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

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2023
OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ____________to ____________
Commission file number: 001-38274

FUNKO, INC.
(Exact name of registrant as specified in its charter)

Delaware	**35-2593276**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2802 Wetmore Avenue **Everett Washington**	**98201**
(Address of principal executive offices)	**(Zip Code)**

(425) 783-3616
(Registrant's telephone number, including area code)
N/A
(Former name, former address and former fiscal year, if changed since last report)

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Class A Common Stock, $0.0001 par value per share	FNKO	The Nasdaq Stock Market LLC

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 ☒ No ☐
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated Filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒
As of August 1, 2023, the registrant had 48,507,993 shares of Class A common stock, $0.0001 par value per share, and 3,293,140 shares of Class B common stock, $0.0001 par value per share, outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements contained in this Quarterly Report on Form 10-Q other than statements of historical fact, including statements regarding our future operating results and financial position, the expected impact of the COVID-19 pandemic and general economic and market conditions on our business, results of operations and financial condition, capital resources and our ability to generate cash to fund our operations, compliance with financial and negative covenants and related impacts to our business, our business strategy and plans, potential acquisitions, market growth and trends, demand for our products, inventory expectations and the anticipated inventory write-down, anticipated future expenses and payments and our objectives for future operations, are forward-looking statements. The words "believe," "may," "will," "estimate," "continue," "anticipate," "intend," "expect," "could," "would," "project," "plan," "potentially," "preliminary," "likely," and similar expressions are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to a number of risks, uncertainties, and assumptions, including the important factors described in this Quarterly Report on Form 10-Q under Part II. Item 1A. "Risk Factors," and in our other filings with the Securities and Exchange Commission, that may cause our actual results, performance or achievements to differ materially and adversely from those expressed or implied by the forward-looking statements.

Any forward-looking statements made herein speak only as of the date of this Quarterly Report on Form 10-Q, and you should not rely on forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, performance, or achievements reflected in the forward-looking statements will be achieved or occur. We undertake no obligation to update any of these forward-looking statements for any reason after the date of this Quarterly Report on Form 10-Q or to conform these statements to actual results or revised expectations.

Summary of Risk Factors

Our business is subject to numerous risks and uncertainties, including those described in Part II, Item 1A. "Risk Factors" in this Quarterly Report on Form 10-Q. Some of the factors that could materially and adversely affect our business, financial condition, results of operations or prospects include, but are not limited to, the following:

- We are subject to several risks related to the operation of our business, including, but not limited to, our ability to execute our business strategy, manage our growth and our inventories, and attract and retain qualified personnel.
- As a purveyor of licensed pop culture consumer products, we are largely dependent on content development and creation by third parties, and are subject to a number of related risks including, but not limited to, the market appeal of the properties we license and the products we create.
- We are subject to risks related to the retail industry including, but not limited to, potential negative impacts of global and regional economic downturns, changes in retail practices, and our ability to maintain and further develop relationships with our retail customers and distributors.
- We are subject to risks related to intellectual property, including our ability to obtain, protect and enforce our intellectual property rights and our ability to operate our business without violating the intellectual property rights of other parties.
- Our success is dependent on our ability to manage fluctuations in our business, including fluctuations in gross margin, seasonal impacts and fluctuations due to the timing and popularity of new product releases.
- Our substantial sales and manufacturing operations outside the United States subject us to risks associated with international operations, including, but not limited to, changes in the global trade markets, as well as fluctuations in foreign currency or tax rates.
- Our business depends in large part on our third-party vendors, manufacturers and outsourcers, and our reputation and ability to effectively operate our business may be harmed by actions taken by these third parties outside of our control.
- We are subject to potential legal risks including, but not limited to, ongoing securities class action litigation, future product liability suits or product recalls, or risks associated with failure to comply to the various laws and regulations to which we are subject, any of which could have a significant adverse effect on our financial condition and results of operations.
- We are subject to risks related to information technology including, but not limited to, risks related to the operation of our e-commerce business, our ability and the ability of third parties to operate our information systems and our compliance with laws related to privacy and the protection of data.
- Our indebtedness could adversely affect our financial health and competitive position, and we may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs.
- TCG has significant influence over us, and its interests may conflict with the interests of our other stockholders.
- There are risks related to our organizational structure, including the Tax Receivable Agreement, which confers certain benefits upon the Continuing Equity Owners that will not benefit Class A common stockholders to the same extent as it will benefit the Continuing Equity Owners.
- There are risks associated with the ownership of our Class A common stock including, but not limited to, potential dilution by future issuances and volatility in the price of our Class A common stock.

Part I – FINANCIAL INFORMATION

Item 1. Financial Statements

FUNKO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(In thousands, except per share data)			
Net sales	$ 240,028	$ 315,716	$ 491,906	$ 624,059
Cost of sales (exclusive of depreciation and amortization shown separately below)	170,019	212,597	372,322	412,246
Selling, general, and administrative expenses	85,632	82,693	185,693	161,113
Depreciation and amortization	14,893	11,483	28,869	21,954
Total operating expenses	270,544	306,773	586,884	595,313
(Loss) income from operations	(30,516)	8,943	(94,978)	28,746
Interest expense, net	7,264	1,667	12,950	2,877
Loss on debt extinguishment	—	—	494	—
Gain on tax receivable agreement liability adjustment	(99,620)	—	(99,620)	—
Other (income) expense, net	(401)	435	421	832
Income (loss) before income taxes	62,241	6,841	(9,223)	25,037
Income tax expense (benefit)	138,103	(8,952)	127,783	(5,274)
Net (loss) income	(75,862)	15,793	(137,006)	30,311
Less: net (loss) income attributable to non-controlling interests	(2,864)	1,121	(8,697)	5,757
Net (loss) income attributable to Funko, Inc.	$ (72,998)	$ 14,672	$ (128,309)	$ 24,554
(Loss) earnings per share of Class A common stock:				
Basic	$ (1.54)	$ 0.34	$ (2.71)	$ 0.58
Diluted	$ (1.54)	$ 0.28	$ (2.71)	$ 0.53
Weighted average shares of Class A common stock outstanding:				
Basic	47,428	43,741	47,338	42,042
Diluted	47,428	53,824	47,338	53,976

See accompanying notes to the unaudited condensed consolidated financial statements.

FUNKO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(In thousands)			
Net (loss) income	$ (75,862)	$ 15,793	$ (137,006)	$ 30,311
Other comprehensive (loss) income:				
Foreign currency translation (loss) gain, net of tax effect of $(405) and $859 for the three months ended June 30, 2023 and 2022, respectively and $(688) and $1,159 for the six months ended June 30, 2023 and 2022, respectively	1,394	(3,379)	2,448	(4,661)
Comprehensive (loss) income	(74,468)	12,414	(134,558)	25,650
Less: Comprehensive (loss) income attributable to non-controlling interests	(2,709)	459	(8,426)	4,749
Comprehensive (loss) income attributable to Funko, Inc.	$ (71,759)	$ 11,955	$ (126,132)	$ 20,901

See accompanying notes to the unaudited condensed consolidated financial statements.

FUNKO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2023	December 31, 2022
	(In thousands, except per share amounts)	
Assets		
Current assets:		
Cash and cash equivalents	$ 36,827	$ 19,200
Accounts receivable, net	137,441	167,895
Inventory	187,311	246,429
Prepaid expenses and other current assets	44,651	39,648
Total current assets	406,230	473,172
Property and equipment, net	104,157	102,232
Operating lease right-of-use assets	66,060	71,072
Goodwill	135,865	131,380
Intangible assets, net	175,314	181,284
Deferred tax asset, net of valuation allowance	—	123,893
Other assets	9,935	8,112
Total assets	$ 897,561	$ 1,091,145
Liabilities and Stockholders’ Equity		
Current liabilities:		
Line of credit	$ 141,000	$ 70,000
Current portion of long-term debt, net of unamortized discount	21,883	22,041
Current portion of operating lease liabilities	18,330	18,904
Accounts payable	81,389	67,651
Income taxes payable	1,341	871
Accrued royalties	53,291	69,098
Accrued expenses and other current liabilities	92,790	112,832
Total current liabilities	410,024	361,397
Long-term debt, net of unamortized discount	142,067	153,778
Operating lease liabilities, net of current portion	76,897	82,356
Deferred tax liability	401	382
Liabilities under tax receivable agreement, net of current portion	—	99,620
Other long-term liabilities	5,420	3,923
Commitments and Contingencies (Note 7)		
Stockholders’ equity:		
Class A common stock, par value $0.0001 per share, 200,000 shares authorized; 47,497 and 47,192 shares issued and outstanding as of June 30, 2023 and December 31, 2022, respectively	5	5
Class B common stock, par value $0.0001 per share, 50,000 shares authorized; 3,293 and 3,293 shares issued and outstanding as of June 30, 2023 and December 31, 2022, respectively	—	—
Additional paid-in-capital	319,531	310,807
Accumulated other comprehensive loss	(426)	(2,603)
(Accumulated deficit) retained earnings	(68,294)	60,015
Total stockholders’ equity attributable to Funko, Inc.	250,816	368,224
Non-controlling interests	11,936	21,465
Total stockholders’ equity	262,752	389,689
Total liabilities and stockholders’ equity	$ 897,561	$ 1,091,145

See accompanying notes to the unaudited condensed consolidated financial statements.

FUNKO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2023	2022
	(In thousands)	
Operating Activities		
Net (loss) income	$ (137,006)	$ 30,311
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation, amortization and other	27,851	21,586
Equity-based compensation	8,437	7,322
Amortization of debt issuance costs and debt discounts	607	433
Loss on debt extinguishment	494	—
Gain on tax receivable agreement liability adjustment	(99,620)	—
Deferred tax expense	123,206	—
Other	(3,124)	2,588
Changes in operating assets and liabilities, net of amounts acquired:		
Accounts receivable, net	33,405	(9,667)
Inventory	61,640	(68,921)
Prepaid expenses and other assets	237	(27,985)
Accounts payable	13,400	57,661
Income taxes payable	559	(15,542)
Accrued royalties	(15,807)	(9,776)
Accrued expenses and other liabilities	(26,315)	(18,149)
Net cash used in operating activities	(12,036)	(30,139)
Investing Activities		
Purchases of property and equipment	(22,712)	(33,713)
Acquisitions of businesses and related intangible assets, net of cash acquired	(5,274)	(13,968)
Other	420	61
Net cash used in investing activities	(27,566)	(47,620)
Financing Activities		
Borrowings on line of credit	71,000	70,000
Debt issuance costs	(1,957)	—
Payments of long-term debt	(11,258)	(9,000)
Distributions to TRA Parties	(1,103)	(10,224)
Proceeds from exercise of equity-based options	287	559
Net cash provided by financing activities	56,969	51,335
Effect of exchange rates on cash and cash equivalents	260	(942)
Net change in cash and cash equivalents	17,627	(27,366)
Cash and cash equivalents at beginning of period	19,200	83,557
Cash and cash equivalents at end of period	$ 36,827	$ 56,191

See accompanying notes to the unaudited condensed consolidated financial statements.

FUNKO, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Operations

The unaudited condensed consolidated financial statements include Funko, Inc. and its subsidiaries (together, the "Company") and have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). All intercompany balances and transactions have been eliminated.

The Company was formed as a Delaware corporation on April 21, 2017. The Company was formed for the purpose of completing an initial public offering ("IPO") of its Class A common stock and related transactions in order to carry on the business of Funko Acquisition Holdings, L.L.C. ("FAH, LLC") and its subsidiaries.

Funko, Inc. operates and controls all of FAH, LLC's operations and, through FAH, LLC and its subsidiaries, conducts FAH, LLC's business as the sole managing member. Accordingly, the Company consolidates the financial results of FAH, LLC and reports a non-controlling interest in its unaudited condensed consolidated financial statements representing the common units of FAH, LLC interests still held by other owners of FAH, LLC (collectively, the "Continuing Equity Owners").

Interim Financial Information

In the opinion of management, all adjustments considered necessary for a fair presentation of the results as of the date of and for the interim periods presented have been included, and such adjustments consist of normal recurring adjustments. Certain prior-year amounts have been reclassified to conform to the current year presentation. The unaudited condensed consolidated results of operations for the current interim period are not necessarily indicative of the results for the entire year ending December 31, 2023, due to seasonality and other factors. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and related notes included in its Annual Report on Form 10-K for the year ended December 31, 2022, filed with the Securities and Exchange Commission ("SEC") on March 1, 2023.

2. Significant Accounting Policies

Use of Estimates

The preparation of the Company's unaudited condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions.

Significant Accounting Policies

A description of the Company's significant accounting policies is included in the audited consolidated financial statements within its Annual Report on Form 10–K for the year ended December 31, 2022.

During the six months ended June 30, 2023, the Company approved an inventory reduction plan to improve U.S. warehouse operational efficiency. The Company recorded a $30.1 million one-time inventory write-down included in cost of sales as presented in the condensed consolidated statements of operations. The physical destruction plan will continue over the third quarter of 2023. The units have been identified and recorded based on an estimate of product costs, associated capitalized freight, net of allocated inventory reserves of the identified units and an estimate of physical destruction costs.

The Company applies the provisions of Accounting Standards Codification ("ASC") Topic No. 740, "Income Taxes" ("ASC 740"). Under ASC 740, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company reviews its deferred tax assets for recoverability every quarter and valuation allowances are established when management determines, based on all the available evidence, that it is more likely than not that a deferred asset will not be realized. In reviewing all the available evidence management looks at historical pre-tax income or losses, projected future taxable income or loss, and the expected timing of the reversals of existing temporary differences, as deemed appropriate. In addition, all other available positive and negative evidence is taken into consideration for purposes of determining the proper balances of such valuation allowances. As a result of this review, the Company determined that based on all the available evidence, including the Company's three-year cumulative pre-tax loss position as of June 30, 2023, it is not more likely than not that the results of operations will generate sufficient taxable income to realize its deferred tax assets. Consequently, the Company established a full valuation allowance of $123.2 million against its deferred tax assets, thus reducing the carrying balance to $0, and recognized a corresponding increase to tax expense in the consolidated statements of operations and comprehensive (loss) income for the three and six months ended June 30, 2023. Future changes to the balances of these valuation allowances, as a result of this continued review and analysis by the Company, could impact the financial statements within the period of change.

Pursuant to the Tax Receivable Agreement ("TRA"), the Company is required to make cash payments to the TRA Parties equal to 85% of the tax benefits, if any, that the Company realizes. Amounts payable under the Tax Receivable Agreement are contingent upon, among other things, (i) generation of taxable income over the term of the Tax Receivable Agreement and (ii) changes in tax laws. If the Company does not generate sufficient taxable income in the aggregate over the term of the Tax Receivable Agreement to utilize the tax benefits, then the Company would not be required to make the related Tax Receivable Agreement Payments, and this would reduce the TRA Liability accordingly.

As a result of the full valuation allowance on the deferred tax assets, and projected inability to fully utilize all or part of the related tax benefits, the Company determined that certain payments to the TRA Parties related to unrealized tax benefits under the TRA are no longer probable and estimable. Based on this assessment, the Company reduced its TRA Liability as of June 30, 2023, to $9.6 million, and recognized a gain of $99.6 million within the accompanying consolidated statements of operations and comprehensive (loss) income for the three and six months ended June 30, 2023. If utilization of the deferred tax assets subject to the TRA becomes more likely than not in the future, the Company will record a liability related to the TRA, which would be recognized as pre-tax expense within the consolidated statements of operations and comprehensive (loss) income.

3. Acquisitions

Mondo. On June 8, 2022, the Company acquired 100% of the membership interests in Mondo Tees Buyer, LLC ("Mondo"), a high-end pop culture collectibles company that creates vinyl records, posters, soundtracks, toys, apparel, books, games and other collectibles. This transaction represents an opportunity to expand the Company's product offerings into posters and other high-end collectibles. The Company accounted for the acquisition as a business combination. The final purchase consideration was $14.0 million in cash.

Goodwill of $5.5 million is calculated as the excess of the purchase price paid over the net assets acquired. The Company does not expect the Goodwill, as recognized, to be deductible for tax purposes. An intangible asset of $7.4 million was recognized for the Mondo trade name, with an estimated life of 10 years.

The activity of Mondo as included in the Company's consolidated statements of operations from the acquisition date to June 30, 2023 was not material.

The following table shows the final purchase price allocation for the Mondo acquisition as of June 8, 2022:

Cash	$	37
Accounts receivable		702
Inventory		2,508
Other current assets		2,545
Intangible assets		7,370
Goodwill		5,458
Current liabilities		(4,615)
Consideration transferred	$	14,004

4. Fair Value Measurements

The Company's financial instruments, other than those discussed below, include cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities. The carrying amounts of these financial instruments approximate fair value due to the short-term nature of these instruments. For financial instruments measured at fair value on a recurring basis, the Company prioritizes the inputs used in measuring fair value according to a three-tier fair value hierarchy defined by U.S. GAAP. For a description of the methods and assumptions that the Company uses to estimate the fair value and determine the classification according to the fair value hierarchy for each financial instrument, see the Company's audited consolidated financial statements and related notes included in its Annual Report on Form 10-K for the year ended December 31, 2022.

Cash equivalents. As of June 30, 2023 and December 31, 2022, cash equivalents included $0.5 million, respectively, of highly liquid money market funds, which are classified as Level 1 within the fair value hierarchy.

Crypto asset safeguarding liability and corresponding asset. The crypto asset safeguarding liability and corresponding safeguarding asset are measured and recorded at fair value on a recurring basis using prices available in the market the Company determines to be the principal market at the balance sheet date. As of June 30, 2023 and December 31, 2022, the estimated fair value of the crypto asset safeguarding liability and corresponding asset was $13.2 million and $11.3 million, respectively, classified at Level 1 within the fair value hierarchy.

Debt. The estimated fair value of the Company's debt instruments, which are classified as Level 3 financial instruments, at June 30, 2023 and December 31, 2022, was approximately $166.2 million and $177.5 million, respectively. The carrying values of the Company's debt instruments at June 30, 2023 and December 31, 2022, were $164.0 million and $175.8 million, respectively.

5. Debt

Debt consists of the following (in thousands):

	June 30, 2023	December 31, 2022
Revolving Credit Facility	$ 141,000	$ 70,000
Term Loan Facility	$ 148,500	$ 157,500
Equipment Finance Loan	17,742	20,000
Debt issuance costs	(2,292)	(1,681)
Total term debt	163,950	175,819
Less: current portion	21,883	22,041
Long-term debt, net	$ 142,067	$ 153,778

New Credit Facilities

On September 17, 2021, FAH, LLC and certain of its material domestic subsidiaries from time to time (the “Credit Agreement Parties”) entered into a new credit agreement (as amended from time to time, the “New Credit Agreement”) with JPMorgan Chase Bank, N.A., PNC Bank, National Association, KeyBank National Association, Citizens Bank, N.A., Bank of the West, HSBC Bank USA, National Association, Bank of America, N.A., U.S. Bank National Association, MUFG Union Bank, N.A., and Wells Fargo Bank, National Association (collectively, the “Initial Lenders”) and JPMorgan Chase Bank, N.A. as administrative agent, providing for a term loan facility in the amount of $180.0 million (the “New Term Loan Facility”) and a revolving credit facility of $100.0 million (the “New Revolving Credit Facility”) (together the “New Credit Facilities”). Proceeds from the New Credit Facilities were primarily used to repay and terminate the Company’s former credit facilities. On April 26, 2022, the Credit Agreement Parties entered into Amendment No. 1 to the New Credit Agreement (the “First Amendment”) with the Initial Lenders and JPMorgan Chase Bank, N.A. as administrative agent, which allows for additional Restricted Payments (as defined in the First Amendment) using specified funding sources. On July 29, 2022, the Credit Agreement Parties entered into Amendment No. 2 to the New Credit Agreement (the “Second Amendment”) with the Initial Lenders and Goldman Sachs Bank USA (collectively, the “Lenders”) and JPMorgan Chase Bank, N.A. as administrative agent, which increased the New Revolving Credit Facility to $215.0 million and converted the New Credit Facility interest rate index from Borrower (as defined in the New Credit Agreement) option LIBOR to SOFR.

On February 28, 2023, the Company entered into an Amendment No. 3 (the “Third Amendment”) to the New Credit Agreement to, among other things, (i) modify the financial covenants under the New Credit Agreement for the period beginning on the date of the Third Amendment through the fiscal quarter ending December 31, 2023 (the “Waiver Period”), (ii) reduce the size of the New Revolving Credit Facility from $215.0 million to $180.0 million as of the date of the Third Amendment and thereafter to $150.0 million on December 31, 2023, which reduction shall be permanent after the Waiver Period, (iii) restrict the ability to draw on the New Revolving Credit Facility during the Waiver Period in excess of the amount outstanding on the date of the Third Amendment, (iv) increase the margin payable under the Credit Facilities during the Waiver Period to (a) 4.00% per annum with respect to any Term Benchmark Loan or RFR Loan (each as defined in the New Credit Agreement), and (b) 3.00% per annum with respect to any Canadian Prime Loan or ABR Loan (as defined in the New Credit Agreement), (v) allow that any calculation of Consolidated EBITDA (each as defined in the New Credit Agreement) that includes the fiscal quarters during the Waiver Period may include certain agreed upon amounts for certain addbacks, (vi) further limit our ability to make certain restricted payments, including the ability to pay dividends or make other distributions on equity interests, or redeem, repurchase or retire equity interests, incur additional indebtedness, incur additional liens, enter into sale and leaseback transactions or issue additional equity interests or securities convertible into or exchange for equity interests (other than the issuance of common stock) during the Waiver Period, (vii) require a minimum qualified cash requirement of at least $10.0 million and (viii) require a mandatory prepayment of the New Revolving Credit Facility during the Waiver Period with any qualified cash proceeds in excess of $25.0 million. Following the Waiver Period, beginning in the fiscal quarter ending March 31, 2024, the Third Amendment resets the maximum Net Leverage Ratio and the minimum Fixed Charge Coverage Ratio (each as defined in the New Credit Agreement) that must be maintained by the Credit Agreement Parties to 2.50:1.00 and 1.25:1.00, respectively, which were the ratios in effect under the New Credit Agreement prior to the Third Amendment.

The New Term Loan Facility matures on September 17, 2026 (the “Maturity Date”) and amortizes in quarterly installments in aggregate amounts equal to 2.50% of the original principal amount of the New Term Loan Facility, with any outstanding balance due and payable on the Maturity Date. The first amortization payment commenced with the quarter ending on December 31, 2021. The New Revolving Credit Facility also terminates on the Maturity Date and loans thereunder may be borrowed, repaid, and reborrowed up to such date.

Subject to the interest rates during the Waiver Period as described above, loans under the New Credit Facilities will, at the Borrowers’ option, bear interest at either (i) SOFR, EURIBOR, HIBOR, CDOR, Daily Simple SONIA and/or the Central Bank Rate, as applicable, plus (x) 4.00% per annum and (y) solely in the case of Term SOFR based loans 0.10% per annum or (ii) ABR or the Canadian prime rate, as applicable, plus 3.00%, in each case of clauses (i) and (ii), subject to two 0.25% step-downs based on the achievement of certain leverage ratios following the Closing Date. Each of SOFR, EURIBOR, HIBOR, CDOR and Daily Simple SONIA rates are subject to a —% floor. For loans based on ABR, the Central Bank Rate or the Canadian prime rate, interest payments are due quarterly. For loans based on Daily Simple SONIA, interest payments are due monthly. For loans based on SOFR, EURIBOR, HIBOR or CDOR, interest payments are due at the end of each applicable interest period.

The New Credit Facilities are secured by substantially all of the assets of the Company and any of its existing or future material domestic subsidiaries, subject to customary exceptions. As of June 30, 2023, the Company was in compliance with the modified covenants that were amended pursuant to the Third Amendment and within the Waiver Period and as of December 31, 2022, the Company was in compliance with all of the covenants in its New Credit Agreement.

At June 30, 2023 and December 31, 2022, the Credit Agreement Parties had $148.5 million and $157.5 million, respectively, of borrowings outstanding under the New Term Loan Facility and $141.0 million and $70.0 million outstanding borrowings under the New Revolving Credit Facility, respectively. Outstanding borrowings under the New Revolving Credit Facility at June 30, 2023 are due within 30 days of the applicable draw. At June 30, 2023 and December 31, 2022, the Credit Agreement Parties had $0.0 million and $145.0 million available under the New Revolving Credit Facility, respectively.

There were no outstanding letters of credit as of June 30, 2023 and December 31, 2022.

Equipment Finance Loan

On November 25, 2022, Funko, LLC, Funko Games, LLC, Funko Acquisition Holdings, L.L.C., Funko Holdings LLC and Loungefly, LLC, (collectively, "Equipment Finance Credit Parties"), entered into a $20.0 million equipment finance agreement ("Equipment Finance Loan") with Wells Fargo Equipment Finance, Inc. The loan is to be repaid in 48 monthly equal installments starting January 15, 2023 utilizing an annual fixed interest rate of 5.71%.

The Equipment Finance Loan is secured by certain identified assets held within our Buckeye, Arizona warehouse.

At June 30, 2023 and December 31, 2022, the Company had $17.7 million and $20.0 million outstanding under the Equipment Finance Loan, respectively.

6. Liabilities under Tax Receivable Agreement

On November 1, 2017, the Company entered into a tax receivable agreement with FAH, LLC (the “Tax Receivable Agreement”) and each of the Continuing Equity Owners, and certain transferees of the Continuing Equity Owners have been joined as parties to the Tax Receivable Agreement (the parties entitled to payments under the Tax Receivable Agreement are referred to herein as the "TRA Parties") that provides for the payment by the Company to the TRA Parties of 85% of the amount of tax benefits, if any, that it realizes, or in some circumstances, is deemed to realize, as a result of (i) future redemptions funded by the Company or exchanges, or deemed exchanges in certain circumstances, of common units of FAH, LLC for Class A common stock of Funko, Inc. or cash, and (ii) certain additional tax benefits attributable to payments made under the Tax Receivable Agreement (the “TRA Payment”).

There were no common units of FAH, LLC acquired during the three and six months ended June 30, 2023. During the three and six months ended June 30, 2022 the Company acquired 5.8 million and 6.5 million, respectively, common units of FAH, LLC. As a result of these exchanges, during the three and six months ended June 30, 2022, the Company recognized an increase to its net deferred tax assets in the amount of $27.4 million and $29.9 million, respectively.

The following table summarizes changes in the amount of the Company's Tax Receivable Agreement liability for the three and six months ended June 30, (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Beginning Balance	$ 109,182	$ 85,556	$ 109,187	$ 82,884
Additional liabilities for exchanges	—	27,177	—	29,849
Liability reduction	(99,620)	—	(99,620)	—
Payments under tax receivable agreement	—	—	(5)	—
Ending balance	$ 9,562	$ 112,733	$ 9,562	$ 112,733

As of June 30, 2023, the Company's total obligation under the Tax Receivable Agreement, including accrued interest, was $9.6 million, which was included in accrued expenses and other current liabilities on the unaudited condensed consolidated balance sheets. As of December 31, 2022, the Company's total obligation under the Tax Receivable Agreement, including accrued interest, was $109.2 million, of which $9.6 million was included in accrued expenses and other current liabilities on the unaudited condensed consolidated balance sheets. As reflected in Note 2. Significant Accounting Policies, the Company determined that payments to the TRA Parties related to unrealized tax benefits under the Tax Receivable Agreement are no longer probable and estimable. Based on this assessment, the Company reduced its Tax Receivable Agreement liability as of June 30, 2023.

7. Commitments and Contingencies

License Agreements

The Company enters into license agreements with various licensors of copyrighted and trademarked characters and design in connection with the products that it sells. The agreements generally require royalty payments based on product sales and in some cases may require minimum royalty and other related commitments.

Employment Agreements

The Company has employment agreements with certain officers. The agreements include, among other things, an annual bonus based on certain performance metrics of the Company, as defined by the board of directors, and up to one year's severance pay beyond termination date.

Debt

The Company is party to a New Credit Agreement which includes a New Term Loan Facility and a New Revolving Credit Facility. The Company is also party to an Equipment Finance Loan. See Note 5, Debt.

Tax Receivable Agreement

The Company is party to the Tax Receivable Agreement that provides for the TRA Payment by the Company to the TRA Parties under certain circumstances. See Note 6, Liabilities under Tax Receivable Agreement.

Leases

The Company has entered into non-cancellable operating leases for office, warehouse, and distribution facilities, with original lease periods expiring through 2032. Some operating leases also contain the option to renew for five-year periods at prevailing market rates at the time of renewal. In addition to minimum rent, certain of the leases require payment of real estate taxes, insurance, common area maintenance charges, and other executory costs.

