2007: the year in review

JAKKS Pacific

JAKKS Pacific®

THE "TOYING OF TECHNOLOGY"

Focusing In: The *EyeClops®* *Bionic Eye*

Take it to the Web

Get Moving

THE YEAR OF *HANNAH MONTANA®* TOYS

ALSO MICROECONOMICS IN TOYLAND

TREND ALERT: WHO DOESN'T LOVE CUPCAKES?

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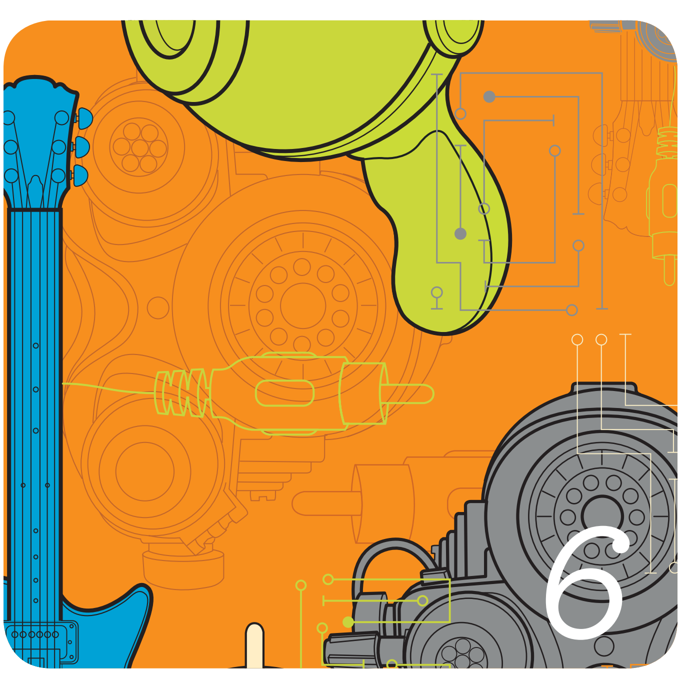

JAKKS Cares
A Division of JAKKS Pacific, Inc.™

THIS BOOK WAS PRINTED WITH THE EARTH IN MIND

JAKKS Pacific is committed to being a philanthropic and socially responsible corporate citizen. Through our JAKKS Cares™ program we support charitable organizations that improve the lives and well-being of children around the world and also seek ways to Reduce, Reuse and Recycle to help save our planet for generations to come. For this year's Annual Report, our printer and paper stock support our commitment to sustainability.

The paper for this magazine is FSC-certified. The cover and text papers used are made from 25% post consumer waste. The paper is certified by SmartWood for the Forest Stewardship Council for responsibly managed forests. The vegetable based inks are formulated to contain significantly reduced VOCs.

For more on *JAKKS Cares*, check out page 22.

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Product group from well-managed forests, controlled sources and recycled wood or fiber
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The impact of printing this magazine with this green-friendly paper rather than using another equivalent virgin-fiber, coated paper is as follows:*

18.9 fully grown trees saved

8,022 gallons of water conserved

888 lbs. of solid waste NOT headed to landfills

1,748 lbs. in greenhouse gases prevented

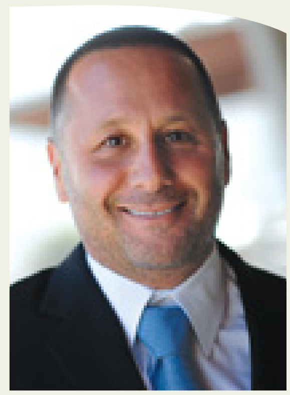
13.3M BTUs of energy NOT consumed

*Calculations are based on research done by Burgo, Ink Systems and ColorGraphics.

"thank you!"
– the trees

A Letter from the EDITORS

TO OUR STOCKHOLDERS:
AS WE REFLECT ON 2007, IT SEEMS WE WEATHERED A STORM WITH AN EVEN MORE ROBUST YEAR FOR JAKKS PACIFIC THAN EXPECTED. NET SALES FOR THE FULL YEAR INCREASED 12.0% TO A RECORD $857.1 MILLION, AND NET INCOME INCREASED A WHOPPING 48.3% FOR THE FOURTH QUARTER AND 24.3% FOR THE YEAR OVERALL, DESPITE AN OVERALL CHALLENGING RETAIL AND MANUFACTURING ENVIRONMENT. WE HAD SEVERAL MAJOR CONTRIBUTORS IN OUR PORTFOLIO, AND, ONCE AGAIN, CLASSIC BRANDS LEAD THE WAY.



Stephen G. Berman
President and
Chief Operating Officer

Jack Friedman
Chairman and
Chief Executive Officer

SIMPLE INNOVATION RULES

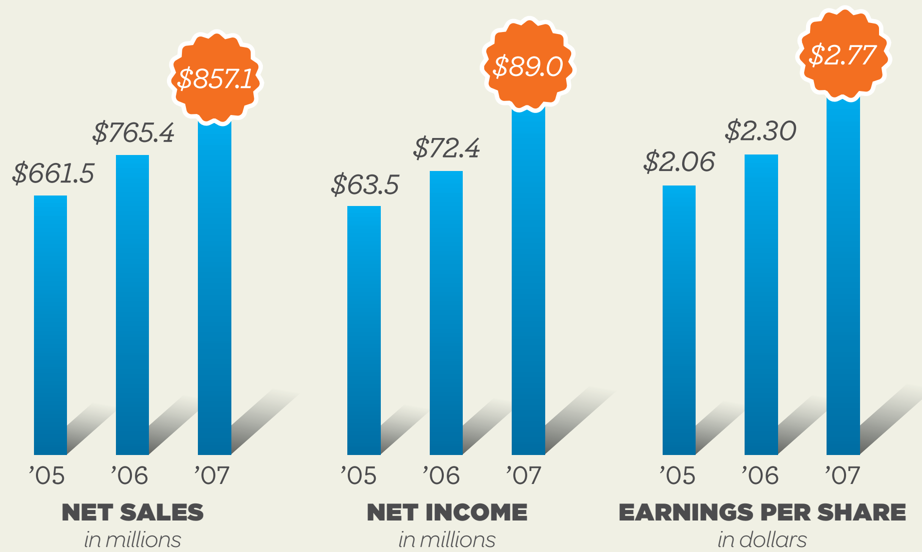
We stayed true to our philosophy of focusing on classic play patterns for our in-house and licensed brands, enhancing them with today's hot characters and trends, and wove-in simple technology, often making them "cooler" and more fun for today's sophisticated kids.

Our *EyeClops Bionic Eye*, developed in early 2007 and quickly brought to market, proved to be an award winning top toy in Fall 2007. The *EyeClops Bionic Eye* is a handheld microscope "in disguise," that uses our *Plug It In & Play TV Games* technology to see everyday things at 200 times magnification on any television. Chosen as the 2007 "Teacher's Pick" by Scholastic's *Instructor®* Magazine and nominated as "Toy of the Year" by the Toy Industry Association, The *EyeClops Bionic Eye* makes science fun for kids around the world. Our original *EyeClops Bionic Eye* also received "Toy of the Year" Awards in 2008 from Germany, Japan, France and Belgium.

For 2008, we extended the *EyeClops* brand into a full line of products. We applied our "Toying of Technology" concept, seeking out high-end technology as it comes down in price, and using it to develop toys based on popular trends at low price points which we believe will have mass appeal. Our *EyeClops Night Vision Goggles*, expected to be a top hit for the 2008 holiday season, is a great example. These are real, working, toy night vision goggles at $69 - $79, when others could cost much more. Our *UltiMotion™* video game system based off the hugely popular motion gaming craze is another example of JAKKS capitalizing on a hot trend and creating an affordable alternative for the masses.

We understand that with age compression of our young consumers, our job is not just to make high quality toys, but to make them highly appealing for today's experienced kids. Even toddlers want high tech gadgets that they see around them. As an example, the *Apple® iPhone™* product hit the market in 2007, selling an estimated 1.4 million *iPhone* units by the end of the year. In that time, JAKKS sold an estimated 4.3 million *Disney Princess™* toy cell phones to young chatterboxes who want to be just like mom and dad. Created by our CDI division, these and other novelty toys sold at check out counters nationwide generate a selling opportunity for JAKKS outside of the toy aisle and offer a great alternative for parents who would rather buy their child a play cell phone than a candy bar.

Kids as young as three are surfing the web. We have developed plush and other toys based on the immense online worlds of *Neopets.com®* (owned by MTV Networks) and *ClubPenguin.com™* (owned by Disney). *JAKKS™* toys are fashioned after the rich characters and environments millions of kids interact with each day at these virtual playgrounds, extending the web experience with tangible play patterns.



WITH A LITTLE HELP FROM OUR FRIENDS

Licensing remains an important part of our overall strategy, and we are proud to have received three distinguished Licensing Awards for excellence in 2007 at the 2008 International Licensing Show. Disney has been a tremendous licensing partner for JAKKS. We caught the wave in early 2007 and quickly brought to market a line of dolls, dress-up products and electronics based on the Disney Channel's hit show *Hannah Montana* and its popular star Miley Cyrus. Our extensive *Hannah Montana* toy line performed phenomenally well last year and was celebrated by the toy industry as "Property of the Year"! For 2008 we have a dynamic line-up for fans of all ages.

Classic *Disney Princess* role play toys were hugely popular among young kids in 2007. We expect new movies based on Disney's *Tinker Bell*™ and *Sleeping Beauty*™ characters coming out in Fall 2008 to extend our line of magical pretend products.

Other timeless favorites resonated with kids and young parents who played with many of the characters when they were kids. The *Care Bears*® characters celebrated 25 years in 2007 with a special Silver Anniversary plush toy, while the *Pokémon* character turned ten with a new *Diamond and Pearl*™ series. *The Smurfs*®, *Cabbage Patch Kids*® and *Barney*® characters celebrate 50, 25 and 20 years, respectively, in 2008, giving us occasion to celebrate these milestones with anniversary products at retailers around the world.

Our boys' action portfolio continues to perform for JAKKS, driven by *WWE* and *Pokémon* licensed action figures, which positioned JAKKS with two of the top five action figure lines at retail for 2007. In 2008 we introduce *NASCAR* toys, in 2009 we launch *UFC Ultimate Fighting Championship* toys, and in 2010, we introduce *TNA (Total Nonstop Action) Wrestling* toys to our portfolio.

American Kennel Club® and *Cat Fanciers' Association*® pet products continue to do very well in our pet area, and we are pleased with our line of *The Humane Society of the United States*® and other licensed product for dogs and cats.

We also worked hard in 2007 to seek out trends, and developed a number of new, homegrown brands, including our *Girl Gourmet*™ and *Spa Factory*™ lines of make-your-own kids gourmet food and spa products. We developed *So Chic Salon*™, *Juku Couture*™, *SpinZ*™ and other non-licensed brands throughout our divisions that launch in Fall 2008, and which we hope to nurture into long-term opportunities for JAKKS.

MICROECONOMICS IN TOYLAND

With the hot Summer months in 2007 came a heightened awareness of safety issues in China. While no one who manufactures overseas is immune, our testing procedures positioned us well, and JAKKS did not have products included in the recalls experienced by some of our peers. We did use it as an opportunity to further increase the number of quality control testers on the ground in mainland China, boost the amount of testing at various stages of the production process, and enhance the testing technology we require of all third party factories. Also, our testing laboratory in China was certified by the Chinese government.

Working closely with our licensors and retail partners, testing and retesting in this sensitive time has certainly increased costs, as all parties seek to mitigate risks. In addition, we have seen other costs rising at unprecedented rates, including oil, labor and resins, which have led to price increases for 2008. Reengineering packaging and products, and saving pennies here and there help us sustain margin criteria while maintaining product integrity. Even in a difficult economic environment, our products continue to sell well, and we are excited by the opportunities that lay ahead.

We ended 2007 with $356.7 million in working capital, including cash and equivalents of $241.3 million, leaving us with tremendous ability to execute on our acquisition strategy as we continue to actively seek-out the next gem to help grow JAKKS' burgeoning consumer products portfolio with the cash we have on hand. This is an investment into our future that we believe will be a fruitful one.

The portfolio of products we have developed and nurtured, along with our relationships with retailers, licensors and consumers have positioned us well for the future. We are working hard on behalf of our stockholders, and are determined to make 2008 the best year yet for JAKKS Pacific. We thank you for your continued support.

Sincerely,

Jack Friedman
Chairman and Chief Executive Officer

Stephen G. Berman
President and Chief Operating Officer

Girl POWER!

WHO WORE IT

Hannah Montana Toys

Miley Cyrus' popularity skyrocketed in '07.

In 2007 *Disney* "It Girl" Miley Cyrus, a.k.a. *Hannah Montana* teen pop star, hit the scene, and JAKKS was right there with her to catch the craze. Tween girls weren't the only ones who took notice of the teen phenom. *Hannah Montana* toys from JAKKS were nominated for "Girls Toy of the Year" by the Toy Industry Association and numerous retailers and media outlets also chose them as their top holiday picks for 2007.

The top-rated *Hannah Montana* TV series from Disney Channel fuses real life and fantasy in a way that translates perfectly to consumer products. When the *Hannah Montana & Miley Cyrus: Best of Both Worlds* 3-D movie debuted in February, it generated over $29M in opening weekend box office sales to become the biggest opening ever for a *Super Bowl*® weekend. In addition, Miley Cyrus picked up two *Kids' Choice*® awards for "Favorite Female Singer" and "Favorite Female Actress," while the *Hannah Montana* TV series received a "Favorite TV Show" nomination. Fans are eagerly awaiting all new episodes of the *Hannah Montana* TV series, which will air its third season in Fall 2008. It's no secret that kids and tweens are in love with the *Hannah Montana* pop star – and judging from the numerous awards and accolades that the toy line picked up in 2007, they're also in love with her toy line!

To continue the success into 2008, JAKKS and Disney Consumer Products will introduce an expanded line of new *Hannah Montana* products for the 2008 Holiday season, including a special Holiday-themed singing doll, the rockin' new *Hannah Montana Pop Tour Plug It In & Play Guitar*, new hairstyle wigs and role play accessories, and the most enormous *Hannah Montana* playset ever – the *Hannah Montana Malibu Beach House*.

BEST?

Hairspray the Movie

From JAKKS, authentic fashion dolls from the movie *Hairspray*, wearing signature fashions from the '07 remake, including the sassy, Amanda Bynes.

Stars LOVE JAKKS

THE CHEETAH GIRLS® TOYS

The Cheetah Girls sold over 2 million CDs of their original soundtrack and sold out an 80-city concert tour, and then stopped into the American International Toy Fair® trade show to help debut their new toy line with the help of "The Toy Guy" toy expert, Chris Byrne.

Camp Rock™ Toys

The Jonas Brothers rocked on this Summer in Disney Channel's original movie *Camp Rock*. JAKKS' line of *Camp Rock* products feature superstar *Shane Gray*™, played by Joe Jonas and *Mitchie Torres*™ played by Demi Lovato, Disney's newest sensation.

Taylor Swift® Toys

JAKKS to debut fashion dolls, playsets and the signature crystal guitar based on the Grammy-nominated American country music singer-songwriter in Fall 2008.

WWE Divas

WWE Diva Sensational Candace Michelle is widely known as the GoDaddy.com girl AND for her "Candy-licious" signature wrestling move.

SPOTLIGHT ON

TREND ALERT

Focusing In: *EyeClops Bionic Eye*

From video game controllers to scientific magnifiers – in 2007 JAKKS expanded on its award-winning *Plug It In & Play TV Game*™ technology and created the *EyeClops Bionic Eye*, a hip, handheld version of a traditional microscope for today's savvy kids. The *EyeClops Bionic Eye* was an eye-opening success in its first year, topping many retailer and media "Best Toy" and Holiday Gift lists in 2007 in addition to its two Toy Of The Year (T.O.T.Y.) nominations for "Best Educational" and "Most Innovative," as well as receiving the "Teacher's Pick" by Scholastic's *Instructor* Magazine.

JAKKS incorporates innovation and high-end technology to toys at price points that keep them affordable. For 2008, JAKKS worked to extend the retail opportunity by creating the *EyeClops* brand, and a whole line of products that allow kids to see things in a new way and discover the amazing world around them. JAKKS expects to launch several new *EyeClops* products in year two, with far reaching retail placement secured for Fall 2008.

"HANDS DOWN ONE OF THE COOLEST SCIENCE TOYS WE'VE SEEN THIS YEAR!"

Stephanie Oppenheim, Oppenheim Toy Portfolio®

The *EyeClops Night Vision Goggles* allow kids to see in total darkness. Normally found only in "real" night vision goggles, JAKKS sought out the technology and developed what the Company believes are the best "toy" night vision goggles ever created for a widely affordable price. Another extension, The *EyeClops BioniCam*™ product is a portable, recordable version of the original *EyeClops* toy that has a multi-zoom lens, memory features and more.

The EyeClops Night Vision Goggles

EVERY Classroom Should Have ONE!

The EyeClops Bionic Eye

WHAT ARE THESE?

We took some pictures using the *EyeClops Bionic Eye* at 200x zoom. Can you guess what these are?

ANSWERS: *ONE: Dollar bill. TWO: Butterfly. THREE: Dragonfly. FOUR: Shirt.*

"OUR FAVORITE 2007 EDUCATIONAL TOY.... THIS PRODUCT MIGHT BE SOLD IN TOY STORES, BUT DON'T BE FOOLED. EYECLOPS IS A POWERFUL MICROSCOPE THAT CAN TRANSFORM A TV SCREEN INTO A WORLD OF WONDER."

Warren Buckleitner, Editor-in-Chief, Children's Technology Review

TECHNOLOGY

HITTING THE JAKKS POT

JAKKS is a big winner in the plug and play category with the *Plug It In & Play TV Games* line that has generated over a billion dollars in sales. Now in year six, the *Plug It In & Play TV Games* brand is an "evergreen" business for JAKKS and steady sales continue with new titles for the young and old leisure gamers.

Plug It In & Play TV Games are all-in-one controllers that plug into the audio/video ports of any standard television for simple, easy-to-play games. The battery-powered systems contain multiple themed game titles based on the top retro video games of the 80s, such as *Pac-Man*® and *Atari*®, as well as games based on popular entertainment properties, including *SpongeBob SquarePants*® and *Disney Princess*. The JAKKS *Plug It In & Play TV Games* line also appeal to adult gamers with game show titles including *Wheel of Fortune*®, *Deal or No Deal*® and *Are You Smarter Than A 5th Grader?*®. *Plug It In & Play TV Games* controllers are small and portable, so kids can bring them on vacation or to grandma's house.

Unlike today's pricey consoles, JAKKS targets *Plug It In & Play TV Games* products to casual gamers who enjoy the low-priced gadgets and simple games, and kids who love their favorite brands, such as *Disney's Sleeping Beauty*™, *Power Rangers*®, *High School Musical*® and *Hannah Montana*.

Stars LOVE JAKKS

Celebrities such as Stacy Keibler and Ian Ziering plugged it in and played at the KIIS-FM Wango Tango® *concert gift lounge.*

TAKING IT ONLINE...

More and more kids are internet-savvy these days and JAKKS is right there with them. Tapping into the hugely popular interactive toys category, JAKKS aligned with the two kids entertainment giants and their respective virtual playgrounds *Neopets.com* from MTV Networks and *ClubPenguin.com* from Disney.

In 2007, JAKKS introduced the *Neopets*®. Based on the expansive virtual world of *Neopets.com,* the plush line hit retailers in early 2008. JAKKS' product line connects the youth-targeted virtual world to the real world, with a focus on collectible plush toys that tie in to the extensive variety of *Neopets* species and characters featured throughout the website. One of the most popular kids and tween online destinations, *Neopets.com* boasts over 44 million registered users worldwide.

In late 2008, JAKKS will introduce a fun and irreverent line tied into the cool igloo world of *Club Penguin*™ with a line of collectible plush and playsets embodying the parties, games, activities, characters and themes kids experience.

TREND ALERT

GET MOVIN' & GROOVIN'!

