 7.00% (determined by reference to a net leverage pricing grid), subject to a 1.00% LIBOR floor, or (ii) base rate plus 5.50% - 6.00% (determined by reference to a net leverage pricing grid), subject to a 2.00% base rate floor. The 2021 BSP Term Loan matures in June 2027.

The 2021 BSP Term Loan Agreement contains negative covenants that, subject to certain exceptions, limit the ability of the Company and its subsidiaries to, among other things, incur additional indebtedness, make restricted payments, pledge its assets as security, make investments, loans, advances, guarantees and acquisitions, undergo fundamental changes and enter into transactions with affiliates. Commencing with the fiscal quarter ending June 30, 2021, the Company is required to maintain a Net Leverage Ratio of 4:00x, with step-downs occurring each fiscal year starting with the quarter ending March 31, 2022 through the quarter ending September 30, 2024 in which the Company is required to maintain a Net Leverage Ratio of 3:00x. As of the Closing Date, the Company must maintain a minimum cash balance of not less than \$20.0 million. The minimum cash balance can be reduced to \$15.0 million in increments of \$1.0 million for every \$5.0 million in principal repayment of the 2021 BSP Term Loan. The terms and covenants are described in more detail in the 2021 BSP Term Loan Agreement.

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The 2021 BSP Term Loan Agreement contains events of default that are customary for a facility of this nature, including (subject in certain cases to grace periods and thresholds) nonpayment of principal, nonpayment of interest, fees or other amounts, material inaccuracy of representations and warranties, violation of covenants, cross-default to certain other existing indebtedness, bankruptcy or insolvency events, certain judgment defaults and a change of control as specified in the 2021 BSP Term Loan Agreement. If an event of default occurs, the maturity of the amounts owed under the 2021 BSP Term Loan Agreement may be accelerated.

The obligations under the 2021 BSP Term Loan Agreement are guaranteed by the Company, the subsidiary borrowers thereunder and certain of the other existing and future direct and indirect subsidiaries of the Company and are secured by substantially all of the assets of the Company, the subsidiary borrowers thereunder and such other subsidiary guarantors, in each case, subject to certain exceptions and permitted liens and subject to the priority lien granted under the JPMorgan ABL Credit Agreement.

The agent and Sole Lead Arranger under the 2021 BSP Term Loan are affiliates of an affiliate of the Company, which affiliate owned common stock and the 3.25% convertible senior notes due 2023 of the Company at the time of the refinancing, as well as a majority of the Company's outstanding Series A Preferred Stock giving the affiliates various rights as described in the Company's public filings.

As of March 31, 2022, the Company had \$98.3 million of outstanding indebtedness under the 2021 BSP Term Loan Agreement and no outstanding indebtedness under its amended and extended JPMorgan ABL Credit Agreement with JPM Chase aside from utilizing \$17.2 million in letters of credit.

On June 2, 2021, the Company repaid in full and terminated the First Lien Term Loan Facility Credit Agreement (the "2019 Recap Term Loan Agreement," formerly known as the "New Term Loan Agreement" in prior filings), dated as of August 9, 2019, with Cortland Capital Market Services LLC, as agent. The Wells Fargo ABL Credit Facility Agreement was also terminated as of June 2, 2021.

The Company was in compliance with the financial covenants under the 2021 BSP Term Loan Agreement and the JPMorgan ABL Agreement as of March 31, 2022.

The Company's unaudited interim condensed consolidated financial statements for the three months ended March 31, 2022 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The Company believes that cash and cash equivalents, including restricted cash, projected cash flow from operations, and borrowings under the Company's credit facility are sufficient to meet the Company's working capital and capital expenditure requirements for the next 12 months.

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

The Company is a worldwide producer and marketer of children's toys and other consumer products, principally engaged in the design, development, production, marketing and distribution of its diverse portfolio of products. The Company's segments are (i) Toys/Consumer Products and (ii) Costumes.

The Toys/Consumer Products segment includes action figures, vehicles, play sets, plush products, dolls, electronic products, construction toys, infant and pre-school toys, child-sized and hand-held role play toys and everyday costume play, foot-to-floor ride-on vehicles, wagons, novelty toys, seasonal and outdoor products, kids' indoor and outdoor furniture, and related products.

The Costumes segment, under its Disguise branding, designs, develops, markets and sells a wide range of every-day and special occasion dress-up costumes and related accessories in support of Halloween, Carnival, Children's Day, Book Day/Week, and every-day/any-day costume play.

Segment performance is measured at the operating income (loss) level. All sales are made to external customers and general corporate expenses have been attributed to the segments based upon relative sales volumes. Segment assets are primarily comprised of accounts receivable and inventories, net of applicable reserves and allowances, goodwill and other assets. Certain assets which are not tracked by operating segment and/or that benefit multiple operating segments have been allocated on the same basis.

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Results are not necessarily those which would be achieved if each segment was an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts for the three months ended March 31, 2022 and 2021 and as of March 31, 2022 and December 31, 2021 are as follows (in thousands):

	Three Months Ended March 31,	
	2022	2021
Net Sales		
Toys/Consumer Products	\$ 111,123	\$ 79,875
Costumes	9,758	3,968
	<u>\$ 120,881</u>	<u>\$ 83,843</u>

	Three Months Ended March 31,	
	2022	2021
Income (Loss) from Operations		
Toys/Consumer Products	\$ 2,007	\$ 356
Costumes	(2,741)	(3,079)
	<u>\$ (734)</u>	<u>\$ (2,723)</u>

	Three Months Ended March 31,	
	2022	2021
Depreciation and Amortization Expense		
Toys/Consumer Products	\$ 1,725	\$ 1,727
Costumes	87	66
	<u>\$ 1,812</u>	<u>\$ 1,793</u>

	March 31,	December 31,
	2022	2021
Assets		
Toys/Consumer Products	\$ 292,362	\$ 338,266
Costumes	23,407	18,781
	<u>\$ 315,769</u>	<u>\$ 357,047</u>

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Net revenues are categorized based upon location of the customer, while long-lived assets are categorized based upon the location of the Company's assets. The following tables present information about the Company by geographic area as of March 31, 2022 and December 31, 2021 and for the three months ended March 31, 2022 and 2021 (in thousands):

	March 31, 2022	December 31, 2021
Long-lived Assets		
United States	\$ 13,999	\$ 16,252
China	12,758	11,655
Hong Kong	2,947	770
United Kingdom	1,182	1,270
Mexico	79	79
Canada	68	73
	<u>\$ 31,033</u>	<u>\$ 30,099</u>

	Three Months Ended March 31,	
	2022	2021
Net Sales by Customer Area		
United States	\$ 97,050	\$ 68,916
Europe	13,389	7,337
Canada	3,379	2,101
Latin America	2,385	2,455
Asia	2,076	1,415
Australia & New Zealand	1,491	1,188
Middle East & Africa	1,111	431
	<u>\$ 120,881</u>	<u>\$ 83,843</u>

Major Customers

Net sales to major customers for the three months ended March 31, 2022 and 2021 were as follows (in thousands, except for percentages):

	Three Months Ended March 31,			
	2022		2021	
	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales
Target	\$ 35,670	29.5%	\$ 22,753	27.1%
Wal-Mart	23,020	19.0	21,638	25.8
Amazon	14,016	11.6	8,034	9.6
	<u>\$ 72,706</u>	<u>60.1%</u>	<u>\$ 52,425</u>	<u>62.5%</u>

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

The concentration of the Company's business with a relatively small number of customers may expose the Company to material adverse effects if one or more of its large customers were to experience financial difficulty. The Company performs ongoing credit evaluations of its top customers and maintains an allowance for potential credit losses.

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Note 3 — Inventory

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

	March 31, 2022	December 31, 2021
Raw materials	\$ 84	\$ 106
Finished goods	85,222	83,848
	<u>\$ 85,306</u>	<u>\$ 83,954</u>

As of March 31, 2022 and December 31, 2021, the inventory obsolescence reserve was \$6.4 million and \$4.6 million, respectively.

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

The Company's contracts with customers only include one performance obligation (i.e., sale of the Company's products). Revenue is recognized in the gross amount at a point in time when delivery is completed and control of the promised goods is transferred to the customers. Revenue is measured as the amount of consideration the Company expects to be entitled to in exchange for those goods. The Company's contracts do not involve financing elements as payment terms with customers are less than one year. Further, because revenue is recognized at the point in time goods are sold to customers, there are no contract assets or contract liability balances.

The Company disaggregates its revenues from contracts with customers by reporting segment: Toys/Consumer Products and Costumes. The Company further disaggregates revenues by major geographic regions (See Note 2 - Business Segments, Geographic Data, and Sales by Major Customers, for further information).

The Company offers various discounts, pricing concessions, and other allowances to customers, all of which are considered in determining the transaction price. Certain discounts and allowances are fixed and determinable at the time of sale and are recorded at the time of sale as a reduction to revenue. Other discounts and allowances can vary and are determined at management's discretion (variable consideration). Specifically, the Company occasionally grants discretionary credits to facilitate markdowns and sales of slow-moving merchandise, and consequently accrues an allowance based on historic credits and management estimates. The Company also participates in cooperative advertising arrangements with some customers, whereby it allows a discount from invoiced product amounts in exchange for customer purchased advertising that features the Company's products. Generally, these allowances range from 1% to 20% of gross sales, and are generally based upon product purchases or specific advertising campaigns. Such allowances are accrued when the related revenue is recognized. To the extent these cooperative advertising arrangements provide a distinct benefit at fair value, they are accounted for as direct selling expenses, otherwise they are recorded as a reduction to revenue. Further, while the Company generally does not allow product returns, the Company does make occasional exceptions to this policy and consequently records a sales return allowance based upon historic return amounts and management estimates. These allowances (variable consideration) are estimated using the expected value method and are recorded at the time of sale as a reduction to revenue. The Company adjusts its estimate of variable consideration at least quarterly or when facts and circumstances used in the estimation process may change. The variable consideration is not constrained as the Company has sufficient history on the related estimates and does not believe there is a risk of significant revenue reversal.

Sales commissions are expensed when incurred as the related revenue is recognized at a point in time and therefore the amortization period is less than one year. As a result, these costs are recorded as direct selling expenses, as incurred.

