

4Kids Entertainment Inc.
KDE - \$24.40 – NYSE
New Recommendation

Rating: 5

Recommendation: Sell Short

Reasons For Recommendation

- **Missed 2003 Q4 EPS estimates of between \$0.39-0.47, actual EPS of \$0.36.**
- **Yugioh, Teenage Mutant Ninja Turtles, and Pokemon were 69% of 2003 revenues, with the bulk of the revenue being Yugioh.**
- **Yugioh and Pokemon were 64% of revenue in 2003.**
- **Yugioh and Pokemon revenues could be DOWN in 2004!**
- **Fox Box ratings stagnant at 1.5, need 1.8 to break even. Lost over \$9 million in 2003.**
- **Shaman King not expected to contribute much in 2004.**
- **Management will not confirm revenue and/or EPS will be up in 2004.**

Financials

| | | | |
|--------------------------|---------------|------------------------|-----------|
| 52 – Week Low 4-8-2003 | \$12.76 | Book Value (mrq) | \$11.49 |
| 52 – Week high 1-27-2004 | \$30.20 | Earnings/Shr (ttm) | \$1.04 |
| Daily Volume Avg. | 200m | Earnings/Shr (mrq) | \$0.36 |
| 52 – Week Change | +86.4% | Sales/Shr (ttm) | \$7.21 |
| Market Capitalization | \$327.6M | Cash/Shr (mrq) | \$8.56 |
| Shares Outstanding | 13.96M | Price/Book (mrq) | 2.12 |
| Float | 13.2M | Price/Earnings (ttm) | 22.5 |
| Profit Margin (ttm) | 14.5% | Price/Sales (ttm) | 3.33 |
| Operating Margin (ttm) | 23.1% | Revenue (ttm) | \$102.08M |
| Return on Assets (ttm) | 8.7% | EBITDA (ttm) | \$25.43M |
| Return on Equity (ttm) | 10.4% | Income to common (ttm) | \$14.8M |
| Current Ratio (mrq) | 5.3 | Shares Short 4-8-03 | 975m |
| Debt/Equity (mrq) | 0 | % of Float Short | 7.39% |
| Total Cash (mrq) | \$119.6M | Short Ratio | 5.6 |

(ttm) = Trailing 12 months, (mrq) = Most recent quarter, M = Millions, B = Billions, m = Thousands

Business Description

4Kids Entertainment, Inc., incorporated in 1970, is a diversified entertainment and media company specializing in the youth-oriented market with operations in the Licensing, Advertising Media and Broadcast, Television and Film Production/Distribution business segments. The Licensing business is conducted by the Company's wholly owned subsidiaries, 4Kids Entertainment Licensing, Inc. and 4Kids International, Ltd., which license commercial rights to children's properties, personalities and product concepts. The Company's Advertising Media and Broadcast business provides all programming content to the Fox Box, Fox Broadcasting Company's Saturday morning programming block. Also included in this segment are the operations of The Summit Media Group, Inc., which provides media planning and buying services for clients in both print and broadcast media. The Company's Television and Film Production/Distribution business is conducted by its wholly owned subsidiaries, 4Kids Productions, Inc., 4Kids Entertainment Music, Inc. and 4Kids Entertainment Home Video, Inc.

Licensing

4Kids Licensing typically acts as exclusive agent in connection with the grant to third parties of licenses to manufacture and sell all types of merchandise based on such properties, personalities and concepts. The licensing of these rights has been primarily in the areas of toys, electronic games, trading cards, food, toiletries, apparel, housewares, footwear and publishing rights. 4Kids Licensing also licenses merchandising rights in connection with certain television shows and motion pictures produced by the Company. 4Kids International manages the Company's properties in the United Kingdom and European marketplace. Licensing revenues accounted for approximately 54% of consolidated net revenues for 2002.