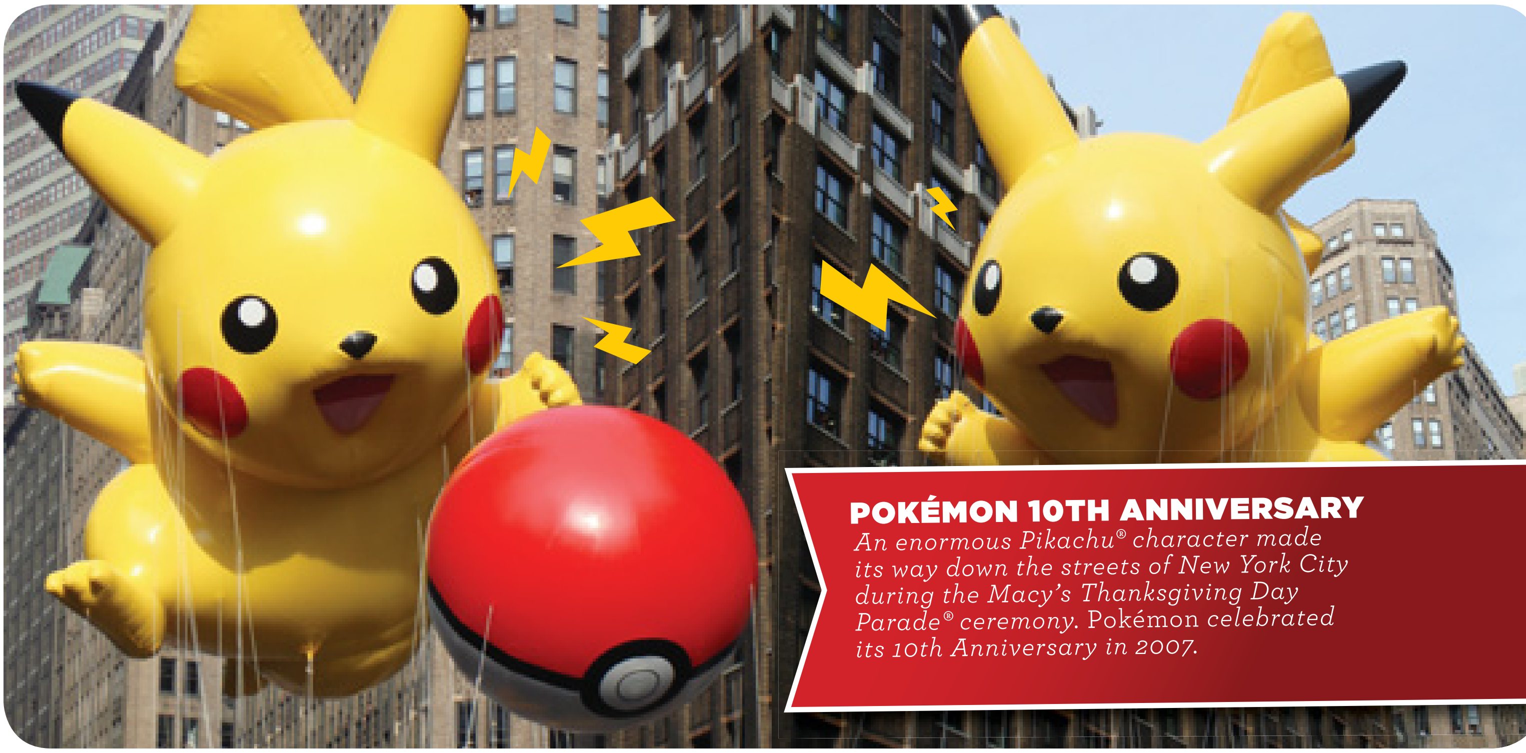
Motion games and rock stars are all the rage

This Fall, JAKKS capitalizes on hugely popular gaming trends with the introduction of the *UltiMotion* video game system and the *Hannah Montana Pop Tour Guitar*. The newest *Plug It In & Play TV Games* products are the latest example of JAKKS combining widely known play patterns with high-end technology to make affordable products with mass appeal.

The low-priced, high-tech *UltiMotion* system uses accelerometer technology that power some of today's pricier brand name motion gaming systems. Yet with the commitment to the "Toying of Technology," the JAKKS' *UltiMotion* gaming system costs a fraction of the popular brands, at well under $100. In addition, JAKKS made simple games on the *UltiMotion* system to appeal to leisure gamers and parents looking for a good deal in motion gaming.

"WII BEGETS A MOTION GAME. JAKKS PACIFIC OF MALIBU, CALIF., MAKES A SET OF CONTROLLERS THAT FALL SOMEWHERE BETWEEN THE WII CONTROLLER AND ACTIVISION'S GUITAR HERO PLAYED ON SONY'S PLAYSTATION 2...*JAKKS* SAYS IT HOPES TO ACHIEVE A ROLE-PLAYING DIMENSION IN VIDEO GAMES, MERGING THE GAMING AND TRADITIONAL TOY SPACES."
- CNBC.com

BOYS *will be* BOYS



POKÉMON 10TH ANNIVERSARY
An enormous Pikachu® character made its way down the streets of New York City during the Macy's Thanksgiving Day Parade® ceremony. Pokémon celebrated its 10th Anniversary in 2007.

'MON OF THE YEAR

Pikachu *character turns 10!*

"Remember *Squirtle*® and *Jigglypuff*™ characters? Suddenly, they're back and in high demand... the *Pokémon* franchise, which enjoyed a long run of popularity in the late 1990s, is a craze that has come back, for reasons that have as much to do with late corporate maneuvers as they do with the tastes of the average 7-year-old," said the New York Times on August 27, 2007.

After 10 years, the *Pokémon* franchise is as hot as ever. Nominated for both "Boys Toy of the Year" and "Property of the Year" for 2007 by the Toy Industry Association, the *JAKKS Pokémon* action figures made a huge mark on the toy scene. With the new *Diamond and Pearl* TV series airing 10 times per week on the *Cartoon Network*® Channel to top ratings, JAKKS had a healthy new portfolio of characters to work with. By the end of 2008 JAKKS will have released more than 100 new characters, with strong sales positioning and a top five action figure brand at many major retailers.

Following its unstoppable collectible strategy, JAKKS will extend the craze in 2008 with the *Pokémon Battle Links*™ System, giving fans a mission to collect and connect all the figures and bases to create a giant *Pokémon* universe.

A New Age Has Begun...

The timeless and fascinating *Narnia* films are based on the classic novels by C.S. Lewis, and have captured the hearts and the imagination of fans and collectors. *The Chronicles of Narnia: Prince Caspian* was the second story in the series to become a major motion picture, following the 2005 release of *The Lion, The Witch and The Wardrobe*, which garnered over $744 million in worldwide box office sales. Like its predecessor, *Prince Caspian* is a live-action and computer graphic imagery film directed by Andrew Adamson (*Shrek, Shrek 2*) and stars many of the same cast members who brought *The Lion, The Witch and The Wardrobe* to life.

"The Chronicles of Narnia is an ageless epic that captures children's imaginations and inspires fantasy role-play," said Tom Delaney, SVP of Marketing, JAKKS Play Along division. "We worked closely with Disney, the leader in family entertainment, to translate the new feature film into an exciting and multi-faceted product line that empowers kids to relive the action-packed scenes from the film and imagine they are part of the magical world of Narnia, rich with talking animals and mythical creatures. The line includes highly-detailed action figures and playsets, as well as realistic role play items."

CLASSIC SUPERSTARS

JAKKS caters to *WWE* fans and action figure collectors with action figures based on top *World Wrestling Entertainment*® Superstars, such as The Classic Superstars Collector Series, which combines the best in wrestling action from the past to the present with top-shelf collectability.

JAKKS is the first ever to feature this grouping of A-list wrestling Superstars from the 70s, 80s, 90s to the present. The Classic Superstars line targets the adult collector with high-end sculpts cool, collector packaging.

Since releasing the Classic Superstars line in early 2004, JAKKS Pacific has released more than 20 waves of figures and over 150 different Classic Superstars variations! JAKKS shipped more than 30 exclusive assortments to mass and specialty retailers in 2007. We are set to ship more than 400 unique *WWE* figures to retail in 2008, far surpassing any other action figure assortment at retail.

JAKKS BOOSTS ITS BRAWN!

JAKKS continues to amaze the action figure community, shipping more than 500 unique *WWE* and *Pokémon* figures to retailers in more than 60 countries around the world in 2007. In 2008, JAKKS added powerhouse male action products to the portfolio, including *NASCAR* and new *MXS*® *MotoCross* figures, and signed new license agreements for *American Gladiators*® and *UFC Ultimate Fighting Championship,* which are expected to launch in 2009.

As the world leader in fighting action figure toys, securing the *UFC* license was quite a coup, and a natural fit given the company's extensive expertise in developing and marketing collector driven sports action figures. *UFC's* enormous and growing mainstream popularity amongst adults, coupled with the extensive roster of physically powerful star fighters, gives JAKKS a substantial base to work with, and should be a robust combination for the line.

With the objective of providing collectors an authentic *UFC* experience, the *UFC* product line will be collector-focused, and the license covers *UFC* legend *Chuck "The Iceman" Liddell, Brock Lesnar, Antonio "Minotauro" Nogueira, Michael "The Count" Bisping* and *UFC Middleweight Champion Anderson "The Spider" Silva,* among others. The license also includes the famed *UFC Octagon*™, and role-play items based on the *UFC* brand and its classic and current roster of star fighters.

SMACKDOWN VS. RAW 2008

For the first time, the THQ/JAKKS Pacific Joint Venture shipped more than 5 million units of *WWE SmackDown vs. Raw 2008*™ video game simultaneously for every major platform, including *Sony PlayStation*®*3* and *PlayStation 2, PSP*® handheld, the *Nintendo Wii*™, *Nintendo DS*™ and *Xbox 360*®.

DID U KNOW?

Eccentric comedian Andy Kaufman and legendary WWE Superstar Jerry Lawlor wrestled throughout the south, culminating in a historic match on an episode of Late Night with David Letterman in 1982.

JAKKS shipped more than 30 exclusive assortments to mass and specialty retailers in 2007.

fun FACTS

TREND ALERT!

VINYL FIGURES

Urban Vinyl is a hot trend that capitalizes on an artistic conceptualization of a character or concept. The Boys Entertainment Marketing group at JAKKS capitalizes on this huge trend with a line of *WWE* vinyl figures collectible art.

Collectors can score *JAKKS* figures online, with online retailers including Figures Inc/Wrestling Superstores.com and RingsideCollectibles.com, generating multi-millions of dollars in sales of *WWE* figures and playsets.

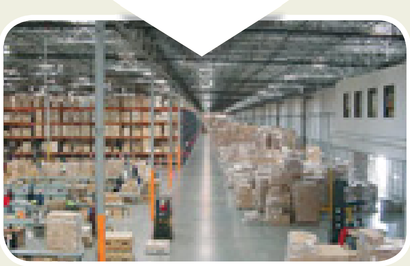
EYE *on* OPERATIONS

DID U KNOW?

JDC spans the length of 14 regulation football fields under one roof

JAKKS is a certified partner in the U.S. Customs-Trade Partnership Against Terrorism

State of the Art storage rack system



SPOTLIGHT ON SAFETY

JAKKS Pacific takes quality control and toy safety extremely serious and has since the company's inception. Extensive measures are in place to ensure that toys meet and often exceed the many stringent and important safety standards that have been established by several different governing bodies, including the Consumer Products Safety Commission, the American Society for Testing & Materials® Standard, the International Toy Council of Toy Industries, as well as the Toy Industry Association.

JAKKS has veteran Quality Control testers on the ground in mainland China that test products for many different issues, including lead paint content. Dozens of inspectors, mandatory random audits of factories, further inspections by our retailers and licensors, and a large percentage of FOB shipments, which require additional levels of inspections, all contribute to JAKKS high safety standards. JAKKS further increased the intensity of testing to include more sophisticated and stringent processes, and the latest technology, following recalls by some industry peers in the summer of 2007. JAKKS continues to diligently ensure the highest quality and safety standards for children and consumers.

JAKKS DISTRIBUTION CENTER (JDC)

From RFID to electric efficiency, JDC has it all

JAKKS currently operates two distribution centers in the United States. The bigger of which spans the length of 14 regulation football fields under its massive roof! With sophisticated systems throughout, our two distribution centers in California and Michigan, are both 100% controlled and run by JAKKS staff and are armed with the latest technology to service any situation. A state-of-the-art storage rack system allows us to use virtually every square foot to the optimum level, and in some portions inventory is stacked more than 30 feet high. We opened a new facility in Michigan in 2007 to handle the distribution of our *Funnoodle*® line for the entire Mid West and East Coast. It also helps save on freight costs from our domestic manufacturers and allows us to handle Canadian shipments in-house without relying on costly third party facilities.

A STATE OF THE ART STORAGE RACK SYSTEM ALLOWS US TO USE EVERY SQUARE FOOT TO THE OPTIMUM LEVEL, IN SOME PORTIONS INVENTORY IS STACKED MORE THAN 30' HIGH.

JAKKS CARES ACTIVITY AT JDC

Lighting is the single largest power use at our JDC warehouse. The new warehouse was built with triple the required skylights, to 3% of roof coverage, which eliminates the need to use electric lighting on sunny days. Projected savings is 60%-70% on monthly electricity bills and is estimated to have paid for itself in eight months. JDC warehouse uses only recycled pallets, which eliminates the need for over 260,000 pallets worth of wood annually.

All equipment at JDC is electric or runs on LP Natural Gas rather than Diesel, including dock equipment and forklifts, and JDC Irrigation for planters and grass is all recycled water, which originates from the City of Industry recycling plant.

RUNNING A TIGHT SHIP

We constantly leverage our growth as a company to negotiate better rates with our carriers, services and suppliers. When others are faced with large fuel surcharges, and increased costs, we're using our buying power and combining our efforts across all divisions to minimize the impact to JAKKS and consumers year after year.

JAKKS imports more than 11,000 containers a year

BBB® AWARD-WINNER

JAKKS operates its customer service department out of JDC, and in 2007 received a "AAA" rating for customer service satisfaction from the Better Business Bureau®.

MADE *in* AMERICA

Every year JAKKS looks for more opportunities to manufacture in the United States, and 2007 saw great strides. Most of the Funnoodle *pool toys line is made in the USA, as are* WWE Wrestling Rings, *and 100% of the ingredients for the Girl Gourmet play food line from JAKKS. In the* JAKKS Pets™ *division, all Pet Treat items, including* White Bites® Oral Care Dog Treats *and* AKC® jerky biscuits *were converted to domestic manufacturing in 2007. JAKKS uses American ingredients and keeps our products as fresh as possible.*

Girl Gourmet™

TREND ALERT

Who Doesn't Love Cupcakes?!

Girl Gourmet Cupcake Maker *predicted as favorite for 2008*

Cupcakes are a hot trend sweeping the nation, and through new food technologies, JAKKS breathes new life into the food play category with an innovative, and hip touch. Kid chefs can whip up delicious home-made cupcakes and other goodies at home in all the yummiest and trendiest flavors without needing an oven with the *Girl Gourmet* line. Launching in Fall 2008, JAKKS expects *Girl Gourmet* Cupcake Maker and homemade Ice Cream Sandwich Maker to be a delicious hit. "We are excited to launch our new *Girl Gourmet* product line, which capitalizes on the hugely popular cupcake trend," said Michael Rinzler, Vice-President of Marketing, JAKKS Pacific. "Cupcakeries are replacing bakeries, and these delicious cakes are the indulgence of choice at parties of all sorts, even taking the place of traditional birthday cakes! Now young girls can easily make cupcakes for their friends and family, just like Mom does, with the *JAKKS Girl Gourmet* product line, hitting retail shelves this Fall."

fun FACT

Fly Wheels® McDonald's® Promotion *The* Fly Wheels *toys from JAKKS spun into kid's lives packaged in Happy Meal® and Mighty Kids Meal® lunches from McDonald's. From July until August 2007, eight different* Fly Wheels *toys were offered in the popular children's meals at more than 14,000 McDonald's restaurant locations throughout the U.S. and Canada.* Fly Wheels *toys from* JAKKS Road Champs® *brand feature replica wheels and launchers that look just like the tires and propellers from real vehicles, including cars, motorcycles, bikes and skate boards – only on a smaller scale.*

Fast Food Nation

Subway, Pizza Hut, McDonald's and others entrust CDI™, a division of JAKKS, to cook up pretend food and role play products based on their beloved brands.

Tea Time! Tinker Bell™ Flower Top Café

is the perfect place for pixie play! "Magical" features include real running water sounds, delightful bubbling and whistling sounds.

Too Cool For School

3.5 million school kids got an eye-popping peek at the world when the *EyeClops Bionic Eye* was featured in September 2007 Back-to-School lunch menus nationwide.

Cabbage Patch Kids® Grow Up!

Burger King®, QVC®, Carvel® and Geico® Celebrate their 25th Anniversary

Commemorating their 25th

The *Cabbage Patch Kids* large doll line was the #1 selling large doll in 2007 (according to NPD). In 2008, JAKKS has big birthday plans with help from some great friends. To commemorate the 25th anniversary both Carvel and Burger King are throwing fun promotions throughout the year. The year-long *Celebration Foods*® and *Carvel* cross-promotions will include TV and print ads, franchise and supermarket point of sale signage, online promos, in-pack sweepstakes and an exclusive *Carvel* ice cream-eating, celebration-themed *Cabbage Patch Kid* dolls created by our *Play Along*® division. To keep the party going, Burger King launched sixteen different *Collectible Cabbage Patch Kids Mini* dolls available exclusively with the purchase of any BK® Kids Meal from February – March 2008 at participating *Burger King* restaurants. An integrated media campaign includes television spots, online content, in-restaurant signage and inclusion in the *Burger King* Adventures Newsletter, distributed in participating *Burger King* restaurants nationwide.

DID U KNOW?

Over 115 Million Cabbage Patch Kids *dolls have been "adopted" since 1983*

CPK® Adds Value

The *Play Along* division of JAKKS has worked with *QVC* to debut each new *Cabbage Patch Kid* doll within the collection since 2003. In December 2007, the high profile *25th Anniversary Cabbage Patch Kid* was launched on *QVC* with spectacular results. The doll debuted as a *QVC* Today's Special Value® at midnight on December 3 and exceeded expectations with more than 95,000 units ordered. CPK got another push when Geico Insurance featured the dolls in a $60 million ad campaign.

Think Global Act Local

What JAKKS is doing in the U.S. and across the globe

The EyeClops Bionic Eye is an International Star!

Honors include:

- *The Canadian Toy Testing Council 3-Star Rating*
- *Toys"R"Us® Canada's Toy of the Year award*
- *2008 Toy Innovation Award at the Nuremberg Toy Fair*
- *Recipient of "Das goldene Schaukelpferd" nomination, a prestigious consumer award in Germany and Austria, sponsored by "Familie und Co," the most popular family magazine in Germany*
- *Nominated for "Top 10 Spielzeug 2008"*
- *France's 2008 Toy of the Year*
- *Belgium's 2008 Toy of the Year*
- *Japan Toy Award in the Innovation Category at the 2008 Tokyo Toy Show*

BloPens® *markers are a Hit in Ecuador*

JAKKS first distributed BloPens activities in Ecuador in 2007. To promote the products, BloPens activity corners were set-up in retail stores where kids could spend hours playing with the products. The promotion was such a huge success that the product was sold out in less than three weeks. BloPens are hugely popular around the world.

Stars **LOVE** *JAKKS*

THE WIGGLES®

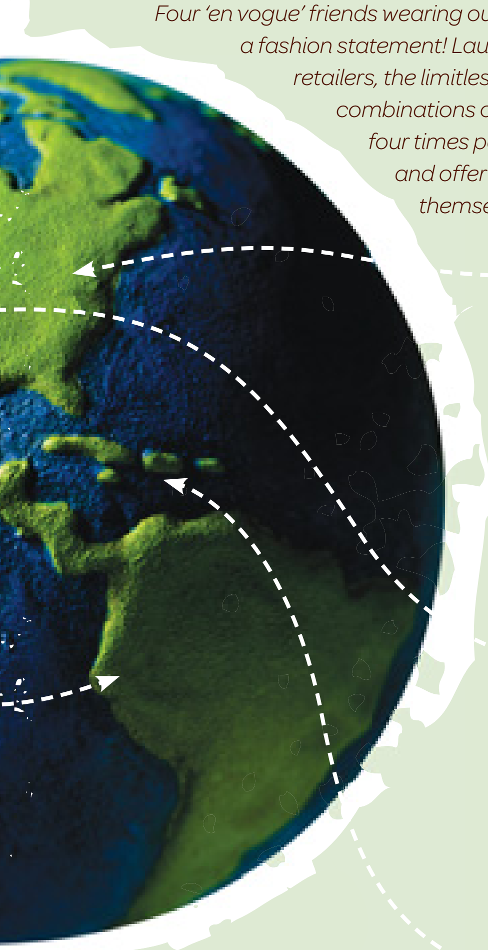
Aussie pop-stars The Wiggles took their Big Red Car® to Dallas Toy Fair where they hosted a Meet and Greet for retail buyers to launch the JAKKS toy line.

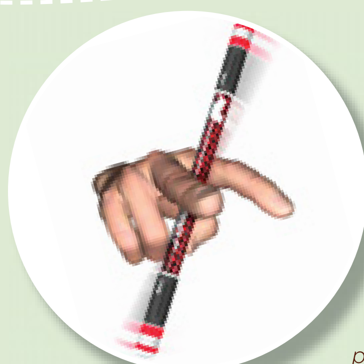
TREND ALERT

Girls Mix Up Their Style with Juku Couture™

Fashion trendsetters in Harajuku, Japan, started purposely mismatching and layering fashion as a form of self-expression. Famous fashionistas and hip girls all over the world followed suit and began creating their own looks with multiple layers of clothing in fun outrageous colors. In 2008 JAKKS plays upon the most popular new trend in high fashion with a unique line of dolls and accessories called Juku Couture.

