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COMPANY UPDATE

JAKKS Pacific, Inc.

JAKK — NASDAQ — Neutral-4

1Q Results Below Year Ago Figures

Key Metrics		
JAKK - NASDAQ (as of 4/24/17)		$5.20
Price Target		N/A
52-Week Range		$4.63 - $9.75
Shares Outstanding (mil.) (basic)		18.1
Market Cap. ($ mil.)		$94
3-Mo. Average Daily Volume		295,784
Institutional Ownership		96%
Total Debt/Total Capital (3/17)		57%
ROE (TTM ended 3/17)		N/A
Book Value/Share (3/17)		$7.36
Price/Book Value		0.7x
Annual Dividend & Yield	Nil	Nil
EBITDA Margin (TTM Ended 3/17)		5.9%

EPS FY 12/31 (GAAP figures)

	2015	2016	Prior 2017E	Curr. 2017E
1Q	($0.40)	($1.01)		($1.01) A
2Q	($0.30)	($0.27)		
3Q	$1.12	$0.82		
4Q	($0.50)	($0.47)		
Year	$0.71	$0.07	$0.34	$0.34
P/E	7.3x	N/A		15.3x

Note: Quarterly EPS figures may not add to annual total due to impact of quarterly net losses, and the treatment of convertible securities and the related impact on share count.

Net Sales ($mm)

	2015	2016	Prior 2017E	Curr. 2017E
1Q	$114	$96		$95 A
2Q	$131	$141		
3Q	$337	$303		
4Q	$163	$167		
Year	$746	$707	$685	$685

Company Description: *JAKKS Pacific, Inc. is a designer and marketer of toys and consumer products, many of which are based on popular entertainment property licenses. Proprietary brands include JAKKS Pacific, Road Champs, Funnoodle, miWorld, Kids Only, Tollytots, Disguise, Maui, Moose Mountain, and TV Games. Additionally, the company is a joint venture partner in DreamPlay Toys, which focuses on digital initiatives and utilizes proprietary image recognition technology.*

Investment Highlights

- **JAKK reported results for the seasonally low volume 1Q period.** Net sales declined about 1% from the year ago period to $94.5 million. Gross margin declined and the SG&A ratio rose. Adjusted EBITDA (earnings before interest, taxes, depreciation & amortization, excluding restricted stock compensation expense) was a negative $10.6 million, 16% wider than the negative figure one year ago. The net loss per share was $1.01 in the recent and year ago periods. The company had not given financial guidance for the quarter, but we expected adjusted EBITDA to be better than the reported figure.
- **The balance sheet has gone through some changes.** In late 2016 and early 2017, the company repurchased or exchanged various amounts of a convertible note issue, which led to a lower cash balance but also lower annualized interest expense. The company expects to continue chipping away at the outstanding amount on the convertible due 2018, recently $55 million.
- **We maintain our 2017 outlook.** We expect annual sales to be lower than in 2016. This reflects management's guidance (directional only) and our views of the toy retailing landscape and the company's product lines. We expect annual profit margins, net income, EPS, and adjusted EBITDA to be higher than last year.
- **We rate JAKK Neutral.** Despite underwhelming 1Q results, we expect operational improvements for the year. We find JAKK shares fairly valued considering industry challenges (conservative ordering from retail and mature industry) and elusive top-line growth at the company. We will continue to monitor the industry environment and the company's progress on its growth ambitions, and search for more attractive risk/reward conditions. Our Suitability rating of 4 reflects the earnings history, seasonality, market capitalization, and the overall debt level.

Note Important Disclosures on Pages 6-7.
Note Analyst Certification on Page 6.

Exhibit 1
Income Statement Highlights (figures in thousands except percentages and per share data)

	Three Months Ended		
	03/31/17	**03/31/16**	**% chg.**
Net Sales	$94,505	$95,809	(1.4%)
Gross Profit	30,021	31,183	(3.7%)
Adjusted EBITDA	(10,596)	(9,157)	15.7%
Operating Income	(15,724)	(13,816)	13.8%
Net Income	(18,285)	(17,383)	5.2%
GAAP EPS, diluted	($1.01)	($1.01)	0.0%
Diluted Shares Outst.	18,104	17,218	5.1%
As a % of Net Sales:			**bp chg.**
Gross Profit	31.77%	32.55%	(78)
Adjusted EBITDA	N/A	N/A	N/A
Operating Income	N/A	N/A	N/A

EBITDA = earnings before interest, taxes, depreciation & amortization
Diluted EPS calculations in presented periods assume no conversion of existing convertible note.

Source: JAKKS Pacific, Inc.