Shipping and handling activities are considered part of the Company's obligation to transfer the products and therefore are recorded as direct selling expenses, as incurred.

The Company's reserve for sales returns and allowances amounted to \$39.4 million as of March 31, 2022, compared to \$46.3 million as of December 31, 2021.

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Note 5 — Debt*Convertible senior notes*

In August 2019, the Company entered into and consummated multiple, binding definitive agreements (collectively, the “Recapitalization Transaction”) among Wells Fargo, Oasis Investments II Master Fund Ltd. and an ad hoc group of holders of the Company’s 4.875% convertible senior notes due 2020 (the “Investor Parties”) to recapitalize the Company’s balance sheet, including the extension to the Company of incremental liquidity and at least three-year extensions of substantially all of the Company’s outstanding convertible debt obligations and revolving credit facility. The Company’s Term Loan Agreement entered into with Great American Capital Partners was paid in full and terminated in connection with the Recapitalization Transaction.

In connection with the Recapitalization Transaction, the Company issued (i) amended and restated notes with respect to the Company’s \$21.6 million Oasis Note issued on November 7, 2017, and the \$8.0 million Oasis Note issued on July 26, 2018 (together, the “Existing Oasis Notes”), and (ii) a new \$8.0 million convertible senior note having the same terms as such amended and restated notes, or the New Oasis Notes. Interest on the New Oasis Notes is payable on each May 1 and November 1 until maturity and accrues at an annual rate of (i) 3.25% if paid in cash or 5.00% if paid in stock plus (ii) 2.75% payable in kind. The New Oasis Notes mature 91 days after the amounts outstanding under the 2019 Recap Term Loan are paid in full, and in no event later than July 3, 2023.

Excluding the impact of the Reverse Stock Split, the New Oasis Notes provide, among other things, that the initial conversion price is \$1.00. The conversion price will be reset on each February 9 and August 9, starting on February 9, 2020 (each, a “reset date”) to a price equal to 105% of the 5-day VWAP preceding the applicable reset date. Under no circumstances shall the reset result in a conversion price be below the greater of (i) the closing price on the trading day immediately preceding the applicable reset date and (ii) 30% of the stock price as of the Transaction Agreement Date, or August 7, 2019, and will not be greater than the conversion price in effect immediately before such reset. The Company may trigger a mandatory conversion of the New Oasis Notes if the market price exceeds 150% of the conversion price under certain circumstances. The Company may redeem the New Oasis Notes in cash if a person, entity or group acquires shares of the Company’s Common Stock, par value \$0.001 per share (the “Common Stock”), and as a result owns at least 49% of the Company’s issued and outstanding Common Stock. In connection with the issuance of the New Oasis Notes, the Company recognized a loss on extinguishment of the Existing Oasis Notes of approximately \$10.4 million. On February 9, 2020, excluding the impact of the Reverse Stock Split, the conversion price of the New Oasis Notes reset to \$1.00 per share (\$10.00 per share after reverse stock split). On August 9, 2020, the conversion price of the New Oasis Notes reset to \$5.647. On February 9, 2021, the conversion price of the New Oasis Notes recalculated and remained unchanged at \$5.647.

During 2021, \$24.0 million of the New Oasis Notes (including \$1.2 million in PIK interest) were converted for 4,246,828 shares of common stock. As a result, the Company recorded an increase to additional paid-in capital of \$50.8 million.

A director of the Company is a portfolio manager at Oasis Management.

The Company has elected to measure and present the New Oasis Notes at fair value using Level 3 inputs and as a result, recognized a loss of \$9.0 million for the three months ended March 31, 2021, related to changes in the fair value of the 3.25% convertible senior notes due 2023.

On February 5, 2021, Benefit Street Partners and Oasis Investment II Master Funds Ltd, both related parties, entered into a purchase and sale agreement wherein Benefit Street Partners purchased \$11.0 million of principal amount, plus all accrued and unpaid interest thereon, of the New Oasis Notes from Oasis Investment II Master Funds Ltd (see Note 17 – Related Party Transactions). The transaction closed on February 8, 2021.

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Term Loan

Term loan consists of the following (in thousands):

	March 31, 2022			December 31, 2021		
	Principal Amount	Debt Discount/ Issuance Costs*	Net Amount	Principal Amount**	Debt Discount/ Issuance Costs*	Net Amount
2021 BSP Term Loan	\$ 98,258	\$ (2,849)	\$ 95,409	\$ 98,505	\$ (2,986)	\$ 95,519

* The term loan was valued using the discounted cash flow method to determine the implied debt discount. The debt discount and issuance costs are being amortized over the life of the term loan on a straight-line basis which approximates the effective interest method.

On June 2, 2021, the Company and certain of its subsidiaries, as borrowers, entered into the 2021 BSP Term Loan Agreement with Benefit Street Partners L.L.C., as Sole Lead Arranger, and BSP Agency, LLC, as agent, for a \$99.0 million Initial Term Loan and a \$19.0 million Delay Draw Term Loan. Net proceeds from the issuance of the 2021 BSP Term Loan, after deduction of \$2.2 million in closing fees and \$0.5 million of other administrative fees paid directly to the lenders, totaled \$96.3 million. These fees are being amortized over the life of the 2021 BSP Term Loan on a straight-line basis which approximates the effective interest method. Proceeds from the Initial Term Loan, together with available cash from the Company, were used to repay the Company's 2019 Recap Term Loan under the agreement dated as of August 9, 2019 with Cortland Capital Market Services LLC, as agent for certain investor parties. The Delayed Draw Term Loan provision was designed to provide necessary capital to redeem any of the Company's outstanding 3.25% convertible senior notes due 2023, upon their maturity, which, upon repayment of the 2019 Recap Term Loan, accelerated to no later than 91 days from the repayment of the 2019 Recap Term Loan, or September 1, 2021. On July 29, the Company terminated its Delayed Draw Term Loan option as it determined it had sufficient liquidity to fund any outstanding convertible senior notes that remained upon maturity.

Amounts outstanding under the 2021 BSP Term Loan will bear interest at either (i) LIBOR plus 6.50% - 7.00% (determined by reference to a net leverage pricing grid), subject to a 1.00% LIBOR floor, or (ii) base rate plus 5.50% - 6.00% (determined by reference to a net leverage pricing grid), subject to a 2.00% base rate floor. The 2021 BSP Term Loan matures in June 2027.

The 2021 BSP Term Loan Agreement contains negative covenants that, subject to certain exceptions, limit the ability of the Company and its subsidiaries to, among other things, incur additional indebtedness, make restricted payments, pledge its assets as security, make investments, loans, advances, guarantees and acquisitions, undergo fundamental changes and enter into transactions with affiliates. Commencing with the fiscal quarter ending June 30, 2021, the Company is required to maintain a Net Leverage Ratio of 4:00x, with step-downs occurring each fiscal year starting with the quarter ending March 31, 2022 through the quarter ending September 30, 2024 in which the Company is required to maintain a Net Leverage Ratio of 3:00x. As of the Closing Date, the Company must maintain a minimum cash balance of not less than \$20.0 million. The minimum cash balance can be reduced to \$15.0 million in increments of \$1.0 million for every \$5.0 million in principal repayment of the 2021 BSP Term Loan.

The 2021 BSP Term Loan Agreement contains events of default that are customary for a facility of this nature, including (subject in certain cases to grace periods and thresholds) nonpayment of principal, nonpayment of interest, fees or other amounts, material inaccuracy of representations and warranties, violation of covenants, cross-default to certain other existing indebtedness, bankruptcy or insolvency events, certain judgment defaults and a change of control as specified in the 2021 BSP Term Loan Agreement. If an event of default occurs, the maturity of the amounts owed under the 2021 BSP Term Loan Agreement may be accelerated.

The obligations under the 2021 BSP Term Loan Agreement are guaranteed by the Company, the subsidiary borrowers thereunder and certain of the other existing and future direct and indirect subsidiaries of the Company and are secured by substantially all of the assets of the Company, the subsidiary borrowers thereunder and such other subsidiary guarantors, in each case, subject to certain exceptions and permitted liens and subject to the priority lien granted under the JPMorgan ABL Credit Agreement.

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The agent and Sole Lead Arranger under the 2021 BSP Term Loan are affiliates of an affiliate of the Company, which affiliate, at the time of refinancing, owned common stock and the 3.25% convertible senior notes due 2023 of the Company, as well as the Company's outstanding Series A Preferred Stock.

Amortization expense classified as interest expense related to the \$1.0 million of debt issuance costs associated with the issuance of the 2021 BSP Term Loan was \$43,584 for the three months ended March 31, 2022.

Amortization expense classified as interest expense related to the \$2.3 million debt discount associated with the issuance of the 2021 BSP Term Loan was \$0.1 million for the three months ended March 31, 2022.

The fair value of the Company's 2021 BSP Term Loan is considered Level 3 fair value (see Note 16 – Fair Value Measurements for further discussion of the fair value hierarchy) and are measured using the discounted future cash flow method. In addition to the debt terms, the valuation methodology includes an assumption of a discount rate that approximates the current yield on a debt security with comparable risk. This assumption is considered an unobservable input in that it reflects the Company's own assumptions about the inputs that market participants would use in pricing the asset or liability. The Company believes that this is the best information available for use in the fair value measurement. The estimated fair value of the 2021 BSP Term Loan was \$91.1 million and \$97.3 million as of March 31, 2022 and December 31, 2021, respectively, compared to a carrying value of \$95.4 million and \$95.5 million as of March 31, 2022 and December 31, 2021, respectively.

As of March 31, 2022, the Company was in compliance with the financial covenants under the 2021 BSP Term Loan Agreement.

Loan under Paycheck Protection Program

On June 12, 2020, the Company received a \$6.2 million PPP Loan under the PPP within the CARES Act. The PPP Loan maturity date was June 2, 2022, and was subject to the CARES Act terms which included, among other terms, an interest rate of 1.00% per annum and monthly installment payments of \$261,275 commencing on September 27, 2021. The PPP Loan allowed for prepayment at any time prior to maturity with no prepayment penalties. The PPP Loan was subject to events of default and other provisions customary for a loan of this type. A PPP Loan may be forgiven, partially or in full, if certain conditions are met, principally based on having been disbursed for permissible purposes and maintaining certain average levels of employment and payroll as required by the CARES Act. On September 10, 2021, the full amount of the PPP Loan was forgiven.