Four 'en vogue' friends wearing outfits that don't match are making a fashion statement! Launching at both mass and specialty retailers, the limitless possibilities and fashionable combinations of Juku Couture *will be shipped four times per year with each fashion season, and offer girls a way to have fun expressing themselves!*



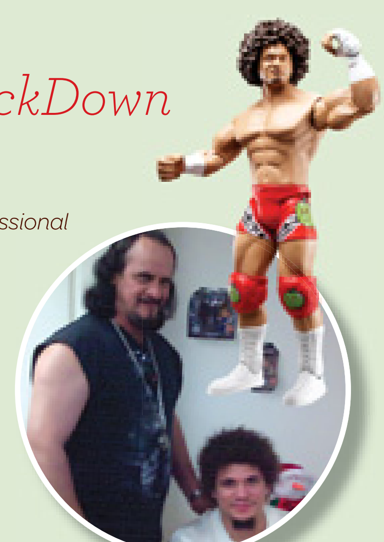


Revolutionary SpinZ™ Products hit U.S. Retailers

Pen Spinning is one of the fastest-growing trends in Europe and Asia, with exciting tournaments attracting the worlds fastest pen spinners and more than 7,500 videos featuring the coolest pen spinning tricks gracing YouTube.com. Capitalizing on this popular trend, JAKKS is introducing Pen Spinning to the U.S. market with its new SpinZ *line of official Pen Spinning pens! Pen Spinning is the sport of manipulating customized pens through the fingers to create different tricks and* SpinZ *is the customizable line of pens. They can be customized with* Mods™ *customization accessories.*

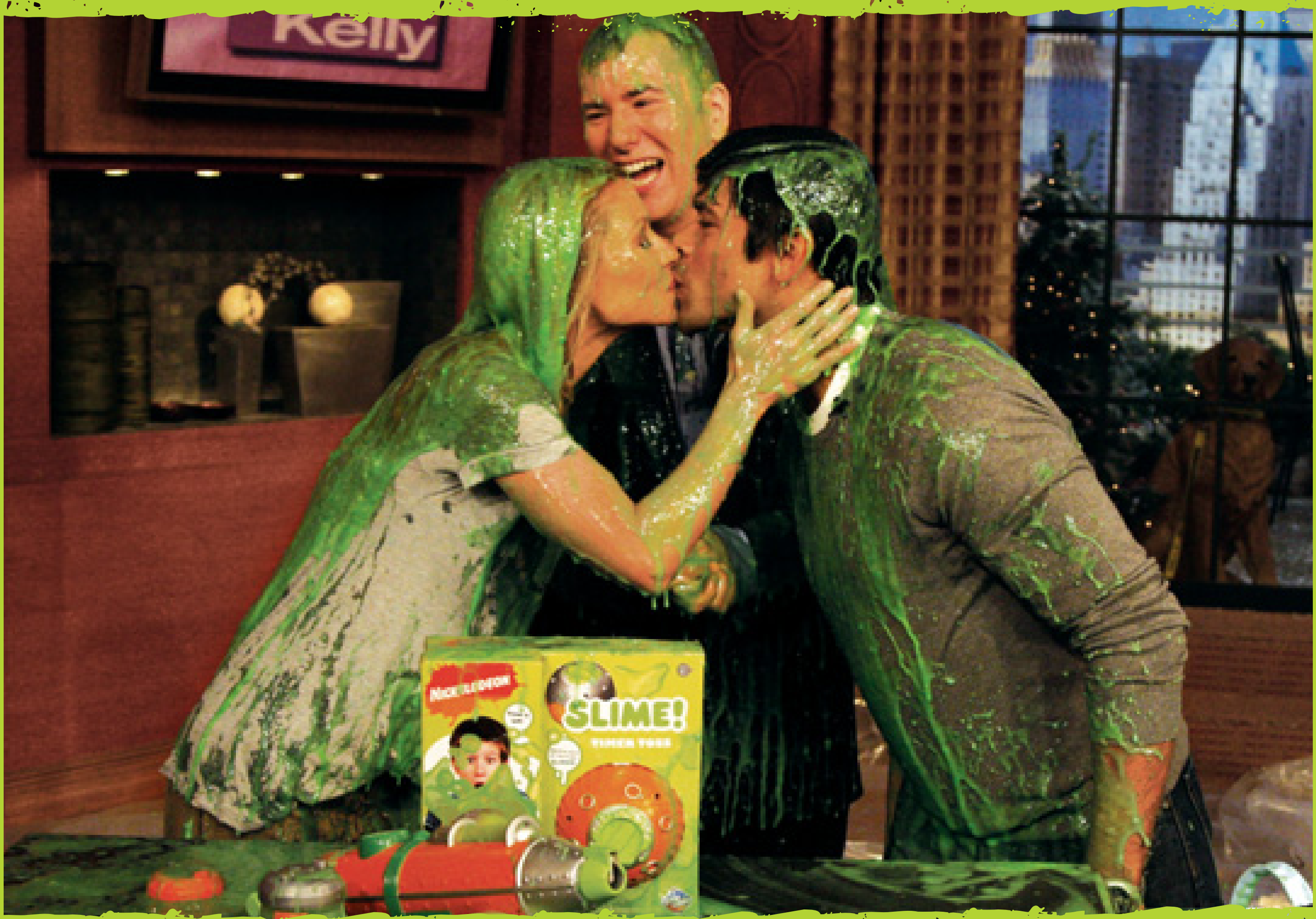
Almost a SmackDown in Puerto Rico

A WWE fan resembling the professional wrestler The Undertaker meets the WWE Superstar Carlito at a JAKKS Wal-Mart event in Puerto Rico.



Fulfilling Play at Every Stage

A new Child Guidance® *line of preschool toys feature a roster of modern-day classic properties that offer youngsters fulfilling play experiences at every stage of their development.* Barney® *toys debuted in Fall 2007, and* The Wiggles, Curious George®, Teletubbies®, Miffy, Max & Ruby™ *and* Clifford® *toys join the fun in Fall 2008.* Child Guidance *toys banded these Favorite First Friends together to inspire children's creativity and imagination and leverage opportunities at retail. Classic and enduring, these seven brands are continuously in the market – on TV, on stage, on screen and online – and these favorite first friends are more popular today than ever before!*



SLIME!™ IS BACK!

Kelly Ripa and Mark Consuelos made history in an icky, sticky, gooey way.

During the 2008 NY Toy Fair, the Live! With Regis & Kelly Show host Kelly Ripa and guest host (and husband) Mark Consuelos made history in an icky, sticky, gooey way. JAKKS is launching the first-ever complete *SLIME!* product line and during a segment highlighting this season's hottest upcoming toys (with The Toy Guy, Chris Byrne, center), Ripa and Consuelos became the first husband and wife to be slimed by Nickelodeon's legendary green goo. *Slime* goo was introduced on Nickelodeon in 1982, and has since become a badge of honor for both kids and celebrities worldwide. JAKKS teamed up with Nickelodeon® and launched a slime-filled summer with a new *Slime Across America*™ Tour, dousing thousands of kids in 10 major cities with Nickelodeon's iconic green slime. Nick's 18-wheel *Slime* Mobile featured an enhanced truck and stage surrounded by themed activity and game pods. The free four-hour event for kids and families included an interactive stage show with musical performances by Sony BMG recording artists Tiffany Evans and Menudo, and where kids have the chance to get slimed using *JAKKS Super Slimer* toy. The *Slime* Tour also featured a *JAKKS Super Slimer* Activity Pod that lets kids battle it out with *JAKKS Super Slimer* toys and have a chance to win cool *Slime!* products; and the Slime! Kiosk where kids can play with and test out JAKKS' entire line of Slime! products.

CAREBEARS give hugs to New Yorkers

CARE BEARS® CELEBRATE IN THE BIG APPLE

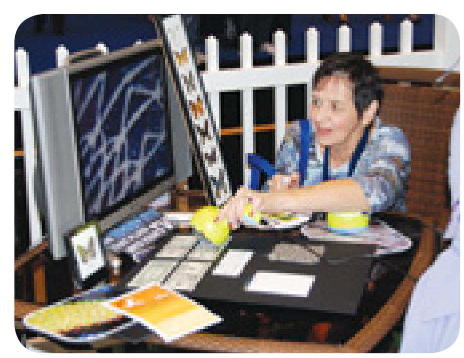
The *Care Bears* family celebrated their 25th Anniversary with *Care Bears* costumed characters invading NYC giving hugs to New Yorkers and with a big birthday bash at *Toys"R"Us* Times Square. The silver anniversary bear with *Swarovski*® crystal eyes sold out in Fall 2007.

DID U KNOW?

Grandparents Shop! 78.2 million baby boomers spend an average of 16% more on toy purchases for their grandchildren than parents and friends do!

Fun for All Ages

JAKKS promoted the *EyeClops Bionic Eye* and Intergenerational Play with the Toy Industry Association at the AARP® National Convention where seniors played with the *EyeClops* toy, just one of the *JAKKS* products that bridge the generations and offers family fun.



THE CHEAPEST REAL ESTATE IN MALIBU!

The 2008 Hannah Montana Malibu Beach House *playset, based on* Disney Channel*'s hit TV show* Hannah Montana, *is not only the most recognizable house on TV, but at $179.99 it is the cheapest piece of real estate in Malibu.*

DID U KNOW?

55% of 7–11 year olds and 47% of 12–17 year olds in the U.S. are fans of NASCAR.

START YOUR ENGINES!

With 75 million fans, *NASCAR* is the No. 1 spectator sport in the U.S. – holding 17 of the top 20 attended sporting events in the U.S. and is the No. 2 rated regular-season sport on television with broadcasts in more than 100 countries. *NASCAR* fans are the most brand loyal in all of sports, and as a result more Fortune 500 companies participate in *NASCAR* racing than any other sport. This fall, the excitement and speed of *NASCAR* racing will head to toy aisles nationwide with the new *NASCAR*-branded toy line by *Play Along*. It focuses on authentic details and play-patterns that are inherent to the fast-action sport. To add to the authenticity, the products feature top *NASCAR* Sprint Cup Series™ drivers including Dale Earnhardt Jr., Jeff Gordon, Jimmie Johnson and Tony Stewart.

PUPPY LOVE

From
PUPPY IN MY POCKET® *to* **AMERICAN KENNEL CLUB®, AMERICANS** *love* **PETS**

That's Some Dog!

AKC Agility™ products from JAKKS Pets *are designed to challenge dogs and their owners through athletic activity in an effort to help dogs combat obesity. Launched at* Toys"R"Us *stores nationwide.*

Totally MyPet™ and American Kennel Club® at Toys"R"Us Stores Nationwide

Toys"R"Us is now a one-stop shop for families purchasing toys for their kids AND their pets with two new pet product lines launched in 2007 for four-legged family members. Designed by *JAKKS Pets, Totally My Pet* is exclusive to *Toys"R"Us* and is an extension of the tween fashion brand, Totally Me, a fun and fashionable line for the tween girls who view their pets as accessories. The American Kennel Club Jr.™ (AKC Jr.™) product line features sporty dog chew toys, clothing, beds, collars and along with *AKC Agility* products that make *Toys"R"Us* a destination for kids and pets!

Puppy Bling

Puppy In My Pocket

Puppy In My Pocket brand is the adorable line of collectable pocket-sized pets that first gained popularity in the 1990s. This line was re-launched in 2007 by Play Along and updated with soft, realistic puppies that girls can wear on fashionable jewelry accessories. With the introduction of 'puppy bling', *Puppy In My Pocket* brand is the only line of wearable, collectible pets for girls!

Created by Morrison Entertainment Group (now MEG), the *Puppy In My Pocket* brand experienced terrific success throughout the '90s, reaching over $120 million in sales. In 2005, the line of small puppies were restyled and updated with soft, flocked fur, and the new "realistic" line was introduced internationally by MEG. After a phenomenal success in the UK, Australia and Italy, the updated *Puppy In My Pocket* brand has made its way to the U.S. and is a success story at retail. By modernizing the brand to appeal to today's kids, Play Along drove the brand into new untapped avenues, expanding into new areas such as kitties, ponies and even a jungle theme for 2008.

fun FACT

Puppy In My Pocket is called "Pelusitos" in Mexico

which is a cute way to express that the product is "flocked." After conducting local market research, it was found that this was the most appealing aspect of the toy! The TV commercial was then revised to focus on this feature.

On the Green Scene

In 2007, JAKKS Pets created a meaningful eco-friendly line of its top-selling *American Kennel Club*® (AKC) branded pet products. Designed for eco-friendly pet owners, the *AKC Green Planet Collection*™ used as many recycled components in each environmentally-friendly dog product. Recycled materials used in the line include 100% recycled polyester stuffing and 80% recycled packaging. Although recycled materials are more difficult to get and cost a little more, *AKC Green Planet Collection* products feature premium quality treats, toys and accessories for dogs. The prestige and heritage of the American Kennel Club is proud to stamp its name on products that are not only safe and good for dogs, but also for the environment.

Helping our Retail Partners Succeed

Working in collaboration with the buyer, JAKKS learns their customer strategy to create products that help expand their brand awareness among their consumers. It is a win-win situation with the *JAKKS* private label pet programs. For example, *Country Pet*™ is an exclusive line of dog plush toys available at Wal-Mart® stores that launched in 2007 and was such a success that plans are in place to expand the line in 2008 with *Eco-Planet*™, an exclusive line of environmentally friendly products. Our private-label business with Wal-Mart will now extend to 6 feet of modular space in all the stores.

JAKKS is now expanding into co-branding opportunities with other retail partners that look to benefit from premium, high-end products that are non-licensed. The retailer Stop N Shop launched *Companion Essentials*® co-branded with *American Kennel Club (AKC)* featuring a wide range of pet products. Stop N Shop wanted to build a brand using the trusted name of the *AKC* and is now looking to explore opportunities with The Cat Fanciers' Association®.

DID U KNOW?

JAKKS sells pet products in virtually every type of retail channel including drug stores, club stores, specialty and mass pet retailers, supermarkets and mass giants including Wal-Mart, Target® and even Toys"R"Us stores, where JAKKS Pets developed and launched both private label and AKC-branded pet products at the world's largest [kids!] toy store. JAKKS also attracts new pet accounts every day, expanding into more than 7,000 drug store doors including Walgreens®, CVS® and Duane Reade® stores nationwide.

ANIMAL PROTECTION

THE HUMANE SOCIETY OF THE UNITED STATES®

With nearly ten million members and constituents, The Humane Society of the United States® (The HSUS™) has worked in the U.S. and abroad since 1954 to defend and promote the protection of animals. JAKKS signed a licensing agreement with The HSUS, known as the largest and most powerful animal protection organization in the U.S., for a diverse line of pet products for dogs and cats that will strengthen the bond that people have with their pets. A portion of the sales go directly to benefit The HSUS and its important programs.

LIKE MINI GROWNUPS

TREND ALERT!

Signs of the Times

Age compression is the phenomenon that today's kids are trending older at a younger age. This reality has challenged the toy industry for years, but JAKKS stays ahead of the curve with products for younger kids that emulate the products their older role models use in everyday life.

From cell phones and laptops to vacuums and spa products, kids' playthings are changing. JAKKS addresses the fast-forward evolution of children's increasingly sophisticated tastes by creating innovative 'toys' that make smart use of technology and entertainment sources. *Disney Princess* cell phones and *Barney* laptops are magical with lights, sounds and fun technological features. *Disney's Sleeping Beauty* and *Lightning McQueen*® "talk" to young chatterboxes when they use their pretend cell phones featuring their favorite licensed characters.

4,300,000
\# of *Disney* Cell Phones that CDI, a division of JAKKS, sold in 2007.

vs.

1,389,000
of Apple® iPhones™ sold in 2007

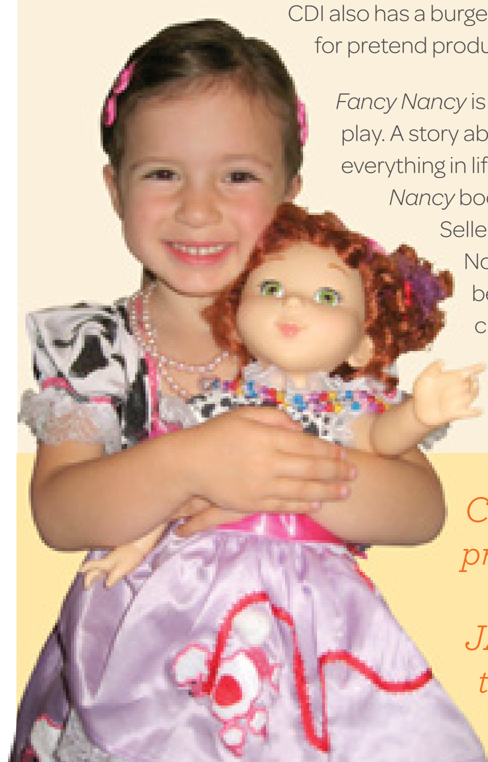
They Chat Like Us!

They're Just Like Us!

They Dress Like Us!

Creative Designs International™ is a division of *JAKKS* that specializes in role play, dress-up and pretend play. Dress-up clothes, large interactive playsets and unique accessories are based on popular children's entertainment licenses and top lifestyle brands of today, including *TinkerBell*, *Disney's Sleeping Beauty*, *Classic Disney Princesses*, Fancy Nancy®, *Hannah Montana* and more. CDI also has a burgeoning private label business for pretend products.

Fancy Nancy is the perfect license for pretend play. A story about a little girl who believes everything in life should be fancy, the *Fancy Nancy* book topped the *NY Times* Best Seller list for more than 100 weeks. Not only did JAKKS create a beautiful large doll and dress-up clothes to gussy her up, but also a line of pretend "fancy" clothes for little girls to get dolled up themselves.



They Clean Like Us!

From *Black & Decker*® pretend tools to *Dirt Devil*® vacuums, now every kid can feel grown-up, and like they can do anything adults can. Parents can feel good encouraging their child's development, creativity and imagination, too.

CDI launched two private label items in 1979. Today JAKKS has more than 200 private label items.

DID U KNOW?

In 2007, CDI built on their success in Role Play by developing a line of Boys' Role Play toys under the Black & Decker brand.

They Rock Like Us!

Every little girl wants to be a rock star and JAKKS continues to rock n' roll with a line of dolls, dress-up and role play musical instruments based on the popular Mexican telenovela, *Rebelde*®, which has certainly made an impact on Latin-American youth. The teen soap opera centers on a group of students who form a pop band. In real life, the actors are in a band, *RBD*®, and perform most of the music featured on the show. *RBD* has been extremely successful in its own right, becoming one of the highest-grossing acts in Mexico and touring internationally. The show is transmitted in the U.S. and in over 65 countries internationally.

They're Curious Like Us!

Discovery Kids®

Discovery Kids branded toys from JAKKS combine learning and fun. From animals with recognition technology to interest-bearing investment toys, the line encourages kids to explore animals and nature, learn about science and expand their know-how.

DID U KNOW?

Nearly 5 million kid primpers hit spas last year (International Spa Association®)

They Relax Like Us!

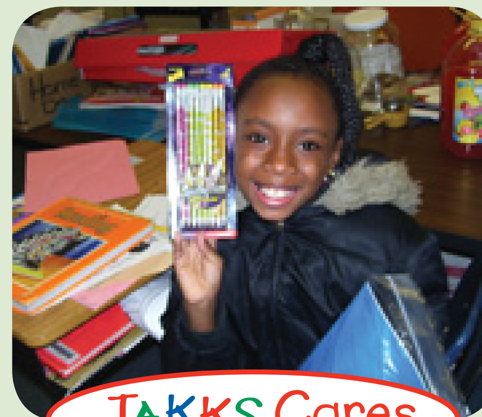
Spas are definitely not just for adults anymore. The desire for beauty treatments for the younger set has skyrocketed, and JAKKS brings the spa experience home for young girls this Fall with its *Spa Factory*™ product line. *The Spa Factory*™ line creates a truly fun-filled pampering experience for young girls with create-your-own spa, beauty and aromatherapy products with do-it-yourself flavors, scents and textures for facials, foot scrubs, perfumes, and lip treatments. Moms can also feel good that all *Spa Factory* ingredients are made in the U.S., are all-natural and are not tested on animals.

JAKKS CARES! Everything We Do is for a Smile™

OUR COMMITMENT

JAKKS Cares is the philanthropic division of JAKKS Pacific. Through JAKKS Cares initiatives, the company utilizes the powerful resources and employees of JAKKS to assist needy children, families and pets around the world. We are strongly committed to being philanthropic and socially responsible corporate citizens, and believe we can create change that will improve the lives and well-being of children for generations to come. JAKKS Cares initiatives also seek ways to Reduce, Reuse and Recycle to help save our planet.

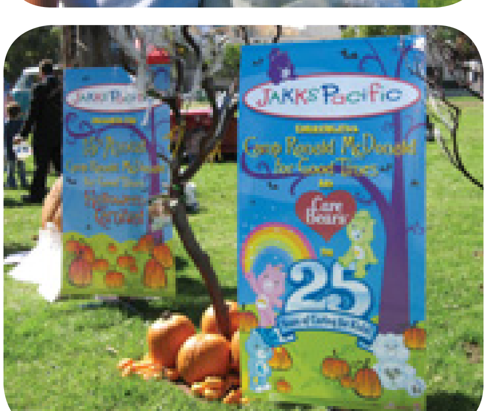
Since inception, JAKKS has donated more than $20 million in toys and school supplies to millions of underprivileged children around the world through JAKKS Cares initiatives. In the end, the most important aspect of the JAKKS Cares program is to help kids smile, play and succeed. *Everything we do is for a smile.*



JAKKS Cares
A Division of JAKKS Pacific, Inc. ™

JAKKS Sends Kids with Cancer to Camp

Camp Ronald McDonald for Good Times provides kids with cancer and their families a fun-filled camp experience, where for a few days, they can laugh, play, swim, dream, play sports and have fun. The environment is made to be safe with proper medical facilities. JAKKS Cares proudly sponsors the Annual Halloween Carnival, and for the Camp's 25th Anniversary in 2007, JAKKS got the *Care Bears* Silver Anniversary involved in the celebrations.



