JAKKS PACIFIC INC
Form 424B4
May 23, 2002

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As filed pursuant to Rule 424(b)(3)

under the Securities Act of 1933
Registration No. 333-86800

PROSPECTUS DATED MAY 23, 2002

3,500,000 Shares

Common Stock

Of the 3,500,000 shares of common stock being offered, we are offering 3,000,000 shares and certain of our stockholders are offering 500,000 shares. Our common stock is traded on the Nasdaq National Market under the symbol JAKK. On May 22, 2002, the last reported sale price of our common stock was $18.00 per share.

Investing in our common stock involves risks. See Risk Factors beginning on page 7 of this prospectus to read about risks that you should consider before buying shares of our common stock.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$17.750	$62,125,000
Underwriting discounts and commissions	$ 0.976	$ 3,416,000
Proceeds, before expenses, to us	$16.774	$50,322,000
Proceeds, before expenses, to the selling stockholders	$16.774	$ 8,387,000

We have granted the underwriters a 30-day option to purchase from us up to an aggregate of 525,000 additional shares of our common stock at the offering price, less the underwriting discount, to cover over-allotments, if any.

The underwriters are severally underwriting the shares being offered. The underwriters expect to deliver the shares against payment in New York, New York, on or about May 29, 2002.

Bear, Stearns & Co. Inc. U.S. Bancorp Piper Jaffray

Advest, Inc.

The date of this Prospectus is May 23, 2002.

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INSIDE FRONT COVER

Pictures or depictions of our products and our licensed and owned marks including Nickelodeon, WWF, Road Champs, Hello Kitty, Flying Colors, Go Fly A Kite, Funnoodle, Pentech, Toymax and Child Guidance.

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You should rely only on the information contained or incorporated in this prospectus. We, the selling stockholders and the underwriters have not authorized anyone to provide you with information different from that contained in this prospectus. We and the selling stockholders are offering to sell, and seeking offers to buy, shares of common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or any sale of our common stock. In this prospectus, references to the Company, JAKKS, we, us and our refer to JAKKS Pacific, Inc. and, where the context requires (such as when we discuss our business, operations, properties or products), our subsidiaries.

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Until June 17, 2002 (25 days after the date of this prospectus), all dealers that buy, sell or trade these securities, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

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

TRADEMARK AND LICENSING INFORMATION

We own or have rights to various trademarks and brand or trade names that we use in conjunction with the sale of our products. These include *World Wrestling Entertainment*®, *Nickelodeon*®, *Rugrats*® and *Hello Kitty*®, among others. We also refer in this prospectus to other trademarks or brand or trade names that are owned or licensed by other companies.

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PROSPECTUS SUMMARY

This summary highlights information more fully described elsewhere in this prospectus. Because it is a summary, it does not contain all the information that you should consider before buying shares of our common stock in this offering. You should read the entire prospectus, especially the   Risk Factors   section beginning on page 7, and our consolidated financial statements and the related notes incorporated by reference elsewhere in this prospectus, before deciding to invest in our common stock. Unless otherwise indicated, all information contained in this prospectus assumes that the underwriters will not exercise their over-allotment option.

JAKKS Pacific, Inc.

Our Business

We are a leading multi-line, multi-brand toy company that designs, develops, produces and markets toys and related products. We focus our business on acquiring or licensing well-recognized trademarks and brand names with long product histories (evergreen brands). We seek to acquire these evergreen brands because we believe they are less subject to market fads or trends. Our products are typically simpler, lower-priced toys and accessories and include:

Action figures and accessories including licensed characters, principally based on *World Wrestling Entertainment,* and toy vehicles, including *Road Champs*® die-cast collectibles and *Remco*™ toy vehicles and role-play toys and accessories;

Craft, activity and stationery products, including *Flying Colors*® activity sets, compounds, playsets and lunch boxes, and *Pentech*® writing instruments, stationery and activity products;

Child Guidance® infant and pre-school electronic toys, toy foam puzzle mats and blocks, activity sets, outdoor products, plush toys and slumber bags; and

Fashion and mini dolls and related accessories, including *Disney*® Princesses sold exclusively in The Disney Store.

We continually review the marketplace to identify and evaluate evergreen brands that we believe have the potential for significant growth. We generate growth within these brands by:

creating innovative products under established brand names;

focusing our marketing efforts to enhance consumer recognition and retailer interest;

linking them with our portfolio of evergreen brands;

adding new items to the branded product lines that we expect will enjoy greater popularity; and

adding new features and improving the functionality of products in the line.

In addition to developing our proprietary brands and marks, we license marks such as *World Wrestling Entertainment, Nickelodeon, Rugrats, Blue   s Clues*®, *Mickey Mouse*®, *Barney*®, *Sesame Street*®, *Winnie the Pooh*®, *Hello Kitty* and *Car and Driver*®. Licensing enables us to use these high-profile marks at a lower cost than we would incur if we purchased these marks or developed comparable marks on our own. By licensing marks, we have access to a far greater range of marks than would be available for purchase. We also license technology produced by unaffiliated inventors and product developers to improve the design and functionality of our products.

We have capitalized on our relationship with World Wrestling Entertainment, Inc. (WWE) by obtaining an exclusive worldwide license for our joint venture with THQ Inc. (THQ), which develops, produces, manufactures and markets video games based on *World Wrestling Entertainment* characters and themes. Since the joint venture   s first title release in 1999, it has released 11 new titles. We have received $27.5 million as our share of the joint venture   s profit through March 31, 2002.

On March 11, 2002, we acquired a controlling interest in Toymax International, Inc. (Toymax), a developer and marketer of toys and related products, which added toy brand names such as *Laser Challenge*™ and *Creepy Crawlers*® to our brand portfolio. In addition, pool-related products branded under the name

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Funnoodle® and kites branded under the name *Go Fly a Kite*™ further diversified our portfolio with products popular in the spring and summer seasons.

Most of our current products are relatively simple and inexpensive. In 2001, approximately 70% of our revenue came from products priced below ten dollars at retail. We believe that these products have enduring appeal and are less subject to general economic conditions, toy product fads and trends, and changes in retail distribution channels. As of March 31, 2002, we had over 4,300 products and 19 product categories. In addition, the simplicity of these products enables us to choose among a wider range of manufacturers and affords us greater flexibility in product design, pricing and marketing. Our product development process typically takes from three to nine months from concept to production and shipment to our customers. We believe that many licensors and retailers recognize and reward our ability to bring product to market faster and more efficiently than many of our competitors.

We sell our products through our in-house sales staff and independent sales representatives to toy and mass-market retail chain stores, department stores, office supply stores, drug and grocery store chains, club stores, toy specialty stores and wholesalers. The *Road Champs, Flying Colors* and *Pentech* products also are sold to smaller hobby shops, specialty retailers and corporate accounts, among others. Our five largest customers are Target, Kmart, Toys R Us, Wal-Mart, and Kay Bee Toys, which collectively accounted for approximately 54.7% of our net sales in 2001. We have over 10,000 other customers, none of which accounted for more than 2.0% of our net sales in 2001.

