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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors. You should read this section in conjunction with our consolidated financial statements and the related notes.

Critical Accounting Policies

The accompanying consolidated financial statements and supplementary information were prepared in accordance with accounting principles generally accepted in the United States of America. Significant accounting policies are discussed in Footnote 2 to the Consolidated Financial Statements. Inherent in the application of many of these accounting policies is the need for management to make estimates and judgments in the determination of certain revenues, expenses, assets and liabilities. As such, materially different financial results can occur as circumstances change and additional information becomes known. The policies with the greatest potential effect on our results of operation and financial position include:

The allowance for doubtful accounts is based on our assessment of the collectibility of specific customer accounts and the aging of the accounts receivable. If there were a deterioration of a major customer's creditworthiness, or actual defaults were higher than our historical experience, our estimates of the recoverability of amounts due to us could be overstated, which could have an adverse impact on our operating results.

Our revenue recognition policy is significant because our revenue is a key component of our results of operations. In addition, our revenue recognition determines the timing of certain expenses, such as commissions and royalties. We follow very specific and detailed guidelines in measuring revenues; however, certain judgments affect the application of our revenue policy. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause our operating results to vary significantly from quarter to quarter.

We assess the impairment of long-lived assets and goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and
- significant negative industry or economic trends.

When we determine that the carrying value of long-lived assets and goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. Net long-lived assets, including goodwill, amounted to $241.5 million as of December 31, 2003.

Recent Developments

On May 31, 2003, we purchased certain product lines, including *ColorWorkshop* and *Blopens*, assets and assumed certain liabilities of P&M Products USA, Inc. and an affiliated United Kingdom company, P&M Products Limited (collectively "P&M"). The total purchase price of approximately $22.0 million consisted of all cash and the assumption of certain liabilities and resulted in goodwill of $16.8 million. Our results of operations have included P&M from the date of acquisition.

Results of Operation

The following table sets forth, for the periods indicated, certain statement of operations data as a percentage of net sales.

Years Ended December 31,	1999	2000	2001	2002	2003
Net sales	100.0%	100.0%	100.0%	100.0%	**100.0%**
Cost of sales	58.6	59.4	57.8	57.9	**59.9**
Gross profit	41.4	40.6	42.2	42.1	**40.1**
Selling, general and administrative expenses	27.8	31.9	31.5	29.6	**33.5**
Acquisition shut-down and product recall costs	—	0.5	0.4	2.2	**0.6**
Income from operations	13.6	8.2	10.3	10.3	**6.0**
Profit from Joint Venture	(2.0)	(6.3)	(2.3)	(2.6)	**(2.3)**
Interest, net	(0.9)	(1.5)	(0.7)	(0.4)	**0.4**
Income before income taxes and minority interest	16.5	16.0	13.3	13.3	**7.9**
Provision for income taxes	4.5	4.6	3.4	2.9	**1.3**
Income before minority interest	12.0	11.4	9.9	10.4	**6.6**
Minority interest	—	—	—	0.3	**—**
Net income	12.0%	11.4%	9.9%	10.1%	**6.6%**

Years Ended December 31, 2003 and 2002

Net Sales. Net sales were $315.8 million in 2003 compared to $310.0 million in 2002, representing an increase of 1.9%. The contribution to net sales by our seasonal products, including *Trendmasters, Go Fly a Kite, Funnoodle* and sports toys, and new product introductions, including *Dragon Ball* and *NASCAR* action toys, TV games and *ColorWorkshop* craft products, were offset by a decrease in sales in our traditional products, and international sales, which included a reduction in sales of our karaoke machines and Equalizer radio control vehicle in 2003, both higher priced items.

Gross Profit. Gross profit decreased $3.9 million, or 3.0%, to $126.6 million, or 40.1% of net sales, in 2003 from $130.6 million, or 42.1% of net sales, in 2002. The overall decrease in gross profit was attributable to a decrease in gross profit margin. The decrease in gross profit margin of 2.0% of net sales was due to higher sales of seasonal products with lower margins and an increase in royalty expense as a percentage of net sales due to changes in the product mix resulting from the sale of more products with higher royalty rates, though offset in part by a decrease in amortization expense of molds and tools used in the manufacture of our products.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $105.8 million in 2003 and $91.8 million in 2002, constituting 33.5% and 29.6% of net sales, respectively. The overall increase of $14.0 million in such costs was primarily due to a charge for the grant of restricted stock of $8.4 million, a charge of $2.1 million to bad debt relating to the bankruptcy of several of our customers, including Kay Bee Toys, and an increase in direct selling expenses, product development costs, option compensation expense resulting from the price reset of options in 2000 and operating expenses incurred in connection with the P&M asset acquisition. We produced and aired television commercials in support of several of our products, including *WWE* and *Dragon Ball Z* action figures and *Flying Colors* products in 2003 and *WWE* action figures and *Flying Colors* products in 2002. From time to time, we may increase our advertising efforts, if we deem it appropriate for particular products.