Back-to-School Essentials For Programs Nationwide and Across the Globe

JAKKS Cares recently donated more than $1 million worth of toys and school supplies to assist children in need during the back-to-school season. JAKKS supported the nationwide back-to-school programs of the Toy Industry Foundation, Feed The Children and the Los Angeles Unified School District to provide millions of underpriviledged children around the world with a great start in school!

School supplies donated to the Toy Industry Foundation will be distributed to underprivileged children around the world throughout July and August 2008 in partnership with Gifts in Kind International.

JAKKS Cares donated writing instruments, markers, erasers, book covers, notebooks and more to Feed the Children®, to fill 100,000 backpacks loaded with essential school supplies that will be distributed to boys and girls living in poverty in all 50 states.

Additionally, JAKKS Cares partnered with the Los Angeles Unified School District's Books Of Summer Campaign by donating toys as incentive prizes for hundreds of children to read this summer. The Books of Summer Campaign is a summer-long program that encourages families to read together. And that's not all – LAUSD got a truck load of school supplies so that local LA schools will have new supplies when they return to school after a long hot summer.

"JAKKS Pacific shares our belief in the power of education to reduce and reverse the cycle of poverty. By helping supply children in need with critical educational supplies, JAKKS Pacific helps us secure our long-term hope for children in need: that they will excel at school and eventually break free from a life of poverty."

Larry Jones, President and Founder of Feed The Children

"OH MY GOSH! THANK YOU! THANK YOU! THANK YOU! What an amazing gift you gave us. We'll be able to provide our asthma patients with *BloPens* for a long time! The patients are going to have such a great time without even realizing the benefit to their lungs. I truly cannot express enough our gratitude."

Victoria, Child Life Specialist at Methodist Children's Hospital in San Antonio, Texas.

THE STARS WERE OUT!

FOX® stars Brad Garrett, Kathy Najimy, Paula Abdul, Randy Jackson and others joined JAKKS employees for a "Day of Giving," handing out toys to thousands of inner city kids, and also hosting a movie screening for kids of Camp Ronald McDonald for Good Times.

Marine Toys for Tots®

"Over the past six years the Marine Toys for Tots® Program has experienced increased success in fulfilling the Christmas holiday dreams of our nation's neediest children. We have done this while many of our Marines have been at war and while the economy has been less than robust. One of the key reasons, we believe, for this success has been the support we've received from JAKKS Pacific. The generous quantities and high quality toys they donated to Toys for Tots in past years has made a significant difference. Without their community spirit, professional skills and love of children, our ability to provide quality toys to children in need would have been far less effective. The Marine Corps believes that every child deserves a little Christmas, and thanks to our friends at JAKKS Pacific, we were able to assist over six million children in each of the past six years. We certainly appreciate the key role they have played in our annual program."

Bill Grein, Major, USMC (Ret), Marine Toys for Tots Foundation

Operation Smile®

JAKKS Pacific proudly supports Operation Smile, a global organization that repairs childhood facial deformities while building public and private partnerships that advocate for sustainable healthcare systems for children and families. Since 1982, more than 115,000 children and young adults have been treated by thousands of volunteers worldwide and thousands of healthcare professionals have been trained globally. For as little as $240, Operation Smile can change a child's life by giving the gift of a surgery, and JAKKS Pacific is working to support their important mission. The newest Operation Smile facility in Hang Ghou, China is a full time hospital conducting surgeries everyday and working to help people throughout Asia who are in desperate need of surgeries to fix their facial deformities and change their lives forever! JAKKS Pacific salutes Operation Smile Founders Bill and Kathy McGee. JAKKS Cares: *Everything we do is for a Smile!*

Operation Smile *is a global organization dedicated to performing surgeries on children with cleft palate and other facial deformities.*

Supporting the Troops

"The toys and school supplies donated in support of the US Humanitarian Aid Mission in Iraq from JAKKS Pacific have realized enormous value by the precious children of this country, resulting in their ability to be children, to enjoy a brighter moment in time and to begin the healing. Many other forms of positive influences have been realized through the simple touch of the American people and companies like yours who have been willing to support this just cause. We are truly blessed that Play Along and JAKKS Pacific support our mission."

Master Chief Charlie MacKenzie, Military Liaison, Humanitarian Assistance-Baghdad

Pink Power!

JAKKS Pink Power Care Bears plush raised money for breast cancer research in 2008. Proceeds to benefit The Breast Cancer Research Foundation.

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Selected FINANCIAL DATA

Selected FINANCIAL DATA

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

	Years Ended December 31,				
(In thousands, except per share data)	*2003*	*2004*	*2005*	*2006*	*2007*
Consolidated Statement of Income Data:					
Net sales	$ 315,776	$ 574,266	$ 661,536	$ 765,386	$ 857,085
Cost of sales	189,334	348,259	394,829	470,592	533,435
Gross profit	126,442	226,007	266,707	294,794	323,650
Selling, general and administrative expenses	113,053	172,282	178,722	202,482	216,652
Acquisition shut-down and product recall costs	2,000	—	—	—	—
Income from operations	11,389	53,725	87,985	92,312	106,998
Profit from video game joint venture	7,351	7,865	9,414	13,226	21,180
Other expense	—	—	(1,401)	—	—
Interest income	1,131	2,052	5,183	4,930	6,819
Interest expense	(2,536)	(4,550)	(4,544)	(4,533)	(5,456)
Income before provision for income taxes	17,335	59,092	96,637	105,935	129,541
Provision for income taxes	1,440	15,533	33,144	33,560	40,550
Net income	$ 15,895	$ 43,559	$ 63,493	$ 72,375	$ 88,991
Basic earnings per share	$ 0.66	$ 1.69	$ 2.37	$ 2.66	$ 3.22
Basic weighted average shares outstanding	24,262	25,797	26,738	27,227	27,665
Diluted earnings per share	$ 0.66	$ 1.49	$ 2.06	$ 2.30	$ 2.77
Diluted weighted average shares and equivalents outstanding	27,426	31,406	32,193	32,714	33,149

In February 2006, we acquired Creative Designs. Also, effective January 1, 2006, we implemented SFAS 123R, which requires the expensing of share-based compensation.

In June 2005, we acquired the Pet Pal line of products.

In June 2004, we acquired Play Along.

	At December 31,				
(In thousands)	*2003*	*2004*	*2005*	*2006*	*2007*
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 118,182	$ 176,544	$ 240,238	$ 184,489	$ 241,250
Working capital	232,601	229,543	301,454	280,363	355,678
Total assets	529,997	696,762	753,955	881,894	982,688
Long-term debt, net of current portion	98,042	98,000	98,000	98,000	98,000
Total stockholders' equity	377,900	451,485	524,651	609,288	690,997

MANAGEMENT'S DISCUSSION *and* ANALYSIS *of* FINANCIAL CONDITION *and* RESULTS *of* OPERATIONS

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

Critical Accounting Policies

The accompanying consolidated financial statements and supplementary information were prepared in accordance with accounting principles generally accepted in the United States of America. Significant accounting policies are discussed in Note 2 to the Consolidated Financial Statements. Inherent in the application of many of these accounting policies is the need for management to make estimates and judgments in the determination of certain revenues, expenses, assets and liabilities. As such, materially different financial results can occur as circumstances change and additional information becomes known. The policies with the greatest potential effect on our results of operations and financial position include:

Allowance for Doubtful Accounts. Our allowance for doubtful accounts is based on management's assessment of the business environment, customers' financial condition, historical collection experience, accounts receivable aging, customer disputes and the collectibility of specific customer accounts. If there were a deterioration of a major customer's creditworthiness, or actual defaults were higher than our historical experience, our estimates of the recoverability of amounts due to us could be overstated, which could have an adverse impact on our operating results. The allowance for doubtful accounts is also affected by the time at which uncollectible accounts receivable balances are actually written off.

Major customers' accounts are monitored on an ongoing basis; more in depth reviews are performed based on changes in customer's financial condition and/or the level of credit being extended. When a significant event occurs, such as a bankruptcy filing by a specific customer, and on a quarterly basis, the allowance is reviewed for adequacy and the balance or accrual rate is adjusted to reflect current risk prospects.

Revenue Recognition. Our revenue recognition policy is to recognize revenue when persuasive evidence of an arrangement exists, title transfer has occurred (product shipment), the price is fixed or readily determinable, and collectibility is probable. We recognize revenue in accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition." Sales are recorded net of sales returns and discounts, which are estimated at the time of shipment based upon historical data. JAKKS routinely enters into arrangements with its customers to provide sales incentives, support customer promotions, and provide allowances for returns and defective merchandise. Such programs are based primarily on customer purchases, customer performance of specified promotional activities, and other specified factors such as sales to consumers. Accruals for these programs are recorded as sales adjustments that reduce gross revenue in the period the related revenue is recognized.

Goodwill and Other Indefinite-Lived Intangible Assets. In accordance with Statement of Financial Accounting Standards ("SFAS") 142, Goodwill and Other Intangible Assets, goodwill and indefinite-lived intangible assets are not amortized, but are tested for impairment at least annually at the reporting unit level.

Factors we consider important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and
- significant negative industry or economic trends.

Due to the subjective nature of the impairment analysis, significant changes in the assumptions used to develop the estimate could materially affect the conclusion regarding the future cash flows necessary to support the valuation of long-lived assets, including goodwill. The valuation of goodwill involves a high degree of judgment and consists of a comparison of the fair value of a reporting unit with its book value. Based on the assumptions underlying the valuation, impairment is determined by estimating the fair value of a reporting unit and comparing that value to the reporting unit's book value. If the implied fair value is more than the book value of the reporting unit, an impairment loss is not indicated. If impairment exists, the fair value of the reporting unit is allocated to all of its assets and liabilities excluding goodwill, with the excess amount representing the fair value of goodwill. An impairment loss is measured as the amount by which the book value of the reporting unit's goodwill exceeds the estimated fair value of that goodwill.

SFAS No. 142 requires that goodwill be allocated to various reporting units, which are either at the operating segment level or one reporting level below the operating segment, for purposes of evaluating whether goodwill is impaired. For 2007, JAKKS' reporting units are: Traditional Toys, Craft/Activity/Writing Products, and Pet Products. Goodwill is allocated within JAKKS' reporting units based on an allocation of brand-specific goodwill to the reporting units selling those brands. As of October 1, 2007, JAKKS performed the annual impairment test required by SFAS No. 142 and determined that its goodwill was not impaired. There were no events or circumstances that indicated the impairment test should be performed again at December 31, 2007.

To determine the fair value of our reporting units, we generally use a present value technique (discounted cash flow) corroborated by market multiples when available and as appropriate. The factor most sensitive to change with respect to our discounted cash flow analyses is the estimated future cash flows of each reporting unit which is, in turn, sensitive to our estimates of future revenue growth and margins for these businesses. If actual revenue growth and/or margins are lower than our expectations, the impairment test results could differ. We applied what we believe to be the most appropriate and consistent valuation methodology for each of the reporting units. If we had established different reporting units or utilized different valuation methodologies, the impairment test results could differ.

Goodwill and intangible assets amounted to $397.6 million as of December 31, 2007.

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

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

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

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

Income Taxes and Interest and Penalties Related to Income Tax Payable. We do not file a consolidated return with our foreign subsidiaries. We file federal and state returns and our foreign subsidiaries each file Hong Kong returns, as applicable. Deferred taxes are provided on a liability method whereby deferred tax assets are recognized as deductible temporary differences and operating loss and tax credit carry-forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

As of January 1, 2007, we adopted the provisions of FASB Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes*, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. As of the date of adoption, tax benefits that are subject to challenge by tax authorities are analyzed and accounted for in the income tax provision. The cumulative effect of the potential liability for unrecognized tax benefits prior to the adoption of FIN 48, along with the associated interest and penalties, are recognized as a reduction in the January 1, 2007 balance of retained earnings.

We accrue a tax reserve for additional income taxes and interest, which may become payable in future years as a result of audit adjustments by tax authorities. The reserve is based on management's assessment of all relevant information, and is periodically reviewed and adjusted as circumstances warrant. As of December 31, 2007, our income tax reserves are approximately $20.3 million and relate to the potential income tax audit adjustments, primarily in the areas of income allocation and transfer pricing.

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

Share-Based Compensation. We grant restricted stock and options to purchase our common stock to our employees (including officers) and non-employee directors under our 2002 Stock Award and Incentive Plan (the "Plan"), which incorporated the shares remaining under our Third Amended and Restated 1995 Stock Option Plan. The benefits provided under the Plan are share-based payments subject to the provisions of revised Statement of Financial Accounting Standards No. 123 (Revised) (SFAS 123R), *Share-Based Payment*. Effective January 1, 2006, we began to use the fair value method to apply the provisions of SFAS 123R. We estimate the value of share-based awards on the date of grant using the Black-Scholes option-pricing model. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price, as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, cancellations, terminations, risk-free interest rates and expected dividends.

Recent Developments

In February 2006, we acquired substantially all of the assets of Creative Designs International, Ltd. and a related Hong Kong company, Arbor Toys Company Limited (collectively, "Creative Designs"). The total initial purchase price of $111.1 million consisted of $101.7 million in cash, 150,000 shares of our common stock at a value of approximately $3.3 million and the assumption of liabilities in the amount of $6.1 million. In addition, we agreed to pay an earn-out of up to an aggregate amount of $20.0 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. For the years ended December 31, 2006 and 2007, $6.9 million and $6.7 million, respectively, of the earn-out was earned and recorded as goodwill. Creative Designs is a leading designer and producer of dress-up and role-play toys and was included in our results of operations from the date of acquisition.

Results of Operations

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

	Years Ended December 31,				
	2003	2004	2005	2006	2007
Net Sales	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Sales	60.0	60.6	59.7	61.5	62.2
Gross profit	40.0	39.4	40.3	38.5	37.8
Selling, general and administrative expenses	35.8	30.0	27.0	26.5	25.3
Acquisition shut-down and product recall costs	0.6	—	—	—	—
Income from operations	3.6	9.4	13.3	12.0	12.5
Profit from video game joint venture	2.3	1.4	1.4	1.7	2.5
Other expense	—	—	(0.2)	—	—
Interest income	0.4	0.4	0.8	0.6	0.7
Interest expense	(0.8)	(0.8)	(0.7)	(0.6)	(0.6)
Income before provision for income taxes	5.5	10.4	14.6	13.7	15.1
Provision for income taxes	0.5	2.7	5.0	4.4	4.7
Net income	5.0%	7.7%	9.6%	9.3%	10.4%

The following unaudited table summarizes, for the periods indicated, certain income statement data by segment (in thousands).

	Years Ended December 31,		
	2005	2006	2007
Net Sales			
Traditional Toys	$589,715	$692,498	$792,998
Craft/Activity/Writing Products	62,058	52,834	39,632
Pet Products	9,763	20,054	24,455
	661,536	765,386	857,085
Cost of Sales			
Traditional Toys	348,626	429,411	490,279
Craft/Activity/Writing Products	39,928	29,044	26,970
Pet Products	6,275	12,137	16,186
	394,829	470,592	533,435
Gross Margin			
Traditional Toys	241,089	263,087	302,719
Craft/Activity/Writing Products	22,130	23,790	12,662
Pet Products	3,488	7,917	8,269
	$266,707	$ 294,794	$ 323,650

COMPARISON *of the* YEARS ENDED DECEMBER 31, 2007 *and* 2006

Net Sales

Traditional Toys. Net sales of our Traditional Toys segment were $793.0 million in 2007, compared to $692.5 million in 2006, representing an increase of $100.5 million, or 14.5%. The increase in net sales was primarily due to impact of sales related to our Creative Designs line of products for the full twelve months ended December 31, 2007, as compared to only a part of the twelve months ended December 31, 2006 (as a result of the February 2006 acquisition of Creative Designs), which had incremental sales of $17.4 million, and increases in sales of WWE® and Pokemon® action figures and accessories, role-play and dress-up toys, Bio Bytes™, Eye Clops™ Bionic Eye, Child Guidance pre-school toys, Hannah Montana™ dolls and accessories, In My Pocket toys, The Cheetah Girls™ toys, Sweet Secrets toys, Funnoodle® pool toys and our Fly Wheels XPV® toys, offset in part by decreases in sales of Dragonball Z® action figures, JAKKS™ dolls, Plug It In & Play TV Games™, wheels products, Telestory®, Vmigo®, Sky Dancers®, Doodle Bear® Dragon Flyz™, Trolls™, Care Bears®, Cabbage Patch Kids®, Speedstacks®, Snugglers™, RC Flight toys and our Go Fly A Kite® and junior sports products.

Craft/Activity/Writing Products. Net Sales of our Craft/Activity/Writing Products were $39.6 million in 2007, compared to $52.8 million in 2006, representing a decrease of $13.2 million, or 25.0%. The decrease in net sales was primarily due to decreases in sales of our Flying Colors and Vivid Velvet activities products and our Pentech and Color Workshop writing instruments and related products.

Pet Products. Net Sales of our Pet Pal line of products were $24.5 million in 2007, compared to $20.1 million in 2006, representing an increase of $4.4 million, or 21.9%. The increase is attributable to the expanding line of products and expanding distribution.

Cost of Sales

Traditional Toys. Cost of sales of our Traditional Toys segment was $490.3 million, or 61.8% of related net sales, in 2007, compared to $429.4 million, or 62.0% of related net sales, in 2006, representing an increase of $60.9 million, or 14.2%. The increase primarily consisted of an increase in product costs of $41.1 million, which is in line with the higher volume of sales. Product costs as a percentage of sales decreased primarily due to the mix of the product sold with lower product cost. Furthermore, royalty expense for our Traditional Toys segment increased by $16.9 million and as a percentage of net sales due to changes in the product mix to more products with higher royalty rates from products with lower royalty rates or proprietary products with no royalty rates. Additionally, certain royalty advances and guarantees were written off for licensed product whose sell-off period had expired or was projected to not recoup the advances through future sales or meet its contractual minimum guaranty. Our depreciation of molds and tools increased by $2.9 million due to the depreciation of new products being sold in this segment.

Craft/Activity/Writing Products. Cost of sales of our Craft/Activity/Writing Products segment was $27.0 million, or 68.1% of related net sales, in 2007, compared to $29.0 million, or 55.0% of related net sales, in 2006, representing a decrease of $2.0 million, or 6.9%. The decrease consisted of a decrease in product costs of $2.2 million, which is in line with the lower volume of sales. Product costs as a percentage of net sales increased primarily due to the mix of the product sold and sell-off of closeout product. Royalty expense increased by $0.3 million and as a percentage of net sales due to changes in the product mix to more products with higher royalty rates from products with lower royalty rates or proprietary products with no royalty rates. Additionally, certain royalty advances and guarantees were written off for licensed product whose sell-off period had expired or was projected to not recoup the advances through future sales or meet its contractual minimum guaranty. Our depreciation of molds and tools decreased by $0.2 million due to lower level of product in this segment requiring molds and tools.

Pet Products. Cost of sales of our Pet Pal line of products was $16.2 million, or 66.2% of related net sales, in 2007, compared to $12.1 million, or 60.5% of related net sales, in 2006, representing an increase of $4.1 million, or 33.9%. The increase primarily consisted of an increase in product costs of $3.5 million, which is in line with the higher volume of sales. Product costs as a percentage of net sales increased primarily due to the mix of the product sold. Royalty expense increased by $0.4 million, which was in line with the higher volume of sales. Additionally, our depreciation of molds and tools was comparable year-over-year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $216.7 million in 2007 and $202.5 million in 2006, constituting 25.3% and 26.5% of net sales, respectively. The overall increase of $14.2 million in such costs was primarily due to increases in general and administrative expenses ($16.8 million), the incremental overhead related to a full quarter impact of operations of Creative Designs ($1.5 million) for the three months ended March 31, 2007 (as compared to a partial quarter of operations for the three months ended March 31, 2006 as a result of the February 2006 acquisition thereof), product development ($2.2 million) and stock based compensation ($2.6 million), offset in part by decreases in other selling expenses ($7.0 million), and amortization expense related to intangible assets other than goodwill ($1.9 million). The increase in general and administrative expenses is primarily due to an increase in salary and payroll taxes ($5.8 million) to support our growing business which includes a lower allocation of JAKKS' overhead to the video game joint venture ($1.2 million), bonus expense ($10.6 million) based on a stronger EPS growth in 2007 compared to 2006, donations expense (2.1 million), rent expense ($1.1 million) and travel and entertainment expense ($0.8 million), offset in part by decreases in other expenses as a result of the reversal of FIN 48 penalties related to income taxes payable ($0.6 million) and the buyout of our New York showroom lease ($1.3 million) and legal and other professional fees ($1.4 million). The decrease in direct selling expenses is primarily due to a decrease in advertising and promotional expenses of $10.9 million in 2007 in support of several of our product lines, offset in part by an increase in sales commissions ($1.2 million) and other direct selling expenses ($2.7 million). From time to time, we may increase or decrease our advertising efforts, if we deem it appropriate for particular products.

