

HASBRO INC
Form 10-K
February 28, 2007

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-K

**þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006**

Commission file number 1-6682

Hasbro, Inc.

(Exact Name of Registrant, As Specified in its Charter)

Rhode Island

(State of Incorporation)

05-0155090

*(I.R.S. Employer
Identification No.)*

**1027 Newport Avenue,
Pawtucket, Rhode Island**

(Address of Principal Executive Offices)

02862

(Zip Code)

Registrant's telephone number, including area code (401) 431-8697

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock	New York Stock Exchange
Preference Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes or No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes or No .

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

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one:)
Large accelerated filer Accelerated filer Non-Accelerated filer

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

The aggregate market value on June 30, 2006 (the last business day of the Company's most recently completed second quarter) of the voting common stock held by non-affiliates of the registrant, computed by reference to the closing price of the stock, was approximately \$2,695,875,000. The registrant does not have non-voting common stock outstanding.

The number of shares of common stock outstanding as of February 8, 2007 was 160,857,841.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our definitive proxy statement for our 2007 Annual Meeting of Shareholders are incorporated by reference into Part III of this Report.

TABLE OF CONTENTS

PART I

Item 1. Business

Item 1A. Risk Factors

Item 1B. Unresolved Staff Comments

Item 2. Properties

Item 3. Legal Proceedings

Item 4. Submission of Matters to a Vote of Security Holders

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Item 6. Selected Financial Data

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Item 8. Financial Statements and Supplementary Data

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Item 9A. Controls and Procedures

Item 9B. Other Information

PART III

Item 10. Directors and Executive Officers of the Registrant

Item 11. Executive Compensation

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Item 13. Certain Relationships and Related Transactions

Item 14. Principal Accountant Fees and Services

PART IV

Item 15. Exhibits and Financial Statement Schedules

Report of Independent Registered Public Accounting Firm

SIGNATURES

EX-3.(d) Amended and Restated By-Laws of Hasbro, Inc.

EX-4.(g) Second Amendment to Rights Agreement

EX-10.(r) Amendment # 8 to Receivables Purchase Agreement

EX-12 Statement re-computation of Ratio of Earnings

EX-21 Subsidiaries of the Registrant

EX-23 Consent of Independent Registered Public Accounting Firm

EX-31.1 Section 302 Certification of C.E.O.

EX-31.2 Section 302 Certification of C.F.O.

EX-32.1 Section 906 Certification of C.E.O.

EX-32.2 Section 906 Certification of C.F.O.

Table of Contents

PART I

Item 1. *Business*

General Development and Description of Business and Business Segments

Except as expressly indicated or unless the context otherwise requires, as used herein, Hasbro, the Company, we, or us, means Hasbro, Inc., a Rhode Island corporation organized on January 8, 1926, and its subsidiaries. Unless otherwise specifically indicated, all dollar or share amounts herein are expressed in thousands of dollars or shares, except for per share amounts.

Overview

We are a worldwide leader in children's and family leisure time and entertainment products and services, including the design, manufacture and marketing of games and toys. Both internationally and in the U.S., our widely recognized core brands such as PLAYSKOOL, TONKA, SUPER SOAKER, MILTON BRADLEY, PARKER BROTHERS, TIGER, and WIZARDS OF THE COAST provide what we believe are the highest quality play experiences in the world. Our offerings encompass a broad variety of games, including traditional board, card, hand-held electronic, trading card, roleplaying, plug and play and DVD games, as well as electronic learning aids and puzzles. Toy offerings include boys' action figures, vehicles and playsets, girls' toys, electronic toys, plush products, preschool toys and infant products, children's consumer electronics, electronic interactive products, creative play and toy related specialty products. In addition, we license certain of our trademarks, characters and other property rights to third parties for use in connection with consumer promotions and for the sale of noncompeting toys and games and non-toy products.

Organizationally, our principal segments are North America and International. Both of these segments engage in the development, marketing and selling of various toy and game products as listed above. Our North American segment covers the United States, Canada and Mexico while the International segment primarily includes Europe, the Asia Pacific region and Latin and South America. Financial information with respect to our segments and geographic areas is included in note 15 to our financial statements, which are included in Item 8 of this Form 10-K.

In addition, the Hasbro Products Group outlicenses our intellectual property to third parties on a worldwide basis and the Global Operations segment is responsible for arranging product manufacturing and sourcing for the North American and International segments.

North America

The North American segment's strategy in 2006 continued to be based on growing core brands through innovation and reinvention, introducing new initiatives driven by consumer and marketplace insights and leveraging opportunistic toy and game lines and licenses. In recent years, a major source of innovation has been the incorporation of greater technology into our products. The use of technology has increased our ability to develop products that appeal to older children who have been shifting from traditional toys and games to consumer electronic products, such as MP3 players, cell phones and other entertainment and lifestyle products. In addition, we seek to grow our business and maintain our brands by refreshing and reintroducing products from our vast portfolio which have been out of the market for extended periods of time. Recent successful reintroductions of products include BABY ALIVE in 2006, LITTLEST PET SHOP in 2005 and MY LITTLE PONY in 2003. Major 2006 brands and products included STAR WARS, PLAYSKOOL, LITTLEST PET SHOP, NERF, MAGIC: THE GATHERING, PLAY-DOH,

TRANSFORMERS and MONOPOLY. In the North American segment, our products are organized into the following categories: (i) games and puzzles; (ii) boys toys; (iii) girls toys; (iv) preschool toys; (v) tween toys; and (vi) other.

