Genius Brands International, Inc.
Form 10-Q
August 14, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2014**

o **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: 000-54389**

**GENIUS BRANDS INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Nevada** | **20-4118216** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| | |
|---|---|
| **9401 Wilshire Boulevard #608** | |
| **Beverly Hills, California** | **90212** |
| (Address of principal executive offices) | (Zip Code) |

**310-273-4222**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 6,383,269 shares of common stock, par value $0.001, were outstanding as of August 8, 2014.

**GENIUS BRANDS INTERNATIONAL, INC.**

**FORM 10-Q**

**For the Quarterly Period Ended June 30, 2014**

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*PART I - FINANCIAL INFORMATION*

**ITEM 1. FINANCIAL STATEMENTS.**

**Genius Brands International, Inc.**

**Consolidated Balance Sheets**

**June 30, 2014 (unaudited) and December 31, 2013 (audited)**

| | 6/30/2014 | 12/31/2013 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and Cash Equivalents | $5,576,206 | $527,110 |
| Accounts Receivable, net | 326,947 | 893,826 |
| Inventory | 132,621 | 224,351 |
| Prepaid and Other Assets | 432,164 | 582,056 |
| Total Current Assets | 6,467,938 | 2,227,343 |
| | | |
| Property and Equipment, net | 56,792 | 78,748 |
| Film and Television Costs | 112,575 | – |
| Capitalized Product Development in Process | – | 54,575 |
| Intangible Assets, net | 1,907,187 | 1,865,706 |
| Goodwill | 10,365,805 | 10,365,805 |
| Investment in Stan Lee Comics, LLC | – | – |
| Total Assets | $18,910,297 | $14,592,177 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT) | | |
| Current Liabilities: | | |
| Accounts Payable | $433,720 | $889,919 |
| Accrued Expenses | 892,555 | 704,539 |
| Accrued Salaries and Wages | 62,788 | 59,958 |
| Disputed Trade Payable | 925,000 | 925,000 |
| Short Term Debt - Related Party | 412,893 | 516,659 |
| Total Current Liabilities | 2,726,956 | 3,096,075 |
| | | |
| Long Term Liabilities: | | |
| Services Advance | 741,758 | – |
| Total Liabilities | 3,468,714 | 3,096,075 |
| | | |
| Stockholders' Equity (Deficit) | | |
| | 6 | – |

| | | |
|---|---|---|
| Preferred Stock, $0.001 par value, 10,000,000 share authorized, respectively; 6,000 and 0 shares issued and outstanding, respectively | | |
| Common Stock, $0.001 par value, 700,000,000 shares authorized, respectively; 6,383,269 and 5,918,704 shares issued and outstanding, respectively | 6,384 | 5,919 |
| Additional Paid in Capital | 34,854,040 | 28,914,238 |
| Accumulated Deficit | (19,418,847) | (17,424,055) |
| Total Equity (Deficit) | 15,441,583 | 11,496,102 |
| Total Liabilities & Stockholders' Equity (Deficit) | $18,910,297 | $14,592,177 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Genius Brands International, Inc.**

**Consolidated Statements of Operations**

**Three Month and Six Month Periods Ended June 30, 2014 and 2013 (unaudited)**

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | 6/30/2014 | 6/30/2013 | 6/30/2014 | 6/30/2013 |
| Revenues: | | | | |
| Product Sales | $118,495 | $394,772 | $204,636 | $1,097,585 |
| Television & Home Entertainment | 36,814 | – | 87,275 | – |
| Licensing & Royalties | 61,887 | 227,552 | 101,567 | 258,978 |
| Total Revenues | 217,196 | 622,324 | 393,478 | 1,356,563 |
| | | | | |
| Cost of Sales (Excluding Depreciation) | 105,112 | 332,668 | 241,147 | 979,977 |
| | | | | |
| Gross Profit | 112,084 | 289,656 | 152,331 | 376,586 |
| | | | | |
| Operating Expenses: | | | | |
| Product Development | 5,926 | 2,848 | 6,813 | 29,839 |
| Professional Services | 300,973 | 113,853 | 620,842 | 178,359 |
| Rent Expense | 34,529 | 1,254 | 70,344 | 8,201 |
| Marketing & Sales | 80,112 | 104,072 | 117,880 | 158,791 |
| Depreciation & Amortization | 29,088 | 39,003 | 53,629 | 78,175 |
| Salaries and Related Expenses | 251,779 | 359,944 | 560,474 | 831,090 |
| Stock Compensation Expense | – | 101,988 | – | 160,268 |
| Bad Debt Expense | 55,000 | – | 55,000 | – |
| Other General & Administrative | 212,959 | 51,285 | 413,680 | 107,490 |
| Total Operating Expenses | 970,366 | 774,247 | 1,898,662 | 1,552,213 |
| | | | | |
| Loss from Operations | (858,282) | (484,591) | (1,746,331) | (1,175,627) |
| | | | | |
| Other Income (Expense): | | | | |
| Other Income | 7,156 | 16 | 7,789 | 32 |
| Interest Expense | (21) | (155,483) | (2,230) | (310,742) |
| Interest Expense - Related Parties | (6,207) | (6,810) | (13,370) | (13,534) |
| Gain (loss) on distribution contracts | (50,000) | – | (47,229) | – |
| Gain (loss) on extinguishment of debt | 12,593 | – | 52,447 | – |
| Gain (loss) on disposition of assets | (70,905) | – | (70,905) | – |
| Gain (loss) on inventory | (174,963) | – | (174,963) | – |
| Gain (loss) on derivative valuation | – | 103,619 | – | 10,757 |
| Net Other Income (Expense) | (282,347) | (58,658) | (248,461) | (313,487) |
| | | | | |
| Loss before Income Tax Expense | (1,140,629) | (543,249) | (1,994,792) | (1,489,114) |
| | | | | |
| Income Tax Expense | – | – | – | – |

| | | | | |
|---|---|---|---|---|
| Net Loss | $(1,140,629) | $(543,249) | $(1,994,792) | $(1,489,114) |
| Net Loss per common share | $(0.18) | $(0.75) | $(0.33) | $(2.05) |
| Weighted average shares outstanding | 6,221,947 | 722,911 | 6,126,292 | 724,903 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Genius Brands International, Inc.**

**Consolidated Statements of Stockholders' Equity (Deficit)**

| | Common Stock | | Preferred Stock | | Additional Paid in | Accumulated | |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Capital | Deficit | Total |
| Balance, December 31, 2013 (audited) | 5,918,704 | $ 5,919 | – | $ – | $ 28,914,238 | $ (17,424,055) | $ 11,496,102 |
| Common Stock Issued for Cash, Net of Offering costs | 102,860 | 103 | – | – | 355,013 | – | 355,116 |
| Common Stock Issued for Purchase Price Adjustment pursuant to Securities Purchase Agreement | 305,562 | 306 | – | – | (306) | – | – |
| Common Stock Issued in exchange for repayment of Accounts Payable | 8,143 | 8 | – | – | 32,564 | – | 32,572 |
| Common Stock Issues for Services | 48,000 | 48 | – | – | 159,252 | – | 159,300 |
| Series A Convertible Preferred Stock Issued for Cash, Net of Offering Costs | – | – | 6,000 | 6 | 5,379,909 | – | 5,379,915 |
| Imputed Interest for Member Advances | – | – | – | – | 13,370 | – | 13,370 |
| Net Loss | – | – | – | – | – | (1,994,792) | (1,994,792) |
| Balance, June 30, 2014 (unaudited) | 6,383,269 | $ 6,384 | 6,000 | $ 6 | $ 34,854,040 | $ (19,418,847) | $ 15,441,583 |

The accompanying notes are an integral part of these consolidated financial statements.

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**Genius Brands International, Inc.**

**Consolidated Statements of Cash Flows**

**Six Month Periods Ended June 30, 2014 and 2013 (unaudited)**

| | 6/30/2014 | 6/30/2013 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Net Loss | $(1,994,792) | $(1,489,114) |
| Adjustments to reconcile net loss to net cash provided in operating activities: | | |
| Depreciation Expense | 25,108 | 5,021 |
| Amortization Expense | 28,521 | 73,154 |
| Imputed Interest Expense | 13,370 | – |
| Bad Debt Expense | 55,000 | – |
| Accretion of Discount on Convertible Debentures | – | 162,244 |
| Issuance of Common Stock for Interest Expense | – | 40,000 |
| Issuance of Common Stock for Services | – | 155,544 |
| Stock Compensation Expense | – | 160,267 |
| Prepaid Consulting Services Expense | 190,469 | – |
| (Gain) Loss on Conversion of Accounts Payable | 4,072 | – |
| (Gain) Loss on Settlement or Extinguishment of Debt | (56,519) | – |
| (Gain) Loss on Derivative Valuation | – | (10,757) |
| (Gain) Loss on Distribution Contracts | 47,229 | – |
| (Gain) Loss on Disposition of Assets | 70,905 | – |
| (Gain) Loss on Inventory | 174,963 | – |
| | | |
| Decrease (increase) in operating assets: | | |
| Accounts Receivable | 511,879 | 747,409 |
| Inventory | (83,233) | 25,986 |
| Prepaid Expenses & Other Assets | 68,723 | (6,492) |
| Film and Television Costs, net | (112,575) | – |
| | | |
| Increase (decrease) in operating liabilities: | | |
| Accounts Payable | (371,183) | (68,795) |
| Accrued Salaries | 2,830 | 271,219 |
| Accrued Interest - Related Party | – | 13,534 |
| Other Accrued Expenses | 190,787 | (165,138) |
| Net cash provided/(used) in operating activities | (1,234,446) | (85,918) |
| | | |
| Cash Flows from Investing Activities: | | |
| Investment in Capitalized Product Development | (16,330) | – |
| Investment in Intangible Assets | (70,000) | (172,518) |
| Investment in Fixed Assets | (3,151) | – |
| Net cash provided/(used) by investing activities | (89,481) | (172,518) |
| | | |
| Cash Flows from Financing Activities: | | |
| Sale of Preferred Stock, net of offering costs | 5,379,915 | – |

| | | |
|---|---|---|
| Sale of Common Stock, net of offering costs | 355,116 | – |
| Proceeds from Services Advance | 750,000 | – |
| Repayment of Services Advance | (8,242 ) | – |
| Issuance Costs on Debenture | – | 64,278 |
| Payments of Related Party Notes | (103,766 ) | – |
| Net cash provided/(used) by financing activities | $6,373,023 | $64,278 |

The accompanying notes are an integral part of these consolidated financial statements.

