COLECO

Coleco Industries, Inc. 1983 Annual Report

About Coleco

Coleco Industries, Inc. is a leading manufacturer of family entertainment and recreation products in two major business segments — Consumer Electronics and Toys and Games. Coleco produces the *ADAM Family Computer System*, the *ColecoVision* video game system, and video game hardware and softwear for systems other than *ColecoVision*.

Coleco also markets the *Cabbage Patch Kids* dolls and related accessories, a broad variety of ride-on vehicles for children, swimming and wading pools, children's backyard play and furniture products, and traditional toys and games.

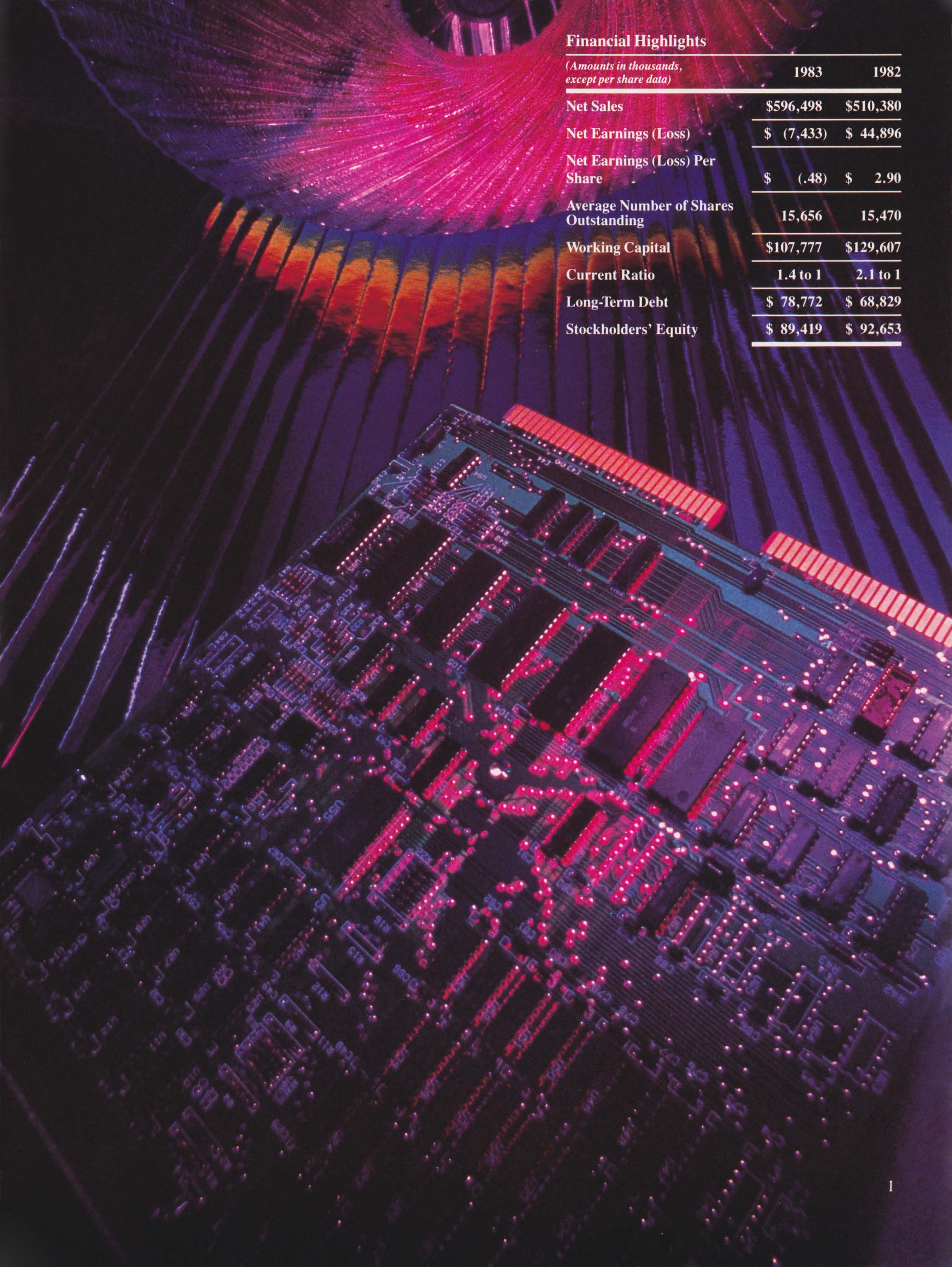
Manufacturing and distribution facilities in the United States and Canada now total nearly 2.6 million square feet, and average employment during 1983 was approximately 6,100 people.

Coleco is well positioned to maintain its product leadership in the Consumer Electronics and Toy and Game businesses, and believes that opportunity exists for substantial growth.

Contents

Financial Highlights

(Amounts in thousands, except per share data)	1983	1982
Net Sales	$596,498	$510,380
Net Earnings (Loss)	$ (7,433)	$ 44,896
Net Earnings (Loss) Per Share	$ (.48)	$ 2.90
Average Number of Shares Outstanding	15,656	15,470
Working Capital	$107,777	$129,607
Current Ratio	1.4 to 1	2.1 to 1
Long-Term Debt	$ 78,772	$ 68,829
Stockholders' Equity	$ 89,419	$ 92,653



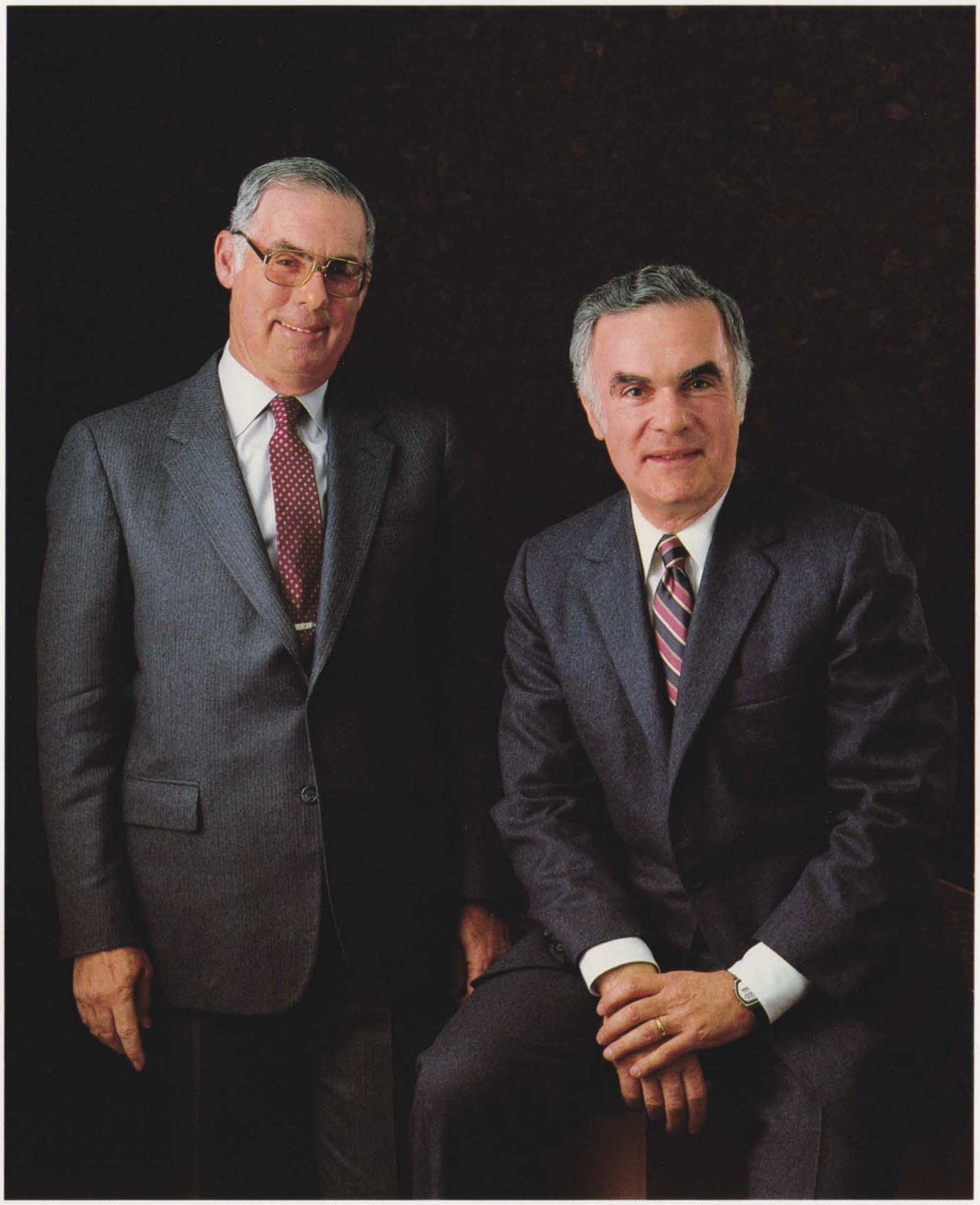
Management Letter

The year 1983 was one of extraordinary challenge — filled with both disappointment and success. The high costs and delay associated with bringing the *ADAM Family Computer System* to market resulted in a loss for the year. At the same time, the development and introduction of both *ADAM* and the *Cabbage Patch Kids* strengthened the strategic foundation of our product lines and should enable us to maintain an important position in both the Consumer Electronics and Toy and Game segments of our business in 1984 and beyond.

Operating Results

Sales for 1983 were a record \$596.5 million, an increase of 17% over the 1982 level of \$510.4 million. We incurred a loss of \$7.4 million for the year compared with a profit of \$44.9 million in 1982.

In order to increase manufacturing capacity, we spent \$34 million on capital asset additions last year, double the 1982 level. We expanded one of our Mayfield, New York facilities by 60,000 square feet and have leased a 138,000 square foot building in Tustin, California to serve as a West Coast assembly and distribution facility.



Leonard E. Greenberg
Chairman

Arnold C. Greenberg
President and
Chief Executive Officer

In July 1983 we sold our chemical subsidiary, Coastal Industries, Inc., and our above ground family swimming pool business. These operations produced sales of approximately $25 million in 1983 and were sold at prices slightly above book value.

International

Our Canadian subsidiary, Coleco (Canada) Limited, is now the leading toy company in Canada. On 1983 sales of $98.7 million, it had operating profits of $12.3 million compared with sales of $55.5 million and operating profits of $7.3 million in 1982. It is now also marketing the CBS toy line in Canada, including the Gabriel, Child Guidance and Ideal products.