Among the properties represented exclusively by 4Kids Licensing are **Yu-Gi-Oh!**, **Pokemon**, **Teenage Mutant Ninja Turtles (TMNT)**, Cubix, Tama and Friends, Ultimate Muscle, Ultraman Tiga, Monster Jam, Cabbage Patch Kids, Fighting Foodons, Cramp Twins and Pirate Islands. Yu-Gi-Oh! began in Japan as a comic book, and was later developed into a television series, video game and card game. Pokemon is Nintendo's video game. TMNT was launched in 1984 as a 40-page comic book. During 2002, the Company was appointed the exclusive worldwide licensing agent, as well as co-owner and co-producer, of a new animated series featuring all new TMNT episodes. Cubix is a 26-episode computer animated television series featuring robots being produced by the Company. Tama and Friends is a Japanese animated television series produced by TBS Service, Inc. Ultimate Muscle is an animated television program produced by Toei Animation in Japan. Ultraman Tiga is a live-action television series created and produced by Tsuburaya Productions in Japan. Monster Jam includes over 300 live Monster Truck events each year and a weekly cable television series. The Company represents all merchandise licensing rights for the Cabbage Patch Kids through December 31, 2003. Fighting Foodons is a comedy adventure launched on the Fox Box in September 2002. Cramp Twins is an animated television program produced by T.V.Loonland. Pirate Islands is a live-action adventure program produced by Tele Images International.

The Company also has exclusive rights for the various characters, trademarks and copyrights arising out of the software for the video games developed and owned by Nintendo, including the Super Mario Bros., Kirby, Donkey Kong, Zelda video games and the GameBoy and Nintendo GameCube video platforms. In addition, the Company developed and owns World Martial Arts Council (WMAC) and Charlie Chan. WMAC is a television-based property utilizing skilled martial arts professionals. Charlie Chan is the fictional Asian detective who has been the subject of numerous films based on the character created by Earl DeBigger.

4Kids Technology, Inc., a wholly owned subsidiary, was established in 2002 to develop ideas and concepts for licensing that integrate new and existing technologies with traditional game and toy play patterns. Websites 4Kids, Inc., a wholly owned subsidiary, also established in 2002, specializes in Website development by creating Websites designed to enhance and support the marketing of children's properties represented by the Company.

Advertising Media and Broadcast

The Company, through a multi-year agreement with the Fox Broadcasting Company, leases Fox's Saturday morning programming block. **The Company provides all programming content to be broadcast on the Fox Box, which airs on Saturday mornings** from 8am to 12pm eastern/pacific time (7am to 11am central time), and **retains all of the revenue from network advertising sales for the four-hour time period.** During 2002, the Company created a new wholly owned subsidiary, 4Kids Ad Sales, Inc., to manage and account for the revenue and costs associated with the Fox Box.

The Company's wholly owned subsidiary, The Summit Media Group, Inc., provides media planning and buying services for clients in both print and broadcast media. Summit Media is compensated by receiving a percentage of the media it places. Summit Media also provides television distribution services for which it receives a fee based on a percentage of the license fee paid by the broadcaster or, in the case of syndicated programming, a percentage of the advertising sales generated by the program that is syndicated. Advertising Media and Broadcast services accounted for 21% of consolidated net revenues for 2002.

Television and Film Production/Distribution

4Kids Productions produces and acquires animated and live-action television programs and theatrical motion pictures for distribution to the television, home video and theatrical markets. 4Kids Productions adapts foreign programming for the United States market and also produces original animated television programming for domestic and international broadcast. In addition, 4Kids Productions will typically produce original music compositions for use with its television and film production activities.

4Kids Music was formed in 2002 to market and administer the musical operations for the Company on certain existing and newly created music associated with its television programming. 4Kids Home Video was formed in 2002 to market and administer the Company's home video operations associated with its television programming. Television and film production and programming/distribution accounted for 25% of consolidated net revenues for 2002.

Missed EPS Estimates

On March 15, 2004 KDE announced 2003 fourth quarter results. Revenue was \$32.4 million compared to \$ 25.9 million in the year earlier period. Net income was \$5.3 million, or \$0.36 per diluted share, compared to \$2.2 million, or \$0.16 per diluted share, in the same period from the previous year.

The EPS estimates for the 2003 fourth quarter were between \$0.39 to as high as \$0.47. KDE's stock price promptly dropped over \$5 per share on this earnings miss. Since that day the stock has regained over \$4 of that price loss. The question to ask is why? We are not sure as 2004 is shaping up as a much more difficult comparison and the key revenue and earnings drivers will most likely be down in 2004 compared to 2003.

Earnings estimates for the current quarter and second quarter as well as the estimates for the 2004 year have all been lowered. For the first quarter of 2004, consensus estimates have been lowered from \$0.29 to \$0.26, a 10% drop. For the second quarter of 2004 estimates have been lowered from \$0.41 to \$0.32, a 22% drop. For the entire year 2004 earnings estimates have been lowered from \$1.81 to \$1.65, a 9% drop.