**Genius Brands International, Inc.**

**Consolidated Statements of Cash Flows**

**Six Month Periods Ended June 30, 2014 and 2013 (unaudited)**

| | 6/30/2014 | 6/30/2013 |
|---|---|---|
| Net increase in Cash and Cash Equivalents | $5,049,096 | $(194,158) |
| Beginning Cash and Cash Equivalents | 527,110 | 447,548 |
| Ending Cash and Cash Equivalents | $5,576,206 | $253,390 |
| | | |
| Supplemental disclosures of cash flow information: | | |
| Cash paid for income taxes | $– | $– |
| Cash paid for interest | $2,230 | $40,000 |
| | | |
| Schedule of non-cash financing and investing activities: | | |
| Common Stock issued as Settlement for Accounts Payable | $32,572 | $– |
| Common Stock issued for Prepaid Services | $113,998 | $– |

The accompanying notes are an integral part of these consolidated financial statements.

**Genius Brands International, Inc.**

**Notes to Financial Statements**

**June 30, 2014 (unaudited)**

**Note 1: Organization and Business**

*Organization and Nature of Business*

Genius Brands International, Inc. ("we", "us", "our" or the "Company"), creates, produces and distributes original "content wit a purpose" for kids, meaning multi-media, multi-format content for kids that we believe is as entertaining as it is enriching. In most cases, the Company wholly owns the original content it produces, and works with a variety of partners who are experts in their respective categories, to develop and distribute it in multiple formats around the world. The Company owns and is developing a portfolio of original children's entertainment to appeal to toddlers to teens.

The Company commenced operations in January 2006, assuming all of the rights and obligations of its then Chief Executive Officer, Klaus Moeller, under an Asset Purchase Agreement between the Company and Genius Products, Inc., in which the Company obtained all rights, copyrights, and trademarks to the brands "Baby Genius," "Little Genius," "Kid Genius," "123 Favorite Music" and "Wee Worship," and all then existing productions under those titles. On October 17, 2011 and October 18, 2011, the Company filed Articles of Merger with the Secretary of State of the State of Nevada and with the Secretary of State of the State of California, respectively. As previously described on the Company's Schedule 14C Information Statement, filed with the Securities and Exchange Commission on September 21, 2011, by filing the Articles of Merger, the Company (i) changed its state of incorporation to Nevada from California, and (ii) changed its name to Genius Brands International, Inc. from Pacific Entertainment Corporation (the "Reincorporation"). In connection with the Reincorporation, on October 12, 2011, the Company filed an Issuer Company-Related Action Notification Form with the Financial Industry Regulatory Authority ("FINRA") and on November 29, 2011 our trading symbol changed from "PENT" to "GNUS".

On November 15, 2013, we entered into an Agreement and Plan of Reorganization (the "Merger Agreement") with A Squared Entertainment LLC, a Delaware limited liability company ("A Squared"), A Squared Holdings LLC, a California limited liability company and sole member of A Squared (the "Member") and A2E Acquisition LLC, our newly formed, wholly-owned Delaware subsidiary ("Acquisition Sub"). Upon closing of the transactions contemplated under the Merger Agreement (the "Merger"), which occurred concurrently with entering into the Merger Agreement, our Acquisition Sub merged with and into A Squared, and A Squared, as the surviving entity, became a wholly-owned subsidiary of the Company. As a result of the Merger, the Company acquired the business and operations of A Squared. A Squared creates, produces and distributes original "content with a purpose" for kids aged 6-11, whereas

Genius Brands previously focused on toddlers. Today the merged company is focused on providing "content with a purpose" for toddlers to tweens, in all media formats, relevant consumer products categories, in territories around the world.

On April 2, 2014, we filed a certificate of amendment to our Articles of Incorporation to affect a reverse split of our issued and outstanding common stock on a one-for-one hundred basis. The reverse stock split was effective with FINRA on April 7, 2014. All common stock share and per share information in this Quarterly Report, including the accompanying consolidated financial statements and notes thereto, have been adjusted to reflect retrospective application of the reverse split, unless otherwise indicated.

During the second quarter of 2014, the Company began a strategic initiative to restructure its product sales business by phasing out the direct sale of physical products including DVDs and CDs and shifting to a licensing model. On July 14, 2014, the Company employed Stone Newman in the newly created position of President – Worldwide Consumer Products wherein he will manage all consumer products, licensing and merchandising sales and rights for the Company's brands and programming (See Note 18 – Subsequent Events).

*Liquidity*

Historically, the Company has incurred net losses. As of June 30, 2014, the Company had an accumulated deficit of $19,418,847 and a total stockholders' equity of $15,441,583. At June 30, 2014, the Company had current assets of $6,467,938, including cash of $5,576,206 and current liabilities of $2,726,956, including short-term debt to related parties which bears no interest and has no stated maturity of $412,893 and certain trade payables of $925,000 to which the Company disputes the claim, resulting in working capital of $3,740,982. For the three and six months ended June 30, 2014, the Company reported a net loss of $1,140,629 and $1,994,792, respectively, and reported net cash used by operating activities during the six months ended June 30 2014 of $1,234,446. Management believes that its sales and cash provided by operations, funds from the issuance of common stock in the first quarter of 2014, funds from the issuance of Series A Convertible Preferred Shares during the second quarter of 2014, proceeds from a long-term, exclusive supply chain services agreement for which it received $750,000 during the first quarter of 2014, and proceeds from a music advance of $250,000 received in the second quarter will be sufficient to fund planned operations for the next twelve months. However, there can be no assurance that operations and operating cash flows will continue at the current levels or improve in the near future. If the Company is unable to obtain profitable operations and positive operating cash flows, it may need to seek additional funding or be forced to scale back its development plans or to significantly reduce or terminate operations.

**Note 2: Summary of Significant Accounting Policies**

*Cash Equivalents*

The Company considers all highly liquid debt instruments with initial maturities of three months or less to be cash equivalents.

*Reverse Stock Split*

On April 2, 2014, we filed a certificate of amendment to our Articles of Incorporation to affect a reverse split of our issued and outstanding common stock on a one-for-one hundred basis. The reverse stock split was effective with FINRA on April 7, 2014. All common stock share and per share information in this Form 10-Q, including the accompanying consolidated financial statements and notes thereto, have been adjusted to reflect retrospective application of the reverse split, unless otherwise indicated.

*Business Combination*

On November 15, 2013, the Company entered into a Merger Agreement with A Squared, the Member, and the Acquisition Sub. Upon closing of the Merger, which occurred concurrently with entering into the Merger Agreement, our Acquisition Sub merged with and into A Squared, and A Squared, as the surviving entity, became a wholly-owned subsidiary of the Company. As a result of the Merger, the Company acquired the business and operations of A Squared.

The audited financial statements have been prepared using the acquisition method of accounting in accordance with FASB Accounting Standards Codification (“ASC”) 805, Business Combinations.

See Note 3 - Business Combination for additional information.

*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Genius Brands International, Inc. and its wholly owned subsidiary A Squared Entertainment, LLC. All significant inter-company balances and transactions have been eliminated in consolidation.

*Use of Estimates*

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods.

*Financial Statement Reclassification*

Certain account balances from prior periods have been reclassified in these unaudited consolidated financial statements so as to conform to current period classifications.

*Significant Accounting Policies*

*Allowance for Sales Returns* - An Allowance for Sales Returns is estimated based on average sales during the previous year.  Based on experience, sales growth, and our customer base, the Company concluded that the allowance for sales returns at June 30, 2014 and December 31, 2013 should be $28,672 and $43,000, respectively.

*Inventories* - Inventories are stated at the lower of cost (average) or market and consist of finished goods such as DVDs, CDs and other products. A reserve for slow-moving and obsolete inventory is established for all inventory deemed potentially non-saleable by management in the period in which it is determined to be potentially non-saleable. The current inventory is considered properly valued and saleable. The Company concluded that there was an appropriate reserve for slow moving and obsolete inventory of $274,241 and $93,607 established as of June 30, 2014 and December 31, 2013, respectively.

*Property and Equipment* - Property and equipment are recorded at cost. Depreciation on property and equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from 5 to 39 years. Maintenance, repairs, and renewals, which neither materially add to the value of the assets nor appreciably prolong their lives, are charged to expense as incurred. Gains and losses from dispositions of property and equipment are reflected in the statement of operations.

*Intangible Assets* - Intangible Assets acquired, either individually or with a group of other assets, are initially recognized and measured based on fair value. In the 2005 acquisition of the assets from Genius Products, fair value was calculated using a discounted cash flow analysis of the revenue streams for the estimated life of the assets. In the 2013 acquisition of the identifiable artistic-related assets from A Squared, fair value was determined through an independent appraisal. The Company determined that these assets are indefinite-lived. Additionally, the Merger with A Squared gave rise to goodwill representing the future economic benefits arising from the assets of A Squared that could not be individually identified and recognized.

The Company develops new video, music, books and digital applications, in addition to adding content, improved animation and songs/features to their existing productions. The costs of new product development and significant improvement to existing products are capitalized while routine and periodic alterations to existing products are expensed as incurred. The Company begins amortization of new products when it is available for general release. Annual amortization cost of intangible assets are computed based on the straight-line method over the remaining economic life of the product, generally such deferred costs are amortized over five years.

The Company reviews all intangible assets periodically to determine if the value has been impaired following the guidance of ASC 350-20 - Goodwill and ASC 350-30 - General Intangibles Other Than Goodwill.

*Capitalized Production Cost* - The Company capitalizes production costs for episodic series produced in accordance with ASC 926-20, Entertainment-Films - Other Assets - Film Costs. Accordingly, production costs are capitalized at actual cost and then charged against revenue based on the initial market revenue evidenced by a firm commitment over the period of commitment. The Company expenses all capitalized costs that exceed the initial market firm commitment revenue in the period of delivery of the episodes.

The Company capitalizes production costs for films produced in accordance with ASC 926-20, Entertainment-Films - Other Assets - Film Costs. Accordingly, production costs are capitalized at actual cost and then charged against revenue quarterly as a cost of production based on the relative fair value of the film(s) delivered and recognized as revenue. The Company evaluates their capitalized production costs annually and limits recorded amounts by their ability to recover such costs through expected future sales.

The Company also develops new videos, music, books and digital applications in addition to adding content, improved animation and bonus songs/features to its existing product catalog. In accordance with ASC 350 - Intangible Assets and ASC 730 - Research and Development, the costs of new product development and significant improvement to existing products are capitalized while routine and periodic alterations to existing products are expensed as incurred.

