MEDIA ARTS GROUP INC
Form 10-K
March 28, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2002

Or

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

For the transition period from to
Commission file number: 0-24294

MEDIA ARTS GROUP, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**77-0354410**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

800 Lightpost Way
Morgan Hill, California 95037
(Address of Principal Executive Offices, including Zip Code)

(408) 201-5000
(Registrant's Telephone Number, including Area Code)

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

None

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

Common Stock, $0.01 par value

Indicate by check mark whether Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether Registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No ý

As of June 28, 2002, the last business day of Registrant's most recently completed second fiscal quarter, there were 13,224,603 shares of Registrant's Common Stock outstanding, and the aggregate market value of such shares held by non-affiliates of Registrant (based upon the closing sale price of such shares on the New York Stock Exchange on June 28, 2002) was approximately $26,166,765. Shares of Registrant's Common Stock held by each executive officer and director and by each entity that owns 5% or more of Registrant's outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On March 20, 2003, 13,224,603 shares of Registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement relating to its Annual Stockholders' Meeting to be held on May 7, 2003 are incorporated by reference into Part III of this Annual Report on Form 10-K.

MEDIA ARTS GROUP, INC.

FORM 10-K

For the Year Ended December 31, 2002

TABLE OF CONTENTS

PART I

This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements that have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. In some cases, forward-looking statements can be identified by the use of such words as "anticipates," expects," "intends," "plans," "believes," "seeks," "estimates," variations of such words and similar expressions, particularly statements referencing our annual and quarterly revenue expectations for fiscal 2003. Such forward-looking statements are based on current expectations, estimates and projections about the Company's industry, management beliefs and certain assumptions made by Media Arts Group, Inc. management. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict; therefore, actual results may differ materially from those expressed or forecasted in any such forward-looking statements. Such risks and uncertainties include those set forth herein under "Risk Factors" beginning on page 7. Unless required by law, we undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. However, readers should carefully review the risk factors set forth in other reports and documents that we file from time to time with the Securities and Exchange Commission, particularly the Quarterly Reports on Form 10-Q and any Current Reports on Form 8-K.

Item 1. Business

Overview

Media Arts Group, Inc. ("Media Arts" or "Company") is the designer, manufacturer, marketer, licensor, and distributor of fine art reproductions, based upon the original paintings of Thomas Kinkade. The Company believes that the message of Thomas Kinkade as a "life-style" brand has far reaching consumer appeal, in that his message celebrates a sense of home, family, nature and traditions, and the Company's products help create a positive environment, in which to live and work.

The Company's core manufactured products include premium canvas, archival and open edition lithographs. Lithographs may be purchased as framed or unframed products. The Company also licenses its artwork and trademarks. Licensed products include stationary, calendars, ornaments, gifts, collectables home accent and home décor products.

The Company serves a wide consumer base by offering its manufactured and licensed products through a number of channels, including an extensive network of independently owned and operated Thomas Kinkade Signature Galleries®, Showcase Galleries and other independent dealers. The Company's breadth of product offerings allows its dealers to offer products at a wide range of retail price points.

In addition, the Company has established strategic business relationships with other companies including QVC, Avon, the Bradford Exchange, Hallmark Cards Inc. NCE, Barth & Dreyfus, Books Are Fun, BloomCraft, Joanne Fabrics, La-Z-Boy, Kincaid Furniture, Amcal, Harvest House, Advanced Art, Bullfinch, Home Interiors, Teleflora, Thomas Nelson Publishers, Madacy Entertainment and other key licensing, manufacturing, distribution and publishing partners. The Company's distribution network has helped to promote Thomas Kinkade as a "life style" brand.

The Company's marketing strategy is to support its dealers and other business partners with marketing campaigns and special consumer promotions to enhance Thomas Kinkade "life style" brand awareness, generate consumer excitement and increase traffic into authorized dealer locations. During 2002, the Company shifted its marketing program from an image based strategy to a branded theme based strategy which enables the Company and its licensing partners to concurrently develop complimentary gift and collectable products based on the Thomas Kinkade brand. During 2002, the Company completed its restructuring and alignment of sales and marketing to focus Company resources exclusively on the Thomas Kinkade "life style" brand.

Products

The Company's product offerings include framed and unframed limited and open edition reproductions of original artwork produced by Thomas Kinkade, as well as licensed products including books, stationery items and other home accessories and gift products that feature Mr. Kinkade's unique use of light and his peaceful, warm and inspiring themes.

Product Categories. Art reproductions are generally categorized as limited or open edition products. Limited editions are high quality canvas and archival lithographs produced in limited quantities, each of which is accompanied by a certificate of authenticity stating the size of the edition and the number of the print. Open editions are products that are produced in unlimited quantities and sold indefinitely. For the year ended December 31, 2002, limited editions and open editions represented approximately 56% and 24% of the Company's net revenue, respectively.

Licensed Products. The Company licenses its artwork and trademarks to licensees that create, manufacture, market, distribute and sell products that feature the artwork and/or name of Thomas Kinkade. In some instances, the Company works directly with a licensee to create the product, and in other instances the licensee will create the product independently. In either case, the Company has approval rights over all licensed products utilizing the artwork or trademarks. Although these products are not manufactured or sold by the Company, they are included as Company products for purposes of this discussion.

Creative Process. The majority of offered products are based on the artwork of Thomas Kinkade, a winner of multiple awards from the National Association of Limited Edition Dealers, including Artist of the Year and Graphic Artist of the Year. Thomas Kinkade paints in his Northern California studio and on location while traveling. Mr. Kinkade is known for his unique use of light and the manner in which his paintings reflect changes in the intensity of the ambient lighting and provide a warm and inviting lifestyle message to the customer.