Acquisition Shut-down and Recall Costs. Acquisition shut-down costs in 2002 relate to shut-down costs, including lease termination, fixed asset abandonment and other costs, of certain operations of Toymax and Kidz Biz. There were no such costs in 2003. Operations impacted by these shut-downs were sales, design, distribution, and administration. The integrations of Toymax and Kidz Biz were completed in 2002. In 2003, we accrued a net amount of $2.0 million for the recall of one of our products, compared to having accrued $2.2 million in 2002 for the recall of the same product.

The remaining component of the acquisition shut-down and recall costs is as follows (in thousands):

	Accrued Balance December 31, 2002	Accrual	Actual	Accrued Balance December 31, 2003
Lease abandonment costs	$2,310	$ —	$(2,310)	$ —
Recall costs	—	2,000	(1,510)	490
Total	$2,310	$2,000	$(3,820)	$490

Profit from Joint Venture. Profit from joint venture decreased by $0.7 million in 2003 due to the joint venture having lower unit sales at lower wholesale prices of its two vehicle combat games of the five games released in 2003 compared to releasing all new titles with higher unit sales at higher wholesale prices in addition to having higher sales of carryover titles in 2002. New releases typically generate higher unit sales resulting in higher overall sales as compared to carryover titles. Profit from the joint venture contributed significantly to our pre-tax profit, representing 19.5% of pre-tax income in 2002 and 22.2% in 2003. We expect to continue to receive a preferred return over the remaining term of the license agreement ending December 31, 2009, although we cannot predict with certainty what levels of return will be achieved and, in any case, we anticipate substantial fluctuations in the amount of the preferred return distributed to us from year to year.

Interest Net. Interest income increased due to higher average cash balances during 2003 than in 2002, but was offset by interest expense of $2.5 million related to the convertible notes issued in June 2003.

Provision for Income Taxes. Provision for income taxes included Federal, state and foreign income taxes in 2002 and 2003, at an effective tax rate of 22.0% and 17% in 2002 and 2003, respectively, benefiting from a flat 16.5% and 17.0% Hong Kong Corporation Tax on our income arising in, or derived from, Hong Kong for 2002 and 2003, respectively. For 2003, the effective rate decreased as a result of a higher proportionate share of income arising in Hong Kong as opposed to income arising in the higher statutory jurisdictions. As of December 31, 2003, we had deferred tax assets of approximately $4.0 million for which no allowance has been provided since, in the opinion of management, realization of the future benefit is probable. In making this determination, management believes it considered all available evidence, both positive and negative, as well as the weight and importance given to such evidence.

Years Ended December 31, 2002 and 2001

Net Sales. Net sales increased $25.7 million, or 9.0%, to $310.0 million in 2002 from $284.3 million in 2001. The growth in net sales was due primarily to the addition of the Toymax products and continuing growth in sales of our *Flying Colors* and doll products which was offset in part by a decrease in sales of our Wheels division, consisting primarily of our *Road Champs* die-cast toy and collectible vehicles with its extreme sports products.

Gross Profit. Gross profit increased $10.5 million, or 8.7%, to $130.6 million in 2002, or 42.1% of net sales, from $120.1 million, or 42.2% of net sales, in 2001. The overall increase in gross profit was attributable to the increase in net sales. Gross profit margin was comparable to last year as lower margins for Toymax products were offset by the decrease in royalty expense as a percentage of net sales due to changes in the product mix resulting from the sale of more products with lower royalty rates or proprietary products with no royalties.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $91.8 million in 2002 and $89.6 million in 2001, constituting 29.6% and 31.5% of net sales, respectively. The overall increase of $2.2 million in such costs was due to costs incurred in support of our Kidz Biz and Toymax acquisitions and increased media buys, offset in part by a decrease in goodwill amortization expense based on the implementation of SFAS 142. The decrease as a percentage of net sales is primarily attributable to the relative fixed nature of certain expenses with a concurrent increase in net sales. We produced and aired television commercials in support of several of our products, including *WWE* action figures and *Flying Colors* products, in 2001 and 2002. From time to time, we may increase our advertising efforts, if we deem it appropriate for particular products.