Our Growth Strategy

The successful execution of our growth strategy has resulted in increased revenues and earnings. From 1996 to 2001, our net sales, EBITDA and net income grew at a compound annual rate of 88.2%, 95.0% and 88.7%, respectively. In 2001, we generated net sales and EBITDA of $284.3 million and $44.1 million, respectively. Key elements of our growth strategy include:

Expand Core Products. We manage our existing and new brands through strong product development initiatives, including introducing new products, modifying existing products and extending existing product lines. Our product designers strive to develop new products or product lines to offer added technological, aesthetic and functional improvements to our product lines. In 2001, we expanded the use of real-scan technology in our action toys, which produces higher quality and better likenesses of the representative characters and vehicle parts. In addition, we introduced action figures with significantly greater ranges of motion, and expanded our electronic action figure recognition play sets.

Enter New Product Categories. We will continue to use our extensive experience in the toy and other industries to evaluate products and licenses in new product categories and to develop additional product lines. We have entered the plush toy category through the licensing of *Pound Puppies*®, as well as through the creation of our own *Limbo Legs*™, and expanded into slumber bags through the licensing of this category from our current licensors, such as MTV Networks, Inc. (Nickelodeon).

Pursue Strategic Acquisitions. We intend to supplement our internal growth rate with selected strategic acquisitions. Since our inception in 1995, we have successfully completed and integrated nine acquisitions of companies and trademarks. These include our acquisitions of Justin Products, Road Champs, *Remco, Child Guidance,* Berk, Flying Colors, Pentech, Kidz Biz and most recently, our controlling interest in Toymax. We will continue focusing our acquisition strategy on businesses or brands that have compatible product lines and offer valuable trademarks or brands.

Acquire Additional Character and Product Licenses. We have acquired the rights to use many familiar corporate, trade and brand names and logos from third parties that we use with our primary trademarks and brands. Currently, we have license agreements with the WWE, Nickelodeon, Disney, and Warner Bros., as well as with the licensors of the many popular licensed children s characters previously mentioned, among others. We intend to continue to pursue new licenses from these entertainment and media companies and other licensors. We also intend to continue to purchase additional inventions and product concepts through our existing network of product developers.

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Expand International Sales. We believe that foreign markets, especially Europe, Australia, Canada, Latin America and Asia, offer us significant growth opportunities. In 2001, our sales generated outside the United States grew 78% to approximately $40.0 million, or 14.1% of total sales. We intend to continue to expand our international sales by capitalizing on our experience and our relationships with foreign distributors and retailers. Our recent expansion efforts included entering into a distribution agreement with Funtastic Ltd., an Australia based toy distributor. In addition, in December 2001, we acquired Kidz Biz for its distribution channels in the United Kingdom and surrounding territories. We expect both initiatives to contribute to our continued international growth in 2002.

Capitalize On Our Operating Efficiencies. We believe that our current infrastructure and low-overhead operating model can accommodate significant growth without a proportionate increase in our operating and administrative expenses, thereby increasing our operating margins.

Industry Overview

According to the Toy Industry Association, Inc. (TIA), the leading toy industry trade group, total retail sales of toys, excluding video games, in the United States, were approximately $25.0 billion in 2001. Sales by domestic toy manufacturers to foreign customers exceeded $5.0 billion in 2001. In the United States video game segment, total retail sales of video game software were approximately $9.4 billion in 2001.

Recent Developments

On March 11, 2002, we purchased 8,100,065 shares of common stock of Toymax, a developer and marketer of toys and related products, from four of its stockholders for approximately $24.3 million in cash and 646,384 shares of our common stock. Previously, between December 2, 2001 and February 4, 2002, we purchased 132,754 shares of Toymax common stock on the open market for an aggregate purchase price of approximately $0.2 million. As a result of these transactions, we own approximately 66.8% of the outstanding shares of Toymax common stock.

We intend to purchase the remaining shares of Toymax common stock in a merger transaction by the end of the second quarter of 2002, at which point Toymax will become our wholly owned subsidiary. We currently estimate that the consideration payable to acquire the remaining shares of Toymax common stock will consist of approximately $12.3 million in cash and approximately 325,853 shares of our common stock.

Toymax has an established portfolio of brand names and products including innovative and technologically advanced toys such as *Laser Challenge* and *Creepy Crawlers* activities brands, *Mighty Mo s*® electronic vehicles and radio-controlled vehicles and robots, as well as pool and water toys and accessories and other outdoor products under the *Funnoodle* brand and kites, banners, *WindWheels*™, weathervanes and wind chimes under the *Go Fly a Kite* brand. These brand names and products further diversify and complement our existing brand names and products. We also expect to benefit from efficiencies generated by lowering our combined operating expenses. In addition, the *Funnoodle* and *Go Fly a Kite* products have significant sales through the spring and summer season.

We recently reported our financial results for the quarter ended March 31, 2002. Net sales for the first quarter of 2002 totaled $59.9 million, as compared to $60.0 million for the first quarter of the prior year. Excluding a one-time restructuring charge of $6.6 million related to our acquisitions of Kidz Biz and Toymax, net income for the first quarter of 2002 increased 16.1% to $7.0 million, or $0.35 per diluted share, compared to net income of $6.0 million, or $0.32 per diluted share, in 2001. Net income, including the one-time charge, was $2.2 million or $0.11 per diluted share. Additional information is included in our Quarterly Report on Form 10-Q for the period ended March 31, 2002, which is incorporated by reference in this prospectus.

Our Corporate Information

We were formed as a Delaware corporation in 1995. Our principal executive offices are located at 22619 Pacific Coast Highway, Malibu, California 90265. Our telephone number is (310) 456-7799. Our Internet website address is www.jakkspacific.com. The contents of our website are not part of this prospectus.

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THE OFFERING

Common stock offered by us	3,000,000 shares
Common stock offered by the selling stockholders	500,000 shares(1)
Common stock outstanding after this offering	23,018,865 shares(2)(3)
Use of proceeds received by us	To purchase the remaining shares of Toymax, to finance potential acquisitions of companies, product lines, brands and licenses, to fund product development and for working capital and general corporate purposes. We will not receive any proceeds from the sale of our common stock by the selling stockholders pursuant to this prospectus.
Risk Factors	An investment in our common stock involves a high degree of risk. See Risk Factors.
Nasdaq National Market symbol	JAKK

(1) Includes 350,078 shares of common stock issuable upon the exercise of stock options.

(2) Assumes the sale of all of the shares offered hereby. Includes 350,078 shares to be sold by selling stockholders which will be issued upon the exercise of options. Does not include 1,395,735 shares reserved by us for issuance upon exercise of all stock options included in our Third Amended and Restated 1995 Employee Stock Option Plan, all of which have already been granted at prices ranging from $3.00 to $26.00 and expiring at various times from October 7, 2002 to January 1, 2012.

(3) If all the over-allotment shares are sold, we would issue an additional 525,000 shares, so that 23,543,865 shares would be outstanding after this offering.

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SUMMARY CONSOLIDATED FINANCIAL DATA

The following summary consolidated financial data have been derived from our audited and unaudited consolidated financial statements, which are incorporated by reference in this prospectus. You should read the financial data set forth below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and notes incorporated by reference in this prospectus.