*Revenue Recognition* - The Company recognized revenue related to product sales when (i) the seller's price is substantially fixed, (ii) shipment has occurred causing the buyer to be obligated to pay for product, (iii) the buyer has economic substance apart from the seller, and (iv) there is no significant obligation for future performance to directly bring about the resale of the product by the buyer as required by ASC 605 - Revenue Recognition.

Revenues associated with the sale of products, are recorded when shipped to customers pursuant to approved customer purchase orders resulting in the transfer of title and risk of loss. Cost of sales, rebates and discounts are recorded at the time of revenue recognition or at each financial reporting date.

The Company recognizes revenue in accordance with ASC 926-605, Entertainment-Films - Revenue Recognition. Accordingly, the Company recognizes revenue when (i) persuasive evidence of a sale with customer exists, (ii) the film is complete and has been delivered or is available for delivery, (iii) the license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale, (iv) the arrangement fee is fixed or determinable, and (v) collection of the arrangement fee is reasonably assured.

For its distribution, TV, and home entertainment income the Company generally enters in to flat fee arrangements to deliver multiple films or episodes. The Company allocates revenue to each film or episode based on their relative fair market values and recognizes revenue as each film or episode is complete and available for delivery.

The Company's licensing and royalty revenue represents both (a) variable payments based on net sales from brand licensees for content distribution rights. These license agreements are held in conjunction with third parties that are responsible for collecting fees due and remitting to the Company its share after expenses. Revenue from licensed products is recognized when realized or realizable based on royalty reporting received from licensees and (b) licensing income the Company recognizes revenue as an agent in accordance with ASC 605-45, Revenue Recognition - Principal Agent. Accordingly, the Company's revenue is its gross billings to its customers less the amounts it pays to suppliers for their products and services.

*Shipping and Handling* - The Company records shipping and handling expenses in the period in which they are incurred and are included in the Cost of Goods Sold.

*Stock Based Compensation* - As required by ASC 718 - Stock Compensation, the Company recognizes an expense related to the fair value of our stock-based compensation awards, including stock options, using the Black-Scholes calculation as of the date of grant.

*Advertising Costs* - The Company's marketing and sales costs are primarily related to advertising, trade shows, public relation fees and production and distribution of collateral materials. In accordance with ASC 720 regarding Advertising Costs, the Company expenses advertising costs in the period in which the expense is incurred. Marketing and Sales costs incurred by licensees are borne fully by the licensee and are not the responsibility of the Company. Advertising expense for the three months ended June 30, 2014 and 2013 was $37,800 and $733, respectively. For the six months ended June 30, 2014 and 2013, advertising expenses was $65,206 and $14,233, respectively.

*Earnings Per Share* - Basic earnings (loss) per common share ("EPS") is calculated by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted EPS is calculated by dividing net income (loss) by the weighted average number of common shares outstanding, plus the assumed exercise of all dilutive securities using the treasury stock or "as converted" method, as appropriate. During periods of net loss, all common stock equivalents are excluded from the diluted EPS calculation because they are antidilutive.

*Income Taxes*- Deferred income tax assets and liabilities are recognized based on differences between the financial statement and tax basis of assets and liabilities using presently enacted tax rates. At each balance sheet date, the Company evaluates the available evidence about future taxable income and other possible sources of realization of deferred tax assets, and records a valuation allowance that reduces the deferred tax assets to an amount that represents management's best estimate of the amount of such deferred tax assets that more likely than not will be realized.

*Fair value of financial instruments* - The carrying amounts of cash, receivables and accrued liabilities approximate fair value due to the short-term maturity of the instruments.

We adopted ASC 820 as of January 1, 2008 for financial instruments measured at fair value on a recurring basis. ASC Topic 820 defines fair value, establishes a framework for measuring fair value in accordance with accounting principles generally accepted in the United States and expands disclosures about fair value measurements.

Fair value is defined as 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. ASC Topic 820 establishes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). These tiers include:

- Level 1, defined as observable inputs such as quoted prices for identical instruments in active markets;
- Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable such as quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in markets that are not active; and
- Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions, such as valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

*Recent Accounting Pronouncements*

In July 2013, the FASB issued Accounting Standards Update No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists” (“ASU No. 2013-11”). ASU No. 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, with limited exceptions. ASU No. 2013-11 is effective for interim and annual periods beginning after December 15, 2013 and may be applied retrospectively. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In April 2014, the FASB issued Accounting Standards Update No. 2014-08, “Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity” (“ASU 2014-08”), which raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued operations and certain other disposals that do not meet the new definition of a discontinued operation. It also allows an entity to present a discontinued operation even when it has continuing cash flows and significant continuing involvement with the disposed component. The amendments in ASU 2014-08 are effective prospectively for disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: identify the contract(s) with a customer; identify the performance obligations in the contract; determine the transaction price; allocate the transaction price to the performance obligations in the contract; and recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 supersedes the revenue recognition requirements in Accounting Standards Codification Topic No. 605, “Revenue Recognition,” most industry-specific guidance throughout the industry topics of the accounting standards codification, and some cost guidance related to construction-type and production-type contracts. ASU 2014-09 is effective for public entities for annual periods and interim periods within those annual periods beginning after December 15, 2016. Early adoption is not permitted. Companies may use either a full retrospective or a modified retrospective approach to adopt ASU 2014-09. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

In June 2014, the FASB issued Accounting Standards Update No. 2014-12, “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period” (“ASU 2014-12”). The amendments in ASU 2014-12 require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Accounting Standards Codification Topic No. 718, “Compensation — Stock Compensation” (“ASC 718”), as it relates to awards with performance conditions that affect vesting to account for such awards. The amendments in ASU 2014-12 are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted. Entities may apply the amendments in ASU 2014-12 either: (a) prospectively to all awards granted or modified after the effective date; or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. We are currently evaluating the potential impact of adopting this guidance on our consolidated financial statements.

**Note 3: Business Combination**

*Overview*

On November 15, 2013, the Company entered into the Merger Agreement with A Squared and Acquisition Sub. Upon closing of the Merger, which occurred concurrently with entering into the Merger Agreement, our Acquisition Sub merged with and into A Squared, and A Squared, as the surviving entity, became a wholly-owned subsidiary of the Company. As a result of the Merger, the Company acquired the business and operations of A Squared. A Squared is a children's entertainment production company that produces original content for children and families that provide entertaining and educational media experiences. A Squared also creates comprehensive consumer product programs in the forms of toys, books and electronics. A Squared works with broadcasters, digital and online distributors and retailers worldwide as well as major toy companies, video game companies and top licensees in the kids and family arena.

Immediately following the Merger, the Company's pre-Merger shareholders and option holders owned approximately 50% of the Company's common stock on a fully-diluted basis, and former A Squared members owned approximately 50% of the Company's common stock on a fully diluted basis.

Pursuant to the terms and conditions of the Merger:

- At the closing of the Merger, the membership interests of A Squared issued and outstanding immediately prior to the closing of the Merger were cancelled and the Member received shares of our common stock. Accordingly, an aggregate of 2,972,183 shares of our common stock were issued to the Member.

- Upon the closing of the Merger, Klaus Moeller resigned as the Company's Chief Executive Officer and Chairman, Larry Balaban resigned as the Company's Corporate Secretary, and Howard Balaban resigned as the Company's Vice President of Business Development. Simultaneously with the effectiveness of the Merger, Andrew Heyward was appointed as the Company's Chief Executive Officer, Amy Moynihan Heyward was appointed as the Company's President and Gregory Payne was appointed as the Company's Corporate Secretary. Mr. Moeller remains a director of the Company.

- Effective upon the Company's meeting its information obligations under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), Michael Meader, Larry Balaban, Howard Balaban and Saul Hyatt resigned as directors of the Company and Andrew Heyward, Amy Moynihan Heyward, Lynne Segall, Jeffrey Weiss, Joseph "Gray" Davis, William McDonough and Bernard Cahill were appointed as directors of the Company. On December 9, 2013, these changes to the Board of Directors were made effective.

*Accounting Treatment*

Although the transaction has been structured as a merger of equals, the merger will be treated as a business combination for accounting purposes. The audited financial statements have been prepared using the acquisition method of accounting in accordance with ASC 805, Business Combinations. Genius Brands is the deemed accounting acquirer, and A Squared is the deemed accounting acquiree based on the following factors: the transfer of the Company's equity as consideration for the merger, the relative size of the pre-merger assets and revenue bases with the Company holding a significantly larger asset and revenue base as compared to A Squared, and the fact that the Company paid a premium over the pre-combination fair value of A Squared.

*Purchase Price Allocation*

The following table summarizes the final purchase accounting for the fair value of the assets acquired and liabilities assumed at the date of the Merger:

| | Allocated Fair Value |
|---|---|
| Cash | $283,199 |
| Accounts Receivable | 89,398 |
| Prepaid Expenses and Other Assets | 145,574 |
| Property and equipment, net | 75,385 |
| Identifiable artistic-related intangible assets (a) | 1,740,000 |
| Total assets acquired | 2,333,556 |
| | |
| Accounts Payable | (404,757 ) |
| Accrued Expenses | (450,000 ) |
| Short Term Debt - Related Party | (516,966 ) |
| Disputed Trade Payable | (925,000 ) |
| Total liabilities assumed | (2,296,723 ) |
| | |
| Net assets acquired | 36,833 |
| | |
| Consideration (b) | 10,402,638 |
| | |
| Goodwill | $10,365,805 |

(a) The value of the identifiable artistic-related intangible assets was determined by an independent Corporate Finance and Business Valuation firm.

(b) As consideration for the net assets acquired in the Merger, the Company issued an aggregate of 2,972,183 shares of its common stock the Parent Member, valued at $3.50 per share. The acquisition-date fair value of the common stock was based on the common stock sold under the private placement on the date of the Merger.

*Proforma*

Included in the consolidated statement of operations for three and six months ended June 30, 2014 are revenues of $36,814 and $97,275, respectively, and net loss of $327,433 and $583,380, respectively, attributed to A Squared from the date of acquisition.

The table below presents the proforma revenue and net loss for the three and six months ended June 30, 2014 and 2013, assuming the Merger had occurred on January 1, 2013, pursuant to ASC 805-10-50. This proforma information does not purport to represent what the actual results of operations of the Company would have been had Merger occurred on this date nor does it purport to predict the results of operations for future periods.

| | Three Months Ended (1) | | Six Months Ended (2) | |
|---|---|---|---|---|
| | 6/30/2014 | 6/30/2013 | 6/30/2014 | 6/30/2013 |
| Revenues | $217,196 | $698,856 | $393,478 | $1,443,867 |
| Net Loss | $(1,140,629) | $(1,329,469) | $(1,994,792) | $(2,824,964) |

(1) Net loss during the three months ended June 30, 2013 includes merger related costs of $339,180 as well as the elimination of interest expense of $155,483 and gain on derivative valuation of $103,619.