The Company and Mr. Kinkade operate under a license agreement dated December 3, 1997 (the "License"). Under the terms of the License, the Company has the complete, unencumbered, exclusive and perpetual rights to reproduce, adapt, manufacture, sub-license, publish, market, distribute, sell and display all art-based and non-art-based products and services associated with Mr. Kinkade and his "artwork" The "artwork" includes at least 150 paintings that Mr. Kinkade is required to provide to the Company between December 1997 and December 2012 (with at least ten (10) paintings to be delivered during each of the first five years), and all original sketches, drawings, writings, paintings and other works of art created by Mr. Kinkade prior to December 1997 (including "archive" images) and during the term of the License. The License also grants the Company the right to use the name and likeness of Mr. Kinkade in promoting the sale of its products and development of any brand name associated with Mr. Kinkade. The Company's creative services department collaborates with Mr. Kinkade, dealers, the sales department and strategic business partners to assist in the creation and development of new products. Proposed new products are tested and pre-marketed prior to product introductions.

Distribution

The Company's manufactured products are sold at retail by approximately 279 independently owned Thomas Kinkade Signature Galleries, three Company-owned stores and a network of approximately 3,600 other independent art dealers. The Company seeks to strengthen its existing art-based brands and increase sales by expanding the network of Thomas Kinkade Signature Galleries and other independent galleries, expanding distribution through strategic business relationships, and expanding its popular licensed products.

Thomas Kinkade Signature Galleries. The independently owned and operated Thomas Kinkade Signature Galleries and the Company-owned Thomas Kinkade Stores provide warm and inviting

environments that convey Thomas Kinkade's "life style" brand message and display Thomas Kinkade reproductions and other products as they might appear in a customer's home. In 1996, the Signature Gallery program was initiated to develop a network of stores owned and operated by individual entrepreneurs selling only Thomas Kinkade products. The Company believes that the Signature Gallery program avails itself of regional knowledge of local Signature Gallery owners to strengthen the Thomas Kinkade brand and broaden the dealer network, with limited investment. In 1999, the Company began to expand Signature Galleries into international markets. At December 31, 2002 there were five Signature Galleries operating in Europe (three in England and one in Scotland) and one Signature Gallery in Toronto, Canada. As of December 31, 2002, 279 Signature Galleries were in operation worldwide, representing approximately $47 million in revenue for the year ended December 31, 2002. The Company intends to carefully expand the Thomas Kinkade Signature Gallery program into communities not currently served by Signature Galleries.

In order to be granted a license to use the Thomas Kinkade Signature Gallery trademark and carry the Company's manufactured product, prospective gallery owners must satisfy certain financial criteria including minimum start-up capital and net worth requirements, and demonstrate related business experience. Signature Gallery owners agree to display a broad collection of Thomas Kinkade images and have limited use of the Thomas Kinkade name. Through the qualification and selection process, the Company attempts to select dealers with the highest probability of long term success.

During the fiscal year ended March 31, 2000, the Company made the strategic decision to limit direct ownership and operation of Company-owned Thomas Kinkade Stores, in favor of increasing the focus on the Signature Gallery program. As of December 31, 2002, the Company operated two Company-owned Thomas Kinkade Stores and one other Company-owned store.

Other Independent Dealers. In addition to sales to Signature Galleries, the Company's manufactured products are also sold to approximately 3,600 other independent dealers, including independent gift and collectible retailers, art galleries and frame stores located principally in the United States and, to a lesser extent, in Canada. Dealers are separated into five dealer levels, with each level operating under different criteria. Dealer levels range from Open Edition Accounts, which are authorized to purchase only open edition products and can be opened with an initial minimum purchase of $500, to Showcase Galleries, which are stores-within-stores, that are committed to purchase a minimum of $30,000 annually in limited edition canvas and paper products. Dealers can be elevated to a higher dealer level by increasing sales of Thomas Kinkade products. Likewise, dealers who do not meet annual revenue targets may be positioned at a lower dealer level. As of December 31, 2002, there were approximately 388 Showcase Galleries, 539 Premier Dealers, 1,137 Authorized and Certified Dealers, and 1,522 Open Edition Accounts.

Distribution of Licensed Products. Products created and manufactured under a license with the Company are distributed through the licensee's distribution channels, which may include department stores, mass merchandisers, gift shops, bookstores, specialty stores, and direct mail catalogs, as well as the Company's dealer network.

Strategic Business Relationships

The Company has entered into agreements with leading consumer marketing companies to build "life style" brand awareness, generate additional sales by reaching a larger audience of consumers and leverage the expertise of these companies in sales and marketing, manufacturing and distribution. Thomas Kinkade products are also sold through direct marketing campaigns, through the Company's licensing and manufacturing partners, on QVC and through third party direct mail catalogs. Lithographs, gift prints and other home accessory/decor products were featured on QVC shows generating sales to QVC of approximately $6.0 million in the year ended December 31, 2002. In fiscal 2002, the Company also sold open edition products to Home Interiors and Park West Galleries, Inc.,

generating approximately $4.8 million and $5.8 million, respectively. The Company intends to continue to develop strategic business relationships with leading consumer marketing companies throughout the world, to provide consumers with greater access to Company products.

The investment in advertising and marketing of licensed Thomas Kinkade products and merchandise by licensees enhances the brand's overall reach. In 2002, licensees that have conducted advertising and marketing of Thomas Kinkade products include: Avon, Bradford Exchange, Hallmark Cards Inc., NCE, Barth & Dreyfus, Books Are Fun, BloomCraft, Joanne Fabrics, La-Z-Boy, Kincaid Furniture, and Amcal. The Company intends to continue to develop strategic relationships with licensees that will undertake such advertising and marketing campaigns.

Creative Services

During the fourth quarter of 2002, the Company established the creative services department to direct, manage and oversee all of its product development activities to extend the Thomas Kinkade "life style" brand into new markets. Located in New York City, the charter of the creative services unit is to "art direct" new product offerings including concept viability, design, testing, development and marketing. The business unit is responsible for the development of creative architectures to facilitate the development of new products by the Company, its licensees and manufacturing alliance partners. Creative architectures include style guides, color palettes, and the development of specific product categories.