Our games and puzzles category includes several well known brands, including MILTON BRADLEY, PARKER BROTHERS, TIGER GAMES, AVALON HILL, and WIZARDS OF THE COAST. The MILTON BRADLEY, PARKER BROTHERS, TIGER GAMES and AVALON HILL brand portfolios consist of a broad assortment of games for children, tweens, families and adults. Core game brands include MONOPOLY,

Table of Contents

BATTLESHIP, GAME OF LIFE, SCRABBLE, CHUTES AND LADDERS, CANDY LAND, TROUBLE, MOUSETRAP, OPERATION, HUNGRY HUNGRY HIPPOS, CONNECT FOUR, TWISTER, YAHTZEE, JENGA, SIMON, CLUE, SORRY!, RISK, BOGGLE, and TRIVIAL PURSUIT, as well as a line of jigsaw puzzles for children and adults, including BIG BEN and CROXLEY, as well as the PUZZ-3D line. WIZARDS OF THE COAST offers a variety of successful trading card and roleplaying games, including MAGIC: THE GATHERING and DUNGEONS & DRAGONS. We seek to keep our core brands relevant through sustained marketing programs as well as by offering consumers new ways to experience them. In 2006, the Company introduced MONOPOLY HERE & NOW, a modernized version of MONOPOLY that reflects contemporary culture and landmarks. In 2007 we plan to continue this reinvention of MONOPOLY through the introduction of several new related products including MONOPOLY TROPICAL TYCOON DVD game and the MONOPOLY HERE & NOW electronic banking game. Other core brand extensions expected for 2007 include a new version of the GAME OF LIFE, TWISTS AND TURNS, as well as a new version of the OPERATION game, OPERATION RESCUE KIT. In addition to our core brands strategy, we seek to develop new game concepts, such as the 2006 introduction of COSMIC CATCH. In 2007, the Company plans to introduce a new line of brain training games, which will include hand held electronics, card games, plug and play games and pocket-sized games. In addition to more traditional game play, in the tween category, we plan to introduce NET JET, a digital internet game system.

Our boys toys include a wide range of core properties such as G.I. JOE and TRANSFORMERS action figures as well as entertainment-based licensed products based on popular movie and television characters, such as STAR WARS and MARVEL toys and accessories. The boys toys category is increasingly competing with video games as boys become more sophisticated in their evaluation of entertainment. In the action figure area, a key part of our strategy focuses on the importance of reinforcing the storyline associated with these products through the use of media-based entertainment. In 2007, the Company expects to have significant sales of MARVEL and TRANSFORMERS products due to the anticipated major motion picture releases of SPIDER-MAN 3 in May of 2007 and TRANSFORMERS in July of 2007. There are two other MARVEL motion picture releases scheduled in 2007, GHOST RIDER and FANTASTIC FOUR: THE RISE OF THE SILVER SURFER for which the Company will be offering products in 2007. In addition to marketing and developing action figures for traditional play, the Company also develops and markets products designed for collectors, which was a key component of the success of the STAR WARS brand in 2006. In 2007, in addition to toys designed around the MARVEL and TRANSFORMERS motion picture releases, the Company will offer products such as the MARVEL ORIGINS product line, designed for the collector market.

In our girls toys category, we seek to provide a traditional and wholesome play experience. Girls toys include the MY LITTLE PONY, LITTLEST PET SHOP, FUR REAL FRIENDS and BABY ALIVE brands as well as the EASY BAKE oven. In 2007, we will seek to continue the growth of the MY LITTLE PONY and LITTLEST PET SHOP brands through innovative new lines, such as the PONYVILLE line and the TEENIEST TINIEST PET line. The FUR REAL FRIENDS line combines plush toys with electronic innovation to provide an interactive play experience.

Our preschool toys category encompasses a range of products for preschoolers in the various stages of development, from infant to kindergarteners. Our preschool products include a portfolio of core brands marketed primarily under the PLAYSKOOL trademark. The PLAYSKOOL line includes such well-known products as MR. POTATO HEAD, WEEBLES, SIT N SPIN and GLOWORM, along with a successful line of infant toys including STEP START WALK N RIDE, 2-IN-1 TUMMY TIME GYM and BUSY BALL POPPER. In addition, starting in 2007, the PLAYSKOOL line will also include the TONKA line of trucks and interactive toys and the PLAY-DOH brand. Through our AGES & STAGES system, we seek to provide consumer friendly information that assists parents in understanding the developmental milestones their children will encounter as well as the role each PLAYSKOOL product can play in helping children to achieve these developmental milestones. In 2007, the Company plans to introduce the MADE FOR ME toy and gear line that will allow parents to customize activities and features to suit a child's developmental needs. Our preschool toys focus on encouraging children to get active through the PLAYSKOOL KID MOTION line of indoor and outdoor toys as well as seek to promote the use of the child's

imagination through products such as the PLAY-DOH line of playsets and products such as DREAMTOWN, a system of role play environments and

Table of Contents

accessories. In 2007, we plan to continue to increase the visibility of our PLAYSKOOL brand through an agreement with the CVS/pharmacy retail chain whereby PLAYSKOOL will serve as the private label brand for CVS baby care products.

Our tweens toys category generally markets products under the TIGER ELECTRONICS and NERF brands and seeks to target those children who have outgrown traditional toys. The age group targeted by this category is generally 8 to 12 years old. In recent years, we have used our consumer insights and electronic innovation to develop a strong line of products focusing on this target audience. Our major tweens toys product lines in 2006 included I-DOG and NERF. As demonstrated through our I-DOG product, an interactive pet that acts as an accessory to an MP3 player, we seek to draw on the popularity of electronic trends in our tween product offerings. In 2007, we will seek to leverage the interest of this age group in music and musical instruments through the introduction of the POWER TOUR GUITAR product.

International

In addition to our business in the United States, Mexico and Canada, in 2006 we operated in more than 20 other countries, selling a representative range of the toy and game products marketed in North America, together with some items that are sold only internationally. The major geographic regions included in the International segment are Europe, Asia Pacific, South America and Latin America, excluding Mexico. In addition to growing core brands and leveraging opportunistic toy lines and licenses, we seek to grow our international business by continuing to expand into Eastern Europe and emerging markets in Asia and Latin and South America. Key international brands for 2006 included MONOPOLY, MY LITTLE PONY, PLAYSKOOL, STAR WARS, and LITTLEST PET SHOP.

Other Segments

In our Global Operations segment, we manufacture and source production of substantially all of our toy and game products. The Company operates manufacturing facilities in East Longmeadow, Massachusetts and Waterford, Ireland. Sourcing of our other production is done through unrelated manufacturers in various Far East countries, principally China, using a Hong Kong based subsidiary for quality control and order coordination purposes. See Manufacturing and Importing below for more details concerning overseas manufacturing.

Through our other segment, the Hasbro Products Group, we generate revenue through the out-licensing worldwide of certain of our intellectual properties to third parties for promotional and merchandising uses in businesses which do not compete directly with our own product offerings.