	Year Ended December 31,					Three Months Ended March 31,	
	1997	**1998**	**1999**	**2000**	**2001**	**2001**	**2002**
			(in thousands, except per share data)				
Consolidated Statement of Operations Data:							
Net sales	$41,945	$85,253	$183,685	$252,288	$284,309	$59,962	$59,895
Cost of sales	25,875	52,000	107,602	149,881	164,222	35,494	33,425
Gross profit	16,070	33,253	76,083	102,407	120,087	24,468	26,470
Income from operations	4,175	9,246	24,929	20,503	29,298(1)	7,267	1,419(2)
(Profit)/loss from joint venture			(3,605)	(15,906)	(6,675)	(728)	(1,297)
Net income	$ 2,786	$ 6,375	$ 21,970	$ 28,637	$ 28,233(1)	$ 6,021	$ 2,156(2)
Diluted earnings per share	$ 0.35	$ 0.59	$ 1.39	$ 1.41	$ 1.45(1)	$ 0.32	$ 0.11(2)
Weighted average shares and equivalents outstanding diluted	9,103	11,403	15,840	20,281	19,410	18,920	20,236

	As of December 31,					As of March 31,	
	1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2002**
						Actual	**As adjusted(3)**
				(in thousands)			
Consolidated Balance Sheet Data:							
Cash and cash equivalents	$ 2,536	$12,452	$ 57,546	$ 29,275	$ 25,036	$ 14,937	$ 67,014
Marketable securities			39,334	13,618	37,119	16,706	16,706
Working capital	3,368	13,736	113,170	86,897	116,487	82,006	134,083
Total assets	43,605	58,736	232,878	248,722	284,041	330,704	382,781
Total long-term debt	6,000	5,940	9	1,000	73	76	76
Total stockholders equity	25,959	37,754	187,501	204,530	244,403	260,890	312,967

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	Year Ended December 31,				
	1997	1998	1999	2000	2001(1)
	(in thousands, except for percentages)				
Other Financial Data:					
EBITDA(4)	$6,161	$12,993	$29,575	$31,377	$44,104
EBITDA growth	293.7%	110.9%	127.6%	6.1%	40.6%
Net sales growth	248.0%	103.2%	115.5%	37.3%	12.7%
Net income growth	136.1%	128.8%	244.6%	30.3%	(1.4)%
EBITDA margin	14.7%	15.2%	16.1%	12.4%	15.5%
Gross profit margin	38.3%	39.0%	41.4%	40.6%	42.2%
Net income margin	6.6%	7.5%	12.0%	11.4%	9.9%

(1) Results reflect a one-time charge of $5.0 million relating to the bankruptcy filing of Kmart.

(2) Results reflect one-time restructuring charges of $6.6 million relating to our acquisitions of Kidz Biz and Toymax.

(3) The adjusted balance sheet gives effect to receipt of the net proceeds from our sale of shares of our common stock in this offering at a public offering price of $17.75 per share, after we deduct the underwriting discount and pay the expenses associated with this offering and the receipt of the option price from the selling stockholders of $2,354,754 upon the exercise of options to purchase 350,078 shares that are being sold in this offering.

(4) EBITDA is defined as earnings from continuing operations before interest and income taxes, net of nonrecurring items, plus depreciation and amortization of long-term assets. EBITDA does not include our profit from the joint venture with THQ in the amounts of $3.6 million, $15.9 million and $6.7 million in the years ended 1999, 2000 and 2001, respectively. EBITDA is generally regarded as providing useful information regarding a company s financial performance, but it is not a measure of financial performance under generally accepted accounting principles. EBITDA should not be considered an alternative to measures of operating performance as determined in accordance with generally accepted accounting principles, including net income as a measure of our operating results and cash flows as a measure of our liquidity. Additionally, EBITDA is not calculated identically by all companies, therefore, our calculation of EBITDA may not be comparable to other similarly titled measures of other companies.

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RISK FACTORS

An investment in our securities involves a high degree of risk. You should carefully consider the following risk factors in conjunction with the other information contained and incorporated by reference in this prospectus before purchasing our securities. If any of the risks discussed in this prospectus actually occur, our business, operating results, cash flows, prospects or financial condition could be materially adversely affected. This may cause the market price of our securities to decline and could cause you to lose all or part of your investment.

We Are Subject to Changing Consumer Preferences and New Product Introductions

Our business and operating results depend largely upon the appeal of our products. Our continued success in the toy industry will depend on our ability to redesign, restyle and extend our existing core products and product lines as consumer preferences evolve, and to develop, introduce and gain customer acceptance of new products and product lines. Several trends in recent years have presented challenges for the toy industry, including:

- the phenomenon of children outgrowing toys at younger ages, particularly in favor of interactive and high technology products;
- increasing use of technology;
- shorter life cycles for individual products; and
- higher consumer expectations for product quality, functionality and value.

We cannot assure you that:

- our current products will continue to be popular with consumers;
- the product lines or products that we introduce will achieve any significant degree of market acceptance; or
- the life cycles of our products will be sufficient to permit us to recover licensing, design, manufacturing, marketing and other costs associated with those products.

We Are Subject to Changing Popularity of Our Products

The success of many of our character-related and theme-related products depends on the popularity of characters in movies, television programs, live wrestling exhibitions and other media. We cannot assure you that:

- media associated with our character-related and theme-related product lines will be released at the times we expect or will be successful;
- the success of media associated with our existing character-related and theme-related product lines will result in substantial promotional value to our products;
- we will be successful in renewing licenses upon expiration on terms that are favorable to us; or
- we will be successful in obtaining licenses to produce new character-related and theme-related products in the future.

There Are Risks Associated with Our License Agreements

Our Current Licenses Require Us to Pay Minimum Royalties

Sales of products under trademarks or trade or brand names licensed from others account for substantially all of our net sales. Product licenses allow us to capitalize on characters, designs, concepts and inventions owned by others or developed by toy inventors and designers. Our license agreements generally require us to make specified minimum royalty payments, even if we fail to sell a sufficient number of units to cover these amounts. In addition, under certain of our license agreements, if we fail to achieve certain prescribed sales targets, we may be unable to retain or renew these licenses.

Some of Our Licenses Are Restricted as to Use

Under some of our license agreements, including WWE and Nickelodeon, the licensors have the right to review and approve our use of their licensed products, designs or materials before we may make any sales. If a licensor refuses to permit our use of any licensed property in the way we propose, or if their review process is delayed, our development or sale of new products could be impeded.

New Licenses Are Difficult and Expensive to Obtain

Our continued success will depend substantially on our ability to obtain additional licenses. Intensive competition exists for desirable licenses in our industry. We cannot assure you that we will be able to secure or renew significant licenses on terms acceptable to us. In addition, as we add licenses, the need to fund additional royalty advances and guaranteed minimum royalty payments may strain our cash resources.

A Limited Number of Licensors Account for a Large Portion of Our Net Sales

We derive a significant portion of our net sales from a limited number of licensors. If one or more of these licensors were to terminate or fail to renew our license or not grant us new licenses, our business, financial condition and results of operations could be adversely affected.

The Toy Industry Is Highly Competitive

The toy industry is highly competitive. Globally, certain of our competitors have financial and strategic advantages over us, including:

- greater financial resources;
- larger sales, marketing and product development departments;
- stronger name recognition;
- longer operating histories; and
- greater economies of scale.

In addition, the toy industry has no significant barriers to entry. Competition is based primarily on the ability to design and develop new toys, to procure licenses for popular characters and trademarks and to successfully market products. Many of our competitors offer similar products or alternatives to our products. Our competitors have obtained and are likely to continue to obtain licenses that overlap our licenses with respect to products, geographic areas and markets. We cannot assure you that we will be able to obtain adequate shelf space in retail stores to support our existing products or to expand our products and product lines or that we will be able to continue to compete effectively against current and future competitors.

