



Interim Report
September 28, 1985

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**Coleco
Industries,
Inc.**

COLECO

To Our Stockholders:

Sales and earnings for the third quarter and nine months ended September 28, 1985 were greater than those for any prior quarter or nine month period in Coleco's history.

Sales for the third quarter were \$242 million, an increase of 33% over sales of \$181.3 million for the year ago quarter. Earnings totaled \$23.2 million or \$1.40 per share, excluding the extraordinary credit of \$3.6 million from utilization of tax loss carryforwards, and net earnings were \$26.8 million or \$1.61 per share, including the credit. The Company's remaining tax loss carryforwards were fully utilized during the third quarter. Net earnings for the year ago quarter were \$3.8 million or \$.23 per share.

Sales for the first nine months totaled \$624 million, an increase of 17% over sales of \$534 million for the first nine months of 1984. Earnings were \$60.1 million or \$3.64 per share, excluding the extraordinary credit of \$18.7 million from utilization of tax loss carryforwards, and net earnings were \$78.8 million or \$4.77 per share, including the credit. Net earnings for the first nine months of 1984 were \$13.4 million or \$.82 per share.

All of the Company's *Adam* inventory has been sold, and related accounts receivable of \$18.3 million represent the only remaining *Adam* asset on the Company's books at the end of the third quarter.

A large portion of the remaining *ColecoVision* inventory was sold in the third quarter, and orders have been received calling for shipment of the balance by year-end. *ColecoVision* related assets at the end of the third quarter totaled \$12.9 million.

Operating results for 1985 include specific charges of approximately \$20 million for the third quarter and approximately \$35 million for the nine months related to *ColecoVision* and, to a lesser extent, *Adam*. As a result, the Company believes there should be no additional charges incurred in connection with *Adam* or *ColecoVision* in the future.

The record operating performance for the quarter and nine months has substantially strengthened Coleco's balance sheet. In the past 12 months, Coleco repaid its entire short-term bank debt of \$161 million and completed the third quarter with \$23 million in cash and equivalents.

Inventories of \$45.6 million at the end of the third quarter were significantly lower than the year-end 1984 level of \$86.5 million. Working capital totaled nearly \$200 million and the current ratio was 2.6 to 1, compared with \$81.3 million and

1.3 to 1 at year-end 1984. Stockholders' equity increased to \$92.8 million, compared with \$10.5 million at the end of 1984.

For the first nine months of 1985, sales of *Cabbage Patch Kids* products exceeded \$475 million. The new *Cabbage Patch Kids* Twins, World Travelers and Show Ponies have received an excellent consumer response, and we believe that sales of the *Cabbage Patch Kids* line for 1985 will exceed last year's level of \$540 million.

As previously announced, Coleco has signed a licensing agreement for the exclusive worldwide rights to manufacture and market a line of *Rambo* toy products, including articulated action figures, action figure accessories and other play items. The Company has scheduled its major *Rambo* product launch for Spring 1986, to coincide with the expected airing of an animated *Rambo* TV series.

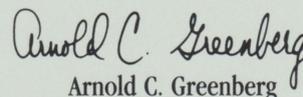
In September Coleco and Original Appalachian Artworks announced the signing of an exclusive licensing agreement for the *Furskins* property. The nine year agreement provides for Coleco's production and mass marketing of *Furskins* bears and accessories and also extends to other product categories, including preschool and infants' toys.

Created by Xavier Roberts, the originator of the *Cabbage Patch Kids*, *Furskins* bears have soft sculptured bodies and are dressed in distinctive country clothing. Roberts' first four *Furskins* have been an outstanding success in gift and specialty stores since their introduction earlier this year.

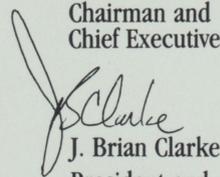
Coleco's *Furskins* will be smaller-sized bears styled after Roberts' originals. The Company expects to begin shipments in the spring of 1986.

Both the *Rambo* and *Furskins* licenses should enable the Company to participate in the success of these attractive properties and will also provide a basis for Coleco's expansion into major new toy product categories in 1986 and thereafter.

We expect Coleco's earnings recovery to continue through the balance of the year, resulting in a further strengthening of the Company's already much improved financial condition.



Arnold C. Greenberg
Chairman and
Chief Executive Officer



J. Brian Clarke
President and
Chief Operating Officer

October 17, 1985

CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

	Three Months Ended		Nine Months Ended	
	Sept. 28 1985	Sept. 29 1984	Sept. 28 1985	Sept. 29 1984
	(In Thousands)			
Net Sales	\$241,976	\$181,268	\$624,024	\$533,978
Costs and Expenses:				
Cost of Goods Sold	132,902	105,614	327,519	342,848
Selling and Administrative Expenses	69,541	58,745	187,799	142,473
Interest Expense	6,267	10,658	21,150	28,312
	<u>208,710</u>	<u>175,017</u>	<u>536,468</u>	<u>513,633</u>
Earnings Before Income Taxes	33,266	6,251	87,556	20,345
Income Tax Provision	10,044	2,473	27,478	6,988
Earnings Before Extraordinary Credit	23,222	3,778	60,078	13,357
Utilization of Tax Loss Carryforwards	3,579		18,700	
Net Earnings	<u>\$ 26,801</u>	<u>\$ 3,778</u>	<u>\$ 78,778</u>	<u>\$ 13,357</u>
Per Share Results:				
Primary:				
Earnings Before Extraordinary Credit	\$ 1.40	\$.23	\$ 3.64	\$.82
Utilization of Tax Loss Carryforwards21		1.13	
Net Earnings	<u>\$ 1.61</u>	<u>\$.23</u>	<u>\$ 4.77</u>	<u>\$.82</u>
Fully Diluted:				
Earnings Before Extraordinary Credit	\$ 1.08	\$.23	\$ 2.96	\$.82
Utilization of Tax Loss Carryforwards10		.88	
Net Earnings	<u>\$ 1.18</u>	<u>\$.23</u>	<u>\$ 3.84</u>	<u>\$.82</u>
Average Shares Outstanding:				
Primary	16,660	16,292	16,510	16,299
Fully Diluted	22,444	19,652	21,315	17,912

CONSOLIDATED BALANCE SHEET SUMMARY

(September 28, 1985 and September 29, 1984 are Unaudited)

	Sept. 28 1985	Dec. 31 1984	Sept. 29 1984
	(In Thousands)		
Assets:			
Cash and Equivalents	\$ 23,412	\$ 1,506	\$ 287
Accounts Receivable	214,694	206,712	243,279
Inventories	45,578	86,474	181,716
Other Current Assets	32,598	30,716	39,387
Total Current Assets	316,282	325,408	464,669
Property, Plant and Equipment (Net)	46,168	49,947	59,599
Other Assets	15,597	13,649	12,488
Total Assets	<u>\$378,047</u>	<u>\$389,004</u>	<u>\$536,756</u>
Liabilities and Stockholders' Equity:			
Notes Payable	\$	\$106,047	\$160,800
Accounts Payable	38,374	86,358	66,301
Other Current Liabilities	81,905	51,693	64,302
Total Current Liabilities	120,279	244,098	291,403
Long-Term Debt	23,602	28,594	23,871
Deferred Liabilities	7,149	700	13,298
Subordinated Debentures	52,422	52,359	52,340
Convertible Subordinated Debentures	81,749	52,751	52,658
Stockholders' Equity	92,846	10,502	103,186
Total Liabilities and Equity	<u>\$378,047</u>	<u>\$389,004</u>	<u>\$536,756</u>





**Coleco Industries, Inc.
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