Other Information

To further extend our range of products in the various segments of our business, we sell our toy and game products directly to retailers, primarily on a direct import basis from the Far East. These sales are reflected in the revenue of the related segment where the customer resides.

Certain of our products are licensed to other companies for sale in selected countries where we do not otherwise have a direct business presence.

No individual line of products accounted for 10% or more of our consolidated net revenues during our 2006 or 2004 fiscal years. During the 2005 fiscal year, revenues generated from the sale of STAR WARS products produced under our license with Lucas Licensing and Lucasfilm were approximately \$494,000, which was 16% of our consolidated net revenues in 2005. No other line of products constituted 10% or more of our consolidated net revenues in 2005.

Working Capital Requirements

Our working capital needs are primarily financed through cash generated from operations and, when necessary, short-term borrowings and proceeds from our accounts receivable securitization program. Our borrowings and the use of our accounts receivable program generally reach peak levels during the fourth

Table of Contents

quarter of each year. This corresponds to the time of year when our receivables also generally reach peak levels as part of the production and shipment of product in preparation for the holiday shipping season. The strategy of retailers has been to make a higher percentage of their purchases of toy and game products within or close to the fourth quarter holiday consumer buying season, which includes Christmas. We expect this trend will continue. Our historical revenue pattern is one in which the second half of the year is more significant to our overall business than the first half and, within the second half of the year, the fourth quarter is more prominent. In 2006, the second half of the year accounted for approximately 68% of full year revenues with the third and fourth quarters accounting for 33% and 35% of full year revenues, respectively. In years where the Company has products tied to a major motion picture release, such as in 2005 with the mid-year release of STAR WARS III: REVENGE OF THE SITH, this concentration is not as pronounced due to the higher level of sales that occur around the time of the motion picture theatrical release. In 2007 the Company has products tied to two anticipated major motion picture releases, SPIDER-MAN 3, expected to be released in May of 2007, and TRANSFORMERS, which is expected to be released in July of 2007.

The toy and game business is also characterized by customer order patterns which vary from year to year largely because of differences each year in the degree of consumer acceptance of product lines, product availability, marketing strategies and inventory policies of retailers, the dates of theatrical releases of major motion pictures for which we have product licenses, and changes in overall economic conditions. As a result, comparisons of our unshipped orders on any date with those at the same date in a prior year are not necessarily indicative of our sales for that year. Moreover, quick response inventory management practices now being used result in fewer orders being placed significantly in advance of shipment with more orders being placed for immediate delivery. Unshipped orders at January 28, 2007 and January 29, 2006 were approximately \$192,000 and \$123,000, respectively. It is a general industry practice that orders are subject to amendment or cancellation by customers prior to shipment. The backlog of unshipped orders at any date in a given year can also be affected by programs that we may employ to incent customers to place orders and accept shipments early in the year. This method is a general industry practice. The programs that we plan to employ to promote sales in 2007 are substantially the same as those we employed in 2006.

Historically, we commit to the majority of our inventory production and advertising and marketing expenditures for a given year prior to the peak third and fourth quarter retail selling season. Our accounts receivable increase during the third and fourth quarter as customers increase their purchases to meet expected consumer demand in the holiday season. Due to the concentrated timeframe of this selling period, payments for these accounts receivable are generally not due until later in the fourth quarter or early in the first quarter of the subsequent year. The timing difference between expenses paid and revenues collected sometimes makes it necessary for us to borrow varying amounts during the year. During 2006 and 2005, we utilized cash from our operations, proceeds from our accounts receivable securitization program, borrowing under our revolving credit agreement as well as our uncommitted lines of credit to meet our cash flow requirements.

Royalties, Research and Development

Our success is dependent on innovation through the continuing development of new products and the redesign of existing products for continued market acceptance. In 2006, 2005, and 2004, we spent \$171,358, \$150,586, and \$157,162, respectively, on activities relating to the development, design and engineering of new products and their packaging (including products brought to us by independent designers) and on the improvement or modification of ongoing products. Much of this work is performed by our internal staff of designers, artists, model makers and engineers.

In addition to the design and development work performed by our own staff, we deal with a number of independent toy and game designers for whose designs and ideas we compete with other toy and game manufacturers. Rights to such designs and ideas, when acquired by us, are usually exclusive and the agreements require us to pay the designer a royalty on our net sales of the item. These designer royalty agreements, in some cases, also provide for advance

royalties and minimum guarantees.

Table of Contents

We also produce a number of toys under trademarks and copyrights utilizing the names or likenesses of characters from movies, television shows and other entertainment media, for whose rights we compete with other toy and game manufacturers. Licensing fees for these rights are generally paid as a royalty on our net sales of the item. Licenses for the use of characters are generally exclusive for specific products or product lines in specified territories. In many instances, advance royalties and minimum guarantees are required by these license agreements. In 2006, 2005, and 2004, we incurred \$169,731, \$247,283, and \$223,193, respectively, of royalty expense. A portion of this expense relates to amounts paid in prior years as royalty advances. Our royalty expenses in any given year vary depending upon the timing of movie releases and other entertainment. In 2005, royalty expense increased due to the release of STAR WARS EPISODE III: REVENGE OF THE SITH, and the corresponding increase of our sales of STAR WARS licensed products. In 2007, the Company has licensed products tied to anticipated MARVEL major motion picture releases, including SPIDER-MAN 3 in May of 2007 as well as FANTASTIC FOUR: THE RISE OF THE SILVER SURFER and GHOSTRIDER. We will also incur royalties on products based on the theatrical release of TRANSFORMERS in July of 2007. As such, we expect higher royalty expense in 2007 than was incurred in 2006.

We have \$116,792 of prepaid royalties, which are a component of prepaid expenses and other current assets on our balance sheet. Included in other assets is \$64,769 representing the long-term portion of royalty advances already paid. As further detailed in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, based on contracts in effect at December 31, 2006, the Company may be required to pay approximately \$164,780 of minimum guaranteed royalties at various times from 2007 through 2011. Amounts paid and advances to be paid relate to anticipated revenues from licensed properties to be sold in the years 2007 through 2018.