Our Video Game Joint Venture with THQ Is Subject to Numerous Risks and Uncertainties

In addition to the risks relating to us and the toy industry, our joint venture with THQ faces the following risks:

- The joint venture depends entirely on a single license, which gives the venture exclusive worldwide rights to produce and market video games based on World Wrestling Entertainment characters and themes. The popularity of professional wrestling, in general, and the World Wrestling Entertainment, in particular, is subject to changing consumer tastes and demands. The relative popularity of professional wrestling has fluctuated significantly in recent years. A decline in the popularity of World Wrestling Entertainment could adversely affect the joint venture s and our business, financial condition and results of operations.
- The joint venture relies on hardware manufacturers and THQ s non-exclusive licenses with them for the right to publish titles for their platforms and for the manufacture of the joint venture s titles. If

THQ s manufacturing licenses were to terminate and the joint venture could not otherwise obtain these licenses from other manufacturers, the joint venture would be unable to publish additional titles for these manufacturers platforms, which would materially adversely affect the joint venture s and our business, financial condition and results of operations.

The software industry has experienced periods of significant growth in consumer interest, followed by periods in which growth has substantially declined. The joint venture s sales of software titles depend, among other factors, on the popularity and unit sales of platforms generally, as well as on the relative popularity and unit sales of various platforms. The relative popularity of certain platforms has fluctuated significantly in recent years. An unexpected decline in the popularity of a particular platform can be expected to have a material adverse affect on consumer demand for titles released or to be released by the joint venture for such platforms.

The joint venture s failure to timely develop titles for new platforms that achieve significant market acceptance, to maintain net sales that are commensurate with product development costs or to maintain compatibility between its personal computer CD-ROM titles and the related hardware and operating systems would adversely affect the joint venture s and our business, financial condition and results of operations.

In general, THQ controls the day-to-day operations of the joint venture and all of its product development and production operations. Accordingly, the joint venture relies exclusively on THQ to manage these operations effectively. THQ s failure to effectively manage the joint venture would have a material adverse effect on the joint venture s and our business and results of operations.

We May Not Be Able To Sustain or Manage Our Rapid Growth

We have experienced rapid growth in net sales, operating income and net income over the last five years. As a result, comparing our period-to-period operating results may not be meaningful and results of operations from prior periods may not be indicative of future results. We cannot assure you that we will continue to experience growth in, or maintain our present level of, net sales or net income.

Our growth strategy calls for us to continuously develop and diversify our toy business by acquiring other companies, entering into additional license agreements, refining our product lines and expanding into international markets, which will place additional demands on our management, operational capacity and financial resources and systems. The increased demand on management may necessitate our recruitment and retention of qualified management personnel. We cannot assure you that we will be able to recruit and retain qualified personnel or expand and manage our operations effectively and profitably. To effectively manage future growth, we must continue to expand our operational, financial and management information systems and to train, motivate and manage our work force. There can be no assurance that our operational, financial and management information systems will be adequate to support our future operations. Failure to expand our operational, financial and management information systems or to train, motivate or manage employees could have a material adverse effect on our business, financial condition and results of operations.

In addition, implementation of our growth strategy is subject to risks beyond our control, including competition, market acceptance of new products, changes in economic conditions, our ability to obtain or renew licenses on commercially reasonable terms and our ability to finance increased levels of accounts receivable and inventory necessary to support our sales growth, if any. Accordingly, we cannot assure you that our growth strategy will continue to be implemented successfully.

We Need To Be Able To Acquire and Integrate Companies and New Product Lines Successfully

Our growth strategy depends in part upon our ability to acquire companies and new product lines. Future acquisitions will succeed only if we can effectively assess characteristics of potential target companies and product lines, such as:

attractiveness of products;

suitability of distribution channels;

management ability;

financial condition and results of operations; and

the degree to which acquired operations can be integrated with our operations.

We cannot assure you that we can identify attractive acquisition candidates or negotiate acceptable acquisition terms, and our failure to do so may adversely affect our results of operations and our ability to sustain growth. Our acquisition strategy involves a number of risks, each of which could adversely affect our operating results, including:

difficulties in integrating acquired businesses or product lines, assimilating new facilities and personnel and harmonizing diverse business strategies and methods of operation;

diversion of management attention from operation of our existing business;

loss of key personnel from acquired companies; and

failure of an acquired business to achieve targeted financial results.

A Limited Number of Customers Account for a Large Portion of Our Net Sales

Our five largest customers accounted for 54.7% of our net sales in 2001. Except for outstanding purchase orders for specific products, we do not have written contracts with or commitments from any of our customers. A substantial reduction in or termination of orders from any of our largest customers could adversely affect our business, financial condition and results of operations. In addition, pressure by large customers seeking price reductions, financial incentives, changes in other terms of sale or for us to bear the risks and the cost of carrying inventory also could adversely affect our business, financial condition and results of operations. If one or more of our major customers were to experience difficulties in fulfilling their obligations to us, cease doing business with us, significantly reduce the amount of their purchases from us or return substantial amounts of our products, it could have a material adverse effect on our business, financial condition and results of operations. In addition, the bankruptcy or other lack of success of one or more of our significant retailers could negatively impact our revenues and bad debt expense. Kmart, one of our major customers, filed for Chapter 11 bankruptcy protection on January 22, 2002. We recorded a $5.0 million charge in our 2001 financial statements to allow for any losses that may result from Kmart s bankruptcy filing. However, it is not possible to predict the ultimate impact of Kmart s bankruptcy filing at this time.

We Depend on Our Key Personnel

Our success is largely dependent upon the experience and continued services of Jack Friedman, our Chairman and Chief Executive Officer, Stephen G. Berman, our President and Chief Operating Officer, and Michael Bianco, Jr., our Executive Vice President and Chief Merchandising Officer. We cannot assure you that we would be able to find an appropriate replacement for Mr. Friedman, Mr. Berman or Mr. Bianco if the need should arise, and any loss or interruption of Mr. Friedman s, Mr. Berman s or Mr. Bianco s services could adversely affect our business, financial condition and results of operations. We maintain, and are the beneficiary of, a $4.0 million key-man life insurance policy on Mr. Friedman, which may be insufficient to fund the cost of employing his successor.

We Depend on Third-Party Manufacturers

We depend on approximately 20 third-party manufacturers who develop, provide and use the tools, dies and molds that we own to manufacture our products. However, we have limited control over the manufacturing processes themselves. As a result, any difficulties encountered by the third-party manufacturers that result in product defects, production delays, cost overruns or the inability to fulfill orders on a timely basis could adversely affect our business, financial condition and results of operations.

We do not have long-term contracts with our third-party manufacturers. Although we believe we could secure other third-party manufacturers to produce our products, our operations would be adversely affected if we lost our relationship with any of our current suppliers or if our current suppliers operations or sea or air transportation with our overseas manufacturers were disrupted or terminated even for a relatively short period of time. Our tools, dies and molds are located at the facilities of our third-party manufacturers.

Although we do not purchase the raw materials used to manufacture our products, we are potentially subject to variations in the prices we pay our third-party manufacturers for products, depending on what they pay for their raw materials.

We Have Substantial Sales and Manufacturing Operations Outside of the United States Subjecting Us to Risks Common to International Operations.