Profit from Video Game Joint Venture

Profit from our video game joint venture in 2007 increased to $21.1 million, as compared to $13.2 million in 2006, due to the strong performance of the new Smackdown vs. Raw 2007 game and stronger sales of existing titles in 2007 compared to 2006. Furthermore, we devoted and allocated $1.2 million less of JAKKS' overhead to the video game joint venture. The amount of the preferred return we will receive from the joint venture after June 30, 2006 became subject to change.

Interest Income

Interest income in 2007 was $6.8 million, as compared to $4.9 million in 2006. The increase is due to higher average cash balances and higher interest rates during 2007 compared to 2006.

Interest Expense

Interest expense was $5.5 million and $4.5 million for 2007 and 2006, respectively. The increase is due to net interest accrued pursuant to our January 1, 2007 adoption of the provisions of FIN 48. Interest expense of $4.5 million related to our convertible senior notes payable were comparable in 2007 and 2006.

Provision for Income Taxes

Provision for income taxes includes federal, state and foreign income taxes at effective tax rates of 31.7% in 2006, and 31.3% in 2007, benefiting from a flat 17.5% tax rate on the Company's income arising in, or derived from, Hong Kong for each of 2006 and 2007. The effective rate in 2007 reflects the recognition of certain discrete income tax adjustments recognized in the quarter ended September 30, 2007. These adjustments included the reconciliation of the 2006 income tax provision to the actual income tax liability as reflected in the Company's income tax return, and the reduction in income tax expense due to the recognition of a previously recorded potential income tax liability for uncertain tax positions that are no longer subject to audit due to the closure of the audit period. These discrete items resulted in approximately a 2.1% reduction in the effective income tax rate for the twelve months ended December 31, 2007. As of December 31, 2007, the Company had net deferred tax assets of approximately $7.3 million for which an allowance of $0.9 million has been provided since, in the opinion of management, realization of the future benefit is uncertain.

COMPARISON *of the* YEARS ENDED DECEMBER 31, 2006 *and* 2005

Net Sales

Traditional Toys. Net sales of our Traditional Toys segment were $692.5 million in 2006, compared to $589.7 million in 2005, representing an increase of $102.8 million, or 17.4%. The increase in net sales was primarily due to the addition of the Creative Designs line of products, which we acquired in February 2006, with sales of $181.1 million and increases in sales of WWE actions figures and accessories, Doodle Bear, Speed Stacks, Snugglers, Dragonflyz, Trolls, Fly Wheels XPV and Flight toys and our Funnoodle pool toys, offset in part by decreases in sales of Plug It In & Play TV Games, wheels products, dolls, Sky Dancers, Care Bears, Cabbage Patch Kids, Go Fly A Kite and junior sports products.

Craft/Activity/Writing Products. Net Sales of our Craft/Activity/Writing Products were $52.8 million in 2006, compared to $62.0 million in 2005, representing a decrease of $9.2 million, or 14.8%. The decrease in net sales was primarily due to decreases in sales of our Flying Colors activities and our Pentech and Color Workshop writing instruments and related products, offset in part by an increase in sales of our Creepy Crawlers® activity sets.

Pet Products. Net Sales of our Pet Pal line of products, which we acquired in June 2005, were $20.1 million in 2006, compared to $9.8 million in 2005, representing an increase of $10.3 million, or 105.1%. The increase is attributable to the growth in sales of this new line of products through our existing distribution channels and having sales for the entire year in 2006.

Cost of Sales

Traditional Toys. Cost of sales of our Traditional Toys segment was $429.4 million in 2006, compared to $348.6 million in 2005, representing an increase of $80.8 million, or 23.2%. The increase primarily consisted of an increase in product costs of $74.5 million, which is in line with the higher volume of sales. Furthermore, royalty expense for our Traditional Toys segment decreased by $1.5 million and as a percentage of net sales due to changes in the product mix to more products with lower royalty rates or proprietary products with no royalty rates, from products with higher royalty rates. Product costs as a percentage of sales increased due to the mix of the product sold and sell-through of closeout product. Our depreciation of molds and tools increased by $7.9 million due to new products being sold in this segment.

Craft/Activity/Writing Products. Cost of sales of our Craft/Activity/Writing Products was $29.0 million in 2006, compared to $39.9 million in 2005, representing a decrease of $10.9 million, or 27.3%. The decrease primarily consisted of decreases in product costs of $8.6 million and royalty expense of $2.2 million, which were in line with the lower volume of sales. Additionally, our depreciation of molds and tools was comparable year-over-year.

Pet Products. Cost of sales of our Pet Pal line of products, which we acquired in June 2005, was $12.1 million in 2006, compared to $6.3 million in 2005, representing an increase of $5.8 million, or 92.1%. The increase primarily consisted of increases in product costs of $4.8 million and royalty expense of $0.8 million, which were in line with the higher volume of sales. Additionally, our depreciation of molds and tools increased by $0.3 million.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $202.5 million in 2006 and $178.7 million in 2005, constituting 26.5% and 27.0% of net sales, respectively. The overall increase of $23.8 million in such costs was primarily due to the addition of overhead related to the operations of Creative Designs ($20.3 million), increases in product development ($2.7 million), amortization expense related to intangible assets other than goodwill ($7.4 million) and stock-based compensation ($3.1 million), offset in part by a decrease in other selling expenses ($12.0 million). Increased grants of restricted stock awards to our non-employee directors and the increase in the price of our common stock in 2006 compared to 2005 resulted in stock-based compensation expense of $6.5 million in 2006, compared to $3.4 million in 2005. The decrease in direct selling expenses is primarily due to efficiencies gained by closing two third-party warehouses, and decreases in sales commission expense of $1.9 million and advertising and promotional expenses of $6.4 million in 2006 in support of several of our product lines. From time to time, we may increase or decrease our advertising efforts, if we deem it appropriate for particular products.

Profit from Video Game Joint Venture

Profit from our video game joint venture in 2006 increased to $13.2 million, as compared to $9.4 million in 2005, due to the strong performance of the three new games released and stronger sales of existing titles in 2006, offset by the reduction of $0.1 million to THQ for their share of profit on our sales of WWE themed Plug It In & Play TV Games compared to 2005, in which period four new games were released and $0.8 million was earned by THQ for the WWE themed Plug It In & Play TV Games. The amount of the preferred return we will receive from the joint venture after June 30, 2006 is subject to change.

Other Expense

Other expense in 2005 of $1.4 million related to the write-off of an investment in a Chinese joint venture. There was no such expense in 2006.

Interest Income

Interest income in 2006 was $4.9 million, as compared to $5.2 million in 2005. This decrease is due to lower average cash balances in 2006 as a result of our acquisition of Creative Designs, offset in part by higher interest rates during 2006 compared to 2005.

Interest Expense

Interest expense in 2006 of $4.5 million related to the convertible senior notes payable was comparable to 2005.

Provision for Income Taxes

Provision for income taxes included federal, state and foreign income taxes at effective tax rates of 34.3% in 2005 and 31.7% in 2006, benefiting from a flat 17.5% Hong Kong Corporation Tax on our income arising in, or derived from, Hong Kong for each of 2005 and 2006. The decrease in the effective tax rate in 2006 is due to the effect, in 2005, of a one-time repatriation of undistributed earnings from our international subsidiaries, which created additional taxes in 2005 on 15% of the dividends received. As of December 31, 2006, we had net deferred tax assets of approximately $8.2 million for which an allowance of $0.9 million has been provided since, in the opinion of management, realization of this portion of the future benefit is uncertain.

QUARTERLY FLUCTUATIONS AND SEASONALITY

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

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

	2006				2007			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$107,244	$124,041	$295,789	$238,312	$124,062	$ 129,547	$ 318,391	$285,085
As a % of full year	14.0%	16.2%	38.7%	31.1%	14.5 %	15.1%	37.1%	33.3%
Gross Profit	44,163	49,280	112,883	88,468	45,508	45,295	124,050	108,797
As a % of full year	15.0%	16.7%	38.3%	30.0%	14.1%	14.0%	38.3%	33.6%
As a % of net sales	41.2%	39.7%	38.2%	37.1%	36.7%	35.0%	39.0%	38.2%
Income from operations	2,244	8,963	58,204	22,901	3,324	6,488	65,057	32,129
As a % of full year	2.4%	9.7%	63.1%	24.8%	3.1%	6.1%	60.8%	30.0%
As a % of net sales	2.1%	7.2%	19.7%	9.6%	2.7%	5.0%	20.4%	11.3%
Income before provision for income taxes	3,283	9,135	57,855	35,662	4,762	7,403	67,087	50,289
As a % of net sales	3.1%	7.4%	19.6%	15.0%	3.8%	5.7%	21.1%	17.6%
Net income	2,331	6,361	40,499	23,184	3,238	5,034	47,318	33,401
As a % of net sales	2.2%	5.1%	13.7%	9.7%	2.6%	3.9%	14.9%	11.7%
Diluted earnings per share	$ 0.09	$ 0.22	$ 1.26	$ 0.73	$ 0.12	$ 0.17	$ 1.45	$ 1.03
Weighted average shares and equivalents outstanding	32,617	32,790	32,736	32,803	27,985	33,133	33,145	33,251

During the fourth quarter of 2005, we recorded a non-cash charge, which impacted net income, of $3.6 million for restricted stock, and we repatriated $105.5 million from our Hong Kong subsidiaries which resulted in incremental income tax expense of $5.4 million and reduced net income.

During 2007, we recorded net interest expense of $0.9 million related to FIN 48.

RECENT ACCOUNTING STANDARDS

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 (“FIN 48”), *Accounting for Uncertainty in Income Taxes*, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Under FIN 48, the tax benefit of uncertain tax positions may be recognized only if it is more likely than not that the tax position will be sustained, based solely on its technical merits presuming the tax authority has full knowledge of all relevant information. Additionally, FIN 48 provides guidance on the de-recognition, classification, and accounting in interim periods and disclosure requirements for uncertain tax positions. In the first quarter of 2007, we adopted FIN 48 which resulted in the recognition of an increased current and non-current income tax payable for unrecognized tax benefits of $15.6 million. We have also recognized an additional liability of $2.5 million for penalties and $2.8 million for interest on the income tax liability. These increases to the liabilities resulted in a reduction of $19.1 million to the January 1, 2007 balance of retained earnings, net of related tax benefits. Current interest on income tax liabilities is recognized as interest expense and penalties on income tax liabilities are recognized as other expense in the consolidated statement of income. During the year ended December 31, 2007, we accrued an additional $0.9 million of net interest expense.

In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 141 (Revised) (“FAS 141(R)”), *Business Combinations*. The provisions of this statement are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning after December 15, 2008. Earlier application is not permitted. FAS141(R) replaces FAS 141 and provides new guidance for valuing assets and liabilities acquired in a business combination. We will adopt FAS141(R) in calendar year 2009.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 157 (“FAS 157”) *Fair Value Measurements*. This standard provides new definitions for fair value and establishes a framework for measuring fair value in financial statements. FAS 157 becomes effective for us as of January 1, 2008. We anticipate that the effect of the adoption of FAS 157 will be immaterial to our financial statements.

Liquidity and Capital Resources

As of December 31, 2007, we had working capital of $355.7 million, as compared to $280.4 million as of December 31, 2006. This increase was primarily attributable to our operating activities, offset in part by the disbursement of earn-out payments related to our Play Along, Creative Designs and Pet Pal acquisitions.

Operating activities provided net cash of $87.7 million in the year ended December 31, 2007, as compared to $63.7 million in 2006. Net cash was provided primarily by net income of $90.0 million and non-cash charges and changes in working capital. Accounts receivable turnover as measured by days sales outstanding in accounts receivable for the three months ended December 31, 2007 decreased from approximately 58 days as of December 31, 2006 to approximately 55 days as of December 31, 2007 primarily due to the larger volume of sales for the quarter ended December 31, 2007 compared to the volume of sales for the quarter ended December 31, 2006. Other than open purchase orders, issued in the normal course of business, we have no obligations to purchase finished goods from our manufacturers. As of December 31, 2007, we had cash and cash equivalents of $241.3 million.

Our investing activities used cash of $33.7 million in the year ended December 31, 2007, as compared to $121.9 million in 2006, consisting primarily of cash paid for the Creative Designs earn-out of $6.7 million, the Play Along earn-out of $6.7 million, the Pet Pal earn-out of $2.0 million and the purchase of office furniture and equipment and molds and tooling of $18.1 million used in the manufacture of our products and other assets. In 2006, our investing activities consisted primarily of cash paid for the purchase of net assets in the Creative Designs acquisition of $101.7 million, the Play Along earn-out of $6.7 million, the Pet Pal earn-out of $1.5 million and the purchase of office furniture and equipment and molds and tooling of $11.2 million used in the manufacture of our products and other assets. As part of our strategy to develop and market new products, we have entered into various character and product licenses with royalties generally ranging from 1% to 14% payable on net sales of such products. As of December 31, 2007, these agreements required future aggregate minimum guarantees of $38.2 million, exclusive of $26.2 million in advances already paid. Of this $38.2 million future minimum guarantee, $21.3 is due over the next twelve months. We do not have any significant capital expenditure commitments as of December 31, 2007.

Our financing activities provided net cash of $2.8 million in the year ended December 31, 2007, as compared to $3.1 million in 2006. In 2007, cash was primarily provided from the exercise of stock options and the tax benefit from stock options exercised. In 2006, cash was primarily provided from the exercise of stock options and the tax benefit from stock options exercised.

The following is a summary of our significant contractual cash obligations for the periods indicated that existed as of December 31, 2007 and is based on information appearing in the notes to the consolidated financial statements (in thousands):

	2008	*2009*	*2010*	*2011*	*2012*	Thereafter	Total
Long-term debt	$ —	$ —	$ —	$ —	$ —	$ 98,000	$ 98,000
Operating leases	9,662	6,796	5,736	5,779	5,451	4,034	37,458
Minimum guaranteed license/royalty payments	21,260	10,224	5,001	1,175	500	—	38,160
Employment contracts	5,919	3,789	2,280	—	—	—	11,988
Total contractual cash obligations	$ 36,841	$ 20,809	$ 13,017	$ 6,954	$ 5,951	$102,034	$185,606

The above table excludes any potential uncertain income tax liabilities that may become payable upon examination of the Company’s income tax returns by taxing authorities. Such amounts and periods of payment cannot be reliably estimated. See Note 12 to the financial statements for further explanation of the Company’s uncertain tax positions. The above table also excludes our contractual obligation with one of our executives regarding his retirement plan. Such amounts and periods of payment cannot be reliably estimated. See Note 15 to the financial statements for further explanation of the Company’s retirement plan commitment.

In February 2008, our Board of Directors authorized us to repurchase up to $30.0 million of our common stock. To date, no shares have been repurchased by us.

In October 2004, the American Jobs Creation Act of 2004 (the “Act”) was signed into law. The Act created a one-time incentive for U.S. corporations to repatriate undistributed earnings from their international subsidiaries by providing an 85% dividends-received deduction for certain international earnings.

The deduction was available to corporations during the tax year that included October 2004, or in the immediately subsequent tax year. In the fourth quarter of 2005, our Board of Directors approved a plan to repatriate $105.5 million in foreign earnings, which was completed in December 2005. The federal and state income tax expense related to this repatriation was approximately $5.4 million.

In October 2004, we were named as a defendant in a lawsuit commenced by WWE (the "WWE Action"). The complaint also named as defendants, among others, the joint venture with THQ Inc., certain of our foreign subsidiaries and our three executive officers. The complaint was dismissed and an appeal has been filed with respect to the Judgment dismissing the WWE Action. In November 2004, several purported class action lawsuits were filed in the United States District Court for the Southern District of New York, alleging damages associated with the facts alleged in the WWE Action. In January 2008, the complaint was dismissed without prejudice to seeking leave to file an amended complaint. Such leave was sought in February 2008. Three shareholder derivative actions have also been filed against us, nominally, and against certain of our Board members (the "Derivative Actions"). The Derivative Actions seek to hold the individual defendants liable for damages allegedly caused to our Company by their actions, and, in one of the Derivative Actions, seeks restitution to our Company of profits, benefits and other compensation obtained by them. In October 2006, WWE commenced a lawsuit against THQ and the joint venture concerning allegedly improper sales of WWE video games in Japan and other countries in Asia, seeking among other things, a declaration that WWE is entitled to terminate its video games license with the joint venture and monetary damages (the "Connecticut Action"). In spring 2007, WWE amended the complaint in the Connecticut Action to allege the matters set forth in the WWE Action. Thereafter, WWE amended the complaint in the Connecticut Action to allege state claim laws that had been alleged in the WWE Action. WWE submitted a proposed case management order in February 2008 and it provided for a trial on or after October 2009. On February 22, 2008, we submitted a response in which we requested that no case management order be adopted prior to the determination of the motion to strike and for summary judgment because it would moot such a case management order but that if a case management order is to be adopted it should provide for a trial, if the matter is not fully dismissed, not before June 2010.

In June 2005, we purchased substantially all of the operating assets and assumed certain liabilities relating to the Pet Pal line of pet products, including toys, treats and related pet products. The total initial purchase price of $10.6 million was paid in cash. In addition, we agreed to pay an earn-out of up to an aggregate amount of $25.0 million in cash over the three years ending June 30, 2008 following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. During the years ended December 31, 2006 and 2007, $1.5 million and $2.0 million, respectively, of the earn-out was earned and recorded as goodwill. Goodwill of $4.6 million arose from this transaction, which represents the excess of the purchase price over the fair value of assets acquired less liabilities assumed. This acquisition expands our product offerings and distribution channels. Our results of operations have included Pet Pal from the date of acquisition.

In February 2006, we acquired substantially all of the assets of Creative Designs. The total initial purchase price of $111.1 million consisted of $101.7 million in cash, 150,000 shares of our common stock at a value of approximately $3.3 million and the assumption of liabilities in the amount of $6.1 million. In addition, we agreed to pay an earn-out of up to an aggregate amount of $20.0 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. For the years ended December 31, 2006 and 2007, $6.9 million and $6.7 respectively, of the earn-out was earned and recorded as goodwill. Creative Designs is a leading designer and producer of dress-up and role-play toys and is included in our results of operations from the date of acquisition.

In June 2003, we sold an aggregate of $98.0 million of 4.625% Convertible Senior Notes due June 15, 2023. The notes may be converted into shares of our common stock at an initial conversion price of $20.00 per share, or 50 shares per note, subject to certain circumstances. The notes may be converted in each quarter subsequent to any quarter in which the closing price of our common stock is at or above a prescribed price for at least 20 trading days in the last 30 trading day period of the quarter. The prescribed price for the conversion trigger is $24.00 through June 30, 2010, and increases nominally each quarter thereafter. Cash interest is payable at an annual rate of 4.625% of the principal amount at issuance, from the issue date to June 15, 2010, payable on June 15 and December 15 of each year, commencing on December 15, 2003. After June 15, 2010, interest will accrue at the same rate on the outstanding notes until maturity. At maturity, we will redeem the notes at their accreted principal amount, which will be equal to $1,811.95 (181.195%) per $1,000 principal amount at issuance, unless redeemed or converted earlier. The notes were not convertible as of December 31, 2007, but are convertible in the first quarter of 2008.

We may redeem the notes at our option in whole or in part beginning on June 15, 2010, at 100% of their accreted principal amount plus accrued and unpaid interest, if any, payable in cash. Holders of the notes may also require us to repurchase all or part of their notes on June 15, 2010, for cash, at a repurchase price of 100% of the principal amount per note plus accrued and unpaid interest, if any. Holders of the notes may also require us to repurchase all or part of their notes on June 15, 2013 and June 15, 2018 at a repurchase price of 100% of the accreted principal amount per note plus accrued and unpaid interest, if any. Any repurchases at June 15, 2013 and June 15, 2018 may be paid in cash, in shares of common stock or a combination of cash and shares of common stock.

We believe that our cash flows from operations and cash and cash equivalents will be sufficient to meet our working capital and capital expenditure requirements and provide us with adequate liquidity to meet our anticipated operating needs for at least the next 12 months. Although operating activities are expected to provide cash, to the extent we grow significantly in the future, our operating and investing activities may use cash and, consequently, this growth may require us to obtain additional sources of financing. There can be no assurance that any necessary additional financing will be available to us on commercially reasonable terms, if at all. We intend to finance our long-term liquidity requirements out of net cash provided by operations and net cash and cash equivalents. As of December 31, 2007, we do not have any off-balance sheet arrangements.

Exchange Rates

Sales from our United States and Hong Kong operations are denominated in U.S. dollars and our manufacturing costs are denominated in either U.S. or Hong Kong dollars. Operations and operating expenses of all of our operations are denominated in local currency, thereby creating exposure to changes in exchange rates. Changes in the Hong Kong dollar/U.S. dollar exchange rate may positively or negatively affect our operating results. The exchange rate of the Hong Kong dollar to the U.S. dollar has been fixed by the Hong Kong government since 1983 at HK$7.80 to US$1.00 and, accordingly, has not represented a currency exchange risk to the U.S. dollar. We cannot assure you that the exchange rate between the United States and Hong Kong currencies will continue to be fixed or that exchange rate fluctuations between the United States and Hong Kong currencies will not have a material adverse effect on our business, financial condition or results of operations.