In addition to marketing *ColecoVision* in overseas markets, CBS, Inc. is also marketing the *ADAM Family Computer System* and the *Cabbage Patch Kids* throughout much of the world. These Coleco products are now receiving increased worldwide attention and the international marketing aspects of our business are taking on considerably greater significance.

1983

The operating achievements of 1983 deserve to be noted. The Toy and Game segment of Coleco's business produced revenues of $192.6 million, 32% of total sales, and produced an operating profit of $17 million, compared with sales in 1982 of $136.8 million or 27% of total sales. The *Cabbage Patch Kids* products represented approximately 35% of this 1983 total, and with first year sales of over 3.2 million units, represented the most successful new doll introduction in the industry's history. A cultural phenomenon which generated worldwide attention, the *Cabbage Patch Kids* dolls were the most sought after item in 1983, with demand always exceeding the supply. With 2.5 million '*Kids* shipped since January 1, 1984, the worldwide demand continues unabated. The balance of the Toy and Game segment consists of ride-on vehicles, swimming and wading pools, children's backyard play and furniture products and traditional toys and games, all of which enjoyed modest growth in 1983.

In 1983 the Consumer Electronics segment of our business accounted for sales of $403.9 million, representing 68% of total sales, and produced an operating loss of $22.3 million, while in 1982 electronic sales were $373.5 million, 73% of the total.

Sales of the *ColecoVision* video game system and related components such as expansion modules and control accessories accounted for the largest portion of total electronic sales. The year's sales of 1.5 million *ColecoVision* units brought the installed base to over 2 million units worldwide.

Video game cartridge sales declined in 1983. While a larger quantity of *ColecoVision* cartridges were sold than in 1982, unit sales and average selling prices for our Atari and Mattel cartridges were lower than in the prior year. Sales of table top electronic arcade games declined in 1983 to about 1.1 million units from about 3 million units in 1982, and a further decline is expected in 1984.

Paradoxically, one of the most important accomplishments and also the cause of the greatest disappointment of 1983 was the introduction of the *ADAM Family Computer System*. Acknowledged by the industry as a revolutionary approach to home computer marketing, the costs and difficulties associated with bringing *ADAM* to market proved to be enormous. Start-up costs, overhead and manufacturing variances, research and development costs, warranty costs and reserves, advertising expenses, and many other charges including the costs of significant short-term borrowing, all incurred in anticipation of shipping a much higher volume of *ADAM* computers than we actually did resulted in a substantial fourth quarter loss. Product development expenses were $29.1 million in 1983 compared with $13.1 million in 1982 with the largest part associated with our Consumer Electronics segment.

1984

Coleco continues to be committed to the support and growth of its Consumer Electronics business and particularly the *ADAM Family Computer System*. The environment in which *ADAM* competes has undergone significant change this past year with Texas Instruments, Mattel, Timex and Milton Bradley discontinuing their home computer/video game operations. The improved competitive situation, coupled with the fact that *ADAM* remains unchallenged in value and performance, provides us with confidence that the opportunity for *ADAM's* success has merely been delayed, not denied. We believe that our investment and confidence in *ADAM* will be appropriately rewarded.

Early this year, we introduced a number of hardware peripherals and accessories that broaden the versatility and appeal of *ADAM*. We also announced the upcoming availability of a substantial number of *ADAM* software programs. Designed to meet the present and future needs of the family, the software line includes an appropriate balance of educational, entertainment and home information management programs as well as languages and programming aids. Significant licensing agreements have been signed with major software firms which permit Coleco to market a variety of applications software including the *CP/M* operating system and *Logo* language. Other agreements enable major software manufacturers to produce and market software for *ADAM* under their own names.

Quality problems associated with the early *ADAM* production units have received a disproportionate amount of media attention. We have corrected the problems found in early production units and have recently doubled *ADAM's* warranty from three to six months as a sign of our confidence in the quality and performance of *ADAM*.

The availability of a broad range of applications software and hardware peripherals beginning in the second quarter should further stimulate *ADAM* sales. *ADAM's* intrinsic value, utility, ease of operation and reliability should enable it to compete successfully in the home computer marketplace.

The *ColecoVision* video game system should continue to enjoy its prominent position in the stabilizing video game market, although at a lower level of sales. As a sophisticated video game system in itself and with the capability of being expanded into the *ADAM Family Computer System*, *ColecoVision* represents an appropriate purchase for the cost-conscious consumer seeking either an advanced video game system or the first step toward a home computer.

Coleco will continue to support *ColecoVision* by producing top quality entertainment and educational software, all of which can be utilized with the *ADAM Family Computer System*.

The *Cabbage Patch Kids* represented the marketing phenomenon of 1983 which generated an insatiable demand for the dolls. The extraordinary consumer interest has continued and is expected to reach even greater proportions in 1984. We believe revenues from this expanded line will be several times as great in 1984 as the $65 million level achieved in 1983.

As a result of Coleco's exclusive licensing agreement with Theodor Geisel, the author of the *Dr. Seuss* books, we are able to produce a variety of electronic and toy and game products incorporating his world famous characters. We are already making use of this valuable license in a number of product categories.

The toy and game part of our business has recently been the subject of significantly greater focus. The success of the *Cabbage Patch Kids* product line has confirmed our belief that there are very attractive opportunities available to us in the non-electronic segment of our business as well. We have strengthened our commitment by allocating more of Coleco's resources to this segment, which should result in profitable growth this year and in the years ahead.

While we are continuing our major commitment to the Consumer Electronics business, the rapid sales growth of our increasingly profitable Toy and Game business makes it likely that in 1984 we will achieve a more equal balance between the two segments than has existed in recent years. This should greatly facilitate the achievement of Coleco's profit objectives for 1984.

We have concluded amendments to our short-term loan agreements which take into account and waive certain year-end 1983 and first quarter 1984 covenants. These agreements should provide adequate resources for us to achieve our 1984 operating plan, which includes a return to profitability during the first six months of the year.

A Look Ahead

The problems associated with unusually rapid growth have been difficult to manage — not only for us, but for many of our competitors as well. Although we have not sustained the level of losses others have, the challenge of managing a business in which 75% of 1983 revenues come from products new since 1981 has not been easy.

Products with great consumer demand such as *ADAM* and the *Cabbage Patch Kids* pose a major challenge to any company because of pressures generated by the marketplace for high volume, quality production to be achieved as soon as possible. While we were very successful in responding to that challenge with the *Cabbage Patch Kids*, we were measurably less so with *ADAM*. Changes in organizational structure and senior management additions are strengthening our ability to execute our operating plans in a timely and cost effective manner. Toward this objective, we have and will continue to strengthen our senior management organization. The appointment of Charles Winterble as Group Vice President-Computer Products is another step in the process of putting in place an experienced management team that will provide expertise in an environment of increasingly effective operating controls.

As we look beyond 1984, we expect to continue the balance between the Consumer Electronics and Toy and Game segments of our business, and will address the challenges and opportunities of providing these diverse segments with the special attention each deserves.

Firmly committed to the home computer business, we believe that *ADAM* is the right home computer product for the family. We will intensify our efforts to develop and market appropriate hardware peripherals and satisfying software products. The extraordinary success of the *Cabbage Patch Kids* provides ample evidence that creative licensing applications have enormous profit potential, and that the toy and game business holds great opportunities for us.

We acknowledge with profound appreciation the support and patience of suppliers, customers, bankers and stockholders. A source of great strength to us has been the intense commitment of our fellow employees to Coleco's success. The depth of that support provides us with the confidence that 1984 will be a year of progress and profitability — a year in which we can all share the satisfaction of important accomplishments.

Arnold C. Greenberg

Arnold C. Greenberg
President and
Chief Executive Officer

Leonard E. Greenberg

Leonard E. Greenberg
Chairman

April 2, 1984

Consumer Electronics

Coleco has been a leading manufacturer of consumer electronic products for family entertainment since 1976. In that year Coleco introduced *Telstar*, an unusually low-priced dedicated video game that proved to be the fastest selling new electronic product of the year. Coleco became an industry leader with its hand held electronic games, including *Electronic Quarterback*, the *Head-to-Head* series of sports games and *Quiz Wiz*. More recently, the Company marketed a line of particularly successful table top arcade games based on the most popular licensed arcade hits, including *Pac-Man* and *Donkey Kong*.

The Company is the manufacturer of the *ColecoVision* video game system and expansion modules which enable it to play all Atari *2600 VCS* compatible cartridges as well as race driving games. Advanced control accessories, like the *Super Action*

Controller and the Roller Controller Console, increase the player's ability to control game action. The *ADAM Family Computer Module* converts *ColecoVision* into the complete *ADAM Family Computer System*.

A large and growing library of software is available for *ColecoVision*, including licensed arcade, action, sports and driving games, and new early learning and self-improvement cartridges.

Coleco produces the *ADAM Family Computer System* — a complete, useful and simple-to-operate home computer that includes all the necessary hardware and software in one box.

Coleco is also marketing a number of *ADAM* hardware peripherals which expand the capabilities of the system, as well as a variety of *ADAM* accessories. An extensive line of *ADAM* software is becoming available, including educational programs, entertainment software and a variety of applications programs. (More on *ADAM* in the following pages.)

The Company also produces *Gemini* — an inexpensive video game system that plays all Atari *2600 VCS* compatible video game cartridges, and the *Kid Vid Voice Module*, which utilizes coordinated cartridges and cassettes that combine video action with licensed character voices and sound effects.

Coleco manufactures video game cartridges for the Atari *2600 VCS* and has marketed a number of licensed arcade games for Mattel's *Intellivision* as well.

The Company has expanded its electronic line to include the *Private Call* Phone, an innovatively designed and merchandised telephone directed to the teenage market. Featuring a programmable "photographic memory" which combines the ease of automatic dialing with the fun of a photo album, it comes in a stylish case that locks for privacy.

Coleco's practical utilization of state-of-the-art technology continues to produce useful, entertaining and affordable electronic products for the mass consumer market.

Toys and Games

Coleco has been a major manufacturer of a variety of toys and games for decades. Using the coin-operated arcade as a research lab to determine consumer preferences, Coleco has produced affordably priced air-action hockey and rod soccer games, pinball machines and pool tables for use in the home. Coleco's line has encompassed a variety of basic play products, including toy appliances, mechanical games, riding vehicles, plastic wading pools and a variety of other outdoor recreational products. Coleco's traditional application of well-known children's licenses to its toys and games contributes to their consumer appeal.

Last year, Coleco introduced the extraordinarily successful *Cabbage Patch Kids*, the first "one-of-a-kind" dolls to be mass produced. The "adoptable" *Cabbage Patch Kids* have soft sculptured bodies that make them unusually huggable, and distinctive characteristics that individualize them.

