

**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 September 30, 2023
- 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 10,073,264 as of November 14, 2023.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
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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	September 30, 2023 (Unaudited)	December 31, 2022
Current assets		
Cash and cash equivalents	\$ 96,252	\$ 85,297
Restricted cash	195	193
Accounts receivable, net of allowances for credit losses of \$3,712 and \$2,865 at September 30, 2023 and December 31, 2022, respectively	206,751	102,771
Inventory	68,832	80,619
Prepaid expenses and other assets	6,721	6,331
Total current assets	378,751	275,211
Property and equipment		
Office furniture and equipment	10,185	10,064
Molds and tooling	119,143	113,714
Leasehold improvements	6,493	6,659
Total	135,821	130,437
Less accumulated depreciation and amortization	121,193	115,575
Property and equipment, net	14,628	14,862
Operating lease right-of-use assets, net	25,743	19,913
Other long-term assets	2,220	2,469
Deferred income tax assets, net	57,856	57,804
Goodwill	35,083	35,083
Total assets	\$ 514,281	\$ 405,342
Liabilities, Preferred Stock and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 94,409	\$ 33,687
Accounts payable – Meisheng (related party)	27,977	9,820
Accrued expenses	65,609	37,998
Reserve for sales returns and allowances	43,512	51,877
Income taxes payable	17,422	8,165
Short term operating lease liabilities	6,415	10,746
Short term debt, net	—	25,529
Total current liabilities	255,344	177,822
Long term operating lease liabilities	19,283	9,863
Accrued expenses - long term	3,750	—
Debt, non-current portion, net of issuance costs and debt discounts	—	41,622
Preferred stock derivative liability	28,586	21,918
Income taxes payable	2,994	2,929
Total liabilities	309,957	254,154
Preferred stock accrued dividends, \$0.001 par value; 5,000,000 shares authorized; 200,000 shares issued and outstanding at September 30, 2023 and December 31, 2022		
	5,608	4,490
Stockholders' Equity		
Common stock, \$0.001 par value; 100,000,000 shares authorized; 10,073,264 and 9,742,236 shares issued and outstanding at September 30, 2023 and December 31, 2022, respectively	10	10
Additional paid-in capital	277,546	275,187
Accumulated deficit	(62,744)	(112,018)
Accumulated other comprehensive loss	(16,808)	(17,482)
Total JAKKS Pacific, Inc. stockholders' equity	198,004	145,697
Non-controlling interests	712	1,001
Total stockholders' equity	198,716	146,698
Total liabilities, preferred stock and stockholders' equity	\$ 514,281	\$ 405,342

See accompanying notes to condensed consolidated financial statements.

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

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	(Unaudited)		(Unaudited)	
	2023	2022	2023	2022
Net sales	\$ 309,744	\$ 322,998	\$ 584,161	\$ 664,301
Cost of sales:				
Cost of goods	149,052	174,334	293,512	368,242
Royalty expense	51,141	52,868	95,074	106,262
Amortization of tools and molds	2,566	3,885	5,955	7,079
Cost of sales	202,759	231,087	394,541	481,583
Gross profit	106,985	91,911	189,620	182,718
Direct selling expenses	10,684	8,397	22,405	20,137
General and administrative expenses	33,821	29,400	92,492	84,067
Depreciation and amortization	81	373	276	1,547
Selling, general and administrative expenses	44,586	38,170	115,173	105,751
Intangibles impairment	—	—	—	300
Income from operations	62,399	53,741	74,447	76,667
Loss from joint ventures	—	—	(565)	—
Other income (expense), net	(52)	251	424	520
Change in fair value of preferred stock derivative liability	(793)	(7,449)	(6,668)	(2,065)
Loss on debt extinguishment	—	—	(1,023)	—
Interest income	384	55	587	64
Interest expense	(1,436)	(4,350)	(5,741)	(8,889)
Income before provision for income taxes	60,502	42,248	61,461	66,297
Provision for income taxes	12,381	11,572	12,476	13,323
Net income	48,121	30,676	48,985	52,974
Net loss attributable to non-controlling interests	(11)	(17)	(289)	(470)
Net income attributable to Jakks Pacific, Inc.	\$ 48,132	\$ 30,693	\$ 49,274	\$ 53,444
Net income attributable to common stockholders	\$ 47,754	\$ 30,336	\$ 48,156	\$ 52,390
Earnings per share - basic	\$ 4.77	\$ 3.13	\$ 4.85	\$ 5.44
Shares used in earnings per share - basic	10,021	9,695	9,922	9,624
Earnings per share - diluted	\$ 4.53	\$ 2.96	\$ 4.58	\$ 5.18
Shares used in earnings per share - diluted	10,542	10,260	10,503	10,111
Comprehensive income	\$ 47,334	\$ 27,847	\$ 49,659	\$ 47,332
Comprehensive income attributable to JAKKS Pacific, Inc.	\$ 47,345	\$ 27,864	\$ 49,948	\$ 47,802

See accompanying notes to condensed consolidated financial statements.