We sell products and operate facilities in numerous countries outside the United States. For the fiscal year ended December 31, 2001, sales to our international customers comprised approximately 14.1% of our net sales. We expect our sales to international customers to account for a greater portion of our revenues in future fiscal periods. Additionally, we utilize third-party manufacturers located principally in The People s Republic of China. These sales and manufacturing operations are subject to the risks normally associated with international operations, including:

currency conversion risks and currency fluctuations;

limitations, including taxes, on the repatriation of earnings;

political instability, civil unrest and economic instability;

greater difficulty enforcing intellectual property rights and weaker laws protecting such rights;

complications in complying with laws in varying jurisdictions and changes in governmental policies;

greater difficulty and expenses associated with recovering from natural disasters;

transportation delays and interruptions; and

the potential imposition of tariffs.

Our reliance on external sources of manufacturing can be shifted, over a period of time, to alternative sources of supply, should such changes be necessary. However, if we were prevented from obtaining products or components for a material portion of our product line due to political, labor or other factors beyond our control, our operations would be disrupted while alternative sources of products were secured. Also, the imposition of trade sanctions by the United States against a class of products imported by us from, or the loss of normal trade relations status by China, could significantly increase our cost of products imported from that nation. Because of the importance of our international sales and international sourcing of manufacturing to our business, our financial condition and results of operations could be significantly and adversely affected if any of the risks described above were to occur.

Our Business Is Subject to Extensive Government Regulation and to Potential Product Liability Claims

Our business is subject to various laws, including the Federal Hazardous Substances Act, the Consumer Product Safety Act, the Flammable Fabrics Act and the rules and regulations promulgated under these acts. These statutes are administered by the Consumer Product Safety Commission (CPSC), which has the authority to remove from the market products that are found to be defective and present a substantial hazard

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or risk of serious injury or death. The CPSC can require a manufacturer to recall, repair or replace these products under certain circumstances. We cannot assure you that defects in our products will not be alleged or found. Any such allegations or findings could result in:

- product liability claims;
- loss of sales;
- diversion of resources;
- damage to our reputation;
- increased warranty costs; and
- removal of our products from the market.

Any of these results may adversely affect our business, financial condition and results of operations. There can be no assurance that our product liability insurance will be sufficient to avoid or limit our loss in the event of an adverse outcome of any product liability claim.

We Depend on Our Proprietary Rights

We rely on trademark, copyright and trade secret protection, nondisclosure agreements and licensing arrangements to establish, protect and enforce our proprietary rights in our products. The laws of certain foreign countries may not protect intellectual property rights to the same extent or in the same manner as the laws of the United States. We cannot assure you that we or our licensors will be able to successfully safeguard and maintain our proprietary rights. Further, certain parties have commenced legal proceedings or made claims against us based on our alleged patent infringement, misappropriation of trade secrets or other violations of their intellectual property rights. We cannot assure you that other parties will not assert intellectual property claims against us in the future. These claims could divert our attention from operating our business or result in unanticipated legal and other costs, which could adversely affect our business, financial condition and results of operations.

Market Conditions and Other Third-Party Conduct Could Negatively Impact Our Margins and Implementation of Other Business Initiatives.

Economic conditions, such as rising fuel prices and decreased consumer confidence, may adversely impact our margins. In addition, general economic conditions were significantly and negatively affected by the September 11th terrorist attacks and could be similarly affected by any future attacks. Such a weakened economic and business climate, as well as consumer uncertainty created by such a climate, could adversely affect our sales and profitability. Other conditions, such as the unavailability of electronics components, may impede our ability to manufacture, source and ship new and continuing products on a timely basis. Significant and sustained increases in the price of oil could adversely impact the cost of the raw materials used in the manufacture of our products, such as plastic.

The Market Price of Our Common Stock May Be Volatile

Market prices of the securities of toy companies are often volatile. The market price of our common stock may be affected by many factors, including:

- fluctuations in our financial results;
- the actions of our customers and competitors, including new product line announcements and introductions;
- new regulations affecting foreign manufacturing;
- other factors affecting the toy industry in general; and
- sales of our common stock into the public market.

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In addition, the stock market periodically has experienced significant price and volume fluctuations, which may have been unrelated to the operating performance of particular companies.

Future Sales of Our Shares Could Adversely Affect Our Stock Price

As of May 22, 2002, there were 19,668,787 shares of our common stock outstanding. An additional 912,467 shares of our common stock are issuable upon the exercise of currently exercisable options. If all these shares were issued, we would have 20,581,254 shares of our common stock outstanding. In addition, 833,346 shares of our common stock are issuable upon the exercise of outstanding options that are not currently exercisable. We are required to register an additional 646,384 shares of our common stock that we issued in connection with our purchase of our controlling interest in Toymax. These shares may not be sold until after we acquire the remaining shares of Toymax common stock. In addition, no more than 25% of these shares may be sold in any given quarter during the 12-month period following our purchase of the remaining shares of Toymax common stock. Furthermore, we anticipate issuing and registering approximately 325,853 additional shares of our common stock upon our purchase of the remaining shares of Toymax common stock. Any sale of a substantial number of shares of our common stock in the public market after this offering, or the perception that such sales could occur, may adversely affect the market price of our common stock.

Our Ability To Issue Blank Check Preferred Stock and Our Obligation to Make Severance Payments Could Prevent or Delay Takeovers

Our certificate of incorporation authorizes the issuance of blank check preferred stock (that is, preferred stock that our board of directors can create and issue without prior stockholder approval) with rights senior to those of our common stock. In addition, our employment agreements with certain of our senior officers require us, under certain conditions, to make substantial severance payments to them if they resign after a change of control. These provisions could delay or impede a merger, tender offer or other transaction resulting in a change in control of JAKKS, even if such a transaction would have significant benefits to our stockholders. As a result, these provisions could limit the price that certain investors might be willing to pay in the future for shares of our common stock.

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USE OF PROCEEDS

The sale of our common stock in this offering will result in net proceeds to us of approximately $49.7 million and the selling stockholders will receive net proceeds of approximately $8.4 million. If the underwriters over-allotment option is exercised in full, we will receive additional net proceeds of approximately $8.8 million. We will not receive or benefit from any proceeds from the sale of shares by the selling stockholders, except that we will receive approximately $2.4 million upon the exercise of options by the selling stockholders to purchase 350,078 shares that are being sold in this offering.

We intend to use approximately $12.3 million of the net proceeds of this offering received by us to complete the purchase of the remaining shares of Toymax common stock and approximately $37.4 million of the net proceeds will be used to finance potential acquisitions of companies, licenses, brands, and product lines, for product development, for working capital and general corporate purposes.

Depending on future events, we may determine at a later time to use our net proceeds for different purposes or to allocate our net proceeds differently among the uses described above. The amounts and timing of our actual expenditures will depend upon numerous factors, including the amount and extent of our acquisitions, our product development activities, our investments in technology and the amount of cash generated by our operations. Actual expenditures may vary substantially from our estimates. We may find it necessary or advisable to use portions of the proceeds for other purposes. Our failure to use such funds effectively could have a material adverse effect on our business, results of operations and financial condition. Pending application of the net proceeds, we intend to invest the net proceeds of this offering in short-term, investment-grade, interest-bearing securities.

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PRICE RANGE OF COMMON STOCK

Our common stock is traded on the Nasdaq National Market under the symbol JAKK. The following table sets forth, for the periods indicated, the range of high and low sale prices for our common stock, as reported by the Nasdaq National Market.