Marketing Programs. The Company utilizes multi-media marketing programs including print, radio and television to enhance its marketing capabilities to consumers and collectors. In addition, the Company designs and sells promotional materials, including postcards, catalogs, videotapes, add slicks, wall talkers and other collateral to Signature Galleries and authorized independent dealers, and to its distribution partners. A print advertising allowance program is available to Signature Galleries on a co-operative basis. Signature Galleries and other high level independent dealers may also participate in regional events (including artist appearances) organized by the Company. In many instances, advertising is also provided by the Company's strategic business partners, such as QVC, Bradford Exchange and others. The Company develops direct marketing campaigns to reach consumers and collectors through its marketing database.

Sales and Business Development

The Company's sales and marketing activities include a sales force that sells to and services dealer accounts, and provides training assistance for retail dealer sales personnel, marketing and promotional programs.

During 2002, the Company completed a reorganization of its sales and customer care organizations to focus attention on existing profitable products and markets, while at the same time improve customer service, assist individual dealers with promotion and create an effective marketing strategy through improved media campaigns which are designed to increase customer traffic into authorized dealers and partner stores.

The Company intends to expand its product-appropriate distribution concept (i.e., certain products will not be available in all channels). This will serve to better differentiate between the Company's market channels and target specific products for specific markets. Strategically, the Company will continue to position the Signature Galleries as the flagships of the Thomas Kinkade brand.

Expansion of markets will be pursued by the sales organization, with emphasis on expansion of distribution channels within North America, and, to a limited extent, in Western Europe.

Sales Force. The Company's sales force includes regional gallery account managers, a customer care team, business development managers, key account managers, and licensing personnel. The sales force is generally compensated on a salary plus incentive basis.

As part of the reorganization of the Company's sales and marketing organizations, during 2002 the Company closed its Retail Development Team's operations in Monterey, California. The team had been responsible for expansion of Signature Galleries and training of the owners. The team's functions were integrated into the Company's sales organization. Exclusive consultative sales personnel will work with individual Signature Galleries to provide training programs and product support for gallery owners. The Company's prior training program, Thomas Kinkade University, was closed in 2001.

Thomas Kinkade Collectors' Society. The Company sponsors and operates a collectors club for consumers of Thomas Kinkade products. As of December 31, 2002, the Thomas Kinkade Collectors' Society had approximately 21,000 members, with an annual membership fee of $50. Membership in the Society includes quarterly newsletters and current information about Mr. Kinkade's artwork, including upcoming releases and events, as well as the opportunity to purchase Collectors Society only product offerings.

Charitable Activities: As part of the Company's corporate citizen mission, during 2002, the Company developed and strengthened key strategic relationships with charitable organizations. During 2002, the Company donated product (mostly canvas and lithographic prints) with a retail value of $325,000 to 338 different charities. No one item exceeded $3,500 in retail value. The Company also made a cash donation of $9,000 to the American Heart Association, as part of an employer matching contribution program for the Heart Walkathon.

In the first quarter of 2002, the Company discontinued a program that was initiated in 2001, to publish, produce and sell artwork of artists other than Mr. Kinkade. In connection with the discontinuation of that program, the Company discontinued the related Masters of Light gallery program.

Manufacturing and Production

Limited edition canvas and archival lithographs are manufactured, assembled, warehoused and shipped from the Company's production facility in Morgan Hill, California. Some open edition lithographs are manufactured, assembled and shipped from the Company's manufacturing alliance partners. Three-dimensional products and gift items are manufactured by third parties under separate manufacturing or licensing arrangements.

The Company's proprietary manufacturing process for a canvas lithograph begins with an original painting. The painting is first digitally photographed to capture the image for color separation and proofing, and approval by the artist. The Company's product development team develops a lithograph that best represents the image of the original painting. The lithographs are printed and sent to the manufacturing facility, where they are sent through a double authentication signing process, inspected, transferred to canvas and hand-highlighted by one of the Company's trained highlighters.

The manufacturing cycle takes approximately five days to complete. Finished canvas lithographs are shipped either framed or unframed, in accordance with customer order specifications. Third party vendors supply the frames, paper, canvas, paint and other raw materials and components used in the canvas lithograph production process. The Company is committed to assuring that products meet rigid quality standards and continually evaluates its manufacturing processes and supplier relations to maintain quality control. Systematic quality control procedures, including spot inspections and regular inspection check stations, are in place at various points in the manufacturing process. In order to improve quality control, shorten production time and increase capacity, the Company may automate certain portions of the production process, invest in packaging, conveyance and MIS equipment, and

vertically integrate certain manufacturing processes and develop further improvements in the lithograph manufacturing process or outsource some or all of its processes.

Backlog

Because products are generally shipped within a short period after receipt of an order, the Company has a limited backlog of unfilled orders. As a result, revenue in any quarter is substantially dependent on orders booked and shipped in that quarter.

Employees

As of December 31, 2002, the Company employed 385 employees, including 214 in manufacturing and distribution, 92 in sales and marketing, 16 in retail sales and administration and 63 in corporate administration. The Company believes that labor relations are satisfactory and has never experienced a work stoppage.

Web Site Postings

The Company makes its annual report on Form 10-K and quarterly reports of Form 10-Q and amendments to such reports, available free of charge through the Company's website as soon as reasonably practicable after it electronically files such material with, or furnishes to, the United States Securities and Exchange Commission at www.mediaarts.com. The information in, or that can be accessed through, the website is not part of this report.

Customers

In the fiscal year ended December 31, 2002, the transition period ended December 31, 2001, the fiscal year ended March 31, 2001, and the fiscal year ended March 31, 2000, no single customer accounted for more than 10% of revenues.

RISK FACTORS

Investing in the Company's Common Stock involves a high degree of risk. Any of the following risks, or additional risks not presently known to the Company that the Company deems immaterial, could materially adversely affect the Company's business, operating results and financial condition and could result in a complete loss of your investment.