Coleco has expanded the *Cabbage Patch Kids* line to include infant *Cabbage Patch Kids Preemies*, *Wykoosa Valley 'Koosas* pets, and collectible 5″ *Cabbage Patch Kids Pin-Ups*. A complete line of high quality outfits are available for the *Cabbage Patch Kids*, as well as a broad range of related play accessories. (More on the *Cabbage Patch Kids* on the following pages.)

Coleco has introduced a line of licensed *Dr. Seuss* plush characters — quality reproductions of the universally known *Cat in the Hat*, *Horton the Elephant*, *Thidwick the Moose*, *Yertle the Turtle*, *Star-Bellied Sneetch*, *Lorax* and *Grinch*.

Coleco pioneered the plastic wading pool business in 1957 and now produces swimming pools up to 12 feet in diameter, water toys and inflatable accessories, as well as a complete line of children's backyard play and furniture products including plastic sandboxes, slides, picnic and play tables with chairs, and play houses. The licensed motifs of these products, featuring the *Care Bears*, *Smurfs* and *Cabbage Patch Kids*, encourage the coordination of complete backyard play environments.

Other toy products include *Colorforms* pre-school activity sets which maximize the play value of the well established brand, as well as doll strollers, carriages and coaches popularized by licensed characters such as *Strawberry Shortcake*, the *Smurfs* and the *Cabbage Patch Kids*.

Snow products, such as plastic coasters, sleds and toboggans are available, as are air-action hockey games and pool tables.

Coleco's extensive ride-on vehicle line is comprised of pre-school riders and pedal motorcycles, *Power Cycle* plastic tricycles, pedal cars and battery operated vehicles. Popular licenses including *Dr. Seuss*, *Sesame Street*, *Knight Rider*, *Cabbage Patch Kids*, *Smurfs*, *G.I. Joe* and others are integrated into the design and decoration of these products.

Coleco's implementation of its distinctive merchandising strategy continues to produce top quality, appealing toys and games with long lasting play value.

Marketing Orientation

"Now, at the dawn of the twenty-first century, high tech/high touch has truly come of age. Technology and our human potential are the two great challenges and adventures facing humankind today. The great lesson we must learn from the principle of high tech/high touch is a modern version of the ancient Greek ideal — *balance*.

We must learn to balance the material wonders of technology with the spiritual demands of our human nature."

Megatrends by John Naisbitt (Warner Books, 1982)


COLECO

"Hello, I'm ADAM.
I think like you do, so you don't have to think like a computer.
I can interact with you in words and graphics you understand."

ADAM

Left: A Coleco technician inspects the *ADAM SmartWRITER* printer.

Above: Coleco's graphic artists complete the design of the self-merchandising *ADAM* package.

At the Consumer Electronics Show in June 1983, Coleco introduced the *ADAM Family Computer System*. Immediately recognized as a new direction in home computer marketing, *ADAM* generated extraordinary media coverage and consumer interest.

Unlike most competitive products in the same price range, *ADAM* is a complete, useful and easy-to-operate home computer system that provides the consumer with all the necessary capacity, peripheral hardware and software. *ADAM* addresses in a unique way the primary uses for the home computer: entertainment, information management and education.

ADAM's design reflects almost two years of extensive planning and development. *ADAM* was created at the same time as *ColecoVision*, thereby making it possible for the advanced video game system to become a powerful home computer, demonstrating the obvious advantages of a system that is both expandable and upwardly compatible.

ADAM is comprised of an 80K RAM memory console with a built-in digital data drive, a letter quality daisy wheel printer and a professionally styled keyboard. The word processing program is built in, and two additional pieces of software, *SmartBASIC* and *Buck Rogers Planet of Zoom* are included.

ADAM is available in two models — as the complete Family Computer System with the *ColecoVision* video game system built in, and as the Family Computer Module, which enables the *ColecoVision* owner to expand his video game system to the complete Family Computer System.

ADAM has been produced at Coleco's upstate New York manufacturing facilities. The Company originally planned to begin shipments of *ADAM* in late August or early September and to ship approximately 500,000 units by year-end. However, delays of various kinds caused the initial shipments to be postponed about six weeks, and Coleco began revising downward its estimated production for 1983.

By the end of the year, Coleco had developed the capacity to maintain high volume production of *ADAM*. However, as a result of this accomplishment coming approximately 60 to 90 days later than originally planned, total shipments of *ADAM* in 1983 were limited to around 95,000 units.

Some early production units caused users to experience various difficulties, many of which resulted from instruction manuals which did not offer the first time user adequate assistance. *ADAM's* early production problems have been solved, and the units currently being produced meet the high standards of quality and performance expected by trade customers and consumers. Recently Coleco doubled *ADAM's* warranty to six months as a sign of confidence in its reliability. The Company's customer service department continues to offer *ADAM* purchasers appropriate operational assistance, and an ongoing survey of *ADAM* owners continues to reveal their high level of satisfaction with the system and their willingness to recommend it to others for purchase.

To ensure *ADAM* owners that the high quality and performance standards of *ADAM* will be maintained in use, Coleco and Honeywell Information Systems, Inc. have agreed to develop a nationwide network of *ADAM* service centers. Many centers are currently in operation, and others will be opened during the balance of the year.

At the January 1984 Consumer Electronics Show, Coleco announced a number of hardware peripherals for *ADAM* that broaden the versatility and appeal of the system. Introduced were a second digital data drive, a 5¼″ disk drive, a 64K memory expander which increases the memory capacity of the system to 144K RAM, and the *ADAMLink* telephone modem which enables users to receive and send data to information services such as CompuServe, The Source and Dow Jones.

Other new *ADAM* products include the *ADAM* accessory kit which contains a variety of supplies and the printer tractor feed which permits use of continuous feed fanfold paper.

Coleco also announced the upcoming availability of a substantial number of software programs for *ADAM*, designed to fulfill the needs of all members of the family.

The family learning category includes programs for children which incorporate the familiar *Dr. Seuss*, *Richard Scarry* and *Smurf* characters into educational and entertaining contexts, Homework Helper programs that provide tutorial assistance and Self-Improvement programs that help users improve their general knowledge skills.

The languages and programming aids category includes programs and tools that open new horizons to the *ADAM* user. Offered are *SmartLOGO*, an unusually simple to use, highly advanced language; Digital Research Inc.'s *CP/M* operating system for *ADAM;* and *SmartBASIC II*, an extended and enhanced Basic program.

The entertainment category features a broad range of licensed arcade and adventure games as well as the Best of Computer Software packages which contain two or three of the most popular software titles from the top computer software publishers.

The home information management category includes word, information and graphics processing programs designed to organize all the data in the home.

Many major independent software manufacturers are developing and marketing educational, entertainment and applications programs for *ADAM* under their own names. Their software support is indicative of the recognition *ADAM* has received as an important system in the home computer industry.

Coleco remains firmly committed to *ADAM* and will intensify its efforts to develop and market new and appropriate hardware peripherals and software products.

The Company will continue to support *ADAM* with an extensive consumer advertising campaign and with trade customer programs designed to maximize *ADAM's* sales potential.

Coleco sees the home computer industry as an opportunity that is just beginning to unfold, and is determined to develop a meaningful market position.

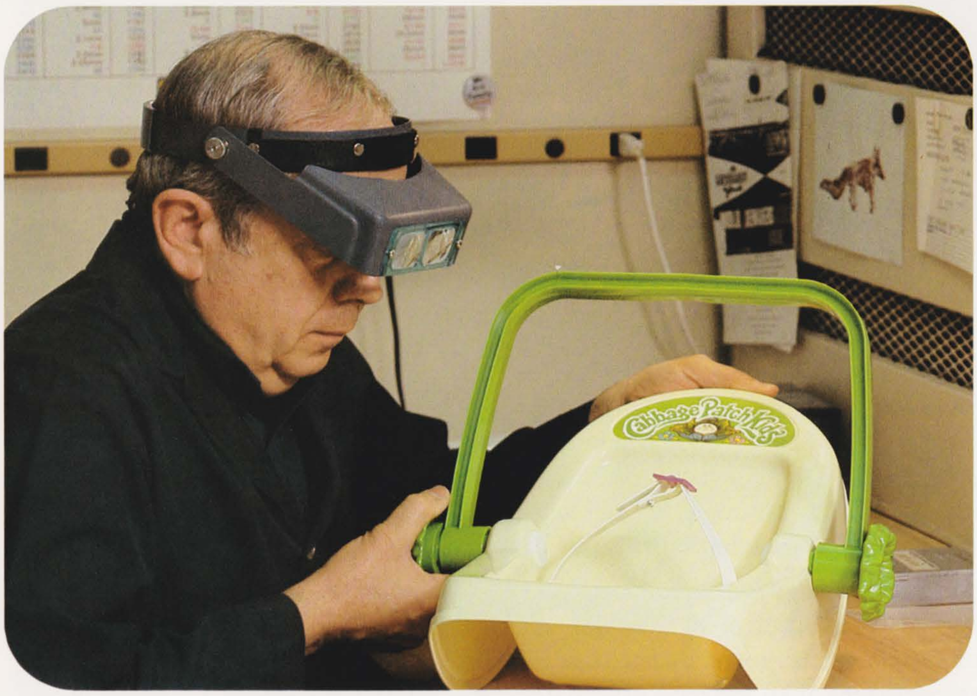
Right: The *ADAM Family Computer System* is complete in one box and easily taken home.


ADAM
THE COLECOVISION FAMILY COMPUTER SYSTEM
80K
EVERYTHING YOU NEED IN ONE PACKAGE!
Word Processing
Super Game Play
BASIC Programming
COLECO
PARKING
FIRE
LANE
TOW ZONE

**"I promise to love my Cabbage Patch Kid with all my heart.
I promise to be a good and kind parent.
I will always remember how special my Cabbage Patch Kid is to me."**

Cabbage Patch Kids™

Oath of Adoption



Left: A Coleco sculptor expertly details one of the *Cabbage Patch Kids* head molds.

Above: A Coleco model maker adjusts a prototype of the *Cabbage Patch Kids* Rocker/Carrier.

Several years ago, a Georgian artisan by the name of Xavier Roberts began creating soft sculptured little people that were each one-of-a-kind. He developed a legend which told of their origination in an enchanted cabbage patch, and appropriately named his handcrafted originals the *Cabbage Patch Kids*. Roberts' creations were so special to him that he initiated a program through which they would be "adopted" rather than merely purchased.