	Sales Prices	
	High	Low
2000		
First quarter	$25.19	$13.94
Second quarter	25.00	13.25
Third quarter	20.75	9.00
Fourth quarter	10.56	7.00
2001		
First quarter	$15.00	$ 8.00
Second quarter	19.44	8.78
Third quarter	21.80	12.60
Fourth quarter	25.38	12.44
2002		
First quarter	$23.70	$15.85
Second quarter (through May 22, 2002)	$23.49	$15.91

As of May 22, 2002, there were approximately 107 holders of record of our common stock. On May 22, 2002, the last sale price of our common stock reported on the Nasdaq National Market was $18.00 per share.

DIVIDEND POLICY

We intend to retain our future earnings, if any, to finance the growth and development of our business, and, accordingly, we do not plan to pay any cash dividends on our common stock in the foreseeable future. The loan agreement relating to our revolving credit line prohibits some of our subsidiaries from distributing funds to us without the lenders consent.

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CAPITALIZATION

The following table reflects our actual capitalization as of March 31, 2002 and as adjusted to reflect the cancellation of 1,493,600 shares of our common stock held by us in treasury and the receipt and application of the net proceeds from the sale of our common stock offered by us hereby at a public offering price of $17.75 per share, after deducting the underwriting discount and estimated offering expenses and the receipt of the option price from the selling stockholders of $2,354,754 upon the exercise of options to purchase 350,078 shares that are being sold in this offering.

	As of March 31, 2002	
	Actual	**As Adjusted**
	(in thousands)	
Cash and cash equivalents	$ 14,937	$ 67,014
Long-term debt(1)	$ 108	$ 108
Stockholders equity:		
Common stock, $.001 par value; 25,000,000 shares authorized, 21,162,387 shares issued and outstanding, actual; 25,000,000 shares authorized, 23,018,865 shares issued and outstanding, as adjusted	21	23
Additional paid-in capital	182,444	221,608
Treasury stock; at cost, 1,493,600, actual; nil, as adjusted	(12,911)	
Retained earnings	91,336	91,336
Total stockholders equity	260,890	312,967
Total capitalization	$260,998	$313,075

(1) Long-term debt includes a current portion of $31,631 as of March 31, 2002.

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SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated statement of operations data and selected consolidated balance sheet data have been derived from our audited consolidated financial statements, which are incorporated by reference in this prospectus. You should read the financial data set forth below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and notes incorporated by reference in this prospectus.

	Year Ended December 31,					Three Months Ended March 31,	
	1997	1998	1999	2000	2001	2001	2002
	(in thousands, except per share data)						
Consolidated Statement of Operations Data:							
Net sales	$41,945	$85,253	$183,685	$252,288	$284,309	$59,962	$59,895
Cost of sales	25,875	52,000	107,602	149,881	164,222	35,494	33,425
Gross profit	16,070	33,253	76,083	102,407	120,087	24,468	26,470
Selling, general and administrative expenses	11,895	24,007	51,154	80,435	89,575	16,894	18,430
Acquisition shut-down and product recall costs				1,469	1,214	306	6,622
Income from operations	4,175	9,246	24,929	20,503	29,298	7,267	1,419
(Profit)/loss from joint venture			(3,605)	(15,906)	(6,675)	(728)	(1,297)
Interest, net	418	423	(1,588)	(3,833)	(2,057)	(485)	(268)
Other (income)/expense	328	591	(182)	(92)			
Income before provision for income taxes and minority interest	3,429	8,232	30,304	40,334	38,030	8,480	2,984
Provision for income taxes	643	1,857	8,334	11,697	9,797	2,459	806
Income before minority interest	2,786	6,375	21,970	28,637	28,233	6,021	2,178
Minority interest							22
Net income	$ 2,786	$ 6,375	$ 21,970	$ 28,637	$ 28,233	$ 6,021	$ 2,156
Basic earnings per share	$ 0.40	$ 0.75	$ 1.55	$ 1.50	$ 1.55	$ 0.33	$ 0.11
Weighted average shares outstanding	6,932	8,539	13,879	19,060	18,199	18,008	19,017
Diluted earnings per share	$ 0.35	$ 0.59	$ 1.39	$ 1.41	$ 1.45	$ 0.32	$ 0.11
Weighted average shares and equivalents outstanding diluted	9,103	11,403	15,840	20,281	19,410	18,920	20,236

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	As of December 31,					As of March 31,
	1997	1998	1999	2000	2001	2002
	(in thousands)					
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$ 2,536	$12,452	$ 57,546	$ 29,275	$ 25,036	$ 14,937
Working capital	3,368	13,736	113,170	86,897	116,487	82,006
Total assets	43,605	58,736	232,878	248,722	284,041	330,704
Long-term debt, net of current portion	6,000	5,940	9	1,000	73	76
Total stockholders equity	25,959	37,754	187,501	204,530	244,403	260,890

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BUSINESS

Company Overview

We are a leading multi-line, multi-brand toy company that designs, develops, produces and markets toys and related products. We focus our business on acquiring or licensing well-recognized trademarks and brand names with long product histories (evergreen brands). We seek to acquire these evergreen brands because we believe they are less subject to market fads or trends. Our products are typically simpler, lower-priced, toys and accessories and include:

Action figures and accessories including licensed characters, principally based on *World Wrestling Entertainment,* and toy vehicles, including *Road Champs* die-cast collectibles and *Remco* toy vehicles and role-play toys and accessories;

Craft, activity and stationery products, including *Flying Colors* activity sets, compounds, playsets and lunch boxes, and *Pentech* writing instruments, stationery and activity products;

Child Guidance infant and pre-school electronic toys, toy foam puzzle mats and blocks, activity sets, outdoor products, plush toys and slumber bags; and

Fashion and mini dolls and related accessories, including *Disney* Princesses sold exclusively in the Disney Store.

We continually review the marketplace to identify and evaluate evergreen brands that we believe have the potential for significant growth. We generate growth within these brands by:

creating innovative products under established brand names;

focusing our marketing efforts to enhance consumer recognition and retailer interest;

linking them with our evergreen portfolio of brands;

adding new items to the branded product lines that we expect will enjoy greater popularity; and

adding new features and improving the functionality of products in the line.

In addition to developing our proprietary brands and marks, we license brands such as *World Wrestling Entertainment, Nickelodeon, Rugrats, Blue s Clues, Mickey Mouse, Barney, Sesame Street, Winnie the Pooh* and *Hello Kitty and Car and Driver.* Licensing enables us to use these high-profile marks at a lower cost than we would incur if we purchased these marks or developed comparable marks on our own. By licensing marks, we have access to a far greater range of marks than would be available for purchase. We also license technology produced by unaffiliated inventors and product developers to improve the design and functionality of our products.

We have capitalized on our relationship with the WWE by obtaining an exclusive worldwide license for our joint venture with THQ, which develops, produces, manufactures and markets video games based on *World Wrestling Entertainment* characters and themes. Since the joint venture s first title release in 1999, it has released 11 new titles. We have received $27.5 million as our share of the joint venture s profit through March 31, 2002.

Our March 11, 2002, we acquired a controlling interest in Toymax, a developer and marketer of toys and related products, which added toy brand names such as *Laser Challenge* and *Creepy Crawlers* to our brand portfolio. In addition, pool-related products branded under the name *Funnoodle* and kites branded under the name *Go Fly a Kite* further diversify our portfolio with products popular in the spring and summer seasons.