Marketing and Sales

Our products are sold nationally and internationally to a broad spectrum of customers, including wholesalers, distributors, chain stores, discount stores, mail order houses, catalog stores, department stores and other traditional retailers, large and small, as well as internet-based e-tailers. Our own sales forces account for the majority of sales of our products. Remaining sales are generated by independent distributors who sell our products, for the most part, in areas of the world where we do not otherwise maintain a direct presence. Although we had more than 2,500 customers in the United States and Canada during 2006, including specialty retailers carrying trading card games and toy-related products, there has been significant consolidation at the retail level over the last several years in our industry, which we expect to continue. As a result, the majority of our sales are to large chain stores, distributors and wholesalers. While the consolidation of customers provides us with certain benefits, such as potentially more efficient product distribution and other decreased costs of sales and distribution, this consolidation also creates additional risks to our business associated with a major customer having financial difficulties or reducing its business with us. In addition, customer concentration may decrease the prices we are able to obtain for some of our products and reduce the number of products we would otherwise be able to bring to market. During 2006, sales to our three largest customers, Wal-Mart Stores, Inc., Target Corporation and Toys R Us, Inc., represented 24%, 13% and 11%, respectively, of consolidated net revenues, and sales to our top five customers accounted for approximately 53% of our consolidated net revenues. During 2006, 90% of the net revenues from our top 5 customers related to the North American segment.

We advertise many of our toy and game products extensively on television. Generally our advertising highlights selected items in our various product groups in a manner designed to promote the sale of not only the selected item, but also other items we offer in those product groups as well. We introduce many of our new products to major customers during the year prior to the year of introduction of such products for retail sale. In addition, we showcase many of our new products at international toy fairs held early in the fiscal year in Hong Kong, London, Nuremberg, and New York City.

In 2006 we spent \$368,996 on advertising, promotion and marketing programs compared to \$366,371 in 2005 and \$387,523 in 2004.

Table of Contents

Manufacturing and Importing

During 2006 substantially all of our products were manufactured in third party facilities in the Far East, primarily China, as well as in our two owned facilities located in East Longmeadow, Massachusetts and Waterford, Ireland.

Most of our products are manufactured from basic raw materials such as plastic, paper and cardboard, although certain products also make use of electronic components. All of these materials are readily available but may be subject to significant fluctuations in price. We generally enter into agreements with suppliers at the beginning of a fiscal year that establish prices for that year. For this reason, we are generally insulated, in the short-term, from increases in the prices of raw materials. However, severe increases in the prices of any of these materials may require renegotiation with our suppliers during the year. Our manufacturing processes and those of our vendors include injection molding, blow molding, spray painting, printing, box making and assembly. We purchase most of the components and accessories used in our toys and certain of the components used in our games, as well as some finished items, from manufacturers in the United States and in other countries. However, the countries of the Far East, and particularly the People's Republic of China, constitute the largest manufacturing center of toys in the world and the substantial majority of our toy products are manufactured in China.

We believe that the manufacturing capacity of our third party manufacturers, together with our own facilities, as well as the supply of components, accessories and completed products which we purchase from unaffiliated manufacturers, are adequate to meet the anticipated demand in 2007 for our products. Our reliance on designated external sources of manufacturing could be shifted, over a period of time, to alternative sources of supply for our products, should such changes be necessary or desirable. However, if we were to be prevented from obtaining products from a substantial number of our current Far East suppliers due to political, labor or other factors beyond our control, our operations and our ability to obtain products would be disrupted while alternative sources of product were secured. The imposition of trade sanctions by the United States or the European Union against a class of products imported by us from, or the loss of normal trade relations status by, the People's Republic of China could significantly disrupt our operations and increase the cost of our products imported into the United States or Europe.

We purchase dies and molds, principally from independent United States and international sources.

Competition

We are a worldwide leader in the design, manufacture and marketing of games and toys, but our business is highly competitive. We compete with several large toy and game companies in our product categories, as well as many smaller United States and international toy and game designers, manufacturers and marketers. Competition is based primarily on meeting consumer entertainment preferences and on the quality and play value of our products. To a lesser extent, competition is also based on product pricing.

In addition to contending with competition from other toy and game companies, in our business we must deal with the phenomena that many children have been moving away from traditional toys and games at a younger age. We refer to this as children getting older younger. As a result, our products not only compete with the offerings of other toy and game manufacturers, but we must compete, particularly in meeting the demands of older children, with the entertainment offerings of many other companies, such as makers of video games and consumer electronic products.

The volatility in consumer preferences with respect to family entertainment and low barriers to entry continually create new opportunities for existing competitors and start-ups to develop products which compete with our toy and game offerings.

Employees

At December 31, 2006, we employed approximately 5,800 persons worldwide, approximately 3,200 of whom were located in the United States.

Table of Contents

Trademarks, Copyrights and Patents

We seek to protect our products, for the most part, and in as many countries as practical, through registered trademarks, copyrights and patents to the extent that such protection is available, cost effective, and meaningful. The loss of such rights concerning any particular product is unlikely to result in significant harm to our business, although the loss of such protection for a number of significant items might have such an effect.

Government Regulation

Our toy and game products sold in the United States are subject to the provisions of The Consumer Product Safety Act (the CPSA), The Federal Hazardous Substances Act (the FHSA), The Flammable Fabrics Act (the FFA), and the regulations promulgated thereunder. In addition, certain of our products, such as the mixes for our EASY BAKE ovens, are also subject to regulation by the Food and Drug Administration.

The CPSA empowers the Consumer Product Safety Commission (the CPSC) to take action against hazards presented by consumer products, including the formulation and implementation of regulations and uniform safety standards. The CPSC has the authority to seek to declare a product a banned hazardous substance under the CPSA and to ban it from commerce. The CPSC can file an action to seize and condemn an imminently hazardous consumer product under the CPSA and may also order equitable remedies such as recall, replacement, repair or refund for the product. The FHSA provides for the repurchase by the manufacturer of articles that are banned.

Consumer product safety laws also exist in some states and cities within the United States and in Canada, Australia and Europe. We maintain laboratories that employ testing and other procedures intended to maintain compliance with the CPSA, the FHSA, the FFA, international standards, and our own standards. Notwithstanding the foregoing, there can be no assurance that our products are or will be hazard free. Any material product recall could have an adverse effect on our results of operations or financial condition, depending on the product and scope of the recall, and could negatively affect sales of our other products, as well.

The Children's Television Act of 1990 and the rules promulgated thereunder by the United States Federal Communications Commission, as well as the laws of certain foreign countries, place limitations on television commercials during children's programming.