The popularity of Roberts' original *Cabbage Patch Kids* grew to such proportions that he opened *Babyland General Hospital* in Cleveland, Georgia. There, his staff of "doctors" and "nurses" bring the *'Kids* forth from the cabbage patch and care for them until they are adopted. Roberts has successfully placed over 350,000 original *Cabbage Patch Kids* at adoption fees of $125 and up in the specialty market.

Coleco recognized the mass market potential of Roberts' unusual concept and entered into a licensing agreement with his company, Original Appalachian Artworks, Inc. and its exclusive licensing agent, Schlaifer Nance & Company. Coleco became a licensee with the exclusive worldwide right to produce mass market versions of the *Cabbage Patch Kids*, and also became a co-developer of the *Cabbage Patch Kids* licensing program.

Coleco's *Cabbage Patch Kids* dolls were designed to be true to the originals. They have endearingly homely faces, 16″ soft sculptured bodies with outstretched arms, detailed fingers and toes, belly buttons and cute "bottoms" showing the birthmark signature of Xavier Roberts. Variations in facial characteristics, hair color and style, eye color, skin tone, freckles and dimples differentiate them. Available as girls, boys and bald *'Kids*, each has a double name and comes wearing a disposable diaper and toddler outfit. In keeping with Roberts' adoption concept, each *Cabbage Patch Kid* comes with a birth certificate and adoption papers.

In June 1983, Coleco began shipping the *Cabbage Patch Kids* to major markets and commenced its advertising campaign and public relations program. During the summer, an unusually high degree of consumer interest developed, and retailers began to report complete sellouts of their *Cabbage Patch Kids* inventory.

Demand escalated in the fall, with consumers lining up hundreds deep in front of stores hours in advance of their opening, hoping to purchase one of the *Cabbage Patch Kids*. Long waiting lists were developed at the retail level, and Coleco was bombarded with thousands of consumer calls and letters. In an attempt to avoid generating additional consumer interest and demand, Coleco suspended TV advertising for the *'Kids*.

With the holiday season approaching, Coleco chartered 747's to fly the *Cabbage Patch Kids* from the Orient. Upon arrival, they were expedited to the Company's facilities in Tustin, California and upstate New York for quality inspection and final packaging. Shipments of approximately 200,000 *Cabbage Patch Kids* per week were made during the final months of 1983.

Intensely determined to acquire a *Cabbage Patch Kids* doll, many consumers resorted to extreme behavior. Newspaper want ads were placed, exorbitant bids were made at auctions and interstate and international shopping trips ensued.

Concurrently, media attention increased dramatically, and the *Cabbage Patch Kids* were discussed on national news and talk shows almost daily. The Wall Street Journal editorialized them, Newsweek featured them on the cover of their December 12, 1983 issue and Time Magazine printed a full *Cabbage Patch Kids* feature. First Lady Nancy Reagan gave them national status with her selection of them as special gifts.

By the end of the year, Coleco had shipped over 3.2 million *Cabbage Patch Kids*, thereby breaking all industry records for first-year doll sales.

Marketers, reporters and sociologists have attempted to understand the remarkable popularity of the *'Kids* and the cultural phenomenon that they represent. Their observations lead them to the conclusion that the expressed vulnerability of the *Cabbage Patch Kids* is the very essence of their appeal. Unlike fashion dolls, the *Cabbage Patch Kids* are not designed to be beautiful or perfect, nor to represent models for comparison. They are imperfect and different, like all of humanity.

They have waif-like faces and chubby little bodies with outstretched arms. These features elicit strong emotional responses and feelings of nurturance. The *Cabbage Patch Kids* provide an appropriate vehicle for the release of unabashed love and affection.

The *Cabbage Patch Kids* provide an interesting mixture of fantasy and reality. While realistic in their toddler-like appearance, the *Cabbage Patch Kids* are devoid of moving parts that can often inhibit the creative play of children.

With the *Cabbage Patch Kids*, the child has the opportunity to have a doll that is uniquely his or her own. This special experience, unusual in today's world of mass production, causes a very meaningful bond to be developed between the child and the doll.

This bond is further strengthened by the adoption process, in which the child promises to be "a good and kind parent" to the *Cabbage Patch Kid*. This expression of commitment contributes to the longevity of the relationship.

The *Cabbage Patch Kids* are adopted by "children of all ages" — youngsters, teens, young marrieds and senior citizens alike and have essentially broken down the age and sex barrier traditionally associated with dolls. Significantly, young boys have reacted strongly to the male *Cabbage Patch Kids*, as they represent dolls they can both befriend and relate to in gender.

Building on the success of the *Cabbage Patch Kids*, Coleco announced a number of new *Cabbage Patch Kids* products and accessories at the 1984 Canadian and American Toy Fairs.

Introduced were infant *Cabbage Patch Kids Preemies* — resembling babies from birth to six months and available for adoption at an earlier age. Each *Preemie* is individualized and clothed in a finely detailed baby outfit.

The Company is also producing *Wykoosa Valley 'Koosas* — pets of an indefinable species. Each has a belly button, tail and wears an I.D. tag. The *'Koosas* come with registration papers to be filed with the *'Koosas Kennel Association*.

Also available are the *Cabbage Patch Kids Pin-Ups* — 5″ collectible *'Kids* in soft framed play environments which stand or hang as decorative room accessories.

There are wardrobes for the *Cabbage Patch Kids*, including western outfits, sports uniforms, play clothes and specially designed actionwear which enables the *Cabbage Patch Kids* to be positioned in lifelike poses.

Coleco's *Cabbage Patch Kids* accessory line, including an umbrella stroller, rocker/carrier, snuggle close carrier and slumber bag has been expanded with a table mate feeding chair, musical swing, 3-in-1 pram and a travel bag.

Coleco is a co-developer of the *Cabbage Patch Kids* licensing program, through which other major manufacturers are licensed to produce *Cabbage Patch Kids* products. Nearly 80 such licenses have been granted by Schlaifer Nance & Company, with many of the licensees already marketing their products.

Both through CBS, Inc., and Coleco's distributors in various countries, the *Cabbage Patch Kids* are being actively marketed on a worldwide basis and have generated exceptional interest.

While the 1983 success of the *Cabbage Patch Kids* can only be described as phenomenal, Coleco believes that the appeal of this extraordinary concept has only begun to be developed.

Right: A Newsweek cover story focuses on the *Cabbage Patch Kids* phenomenon.

Newsweek

December 12, 1983 / $1.50

A U.S. CLASH WITH SYRIA

What a Doll!

The Cabbage Patch Craze

Marketing a Christmas Fad

19

Coleco's product designers utilize "mini-kins" in the human engineering of ride-on vehicles.

Coleco Industries, Inc.

Consolidated Statement of Operations

Years Ended December 31, 1983, 1982 and 1981

(Amounts in thousands, except per share data)	1983	1982	1981
Net Sales	**$596,498**	$510,380	$178,031
Costs and Expenses:			
Cost of goods sold	**403,793**	279,840	115,172
Selling and administrative expenses	**197,959**	135,386	44,925
Interest expense	**19,595**	9,707	4,470
	621,347	424,933	164,567
Earnings (Loss) Before Income Taxes	**(24,849)**	85,447	13,464
Income Tax Provision (Benefit)	**(17,416)**	40,551	5,753
Net Earnings (Loss)	**$ (7,433)**	$ 44,896	$ 7,711
Net Earnings (Loss) Per Share	**$ (.48)**	$ 2.90	$ .51

The accompanying notes are an integral part of the financial statements.

Coleco Industries, Inc.

Consolidated Balance Sheet

December 31, 1983 and 1982

(Amounts in thousands)	**1983**	1982
Assets		
Current Assets:		
Cash and cash equivalents	**$ 5,931**	$ 52,474
Accounts receivable, less allowances of $42,549 and $55,441	**158,022**	107,803
Inventories	**164,664**	69,149
Income tax refund	**40,200**	
Other current assets	**38,273**	21,489
Total current assets	**407,090**	250,915
Property, Plant & Equipment, at cost less accumulated depreciation of $35,649 and $32,996	**58,183**	31,893
Other Assets	**12,259**	3,057
	$477,532	$285,865

The accompanying notes are an integral part of the financial statements.

	1983	1982
Liabilities and Stockholders' Equity		
Current Liabilities:		
Long-term debt-current portion	**$ 3,669**	$ 3,604
Notes payable	**166,420**	
Accounts payable	**81,385**	64,388
Income taxes payable	**2,732**	9,951
Accrued expenses	**45,107**	43,365
Total current liabilities	**299,313**	121,308
Long Term Debt	**26,485**	16,604
Deferred Income Taxes	**10,028**	3,075
Subordinated Debentures	**52,287**	52,225
Stockholders' Equity:		
Preferred stock — $1 par value, 300,000 shares authorized; no shares issued		
Common stock — $1 par value, 75,000,000 shares authorized; 1983 — 16,013,704 shares issued, 1982 — 15,297,704 shares issued	**16,014**	15,298
Capital in excess of par value	**10,035**	6,427
Retained earnings	**63,370**	70,928
Total stockholders' equity	**89,419**	92,653
	$477,532	$285,865

Coleco Industries, Inc.

Consolidated Statement of Stockholders' Equity

Years Ended December 31, 1983, 1982 and 1981

(Amounts in thousands)	Common Stock	Capital in Excess of Par Value	Retained Earnings
Balances at December 31, 1980	**$ 7,515**	$12,503	$19,165
Net earnings			7,711
Stock options exercised	**134**	439	
Balances at December 31, 1981	**7,649**	12,942	26,876
Net earnings			44,896
Two-for-one stock split	**7,649**	(7,649)	
Increase under long-term incentive plan		1,134	
Cumulative foreign currency translation adjustment			(844)
Balances at December 31, 1982	**15,298**	6,427	70,928
Net earnings (loss)			(7,433)
Issuance of common stock for subscriptions	**716**	(716)	
Increase under long-term incentive plan		4,324	
Foreign currency translation adjustment			(125)
Balances at December 31, 1983	**$16,014**	$10,035	$63,370

The accompanying notes are an integral part of the financial statements.