Note 6 — Credit Facilities

JPMorgan Chase

On June 2, 2021, the Company and certain of its subsidiaries, as borrowers, entered into the JPMorgan ABL Credit Agreement with JPMorgan Chase Bank, N.A., as agent and lender for a \$67,500,000 senior secured revolving credit facility. The JPMorgan ABL Credit Agreement replaced the Company's Wells Fargo ABL Facility, dated as of March 27, 2014, with General Electric Capital Corporation, since assigned to Wells Fargo Bank, National Association. The Company pays a commitment fee (0.25% - 0.375%) based on the unused portion of the revolving credit facility. Any amounts borrowed under the JPMorgan ABL Facility will bear interest at either (i) Eurodollar spread plus 1.50% - 2.00% (determined by reference to an excess availability pricing grid) or (ii) Alternate Base Rate plus 0.50% - 1.00% (determined by reference to an excess availability pricing grid and base rate subject to a 1.00% floor). The JPMorgan ABL Facility matures in June 2026. As of March 31, 2022, the weighted average interest rate on the credit facility with JPMorgan Chase Bank was 1.88%.

The JPMorgan ABL Credit Agreement contains negative covenants that, subject to certain exceptions, limit the ability of the Company and its subsidiaries to, among other things, incur additional indebtedness, make restricted payments, pledge their assets as security, make investments, loans, advances, guarantees and acquisitions, undergo fundamental changes and enter into transactions with affiliates. Under certain circumstances the Company is also subject to a springing fixed charge coverage ratio covenant of not less than 1.1 to 1.0, as described in more detail in the JPMorgan ABL Credit Agreement.

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The JPMorgan ABL Credit Agreement contains events of default that are customary for a facility of this nature, including (subject in certain cases to grace periods and thresholds) nonpayment of principal, interest, fees or other amounts, material inaccuracy of representations and warranties, violation of covenants, cross-default to certain other existing indebtedness, bankruptcy or insolvency events, certain judgment defaults, loss of liens or guarantees and a change of control as specified in the JPMorgan ABL Credit Agreement. If an event of default occurs, the commitments of the lenders to lend under the JPMorgan ABL Credit Agreement may be terminated and the maturity of the amounts owed may be accelerated.

The obligations under the JPMorgan ABL Credit Agreement are guaranteed by the Company, the subsidiary borrowers thereunder and certain of the other existing and future direct and indirect subsidiaries of the Company and are secured by substantially all of the assets of the Company, the subsidiary borrowers thereunder and such other subsidiary guarantors, in each case, subject to certain exceptions and permitted liens.

As of March 31, 2022, the amount of outstanding borrowings was nil and the total excess borrowing availability was \$49.4 million.

As of March 31, 2022, off-balance sheet arrangements include letters of credit issued by JPMorgan of \$17.2 million.

Amortization expense classified as interest expense related to the \$1.6 million of debt issuance costs associated with the transaction that closed on June 2, 2021 (i.e., JPMorgan ABL Credit Agreement) was \$0.1 million for the three months ended March 31, 2022.

As of March 31, 2022, the Company was in compliance with the financial covenants under the JPMorgan ABL Credit Agreement.

Note 7 — 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 returns in their respective jurisdiction.

The Company's income tax expense of \$0.4 million for the three months ended March 31, 2022, reflects an effective tax rate of (11.9)%. The Company's income tax expense of \$0.1 million for the three months ended March 31, 2021, reflects an effective tax rate of (0.4)%. The tax expense for the three months ended March 31, 2022 and March 31, 2021 relates to foreign income taxes and discrete items.

Note 8 — Loss Per Share

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

Loss per share - basic and diluted	Three Months Ended March 31,	
	2022	2021
Net loss	\$ (3,909)	\$ (24,051)
Net income (loss) attributable to non-controlling interests	(100)	35
Net loss attributable to JAKKS Pacific, Inc.	(3,809)	(24,086)
Preferred stock dividend	346	326
Net loss attributable to common stockholders *	\$ (4,155)	\$ (24,412)
Weighted average common shares outstanding - basic and diluted	9,588	5,379
Loss per share available to common stockholder- basic and diluted	\$ (0.43)	\$ (4.54)

* Net loss attributable to common stockholders was computed by deducting preferred dividends of \$0.3 million for the three months ended March 31, 2022 and 2021.

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Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. Diluted loss per share is calculated using the weighted average number of common shares and common share equivalents outstanding during the period (which consist of restricted stock awards, restricted stock units and convertible debt to the extent they are dilutive). For the three months ended March 31, 2022 and 2021, the convertible senior notes interest and related weighted common share equivalent of nil and 3,853,393, respectively, were excluded from the diluted loss per share calculation since they would have been anti-dilutive. Potentially dilutive restricted stock awards and units of 310,907 and 239,707 for the three months ended March 31, 2022, and 2021, respectively, were excluded from the computation of diluted loss per share since they would have been anti-dilutive.

Note 9 — Common Stock and Preferred Stock

Common Stock

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

During 2021, certain employees, including two executive officers, surrendered an aggregate of 32,846 shares of restricted stock for \$0.2 million to cover income taxes due on the vesting of restricted shares. Additionally, an aggregate of 93,352 shares of restricted stock granted in 2018 with a value of approximately \$0.5 million was forfeited during 2021.

During 2022, certain employees, including two executive officers, surrendered an aggregate of 63,292 shares of restricted stock units for \$0.6 million to cover income taxes due on the vesting of restricted shares. Additionally, an aggregate of 11,480 shares of restricted stock granted in 2019 with a value of approximately \$0.1 million was forfeited during 2022.

No dividend was declared or paid in the three months ended March 31, 2022 and 2021.

Preferred Stock

On August 9, 2019, in connection with the Recapitalization Transaction (see Note 5 - Debt), the Company issued 200,000 shares of Series A Senior Preferred Stock (the "Series A Preferred Stock"), \$0.001 par value per share, to the Investor Parties (the "New Preferred Equity"). As of March 31, 2022 and December 31, 2021, 200,000 shares of Series A Preferred Stock were outstanding.

Each share of Series A Preferred Stock has an initial value of \$100 per share, which is automatically increased for any accrued and unpaid dividends (the "Accreted Value").

The Series A Preferred Stock has the right to receive dividends on a quarterly basis equal to 6.0% per annum, payable in cash or, if not paid in cash, by an automatic accretion of the Series A Preferred Stock. No cash dividends have been declared or paid. For the three months ended March 31, 2022 and 2021, the Company recorded \$0.3 million of preferred stock dividends as an increase in the value of the Series A Preferred Stock.

The Series A Preferred Stock has no stated maturity, however, the Company has the right to redeem all or a portion of the Series A Preferred Stock at its Liquidation Preference (as defined below) at any time after payment in full of the 2019 Recap Term Loan. In addition, upon the occurrence of certain change of control type events, holders of the Series A Preferred Stock are entitled to receive an amount (the "Liquidation Preference"), in preference to holders of Common Stock or other junior stock, equal to (i) 20% of the Accreted Value in the case of a certain specified transaction, or (ii) otherwise, 150% of the Accreted value, plus any accrued and unpaid dividends.

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The Company has the right, but is not required, to repurchase all or a portion of the Series A Preferred Stock at its Liquidation Preference at any time after payment in full of the 2019 Recap Term Loan (see Note 5 - Debt). The Series A Preferred Stock does not have any voting rights, except to the extent required by the Delaware General Corporation Law, except for the exclusive right to elect the Series A Preferred Directors (as described below) and except for certain approval rights over certain transactions (as described below). These approval rights require the prior consent of specified percentages of holders (or in certain cases, all holders) of the Series A Preferred Stock in order for the Company to take certain actions, including the issuance of additional shares of Series A Preferred Stock or parity stock, the issuance of senior stock, certain amendments to the Amended and Restated Certificate of Incorporation, the Certificate of Designations of the Series A Preferred Stock (the "Certificate of Designations"), the Second Amended and Restated By-laws or the Amended and Restated Nominating and Corporate Governance Committee Charter, material changes in the Company's line of business and certain change of control type transactions. In addition, the Certificate of Designations provides that the approval of at least six directors is required for any related person transaction within the meaning of Item 404 of Regulation S-K under the Securities Act of 1933, as amended, including, without limitation, the adoption of, or any amendment, modification or waiver of, any agreement or arrangement related to any such transaction. The Certificate of Designations also includes restrictions on the ability of the Company to pay dividends on or make distributions with respect to, or redeem or repurchase, shares of Common Stock or other junior stock. In addition, holders of the Series A Preferred Stock have preemptive rights regarding future issuance of Series A Preferred Stock or parity stock.

In addition, the Certificate of Designations provides the holders of Series A Preferred Stock certain board representation rights. The Certificate of Designations provides, among other things, that, for so long as at least 50,000 shares of Series A Preferred Stock remain outstanding, (i) the holders of a majority of the outstanding shares of Series A Preferred Stock have the sole right to nominate two candidates to serve as the Series A Preferred Directors and (ii) the holders of shares of Series A Preferred Stock, voting as a separate class, have the right to elect two individuals to serve as the Series A Preferred Directors. From and after (i) the first annual meeting of stockholders occurring after less than 50,000 shares of Series A Preferred Stock remain outstanding, the holders of Series A Preferred Stock will only have the right to nominate and elect one Series A Preferred Director, and (ii) the time no shares of Series A Preferred Stock remain outstanding, the holders of Series A Preferred Stock will no longer have the right to nominate or elect any Series A Preferred Directors. The Series A Preferred Directors (or Director if less than 50,000 Series A Preferred shares are outstanding) serve for terms ending at the annual meeting of stockholders in 2023 and for successive three-year terms thereafter (until no shares of Series A Preferred Stock remain outstanding), the number of directors elected by the holders of the Company's Common Stock and the number of Series A Preferred Directors is fixed and cannot be amended without the approval of holders of a majority of the outstanding Common Stock and holders of at least 80% of the outstanding shares of Series A Preferred Stock, each voting as a separate class.