The Company Faces Risks Related to Its Dependence on One Artist. If the license agreement with Thomas Kinkade were terminated or if he were unable or unwilling to produce new artwork for any reason, the loss of Mr. Kinkade's services would have a material adverse effect on the Company's business, operating results, financial position and cash flow. Life and disability insurance covering Thomas Kinkade in the amount of approximately $60 million and $30 million, respectively, is currently maintained by the Company. The available remedies in the event of a breach of the license agreement by Mr. Kinkade are limited to monetary damages because the license is a personal service contract. In limited circumstances, Mr. Kinkade has the right to terminate the Company's rights to certain images. Upon any loss of Mr. Kinkade's services, the Company may seek to expand the number of products based upon Mr. Kinkade's then existing images, to the extent Mr. Kinkade has not terminated the Company's rights thereto, and/or develop relationships with other artists and offer products based upon their work. In addition, the Company is highly dependent upon continued consumer satisfaction with Thomas Kinkade and the brand, and consumer demand for products based upon the artwork of Thomas Kinkade. Consumer dissatisfaction with Thomas Kinkade or the brand could result in a decline in sales of Thomas Kinkade products or a failure of such products to gain consumer acceptance in new market channels, which could have a material adverse effect on the Company's business, financial position, operating results and cash flow.

The Company Faces Risks Associated with Expansion of Existing Dealer Network Distribution Channels. The Company's strategy includes expansion of its dealer network and distribution channels. The Company's ability to increase revenues will depend, in part, upon the effectiveness of this strategy and the market's continued acceptance of Thomas Kinkade art and products related to the brand. As in the past, the Company continues to direct capital and personnel resources toward enhancing retail support services to licensed gallery owners and licensees, improving manufacturing systems and streamlining systems and procedures.

The expansion of exclusive Thomas Kinkade Signature Galleries and Showcase Galleries is dependent upon a number of factors, including the Company's ability to locate suitable sites, identify appropriate dealer/owners and integrate them into the independent dealer network, as well as the ability of such owners to effectively promote and sell products. The Company may authorize galleries in certain geographic markets that may present competitive challenges that have not been experienced to date. In addition, new stores may open in the proximity of existing galleries and dealers, which may reduce revenue to existing locations. Furthermore, the laws of certain states may limit the Company's ability to terminate, cancel or refuse to renew dealer agreements with dealers operating in those states. Failure of the Company to achieve expansion of, or maintain current levels of, Thomas Kinkade Signature and Showcase Galleries, or of the galleries to remain profitable, could have a material adverse effect on the Company's business, financial position, operating results and cash flow. There can be no assurance that the Company will be able to identify suitable owners for Signature Galleries or that such owners will become effective dealers for our products.

The Company Faces Risks Associated with Expansion Into New Distribution Channels. The Company's strategy includes expansion into new distribution channels. The Company's ability to increase revenues will depend, in large part, upon the effectiveness of this strategy and the market's acceptance of Thomas Kinkade art and products featuring the Thomas Kinkade lifestyle brand. The Company's expansion into new distribution channels is dependent upon a number of factors including the Company's ability to identify suitable partners that will enhance the Thomas Kinkade lifestyle brand and the integration of new distribution channels with the Company's existing dealer network and distribution channels. The Company intends to avoid conflict among the dealer network and distribution channels through product, image, territory, market and demographic differentiation. However, actual or perceived conflict among the dealer network and distribution channels could materially adversely impact the Company's expansion plans, the Company's overall strategy and the Company's business, financial position, operating results and cash flow, and may significantly reduce revenue from the Company's existing established dealer network and distribution channels.

The Company Faces Risks Associated with Development and Promotion of the Thomas Kinkade Lifestyle Brand. The Company intends to direct significant capital and personnel resources to develop and promote the Thomas Kinkade lifestyle brand and expand the Company's and its licensees' product offerings beyond products bearing artwork. There can be no assurance that the Company will be successful in expanding the Thomas Kinkade lifestyle brand or that new branded products will gain market acceptance. The inability to effectively expand the Thomas Kinkade lifestyle brand could result in lower than anticipated revenue and adversely affect the Company's expansion plans, the Company's overall business strategy and the Company's business, financial position, operating results and cash flow.

The Company Faces Risks Related to Its Introduction of New Product Lines. A significant element of the Company's business strategy is to expand the Thomas Kinkade brand into new product lines. Historically, a substantial portion of the revenue from Thomas Kinkade products was generated from the sale of limited edition and open edition wall art products and, to a lesser extent, the sale of other home decorative accessories and gift products. As new products are developed by the Company and its licensees, there can be no assurance that these new products will be successfully marketed or that any of the new product lines will gain market acceptance. The inability to market new products could result

in lower than anticipated revenue for such products and adversely affect the image and value of the Thomas Kinkade brand.

The Company May Have Difficulty Effectively Managing Expansion. The Company's strategy for developing and expanding the Thomas Kinkade lifestyle brand, developing new products, expanding the existing dealer network and distribution channels and expanding into new distribution channels could place a significant strain on management and operations. Expansion requires the need to address changing operational demands and to implement and develop systems and procedures to appropriately deal with those changes. There can be no assurance that the Company will anticipate increased demands. In addition, the Company may need to increase labor staffing or implement other efficiencies to satisfy any significant future increase in product revenue. The failure to increase operational and manufacturing capacity in a timely and effective manner, while maintaining rigid product quality and customer service standards, could result in a failure to meet demand on a timely basis. The Company's inability to increase manufacturing capacity would have a material adverse effect on the business and results of operations. Failure by the Company to continue to upgrade operating and financial control systems and address operational inefficiencies could have a material adverse effect on the Company and its results of operations. There can be no assurance that such systems and controls will be adequate to sustain and effectively monitor future growth. Moreover, in the event any overproduction results from expansion activities, the oversupply of product could, among other things, reduce the perceived value and collectibility of products, resulting in reduced demand for products, particularly highly popular limited editions. Any reductions in revenue or margins resulting from a decrease in demand could have a material adverse effect on the Company's business, financial position, operating results and cash flows.

The Company Faces Risks Related to Its Dependence upon Consumer Preferences. Revenue from existing and new products depends significantly upon continued consumer demand for the Thomas Kinkade brand and product. Demand for products may be affected by consumer preferences, which are subject to frequent and unanticipated changes. The Company is dependent upon its ability to continue to produce appealing and popular Thomas Kinkade art-based products that anticipate, gauge and respond in a timely manner to changing consumer demands and preferences. Failure by the Company to anticipate and respond to changes in consumer preferences could lead to, among other things, lower revenue, excess inventories, diminished consumer loyalty and lower margins, all of which would have a material adverse effect on the Company's business and results of operations. There can be no assurance that the current level of demand for products based upon Mr. Kinkade's artwork will be sustained or grow. Any decline in the demand for such products or failure of demand to grow would have a material adverse effect on the Company's business, financial position, operating results and cash flow.