Additional comments on 1Q results. According to management, the quarter's sales were in line with internal expectations and represented the seasonality of the business. With revenues down 1% and expenses higher due in part to growth-related initiatives (youth make-up and skin care product line, animation content development, etc.), profit margins were lower. Top line contributions came from product lines based on Disney's *Beauty and the Beast* and *Moana* movies, among others. A new videogame console from Nintendo (called Switch) and related games led to increased sales of toys based on the company's Nintendo licenses. The *Disney Princess* doll line remained a key contributor.

China growth prospects may have improved. In March 2017, JAKKS announced it was selling 3.66 million common shares to Hong Kong Meisheng Culture Company Ltd for $19.3 million, representing a price of approximately $5.27 per share. Prior to this transaction, Meisheng owned 1.58 million JAKK shares. With this transaction, which is set to close in the coming days, Meisheng will own just under 20% of the issued and outstanding shares of JAKKS Pacific.

Management was enthused about Meisheng's equity stake, noting broad opportunities in the Chinese market. The two companies have had a business relationship for years and are partners in two current joint ventures—one that develops proprietary animation content and one that distributes JAKKS products in China. Meisheng's Chairman, Xiaoqiang Zhao, will become a Board member at JAKKS Pacific and will chair a new committee focusing on commercial development in the Greater China region.

Financial condition. Long-term debt at March 31, 2017 amounted to $164.5 million. This reflected two convertible notes— a 4.25% issue due in 2018 and a 4.875% issue due in 2020. During the quarter, the company exchanged and retired $39.1 million principal amount of its 2018 notes for 2.9 million JAKK common shares and $24.1 million in cash. The remaining principal amount of these notes is $54.7 million. Management expects to continue focusing on this balance ahead of the August 2018 maturity. To date, the convertible note exchanges and retirements has reduced the number of shares underlying the notes by 1.6 million and reduced annualized interest expense by $1.7 million. Our 2017 financial outlook, as noted in Exhibit 1, reflects these transactions.

At quarter end, total debt (including some modest short-term debt) represented approximately 57% of total capitalization. Accounts receivable and inventory were at reasonable levels, considering the seasonality of the business, in our view. Shareholders' equity was $133.2 million.

Outlook. We are maintaining our 2017 views on the industry, the company's business outlook, and its financial results. We are not making any changes to key metrics such as net sales, adjusted EBITDA, and EPS. One variable that could affect business late this year is a planned 22-minute animated short from Disney based on the highly popular *Frozen* franchise. This franchise has been a major driver for JAKKS and its related doll/toy lines, which are now generating year-over-year sales declines based on tough comparisons and the age of the property (film debuted in November 2013). Although a full-length sequel to *Frozen* is in development (no release date has been set), we believe even this relatively short content release could boost sales for JAKKS.

Valuation. The price/earnings multiple on our 2017 earnings estimate of $0.34 per share is 15.3x. A small applicable peer group comprised of the industry's two main large-cap competitors (Mattel and Hasbro) is trading at an average of 19x the consensus 2017 earnings estimate. As for comparable market indices, the S&P 500 is trading at 18x estimated 2017 earnings and the S&P Consumer Discretionary sector is trading at 20x. We believe some valuation discount for JAKKS is likely warranted due to the company's small size and history of uneven operating results including past annual net losses (2012-2013, for example).

Enterprise value divided by EBITDA is a frequently cited valuation for various Consumer Discretionary companies, including some toy companies. This calculation focuses on the implied total value of a company (market capitalization plus net debt) relative to cash flow. We have not used this metric often in analyzing JAKK given historical low levels of interest expense. However, with recent convertible note issues along with the presence of depreciation & amortization, we believe this valuation measure has become more meaningful. Based on the recent stock price, Enterprise Value represented under 5x our 2017 adjusted EBITDA estimate. This assumes conversion of the convertible securities and uses a fully diluted share count of approximately 40.1 million at calendar year end.

Opinion. We continue to believe the company has some work to do in building its product portfolio and integrating several small, recent acquisitions. In addition, JAKKS may need to earn investors' confidence by producing several quarters of sales and profits that meet or beat expectations before stock valuations can meaningfully expand, in our view.

We are supportive of strategic initiatives for 2017. This includes putting a priority on cost-cutting, forging new business relationships, and making financial adjustments that includes a focus on shoring up the balance sheet. From a product portfolio perspective, goals include strengthening the evergreen product lines, creating new wholly owned intellectual properties (such as animation), entering new product categories and geographies (with several new international sales offices), and expanding relationships with online retailers.

Despite the low absolute stock price, we prefer the sidelines at this time as we closely monitor additions to the product portfolio, the progression of quarterly operating results, industry conditions, and perhaps most importantly, stock valuation. With 1Q results a bit underwhelming to us, we now look to the current 2Q for potentially meeting or beating expectations. We believe patience and close monitoring of the stock and the business is most prudent at this time. Should we consider the risk/reward relationship to be favorable at some point, we would consider a purchase recommendation on JAKK. For now, we remain Neutral.