The Series A Preferred Stock redemption amount is contingent upon certain events with no stated redemption date as of the reporting date, although may become redeemable in the future. In accordance with the SEC guidance within ASC Topic 480, *Distinguishing Liabilities from Equity: Classification and Measurement of Redeemable Securities*, the Company classified the Series A Preferred Stock as temporary equity as the Series A Preferred Stock contains a redemption feature which is contingent upon certain deemed liquidation events, the occurrence of which may not solely be within the control of the Company.

Under ASC 815, *Derivatives and Hedging*, certain contractual terms that meet the accounting definition of a derivative must be accounted for separately from the financial instrument in which they are embedded. The Company has concluded that the redemption upon a change of control and the repurchase option by the Company constitute embedded derivatives.

The embedded redemption upon a change of control must be accounted for separately from the Series A Preferred Stock. The redemption provision specifies if certain events that constitute a change of control occur, the Company may be required to settle the Series A Preferred Stock at 150% of its accreted amount. Accordingly, the redemption provision meets the definition of a derivative, and its economic characteristics are not considered clearly and closely related to the economic characteristics of the Series A Preferred Stock, which is considered more akin to a debt instrument than equity.

Accordingly, these two embedded derivatives are required to be bundled into a single derivative instrument and accounted for separately from the Series A Preferred Stock at fair value.

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The Company considers the repurchase option to have no value as the likelihood is remote that this event, within the Company's control, would ever occur. On August 9, 2019, the Company determined that the fair value of the redemption provision upon a change of control was \$4.9 million and recorded as a long term liability. In subsequent periods, the liability is accounted for at fair value, with changes in fair value recognized as other income (expense) on the Company's condensed consolidated statements of operations. The value of the redemption provision explicitly considered the present value of the potential premium that would be paid related to, and the probability of, an event that would trigger its payment. The probability of a triggering event was based on management's estimates of the probability of a change of control event occurring.

As of March 31, 2022, the Series A Preferred Stock is recorded in temporary equity at the amount of accrued, but unpaid dividends of \$3.4 million, and the redemption provision, as a bifurcated derivative, is recorded as a long term liability with an estimated value of \$21.9 million. As of December 31, 2021, the Series A Preferred Stock is recorded in temporary equity at the amount of accrued, but unpaid dividends of \$3.1 million, and the redemption provision, as a bifurcated derivative, is recorded as a long term liability with an estimated value of \$21.3 million.

The following table provides a reconciliation of the beginning and ending balances of the Series A Preferred Stock, which is recorded in temporary equity:

	<u>2022</u>	<u>2021</u>
Balance, January 1,	\$ 3,074	\$ 1,740
Preferred stock accrued dividends	346	326
Balance, March 31,	<u>\$ 3,420</u>	<u>\$ 2,066</u>

Note 10 — Joint Ventures

In November 2014, the Company entered into a joint venture with Meisheng Culture & Creative Corp., for the purpose of providing certain JAKKS licensed and non-licensed toys and consumer products to agreed-upon territories of the People's Republic of China. The joint venture includes a subsidiary in the Shanghai Free Trade Zone that sells, distributes and markets these products, which include dolls, plush, role play products, action figures, costumes, seasonal items, technology and app-enhanced toys, based on top entertainment licenses and JAKKS' own proprietary brands. The Company owns fifty-one percent of the joint venture and consolidates the joint venture since control rests with the Company. The non-controlling interest's share of the income (loss) was (\$0.1) million and \$35,000 for the three months ended March 31, 2022 and 2021, respectively.

In October 2016, the Company entered into a joint venture with Hong Kong Meisheng Cultural Company Limited ("Meisheng"), a Hong Kong-based subsidiary of Meisheng Culture & Creative Corp., for the purpose of creating and developing original, multiplatform content for children including new short-form series and original shows. JAKKS and Meisheng each own fifty percent of the joint venture and will jointly own the content. JAKKS will retain merchandising rights for kids' consumer products in all markets except China, which Meisheng Culture & Creative Corp. will oversee through the Company's existing distribution joint venture. The results of operations of the joint venture are consolidated with the Company's results. The non-controlling interest's share of the income (loss) from the joint venture for the three months ended March 31, 2022 and 2021 was nil.

Note 11 — Goodwill

The Company applies a fair value-based impairment test to the carrying value of goodwill and indefinite-lived intangible assets on an annual basis and, on an interim basis, if certain events or circumstances indicate that an impairment loss may have been incurred. Goodwill impairment exists when the estimated fair value of goodwill is less than its carrying value. For the three months ended March 31, 2022, there were no events or circumstances that indicated that an impairment loss may have been incurred.

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Note 12 — Intangible Assets Other Than Goodwill

Intangible assets other than goodwill consist primarily of licenses, product lines, customer relationships and trademarks. Amortized intangible assets are included in intangibles in the accompanying condensed consolidated balance sheets. Trademarks are disclosed separately in the accompanying condensed consolidated balance sheets. Intangible assets as of March 31, 2022 and December 31, 2021 include the following (in thousands, except for weighted useful lives):

	Weighted Useful Lives (Years)	March 31, 2022			December 31, 2021		
		Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets:							
Licenses	5.81	\$ 20,130	\$ (20,130)	\$ —	\$ 20,130	\$ (20,130)	\$ —
Product lines	10.36	33,858	(33,097)	761	33,858	(32,843)	1,015
Customer relationships	4.90	3,152	(3,152)	—	3,152	(3,152)	—
Trade names	5.00	3,000	(3,000)	—	3,000	(3,000)	—
Non-compete agreements	5.00	200	(200)	—	200	(200)	—
Total amortized intangible assets		<u>\$ 60,340</u>	<u>\$ (59,579)</u>	<u>\$ 761</u>	<u>\$ 60,340</u>	<u>\$ (59,325)</u>	<u>\$ 1,015</u>
Unamortized Intangible Assets:							
Trademarks		<u>\$ 300</u>	<u>\$ —</u>	<u>\$ 300</u>	<u>\$ 300</u>	<u>\$ —</u>	<u>\$ 300</u>

Note 13 — Comprehensive Loss

The table below presents the components of the Company's comprehensive loss for the three months ended March 31, 2022 and 2021 (in thousands):

	Three Months Ended	
	March 31,	
	2022	2021
Net loss	\$ (3,909)	\$ (24,051)
Other comprehensive income (loss):		
Foreign currency translation adjustment	(662)	(58)
Comprehensive loss	(4,571)	(24,109)
Less: Comprehensive income (loss) attributable to non-controlling interests	(100)	35
Comprehensive loss attributable to JAKKS Pacific, Inc.	<u>\$ (4,471)</u>	<u>\$ (24,144)</u>

Note 14 — Litigation and Contingencies

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. The Company accrues for losses when the loss is deemed probable and the liability can reasonably be estimated. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, the Company records the minimum estimated liability related to the claim. As additional information becomes available, the Company assesses the potential liability related to its pending litigation and revises its estimates.

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A putative class action lawsuit was filed on May 18, 2021 in the Superior Court of the State of California for the County of Los Angeles (Isaiah Villarica v. JAKKS Pacific, Inc.). Plaintiff formerly worked in one of the Company's warehouses and was retained via Workforce Enterprises, a provider of temporary employees. The lawsuit alleges that the Company violated various California Labor Code provisions governing wage and hour requirements, including that the Company failed to pay all minimum and overtime wages owed, provide legally compliant meal and rest periods, or reimburse business expenses. The lawsuit further alleges derivative wage and hour claims for failure to timely pay all wages owed at separation of employment, failure to provide accurate wage statements, and unfair business practices. Plaintiff seeks to represent a class consisting of all individuals who have worked for the Company—either directly or through a staffing agency—in California since November 19, 2016 and who were classified as non-exempt. Plaintiff seeks unpaid wages, meal and rest period premiums, interest, various statutory penalties, attorneys' fees, and costs, all in unspecified amounts. Workforce Enterprises has also been named as a defendant in this matter.

The same counsel in the Villarica matter filed a related lawsuit on February 15, 2022 in the same court (Matthew Cordova v. JAKKS Pacific, Inc). Plaintiff also formerly worked in one of the Company's warehouses and was retained via Workforce Enterprises, a provider of temporary employees. The lawsuit alleges that the Company committed wage and hour violations under the California Private Attorneys General Act, including failing to provide compliant meal and rest periods, properly calculate and pay all minimum and overtime wages, provide accurate wage statements, provide all wages due at separation of employment, provide sick leave, maintain accurate payroll records, or reimburse business expenses. Plaintiff seeks to collect civil penalties on behalf of the State of California under the Private Attorneys General Act for each violation experienced by "aggrieved employees," defined as all individuals who have worked for the Company—either directly or through a staffing agency—in California since December 8, 2020 and who were classified as non-exempt.

At a mediation between the Company, counsel to three temporary providers who provided temporary employees to the Company during the relevant time periods, and counsel for both lawsuits occurred on March 24, 2022. The Company is responsible for its own fees related to the lawsuits and has demanded and is in the process of obtaining indemnification for the settlement amounts for both of these matters from the three temporary employee providers who supplied temporary employees to the Company during the relevant time periods at issue in the lawsuits. Following mediation in March 2022, the Company agreed to settlement terms with respect to both cases and are currently waiting for the settlement paperwork to be finalized. The Company currently expects to incur only a nominal amount to settle both cases.

In the normal course of business, the Company may provide certain indemnifications and/or other commitments of varying scope to a) its licensors, customers and certain other parties, including against third-party claims of intellectual property infringement, and b) its officers, directors and employees, including against third-party claims regarding the periods in which they serve in such capacities with the Company. The duration and amount of such obligations is, in certain cases, indefinite. The Company's director's and officer's liability insurance policy may, however, enable it to recover a portion of any future payments related to its officer, director or employee indemnifications. For the past five years, costs related to director and officer indemnifications have not been significant. Other than certain liabilities recorded in the normal course of business related to royalty payments due to the Company's licensors, no liabilities have been recorded for indemnifications and/or other commitments.