The Company Faces a Number of Risks Related to Product Revenue Derived Through Third Parties. Retail product sales, as well as communication with the end customer, are primarily made by independent dealers, including Signature Gallery owners whose stores may bear the Thomas Kinkade name and licensees who license our trademark and brand. The Company has entered into licensing agreements with Signature Gallery owners and other licensees granting them limited use of the Thomas Kinkade name. However, the failure of these dealers or licensees to properly represent the Company's products could damage its reputation or the reputation of Thomas Kinkade and adversely affect the Company's ability to build the Thomas Kinkade brand, resulting in a material adverse effect on the business, consolidated financial position, operating results and cash flows of the Company. Although the Company conducts its business through an independently owned and operated dealer network, state business opportunity and franchise laws may impact our relationships with our dealers. Certain of the Company's dealers and licensees may sell products that may compete with the Company's products. While the Company encourages its dealers and licensees to focus on products through market and support programs, these dealers and licensees may give priority to products of competitors. As

discussed below, poor economic conditions could adversely affect independent dealers and licensees which, in turn could adversely affect the Company.

Changes in Economic Conditions and Consumer Spending Could Adversely Impact the Company's Revenue. During 2001 and 2002, several Thomas Kinkade Signature Galleries and other art galleries that were customers of the Company closed and/or filed for bankruptcy protection. A poor economic climate, as experienced during 2002 and 2003 to date, could result in an increased number of such bankruptcies or store closings and/or an acceleration of such bankruptcies or store closings. Sales of the Company's products to Thomas Kinkade Signature Galleries account for approximately 45% of the Company's revenue, and sales to art galleries in general account for approximately 62% of the

Company's revenue, and accordingly, an increase in bankruptcies or store closings of such galleries could materially adversely affect the Company's revenues, business, financial position, operating results and cash flow. Galleries and licensees may experience financial difficulties, which could adversely impact the Company's collection of accounts receivables and royalties. The Company regularly reviews the credit-worthiness of its dealers to determine an appropriate allowance for doubtful accounts. The Company's actual uncollectible accounts could exceed its current or future allowances.

In addition, the home decorative accessories, collectibles and gift product industries are subject to cyclical variations. Purchases of these products are discretionary for consumers and, therefore, such purchases tend to decline during periods of recession in the national or regional economies and may also decline at other times. Additionally, purchases of these products may be subject to seasonal cycles. The Company's success depends, in part, upon a number of economic factors relating to discretionary consumer spending, including employment rates, business conditions, future economic prospects, interest rates and tax rates. In addition, the Company's business is sensitive to consumer spending patterns and preferences. Shifts in consumer discretionary spending away from home decorative accessories, collectibles or gift products, as well as general declines in consumer spending, could have a material adverse effect on the Company's business, financial position, operating results and cash flow.

The Company Faces Risks Due to Reliance on Third Parties. The Company utilizes third parties to manufacture certain products and supply certain materials and components for use in the manufacturing processes. Reliance on third party manufacturers involves a number of risks, including the lack of control over the manufacturing process and the potential absence or unavailability of adequate capacity. Most of the Company's three-dimensional products and gift items are manufactured by third parties under licensing or manufacturing arrangements. The failure of any of these third party manufacturers to produce products that meet rigid specifications could result in lower revenue or otherwise adversely affect consumer perceptions of Company brands and products. Poor consumer perception could have a material adverse effect on the business, consolidated financial position, operating results and cash flows of the Company.

In addition, third party vendors also supply the paper, canvas, paint, frames and other raw materials and components used in the canvas lithograph production process. The failure of any of these third party vendors to produce products that meet the Company's rigid specifications could result in lower revenue or otherwise adversely affect consumer perceptions of the Kinkade brand and products. Although the Company maintains relationships with several suppliers, in the past shortages of raw materials and components have been problematic. Any significant shortage could lead to cancellations of customer orders or delays in placement of orders. There can be no assurance that the Company will not encounter shortages in the future, and any prolonged shortage of paper, canvas, paint, frames or other materials could have a material adverse effect on the Company's business, consolidated financial position, operating results and cash flows.

Pending or Future Litigation. From time to time, the Company is involved in various legal proceedings arising from the normal course of its business activities. Included among these various legal proceedings are lawsuits, claims and other proceedings against the Company and its affiliates by dealers

and gallery owners. These dealer and gallery owner matters generally arise out of contractual, dealer and other relationships with the Company, and involve or may involve compensatory, punitive, antitrust or other damage claims or demands for restitution, rescission, damages or equitable relief. Generally, the Company also has claims against these dealers or gallery owners, primarily for non-payment of trade accounts payable to the Company incurred by the dealer or gallery owner from the purchase of reproductions and other products. The Company regularly evaluates the expected outcome of these litigation matters. Any adverse outcome from these matters is currently not expected to have a material adverse impact on the results of operations, cash flows or financial position of the Company, either individually or in the aggregate. However, the Company's evaluation of the likely impact of these pending disputes could change in the future. In addition, although the Company does not currently expect any adverse outcomes in these litigation matters to have a material adverse impact, due to the inherently uncertain nature of litigation, the Company may be unable to successfully defend itself in these litigation matters, and its results of operations, cash flows or financial position could be materially adversely affected as a result.

Seasonality in Product Sales. The Company's business has experienced, and is expected to continue to experience, seasonal fluctuations in net revenue and income. Its net revenue historically has been highest in the December quarter and lower in the March, June and September quarters. The Company believes that the seasonal effect is due to customer buying patterns, particularly with respect to holiday purchases, and is typical of the home decorative accessories, collectibles and gift product industries. The Company expects these seasonal trends to continue in the foreseeable future.