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

Three and Nine Months Ended September 30, 2023
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	JAKKS Pacific, Inc. Stockholders' Equity	Non-Controlling Interests	Total Stockholders' Equity
Balance, December 31, 2022	\$ 10	\$ 275,187	\$ (112,018)	\$ (17,482)	\$ 145,697	\$ 1,001	\$ 146,698
Share-based compensation expense	—	2,089	—	—	2,089	—	2,089
Repurchase of common stock for employee tax withholding	—	(1,214)	—	—	(1,214)	—	(1,214)
Preferred stock accrued dividends	—	(367)	—	—	(367)	—	(367)
Net loss	—	—	(5,313)	—	(5,313)	(5)	(5,318)
Foreign currency translation adjustment	—	—	—	332	332	—	332
Balance, March 31, 2023	10	275,695	(117,331)	(17,150)	141,224	996	142,220
Share-based compensation expense	—	1,856	—	—	1,856	—	1,856
Preferred stock accrued dividends	—	(373)	—	—	(373)	—	(373)
Net income (loss)	—	—	6,455	—	6,455	(273)	6,182
Foreign currency translation adjustment	—	—	—	1,129	1,129	—	1,129
Balance, June 30, 2023	10	277,178	(110,876)	(16,021)	150,291	723	151,014
Share-based compensation expense	—	2,025	—	—	2,025	—	2,025
Repurchase of common stock for employee tax withholding	—	(1,279)	—	—	(1,279)	—	(1,279)
Preferred stock accrued dividends	—	(378)	—	—	(378)	—	(378)
Net income (loss)	—	—	48,132	—	48,132	(11)	48,121
Foreign currency translation adjustment	—	—	—	(787)	(787)	—	(787)
Balance, September 30, 2023	<u>\$ 10</u>	<u>\$ 277,546</u>	<u>\$ (62,744)</u>	<u>\$ (16,808)</u>	<u>\$ 198,004</u>	<u>\$ 712</u>	<u>\$ 198,716</u>

Three and Nine Months Ended September 30, 2022
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	JAKKS Pacific, Inc. Stockholders' Equity	Non-Controlling Interests	Total Stockholders' Equity
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 loss	—	—	(3,809)	—	(3,809)	(100)	(3,909)
Foreign currency translation adjustment	—	—	—	(662)	(662)	—	(662)
Balance, March 31, 2022	10	272,821	(207,240)	(13,614)	51,977	1,231	53,208
Share-based compensation expense	—	1,155	—	—	1,155	—	1,155
Preferred stock accrued dividends	—	(351)	—	—	(351)	—	(351)
Net income (loss)	—	—	26,560	—	26,560	(353)	26,207
Foreign currency translation adjustment	—	—	—	(2,151)	(2,151)	—	(2,151)
Balance, June 30, 2022	10	273,625	(180,680)	(15,765)	77,190	878	78,068
Share-based compensation expense	—	1,411	—	—	1,411	—	1,411
Repurchase of common stock for employee tax withholding	—	(639)	—	—	(639)	—	(639)
Preferred stock accrued dividends	—	(357)	—	—	(357)	—	(357)
Net income (loss)	—	—	30,693	—	30,693	(17)	30,676
Foreign currency translation adjustment	—	—	—	(2,829)	(2,829)	—	(2,829)
Balance, September 30, 2022	<u>\$ 10</u>	<u>\$ 274,040</u>	<u>\$ (149,987)</u>	<u>\$ (18,594)</u>	<u>\$ 105,469</u>	<u>\$ 861</u>	<u>\$ 106,330</u>

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	(Unaudited)	
	2023	2022
Cash flows from operating activities		
Net income	\$ 48,985	\$ 52,974
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses	983	362
Depreciation and amortization	6,231	8,626
Write-off and amortization of debt discount	714	776
Write-off and amortization of debt issuance costs	567	597
Share-based compensation expense	5,970	3,436
(Gain) loss on disposal of property and equipment	5	(46)
Loss on debt extinguishment	1,023	—
Intangibles impairment	—	300
Deferred income taxes	(52)	2
Change in fair value of preferred stock derivative liability	6,668	2,065
Changes in operating assets and liabilities:		
Accounts receivable	(104,963)	(57,824)
Inventory	11,787	(25,217)
Prepaid expenses and other assets	(378)	(7)
Accounts payable	60,931	24,666
Accounts payable - Meisheng (related party)	17,622	12,687
Accrued expenses	27,611	26,652
Reserve for sales returns and allowances	(8,365)	12,931
Income taxes payable	9,322	12,931
Other liabilities	3,009	(650)
Total adjustments	<u>38,685</u>	<u>22,287</u>
Net cash provided by operating activities	87,670	75,261
Cash flows from investing activities		
Purchases of property and equipment	(5,713)	(8,089)
Proceeds from sale of property and equipment	37	2
Net cash used in investing activities	<u>(5,676)</u>	<u>(8,087)</u>
Cash flows from financing activities		
Repurchase of common stock for employee tax withholding	(2,493)	(1,283)
Repayment of credit facility borrowings	(10,000)	(13,000)
Proceeds from credit facility borrowings	10,000	13,000
Repayment of 2021 BSP Term Loan	(69,218)	(28,985)
Net cash used in financing activities	<u>(71,711)</u>	<u>(30,268)</u>
Net increase in cash, cash equivalents and restricted cash	10,283	36,906
Effect of foreign currency translation	674	(5,642)
Cash, cash equivalents and restricted cash, beginning of period	85,490	45,332
Cash, cash equivalents and restricted cash, end of period	<u>\$ 96,447</u>	<u>\$ 76,596</u>
Supplemental disclosures of cash flow information:		
Cash paid for income taxes, net	<u>\$ 3,215</u>	<u>\$ 1,080</u>
Cash paid for interest	<u>\$ 4,141</u>	<u>\$ 6,862</u>

As of September 30, 2023 and 2022, there was \$3.9 million and \$4.7 million, respectively, of property and equipment purchases included in accounts payable.

See Notes 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)
September 30, 2023

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, 2022.