Note 15 — Share-Based Payments

The Company's 2002 Stock Award and Incentive Plan (the "Plan"), as amended, provides for the awarding of stock options, restricted stock and restricted stock units to certain key employees, executive officers and non-employee directors. Current awards under the Plan include grants to directors, executive officers and certain key employees of restricted stock awards and units, with vesting contingent upon (a) the completion of specified service periods ranging from one to four years and/or (b) meeting certain financial performance and/or market-based metrics. Unlike the restricted stock awards, the shares for the restricted stock units are not issued until they vest. The Plan is more fully described in Notes 15 and 18 to the consolidated financial statements in the Company's 2021 Annual Report on Form 10-K.

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The following table summarizes the total share-based compensation expense recognized for the three months ended March 31, 2022 and 2021 (in thousands)

	Three Months Ended			
	March 31,			
	2022	2021	2022	2021
Share-based compensation expense	\$ 870	\$ 382		

Restricted Stock Units

Restricted stock unit activity (including those with performance-based vesting criteria) for the three months ended March 31, 2022 is summarized as follows:

	Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding, December 31, 2021	1,073,902	\$ 8.62
Granted	318,627	10.16
Vested	(130,280)	7.34
Forfeited	(149,238)	14.70
Outstanding, March 31, 2022	<u>1,113,011</u>	<u>8.40</u>

As of March 31, 2022, there was \$8.5 million of total unrecognized compensation cost related to non-vested restricted stock units, which is expected to be recognized over a weighted-average period of 2.39 years.

Note 16 — Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based upon these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market-corroborated, or unobservable inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based upon observable inputs used in the valuation techniques, the Company is required to provide information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values into three broad levels as follows:

- Level 1: Valuations for assets and liabilities traded in active markets from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third-party pricing services for identical or similar assets or liabilities.
- Level 3: Valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

In instances where the determination of the fair value measurement is based upon inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based upon the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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The following tables summarize the Company's financial liabilities measured at fair value on a recurring basis as of March 31, 2022 and December 31, 2021 (in thousands):

	Carrying Amount as of March 31, 2022	Fair Value Measurements as of March 31, 2022		
		Level 1	Level 2	Level 3
Preferred stock derivative liability	\$ 21,927	\$ —	\$ —	\$ 21,927

	Carrying Amount as of December 31, 2021	Fair Value Measurements as of December 31, 2021		
		Level 1	Level 2	Level 3
Preferred stock derivative liability	\$ 21,282	\$ —	\$ —	\$ 21,282

The following tables provide a reconciliation of the beginning and ending balances of liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

3.25% convertible senior notes due in 2023	2022	2021
Balance, January 1,	\$ —	\$ 34,134
Conversion of convertible senior notes	—	(5,631)
Change in fair value	—	9,047
PIK interest	—	158
Balance, March 31,	<u>\$ —</u>	<u>\$ 37,708</u>

Preferred stock derivative liability	2022	2021
Balance, January 1,	\$ 21,282	\$ 8,063
Change in fair value	645	7,375
Balance, March 31,	<u>\$ 21,927</u>	<u>\$ 15,438</u>

The Company's derivative liability is classified within Level 3 of the fair value hierarchy because unobservable inputs were used in estimating the fair value. The fair value of the redemption provision embedded in the Series A Preferred Stock is estimated based on a discounted cash flow model and probability assumptions based on management's estimates of a change of control event occurring. In subsequent periods, the derivative liability is accounted for at fair value, with changes in fair value recognized as other income (expense) on the Company's condensed consolidated statements of operations.

The Company has elected the fair value option of measurement for the 3.25% 2023 Notes, under ASC 815, Derivatives and Hedging. As a result, these notes are re-measured each reporting period using Level 3 inputs (Monte Carlo simulation model and inputs for stock price, risk-free rate and volatility), with changes in fair value reflected in current period earnings in its condensed consolidated statements of operations.

The fair value of the Series A Preferred Stock derivative liability is calculated using unobservable inputs (Level 3 fair measurements). The value of the redemption provision explicitly considered the present value of the potential premium that would be paid related to, and the probability of, an event that would trigger its payment. The probability of a triggering event was based on management's estimates of the probability of a change of control event occurring.

The Company's accounts receivable, accounts payable, and accrued expenses represent financial instruments. The carrying value of these financial instruments is a reasonable approximation of fair value.

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Note 17 — Related Party Transactions

In November 2014, the Company entered into a joint venture with Meisheng Cultural & Creative Corp., Ltd., (“MC&C”) for the purpose of providing certain JAKKS licensed and non-licensed toys and consumer products to agreed-upon territories of the People’s Republic of China. The joint venture includes a subsidiary in the Shanghai Free Trade Zone that sells, distributes and markets these products, which include dolls, plush, role play products, action figures, costumes, seasonal items, technology and app-enhanced toys, based on top entertainment licenses and JAKKS’ own proprietary brands. The Company owns fifty-one percent of the joint venture and consolidates the joint venture since control rests with the Company. The non-controlling interest’s share of the income (loss) was (\$0.1) million and \$35,000 for the three months ended March 31, 2022 and 2021, respectively.

In October 2016, the Company entered into a joint venture with Hong Kong Meisheng Cultural Company Limited (“Meisheng”), a Hong Kong-based subsidiary of Meisheng Culture & Creative Corp, for the purpose of creating and developing original, multiplatform content for children including new short-form series and original shows. JAKKS and Meisheng each own fifty percent of the joint venture and will jointly own the content. JAKKS will retain merchandising rights for kids’ consumer products in all markets except China, which Meisheng Culture & Creative Corp. will oversee through the Company’s existing distribution joint venture. The results of operations of the joint venture are consolidated with the Company’s results. The non-controlling interest’s share of the income (loss) from the joint venture for the three months ended March 31, 2022 and 2021 was nil. MC&C is an affiliate of Meisheng and Meisheng holds shares of the Company’s outstanding common stock.

In March 2017, the Company entered into an equity purchase agreement with Meisheng which provided, among other things, that as long as Meisheng and its affiliates hold 10% or more of the issued and outstanding shares of common stock of the Company, Meisheng shall have the right from time to time to designate a nominee (who currently is Mr. Xiaoqiang Zhao) for election to the Company’s board of directors.

Meisheng also serves as a significant manufacturer of the Company. For the three months ended March 31, 2022 and 2021, the Company made inventory-related payments to Meisheng of approximately \$15.5 million and \$7.5 million, respectively. As of March 31, 2022 and December 31, 2021, amounts due to Meisheng for inventory received by the Company, but not paid totaled \$15.5 million and \$15.9 million, respectively.

A director of the Company is a portfolio manager at Oasis Management. (see Note 5 - Debt)

A director of the Company is a director at Benefit Street Partners. As of March 31, 2022, Benefit Street Partners held \$98.3 million in principal amount of the 2021 BSP Term Loan. (see Note 5 - Debt)

Note 18 — Prepaid Expenses and Other Assets

Prepaid expenses and other assets as of March 31, 2022 and December 31, 2021 consist of the following (in thousands):

	March 31, 2022	December 31, 2021
Royalty advances	\$ 6,690	\$ 2,619
Prepaid expenses	6,780	4,151
Employee retention credit	2,390	2,390
Income taxes receivable	1,432	1,527
Other assets	120	190
Prepaid expenses and other assets	<u>\$ 17,412</u>	<u>\$ 10,877</u>

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Note 19 — Subsequent Events

On April 26, 2022 the Company entered into a First Amendment to the 2021 BSP Term Loan Agreement, to provide, among other things, that the Company must maintain Qualified Cash of at least: (a) at all times after the Closing Date and prior to the First Amendment Effective Date, \$20,000,000; (b) at all times during the period commencing on the First Amendment Effective Date through and including June 30, 2022, \$15,000,000; and (c) at all times on and after July 1, 2022, through September 30, 2022, \$17,500,000; provided, however, that if the Total Net Leverage Ratio exceeded 1.75:1.00 as of the last day of the most recently ended month for which financial statements were required to have been delivered pursuant to Section 5.1(a) of the 2021 BSP Term Loan Agreement, then the amount set forth in this clause (c) shall be increased to \$20,000,000 on the third Business Day following the due date of such financial statements. Notwithstanding the foregoing, the Applicable Minimum Cash Amount shall be reduced by \$1,000,000 for every \$5,000,000 principal prepayment or repayment of the Term Loans following the First Amendment Effective Date; provided however, that, the Applicable Minimum Cash Amount shall in no event be reduced below \$15,000,000.

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

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

Explanatory Note

As of the date of filing of this Quarterly Report on Form 10-Q (this "Report"), there continue to be uncertainties regarding the current Novel Coronavirus ("COVID-19") pandemic, including the scope of health issues, the duration of the pandemic, and the continuing local and worldwide social, and economic disruption. To date, the COVID-19 pandemic has had far-reaching impacts on many aspects of the operations of JAKKS Pacific, Inc. (the "Company," "we," "our" or "us"), including on consumer behavior, customer store traffic, production capabilities, timing of product availability, our employees' personal and business lives, and the market generally. The scope and nature of these impacts continue to evolve each day. The COVID-19 pandemic has resulted in, and may continue to result in, regional and local quarantines, labor stoppages and shortages, changes in consumer purchasing patterns, mandatory or elective shut-downs of retail locations, disruptions to supply chains, including the inability of our suppliers and service providers to deliver materials and services on a timely basis, or at all, severe market volatility, liquidity disruptions, and overall economic instability, which, in many cases, have had, and we expect will continue to have, adverse impacts on our business, financial condition and results of operations. This situation is changing rapidly, and additional impacts may arise that we are not aware of currently.

In light of the uncertain and rapidly evolving situation relating to the COVID-19 pandemic, we have taken certain precautionary measures over the past two years intended to help minimize the risk to our Company, employees and customers. A recap of the key elements as of today would include the following:

- On March 23, 2020, we encouraged our staff to begin working from home. In the US, we began to return to an in-office working model in July 2021, but paused that transition in consideration of the rise in cases attributable to the Delta-variant of COVID-19. As of March 31, 2022, we have returned to an in-office operating model in our US offices. We continue to monitor federal, state and local guidelines;
- Although our distribution center in the City of Industry, California currently continues to operate, we continue to evaluate its operations, and may elect, or be required, to shut down its operations temporarily at any time in the future;
- We are slowly increasing employee attendance at industry events and in-person work-related meetings.