(2) Net loss during the six months ended June 30, 2013 includes merger related costs of $339,180 as well as the elimination of interest expense of $310,742 and gain on derivative valuation of $10,757.

**Note 4: Investment in Stan Lee Comics LLC**

In November 2009, A Squared formed a joint venture, Stan Lee Comics, LLC, with POW Entertainment Inc. (“POW”), a California corporation, and Archie Comic Publications, Inc. (“Archie”), a New York corporation, to create, distribute and exploit comic books and other intellectual property based on exclusive properties created by Stan Lee and owned by POW Entertainment, Inc. Each of A Squared, POW, and Archie own one-third of Stan Lee Comics, LLC.

Upon formation, the parties agreed that POW would contribute certain properties to Stan Lee Comics, LLC as consideration for its ownership interest. Similarly, A Squared would contribute certain creative development functions and be entitled to the exercise of all audio-visual development, production and distribution rights in all media, as well as all merchandising rights, in and to the contributed properties as consideration for its ownership interest. Finally, Archie would be entitled to all comic book publication and distribution rights in and to the contributed properties as consideration for its ownership interest. Each party would be entitled to one-third of any net proceeds derived from the contributed properties or their derivative works after recoupment of production cost and fees. Stan Lee Comics, LLC is the owner of the *Stan Lee and the Mighty 7* property.

Upon closing of the Merger, the Company assumed the rights to Stan Lee Comics, LLC held by A Squared.

Pursuant to ASC 323-30, as of June 30, 2014, the Company has recorded the Investment in Stan Lee Comics LLC at $0 as no monetary consideration was paid by A Squared, or assumed by the Company in the Merger, for the ownership interest in Stan Lee Comics, LLC.

**Note 5: Inventory**

During the second quarter of 2014, the Company began a strategic initiative to restructure its product sales business by phasing out the direct sale of physical products including DVDs and CDs and shifting to a licensing model. On July 14, 2014, the Company employed Stone Newman in the newly created position of President – Worldwide Consumer Products wherein he will manage all consumer products, licensing and merchandising sales and rights for the Company's brands and programming (See Note 18 – Subsequent Events).

As of June 30, 2014, the Company determined that a portion of its inventory may not be saleable and recorded an additional reserve of $174,963 bringing the total reserve to $274,241. This additional reserve has been recorded as a loss on inventory.

**Note 6: Property and Equipment, Net**

The Company has property and equipment as follows as of June 30, 2014 and December 31, 2013:

| | 6/30/2014 | 12/31/2013 |
|---|---|---|
| Furniture and Equipment | $12,385 | $ 12,385 |
| Computer Equipment | 35,645 | 32,493 |
| Leasehold Improvements | 99,778 | 99,778 |
| Software | 15,737 | 15,737 |
| Less Accumulated Depreciation | (106,753) | (81,645 ) |
| Property and Equipment, Net | $56,792 | $ 78,748 |

During the three months ended June 30, 2014 and 2013, the Company recorded depreciation expense of $12,637 and $2,426, respectively. During the six months ended June 30, 2014 and 2013, the Company recorded depreciation expense of $25,108 and $5,021, respectively.

**Note 7: Film and Television Costs and Capitalized Product Development in Process**

As of June 30, 2014, the Company had Film and Television Costs of $112,575 compared to $0 at December 31, 2013. The increase relates to the commencement of production of the second installment of the feature film *Stan Lee and the Mighty 7* and episodes of the *Thomas Edison: Secret Lab*.

As of June 30, 2014, the Company had Capitalized Product Development in Process of $0 compared to $54,575 as of December 31, 2013. The Company ceased development of its e-commerce website and web-based streaming services. As the Company deemed the services unusable, it recognized impairment expense of $70,905 during the quarter.

**Note 8: Goodwill and Intangible Assets, Net**

*Goodwill*

In association with the Merger, the Company recognized $10,365,806 in Goodwill, representing the excess of the fair value of the consideration for the Merger over net identifiable assets acquired (See Note 3 - Business Combination for additional information). Pursuant to ASC 350-20, Goodwill is not subject to amortization but is subject to annual review to determine if certain events warrant impairment to the Goodwill asset. As of December 31, 2013, no impairment was warranted or recognized.

*Intangible Assets, Net*

The Company had following intangible assets as of June 30, 2014 and December 31, 2013:

| | 6/30/2014 | 12/31/2013 |
|---|---|---|
| Identifiable artistic-related assets (a) | $1,740,000 | $1,740,000 |
| Trademarks (b) | 129,831 | 129,831 |
| Product Masters (b) | 3,257,129 | 3,257,129 |
| Other Intangible Assets | 70,000 | – |
| Less Accumulated Amortization (c) | (3,289,773) | (3,261,254) |
| Intangible Assets, Net | $1,907,187 | $1,865,706 |

(a) In association with the Merger, the Company acquired $1,740,000 in identifiable artistic-related assets. These assets, related to certain properties owned by A Squared and assumed by the Company, were valued using an independent firm during the fourth quarter of 2013. Based on certain legal, regulatory, contractual, and economic factors, the Company has deemed these assets to be indefinite-lived. Hence, pursuant to ASC 350-30, these assets are not subject to amortization. They are tested annually for the recognition of impairment expense.

(b) Pursuant to ASC 350-30-35, the Company reviews these intangible assets periodically to determine if the value should be retired or impaired due to recent events. At December 31, 2013, it was determined that certain “Other Intangible Assets” totaling $470,685 in gross asset value, with accumulated amortization of $228,961, were to be retired giving rise to an associated loss on disposition of assets totaling $241,723. During the period ended June 30, 2014, the Company did not recognize any similar impairment.

(c) During the three months ended June 30, 2014 and 2013, the Company recognized $16,451 and $36,577, respectively, in amortization expense related to these intangible assets. During the six months ended June 30, 2014 and 2013, the Company recognized $28,521 and $73,154, respectively, in amortization expense related to these intangible assets.

**Note 9: Accrued Liabilities**

As of June 30, 2014 and December 31, 2013, the Company has the following accrued liabilities:

| | 6/30/2014 | 12/31/2013 |
|---|---|---|
| Accrued Salaries and Wages | | |
| Accrued Salaries and Wages | $62,788 | $59,958 |
| | | |
| Disputed Trade Payables | | |
| Disputed Trade Payables (a) | 925,000 | 925,000 |
| | | |
| Services Advance | | |
| Services Advance (b) | 741,758 | – |
| | | |
| Accrued Expenses | | |
| Allowance for Sales Returns | 28,672 | 43,000 |
| Distribution Arrangements Payable | 17,674 | 13,905 |
| Deferred Revenue | 58,759 | – |
| Royalties Payable | 4,953 | 9,638 |
| Music Advances (c) | 672,000 | 450,000 |
| Other Accrued Expenses | 110,497 | 187,996 |
| Total Accrued Expenses | 892,555 | 704,539 |
| | | |
| Total Accrued Liabilities | $2,622,101 | $1,689,497 |

(a) As part of the Merger, the Company assumed certain liabilities from a previous member of A Squared which has claimed certain liabilities totaling $925,000. The Company disputes the basis for this liability and has not heard from the claimant for two years.

(b) During the first quarter of 2014, the Company entered into an exclusive long-term agreement with Sony DADC, the optical disc manufacturing and fulfillment arm of Sony, to provide all CD, DVD and BD replication, packaging and distribution to Genius Brands International's direct customers. Under the terms of the long-term, exclusive supply chain services agreement, the Company will order a minimum level of disc replication, packaging and distribution services for its content across all physical media, including DVD, CD, and Blu-ray from Sony DADC. As consideration for these minimum order levels, the Company will receive a total of $1,500,000, $750,000 of which was received during the first quarter of 2014 with the remaining $750,000 due by January 17, 2015.

(c) In the Merger, the Company assumed from A Squared an April 2013 agreement for an advance of $450,000 for the music rights of certain A Squared properties. During the second quarter of 2014, the Company executed an agreement with the same counterparty for another music advance of $250,000 covering the properties held by the

Company prior to the Merger. Pursuant to ASC 928-430-25-1, the Company began recognizing revenue under these agreements on May 1, 2014.

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**Note 10: Short Term Debt - Related Parties**

As part of the Merger, the Company acquired certain liabilities from A Squared. From time to time, A Squared required short-term advances to fund its operations and provide working capital from its founder, the Company's current Chief Executive Officer, Andrew Heyward. As of June 30, 2014, these advances totaled $412,893, compared to $516,659 as of December 31, 2013. On March 3, 2014, the Company repaid a portion of the advances to its Chief Executive Officer, Andrew Heyward, in the amount of $100,000.

These advances are interest free and have no stated maturity. The Company has applied an imputed interest rate of 6% in accordance with ASC 835-30-45. During the three and six months ended June 30, 2014, the Company recognized imputed interest expense of $6,207 and $13,370, respectively.

**Note 11: Stockholders' Equity**

*Common Stock*

As part of the Reincorporation, the total number of authorized shares of common stock was changed to 250,000,000 shares, $0.001 par value per share. The common stock and additional paid in capital accounts were restated as of December 31, 2012, and for the years then ended, to recognize the change from no par common stock to a par value of $0.001 per share. The Company conducted a consent solicitation of its stockholders of record as of September 3, 2013 (the "Record Date") to approve certain corporation actions. Stockholders, representing at least a majority of outstanding shares of the Company's voting capital as of the Record Date voted by written consent to approve an amendment to the company's Article of Incorporation in order to increase the number of common stock authorized to 700,000,000 from 250,000,000. As of June 30, 2014 and December 31, 2013, the total number of authorized shares of common stock was 700,000,000.

As part of the aforementioned consent solicitation, stockholders, representing at least a majority of outstanding shares of the Company's voting capital as of the Record Date, also voted by written consent to approve a proposal to effect a reverse split of the Company's common stock in a ratio to be determined by the Board which would not be less than One for Ten (1:10) and not more than One for One-Hundred (1:100), which was to be effective no later than September 30, 2014, at the sole discretion of the Board and in lieu of issuing any fractional shares resulting from the reverse split, to issue the next whole share (the "Reverse Split").