We maintain programs to comply with various United States federal, state, local and international requirements relating to the environment, plant safety and other matters.

Financial Information About International and United States Operations and Export Sales

The information required by this item is included in note 15 of the Notes to Consolidated Financial Statements included in Item 8 of Part II of this report and is incorporated herein by reference.

Availability of Information

Our internet address is <http://www.hasbro.com>. We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, available free of charge on or through our website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

Item 1A. *Risk Factors*

Forward-Looking Information and Risk Factors That May Affect Future Results

From time to time, including in this Annual Report on Form 10-K and in our annual report to shareholders, we publish forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may relate to such matters as our anticipated financial performance or business prospects in future periods, expected technological developments, the

Table of Contents

expected timing of new product introductions or our expectations concerning the future acceptance of products by customers, the timing of entertainment releases, marketing and promotional efforts, research and development activities, liquidity, and similar matters. Forward-looking statements are inherently subject to risks and uncertainties. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. These statements may be identified by the use of forward-looking words or phrases such as anticipate, believe, could, expect, intend, looking forward, may, planned, potential, should, will and would or any variations of words with similar meanings. We note that a variety of factors could cause our actual results and experience to differ materially from the anticipated results or other expectations expressed or anticipated in our forward-looking statements. The factors listed below are illustrative and other risks and uncertainties may arise as are or may be detailed from time to time in our public announcements and our filings with the Securities and Exchange Commission, such as on Forms 8-K, 10-Q and 10-K. We undertake no obligation to make any revisions to the forward-looking statements contained in this Annual Report on Form 10-K or in our annual report to shareholders to reflect events or circumstances occurring after the date of the filing of this report. Unless otherwise specifically indicated, all dollar or share amounts herein are expressed in thousands of dollars or shares, except for per share amounts.

Volatility of consumer preferences, combined with the high level of competition and low barriers to entry in the family entertainment industry make it difficult to maintain the success of existing product lines or consistently introduce successful new products. In addition, an inability to develop and introduce planned new products and product lines in a timely and cost-effective manner may damage our business.

The family entertainment business is a fashion industry. Our success is critically dependent upon the consumer appeal of our products, principally games and toys. Our failure to successfully anticipate, identify and react to children's interests and the current preferences in family entertainment could significantly lower sales of our products and harm our profitability.

A decline in the popularity of our existing products and product lines, or the failure of our new products and product lines to achieve and sustain market acceptance with retailers and consumers, could significantly lower our sales and operating margins, which would in turn harm our profitability, business and financial condition. In our industry, it is important to identify and offer what are considered to be the hot toys and games on children's wish lists. Our continued success will depend on our ability to develop, market and sell popular toys, games and children's electronic products which are sought after by both children and their parents. We seek to achieve and maintain market popularity for our products through the redesign and extension of our existing family entertainment properties in ways we believe will capture evolving consumer interest and imagination and remain relevant in today's world, and by developing, introducing and gaining customer interest for new family entertainment products. This process involves anticipating and extending successful play patterns and identifying entertainment concepts and properties that appeal to children's imaginations. However, consumer preferences with respect to family entertainment are continuously changing and are difficult to anticipate. Evolving consumer tastes, coupled with an ever changing pipeline of entertainment properties and products which compete for consumer interest and acceptance, creates an environment in which products can be extremely popular during a certain period in time but then rapidly be replaced in consumer's minds with other properties. As a result, individual family entertainment products and properties generally, and high technology products in particular, often have short consumer life cycles.

Not only must we address rapidly changing consumer tastes and interests but we face competitors who are also constantly monitoring consumer tastes, seeking ideas which will appeal to consumers and introducing new products that compete with our products for consumer purchasing. In addition to existing competitors, the barriers to entry for new participants in the family entertainment industry are low. New participants with a popular product idea or property can gain access to consumers and become a significant source of competition for our products. In some cases our competitors' products may achieve greater market acceptance than our products and potentially reduce demand for our products.

The challenge of developing and offering products that are sought after by children is compounded by the trend of children getting older younger . By this we mean that children are losing interest in traditional toys at younger ages and, as a result, at younger and younger ages, our products compete with the offerings of

Table of Contents

video game suppliers, consumer electronics companies and other businesses outside of the traditional toy and game industry.

In addition to designing and developing products based on our own brands, we seek to fulfill consumer preferences and interests by producing products based on popular entertainment properties developed by other parties and licensed to us. The success of entertainment properties released theatrically for which we have a license, such as MARVEL or STAR WARS related products, can significantly affect our revenues. If we produce a line of products based on a movie or television series, the success of the movie or series has a critical impact on the level of consumer interest in the associated products we are offering. In addition, competition in our industry for access to entertainment properties can lessen our ability to secure, maintain, and renew popular licenses to entertainment products on beneficial terms, if at all, and to attract and retain the talented employees necessary to design, develop and market successful products based on these properties. The loss of ownership rights granted pursuant to any of our licensing agreements could harm our business and competitive position.

There is no guarantee that:

Any of our current products or product lines will continue to be popular;

Any property for which we have a significant license will achieve or sustain popularity;

Any new products or product lines we introduce will be considered interesting to consumers and achieve an adequate market acceptance;

Any new product's life cycle will be sufficient to permit us to profitably recover development, manufacturing, marketing, royalties (including royalty advances and guarantees) and other costs of producing and selling the product; or

We will be able to manufacture, source and ship new or continuing products in a timely and cost-effective basis to meet constantly changing consumer demands, a risk that is heightened by our customers' compressed shipping schedules and the seasonality of our business.

In developing new products and product lines, we have anticipated dates for the associated product introductions. When we state that we will introduce, or anticipate introducing, a particular product or product line at a certain time in the future those expectations are based on completing the associated development and implementation work in accordance with our currently anticipated development schedule. Unforeseen delays or difficulties in the development process, or significant increases in the planned cost of development, may cause the introduction date for products to be later than anticipated or, in some situations, may cause a product introduction to be discontinued. Similarly, the success of our products is often dependent on the timelines and effectiveness of related advertising and media efforts. Television programming, movie and DVD releases, comic book releases, and other media efforts are often critical in generating interest in our products. Not only our efforts, but the efforts of third parties, heavily impact the launch dates and success of these media efforts. When we say that products or brands will be supported by certain media releases, those statements are based on our current plans and expectations. Unforeseen factors may delay these media releases or even lead to their cancellation. Any delay or cancellation of planned product development work, introductions, or media support may decrease the number of products we sell and harm our business.