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 JAKKS Pacific Trading 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.

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 adopted ASU 2016-13 and its related amendments on January 1, 2023. The adoption of this new accounting 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. In December 2022, the FASB issued ASU 2022-06 which extended the effective date of the new standard to fiscal years beginning after December 15, 2024, including interim periods within those fiscal years, with early adoption permitted. In Q1 2023, the Company entered into amendments to its 2021 BSP Term Loan Agreement and its JPMorgan ABL Credit Agreement, which transitioned the interest reference rate on its term loan and revolving line of credit from LIBOR to the Secured Overnight Financing Rate (“SOFR”) (See Note 5 – Debt and Note 6 – Credit Facilities). The adoption of this new accounting standard did not have a material impact on the Company’s condensed consolidated financial statements.

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.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
September 30, 2023

No new additional accounting pronouncements were issued or adopted for the nine months ended September 30, 2023 that materially impacted the Company.

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.

Results are not necessarily those which would be achieved if each segment was an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts for the three and nine months ended September 30, 2023 and 2022 and as of September 30, 2023 and December 31, 2022 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Net Sales				
Toys/Consumer Products	\$ 246,004	\$ 269,607	\$ 461,831	\$ 529,590
Costumes	63,740	53,391	122,330	134,711
	<u>\$ 309,744</u>	<u>\$ 322,998</u>	<u>\$ 584,161</u>	<u>\$ 664,301</u>

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Income from Operations				
Toys/Consumer Products	\$ 55,494	\$ 53,643	\$ 70,020	\$ 74,097
Costumes	6,905	98	4,427	2,570
	<u>\$ 62,399</u>	<u>\$ 53,741</u>	<u>\$ 74,447</u>	<u>\$ 76,667</u>

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Depreciation and Amortization Expense				
Toys/Consumer Products	\$ 2,594	\$ 4,139	\$ 6,084	\$ 8,176
Costumes	53	119	147	450
	<u>\$ 2,647</u>	<u>\$ 4,258</u>	<u>\$ 6,231</u>	<u>\$ 8,626</u>

	September 30,	December 31,
	2023	2022
Assets		
Toys/Consumer Products	\$ 462,358	\$ 377,605
Costumes	51,923	27,737
	<u>\$ 514,281</u>	<u>\$ 405,342</u>

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
September 30, 2023

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 September 30, 2023 and December 31, 2022 and for the three and nine months ended September 30, 2023 and 2022 (in thousands):

	September 30, 2023	December 31, 2022
Long-lived Assets		
United States	\$ 23,247	\$ 17,383
China	15,464	14,161
United Kingdom	830	974
Italy	604	—
Hong Kong	140	2,142
Mexico	58	69
Canada	28	46
	<u>\$ 40,371</u>	<u>\$ 34,775</u>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Net Sales by Customer Area				
United States	\$ 244,931	\$ 253,854	\$ 461,561	\$ 543,388
Europe	31,676	38,075	58,476	65,911
Latin America	15,319	9,504	27,590	15,712
Canada	11,453	12,804	22,306	21,720
Asia	3,192	4,294	6,403	8,733
Australia & New Zealand	2,692	3,941	6,056	7,014
Middle East & Africa	481	526	1,769	1,823
	<u>\$ 309,744</u>	<u>\$ 322,998</u>	<u>\$ 584,161</u>	<u>\$ 664,301</u>

Major Customers

Net sales to major customers for the three and nine months ended September 30, 2023 and 2022 were as follows (in thousands, except for percentages):

	Three Months Ended September 30,				Nine Months Ended June 30,			
	2023		2022		2023		2022	
	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales
Target	\$ 96,322	31.1%	\$ 75,327	23.3%	\$ 175,417	30.0%	\$ 176,119	26.5%
Wal-Mart	59,541	19.2	88,954	27.5	117,888	20.2	182,345	27.5
Amazon	44,073	14.2	17,718	5.5	61,367	10.5	49,765	7.5
	<u>\$ 199,936</u>	<u>64.5%</u>	<u>\$ 181,999</u>	<u>56.3%</u>	<u>\$ 354,672</u>	<u>60.7%</u>	<u>\$ 408,229</u>	<u>61.5%</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.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
September 30, 2023

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):

	September 30, 2023	December 31, 2022
Raw materials	\$ 117	\$ 69
Finished goods	68,715	80,550
	<u>\$ 68,832</u>	<u>\$ 80,619</u>

The inventory obsolescence reserve was \$9.0 million as of September 30, 2023 and December 31, 2022.

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. For the three and nine months ended September 30, 2023, sales commissions were \$1.2 million and \$2.4 million, respectively. For the three and nine months ended September 30, 2022, sales commissions were \$1.1 million and \$2.2 million, respectively.

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. For the three and nine months ended September 30, 2023, shipping and handling costs were \$2.6 million and \$6.1 million, respectively. For the three and nine months ended September 30, 2022, shipping and handling costs were \$1.1 million and \$4.8 million, respectively.

The Company's reserve for sales returns and allowances amounted to \$43.5 million as of September 30, 2023, compared to \$51.9 million as of December 31, 2022.

The Company's net accounts receivable as of September 30, 2023, December 31, 2022 and December 31, 2021 were \$206.8 million, \$102.8 million and \$147.4 million, respectively.

