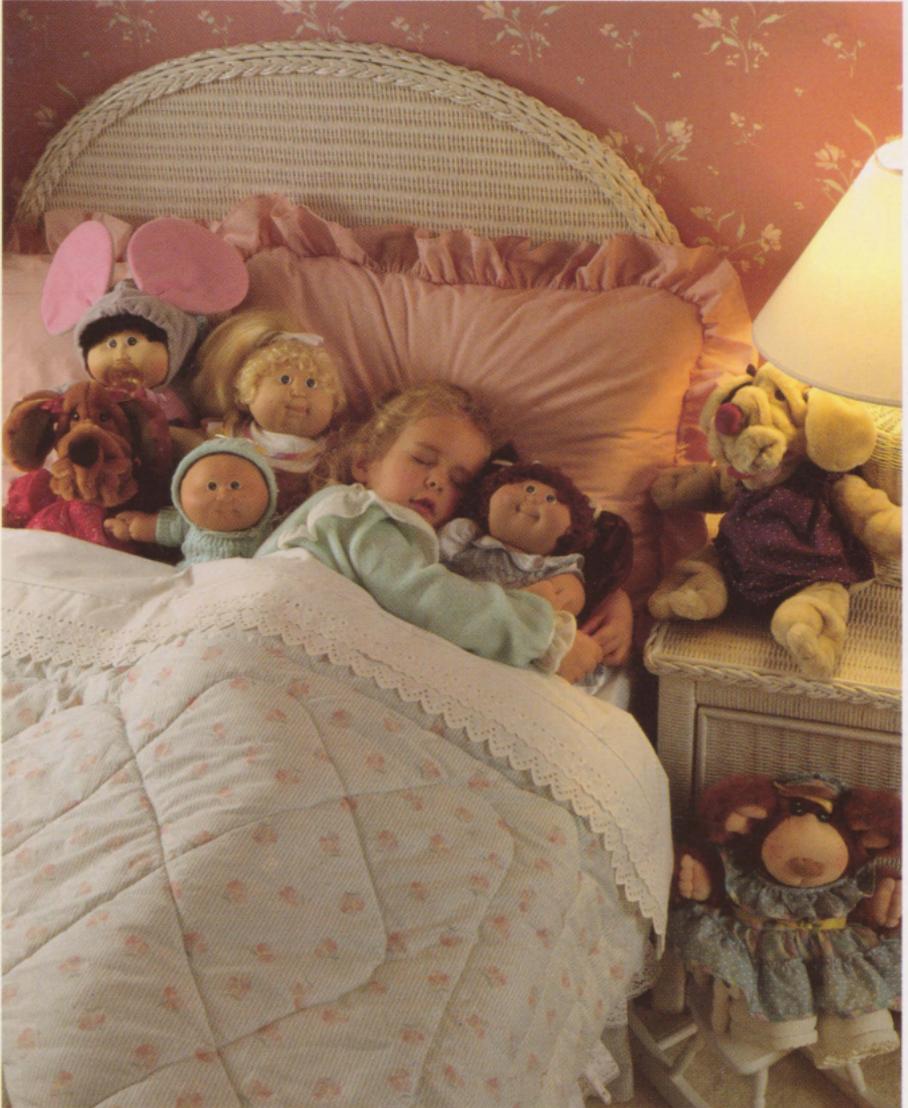


COLECO INDUSTRIES, INC.
Interim Report
March 29, 1986

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To Our Stockholders:

Sales for the quarter ended March 29, 1986 totaled \$113.4 million compared with sales of \$194.1 million for the year ago quarter.

Earnings were \$5.7 million or \$.34 per share on a primary basis, and \$.31 per share on a fully diluted basis. These compare with first quarter 1985 earnings of \$19.4 million or \$1.18 per share on a primary basis, and \$1.00 per share fully diluted, excluding the extraordinary \$8 million credit resulting from utilization of tax loss carryforwards.

Coleco's financial condition continued to strengthen during the first quarter, primarily as a result of the net proceeds of \$160 million from the sale of 15-year subordinated debentures. The Company's working capital increased to approximately \$340 million, more than three times the year ago level, and the current ratio increased to 4 to 1.

Coleco's product line was significantly expanded for 1986 with a number of new product introductions, but initial production limitations resulted in the shipment of only modest quantities of some of these new products in the first quarter. Due in part to the limited availability of new products, first quarter sales of *Cabbage Patch Kids* products were substantially lower than those for the year ago quarter. Although sales for *Cabbage Patch Kids* products are expected to be lower for the full year, it remains the largest selling product line in the toy industry.