Acquisition Shut-down and Recall Costs. Acquisition shut-down costs in 2002 relate to shut-down costs, including lease termination, fixed asset abandonment and other costs, of certain operations of Toymax and Kidz Biz. Such costs in 2001 relate to shut-down costs of certain operations of Pentech, acquired in 2000. Operations impacted by these shut-downs were sales, design, distribution and administration. The integration of Pentech was completed in 2001 and the integration of Toymax and Kidz Biz was completed in 2002. In 2002, we accrued $2.2 million for the recall of one of our products.

The components of the acquisition shut-down and recall costs are as follows (in thousands):

	Accrued Balance December 31, 2001	Accrual	Actual	Accrued Balance December 31, 2002
Lease abandonment costs	$—	$3,724	$(1,414)	$2,310
Fixed asset write-off	—	260	(260)	—
Other	—	559	(559)	—
Recall	—	2,175	(2,175)	—
Total acquisition shut-down and recall costs	$—	$6,718	$(4,408)	$2,310

Profit from Joint Venture. Profit from joint venture increased by $1.3 million in 2002 due to the joint venture having sales of only carryover titles in 2001 compared to releasing a new Microsoft *Xbox* title in addition to having sales of carryover titles in 2002. New releases typically generate higher unit sales resulting in higher overall sales as compared to carryover titles. Profit from the joint venture contributed significantly to our pre-tax profit, representing 17.6% of pre-tax income in 2001 and 19.5% in 2002.

Interest, Net. Interest income decreased in 2002 compared to 2001 in spite of higher average cash balances due to lower interest rates.

Provision for Income Taxes. Provision for income taxes included Federal, state and foreign income taxes in 2001 and 2002, at effective tax rates of 26% in 2001 and 22% in 2002, benefiting from a flat 16.5% Hong Kong Corporation Tax on our income arising in, or derived from, Hong Kong. The decrease in the current year effective rate results primarily from certain permanently non-taxable items in addition to a continued shift in profits to more favorable tax jurisdictions.

Quarterly Fluctuations and Seasonality

We have experienced significant quarterly fluctuations in operating results and anticipate these fluctuations in the future. The operating results for any quarter are not necessarily indicative of results for any future period. Our first quarter is typically expected to be the least profitable as a result of lower net sales but substantially similar fixed operating expenses. This is consistent with the performance of many companies in the toy industry.

The following table presents our unaudited quarterly results for the years indicated. The seasonality of our business is reflected in this quarterly presentation.

	2001			
(In thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$59,962	$70,141	$ 92,768	$61,438
As a % of full year	21.1%	24.7%	32.6%	21.6%
Gross profit	$24,468	$32,609	$ 39,056	$23,954
As a % of full year	20.4%	27.2%	32.5%	19.9%
As a % of net sales	40.8%	46.5%	42.1%	39.0%
Income (loss) from operations	$ 7,267	$ 8,879	$ 14,562	$ (1,410)
As a % of full year	24.8%	30.3%	49.7%	(4.8)%
As a % of net sales	12.7%	12.1%	15.7%	(2.3)%
Income before income taxes and minority interest	$ 8,480	$ 9,478	$ 15,250	$ 4,822
As a % of net sales	14.1%	13.5%	16.4%	7.8%
Net income	$ 6,021	$ 6,873	$ 10,949	$ 4,390
As a % of net sales	10.0%	9.8%	11.8%	7.1%
Diluted earnings per share	$ 0.32	$ 0.36	$ 0.56	$ 0.22
Weighted average shares and equivalents outstanding	18,920	19,259	19,586	19,763