CONSOLIDATED FINANCIAL STATEMENTS *and* SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
JAKKS Pacific, Inc.
Malibu, California

We have audited the accompanying consolidated balance sheets of JAKKS Pacific, Inc. (the "Company") as of December 31, 2007 and 2006 and the related consolidated statements of income, other comprehensive income, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of JAKKS Pacific, Inc. as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As more fully described in Note 2 to the consolidated financial statements, effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109," and effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), JAKKS Pacific, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 28, 2008 expressed an unqualified opinion thereon.

BDO Seidman, LLP

BDO Seidman, LLP

Los Angeles, California
February 28, 2008

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
JAKKS Pacific, Inc. and Subsidiaries

We have audited the accompanying consolidated statements of income, other comprehensive income, stockholders' equity, and cash flows and the financial statement schedule of JAKKS Pacific, Inc. and Subsidiaries (Company) for the year ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements and schedule referred to above present fairly, in all material respects, the results of operations and cash flows of JAKKS Pacific, Inc. and Subsidiaries for the year ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

PKF

PKF

Certified Public Accountants
A Professional Corporation
Los Angeles, California
February 13, 2006

JAKKS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	December 31, 2006	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$184,489	$ 241,250
Marketable securities	210	218
Accounts receivable, net of allowance for uncollectible accounts of $1,206 and $1,354, respectively	153,116	174,451
Inventory	76,788	75,486
Deferred income taxes	10,592	12,945
Prepaid expenses and other	26,543	21,733
Total current assets	451,738	526,083
Property and equipment		
Office furniture and equipment	8,299	9,961
Molds and tooling	36,600	44,333
Leasehold improvements	4,882	5,186
Total	49,781	59,480
Less accumulated depreciation and amortization	32,898	38,073
Property and equipment, net	16,883	21,407
Intangibles and other, net	40,833	26,200
Investment in video game joint venture	14,873	36,090
Goodwill, net	337,999	353,340
Trademarks, net	19,568	19,568
Total assets	$881,894	$982,688
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$ 65,574	$ 52,287
Accrued expenses	54,664	70,085
Reserve for sales returns and allowances	32,589	26,036
Income taxes payable	18,548	21,997
Total current liabilities	171,375	170,405
Convertible senior notes	98,000	98,000
Other liabilities	854	6,432
Income taxes payable	—	11,294
Deferred income taxes	2,377	5,560
Total liabilities	272,606	291,691
Commitments and contingencies		
Stockholders' equity		
Preferred shares, $.001 par value; 5,000,000 shares authorized; nil outstanding	—	—
Common stock, $.001 par value; 100,000,000 shares authorized; 27,776,947 and 28,275,116 shares issued and outstanding, respectively	28	28
Additional paid-in capital	300,255	312,127
Retained earnings	312,432	382,288
Accumulated other comprehensive loss	(3,427)	(3,446)
Total stockholders' equity	609,288	690,997
Total liabilities and stockholders' equity	$881,894	$982,688

See notes to consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
(In thousands, except per share amounts)	*2005*	*2006*	*2007*
Net sales	$ 661,536	$ 765,386	$ 857,085
Cost of sales	394,829	470,592	533,435
Gross profit	266,707	294,794	323,650
Selling, general and administrative expenses	178,722	202,482	216,652
Income from operations	87,985	92,312	106,998
Profit from video game joint venture	9,414	13,226	21,180
Other expense	(1,401)	—	—
Interest income	5,183	4,930	6,819
Interest expense	(4,544)	(4,533)	(5,456)
Income before provision for income taxes	96,637	105,935	129,541
Provision for income taxes	33,144	33,560	40,550
Net income	$ 63,493	$ 72,375	$ 88,991
Basic earnings per share	$ 2.37	$ 2.66	$ 3.22
Basic weighted number of shares	26,738	27,227	27,665
Diluted earnings per share	$ 2.06	$ 2.30	$ 2.77
Diluted weighted number of shares	32,193	32,714	33,149

See notes to consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME

	Years Ended December 31,		
(In thousands)	*2005*	*2006*	*2007*
Other comprehensive income:			
Net income	$63,493	$72,375	$88,991
Foreign currency translation adjustment	(1,042)	(638)	(19)
Other comprehensive income	$62,451	$71,737	$88,972

See notes to consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2005, 2006 AND 2007

	Common Stock					
(In thousands)	Number of Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance, December 31, 2004	26,234	$26	$276,642	$176,564	$ (1,747)	$451,485
Exercise of options	567	1	4,872	—	—	4,873
Stock option income tax benefit	—	—	4,119	—	—	4,119
Restricted stock grants	245	—	5,130	—	—	5,130
Compensation for vested stock options	—	—	(1,706)	—	—	(1,706)
Retirement of common stock	(101)	—	(1,701)	—	—	(1,701)
Net income	—	—	—	63,493	—	63,493
Foreign currency translation adjustment	—	—	—	—	(1,042)	(1,042)
Balance, December 31, 2005	26,945	27	287,356	240,057	(2,789)	524,651
Exercise of options	333	—	4,382	—	—	4,382
Stock option income tax benefit	—	—	1,509	—	—	1,509
Restricted stock grants	473	1	4,579	—	—	4,580
Compensation for vested stock options	—	—	1,902	—	—	1,902
Retirement of common stock	(124)	—	(2,798)	—	—	(2,798)
Issuance of common stock for Creative Designs	150	—	3,325	—	—	3,325
Net income	—	—	—	72,375	—	72,375
Foreign currency translation adjustment	—	—	—	—	(638)	(638)
Balance, December 31, 2006	27,777	28	300,255	312,432	(3,427)	609,288
Adoption of FIN 48	—	—	—	(19,135)	—	(19,135)
Exercise of options	391	—	6,470	—	—	6,470
Stock option income tax benefit	—	—	1,053	—	—	1,053
Restricted stock grants	323	—	8,082	—	—	8,082
Compensation for vested stock options	—	—	972	—	—	972
Retirement of common stock	(191)	—	(4,675)	—	—	(4,675)
Retirement of restricted stock	(25)	—	(30)	—	—	(30)
Net income	—	—	—	88,991	—	88,991
Foreign currency translation adjustment	—	—	—		(19)	(19)
Balance, December 31, 2007	28,275	$28	$ 312,127	$382,288	$(3,446)	$690,997

See notes to consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Years Ended December 31, 2005	2006	2007
Cash flows from operating activities			
Net income	$ 63,493	$ 72,375	$ 88,991
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	15,527	26,166	26,663
Share-based compensation expense	3,424	6,482	9,054
Profit from video game joint venture	(548)	(5,147)	(21,856)
Loss on disposal of property and equipment	104	48	1,781
Write-off of investment in Chinese Joint Venture	1,401	—	—
Changes in operating assets and liabilities Accounts receivable	16,697	(52,885)	(21,334)
Inventory	(13,272)	(8,352)	1,329
Prepaid expenses and other	1,088	(8,293)	4,817
Accounts payable	(9,437)	12,608	(13,061)
Accrued expenses	(1,915)	1,882	14,493
Income taxes payable	(2,936)	14,756	(891)
Reserve for sales returns and allowances	1,732	5,253	(6,489)
Other liabilities	995	(140)	1,519
Deferred income taxes	(5,292)	(1,043)	2,644
Total adjustments	7,568	(8,665)	(1,331)
Net cash provided by operating activities	71,061	63,710	87,660
Cash flows from investing activities			
Purchases of property and equipment	(8,270)	(11,204)	(18,116)
Change in other assets	(123)	46	(6)
Sale (purchases) of deposits	241	(701)	17
Cash paid for net assets	(20,362)	(109,845)	(15,605)
Net (purchases) sales of marketable securities	19,047	(210)	(7)
Net cash used by investing activities	(9,467)	(121,914)	(33,717)
Cash flows from financing activities			
Proceeds from stock options exercised (net of cash-less exercises of $1.7 million, $2.8 million and $4.7 million in 2005, 2006 and 2007, respectively)	3,173	1,584	1,765
Tax benefit from stock options exercised	—	1,509	1,053
Net cash provided by financing activities	3,173	3,093	2,818
Impact of foreign currency translation	(1,073)	(638)	—
Net increase (decrease) in cash and cash equivalents	63,694	(55,749)	56,761
Cash and cash equivalents, beginning of year	176,544	240,238	184,489
Cash and cash equivalents, end of year	$ 240,238	$ 184,489	$ 241,250
Cash paid during the period for:			
Interest	$ 4,533	$ 4,533	$ 4,533
Income taxes	$ 41,284	$ 19,496	$ 32,198

See Notes 5 and 18 for additional supplemental information to consolidated statements of cash flows.

See notes to consolidated financial statements.

JAKKS PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007

Note 1—Principal Industry

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

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

Note 2—Summary of Significant Accounting Policies

Principles of consolidation

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

Cash and cash equivalents

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

Use of estimates

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

Revenue recognition

Revenue is recognized upon the shipment of goods to customers or their agents, depending on terms, provided that there are no uncertainties regarding customer acceptance, the sales price is fixed or determinable, and collectibility is reasonably assured and not contingent upon resale.

Generally, the Company does not allow for product returns. The Company provides a negotiated allowance for breakage or defects to its customers, which is recorded when the related revenue is recognized. However, the Company does make occasional exceptions to this policy and consequently accrues a return allowance in gross sales based on historic return amounts and management estimates.

The Company also will occasionally grant credits to facilitate markdowns and sales of slow moving merchandise. These credits are recorded as a reduction of gross sales at the time of occurrence. The Company's reserve for sales returns and allowances decreased by $6.6 million from $32.6 million as of December 31, 2006 to $26.0 million as of December 31, 2007.

Inventory

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

	December 31,	
	2006	*2007*
Raw materials	$ 3,845	$ 1,694
Finished goods	72,943	73,792
	$ 76,788	$ 75,486

Fair value of financial instruments

The Company's cash and cash equivalents, marketable securities, accounts receivable, accounts payable and accrued expenses represent financial instruments. The carrying value of these financial instruments is a reasonable approximation of fair value. The fair value of the $98.0 million of convertible senior notes payable at December 31, 2006 and 2007 was approximately $127.4 million and $137.7 million, respectively, based on the most recent quoted market price.

Property and equipment

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

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

For the years ended December 31, 2005, 2006, and 2007, the Company's aggregate depreciation expense related to property and equipment was $6.3 million, $8.5 million and $11.4 million, respectively.

Advertising

Production costs of commercials and programming are charged to operations in the year during which the production is first aired. The costs of other advertising, promotion and marketing programs are charged to operations in the year incurred. Advertising expense for the three years in the period ended December 31, 2007, was approximately $38.8 million, $36.7 million and $22.3 million, respectively.

The Company also participates in cooperative advertising arrangements with some customers, whereby it allows a discount from invoiced product amounts in exchange for customer purchased advertising that features the Company's products. Typically, these discounts range from 1% to 6% of gross sales, and are generally based on product purchases or on specific advertising campaigns. Such amounts are accrued when the related revenue is recognized or when the advertising campaign is initiated. These cooperative advertising arrangements are accounted for as direct selling expenses.

Income taxes

The Company does not file a consolidated return with its foreign subsidiaries. The Company files federal and state returns and its foreign subsidiaries each file Hong Kong returns, as applicable. Deferred taxes are provided on a liability method whereby deferred tax assets are recognized as deductible temporary differences and operating loss and tax credit carry-forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Translation of foreign currencies

Assets and liabilities denominated in Hong Kong dollars are translated into United States dollars at the rate of exchange ruling at the balance sheet date. Transactions during the period are translated at the rates ruling at the dates of the transactions.

Profits and losses resulting from the above translation policy are recognized in the statements of other comprehensive income.

Accounting for the impairment of long-lived assets

Long-lived assets with finite lives, which include property and equipment and intangible assets other than goodwill, are evaluated at least annually for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable through the estimated undiscounted future cash flows from the use of these assets. When any such impairment exists, the related assets will be written down to fair value. Finite-lived intangible assets consist primarily of product technology rights, acquired backlog, customer relationships, product lines and license agreements. These intangible assets are amortized over the estimated economic lives of the related assets. Accumulated amortization as of December 31, 2006 and 2007 was $48.5 million and $63.1 million, respectively.

Goodwill and other indefinite-lived intangible assets

In accordance with Statement of Financial Accounting Standards ("SFAS") 142, *Goodwill and Other Intangible Assets*, goodwill and indefinite-lived intangible assets are not amortized, but are tested for impairment at least annually at the reporting unit level. Losses in value are recorded when and as material impairment has occurred in the underlying assets or when the benefits of the identified intangible assets are realized. As of December 31, 2007, there was no impairment to the underlying value of goodwill or indefinite-lived intangible assets other than goodwill. Indefinite-lived intangible assets other than goodwill consist of trademarks.

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

Share-based Compensation

In December 2004, the FASB issued SFAS 123 (Revised), *Share-Based Payment*, ("SFAS 123R") which amends SFAS 123, *Accounting for Stock Based Compensation*, and SFAS 95, *Statement of Cash Flows*. SFAS 123R requires companies to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements, and requires additional accounting and disclosure related to the income tax and cash flow effects resulting from share-based payment arrangements. SFAS 123R was effective for the Company beginning as of January 1, 2006, and the Company recorded $1.9 million and $1.0 million of stock option expense in 2006 and 2007, respectively, and $4.6 million and $8.1 million of restricted stock expense, respectively, in 2006 and 2007. See Note 16 for further details relating to share based compensation.

Earnings per share

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

	2005		
	Income	Weighted Average Shares	Per Share
Basic EPS			
Income available to common stockholders	$63,493	26,738	$ 2.37
Effect of dilutive securities			
Assumed conversion of convertible senior notes	2,978	4,900	
Options and warrants	—	555	
Diluted EPS			
Income available to common stockholders plus assumed exercises and conversion	$ 66,471	32,193	$ 2.06

	2006		
	Income	Weighted Average Shares	Per Share
Basic EPS			
Income available to common stockholders	$ 72,375	27,227	$ 2.66
Effect of dilutive securities			
Assumed conversion of convertible senior notes	2,946	4,900	
Options and warrants	—	362	
Unvested restricted stock grants	—	225	
Diluted EPS			
Income available to common stockholders plus assumed exercises and conversion	$ 75,321	32,714	$ 2.30

	2007		
	Income	Weighted Average Shares	Per Share
Basic EPS			
Income available to common stockholders	$ 88,991	27,665	$ 3.22
Effect of dilutive securities			
Assumed conversion of convertible senior notes	2,946	4,900	
Options and warrants	—	328	
Unvested restricted stock grants	—	256	
Diluted EPS			
Income available to common stockholders plus assumed exercises and conversion	$ 91,937	33,149	$ 2.77

Basic earnings per share has been computed using the weighted average number of common shares outstanding. Diluted earnings per share has been computed using the weighted average number of common shares and common share equivalents outstanding (which consist of warrants, options, restricted stock and convertible debt to the extent they are dilutive). Potentially dilutive stock options of 487,506, 406,612 and nil for the years ended December 31, 2005, 2006 and 2007, respectively, were not included in the computation of diluted earnings per share as the average market price of the Company's common stock did not exceed the weighted average exercise price of such options and to have included them would have been anti-dilutive. Potentially dilutive restricted stock of 13,907 for the year ended December 31, 2007 was not included in the computation of diluted earnings per share as the average market price of the Company's common stock did not exceed the weighted average exercise price of such restricted stock and to have included them would have been anti-dilutive.

Recent Accounting Standards

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes*, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Under FIN 48, the tax benefit of uncertain tax positions may be recognized only if it is more likely than not that the tax position will be sustained, based solely on its technical merits presuming the tax authority has full knowledge of all relevant information. Additionally, FIN 48 provides guidance on the de-recognition, classification, and accounting in interim periods and disclosure requirements for uncertain tax positions. In the first quarter of 2007, the Company adopted FIN 48 which resulted in the recognition of an increased current and non-current income tax payable for unrecognized tax benefits of $15.6 million. The Company has also recognized an additional liability of $2.5 million for penalties and $2.8 million for interest on the income tax liability. These increases to the liabilities resulted in a reduction of $19.1 million to the January 1, 2007 balance of retained earnings, net of related tax benefits. Current interest on income tax liabilities is recognized as interest expense and penalties on income tax liabilities are recognized as other expense in the consolidated statement of income. During the year ended December 31, 2007, the Company accrued an additional $0.9 million of net interest expense.

In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 141 (Revised) ("FAS141(R)"), *Business Combinations*. The provisions of this statement are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning after December 15, 2008. Earlier application is not permitted. FAS141(R) replaces FAS 141 and provides new guidance for valuing assets and liabilities acquired in a business combination. The Company will adopt FAS141(R) in calendar year 2009.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 157 ("FAS 157") *Fair Value Measurements*. This standard provides new definitions for fair value and establishes a framework for measuring fair value in financial statements. FAS 157 becomes effective for the Company as of January 1, 2008. The Company anticipates that the effect of the adoption of FAS 157 will be immaterial to its financial statements.

Reclassifications

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

Note 3—Business Segments, Geographic Data, Sales by Product Group, and Major Customers

The Company is a worldwide producer and marketer of children's toys and related products, principally engaged in the design, development, production, marketing and distribution of traditional toys, including boys' action figures, vehicles and playsets, dolls, craft and activity products, writing instruments, compounds, girls' toys, plush, construction toys, and infant and preschool toys, as well as pet treats, toys and related pet products.

The Company's reportable segments are Traditional Toys, Craft/Activity/Writing Products, and Pet Products, each of which include worldwide sales. Traditional Toys include boys' action figures, vehicles and playsets, plush products, role-play, electronic toys, swimming pool toys, kites, remote control flying vehicles, squirt guns, and related products. Craft/Activity/Writing Products include pens, pencils, stationery and drawing, painting and other craft related products. Pet Products include pet treats, toys and related pet products. Prior to 2007, the Company had accounted for seasonal and outdoor products as a separate reporting unit. During 2007, the Company restructured its internal operations and consolidated the former seasonal/outdoor reporting unit into the Traditional reporting unit. These products share key characteristics, including common management, distribution, and marketing strategies. Prior segment reporting units have been restated to reflect this change.

Segment performance is measured at the operating income level. All sales are made to external customers, and general corporate expenses have been attributed to the various segments based on sales volumes. Segment assets are comprised of accounts receivable and inventories, net of applicable reserves and allowances, goodwill and other assets.

Results are not necessarily those that would be achieved were each segment an unaffiliated business enterprise. Information by segment and a reconciliation to reported amounts for the three years in the period ended December 31, 2007 are as follows (in thousands):

	Years Ended December 31,		
	2005	*2006*	*2007*
Net Sales			
Traditional Toys	$589,715	$692,498	$792,998
Craft/Activity/Writing Products	62,058	52,834	39,632
Pet Products	9,763	20,054	24,455
	$661,536	$765,386	$857,085

	Years Ended December 31,		
	2005	*2006*	*2007*
Operating Income			
Traditional Toys	$ 78,433	$ 83,521	$100,227
Craft/Activity/Writing Products	8,254	6,372	4,079
Pet Products	1,298	2,419	2,692
	$ 87,985	$ 92,312	$106,998

	Years Ended December 31,		
	2005	*2006*	*2007*
Depreciation and Amortization Expense			
Traditional Toys	$ 14,430	$ 24,780	$ 25,339
Craft/Activity/Writing Products	1,085	995	829
Pet Products	12	391	495
	$ 15,527	$ 26,166	$ 26,663

	December 31,	
	2006	2007
Assets		
Traditional Toys	$743,946	$ 840,848
Craft/Activity/Writing Products	119,883	115,034
Pet Products	18,065	26,806
	$881,894	$ 982,688

The following tables present information about the Company by geographic area as of and for the three years ended December 31, 2007 (in thousands):

	December 31,	
	2006	2007
Long-lived Assets		
United States	$ 13,451	$ 19,372
Hong Kong	3,432	2,035
	$ 16,883	$ 21,407

	Years Ended December 31,		
	2005	2006	2007
Net Sales by Geographic Area			
United States	$562,396	$ 666,294	$ 730,971
Europe	38,620	30,169	37,585
Canada	20,589	27,067	29,155
Hong Kong	24,388	17,500	30,175
Other	15,543	24,356	29,199
	$ 661,536	$ 765,386	$857,085

Major Customers

Net sales to major customers were approximately as follows (in thousands, except for percentages):

	2005		2006		2007	
	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales	Amount	Percentage of Net Sales
Wal-Mart	$ 212,620	32.1%	$ 210,758	27.5%	$ 165,574	19.3%
Target	95,716	14.5	134,347	17.6	124,089	14.5
Toys 'R' Us	82,732	12.5	104,392	13.6	120,873	14.1
	$ 391,068	59.1%	$449,497	58.7%	$410,536	47.9%

No other customer accounted for more than 10% of our total net sales.

At December 31, 2006 and 2007, the Company's three largest customers accounted for approximately 78.1% and 82.2%, respectively, of net accounts receivable. The concentration of the Company's business with a relatively small number of customers may expose the Company to material adverse effects if one or more of its large customers were to experience financial difficulty. The Company performs ongoing credit evaluations of its top customers and maintains an allowance for potential credit losses.