Each of the remedial measures taken by us has had, and we expect will continue to have, adverse impacts on our current business, financial condition and results of operations, and may create additional risks for us. While we anticipate that the foregoing measures are temporary, we cannot predict the specific duration for which these precautionary measures will stay in effect, and we may elect or need to take additional measures as the information available to us continues to develop, including with respect to our employees, inventory receipts, and relationships with our licensors. We expect to continue to assess the evolving impact of the COVID-19 pandemic on our customers, consumers, employees, supply chain, and operations, and intend to make adjustments to our responses accordingly. However, the extent to which the COVID-19 pandemic and our precautionary measures in response thereto may impact our business, financial condition, and results of operations will depend on how the COVID-19 pandemic and its impact continues to develop in the United States and elsewhere in the world, which remains highly uncertain and cannot be predicted at this time.

In light of these uncertainties, for purposes of this report, except where otherwise indicated, the descriptions of our business, our strategies, our risk factors, and any other forward-looking statements, including regarding us, our business and the market generally, do not reflect the potential impact of the COVID-19 pandemic or our responses thereto. In addition, the disclosures contained in this report are made only as of the date hereof, and we undertake no obligation to publicly update or revise any forward-looking statement as a result of new information, future events or otherwise, except as otherwise required by law. For further information, see "Disclosure Regarding Forward-Looking Statements" and "Risk Factors."

Disclosure Regarding Forward-Looking Statements

This Report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. For example, statements included in this Report regarding our financial position, business strategy and other plans and objectives for future operations, and assumptions and predictions about future product demand, supply, manufacturing, costs, marketing and pricing factors are all forward-looking statements. When we use words like “intend,” “anticipate,” “believe,” “estimate,” “plan” or “expect,” or other words of a similar import, we are making forward-looking statements. We believe that the assumptions and expectations reflected in such forward-looking statements are reasonable, based upon information available to us on the date hereof (but excluding the impact of COVID-19, as described above in “Explanatory Note”), but we cannot assure you that these assumptions and expectations will prove to have been correct or that we will take any action that we may presently be planning. We have disclosed certain important factors (e.g., see “Explanatory Note” and “Risk Factors”) that could cause our actual results to differ materially from our current expectations elsewhere in this Report. You should understand that forward-looking statements made in this Report are necessarily qualified by these factors. We are not undertaking to publicly update or revise any forward-looking statement if we obtain new information or upon the occurrence of future events or otherwise.

Critical Accounting Policies & Estimates

The accompanying condensed consolidated financial statements and supplementary information were prepared in accordance with accounting principles generally accepted in the United States of America. Significant accounting policies are discussed in Note 2 to the consolidated financial statements set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021. Inherent in the application of many of these accounting policies is the need for management to make estimates and judgments in the determination of certain revenues, expenses, assets and liabilities. As such, materially different financial results can occur as circumstances change and additional information becomes known. The policies with the greatest potential effect on our results of operations and financial position include:

Allowance for Doubtful Accounts. Our allowance for doubtful accounts is based upon management’s assessment of the business environment, customers’ financial condition, historical collection experience, accounts receivable aging, customer disputes and the collectability of specific customer accounts. If there were a deterioration of a major customer’s creditworthiness, or actual defaults 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 allowance for doubtful accounts is also affected by the time at which uncollectible accounts receivable balances are actually written off.

Major customers’ accounts are monitored on an ongoing basis and more in-depth reviews are performed based upon changes in a customer’s financial condition and/or the level of credit being extended. When a significant event occurs, such as a bankruptcy filing by a specific customer, and on a quarterly basis, the allowance is reviewed for adequacy and the balance or accrual rate is adjusted to reflect current risk prospects. When certain shocks to the market occur, customers are unilaterally reviewed to assess the potential impact of that shock on their financial stability. Many retailers have been operating under financial duress for several years. Ultimately, we assess the risk of liquidation bankruptcy by a customer and the associated likelihood that we will not be paid for product shipped. To that end, it is not only outstanding accounts receivable balances but the decisions to design and develop account-specific product and ultimately ship product on a go-forward basis that plays into our attempts to maximize profitability while minimizing uncollectable accounts receivable.

Revenue Recognition. Our contracts with customers only include one performance obligation (i.e., sale of our products). Revenue is recognized in the gross amount at a point in time when delivery is completed and control of the promised goods is transferred to the customers. Revenue is measured as the amount of consideration we expect to be entitled to in exchange for those goods. Our contracts do not involve financing elements as payment terms with customers are less than one year. Further, because revenue is recognized at the point in time goods are sold to customers, there are no contract assets or contract liability balances.

We disaggregate our revenues from contracts with customers by reporting segment: Toys/Consumer Products and Costumes. We further disaggregate revenues by major geographic region. See Note 2 to the condensed consolidated financial statements for further information.

We offer various discounts, pricing concessions, and other allowances to customers, all of which are considered in determining the transaction price. Certain discounts and allowances are fixed and determinable at the time of sale and are recorded at the time of sale as a reduction to revenue. Other discounts and allowances can vary and are determined at management's discretion (variable consideration). Specifically, we occasionally grant discretionary credits to facilitate markdowns and sales of slow moving merchandise, and consequently accrue an allowance based on historic credits and management estimates. We also participate in cooperative advertising arrangements with some customers, whereby we allow a discount from invoiced product amounts in exchange for customer purchased advertising that features our products. Generally, these allowances range from 1% to 20% of gross sales, and are generally based upon product purchases or specific advertising campaigns. Such allowances are accrued when the related revenue is recognized. To the extent these cooperative advertising arrangements provide a distinct benefit at fair value, they are accounted for as direct selling expenses, otherwise they are recorded as a reduction to revenue. Further, while we generally do not allow product returns, we do make occasional exceptions to this policy, and consequently record a sales return allowance based upon historic return amounts and management estimates. These allowances (variable consideration) are estimated using the expected value method and are recorded at the time of sale as a reduction to revenue. We adjust our estimate of variable consideration at least quarterly or when facts and circumstances used in the estimation process may change. The variable consideration is not constrained as we have sufficient history on the related estimates and do not believe there is a risk of significant revenue reversal.

Sales commissions are expensed when incurred as the related revenue is recognized at a point in time and therefore the amortization period is less than one year. As a result, these costs are recorded as direct selling expenses, as incurred.

Shipping and handling activities are considered part of our obligation to transfer the products and therefore are recorded as direct selling expenses, as incurred.

Our reserve for sales returns and allowances amounted to \$39.4 million as of March 31, 2022 and \$46.3 million as of December 31, 2021.

Royalties. We enter into license agreements with strategic partners, inventors, designers and others for the use of intellectual properties in our products. These agreements may call for payment in advance or future payment of minimum guaranteed amounts. Amounts paid in advance are recorded as an asset and charged to expense when the related revenue is recognized. If all or a portion of the minimum guaranteed amounts appear not to be recoverable through future use of the rights obtained under the license, the non-recoverable portion of the guaranty is charged to expense at that time.

Fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, we use various methods including market, income and cost approaches. Based upon these approaches, we often utilize certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and/or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market-corroborated, or unobservable inputs. We utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based upon observable inputs used in the valuation techniques, we are required to provide information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values into three broad levels as follows:

- Level 1: Valuations for assets and liabilities traded in active markets from readily available pricing sources for market transactions involving identical assets or liabilities.
- Level 2: Valuations for assets and liabilities traded in less active dealer or broker markets. Valuations are obtained from third-party pricing services for identical or similar assets or liabilities.
- Level 3: Valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

In instances where the determination of the fair value measurement is based upon inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based upon the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability. See Note 16 to the condensed consolidated financial statements included within for further information.

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

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

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

When unexpected shocks to market demand occur, we review whether that shock has materially impacted the value of our owned inventory. In some cases where customers have cancelled orders, accommodation can be reached that the product will be reordered when the customer has restarted operations (in the event of store closures) or the customer agrees to minimize/eliminate requests for product line refreshment (in the event of Halloween order cancellations) which allows the inventory and in some cases raw materials to be held through to the following calendar year without incurring any additional obsolescence.

Income Allocation for Income Taxes. Our annual income tax provision and related income tax assets and liabilities are based upon actual income as allocated to the various tax jurisdictions based upon our transfer pricing study, US and foreign statutory income tax rates and tax regulations and planning opportunities in the various jurisdictions in which we operate. Significant judgment is required in interpreting tax regulations in the U.S. and foreign jurisdictions, and in evaluating worldwide uncertain tax positions. Actual results could differ materially from those judgments, and changes from such judgments could materially affect our condensed consolidated financial statements.

Discrete Items for Income Taxes. The discrete expense recorded in the three months ended March 31, 2022 is \$0.1 million which is related to excess tax deficiencies fully offset by valuation allowance, foreign return-to-provision adjustments, and state income taxes. For the comparable period in 2021, a discrete tax expense of \$22,000 was recorded related primarily to excess tax deficiencies fully offset by valuation allowance, state income taxes and foreign return-to-provision adjustments.

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

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

We accrue a tax reserve for additional income taxes, which may become payable in future years as a result of audit adjustments by tax authorities. The reserve is based upon management's assessment of all relevant information and is periodically reviewed and adjusted as circumstances warrant. As of March 31, 2022 and December 31, 2021, our income tax reserves were approximately \$0.2 million. The \$0.2 million balance primarily relates to the potential tax settlements in Hong Kong. Our income tax reserves are included in income tax payable on the condensed consolidated balance sheets and within provision for (benefit from) income taxes on the condensed consolidated statements of operations.

We recognize current period interest expense and penalties and the reversal of previously recognized interest expense and penalties that has been determined to not be assessable due to the expiration of the related audit period or other compelling factors on the income tax liability for unrecognized tax benefits as a component of the income tax provision recognized in the condensed consolidated statements of operations.

New Accounting Pronouncements.

See Note 1 to the condensed consolidated financial statements.