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Note 5 — Debt

Term Loan

Term loan consists of the following (in thousands):

	September 30, 2023			December 31, 2022		
	Principal Amount	Debt Discount/ Issuance Costs	Net Amount	Principal Amount	Debt Discount/ Issuance Costs*	Net Amount
2021 BSP Term Loan	\$ —	\$ —	\$ —	\$ 68,901	\$ (1,750)	\$ 67,151

* The term loan was valued using the discounted cash flow method to determine the implied debt discount. The debt discount and issuance costs are 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 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 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 former 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 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, 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 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.

In January 2023, the Company entered into a second amendment for its 2021 BSP Term Loan Agreement, which transitioned the interest reference rate on its 2021 BSP Term Loan from LIBOR to the Secured Overnight Financing Rate (“SOFR”). The new interest reference rate for the 2021 BSP Term Loan will be effective on April 1, 2023. In addition to the transition to SOFR, the amendment also includes a constant 0.10% spread adjustment until the maturity of the 2021 BSP Term Loan.

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. 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, April 26, 2022, \$20.0 million; (b) at all times during the period commencing on the First Amendment Effective Date through and including June 30, 2022, \$15.0 million; and (c) at all times on and after July 1, 2022, through September 30, 2022, \$17.5 million; 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, then the amount set forth in this clause shall be increased to \$20.0 million. Notwithstanding the foregoing, the Applicable Minimum Cash Amount shall be reduced by \$1.0 million for every \$5.0 million 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 \$15.0 million.

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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 (see Note 6 – Credit Facility).

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 (see Note 16 – Related Party Transactions).

The fair value of the Company's 2021 BSP Term Loan is considered Level 3 fair value (see Note 15 – 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 \$69.3 million as of December 31, 2022 compared to a carrying value of \$68.9 million as of December 31, 2022.

On June 27, 2022, as permitted by the terms within the 2021 BSP Term Loan Agreement, the Company made a voluntary fee-free \$10.0 million prepayment towards the outstanding principal amount of the 2021 BSP Term Loan.

On September 28, 2022, as permitted by the terms within the 2021 BSP Term Loan Agreement, the Company made a voluntary \$17.5 million prepayment towards the outstanding principal amount of the 2021 BSP Term Loan and incurred a \$0.5 million prepayment penalty.

On January 3, 2023, as permitted by the terms within the 2021 BSP Term Loan Agreement, the Company made a voluntary \$15.0 million prepayment towards the outstanding principal amount of the 2021 BSP Term Loan and incurred a \$0.2 million prepayment penalty.

On March 3, 2023, as required by the terms within the 2021 BSP Term Loan Agreement under the Excess Cash Flow ("ECF") Sweep provision, the Company made a mandatory \$23.1 million payment towards the outstanding principal amount of the 2021 BSP Term Loan.

On June 5, 2023, the Company paid in full the 2021 BSP Term Loan and terminated the 2021 BSP Term Loan Agreement by making a \$30.2 million prepayment towards the outstanding principal amount. Additionally, the Company made a \$0.4 million payment towards the outstanding accrued interest, and a \$0.2 million payment for the prepayment penalty and other related fees. In connection with this transaction, the Company recognized a loss on debt extinguishment of \$1.0 million on its condensed consolidated statements of operations.

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Note 6 — Credit Facilities

JPMorgan Chase

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) LIBOR 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 September 30, 2023, the weighted average interest rate on the credit facility with JPMorgan Chase Bank was 6.8%.

In March 2023, the Company entered into a first amendment for its JPMorgan ABL Credit Agreement, which transitioned the interest reference rate on its JPMorgan ABL Facility from LIBOR to the Secured Overnight Financing Rate (“SOFR”). The new interest reference rate for the ABL Facility became effective on March 16, 2023. Any amounts borrowed under the JPMorgan ABL Facility will bear interest at either (i) SOFR plus 1.50% - 2.00% (determined by reference to an excess availability pricing grid) plus a constant 0.10% spread adjustment 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 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.

As of September 30, 2023, the amount of outstanding borrowings was nil and the total excess borrowing availability was \$53.7 million.

As of September 30, 2023, off-balance sheet arrangements include letters of credit issued by JPMorgan of \$9.3 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 and \$0.3 million for the three and nine months ended September 30, 2023, respectively.

As of September 30, 2023, the Company was in compliance with the financial covenants under the JPMorgan ABL Credit Agreement.

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Note 7 — Income Taxes

The Company's income tax expense of \$12.4 million for the three months ended September 30, 2023, reflects an effective tax rate of 20.5%. The Company's income tax expense of \$11.6 million for the three months ended September 30, 2022, reflects an effective tax rate of 27.4%. The tax expense for the three months ended September 30, 2023 primarily relates to U.S. and foreign income taxes and discrete items. The tax expense for the three months ended September 30, 2022 primarily relates to U.S. and foreign income taxes and discrete items.

The Company's income tax expense of \$12.5 million for the nine months ended September 30, 2023 reflects an effective tax rate of 20.3%. The Company's income tax expense of \$13.3 million for the nine months ended September 30, 2022 reflects an effective tax rate of 20.1%. The majority of the tax expense for the nine months ended September 30, 2023 primarily relates to U.S. and foreign income taxes offset by discrete items. The majority of the tax expense for the nine months ended September 30, 2022 relates to U.S. and foreign income taxes and discrete items.