On April 2, 2014, we filed a certificate of amendment to our Articles of Incorporation to affect the Reverse Split on a one-for-one hundred basis. The Reverse Split was effective with FINRA on April 7, 2014. All common stock share and per share information in this Form 10-Q, including the accompanying consolidated financial statements and notes thereto, have been adjusted to reflect retrospective application of the Reverse Split, unless otherwise indicated. The total number of authorized shares of common stock was not adjusted in conjunction with the Reverse Split.

As of June 30, 2014 and December 31, 2013, there were 6,383,269 and 5,918,704 shares of common stock outstanding, respectively. Below are the changes to the Company's common stock during the six months ended June 30, 2014:

- On January 10, 2014, the Company issued 102,860 shares of the Company's common stock in a private placement to certain investors at $3.50 per share. The Company received gross proceeds of $360,000 and paid related offering costs of $4,884.

- On January 10, 2014, the Company issued 8,143 shares of common stock as an extinguishment of a $28,500 accounts payable balance for services rendered in relation to the private placement. The shares were valued at the market price of $4.00 per share giving rise to a loss on the extinguishment of accounts payable of $4,072.

- On January 29, 2014, the Company issued 18,000 shares of common stock to a third party for prepaid investor relations services at $3.50 per share for a six month period beginning in January 2014.

- On May 1, 2014, the Company authorized the issuance of 30,000 shares of common stock to a third party for creative design and development services at $3.21 per share.

- On June 16, 2014, the Company issued 305,562 shares of common stock to investors in the Company's November 2013 and January 2014 private placement. Pursuant to the Securities Purchase Agreement associated with that offering, for a period of three years after the initial closing of the offering, investors are entitled to additional shares if the Company issues securities pursuant to which shares of common stock may be acquired at a price less than the per share purchase price in that offering or $3.50 per share. The issuance of the Series A Convertible Preferred Stock in May of 2014, as described below, triggered this issuance of these additional shares.

*Preferred Stock*

The Company has 10,000,000 shares of preferred stock authorized with a par value of $0.001 per share. The Board of Directors is authorized, subject to any limitations prescribed by law, without further vote or action by our stockholders, to issue from time to time shares of preferred stock in one or more series. Each series of preferred stock will have such number of shares, designations, preferences, voting powers, qualifications and special or relative rights or privileges as shall be determined by our board of directors, which may include, among others, dividend rights, voting rights, liquidation preferences, conversion rights and preemptive rights.

As of June 30, 2014, 6,000 shares of preferred stock were issued and outstanding. As of December 31, 2013, the Board of Directors had not authorized issuance of preferred shares.

On May 12, 2014, the Board of Directors authorized the designation of a class of preferred stock called the Series A Convertible Preferred Stock. On May 14, 2014, the Company filed the Certificate of Designation, Preferences and Rights of the 0% Series A Convertible Preferred Stock with the Secretary of State of the State of Nevada.

Each share of the newly designated Series A Preferred Stock is convertible into shares of the Company's common stock, par value $0.001 per share based on a conversion calculation equal to the Base Amount divided by the conversion price. The Base Amount is defined as the sum of (i) the aggregate stated value of the Series A Preferred Stock to be converted and (ii) all unpaid dividends thereon. The stated value of each share of the Series A Preferred Stock is $1,000 and the initial conversion price is $2.00 per share, subject to adjustment in the event of stock splits, dividends and recapitalizations. Additionally, in the event the Company issues shares of its common stock or common stock equivalents at a per share price that is lower than the conversion price then in effect, the conversion price shall be adjusted to such lower price, subject to certain exceptions. The Company is prohibited from effecting a conversion of the Series A Preferred Stock to the extent that as a result of such conversion, the investor would beneficially own more than 9.99% in the aggregate of the issued and outstanding shares of the Company's common stock, calculated immediately after giving effect to the issuance of shares of common stock upon conversion of the Series A Preferred Stock. The shares of Series A Preferred Stock possess no voting rights.

On May 14, 2014, we entered into securities purchase agreements with certain accredited investors pursuant to which the Company sold an aggregate of 6,000 shares of its newly designated Series A Convertible Preferred Stock at a price of $1,000 per share for gross proceeds to the Company of $6,000,000. The closing of the transaction was subject to certain customary closing conditions and closed on May 15, 2014.

**Note 12: Stock Options**

The Company has adopted the provisions of ASC 718 - Compensation which requires companies to measure the cost of employee services received in exchange for equity instruments based on the grant date fair value of those awards and to recognize the compensation expense over the requisite service period during which the awards are expected to vest.

On December 29, 2008, the Company adopted the Pacific Entertainment Corporation 2008 Stock Option Plan (the “Plan”), which provides for the issuance of qualified and non-qualified stock options to officers, directors, employees and other qualified persons. The Plan is administered by the Board of Directors of the Company or a committee appointed by the Board of Directors. The number of shares of the Company’s common stock initially reserved for issuance under the Plan was 110,000. On September 2, 2011, the shareholders holding a majority of the Company’s outstanding common stock adopted an amendment to the Company’s 2008 Stock Option Plan to increase the number of shares of common stock issuable under the plan to 500,000.

The following schedule summarizes the changes in the Company's stock option plan during the six months ended June 30, 2014:

| | Options Outstanding Number of Shares | Exercise Price per Share | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value | Weighted Average Exercise Price per Share |
|---|---|---|---|---|---|
| Balance at December 31, 2013 | 37,150 | $6.00 - 55.00 | 3.55 years | $ – | $ 32.00 |
| Options Granted | – | | | | |
| Options Exercised | – | | | | |
| Options Expired | – | | | | |
| Balance at June 30, 2014 | 37,150 | $6.00 - 55.00 | 3.07 years | $ – | $ 32.00 |
| Exercisable June 30, 2014 | 37,150 | $6.00 - 55.00 | 3.07 years | $ – | $ 32.00 |
| Exercisable December 31, 2013 | 37,150 | $6.00 - 55.00 | 3.41 years | $ – | $ 32.00 |

During the three and six months ended June 30, 2014, the Company did not recognize any stock based compensation expense. During the three and six months ended June 30, 2013, the Company recognized stock based compensation expense of $101,988 and $160,268, respectively.

**Note 13: Warrants**

The Company has warrants outstanding to purchase up to 300,000 and 0 shares of our common stock at June 30, 2014 and December 31, 2013, respectively.

In connection with the sale of the Company's newly designated Series A Convertible Preferred Stock in May 2014, Chardan Capital Markets LLC acted as sole placement agent in consideration for which Chardan received a cash fee of $535,000 and a warrant to purchase up to 300,000 shares of the Company's common stock. These warrants vested immediately, have an exercise price of $2.00 per share, and have a five year term.

The following schedule summarizes the changes in the Company’s outstanding warrants during the six months ended June 30, 2014:

| | Warrants Outstanding Number of Shares | Exercise Price per Share | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value | Weighted Average Exercise Price per Share |
|---|---|---|---|---|---|
| Balance at December 31, 2013 | – | – | – | – | – |
| Warrants Granted | 300,000 | $ 2.00 | 5.00 years | – | $ 2.00 |
| Warrants Exercised | – | – | – | – | – |
| Warrants Expired | – | – | – | – | – |
| Balance at June 30, 2014 | 300,000 | $ 2.00 | 4.88 years | $ 285,000 | $ 2.00 |
| Exercisable June 30, 2014 | 300,000 | $ 2.00 | 4.88 years | $ 285,000 | $ 2.00 |
| Exercisable December 31, 2013 | – | – | – | – | |

**Note 14: Income Taxes**

The Company accounts for income taxes in accordance with Accounting Standards Codification Topic 740, Income Taxes (“Topic 740”), which requires the recognition of deferred tax liabilities and assets at currently enacted tax rates for the expected future tax consequences of events that have been included in the financial statements or tax returns.  A valuation allowance is recognized to reduce the net deferred tax asset to an amount that is more likely than not to be realized.

Topic 740 provides guidance on the accounting for uncertainty in income taxes recognized in a company’s financial statements.  Topic 740 requires a company to determine whether it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position.  If the more-likely-than-not threshold is met, a company must measure the tax position to determine the amount to recognize in the financial statements.

At the adoption date of January 1, 2008, the Company had no unrecognized tax benefit which would affect the effective tax rate if recognized.

The Company includes interest and penalties arising from the underpayment of income taxes in the statements of operation in the provision for income taxes.  As of June 30, 2014 and December 31, 2013, the Company had no accrued interest or penalties related to uncertain tax positions.

The Company files income tax returns in the U.S. federal jurisdiction and in the state of California.  The Company is currently subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities since inception of the Company.

**Note 15: Employment Agreements**

On November 15, 2013, as a closing condition to the Merger, the Company entered into five-year employment agreements with Andrew Heyward, to serve as Chief Executive Officer, and Amy Moynihan Heyward, to serve as President of the Company, for which each receives an annual base salary of $200,000 and $180,000, respectively.

Effective May 26, 2014, the Company entered into an employment agreement with Andrew Berman for the newly created position of Senior Vice President – International Sales. The agreement has a one year term with one additional one year term subject to approval of the Company and Mr. Berman. The agreement provides for an annual salary of $175,000.

**Note 16: Lease Commitments**

The Company has no capital leases subject to the Capital Lease guidelines in the FASB Accounting Standards Codification.

Rental expenses incurred for operating leases during the three months ended June 30, 2014 and 2013 were $34,529 and $1,254, respectively. During the six months ended June 30, 2014 and 2013, rental expenses were $70,344 and $8,201, respectively.

Warehouse space of approximately 2,000 square feet in Rogers, Minnesota was rented on a month to month basis and was vacated as of October 31, 2013. In November 2012, the Company signed a nine month lease to occupy three offices in San Diego, California, which terminated as of April 30, 2013.

Currently, the Company leases approximately 2,807 square feet of office space at 9401 Wilshire Boulevard, Beverly Hills, California pursuant to a standard office lease dated February 3, 2012. The lease has a term of 3 years, from May 1, 2012 through April 30, 2015. The monthly rent is $10,807 which is to be adjusted upward 3% each year on the anniversary of the lease.

The following is a schedule of future minimum lease payments required by the non-cancelable operating lease agreement:

| Year | Amount |
|---|---|
| 2014 | $68,323 |
| 2015 | 45,860 |
| | $114,183 |

**Note 17: Commitment and Contingencies**

In the normal course of the its business, the Company enters into agreements which call for the payment of royalties or “profit” participations for the use of third party intellectual property. For properties such as *Gisele & The Green Team*, *Martha & Friends* and *Stan Lee and the Mighty 7*, the Company is obligated to share net profits with the underlying rights holders on a certain basis, defined in the respective agreements.