	2002			
(In thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$59,895	$78,992	$102,640	$68,489
As a % of full year	19.3%	25.5%	33.1%	22.1%
Gross profit	$26,470	$35,192	$ 41,812	$27,077
As a % of full year	20.3%	27.0%	32.0%	20.7%
As a % of net sales	44.2%	44.6%	40.7%	39.5%
Income from operations	$ 1,420	$ 9,912	$ 18,895	$ 1,757
As a % of full year	4.4%	31.0%	59.1%	5.5%
As a % of net sales	2.4%	12.5%	18.4%	2.6%
Income before income taxes and minority interest	$ 2,985	$10,849	$ 19,944	$ 7,351
As a % of net sales	5.0%	13.7%	19.4%	10.7%
Net income	$ 2,156	$ 7,832	$ 13,954	$ 7,329
As a % of net sales	3.6%	9.9%	13.6%	10.7%
Diluted earnings per share	$ 0.11	$ 0.36	$ 0.58	$ 0.30
Weighted average shares and equivalents outstanding	20,236	21,953	24,059	24,800

(In thousands, except per share data)	2003 First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales	$67,759	$73,290	$90,308	$84,419
As a % of full year	21.5%	23.2%	28.6%	26.7%
Gross profit	$27,442	$27,906	$36,226	$35,060
As a % of full year	21.7%	22.0%	28.6%	27.7%
As a % of net sales	40.5%	38.1%	40.1%	41.5%
Income (loss) from operations	$ 7,504	$ 4,065	$12,578	$ (5,284)
As a % of full year	39.8%	21.6%	66.7%	(28.0)%
As a % of net sales	11.1%	5.5%	13.9%	(6.3)%
Income before income taxes and minority interest	$ 7,842	$ 4,222	$12,593	$ 152
As a % of net sales	11.6%	5.8%	13.9%	0.2%
Net income	$ 5,960	$ 3,208	$ 9,570	$ 1,866
As a % of net sales	8.8%	4.4%	10.6%	2.2%
Diluted earnings per share	$ 0.24	$ 0.13	$ 0.39	$ 0.08
Weighted average shares and equivalents outstanding	24,917	24,683	24,629	24,642

During the fourth quarter of 2001, we recorded a charge of $5.0 million to bad debt impacting operating income relating to the bankruptcy filing of one of our customers, Kmart.

During the first quarter of 2002, we recorded a charge which impacted operating income by approximately $6.6 million relating to the restructuring of Toymax and Kidz Biz.

During the second quarter of 2002, we recorded a charge which impacted operating income by approximately $1.5 million relating to the recall of one of our products.

During the fourth quarter of 2002, we reversed $2.1 million of the restructuring charge recorded in the first quarter of 2002 and recorded an additional charge of approximately $0.7 million relating to the recall of one of our products, the net of which favorably impacted operating income by approximately $1.4 million. In addition, our effective tax rate for the year 2002 was reduced from 26% to 22%.

During the second quarter of 2003, we recorded a charge which impacted operating income by approximately $2.7 million relating to the recall of one of our products.

During the third quarter of 2003, we recovered $0.7 million of the recall costs, recorded in the second quarter of 2003, from one of our factories.

During the fourth quarter of 2003, we recorded a non-cash charge of $8.4 million which impacted operating income relating to the grant of restricted stock and a charge of $2.1 million to bad debt impacting operating income relating to the bankruptcy filing of several of our customers, including Kay Bee Toys.

Recent Accounting Standards

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"). The objective of SFAS 143 is to establish an accounting standard for the recognition and measurement of an asset retirement obligation on certain long-lived assets. The retirement obligation must be one that results from the acquisition, construction or normal operation of a long-lived asset. SFAS 143 requires the legal obligation associated with the retirement of a tangible long-lived asset to be recognized at fair value as a liability when incurred, and the cost to be capitalized by increasing the carrying amount of the related long-lived asset. SFAS 143 was adopted effective January 1, 2003 and the adoption of this statement had no material impact on the consolidated financial statements.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, "Rescission of Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"). SFAS 145 eliminates extraordinary accounting treatment for reporting gains or losses on debt extinguishments, and amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. SFAS 145 was adopted effective January 1, 2003 and the adoption of this statement had no material impact on the consolidated financial statements.

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), which changes the accounting for costs such as lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity initiated after December 31, 2002. The standard requires companies to recognize the fair value of costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The adoption of SFAS 146 had no material effect on the Company's financial position or results of operations.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("Interpretation 45"), which addresses the accounting for and disclosure of guarantees. Interpretation 45 requires a guarantor to recognize a liability for the fair value of a guarantee at inception. The recognition of the liability is required even if it is not probable that payments will be required under the guarantee. The disclosure requirements are effective for interim and annual financial statements ending after December 15, 2002. The initial recognition and measurement provisions are effective for all guarantees within the scope of Interpretation 45 issued or modified after December 31, 2002. The application of Interpretation 45 did not have a material effect on the Company's financial position or results of operations.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS 150"). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The provisions of SFAS 150 were adopted effective June 9, 2003. The adoption of SFAS 150 did not have a material effect on the Company's financial position or results of operations.