Legal Contingencies

The Company is involved in claims and litigation in the ordinary course of business, some of which seek monetary damages, including claims for punitive damages, which are not covered by insurance. For certain pending matters, accruals have not been established because such matters have not progressed sufficiently through discovery, and/or development of important factual information and legal information is insufficient to enable the Company to estimate a range of possible loss, if any. An adverse determination in one or more of these pending matters could have an adverse effect on the Company’s consolidated financial position, results of operations or cash flows.

The Company is, and may in the future become, subject to various legal proceedings and claims that arise in or outside the ordinary course of business. For example, several stockholder derivative actions based on the Company’s earnings announcement and Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 have been brought on behalf of the Company against certain of its directors and officers. Specifically, on April 23, June 5, and June 10, 2020, the actions captioned *Cassella v. Mariotti et al.*, *Evans v. Mariotti et al.*, and *Igelido v. Mariotti et al.*, respectively, were filed in the United States District Court for the Central District of California. On July 6, 2020, these three actions were consolidated for all purposes into one action under the title *In re Funko, Inc. Derivative Litigation*, and on August 13, 2020, the consolidated action was stayed pending final resolution of the motion to dismiss in the *Ferreira* action. On May 9, 2022, another complaint, asserting substantially similar claims, was filed in the U.S. District Court for the Central District of California, captioned *Smith v. Mariotti*, et al. On July 5, 2022, two purported stockholders filed an additional derivative action in the Court of Chancery of the State of Delaware, captioned *Fletcher, et al. v. Mariotti*. The Company has reached a non-monetary settlement in principle in the consolidated action, *Smith v. Mariotti, and Fletcher, et al. v. Mariotti* and the actions are stayed pending finalization of the settlement.

On June 11, 2021, a purported stockholder filed a related derivative action, captioned *Silverberg v. Mariotti, et al.*, in the Court of Chancery of the State of Delaware. The Company moved to dismiss the *Silverberg* complaint on April 3, 2023. Plaintiff responded on May 3, 2023, and briefing was completed on May 18, 2023.

Additionally, between November 16, 2017 and June 12, 2018, seven purported stockholders of the Company filed putative class action lawsuits in the Superior Court of Washington in and for King County against the Company, certain of its officers and directors, ACON, Fundamental Capital, LLC and Funko International, LLC (collectively, “Fundamental”), the underwriters of its IPO, and certain other defendants.
On July 2, 2018, the suits were ordered consolidated for all purposes into one action under the title *In re Funko, Inc. Securities Litigation*. On August 1, 2018, plaintiffs filed a consolidated complaint against the Company, certain of its officers and directors, ACON, Fundamental, and certain other defendants. The Company moved to dismiss twice, and the Court twice granted the Company's motions to dismiss, the second time with prejudice. Plaintiffs appealed, and on November 1, 2021, the Court of Appeals reversed the trial court’s dismissal decision in most respects. On May 4, 2022, the Washington State Supreme Court denied the Company’s petition, and the case was remanded to the Superior Court for further proceedings. The Company filed its answer on September 19, 2022 and discovery is currently ongoing. Plaintiffs filed a motion for class certification on July 7, 2023, and briefing will be completed on the class certification motion on October 25, 2023.

On June 4, 2018, a putative class action lawsuit entitled *Kanugonda v. Funko, Inc., et al.* was filed in the United States District Court for the Western District of Washington against the Company, certain of its officers and directors, and certain other defendants. On January 4, 2019, a lead plaintiff was appointed in that case. On April 30, 2019, the lead plaintiff filed an amended complaint against the previously named defendants. The Company moved to dismiss the Complaint in the federal action, now captioned *Berkelhammer v. Funko, Inc. et al.*, on June 14, 2023, and briefing is scheduled to be completed on the motion to dismiss on August 18, 2023.

The cases in Washington state court and *Berkelhammer v. Funko, Inc. et al.* allege that the Company violated Sections 11, 12, and 15 of the Securities Act of 1933, as amended, by making allegedly materially misleading statements in documents filed with the U.S. Securities and Exchange Commission in connection with the Company's IPO and by omitting material facts necessary to make the statements made therein not misleading. The lawsuits seek, among other things, compensatory statutory damages and rescissory damages in account of the consideration paid for the Company's Class A common stock by the plaintiffs and members of the putative class, as well as attorneys' fees and costs.

On January 18, 2022, a purported stockholder filed a putative class action lawsuit in the Court of Chancery of the State of Delaware, captioned *Shumacher v. Mariotti, et al.*, relating to the Company's corporate "Up-C" structure and bringing direct claims for breach of fiduciary duties against certain current and former officers and directors. On March 31, 2022, the defendants moved to dismiss the action. In response to defendants' motion to dismiss. Plaintiff filed an Amended Complaint on May 25, 2022. The amendment did not materially change the claims at issue, and the Defendants again moved to dismiss on July 29, 2022. On December 15, 2022, Plaintiff opposed the Defendants' motion to dismiss, and also moved for attorneys' fees. Briefing on the motion to dismiss was completed on February 8, 2023; briefing on Plaintiff's fee application was completed on April 6, 2023. The Court heard oral argument on both motions on July 24, 2023.

On June 2, 2023, a purported stockholder filed a putative class action lawsuit in the United States District Court for the Western District of Washington, captioned *Studen v. Funko, Inc.*, *et al.*. The Complaint alleges that the Company and certain individual defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as well as Rule 10b-5 promulgated thereunder by making allegedly materially misleading statements in documents filed with the SEC, as well as in earnings calls and presentations to investors, regarding a planned upgrade to its enterprise resource planning system and the relocation of a distribution center, as well as by omitting material facts about the same subjects necessary to make the statements made therein not misleading. The lawsuits seek, among other things, compensatory damages and attorneys' fees and costs. The parties have agreed that the Company is not required to respond to the complaint until after a lead plaintiff is appointed by the Court.

The Company is party to additional legal proceedings incidental to its business. While the outcome of these additional matters could differ from management's expectations, the Company does not believe that the resolution of such matters is reasonably likely to have a material effect on its results of operations or financial condition.

8. Segments

The Company identifies its segments according to how the business activities are managed and evaluated and for which discrete financial information is available and regularly reviewed by its Chief Operating Decision Maker (the “CODM”) to allocate resources and assess performance. Because its CODM reviews financial performance and allocates resources at a consolidated level on a regular basis, the Company has one segment.

The following table presents summarized product information as a percent of sales:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Core Collectible	72.4 %	73.8 %	72.6 %	75.7 %
Loungefly	20.8 %	22.2 %	20.8 %	19.2 %
Other	6.8 %	4.0 %	6.6 %	5.1 %

The following tables present summarized geographical information (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Net sales:				
United States	$ 171,219	$ 231,196	$ 349,004	$ 463,361
Europe	50,495	63,392	109,831	120,449
Other International	18,314	21,128	33,071	40,249
Total net sales	$ 240,028	$ 315,716	$ 491,906	$ 624,059

	June 30, 2023	December 31, 2022
Long-term assets:		
United States	$ 126,481	$ 131,549
United Kingdom	20,570	21,056
Vietnam and China	33,101	28,811
Total long-lived assets	$ 180,152	$ 181,416

9. Income Taxes

Funko, Inc. is taxed as a corporation and pays corporate federal, state and local taxes on income allocated to it from FAH, LLC based upon Funko, Inc.'s economic interest held in FAH, LLC. FAH, LLC is treated as a pass-through partnership for income tax reporting purposes. FAH, LLC's members, including the Company, are liable for federal, state and local income taxes based on their share of FAH, LLC's pass-through taxable income.

The Company recorded income tax expense of $138.1 million and $127.8 million for the three and six months ended June 30, 2023, respectively and an income tax benefit of $9.0 million and $5.3 million for the three and six months ended June 30, 2022, respectively. As reflected in Note 2. Significant Accounting Policies, the Company established a full valuation allowance of $123.2 million against its deferred tax assets. The Company's effective tax rate for the six months ended June 30, 2023 was (1385.5)%. The Company's effective tax rate differs from the statutory rate of 21% primarily due to the establishment of the valuation allowance as of June 30, 2023.

The Company is party to the Tax Receivable Agreement that provides for the TRA Payment by the Company to the TRA Parties under certain circumstances. See Note 6, Liabilities under Tax Receivable Agreement.

10. Stockholders' Equity

The following is a reconciliation of changes in stockholders' equity for the three and six months ended June 30, 2023 and 2022:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(In thousands)			
Class A common stock				
Beginning balance	$ 5	$ 4	$ 5	$ 4
Shares issued	—	1	—	1
Ending balance	$ 5	$ 5	$ 5	$ 5
Class B common stock				
Beginning balance	$ —	$ 1	$ —	$ 1
Redemption of common units of FAH, LLC	—	(1)	—	(1)
Ending balance	$ —	$ —	$ —	$ —
Additional paid-in capital				
Beginning balance	$ 314,537	$ 260,090	$ 310,807	$ 252,505
Equity-based compensation	4,795	3,953	8,437	7,322
Shares issued for equity-based compensation awards	199	482	287	559
Redemption of common units of FAH, LLC	—	33,678	—	37,901
Recapitalization of FAH, LLC	—	5,873	—	5,873
Establishment of liabilities under tax receivable agreement and related changes to deferred tax assets	—	182	—	98
Ending balance	$ 319,531	$ 304,258	$ 319,531	$ 304,258
Accumulated other comprehensive (loss) income				
Beginning balance	$ (1,665)	$ 142	$ (2,603)	$ 1,078
Foreign currency translation (loss) gain, net of tax	1,239	(2,717)	2,177	(3,653)
Ending balance	$ (426)	$ (2,575)	$ (426)	$ (2,575)
(Accumulated deficit) retained earnings				
Beginning balance	$ 4,704	$ 77,932	$ 60,015	$ 68,050
Net (loss) income attributable to Funko, Inc.	(72,998)	14,672	(128,309)	24,554
Ending balance	$ (68,294)	$ 92,604	$ (68,294)	$ 92,604
Non-controlling interests				
Beginning balance	$ 15,748	$ 71,579	$ 21,465	$ 74,920
Distributions to TRA Parties	(1,103)	(6,816)	(1,103)	(10,224)
Redemption of common units of FAH, LLC	—	(33,678)	—	(37,901)
Recapitalization of FAH, LLC	—	(5,873)	—	(5,873)
Foreign currency translation (loss) gain, net of tax	155	(662)	271	(1,008)
Net (loss) income attributable to non-controlling interests	(2,864)	1,121	(8,697)	5,757
Ending balance	$ 11,936	$ 25,671	$ 11,936	$ 25,671
Total stockholders' equity	$ 262,752	$ 419,963	$ 262,752	$ 419,963

The following is a reconciliation of changes in Class A and Class B common shares outstanding for the three and six months ended June 30, 2023 and 2022:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(In thousands)			
Class A common shares outstanding				
Beginning balance	47,326	40,797	47,192	40,088
Shares issued for equity-based compensation awards	171	223	305	248
Redemption of common units of FAH, LLC	—	5,812	—	6,496
Ending balance	47,497	46,832	47,497	46,832
Class B common shares outstanding				
Beginning balance	3,293	10,007	3,293	10,691
Redemption of common units of FAH, LLC	—	(5,804)	—	(6,488)
Recapitalization of Class B common shares	—	(910)	—	(910)
Ending balance	3,293	3,293	3,293	3,293
Total Class A and Class B common shares outstanding	50,790	50,125	50,790	50,125

11. Non-controlling interests

Funko, Inc. is the sole managing member of FAH, LLC and as a result consolidates the financial results of FAH, LLC and reports a non-controlling interest representing the common units of FAH, LLC held by the Continuing Equity Owners. Changes in Funko, Inc.'s ownership interest in FAH, LLC while Funko, Inc. retains its controlling interest in FAH, LLC will be accounted for as equity transactions. As such, future redemptions or direct exchanges of common units of FAH, LLC by the Continuing Equity Owners will result in a change in ownership and reduce the amount recorded as non-controlling interest and increase or decrease additional paid-in capital when FAH, LLC has positive or negative net assets, respectively.

Net (loss) income and comprehensive (loss) income are attributed between Funko, Inc. and non-controlling interest holders based on each party's relative economic ownership interest in FAH, LLC. As of June 30, 2023 and December 31, 2022, Funko, Inc. owned 47.5 million and 47.2 million of FAH, LLC common units, respectively, representing a 91.4% and 91.6% economic ownership interest in FAH, LLC, respectively.

Net (loss) income and comprehensive (loss) income of FAH, LLC excludes certain activity attributable to Funko, Inc., including equity-based compensation expense for share-based compensation awards issued by Funko, Inc., income tax (benefit) expense for corporate, federal, state and local taxes attributable to Funko, Inc. and tax receivable agreement liability adjustments. The following represents the amounts excluded from the computation of net (loss) income and comprehensive (loss) income of FAH, LLC for the three and six months ended June 30, 2023 and 2022:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(In thousands)			
Funko, Inc.				
Equity-based compensation	$ 4,795	$ 3,953	$ 8,437	$ 7,322
Income tax expense (benefit)	$ 134,174	$ (9,683)	$ 123,206	$ (6,675)
Tax receivable agreement liability adjustment	$ (99,620)	$ —	$ (99,620)	$ —

12. Earnings per Share

Basic (loss) earnings per share of Class A common stock is computed by dividing net (loss) income attributable to Funko, Inc. by the weighted-average number of shares of Class A common stock outstanding during the period. Diluted (loss) earnings per share of Class A common stock is computed by dividing net (loss) income attributable to Funko, Inc. by the weighted-average number of shares of Class A common stock outstanding adjusted to give effect to potentially dilutive securities.

The following table sets forth reconciliations of the numerators and denominators used to compute basic and diluted (loss) earnings per share of Class A common stock (in thousands, except shares and per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Numerator:				
Net (loss) income	$ (75,862)	$ 15,793	$ (137,006)	$ 30,311
Less: net (loss) income attributable to non-controlling interests	(2,864)	1,121	(8,697)	5,757
Net income attributable to Funko, Inc. — basic	$ (72,998)	$ 14,672	$ (128,309)	$ 24,554
Add: Reallocation of net (loss) income attributable to non-controlling interests from the assumed exchange of common units of FAH, LLC for Class A common stock	—	619	—	4,206
Net (loss) income attributable to Funko, Inc. — diluted	$ (72,998)	$ 15,291	$ (128,309)	$ 28,760
Denominator:				
Weighted-average shares of Class A common stock outstanding — basic	47,427,510	43,740,737	47,338,090	42,041,750
Add: Dilutive common units of FAH, LLC that are convertible into Class A common stock	—	7,847,603	—	9,794,925
Add: Dilutive Funko, Inc. equity compensation awards	—	2,235,243	—	2,139,671
Weighted-average shares of Class A common stock outstanding — diluted	47,427,510	53,823,583	47,338,090	53,976,346
(Loss) earnings per share of Class A common stock — basic	$ (1.54)	$ 0.34	$ (2.71)	$ 0.58
(Loss) earnings per share of Class A common stock — diluted	$ (1.54)	$ 0.28	$ (2.71)	$ 0.53

For the three months ended June 30, 2023 and 2022, an aggregate of 10.9 million and 2.2 million, respectively, and for the six months ended June 30, 2023 and 2022, an aggregate of 10.7 million and 2.0 million, respectively, of potentially dilutive securities were excluded from the weighted-average in the computation of diluted earnings per share of Class A common stock because the effect would have been anti-dilutive. For the three and six months ended June 30, 2023, there were 4.4 million common units of FAH, LLC that are convertible into Class A common stock, and, excluded from the computations of diluted (loss) earnings per share because the effect would have been anti-dilutive under the if-converted method. For the three and six months ended June 30, 2022, there were no common units of FAH, LLC that were excluded from the calculations of diluted earnings per share.

Shares of the Company's Class B common stock do not participate in the earnings or losses of the Company and are therefore not participating securities. As such, separate presentation of basic and diluted earnings per share of Class B common stock under the two-class method has not been presented.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis of our financial condition and results of operations together with our unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q, as well as our audited consolidated financial statements and related notes as disclosed in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on March 1, 2023. This discussion and analysis contains forward-looking statements based upon current plans, expectations and beliefs involving risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various important factors, including those set forth under "Risk Factors" included in this Quarterly Report on Form 10-Q.

As used in this Quarterly Report on Form 10-Q, unless the context otherwise requires, references to:

- *"we," "us," "our," the "Company," "Funko"* and similar references refer: Funko, Inc., and, unless otherwise stated, all of its direct and indirect subsidiaries, including FAH, LLC.
- *"ACON"* refers to ACON Funko Investors, L.L.C., a Delaware limited liability company, and certain funds affiliated with ACON Funko Investors, L.L.C. (including each of the Former Equity Owners).
- "*ACON Sale*" refers to the sale by ACON and certain of its affiliates to TCG of an aggregate of 12,520,559 shares of our Class A common stock pursuant to a Stock Purchase Agreement, dated as of May 3, 2022, by and among ACON, certain affiliates of ACON and TCG.
- *"Continuing Equity Owners"* refers collectively to ACON Funko Investors, L.L.C., Fundamental, the Former Profits Interests Holders, certain former warrant holders and certain current and former executive officers, employees and directors and each of their permitted transferees, in each case, that owned common units in FAH, LLC after our initial public offering ("IPO") and who may redeem at each of their options, their common units for, at our election, cash or newly-issued shares of Funko, Inc.'s Class A common stock.
- *"FAH, LLC"* refers to Funko Acquisition Holdings, L.L.C., a Delaware limited liability company.
- *"FAH LLC Agreement"* refers to FAH, LLC's second amended and restated limited liability company agreement, as amended from time to time.
- *"Former Equity Owners"* refers to those Original Equity Owners affiliated with ACON who transferred their indirect ownership interests in common units of FAH, LLC for shares of Funko, Inc.'s Class A common stock (to be held by them either directly or indirectly) in connection with our IPO.
- *"Former Profits Interests Holders"* refers collectively to certain of our directors and certain current executive officers and employees, in each case, who held existing vested and unvested profits interests in FAH, LLC pursuant to FAH, LLC's prior equity incentive plan and received common units of FAH, LLC in exchange for their profits interests (subject to any common units received in exchange for unvested profits interests remaining subject to their existing time-based vesting requirements) in connection with our IPO.
- "*Fundamental*" refers collectively to Fundamental Capital, LLC and Funko International, LLC.
- *"Original Equity Owners"* refers to the owners of ownership interests in FAH, LLC, collectively, prior to the IPO, which include ACON, Fundamental, the Former Profits Interests Holders and certain current and former executive officers, employees and directors.
- *"Tax Receivable Agreement"* refers to a tax receivable agreement entered into between Funko, Inc., FAH, LLC and each of the Continuing Equity Owners and certain transferees.
- *"TCG"* refers to TCG 3.0 Fuji, LP.

Overview

Funko is a leading pop culture lifestyle brand. Our business is built on the principle that almost everyone is a fan of something and the evolution of pop culture is leading to increasing opportunities for fan loyalty. We create whimsical, fun and unique products that enable fans to express their affinity for their favorite "something"—whether it is a movie, TV show, video game, musician or sports team. We infuse our distinct designs and aesthetic sensibility into one of the industry's largest portfolios of licensed content over a wide variety of product categories, including figures, plush, accessories, apparel, homewares, vinyl record, poster or digital NFT.

We sell our products in numerous countries across North America, Europe, Latin America, Asia and Africa, with approximately 29% of our net sales generated outside of the United States. We also source and procure inventory, primarily out of China, Vietnam and Mexico. As such, we are exposed to and impacted by global macroeconomic factors. Current macroeconomic factors remain very dynamic, such as greater political unrest or instability in Central and Eastern Europe (including the ongoing Russia-Ukraine War), the Middle East, certain Southeast Asia markets as well as financial instability, rising interest rates and heightened inflation could reduce our net sales or have impacts to our gross margin, net income and cash flows.

In addition, we are operating in a challenging retail environment where retailers have slowed their restocking, prioritized lower inventory levels and, in some cases, have canceled their orders. This has had an impact across our brands and geographies reducing our net sales, gross margin and net income. We expect this trend to continue for at least the third quarter of 2023.

Key Performance Indicators

We consider the following metrics to be key performance indicators to evaluate our business, develop financial forecasts, and make strategic decisions.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(amounts in thousands)			
Net sales	$ 240,028	$ 315,716	$ 491,906	$ 624,059
Net (loss) income	$ (75,862)	$ 15,793	$ (137,006)	$ 30,311
EBITDA (1)	$ 84,398	$ 19,991	$ 32,596	$ 49,868
Adjusted EBITDA (1)	$ (7,634)	$ 31,751	$ (21,649)	$ 68,004

(1) Earnings before interest, taxes, depreciation and amortization ("EBITDA") and Adjusted EBITDA are financial measures not calculated in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"), or non-GAAP financial measures. For a reconciliation of EBITDA and Adjusted EBITDA to net (loss) income, the most closely comparable U.S. GAAP financial measure, see "Non-GAAP Financial Measures" below.

Results of Operations

Three Months Ended June 30, 2023 Compared to Three Months Ended June 30, 2022

The following table sets forth information comparing the components of net income for the three months ended June 30, 2023 and 2022:

	Three Months Ended June 30,		Period over Period Change	
	2023	2022	Dollar	Percentage
	(amounts in thousands, except percentages)			
Net sales	$ 240,028	$ 315,716	$ (75,688)	(24.0)%
Cost of sales (exclusive of depreciation and amortization shown separately below)	170,019	212,597	(42,578)	(20.0)%
Selling, general, and administrative expenses	85,632	82,693	2,939	3.6 %
Depreciation and amortization	14,893	11,483	3,410	29.7 %
Total operating expenses	270,544	306,773	(36,229)	(11.8)%
(Loss) income from operations	(30,516)	8,943	(39,459)	nm
Interest expense, net	7,264	1,667	5,597	nm
Gain on tax receivable agreement liability adjustment	(99,620)	—	(99,620)	nm
Other (income) expense, net	(401)	435	(836)	nm
Income (loss) before income taxes	62,241	6,841	55,400	nm
Income tax expense (benefit)	138,103	(8,952)	147,055	nm
Net (loss) income	(75,862)	15,793	(91,655)	nm
Less: net (loss) income attributable to non-controlling interests	(2,864)	1,121	(3,985)	nm
Net (loss) income attributable to Funko, Inc.	$ (72,998)	$ 14,672	$ (87,670)	nm

Net Sales

Net sales were $240.0 million for the three months ended June 30, 2023, a decrease of 24.0%, compared to $315.7 million for the three months ended June 30, 2022. The decrease in net sales was due primarily to decreased sales to specialty retailers, mass-market retailers and e-commerce sites for the three months ended June 30, 2023 compared to the three months ended June 30, 2022, primarily as a result of ongoing inventory de-stocking and an overall challenging retail environment. We anticipate that this trend will continue into the third quarter of 2023.

For the three months ended June 30, 2023, the number of active properties decreased 0.8% to 756 as compared to 762 for the three months ended June 30, 2022, and the average net sales per active property decreased 23.4% for the three months ended June 30, 2023 as compared to the three months ended June 30, 2022. An active property is a licensed property from which we generate sales of products during a given period. While we expect to see growth in the number of active properties and average sales per active property over time, we expect that the number of active properties and the average sales per active property will fluctuate from quarter to quarter based on what is relevant in pop culture at that time, the types of properties we are producing against and general economic trends.

On a geographical basis, net sales in the United States decreased 25.9% to $171.2 million in the three months ended June 30, 2023 as compared to $231.2 million in the three months ended June 30, 2022. Net sales in Europe decreased 20.3% to $50.5 million in the three months ended June 30, 2023 as compared to $63.4 million in the three months ended June 30, 2022 and net sales in other international locations decreased 13.3% to $18.3 million in the three months ended June 30, 2023 as compared to $21.1 million in the three months ended June 30, 2022.

On a branded product basis, net sales of the Core Collectible branded category decreased 25.5% to $173.7 million in the three months ended June 30, 2023 as compared to $233.0 million in the three months ended June 30, 2022, Loungefly branded products net sales decreased 28.5% to $50.0 million in the three months ended June 30, 2023 as compared to $70.0 million in the three months ended June 30, 2022 and net sales of other branded products increased 28.8% to $16.4 million in the three months ended June 30, 2023 as compared to $12.7 million in the three months ended June 30, 2022.

Cost of Sales and Gross Margin (exclusive of depreciation and amortization)

Cost of sales (exclusive of depreciation and amortization) was $170.0 million for the three months ended June 30, 2023, a decrease of 20.0%, compared to $212.6 million for the three months ended June 30, 2022. Cost of sales (exclusive of depreciation and amortization) decreased primarily as a result of decreased sales, as discussed above, as well as higher costs as a percentage of net sales as described below.

Gross margin (exclusive of depreciation and amortization), calculated as net sales less cost of sales as a percentage of net sales, was 29.2% for the three months ended June 30, 2023, compared to 32.7% for the three months ended June 30, 2022. The decrease in gross margin (exclusive of depreciation and amortization) for the three months ended June 30, 2023 compared to the three months ended June 30, 2022 was driven primarily by an increase in inventory reserves, other inventory adjustments, and sales of inventory that were initially recorded with higher freight costs during the three months ended June 30, 2023.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses were $85.6 million for the three months ended June 30, 2023, an increase of 3.6%, compared to $82.7 million for the three months ended June 30, 2022. The increase was driven primarily by a $3.9 million increase to personnel and related costs (including salary and related taxes/benefits, commissions, equity-based compensation and variable warehouse labor and third party logistics expenses), and a $3.1 million increase in rent, facility and warehouse support related to a full quarter of costs associated with our Buckeye, Arizona distribution center and rent related to an additional offsite staging facility. This was offset by a $2.7 million decrease in professional fees, which included one-time transaction expenses for the consolidation of the Washington state-based warehouse and distribution centers and move to Arizona for the three months ended June 30, 2022. Selling, general and administrative expenses were 35.7% and 26.2% of net sales for the three months ended June 30, 2023 and 2022, respectively.

Depreciation and Amortization

Depreciation and amortization expense was $14.9 million for the three months ended June 30, 2023, an increase of 29.7%, compared to $11.5 million for the three months ended June 30, 2022, primarily related to the type and timing of assets placed in service, including a full quarter depreciation of the Buckeye, Arizona related assets in the 2023 period.

Interest Expense, Net

Interest expense, net was $7.3 million for the three months ended June 30, 2023, an increase of 335.8%, compared to $1.7 million for the three months ended June 30, 2022. The increase in interest expense, net was due primarily to a higher average balance on debt outstanding, including $141.0 million outstanding on the revolving line of credit during the three months ended June 30, 2023, as compared to $25.8 million for the three months ended June 30, 2022.

Gain on tax receivable agreement liability adjustment

As a result of recognizing a full valuation allowance related to the Company's deferred tax assets, the Company determined as of June 30, 2023 that no future tax benefits were expected to be realized under the Tax Receivable Agreement. The long-term portion of the tax receivable agreement liability was reduced and we recorded a gain of $99.6 million during the three months ended June 30, 2023.

Other (income) expense, net

Other income, net was $0.4 million for the three months ended June 30, 2023, compared to other expense of $0.4 million for the three months ended June 30, 2022. Other (income) expense, net for the three months ended June 30, 2023 and 2022 was primarily related to foreign currency gains and losses relating to transactions denominated in currencies other than the U.S. dollar.

Income tax expense (benefit)

Income tax expense was $138.1 million for the three months ended June 30, 2023 and income tax benefit was $9.0 million for the three months ended June 30, 2022. The increase in income tax expense for the three months ended June 30, 2023 from June 30, 2022 was related to recognizing a full valuation allowance on the Company's deferred tax assets.

Net (loss) income

Net loss was $75.9 million for the three months ended June 30, 2023, compared to net income of $15.8 million for the three months ended June 30, 2022. The decrease in net income for the three months ended June 30, 2023 as compared to the three months ended June 30, 2022 was primarily due to the decrease in net sales and certain increases in cost of sales (exclusive of depreciation and amortization), and, selling, general and administrative expenses and the tax impact related to recognizing a deferred tax asset valuation allowance, partially offset by a gain on the tax receivable agreement liability adjustment, as discussed above.