In addition, the Company has also entered into an agreement with XingXing Digital Corporation, an animation company based in China pursuant to which in exchange for the investment of 100% of the costs of the animation, XingXing is entitled to receive a specified percentage of the net proceeds received by the Company from the exploitation of those series on which XingXing has provided animation services. The series covered by this arrangement are *Secret Millionaires Club* and *Gisele & the Green Team*.

The Company has also entered into a similar arrangement with another production vendor, BangZoom Entertainment, which calls for a payment of $120,000 from the net profits received by the Company from the exploitation of the series *Secret Millionaires Club*. The payment represents the deferral of certain costs and fees for audio/video post-production work performed by such vendor in connection with that series.

**Note 18: Subsequent Events**

Pursuant to FASB ASC 855, Management has evaluated all events and transactions that occurred from June 30, 2014 through the date of issuance of these financial statements. During this period, we did not have any significant subsequent events, except as disclosed below:

- On July 14, 2014, the Company employed Stone Newman in the newly created operating position of President – Worldwide Consumer Products and executed a three-year employment agreement which either party may terminate on the 12th and 24th month anniversary upon thirty (30) days' notice. Mr. Newman will have oversight over all consumer products, licensing and merchandising sales and rights for the Company's brands and programming as well as certain brands he previously managed prior to his employment by the Company. The agreement provides Mr. Newman with an annual salary of $275,000 plus an additional participation for certain customers.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion and analysis of our results of operations, financial condition and liquidity and capital resources should be read in conjunction with our unaudited financial statements and related notes for the three and six months ended June 30, 2014 and 2013. In addition to historical financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements.*

**Forward Looking Statements**

This report on Form 10-Q contains forward-looking statements which involve assumptions and describe our future plans, strategies and expectations. When used in this statement, the words “may,” “will,” “expect,” “anticipate,” “continue,” “estimate,” “project,” “intend,” and similar expressions are intended to identify forward-looking statements regarding events, conditions, and financial trends that may affect the Company’s future plans of operations, business strategy, operating results, and financial position. These statements are expressed in good faith and based upon a reasonable basis when made, but there can be no assurance that these expectations will be achieved or accomplished.

Persons reviewing this report are cautioned that any forward-looking statements are not guarantees of future performance and are subject to risks and uncertainties and actual results may differ materially from those included within the forward looking statements as a result of various factors. Such factors include, among other things, uncertainties relating to our success in judging consumer preferences, financing our operations, entering into strategic partnerships, engaging management, seasonal and period-to-period fluctuations in sales, failure to increase market share or sales, inability to service outstanding debt obligations, dependence on a limited number of customers, increased production costs or delays in production of new products, intense competition within the industry, inability to protect intellectual property in the international market for our products, changes in market condition and other matters disclosed by us in our public filings from time to time. Forward-looking statements speak only as to the date they are made. The Company does not undertake to update forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

**Overview**

The MD&A is based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make certain estimates and judgments that affect the reported amounts of assets, liabilities and expenses and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions and conditions.

**Our Business**

We create and distribute products which we believe are entertaining, educational and beneficial to the well-being of infants and young children under our brands. We create market and sell children's videos, music, books and other products. We license the use of our intellectual property, both domestically and internationally, to others to manufacture, market and sell products based on our characters and brand. We own, control, distribute and seek to build animated content and brands aimed at kids, and then license the brands and characters onto various products, including toys, publishing video games, music, apparel and soft goods. In most cases, we create our own original content. In other cases, we partner with existing rights holders to develop an idea or an existing brand.

On November 15, 2013, we entered into an Agreement and Plan of Reorganization (the "Merger Agreement") with A Squared Entertainment LLC, a Delaware limited liability company ("A Squared"), A Squared Holdings LLC, a California limited liability company and sole member of A Squared (the "Member") and A2E Acquisition LLC, our newly formed, wholly-owned Delaware subsidiary ("Acquisition Sub"). Upon closing of the transactions contemplated under the Merger Agreement (the "Merger"), which occurred concurrently with entering into the Merger Agreement, our Acquisition Sub merged with and into A Squared, and A Squared, as the surviving entity, became a wholly-owned subsidiary of the Company. As a result of the Merger, the Company acquired the business and operations of A Squared. A Squared is a children's entertainment production company that produces original content for children and families and provides entertaining and educational media experiences. A Squared also creates comprehensive consumer product programs in the forms of toys, books and electronics. A Squared works with broadcasters, digital and online distributors and retailers worldwide as well as major toy companies, video game companies and top licensees in the kids and family arena.

On April 2, 2014, we filed a certificate of amendment to our Articles of Incorporation to affect a reverse split of our issued and outstanding common stock on a one-for-one hundred basis. The reverse stock split was effective with FINRA (Financial Industry Regulatory Authority) on April 7, 2014. All common stock share and per share information in this Quarterly Report, including the accompanying consolidated financial statements and notes thereto, has been adjusted to reflect retrospective application of the reverse split, unless otherwise indicated.

**Recent Updates**

During the second quarter of 2014, the Company began a strategic initiative to restructure its product sales business by phasing out the direct sale of physical products including DVDs and CDs and shifting to a licensing model. On July 14, 2014, the Company employed Stone Newman in the newly created position of President – Worldwide Consumer Products wherein he will manage all consumer products, licensing and merchandising sales and rights for the Company's brands and programming.

On May 12, 2014, the Board of Directors authorized the designation of a class of preferred stock called the Series A Convertible Preferred Stock. On May 14, 2014, the Company filed the Certificate of Designation, Preferences and Rights of the 0% Series A Convertible Preferred Stock with the Secretary of State of the State of Nevada.

On May 14, 2014, we entered into securities purchase agreements with certain accredited investors pursuant to which the Company sold an aggregate of 6,000 shares of its newly designated Series A Convertible Preferred Stock at a price of $1,000 per share for gross proceeds to the Company of $6,000,000. The closing of the transaction was subject to certain customary closing conditions and closed on May 15, 2014.

**Results of Operations**

*Comparison of Results of Operations for the three months ended June 30, 2014 and 2013*

Our summary results for the three months ended June 30, 2014 and 2013 are below:

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Revenues | $217,196 | $622,324 | $(405,128) | -65% |
| Costs and Operating Expenses | (1,046,389) | (1,067,912) | 21,523 | -2% |
| Depreciation and Amortization | (29,088) | (39,003) | 9,915 | -25% |
| Loss from Operations | (858,282) | (484,591) | (373,691) | -77% |
| | | | | |
| Other Income | 7,156 | 16 | 7,140 | 44625% |
| Interest Expense | (21) | (155,483) | 155,462 | -100% |
| Interest Expense - Related Parties | (6,207) | (6,810) | 603 | -9% |
| Gain (loss) on distribution contracts | (50,000) | – | (50,000) | N/A |
| Gain (loss) on extinguishment of debt | 12,593 | – | 12,593 | N/A |
| Gain (loss) on disposition of assets | (70,905) | – | (70,905) | N/A |
| Gain (loss) on inventory | (174,963) | – | (174,963) | N/A |
| Gain (loss) on derivative valuation | – | 103,619 | (103,619) | -100% |
| Net Other Income (Expense) | (282,347) | (58,658) | (223,689) | 381% |
| | | | | |
| Income tax provision | – | – | – | N/A |
| | | | | |
| Net Loss | $(1,140,629) | $(543,249) | $(597,380) | -110% |
| | | | | |
| Net Loss per common share | $(0.18) | $(0.75) | | |
| | | | | |
| Weighted average shares outstanding | 6,221,947 | 722,911 | | |

**Revenues.** Revenues by product segment and for the Company as a whole were as follows:

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Product Sales | $118,495 | $394,772 | $(276,277) | -70% |
| Content Distribution | 36,814 | – | 36,814 | N/A |
| Licensing & Royalties | 61,887 | 227,552 | (165,665) | -73% |
| Total Revenue | $217,196 | $622,324 | $(405,128) | -65% |

Product sales represent physical products in which the Company holds intellectual property rights such as trademarks and copyrights, whether registered or unregistered, to the characters and which are manufactured and sold by the Company either directly at wholesale to retail stores or direct to consumers through daily deal sites and our website. During the three months ended June 30, 2014, product sales decreased by $276,277 due in part to a general decline in market demand for CDs and DVDs as well as the Company’s shift in emphasis away from physical goods distribution.

Television & Home Entertainment revenue totaled $36,814 during three months ended June 30, 2014 with no comparable amounts in 2013 due to the Merger. Television & Home Entertainment revenue is generated from distribution of our properties for broadcast on television in domestic and foreign markets and the sale of DVDs for home entertainment.

Licensing and royalty revenue includes items for which we license the rights from other companies to copyrights and trademarks of select brands we feel will do well within our distribution channels as well as for our brands licensed to others to manufacture and/or market, both internationally and domestically. During the three month period ended June 30, 2014 compared to June 30, 2013, this category had decreased from $227,552 to $61,887, or $165,665 (73%). This decrease is due to the shift in the Company's focus from third party off-brand product to more kid-oriented product that is more consistent with the Company's brand.

**Costs.** Costs and expenses, excluding depreciation and amortization, consisting primarily of cost of sales, marketing and sales expenses, and general and administrative costs, decreased $21,524 (2%) for the three month period ended June 30, 2014 compared to the three month period ended June 30, 2013.

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Cost of Sales | $105,112 | $332,668 | $(227,556) | -68% |
| General and Administrative | 855,238 | 628,324 | 226,914 | 36% |
| Marketing and Sales | 80,112 | 104,072 | (23,960 ) | -23% |
| Product Development | 5,926 | 2,848 | 3,078 | 108% |
| Total Costs and Operating Expenses | $1,046,388 | $1,067,912 | $(21,524 ) | -2% |

Cost of Sales decreased $227,556 (68%), during three months ended June 30, 2014 compared to the same period of 2013. The decrease was a result of the decrease in product sales discussed above.

General and Administrative expenses consist primarily of salaries, employee benefits, as well as other expenses associated with finance, legal, facilities, marketing, rent, and other professional services. General and administrative costs for the three months ended June 30, 2014 increased $226,914 (36%) as compared to the three months ended June 30, 2013. The aggregate increase for the category includes increases of professional fees of $186,621, other general and administration expenses of $162,173, and bad debt expense of $55,000 all offset by decreases of $108,165 in salaries and wages and $101,988 in stock based compensation expense.