Our business is seasonal and therefore our annual operating results will depend, in large part, on our sales during the relatively brief holiday season. This seasonality is exacerbated as retailers become more efficient in their control of inventory levels through quick response inventory management techniques.

Sales of our family entertainment products at retail are extremely seasonal, with a majority of retail sales occurring during the period from September through December in anticipation of the holiday season, including Christmas. This seasonality has increased over time, as retailers become more efficient in their control of inventory levels through quick response inventory management techniques. These customers are timing their orders so that they are being filled by suppliers, such as us, closer to the time of purchase by consumers. For toys, games and other family entertainment products which we produce, a majority of retail sales occur in the

Table of Contents

fourth quarter, close to the holiday season. As a consequence, the majority of our sales to our customers occur in the period from September through December, as our customers do not want to maintain large on-hand inventories throughout the year to meet consumer demand. While these techniques reduce a retailer's investment in inventory, they increase pressure on suppliers like us to fill orders promptly and thereby shift a significant portion of inventory risk and carrying costs to the supplier.

The limited inventory carried by retailers may also reduce or delay retail sales, resulting in lower revenues for us. If we or our customers determine that one of our products is more popular at retail than was originally anticipated, we may not have sufficient time to produce and ship enough additional product to fully capture consumer interest in the product. Additionally, the logistics of supplying more and more product within shorter time periods increases the risk that we will fail to achieve tight and compressed shipping schedules, which also may reduce our sales and harm our financial performance. This seasonal pattern requires significant use of working capital, mainly to manufacture or acquire inventory during the portion of the year prior to the holiday season, and requires accurate forecasting of demand for products during the holiday season in order to avoid losing potential sales of popular products or producing excess inventory of products that are less popular with consumers. Our failure to accurately predict and respond to consumer demand, resulting in our underproducing popular items and/or overproducing less popular items, would reduce our total sales and harm our results of operations. In addition, as a result of the seasonal nature of our business, we would be significantly and adversely affected, in a manner disproportionate to the impact on a company with sales spread more evenly throughout the year, by unforeseen events, such as a terrorist attack or economic shock, that harm the retail environment or consumer buying patterns during our key selling season, or by events, such as strikes or port delays, that interfere with the shipment of goods, particularly from the Far East, during the critical months leading up to the holiday purchasing season.

The continuing consolidation of our retail customer base means that economic difficulties or changes in the purchasing policies of our major customers could have a significant impact on us.

We depend upon a relatively small retail customer base to sell the majority of our products. For the fiscal year ended December 31, 2006, Wal-Mart Stores, Inc., Target Corporation, and Toys 'R Us, Inc., accounted for approximately 24%, 13% and 11%, respectively, of our consolidated net revenues and our five largest customers, including Wal-Mart, Target and Toys 'R Us, in the aggregate accounted for approximately 53% of our consolidated net revenues. These net revenues were primarily related to the North American segment. While the consolidation of our customer base may provide certain benefits to us, such as potentially more efficient product distribution and other decreased costs of sales and distribution, this consolidation also means that if one or more of our major customers were to experience difficulties in fulfilling their obligations to us, cease doing business with us, significantly reduce the amount of their purchases from us or return substantial amounts of our products, it could harm our business, financial condition and results of operations. Increased concentration among our customers could also negatively impact our ability to negotiate higher sales prices for our products and could result in lower gross margins than would otherwise be obtained if there were less consolidation among our customers. In addition, the bankruptcy or other lack of success of one or more of our significant retail customers could negatively impact our revenues and bad debt expense.

We may not realize the full benefit of our licenses if the licensed material has less market appeal than expected or if sales revenue from the licensed products is not sufficient to earn out the minimum guaranteed royalties.

An important part of our business involves obtaining licenses to produce products based on various entertainment properties and theatrical releases, such as those based upon MARVEL or STAR WARS characters. The license agreements we enter to obtain these rights usually require us to pay minimum royalty guarantees that may be substantial, and in some cases may be greater than what we are ultimately able to recoup from actual sales, which could result in write-offs of significant amounts which in turn would harm our results of operations. At December 31, 2006, we had \$181,561 of prepaid royalties, \$116,792 of which are included in prepaid expenses and other current

assets and \$64,769 of which are included in other assets. Under the terms of existing contracts as of December 31, 2006, we may be required to pay future minimum

Table of Contents

guaranteed royalties and other licensing fees totaling approximately \$164,780. Acquiring or renewing licenses may require the payment of minimum guaranteed royalties that we consider to be too high to be profitable, which may result in losing licenses we currently hold when they become available for renewal, or missing business opportunities for new licenses. Additionally, as a licensee of entertainment based properties we have no guaranty that a particular property or brand will translate into successful toy or game products.

We anticipate that the shorter theatrical duration for movie releases will make it increasingly difficult for us to profitably sell licensed products based on entertainment properties and may lead our customers to reduce their demand for these products in order to minimize their inventory risk. Furthermore, there can be no assurance that a successful brand will continue to be successful or maintain a high level of sales in the future, as new entertainment properties and competitive products are continually being introduced to the market. In the event that we are not able to acquire or maintain successful entertainment licenses on advantageous terms, our revenues and profits may be harmed.

Our substantial sales and manufacturing operations outside the United States subject us to risks associated with international operations.

We operate facilities and sell products in numerous countries outside the United States. For the year ended December 31, 2006, our net revenues from international customers comprised approximately 40% of our total consolidated net revenues. We expect our sales to international customers to continue to account for a significant portion of our revenues. Additionally, we utilize third-party manufacturers located principally in the Far East, to produce the majority of our products, and we have a manufacturing facility in Ireland. These sales and manufacturing operations are subject to the risks associated with international operations, including:

Currency conversion risks and currency fluctuations;

Limitations, including taxes, on the repatriation of earnings;

Political instability, civil unrest and economic instability;

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

Complications in complying with different laws in varying jurisdictions, which laws may dictate that certain practices which are acceptable in some jurisdictions are not acceptable in others, and changes in governmental policies;

Natural disasters and the greater difficulty and expense in recovering therefrom;

Difficulties in moving materials and products from one country to another, including port congestion, strikes and other transportation delays and interruptions;

Changes in international labor costs and other costs of doing business internationally; and

The imposition of tariffs.