Fluctuations in Operating Results. The Company's quarterly operating results have fluctuated significantly in the past and may continue to fluctuate as a result of numerous factors, including:

- Change in demand for the art of Thomas Kinkade and the Company's (and its licensees') Thomas Kinkade products (including new product categories and series);
- The Company's ability to achieve its expansion plans;
- The timing, mix and number of new product releases;
- The continued success of the Signature Gallery program;
- The Company's successful entrance into new, and expansion of existing, distribution channels, both foreign and domestic, and new retail concepts;
- The Company's ability to implement strategic business alliances, including attracting and retaining licensees;
- Continued implementation of manufacturing efficiencies;
- Timing of product deliveries;
- The ability to absorb other operating costs and;
- Conflict among distribution channels.

In addition, since a significant portion of the Company's net revenue is generated from orders received in the quarter, revenue in any quarter is substantially dependent on orders booked in that quarter. Results of operations may also fluctuate based on extraordinary events. Accordingly, the results of operations in any quarter will not necessarily be indicative of the results that may be achieved for a full fiscal year or any other quarter. Fluctuations in operating results may also result in volatility in the price of the Company's Common Stock.

The Company Faces Significant Competition. The art-based home decorative accessories, collectibles and gift products industries are highly fragmented and competitive. Participants in these

industries compete generally on the basis of product and brand appeal, quality, price and service. The Company's (and its licensees') product lines compete with products marketed by numerous regional, national and foreign companies that are distributed through a variety of retail formats including department stores, mass merchants, art and gift galleries and frame shops, bookstores, mall-based specialty retailers, direct response marketing programs, catalogs, and furniture and home décor stores. The number of marketers and retail outlets selling home decorative accessories, collectibles and gift products has increased in recent years, and the entry of these companies, together with the lack of significant barriers to entry, may result in increased competition. The Company intends to expand exclusive branded galleries in new geographic markets and those galleries may encounter competitive challenges that have not been previously experienced. Such competition could have a material adverse effect on the Company's business, financial position, operating results and cash flow. Some competitors have better resources, including name recognition, capital resources, more diversified product offerings and broader distribution channels than the Company. The Company's success is highly dependent upon its (and its licensees') ability to produce a wide variety of products with a broad range of customer appeal and provide ready consumer access to such products.

The Company Relies Heavily on Intellectual Property Rights and Faces Risk of Infringement and Unauthorized Sales. The Company relies on a combination of contractual rights, trademarks, trade secrets, and copyrights to establish and protect proprietary rights in its products and brand. Steps taken by the Company to protect its products and brand may not deter their misuse or theft. The Company is aware of a number of unauthorized sales and uses of its products and brand. The growth of the internet has made the unauthorized sale, reproduction, advertising and distribution of the Company's intellectual property and products easier, and has made it more difficult for the Company to protect its rights. Litigation may be necessary to enforce and protect the Company's intellectual property rights. Such litigation could be expensive and divert management's attention away from the operation of the business. In addition, unauthorized sales over the internet or otherwise could reduce sales by authorized sellers, and therefore adversely impact the Company's revenues.

Return Privileges. Certain of the Company's customers have return privileges, allowing such customer to return product purchased from the Company for any reason. Historically, returns by these customers have been immaterial. However, if returns from these customers should exceed historic levels, such returns could materially adversely affect the Company's business, financial position, operating results and cash flow.

Critical Personnel May be Difficult to Attract, Assimilate and Retain. The Company is dependent upon the efforts of executive officers and other key personnel, as well as its ability to continue to attract and retain qualified personnel in the future. The loss of certain executive officers and key personnel or inability to attract and retain qualified personnel in the future could have a material adverse effect on the business and results of operations.

The Company Has Liability on Certain Leases on Property Where It Is Not a Tenant or Occupant. The Company is a guarantor or assignor on facility leases for 11 owned stores that were previously owned by the Company and that were sold to third parties. If the purchaser defaults on the facility lease, the lessor has the right to seek recourse from the Company. The Company has established a reserve for rent for leases where there is evidence of default or potential default and the associated liability is probable and reasonably estimable. In addition, the Company vacated a warehouse facility in Morgan Hill, California and established a reserve for the estimated loss on the sublease of this facility based upon estimates of future sub-lease revenue. Their can be no assurance that the Company will not ultimately incur obligations in excess of these estimates, which could have a material adverse effect on the Company's financial position, results of operations and cash flows.

The Company Must Continue to Satisfy NYSE Listing Requirements. The Company's Common Stock is currently listed for trading on the New York Stock Exchange. The New York Stock Exchange

has established criteria that all listed companies must satisfy to remain listed. The Company currently satisfies the existing criteria for continued listing. There can be no assurance that the Company will continue to satisfy the listing criteria in the future, or remain listed on the New York Stock Exchange. If the Company's stock is no longer listed, it could adversely affect the liquidity of the stock and could significantly adversely affect its value.

Item 2. Properties

The Company's manufacturing, distribution, sales and marketing, administration and executive offices are in two leased campus facilities in Morgan Hill, California encompassing approximately 260,000 square feet. As of December 31, 2002, the Company directly operated retail operations located in three leased sites in the United States ranging from 900 to 1,500 square feet, with an aggregate of approximately 4,000 square feet. The Company has a fifteen year lease for an approximately 127,000 square foot facility in Morgan Hill, California which it has vacated and is holding for sublease. The Company believes that its existing facilities are adequate for its present and future needs.

Item 3. Legal Proceedings

From time to time, the Company is involved in various legal proceedings arising from the normal course of its business activities. Included among these various legal proceedings are lawsuits, claims and other proceedings against the Company and its affiliates by dealers and gallery owners. These dealer and gallery owner matters generally arise out of contractual, dealer and other relationship claims or demands for rescission, damages or equitable relief. Generally, the Company also has claims against these dealers or gallery owners, primarily for non-payment of trade accounts payable to the Company incurred by the dealer or gallery owner from the purchase of reproductions and other products. The Company regularly evaluates the expected outcome of these litigation matters. Any adverse outcome from these matters is currently not expected to have a material adverse impact on the results of operations, cash flows or financial position of the Company, either individually or in the aggregate. However, the Company's evaluation of these pending disputes could change in the future. In addition, although the Company does not currently expect any adverse outcomes in these litigation matters to have a material adverse impact, due to the inherently uncertain nature of litigation, the Company may be unable to successfully defend itself in these litigation matters, and its results of operations, cash flows or financial position could be materially adversely affected as a result.