Consolidated Statement of Changes in Financial Position

(Amounts in thousands)	1983	1982	1981
	Years Ended December 31,		
Financial Resources Were Provided by:			
Net earnings (loss)	**$ (7,433)**	$ 44,896	$ 7,711
Add items not requiring working capital:			
Depreciation and amortization	**7,655**	6,028	3,205
Noncurrent deferred tax provision	**6,953**	2,189	178
Total provided by operations	**7,175**	53,113	11,094
Disposal of property, plant and equipment	**2,609**	24	80
Proceeds from long-term debt	**14,340**	55,774	70
Proceeds from issuance of common stock, net			568
Increase in stockholders' equity under long-term incentive plan	**4,324**	1,134	
	28,448	110,045	11,812
Financial Resources Were Used for:			
Purchase of property, plant and equipment	**34,148**	16,862	6,269
Reduction of long-term debt	**4,461**	3,749	494
Increase in property under capital leases	**2,833**		
Reclass of prepaid barter advertising to long-term	**7,000**		
Increase in long-term receivable	**3,300**		
Other, net	**(1,464)**	991	279
	50,278	21,602	7,042
Increase (Decrease) in Working Capital	**(21,830)**	88,443	4,770
Working Capital at beginning of year	**129,607**	41,164	36,394
Working Capital at end of year	**$107,777**	$129,607	$ 41,164
Changes in Working Capital Items:			
Increase (Decrease) in Current Assets:			
Cash and cash equivalents	**$ (46,543)**	$ 44,725	$ (4,016)
Accounts receivable	**50,219**	86,567	7,470
Inventories	**95,515**	26,520	12,696
Income tax refund	**40,200**		
Other current assets	**16,784**	17,987	760
(Increase) Decrease in Current Liabilities:			
Short-term debt and current portion of long-term debt	**(166,485)**	(2,410)	(150)
Accounts payable	**(16,997)**	(45,258)	(11,441)
Income taxes payable	**7,219**	(7,961)	2,115
Accrued expenses	**(1,742)**	(31,727)	(2,664)
Increase (Decrease) in Working Capital	**$ (21,830)**	$ 88,443	$ 4,770

The accompanying notes are an integral part of the financial statements.

Notes to Consolidated Financial Statements

Note 1 — Summary of Significant Accounting Policies:

Principles of Consolidation — The consolidated financial statements include the accounts of the Company and all of its subsidiaries, including a Canadian subsidiary, after elimination of intercompany accounts and transactions. Certain amounts for 1981 and 1982 have been reclassified to conform with the 1983 financial statement presentation.

Translation of Foreign Currency — Effective January 1, 1982, the Company changed its accounting policy for the translation of foreign currency to comply with the provisions of the Financial Accounting Standards Board's Statement No. 52. No restatement of the prior periods was made because the amounts involved were immaterial. The assets and liabilities of the Canadian subsidiary are translated at the current exchange rate, and revenue and expense accounts are translated at the average exchange rate during the period. Gains or losses from foreign currency transactions are recognized currently. The gain or loss resulting from translation of the Canadian financial statements is included as a cumulative translation adjustment in retained earnings.

Accounts Receivable — The Company provides for allowances for doubtful accounts, estimated returns for defective product, and other credits including cooperative advertising.

Inventories — Inventories are valued at the lower of cost or market, determined on the first-in, first-out method.

Prepaid Advertising — The Company enters into agreements which provide for products and cash to be exchanged for media advertising. Prepaid advertising which was based on the fair market value of the media advertising was $27,295,000 at December 31, 1983 and $14,178,000 at December 31, 1982. Of the December 31, 1983 balance, approximately $7,000,000 has been classified as a non-current asset.

Property, Plant and Equipment — Property, plant and equipment are recorded at cost. Depreciation is provided on the straight-line method over the estimated useful lives of the related assets. Major improvements to existing plant and equipment are capitalized. Expenditures for maintenance and repairs which do not extend the life of the asset are charged to expense as incurred. The costs of molds, dies, and fixtures are depreciated over the estimated market life of the related products, but not more than three years. Cost of assets sold or retired and the related amounts of accumulated depreciation are eliminated from the accounts in the year of disposal, and any resulting gain or loss is included in earnings.

Goodwill — The excess of cost over the net assets of businesses acquired is amortized on the straight-line method over periods not exceeding 40 years.

Product Warranties — The Company provides at the time of the sale for the estimated costs to repair or replace certain electronic products which are warranted for various periods of time from the original purchase date against defective workmanship or materials.

Income Taxes — Deferred income taxes are provided for income and expense items which are recognized in different years for tax purposes than for financial reporting purposes. Investment tax credits are recorded as reductions of income tax expense in the year they are realized except for the investment tax credit resulting from the safe harbor tax lease. The Company accounts for the purchase of tax benefits in connection with safe harbor tax leases as an investment. The investment is reduced over the lease period by realized tax savings and deferred income taxes resulting from the transaction are appropriately recorded. No provision is made for taxes on the undistributed earnings of subsidiaries not consolidated for U.S. income tax purposes since it is the intention of the Company to reinvest such undistributed earnings in the foreign location.

Earnings Per Share — Net earnings per share of common stock are based upon the weighted average number of common shares outstanding during the respective periods, adjusted for dilutive common stock equivalents (15,656,000 shares in 1983, 15,470,000 shares in 1982 and 15,264,000 shares in 1981).

Note 2 — Income Taxes:

The income tax provision (benefit) for the years ended December 31 consisted of the following:

(Amounts in thousands)	**1983**	1982	1981
Current:			
Federal	**$(31,367)**	$26,789	$2,602
Foreign	**4,545**	2,534	2,578
State	**(2,660)**	4,625	187
Total Current	**(29,482)**	33,948	5,367
Deferred:			
Prepaid royalties	**5,208**	1,213	
Safe harbor tax lease	**4,067**	7,586	
Deferred royalty income	**3,242**	(3,750)	
Depreciation	**1,741**	411	236
Compensation under incentive plans	**(1,027)**	2,648	
Other	**(1,165)**	(1,505)	150
Total Deferred	**12,066**	6,603	386
Total Provision (Benefit)	**$(17,416)**	$40,551	$5,753

The differences between the amount of reported total income tax provision (benefit) and the amount computed using the statutory federal rate for years ended December 31 were as follows:

(Amounts in thousands)	**1983**		1982		1981	
	$	%	$	%	$	%
Total income tax provision (benefit) at the statutory federal rate of 46%	**$(11,431)**	(46.0)	$39,306	46.0	$6,193	46.0
Research and development credits	**(1,400)**	(5.6)	(850)	(1.0)	(60)	(.5)
Investment tax credits	**(1,291)**	(5.2)	(920)	(1.1)	(365)	(2.7)
Difference between statutory federal rate and foreign effective rate	**(1,163)**	(4.7)	(469)	(.5)	(138)	(1.0)
State income taxes (net of federal tax benefit)	**(1,085)**	(4.4)	2,440	2.9	117	.9
Miscellaneous	**(1,046)**	(4.2)	1,044	1.2	6	
	$(17,416)	(70.1)	$40,551	47.5	$5,753	42.7

At December 31, 1983, the net undistributed earnings of subsidiaries not consolidated for U.S. income tax purposes was $22,504,000.

Note 3 — Long-Term Liabilities and Credit Lines:

Long-Term Debt — Long-term debt at December 31 consisted of the following:

(Amounts in thousands)	**1983**	1982
11% term loan due 1988	**$12,709**	$14,985
Mortgage and equipment loans due in years through 1998	**14,781**	4,429
Capitalized lease obligations	**2,664**	794
	30,154	20,208
Current portion	**(3,669)**	(3,604)
Long-term debt	**$26,485**	$16,604

The term loan bears interest at 11% with annual principal payments increasing from $2,018,000 in 1984 to $3,127,000 in 1988. The mortgage and equipment loans bear interest at rates up to ½% over the prime rate with annual principal payments ranging from $1,587,000 in 1984 to $326,000 in 1998. The term loan and the mortgage and equipment loans are collateralized by substantially all of the Company's property, plant and equipment.

Subsequent to December 31, 1983, the Company's Canadian subsidiary entered into an agreement in principle with a Canadian lender for a five-year term loan in an amount up to Can. $14.0 million which amount becomes available at various times and in various amounts based on certain conditions precedent.

Subordinated Debentures — On September 15, 1982, the Company made a public offering of $60,500,000 of 14⅜% subordinated debentures due 2002. The debentures were issued at 89.385% of face value resulting in a yield to maturity of 16.16% and net proceeds of $52,215,000 after deducting $8,285,000 of underwriting discount and other issue costs. The debentures are redeemable at any time at the option of the Company, except that they may not be redeemed prior to November 1, 1987 with money borrowed at an annual interest cost of less than 16.16%. Annual sinking fund requirements of $6,050,000 in cash or acquired debentures commence in 1993. The proceeds of the offering were used to reduce certain short-term bank debt originally incurred for working capital purposes.

Scheduled Maturities — Aggregate annual principal payments under long-term liabilities (excluding capitalized leases) are: 1984 — $3,605,000; 1985 — $4,368,000; 1986 — $4,585,000; 1987 — $4,818,000; 1988 — $4,811,000.

Credit Lines — At December 31, 1983, the Company's consolidated lines of credit totaled $196,500,000. Subsequent thereto, the Company agreed to reduce its domestic lines of credit by $33,000,000 by the end of June 1984. Substantially all of the Company's tax refund will be used to effectuate this reduction. Agreements totaling $25,500,000, $19,000,000 of which were entered into by the Company's Canadian subsidiary, expire between April and September 1984 and are expected to be renewed or replaced at their expiration. Borrowings under the credit agreements bear interest at rates ranging from the prime rate to 1½% over prime. Certain of the lines carry facility fees of up to ½%.

A majority of the lines of credit are limited by a collateral formula based on levels of accounts receivable as defined in the agreements. Substantially all of these lines are collateralized by the accounts receivable and inventory of the Company. There are no compensating balance requirements under any of the borrowing agreements.

The credit agreements contain various covenants including maintenance of working capital, net worth and pretax income, debt-to-net-worth and restrictions on unsecured indebtedness.

Supplemental Information — Short-term borrowing in 1983, 1982 and 1981 pursuant to the Company's lines of credit were as follows:

(Amounts in thousands)	**1983**	1982	1981
Average amount outstanding	**$81,314**	$25,262	$12,224
Maximum amount outstanding	**$171,164**	$59,779	$27,300
Average effective interest rate	**10.3%**	14.4%	18.9%

Note 4 — Common Stock and Capital in Excess of Par Value:

On November 15, 1982, the Board of Directors declared a two-for-one common stock split effected in the form of a 100% stock dividend to shareholders of record on December 31, 1982. Per share amounts and outstanding share data for all prior periods have been restated to reflect the two-for-one stock split.

Subscription rights for the purchase of common stock were granted to key employees in 1983 and 1982 under the 1981 Long-

Term Incentive Plan (see note 5). The amounts receivable from such subscriptions at December 31, 1983 and 1982 were $1,400,000 and $3,047,000, respectively. During 1983, $1,647,000 of the amount receivable from subscriptions was paid and 716,000 shares were issued. Subscriptions Receivable bear interest at rates up to 12% and are generally payable in four equal annual installments through 1987. Subscriptions Receivable have been deducted from Common Stock Subscribed.