Marketing and sales expenses decreased $23,960 (23%) for the three months ended June 30, 2014 compared to the three months ended June 30, 2013 primarily due to decreases in sales commission expenses and other advertising expenses.

Product development expenses are for routine and periodic alterations to existing products. For the three months ended June 30, 2014 compared to the three months ended June 30, 2013, these expenses increased by $3,078 (108%), primarily due to increased demand for alterations to our existing products.

**Interest Expense.** During the three months ended June 30, 2014, interest expense resulted from certain related party short-term debt and other operating interest expense. During the prior period, interest expense related to interest expense recognized in relation to certain related-party notes payable and other operating interest expense as well as interest expense related to certain debentures.

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Interest Expense - Operating | $ 21 | $ 2,222 | $ (2,202 ) | -99% |
| Interest Expense - Related Party | 6,207 | 6,810 | (603 ) | -9% |
| Interest Expense - Debenture | – | 153,261 | (153,261 ) | -100% |
| Interest Expense | $ 6,228 | $ 162,293 | $ (156,065 ) | -96% |

From 2007 through 2009, the Company borrowed funds from members of its previous management team, the proceeds of which were used to pay operating obligations of the Company. In association with the Merger, all remaining balances in association with these notes were converted into common stock. Interest expense was recorded in the three months ended June 30, 2014 and 2013 in the amounts of $0 and $3,722, respectively.

During 2011, four of the Company's former officers agreed to convert accrued but unpaid salaries through December 31, 2010 to subordinated long term notes payable. In association with the Merger, all remaining balances in association with these notes were converted into common stock. Interest expense was recorded in the three months ended June 30, 2014 and 2013 in the amounts of $0 and $3,088, respectively.

As part of the Merger, the Company acquired certain liabilities from A Squared. From time to time, A Squared required short-term advances to fund its operations and provide working capital from its founder, the Company's Chief Executive Officer, Andrew Heyward. As of June 30, 2014, these advances totaled $415,787. These advances are interest free and have no stated maturity. The Company has applied an imputed interest rate of 6%. During the quarter ended June 30, 2014, the Company recognized imputed interest expense of $6,207 with no comparable amount recognized in the prior period.

On June 27, 2012, the Company entered into a Securities Purchase Agreement whereby the Company issued and sold (i) a $1,000,000 16% senior secured convertible debenture due June 27, 2014 (the "Debenture"), and (ii) a common stock purchase warrant (the "Debenture Warrant") to purchase up to 50,000 shares of the Company's common stock. On August 29, 2013, pursuant to an agreement between the Company and certain holders, the original Debenture was assigned and exchanged for an aggregate of $1,163,333 in new notes with the same provisions (the "Reissued Debenture"). The interest rate and maturity date of the Reissued Debenture were not changed. In association with the Merger, the Company converted all remaining balances into shares of common stock. For the three months ended June 30, 2014 compared to the same period of 2013, interest expense for the Debenture and Reissued Debenture was recorded in amounts of $0 and $153,261, respectively.

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*Comparison of Results of Operations for the six months ended June 30, 2014 and 2013*

Our summary results for the six months ended June 30, 2014 and 2013 are below:

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Revenues | $393,478 | $1,356,563 | $(963,085) | -71% |
| Costs and Operating Expenses | (2,086,180) | (2,454,015) | 367,835 | -15% |
| Depreciation and Amortization | (53,629) | (78,175) | 24,546 | -31% |
| Loss from Operations | (1,746,331) | (1,175,627) | (570,704) | -49% |
| | | | | |
| Other Income | 7,789 | 32 | 7,757 | 24241% |
| Interest Expense | (2,230) | (310,742) | 308,512 | -99% |
| Interest Expense - Related Parties | (13,370) | (13,534) | 164 | -1% |
| Gain (loss) on distribution contracts | (47,229) | – | (47,229) | N/A |
| Gain (loss) on extinguishment of debt | 52,447 | – | 52,447 | N/A |
| Gain (loss) on disposition of assets | (70,905) | – | (70,905) | N/A |
| Gain (loss) on inventory | (174,963) | – | (174,963) | N/A |
| Gain (loss) on derivative valuation | – | 10,757 | (10,757) | -100% |
| Net Other Income (Expense) | (248,461) | (313,487) | 65,026 | -21% |
| | | | | |
| Income tax provision | – | – | – | N/A |
| | | | | |
| Net Loss | $(1,994,792) | $(1,489,114) | $(505,678) | -34% |
| | | | | |
| Net Loss per common share | $(0.33) | $(2.05) | | |
| | | | | |
| Weighted average shares outstanding | 6,126,292 | 724,903 | | |

**Revenues.** Revenues by product segment and for the Company as a whole were as follows:

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Product Sales | $204,636 | $1,097,585 | $(892,949) | -81% |
| Content Distribution | 87,275 | – | 87,275 | N/A |
| Licensing & Royalties | 101,567 | 258,978 | (157,411) | -61% |
| Total Revenue | $393,478 | $1,356,563 | $(963,085) | -71% |

Product sales represent physical products in which the Company holds intellectual property rights such as trademarks and copyrights, whether registered or unregistered, to the characters and which are manufactured and sold by the

Company either directly at wholesale to retail stores or direct to consumers through daily deal sites and our website. During the six months ended June 30, 2014, product sales decreased by $892,949 due in part to a general decline in market demand for CDs and DVDs as well as the Company’s shift in emphasis away from physical goods distribution.

Television & Home Entertainment revenue totaled $87,275 during six months ended June 30, 2014 with no comparable amounts in 2013 due to the Merger. Television & Home Entertainment revenue is generated from distribution of our properties for broadcast on television in domestic and foreign markets and the sale of DVDs for home entertainment.

Licensing and royalty revenue includes items for which we license the rights from other companies to copyrights and trademarks of select brands we feel will do well within our distribution channels as well as for our brands licensed to others to manufacture and/or market, both internationally and domestically. During the six month period ended June 30, 2014 compared to June 30, 2013, this category decreased from $258,978 to $101,567, or $157,411 (61%). This decrease is due to the shift in the Company's focus from third party off-brand product to more kid-oriented product that is more consistent with the Company's brand.

**Costs.** Costs and expenses, excluding depreciation and amortization, consisting primarily of cost of sales, marketing and sales expenses, and general and administrative costs, decreased $367,835 (15%) for the six month period ended June 30, 2014 compared to the six month period ended June 30, 2013.

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Cost of Sales | $241,147 | $979,977 | $(738,830) | -75% |
| General and Administrative | 1,720,340 | 1,285,408 | 434,932 | 34% |
| Marketing and Sales | 117,880 | 158,791 | (40,911) | -26% |
| Product Development | 6,813 | 29,839 | (23,026) | -77% |
| Total Costs and Operating Expenses | $2,086,180 | $2,454,015 | $(367,835) | -15% |

Cost of Sales decreased $738,830 (75%), during six months ended June 30, 2014 compared to the same period of 2013. The decrease was a result of the decrease in product sales discussed above.

General and Administrative expenses consist primarily of salaries, employee benefits, as well as other expenses associated with finance, legal, facilities, marketing, rent, and other professional services. General and administrative costs for the six months ended June 30, 2014 increased $434,932 (34%) as compared to the six months ended June 30, 2013. The aggregate increase for the category includes increases of professional fees of $441,984, other general and administration expenses of $306,689, and bad debt expense of $55,000 all offset by decreases of $270,616 in salaries and wages and $160,268 in stock based compensation expense.

Marketing and sales expenses decreased $40,911 (26%) for the six months ended June 30, 2014 compared to the six months ended June 30, 2013 primarily due to decreases in sales commission expenses and other advertising expenses.

Product development expenses are for routine and periodic alterations to existing products. For the six months ended June 30, 2014 compared to the six months ended June 30, 2013, these expenses decreased by $23,026 (77%), primarily due to decreased demand for alterations to our existing products.

**Interest Expense.** During the six months ended June 30, 2014, interest expense resulted from certain related party short-term debt and other operating interest expense. During the prior period, interest expense related to interest expense recognized in relation to certain related-party notes payable and other operating interest expense as well as interest expense related to certain debentures.

| | 6/30/2014 | 6/30/2013 | Change | % Change |
|---|---|---|---|---|
| Interest Expense - Operating | $ 2,230 | $ 4,220 | $ (1,991 ) | -47% |
| Interest Expense - Related Party | 13,370 | 13,534 | (164 ) | -1% |
| Interest Expense - Debenture | – | 306,522 | (306,522) | -100% |
| Interest Expense | $ 15,600 | $ 324,276 | $ (308,676) | -95% |

From 2007 through 2009, the Company borrowed funds from members of its previous management team, the proceeds of which were used to pay operating obligations of the Company. In association with the Merger, all remaining balances in association with these notes were converted into common stock. Interest expense was recorded in the six months ended June 30, 2014 and 2013 in the amounts of $0 and $7,388, respectively.

During 2011, four of the Company's former officers agreed to convert accrued but unpaid salaries through December 31, 2010 to subordinated long term notes payable. In association with the Merger, all remaining balances in association with these notes were converted into common stock. Interest expense was recorded in the six months ended June 30, 2014 and 2013 in the amounts of $0 and $6,146, respectively.

As part of the Merger, the Company acquired certain liabilities from A Squared. From time to time, A Squared required short-term advances to fund its operations and provide working capital from its founder, the Company's Chief Executive Officer, Andrew Heyward. As of June 30, 2014, these advances totaled $415,787. These advances are interest free and have no stated maturity. The Company has applied an imputed interest rate of 6%. During the six months ended June 30, 2014, the Company recognized imputed interest expense of $13,370 with no comparable amount recognized in the prior period.

On June 27, 2012, the Company entered into a Securities Purchase Agreement whereby the Company issued and sold (i) the $1,000,000 16% Debenture, and (ii) the Debenture Warrant to purchase up to 50,000 shares of the Company's common stock. On August 29, 2013, pursuant to an agreement between the Company and certain holders, the original Debenture was assigned and exchanged for an aggregate of $1,163,333 a Reissued Debenture. The interest rate and maturity date of the Reissued Debenture were not changed. In association with the Merger, the Company converted all remaining balances into shares of common stock. For the six months ended June 30, 2014 compared to the same period of 2013, interest expense for the Debenture and Reissued Debenture was recorded in amounts of $0 and $306,522, respectively.