Note 4—Joint Ventures

The Company owns a fifty percent interest in a joint venture with THQ Inc. ("THQ") which develops, publishes and distributes interactive entertainment software for the leading hardware game platforms in the home video game market. The joint venture has entered into a license agreement with an initial license period expiring December 31, 2009 and a renewal period at the option of the joint venture expiring December 31, 2014 under which it acquired the exclusive worldwide right to publish video games based on the WWE franchise on all hardware platforms. The Company's investment is accounted for using the cost method due to the financial and operating structure of the venture and its lack of significant influence over the joint venture. The Company's basis consists primarily of organizational costs, license costs and recoupable advances and is being amortized over the term of the initial license period. The joint venture agreement provides for the Company to receive guaranteed preferred returns through June 30, 2006 at varying rates of the joint venture's net sales depending on the cumulative unit sales and platform of each particular game. The preferred return was subject to change after June 30, 2006 and was to be set for the distribution period beginning July 1, 2006 and ending December 31, 2009 (the "Next Distribution Period"). The agreement provides that the parties will negotiate in good faith and agree to the preferred return not less than 180 days prior to the start of the Next Distribution Period. It further provides that if the parties are unable to agree on a preferred return, the preferred return will be determined by arbitration. The parties have not reached an agreement with respect to the preferred return for the Next Distribution Period and the preferred return for the Next Distribution Period is to be determined through arbitration. The preferred return is accrued in the quarter in which the licensed games are sold and the preferred return is earned. Based on the same rates as set forth under the original joint venture agreement, an estimated receivable of $35.3 million has been accrued for the eighteen months ended December 31, 2007, pending the resolution of this outstanding issue. As of December 31, 2006 and 2007, the balance of the investment in the video game joint venture includes the following components (in thousands):

	December 31,	
	2006	2007
Preferred return receivable	$ 13,482	$ 35,338
Investment costs, net	1,391	752
	$ 14,873	$ 36,090

The Company's joint venture partner retains the financial risk of the joint venture and is responsible for day-to-day operations, including development, sales and distribution, for which they are entitled to any remaining profits. In addition, THQ is entitled to receive a preferred return based on the sale by the Company of its WWE-themed TV Games. During 2006 and 2007, the Company incurred a liability of approximately $0.1 million and nil, respectively, which is recorded as a reduction of profit from the joint venture. During 2005, 2006 and 2007, the Company earned $9.4 million, $13.2 million and $21.2 million, respectively, in net profit from the joint venture.

During 2005, the Company wrote-off its $1.4 million investment in a Chinese joint venture to Other Expense on its determination that none of the value would be realized.

Note 5—Business Combinations

The Company acquired the following entities to further enhance its existing product lines and to continue diversification into other toy categories and seasonal businesses:

On February 9, 2006, the Company acquired substantially all of the assets of Creative Designs International, Ltd. and a related Hong Kong company, Arbor Toys Company Limited (collectively, "Creative Designs"). The total initial consideration of $111.1 million consisted of cash paid at closing in the amount of $101.7 million, the issuance of 150,000 shares of the Company's common stock valued at approximately $3.3 million and the assumption of liabilities in the amount of $6.1 million, and resulted in the recording of goodwill in the amount of $53.6 million. Goodwill represents anticipated synergies to be gained via the combination of Creative Designs with the Company. In addition, the Company agreed to pay an earn-out of up to an aggregate of $20.0 million in cash over the three calendar years following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. For the years ended December 31, 2006 and 2007, $6.9 million and $6.7 million of the earn-out was earned and recorded as goodwill. Creative Designs is a leading designer and producer of dress-up and role-play toys. This acquisition expands the Company's product offerings in the girls role-play and dress-up area and brings it new product development and marketing talent. The Company's results of operations have included Creative Designs from the date of acquisition.

The amount of goodwill from the Creative Designs acquisition that is expected to be deductible for federal and state income tax purposes is approximately $51.4 million. The total purchase price was allocated based on studies and valuations performed to the estimated fair value of assets acquired and liabilities assumed. The purchase price allocation including an aggregate earn-out amount of $13.6 million earned through December 31, 2007 is set forth in the following table (in thousands):

Estimated fair value of net assets:	
Current assets acquired	$ 15,655
Property and equipment, net	1,235
Other assets	103
Liabilities assumed	(6,081)
Intangible assets other than goodwill	40,488
Goodwill	67,186
	$118,586

The following unaudited pro forma information represents the Company's consolidated results of operations as if the acquisition of Creative Designs had occurred on January 1, 2006 and after giving effect to certain adjustments including the elimination of certain general and administrative expenses and other income and expense items not attributable to ongoing operations, interest expense, and related tax effects. Such pro forma information does not purport to be indicative of operating results that would have been reported had the acquisition of Creative Designs actually occurred on January 1, 2006 or on future operating results (in thousands, except per share data).

	Year Ended December 31, 2006
Net sales	$778,269
Net income	$ 75,221
Basic earnings per share	$ 2.73
Weighted average shares outstanding	27,512
Diluted earnings per share	$ 2.38
Weighted average shares and equivalents outstanding	32,777

In June 2005, the Company purchased substantially all of the operating assets and assumed certain liabilities relating to the Pet Pal line of pet products, including toys, treats and related pet products. The total initial purchase price of $10.6 million was paid in cash. In addition, the Company agreed to pay an earn-out of up to an aggregate amount of $25.0 million in cash over the three years ending June 30, 2008 following the acquisition based on the achievement of certain financial performance criteria, which will be recorded as goodwill when and if earned. During the years ended December 31, 2006 and 2007, $1.5 million and $2.0 million, respectively, of the earn-out was earned and recorded as goodwill. Goodwill of $4.6 million arose from this transaction, which represents the excess of the purchase price over the fair value of assets acquired less the liabilities assumed. This acquisition expands the Company's product offerings and distribution channels. The Company's results of operations have included Pet Pal from the date of acquisition. Pro forma results of operations are not provided since the amounts are not material to the consolidated results of operations.

Note 6—Goodwill

The changes in the carrying amount of goodwill for the year ended December 31, 2007 are as follows (in thousands):

	Traditional Toys	Craft/Activity /Writing Products	Pet Products	Total
Balance, December 31, 2005	$ 181,868	$ 82,826	$ 4,604	$ 269,298
Adjustments to goodwill during the year	67,181	—	1,520	68,701
Balance, December 31, 2006	249,049	82,826	6,124	337,999
Adjustments to goodwill during the year	13,341	—	2,000	15,341
Balance at end of the year	$ 262,390	$ 82,826	$ 8,124	$ 353,340

Adjustments to goodwill during the year represent earn-outs earned during the year on acquisitions made in prior years.

Note 7—Intangible Assets Other Than Goodwill

Intangible assets other than goodwill consist primarily of licenses, product lines, debt offering costs from the Company's convertible senior notes and trademarks. Amortized intangible assets are included in the Intangibles and other, net, in the accompanying balance sheets. Trademarks are disclosed separately in the accompanying balance sheets. Intangible assets are as follows (in thousands):

		December 31, 2006			December 31, 2007		
	Weighted Useful Lives	Gross Carrying Amount	Accumulated Amortization	Net Amount	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets:	(Years)						
Acquired order backlog	0.50	$ 1,298	$ (1,298)	$ —	$ 1,298	$ (1,298)	$ —
Licenses	4.77	58,699	(25,821)	32,878	58,699	(39,091)	19,608
Product lines	3.45	17,700	(17,700)	—	17,700	(17,700)	—
Customer relationships	6.23	3,646	(1,239)	2,407	3,646	(1,805)	1,841
Non-compete/Employment contracts	4.00	2,748	(1,753)	995	2,748	(2,348)	400
Debt offering costs	20.00	3,705	(662)	3,043	3,705	(847)	2,858
Total amortized intangible assets		87,796	(48,473)	39,323	87,796	(63,089)	24,707
Unamortized Intangible Assets:							
Trademarks	indefinite	19,568	N/A	19,568	19,568	N/A	19,568
		$107,364	$(48,473)	$58,891	$107,364	$(63,089)	$44,275

For the years ended December 31, 2005, 2006, and 2007, the Company's aggregate amortization expense related to intangible assets was $9.1 million, $16.5 million and $14.6 million, respectively. The Company currently estimates continuing amortization expense for the next five years to be approximately (in thousands):

2008	$ 8,568
2009	5,578
2010	3,048
2011	2,011
2012	2,043

Note 8—Concentration of Credit Risk

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

The Company performs ongoing credit evaluations of its customers' financial condition, but does not require collateral to support domestic customer accounts receivable. Most goods shipped FOB Hong Kong or China are secured with irrevocable letters of credit.

At December 31, 2006 and 2007, the Company's three largest customers accounted for approximately 78.1% and 82.2%, respectively, of net accounts receivable. The concentration of the Company's business with a relatively small number of customers may expose the Company to material adverse effects if one or more of its large customers were to experience financial difficulty. The Company performs ongoing credit evaluations of its top customers and maintains an allowance for potential credit losses.

Note 9—Accrued Expenses

Accrued expenses consist of the following (in thousands):

	2006	2007
Royalties	$ 17,829	$ 25,318
Bonuses	7,172	17,223
Acquisition earn-out	13,598	13,333
Employee salaries and benefits	1,616	1,273
Promotional commitment	1,341	—
Sales commissions	1,764	2,225
Molds and tools	1,489	1,952
Other	9,855	8,761
	$54,664	$70,085

Note 10—Related Party Transactions

A director of the Company is a partner in a law firm that acts as counsel to the Company. The Company incurred legal fees and expenses to the law firm in the amount of approximately $3.2 million in 2005, $2.7 million in 2006 and $1.9 million in 2007.

Note 11—Convertible Senior Notes

Convertible senior notes consist of the following (in thousands):

	2006	2007
4.625% Convertible senior notes	$98,000	$ 98,000

In June 2003, the Company sold an aggregate of $98.0 million of 4.625% Convertible Senior Notes due June 15, 2023. The notes may be converted into shares of the Company's common stock at an initial conversion price of $20.00 per share, or 50 shares per note, subject to certain circumstances. The notes may be converted in each quarter subsequent to any quarter in which the closing price of the Company's common stock is at or above a prescribed price for at least 20 trading days in the last 30 trading day period of the quarter. The prescribed price for the conversion trigger is $24.00 through June 30, 2010, and increases nominally each quarter thereafter. Cash interest is payable at an annual rate of 4.625% of the principal amount at issuance, from the issue date to June 15, 2010, payable on June 15 and December 15 of each year, commencing on December 15, 2003. After June 15, 2010, interest will accrue at the same rate on the outstanding notes. At maturity, the Company will redeem the notes at their accreted principal amount, which will be equal to $1,811.95 (181.195%) per $1,000 principal amount at issuance, unless redeemed or converted earlier. The notes were not convertible as of December 31, 2007, but are convertible in the first quarter of 2008.

The Company may redeem the notes at its option in whole or in part beginning on June 15, 2010, at 100% of their accreted principal amount plus accrued and unpaid interest, if any, payable in cash. Holders of the notes may also require the Company to repurchase all or part of their notes on June 15, 2010, for cash, at a repurchase price of 100% of the principal amount per note plus accrued and unpaid interest, if any. Holders of the notes may also require the Company to repurchase all or part of their notes on June 15, 2013 and June 15, 2018 at a repurchase price of 100% of the accreted principal amount per note plus accrued and unpaid interest, if any. Any repurchases at June 15, 2013 and June 15, 2018 may be paid in cash, in shares of common stock or a combination of cash and shares of common stock.

The Company's convertible senior notes of $98.0 million are not scheduled to be paid during the next five years.

Note 12—Income Taxes

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

	2005	2006	2007
Federal	$ 20,821	$ 22,031	$ 23,931
State and local	4,326	4,310	6,016
Foreign	13,290	8,204	8,719
	38,437	34,545	38,666
APIC	—	58	1,053
Deferred	(5,293)	(1,043)	831
	$ 33,144	$33,560	$40,550

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

	2006	2007
Net deferred tax assets/(liabilities):		
Current:		
Reserve for sales allowances and possible losses	$ 881	$ 115
Accrued expenses	2,404	4,915
Restricted stock grant	1,882	3,076
Federal and state net operating loss carryforwards	2,993	2,993
Uncertain tax positions	—	624
Deductible intangible assets	2,079	—
State income taxes	1,302	2,272
Other	(29)	(130)
	11,512	13,865
Long-term:		
Property and equipment	(608)	1,064
Original issue discount interest	(8,816)	(12,249)
Deductible goodwill and intangibles	1,873	1,678
Foreign tax credit	2,718	2,718
Stock options	686	802
Section 481(a) adjustments	—	(2,312)
Income from joint venture	1,770	1,763
Uncertain tax positions	—	976
	(2,377)	(5,560)
Valuation allowance related to federal and state net operating loss carryforwards	(920)	(920)
Total net deferred tax assets/(liabilities)	$ 8,215	$ 7,385

In October 2004, the American Jobs Creation Act of 2004 (the "Act") was signed into law. The Act created a one-time incentive for U.S. corporations to repatriate undistributed earnings from their international subsidiaries by providing an 85% dividends-received deduction for certain international earnings. The deduction was available to corporations during the tax year that included October 2004, or in the immediately subsequent tax year. In the fourth quarter of 2005, the Company's Board of Directors approved a plan to repatriate $105.5 million in foreign earnings, which was completed in December 2005. The Federal and State income tax expense related to this repatriation was approximately $5.4 million.

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

	2005	2006	2007
Federal income tax expense	35.0%	35.0%	35.0%
State income tax expense, net of federal tax effect	2.1	2.6	3.3
One time dividend from foreign subsidiaries	8.3	—	—
Effect of differences in U.S. and Foreign statutory rates	(9.0)	(5.4)	(5.1)
Other, including adjustments to previously accrued taxes for statute expirations	(2.1)	(0.5)	(1.9)
	34.3%	31.7%	31.3%

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

As of December 31, 2007, the Company has federal and state net operating loss carryforwards of $5.9 million and $12.5 million, respectively, expiring through 2023 and 2024. These carryforwards resulted from the acquisitions of Pentech and Toymax. The utilization of these losses to offset future income is limited under IRC§382. As of December 31, 2007, the Company's management concluded that a deferred tax asset valuation allowance was necessary for $0.9 million of the state net operating loss carryforwards due to uncertainty about the ability to utilize these losses prior to expiration.

The components of income before provision for income taxes are as follows (in thousands):

	2005	2006	2007
Domestic	$24,953	$ 58,227	$ 73,115
Foreign	71,684	47,708	56,426
	$96,637	$105,935	$129,541

As of January 1, 2007, the Company adopted the provisions of FIN 48 "Accounting for Uncertainty in Income Taxes" which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions ("UTP") taken or expected to be take in a tax return. As a result of FIN 48, the Company recognized a liability for UTP of $22.8 million, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. These UTPs are primarily due to income allocation issues between the United States and Hong Kong, and fixed asset depreciation in Hong Kong. The Company has also recognized an additional liability of $2.5 million for penalties and $2.8 for interest on the potential tax liability. These amounts were also accounted for as a reduction in the January 1, 2007 balance of retained earnings. Current interest on potential tax liabilities is recognized as interest expense.

Approximately $0.3 million of the liability for UTP relating to the timing of interest deductions were recognized during 2007. The following table provides further information of UTPs that would affect the effective tax rate, if recognized, as of 12/31/07 (in millions):

Balance, January 1, 2007	$ 22.8
Current year additions	0.3
Current year reduction due to lapse of applicable statute of limitations	(2.8)
Balance, December 31, 2007	$ 20.3

Current year interest and penalties related to UTPs are $0.9 million and $0.6 million, respectively. The interest and penalty liabilities related to UTPs is $3.7 million and $2.0 million on the December 31, 2007 statement of financial position.

Approximately $1.3 million of United States based, and $1.5 million of Hong Kong based UTPs became recognized during 2007 as they related to income tax years for which the audit period had expired. These items are included in the 2007 income tax provision. The tax years 2001 through 2007 are subject to examination in Hong Kong, the tax years 2004 through 2007 are subject to examination in the United States, and the tax year 2003 through 2007 are subject to examination in California.

Note 13—Leases

The Company leases office, warehouse and showroom facilities and certain equipment under operating leases. Rent expense for the years ended December 31, 2005, 2006 and 2007 totaled $7.1 million, $9.1 million and $10.4 million, respectively. The following is a schedule of minimum annual lease payments (in thousands).

2008	$ 9,662
2009	6,796
2010	5,736
2011	5,779
2012	5,451
Thereafter	4,034
	$37,458

Note 14—Common Stock, Preferred Stock and Warrants

The Company has 105,000,000 authorized shares of stock consisting of 100,000,000 shares of $.001 par value common stock and 5,000,000 shares of $.001 par value preferred stock.

During 2007, the Company issued an aggregate of 240,000 shares of restricted stock to two of its executive officers, which vest 50% in each of January 2008 and 2009 subject to acceleration based on the Company achieving certain financial performance criteria, and an aggregate of 27,340 shares of restricted stock to its five non-employee directors, which vest in January 2008, at an aggregate value of approximately $5.8 million. In July 2007, the Company issued 15,000 shares of restricted stock at a value of $0.5 million to an executive officer, which vests one-third on each of December 31, 2007, 2008 and 2009. During 2007, the Company also issued 216,200 shares of common stock on the exercise of options at a value of $3.6 million, and 83,644 shares of restricted stock previously received by two executive officers were surrendered at a value of $1.8 million to cover their income taxes due on the 2007 vesting of the restricted shares granted them in 2006. This surrendered restricted stock was subsequently retired by the Company. Additionally, one executive officer surrendered 107,637 shares of common stock of the Company at a value of $2.8 million to cover his exercise of options to purchase 175,000 shares of common stock of the Company. During 2007, certain employees surrendered an aggregate of 1,340 shares of restricted stock at a value of $29,931 to cover their income taxes on the 2007 vesting of the restricted shares granted them in 2006. The Company granted and issued an aggregate of 41,000 shares of restricted stock to its employees at an aggregate value of approximately $1.1 million. As of December 31, 2007, 536,977 shares of the restricted stock remained unvested, of which $2.9 million remained unamortized.

In February 2008, the Board of Directors of the Company authorized the repurchase of up to $30.0 million of the Company's common stock. To date, no shares have been repurchased.

During 2006, the Company issued 150,000 shares of common stock at a value of $3.3 million in connection with the Creative Designs acquisition. The Company issued 473,160 shares of restricted stock to two executive officers, five non-employee directors of the Company and certain of the Company's management at a value of approximately $9.0 million. The Company also issued 333,228 shares of common stock on the exercise of options for a total value of $4.4 million, including 37,910 shares of common stock acquired by two executive officers in a cashless exercise of options through the surrender of an aggregate of 13,264 shares of restricted stock as payment of the exercise prices therefor at a value of $0.3 million. In addition, the two executive officers surrendered an aggregate of 110,736 shares of restricted stock at a value of $2.5 million as payment for income taxes due on the vesting of such stock. This restricted stock was subsequently retired by the Company.

During 2005, the Company issued 245,000 shares of restricted stock to two executive officers and five non-employee directors of the Company at a value of approximately $5.1 million. The Company also issued 566,546 shares of common stock on the exercise of options for a total of $4.9 million, including 215,982 shares of common stock acquired by two executive officers in a cashless exercise of options through the surrender of an aggregate of 101,002 shares of restricted stock as payment of the exercise prices therefor at a value of $1.7 million. This restricted stock was subsequently retired by the Company.

During 2003, the Company awarded 2,760,000 shares of restricted stock to four executive officers of the Company pursuant to its 2002 Stock Award and Incentive Plan ("the Award'), of which 636,000 were earned during 2003, 396,000 were earned during 2004, 288,000 were canceled upon the termination of employment of one of our executive officers in October 2004, and the balance may be earned through 2010 based upon the achievement of certain financial criteria and continuing employment (see Note 16.)

During 2003, the Company issued 100,000 fully vested warrants, expiring in 2013, in connection with license costs relating to its video game joint venture. The fair value of these warrants was approximately $1.1 million and has been included in the basis of the joint venture (Note 4). The Company also issued $98.0 million of convertible senior notes payable that may be converted (at their initial conversion rate of $20.00 per share) into an aggregate of 4.9 million shares of the Company's common stock (Note 11).

Warrant activity is summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding, December 31, 2007	100,000	$11.35

There has been no other warrant activity since the issuance in 2003.

Note 15—Commitments

The Company has entered into various license agreements whereby the Company may use certain characters and intellectual properties in conjunction with its products. Generally, such license agreements provide for royalties to be paid at 1% to 14% of net sales with minimum guarantees and advance payments.

Future annual minimum royalty guarantees as of December 31, 2007 are as follows (in thousands):

2008	$21,260
2009	10,224
2010	5,001
2011	1,175
2012	500
	$38,160

The Company has entered into employment and consulting agreements with certain executives expiring through December 31, 2010. The aggregate future annual minimum guaranteed amounts due under those agreements as of December 31, 2007 are as follows (in thousands):

2008	$ 5,919
2009	3,789
2010	2,280
	$ 11,988

The Company has entered into a retirement plan agreement with one of its executives. Upon meeting the eligibility criteria for retirement, the executive can elect to retire and receive a single-life annuity retirement payment of approximately $1.0 million per year for a period of ten years following his retirement. Furthermore, in the event of his death during such period, his estate will receive a death benefit equal to the difference between approximately $2.9 million and retirement benefits previously paid to him. This retirement benefit is conditioned upon the executive agreeing to accept the position of Chairman Emeritus of our Board of Directors, if so requested by the Board.