Most of our current products are relatively simple and inexpensive toys. In 2001, approximately 70% of our revenue came from products priced less than ten dollars at retail. We believe that these products have enduring appeal and are less subject to general economic conditions, toy product fads and trends, and changes in retail distribution channels. As of March 31, 2002, we had over 4,300 products and 19 product categories. In addition, the simplicity of these products enables us to choose among a wider range of manufacturers and

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affords us greater flexibility in product design, pricing and marketing. Our product development process typically takes from three to nine months from concept to production and shipment to our customers. We believe that many licensors and retailers recognize and reward our ability to bring product to market faster and more efficiently than many of our competitors.

We sell our products through our in-house sales staff and independent sales representatives to toy and mass-market retail chain stores, department stores, office supply stores, drug and grocery store chains, club stores, toy specialty stores and wholesalers. The *Road Champs, Flying Colors* and *Pentech* products also are sold to smaller hobby shops, specialty retailers and corporate accounts, among others. Our five largest customers are Target, Kmart, Toys R Us, Wal-Mart, and Kay Bee Toys, which collectively accounted for approximately 54.7% of our net sales in 2001. We have over 10,000 other customers, none of which accounted for more than 2.0% of our net sales in 2001.

Our Growth Strategy

The successful execution of our growth strategy has resulted in increased revenues and earnings. From 1996 to 2001, our net sales, EBITDA and net income grew at a compound annual rate of 88.2%, 95.0% and 88.7%, respectively. In 2001, we generated net sales and EBITDA of $284.3 million and $44.1 million, respectively. Key elements of our growth strategy include:

Expand Core Products. We manage our existing and new brands through strong product development initiatives, including introducing new products, modifying existing products and extending existing product lines. Our product designers strive to develop new products or product lines to offer added technological, aesthetic and functional improvements to our product lines. In 2001, we expanded the use of real-scan technology in our action toys, which produces higher quality and better likenesses of the representative characters and vehicle parts. In addition, we introduced action figures with significantly greater ranges of motion, and expanded our electronic action figure recognition play sets.

Enter New Product Categories. We will continue to use our extensive experience in the toy and other industries to evaluate products and licenses in new product categories and to develop additional product lines. We have entered the plush toy category through the licensing of *Pound Puppies,* as well as through the creation of our own *Limbo Legs,* and expanded into slumber bags through the licensing of this category from our current licensors, such as Nickelodeon.

Pursue Strategic Acquisitions. We intend to supplement our internal growth rate with selected strategic acquisitions. Since our inception in 1995, we have successfully completed and integrated nine acquisitions of companies and trademarks. These include our acquisitions of Justin Products, Road Champs, *Remco, Child Guidance,* Berk, Flying Colors, Pentech, Kidz Biz and most recently, our controlling interest in Toymax. We will continue focusing our acquisition strategy on businesses or brands that have compatible product lines and offer valuable trademarks or brands.

Acquire Additional Character and Product Licenses. We have acquired the rights to use many familiar corporate, trade and brand names and logos from third parties that we use with our primary trademarks and brands. Currently, we have license agreements with the WWE, Nickelodeon, Disney, and Warner Bros., as well as with the licensors of the many popular licensed children s characters previously mentioned, among others. We intend to continue to pursue new licenses from these entertainment and media companies and other licensors. We also intend to continue to purchase additional inventions and product concepts through our existing network of product developers.

Expand International Sales. We believe that foreign markets, especially Europe, Australia, Canada, Latin America and Asia, offer us significant growth opportunities. In 2001, our sales generated outside the United States grew 78% to approximately $40.0 million, or 14.1% of total sales. We intend to continue to expand our international sales by capitalizing on our experience and our relationships with foreign distributors and retailers. Our recent expansion efforts included entering into a distribution agreement with Funtastic Ltd., an Australia based toy distributor. In addition, in December 2001, we acquired Kidz Biz for its distribution channels in the United Kingdom and surrounding territories. We expect both initiatives to contribute to our continued international growth in 2002.

Capitalize On Our Operating Efficiencies. We believe that our current infrastructure and low-overhead operating model can accommodate significant growth without a proportionate increase in our operating and administrative expenses, thereby increasing our operating margins.

Industry Overview

According to the TIA, the leading toy industry trade group, the United States is the world s largest toy market, followed by Japan and Western Europe. Total retail sales of toys, excluding video games, in the United States, were approximately $25.0 billion in 2001. Sales by domestic toy manufacturers to foreign customers exceeded $5.0 billion in 2001. We believe the two largest United States toy companies, Mattel and Hasbro, collectively hold a dominant share of the domestic non-video toy market. In addition, hundreds of smaller companies compete in the design and development of new toys, the procurement of character and product licenses, and the improvement and expansion of previously introduced products and product lines. In the United States video game segment, total retail sales of video game software were approximately $9.4 billion in 2001.

Over the past few years, the toy industry has experienced substantial consolidation among both toy companies and toy retailers. We believe that the ongoing consolidation of toy companies provides us with increased growth opportunities due to retailers desire to not be entirely dependent on a few dominant toy companies. Retailer concentration also enables us to ship products, manage account relationships and track retail sales more effectively and efficiently.

Products

We focus our business on acquiring or licensing well-recognized trademarks or brand names, and we seek to acquire evergreen brands which are less subject to market fads or trends. Some of our license agreements for products and concepts call for royalties ranging from 1% to 6% of net sales, and some may require minimum guarantees and advances. Our principal products include:

World Wrestling Entertainment Action Figures and Accessories

We have an extensive toy license with the WWE pursuant to which we have the exclusive worldwide right, until December 31, 2009, to develop and market a full line of toy products based on the popular *World Wrestling Entertainment* professional wrestlers. These wrestlers perform throughout the year at live events that attract large crowds, many of which are broadcast on free and cable television, including pay-per-view specials. We launched this product line in 1996 with various series of 6 inch articulated action figures that have movable body parts and feature real-life action sounds from our patented bone-crunching mechanism that allows the figures bones to crack when they are bent. We continually expand and enhance this product line by using technology in the development and in the products themselves. The 6 inch figures currently make up a substantial portion of our overall *World Wrestling Entertainment* line, which has since grown to include many other new products including playsets using interactive technology. Our strategy has been to release new figures and accessories frequently to keep the line fresh and to retain the interest of the consumers.

Flying Colors/ Pentech Activity Sets, Compound Playsets, Writing Instruments and Lunch Boxes

Through our acquisition of Flying Colors Toys we entered into the toy activity category with compounds and plastic molded activity cases containing a broad range of activities, such as make and paint your own characters, jewelry making, art studios, posters, puzzles and other projects. The activity cases, with molded and painted likenesses of popular characters, such as Nickelodeon s *Rugrats* and *Blue s Clues, Powerpuff Girls®, Looney Tunes®, Hello Kitty* and *Scooby Doo®*, have immediate visual appeal. Using a related production technology, our lunch boxes complement this line with similarly-styled molded and painted likenesses featuring these and other popular characters. Through our acquisition of Pentech International in

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2000, we expanded the other categories of products offered by Flying Colors, which now include stationery, back-to-school pens, pencils, markers and notebooks.