Six Months Ended June 30, 2023 Compared to Six Months Ended June 30, 2022

The following table sets forth information comparing the components of net income for the six months ended June 30, 2023 and 2022:

	Six Months Ended June 30,		Period over Period Change	
	2023	2022	Dollar	Percentage
	(amounts in thousands, except percentages)			
Net sales	$ 491,906	$ 624,059	$ (132,153)	(21.2)%
Cost of sales (exclusive of depreciation and amortization shown separately below)	372,322	412,246	(39,924)	(9.7)%
Selling, general, and administrative expenses	185,693	161,113	24,580	15.3 %
Depreciation and amortization	28,869	21,954	6,915	31.5 %
Total operating expenses	586,884	595,313	(8,429)	(1.4)%
(Loss) income from operations	(94,978)	28,746	(123,724)	nm
Interest expense, net	12,950	2,877	10,073	nm
Loss on debt extinguishment	494	—	494	nm
Gain on tax receivable agreement liability adjustment	(99,620)	—	(99,620)	nm
Other expense, net	421	832	(411)	(49.4)%
(Loss) income before income taxes	(9,223)	25,037	(34,260)	nm
Income tax expense (benefit)	127,783	(5,274)	133,057	nm
Net (loss) income	(137,006)	30,311	(167,317)	nm
Less: net (loss) income attributable to non-controlling interests	(8,697)	5,757	(14,454)	nm
Net (loss) income attributable to Funko, Inc.	$ (128,309)	$ 24,554	$ (152,863)	nm

Net Sales

Net sales were $491.9 million for the six months ended June 30, 2023, a decrease of 21.2%, compared to $624.1 million for the six months ended June 30, 2022. The decrease in net sales was due primarily to decreased sales to mass-market retailers, specialty retailers, and e-commerce sites for the six months ended June 30, 2023 compared to the six months ended June 30, 2022, primarily as a result of ongoing inventory de-stocking and an overall challenging retail environment. We anticipate that this trend will continue into the third quarter of 2023.

For the six months ended June 30, 2023, the number of active properties decreased 3.2% to 824 as compared to 851 for the six months ended June 30, 2022, and the average net sales per active property increased to 18.6% for the six months ended June 30, 2023 as compared to the six months ended June 30, 2022.

On a geographical basis, net sales in the United States decreased 24.7% to $349.0 million in the six months ended June 30, 2023 as compared to $463.4 million in the six months ended June 30, 2022. Net sales in Europe decreased 8.8% to $109.8 million in the six months ended June 30, 2023 as compared to $120.4 million in the six months ended June 30, 2022 and net sales in other international locations decreased 17.8% to $33.1 million in the six months ended June 30, 2023 as compared to $40.2 million in the six months ended June 30, 2022.

On a branded product basis, net sales of Core Collectible branded products decreased 24.4% to $357.1 million in the six months ended June 30, 2023 as compared to $472.7 million in the six months ended June 30, 2022, Loungefly branded products decreased 14.9% to $102.2 million in the six months ended June 30, 2023 as compared to $120.1 million in the six months ended June 30, 2022 and net sales of other branded products increased 4.1% to $32.6 million in the six months ended June 30, 2023 as compared to $31.3 million in the six months ended June 30, 2022.

Cost of Sales and Gross Margin (exclusive of depreciation and amortization)

Cost of sales (exclusive of depreciation and amortization) was $372.3 million for the six months ended June 30, 2023, a decrease of 9.7%, compared to $412.2 million for the six months ended June 30, 2022. Cost of sales (exclusive of depreciation and amortization) decreased primarily as a result of decreased sales, as discussed above, as well as higher costs as a percentage of net sales as described below.

Gross margin (exclusive of depreciation and amortization), calculated as net sales less cost of sales as a percentage of net sales, was 24.3% for the six months ended June 30, 2023, compared to 33.9% for the six months ended June 30, 2022. The decrease in gross margin (exclusive of depreciation and amortization) for the six months ended June 30, 2023 compared to the six months ended June 30, 2022 was driven primarily by a one-time inventory write-down of $30.1 million.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses were $185.7 million for the six months ended June 30, 2023, an increase of 15.3%, compared to $161.1 million for the six months ended June 30, 2022. The increase was driven primarily by a $16.7 million increase to personnel and related costs (including salary and related taxes/benefits, commissions, equity-based compensation and variable warehouse labor and third party logistics expenses), a $7.7 million increase in rent, facility and warehouse support, primarily related to the Buckeye, Arizona warehouse, and a $2.6 million increase in advertising and marketing costs, offset by a $2.0 million decrease in professional fees, primarily related to decreased consulting fees. Selling, general and administrative expenses were 37.7% and 25.8% of net sales for the six months ended June 30, 2023 and 2022, respectively.

Depreciation and Amortization

Depreciation and amortization expense was $28.9 million for the six months ended June 30, 2023, an increase of 31.5%, compared to $22.0 million for the six months ended June 30, 2022, primarily related to the type and timing of assets placed in service, including a full six months depreciation of the Buckeye, Arizona related assets in the 2023 period.

Interest Expense, Net

Interest expense, net was $13.0 million for the six months ended June 30, 2023, an increase of 350.1%, compared to $2.9 million for the six months ended June 30, 2022. The increase in interest expense, net was due primarily to a higher average balance on debt outstanding during the six months ended June 30, 2023 as compared to the six months ended June 30, 2022.

Loss on debt extinguishment

As a result of the debt refinancing in February 2023, a $0.5 million loss on debt extinguishment was recorded for the six months ended June 30, 2023 as unamortized debt financing fees were written-off.

Gain on tax receivable agreement liability adjustment

As a result of recognizing a full valuation allowance related to the Company's deferred tax assets, the Company determined as of June 30, 2023 that no future tax benefits were expected to be realized under the Tax Receivable Agreement. The long-term portion of the tax receivable agreement liability was reduced and we recorded a gain of $99.6 million during the six months ended June 30, 2023.

Other expense, net

Other expense, net was $0.4 million and $0.8 million for the six months ended June 30, 2023 and 2022, respectively. Other expense, net for the six months ended June 30, 2023 and 2022 was primarily related to foreign currency gains and losses relating to transactions denominated in currencies other than the U.S. dollar.

Income tax expense (benefit)

Income tax expense was $127.8 million for the six months ended June 30, 2023 and an income tax benefit of $5.3 million for the six months ended June 30, 2022. The increase in income tax expense for the six months ended June 30, 2023 from June 30, 2022 was related to recognizing a full valuation allowance on the Company's deferred tax assets.

Net (loss) income

Net loss was $137.0 million for the six months ended June 30, 2023, compared to net income of $30.3 million for the six months ended June 30, 2022. The decrease in net income for the six months ended June 30, 2023 as compared to the six months ended June 30, 2022 was primarily due to the decrease in net sales and certain increases in cost of sales (exclusive of depreciation and amortization), and selling, general and administrative expenses and tax impact related to recognizing a deferred tax asset valuation allowance, partially offset by a gain on the tax receivable agreement liability adjustment, as discussed above.

Non-GAAP Financial Measures

EBITDA, Adjusted EBITDA, Adjusted Net (Loss) Income and Adjusted (Loss) Earnings per Diluted Share (collectively the "Non-GAAP Financial Measures") are supplemental measures of our performance that are not required by, or presented in accordance with, U.S. GAAP. The Non-GAAP Financial Measures are not measurements of our financial performance under U.S. GAAP and should not be considered as an alternative to net (loss) income, (loss) earnings per share or any other performance measure derived in accordance with U.S. GAAP. We define EBITDA as net (loss) income before interest expense, net, income tax (benefit) expense, depreciation and amortization. We define Adjusted EBITDA as EBITDA further adjusted for non-cash charges related to equity-based compensation programs, loss on extinguishment of debt, acquisition transaction costs and other expenses, certain severance, relocation and related costs, foreign currency transaction gains and losses, one-time inventory write-down, tax receivable agreement liability adjustments, one-time disposal costs for unfinished inventory held at offshore factories and other unusual or one-time items. We define Adjusted Net (Loss) Income as net (loss) income attributable to Funko, Inc. adjusted for the reallocation of income attributable to non-controlling interests from the assumed exchange of all outstanding common units and options in FAH, LLC for newly issued-shares of Class A common stock of Funko, Inc. and further adjusted for the impact of certain non-cash charges and other items that we do not consider in our evaluation of ongoing operating performance. These items include, among other things, non-cash charges related to equity-based compensation programs, loss on extinguishment of debt, acquisition transaction costs and other expenses, certain severance, relocation and related costs, foreign currency transaction gains and losses, one-time inventory write-down, tax receivable agreement liability adjustments, one-time disposal costs for unfinished inventory held at offshore factories and the income tax expense effect of these adjustments. We define Adjusted (Loss) Earnings per Diluted Share as Adjusted Net (Loss) Income divided by the weighted-average shares of Class A common stock outstanding, assuming (1) the full exchange of all outstanding common units and options in FAH, LLC for newly issued-shares of Class A common stock of Funko, Inc. and (2) the dilutive effect of stock options and unvested common units, if any. We caution investors that amounts presented in accordance with our definitions of the Non-GAAP Financial Measures may not be comparable to similar measures disclosed by our competitors, because not all companies and analysts calculate the Non-GAAP Financial Measures in the same manner. We present the Non-GAAP Financial Measures because we consider them to be important supplemental measures of our performance and believe they are frequently used by securities analysts, investors, and other interested parties in the evaluation of companies in our industry. Management believes that investors' understanding of our performance is enhanced by including these Non-GAAP Financial Measures as a reasonable basis for comparing our ongoing results of operations.

Management uses the Non-GAAP Financial Measures:

- as a measurement of operating performance because they assist us in comparing the operating performance of our business on a consistent basis, as they remove the impact of items not directly resulting from our core operations;
- for planning purposes, including the preparation of our internal annual operating budget and financial projections;
- as a consideration to assess incentive compensation for our employees;
- to evaluate the performance and effectiveness of our operational strategies; and
- to evaluate our capacity to expand our business.

By providing these Non-GAAP Financial Measures, together with reconciliations, we believe we are enhancing investors' understanding of our business and our results of operations, as well as assisting investors in evaluating how well we are executing our strategic initiatives. The Non-GAAP Financial Measures have limitations as analytical tools, and should not be considered in isolation, or as an alternative to, or a substitute for net income or other financial statement data presented in our unaudited condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q as indicators of financial performance. Some of the limitations are:

- such measures do not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
- such measures do not reflect changes in, or cash requirements for, our working capital needs;
- such measures do not reflect the interest expense, or the cash requirements necessary to service interest or principal payments on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future and such measures do not reflect any cash requirements for such replacements; and
- other companies in our industry may calculate such measures differently than we do, limiting their usefulness as comparative measures.

Due to these limitations, Non-GAAP Financial Measures should not be considered as measures of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our U.S. GAAP results and using these non-GAAP measures only supplementally. As noted in the table below, the Non-GAAP Financial Measures include adjustments for non-cash charges related to equity-based compensation programs, loss on extinguishment of debt, acquisition transaction costs and other expenses, certain severance, relocation and related costs, foreign currency transaction gains and losses, one-time inventory write-down, tax receivable agreement liability adjustments, one-time disposal costs for unfinished inventory held at offshore factories and other unusual or one-time items. It is reasonable to expect that certain of these items will occur in future periods. However, we believe these adjustments are appropriate because the amounts recognized can vary significantly from period to period, do not directly relate to the ongoing operations of our business and complicate comparisons of our internal operating results and operating results of other companies over time. Each of the normal recurring adjustments and other adjustments described herein and in the reconciliation table below help management with a measure of our core operating performance over time by removing items that are not related to day-to-day operations.

The following tables reconcile the Non-GAAP Financial Measures to the most directly comparable U.S. GAAP financial performance measure, which is net income, for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(In thousands, except per share data)			
Net (loss) income attributable to Funko, Inc.	$ (72,998)	$ 14,672	$ (128,309)	$ 24,554
Reallocation of net income attributable to non-controlling interests from the assumed exchange of common units of FAH, LLC for Class A common stock (1)	(2,864)	1,121	(8,697)	5,757
Equity-based compensation (2)	4,795	3,953	8,437	7,322
Loss on extinguishment of debt (3)	—	—	494	—
Acquisition transaction costs and other expenses (4)	444	1,920	1,454	2,850
Certain severance, relocation and related costs (5)	346	5,453	2,081	7,133
Foreign currency transaction (gain) loss (6)	(401)	434	421	831
One-time inventory write-down (7)	—	—	30,084	—
Tax receivable agreement liability adjustments (8)	(99,620)	—	(99,620)	—
One-time disposal costs for unfinished inventory held at offshore factories (9)	2,404	—	2,404	—
Income tax expense (10)	145,551	(13,602)	143,650	(16,067)
Adjusted net (loss) income	$ (22,343)	$ 13,951	$ (47,601)	$ 32,380
Weighted-average shares of Class A common stock outstanding-basic	47,428	43,741	47,338	42,042
Equity-based compensation awards and common units of FAH, LLC that are convertible into Class A common stock	4,481	10,083	4,423	11,935
Adjusted weighted-average shares of Class A stock outstanding - diluted	51,909	53,824	51,761	53,977
Adjusted (loss) earnings per diluted share	$ (0.43)	$ 0.26	$ (0.92)	$ 0.60

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
	(amounts in thousands)			
Net (loss) income	$ (75,862)	$ 15,793	$ (137,006)	$ 30,311
Interest expense, net	7,264	1,667	12,950	2,877
Income tax expense (benefit)	138,103	(8,952)	127,783	(5,274)
Depreciation and amortization	14,893	11,483	28,869	21,954
EBITDA	$ 84,398	$ 19,991	$ 32,596	$ 49,868
Adjustments:				
Equity-based compensation (2)	4,795	3,953	8,437	7,322
Loss on extinguishment of debt (3)	—	—	494	—
Acquisition transaction costs and other expenses (4)	444	1,920	1,454	2,850
Certain severance, relocation and related costs (5)	346	5,453	2,081	7,133
Foreign currency transaction (gain) loss (6)	(401)	434	421	831
One-time inventory write-down (7)	—	—	30,084	—
Tax receivable agreement liability adjustments (8)	(99,620)	—	(99,620)	—
One-time disposal costs for unfinished inventory held at offshore factories (9)	2,404	—	2,404	—
Adjusted EBITDA	$ (7,634)	$ 31,751	$ (21,649)	$ 68,004

(1) Represents the reallocation of net income attributable to non-controlling interests from the assumed exchange of common units of FAH, LLC for Class A common stock in periods in which income was attributable to non-controlling interests.
(2) Represents non-cash charges related to equity-based compensation programs, which vary from period to period depending on the timing of awards.
(3) Represents write-off of unamortized debt financing fees for the six months ended June 30, 2023.
(4) For the three months ended June 30, 2023 includes one-time bank monitoring fees. For the six months ended June 30, 2023 includes acquisition-related costs related to due diligence fees. For the three and six months ended June 30, 2022 includes acquisition-related costs related to investment banking and due diligence fees.
(5) For the three months ended June 30, 2023, includes charges to remove leasehold improvements and return multiple Washington-based warehouses. For the six months ended June 30, 2023, includes charges related to severance and benefit costs for a reduction-in-force. For the three and six months ended June 30, 2022, includes charges related to one-time relocation costs for U.S. warehouse personnel and inventory in connection with the new opening of a warehouse and distribution facility in Buckeye, Arizona.
(6) Represents both unrealized and realized foreign currency gains and losses on transactions denominated other than in U.S. dollars, including derivative gains and losses on foreign currency forward exchange contracts.
(7) For the six months ended June 30, 2023, represents a one-time inventory write-down to improve U.S. warehouse operational efficiency.
(8) Represents reduction of the tax receivable agreement liability as a result of recognizing a full valuation allowance of the Company's deferred tax assets and anticipated inability to realize future tax benefits.
(9) For the three and six months ended June 30, 2023, represents one-time disposal costs related to unfinished inventory held at offshore factories.
(10) Represents the income tax expense effect of the above adjustments, except for the tax liability receivable adjustment. This adjustment uses an effective tax rate of 25% for all periods presented. For the three and six months ended June 30, 2023, this also includes $123.2 million recognized valuation allowance on the Company's deferred tax assets. For the three and six months ended June 30, 2022, this also includes the $11.0 million discrete benefit from the release of a valuation allowance on the outside basis deferred tax asset.

Liquidity and Financial Condition

Introduction

Our primary requirements for liquidity and capital are working capital, inventory management, capital expenditures, debt service and general corporate needs.

Notwithstanding our obligations under the Tax Receivable Agreement between Funko, Inc., FAH, LLC and each of the Continuing Equity Owners, and certain transferees of the Continuing Equity Owners have been joined as parties to the Tax Receivable Agreement (the parties entitled to payments under the Tax Receivable Agreement are referred to herein as the "TRA Parties"), we believe that our sources of liquidity and capital will be sufficient to finance our continued operations, growth strategy, our planned capital expenditures and the additional expenses we expect to incur for at least the next 12 months.

However, we cannot assure you that our cash provided by operating activities, cash and cash equivalents or cash available under our Revolving Credit Facility will be sufficient to meet our future needs. If we are unable to generate sufficient cash flows from operations in the future, and if availability under our Revolving Credit Facility is not sufficient, we may have to obtain additional financing. If we obtain additional capital by issuing equity, the interests of our existing stockholders will be diluted. If we incur additional indebtedness, that indebtedness may contain significant financial and other covenants that may significantly restrict our operations. We cannot assure you that we could obtain refinancing or additional financing on favorable terms or at all.

Liquidity and Capital Resources

The following table shows summary cash flow information for the six months ended June 30, 2023 and 2022 (in thousands):

	Six Months Ended June 30,	
	2023	2022
Net cash used in operating activities	$ (12,036)	$ (30,139)
Net cash used in investing activities	(27,566)	(47,620)
Net cash provided by financing activities	56,969	51,335
Effect of exchange rates on cash and cash equivalents	260	(942)
Net change in cash and cash equivalents	$ 17,627	$ (27,366)

Operating Activities. Net cash used in operating activities was $12.0 million for the six months ended June 30, 2023, compared to net cash used in operating activities of $30.1 million for the six months ended June 30, 2022. Changes in net cash provided by operating activities result primarily from cash received from net sales and cash payments for product costs and royalty expenses paid to our licensors. Other drivers of the changes in net cash provided by operating activities include shipping and freight costs, selling, general and administrative expenses (including personnel expenses and commissions and rent and facilities costs) and interest payments made for our short-term borrowings and long-term debt. Our accounts receivable typically are short term and settle in approximately 30 to 90 days.

The decrease in net cash used in operating activities for the six months ended June 30, 2023 compared to the six months ended June 30, 2022 was primarily due to an increase related to changes in working capital that increased net cash provided by operating activities by $159.5 million. The working capital increase was primarily due to increases in inventory of $130.6 million, accounts receivable of $43.1 million, prepaid expenses and other assets of $28.2 million, and a decrease in income taxes payable of $16.1 million, offset by increases in accounts payable of $44.3 million and accrued expense and other current liabilities of $8.2 million.

Investing Activities. Our net cash used in investing activities primarily consists of purchases of property and equipment. For the six months ended June 30, 2023, net cash used in investing activities was $27.6 million, which primarily related to purchases of tooling and molds used in production for our product lines. In addition, we used $5.3 million in net cash for the purchase of the stock of MessageMe, Inc. (d/b/a HipDot). For the six months ended June 30, 2022, net cash used in investing activities was $47.6 million and was primarily related to purchases of tooling and molds used in production our product lines and for the acquisition of Mondo.

Financing Activities. Our financing activities primarily consist of proceeds from the issuance of long-term debt, net of debt issuance costs, the repayment of long-term debt, payments and borrowings under our line of credit facility, distributions to the TRA Parties and proceeds from the exercise of equity-based options.

For the six months ended June 30, 2023, net cash provided by financing activities was $57.0 million, primarily related to a draw of $71.0 million on the New Revolving Credit Facility, offset by payments on the Term Loan Facility of $11.3 million and distributions to the TRA Parties of $1.1 million. For the six months ended June 30, 2022, net cash provided by financing activities was $51.3 million, primarily related to a draw of $70.0 million on the New Revolving Credit Facility, offset by payments on the Term Loan Facility of $9.0 million and distributions to the TRA Parties of $10.2 million.

Credit Facilities

On September 17, 2021, the Company, entered into a new credit agreement (as amended from time to time, the “New Credit Agreement”) with JPMorgan Chase Bank, N.A., PNC Bank, National Association, KeyBank National Association, Citizens Bank, N.A., Bank of the West, HSBC Bank USA, National Association, Bank of America, N.A., U.S. Bank National Association, MUFG Union Bank, N.A., and Wells Fargo Bank, National Association (collectively, the “Initial Lenders”) and JPMorgan Chase Bank, N.A. as administrative agent, providing for a term loan facility in the amount of $180.0 million (the “New Term Loan Facility”) and a revolving credit facility of $100.0 million (the “New Revolving Credit Facility”) (together the “New Credit Facilities”). Proceeds from the New Credit Facilities were primarily used to repay the Company’s former credit facilities. On April 26, 2022, the parties to the New Credit Agreement entered into Amendment No. 1 to the New Credit Agreement (the “First Amendment”) with the Initial Lenders and JPMorgan Chase Bank, N.A. as administrative agent, which allows for additional Restricted Payments (as defined in the First Amendment) using specified funding sources. On July 29, 2022, the parties to the New Credit Agreement entered into Amendment No. 2 to the New Credit Agreement (the “Second Amendment”) with the Initial Lenders and Goldman Sachs Bank USA (collectively, the “Lenders”) and JPMorgan Chase Bank, N.A. as administrative agent, which increases the New Revolving Credit Facility to $215.0 million and converts the New Credit Facility interest rate index from Borrower (as defined in the New Credit Agreement) option LIBOR to SOFR.

On February 28, 2023, the Company entered into Amendment No. 3 (the “Third Amendment”) to the New Credit Agreement to, among other things, (i) modify the financial covenants under the New Credit Agreement for the period beginning on the date of the Third Amendment through the fiscal quarter ending December 31, 2023 (the “Waiver Period”), (ii) reduce the size of the New Revolving Credit Facility from $215.0 million to $180.0 million as of the date of the Third Amendment and thereafter to $150.0 million on December 31, 2023, which reduction shall be permanent after the Waiver Period, (iii) restrict the ability to draw on the New Revolving Credit Facility during the Waiver Period in excess of the amount outstanding on the date of the Third Amendment, (iv) increase the margin payable under the Credit Facilities during the Waiver Period to (a) 4.00% per annum with respect to any Term Benchmark Loan or RFR Loan (each as defined in the New Credit Agreement), and (b) 3.00% per annum with respect to any Canadian Prime Loan or ABR Loan (as defined in the New Credit Agreement), (v) allow that any calculation of Consolidated EBITDA (each as defined in the New Credit Agreement) that includes the fiscal quarters during the Waiver Period may include certain agreed upon amounts for certain addbacks, (vi) further limit our ability to make certain restricted payments, including the ability to pay dividends or make other distributions on equity interests, or redeem, repurchase or retire equity interests, incur additional indebtedness, incur additional liens, enter into sale and leaseback transactions or issue additional equity interests or securities convertible into or exchange for equity interests (other than the issuance of common stock) during the Waiver Period, (vii) require a minimum qualified cash requirement of at least $10.0 million and (viii) require a mandatory prepayment of the New Revolving Credit Facility during the Waiver Period with any qualified cash proceeds in excess of $25.0 million. Following the Waiver Period, beginning in the fiscal quarter ending March 31, 2024, the Third Amendment will reset the maximum Net Leverage Ratio and the minimum Fixed Charge Coverage Ratio (each as defined in the New Credit Agreement) that must be maintained by the Credit Agreement Parties to 2.50:1.00 and 1.25:1.00, respectively, which were the ratios in effect under the New Credit Agreement prior to the Third Amendment. We cannot assure you that we will be able to maintain compliance with our financial covenants as amended after the Waiver Period, or that we will be able to further amend the New Credit Agreement should similar circumstances arise in the future. As of February 28, 2023, the Company had $141.0 million in borrowings outstanding under the New Revolving Credit Facility.

If our operating results fail to improve or if we are otherwise unable to maintain compliance with the financial or other covenants under the New Credit Agreement, our lenders could, among other things, continue to refuse to permit any additional borrowings under the New Revolving Credit Facility, terminate all outstanding commitments thereunder and accelerate all outstanding borrowings and other obligations, which would require us to seek additional financing. Even in the absence of such event, if we are unable to generate sufficient cash flows from operations in the future, and if availability under our Revolving Credit Facility is not sufficient after the Waiver Period, we may have to obtain additional financing. If we obtain additional capital by issuing equity, the interests of our existing stockholders will be diluted. If we incur additional indebtedness, that indebtedness may contain significant financial and other covenants that may significantly restrict our operations. We cannot assure you that we could obtain refinancing or additional financing on favorable terms or at all, particularly during the Waiver Period.

The New Term Loan Facility matures on September 17, 2026 (the "Maturity Date") and amortizes in quarterly installments in aggregate amounts equal to 2.50% of the original principal amount of the New Term Loan Facility, with any outstanding balance due and payable on the Maturity Date. The first amortization payment commenced with the quarter ending on December 31, 2021. The New Revolving Credit Facility also terminates on the Maturity Date and loans thereunder may be borrowed, repaid, and reborrowed, to the extent consistent with the Third Amendment, up to such date.

Subject to the interest rates during the Waiver Period as described above, loans under the New Credit Facilities will, at the Borrowers' option, bear interest at either (i) Term SOFR, EURIBOR, HIBOR, CDOR, SONIA and/or the Central Bank Rate, as applicable, plus (x) 4.00% per annum and (y) solely in the case of Term SOFR based loans, 0.10% per annum or (ii) ABR or the Canadian prime rate, as applicable, plus 3.00% per annum, in each case of clauses (i) and (ii), subject to two 0.25% per annum step-downs based on the achievement of certain leverage ratios. Each of Term SOFR, EURIBOR, HIBOR, CDOR and Daily Simple SONIA rates are subject to a 0% floor. For loans based on ABR, the Central Bank Rate or the Canadian prime rate, interest payments are due quarterly. For loans based on SONIA, interest payments are due monthly. For loans based on Term SOFR, EURIBOR, HIBOR or CDOR, interest payments are due at the end of each applicable interest period.

The New Credit Agreement contains a number of covenants that, among other things and subject to certain exceptions, restrict our ability to:

- incur additional indebtedness;
- incur certain liens;
- consolidate, merge or sell or otherwise dispose of our assets;
- make investments, loans, advances, guarantees and acquisitions;
- pay dividends or make other distributions on equity interests, or redeem, repurchase or retire equity interests;
- enter into transactions with affiliates;
- enter into sale and leaseback transactions in respect to real property;
- enter into swap agreements;
- enter into agreements restricting our subsidiaries' ability to pay dividends;
- issue or sell equity interests or securities convertible into or exchangeable for equity interests;
- redeem, repurchase or refinance other indebtedness; and
- amend or modify our governing documents.

These limitations are also more restrictive during the Waiver Period as described herein. In addition, the New Credit Agreement requires FAH, LLC and its subsidiaries to comply on a quarterly basis with a maximum Net Leverage Ratio and a minimum fixed charge coverage ratio (in each case, measured on a trailing four-quarter basis) other than during the Waiver Period. The maximum Net Leverage Ratio and the minimum fixed charge coverage ratio for the fiscal quarter ended December 31, 2022 were 2.50:1.00 and 1.25:1.00, respectively, and such ratios will apply again commencing after the Waiver Period for the fiscal quarter ending March 31, 2024.

As of June 30, 2023 and December 31, 2022, we were in compliance with all covenants in our respective credit agreements in effect at such time. Subsequent to the Third Amendment, we expect to maintain compliance with our covenants for at least one year from the issuance of these financial statements based on our current expectations and forecasts. If economic conditions worsen, such as due to the COVID-19 pandemic or international conflict, and negatively impact the Company's earnings and operating cash flows, this could impact our ability to regain compliance with our amended financial covenants and require the Company to seek additional amendments to our New Credit Agreement.

The New Credit Agreement also contains certain customary representations and warranties and affirmative covenants, and certain reporting obligations. In addition, the lenders under the New Credit Facilities will be permitted to accelerate all outstanding borrowings and other obligations, terminate outstanding commitments and exercise other specified remedies upon the occurrence of certain events of default (subject to certain grace periods and exceptions), which include, among other things, payment defaults, breaches of representations and warranties, covenant defaults, certain cross-defaults and cross-accelerations to other indebtedness, certain events of bankruptcy and insolvency, certain material monetary judgments and changes of control. The New Credit Agreement defines "change of control" to include, among other things, any person or group other than ACON and its affiliates becoming the beneficial owner of more than 35% of the voting power of the equity interests of Funko, Inc.

As of June 30, 2023, we had $164.0 million of indebtedness outstanding under our New Term Loan Facility (net of unamortized discount of $2.3 million) and $141.0 million outstanding borrowings under our New Revolving Credit Facility, leaving $0.0 million available under our New Revolving Credit Facility.

Form S-3 Registration Statement

On July 15, 2022, we filed a preliminary shelf registration statement on Form S-3 with the SEC. The Form S-3 was declared effective by the SEC on July 26, 2022 and will remain effective until through July 25, 2025. The Form S-3 allows us to offer and sell from time-to-time up to $100.0 million of Class A common stock, preferred stock, debt securities, warrants, purchase contracts or units comprised of any combination of these securities for our own account and allows certain selling stockholders to offer and sell 17,318,008 shares of Class A common stock in one or more offerings.