Note 5 — Stock Option and Incentive Plans:

The 1981 Long-Term Incentive Plan for all officers and key employees of the Company provides for various types of awards. These awards may include nonqualified stock options with or without related stock appreciation rights, performance units, restricted stock or options for restricted stock, incentive stock options and stock subscription rights. The number of shares authorized for award under the plan is 2,000,000. Through December 31, 1983, grants have been made as follows: Subscription Rights — 1,180,000 shares; Incentive Stock Options — 72,000 shares; Restricted Stock Awards — 115,000 shares and 633,000 shares were available for award.

Stock Subscription Rights granted under the Plan generally provide for a subscription price equal to one-third of the fair market value of the common stock on the date of grant. The average price of the 1,030,000 shares subscribed for at December 31, 1982 was $2.96 per share. During 1983, subscription rights for 150,000 shares at an average price of $1.44 were granted.

Restricted Stock Awards made under the Plan provide for the issuance of shares two years after the date of award. In addition, shares awarded are subject to reacquisition by the Company for a period of five years from the date of award. A restricted stock award of 10,000 shares was made in 1983.

Incentive Stock Options granted under the Plan are generally exercisable in three cumulative annual installments beginning one year after the date of grant and expire in 1992. Options are granted at prices equal to 100% of the fair market value of the common stock on the date of grant. Changes in Incentive Stock Options under the 1981 Plan were as follows:

	Number of Shares	Option Price Per Share	Option Price Total
Options outstanding at December 31, 1982	77,000	$17.35	$1,336,000
Granted	3,000	$27.50-$37.25	92,000
Canceled	(8,000)	$17.35	(139,000)
Options outstanding at December 31, 1983	72,000	$17.35-$37.25	$1,289,000

None of the outstanding Incentive Stock Options were exercisable at December 31, 1983.

Note 6 — Pension Plan:

The Company has a noncontributory pension plan covering U.S. salaried, clerical and administrative employees. Pension expense was actuarially computed and includes amortization of past service cost over a ten year period. Pension expense for the years ended December 31, 1983, 1982 and 1981 was $695,000, $575,000 and $296,000, respectively. The Company makes annual contributions to the plan equal to the amounts accrued for pension expense.

The actuarial present value of accumulated benefits to participants of the plan and the net assets available for those benefits (at the valuation date of January 31) were as follows:

(Amounts in thousands)	**1983**	1982
Actuarial present value of accumulated plan benefits:		
Vested	**$2,854**	$2,246
Nonvested	**359**	298
Total	**$3,213**	$2,544
Net assets available for benefits	**$2,729**	$1,815

An assumed weighted average rate of return of 8% was used for 1983 and 1982 in determining the actuarial present value of accumulated plan benefits.

Note 7 — Contingencies and Commitments:

The Company is involved in a number of lawsuits incidental to its business. In the opinion of management, such proceedings in the aggregate will not have a material adverse effect on the Company's consolidated financial position.

At December 31, 1983 and 1982, the Company was contingently liable for outstanding letters of credit in the amounts of $4,400,000 and $4,900,000, respectively.

Minimum royalty commitments and guarantees under certain licensing agreements aggregated approximately $33,365,000 at December 31, 1983, and are payable principally over a five year period.

Note 8 — Leases:

Rental expense under operating leases amounted to $1,556,000, $1,136,000 and $950,000 for the years ended December 31, 1983, 1982 and 1981, respectively. The Company had no material capital leases at December 31, 1983 or 1982.

Future minimum lease payments as of December 31, 1983 under all leases with initial or remaining non-cancelable terms in excess of one year are summarized as follows:

(Amounts in thousands)	All Leases
Year Ended:	
December 31, 1984	$ 2,882
December 31, 1985	2,564
December 31, 1986	2,297
December 31, 1987	2,074
December 31, 1988	1,967
Subsequent years	5,314
Total minimum payments	$17,098

The Company leases its corporate headquarters (134,000 square feet) from a partnership of which Arnold C. Greenberg and Leonard E. Greenberg together own a 50% interest. The lease, entered into on August 3, 1982, is for an initial period of ten years at an annual rent of $180,900 for the first five years and $189,945 for the remaining five years on a "triple net basis," plus the annual debt service of $837,528 payable by the Landlord on its first mortgage. The Company has the right to extend the lease for four additional terms of five years and the right to purchase the leased premises at any time after the fifth year. Based on two independent appraisals it received, the Company believes that the annual rent under the lease is less than the rent which would be paid for similar property in the Greater Hartford area.

Note 9 — Supplementary Financial Information:

(Amounts in thousands)	**1983**	1982
Inventories include the following:		
Raw materials	**$ 72,657**	$35,376
Work-in-process	**41,634**	10,627
Finished goods	**50,373**	23,146
	$164,664	$69,149

(Amounts in thousands)	**1983**	1982
Property, plant and equipment includes the following:		
Land	**$ 1,178**	$ 1,048
Buildings	**23,275**	13,374
Machinery and equipment	**49,246**	35,546
Molds, dies and fixtures	**20,133**	14,921
Total, at cost	**93,832**	64,889
Less: accumulated depreciation	**(35,649)**	(32,996)
	$ 58,183	$31,893

(Amounts in thousands)	**1983**	1982
Accrued expenses include the following:		
Royalties	**$ 7,419**	$12,791
Payroll and other compensation	**9,326**	10,063
Advertising	**10,801**	7,007
Deferred royalty income	**3,730**	7,500
Other	**13,831**	6,004
	$ 45,107	$43,365

(Amounts in thousands)	**1983**	1982	1981
Other supplementary financial information:			
Advertising expense	**$75,770**	$ 46,456	$16,226
Royalty expense	**$28,985**	$ 27,001	$ 2,477
Product development expense	**$29,083**	$ 13,085	$ 5,568
Maintenance and repairs expense	**$ 3,485**	$ 3,267	$ 2,429

Note 10 — Business Segment Information:

Product Line Information — As a result of the increasing importance of consumer electronics to the Company, and the divestiture of its family pool line and its Coastal Chemical subsidiary in 1983, the Company has restructured its industry segments as follows:

Consumer Electronics consists of home computer and video game systems, home computer and video game software and portable electronic games.

Toys and Games consists of dolls and accessories, plush toys, traditional toys and games, wading/splasher pools and outdoor recreational products.

These operations are generally carried out in joint facilities with common management. Joint facilities were allocated on the basis of sales value of production. In other instances, where the separation of the Company's business segments was indefinite, allocations were made based primarily upon management's judgment. Prior periods were restated to give effect to the Company's new industry segments.

The following sets forth selected financial information relating to industry segments for the years 1981 through 1983:

(Amounts in thousands)	**1983**	1982	1981
Net Sales:			
Consumer Electronics	**$403,930**	$373,547	$ 58,148
Toys and Games	**192,568**	136,833	119,883
	$596,498	$510,380	$178,031
Operating Profit:			
Consumer Electronics	**$ (22,265)**	$ 81,483	$ 5,245
Toys and Games	**17,011**	13,671	12,689
Operating Profit (Loss)	**$ (5,254)**	$ 95,154	$ 17,934
Interest Expense	**(19,595)**	(9,707)	(4,470)
Earnings (Loss) Before Income Taxes	**$ (24,849)**	$ 85,447	$ 13,464
Identifiable Assets:			
Consumer Electronics	**$348,650**	$209,649	$ 29,521
Toys and Games	**119,608**	70,149	66,522
Corporate and Unallocable	**9,274**	6,067	3,352
	$477,532	$285,865	$ 99,395
Capital Expenditures:			
Consumer Electronics	**$ 27,124**	$ 8,881	$ 3,303
Toys and Games	**7,024**	7,981	2,966
	$ 34,148	$ 16,862	$ 6,269
Depreciation Expense:			
Consumer Electronics	**$ 4,780**	$ 1,578	$ 942
Toys and Games	**2,502**	3,454	2,058
	$ 7,282	$ 5,032	$ 3,000

Geographical Information — The Company's operations are conducted primarily in the U.S. and Canada. Generally, intercompany sales are at prices approximating those which the selling entity is able to obtain on sales of similar products to unaffiliated customers.

The following table sets forth selected information relating to U.S. and foreign (primarily Canadian) operations, including export sales, for the years 1981 through 1983:

(Amounts in thousands)	**1983**	1982	1981
Net Sales:			
United States	**$526,051**	$472,504	$155,679
Foreign	**98,652**	55,470	32,565
Intergeographic	**(28,205)**	(17,594)	(10,213)
	$596,498	$510,380	$178,031
Operating Profit:			
United States	**$(17,513)**	$ 87,863	$ 12,738
Foreign	**12,259**	7,291	5,196
Operating Profit (Loss)	**(5,254)**	95,154	17,934
Interest Expense	**(19,595)**	(9,707)	(4,470)
Earnings (Loss) Before Income Taxes	**$(24,849)**	$ 85,447	$ 13,464
Identifiable Assets:			
United States	**$420,237**	$251,006	$ 77,325
Foreign	**57,295**	34,859	22,070
	$477,532	$285,865	$ 99,395

Note 11 — Selected Quarterly Information (Unaudited):

(Amounts in thousands, except per share data)

1983 Quarter Ended	**Apr 2**	**July 2**	**Oct 1**	**Dec 31**	**For the Year**
Net Sales	**$180,170**	**$126,338**	**$114,480**	**$175,510**	**$596,498**
Gross Profit	**$ 78,574**	**$ 60,405**	**$ 46,370**	**$ 7,356**	**$192,705**
Net Earnings (Loss)	**$ 16,210**	**$ 9,065**	**$ 2,302**	**$ (35,010)**	**$ (7,433)**
Net Earnings (Loss) Per share	**$ 1.01**	**$ .56**	**$ .14**	**$ (2.19)**	**$ (.48)**

1982 Quarter Ended	Mar 31	June 30	Sept 30	Dec 31	For the Year
Net Sales	$54,739	$86,801	$165,588	$203,252	$510,380
Gross Profit	$21,544	$34,382	$ 86,612	$ 88,002	$230,540
Net Earnings	$ 4,520	$ 7,437	$ 17,559	$ 15,380	$ 44,896
Net Earnings Per share	$ .29	$ .49	$ 1.15	$ .97	$ 2.90

Note: The fourth quarter of 1983 was adversely affected by the high costs associated with bringing the ADAM Family Computer System to market. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

Note 12 — Inflation Accounting (Unaudited):

The following supplemental information is supplied in accordance with the requirements of Statement of Financial Accounting Standards No. 33 (SFAS 33), "Financial Reporting and Changing Prices", for the purpose of providing certain information about the effects of changing prices. It should be viewed as an estimate of the approximate effect of inflation, rather than as a precise measure.