Our compounds represent another significant area of emphasis for Flying Colors. Launched under the *Blue s Clues* license, this line has expanded from play clay in a bucket to an entire *Blue s Clues* playset featuring book molds, extrusion and other devices. We are continuing to expand the compound area and have introduced a full line of innovative compounds under the *Nickelodeon* brand, including *Goooze*®, *Zyrofoam*® and *Gak Splat*™, among others.

Wheels Division Products

Road Champs die-cast collectible and toy vehicles

The *Road Champs* product line consists of highly detailed, die-cast replicas of new and classic cars, trucks, motorcycles, emergency vehicles and service vehicles, primarily in 1/43 scale (including police cars, fire trucks and ambulances), buses and aircraft (including propeller planes, jets and helicopters). Through licenses, we produce replicas of well-known vehicles including those from *Ford*®, *Chevrolet*® and *Porsche*®. We believe that these licenses, increase the perceived value of the products and enhance their marketability.

Extreme sports die-cast collectibles and toy vehicles and action figures

In 1999, we launched our extreme sports category with a new line of die-cast bicycles called *BXS*®. These BMX-style bicycles feature removable and interchangeable parts for complete customization by users as well as working cranks. We have licensed the *Schwinn*®, *GT*® and *Haro*® brand names, among others, as well as the names of some of the top riders, such as Dave Mirra and Ryan Nyquist, for use in connection with this product line.

In 2000, we expanded our extreme sports offerings with the introduction of our *MXS*® line of motorcycles with riders featuring click n grip functionality which allows the user to release the rider from the motorcycle seat and perform the signature moves of the sport s top riders. Other additions included off-road vehicles, personal watercraft, surfboards and skateboards, all sold individually and with playsets and accessories.

*BattleBots® and Junkyard Wars*TM

We introduced product lines featuring assembled and non-assembled vehicles and playsets, which create a do-it-yourself play pattern, based on the *BattleBots* and *Junkyard Wars* television shows.

Remco toy vehicles and role-play

Our *Remco* toy line includes toy vehicles, role-play and other toys. Our toy vehicle line is comprised of a large assortment of rugged die-cast and plastic vehicles that range in size from four and three-quarter inch to big-wheeled seventeen inch vehicles. The breadth of the line is extensive, with themes ranging from emergency, fire, farm and construction, to racing and jungle adventure.

We offer a variety of branded and non-branded role playsets in this new category under the *Remco* name. Themes include *Caterpillar*® construction, *B.A.S.S. Masters*® fishing, police, fire and *NASA*®. Additionally, capitalizing on the popularity of World Wrestling Entertainment, we introduced a *World Wrestling Entertainment* role-play product, which will give children the opportunity to dress like and imagine being one of their favorite wrestling superstars.

Child Guidance

Infant and pre-school toys

Our line of pre-school electronic toys features products that enhance sensory stimulation and learning through play, while offering value to the trade as well as to the consumer. Our products are designed for children ages two and under. We have combined the fun of music, lights, motion and sound with the early introduction of numbers, letters, shape and color recognition, all at a value price. These products carry the

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Good Housekeeping Seal of Approval®. In 2001, we introduced a line of musical toys in conjunction with Baby Genius, the marketer of a popular line of music-oriented CDs and home videos whose aim is to stimulate the development of young children through music.

In addition to creating products internally, we often acquire products and concepts from numerous toy inventors with whom we have ongoing relationships. Both development of internally-created items and acquiring items are ongoing efforts. In either case, it may take as long as nine months for an item to reach the market. As part of an effort to keep the product line fresh and to extend the life of the item, we create new packaging, change sound chips and change product colors from time to time.

Plush toys

In 2000, we entered this category by licensing for reintroduction *Pound Puppies* and have since expanded our offerings with the internally developed *Limbo Legs,* a collection of 6 inch and 12 inch long-legged animals in a variety of colors and fabrics.

Foam puzzle mats and playsets

The acquisition of Berk in 1999 added the foam toy category to our business. We incorporated this new toy category into our *Child Guidance* product line, based on the demographics and target market for foam toy products. This line further expanded the breadth of our *Child Guidance* brand. The foam toy products include puzzle mats featuring licensed characters, such as *Winnie the Pooh, Blue s Clues, Barney, Teletubbies*® and *Sesame Street,* among others, as well as letters of the alphabet and numbers. The inter-locking puzzle pieces can also be used to build houses and other play areas. Other products include foam puzzles of the United States, foam vehicles and outdoor foam products.

Fashion and Mini Dolls and Related Accessories

We produce various proprietary and licensed fashion and mini dolls and accessories for children between the ages of three and ten. The proprietary product lines include 11 1/2 inch fashion dolls customized with high-fashion designs that correspond with particular holidays, events or themes, and fashion dolls based on children s classic fairy tales and holidays. We also produce licensed 15 1/2 inch dolls based on the fashion magazine *Elle*®, and 11 1/2 inch dolls based on the feature films, *Charlie s Angels*™ and *Josie and the Pussycats*™. These dolls feature a new skeleton with more realistic features and movement. We also have an agreement with The Disney Store to manufacture a full line of dolls under a private label which features *Disney* Princesses and classic Disney characters.

For 2002, we created a new assortment of 6 inch dolls called the *Fresh Look Friends*™ and a line of 4 inch dolls consisting of puppies that have magnetic mechanisms that allow children to perform tricks and to create action with the toys. We also created playsets in the form of houses for these dolls, which are sold under the *Tiny Tots in Puppy Towne*™ label.

Our in-house product developers originate the design and functionality of most of our fashion dolls. In many cases, they work with retailers and incorporate their input on doll characteristics, packaging and other design elements to create exclusive product lines for them.

World Wrestling Entertainment Video Games

In June 1998, we formed a joint venture with THQ, a developer, publisher and distributor of interactive entertainment software for the leading hardware game platforms in the home video game market. The joint venture entered into a license agreement with the WWE under which it acquired the exclusive worldwide right to publish *World Wrestling Entertainment* video games on all hardware platforms. The term of the license agreement expires on December 31, 2009, and the joint venture has a right to renew the license for an additional five years under various conditions.

The games are designed, developed, manufactured and distributed by THQ. THQ arranges for the manufacture of the CD-ROMs and game cartridges used in the various video game platforms, under non-exclusive licenses held by Sony, Nintendo, Sega and Microsoft. No other licenses are required for the manufacture of the personal computer titles.

Through June 30, 2006, we are entitled to receive a guaranteed preferred return from the joint venture at varying rates of net sales of the video games depending on the cumulative unit sales and platform of each particular game, as well as on the royalties earned by the joint venture from the publishing of game guides by third parties. After June 30, 2006, the amount of our preferred return from the joint venture will be subject to renegotiation between THQ and us. The minimum preferred return from the joint venture to be distributed to us in each of the years in the period ending December 31, 2003 is $2.6 million per year. THQ is entitled to receive the balance of the profits.

The joint venture currently publishes titles for the Sony *PlayStation*® and *PlayStation 2*®, *Nintendo 64*® and *GameCube*® and Microsoft *Xbox*® consoles, Nintendo *Game Boy Color*® and *Game Boy Advance*® hand-held platforms and personal computers. The joint venture launched its first products, a video game for the Nintendo 64 platform and a video game for *Game Boy Color,* in November 1999. It will also publish titles for new hardware platforms, when and as they are introduced to the market and have established a sufficiently installed base to support new software. Thes