During the first quarter we began shipping the *Furskins* bears created by Xavier Roberts, and the *Wrinkles* plush puppies. We also began limited shipments of new varieties of *Cabbage Patch Kids*, including *Kids* with the new "hand that holds" feature; *Circus Kids* dressed in colorful clown outfits; Baseball All Stars in the official uniforms of the major league teams and *Corn silk Kids* with silky hair that can be combed and styled. Initial consumer response to these products has been positive.

We will begin initial shipments of additional new products during the second quarter, such as the *Cabbage Patch Kids Young Astronauts* dressed in authentically detailed space suits, and the 12" *Cabbage Patch Kids Babies* with soft, cuddly bodies.

Shipments of our *Rambo* action figure and accessory line will also begin during the second quarter in coordination with the launch of the animated *Rambo* TV mini series. Initial shipments will also be made of electronic play and learn products, such as *My Talking Computer* and *Talking Teacher*.

In March Coleco and Original Appalachian Artworks announced an agreement which allows both companies to market the four original 22" *Furskins* bears created by Xavier Roberts. Coleco will distribute them nationally to its mass market toy accounts, and OAA will continue to distribute them to gift and specialty stores. A major TV advertising campaign will begin in early May in the top 20 retail markets.

During the first quarter Coleco completed the previously announced acquisition of Leisure Dynamics, Inc. and changed the name to Lakeside Industries, Inc. Lakeside is the name under which most of the subsidiary's major products are known.

The Company plans to continue to broaden the base of its business through acquisition and internal product development. Coleco's plans for its 1987 product line are well underway, and we look forward to the continued expansion of the Company's business into major toy industry product categories.

Arnold C. Greenberg
Chairman and
Chief Executive Officer

J. Brian Clarke
President and
Chief Operating Officer

April 18, 1986

CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

	Three Months Ended	
	March 29 1986	March 30 1985
	(In Thousands)	
Net Sales	<u>\$113,418</u>	<u>\$194,130</u>
Costs and Expenses:		
Cost of Goods Sold	51,484	105,110
Selling and Administrative Expenses	45,580	52,546
Interest Expense	5,920	8,057
	<u>102,984</u>	<u>165,713</u>
Earnings Before Income Taxes and Extraordinary Credit	10,434	28,417
Income Tax Provision	4,696	9,044
Earnings Before Extraordinary Credit	5,738	19,373
Utilization of Tax Loss Carryforwards		8,024
Net Earnings	<u>\$ 5,738</u>	<u>\$ 27,397</u>
Per Share Results:		
Primary:		
Earnings Before Extraordinary Credit	\$.34	\$ 1.18
Utilization of Tax Loss Carryforwards		.49
Net Earnings	<u>\$.34</u>	<u>\$ 1.67</u>
Fully Diluted:		
Earnings Before Extraordinary Credit	\$.31	\$ 1.00
Utilization of Tax Loss Carryforwards		.42
Net Earnings	<u>\$.31</u>	<u>\$ 1.42</u>
Average Shares Outstanding:		
Primary	17,120	16,384
Fully Diluted	22,448	20,405

CONSOLIDATED BALANCE SHEET SUMMARY

(March 29, 1986 and March 30, 1985 are Unaudited)

	March 29 1986	Dec. 31 1985	March 30 1985
	(In Thousands)		
Assets:			
Cash and Equivalents	\$178,057	\$110,734	\$ 672
Accounts Receivable (Net)	145,407	100,314	167,802
Inventories	51,926	40,672	83,861
Other Current Assets	68,915	53,893	31,638
Total Current Assets	444,305	305,613	283,973
Property, Plant and Equipment (Net)	53,409	49,912	49,221
Other Assets	55,557	42,016	11,099
Total Assets	<u>\$553,271</u>	<u>\$397,541</u>	<u>\$344,293</u>
Liabilities and Stockholders' Equity:			
Long-Term Debt — Current Portion	\$ 5,986	\$ 5,784	\$ 5,175
Notes Payable			64,382
Accounts Payable	30,659	35,382	50,721
Income Taxes Payable	2,802	15,060	1,120
Other Current Liabilities	64,710	62,069	51,601
Total Current Liabilities	104,157	118,295	172,999
Long-Term Debt	20,570	21,670	26,972
Deferred Liabilities	31,061	27,002	1,100
Subordinated Debentures	212,511	52,445	52,380
Convertible Subordinated Debentures	76,272	75,777	52,850
Stockholders' Equity	108,700	102,352	37,992
Total Liabilities and Equity	<u>\$553,271</u>	<u>\$397,541</u>	<u>\$344,293</u>





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