SFAS 33 requires that the effects of inflation on the Company be measured under two methods, both of which involve the use of assumptions and estimates. The first method provides data adjusted for general inflation using the Consumer Price Index for all Urban Consumers (CPI-U) as the measure of the general inflation rate. The objective of this approach is to provide financial information in dollars of equivalent value or purchasing power (constant dollars). The second method of measurement adjusts for changes in specific prices (current cost) related to individual assets and expenses. The objective of this method is to reflect the effects of changes in specific prices of the resources actually used in the Company's operations.

The effects of inflation under the constant dollar method were determined by adjusting the historical cost of inventories; property, plant, and equipment; cost of sales; and depreciation expense to average 1983 dollars by use of the CPI-U. Current cost information was omitted as there was no material difference between the amount of income from continuing operations on a historical cost/constant dollar basis and the amount of income from continuing operations on a current cost basis.

As prescribed in SFAS 33 income taxes were not adjusted from the amount in the primary financial statements.

Statement of Income from Continuing Operations Adjusted for Changing Prices for the Year 1983

(Amounts in thousands)	As reported in consolidated statement of operations	Constant Dollar (adjusted for general inflation)*
Net Sales	$596,498	$596,498
Costs and Expenses:		
Cost of goods sold (excluding depreciation)	396,511	400,082
Depreciation	7,282	7,853
Selling and administrative expenses	197,959	197,959
Interest expense	19,595	19,595
	621,347	625,489
Earnings (Loss) Before Income Taxes	(24,849)	(28,991)
Income Tax Provision (Benefit)	(17,416)	(17,416)
Net Earnings (Loss)	$ (7,433)	$ (11,575)
Gain from decline in purchasing power of net monetary liabilities		$ 3,200

*In average 1983 dollars.

Five Year Comparison of Selected Supplementary Financial Data Adjusted For Effects of Changing Prices

(Dollars in thousands, except per share amounts)	Years Ended December 31				
	1983	1982	1981	1980	1979
Net Sales:					
Historical	**$596,498**	$510,380	$178,031	$162,907	$136,495
Adjusted for general inflation*	**$596,498**	$526,798	$195,024	$196,967	$187,351
Historical cost information adjusted for general inflation*:					
Earnings (loss) from continuing operations	**$ (11,575)**				
Earnings (loss) from continuing operations per common share	**$ (.74)**				
Net assets at year-end	**$108,327**				
Other information:					
Gain from decline in purchasing power of net monetary liabilities*	**$ 3,200**				
Market price per common share at year-end:					
Historical	**$ 19.50**	$ 18.38	$ 3.44	$ 3.94	$ 2.19
Adjusted for general inflation*	**$ 19.17**	$ 18.75	$ 3.64	$ 4.55	$ 2.84
Average consumer price index — (CPI-U)	**298.4**	289.1	272.4	246.8	217.4

*In average 1983 dollars.

Report of Independent Certified Public Accountants

To the Stockholders and Board of Directors of
Coleco Industries, Inc.:.

We have examined the consolidated balance sheets of Coleco Industries, Inc. and subsidiaries at December 31, 1983 and 1982, and the related consolidated statements of operations, stockholders' equity and changes in financial position for the years ended December 31, 1983, 1982 and 1981. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Coleco Industries, Inc. and subsidiaries at December 31, 1983 and 1982, and the consolidated results of their operations and the changes in their financial position for the years ended December 31, 1983, 1982 and 1981, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Hartford, Connecticut
March 8, 1984

Five Year Financial Summary

(Amounts in thousands, except per share data)

	1983	1982	1981	1980	1979
Operating Data:					
Net Sales	**$596,498**	$510,380	$178,031	$162,907	$136,495
Cost of goods sold	**403,793**	279,840	115,172	97,595	90,354
Selling and administrative expenses	**197,959**	135,386	44,925	38,539	29,908
Interest expense	**19,595**	9,707	4,470	3,672	6,082
Earnings (Loss) Before Income Taxes and Extraordinary Credit	**(24,849)**	85,447	13,464	23,101	10,151
Income Tax Provision (Benefit)	**(17,416)**	40,551	5,753	10,064	4,793
Earnings (Loss) Before Extraordinary Credit	**(7,433)**	44,896	7,711	13,037	5,358
Extraordinary Credit Resulting from Utilization of Tax Loss Carryforwards				3,612	3,728
Net Earnings (Loss)	**$ (7,433)**	$ 44,896	$ 7,711	$ 16,649	$ 9,086
Average Common Shares Outstanding	**15,656**	15,470	15,264	14,287	13,822
Net Earnings (Loss) Per Share:					
Earnings (Loss) Before Extraordinary Credit	**$ (.48)**	$ 2.90	$ .51	$ .92	$ .39
Extraordinary Credit Resulting from Utilization of Tax Loss Carryforwards				.25	.27
Net Earnings (Loss) Per Share	**$ (.48)**	$ 2.90	$ .51	$ 1.17	$ .66
Balance Sheet Data:					
Working capital	**$107,777**	$129,607	$ 41,164	$ 36,394	$ 13,525
Current ratio	**1.4 to 1**	2.1 to 1	2.2 to 1	2.7 to 1	1.6 to 1
Capital expenditures	**$ 34,148**	$ 16,862	$ 6,269	$ 3,838	$ 2,691
Depreciation	**$ 7,282**	$ 5,032	$ 3,000	$ 2,862	$ 4,067
Total assets	**$477,532**	$285,865	$ 99,395	$ 79,217	$ 56,558
Long-term debt	**$ 78,772**	$ 68,829	$ 17,075	$ 17,499	$ 17,788
Stockholders' equity	**$ 89,419**	$ 92,653	$ 47,467	$ 39,183	$ 16,838
Book value per common share	**$ 5.58**	$ 6.06	$ 3.10	$ 2.61	$ 1.22

Management's Discussion and Analysis of Financial Condition and Results of Operations

Financial Condition

The Company's financial condition in 1983 suffered from the high costs associated with bringing the *ADAM Family Computer System* to market including start-up costs, manufacturing inefficiencies, research and development costs, warranty provisions, advertising expenses and other charges incurred in anticipation of shipping a much higher volume of *ADAM* than actually occurred. Capital expenditures more than doubled from 1982 levels with the largest portion of the increase related to *ADAM* design, production and testing equipment and tooling. Delays in bringing the *ADAM* to market also resulted in higher than planned inventories, primarily raw materials and work-in-process.

Cash requirements in 1983 for inventory, accounts receivable and capital assets were met primarily through increased short-term borrowings. This contrasted sharply with 1982 and 1981 when working capital and capital asset needs were funded primarily with long-term debt and cash generated from operations.

Inventories of $164.7 million were $95.5 million higher than at year-end 1982. Raw material and work-in-process inventories were significantly higher primarily due to an increase of *ADAM* related inventories. Finished goods inventory was also higher due to additional *ColecoVision* inventory. *ColecoVision* was first introduced in the third quarter of 1982 and finished goods inventory levels at year-end 1982 were minimal as production was not able to support the demand for the product. *ColecoVision* related raw material and work-in-process inventory at year-end 1982 accounted for substantially all of the increase in the inventory balance over 1981.

Accounts receivable and related allowances at December 31 are as follows (amounts in thousands):

	1983	1982	1981
Accounts Receivable	**$200,571**	$163,244	$32,792
Allowances	**42,549**	55,441	11,556
Net Accounts Receivable	**$158,022**	$107,803	$21,236

Accounts receivable increased by $37.3 million over 1982 primarily due to lengthened customer payment terms. The increase from 1981 to 1982 was primarily a result of a significant increase in 1982 fourth quarter sales volume.

The Company establishes allowances against accounts receivable for defective returns, doubtful accounts and advertising and other credits. Allowances are accumulated throughout the year based on sales levels for the Company's products and generally are at their highest level at year-end. The decrease in allowance levels in 1983 compared with 1982 was primarily the result of the establishment of a warranty repair program. During 1983, the Company began using independent service agencies to repair and service its electronic products and, as a result, a warranty liability account was established. Consequently, the allowance for defective returns declined and the warranty liability increased.

Other current assets increased by $16.8 million over 1982. The principal components included in other current assets are prepaid advertising and prepaid royalties. Prepaid advertising resulting from barter transactions increased by $13.1 million over 1982. At year-end, the Company did not expect to utilize all of the prepaid advertising asset within twelve months and consequently, $7.0 million was classified as a non-current asset. Prepaid royalties which represent advance payments to licensors for various copyright and trademark rights increased by $10.4 million over 1982 balances. These payments are expensed as the related products are shipped and the royalties earned by the licensor. Other current assets also increased in 1982 compared with 1981 primarily as a result of barter transactions and increased payments to licensors.

Capital expenditures of $34.1 million in 1983 were more than double 1982 levels. The 1983 capital budget was increased over 1982 in order to provide the necessary production and test equipment and tooling for the *ADAM Family Computer.* The Company had no material outstanding commitments for capital expenditures at December 31, 1983. In 1984, the Company expects to reduce its level of capital expenditures to be consistent with operating requirements.

In 1983, the Company increased its consolidated lines of credit from $72.5 million to $196.5 million. The agreements representing the lines of credit consist of a number of financing options which have borne interest at rates that, historically, have been equal to or below the prime rate. The effective interest rate on short-term borrowings for 1983 was 10.3% compared to an average prime rate of 10.8%.

Subsequent to year-end, the Company agreed to a reduction in its U.S. lines of credit totaling $33.0 million to take effect at various dates through June 16, 1984. The reduction will occur upon the earlier of the receipt by the Company of its tax refund or June 16, 1984. The Company's Canadian subsidiary has also entered into an agreement in principle with a Canadian lender for a five-year term loan in an amount up to Can. $14.0 million, which amount becomes available at various times and in various amounts based on certain conditions precedent. The Company expects that not less than $9.0 million will be utilized during 1984. The Company expects that available credit lines will be adequate to fund expected requirements in 1984.

1983 Compared with 1982

Net sales were a record $596.5 million, an increase of $86.1 million (16.9%). Sales of Consumer Electronics increased by $30.4 million (8.1%) and sales of Toys and Games increased by $55.7 million (40.7%). The increase in Consumer Electronics resulted primarily from the introduction of the *ADAM Family Computer System.* In addition, increased shipments of *ColecoVision* substantially offset lower sales of software for competing home video game systems and portable table top arcade games. The increase in Toys and Games was due to the successful introduction of the *Cabbage Patch Kids* line of dolls and accessories. More than three million of these dolls were shipped in 1983.