Note 8 — Earnings Per Share

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
<u>Earnings per share - basic and diluted</u>	2023	2022	2023	2022
Net income	\$ 48,121	\$ 30,676	\$ 48,985	\$ 52,974
Net loss attributable to non-controlling interests	(11)	(17)	(289)	(470)
Net income attributable to JAKKS Pacific, Inc.	48,132	30,693	49,274	53,444
Preferred stock dividend*	378	357	1,118	1,054
Net income attributable to common stockholders **	\$ 47,754	\$ 30,336	\$ 48,156	\$ 52,390
Weighted average common shares outstanding - basic	10,021	9,695	9,922	9,624
Earnings per share available to common stockholder - basic	\$ 4.77	\$ 3.13	\$ 4.85	\$ 5.44
Weighted average common shares outstanding - diluted	10,542	10,260	10,503	10,111
Earnings per share available to common stockholder - diluted	\$ 4.53	\$ 2.96	\$ 4.58	\$ 5.18

* The 200,000 shares issued and outstanding are non-participating.

** Net income attributable to common stockholders was computed by deducting preferred dividends of \$0.4 million and \$1.1 million for the three and nine months ended September 30, 2023, respectively. Net income attributable to common stockholders was computed by deducting preferred dividends of \$0.4 million and \$1.1 million for the three and nine months ended September 30, 2022, respectively.

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated using the weighted average number of common shares and common share equivalents outstanding during the period (which consist of restricted stock units to the extent they are dilutive). No restricted stock units were excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2023 and 2022.

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.

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During 2022, certain employees, including three executive officers, surrendered an aggregate of 113,162 shares of restricted stock units for \$1.4 million to cover income taxes due on the vesting of restricted shares. Additionally, an aggregate of 149,238 shares of restricted stock granted in 2019 with a value of approximately \$2.2 million was forfeited during 2022.

During 2023, certain employees, including two executive officers, surrendered an aggregate of 136,532 shares of restricted stock for \$2.5 million to cover income taxes due on the vesting of restricted shares. Additionally, an aggregate of 2,206 shares of restricted stock granted in 2019 with the value of approximately \$41,000 was forfeited during 2023.

No dividend was declared or paid in the three and nine months ended September 30, 2023 and 2022.

At the Market Offering

On July 1, 2022, the Company entered into an At the Market Issuance Sales Agreement (“ATM Agreement”) with B. Riley, as agent pursuant to which the Company may, from time to time, sell shares of its common stock, up to \$75 million of common stock, in one or more offerings in amounts, prices and at terms that the Company will determine at the time of the offering.

As of September 30, 2023, the Company has not sold any shares of common stock under the ATM Agreement.

The Company has on file with the SEC an effective registration statement pursuant to which it may issue, from time to time, up to an additional \$75 million of securities consisting of, or any combination of, common stock, preferred stock, debt securities, warrants, rights and/or units, in one or more offerings in amounts, prices and at terms that the Company will determine at the time of the offering.

As of September 30, 2023, the Company has not sold any securities pursuant to its shelf registration statement.

Redeemable Preferred Stock

On August 9, 2019, the Company entered into and consummated multiple, binding definitive agreements (collectively, the “Recapitalization Transaction”) among various investor parties to recapitalize the Company’s balance sheet. In connection with the Recapitalization Transaction, 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 September 30, 2023 and December 31, 2022, 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 and nine months ended September 30, 2023, the Company recorded \$0.4 million and \$1.1 million, respectively, of preferred stock dividends as an increase in the value of the Series A Preferred Stock. For the three and nine months ended September 30, 2022, the Company recorded \$0.4 million and \$1.1 million of preferred stock dividends as an increase in the value of the Series A Preferred Stock, respectively.

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. 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 2022, an agreement was reached with the preferred shareholders to eliminate their ability to elect members to the Company's Board of Directors on a going-forward basis.

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, and is more akin to a debt instrument than equity.

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. 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 (see Note 15 – Fair Value Measurement). 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.

Accordingly, these two embedded derivatives are accounted for separately from the Series A Preferred Stock at fair value.

As of September 30, 2023, the Series A Preferred Stock is recorded in temporary equity at the amount of accrued, but unpaid dividends of \$5.6 million, and the redemption provision, as a bifurcated derivative, is recorded as a long-term liability with an estimated value of \$28.6 million. As of December 31, 2022, the Series A Preferred Stock is recorded in temporary equity at the amount of accrued, but unpaid dividends of \$4.5 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 September 30, 2023, the Series A Preferred Stock had a carrying value of \$25.6 million and a liquidation value of \$38.4 million. As of December 31, 2022, the Series A Preferred Stock had a carrying value of \$24.5 million and a liquidation value of \$36.7 million.

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

	2023	2022
Balance, January 1,	\$ 4,490	\$ 3,074
Preferred stock accrued dividends	367	346
Balance, March 31,	4,857	3,420
Preferred stock accrued dividends	373	351
Balance, June 30,	5,230	3,771
Preferred stock accrued dividends	378	357
Balance, September 30,	\$ 5,608	\$ 4,128

Note 10 — Joint Ventures

In November 2014, the Company entered into a joint venture with Meisheng Culture & 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 loss was \$11,000 and \$289,000 for the three and nine months ended September 30, 2023. The non-controlling interest’s share of the loss was \$17,000 and \$470,000 for the three and nine months ended September 30, 2022, 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 loss from the joint venture for the three months and nine months ended September 30, 2023 and 2022 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 and nine months ended September 30, 2023, there were no events or circumstances that indicated that an impairment loss may have been incurred.

Based on the Company’s April 1 annual assessment, it determined that the fair values of its reporting units were not less than the carrying amounts. No goodwill impairment was determined to have occurred for the nine months ended September 30, 2023 and 2022.