Even with the new lowered earnings estimates for 2004 of \$1.65, this would be an increase of 60 cents, or 57% over 2003 EPS of \$1.05. **It is hard to understand how this will take place given that the main revenue contributors will be down in 2004.**

Main Revenue Contributors

In 2003 there were three main revenue contributors. 1). **Yugioh**, 2). **Pokemon**, and 3). **Teenage Mutant Ninja Turtles (TMNT)**. **These three accounted for 69% of 2003 revenue.** TMNT accounted for less than 10% of revenue in 2003. Therefore Yugioh and Pokemon accounted for 64% of 2003 revenue, with the bulk of that from Yugioh.

According to the conference call following the release of the 2003 fourth quarter results, **Yugioh revenues are expected to be DOWN in 2004**. The company expects declines in the U.S. offset somewhat by international expansion. Earlier this year management and bullish analysts were forecasting explosive growth from Yugioh in 2004!

The second largest revenue generator in 2003, **Pokemon, will also see a revenue decline in 2004** because this revenue was largely guaranteed from Hasbro which they will stop collecting in 2004. So KDE's two largest revenue generators that accounted for 64% of 2003 revenue will both be down in 2004, yet earnings are going to increase 57%?

The third largest revenue contributor in 2003 was TMNT, which accounted for less than 10% of 2003 revenue. This revenue source is supposed to be up in 2004. TMNT has already had one complete boom to bust cycle in the mid 1990's.

Fox Box

For the last year Fox Box television ratings have stayed stagnant in the 1.4 to 1.5 range. Fox Box lost \$9.2 million in 2003. Fox Box needs a 1.8 rating to break even. Management expects it to break even in 2004. We are not as sure. Management has made line-up changes and past assurances of improvement that did not improve ratings. Fox Box is a four hour time slot on Fox of eight half hour shows starting at 8 am.(EST.) and running till noon. The shows in order are: 1). Cubix: Robots For Everyone; 2). Sonic X; 3). Kirby: Right Back at Ya; 4). TMNT; 5). Sonic X; 6). Shaman King; 7). Ultimate Muscle; and 8). Kirby: Right back at Ya. For a sample, see the link: <http://www.foxbox.tv/main2.html>

Shaman King

Shaman King, a cartoon show about kids that can talk to ghosts was supposed to be the next big thing but now the company expects it to contribute very little in 2004. For a sample, see the link: <http://www.foxbox.tv/shamanking/home.php>