Note 16—Share-Based Payments

Under its 2002 Stock Award and Incentive Plan (“the Plan”), which incorporated its Third Amended and Restated 1995 Stock Option Plan, the Company has reserved 6,025,000 shares of its common stock for issuance upon the exercise of options granted under the Plan, as well as for the awarding of other securities. Under the Plan, employees (including officers), non-employee directors and independent consultants may be granted options to purchase shares of common stock and other securities (Note 14). The vesting of these options and other securities may vary, but typically vest on a step-up basis over a maximum period of 5 years and restricted shares typically vest over one to two years. Share-based compensation expense is recognized on a straight-line basis over the requisite service period.

Restricted Stock

Under the Plan, share-based compensation payments may include the issuance of shares of restricted stock. Two executive officers are each entitled to be awarded 120,000 shares of restricted stock annually on each January 1 (through and including January 1, 2010). Such awards vest 50% each on the first and second anniversaries of issuance, subject to acceleration. Beginning in January 2006, the Company’s five non-employee directors each receive annual grants of restricted stock at a value of $120,000 (or, for 2007, 5,468 shares per director) which vest after one year. In March 2003, two executive officers of the Company were each granted 240,000 shares of restricted stock which, based on the achievement of certain financial performance criteria, vested on January 1, 2004. In January 2004, the Company issued 240,000 shares of restricted stock which, based on the achievement of certain financial performance criteria, vested on January 1, 2005. In January 2006 and 2007, respectively, the Company issued 268,660 shares of restricted stock at a value of $5.6 million and 267,340 shares of restricted stock at a value of $5.8 million to two executive officers and five non-employee directors of the Company. In July 2007, the Company issued 15,000 shares of restricted stock at a value of $0.5 million to an executive officer, which vests one-third on each of December 31, 2007, 2008 and 2009. During 2006, the Company granted and issued an aggregate of 204,500 shares of restricted stock to its employees, which vest over a five-year period, at an aggregate value of approximately $3.4 million, which represents the fair market value at the grant date. During 2007, the Company granted and issued an aggregate of 41,000 shares of restricted stock to its employees at an aggregate value of approximately $1.1 million. As of December 31, 2007, 536,977 shares of the restricted stock remained unvested, of which $2.9 million remained unamortized.

The table below summarizes the grant activity for the year ending December 31, 2007 and is broken down in the following three distinct groups because each group has unique characteristics: executives, board of directors, and employees:

Group Type	Number of Shares Granted	Grant Price Range	Vest Schedule Range
Executives	255,000	$ 21.84 – 31.04	2 – 3 years
Board of directors	27,340	$ 21.84	1 year
Employees	41,000	$ 24.60 – 26.86	3 – 5 years
Total	323,340	$ 21.84 – 31.04	1 – 5 years

Stock Options

Under SFAS 123R, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee’s requisite service period. The Company adopted the provisions of SFAS 123R using a modified prospective application. The valuation provisions of SFAS 123R apply to new awards and to awards that are outstanding on the effective date and subsequently vest or are modified or cancelled. Estimated compensation expense for awards outstanding at the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under SFAS 123, *Accounting for Stock-Based Compensation*.

The Company uses the Black-Scholes method of valuation for share-based option awards. In valuing the stock options, the Black-Scholes model incorporates assumptions about stock volatility, expected term of stock options, and risk free interest rate. The valuation is reduced by an estimate of stock option forfeitures.

The amount of share-based compensation expense recognized in the year ended December 31, 2007 is based on options granted prior to January 1, 2006 and restricted stock issued during the years ended December 31, 2006 and 2007, and ultimately expected to vest, and it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The following table summarizes the total share-based compensation expense and related tax benefits recognized (in thousands):

	Years Ended December 31,	
	2006	*2007*
Stock option compensation expense	$ 1,903	$ 972
Tax benefit related to stock option compensation	$ 623	$ 314
Restricted stock compensation expense	$ 4,580	$ 8,082
Tax benefit related to restricted stock compensation	$ 1,404	$ 2,859

As of December 31, 2007, 807,876 shares were available for future grant. Additional shares may become available to the extent that options or shares of restricted stock presently outstanding under the Plan terminate or expire. Stock option activity pursuant to the Plan is summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Outstanding, December 31, 2004	2,088,006	$13.28
Granted	360,000	21.74
Exercised	(566,546)	8.60
Canceled	(77,354)	15.74
Outstanding, December 31, 2005	1,804,106	16.33
Granted	—	—
Exercised	(333,228)	13.15
Canceled	(8,500)	17.23
Outstanding, December 31, 2006	1,462,378	$ 17.05
Granted	—	—
Exercised	(391,200)	16.54
Canceled	(235,000)	17.10
Outstanding, December 31, 2007	836,178	$ 17.27

The weighted average fair value of options granted to employees in 2005 was $21.74 per share.

In 2005, the fair value of each employee option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used: risk-free rate of interest of 4.25%; dividend yield of 0%; with volatility of 130.2%; and expected term of five years. There were no option grants in 2006 and 2007.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2007:

	Outstanding			Exercisable	
Option Price Range	Number of Shares	Weighted Average Life in Years	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
$ 7.875 – $13.39	280,063	3.55	$ 11.20	276,313	$ 11.19
$ 13.47 – $20.55	281,100	4.39	$ 18.69	201,050	$ 18.31
$ 20.94 – $22.11	275,015	3.85	$ 21.99	95,469	$21.96

The following characteristics apply to the Plan stock options that are fully vested, or expected to vest, as of December 31, 2007:

Number of options outstanding	836,178
Weighted-average exercise price	$ 17.27
Aggregate intrinsic value of options outstanding	$ 5,304,576
Weighted-average contractual term of options outstanding	3.9 years
Number of options currently exercisable	572,832
Weighted-average exercise price of options currently exercisable	$ 15.48
Aggregate intrinsic value of options currently exercisable	$ 4,656,208
Weighted-average contractual term of currently exercisable	4.34 years

At and for the year ended December 31, 2005, the Company accounted for options granted under the Plan using the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations. Prior to the implementation of SFAS 123R, stock-based employee compensation expense was not generally reflected in net income, as all options granted under the Plan had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123R to stock-based employee compensation for the year ended December 31, 2005 (in thousands, except per share data):

	Year Ended December 31, 2005
Net income, as reported	$ 63,493
Add (Deduct): Stock-based employee compensation expense (income) included in reported net income net of related tax effects	(1,121)
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards net of related tax effects	(2,343)
Pro forma net income	$ 60,029
Earnings per share:	
Basic – as reported	$ 2.37
Basic – pro forma	$ 2.25
Diluted – as reported	$ 2.06
Diluted – pro forma	$ 1.96

Note 17—Employee Benefits Plan

The Company sponsors for its U.S. employees, a defined contribution plan under Section 401(k) of the Internal Revenue Code. The plan provides that employees may defer up to 50% of their annual compensation subject to annual dollar limitations, and that the Company will make a matching contribution equal to 100% of each employee's deferral, up to 5% of the employee's annual compensation. Company matching contributions, which vest immediately, totaled $0.5 million, $0.7 million and $0.9 million for 2005, 2006 and 2007, respectively.

Note 18—Supplemental Information to Consolidated Statements of Cash Flows

In 2007, two executive officers surrendered an aggregate of 83,644 shares of restricted at a value of $1.8 million to cover their income taxes due on the 2007 vesting of the restricted shares granted them in 2006. This surrendered restricted stock was subsequently retired by the Company. Additionally, one executive officer surrendered 107,637 shares of common stock of the Company at a value of $2.8 million to cover his exercise of options to purchase 175,000 shares of common stock of the Company. During 2007, certain employees surrendered an aggregate of 1,340 shares of restricted stock at a value of $29,931 to cover their incomes taxes on the 2007 vesting of the restricted shares granted them in 2006. Additionally, the Company recognized a $1.1 million tax benefit from the exercise of stock options.

In 2006, two executive officers acquired 37,910 shares of common stock in a cashless exercise of options through the surrender of an aggregate of 13,264 shares of restricted stock as payment of the exercise prices therefor at a value of $0.3 million. In addition, the two executive officers surrendered an aggregate of 110,736 shares of restricted stock at a value of $2.5 million as payment for income taxes due on the vesting of such stock. This restricted stock was subsequently retired by the Company. Additionally, the Company recognized a $1.5 million tax benefit from the exercise of stock options. During 2006, the Company issued 150,000 shares of common stock at a value of $3.3 million in connection with the Creative Designs acquisition.

In 2005, two executive officers acquired 215,982 shares of common stock in a cashless exercise of options through the surrender of an aggregate of 101,002 shares of restricted stock as payment of the exercise prices therefor at a value of $1.7 million. This restricted stock was subsequently retired by the Company. Additionally, the Company recognized a $4.1 million tax benefit from the exercise of stock options.

Note 19—Selected Quarterly Financial Data (Unaudited)

Selected unaudited quarterly financial data for the years 2006 and 2007 are summarized below:

	2006				*2007*			
(In thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$107,244	$ 124,041	$ 295,789	$ 238,312	$ 124,062	$ 129,547	$ 318,391	$285,085
Gross profit	$ 44,163	$ 49,280	$ 112,883	$ 88,468	$ 45,508	$ 45,295	$ 124,050	$ 108,797
Income from operations	$ 2,244	$ 8,963	$ 58,204	$ 22,901	$ 3,324	$ 6,488	$ 65,057	$ 32,129
Income before income taxes	$ 3,283	$ 9,135	$ 57,855	$ 35,662	$ 4,762	$ 7,403	$ 67,087	$ 50,289
Net income	$ 2,331	$ 6,361	$ 40,499	$ 23,184	$ 3,238	$ 5,034	$ 47,318	$ 33,401
Basic earnings per share	$ 0.09	$ 0.23	$ 1.46	$ 0.85	$ 0.12	$ 0.18	$ 1.71	$ 1.20
Weighted average shares outstanding	27,310	27,536	27,694	27,298	27,498	27,631	27,733	27,738
Diluted earnings per share	$ 0.09	$ 0.22	$ 1.26	$ 0.73	$ 0.12	$ 0.17	$ 1.45	$ 1.03
Weighted average shares and equivalents outstanding	32,617	32,790	32,736	32,803	27,985	33,133	33,145	33,251

Note 20—Litigation

In October 2004, the Company was named as a defendant in a lawsuit commenced by World Wrestling Entertainment, Inc. ("WWE") (the "WWE Action"). The complaint also named as defendants, among others, the joint venture with THQ Inc., certain of the Company's foreign subsidiaries and the Company's three executive officers. The Complaint was amended, the antitrust claims were dismissed and, on grounds not previously considered by the Court, a motion to dismiss the RICO claim, the only remaining basis for jurisdiction, was argued and submitted in September 2006. Discovery remained stayed. In December 2007 the Court dismissed the WWE Action and WWE appealed. The Company sought reconsideration of and filed a cross-appeal with respect to certain parts of the Court's Orders. In November 2004, several purported class action lawsuits were filed in the United States District Court for the Southern District of New York, alleging damages associated with the facts alleged in the WWE Action (the "Class Action"). A motion to dismiss was filed, was fully briefed and argument occurred on November 30, 2006. The motion was granted without prejudice to seeking leave to amend; such leave has been sought by plaintiffs. Three shareholder derivative actions have also been filed against the Company, nominally, and against certain of the Company's Board members (the "Derivative Actions"). The Derivative Actions seek to hold the individual defendants liable for damages allegedly caused to the Company by their actions, and, in one of the Derivative Actions, seeks restitution to the Company of profits, benefits and other compensation obtained by them. These actions are currently stayed or the time to answer has been extended.

The Company received notice from WWE alleging breaches of the video game license in connection with sales of WWE video games in Japan and other countries in Asia. The joint venture responded that WWE acquiesced in the arrangements, and separately released any claim against the joint venture in connection therewith and accordingly there is no breach of the joint venture's video game license. While the joint venture does not believe that WWE has a valid claim, it tendered a protective "cure" of the alleged breaches with a full reservation of rights. WWE "rejected" that cure and reserved its rights. On October 12, 2006, WWE commenced a lawsuit in Connecticut state court against THQ and the joint venture, involving the claim set forth above concerning allegedly improper sales of WWE video games in Japan and other countries in Asia (the "JV Action"). The lawsuit seeks, among other things, a declaration that WWE is entitled to terminate the video game license and monetary damages. A motion to strike one claim was argued on March 12, 2007 and submitted to the Court. Additionally, a schedule was set, with trial no earlier than October 2008. Thereafter, WWE amended the complaint to import state law claims from the WWE Action. WWE has proposed a case management order calling for trial on or after October 2009. O n February 22, 2008, we submitted a response in which we requested that no case management order be adopted prior to the determination of the motion to strike and for summary judgment because it would moot such a case management order but that if a case management order is to be adopted it should provide for a trial, if the matter is not fully dismissed, not before June 2010.

In connection with the joint venture with THQ (see Note 4), the Company receives its profit through a preferred return based on net sales of the joint venture, which was to be reset as of July 1, 2006 for the period through December 31, 2009 (the "Next Distribution Period"). The agreement with THQ provides for the parties to agree on the reset of the preferred return or, if no agreement is reached, for arbitration of the issue. No agreement has been reached and the preferred return for the Next Distribution Period is to be determined through arbitration. The preferred return is accrued in the quarter in which the licensed games are sold and the preferred return is earned. Based on the same rates as set forth under the original joint venture agreement, an estimated receivable of $35.3 million has been accrued for the eighteen months ended December 31, 2007, pending the resolution of this outstanding issue.

The Company is a party to, and certain of its property is the subject of, various other pending claims and legal proceedings that routinely arise in the ordinary course of its business. Other than with respect to the claims in the WWE Action, the Class Action, the JV Action and the matter of the reset of the preferred return from THQ in connection with the joint venture, with respect to which the Company cannot give assurance as to the outcome, the Company does not believe that any of these claims or proceedings will have a material effect on its business, financial condition or results of operations.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
JAKKS Pacific, Inc.
Malibu, California

The audits referred to in our report dated February 28, 2008 relating to the 2007 and 2006 consolidated financial statements of JAKKS Pacific, Inc., which is contained in Item 8 of this Form 10-K also included the audit of the 2007 and 2006 amounts in the accompanying financial statement schedule. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based upon our audits.

In our opinion such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information for 2007 and 2006 set forth therein.

BDO Seidman, LLP

BDO Seidman, LLP

Los Angeles, California
February 28, 2008

JAKKS PACIFIC, INC. AND SUBSIDIARIES
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED DECEMBER 31, 2005, 2006 and 2007

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

(In thousands)	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
Year ended December 31, 2005:					
Allowance for:					
Uncollectible accounts	$ 7,058	$ 902	$ (1,291)[a]	$ (4,333)	$ 2,336
Reserve for potential product obsolescence	8,042	6,981	—	(7,576)	7,447
Reserve for sales returns and allowances	23,173	54,767	218[b]	(53,035)	25,123
	$ 38,273	$ 62,650	$ (1,073)	$ (64,944)	$34,906
Year ended December 31, 2006:					
Allowance for:					
Uncollectible accounts	$ 2,336	$ 37	$ —	$ (1,167)	$ 1,206
Reserve for potential product obsolescence	7,447	3,412	—	(3,504)	7,355
Reserve for sales returns and allowances	25,123	49,951	2,213[c]	(44,698)	32,589
	$34,906	$ 53,400	$ 2,213	$ (49,369)	$ 41,150
Year ended December 31, 2007:					
Allowance for:					
Uncollectible accounts	$ 1,206	$ (269)	$ —	$ 417	$ 1,354
Reserve for potential product obsolescence	7,355	2,788	—	(5,072)	5,071
Reserve for sales returns and allowances	32,589	40,193	—	(46,746)	26,036
	$ 41,150	$ 42,712	$ —	$ (51,401)	$ 32,461

(a) Pet Pal acquired reserve, $0.1 million; customer preference payments booked to Accrued Expenses, ($1.4 million).

(b) Pet Pal acquired reserve.

(c) Creative Designs acquired reserve.

Management's Annual Report on Internal Control over Financial Reporting

We, as management, are responsible for establishing and maintaining adequate "internal control over financial reporting" (as defined in Exchange Act Rule 13a-15(f)). Our internal control system was designed by or is under the supervision of management and our board of directors to provide reasonable assurance regarding the reliability of financial reporting and the preparation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our internal control over financial reporting as of December 31, 2007. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. We believe that, as of December 31, 2007, our internal control over financial reporting is effective based on those criteria.

Our independent auditors have issued a report on our internal controls over financial reporting. This report appears below.

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
JAKKS Pacific, Inc.
Malibu, California

We have audited JAKKS Pacific, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). JAKKS Pacific, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, "Management's Annual Report on Internal Control over Financial Reporting." Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, JAKKS Pacific, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria .

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of JAKKS Pacific, Inc. as of December 31, 2007 and 2006 and the related consolidated statements of income, other comprehensive income, stockholders' equity and cash flows for the years then ended and our report dated February 28, 2008 expressed an unqualified opinion thereon.

BDO Seidman, LLP

BDO Seidman, LLP

Los Angeles, California
February 28, 2008

CREDITS

EXECUTIVE MANAGEMENT

Board of Directors

Jack Friedman
Chairman
Chief Executive Officer
JAKKS Pacific, Inc.

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

Dan Almagor
Chairman
ACG Inc.

David C. Blatte
Managing Director
Centre Partners Management LLP

Robert E. Glick
Apparel Manufacturing Executive

Michael G. Miller
Advertising Executive

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

Corporate Officers

Jack Friedman
Chief Executive Officer

Stephen G. Berman
President
Chief Operating Officer

Joel M. Bennett
Executive Vice President
Chief Financial Officer

Senior Executive Team

John Ardell
Senior Vice President,
Marketing-Interactive Products

Michael Bernstein
Senior Vice President,
Marketing-Boys Action

Peter Coe
Executive Vice President,
Creative Designs International

Tom Delaney
Senior Vice President,
Marketing-Play Along

Michael Dwyer
Senior Vice President,
Legal & Human Resources

Geoffrey Greenberg
President
Creative Designs International

Henry Ho
Managing Director-Arbor Toys

Wills Hon
Managing Director-Asia

Bruce Katz
Senior Vice President,
Sales

Tony Lawlor
Senior Vice President,
Marketing-JAKKS Pets

Nelo Lucich
Senior Vice President,
Information Technology & Interactive

Jack McGrath
Executive Vice President,
Operations

Ken Price
Executive Vice President,
Sales

Jennifer Richmond
Senior Vice President,
Licensing and Media

Scott Robinson
Senior Vice President,
Finance

Genna Rosenberg
Senior Vice President,
Communications & Investor Relations

Carmine Russo
Senior Vice President,
International Sales

Rick Watkins
Senior Vice President,
Product Development-Play Along

Gene Work
Senior Vice President,
Creative Services-Play Along

Corporate Offices

Corporate Headquarters
22619 Pacific Coast Highway
Malibu, CA 90265
Tel: 310-456-7799
Fax: 310-317-8527

Distribution Centers
21749 Baker Parkway
Industry, CA 91789
Tel: 909-594-1379
Fax: 909-594-2179

1500 South Carney Drive
St. Clair, MI 48079
Tel: 810-326-1223
Fax: 810-326-1513

Sales Offices and Showrooms
11 East 26th Street, 5th Floor
New York, NY 10010
Tel: 212-929-9222
Fax: 212-929-9278

809 Southwest I Street, Suite 5
Bentonville, AK 72712
Tel: 479-254-1379
Fax: 479-366-3072

Play Along
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Tel: 954-596-2210
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Trevose, PA 19053
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(Creative Designs International)
Suite 816, Chinachem Golden Plaza,
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Fax: 852-2366-1689

SHAREHOLDER INFORMATION

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New York, NY 10022

Independent Auditors

BDO Seidman, LLP
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Investor Relations

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Transfer Agent

Computershare Trust Company, N.A.
250 Royall Street
Canton, MA 02021

Stock Exchange Listing

Our common stock trades on the NASDAQ Global Select exchange under the symbol "JAKK." As of July 30, 2008, approximately 177 shareholders of record and approximately 14,318 beneficial owners held our common stock. The Company has not paid cash dividends and does not anticipate paying cash dividends in the foreseeable future.

Annual Report

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

Common Stock Price Data

	High	Low
2006:		
First Quarter	$ 27.10	$ 19.23
Second Quarter	$ 28.50	$ 17.06
Third Quarter	$ 20.24	$ 15.26
Fourth Quarter	$ 23.38	$ 17.17
2007:		
First Quarter	$ 25.96	$ 19.31
Second Quarter	$ 28.93	$ 23.58
Third Quarter	$ 31.42	$ 18.19
Fourth Quarter	$ 28.48	$ 23.12
2008:		
First Quarter	$ 29.70	$ 20.18
Second Quarter	$ 30.55	$ 21.65

This annual report contains statements that may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations, estimates and projections about *JAKKS'* business based, in part, on assumptions made by its management. These statements are not guarantees of *JAKKS'* future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors, including, but not limited to, those described above and the following: changes in demand for *JAKKS'* products, product mix, the timing of customer orders and deliveries, the impact of competitive products and pricing and difficulties encountered in the integration of acquired businesses. The forward-looking statements contained herein speak only as of the date on which they are made, and *JAKKS* does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this annual report.


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Music by Hannah Montana. Figure by JAKKS Pacific.
www.jakks.com
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