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Note 12 — Comprehensive Income

The table below presents the components of the Company's comprehensive income for the three and nine months ended September 30, 2023 and 2022 (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Net income	\$ 48,121	\$ 30,676	\$ 48,985	\$ 52,974
Other comprehensive income:				
Foreign currency translation adjustment	(787)	(2,829)	674	(5,642)
Comprehensive income	47,334	27,847	49,659	47,332
Less: Comprehensive loss attributable to non-controlling interests	(11)	(17)	(289)	(470)
Comprehensive income attributable to JAKKS Pacific, Inc.	<u>\$ 47,345</u>	<u>\$ 27,864</u>	<u>\$ 49,948</u>	<u>\$ 47,802</u>

Note 13 — 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.

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 14 — 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 executive officers and certain key employees of restricted stock 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. Shares for the restricted stock units are not issued until they vest.

The following table summarizes the total share-based compensation expense recognized for the three and nine months ended September 30, 2023 and 2022 (in thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2023	2022	2023	2022
Share-based compensation expense	\$ 2,025	\$ 1,411	\$ 5,970	\$ 3,436

JAKKS PACIFIC, INC. AND SUBSIDIARIES
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(Unaudited)
September 30, 2023

Restricted Stock Units

Restricted stock unit activity (including those with performance-based vesting criteria) for the nine months ended September 30, 2023 is summarized as follows:

	Restricted Stock Units	
	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding, December 31, 2022	1,408,586	\$ 12.82
Granted	278,081	17.49
Vested	(460,961)	11.69
Forfeited	(18,852)	17.28
Outstanding, September 30, 2023	<u>1,206,854</u>	<u>14.05</u>

As of September 30, 2023, there was \$13.2 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 2.1 years.

Note 15 — 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.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
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The following tables summarize the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2023 and December 31, 2022 (in thousands):

	Carrying Amount as of September 30, 2023	Fair Value Measurements as of September 30, 2023		
		Level 1	Level 2	Level 3
Money market funds	\$ 56,013	\$ 56,013	\$ —	\$ —
Preferred stock derivative liability	28,586	—	—	28,586

	Carrying Amount as of December 31, 2022	Fair Value Measurements as of December 31, 2022		
		Level 1	Level 2	Level 3
Preferred stock derivative liability	\$ 21,918	\$ —	\$ —	\$ 21,918

The following table provides 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):

Preferred stock derivative liability	2023	2022
Balance, January 1,	\$ 21,918	\$ 21,282
Change in fair value	6,668	2,065
Balance, September 30,	<u>\$ 28,586</u>	<u>\$ 23,347</u>

The Company's Series A Preferred 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. 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. 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.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
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The following table provides quantitative information of liabilities measured at fair value and the significant unobservable inputs (Level 3), the range of the significant unobservable inputs, and the valuation techniques.

	Fair Value As of September 30, 2023 (In thousands)	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Preferred Stock Derivative Liability	\$ 28,586	Discounted Cash Flow	Change-in-control probability assumptions	Range: 0% to 100%
			Timing of change-in-control assumptions	Range: 1 to 10 years
			Discount Rate	*
			Market yield*	*

	Fair Value As of December 31, 2022 (In thousands)	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Preferred Stock Derivative Liability	\$ 21,918	Discounted Cash Flow	Change-in-control probability assumptions	Range: 0% to 100%
			Timing of change-in-control assumptions	Range: 1 to 10 years
			Discount Rate	**
			Implied yield**	**

*Represents the hypothetical market yield

**Represents the implied yield of the 2021 BSP Term Loan

The Company's cash and cash equivalents including restricted cash, accounts receivable, accounts payable, and accrued expenses represent financial instruments. The carrying value of these financial instruments is a reasonable approximation of fair value due to the short-term nature of the instruments.

Note 16 — Related Party Transactions

In November 2014, the Company entered into a joint venture with 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 (see Note 10 – Joint Ventures).

In October 2016, the Company entered into a joint venture with Hong Kong Meisheng Cultural Company Limited, 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 (see Note 10 – Joint Ventures).

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.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
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Meisheng also serves as a significant manufacturer of the Company. For the three and nine months ended September 30, 2023, the Company made inventory, molds and tooling related payments to Meisheng of approximately \$35.2 million and \$65.1 million, respectively. For the three and nine months ended September 30, 2022, the Company made inventory, molds and tooling related payments to Meisheng of approximately \$44.1 million and \$111.0 million, respectively. As of September 30, 2023 and December 31, 2022, amounts due to Meisheng for inventory, molds and tooling received by the Company, but not paid totaled \$27.9 million and \$9.8 million, respectively.

A director of the Company is a director at Benefit Street Partners, who owns 145,788 shares of the Series A Preferred Stock (see Note 9 – Common Stock and Preferred Stock).

Note 17 — Prepaid Expenses and Other Assets

Prepaid expenses and other assets as of September 30, 2023 and December 31, 2022 consist of the following (in thousands):

	September 30,	December 31,
	2023	2022
Income tax receivable	\$ 2,218	\$ 2,217
Royalty advances	2,123	1,822
Prepaid expenses	1,928	994
Employee retention credit	265	1,179
Other assets	187	119
Prepaid expenses and other assets	<u>\$ 6,721</u>	<u>\$ 6,331</u>

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.

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 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 “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 Estimates

Our critical accounting policies and estimates are included in the 2022 Annual Report on Form 10-K and did not materially change during the first nine months of 2023.