Results of Operations

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

	Three Months Ended March 31, (Unaudited)	
	2022	2021
Net sales	100.0%	100.0%
Cost of sales:		
Cost of goods	59.6	52.5
Royalty expense	14.6	15.0
Amortization of tools and molds	1.1	1.4
Cost of sales	75.3	68.9
Gross profit	24.7	31.1
Direct selling expenses	4.1	8.1
General and administrative expenses	20.8	25.6
Depreciation and amortization	0.5	0.7
Selling, general and administrative expenses	25.4	34.4
Loss from operations	(0.7)	(3.3)
Other income, net	0.1	0.1
Change in fair value of preferred stock derivative liability	(0.5)	(8.8)
Change in fair value of convertible senior notes	—	(10.8)
Interest income	—	—
Interest expense	(1.8)	(5.8)
Loss before provision for income taxes	(2.9)	(28.6)
Provision for income taxes	0.3	0.1
Net loss	(3.2)	(28.7)
Net income (loss) attributable to non-controlling interests	(0.1)	—
Net loss attributable to JAKKS Pacific, Inc.	(3.1)%	(28.7)%

The following unaudited table summarizes, for the periods indicated, certain statements of operations data by segment (in thousands):

	Three Months Ended March 31, (Unaudited)	
	2022	2021
Net Sales		
Toys/Consumer Products	\$ 111,123	\$ 79,875
Costumes	9,758	3,968
	<u>120,881</u>	<u>83,843</u>
Cost of Sales		
Toys/Consumer Products	82,966	54,192
Costumes	7,998	3,557
	<u>90,964</u>	<u>57,749</u>
Gross Profit		
Toys/Consumer Products	28,157	25,683
Costumes	1,760	411
	<u>\$ 29,917</u>	<u>\$ 26,094</u>

Comparison of the Three Months Ended March 31, 2022 and 2021

Net Sales

Toys/Consumer Products. Net sales of our Toys/Consumer Products segment were \$111.1 million for the three months ended March 31, 2022 compared to \$79.9 million for the prior year period, representing an increase of \$31.2 million, or 39.0%. The Doll/Dress-Up/Nurturing Play and Action Play and Collectibles division sales increased, led by Disney Encanto™ and Sonic the Hedgehog®.

Costumes. Net sales of our Costumes segment were \$9.8 million for the three months ended March 31, 2022 compared to \$4.0 million for the prior year period, representing an increase of \$5.8 million, or 145%. Much of the increase in sales was related to delayed Q4 2021 customer FOB shipments occurring in Q1 2022.

Cost of Sales

Toys/Consumer Products. Cost of sales of our Toys/Consumer Products segment was \$83.0 million, or 74.7% of related net sales for the three months ended March 31, 2022 compared to \$54.2 million, or 67.8% of related net sales for the prior year period, representing an increase of \$28.8 million, or 53.1%. The increase in dollars is related to higher overall sales. The increase as a percentage of net sales, year over year, is due to higher freight costs, slightly offset by lower product costs.

Costumes. Cost of sales of our Costumes segment was \$8.0 million, or 81.6% of related net sales for the three months ended March 31, 2022, compared to \$3.6 million, or 90.0% of related net sales for the prior year period, representing an increase in dollars of \$4.4 million, or 122.2%. The increase in dollars is related to higher overall sales. The decrease as a percentage of net sales was primarily driven by a lower average royalty rate.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$30.7 million for the three months ended March 31, 2022 compared to \$28.8 million for the prior year period constituting 25.4% and 34.4% of net sales, respectively. Selling, general and administrative expenses increased as a result of higher payroll costs.

Interest Expense

Interest expense was \$2.2 million for the three months ended March 31, 2022, as compared to \$4.9 million in the prior year period. During the three months ended March 31, 2022, we incurred interest expense of \$2.0 million related to our 2021 BSP Term Loan and \$0.2 million related to our revolving credit facility. During the three months ended March 31, 2021, we incurred interest expense of \$4.3 million related to our 2019 Recap Term Loan, \$0.4 million related to our convertible senior notes due in 2023, and \$0.2 million related to our revolving credit facility.

Provision for Income Taxes

Our income tax expense, which includes federal, state and foreign income taxes and discrete items, was \$0.4 million, or an effective tax rate of (11.9)%, for the three months ended March 31, 2022. During the comparable period in 2021, our income tax expense was \$0.1 million, or an effective tax rate of (0.4)%.

Seasonality and Backlog

The retail toy industry is inherently seasonal. Generally, our sales have been highest during the third and fourth quarters, and collections for those sales have been highest during the succeeding fourth and first quarters. Our working capital needs have been highest during the second and third quarters as we make royalty advance payments for some of our licenses and buy and sell inventory subject to customer payment terms.

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

Liquidity and Capital Resources

As of March 31, 2022, we had working capital (inclusive of cash, cash equivalents and restricted cash) of \$109.1 million, compared to \$114.5 million as of December 31, 2021, representing a decrease in working capital of \$5.4 million during the three-month period ended March 31, 2022.

Operating activities used net cash of \$2.7 million during the three months ended March 31, 2022, as compared to using net cash of \$7.0 million in the prior year period. The decrease in net cash used in operating activities year-over-year is primarily due to a lower net loss, partially offset by lower non-cash charges related to valuation adjustments for our convertible senior notes and preferred stock derivative liability. Other than open purchase orders issued in the normal course of business related to shipped product, we have no obligations to purchase inventory from our manufacturers. However, we may incur costs or other losses as a result of not placing orders consistent with our forecasts for product manufactured by our suppliers or manufacturers for a variety of reasons including customer order cancellations or a decline in demand. As part of our strategy to develop and market new products, we have entered into various character and product licenses with royalties/obligations generally ranging from 1% to 23% payable on net sales of such products. As of March 31, 2022, these agreements required future aggregate minimum royalty guarantees of \$61.4 million exclusive of \$6.7 million in advances already paid. Of this \$61.4 million future minimum royalty guarantee, \$26.6 million is due over the next twelve months.

Investing activities used net cash of \$1.8 million and \$1.5 million for the three months ended March 31, 2022 and 2021, respectively, and consisted primarily of cash paid for the purchase of molds and tooling used in the manufacture of our products.

Financing activities used net cash of \$0.9 million and \$0.2 million for the three months ended March 31, 2022 and 2021, respectively. The cash used in financing activities during the three months ended March 31, 2022, primarily consists of the repayment of our 2021 BSP Term Loan of \$0.2 million, and the repurchase of common stock for employee tax withholding of \$0.6 million. The cash used in financing activities during the three months ended March 31, 2021 consists of the repurchase of common stock for employee tax withholding.

As of March 31, 2022, we have \$98.3 million of outstanding indebtedness under our first-lien secured term loan (the “2021 BSP Term Loan Agreement”) and we have no outstanding indebtedness under our senior secured revolving credit facility (the “JPMorgan ABL Facility”), aside from utilizing \$17.2 million in letters of credit.

The First Lien Term Loan Facility Credit Agreement (the “2021 BSP Term Loan Agreement”) and the Credit Agreement with JPMorgan Chase Bank, N.A., as agent and lender (the “JPMorgan ABL Credit Agreement”) each contain negative covenants that, subject to certain exceptions, limit our ability and our subsidiaries ability to, among other things, incur additional indebtedness, make restricted payments, pledge our assets as security, make investments, loans, advances, guarantees and acquisitions, undergo fundamental changes and enter into transactions with affiliates. The terms of the 2021 BSP Term Loan Agreement also require us to maintain a Net Leverage Ratio of 4:00x, with step-downs occurring each fiscal year starting with the quarter ending March 31, 2022 through the quarter ending September 30, 2024 in which we are required to maintain a Net Leverage Ratio of 3:00x. As of the Closing Date, we must maintain a minimum cash balance of not less than \$20.0 million. The minimum cash balance can be reduced to \$15.0 million in increments of \$1.0 million for every \$5.0 million in principal repayment of the 2021 BSP Term Loan. The terms of the JPMorgan ABL Credit Agreement also subject us to a springing fixed charge coverage ratio covenant of not less than 1.1 to 1.0 under certain circumstances. The terms of both Agreements are described in more detail in their respective Agreements.

The 2021 BSP Term Loan Agreement and the JPMorgan ABL Agreement contain events of default that are customary for a facility of this nature, including (subject in certain cases to grace periods and thresholds) nonpayment of principal, nonpayment of interest, fees or other amounts, material inaccuracy of representations and warranties, violation of covenants, cross-default to certain other existing indebtedness, bankruptcy or insolvency events, certain judgment defaults and a change of control as specified in each Agreement. If an event of default occurs under either Agreement, the maturity of the amounts owed under the 2021 BSP Term Loan Agreement and the JPMorgan ABL Agreement may be accelerated.

We were in compliance with the financial covenants under the 2021 BSP Term Loan Agreement and the JPMorgan ABL Agreement as of March 31, 2022.

See Note 5 – Debt and Note 6 – Credit Facilities for additional information pertaining to our Debt and Credit Facilities.

As of March 31, 2022 and December 31, 2021, we held cash and cash equivalents, including restricted cash, of \$39.2 million and \$45.3 million, respectively. Cash, and cash equivalents, including restricted cash held outside of the United States in various foreign subsidiaries totaled \$33.3 million and \$30.7 million as of March 31, 2022 and December 31, 2021, respectively. The cash and cash equivalents, including restricted cash balances in our foreign subsidiaries have either been fully taxed in the U.S. or tax has been accounted for in connection with the Tax Cuts and Jobs Act, or may be eligible for a full foreign dividends received deduction under such Act, and thus would not be subject to additional U.S. tax should such amounts be repatriated in the form of dividends or deemed distributions. Any such repatriation may result in foreign withholding taxes, which we expect would not be significant as of March 31, 2022.

Our primary sources of working capital are cash flows from operations and borrowings under our JPMorgan ABL Facility (see Note 6 - Credit Facilities).