Suitability. Our Suitability rating of 4 reflects past earnings volatility, extreme seasonality whereby the bulk of annual profits come from one quarter (September), recent changes in the company's consumer product licenses, a small market capitalization, and a relatively mature industry.

Risks. Factors that could impact the share price include toy safety issues, weakening of the domestic retailing environment, the impact of geopolitical events on international sales potential, competitive threats to current popular products, tepid consumer reaction to future products, and risks associated with acquiring and integrating businesses.

We note that Dr. Patrick Soon-Shiong, founder of NantWorks, LLC (JAKKS' joint venture partner in DreamPlay Toys), and related entities recently held an estimated 15% equity stake in JAKKS Pacific through ownership of common stock and convertible notes. Given the equity stake soon held by Hong Kong Meisheng Culture Company Ltd (see page 2), a significant degree of ownership in JAKKS Pacific would be held by these two partners of the company.

Exhibit 1
GAAP-based Consolidated Statements of Income (figures in thousands except percentages and per share data)

	2017E	% chg.	2016	% chg.	2015	% chg.	2014	% chg.
Net Sales	$685,000	(3.1%)	$706,603	(5.2%)	$745,741	(7.9%)	$810,060	28.0%
Cost of Goods	360,000	(3.6%)	373,610	(7.6%)	404,132	(11.3%)	455,756	19.6%
Royalty Expense	93,500	(4.5%)	97,904	(5.4%)	103,484	(5.4%)	109,406	26.7%
Amort. Of Tools & Molds	12,100	0.3%	12,068	26.3%	9,556	5.1%	9,091	(7.6%)
Gross Profit	219,400	(1.6%)	223,021	(2.4%)	228,569	(3.1%)	235,807	51.4%
Direct Selling Exp.	62,000	(5.8%)	65,797	11.4%	59,090	(11.2%)	66,525	46.8%
SG&A	127,300	(1.5%)	129,242	(0.3%)	129,645	2.1%	126,921	(8.3%)
Reorganization Exp.	0		0		0		1,154	
Depreciation & Amort.	11,000	1.1%	10,876	16.9%	9,304	(5.8%)	9,880	(14.6%)
Operating Income	19,100	11.7%	17,106	(44.0%)	30,530	(2.5%)	31,327	NM
Income from Jt. Venture ~	535		889		2,761		314	
Other Items (Exp.)	0		305		5,642		5,932	
Net Interest Inc. (Exp.)	(10,500)	(18.8%)	(12,924)	4.7%	(12,340)	(0.1%)	(12,349)	28.4%
Income Before Taxes	9,135	69.9%	5,376	(79.8%)	26,593	5.4%	25,224	NM
Taxes	1,810	(56.1%)	4,127	20.6%	3,423	(7.9%)	3,715	NM
Net Income	$7,325	486.5%	$1,249	(94.6%)	$23,170	7.7%	$21,509	NM
N.I. Attrib. to non-control. int.	0		6		(84)			
N.I. Attrib. to JAKKS	$7,325	489.3%	$1,243	(94.7%)	$23,254			
GAAP-based EPS	**$0.34**	350.9%	**$0.07**	(89.4%)	**$0.71**	0.8%	**$0.70**	NM
Diluted Shares Outst. *	40,100	140.6%	16,665	(61.5%)	43,321	4.3%	41,516	87.0%
Adjusted EBITDA	$45,000	8.0%	$41,671	(18.2%)	$50,949	(3.7%)	$52,925	NM
As a % of Net Sales:								
Gross Profit	32.03%		31.56%		30.65%		29.11%	
Direct Selling Exp.	9.05%		9.31%		7.92%		8.21%	
SG&A	18.58%		18.29%		17.38%		15.67%	
Adjusted EBITDA	6.57%		5.90%		6.83%		6.53%	
Operating Income	2.79%		2.42%		4.09%		3.87%	
Net Income	1.07%		0.18%		3.11%		2.66%	
Tax Rate	19.81%		76.77%		12.87%		14.73%	

* Share count and EPS calculations assume conversion of convertible securities in years when profit threshold is met (2017E, 2015, 2014), thus requiring use of fully diluted shares under the "if converted" calculation method. In years of modest profit or a net loss (2016), no conversion is assumed.

Note: Expense figures include stock-based compensation charges and legal/advisory expenses.

Source: JAKKS Pacific, Inc. and Hilliard Lyons estimates — Note: December fiscal year

Additional information is available upon request.

Prices of other stocks mentioned:
The Walt Disney Co. - DIS - $113.70 - LT Buy
Mattel Inc. - MAT - $21.60
Hasbro Inc. - HAS - $101.70
Nintendo Co. Ltd. - NTDOY - $31.10

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	36	30%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 2017

Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

Other Disclosures

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