The Form S-3 is intended to provide us flexibility to conduct registered sales of our securities, subject to market conditions and our future capital needs. The terms of any future offering under the shelf registration statement will be established at the time of such offering and will be described in a prospectus supplement filed with the SEC prior to the completion of any such offering.

Future Sources and Uses of Liquidity

As of June 30, 2023, we had $36.8 million of cash and cash equivalents and $(3.8) million of working capital, compared with $19.2 million of cash and cash equivalents and $111.8 million of working capital as of December 31, 2022. Working capital is impacted by the seasonal trends of our business and the timing of new product releases, as well as our current portion of long-term debt and draw downs on our New Revolving Credit Facility.

Sources

As noted above, historically, our primary sources of cash flows have been cash flows from operating activities and borrowings under our credit facilities. We expect these sources of liquidity to continue to be our primary sources of liquidity. For a discussion of our credit facilities, see "Credit Facilities" above and Note 5, Debt. In addition, as described above, on July 15, 2022, we filed a preliminary shelf registration statement on Form S-3 with the SEC, which was declared effective by the SEC on July 26, 2022. The terms of any offering under the shelf registration statement will be established at the time of such offering and will be described in a prospectus supplement filed with the SEC prior to the completion of any such offering.

Uses

As noted above, our primary requirements for liquidity and capital are working capital, inventory management, capital expenditures, debt service and general corporate needs. There have been no material changes to our liquidity and capital commitments as described in our Annual Report on Form 10-K for the year ended December 31, 2022.

Additional future liquidity needs may include tax distributions, the redemption right held by the Continuing Equity Owners that they may exercise from time to time (should we elect to exchange their common units for a cash payment), payments under the Tax Receivable Agreement and general cash requirements for operations and capital expenditures (including integration of our warehouse management system (WMS), additional platforms to support our direct-to-consumer experience, and capital build out of new leased warehouse and office space). The Continuing Equity Owners may exercise their redemption right for as long as their common units remain outstanding. If utilization of the deferred tax assets subject to the Tax Receivable Agreement becomes more likely than not in the future, the Company will record a liability related to the Tax Receivable Agreement and we expect that the payments we will be required to make to the TRA Parties will be significant. Any payments made by us to the TRA Parties under the Tax Receivable Agreement will generally reduce the amount of overall cash flow that might have otherwise have been available to us or to FAH, LLC and, to the extent that we are unable to make payments under the Tax Receivable Agreement for any reason, the unpaid amounts generally will be deferred and will accrue interest until paid by us; provided however, that nonpayment for a specified period may constitute a material breach under the Tax Receivable Agreement and therefore may accelerate payments due under the Tax Receivable Agreement.

Seasonality

While our customers in the retail industry typically operate in highly seasonal businesses, we have historically experienced only moderate seasonality in our business. Historically, over 50% of our net sales are made in the third and fourth quarters, primarily in the period from August through November, as our customers build up their inventories in anticipation of the holiday season. Historically, the first quarter of the year has represented the lowest volume of shipment and sales in our business and in the retail and toy industries generally and it is also the least profitable quarter due to the various fixed costs of the business. However, the rapid growth we have experienced in recent years may have masked the full effects of seasonal factors on our business to date, and as such, seasonality may have a greater effect on our results of operations in future periods.

Critical Accounting Policies and Estimates

Discussion and analysis of our financial condition and results of operations are based on our unaudited condensed consolidated financial statements which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and related disclosures of contingent assets and liabilities, revenue and expenses at the date of the unaudited condensed consolidated financial statements. We base our estimates on historical experience and on various other assumptions in accordance with U.S. GAAP that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies and estimates are those that we consider the most important to the portrayal of our financial condition and operating results and require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Our critical accounting policies and estimates include those related to revenue recognition and sales allowances, royalties, inventory, goodwill and intangible assets, and income taxes. Changes to these policies and estimates could have a material adverse effect on our results of operations and financial condition.

The Company applies the provisions of Accounting Standards Codification ("ASC") Topic No. 740, "Income Taxes" ("ASC 740"). Under ASC 740, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company reviews its deferred tax assets for recoverability every quarter and valuation allowances are established when management determines, based on all the available evidence, that it is more likely than not that a deferred asset will not be realized. In reviewing all the available evidence management looks at historical pre-tax income or losses, projected future taxable income or loss, and the expected timing of the reversals of existing temporary differences, as deemed appropriate. In addition, all other available positive and negative evidence is taken into consideration for purposes of determining the proper balances of such valuation allowances. As a result of this review, the Company determined that based on all the available evidence, including the Company's three-year cumulative pre-tax loss position as of June 30, 2023, it is not more likely than not that the results of operations will generate sufficient taxable income to realize its deferred tax assets. Consequently, the Company established a full valuation allowance of $123.2 million against its deferred tax assets, thus reducing the carrying balance to $0, and recognized a corresponding increase to tax expense in the consolidated statements of operations and comprehensive (loss) income for the three and six months ended June 30, 2023. Future changes to the balances of these valuation allowances, as a result of this continued review and analysis by the Company, could impact the financial statements within the period of change.

Pursuant to the Tax Receivable Agreement ("TRA"), the Company is required to make cash payments to the TRA Parties equal to 85% of the tax benefits, if any, that the Company realizes. Amounts payable under the Tax Receivable Agreement are contingent upon, among other things, (i) generation of taxable income over the term of the Tax Receivable Agreement and (ii) changes in tax laws. If the Company does not generate sufficient taxable income in the aggregate over the term of the Tax Receivable Agreement to utilize the tax benefits, then the Company would not be required to make the related Tax Receivable Agreement Payments, and this would reduce the TRA Liability accordingly.

As a result of the full valuation allowance on the deferred tax assets, and projected inability to fully utilize all or part of the related tax benefits, the Company determined that certain payments to the TRA Parties related to unrealized tax benefits under the TRA are no longer probable and estimable. Based on this assessment, the Company reduced its TRA Liability as of June 30, 2023, to $9.6 million, and recognized a gain of $99.6 million within the accompanying consolidated statements of operations and comprehensive (loss) income for the three and six months ended June 30, 2023. If utilization of the deferred tax assets subject to the TRA becomes more likely than not in the future, the Company will record a liability related to the TRA, which would be recognized as pre-tax expense within the consolidated statements of operations and comprehensive (loss) income.

There have been no significant changes to our critical accounting policies to our disclosure reported in “Critical Accounting Policies and Estimates” in our Annual Report on Form 10-K for the year ended December 31, 2022.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to market risk from changes in interest rates, foreign currency and inflation. All of these market risks arise in the normal course of business, as we do not engage in speculative trading activities. There have been no material changes in our market risk from the disclosure included under “Quantitative and Qualitative Disclosures of Market Risk” in the Annual Report on Form 10-K for the year ended December 31, 2022.

Item 4. Controls and Procedures.

Limitations on Effectiveness of Disclosure Controls and Procedures.

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Interim Chief Executive Officer and Chief Financial Officer, has concluded, based on its evaluation as of June 30, 2023, that our “disclosure controls and procedures” (as such term is defined in Rules 13a–15(e) and 15d–15(e) under the Securities and Exchange Act of 1934, as amended (the “Exchange Act”)), were not effective at the reasonable assurance level as of such date because of the material weaknesses in our internal control over financial reporting previously described in Item 9A. “Controls and Procedures” of our 2022 Annual Report on Form 10-K.

Remediation Efforts to Address the Material Weaknesses

Our remediation efforts to address the above material weaknesses are ongoing and include:

- performing a rigorous scoping and risk assessment process to identify and analyze risk across the various levels of the Company;
- utilizing the SOX Steering Committee to identify and analyze risks, communicate and emphasize the importance of internal control, and to report regularly to the Company’s Audit Committee;

- enhancing the design of control activities to operate at a level of precision to identify all potentially material errors, and training control owners to improve required retention of documentation evidencing their operation;
- designing and implementing controls that review, approve, and periodically re-evaluate the user access privileges for all system users and the business purpose for allowing access for each authorized user to address segregation of duties;
- designing and implementing controls that require review and approval of changes to key financial information technology systems and reports utilized in the performance of internal controls used in financial reporting; and
- investing in training and hiring personnel with appropriate expertise to plan and perform more timely and thorough monitoring activities for internal controls over financial reporting.

We anticipate that our remediation efforts will continue throughout 2023 however, we cannot provide assurance as to when our remediation measures will be complete, and the material weaknesses cannot be considered remediated until the applicable controls have operated for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively.

Changes in Internal Control over Financial Reporting

Other than the management's continuing efforts to remediate the material weaknesses discussed above, there were no changes in our internal control over financial reporting during the quarter ended June 30, 2023, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

See Note 7 “Commitments and Contingencies - Legal Contingencies” in the Notes to Unaudited Condensed Consolidated Financial Statements included in this Form 10-Q for a discussion of material legal proceedings.

Item 1A. Risk Factors.

Our business faces significant risks and uncertainties. Certain important factors may have a material adverse effect on our business prospects, financial condition and results of operations, and they should be carefully considered. Accordingly, in evaluating our business, we encourage you to consider the following discussion of risk factors in its entirety, in addition to other information contained in or incorporated by reference into this Quarterly Report on Form 10-Q and our other public filings with the Securities and Exchange Commission (“SEC”). Other events that we do not currently anticipate or that we currently deem immaterial may also affect our business, prospects, financial condition and results of operations.

BUSINESS, ECONOMIC, MARKET AND OPERATING RISKS

Our success depends on our ability to execute our business strategy.

Our net sales and profitability have generally grown rapidly in the last several years; however, this should not be considered indicative of our future performance. Our future growth, profitability and cash flows depend upon our ability to successfully manage our operations and execute our business strategy, which is dependent upon a number of factors, including our ability to:

- expand our market presence in existing sales channels and enter additional sales channels;
- anticipate, gauge and respond to rapidly changing consumer preferences and pop culture trends;
- acquire or enter into new licenses in existing product categories or in new product categories and renew existing licenses;
- expand our geographic presence to take advantage of opportunities outside of the United States;
- enhance and maintain favorable brand recognition for our Company and product offerings;
- maintain and expand margins through sales growth and efficiency initiatives;
- effectively manage our relationships with third-party manufacturers;
- effectively manage our debt, working capital and capital investments to maintain and improve the generation of cash flow; and
- execute any acquisitions quickly and efficiently and integrate businesses successfully.

There can be no assurance that we can successfully execute our business strategy in the manner or time period that we expect, particularly in light of the macroeconomic pressures impacting the global economy and consumer demand. Further, achieving these objectives will require investments that may result in short-term costs without generating any current sales or countervailing cost savings and, therefore, may be dilutive to our earnings, at least in the short term. In addition, we may decide to divest or discontinue certain brands or products or streamline operations and incur other costs or special charges in doing so. We may also decide to discontinue certain programs or sales to certain retailers based on anticipated strategic benefits. The failure to realize the anticipated benefits from our business strategy could have a material adverse effect on our prospects, business, financial condition and results of operations.

Our success depends, in part, on our ability to successfully manage our inventories.

We must maintain sufficient inventory levels to operate our business successfully, but we must also avoid accumulating excess inventory, which increases working capital needs and lowers gross margin. We obtain substantially all of our inventory from third-party manufacturers located outside the United States and must typically order products well in advance of the time these products will be offered for sale to our customers. As a result, it may be difficult to respond to changes in consumer preferences and market conditions, which, for pop culture products, can change rapidly. If we do not accurately anticipate the popularity of certain products, then we may not have sufficient inventory to meet demand. Alternatively, if demand or future sales do not reach forecasted levels, we could have excess inventory that we may need to hold for a long period of time, write down, sell at prices lower than expected or discard.

In addition, we may face difficulties processing inventory through our distribution centers, which could cause us to hold inventory for an extended period of time. If market conditions, demand for our products or consumer preferences shift or we face distribution challenges prior to the sales of the inventory, we may have excess inventory that we may need to hold for a long period of time, write down, and/or sell at prices lower than expected or discard.

We may also be negatively affected by changes in retailers' inventory policies and practices, including as a result of macroeconomic factors. As a result of the desire of retailers to more closely manage inventory levels, we are required to more closely anticipate demand and this could require us to carry additional inventory. Policies and practices of individual retailers may adversely affect us as well, including those relating to access to and time on shelf space, price demands, payment terms and favoring the products of our competitors. Our retail customers make no binding long-term commitments to us regarding purchase volumes and make all purchases by delivering purchase orders. Any retailer can therefore freely reduce its overall purchase of our products, including the number and variety of our products that it carries, and reduce the shelf space allotted for our products. We have recently experienced canceled orders and if demand or future sales do not reach forecasted levels, we could have excess inventory that we may need to hold for a long period of time, write down, sell at prices lower than expected or discard. For example, during the six months ended June 30, 2023, we incurred a one-time inventory write-down of $30.1 million due to our decision to increase operational efficiency and reduce storage costs which contributed to the Company's net loss for the period. If we are not successful in managing our inventory, our business, financial condition and results of operations could be adversely affected.

If we fail to manage our growth effectively, our financial performance may suffer.

We have generally experienced rapid growth over the last several years, which has placed a strain on our managerial, operational, product design and development, sales and marketing, administrative and financial infrastructure. For example, we increased our total number of full-time employees from 702 as of December 31, 2018 to 1,487 as of June 30, 2023. We also lease distribution centers in the U.S. and the United Kingdom and utilize third party distribution centers in the U.S. and the Netherlands. Our success depends in part upon our ability to manage our growth effectively. To do so, we must continue to increase the productivity of our existing employees and to hire, train and manage new employees as needed, which we may not be able to do successfully or without compromising our corporate culture. See “Our success is critically dependent on the efforts and dedication of our officers and other employees, and the loss of one or more key employees, or our inability to attract and retain qualified personnel and maintain our corporate culture, could adversely affect our business.” To manage domestic and international growth of our operations and personnel, we have invested and continue to invest in the development of warehouse management systems, additional platforms to support our direct-to-consumer experience, and capital build out of new leased warehouse and office spaces. In August 2022, we announced that we were delaying the remaining steps for implementation of our enterprise resource planning software to 2023, which has caused us to incur increased costs and adversely impacted our financial results. At December 31, 2022, we determined the enterprise resource planning project was not feasible for its intended use and abandoned the cloud computing arrangement and incurred a write down of $32.5 million. We will need to continue to improve our product development, supply chain, financial and management controls and our reporting processes and procedures to support our infrastructure and new business initiatives. These additional investments will increase our operating costs, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term. Moreover, if we fail to scale our operations or manage our growth successfully, our business, financial condition and operating results could be adversely affected.

Our business is dependent upon our license agreements, which involve certain risks.

Products from which we generate substantially all of our net sales are produced under license agreements which grant us the right to use certain intellectual property in such products. These license agreements typically have short terms (between two and three years), are not automatically renewable, and, in some cases, give the licensor the right to terminate the license agreement at will.

Our license agreements typically provide that our licensors own the intellectual property rights in the products we design and sell under the license. As a result, upon termination of the license, we would no longer have the right to sell these products, while our licensors could engage a competitor to do so. We believe our ability to retain our license agreements depends, in large part, on the strength of our relationships with our licensors. Any events or developments adversely affecting those relationships, or changes in our management team, could adversely affect our ability to maintain and renew our license agreements on similar terms or at all. We recently announced that our Chief Executive Officer, Brian Mariotti, would take a six-month sabbatical and that he would be replaced by Michael Lunsford, our Interim Chief Executive Officer. No assurance can be made that this change in our leadership will not have a material adverse impact on our relationships with licensors, and if we fail to manage our licensor relationships successfully, our business, financial condition or results of operations could be adversely affected. Our top ten licensors collectively accounted for approximately 70% and 74% of our sales for the six months ended June 30, 2023 and 2022, respectively. Moreover, while we have separate licensing arrangements with Disney, LucasFilm and Marvel, these parties are all under common ownership by Disney and collectively these licensors accounted for approximately 40% and 43% of our sales for the six months ended June 30, 2023 and 2022, respectively. The termination or failure to renew one or more of our license agreements, or the renewal of a license agreement on less favorable terms, could have a material adverse effect on our business, financial condition and results of operations. While we may enter into additional license agreements in the future, the terms of such license agreements may be less favorable than the terms of our existing license agreements.

Our license agreements are complex, and typically grant our licensors the right to audit our compliance with the terms and conditions of such agreements. Any such audit could result in a dispute over whether we have paid the proper royalties and a requirement that we pay additional royalties, the amounts of which could be material. As of June 30, 2023, we had a reserve of $21.3 million on our balance sheet related to ongoing and future royalty audits, based on estimates of the costs we expect to incur. In addition to royalty payments, these agreements as a whole impose numerous other obligations on us, including, among other things, obligations to:

- maintain the integrity of the applicable intellectual property;
- obtain the licensor’s approval of the products we develop under the license prior to making any sales;
- permit the licensor’s involvement in, or obtain the licensor’s approval of, advertising, packaging and marketing plans;
- maintain minimum sales levels or make minimum guaranteed royalty payments;
- actively promote the sale of the licensed product and maintain the availability of the licensed product throughout the license term;
- spend a certain percentage of our sales of the licensed product on marketing and advertising for the licensed product;
- sell the products we develop under the license only within a specified territory or within specified sales channels;
- indemnify the licensor in the event of product liability or other claims related to the licensed product and advertising or other materials used to promote the licensed product;
- sell the licensed products to the licensor at a discounted price or at the lowest price charged to our customers;
- obtain the licensor’s consent prior to assigning or sub-licensing to third parties; and
- provide notice to, obtain approval from, or, in limited circumstances, make certain payments to the licensor in connection with certain changes in control.

If we breach any of these obligations or any other obligations set forth in any of our license agreements, we could be subject to monetary penalties and our rights under such license agreements could be terminated, either of which could have a material adverse effect on our business, financial condition and results of operations.

Our success is also partially dependent on the reputation of our licensors and the goodwill associated with their intellectual property, and their ability to protect and maintain the intellectual property rights that we use in connection with our products, all of which may be harmed by factors outside our control. See also “If we are unable to obtain, maintain and protect our intellectual property rights, in particular trademarks and copyrights, or if our licensors are unable to maintain and protect their intellectual property rights that we use in connection with our products, our ability to compete could be negatively impacted.”

Global and regional economic downturns that negatively impact the retail and credit markets, or that otherwise damage the financial health of our retail customers and consumers, can harm our business and financial performance.

We design, manufacture and market a wide variety of consumer products worldwide for sale to our retail customers and directly to consumers. Our financial performance is impacted by the level of discretionary consumer spending in the markets in which we operate. Recessions, credit crises and other economic downturns, or disruptions in credit markets, in the United States and in other markets in which our products are sold can result in lower levels of economic activity, lower employment levels, less consumer disposable income, and lower consumer confidence. The retail industry is subject to volatility, especially during uncertain economic conditions. A downturn in the retail industry in particular may disproportionately affect us because a substantial majority of our net sales are to retail customers. In addition, our business is subject to significant pressure on costs and pricing caused by general inflationary pressures as well as inflation caused by constrained sourcing capacity, the availability of qualified labor and related wage inflation, as well as inflationary pressures to increase commissions and benefits expenses, and associated changes in consumer demand. Significant increases in the costs of other products which are required by consumers, such as gasoline, home heating fuels, or groceries, may reduce household spending on our products. Such cost increases and weakened economic conditions may result from any number of factors, including pandemics, terrorist attacks, wars and other conflicts, natural disasters, increases in critical commodity prices or labor costs, sovereign debt defaults or the prospect of such events. General inflation in the United States, Europe and other geographies has recently risen to levels not experienced in decades. Such a weakened economic and business climate, as well as consumer uncertainty created by such a climate, has adversely impacted and could in the future materially harm our sales and profitability. Similarly, reductions in the value of key assets held by consumers, such as their homes or stock market investments, can lower consumer confidence and consumer spending power. Any of these factors can reduce the amount which consumers spend on the purchase of our products. This, in turn, can reduce our sales and harm our financial performance and profitability.

In addition to experiencing potentially lower sales of our products during times of economic difficulty, in an effort to maintain sales during such times, we may need to increase our promotional spending or sales allowances, or take other steps to encourage retailer and consumer purchases of our products. Those steps may lower our net sales or increase our costs, thereby decreasing our operating margins and lowering our profitability. As a result of increased inflation or supply constraints, like we are currently facing, we have increased prices of certain products, and may in the future need to increase our prices further in order to cover increased costs of goods sold, which may reduce demand for our products and may not fully offset our increased costs.

The Company maintains the majority of its cash and cash equivalents in accounts with major U.S. and multi-national financial institutions, and our deposits at certain of these institutions exceed insured limits. Market conditions can impact the viability of these institutions. In the event of failure of any of the financial institutions where we maintain our cash and cash equivalents, there can be no assurance that we will be able to access uninsured funds in a timely manner or at all.

Changes in the retail industry and markets for consumer products affecting our retail customers or retailing practices could negatively impact our business, financial condition and results of operations.

Our products are primarily sold to consumers through retailers that are our direct customers or customers of our distributors. As such, trends and changes in the retail industry can negatively impact our business, financial condition and results of operations. For example, in 2022 and the first half of 2023, the retail industry faced reductions in sales due to macroeconomic uncertainty, and we currently expect the retail industry will continue to face sales challenges at least into the third quarter of 2023, which may adversely impact our sales.

Due to the challenging environment for traditional “brick-and-mortar” retail locations caused by declining in-store traffic, many retailers have closed physical stores, and some traditional retailers have engaged in significant reorganizations, filed for bankruptcy and gone out of business. In addition to furthering consolidation in the retail industry, such a trend could have a negative effect on the financial health of our retail customers and distributors, potentially causing them to experience difficulties in fulfilling their payment obligations to us or our distributors, reduce the amount of their purchases, seek extended credit terms or otherwise change their purchasing patterns, alter the manner in which they promote our products or the resources they devote to promoting and selling our products or cease doing business with us or our distributors. If any of our retail customers were to file for bankruptcy, we could be unable to collect amounts owed to us and could even be required to repay certain amounts paid to us prior to the bankruptcy filing. The occurrence of any of these events would have an adverse effect on our business, cash flows, financial condition and results of operations.

If we do not effectively maintain and further develop our relationships with retail customers and distributors, our growth prospects, business and results of operations could be harmed.

Historically, a majority of all of our net sales have been derived from our retail customers and distributors, upon which we rely to reach the consumers who are the ultimate purchasers of our products. In the United States, we primarily sell our products directly to specialty retailers, mass-market retailers and e-commerce sites. In international markets, we sell our products directly to similar retailers, primarily in Europe, through our subsidiary Funko UK, Ltd. We also sell our products to distributors for sale to retailers in the United States and in certain countries internationally, typically in those countries in which we do not currently have a direct presence. Our top ten customers represented approximately 45% of our sales for the six months ended June 30, 2023 and 2022.

We depend on retailers to provide adequate and attractive space for our products and point of purchase displays in their stores. We further depend on our retail customers to employ, educate and motivate their sales personnel to effectively sell our products. If our retail customers do not adequately display our products or choose to promote competitors’ products or their own private label products over ours, our sales could decrease, and our business could be harmed. Similarly, we depend on our distributors to reach retailers in certain market segments in the United States and to reach international retailers in countries where we do not have a direct presence. Our distributors generally offer products from several different companies, including our competitors. Accordingly, we are at risk that these distributors may give higher priority to selling other companies’ products. If we were to lose the services of a distributor, we might need to find another distributor in that area, and there can be no assurance of our ability to do so in a timely manner or on favorable terms.

In addition, our business could be adversely affected if any of our retail customers or distributors were to reduce purchases of our products, as has occurred in recent periods. Our retail customers and distributors generally build inventories in anticipation of future sales and will decrease the size of their future product orders if sales do not occur as rapidly as they anticipate. Our customers make no long-term commitments to us regarding purchase volumes and can therefore freely reduce their purchases of our products, and as a result we may have excess inventory. Any reduction in purchases of our products by our retail customers and distributors, or the loss of any key retailer or distributor, could adversely affect our net sales, operating results and financial condition. As a result of the COVID-19 pandemic and recent macroeconomic trends, we have had certain of our retail customers reduce and, in some instances, cancel purchase orders as a result of store closures or a shift of purchasing to focus only on essential consumer products.

Furthermore, consumer preferences have shifted, and may continue to shift in the future, to sales channels other than traditional retail, including e-commerce, in which we have more limited experience, presence and development. In addition, our entry into new product categories and geographies has exposed, and may continue to expose, us to new sales channels in which we have less expertise. If we are not successful in developing our e-commerce channel and other new sales channels, our net sales and profitability may be adversely affected.

The COVID-19 pandemic adversely impacted our business. Ongoing impacts of the COVID-19 pandemic or its variants could materially adversely impact our business, financial condition and results of operations going forward.

We and certain of our suppliers and the manufacturers of certain of our products have in the past been adversely impacted by COVID-19. We faced delays and difficulty sourcing products, and significant increases in shipping costs, which have negatively affected our business and financial results. If such supplier and manufacturer challenges continue or recur, the impact on our supply chain and manufacturing could negatively affect our financial results for future reporting periods. Even if we are able to find alternate sources for such products, they may cost more, which could adversely impact our profitability and financial condition.

During the six months ended June 30, 2023, our business did not experience a material effect from COVID-19, however, any renewed surge that leads to the curtailment of activities by businesses and consumers in much of the world, including as a result of restrictions imposed by governments and others to limit the spread of the disease and its variants such as through business and transportation shutdowns and restrictions on people’s movement and congregation, would adversely affect our business, financial position and results of operations going forward. Other pandemics or health crises may have similar adverse impacts.

Additionally, concerns over the economic impact of the COVID-19 pandemic have previously caused extreme volatility in financial and capital markets and may continue to do so in the future, which may materially adversely impact our stock price and our ability to access capital markets.

Our industry is highly competitive and the barriers to entry are low. If we are unable to compete effectively with existing or new competitors, our sales, market share and profitability could decline.

Our industry is, and will continue to be, highly competitive. We compete with toy companies in many of our product categories, some of which have substantially more resources than us, stronger name recognition, longer operating histories and greater economies of scale. We also compete with numerous smaller domestic and foreign collectible product designers and manufacturers. Across our business, we face competitors who are constantly monitoring and attempting to anticipate consumer tastes and trends, seeking ideas that will appeal to consumers and introducing new products that compete with our products for consumer acceptance and purchase.

In addition to existing competitors, the barriers to entry for new participants in our industry are low, and the increasing use of digital technology, social media and the internet to spark consumer interest has further increased the ability for new participants to enter our markets and has broadened the array of companies against which we compete. New participants can gain access to retail customers and consumers and become a significant source of competition for our products in a very short period of time. Additionally, since we do not have exclusive rights to any of the properties we license or the related entertainment brands, our competitors, including those with more resources and greater economies of scale, can obtain licenses to design and sell products based on the same properties that we license, potentially on more favorable terms. Any of these competitors may be able to bring new products to market more quickly, respond more rapidly than us to changes in consumer preferences and produce products of higher quality or that can be sold at more accessible price points. To the extent our competitors' products achieve greater market acceptance than our products, our business, financial condition and results of operations will be adversely affected.

In addition, certain of our licensors have reserved the rights to manufacture, distribute and sell identical or similar products to those we design and sell under our license agreements. These products could directly compete with our products and could be sold at lower prices than those at which our products are sold, resulting in higher margins for our customers compared to our products, potentially lessening our customers' demand for our products and adversely affecting our sales and profitability.

Furthermore, competition for access to the properties we license is intense, and we must vigorously compete to obtain licenses to the intellectual property we need to produce our products. This competition could lessen our ability to secure, maintain, and renew our existing licenses, or require us to pay licensors higher royalties and higher minimum guaranteed payments in order to obtain new licenses or retain our existing licenses. To the extent we are unable to license properties on commercially reasonable terms, or on terms at least as favorable as our competitors, our competitive position and demand for our products will suffer. Because our ability to compete for licensed properties is based largely on our ability to increase fan engagement and generate royalty revenues for our licensors, any reduction in the demand for and sales of our products will further inhibit our ability to obtain licenses on commercially reasonable terms or at all. As a result, any such reduction in the demand for and sales of our products could have a material adverse effect on our business, financial condition and results of operations.

We also increasingly compete with toy companies and other product designers for shelf space at specialty, mass-market and other retailers. Our retail customers will allocate shelf space and promotional resources based on the margins of our products for our customers, as well as their sales volumes. If toy companies or other competitors produce higher margin or more popular merchandise than our products, our retail customers may reduce purchases of our products and, in turn, devote less shelf space and resources to the sale of our products, which could have a material adverse effect on our sales and profitability.