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 September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2023	2022	2023	2022
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales:				
Cost of goods	48.2	54.0	50.2	55.4
Royalty expense	16.5	16.3	16.3	16.0
Amortization of tools and molds	0.8	1.2	1.0	1.1
Cost of sales	65.5	71.5	67.5	72.5
Gross profit	34.5	28.5	32.5	27.5
Direct selling expenses	3.5	2.6	3.8	3.0
General and administrative expenses	10.9	9.1	15.9	12.7
Depreciation and amortization	—	0.1	0.1	0.2
Selling, general and administrative expenses	14.4	11.8	19.8	15.9
Intangibles impairment	—	—	—	—
Income from operations	20.1	16.7	12.7	11.6
Loss from joint ventures	—	—	(0.1)	—
Other income (expense), net	—	0.1	0.1	—
Change in fair value of preferred stock derivative liability	(0.3)	(2.3)	(1.1)	(0.3)
Loss on debt extinguishment	—	—	(0.2)	—
Interest income	0.1	—	0.1	—
Interest expense	(0.4)	(1.4)	(1.0)	(1.3)
Income before provision for income taxes	19.5	13.1	10.5	10.0
Provision for income taxes	4.0	3.6	2.1	2.0
Net income	15.5	9.5	8.4	8.0
Loss attributable to non-controlling interests	—	—	—	—
Net income attributable to JAKKS Pacific, Inc.	15.5%	9.5%	8.4%	8.0%

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Net Sales				
Toys/Consumer Products	\$ 246,004	\$ 269,607	\$ 461,831	\$ 529,590
Costumes	63,740	53,391	122,330	134,711
	<u>\$ 309,744</u>	<u>\$ 322,998</u>	<u>\$ 584,161</u>	<u>\$ 664,301</u>
Cost of Sales				
Toys/Consumer Products	\$ 156,854	\$ 186,309	\$ 303,131	\$ 375,015
Costumes	45,905	44,778	91,410	106,568
	<u>\$ 202,759</u>	<u>\$ 231,087</u>	<u>\$ 394,541</u>	<u>\$ 481,583</u>
Gross Profit				
Toys/Consumer Products	\$ 89,150	\$ 83,298	\$ 158,700	\$ 154,575
Costumes	17,835	8,613	30,920	28,143
	<u>\$ 106,985</u>	<u>\$ 91,911</u>	<u>\$ 189,620</u>	<u>\$ 182,718</u>

Comparison of the Three Months Ended September 30, 2023 and 2022

Net Sales

Toys/Consumer Products. Net sales of our Toys/Consumer Products segment were \$246.0 million for the three months ended September 30, 2023 compared to \$269.6 million for the prior year period, representing a decrease of \$23.6 million, or 8.8%. The decrease was primarily driven by lower sales in North America, which were down \$21.3 million, or 9.7%, consistent with the year-to-date trend and in part attributable to our retail customers looking to reduce their inventory levels, again consistent with the full-year trend.

Costumes. Net sales of our Costumes segment were \$63.7 million for the three months ended September 30, 2023 compared to \$53.4 million for the prior year period, representing an increase of \$10.3 million, or 19.3%. The increase in net sales was primarily driven by a return to more normal ordering patterns versus a year ago when customers placed more costume orders in Q2. Retailers moved back to the pre-pandemic ordering pattern which existed prior to the 2021 importation bottleneck and related spike in container costs.

Cost of Sales

Toys/Consumer Products. Cost of sales of our Toys/Consumer Products segment was \$156.9 million, or 63.8% of related net sales for the three months ended September 30, 2023 compared to \$186.3 million, or 69.1% of related net sales for the prior year period, representing a decrease of \$29.4 million, or 15.8%. The decrease in dollars is related to lower overall sales. The decrease as a percentage of net sales, year over year, is primarily due to lower freight costs.

Costumes. Cost of sales of our Costumes segment was \$45.9 million, or 72.1% of related net sales for the three months ended September 30, 2023, compared to \$44.8 million, or 83.9% of related net sales for the prior year period, representing an increase in dollars of \$1.1 million, or 2.5%. The increase in dollars is related to higher overall sales. The decrease as a percentage of net sales, year over year, is primarily due to lower freight costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$44.6 million for the three months ended September 30, 2023 compared to \$38.2 million for the prior year period constituting 14.4% and 11.8% of net sales, respectively. The increase in selling, general and administrative expenses as a percentage of net sales was primarily due to an increase in media spend and headcount.

Interest Expense

Interest expense was \$1.4 million for the three months ended September 30, 2023, as compared to \$4.4 million in the prior year period. During the three months ended September 30, 2023, we incurred interest expense of \$1.3 million related to discounting of some receivables and \$0.1 million related to our revolving credit facility. During the three months ended September 30, 2022, we incurred interest expense of \$3.4 million related to our 2021 BSP Term Loan, \$0.8 million related to discount of some receivables and \$0.2 million related to our revolving credit facility.

Provision for (Benefit From) Income Taxes

Our income tax expense, which includes federal, state, and foreign income taxes and discrete items, was \$12.4 million, or an effective tax rate of 20.5%, for the three months ended September 30, 2023. During the comparable period in 2022, our income tax expense was \$11.6 million, or an effective tax rate of 27.4%.

Comparison of the Nine Months Ended September 30, 2023 and 2022

Net Sales

Toys/Consumer Products. Net sales of our Toys/Consumer Products segment were \$461.8 million for the nine months ended September 30, 2023 compared to \$529.6 million for the prior year period, representing a decrease of \$67.8 million, or 12.8%. The decrease was primarily driven by lower sales in North America attributable to typical lifecycle of declining toy sales behind a 2021 film release as well as retail customers desire to reduce their inventory levels over the course of calendar year 2023.