Typically, cash flows from operations are impacted by the effect on sales of (1) the appeal of our products, (2) the success of our licensed brands in motivating consumer purchase of related merchandise, (3) the highly competitive conditions existing in the toy industry and in securing commercially-attractive licenses, (4) dependency on a limited set of large customers, and (5) general economic conditions. A downturn in any single factor or a combination of factors could have a material adverse impact upon our ability to generate sufficient cash flows to operate the business. In addition, our business and liquidity are dependent to a significant degree on our vendors and their financial health, as well as the ability to accurately forecast the demand for products. The loss of a key vendor, or material changes in support by them, or a significant variance in actual demand compared to the forecast, can have a material adverse impact on our cash flows and business. Given the conditions in the toy industry environment in general, vendors, including licensors, may seek further assurances or take actions to protect against non-payment of amounts due to them. Changes in this area could have a material adverse impact on our liquidity.

As of March 31, 2022 off-balance sheet arrangements include letters of credit issued by JPMorgan of \$17.2 million.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Our exposure to market risk includes interest rate fluctuations in connection with our BSP Term Loan (see Note 5 – Debt) and our 2021 JPMorgan ABL Facility (see Note 6 – Credit Facilities). As of March 31, 2022, we have \$98.3 million of outstanding indebtedness under our BSP Term Loan which is due June 2027 with interest at either (i) LIBOR plus 6.50% - 7.00% (determined by reference to a net leverage pricing grid), subject to a 1.00% LIBOR floor, or (ii) base rate plus 5.50% - 6.00% (determined by reference to a net leverage pricing grid), subject to a 2.00% base rate floor. Borrowings under our JPMorgan ABL Facility bear interest at either (i) Eurodollar spread plus 1.50% - 2.00% (determined by reference to an excess availability pricing grid) or (ii) Alternate Base Rate plus 0.50% - 1.00% (determined by reference to an excess availability pricing grid and base rate subject to a 1.00% floor). Borrowings under the BSP Term Loan and 2021 JPMorgan ABL Facility are therefore subject to risk based upon prevailing market interest rates. Interest rate risk may result from many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors that are beyond our control. During the three-month period ended March 31, 2022, the maximum amount borrowed under the revolving credit facility was \$13.0 million and the average amount of borrowings outstanding was \$0.8 million. As of March 31, 2022, the amount of total borrowings outstanding under the revolving credit facility was nil.

London Interbank Offering Rate (“LIBOR”) is an interest rate benchmark used as a reference rate for our term loan. Borrowings under our term loan will bear interest at a variable rate, primarily based on LIBOR. In July 2017, the United Kingdom’s Financial Conduct Authority (the “FCA”), which regulates LIBOR, announced that it will no longer persuade or compel banks to submit rates for the calculation of LIBOR after 2021. It is unclear whether or not LIBOR will cease to exist at that time (and if so, what reference rate will replace it) or if new methods of calculating LIBOR will be established such that it continues to exist after 2021. On November 30, 2020, ICE Benchmark Administration (“IBA”), the administrator of LIBOR, with the support of the United States Federal Reserve and the United Kingdom’s FCA, announced plans to consult on ceasing publication of USD LIBOR on December 31, 2021 for only the one-week and two-month USD LIBOR tenors, and on June 30, 2023 for all other USD LIBOR tenors. While this announcement extends the transition period to June 2023, the United States Federal Reserve concurrently issued a statement advising banks to stop new USD LIBOR issuances by the end of 2021. In light of these recent announcements, the future of LIBOR at this time is uncertain and any changes in the methods by which LIBOR is determined or regulatory activity related to LIBOR’s phase-out could cause LIBOR to perform differently than in the past or cease to exist.

The Alternative Reference Rates Committee (“ARRC”) has identified the Secured Overnight Financing Rate (“SOFR”) as the recommended alternative for use in financial and other derivatives contracts that are currently indexed to U.S. dollar LIBOR. At this time, it is not possible to predict the effect any modification or discontinuation of LIBOR, or the establishment of alternative reference rates such as SOFR, will have on our business and financial condition. Although regulators and IBA have made clear that the recent announcements should not be read to say that LIBOR has ceased or will cease, in the event LIBOR does cease to exist, our term loan and related agreements would transition from LIBOR to SOFR, which may result in interest rates and/or payments that do not correlate over time with the interest rates and/or payments that would have been made on its obligations if LIBOR was available in its current form.

Foreign Currency Risk

We have wholly-owned subsidiaries in Hong Kong, China, the United Kingdom, Germany, France, the Netherlands, Canada and Mexico. Sales are generally made by these operations on FOB China or Hong Kong terms and are denominated in U.S. dollars. However, purchases of inventory and Hong Kong operating expenses are typically denominated in Hong Kong dollars and local operating expenses in the United Kingdom, Germany, France, the Netherlands, Canada, Mexico and China are denominated in local currency, thereby creating exposure to changes in exchange rates. Changes in the U.S. dollar exchange rates may positively or negatively affect our results of operations. The exchange rate of the Hong Kong dollar to the U.S. dollar has been linked to the U.S. dollar by the Hong Kong Monetary Authority at HK\$7.75 - HK\$7.85 to US\$1.00 since 2005 and, accordingly, has not represented a currency exchange risk to the U.S. dollar. We do not believe that near-term changes in these exchange rates, if any, will result in a material effect on our future earnings, fair values or cash flows. Therefore, we have chosen not to enter into foreign currency hedging transactions. We cannot assure you that this approach will be successful, especially in the event of a significant and sudden change in the value of these foreign currencies.

Item 4. Controls and Procedures

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

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are a party to, and certain of our property is the subject of, various pending claims and legal proceedings that routinely arise in the ordinary course of our business. We accrue for losses when the loss is deemed probable and the liability can reasonably be estimated. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, we record the minimum estimated liability related to the claim. As additional information becomes available, we assess the potential liability related to its pending litigation and revises our estimates.

A putative class action lawsuit was filed on May 18, 2021 in the Superior Court of the State of California for the County of Los Angeles (Isaiah Villarica v. JAKKS Pacific, Inc.). Plaintiff formerly worked in one of our warehouses and was retained via Workforce Enterprises, a provider of temporary employees. The lawsuit alleges that we violated various California Labor Code provisions governing wage and hour requirements, including that we failed to pay all minimum and overtime wages owed, provide legally compliant meal and rest periods, or reimburse business expenses. The lawsuit further alleges derivative wage and hour claims for failure to timely pay all wages owed at separation of employment, failure to provide accurate wage statements, and unfair business practices. Plaintiff seeks to represent a class consisting of all individuals who have worked for us—either directly or through a staffing agency—in California since November 19, 2016 and who were classified as non-exempt. Plaintiff seeks unpaid wages, meal and rest period premiums, interest, various statutory penalties, attorneys’ fees, and costs, all in unspecified amounts. Workforce Enterprises has also been named as a defendant in this matter.

The same counsel in the Villarica matter filed a related lawsuit on February 15, 2022 in the same court (Matthew Cordova v. JAKKS Pacific, Inc). Plaintiff also formerly worked in one of our warehouses and was retained via Workforce Enterprises, a provider of temporary employees. The lawsuit alleges that we committed wage and hour violations under the California Private Attorneys General Act, including failing to provide compliant meal and rest periods, properly calculate and pay all minimum and overtime wages, provide accurate wage statements, provide all wages due at separation of employment, provide sick leave, maintain accurate payroll records, or reimburse business expenses. Plaintiff seeks to collect civil penalties on behalf of the State of California under the Private Attorneys General Act for each violation experienced by “aggrieved employees,” defined as all individuals who have worked for us—either directly or through a staffing agency—in California since December 8, 2020 and who were classified as non-exempt.

At a mediation between us, counsel to three temporary providers who provided temporary employees to us during the relevant time periods, and counsel for both lawsuits occurred on March 24, 2022. We are responsible for our own fees related to the lawsuits and have demanded and are in the process of obtaining indemnification for the settlement amounts for both of these matters from the three temporary employee providers who supplied temporary employees to us during the relevant time periods at issue in the lawsuits. Following mediation in March 2022, we agreed to settlement terms with respect to both cases and are currently waiting for the settlement paperwork to be finalized. We currently expect to incur only a nominal amount to settle both cases.

In the normal course of business, we may provide certain indemnifications and/or other commitments of varying scope to a) our licensors, customers and certain other parties, including against third-party claims of intellectual property infringement, and b) our officers, directors and employees, including against third-party claims regarding the periods in which they serve in such capacities with us. The duration and amount of such obligations is, in certain cases, indefinite. Our director’s and officer’s liability insurance policy may, however, enable us to recover a portion of any future payments related to our officer, director or employee indemnifications. For the past five years, costs related to director and officer indemnifications have not been significant. Other than certain liabilities recorded in the normal course of business related to royalty payments due to our licensors, no liabilities have been recorded for indemnifications and/or other commitments.

Item 1A. Risk Factors

Risk factors with respect to us and our business are contained in “Part I, Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2021. There have been no material changes from the risk factors previously disclosed in such filing. The disclosures made in this Quarterly Report should be reviewed together with the risk factors contained therein.

Item 6. Exhibits

Number	Description
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer (1)
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer (1)
32.1	Section 1350 Certification of Chief Executive Officer (1)
32.2	Section 1350 Certification of Chief Financial Officer (1)
101.INS	Inline XBRL Instance Document
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

(1) Filed herewith.

SIGNATURES

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

JAKKS PACIFIC, INC.

Date: May 10, 2022

By: /s/ John Kimble
John Kimble
Executive Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial Officer)

CERTIFICATIONS

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

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

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

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

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

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

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

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

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

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

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

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

By: _____
/s/ Stephen G. Berman
Stephen G. Berman
Chief Executive Officer

Date: May 10, 2022

CERTIFICATIONS

I, John Kimble, Chief Financial Officer, certify that:

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

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

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

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

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

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

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

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

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

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

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

By:

/s/ John Kimble

John Kimble
Chief Financial Officer

Date: May 10, 2022

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

Pursuant to 18 U.S.C. Section 1350, the undersigned officer of JAKKS Pacific, Inc. (“Registrant”) hereby certifies that the Registrant’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2022 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Stephen G. Berman

Stephen G. Berman

Chief Executive Officer

Date: May 10, 2022

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

Pursuant to 18 U.S.C. Section 1350, the undersigned officer of JAKKS Pacific, Inc. (“Registrant”) hereby certifies that the Registrant’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2022 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ John Kimble

John Kimble
Chief Financial Officer

Date: May 10, 2022