Our gross margin may not be sustainable and may fluctuate over time.

Our gross margin has historically fluctuated, primarily as a result of changes in product mix, changes in our costs, price competition and acquisitions. For the six months ended June 30, 2023 and 2022, our gross margins (exclusive of depreciation and amortization) were 24.3% and 33.9%, respectively. Our current or historical gross margins may not be sustainable or predictive of future gross margins, and our gross margin may decrease over time. A decrease in gross margin can be the result of numerous factors, including, but not limited to:

- changes in customer, geographic, or product mix;
- introduction of new products, including our expansion into additional product categories;
- increases in the royalty rates under our license agreements;
- inability to meet minimum guaranteed royalties;

- increases in, or our inability to reduce, our costs, including as a result of inflation;
- entry into new markets or growth in lower margin markets;
- increases in raw materials, labor or other manufacturing- and inventory-related costs;
- increases in transportation costs, including the cost of fuel, and increased shipping costs to meet customer demand;
- increased price competition;
- changes in the dynamics of our sales channels, including those affecting the retail industry and the financial health of our customers;
- inability to increase prices in order to meet increased costs;
- increases in sales discounts and allowances provided to our customers;
- acquisitions of companies with a lower gross margin than ours; and
- overall execution of our business strategy and operating plan.

If any of these factors, or other factors unknown to us at this time, occur, then our gross margin could be adversely affected, which could have a material adverse effect on our business, financial condition and results of operations.

Our business is largely dependent on content development and creation by third parties.

We spend considerable resources in designing and developing products in conjunction with planned movie, television, video game, music and other content releases by various third-party content providers. The timing of the development and release, and the ultimate consumer interest in and success of, such content depends on the efforts of these third parties, as well as conditions in the media and entertainment industry generally. We do not control when or if any particular project will be greenlit, developed or released, and the creators of such projects may change their plans with respect to release dates or cancel development altogether. This can make it difficult for us to successfully develop and market products in conjunction with a given content release, given the lead times involved in product development and successful marketing efforts. Additionally, unforeseen factors in the media and entertainment industry, including labor strikes and unforeseen developments with talent such as accusations of a star’s wrongdoing, may also delay or cancel the release of such projects. For example, in the summer of 2023, both the Writers’ Guild of America and Screen Actors Guild – American Federation of Television and Radio Artists voted to authorize strikes by their respective members. These strikes have resulted in projects that were originally scheduled for 2023 release dates to be delayed into 2024, and may delay further development and production of new and ongoing productions. Any such delay or cancellation may decrease the number of products we sell and harm our business.

As a purveyor of licensed pop culture consumer products, we may not be able to design and develop products that will be popular with consumers, and we may not be able to maintain the popularity of successful products.

The interests of consumers evolve extremely quickly and can change dramatically from year to year. To be successful we must correctly anticipate both the products and the movies, TV shows, video games, music, sports and other content releases (including the related characters) that will appeal to consumers and quickly develop and introduce products that can compete successfully for consumers' limited time, attention and spending. Evolving consumer tastes and shifting interests, coupled with an ever changing and expanding pipeline of products and content that compete for consumers' interest and acceptance, create an environment in which some products and content can fail to achieve consumer acceptance, while others can be popular during a certain period of time but then be rapidly replaced. As a result, consumer products, particularly those based on pop culture such as ours, can have short life cycles. In addition, given the growing market for digital products and the increasingly digital nature of pop culture, there is also a risk that consumer demand for physical products may decrease over time. If we devote time and resources to developing and marketing products that consumers do not find appealing enough to buy in sufficient quantities, our sales and profits may decline, and our business performance may be damaged. Similarly, if our product offerings fail to correctly anticipate consumer interests, our sales and earnings will be adversely affected.

Additionally, our business is increasingly global and depends on interest in and acceptance of our products and our licensors' brands by consumers in diverse markets around the world with different tastes and preferences. As such, our success depends on our ability to successfully predict and adapt to changing consumer tastes and preferences in multiple markets and geographies and to design products that can achieve popularity globally over a broad and diverse consumer audience. There is no guarantee that we will be able to successfully develop and market products with global appeal.

Consumer demand for pop culture products can and does shift rapidly and without warning. As a result, even if our product offerings are initially successful, there can be no guarantee that we will be able to maintain their popularity with consumers. Accordingly, our success will depend, in part, on our ability to continually design and introduce new products that consumers find appealing. To the extent we are unable to do so, our sales and profitability will be adversely affected. This is particularly true given the concentration of our sales under certain of our brand categories, particularly Core Collectibles. Sales of our Core Collectible branded category products accounted for approximately 73% and 76% of our sales for the six months ended June 30, 2023 and 2022, respectively. If consumer demand for our Core Collectible branded category products were to decrease, our business, financial condition and results of operations could be adversely affected unless we were able to develop and market additional products that generated an equivalent amount of net sales at a comparable gross margin, which there is no guarantee we would be able to do.

We may not realize the full benefit of our licenses if the properties we license have less market appeal than expected or if sales from the products that use those properties are not sufficient to satisfy the minimum guaranteed royalties.

We seek to fulfill consumer preferences and interests by designing and selling products primarily based on properties owned by third parties and licensed to us. The popularity of the properties we license can significantly affect our sales and profitability. If we produce products based on a particular movie, TV show or video game, the success of the underlying content has a critical impact on the level of consumer interest in the associated products we are offering. Although we license a wide variety of properties, sales of products tied to major movie franchises have been significant contributors to our business. In addition, the theatrical duration of movie releases has decreased over time and we expect this trend to continue with the increase of content made available on video streaming services. This may make it increasingly difficult for us to sell products based on such properties or lead our customers to reduce demand for our products to minimize their inventory risk. If the performance of one or more of such movie franchises failed to meet expectations or if there was a shift in consumer tastes away from such franchises generally, our results of operations could be adversely affected. In addition, competition in our industry for access to licensed properties can lessen our ability to secure, maintain, and renew our existing licenses on commercially reasonable terms, if at all, and to attract and retain the talented employees necessary to design, develop and market successful products based on these properties.

Our license agreements usually also require us to pay minimum royalty guarantees, which may in some cases be greater than what we are ultimately able to recoup from actual sales. When our licensing agreements require minimum royalty guarantees, we accrue a royalty liability based on the contractually required percentage, as revenues are earned. In the case that a minimum royalty guarantee is not expected to be met through sales, we will accrue up to the minimum amount required to be paid. As of June 30, 2023 and December 31, 2022, we recorded reserves of $1.5 million and $0.8 million, respectively, related to prepaid royalties we estimated would not be recovered through sales. 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 that we currently hold when they become available for renewal, or missing business opportunities for new licenses. Additionally, we have no guarantee that any particular property we license will translate into a successful product. Products tied to a particular content release may be developed and released before demand for the underlying content is known. The underperformance of any such product may result in reduced sales and operating profit for us.

An inability to develop and introduce products in a timely and cost-effective manner may damage our business.

Our sales and profitability depend on our ability to bring products to market to meet customer demands and before consumers begin to lose interest in a given property. There is no guarantee that we will be able to manufacture, source, ship and distribute new or continuing products in a timely manner or on a cost-effective basis to meet constantly changing consumer demands. This risk is heightened by our customers' increasingly compressed shipping schedules and the seasonality of our business. Furthermore, our license agreements typically require us to obtain the licensor's approval of the products we develop under a particular license prior to making any sales, which can have the effect of delaying our product releases. Additionally, for products based on properties in our movie, TV show and video game categories, this risk may also be exacerbated by our need to introduce new products on a timeframe that corresponds with a particular content release. These time constraints may lead our customers to reduce their demand for these products in order to minimize their inventory risk. Moreover, unforeseen delays or difficulties in the development process, significant increases in the planned cost of development, manufacturing or distribution delays or changes in anticipated consumer demand for our products and new brands, or the related third party content, may cause the introduction date for products to be later than anticipated, may reduce or eliminate the profitability of such products or, in some situations, may cause a product or new brand introduction to be discontinued.

If we are unable to obtain, maintain and protect our intellectual property rights, in particular trademarks and copyrights, or if our licensors are unable to maintain and protect their intellectual property rights that we use in connection with our products, our ability to compete could be negatively impacted.

Our intellectual property is a valuable asset of our business. As of June 30, 2023, we owned approximately 120 registered U.S. trademarks, 280 registered international trademarks, 31 pending U.S. trademark applications and 76 pending international trademark applications. The market for our products depends to a significant extent upon the value associated with our product design, our proprietary brands and the properties we license. Although certain of our intellectual property is registered in the United States and in several of the foreign countries in which we operate, there can be no assurances with respect to the rights associated with such intellectual property in those countries, including our ability to register, use, maintain or defend key trademarks and copyrights. We rely on a combination of trademark, trade dress, copyright and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our intellectual property or other proprietary rights. However, these laws, procedures and restrictions provide only limited and uncertain protection and any of our intellectual property rights may be challenged, invalidated, circumvented, infringed or misappropriated, including by counterfeiters and parallel importers. In addition, our intellectual property portfolio in many foreign countries is less extensive than our portfolio in the United States, and the laws of foreign countries, including many emerging markets in which our products are produced or sold, may not protect our intellectual property rights to the same extent as the laws of the United States. The costs required to protect our trademarks and copyrights may be substantial.

In addition, we may fail to apply for, or be unable to obtain, protection for certain aspects of the intellectual property used in or beneficial to our business. Further, we cannot provide assurance that our applications for trademarks, copyrights and other intellectual property rights will be granted, or, if granted, will provide meaningful protection. In addition, third parties have in the past and could in the future bring infringement, invalidity or similar claims with respect to any of our current trademarks and copyrights, or any trademarks or copyrights that we may seek to obtain in the future. Any such claims, whether or not successful, could be extremely costly to defend, divert management's attention and resources, damage our reputation and brands, and substantially harm our business and results of operations.

In order to protect or enforce our intellectual property and other proprietary rights, or to determine the enforceability, scope or validity of the intellectual or proprietary rights of others, we may initiate litigation or other proceedings against third parties. Any lawsuits or proceedings that we initiate could be expensive, take significant time and divert management's attention from other business concerns. Litigation and other proceedings also put our intellectual property at risk of being invalidated, or if not invalidated, may result in the scope of our intellectual property rights being narrowed. In addition, our efforts to try to protect and defend our trademarks and copyrights may be ineffective. Additionally, we may provoke third parties to assert claims against us. We may not prevail in any lawsuits or other proceedings that we initiate, and the damages or other remedies awarded, if any, may not be commercially valuable. The occurrence of any of these events may have a material adverse effect on our business, financial condition and results of operations.

In addition, most of our products bear the trademarks and other intellectual property rights of our licensors, and the value of our products is affected by the value of those rights. Our licensors' ability to maintain and protect their trademarks and other intellectual property rights is subject to risks similar to those described above with respect to our intellectual property. We do not control the protection of the trademarks and other intellectual property rights of our licensors and cannot ensure that our licensors will be able to secure or protect their trademarks and other intellectual property rights. The loss of any of our significant owned or licensed trademarks, copyrights or other intellectual property could have a material adverse effect on our business, financial condition and results of operations. In addition, our licensors may engage in activities or otherwise be subject to negative publicity that could harm their reputation and impair the value of the intellectual property rights we license from them, which could reduce consumer demand for our products and adversely affect our business financial condition and results of operations.

Our success depends on our ability to operate our business without infringing, misappropriating or otherwise violating the trademarks, copyrights and proprietary rights of other parties.

Our commercial success depends at least in part on our ability to operate without infringing, misappropriating or otherwise violating the trademarks, copyrights and other proprietary rights of others. However, we cannot be certain that the conduct of our business does not and will not infringe, misappropriate or otherwise violate such rights. Many companies have employed intellectual property litigation as a way to gain a competitive advantage, and to the extent we gain greater visibility and market exposure as a public company, we may also face a greater risk of being the subject of such litigation. For these and other reasons, third parties may allege that our products or activities, including products we make under license, infringe, misappropriate or otherwise violate their trademark, copyright or other proprietary rights. While we typically receive intellectual property infringement indemnities from our licensors, the indemnities are often limited to third-party copyright infringement claims to the extent arising from our use of the licensed material. Defending against allegations and litigation could be expensive, take significant time, divert management's attention from other business concerns, and delay getting our products to market. In addition, if we are found to be infringing, misappropriating or otherwise violating third-party trademark, copyright or other proprietary rights, we may need to obtain a license, which may not be available on commercially reasonable terms or at all, or may need to redesign or rebrand our products, which may not be possible. We may also be required to pay substantial damages or be subject to a court order prohibiting us and our customers from selling certain products or engaging in certain activities. Any claims of violating others' intellectual property, even those without merit, could therefore have a material adverse effect on our business, financial condition and results of operations.

Our operating results may be adversely affected and damage to our reputation may occur due to production and sale of counterfeit versions of our products.

As we have expanded internationally, and the global popularity of our products has increased, our products are increasingly subject to efforts by third parties to produce counterfeit versions of our products. There can be no guarantee that our efforts, including our work with customs officials and law enforcement authorities, to block the manufacture of counterfeit goods, prevent their entry in end markets, and detect counterfeit products in customer networks will be successful or result in any material reduction in the availability of counterfeit goods. Any such counterfeit sales, to the extent they replace otherwise legitimate sales, could adversely affect our operating results and damage our reputation.

Our success is critically dependent on the efforts and dedication of our officers and other employees, and the loss of one or more key employees, or our inability to attract and retain qualified personnel and maintain our corporate culture, could adversely affect our business.

Our officers and employees are at the heart of all of our efforts. It is their skill, creativity and hard work that drive our success. In particular, our success depends to a significant extent on the continued service and performance of our senior management team. We are dependent on their talents and continuing employment, and believe they are integral to our relationships with our licensors, certain of our key retail customers and to our overall selling and creative design processes. In December 2022, we announced that Brian Mariotti would replace Andrew Perlmutter as our Chief Executive Officer and that Mr. Perlmutter would return to his role as President. In July 2023, we announced that Mr. Mariotti would take a six-month sabbatical and that he would be replaced by a member of our Board of Directors, Michael Lunsford, as our Interim Chief Executive Officer. These changes in our leadership could have a material adverse impact on our business, financial condition and results of operations. The loss or temporary absence of any member of our senior management team, or of any other key employees, or the inability to successfully complete planned management transitions, could impair our ability to execute our business plan and could therefore have a material adverse effect on our business, financial condition and results of operations. We do not currently maintain key man life insurance policies on any member of our senior management team or on our other key employees.

In addition, competition for qualified personnel is intense. We compete with many other potential employers in recruiting, hiring and retaining our senior management team and our many other skilled officers and other employees around the world. Our headquarters is located near Seattle and competition in the Seattle area for qualified personnel, particularly those with technology-related skills and experience, is intense due to the increasing number of technology and e-commerce companies with a large or growing presence in Seattle, some of whom have greater resources than us and may be located closer to the city of Seattle than we are. In 2022 and 2021, we also faced higher than normal recruitment and personnel costs in efforts to seek and retain qualified personnel.

Furthermore, as we continue to grow our business and hire new employees, it may become increasingly challenging to hire people who will maintain our corporate culture. We believe our corporate culture, which fosters speed, teamwork and creativity, is one of our key competitive strengths. As we continue to grow, we may be unable to identify, hire or retain enough people who will maintain our corporate culture, including those in management and other key positions. Conversely, when we furlough or lay off employees, as we did in connection with our cost-cutting reduction-in-force measures during the six months ended June 30, 2023, there have been and may in the future be adverse consequences for our corporate culture and employee morale. In July 2023, we announced a further reduction in force of approximately 12-13% of our workforce, or 180-200 positions. No assurance can be made that our cost cutting measures, including our recent reduction in force, will not harm our corporate culture, employee morale, or have a material adverse impact on our business, financial condition and results of operations. Our corporate culture could also be adversely affected by the increasingly global distribution of our employees, as well as their increasingly diverse skill sets. If we are unable to maintain the strength of our corporate culture, our competitive ability and our business may be adversely affected.

Our operating results may fluctuate from quarter to quarter and year to year due to the seasonality of our business, as well as due to the timing and popularity of new product releases.

The businesses of our retail customers are highly seasonal, with a majority of retail sales occurring during the period from October through December in anticipation of the holiday season. As a consequence, we have experienced moderate seasonality in our business. Approximately 53.0%, 59.0% and 64.0%, of our net sales for the years ended December 31, 2022, 2021 and 2020, respectively, were made in the third and fourth quarters, as our customers build up their inventories in anticipation of the holiday season. This seasonal pattern requires significant use of working capital, mainly to manufacture 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 highly popular products or producing excess inventory of less popular products. 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 during the critical months leading up to the holiday shopping season.

The timing and mix of products we sell in any given year will depend on various factors, including the timing and popularity of new releases by third-party content providers and our ability to license properties based on these releases. Sales of a certain product or group of products tied to a particular content release can dramatically increase our net sales in any given quarter or year.

Our results of operations may also fluctuate as a result of factors such as the delivery schedules set by our customers and holiday shut down schedules set by our third-party manufacturers. Additionally, the rapid growth we have experienced in recent years may have masked the full effects of seasonal factors on our business to date, and as such, these factors may have a greater effect on our results of operations in future periods.

Our use of third-party manufacturers to produce our products presents risks to our business.

We use third-party manufacturers to manufacture all of our products and have historically concentrated production with a small number of manufacturers and factories. As a result, the loss or unavailability of one of our manufacturers or one of the factories in which our products are produced, even on a temporary basis, could have a negative impact on our business, financial condition and results of operations. This risk is exacerbated by the fact that we do not have written contracts reserving capacity or providing loss contingencies with certain of our manufacturers. While we believe our external sources of manufacturing could be shifted, if necessary, to alternative sources of supply, we would require a significant period of time to make such a shift. Because we believe our products represent a significant percentage of the total capacity of each factory in which they are produced, such a shift may require us to establish relationships with new manufacturers, which we may not be able to do on a timely basis, on similar terms, or at all. We may also be required to seek out additional manufacturers in response to increased demand for our products, as our current manufacturers may not have the capacity to increase production. If we were prevented from or delayed in obtaining a material portion of the products produced by our manufacturers, or if we were required to shift manufacturers (assuming we would be able to do so), our sales and profitability could be significantly reduced.

In addition, while we require that our products supplied by third-party manufacturers be produced in compliance with all applicable laws and regulations, and we have the right to monitor compliance by our third-party manufacturers with our manufacturing requirements and to oversee the quality control process at our manufacturers' factories, there is risk that one or more of our third-party manufacturers will not comply with our requirements, and that we will not promptly discover such non-compliance. For example, the Consumer Product Safety Improvement Act of 2008 (the "CPSIA") limits the amounts of lead and phthalates that are permissible in certain products and requires that our products be tested to ensure that they do not contain these substances in amounts that exceed permissible levels. In the past, products manufactured by certain of our third-party manufacturers have tested positive for phthalates. Though the amount was not in excess of the amount permissible under the CPSIA, we cannot guarantee that products made by our third-party manufacturers will not in the future contain phthalates in excess of permissible amounts, or will not otherwise violate the CPSIA, other consumer or product safety requirements, or labor or other applicable requirements. Any failure of our third-party manufacturers to comply with such requirements in manufacturing products for us could result in damage to our reputation, harm our brand image and sales of our products and potentially create liability for us.

Additionally, there are increasing expectations in various jurisdictions that companies monitor the environmental and social performance of their suppliers, including compliance with a variety of labor practices, as well as consider a wider range of potential environmental and social matters, including the end of life considerations for products. Compliance can be costly, require us to establish or augment programs to diligence or monitor our suppliers, or, in the case of legislation such as the Uyghur Forced Labor Prevention Act, to design supply chains to avoid certain regions altogether. Failure to comply with such regulations can result in fines, reputational damage, import ineligibility for our products, or otherwise adversely impact our business. Monitoring compliance by independent manufacturers is complicated by the fact that expectations of ethical business practices continually evolve, may be substantially more demanding than applicable legal requirements and are driven in part by legal developments and by diverse groups active in publicizing and organizing public responses to perceived ethical shortcomings. Accordingly, we cannot predict how such expectations might develop in the future and cannot be certain that our manufacturing requirements, even if complied with, would satisfy all parties who are active in monitoring and publicizing perceived shortcomings in labor and other business practices worldwide.

Additionally, the third-party manufacturers that produce most of our products are located in Vietnam, China and Mexico. As a result, we are subject to various risks resulting from our international operations. See "Our substantial sales and manufacturing operations outside the United States subject us to risks associated with international operations."

We are subject to a series of risks related to climate change.

There are inherent climate-related risks wherever business is conducted. Various meteorological phenomena and extreme weather events (including, but not limited to, storms, flooding, drought, wildfire, and extreme temperatures) may disrupt our operations or those of our suppliers, requiring us to incur additional operating or capital expenditures, or otherwise adversely impact our business, financial condition, or results of operations. Climate change may impact the frequency and/or intensity of such events. While we may take various actions to mitigate our business risks associated with climate change, this may require us to incur substantial costs and may not be successful, due to, among other things, the uncertainty associated with the longer-term projections associated with managing climate risks.

Additionally, regulatory, market, and other changes to respond to climate change may adversely impact our business, financial condition, or results of operations. Developing products that satisfy the market's evolving expectations for product composition may require us to incur significant costs. Reporting expectations are also increasing, with a variety of stakeholders seeking increased information on climate related risks. For example, the SEC has published proposed rules that would require companies to provide significantly expanded climate-related disclosures in their periodic reporting, which may require us to incur significant additional costs to comply, including the implementation of significant additional internal controls processes and procedures regarding matters that have not been subject to such controls in the past, and impose increased oversight obligations on our management and board of directors. All of these risks may also impact our suppliers or business partners, which may indirectly impact our business, financial condition, or results of operations.

Increased attention to, and evolving expectations for, sustainability and environmental, social, and governance ("ESG") initiatives could increase our costs, harm our reputation, or otherwise adversely impact our business.

Companies across industries are facing increasing scrutiny from a variety of stakeholders related to their ESG and sustainability practices. Expectations regarding voluntary ESG initiatives and disclosures may result in increased costs (including but not limited to increased costs related to compliance, stakeholder engagement, contracting and insurance), changes in demand for certain products, enhanced compliance or disclosure obligations, or other adverse impacts to our business, financial condition, or results of operations.

Our operations, including our corporate headquarters, primary distribution facilities and third-party manufacturers, are concentrated in certain geographic regions, which makes us susceptible to adverse conditions in those regions.

Our corporate headquarters are currently located in Everett, Washington and our primary distribution warehouse is located in Buckeye, Arizona. We also have additional warehouse facilities and/or offices located in Coventry, England; London, England; Burbank, California; and San Diego, California. In addition, the factories that produce most of our products are located in Vietnam, China and Mexico. As a result, our business may be more susceptible to adverse conditions in these regions than the operations of more geographically diverse competitors. Such conditions could include, among others, adverse economic and labor conditions, as well as demographic trends. Furthermore, Buckeye is the location from which most of the products we sell are received, stored and shipped to our customers. We depend heavily on ocean container delivery to receive products from our third-party manufacturers located in Asia and contracted third-party delivery service providers to deliver our products to our distribution facilities. Any disruption to or failures in these delivery services, at our headquarters or at our warehouse facilities, whether as a result of extreme or severe weather conditions, natural disasters, labor unrest or otherwise, affecting western Washington or Arizona in particular, or the West Coast in general, or in other areas in which we operate, could significantly disrupt our operations, damage or destroy our equipment and inventory and cause us to incur additional expenses, any of which could have a material adverse effect on our business, financial condition and results of operations.

For example, in 2020, 2021 and early 2022, certain of our suppliers and the manufacturers of certain of our products were adversely impacted by COVID-19. As a result, we faced delays or difficulty sourcing products, which negatively affected our business and financial results. In response, we shifted a greater amount of our production from China to Vietnam. Although we possess insurance for damage to our property and the disruption of our business, this insurance, and in particular earthquake insurance, which is subject to various limitations and requires large deductibles or co-payments, may not be sufficient to cover all of our potential losses, and may be cancelled by us in the future or otherwise cease to be available to us on reasonable terms or at all. Similarly, natural disasters and other adverse events or conditions affecting east or southeast Asia, where most of our products are produced, could halt or disrupt the production of our products, impair the movement of finished products out of those regions, damage or destroy the molds and tooling necessary to make our products and otherwise cause us to incur additional costs and expenses, any of which could also have a material adverse effect on our business, financial condition and results of operations.

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. Sales to our international customers comprised approximately 29% and 26% of our sales for the six months ended June 30, 2023 and 2022, respectively. We expect sales to our international customers to account for an increasing portion of our sales in future fiscal years. Over time, we expect our international sales and operations to continue to grow both in dollars and as a percentage of our overall business as a result of a key business strategy to expand our presence in emerging and underserved international markets. Additionally, as discussed above, we use third-party manufacturers located in Vietnam, China and Mexico to produce most of our products. These international sales and manufacturing operations, including operations in emerging markets, are subject to risks that may significantly harm our sales, increase our costs or otherwise damage our business, including:

- currency conversion risks and currency fluctuations;
- limitations on the repatriation of earnings;
- potential challenges to our transfer pricing determinations and other aspects of our cross-border transactions, which can materially increase our taxes and other costs of doing business;
- political instability, civil unrest, war and economic instability, such as the current situation with Ukraine and Russia and any impacts on surrounding regions;
- greater difficulty enforcing intellectual property rights and weaker laws protecting such rights;
- complications in complying with different laws and regulations in varying jurisdictions, including the U.S. Foreign Corrupt Practices Act (“FCPA”), the U.K. Bribery Act of 2010, similar anti-bribery and anti-corruption laws and local and international environmental, labor, health and safety laws, and in dealing with changes in governmental policies and the evolution of laws and regulations and related enforcement;
- difficulties understanding the retail climate, consumer trends, local customs and competitive conditions in foreign markets which may be quite different from the United States;
- changes in international labor costs and other costs of doing business internationally;

- the imposition of and changes in tariffs, quotas, border adjustment taxes or other protectionist measures by any major country or market in which we operate, which could make it significantly more expensive and difficult to import products into that country or market, raise the cost of such products, decrease our sales of such products or decrease our profitability;
- proper payment of customs duties and/or excise taxes;
- natural disasters and pandemics, including related to the COVID-19 pandemic, the greater difficulty and cost in recovering therefrom;
- transportation delays and interruptions;
- difficulties in moving materials and products from one country to another, including port congestion, strikes or other labor disruptions and other transportation delays and interruptions; and
- increased investment and operational complexity to make our products compatible with systems in various countries and compliant with local laws.

Because of the importance of international sales, sourcing and 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 or if we are otherwise unsuccessful in managing our increasingly global business.

Increases in tariffs, trade restrictions or taxes on our products could have an adverse impact on our operations.

The commerce we conduct in the international marketplace makes us subject to tariffs, trade restrictions and other taxes when the raw materials or components we purchase, and the products we ship, cross international borders. Trade tensions between the United States and China, and other countries have been escalating in recent years. U.S. tariff impositions against Chinese exports have been followed by retaliatory Chinese tariffs on U.S. exports to China. Certain of the products we purchase from manufacturers in China have been or may in the future be subject to these tariffs, which could make our products less competitive than those of our competitors whose inputs are not subject to these tariffs. Products we sell into certain foreign markets could also become subject to similar retaliatory tariffs, making the products we sell uncompetitive compared to similar products not subjected to such import tariffs. More recently, the U.S. government enacted the Uyghur Forced Labor Prevention Act, which effectively bars the importation into the United States of products made in or sourced from the Xinjiang region of China. The Xinjiang region of China is the source of a large portion of the world's cotton supply and this import ban may impact prices and the availability of cotton for our clothing products.

As a U.S. company, we are subject to U.S. export control and economic sanctions laws and regulations, and we are required to export our products in compliance with those laws and regulations, including the U.S. Export Administration Regulations and economic and trade sanctions programs administered by the Treasury Department’s Office of Foreign Assets Control. U.S. economic sanctions and export control laws and regulations prohibit the shipment of specified products and services to countries, governments and persons that are the subject of U.S. sanctions. While we take precautions against doing any business, directly or indirectly, in or with countries, governments and persons subject to U.S. sanctions, such measures may be circumvented. There can be no assurance that we will be in compliance with U.S. export control or economic sanctions laws and regulations in the future. Any such violation could result in criminal or civil fines, penalties or other sanctions and repercussions, including reputational harm that could materially adversely affect our business.

Further changes in U.S. trade policies, tariffs, taxes, export restrictions or other trade barriers, or restrictions on raw materials or components may limit our ability to produce products, increase our manufacturing costs, decrease our profit margins, reduce the competitiveness of our products, or inhibit our ability to sell products or purchase raw materials or components, which would have a material adverse effect on our business, results of operations and financial condition.