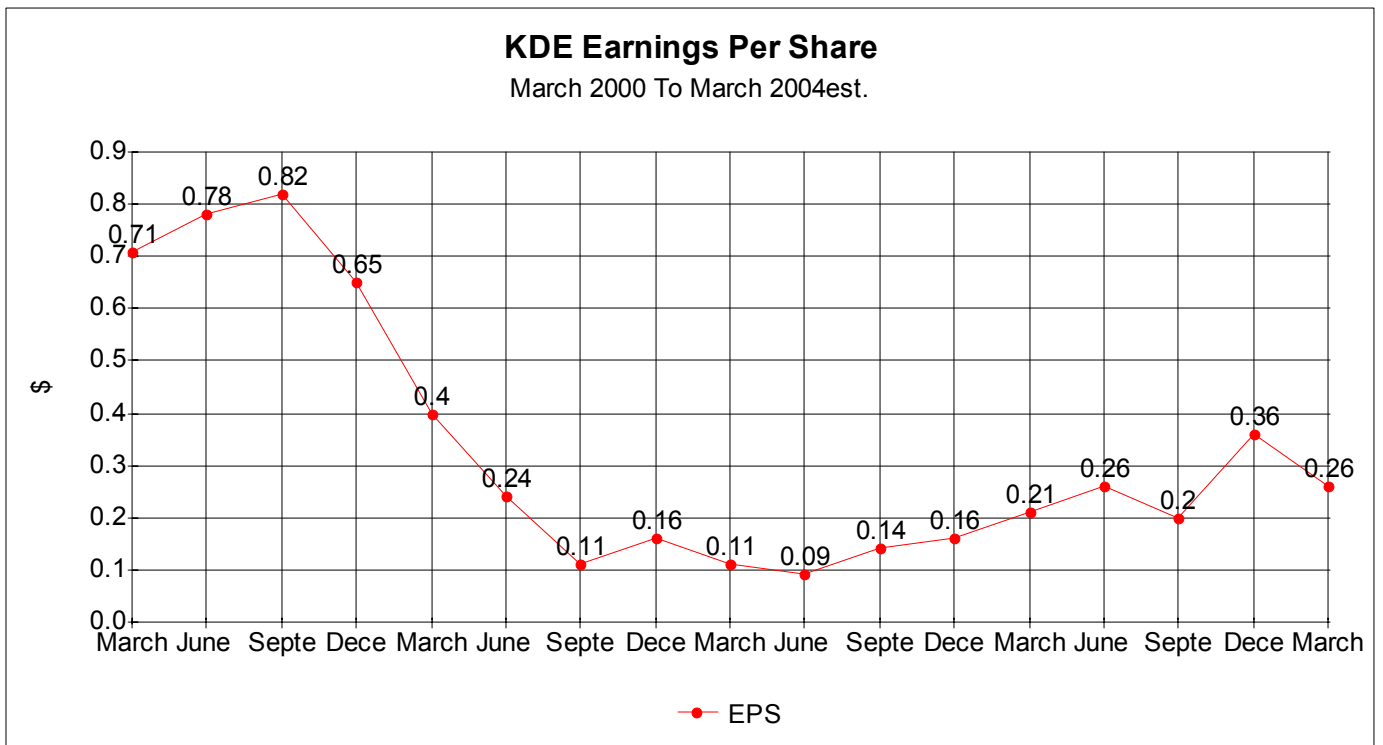
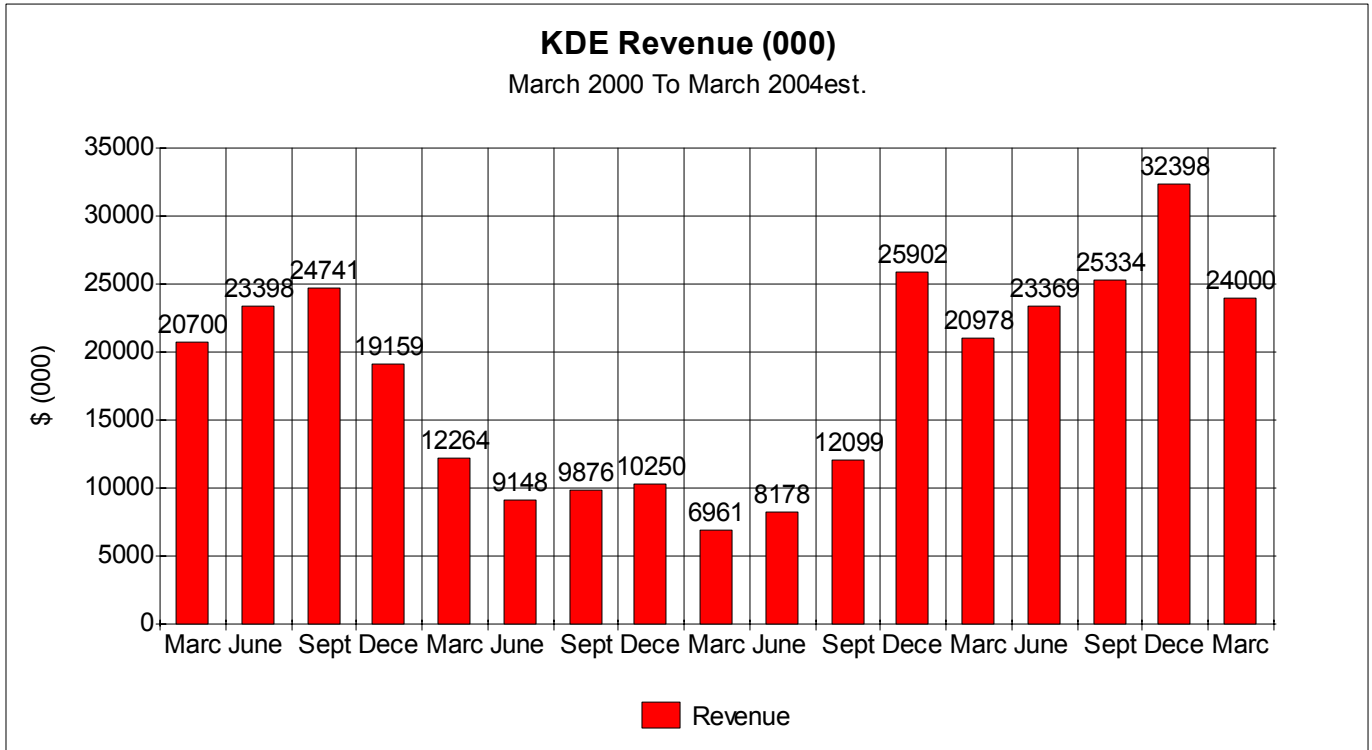
Conclusion