Item 4. Submission of Matters to a Vote of Securities Holders.

The Company did not submit any matters to a vote of security holders during the fourth quarter of fiscal 2002.

PART II

Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters

(a) Price Range of Common Stock. The Company's stock has been traded on the New York Stock Exchange since December 7, 1998 under the symbol "MDA". Previously, it had been traded on the NASDAQ National Market since the Company's initial public offering on August 10, 1994 under the symbol "ARTS". The following table sets forth, for the periods indicated, the high and low per share closing sales prices for the Company's Common Stock, as reported by the New York Stock Exchange:

Year ended March 31, 2001, Nine-month period ended December 31, 2001 and Year Ended December 31, 2002	**High**	**Low**
Year ended March 31, 2001		
First Quarter	$ 6.69	$ 3.88
Second Quarter	4.31	3.38
Third Quarter	5.31	3.38
Fourth Quarter	5.50	4.13
Nine-month period ended December 31, 2001		
Three months ended June 30	$ 4.30	$ 2.47
Three months ended September 30	3.35	2.01
Three months ended December 31	3.60	1.95
Year ended December 31, 2002		
First Quarter	$ 3.27	$ 2.70
Second Quarter	4.50	2.35
Third Quarter	4.43	1.74
Fourth Quarter	3.75	1.57

As of December 31, 2002 there were approximately 476 holders of record of the Company's Common Stock.

The Company has never paid cash dividends on its Common Stock. The Company's current intent is to retain earnings, if any, for use in the business and the Company does not anticipate paying cash dividends in the foreseeable future. Pursuant to the terms of the Company's line-of-credit with Comerica Bank-California, the Company is prohibited from paying any dividends or making any other distributions or payments on account for redemption, retirement or purchase of its capital stock without the bank's approval. In addition, as part of its financial covenants, there is a $2 million compensating balance requirement.

(b) Recent Sales of Unregistered Securities. In November 2002, the Company issued to its landlord, a warrant to purchase 150,000 shares of the Common Stock of the Company. The warrant has a term of five years from the date of issuance and an exercise price of $2.00 per share. The warrant is exercisable, in whole or in part, immediately and ending on the expiration of the warrant, and the exercise is effected by the surrender of the warrant and payment of the aggregate exercise price for the number of shares being purchased. The warrant expires upon a change of control as defined in the warrant. In consideration of the issuance of the warrant, the landlord terminated a lease and agreement which would have required the Company to pay rent on an additional property for 15 years. The issuance of the warrant was made under Section 4(2) of the Securities Act of 1933, as amended.

(c) Use of Proceeds from Sales of Registered Securities. The Company did not issue any registered securities during the fiscal year ended December 31, 2002.

The information required by this Item regarding equity compensation plans is contained in Item 12 of this Annual Report on Form 10-K.

Item 6. Selected Financial Data

On January 24, 2002, the Company's Board of Directors changed the fiscal year to a calendar year effective December 31, 2001. The selected financial data for the nine-month period ended December 31, 2001 and the years ended December 31, 2002 and March 31, 2001 have been derived from the Company's audited financial statements (except where otherwise indicated). The selected financial data is qualified in its entirety and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Company's consolidated financial statements and the notes thereto included elsewhere in this Annual Report on Form 10-K. The historical results presented below are not necessarily indicative of future results.

	Year ended December 31	Nine-Months ended December 31	Year Ended March 31,		
	2002	2001	2001	2000	1999
Selected Statement of Operations Data:					
Net Revenues	$ 103,780	$ 80,894	$ 132,091	$ 141,065	$ 129,204
Gross Profit	49,576	34,456	76,436	87,918	84,261
Total operating expenses	51,822	52,962	62,753	64,805	55,033
Operating income (loss)	(2,246)	(18,506)	13,683	23,113	29,228
Income (loss) from continuing operations	(1,116)	(12,750)	8,904	14,150	18,352
Income from discontinued operations		1,869			
Net income (loss)	(1,116)	(10,881)	8,904	14,150	14,150
Income (loss) from continuing operations per share (diluted) (1)	(0.08)	(0.97)	0.67	1.07	1.34
Income from discontinued operations per share (diluted)		0.15			
Net income (loss) per share (diluted) (1)	(0.08)	(0.82)	0.67	1.07	1.34
Selecting Operating Data:					
Number of company-owned Thomas Kinkade Stores	2	2	2	7	32
Number of other company-owned stores	1	1	1		
Number of independently owned Thomas Kinkade Signature Galleries	279	344	357	297	169
Selected Balance Sheet Data:					
Cash and cash equivalents	$ 24,538	$ 2,148	$ 5,136	$ 5,544	$ 6,361
Working capital	45,555	39,969	57,294	47,367	41,785
Total assets	82,308	85,490	93,428	88,780	68,146
Long-term obligations	2,571		4,539	4,211	2,108
Stockholders' equity	63,931	64,798	75,589	66,408	51,791

(1) See Note 1 of Notes to Consolidated Financial Statements for an explanation of the determination of shares used in computing income (loss) per share.

Quarterly data for the year ended December 31, 2002 and the nine-month period ended December 31, 2001 and for the quarter ended March 31, 2001 is presented under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K.

15

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Change of Fiscal Year

On January 24, 2002, the Board of Directors of the Company changed the fiscal year to a calendar year effective December 31, 2001.

Financial data for the year ended December 31, 2002, the nine-month period ended December 31, 2001 and the year ended March 31, 2001, have been derived from the Company's audited financial statements.

The following discussion and analysis of the Company's financial condition and results of operations should be read in conjunction with "Selected Financial Data" and the Company's consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K.