The United Kingdom's withdrawal from the European Union may have a negative effect on global economic conditions, financial markets and our business.

Following a national referendum and subsequent legislation, the United Kingdom formally withdrew from the European Union, commonly referred to as "Brexit," and ratified a trade and cooperation agreement governing its future relationship with the European Union. Among other things, the agreement, which became effective in 2021, addresses trade, economic arrangements, law enforcement, judicial cooperation and governance. Because the agreement merely sets forth a framework in many respects that requires complex additional bilateral negotiations between the United Kingdom and the European Union, significant uncertainty remains about how the precise terms of the relationship between the parties will differ from the terms before withdrawal.

These developments, or the perception that any of them could occur, have had and may continue to have a material adverse effect on global economic conditions and the stability of global financial markets, and may significantly reduce global market liquidity and restrict the ability of key market participants to operate in certain financial markets.

Any of these factors could have a material adverse effect on our business, financial condition and results of operations. Our operations in the United Kingdom subject us to revenue risk with respect to our customers in the United Kingdom and adverse movements in foreign currency exchange rates, in addition to risks related to the general economic and legal uncertainty related to Brexit described above.

Unanticipated changes in effective tax rates or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our operating results and financial condition.

We are subject to income taxes in the United States and the United Kingdom, and our tax liabilities will be subject to the allocation of expenses in differing jurisdictions. Our future effective tax rates could be subject to volatility or adversely affected by a number of factors, including:

- changes in the valuation of our deferred tax assets and liabilities;
- expected timing and amount of the release of any tax valuation allowances;
- tax effects of equity-based compensation;
- costs related to intercompany restructurings; or
- changes in tax laws, regulations or interpretations thereof.

In addition, we may be subject to audits of our income, sales and other transaction taxes by the U.K., U.S. federal and state authorities. Outcomes from these audits could have an adverse effect on our operating results and financial condition.

Our business depends in large part on our vendors and outsourcers, and our reputation and ability to effectively operate our business may be harmed by actions taken by these third parties outside of our control.

We rely significantly on vendor and outsourcing relationships with third parties for services and systems including manufacturing, transportation, logistics and information technology. We use third party logistics companies to process and fulfill customer orders in Europe and the U.S. Any shortcoming of one of our vendors or outsourcers, including our third party logistics providers, particularly one affecting the quality of these services or systems, may be attributed by customers to us, thus damaging our reputation and brand value, and potentially affecting our results of operations. This includes potential shipping delays as a result of container availability or other global capacity constraints. In addition, problems with transitioning these services and systems to, or operating failures with, these vendors and outsourcers could cause delays in product sales, reduce the efficiency of our operations and require significant capital investments to remediate.

We are subject to various government regulations and may be subject to additional regulations in the future, violation of which could subject us to sanctions or otherwise harm our business.

As a company that designs and sells consumer products, we are subject to significant government regulation, including, in the United States, under the CPSA, the FHSA, the CPSIA and the FFA, as well as under product safety and consumer protection statutes in our international markets. There can be no assurance that we will be in compliance, and failure to comply with these acts could result in sanctions which could have a negative impact on our business, financial condition and results of operations. This risk is exacerbated by our reliance on third parties to manufacture our products. See "Our use of third-party manufacturers to produce our products presents risks to our business."

Governments and regulatory agencies in the markets in which we manufacture and sell products may enact additional regulations relating to product safety and consumer protection in the future and may also increase the penalties for failing to comply with such regulations. In addition, one or more of our customers might require changes in our products, such as the non-use of certain materials, in the future. Complying with any such additional regulations or requirements could impose increased costs on our business. Similarly, increased penalties for non-compliance could subject us to greater expense in the event any of our products were found to not comply with such regulations. Such increased costs or penalties could harm our business.

As discussed above, our international operations subject us to a host of other governmental regulations throughout the world, including antitrust, customs and tax requirements, anti-boycott regulations, environmental regulations and the FCPA. Complying with these regulations imposes costs on us which can reduce our profitability, and our failure to successfully comply with any such legal requirements could subject us to monetary liabilities and other sanctions that could further harm our business and financial condition.

For example, in 2019 we identified that our subsidiary, Loungefly, historically underpaid certain duties owed to U.S. Customs. In May 2019, we notified U.S. Customs of potential underpayments of customs duties and commenced an internal investigation to determine the cause of the underpayments and the proper amount of duties owed for the applicable five-year statute of limitations period. We identified a total of approximately $7.8 million in underpayments to U.S. Customs during the period from May 24, 2014 through June 30, 2019, $6.3 million of which related to previously issued financial statements. In July 2019, we submitted payment of $7.8 million to U.S. Customs along with a report explaining the nature of the underpayments. Pursuant to the applicable statute, for an importer that meets all of the requirements for self-reporting underpayments, the maximum civil potential penalty is 100% of the lawful duties, taxes, and fees due to U.S. Customs and the civil penalty for an importer who fails to meet the self-reporting requirements is up to the value of the merchandise associated with underpayment. We have recorded a contingent liability of $1.0 million related to potential penalties that may be assessed by U.S. Customs in this matter. This amount is recorded under the caption “Accrued expenses and other current liabilities” in our consolidated balance sheet, as of June 30, 2023. Following a review by U.S. Customs, it was determined that we owe $1.0 million in penalties and interest related to the underpayment. We expect to make this payment in the third quarter of 2023.

As digital assets are a relatively new and emerging asset class, the regulatory, commercial, and legal framework governing digital assets and associated products and services is likely to evolve both in the U.S. and internationally and implicates issues regarding a range of matters, including, but not limited to, intellectual property rights, consumer protection, privacy and cybersecurity, anti-money laundering, sanctions and currency, tax, money transmission, commodity, and securities law compliance. We may need to comply with new licensing or registration requirements, revise our compliance and risk mitigation measures, institute a ban on certain digital assets or transactions thereof, and/or suspend or shut down our products or services in one or more jurisdictions. We may also face substantial costs to operationalize and comply with new legal or regulatory requirements. It is difficult to predict how the legal and regulatory framework and oversight/enforcement infrastructure around digital assets will develop and how such developments will impact our business and these new product offerings since the market for digital assets, and NFTs in particular, is relatively nascent.

Our e-commerce business is subject to numerous risks that could have an adverse effect on our business and results of operations.

Although sales through our websites have constituted a small portion of our net sales historically, we expect to continue to grow our e-commerce business in the future. Though sales through our websites generally have higher profit margins and provide us useful insight on the sales impact of certain of our marketing campaigns, further development of our e-commerce business also subjects us to a number of risks. Our online sales may negatively impact our relationships with our retail customers and distributors if they perceive that we are competing with them. In addition, online commerce is subject to increasing regulation by states, the federal government and various foreign jurisdictions. Compliance with these laws will increase our costs of doing business, and our failure to comply with these laws could also subject us to potential fines, claims for damages and other remedies, any of which would have an adverse effect on our business, financial condition and results of operations.

Additionally, some jurisdictions have implemented, or may implement, laws that require remote sellers of goods and services to collect and remit taxes on sales to customers located within the jurisdiction. In particular, the Streamlined Sales Tax Project (an ongoing, multi-year effort by U.S. state and local governments to pursue federal legislation that would require collection and remittance of sales tax by out-of-state sellers) could allow states that meet certain simplification and other criteria to require out-of-state sellers to collect and remit sales taxes on goods purchased by in-state residents. Furthermore, in June 2018, the U.S. Supreme Court ruled in *South Dakota v. Wayfair* that a U.S. state may require an online retailer with no in-state property or personnel to collect and remit sales taxes on sales made to the state's residents, which may permit wider enforcement of sales tax collection requirements. These collection responsibilities and the complexity associated with tax collection, remittance and audit requirements would also increase the costs associated with our e-commerce business.

Furthermore, our e-commerce operations subject us to risks related to the computer systems that operate our websites and related support systems, such as system failures, viruses, computer hackers, cyberattacks and similar disruptions, or the perception thereof. If we are unable to continually add software and hardware, effectively upgrade our systems and network infrastructure and take other steps to improve the efficiency of our systems, system interruptions or delays could occur that adversely affect our operating results and harm our brand. While we depend on our technology vendors to manage "up-time" of the front-end e-commerce store, manage the intake of our orders, and export orders for fulfillment, we could begin to run all or a greater portion of these components ourselves in the future. Any failure on the part of our third-party e-commerce vendors or in our ability to transition third-party services effectively could result in lost sales and harm our brand.

There is a risk that consumer demand for our products online may not generate sufficient sales to make our e-commerce business profitable, as consumer demand for physical products online may be less than in traditional retail sales channels. To the extent our e-commerce business does not generate more net sales than costs, our business, financial condition and results of operations will be adversely affected.

We could be subject to future product liability suits or product recalls which could have a significant adverse effect on our financial condition and results of operations.

As a company that designs and sells consumer products, we may be subject to product liability suits or involuntary product recalls or may choose to voluntarily conduct a product recall. While costs associated with product liability claims and product recalls have generally not been material to our business, the costs associated with future product liability claims or product recalls in any given fiscal year, individually or in the aggregate, could be significant. In addition, any product recall, regardless of the direct costs of the recall, could harm consumer perceptions of our products, subject us to additional government scrutiny, divert development and management resources, adversely affect our business operations and otherwise put us at a competitive disadvantage compared to other companies in our industry, any of which could have a significant adverse effect on our financial condition and results of operations.

We are currently subject to securities class action and derivative litigation and may be subject to similar or other litigation in the future, all of which will require significant management time and attention, result in significant legal expenses and may result in unfavorable outcomes, which may have a material adverse effect on our business, operating results and financial condition, and negatively affect the price of our Class A common stock.

We are, and may in the future become, subject to various legal proceedings and claims that arise in or outside the ordinary course of business. For example, several stockholder derivative actions based on the Company's earnings announcement and Quarterly Report on Form 10-Q for the quarter ended September 30, 2019 have been brought on behalf of the Company against certain of our directors and officers. Specifically, on April 23, June 5, and June 10, 2020, the actions captioned *Cassella v. Mariotti et al., Evans v. Mariotti et al*., and *Igelido v. Mariotti et al.*, respectively, were filed in the United States District Court for the Central District of California. On July 6, 2020, these three actions were consolidated for all purposes into one action under the title *In re Funko, Inc. Derivative Litigation*, and on August 13, 2020, the consolidated action was stayed pending final resolution of the motion to dismiss in the *Ferreira* action. On May 9, 2022, another complaint, asserting substantially similar claims, was filed in the U.S. District Court for the Central District of California, captioned *Smith v. Mariotti, et al.* On July 5, 2022, two purported stockholders filed an additional derivative action in the Court of Chancery of the State of Delaware, captioned *Fletcher, et al. v. Mariotti*. The Company has reached a non-monetary settlement in principle in the consolidated action, *Smith v. Mariotti*, and *Fletcher, et al. v. Mariotti* and the actions are stayed pending finalization of the settlement.

On June 11, 2021, a purported stockholder filed an additional derivative action, captioned *Silverberg v. Mariotti, et al.*, in the Court of Chancery of the State of Delaware. The Company moved to dismiss the *Silverberg* complaint on April 3, 2023. Plaintiff responded on May 3, 2023, and briefing was completed on May 18, 2023.

Additionally, between November 16, 2017 and June 12, 2018, seven purported stockholders of the Company filed putative class action lawsuits in the Superior Court of Washington in and for King County against us, certain of our officers and directors, ACON, Fundamental, the underwriters of our IPO, and certain other defendants.

On July 2, 2018, the suits were ordered consolidated for all purposes into one action under the title *In re Funko, Inc. Securities Litigation*. On August 1, 2018, plaintiffs filed a consolidated complaint against us, certain of our officers and directors, ACON, Fundamental, and certain other defendants. The Company moved to dismiss twice, and the Court twice granted our motions to dismiss, the second time with prejudice. Plaintiffs appealed and on November 1, 2021, the Court of Appeals reversed the trial court's dismissal decision in most respects. On May 4, 2022, the Washington State Supreme Court denied the Defendants' petition, and the case was remanded to the Superior Court for further proceedings. We filed our answer on September 19, 2022, and discovery is currently ongoing. Plaintiffs filed a motion for class certification on July 7, 2023, and briefing will be completed on the class certification motion on October 25, 2023.

On June 4, 2018, a putative class action lawsuit entitled *Kanugonda v. Funko, Inc., et al.* was filed in the United States District Court for the Western District of Washington against us, certain of our officers and directors, and certain other defendants. On January 4, 2019, a lead plaintiff was appointed in that case. On April 30, 2019, the lead plaintiff filed an amended complaint against the previously named defendants. Funko moved to dismiss the Complaint in the federal action, now captioned *Berkelhammer v. Funko, Inc. et al.*, on June 14, 2023, and briefing is scheduled to be completed on the motion to dismiss on August 18, 2023.

The cases in Washington state court and *Berkelhammer v. Funko, Inc. et al.* allege that we violated Sections 11, 12, and 15 of the Securities Act of 1933, as amended ("Securities Act"), by making allegedly materially misleading statements in documents filed with the SEC in connection with our IPO and by omitting material facts necessary to make the statements made therein not misleading. The lawsuits seek, among other things, compensatory statutory damages and rescissory damages in account of the consideration paid for our Class A common stock by the plaintiffs and members of the putative class, as well as attorneys' fees and costs.

On January 18, 2022, a purported stockholder filed a putative class action lawsuit in the Court of Chancery of the State of Delaware, captioned *Shumacher v. Mariotti, et al.*, relating to our corporate "Up-C" structure and bringing direct claims for breach of fiduciary duties against certain current and former officers and directors. On March 31, 2022, we moved to dismiss the action. In response to defendants' motion to dismiss, Plaintiff filed an Amended Complaint on May 25, 2022. The amendment did not materially change the claims at issue, and the Defendants again moved to dismiss on July 29, 2022. On December 15, 2022, Plaintiff opposed the Defendants' motion to dismiss, and also moved for attorneys' fees. Briefing on the motion to dismiss was completed on February 8, 2023; briefing on Plaintiff's fee application was completed on April 6, 2023. The Court heard oral argument on both motions on July 24, 2023.

On June 2, 2023, a purported stockholder filed a putative class action lawsuit in the United States District Court for the Western District of Washington, captioned *Studen v. Funko, Inc.*, *et al.*. The Complaint alleges that the Company and certain individual defendants violated Sections 10(b) and 20(a) of the Exchange Act, as amended, as well as Rule 10b-5 promulgated thereunder by making allegedly materially misleading statements in documents filed with the SEC, as well as in earnings calls and presentations to investors, regarding a planned upgrade to its enterprise resource planning system and the relocation of a distribution center, as well as by omitting material facts about the same subjects necessary to make the statements made therein not misleading. The lawsuits seek, among other things, compensatory damages and attorneys' fees and costs. The parties have agreed that the Company is not required to respond to the complaint until after a lead plaintiff is appointed by the Court.

The results of the securities class action lawsuits, derivative lawsuits, and any future legal proceedings cannot be predicted with certainty. Also, our insurance coverage may be insufficient, our assets may be insufficient to cover any amounts that exceed our insurance coverage, and we may have to pay damage awards or otherwise may enter into settlement arrangements in connection with such claims. Any such payments or settlement arrangements in current or future litigation could have a material adverse effect on our business, operating results or financial condition. Even if the plaintiffs' claims are not successful, current or future litigation could result in substantial costs and significantly and adversely impact our reputation and divert management's attention and resources, which could have a material adverse effect on our business, operating results and financial condition, and negatively affect the price of our Class A common stock. In addition, such lawsuits may make it more difficult to finance our operations.

We may not realize the anticipated benefits of acquisitions or investments, the realization of such benefits may be delayed or reduced or our acquisitions or investments may have unexpected costs.

Acquisitions have been a component of our growth and the development of our business and are likely to continue to be in the future. Acquisitions can broaden and diversify our brand holdings and product offerings, expand our distribution capabilities and allow us to build additional capabilities and competencies. We cannot be certain that the products and offerings of companies we may acquire, or acquire an interest in, will achieve or maintain popularity with consumers in the future or that any such acquired companies or investments will allow us to more effectively distribute our products, market our products, develop our competencies or grow our business.

For example, in the first quarter of 2021 we acquired a majority interest and in October 2022 acquired the remainder of the membership interests in TokenWave LLC, the developer of a mobile application for tracking and displaying NFTs, to accelerate our entry into the digital collectible space. We launched our first Digital Pop! NFT collection in the third quarter of 2021 and have conducted additional NFT "drops" on a regular cadence since then. The market and consumer demand, as well as the legal and regulatory framework, for NFTs and other digital collectible products is new, rapidly developing and highly uncertain. No assurance can be given that our investment in TokenWave LLC, or our development or future launch of NFT or digital collectible products, will be successful.

Similarly, in the year ended December 31, 2022, we acquired Mondo Collectibles, LLC (f/k/a Mondo Tees Buyer, LLC) ("Mondo"), a high-end pop culture collectibles company that creates vinyl records, posters, soundtracks, toys, apparel, books, games and other collectibles for preliminary purchase consideration of $14.0 million in cash. This transaction represents an opportunity to expand the Company's product offerings into vinyl records, posters and other high-end collectibles, however the Company has limited experience selling these product categories and there can be no assurance that we will be able to successfully or profitably enter these product categories at scale.

In some cases, we expect that the integration of the companies that we may acquire into our operations will create production, distribution, marketing and other operating synergies which will produce greater sales 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 may acquire or invest in companies that we believe have strong and creative management, in which case we may plan to operate them more autonomously rather than fully integrating them into our operations. We cannot be certain that the key individuals at these companies would continue to work for us after the acquisition or that they would develop popular and profitable products, in the future. There is no guarantee that any acquisition or investment we may make will be successful or beneficial or that we will be able to manage the integration process successfully, and acquisitions can consume significant amounts of management attention and other resources, which may negatively impact other aspects of our business.

The further development and acceptance of blockchain networks, which are part of a new and rapidly changing industry, are subject to a variety of factors that are difficult to evaluate. The slowing or stopping of the development or acceptance of blockchain networks and blockchain assets could have an adverse material effect on the successful development and adoption of our non-fungible token ("NFT") and digital collectible business.

The growth of the blockchain industry in general, as well as the blockchain networks on which our NFT and digital collectible business relies, is subject to a high degree of uncertainty. The factors affecting the further development of blockchain networks and digital assets, include, without limitation:

- worldwide growth in the adoption and use of digital assets and other blockchain technologies;
- government and quasi-government regulation of digital assets and their use, or restrictions on or regulation of access to and operation of blockchain networks or similar systems;
- the maintenance and development of the open-source software protocol of blockchain networks;
- changes in consumer demographics and public tastes and preferences;
- the availability and popularity of other forms or methods of buying and selling goods and services, or trading assets including new means of using government-backed currencies or existing networks;

- the extent to which current purchaser interest in cryptocurrencies represents a speculative “bubble;”
- the extent to which historic price volatility in cryptocurrencies and digital assets continues into the future;
- general economic conditions in the United States and the world;
- the regulatory environment relating to cryptocurrencies and blockchains; and
- a decline in the popularity or acceptance of cryptocurrencies or other blockchain-based tokens.

Moreover, if and to the extent we are unable to successfully expand our NFT and digital collectible business, we may incur unanticipated costs and losses, and face other adverse consequences, such as negative reputational effects. In addition, the actual effects of pursuing these initiatives may differ, possibly materially, from the benefits that we expect to realize from them, such as the generation of additional revenues.

The digital assets industries as a whole have been characterized by rapid changes and innovations and are constantly evolving. Although they have experienced significant growth in recent years, the slowing or stopping of the development, general acceptance and adoption and usage of blockchain networks and blockchain assets may deter or delay the acceptance and adoption of our NFT and digital collectible business and, as a result, adversely affect the future prospects of our NFT and digital collectible business as well as our financial results and financial condition.

Digital assets are a novel asset class that carries unique risks, including extreme price volatility.

Cryptocurrencies, digital currencies, coins, tokens, NFTs, stablecoins, and other digital or crypto assets or instruments that are issued and transferred using distributed ledger or blockchain technology (collectively referred to herein as “digital assets”) are a new and evolving asset class. The characteristics of particular digital assets within this broad asset class may differ significantly.

We receive payments in digital assets in connection with our secondary sales in our NFT and digital collectibles business. We also purchase digital assets for use as a currency for certain expenses related to our NFT and digital collectibles business. There is no guarantee that these investments and payments will maintain their value as measured against fiat currencies or that such digital assets can be converted into or sold for fiat currencies. Digital assets continue to be an emerging asset class based on emerging technologies, and our use of digital assets is subject to a number of factors relating to the capabilities and development of blockchain technologies, such as the infancy of their development, their dependence on the internet and other technologies, their dependence on the role played by miners, validators and developers and the potential for malicious activity, among other factors. Further, there can be no assurance that the blockchain technology on which digital assets are transacted does not have undiscovered flaws that may allow for such digital assets to be compromised, resulting in the loss of some or all of the digital assets we hold. Finally, the intrinsic value of digital assets is particularly uncertain and difficult to determine due to the novel and rapidly changing nature of digital asset markets. There can be no assurance that digital assets will maintain their value in the future, or that acceptance of using digital assets as currency or to make payments by mainstream retail merchants and commercial businesses, or for any other uses, will continue to grow. Moreover, due to the novelty of the asset class and the evolving patchwork of regulatory oversight of digital asset markets, fraud and market manipulation are not uncommon in such markets, all of which could negatively impact the value of our digital assets and have an adverse impact on our business.

Use of social media may materially and adversely affect our reputation or subject us to fines or other penalties.

We rely to a large extent on our online presence to reach consumers and use third-party social media platforms as marketing tools. For example, we maintain Facebook, Twitter, Instagram, TikTok and YouTube accounts. As e-commerce and social media platforms continue to rapidly evolve, we must continue to maintain a presence on these platforms and establish presences on new or emerging popular social media platforms. If we are unable to cost-effectively use social media platforms as marketing tools, our ability to acquire new consumers and our financial condition may suffer. Furthermore, as laws and regulations rapidly evolve to govern the use of these platforms, the failure by us, our employees or third parties acting at our direction to abide by applicable laws and regulations in the use of these platforms could subject us to regulatory investigations, class action lawsuits, liability, fines or other penalties and have a material adverse effect on our business, financial condition and result of operations.

Failure to successfully operate our information systems and implement new technology effectively could disrupt our business or reduce our sales or profitability.

We rely extensively on various information technology systems and software applications, including our enterprise resource planning software, to manage many aspects of our business, including product development, management of our supply chain, sale and delivery of our products, financial reporting and various other processes and transactions. We are critically dependent on the integrity, security and consistent operations of these systems and related back-up systems. These systems are subject to damage or interruption from power outages, computer and telecommunications failures, usage errors by our employees, software bugs or misconfigurations, cybersecurity attacks, computer viruses, malware and other security breaches, as well as catastrophic events such as hurricanes, fires, floods, earthquakes, tornadoes, acts of war or terrorism and global pandemics. For example, the widely publicized vulnerability in Apache's Log4j software library disclosed in December 2021 was reported to have affected many organizations globally, requiring updates to patched versions of the software. While we were not impacted by this vulnerability, this incident demonstrates that similar third-party software vulnerabilities may impact us in the future. The efficient operation and successful growth of our business depends on these information systems, including our ability to operate and upgrade them effectively and to select and implement adequate disaster recovery systems successfully. The failure of these information systems to perform as designed, our failure to operate them effectively, or a security breach or disruption, or the perception thereof, in operation of our information systems could disrupt our business, require significant capital investments to remediate a problem or subject us to liability. At December 31, 2022, we determined the enterprise resource planning software was not feasible for its intended purpose and abandoned the cloud computing arrangement, incurring a $32.5 million write-down.

In addition, we have recently implemented, and expect to continue to invest in and implement, modifications and upgrades to our information technology systems and procedures to support our growth and the development of our e-commerce business. These modifications and upgrades could require substantial investment and may not improve our profitability at a level that outweighs their costs, or at all. In addition, the process of implementing any new technology systems involves inherent costs and risks, including potential delays and system failures, the potential disruption of our internal control structure, the diversion of management’s time and attention, and the need to re-train or hire new employees, any of which could disrupt our business operations and have a material adverse effect on our business, financial condition and results of operations.

Our indebtedness could adversely affect our financial health and competitive position.

On September 17, 2021, we entered into a new credit agreement (the "New Credit Agreement"), providing for a term loan facility in the amount of $180.0 million (the "New Term Loan Facility") and a revolving credit facility of $100.0 million (the "New Revolving Credit Facility" and together with the New Term Loan Facility, the " New Credit Facilities"). Proceeds from the New Term Loan Facility were primarily used to repay the Company's former term loan facility. On July 29, 2022, the New Credit Agreement was further amended by the Second Amendment, which, among other things, increased the New Revolving Credit Facility to $215.0 million. On February 28, 2023, we entered into a further amendment (the "Third Amendment") to the New Credit Agreement to, among other things, (i) modify the financial covenants under the New Credit Agreement for the period beginning on the date of the Third Amendment through the fiscal quarter ending December 31, 2023 (the "Waiver Period"), (ii) reduce the size of the New Revolving Credit Facility from $215 million to $180.0 million as of the date of the Third Amendment and thereafter to $150.0 million on December 31, 2023, which reduction shall be permanent after the Waiver Period, (iii) restrict the ability to draw on the New Revolving Credit Facility during the Waiver Period in excess of the amount outstanding on the date of the Third Amendment, (iv) increase the margin payable under the Credit Facilities during the Waiver Period to (a) 4.00% per annum with respect to any Term Benchmark Loan or RFR Loan (each as defined in the New Credit Agreement), and (b) 3.00% per annum with respect to any Canadian Prime Loan or ABR Loan (each as defined in the New Credit Agreement), (v) allow that any calculation of Consolidated EBITDA (as defined in the New Credit Agreement) that includes the fiscal quarters during the Waiver Period may include certain agreed upon amounts for certain addbacks, (vi) further limit our ability to make certain restricted payments, including the ability to pay dividends or make other distributions on equity interests, or redeem, repurchase or retire equity interests, incur additional indebtedness, incur additional liens, enter into sale and leaseback transactions or issue additional equity interests or securities convertible into or exchange for equity interests (other than the issuance of common stock) during the Waiver Period, (vii) require a minimum qualified cash requirement of at least $10.0 million and (viii) require a mandatory prepayment of the New Revolving Credit Facility during the Waiver Period with any qualified cash proceeds in excess of $25.0 million. Following the Waiver Period, beginning in the fiscal quarter ending March 31, 2024, the Third Amendment will reset the maximum Net Leverage Ratio and the minimum Fixed Charge Coverage Ratio (each as defined in the New Credit Agreement) that must be maintained by the Credit Agreement Parties to 2.50:1.00 and 1.25:1.00, respectively, which were the ratios in effect under the New Credit Agreement prior to the Third Amendment. As of June 30, 2023, we had $287.2 million of indebtedness outstanding under our New Credit Facilities, consisting of $146.2 million outstanding under our New Term Loan Facility (net of unamortized discount of $2.3 million) and $141.0 million outstanding borrowings under our New Revolving Credit Facility.

On November 25, 2022, Funko, LLC, Funko Games, LLC, Funko Acquisition Holdings, L.L.C., Funko Holdings LLC and Loungefly, LLC, (collectively, "Equipment Finance Credit Parties"), entered into a $20.0 million equipment finance agreement ("Equipment Finance Loan") with Wells Fargo Equipment Finance, Inc. The Equipment Finance Loan is secured by certain identified assets held within our Buckeye, Arizona warehouse. As of June 30, 2023, the Company had $17.7 million outstanding under the Equipment Finance Loan.

In order to service this indebtedness and any additional indebtedness we may incur in the future, we need to generate cash. Our ability to generate cash is subject, to a certain extent, to our ability to successfully execute our business strategy, as well as general economic, financial, competitive, regulatory and other factors beyond our control. We cannot assure you that our business will be able to generate sufficient cash flow from operations or that future borrowings or other financing will be available to us in an amount sufficient to enable us to service our indebtedness and fund our other liquidity needs. To the extent we are required to use our cash flow from operations or the proceeds of any future financing to service our indebtedness instead of funding working capital, capital expenditures or other general corporate purposes, we will be less able to plan for, or react to, changes in our business, industry and in the economy generally. This will place us at a competitive disadvantage compared to our competitors that have less indebtedness.