Our reliance on external sources of manufacturing can be shifted, over a period of time, to alternative sources of supply, should such changes be necessary. However, if we were prevented from obtaining products or components for a material portion of our product line due to political, labor or other factors beyond our control, our operations would be disrupted, potentially for a significant period of time, while alternative sources of products were secured. In particular, as the majority of our toy products, in addition to certain other products, are manufactured in the People's

Republic of China, health conditions and other factors affecting social and economic activity in China and affecting the movement of people and products into and from China to our major markets, including North America and Europe, and the labor and other costs of doing business in China, could have a significant negative impact on our operations, revenues and earnings. Factors that could negatively affect our business include a potential revaluation of the Chinese yuan, which may result in an increase in the cost of producing products in China, increases in labor costs and difficulties in moving products manufactured in the Far East through the ports on the western coast of North America, whether due to port congestion, labor disputes or other factors. Also, the imposition of trade sanctions by the United States or the European Union against a class of products imported by us from, or the loss of normal trade relations status

Table of Contents

with, the People's Republic of China, could significantly increase our cost of products imported into the United States or Europe and harm our business. Because of the importance of our international sales and international sourcing of manufacturing to our business, our financial condition and results of operations could be significantly harmed if any of the risks described above were to occur.

Part of our strategy for remaining relevant to older children is to offer innovative children's toy and game electronic products. The margins on many of these products are lower than more traditional toys and games and such products may have a shorter lifespan than more traditional toys and games. As a result, increasing sales of children's toy and game electronic products may lower our overall operating margins and produce more volatility in our business.

As children have grown older/younger and have become interested in more and more sophisticated and adult products, such as videogames and consumer electronics, at younger and younger ages, we have needed to work even harder to keep our products relevant for these consumers. One initiative we have been pursuing to capture the interest of older children is to offer innovative children's electronic toys and games. Examples of such products in the last few years include VIDEONOW, CHATNOW, ZOOMBOX, our I-branded products such as I-DOG and I-CAT, and our FURREAL FRIENDS line of products, including BUTTERSCOTCH. These products, if successful, can be an effective way for us to connect with consumers and increase sales. However, children's electronics, in addition to the risks associated with our other family entertainment products, also face certain additional risks.

Our costs for designing, developing and producing electronic products tend to be higher than for many of our other more traditional products, such as board games and action figures. The ability to recoup these higher costs through sufficient sales quantities and to reflect higher costs in higher prices is constrained by heavy competition in consumer electronics. As a consequence, our margins on the sales of electronic products tend to be lower than for more traditional products and we can face increased risk of not achieving sales sufficient to recover our costs. In addition, the pace of change in product offerings and consumer tastes in the electronics area is potentially even greater than for our other products. This pace of change means that the window in which a product can achieve and maintain consumer interest may be even shorter.

Market conditions, including commodity and fuel prices, public health conditions and other third party conduct could negatively impact our revenues, margins and our other business initiatives.

Economic and public health conditions, including factors that impact the strength of the retail market and retail demand, or our ability to manufacture and deliver products, can have a significant impact on our business. The success of our family entertainment products is dependent on consumer purchasing of those products. Consumers may not purchase our products because the products do not capture consumer interest and imagination or because competitor family entertainment offerings are deemed more attractive. But consumer spending on our products can also be harmed by factors that negatively impact consumers' budgets generally, and which are not due to our product offerings. Significant increases in the costs of other products which are required by consumers, such as gasoline and home heating fuels, may reduce household spending on entertainment products we offer. In addition, rising fuel and raw material prices, for components such as resin used in plastics, or increased transportation costs, may increase our costs for producing and transporting our products, which in turn may reduce our margins and harm our business.

In addition, general economic conditions and employment levels can impact demand for our products. Economic conditions were significantly harmed by the September 11, 2001 terrorist attacks and could be similarly affected by any future attacks. Economic conditions may also be negatively impacted by wars and other conflicts, increases in critical commodity prices, or the prospect of such events. Such a weakened economic and business climate, as well as consumer uncertainty created by such a climate, could harm our sales and profitability.

Other conditions, such as the unavailability of electrical components, may impede our ability to manufacture, source and ship new and continuing products on a timely basis. Additional factors outside of our control could delay or increase the cost of implementing our business initiatives and product plans or alter our

Table of Contents

actions and reduce actual results. For example, work stoppages, slowdowns or strikes, a severe public health pandemic or the occurrence or threat of wars or other conflicts, could impact our ability to manufacture or deliver product, resulting in increased costs and/or lost sales for our products.

Our business is dependent on intellectual property rights and we may not be able to protect such rights successfully. In addition, we have a material amount of acquired product rights which, if impaired, would result in a reduction of our income.

Our intellectual property, including our license agreements and other agreements that establish our ownership rights and maintain the confidentiality of our intellectual property, are of great value. We rely on a combination of trade secret, copyright, trademark, patent and other proprietary rights laws to protect our rights to valuable intellectual property related to our brands. From time to time, third parties have challenged, and may in the future try to challenge, our ownership of our intellectual property. In addition, our business is subject to the risk of third parties counterfeiting our products or infringing on our intellectual property rights. We may need to resort to litigation to protect our intellectual property rights, which could result in substantial costs and diversion of resources. Our failure to protect our intellectual property rights could harm our business and competitive position. Much of our intellectual property has been internally developed and has no carrying value on our balance sheet. However, as of December 31, 2006, we had approximately \$532,257 of acquired product and licensing rights included in other assets on our balance sheet. Declines in the profitability of the acquired brands or licensed products may impact our ability to recover the carrying value of the related assets and could result in an impairment charge. Reduction in our net income caused by impairment charges could harm our financial results.

We may not realize the anticipated benefits of future acquisitions or those benefits may be delayed or reduced in their realization.