Costumes. Net sales of our Costumes segment were \$122.3 million for the nine months ended September 30, 2023 compared to \$134.7 million for the prior year period, representing a decrease of \$12.4 million, or 9.2%. The reduction in year-to-date costume sales is primarily attributable to some customers recalibrating their purchase levels downward as a result of Halloween 2022 sell-through.

Cost of Sales

Toys/Consumer Products. Cost of sales of our Toys/Consumer Products segment was \$303.1 million, or 65.6% of related net sales for the nine months ended September 30, 2023 compared to \$375.0 million, or 70.8% of related net sales for the prior year period, representing a decrease of \$71.9 million, or 19.2%. The decrease in dollars is related to lower overall sales. The decrease as a percentage of net sales, year over year, is due to lower freight costs.

Costumes. Cost of sales of our Costumes segment was \$91.4 million, or 74.7% of related net sales for the nine months ended September 30, 2023, compared to \$106.6 million, or 79.1% of related net sales for the prior year period, representing a decrease in dollars of \$15.2 million, or 14.3%. The decrease in dollars is related to lower overall sales. The decrease as a percentage of net sales, year over year, is due to lower freight costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$115.2 million for the nine months ended September 30, 2023 compared to \$105.8 million for the prior year period constituting 19.8% and 15.9% of net sales, respectively. Selling, general and administrative expenses increased as a result of higher professional services and employee related expenses.

Interest Expense

Interest expense was \$5.7 million for the nine months ended September 30, 2023, as compared to \$8.9 million in the prior year period. Expense is lower due to our aggressively paying down loan principal in calendar year 2022 and 2023, due to increases in cash flow and in response to rising market interest rates. During the nine months ended September 30, 2023, we incurred interest expense of \$3.2 million related to our 2021 BSP Term Loan, \$2.1 million related to discounting of some receivables and \$0.4 million related to our revolving credit facility. During the nine months ended September 30, 2022, we incurred interest expense of \$7.4 million related to our 2021 BSP Term Loan, \$1.0 million related to discounting of some receivables and \$0.5 million related to our revolving credit facility.

Provision for (Benefit From) Income Taxes

Our income tax expense, which includes federal, state, and foreign income taxes and discrete items, was \$12.5 million, or an effective tax rate of 20.3%, for the nine months ended September 30, 2023. During the comparable period in 2022, our income tax expense was \$13.3 million, or an effective tax rate of 20.1%.

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 September 30, 2023, we had working capital (inclusive of cash, cash equivalents and restricted cash) of \$123.4 million, compared to \$97.4 million as of December 31, 2022, representing an increase in working capital of \$26.0 million during the nine-month period ended September 30, 2023.

Operating activities provided net cash of \$87.7 million during the nine months ended September 30, 2023, as compared to net cash provided of \$75.3 million in the prior year period. The increase in net cash provided by operating activities year-over-year is primarily due to lower working capital usage and higher non-cash charges related to the valuation adjustment for our 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 22% payable on net sales of such products. As of September 30, 2023, these agreements required future aggregate minimum royalty guarantees of \$65.3 million exclusive of \$2.1 million in advances already paid. Of this \$65.3 million future minimum royalty guarantee, \$44.0 million is due over the next twelve months.

Investing activities used net cash of \$5.7 million and \$8.1 million for the nine months ended September 30, 2023 and 2022, 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 \$71.7 million and \$30.3 million for the nine months ended September 30, 2023 and 2022, respectively. The cash used in financing activities during the nine months ended September 30, 2023, primarily consists of the repayment of our 2021 BSP Term Loan of \$69.2 million and the repurchase of common stock for employee tax withholding of \$2.5 million. The cash used in financing activities during the nine months ended September 30, 2022, primarily consists of the repayment of our 2021 BSP Term Loan of \$29.0 million, and the repurchase of common stock for employee tax withholding of \$1.3 million.

As of September 30, 2023, we have no outstanding indebtedness under our first-lien secured term loan (the “2021 BSP Term Loan Agreement”) and under our senior secured revolving credit facility (the “JPMorgan ABL Facility”), aside from utilizing \$9.3 million in letters of credit.

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

As of September 30, 2023 and December 31, 2022, we held cash and cash equivalents, including restricted cash, of \$96.4 million and \$85.5 million, respectively. Cash, and cash equivalents, including restricted cash held outside of the United States in various foreign subsidiaries totaled \$37.6 million and \$39.4 million as of September 30, 2023 and December 31, 2022, 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 September 30, 2023.

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 September 30, 2023 off-balance sheet arrangements include letters of credit issued by JPMorgan of \$9.3 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 JPMorgan ABL Facility (see Note 6 – Credit Facilities). Borrowings under our JPMorgan ABL Facility bear interest at either (i) LIBOR 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 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 June 30, 2023, we utilized the revolving credit facility to borrow \$10 million, and subsequently, the entire amount was repaid, resulting in no outstanding balances as of September 30, 2023.

In Q1 2023, we entered into an amendment to our JPMorgan ABL Credit Agreement which changed the interest reference rate on our revolving line of credit from LIBOR to the Secured Overnight Financing Rate (“SOFR”).

Foreign Currency Risk

We have wholly-owned subsidiaries in Hong Kong, China, the United Kingdom, Germany, France, the Netherlands, Canada, Italy 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, Italy, 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 the pending litigation and revise our estimates.

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, 2022. 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: November 14, 2023

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: November 14, 2023

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: November 14, 2023

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 September 30, 2023 (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: November 14, 2023

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 September 30, 2023 (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: November 14, 2023