In addition, the New Credit Agreement contains, and any agreements evidencing or governing other future indebtedness may contain, certain restrictive covenants that limit our ability, among other things, to engage in certain activities that are in our long-term best interests, including our ability to:

- incur additional indebtedness;
- incur certain liens;
- consolidate, merge or sell or otherwise dispose of our assets;
- make investments, loans, advances, guarantees and acquisitions;
- pay dividends or make other distributions on equity interests, or redeem, repurchase or retire equity interests;
- enter into transactions with our affiliates;
- enter into sale and leaseback transactions in respect to real property;
- enter into swap agreements;
- enter into agreements restricting our subsidiaries’ ability to pay dividends;
- issue or sell equity interests or securities convertible into or exchangeable for equity interests;
- redeem, repurchase or refinance our other indebtedness; and
- amend or modify our governing documents.

Additionally, as noted above, during the Waiver Period these restrictive covenants contain incremental requirements that limit our ability to engage in certain of these activities and, as such, our operations may be even more limited during this period, which could limit our ability to engage in transactions that may be in our long-term best interests. The restrictive covenants in the New Credit Agreement also include certain financial covenants that require us to comply on a quarterly basis with a maximum net leverage ratio and a minimum fixed charge coverage ratio (in each case, measured on a trailing four-quarter basis), as modified during the Waiver Period. There can be no guarantee that we will not breach these covenants in the future, for the remainder of or after the Waiver Period. Our ability to comply with our financial covenants and the other covenants and restrictions under our credit facilities may be affected by events and factors beyond our control, and there can be no guarantee that we will be able to further amend our credit facilities in order to avoid or mitigate the risk of any potential breach that may occur in the future. Our failure to comply with our financial covenants as described above, or with any of the other covenants or restrictions under our credit facilities, could result in an event of default under our credit facilities. This would permit the lending banks under such facilities to take certain actions, including halting future borrowings under the New Revolving Credit Facility, terminating all outstanding commitments and declaring all amounts due under our New Credit Agreement to be immediately due and payable, including all outstanding borrowings, accrued and unpaid interest thereon, and prepayment premiums with respect to such borrowings and any terminated commitments. In addition, the Lenders would have the right to proceed against the collateral we granted to them, which includes substantially all of our assets. The occurrence of any of these events could have a material adverse effect on our business, financial condition and results of operations.

We may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs.

In the future, we may require additional capital to respond to business opportunities, challenges, acquisitions or unforeseen circumstances, including in the event we are unable to maintain compliance with the financial or other covenants contained in the New Credit Agreement, and may determine to engage in equity or debt financings or enter into credit facilities or refinance existing indebtedness for other reasons. As discussed above, under the terms of the Third Amendment to the New Credit Agreement we are unable to draw amounts in excess of the amount outstanding on the effective date of the Third Amendment under our New Revolver Credit Facility until the end of the Waiver Period.

We may not be able to timely secure additional debt or equity financing on favorable terms, or at all, including due to market volatility and uncertainty resulting from the COVID-19 pandemic, the war in Ukraine or the potential for U.S. sovereign debt default. As discussed above, the New Credit Agreement contains restrictive covenants that limit our ability to incur additional indebtedness and engage in other capital-raising activities, which restrictive covenants contain additional limitations on our ability to raise debt and issue new equity (other than common equity) during the Waiver Period. Any debt financing obtained by us in the future could involve covenants that further restrict our capital raising activities and other financial and operational matters, which may make it more difficult for us to operate our business, obtain additional capital and pursue business opportunities, including potential acquisitions. Furthermore, if we raise additional funds through the issuance of equity or convertible debt or other equity-linked securities, our existing stockholders could suffer significant dilution. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to grow or support our business, respond to business challenges and continue as a going concern could be significantly limited.

ORGANIZATIONAL STRUCTURE RISKS

TCG has significant influence over us, including over decisions that require the approval of stockholders, and its interests, along with the interests of our Continuing Equity Owners and certain other parties, in our business may conflict with the interests of our other stockholders.

Each share of our Class A common stock and Class B common stock entitles its holders to one vote per share on all matters presented to our stockholders. On May 19, 2022, ACON completed, pursuant to the Stock Purchase Agreement with TCG, the sale of 12,520,559 shares of our Class A common stock (including shares of Class A common stock issued upon the transfer of common units of FAH, LLC and the cancellation of shares of our Class B common stock) to TCG (the "ACON Sale"). Accordingly, TCG currently has significant influence over substantially all transactions and other matters submitted to a vote of our stockholders, such as a merger, consolidation, dissolution or sale of all or substantially all of our assets, the issuance or redemption of certain additional equity interests, and the election of directors. This influence may increase the likelihood that we will consummate transactions that are not in the best interests of holders of our Class A common stock or, conversely, prevent the consummation of transactions that are in the best interests of holders of our Class A common stock.

We entered into a new Stockholders Agreement with TCG (the “New Stockholders Agreement”), as well as a Joinder and Amendment to our Registration Rights Agreement, both of which became effective at the closing of the ACON Sale. Pursuant to the New Stockholders Agreement, TCG has the right to designate certain of our directors, which we refer to as the TCG Directors, which will be two TCG Directors for as long as the TCG Related Parties (as defined in the New Stockholders Agreement) beneficially own directly or indirectly, in the aggregate at least 20% of our Class A common stock, and one TCG Director for as long as the TCG Related Parties beneficially own directly or indirectly, in the aggregate, less than 20% but at least 10% or more of our Class A common stock (assuming in each such case that all outstanding common units in FAH, LLC are redeemed for newly issued shares of our Class A common stock on a one-for-one basis). The TCG Related Parties are not entitled to designate any TCG director designee if at any time, the TCG Related Parties beneficially own, directly or indirectly, in the aggregate less than 10% of all issued and outstanding shares of Class A common stock (assuming in each such case that all outstanding common units in FAH, LLC are redeemed for newly issued shares of our Class A common stock on a one-for-one basis). Additionally, we are required to take all commercially reasonable action to cause (1) the board of directors to be comprised of at least seven directors or such other number of directors as our board of directors may determine; (2) the individuals designated in accordance with the terms of the New Stockholders Agreement to be included in the slate of nominees to be elected to the board of directors at each annual meeting of our stockholders at which a director’s term expires; and (3) the individuals designated in accordance with the terms of the New Stockholders Agreement to fill the applicable vacancies on the board of directors.

In addition, the New Stockholders Agreement provides that for as long as the TCG Related Parties, beneficially own, directly or indirectly, in the aggregate, 22% or more of all issued and outstanding shares of our Class A common stock (assuming that all outstanding common units in FAH, LLC are redeemed for newly issued shares of our Class A common stock on a one-for-one basis), we will not take, and will cause our subsidiaries not to take, certain actions or enter into certain transactions (whether by merger, consolidation, or otherwise) without the prior written approval of TCG, including:

- entering into any transaction or series of related transactions in which any person or group (other than the TCG Related Parties and any group that includes the TCG Related Parties), acquires, directly or indirectly, in excess of 50% of the then outstanding shares of any class of our or our subsidiaries’ capital stock, or following which any such person or group has the direct or indirect power to elect a majority of the members of our board of directors or to replace us as the sole manager of FAH, LLC (or to add another person as co-manager of FAH, LLC);

- the reorganization, voluntary bankruptcy, liquidation, dissolution or winding up of us or any of our subsidiaries;
- the sale, lease or exchange of all or substantially all of our and our subsidiaries' property and assets;
- the resignation, replacement or removal of us as the sole manager of FAH, LLC, or the appointment of any additional person as a manager of FAH, LLC;
- the creation of a new class or series of capital stock or other equity securities of us or, in the event such creation would materially and adversely impair the rights of the TCG Related Parties as holders of our Class A common stock, any of our subsidiaries;
- the issuance of additional shares of Class A common stock, Class B common stock, preferred stock or other equity securities of us other than (x) under any stock option or other equity compensation plan approved by our board of directors or the compensation committee, or (y) pursuant to the exercise or conversion of any options, warrants or other securities existing as of the date of the New Stockholders Agreement or, in the event such creation would materially and adversely impair the rights of the TCG Related Parties as holders of our Class A common stock, equity securities of any of our subsidiaries;
- any amendment or modification of our certificate of incorporation or bylaws or any similar organizational documents of any of our subsidiaries that would, in either case, materially and adversely impair the rights of the TCG Related Parties as holders of our Class A common stock, and
- except to the extent of the express restrictions applicable to TCG and its controlled affiliates in the New Stockholders Agreement, any action to adopt, approve or implement any plan, agreement or provision that would, among other things, negatively affect TCG's or its controlled affiliates' ability to continue to hold or acquire additional shares of our capital stock or other securities.

Additionally, the Continuing Equity Owners who, as of August 1, 2023, collectively hold approximately 7.9% of the combined voting power of our common stock, and certain transferees of former Continuing Equity Owners that have been joined to our Tax Receivable Agreement (the "TRA Parties") may receive payments from us under the Tax Receivable Agreement in connection with our purchase of common units of FAH, LLC directly from certain of the Continuing Equity Owners upon a redemption or exchange of their common units in FAH, LLC, including the issuance of shares of our Class A common stock upon any such redemption or exchange. Moreover, Continuing Equity Owners own interests in our business by holding interests in FAH, LLC directly (rather than through ownership of our Class A common stock). As a result of these considerations, the interests of the Continuing Equity Owners and such transferees as well as the TRA Parties may conflict with the interests of holders of our Class A common stock. For example, the TRA Parties may have different interests in the tax positions or other actions that we take which could influence their decisions regarding whether and when to dispose of assets, whether and when to incur new or refinance existing indebtedness, and whether and when we should terminate the Tax Receivable Agreement and accelerate our obligations thereunder. In addition, the structuring of future transactions may take into consideration tax or other considerations of the TRA Parties even in situations where no similar considerations are relevant to us.

Our amended and restated certificate of incorporation provides that the doctrine of "corporate opportunity" does not apply with respect to any director or stockholder who is not employed by us or our subsidiaries.

The doctrine of corporate opportunity generally provides that a corporate fiduciary may not develop an opportunity using corporate resources, acquire an interest adverse to that of the corporation or acquire property that is reasonably incident to the present or prospective business of the corporation or in which the corporation has a present or expectancy interest, unless that opportunity is first presented to the corporation and the corporation chooses not to pursue that opportunity. The doctrine of corporate opportunity is intended to preclude officers or directors or other fiduciaries from personally benefiting from opportunities that belong to the corporation. Our amended and restated certificate of incorporation provides that the doctrine of "corporate opportunity" does not apply with respect to any director or stockholder who is not employed by us or our subsidiaries. Any director or stockholder who is not employed by us or our subsidiaries therefore has no duty to communicate or present corporate opportunities to us, and has the right to either hold any corporate opportunity for their (and their affiliates') own account and benefit or to recommend, assign or otherwise transfer such corporate opportunity to persons other than us, including to any director or stockholder who is not employed by us or our subsidiaries.

As a result, certain of our stockholders, directors and their respective affiliates are not prohibited from operating or investing in competing businesses. We therefore may find ourselves in competition with certain of our stockholders, directors or their respective affiliates, and we may not have knowledge of, or be able to pursue, transactions that could potentially be beneficial to us. Accordingly, we may lose a corporate opportunity or suffer competitive harm, which could negatively impact our business or prospects.

Our principal asset consists of our interest in FAH, LLC, and accordingly, we depend on distributions from FAH, LLC to pay taxes and expenses, including payments under the Tax Receivable Agreement. FAH, LLC's ability to make such distributions may be subject to various limitations and restrictions.

We have no material assets other than our ownership of 48,507,993 common units of FAH, LLC as of August 1, 2023, representing approximately 91.5% of the economic interest in FAH, LLC. We have no independent means of generating revenue or cash flow, and our ability to pay dividends in the future, if any, is dependent upon the financial results and cash flows of FAH, LLC and its subsidiaries and distributions we receive from FAH, LLC. There can be no assurance that our subsidiaries will generate sufficient cash flow to dividend or distribute funds to us or that applicable local law and contractual restrictions, including negative covenants in our debt instruments, will permit such dividends or distributions.

FAH, LLC is treated as a partnership for U.S. federal income tax purposes and, as such, generally is not subject to entity-level U.S. federal income tax. Instead, taxable income is allocated to holders of its common units, including us. As a result, we incur income taxes on our allocable share of net taxable income of FAH, LLC. Under the terms of the FAH LLC Agreement, FAH, LLC is obligated to make tax distributions to its members, including us, except to the extent such distributions would render FAH, LLC insolvent or are otherwise prohibited by law or any limitations or restrictions in our debt agreements. The amount of such tax distribution is calculated based on the highest combined federal, state and local tax rate that may potentially apply to any one of FAH, LLC's members, regardless of the actual final tax liability of any such member. As a result of the foregoing, FAH, LLC may be obligated to make tax distributions in excess of some or all of its members' actual tax liability, which could reduce its cash available for its business operations. In addition to tax expenses, we also incur expenses related to our operations, our interests in FAH, LLC and related party agreements, including payment obligations under the Tax Receivable Agreement and expenses and costs of being a public company, all of which could be significant. We intend, as its managing member, to cause FAH, LLC to make distributions in an amount sufficient to allow us to pay our taxes and operating expenses, including any ordinary course payments due under the Tax Receivable Agreement. However, FAH, LLC's ability to make such distributions may be subject to various limitations and restrictions including, but not limited to, restrictions on distributions that would either violate any contract or agreement to which FAH, LLC is then a party, including debt agreements, or any applicable law, or that would have the effect of rendering FAH, LLC insolvent. If FAH, LLC does not have sufficient funds to pay tax distributions or other liabilities to fund our operations, we may have to borrow funds, which could materially adversely affect our liquidity and financial condition and subject us to various restrictions imposed by any such lenders. To the extent that we are unable to make payments under the Tax Receivable Agreement for any reason, such payments will be deferred and will accrue interest until paid; provided, however, that nonpayment for a specified period may constitute a material breach of a material obligation under the Tax Receivable Agreement and therefore may accelerate payments due under the Tax Receivable Agreement. If FAH, LLC does not have sufficient funds to make distributions, our ability to declare and pay cash dividends may also be restricted or impaired. See "Ownership of Our Class A Common Stock Risks."

In certain circumstances, FAH, LLC will be required to make distributions to us and the Continuing Equity Owners and certain of their transferees, and the distributions that FAH, LLC will be required to make may be substantial.

As discussed above, under the terms of the FAH LLC Agreement, FAH, LLC is obligated to make tax distributions to us and the Continuing Equity Owners and certain of their transferees based on the highest combined federal, state and local tax rates that may potentially apply to any one member of FAH, LLC and such distributions will generally be made to such holders pro rata based on their interests in FAH, LLC. As a result of potential differences in the amount of net taxable income allocable to us and to the Continuing Equity Owners and certain of their transferees, as well as the use of an assumed tax rate in calculating FAH, LLC's distribution obligations, we may receive distributions significantly in excess of our tax liabilities and obligations to make payments under the Tax Receivable Agreement. Funds we receive from FAH, LLC to satisfy its tax distribution obligations will not be available for reinvestment in our business. Our board of directors will determine the appropriate uses for any excess cash so accumulated, which may include, among other uses, the payment of a cash dividend on our Class A common stock, the payment of obligations under the Tax Receivable Agreement, the declaration of a stock dividend on our Class A common stock, along with the purchase of a corresponding number of common units in FAH, LLC, or the purchase of additional common units in FAH, LLC, along with a recapitalization of all of the outstanding common units in FAH, LLC. For example, on May 3, 2022, we entered into a common unit subscription agreement with FAH, LLC pursuant to which we purchased 4,251,701 newly issued common units in exchange for a capital contribution of approximately $74.0 million (the "Capital Contribution"). Following the Capital Contribution, (i) the common units of FAH, LLC were recapitalized through a reverse unit split in order to maintain a one-to-one ratio between the number of common units owned by us and the number of outstanding shares of our Class A common stock in accordance with the FAH LLC Agreement, and (ii) approximately 0.9 million outstanding shares of our Class B common stock were cancelled in order to maintain a one-to-one ratio between the number of shares of Class B common stock and the number of common units (other than common units issuable upon the exercise of options), in each case, held by the Continuing Equity Owners, in accordance with our amended and restated certificate of incorporation (clauses (i) and (ii) together, the "Recapitalization"). To the extent we do not take such actions in the future and instead, for example, hold such cash balances or lend them to FAH, LLC, the Continuing Equity Owners and certain of their transferees that hold interests in FAH, LLC would benefit from any value attributable to such accumulated cash balances as a result of their ownership of Class A common stock following an exchange of their common units for Class A common stock.

Our Tax Receivable Agreement requires us to make cash payments in respect of certain tax benefits to which we may become entitled, the amounts that we may be required to pay could be significant, and we may not realize such tax benefits.

In connection with the consummation of the IPO, we entered into the Tax Receivable Agreement. Pursuant to the Tax Receivable Agreement, we are required to make cash payments to the TRA Parties equal to 85% of the tax benefits, if any, that we realize, or in some circumstances are deemed to realize as a result of (1) any future redemptions funded by us or exchanges (or deemed exchanges in certain circumstances) of common units for Class A common stock or cash, and (2) certain additional tax benefits attributable to payments under the Tax Receivable Agreement. At June 30, 2023, as a result of the recognition of a full valuation allowance on the deferred tax assets, and projected inability to fully utilize all or part of the related tax benefits, the Company determined that payments to the TRA Parties related to unrealized tax benefits under the Tax Receivable Agreement are no longer probable and estimable and we have reduced the Tax Receivable Agreement liability accordingly. The amount of the cash payments that we may be required to make under the Tax Receivable Agreement could be significant. Payments under the Tax Receivable Agreement will generally be based on the tax reporting positions that we determine, which are subject to challenge by taxing authorities. Payments made under the Tax Receivable Agreement will not be returned upon a successful challenge by a taxing authority to our reporting positions. Any payments made by us to the TRA Parties under the Tax Receivable Agreement will generally reduce the amount of overall cash flow that might have otherwise been available to us. To the extent that we are unable to make timely payments under the Tax Receivable Agreement for any reason, the unpaid amounts will be deferred and will accrue interest until paid by us. Nonpayment for a specified period may constitute a material breach of a material obligation under the Tax Receivable Agreement and therefore may accelerate payments due under the Tax Receivable Agreement. Furthermore, our future obligation to make payments under the Tax Receivable Agreement could make us a less attractive target for an acquisition, particularly in the case of an acquirer that cannot use some or all of the tax benefits that may be deemed realized under the Tax Receivable Agreement upon a change of control. The payments under the Tax Receivable Agreement are also not conditioned upon the TRA Parties maintaining a continued ownership interest in FAH, LLC.

The amounts that we may be required to pay to the TRA Parties under the Tax Receivable Agreement may be accelerated in certain circumstances and may also significantly exceed the actual tax benefits that we ultimately realize.

The Tax Receivable Agreement provides that if certain mergers, asset sales, other forms of business combination, or other changes of control were to occur, if we materially breach any of our material obligations under the Tax Receivable Agreement or if, at any time, we elect an early termination of the Tax Receivable Agreement, then the Tax Receivable Agreement will terminate and our obligations, or our successor's obligations, to make future payments under the Tax Receivable Agreement would accelerate and become immediately due and payable. In those circumstances members of FAH, LLC would be deemed to exchange any remaining outstanding common units of FAH, LLC for Class A common stock and would generally be entitled to payments under the Tax Receivable Agreement resulting from such deemed exchange. The amount due and payable in those circumstances is determined based on certain assumptions, including an assumption that we would have sufficient taxable income to fully utilize all potential future tax benefits that are subject to the Tax Receivable Agreement. We may need to incur debt to finance payments under the Tax Receivable Agreement to the extent our cash resources are insufficient to meet our obligations under the Tax Receivable Agreement.

As a result of the foregoing, we would be required to make an immediate cash payment equal to the present value of the anticipated future tax benefits that are the subject of the Tax Receivable Agreement, which payment may be made significantly in advance of the actual realization, if any, of such future tax benefits. We could also be required to make cash payments to the TRA Parties that are greater than the specified percentage of the actual benefits we ultimately realize in respect of the tax benefits that are subject to the Tax Receivable Agreement. Our obligations under the Tax Receivable Agreement could have a substantial negative impact on our liquidity and could have the effect of delaying, deferring or preventing certain mergers, asset sales, other forms of business combination, or other changes of control. There can be no assurance that we will be able to finance our obligations under the Tax Receivable Agreement.

We will not be reimbursed for any payments made to the TRA Parties under the Tax Receivable Agreement in the event that any tax benefits are disallowed.

We will not be reimbursed for any cash payments previously made to the TRA Parties pursuant to the Tax Receivable Agreement if any tax benefits initially claimed by us are subsequently challenged by a taxing authority and are ultimately disallowed. Instead, any excess cash payments made by us to a TRA Party will be netted against any future cash payments that we might otherwise be required to make under the terms of the Tax Receivable Agreement. However, a challenge to any tax benefits initially claimed by us may not arise for a number of years following the initial time of such payment or, even if challenged early, such excess cash payment may be greater than the amount of future cash payments that we might otherwise be required to make under the terms of the Tax Receivable Agreement and, as a result, there might not be future cash payments from which to net against. The applicable U.S. federal income tax rules are complex and factual in nature. Significant management judgment is required in connection with interpreting applicable tax laws and in taking valuation positions relevant to our tax compliance obligations. We are constantly evaluating our tax return positions, and changes in our return positions could affect our liabilities and risks that we face in connection with determining our the taxes we owe and the amounts that we are required to pay in connection with the Tax Receivable Agreement. There can be no assurance that the IRS or a court will not disagree with our tax reporting positions. As a result, it is possible that we could incur additional costs in connection with these risks, including by making cash payments under the Tax Receivable Agreement that are substantially greater than our actual cash tax savings.

Our organizational structure, including the Tax Receivable Agreement, confers certain benefits upon the TRA Parties that will not benefit Class A common stockholders to the same extent as it will benefit the Continuing Equity Owners and transferees.

Our organizational structure, including the Tax Receivable Agreement, confers certain benefits upon the TRA Parties and the Continuing Equity Owners and certain of their transferees that will not benefit the holders of our Class A common stock to the same extent. We have entered into the Tax Receivable Agreement with FAH, LLC and the TRA Parties, and it provides for the payment by us to the TRA Parties of 85% of the amount of tax benefits, if any, that we realize, or in some circumstances are deemed to realize, as a result of (1) any future redemptions funded by us or exchanges (or deemed exchanges in certain circumstances) of common units for Class A common stock or cash and (2) certain additional tax benefits attributable to payments under the Tax Receivable Agreement. This and other aspects of our organizational structure may adversely impact the future trading market for our Class A common stock.

OWNERSHIP OF OUR CLASS A COMMON STOCK RISKS

The Continuing Equity Owners own common units in FAH, LLC, and the Continuing Equity Owners have the right to redeem their common units in FAH, LLC pursuant to the terms of the FAH LLC Agreement for shares of Class A common stock or cash.

As of August 1, 2023, we had an aggregate of 151,492,007 shares of Class A common stock authorized but unissued, as well as approximately 4,481,229 shares of Class A common stock issuable, at our election, upon redemption of FAH, LLC common units held by the Continuing Equity Owners. FAH, LLC has entered into the FAH LLC Agreement, and subject to certain restrictions set forth in such agreement, the Continuing Equity Owners are entitled to have their common units redeemed from time to time at each of their options (subject in certain circumstances to time-based vesting requirements) for, at our election, newly-issued shares of our Class A common stock on a one-for-one basis or a cash payment equal to a volume weighted average market price of one share of Class A common stock for each common unit redeemed, in each case, in accordance with the terms of the FAH LLC Agreement; provided that, at our election, we may effect a direct exchange by us of such Class A common stock or such cash, as applicable, for such common units. The Continuing Equity Owners may exercise such redemption right for as long as their common units remain outstanding. We also entered into a Registration Rights Agreement pursuant to which the shares of Class A common stock issued to certain of the Continuing Equity Owners (including each of our then-current executive officers) upon such redemption and remaining shares of Class A common stock issued to the Former Equity Owners in connection with the Transactions (such shares now being held by TCG) are eligible for resale, subject to certain limitations set forth in the Registration Rights Agreement.

We cannot predict the size of future issuances of our Class A common stock or the effect, if any, that future issuances and sales of shares of our Class A common stock may have on the market price of our Class A common stock. Sales or distributions of substantial amounts of our Class A common stock, including shares issued in connection with an acquisition, or the perception that such sales or distributions could occur, may cause the market price of our Class A common stock to decline.

You may be diluted by future issuances of additional Class A common stock or common units in connection with our incentive plans, acquisitions or otherwise; future sales of such shares in the public market, or the expectations that such sales may occur, could lower our stock price.

Our amended and restated certificate of incorporation authorizes us to issue shares of our Class A common stock and options, rights, warrants and appreciation rights relating to our Class A common stock for the consideration and on the terms and conditions established by our board of directors in its sole discretion, whether in connection with acquisitions or otherwise. In addition, we, FAH, LLC and the Continuing Equity Owners are party to the FAH LLC Agreement under which the Continuing Equity Owners (or certain permitted transferees thereof) have the right (subject to the terms of the FAH LLC Agreement) to have their common units redeemed from time to time at each of their options (subject in certain circumstances to time-based vesting requirements) by FAH, LLC in exchange for, at our election, newly-issued shares of our Class A common stock on a one-for-one basis or a cash payment equal to a volume-weighted average market price of one share of Class A common stock for each common unit redeemed, in each case, in accordance with the terms of the FAH LLC Agreement; provided that, at our election, we may effect a direct exchange by us of such Class A common stock or such cash, as applicable, for such common units. The Continuing Equity Owners may exercise such redemption right for as long as their common units remain outstanding. The market price of shares of our Class A common stock could decline as a result of these redemptions or exchanges or the perception that a redemption or exchange could occur. These redemptions or exchanges, or the possibility that these redemptions or exchanges may occur, also might make it more difficult for holders of our Class A common stock to sell such stock in the future at a time and at a price that they deem appropriate.

We originally reserved for issuance 5,518,518 shares of Class A common stock under our 2017 Incentive Award Plan (the “2017 Plan”), including, as of June 30, 2023, 2,479,776 shares of Class A common stock underlying stock options we granted to certain of our directors, executive officers and other employees and 2,684,968 shares of Class A common stock underlying restricted stock units we granted to certain of our executive officers, consultants and other employees. We have also reserved for issuance an aggregate number of shares under the Company’s 2019 Incentive Award Plan (the “2019 Plan”) equal to the sum of (i) 3,000,000 shares of our Class A common stock and (ii) an annual increase on the first day of each calendar year beginning on January 1, 2020 and ending on and including January 1, 2029, equal to the lesser of (A) 2% of the shares of Class A common stock outstanding as of the last day of the immediately preceding fiscal year on a fully-diluted basis and (B) such lesser number of shares of Class A common stock as determined by our board of directors. As of June 30, 2023, we had granted 2,264,569 shares of Class A common stock underlying stock options, 2,061,971 shares of Class A common stock underlying restricted stock units and 173,391 shares of Class A common stock underlying performance stock units under the 2019 Plan to certain of our executive officers, consultants and other employees. Any shares of Class A common stock that we issue, including under our 2017 Plan, our 2019 Plan or other equity incentive plans that we may adopt in the future, would dilute the percentage ownership held by the holders of our Class A common stock.

In the future, we may also issue additional securities if we need to raise capital, including, but not limited to, in connection with acquisitions, which could constitute a material portion of our then-outstanding shares of Class A common stock. Further, in connection with the completion of the IPO, we entered into a Registration Rights Agreement with certain of the Original Equity Owners (including each of our then-current executive officers), pursuant to which TCG has been joined as a party. On July 15, 2022, we filed a preliminary shelf registration statement on Form S-3 with the SEC. The Form S-3 was declared effective by the SEC on July 26, 2022. The Form S-3 allows us to sell from time to time up to $100.0 million of Class A common stock, preferred stock, debt securities, warrants, purchase contracts or units comprised of any combination of these securities for our own account and, allows parties to the Registration Rights Agreement to sell 17,318,008 shares of Class A common stock in one or more offerings. If we offer and sell Class A common stock under the Form S-3, it would dilute the percentage ownership held by the existing holders of our Class A common stock. Any sales in connection with the Registration Rights Agreement, or the prospect of any such sales, could materially impact the market price of our Class A common stock and could impair our ability to raise capital through future sales of equity securities.

We do not intend to pay dividends on our Class A common stock for the foreseeable future.