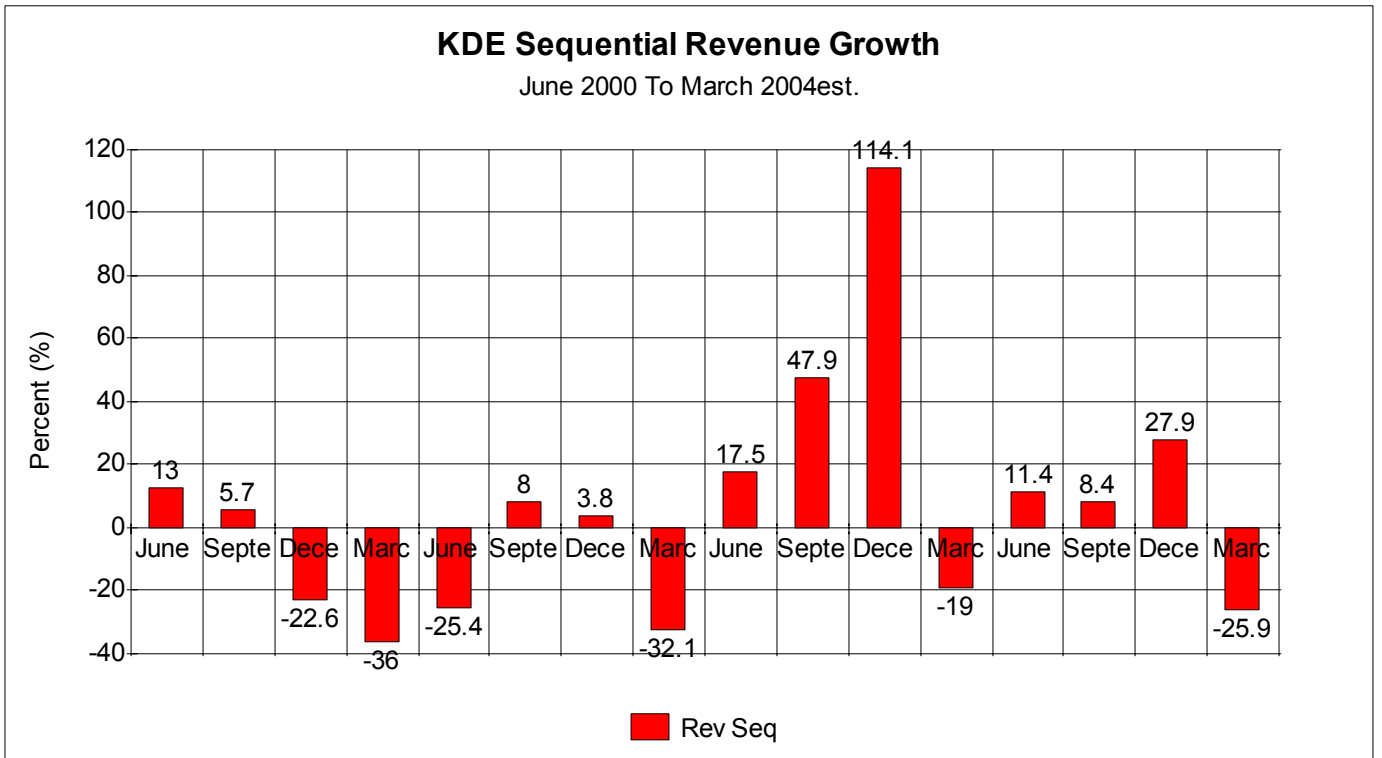
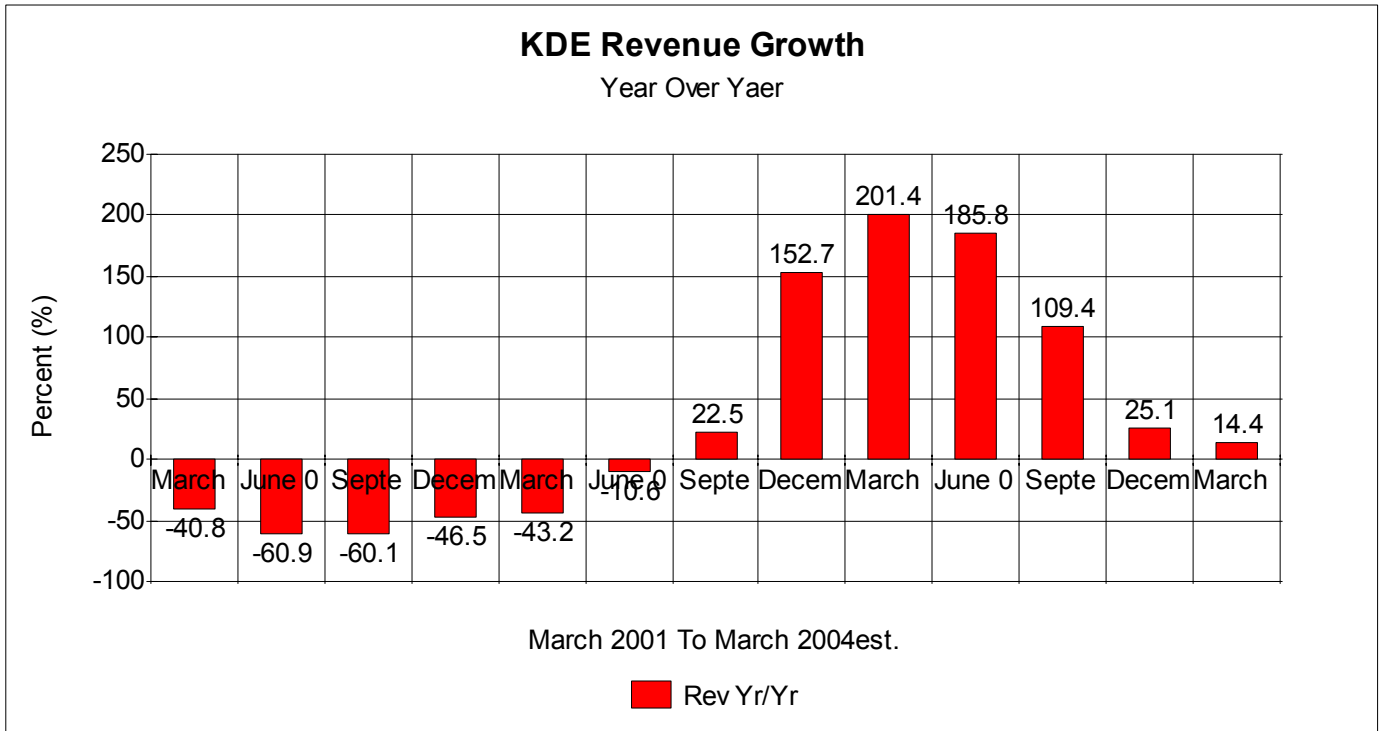
Following the 2003 fourth quarter earnings release during the conference call management would not confirm that 2004 revenues and/or earnings per share will be up compared to 2003! This caused the stock price to decline by over \$5 per share. As of this writing the stock price has recovered over \$4 of that decline. We are not sure why as going forward business does not look to be improving.