Costs of goods sold was $403.8 million, an increase of $124.0 million (44.3%) as a result of the high costs associated with bringing the *ADAM Family Computer System* to market and higher sales volume. The overall gross profit margin decreased from

45.2% to 32.3%. The decrease was substantially due to start-up costs, manufacturing and overhead variances and warranty costs associated with *ADAM*. Decreased sales of higher margin electronic products including home video game software also contributed to the reduced margin.

Selling, general and administrative expenses were $198.0 million, an increase of $62.6 million (46.2%). The increase was primarily due to higher advertising and product development costs principally related to *ADAM*. Selling and administrative expenses as a percent of net sales were 33.2% compared with 26.5% in 1982.

Interest expense was $19.6 million, an increase of $9.9 million (101.9%). The increase resulted from significantly higher short-term borrowings and interest expense on the 14⅞% subordinated debentures issued in September 1982.

As a result of the foregoing, the Company sustained a loss before income taxes of $24.8 million compared with a pretax profit of $85.4 million in 1982. The provision (benefit) for income taxes was a benefit of 70.1% compared to a provision of 47.5% in 1982. The full income tax benefit was realized from the carryback of the loss to prior years. The net loss of $7.4 million compared with net earnings of $44.9 million in 1982.

1982 Compared with 1981

Net sales in 1982 were a record $510.4 million, an increase of $332.3 million (186.7%) over 1981. Sales of Consumer Electronics contributed $315.4 million of the increase, primarily as a result of the introduction of new table top arcade games and home video game products. Shipments of table top arcade games totaled approximately three million units. The Company also shipped approximately 560,000 units of its *ColecoVision* home video game system together with two million units of software for the system. In addition, more than six million units of software were shipped for competing home video game systems. These newly introduced products accounted for more than 70% of total sales. Sales of Toys and Games increased by $16.9 million, primarily due to higher unit volume in the ride-on category.

Cost of goods sold was $279.8 million, an increase of $164.7 million (143.0%) as a result of higher sales volume. The overall gross profit margin increased to 45.2% compared with 35.3% in 1981, primarily as a result of the significant sales volume of the new, higher margin electronic products including home video game software and table top arcade games. In addition, margins in all other product categories increased in 1982 as compared to 1981.

Selling and administrative expenses were $135.4 million, an increase of $90.5 million (201.4%), primarily due to increased advertising expenses, licensing fees and product development costs. Advertising expenses increased as a result of the Company's expanded television advertising program. Licensing fees were also higher due to an increase in sales of licensed products. Product development costs increased as the Company continued to devote more resources to the development and introduction of new products. Selling and administrative expenses as a percentage of net sales increased to 26.5% from 25.2% in 1981.

Interest expense was $9.7 million, an increase of $5.2 million (117.2%) as a result of higher average borrowings, which was partially offset by lower effective interest rates.

As a result of the foregoing, earnings before income taxes increased by $72.0 million (534.6%) to $85.4 million. The provision for income taxes was 47.5% of earnings before taxes in 1982, up from 42.7% in 1981. The higher effective tax rate in 1982 resulted primarily from higher state income taxes and lower investment credits as a percentage of earnings before taxes. Net earnings were a record $44.9 million, an increase of $37.2 million over 1981.

Market Price of the Registrant's Common Equity and Related Stockholder Matters

The Company's common stock is listed on the New York and Toronto Stock Exchanges (trading symbol "CLO"). The following table sets forth the range of reported high and low sale prices of the stock for the periods indicated (restated for the two-for-one common stock split, effected in the form of a 100% stock dividend, distributed on January 28, 1983 to shareholders of record on December 31, 1982):

		High	Low
1983	**1st Quarter**	**28⅝**	**16¾**
	2nd Quarter	**65**	**20⅜**
	3rd Quarter	**48**	**29½**
	4th Quarter	**33¼**	**16**
1982	1st Quarter	7⅜	3⅝
	2nd Quarter	9⅛	6⅝
	3rd Quarter	9¾	6¾
	4th Quarter	25⅜	8⅞

The number of registered holders of the Company's common stock as of March 16, 1984 was 10,799.

The Company has not paid any cash dividends since 1974. Subsequent to December 31, 1983, the Company amended its financing agreements to limit the amount of any cash dividends to be paid on its common stock to 25% of consolidated net income in the preceding year. The payment of future dividends and the kind and amount thereof, will depend on the earnings, capital requirements, financial condition of the Company and other pertinent factors normally influencing dividend policy.

Facilities

Corporate Headquarters

Coleco Corporate Center
999 Quaker Lane South
West Hartford, Connecticut 06110
(203) 725-6000

Manufacturing Facilities and Distribution Centers

21 West Main Street
Mayfield, New York 12117

Coleco Park
Mayfield, New York 12117

80 Lincoln Street
Gloversville, New York 12078

Operations Center
2 Park Street
Amsterdam, New York 12010

37 Prospect Street
Amsterdam, New York 12010

50 Park Street
Amsterdam, New York 12010

31-35 Willow Street
Amsterdam, New York 12010

50 Willow Street
Amsterdam, New York 12010

1231 Warner Avenue
Tustin, California 92680

Subsidiary

Coleco (Canada) Limited
4000 St. Ambroise Street
Montreal, Quebec, Canada H4C 2C8

Company Sales Offices

New York
200 Fifth Avenue
New York, New York 10010

Chicago
4825 North Scott
Schiller Park, Illinois 60176

Los Angeles
1231 Warner Avenue
Tustin, California 92680

Montreal
4000 St. Ambroise Street
Montreal, Quebec, Canada H4C 2C8

Toronto
5149 Bradco Boulevard
Mississauga, Ontario, Canada L4W 2A6

Transfer Agent and Registrar

Manufacturers Hanover Trust Company
450 West 33rd Street
New York, New York 10001

Independent Certified Public Accountants

Coopers & Lybrand
280 Trumbull Street
Hartford, Connecticut 06103

Stock Exchange Listings

The Company's Common Stock is listed on the New York Stock Exchange and the Toronto Stock Exchange.
Ticker Symbol: CLO

Stockholders may obtain a copy of the Company's 1983 Annual Report on Form 10-K filed with the Securities and Exchange Commission by writing to Richard A. Blumenthal, Secretary, Coleco Industries, Inc., Coleco Corporate Center, 999 Quaker Lane South, West Hartford, Connecticut 06110

Board of Directors

Arnold C. Greenberg[1,2]

Leonard E. Greenberg[1]

Melvin Y. Gershman

J. Brian Clarke

Morton E. Handel

Christopher W. Carriuolo[1,2,3]
President
C & D Enterprises
Farmington, Connecticut

Omer S.J. Williams[2,4]
Attorney at Law, Partner
Thacher, Proffitt & Wood
New York, New York

Mary Anne Krupsak[3,4]
Attorney at Law
Albany, New York

Murray Hillman[1,3,4]
President
The Strategy Workshop, Inc.
New York, New York

Seymour M. Leslie[1,3,4]
Chairman, President
and Chief Executive Officer
MGM/UA Home Entertainment Group, Inc.
New York, New York

[1]Member of Executive Committee.
[2]Member of Nominating Committee.
[3]Member of Human Resources Committee.
[4]Member of Audit Committee.

John F. Moran
Director Emeritus
West Hartford, Connecticut

Executive Officers

Arnold C. Greenberg
President and Chief Executive Officer

Leonard E. Greenberg
Chairman

J. Brian Clarke
Executive Vice President

Melvin Y. Gershman
Vice Chairman

Eric D. Bromley
Executive Vice President-
Advanced Research and Development

Philip Cohen
Executive Vice President-
Sales

George V. Goudreault
Executive Vice President-
Operations

Morton E. Handel
Executive Vice President-
Corporate Communications

Alfred R. Kahn
Executive Vice President-
Marketing

Charles B. Winterble
Group Vice President-
Computer Products

Mark L. Yoseloff
Executive Vice President

Frank T. Alfieri
Senior Vice President-
Finance;
Chief Financial Officer

Paul C. Meyer
Senior Vice President-
Operations Planning and Control

Martin Nadborny
Senior Vice President-
Operations

Marvin Posner
Senior Vice President-
Sales

Michael S. Schwefel
Senior Vice President
and General Counsel

Richard A. Blumenthal
Secretary;
Assistant General Counsel

Charles H. Murphy
Treasurer

Operating Executives

Coleco — United States

Corporate Center

Marvin Belsky
Vice President-Electronic Purchasing

Alvin R. Brown
Vice President-Far East Operations

Donald S. Crocker
Vice President-Sales Administration

Lawrence J. Karam
Vice President-Materials Management

George P. Kiss
Vice President-Applications Software

James J. Pasquale
Vice President-Corporate Information Services

John A. Passante
Vice President-Human Resources

Bert L. Reiner
Vice President-Product Development

Raymond H. Ringston
Vice President-Marketing Planning

Jerry D. Wood
Vice President-Marketing, Toys and Games

Manufacturing

Michael A. Appel
Vice President-Materials

Frank Dempsey
Vice President-Purchasing

John J. Driska
Vice President-Manufacturing

Paul A. Dwyer
Vice President-Transportation

Douglas L. Glaspie
Vice President-Manufacturing

Lawrence H. Hewitt, Sr.
Vice President-Distribution

Ralph R. Liguori
Vice President-Operations Control

Clark Miller
Vice President-Employee Relations

Victor J. Ragusa
Vice President-Industrial Relations

Dino G. Zampini
Vice President-Technical Services

Sales

Marvin Berger
Vice President

Michael R. Kirsch
Vice President

Ralph Lancellotti
Vice President

Robert Rosenbaum
Vice President

Sidney Silverman
Vice President

Coleco (Canada) Limited

J. Brian Clarke
Chairman, President
and Chief Executive Officer

Georges Dussault
Senior Vice President-Operations

Gene M. Florio
Senior Vice President-Finance
and Administration

Donald V. Taylor
Senior Vice President-Sales
and Marketing

Denis Durnin
Vice President-Finance

Gerry Goldenberg
Vice President-Distribution
and Sales Administration

Bruce D. Morrow
Vice President-Sales, Toys

Michael F. Richards
Vice President-Sales, Electronics

Pierre Rouette
Vice President-Manufacturing

Pierre Tanguay
Vice President-Human Resources

M.U. (Rich) Tanner
Vice President-Materials Management

Design:
Bloch Graulich Whelan Inc.
New York

Still Life Photography:
Peggy and Ron Barnett

Location Photography:
Harry Benson
Bill Ray
Charles West

Coleco Industries, Inc.
Coleco Corporate Center
999 Quaker Lane South
West Hartford
Connecticut 06110