We currently intend to retain all available funds and any future earnings to fund the development and growth of our business and to repay indebtedness. As a result, we do not anticipate declaring or paying any cash dividends on our Class A common stock in the foreseeable future. Any decision to declare and pay dividends in the future will be made at the discretion of our board of directors and will depend on, among other things, our business prospects, results of operations, financial condition, cash requirements and availability, industry trends and other factors that our board of directors may deem relevant. Any such decision will also be subject to compliance with contractual restrictions and covenants in the agreements governing our current and future indebtedness. Our New Credit Facilities contain certain covenants that restrict the ability of FAH, LLC and its subsidiaries to pay dividends or make distributions. Because we are a holding company, our ability to pay dividends on our Class A common stock depends on our receipt of cash distributions from FAH, LLC and, through FAH, LLC, cash distributions and dividends from our other direct and indirect wholly owned subsidiaries. In addition, we may incur additional indebtedness, the terms of which may further restrict or prevent us from paying dividends on our Class A common stock. As a result, you may have to sell some or all of your Class A common stock after price appreciation in order to generate cash flow from your investment, which you may not be able to do. Our inability or decision not to pay dividends, particularly when others in our industry have elected to do so, could also adversely affect the market price of our Class A common stock.

Delaware law and certain provisions in our amended and restated certificate of incorporation and our amended and restated bylaws may prevent efforts by our stockholders to change the direction or management of our company.

We are a Delaware corporation, and the anti-takeover provisions of Delaware law impose various impediments to the ability of a third party to acquire control of us, even if a change of control would be beneficial to our existing stockholders. In addition, our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors, including, but not limited to, the following:

- our board of directors is classified into three classes, each of which serves for a staggered three-year term;
- only the chairperson of our board of directors or a majority of our board of directors may call special meetings of our stockholders;
- we have authorized undesignated preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval;
- any action required or permitted to be taken by our stockholders at an annual meeting or special meeting of stockholders may not be taken by written consent in lieu of a meeting;
- our amended and restated certificate of incorporation and our amended and restated bylaws may be amended or repealed by the affirmative vote of the holders of at least $66^{2/3}$% of the votes which all our stockholders would be entitled to cast in any annual election of directors and our amended and restated bylaws may also be amended or repealed by a majority vote of our board of directors;
- we require advance notice and duration of ownership requirements for stockholder proposals; and
- we have opted out of Section 203 of the Delaware General Corporation Law of the State of Delaware, or the DGCL, however, our amended and restated certificate of incorporation contains provisions that are similar to Section 203 of the DGCL (except with respect to TCG and certain other parties (including certain affiliates, associates and transferees of TCG).

These provisions could discourage, delay or prevent a transaction involving a change in control of our company. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors of your choosing and cause us to take other corporate actions you desire, including actions that you may deem advantageous, or negatively affect the trading price of our Class A common stock. In addition, because our board of directors is responsible for appointing the members of our management team, these provisions could in turn affect any attempt by our stockholders to replace current members of our management team.

Please see “Organizational Structure Risks—TCG has significant influence over us, including over decisions that require the approval of stockholders, and its interests, along with the interests of our other Continuing Equity Owners and certain other parties, in our business may conflict with the interests of our other stockholders.”

Our amended and restated certificate of incorporation provides, subject to certain exceptions, that the Court of Chancery of the State of Delaware will be the sole and exclusive forum for certain stockholder litigation matters, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers, employees or stockholders.

Our amended and restated certificate of incorporation provides, subject to limited exceptions, that the Court of Chancery of the State of Delaware will, to the fullest extent permitted by law, be the sole and exclusive forum for (1) any derivative action or proceeding brought on our behalf; (2) any action asserting a claim of breach of a fiduciary duty owed by any of our directors, officers or other employees to us or our stockholders; (3) any action asserting a claim against us, any director or our officers and employees arising pursuant to any provision of the DGCL, our amended and restated certificate of incorporation or our amended and restated bylaws, or as to which the DGCL confers exclusive jurisdiction on the Court of Chancery; or (4) any action asserting a claim against us, any director or our officers or employees that is governed by the internal affairs doctrine. This provision would not apply to suits brought to enforce a duty or liability created by the Exchange Act, Securities Act, or, in each case, the rules and regulations thereunder, or any other claim for which the U.S. federal courts have exclusive jurisdiction. Any person or entity purchasing or otherwise acquiring any interest in shares of our capital stock shall be deemed to have notice of and to have consented to the provisions of our amended and restated certificate of incorporation described above. This choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or any of our directors, officers, other employees or stockholders which may discourage lawsuits with respect to such claims. Alternatively, if a court were to find the choice of forum provision that will be contained in our amended and restated certificate of incorporation to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could materially adversely affect our business, financial condition and results of operations.

We may issue shares of preferred stock in the future, which could make it difficult for another company to acquire us or could otherwise adversely affect holders of our Class A common stock, which could depress the price of our Class A common stock.

Our amended and restated certificate of incorporation authorizes us to issue one or more series of preferred stock. Our board of directors has the authority to determine the preferences, limitations and relative rights of the shares of preferred stock and to fix the number of shares constituting any series and the designation of such series, without any further vote or action by our stockholders. Our preferred stock could be issued with voting, liquidation, dividend and other rights superior to the rights of our Class A common stock. The potential issuance of preferred stock may delay or prevent a change in control of us, discouraging bids for our Class A common stock at a premium to the market price, and materially and adversely affect the market price and the voting and other rights of the holders of our Class A common stock.

As a public reporting company, we are subject to rules and regulations established from time to time by the SEC regarding our internal control over financial reporting. Any failure to establish and maintain effective internal control over financial reporting and disclosure controls and procedures may cause us to not be able to accurately report our financial results or report them in a timely manner.

We are a public reporting company subject to the rules and regulations established from time to time by the SEC and The Nasdaq Stock Market. These rules and regulations require, among other things, that we have and periodically evaluate procedures with respect to our internal control over financial reporting. Reporting obligations as a public company are likely to continue to place a considerable strain on our financial and management systems, processes and controls, as well as on our personnel.

Under Section 404(a) of the Sarbanes-Oxley Act our management is required to assess and report annually on the effectiveness of our internal control over financial reporting and to identify any material weaknesses in our internal control over financial reporting. As we are no longer an emerging growth company, Section 404(b) of the Sarbanes-Oxley Act requires our independent registered public accounting firm to issue an annual report that addresses the effectiveness of our internal control over financial reporting.

We have identified material weaknesses in our internal control over financial reporting, as discussed in Part I, Item 4 of this Quarterly Report on Form 10-Q and our independent registered public accounting firm was not able to render an unqualified opinion on management's assessment and the effectiveness of our internal control over financial reporting in our Annual Report on Form 10-K for the year ended December 31, 2022. In addition to taking remediation measures in response to the material weaknesses we identified, we may need to expend additional resources and provide additional management oversight in order to establish effective disclosure controls and procedures and internal control over financial reporting. Implementing any appropriate changes to our internal controls may require specific compliance training of our employees, entail substantial costs, take a significant period of time to complete or divert management's attention from other business concerns.

The material weaknesses will not be considered remediated until our remediation plan has been fully implemented, the applicable controls operate for a sufficient period of time, and we have concluded, through testing, that the newly implemented and enhanced controls are operating effectively. At this time, we cannot predict the success of such efforts or the outcome of our assessment of the remediation efforts. We can give no assurance that our efforts will remediate these material weaknesses in our internal control over financial reporting, or that additional material weaknesses will not be identified in the future. Our failure to implement and maintain effective internal control over financial reporting could result in errors in our consolidated financial statements that could result in a restatement of our financial statements, and could cause us to fail to meet our reporting obligations, any of which could diminish investor confidence in us and cause a decline in the price of our common stock. Additionally, ineffective internal control could expose us to an increased risk of financial reporting fraud and the misappropriation of assets and subject us to potential delisting from the stock exchange on which we list or to other regulatory investigations and civil or criminal sanctions.

In addition, as a result of our current material weaknesses or future material weaknesses in our internal control over financial reporting, we could be subject to sanctions or investigations by the SEC, the Nasdaq Stock Market or other regulatory authorities, a loss of public and investor confidence, and litigation from investors and stockholders, any of which could have a material adverse effect on our business and our stock price. Our failure to implement and maintain effective internal control over financial reporting could result in errors in our consolidated financial statements that could result in a restatement of our financial statements, and could cause us to fail to meet our reporting obligations, any of which could also diminish investor confidence in us and cause a decline in the price of our common stock. Additionally, ineffective internal controls could expose us to an increased risk of financial reporting fraud and the misappropriation of assets and subject us to potential delisting from the stock exchange on which we list or to other regulatory investigations and civil or criminal sanctions.

GENERAL RISKS

Changes in foreign currency exchange rates can significantly impact our reported financial performance.

Our increasingly global operations mean we produce, buy, and sell products in many different markets with many different currencies. As a result, if the exchange rate between the U.S. dollar and a local currency for an international market in which we have significant sales or operations changes, our financial results as reported in U.S. dollars may be meaningfully impacted even if our business in the local currency is not significantly affected. Similarly, our expenses can be significantly impacted, in U.S. dollar terms, by exchange rates, meaning the profitability of our business in U.S. dollar terms can be negatively impacted by exchange rate movements which we do not control. In recent years, certain key currencies, such as the euro and the British pound sterling, depreciated significantly compared to the U.S. dollar. Depreciation in key currencies during 2023 and beyond may have a significant negative impact on our sales and earnings as they are reported in U.S. dollars.

If our or our third-party providers' electronic data is compromised our business could be significantly harmed.

We rely extensively on various information technology systems and software applications (collectively “IT Systems”) for internal and external operations and while we operate certain of these IT Systems, we also rely on third-party providers for a host of technologies, products and services. In addition, in the ordinary course of business, both we and our third-party providers collect, process and maintain significant amounts of data electronically, including proprietary and confidential business information as well as personal information. This data relates to all aspects of our business, including but not limited to current and future products and entertainment under development, and also contains certain customer, consumer, supplier, partner and employee data.

We maintain systems and processes designed to protect the data within our control, but notwithstanding such protective measures, there is a risk of intrusion or tampering that could compromise the integrity and privacy of this data. In addition, we provide confidential and proprietary information to our third-party business partners in certain cases where doing so is necessary or appropriate to conduct our business. While we obtain assurances from those parties that they have systems and processes in place to protect such data, and where applicable, that they will take steps to assure the protections of such data by third parties, nonetheless those partners may also be subject to data intrusion or otherwise compromise the protection of such data.

We and many third parties have experienced and expect to continue to experience cyberattacks and other security incidents. Threat actors are becoming more sophisticated and increasingly using techniques designed to circumvent security controls, to evade detection and to obfuscate or remove forensic evidence, which means we may be unable to timely or effectively detect, identify, contain, or remediate future attacks or incidents. Disruptive attacks, such as through ransomware and other extortion-based tactics, that can temporarily or permanently disable operations are becoming increasingly prevalent. Such attacks may involve internal or external actors, and may result from the exploitation of bugs, misconfigurations or vulnerabilities in our IT Systems, human error, social engineering, supply chain attacks, or malware deployment (for example, ransomware), and may disrupt our operations and/or compromise data. Also, remote working arrangements that started during the COVID-19 pandemic may continue in the future, which increases the risk that threat actors will engage in social engineering and exploit vulnerabilities inherent in many non-corporate home networks. Any compromise of the confidential data of our customers, consumers, suppliers, partners, employees or ourselves, or failure to prevent or mitigate the loss of or damage to this data through breach of our information technology systems or other means could substantially disrupt our operations, harm our customers, consumers and other business partners, damage our reputation, violate applicable laws and regulations and subject us to litigation or regulatory actions, to additional costs for remediation and compliance, as well to liabilities and loss of business that could be material. Global consumer protection, data privacy and cybersecurity legal requirements, such as under the European Union’s General Data Protection Regulation (the “GDPR”) and California Consumer Privacy Act (the “CCPA”), are evolving rapidly and increasingly exposing companies to significant fines and penalties for violations. While we carry insurance, our policies may not cover, or may not fully cover or reimburse us for, any or all costs and losses associated with cybersecurity related events.

Any impairment in the value of our goodwill or other assets could adversely affect our financial condition and results of operations.

We are required, at least annually, or as facts and circumstances warrant, to test goodwill and other assets to determine if impairment has occurred. Impairment may result from any number of factors, including adverse changes in assumptions used for valuation purposes, such as actual or projected net sales growth rates, profitability or discount rates, or other variables. If the testing indicates that impairment has occurred, we are required to record a non-cash impairment charge for the difference between the carrying value of the goodwill or other assets and the implied fair value of the goodwill or the fair value of other assets in the period the determination is made. We cannot always predict the amount and timing of any impairment of assets. Should the value of goodwill or other assets become impaired, it would have an adverse effect on our financial condition and results of operations.

Our Class A common stock price may be volatile or may decline regardless of our operating performance and you may not be able to resell your shares at or above the price you paid for them.

Volatility in the market price of our Class A common stock may prevent you from being able to sell your shares at or above the price you paid for them. Many factors, which are outside our control, may cause the market price of our Class A common stock to fluctuate significantly, including those described elsewhere in this “Risk Factors” section, as well as the following:

- our operating and financial performance and prospects;
- our quarterly or annual earnings or those of other companies in our industry compared to market expectations;
- conditions that impact demand for our products;
- future announcements concerning our business, our customers’ businesses or our competitors’ businesses;

- the public’s reaction to our press releases, other public announcements and filings with the SEC;
- the size of our public float;
- coverage by or changes in financial estimates by securities analysts or failure to meet their expectations;
- market and industry perception of our success, or lack thereof, in pursuing our growth strategy;
- short sales of our stock or trading phenomena such as "short squeezes";
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- changes in laws or regulations which adversely affect our industry, our licensors or us;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in senior management or key personnel;
- issuances, exchanges or sales, or expected issuances, exchanges or sales of our capital stock;
- changes in our dividend policy;
- adverse resolution of new or pending litigation against us;
- the imposition of fines or other remedial measures as a result of regulatory violations or civil liability such as due to the underpayment of customs duties at Loungefly; and
- changes in general market, economic and political conditions in the United States and global economies or financial markets, including those resulting from natural disasters, terrorist attacks, acts of war, pandemics such as COVID-19, and responses to such events.

As a result, volatility in the market price of our Class A common stock may prevent investors from being able to sell their Class A common stock at or above the price they paid for them or at all. These broad market and industry factors may materially reduce the market price of our Class A common stock, regardless of our operating performance. In addition, price volatility may be greater if the public float and trading volume of our Class A common stock is low. As a result, you may suffer a loss on your investment.

We may fail to meet analyst expectations, or analysts may issue unfavorable commentary about us or our industry or downgrade our Class A common stock, which could cause the price of our Class A common stock to decline.

Our Class A common stock is traded publicly, and various securities analysts follow our company and issue reports on us. These reports include information about our historical financial results as well as the analysts’ estimates of our future performance. The analysts’ estimates are based upon their own independent opinions and may be different from our own estimates or expectations. If our operating results are below the estimates or expectations of public market analysts and investors, the trading price of our Class A common stock could decline. In addition, one or more analysts could cease to cover our company, which could cause us to lose visibility in the market, and one or more analysts could downgrade our Class A common stock or issue other negative commentary about our company or our industry. As a result of one or more of these factors, the trading price of our Class A common stock could decline.

A new 1% U.S. federal excise tax could be imposed on us if we were to undertake redemptions or certain other transactions.

On August 16, 2022, the Inflation Reduction Act of 2022 (the "IRA") was signed into federal law. The IRA provides for, among other things, a new U.S. federal 1% excise tax on certain repurchases (including redemptions) of stock by publicly traded U.S. corporations and certain other persons (a "covered corporation"). Because we are a Delaware corporation and our securities are trading on the Nasdaq, we are a "covered corporation" for this purpose. The excise tax is imposed on the repurchasing corporation itself, not its stockholders from which shares are repurchased. The amount of the excise tax is generally 1% of the fair market value of the shares repurchased at the time of the repurchase. However, for purposes of calculating the excise tax, repurchasing corporations are permitted to net the fair market value of certain new stock issuances against the fair market value of stock repurchases during the same taxable year. In addition, certain exceptions apply to the excise tax. The U.S. Department of Treasury has been given authority to provide regulations and other guidance to carry out, and prevent the abuse or avoidance of the excise tax. The IRA applies only to repurchases that occur after December 31, 2022. If we were to conduct repurchases of our stock or other transactions covered by the excise tax described above, we could potentially be subject to this excise tax, which could increase our costs and adversely affect our operating results.

Failure to comply with anti-corruption and anti-bribery laws could result in fines, criminal penalties and materially adversely affect our business, financial condition and results of operations.

A significant risk resulting from our global operations is compliance with a wide variety of U.S. federal and state and non-U.S. laws, regulations and policies, including laws related to anti-corruption, anti-bribery and laundering. The FCPA, the U.K. Bribery Act of 2010 and similar anti-corruption and anti-bribery laws in other jurisdictions generally prohibit companies, their officers, directors, employees and third-party intermediaries, business partners, and agents from making improper payments or other improper things of value to government officials or other persons. There has been an increase in anti-bribery and anti-corruption law enforcement activity in recent years, with more frequent and aggressive investigations and enforcement proceedings by both the U.S. Department of Justice and the SEC, increased enforcement activity by non-U.S. regulators, and increases in criminal and civil proceedings brought against companies and individuals. We operate in parts of the world that are considered high-risk from an anti-bribery and anti-corruption perspective, and strict compliance with anti-bribery and anti-corruption laws may conflict with local customs and practices. We cannot assure you that our internal controls, policies and procedures will protect us from improper conduct by our officers, directors, employees, third-party intermediaries, business partners or agents. To the extent that we learn that any of these parties do not adhere to our internal control policies, we are committed to taking appropriate remedial action. In the event that we believe or have reason to believe that any such party has or may have violated such laws, we may be required to investigate or have outside counsel investigate the relevant facts and circumstances, and detecting, investigating and resolving actual or alleged violations can be expensive and require a significant diversion of time, resources and attention from senior management. Any violation of U.S. federal and state and non-U.S. anti-bribery and anti-corruption laws, regulations and policies could result in substantial fines, sanctions, civil or criminal penalties, and curtailment of operations in the U.S. or other applicable jurisdictions. In addition, actual or alleged violations could damage our reputation and ability to do business. Any of the foregoing could materially adversely affect our business, financial condition and results of operations.

A failure to comply with laws and regulations relating to privacy and the protection of data relating to individuals may result in negative publicity, claims, investigations and litigation, and adversely affect our financial performance.

We are subject to laws, rules, and regulations in the United States, the European Union, and other jurisdictions relating to the collection, use, and security of personal information and data. Such data privacy laws, regulations, and other obligations may require us to change our business practices and may negatively impact our ability to expand our business and pursue business opportunities. We may incur significant expenses to comply with the laws, regulations and other obligations that apply to us. Additionally, the privacy- and data protection-related laws, rules, and regulations applicable to us are subject to significant change. Several jurisdictions have passed new laws and regulations in this area, and other jurisdictions are considering imposing additional restrictions.

For example, our operations are subject to the GDPR, which imposes data privacy and security requirements on companies doing business in the European Union, including: providing detailed disclosures about how personal data is collected and processed; demonstrating an appropriate legal basis; granted new rights for data subjects in regard to their personal data; and imposing limitations on retention of personal data; and maintaining a record of data processing. Each of the GDPR and the UK data protection regime can result in fines up to the greater of EUR 20 million or £17 million, as applicable, or 4% of total global annual turnover. We are also subject to European Union rules with respect to cross-border transfers of personal data out of the EEA and the United Kingdom. Recent legal developments in Europe have created complexity and uncertainty regarding transfers of personal information from the EEA and the United Kingdom to the United States. These recent developments may require us to review and amend the legal mechanisms by which we make and/or receive personal data transfers to/in the U.S. The CCPA, which went into effect on January 1, 2020, imposes similar requirements on companies handling data of California residents and creates a new and potentially severe statutory damages framework for (i) violations of the CCPA and (ii) businesses that fail to implement reasonable security procedures and practices to prevent data breaches. Additionally, the California Privacy Rights Act (the “CPRA”), imposes additional data protection obligations on companies doing business in California, including additional consumer rights processes, limitations on data uses, new audit requirements for higher risk data, and opt outs for certain uses of sensitive data. It will also create a new California data protection agency authorized to issue substantive regulations and could result in increased privacy and information security enforcement. The majority of the provisions went into effect on January 1, 2023, and additional compliance investment and potential business process changes may be required.

Privacy and data protection-related laws and regulations also may be interpreted and enforced inconsistently over time and from jurisdiction to jurisdiction. In addition to government regulation, privacy advocates and industry groups may propose new and different self-regulatory standards that either legally or contractually apply to us. One example of such self-regulatory standards to which we may be contractually bound is the Payment Card Industry Data Security Standard, or PCI DSS. Though we currently use third-party vendors to process and store credit card data in connection with our e-commerce business, to the extent we process or store such data ourselves in the future, we may be subject to various aspects of the PCI DSS, and fines, penalties, and a loss of the ability to process credit card payments could result from any failure to comply with the PCI DSS. Any actual or perceived inability to comply with applicable privacy or data protection laws, regulations, or other obligations could result in significant cost and liability, litigation or governmental investigations, damage our reputation, and adversely affect our business.

Item 2. Unregistered Sales of Equity Securities, Use of Proceeds, and Issuer Purchases of Equity Securities

None.

Item 5. Other Information

During the three months ended June 30, 2023, no director or officer of the Company adopted or terminated a “Rule 10b5-1 trading arrangement” or “non-Rule 10b5-1 trading arrangement,” as each term is defined in Item 408(a) of Regulation S-K.

Item 6. Exhibits

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed/ Furnished Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation of Funko, Inc.	S-8	333-221390	4.1	11/7/2017	
3.2	Certificate of Amendment to Amended and Restated Certificate of Incorporation of Funko, Inc.					*
3.3	Amended and Restated Bylaws of Funko, Inc.	S-8	333-221390	4.2	11/7/2017	
10.1	Letter between the Company and Michael Lunsford, dated July 13, 2023	8-K	001-38274	10.1	7/18/2023	
10.2	Letter between the Company and Brian Mariotti, dated July 13, 2023	8-K	001-38274	10.2	7/18/2023	
31.1	Certification of Interim Chief Executive Officer pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended.					*
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934, as amended.					*
32.1	Certification of Interim Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					**
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					**
101.INS	Inline XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.					*
101.SCH	Inline XBRL Taxonomy Extension Schema Document.					*

101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.	*
101.DEF	Inline XBRL Taxonomy Definition Linkbase Document.	*
101.LAB	Inline XBRL Taxonomy Label Linkbase Document.	*
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.	*
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101).	

* Filed herewith
** Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FUNKO, INC.
(Registrant)

Date: August 3, 2023	By:	/s/ Steve Nave
		Steve Nave
		Chief Financial Officer and Chief Operating Officer (Principal Financial Officer)

CERTIFICATE OF AMENDMENT

TO

AMENDED AND RESTATED CERTIFICATE OF INCORPORATION

OF

FUNKO, INC.

Pursuant to Section 242 of the
General Corporation Law of the State of Delaware

Funko, Inc., a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware (the "Corporation"), does hereby certify as follows:

FIRST: That, at a meeting of the Board of Directors of the Corporation, resolutions were duly adopted recommending and declaring advisable that the Amended and Restated Certificate of Incorporation of the Corporation be amended and that such amendments be submitted to the stockholders of the Corporation for their consideration, as follows:

RESOLVED, that Section 14.3 of the Amended and Restated Certificate of Incorporation of the Corporation, as amended and/or restated to date, be amended and restated in its entirety to read as follows:

Section 14.3 Definitions. As used in this Amended and Restated Certificate of Incorporation, the following terms shall have the following meaning:

a. "ACON" means ACON Funko Investors, L.L.C., a Delaware limited liability company.

b. "ACON Related Parties" means, collectively, (i) ACON, (ii) ACON Funko Investors Holdings 1, L.L.C., a Delaware limited liability company, (iii) ACON Funko Investors Holdings 2, L.L.C., a Delaware limited liability company, (iv) ACON Funko Investors Holdings 3, L.L.C., a Delaware limited liability company and (v) each of their respective Permitted Transferees.

c. "Affiliate" means a Person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, another Person.

d. "Associate," when used to indicate a relationship with any Person, means: (i) any corporation, partnership, unincorporated association or other entity of which such Person is a director, officer or partner or is, directly or indirectly, the owner of 20% or more of any class of shares of voting stock of the Corporation; (ii) any trust or other estate in which such Person has at least a 20% beneficial interest or as to which such Person serves as trustee or in a similar fiduciary capacity; and (iii) any relative or spouse of such Person, or any relative of such spouse, who has the same residence as such Person.

e. "Business Combination" means (i) any merger or consolidation of the Corporation or any direct or indirect majority-owned subsidiary of the Corporation with the Interested Stockholder or (ii) any sale, lease, exchange, mortgage, pledge, transfer or other disposition (in one transaction or a series of transactions), except proportionately as a stockholder of the Corporation, to or with the Interested Stockholder, whether as part of a dissolution or otherwise, of assets of the Corporation or of any direct or indirect majority-owned subsidiary of the Corporation which assets have an aggregate market value equal to ten percent (10%) or more of either the aggregate market value of all the assets of the Corporation determined on a consolidated basis or the aggregate market value of all the outstanding shares of capital stock of the Corporation.

f. "Fundamental" means Fundamental Capital and Funko International.

g. "Fundamental Capital" means Fundamental Capital, LLC, a Delaware limited liability company.

h. "Fundamental Related Parties" means Fundamental Capital and Funko International together with each of their Permitted Transferees.

i. "Funko International" means Funko International, LLC, a Delaware limited liability company.

j. "Interested Stockholder" means any Person (other than the Corporation and any direct or indirect majority-owned subsidiary of the Corporation, including, without limitation, the Blockers (as defined in the LLC Agreement)) that (i) is the owner of fifteen percent (15%) or more of the outstanding shares of capital stock of the Corporation that are entitled to vote, or (ii) is an Affiliate of the Corporation and was the owner of fifteen percent (15%) or more of the outstanding shares of capital stock of the Corporation that are entitled to vote at any time within the three-year period immediately prior to the date on which it is sought to be determined whether such Person is an Interested Stockholder, and the Affiliates and Associates of such Person. Notwithstanding anything in this Article XIV to the contrary, the term "Interested Stockholder" shall not include: (x) the TCG Related Parties or any of their Affiliates or Associates, including any investment funds managed, directly or indirectly, by TCG or any other Person with whom any of the foregoing are acting as a group or in concert for the purpose of acquiring, holding, voting or disposing of shares of capital stock of the Corporation or (y) any Person who acquires voting stock of the Corporation directly from a TCG Related Party, and excluding, for the avoidance of doubt, any Person who acquires voting stock of the Corporation through a broker's transaction executed on any securities exchange or other over-the-counter market or pursuant to an underwritten public offering.

k. "Person" means any individual, corporation, partnership, unincorporated association or other entity.

l. "TCG" means TCG 3.0 Fuji, LP, a Delaware limited partnership.

m. "TCG Related Parties" means, collectively, (i) TCG and (ii) any Affiliate of TCG to which TCG transfers Class A Common Stock.

RESOLVED, that Article XI of the Amended and Restated Certificate of Incorporation of the Corporation, as amended and/or restated to date, be amended and restated in its entirety to read as follows:

ARTICLE XI.

The Corporation is authorized to indemnify, and to advance expenses to, each current or former Director, officer, employee or agent of the Corporation to the fullest extent permitted by Section 145 of the DGCL. To the fullest extent permitted by the DGCL, no Director or officer shall be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director or officer, as applicable. No amendment to, or modification or repeal of, this Article XI shall adversely affect any right or protection of a Director or of any officer, employee or agent of the Corporation existing hereunder with respect to any act or omission occurring prior to such amendment, modification or repeal.

SECOND: That the aforesaid amendments were duly adopted by the stockholders of the Corporation at the annual meeting of stockholders of the Corporation held on June 13, 2023.

THIRD: That, the aforesaid amendments were duly adopted in accordance with the applicable provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the Corporation has caused this Certificate of Amendment to be signed by its Chief Legal Officer and Secretary on this 15th day of June, 2023.

FUNKO, INC.

By: /s/ Tracy D. Daw
Tracy D. Daw
Chief Legal Officer and Secretary

EXHIBIT 31.1

CERTIFICATION

I, Michael Lunsford, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Funko, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2023

/s/ Michael Lunsford

Michael Lunsford
Interim Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Steve Nave, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Funko, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 3, 2023

/s/ Steve Nave

Steve Nave
Chief Financial Officer and Chief Operating Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350

In connection with this Quarterly Report on Form 10-Q of Funko, Inc. (the “Company”) for the period ended June 30, 2023 (the “Report”), I, Michael Lunsford, Interim Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 3, 2023	/s/ Michael Lunsford
	Michael Lunsford
	Interim Chief Executive Officer

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350

In connection with this Quarterly Report on Form 10-Q of Funko, Inc. (the “Company”) for the period ended June 30, 2023 (the “Report”), I, Steve Nave, Chief Financial Officer and Chief Operating Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 3, 2023

/s/ Steve Nave

Steve Nave

Chief Financial Officer and Chief Operating Officer