In January 2003 and as revised in December 2003, FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("Interpretation 46") and FASB Interpretation No. 46R. Interpretations 46 and 46R require companies with a variable interest in a variable interest entity to apply this guidance as of the beginning of the first reporting period after December 15, 2003. The application of the guidance could result in the consolidation of a variable interest entity. The Company anticipates that the adoption of Interpretations 46 and 46R will not have a material effect on the Company's financial position or results of operations.

Liquidity and Capital Resources

As of December 31, 2003, we had working capital of $232.6 million, as compared to $129.2 million as of December 31, 2002. This increase was primarily attributable to the receipt of net proceeds from the issuance of our convertible notes payable and from operating activities offset in part by disbursements relating to the acquisition of certain assets of P&M.

Operating activities provided net cash of $7.2 million in the year ended December 31, 2003 as compared to $66.2 million, including cash provided from the sale of marketable securities of $37.1 million, in 2002. Net cash was provided primarily by net income and non-cash charges, such as the grant of restricted stock and depreciation and amortization, as well as increases in accounts payable and deferred income taxes, which were offset in part by an increase in accounts receivable, inventory, prepaid expenses and other and decreases in accrued expenses, income taxes payable, and reserve for sales returns and allowances. As of December 31, 2003, we had cash and cash equivalents of $118.2 million and marketable securities of $19.3 million.

Our investing activities used cash of $47.5 million in the year ended December 31, 2003, as compared to $87.8 million in 2002, consisting primarily of the purchase of office furniture and equipment and molds and tooling used in the manufacture of our products, the purchase of other assets, the goodwill acquired in the acquisition of P&M and the purchase of marketable securities, partially offset by the repayment of notes receivable from officers. In 2002, our investing activities consisted primarily of the purchase of molds and tooling used in the manufacture of our products, the goodwill acquired in the acquisitions of Toymax and Trendmasters, plus the $4.5 million in goodwill relating to the final earn-out for Flying Colors, partially offset by the repayment of notes receivable from officers. As part of our strategy to develop and market new products, we have entered into various character and product licenses with royalties ranging from 1% to 18% payable on net sales of such products. As of December 31, 2003, these agreements required future aggregate minimum guarantees of $21.9 million, exclusive of $4.8 million in advances already paid.

Our financing activities provided net cash of $90.0 million in the year ended December 31, 2003, as compared to $64.9 million in 2002. In 2003, cash was primarily provided from the sale of our convertible senior notes and from the exercise of stock options, partially offset by the repurchase of our common stock and the repayment of long-term debt. In 2002, cash was primarily provided from the sale of our common stock and from the exercise of stock options and warrants, partially offset by the repayment of debt.

The following is a summary of our significant contractual cash obligations for the periods indicated that existed as of December 31, 2003 and is based on information appearing in the notes to the consolidated financial statements (in thousands):

	2004	2005	2006	2007	2008	Thereafter	Total
Long-term debt	$ 19	$ 21	$ 21	$ —	$ —	$ 98,000	$ 98,061
Operating leases	4,757	4,285	4,022	3,531	444	481	17,520
Minimum guaranteed license/royalty payments	6,593	7,682	3,571	1,198	1,427	1,435	21,906
Employment contracts	4,675	4,473	3,215	2,930	2,180	4,510	21,983
Total contractual cash obligations	$16,044	$16,461	$10,829	$7,659	$4,051	$104,426	$159,470

In December 2001, we acquired all of the outstanding capital stock of Kidz Biz Limited, a United Kingdom company, and an affiliated Hong Kong company, Kidz Biz Far East Limited, for an aggregate purchase price of approximately $12.4 million. Total consideration was paid on the closing of the transaction in cash in the amount of $6.4 million and the issuance of 308,992 shares of our common stock at a value of $6.0 million. In addition, we agreed to pay an earn-out for each of 2002, 2003, 2004 and 2005, based on the year over year increase in Kidz Biz sales, payable by delivery of up to 25,749 shares of our common stock per year. In 2002 and 2003, no earn-outs were earned.