KDE's main product Yu-Gi-Oh! Is a blatant copy of the previously successful Pokemon phenomenon. Pokemon swept the nation a few years back and propelled KDE's stock price to near \$100 per share, but then almost as quickly crashed and burned and the stock fell into the low teens. Pokemon was a trading card game that you played against other kids, so is Yu-Gi-Oh! For a comparison see the Yu-Gi-Oh! Site: <http://www.upperdeckentertainment.com/vugioh/deck.asp>

This August a Yu-Gi-Oh! Movie will be released. This has all been done before with Pokemon, it does not last and tends to hit the wall very suddenly and without much warning. Why did Pokemon fall so quickly? Because they are counting on the attention span of 6 to 11 year old boys.

Teenage Mutant Ninja Turtles is another product that was successful and then died out. We believe that process will happen again. KDE will constantly have to come up with NEW hit products and shows if it is going to be successful. In 2003 KDE had very easy comparisons versus 2002. This year will be much more difficult to show any/large gains in revenue and earnings. In fact it is very possible that revenue will be down in 2004 versus 2003. We think this stock could decline to near \$10 per share and are advising investors to sell as more investors begin to realize that there is no growth here. There has already been one earnings miss. There are likely to be more in our opinion.





4 KIDS ENTERTAINMENT INC
 as of 7-Apr-2004

Splits: ▼



Note: Year over year revenue growth peaked in March 2003 at up 201.4%. Since then year over year revenue growth has gone down every quarter toward single digits. Revenue growth has gone from 201.4% to 185% to 109.4% to 25.1% and to an estimated 14.4% in the current quarter March 2004. It might not be long before we are seeing single digit year over year growth.