Although we have not made any major acquisitions in the last few years, acquisitions have been a significant part of our historical growth and have enabled us to further broaden and diversify our product offerings. In making acquisitions, we target companies that we believe offer attractive family entertainment products. We may also target companies in markets where we would like to increase our local presence. However, we cannot be certain that the products of companies we may acquire in the future will achieve or maintain popularity with consumers or that we will be successful in a particular geographic region. In some cases, we expect that the integration of the product lines of the companies that we acquire into our operations will create production, marketing and other operating synergies which will produce greater revenue growth and profitability and, where applicable, cost savings, operating efficiencies and other advantages. However, we cannot be certain that these synergies, efficiencies and cost savings will be realized. Even if achieved, these benefits may be delayed or reduced in their realization. In other cases, we acquire companies that we believe have strong and creative management, in which case we plan to operate them more autonomously rather than fully integrating them into our operations. We cannot be certain that the key talented individuals at these companies will continue to work for us after the acquisition or that they will continue to develop popular and profitable products or services.

From time to time, we are involved in litigation, arbitration or regulatory matters where the outcome is uncertain and which could entail significant expense.

As is the case with many large multinational corporations, we are subject from time to time to regulatory investigations, litigation and arbitration disputes. Because the outcome of litigation, arbitration and regulatory investigations is inherently difficult to predict, it is possible that the outcome of any of these matters could entail significant expense for us and harm our business. The fact that we operate in significant numbers of international markets also increases the risk that we may face legal and regulatory exposures as we attempt to comply with a large number of varying legal and regulatory requirements.

Table of Contents

We rely on external financing, including our credit facilities and accounts receivable securitization facility, to fund our operations. If we were unable to obtain or service such financing, or if the restrictions imposed by such financing were too burdensome, our business would be harmed.

Due to the seasonal nature of our business, in order to meet our working capital needs, particularly those in the third and fourth quarters, we rely on our revolving credit facility and our other credit facilities for working capital. We currently have a five-year revolving credit agreement, which provides for a \$300,000 committed revolving credit facility which provides the Company the ability to request increases in the committed facility in additional increments of \$50,000, up to a total of \$500,000. The credit agreement contains certain restrictive covenants setting forth leverage and coverage requirements, and certain other limitations typical of an investment grade facility. These restrictive covenants may limit our future actions, and financial, operating and strategic flexibility. In addition, our financial covenants were set at the time we entered into our credit facility. Our performance and financial condition may not meet our original expectations, causing us to fail to meet such financial covenants. Non-compliance with our debt covenants could result in us being unable to utilize borrowings under our revolving credit facility and other bank lines, a circumstance which potentially could occur when operating shortfalls would most require supplementary borrowings to enable us to continue to fund our operations.

As an additional source of working capital and liquidity, we currently have a \$250,000 accounts receivable securitization program, which is increased to \$300,000 from fiscal October through fiscal January. Under this program, we sell on an ongoing basis, substantially all of our U.S. dollar denominated trade accounts receivable to a bankruptcy remote special purpose entity. Under this facility, the special purpose entity is able to sell, on a revolving basis, undivided ownership interests in the eligible receivables to bank conduits. During the term of the facility, we must maintain certain performance ratios. If we fail to maintain these ratios, we could be prevented from accessing this cost-effective source of working capital and short-term financing.

We believe that our cash flow from operations, together with our cash on hand and access to existing credit facilities and our accounts receivable securitization facility, are adequate for current and planned needs in 2007. However, our actual experience may differ from these expectations. Factors that may lead to a difference include, but are not limited to, the matters discussed herein, as well as future events that might have the effect of reducing our available cash balance, such as unexpected material operating losses or increased capital or other expenditures, as well as increases in inventory or accounts receivable that are ineligible for sale under our securitization facility, or future events that may reduce or eliminate the availability of external financial resources.

We also may choose to finance our capital needs, from time to time, through the issuance of debt securities. Our ability to issue such securities on satisfactory terms, if at all, will depend on the state of our business and financial condition, any ratings issued by major credit rating agencies, market interest rates, and the overall condition of the financial and credit markets at the time of the offering. The condition of the credit markets and prevailing interest rates have fluctuated in the past and are likely to fluctuate in the future. Variations in these factors could make it difficult for us to sell debt securities or require us to offer higher interest rates in order to sell new debt securities. The failure to receive financing on desirable terms, or at all, could damage our ability to support our future operations or capital needs or engage in other business activities.

As of December 31, 2006, we had \$494,983 of total principal amount of indebtedness outstanding. If we are unable to generate sufficient available cash flow to service our outstanding debt we would need to refinance such debt or face default. There is no guarantee that we would be able to refinance debt on favorable terms, or at all. This total indebtedness includes \$249,996 in aggregate principal amount of 2.75% senior convertible debentures that we issued in 2001. On December 1, 2011 and December 1, 2016, and upon the occurrence of certain fundamental corporate changes, holders of the 2.75% senior convertible debentures may require us to purchase their debentures. At that time,

the purchase price may be paid in cash, shares of common stock or a combination of the two, at our discretion, provided that we will pay accrued and unpaid

Table of Contents

interest in cash. We may not have sufficient cash at that time to make the required repurchases and may be required to settle in shares of common stock.

We previously issued warrants that provide the holder with an option through January 2008 to sell all of these warrants to us for a price to be paid, at our election, of either \$100,000 in cash or \$110,000 in our common stock, such stock being valued at the time of the exercise of the option. Should we be required to settle these warrants under this option, we believe that we will have adequate funds to settle in cash if necessary. However, we may not have sufficient funds at that time to make the required payment and may be required to settle the warrants in stock.

As a manufacturer of consumer products and a large multinational corporation, we are subject to various government regulations, violation of which could subject us to sanctions. In addition, we could be the subject of future product liability suits or product recalls, which could harm our business.

As a manufacturer of consumer products, we are subject to significant government regulations under The Consumer Products Safety Act, The Federal Hazardous Substances Act, and The Flammable Fabrics Act. In addition, certain of our products are subject to regulation by the Food and Drug Administration. While we take all the steps we believe are necessary to comply with these acts, there can be no assurance that we will be in compliance in the future. Failure to comply could result in sanctions which could have a negative impact on our business, financial condition and results of operations. We may also be subject to involuntary product recalls or may voluntarily conduct a product recall. While costs associated with product recalls have generally not been material to our business, the costs associated with future product recalls individually and in the aggregate in any given fiscal year, could be significant. In addition, any product recall, regardless of direct costs of the recall, may harm consumer perceptions of our products and have a negative impact on our future sales and results of operations.

In addition to government regulation, products that have been or may be developed by