**Liquidity**

*Six Months Ended June 30, 2014 Compared to June 30, 2013*

Cash totaled $5,576,206 and $253,390at June 30, 2014 and 2013, respectively. The change in cash is as follows:

| | 6/30/2014 | 6/30/2013 | Change |
|---|---|---|---|
| Cash provided (used) by operations | $(1,234,446) | $(85,918) | $(1,148,528) |
| Cash provided (used) in investing activities | (89,481) | (172,518) | 83,037 |
| Cash provided (used) in financing activities | 6,373,023 | 64,278 | 6,308,745 |
| Increase (decrease) in cash | $5,049,096 | $(194,158) | $5,243,254 |

During our periods ended June 30, 2014 and 2013, our primary sources of cash were financing activities. During 2014, our financing activities related primarily to the sale of shares of common stock and Series A Convertible Preferred Stock as well as the execution of a long-term, exclusive supply chain services agreement. During the comparable period in 2013, our financing activities related to the receipt of funds related to the issuance costs of certain debentures. During both periods, these funds were primarily used to fund operations as well as investments in intangible assets and capitalized product development.

***Operating Activities***

Cash used by operations in the six months ended June 30, 2014 was $1,234,446 as compared to a use of $85,918 during the same period of 2013, representing an increase in cash used in operations of $1,148,528 based on the operating results discussed above as well as increases in film and television costs related to the commencement of production of the second installment of the feature film *Stan Lee and the Mighty 7* and episodes of the *Thomas Edison: Secret Lab* off-set by the receipt of $250,000 for a musical composition administration services with a third party.

***Investing Activities***

Cash used by investing activities for the six months ended June 30, 2014 was $89,481 as compared to a use of funds of $172,518 for the comparable period in 2013 is the result of the creation of a new website and the ongoing development of the Company's web-based streaming service.

***Financing Activities***

Cash generated from financing activities during the six months ended June 30, 2014 was $6,373,023 as compared to $64,278 generated in comparable period in 2013. The increase in cash provided by financing activities relates to the following activities during the first half of 2014:

- The sale of common stock during the first quarter of 2014 for which the Company received net proceeds of $355,116;
- The execution of a long-term, exclusive supply chain services agreement for which it received $750,000 during the first quarter of 2014, with the remaining $750,000 due by January 17, 2015;
- The sale of 6,000 shares of the Company's newly designated Series A Convertible Preferred Stock at a price of $1,000 per share for which the Company received net proceeds of $5,379,915; and
- Expenditures of $103,766 for the repayment of related party notes offset these increases.

**Capital Resources**

As of June 30, 2014, the Company does not have any material commitments for capital expenditures.

**Critical Accounting Policies**

The Company's accounting policies are described in the notes to the financial statements. Below is a summary of the critical accounting policies, among others, that management believes involve significant judgments and estimates used in the preparation of its financial statements.

*Principles of Consolidation* - The Company's consolidated financial statements include the accounts of Genius Brands International, Inc. and its wholly owned subsidiary A Squared Entertainment, LLC. All significant inter-company balances and transactions have been eliminated in consolidation.

*Intangible Assets* - Intangible Assets acquired, either individually or with a group of other assets, are initially recognized and measured based on fair value. In the 2005 acquisition of the assets from Genius Products, fair value was calculated using a discounted cash flow analysis of the revenue streams for the estimated life of the assets. In the 2013 acquisition of the identifiable artistic-related assets from A Squared, fair value was determined through an independent appraisal. The Company determined that these assets are indefinite-lived. Additional, the Merger transaction with A Squared gave rise to goodwill representing the future economic benefits arising from the assets of A Squared that could not be individually identified and recognized.

The Company develops new video, music, books and digital applications, in addition to adding content, improved animation and songs/features to their existing productions. The costs of new product development and significant improvement to existing products are capitalized while routine and periodic alterations to existing products are expensed as incurred. The Company begins amortization of new products when it is available for general release. Annual amortization cost of intangible assets are computed based on the straight-line method over the remaining economic life of the product, generally such deferred costs are amortized over five years.

The Company reviews all intangible assets periodically to determine if the value has been impaired following the guidance of ASC 350-20 - Goodwill and ASC 350-30 - General Intangibles Other Than Goodwill.

*Capitalized Production Cost* - The Company capitalizes production costs for episodic series produced in accordance with ASC 926-20, Entertainment-Films - Other Assets - Film Costs. Accordingly, production costs are capitalized at actual cost and then charged against revenue based on the initial market revenue evidenced by a firm commitment over the period of commitment. The Company expenses all capitalized costs that exceed the initial market firm commitment revenue in the period of delivery of the episodes.

The Company capitalizes production costs for films produced in accordance with ASC 926-20, Entertainment-Films - Other Assets - Film Costs. Accordingly, production costs are capitalized at actual cost and then charged against revenue quarterly as a cost of production based on the relative fair value of the film(s) delivered and recognized as revenue. The Company evaluates their capitalized production costs annually and limits recorded amounts by their ability to recover such costs through expected future sales.

The Company also develops new videos, music, books and digital applications in addition to adding content, improved animation and bonus songs/features to its existing product catalog. In accordance with ASC 350 - Intangible Assets and ASC 730 - Research and Development, the costs of new product development and significant improvement to existing products are capitalized while routine and periodic alterations to existing products are expensed as incurred.

*Revenue Recognition* - The Company recognized revenue related to product sales when (i) the seller’s price is substantially fixed, (ii) shipment has occurred causing the buyer to be obligated to pay for product, (iii) the buyer has economic substance apart from the seller, and (iv) there is no significant obligation for future performance to directly bring about the resale of the product by the buyer as required by ASC 605 - Revenue Recognition.

Revenues associated with the sale of products, are recorded when shipped to customers pursuant to approved customer purchase orders resulting in the transfer of title and risk of loss. Cost of sales, rebates and discounts are recorded at the time of revenue recognition or at each financial reporting date.

The Company recognizes revenue in accordance with ASC Topic 926-605, Entertainment-Films - Revenue Recognition. Accordingly, the Company recognizes revenue when (i) persuasive evidence of a sale with customer exists, (ii) the film is complete and has been delivered or is available for delivery, (iii) the license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale, (iv) the arrangement fee is fixed or determinable, and (v) collection of the arrangement fee is reasonably assured.

For its distribution, TV, and home entertainment income the Company generally enters in to flat fee arrangements to deliver multiple films or episodes. The Company allocates revenue to each film or episode based on their relative fair market values and recognizes revenue as each film or episode is complete and available for delivery.

The Company's licensing and royalty revenue represents both (a) variable payments based on net sales from brand licensees for content distribution rights. These license agreements are held in conjunction with third parties that are responsible for collecting fees due and remitting to the Company its share after expenses. Revenue from licensed products is recognized when realized or realizable based on royalty reporting received from licensees and (b) licensing income the Company recognizes revenue as an agent in accordance with ASC 605-45, Revenue Recognition - Principal Agent. Accordingly, the Company's revenue is its gross billings to its customers less the amounts it pays to suppliers for their products and services.

*Other Estimates* - The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods.

**Off Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not applicable

## ITEM 4. CONTROLS AND PROCEDURES.

### Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and interim chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the ‘‘Exchange Act’’). Disclosure controls and procedures include, without limitation, controls and procedures that are designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon our evaluation, our chief executive officer and interim chief financial officer concluded that our disclosure controls and procedures are ineffective, for the period ended June 30, 2014, in ensuring that information that we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

### Changes in Internal Control Over Financial Reporting

As noted in our December 31, 2013 Form 10-K, the Company disclosed certain material weaknesses and during the period ending June 30, 2014, the Company has taken the following steps to correct the material weaknesses identified in that report:

1. The Company has closed its San Diego office and consolidated all accounting activities into one location at our Beverly Hills location.

2. A new Controller has been hired with the proper accounting and auditing background and experience to establish procedures for the proper recognition of revenue and expenses and to properly document the delivery of products to customer.

3. With the consolidation of the accounting activities into one office, the segregation of duties has been expanded so that several people perform the various accounting duties necessary to insure proper internal control.

4. While there are no debt instruments on the balance sheet as of December 31, 2013, in the future, should the Company issue certain complex debt or equity instruments, management intends to mitigate any risks by utilizing external financial consulting services prior to the review by our principal independent accounting firm to ensure that all information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported accurately and within the time periods specified in the Commission's rule and forms.

5. Management intends to ensure that all actions of management and the Board of Directors are communicated to the internal accounting staff for proper disclosure and, if necessary, will utilize the services of external financial consultants with technical accounting expertise to assess the impact.

***PART II - OTHER INFORMATION***

## ITEM 1. LEGAL PROCEEDINGS.

There are presently no material pending legal proceedings to which the Company is a party or as to which any of its property is subject, and no such proceedings are known to the Company to be threatened or contemplated against it.

## ITEM 1A. RISK FACTORS.

There have been no changes to the Risk Factors set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

On June 16, 2014, the Company issued 305,562 shares of common stock to investors in the Company's November 2013 and January 2014 private placement. Pursuant to the Securities Purchase Agreement associated with that offering, for a period of three years after the initial closing of the offering, investors are entitled to additional shares if the Company issues securities pursuant to which shares of common stock may be acquired at a price less than the per share purchase price in that offering or $3.50 per share. The issuance of the Series A Convertible Preferred Stock in May of 2014, as described above, triggered this issuance of these additional shares.

The securities referenced above were offered and sold solely to "accredited investors" in reliance on the exemption from registration afford by Rule 506 of Regulation D and/or Section 4(a)(2) of the Securities Act as a transaction by an issuer not involving a public offering.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

There were no reportable events under this Item 3 during the three months ended June 30, 2014.

**ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**ITEM 5. OTHER INFORMATION.**

None.

**ITEM 6. EXHIBITS.**

| Exhibit No. | Description |
|---|---|
| 31.1 | Section 302 Certification of Chief Executive Officer. |
| 31.2 | Section 302 Certification of Chief Financial Officer. |
| 32.1 | Section 906 Certification of Chief Executive Officer. |
| 32.2 | Section 906 Certification of Chief Financial Officer |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Schema Document |
| 101.CAL | XBRL Calculation Linkbase Document |
| 101.DEF | XBRL Definition Linkbase Document |
| 101.LAB | XBRL Label Linkbase Document |
| 101.PRE | XBRL Presentation Linkbase Document |

**SIGNATURES**

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

**GENIUS BRANDS INTERNATIONAL, INC.**

Date: August 14, 2014 By: */s/ Andrew Heyward*
Andrew Heyward, Chief Executive Officer

(Principal Executive Officer)

Date: August 14, 2014 By: */s/ Richard Staves*
Richard Staves, Interim Chief Financial Officer
(Principal Financial and Accounting Officer)