In October 2001, we and all of our domestic subsidiaries jointly and severally secured a syndicated line of credit totaling $50.0 million with a consortium of banks led by Bank of America, N.A. ("Line of Credit"). On June 3, 2003, we and the banks amended the loan agreements governing the Line of Credit (the "Loan Agreements"), pursuant to which amendment (i) the banks suspended certain of our covenants under the Loan Agreements, including those that prohibited us from consummating the Convertible Senior Notes offering (note 8) without the banks' consent, and (ii) the banks' obligations to extend credit under the Line of Credit were simultaneously suspended. The amendment contemplates that we and the banks will attempt to negotiate revised terms for the Line of Credit, to be reflected in a further amendment to the Loan Agreements, while waiving the requirement for obtaining consent for this offering. Neither we nor the banks, however, have any obligation to enter into such further amendment to the Loan Agreements. The amendment did not otherwise affect our right under the Loan Agreements to voluntarily reduce or terminate the Line of Credit. There have never been any outstanding borrowings under the Line of Credit since its inception.

In February 2003, our Board of Directors approved a buyback of up to $20 million of our common stock. As of December 31, 2003, we repurchased and retired 554,500 shares of our common stock for a total of approximately $6.1 million.

On May 31, 2003, we purchased certain product lines, related assets and assumed certain liabilities of P&M. The total purchase price of approximately $22.0 million consisted of cash paid in the amount of $20.7 million and liabilities of $1.3 million and resulted in goodwill of $16.8 million. Results of operations have included P&M from the date of acquisition.

Pursuant to the terms of a Purchase Agreement, dated June 9, 2003, we sold an aggregate of $98 million of 4.625% Convertible Senior Notes due June 15, 2023. The holders of the notes may convert the notes into shares of our common stock at any time at an initial conversion price of $20.00 per share, subject to certain circumstances described in the notes. We will pay cash interest on the notes at an annual rate of 4.625% of the principal amount at issuance, from the issue date to June 15, 2010, payable on June 15 and December 15 of each year, commencing on December 15, 2003. After June 15, 2010, we will not pay cash interest on the notes. At maturity, on June 15, 2023, we will redeem the notes at their accreted principal amount, which will be equal to $1,811.95 (181.195%) per $1,000 principal amount at issuance.

We may redeem the notes at our option in whole or in part beginning on June 15, 2010, at 100% of their accreted principal amount plus accrued and unpaid interest (including contingent interest and additional amounts), if any, payable in cash. Holders of the notes may also require us to repurchase all or part of their notes on June 15, 2010, for cash, at a repurchase price of 100% of the principal amount per note plus accrued and unpaid interest (including contingent interest and additional amounts), if any. Holders of the notes may also require us to repurchase all or part of their notes on June 15, 2013 and June 15, 2018 at a repurchase price of 100% of the accreted principal amount per note plus accrued and unpaid interest (including contingent interest and additional amounts), if any. Any repurchases at June 15, 2013 and June 15, 2018 may be paid in cash, in shares of common stock or a combination of cash and shares of common stock.

We believe that our cash flows from operations, cash and cash equivalents on hand and marketable securities will be sufficient to meet our working capital and capital expenditure requirements and provide us with adequate liquidity to meet our anticipated operating needs for at least the next 12 months. Although operating activities are expected to provide cash, to the extent we grow significantly in the future, our operating and investing activities may use cash and, consequently, this growth may require us to obtain additional sources of financing. There can be no assurance that any necessary additional financing will be available to us on commercially reasonable terms, if at all.

Exchange Rates

Sales from our United States and Hong Kong operations are denominated in U.S. dollars and our manufacturing costs are denominated in either U.S. or Hong Kong dollars. Domestic sales from our United Kingdom operations and operating expenses of all of our operations are denominated in local currency, thereby creating exposure to changes in exchange rates. Changes in the Hong Kong dollar or British pound/U.S. dollar exchange rate may positively or negatively affect our gross margins, operating income and retained earnings. The exchange rate of the Hong Kong dollar to the U.S. dollar has been fixed by the Hong Kong government since 1983 at HK$7.80 to US$1.00 and, accordingly, has not represented a currency exchange risk to the U.S. dollar. We cannot assure you that the exchange rate between the United States and Hong Kong currencies will continue to be fixed or that exchange rate fluctuations between the United States and Hong Kong and United Kingdom currencies will not have a material adverse effect on our business, financial condition or results of operations.