Overview

Media Arts Group, Inc. was founded in 1990 and is the designer, manufacturer, marketer, licensor, and distributor of fine art reproductions, based upon the original paintings of Thomas Kinkade. The Company sells its products to approximately 3,600 independent retailers, located primarily in the United States, and through companies such as QVC, Avon, Home Interiors, Advanced Art, and other retailers. The Company also licenses its brand to book publishers such as Bullfinch, Thomas Nelson and Harvest House, collectible distributors, such as the Bradford Exchange and Books are Fun, and gift products through companies such as Avon, Books are Fun and Hallmark Cards. The Company owns 3 retail stores, which serve as sales and marketing test sites, and also sells its products as well as sales through the Company internet site, www.mediaarts.com and www.thomaskinkade.com. Revenue from company-owned stores and the internet web site amounted to less than 3% of the Company's net revenues. Average quarterly revenue of the Company declined by approximately 4% in the year ended December 31, 2002 compared to average quarterly revenue in the nine-month period ended December 31, 2001 and by approximately 27% from average quarterly revenue for the year ended March 31, 2001.

During the year ended December 31, 2002, the Company's principal products included limited and open edition canvas and archival lithographs based on the artwork of Thomas Kinkade. During the year ended December 31, 2002, canvas, archival and open edition lithograph sales accounted for 81.4% of the Company's net revenue. The Company continues to expand the Thomas Kinkade product lines to include home decorative accessories, collectibles and gift products featuring the artwork of Thomas Kinkade. This is being accomplished by selling into new channels of distribution as well as through expansion of licensing of the Thomas Kinkade branded products. Licensing revenues amounted to $10.2 million, $7.7 million and $8.6 million for the year ended December 31, 2002, the nine-month period ended December 31, 2001 and the year ended March 31, 2001, respectively.

The Company is focused on expansion by distributing its products through branded Thomas Kinkade Signature Galleries as well as other independent dealers and distribution partners. In 1996, as part of the Company's strategy of expanding branded distribution, the Company initiated the Thomas Kinkade Signature Gallery program. The Signature Galleries are independently owned and operated galleries that exclusively sell products based on the artwork of Thomas Kinkade. Thomas Kinkade Signature Galleries are part of the Company's core dealer network. During the year ended December 31, 2002, revenue from Signature Galleries accounted for 44.7% of consolidated net revenues, compared to 53.9% for the nine-month period ended December 31, 2001 and 52.6% in the year ended March 31, 2001. Thomas Kinkade Signature Galleries continue to represent the Company's core business, however emphasis will be placed on developing and expanding other distribution partners that provide greater access to Company products at appropriate price points in a particular market.

16

The Company has established distribution alliances with major partners such as Avon, NCE, Amcal, Books are Fun, Home Interiors, Advanced Art, Hallmark and La-Z-Boy.

Normal first quarter seasonality and the ongoing economic uncertainty is continuing to adversely impact the Company's revenues during the first quarter of 2003. Most of the Company's operating costs are based on its expectation of revenues and are relatively fixed in the short term, and accordingly cannot be adjusted quickly enough on a short term basis in response to unanticipated revenue shortfalls. As a result, the Company will experience a loss in the first quarter of 2003.

Results of Operations

The following table sets forth, for the periods indicated, certain items from the Company's consolidated income statement as a percentage of net revenue.

	Year ended December 31, 2002	Nine-months Ended December 31, 2001	Year ended March 31, 2001
Net revenues	100.0%	100.0%	100.0%
Cost of revenues	52.2	57.4	42.1
Gross margin	47.8	42.6	57.9
Operating expenses:			
Selling and marketing	25.2	25.3	22.5
General and administrative	24.8	37.8	23.1
Write-down of Internet business assets		2.4	1.9
Total operating expenses	50.0	65.5	47.5
Operating income (loss)	(2.2)	(22.9)	10.4
Interest income, net	0.1	0.3	
Gain on sales of company-owned store	0.2	0.1	0.3
Income (loss) before taxes	(1.9)	(22.5)	10.7
Provision for (benefit from) income taxes	(0.8)	(6.7)	4.0
Income (loss) from continuing operations	(1.1)	(15.8)	6.7
Discontinued operations tax benefits from closure of subsidiary		(2.3)	
Net income (loss)	(1.1)	(13.5)	6.7

Sales Revenues.

Net revenues. The Company's net revenues were $103.8 million for the year ended December 31, 2002, as compared to $106.1 million (unaudited) for the twelve month period ended December 31, 2001, $80.9 million for the nine-month period ended December 31, 2001 and $132.0 million for the year ended March 31, 2001. Average quarterly revenue in the year ended December 31, 2002 amounted to $26.0 million as compared to $27.0 million in the nine-month period ended December 31, 2001 and $33.0 million in the year ended March 31, 2001. The decrease in net revenue for the year ended December 31, 2002 as compared to the nine-month period ended December 31, 2001(on a quarterly average basis) and for the year ended March 31, 2001 was due primarily to the general slowdown in the United States economy which began in calendar 2000.

Revenues from Signature Dealers were $46.6, $43.6 and $70.4 million for the year ended December 31, 2002, the nine-month period ended December 31, 2001 and the year ended March 31, 2001, respectively. Average quarterly revenues from Signature Dealers were $11.7 million, $14.5 million and $17.6 million for year ended December 31, 2002, the nine-month period ended December 31, 2001

and the year ended March 31, 2001, respectively. The Company believes the decline is due to reduced consumer spending for non-essential products during the current period of economic uncertainty and the resulting closure of some Thomas Kinkade Signature Galleries.

Revenue from all other dealers was $42.4 million, $29.0 million and $48.5 million for the year ended December 31, 2002, the nine-month period ended December 31, 2001 and the year ended March 31, 2001, respectively. Average quarterly revenues from all other dealers were

$10.6 million, $9.7 million and $12.1 million for year ended December 31, 2002, the nine-month period ended December 31, 2001 and the year ended March 31, 2001, respectively. The Company believes the decline is due to reduced consumer spending for non-essential products during the current period of economic uncertainty and the resulting closure of some dealers.

Licensing revenue was $10.2 million, $7.6 million and $8.6 million for the year ended December 31, 2002, the nine-month period ended December 31, 2001 and the year e