Annual Report 2010

Zapf Creation AG
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Key Figures for the Group (IFRS)	2010 € million	2009 € million	+ / - %
Adjusted financial performance (excluding restructuring costs and one-off items)			
Continuing operations			
EBITDA	5.1	-0.6	-
EBIT	1.8	-4.5	-
EBIT margin (%)	2.3	-5.6	-
EBT	-2.7	-9.5	72
Net profit (loss) from continuing operations	-2.8	-11.0	75
Discontinued operations			
Net profit (loss) from discontinued operations	0.4	0.0	>100
Group			
Net profit (loss) for the period	-2.3	-10.9	79
Earnings per share (€) 1)	-0.12	-0.58	79
Financial performance as reported in the income statement (including restructuring costs and one-off items)			
Continuing operations			
Sales revenue	79.3	79.3	0
Gross margin (%)	35.5	37.1	-
EBITDA	3.3	-0.8	-
EBIT	-0.1	-4.6	99
EBIT margin (%)	-0.1	-5.8	-
EBT	-4.5	-9.6	53
Net profit (loss) from continuing operations	-4.6	-11.1	58
Restructuring costs and one-off items included	1.9	0.1	>100
Depreciation and amortization expense included	3.3	3.8	-13
Discontinued operations			
Net profit (loss) from discontinued operations	0.4	0.0	>100
Restructuring costs and one-off items included	0.0	0.0	-
Depreciation and amortization expense included	0.0	0.0	-
Group			
Net profit (loss) for the period	-4.2	-11.1	62
Earnings per share (€) 1)	-0.22	-0.59	62
Balance sheet			
Total assets	67.1	75.7	-11
Non-current assets	15.8	18.8	-16
Capital expenditure	0.9	1.2	-23
Current assets	51.3	56.9	-10
Equity	8.0	12.5	-36
Equity ratio (%)	11.9	16.5	-
Liabilities to banks	27.1	33.3	-19
Net debt	13.6	25.3	-46
Cash flow			
Cash flow from operating activities	16.8	8.4	99
Cash flow from operating activities per share (€)	0.89	0.45	98
Net cash flow	5.6	0.5	>100
Employees			
Number of employees as at the balance sheet date 2)	159	224	-29

The Key Figures have been rounded and are shown in millions of euros. This may result in some discrepancies in totals and ratios compared with the Consolidated Financial Statements.

1) Basic = diluted; 2) Excluding Management Board and trainees

Dear Shareholders,

In the 2010 financial year we have laid a solid foundation from which we can rigorously press ahead with the new strategic alignment of the Zapf Creation Group. The financial basis for this was the repayment of the bank loans which was carried out on January 31, 2011. €20.1 million of the bank loans were taken over by investors.

In the 2010 financial year, we have achieved significant success in the area of operations. With sales revenues of €79.3 million maintained at a steady level, the Zapf Creation Group generated an EBIT, which at minus €0.1 million compared to minus €4.6 million, was able to be significantly improved. Even more noteworthy, we value the positive cash flows from operating activities, which at €16.8 million almost doubled compared to the prior year. This helped to contribute to the fact that the liquidity of the Group, and therefore its flexibility, was noticeably increased by €5.6 million to €13.5 million, despite a reduction in bank liabilities.

At the same time, we have optimized the operational processes within the Group. In this connection, we discontinued the operations of the subsidiaries in Poland and France in the reporting year. Since then, we are serving both these markets with capable distributors. As a result, we have managed to further increase the efficiency of the sales processes and to streamline the cost structures. In addition, we have expanded our product range beyond the portfolio of a pure doll manufacturer to an offering of toys for girls. Here, we want to take advantage of our outstanding market position in the area of toys and functional dolls. Furthermore, we are expanding our licensing business, which already contributed positively to sales in 2010.

In connection with all of these measures, we are especially keeping our margin in focus. Growth at any price is not our aim. To the extent possible, we will attempt to avoid business that does not meet our profitability criteria. A sustainable return to profitability has the highest priority. Highly unfortunate was the announcement of our Management Board chairman, Jaime Ferri Llorens, at the end of February, 2011, that he will be resigning from his post due to health reasons. However, we will not lose the know-how that he acquired over 30 years as CEO and executive chairman of one of the largest toy manufacturers in Spain. He will support us in the future in a consulting role and will especially aid in the further development of the product portfolio. We assume that together we will be able to make a large step toward profitability in the 2011 financial year.

To our shareholders, we would like to express our appreciation for your trust and patience in accompanying us thought these difficult past years. We would also like to thank our employees, who with their great commitment have critically contributed to the positive perspective that the Zapf Creation Group once again has.

Rödental, March 15, 2011

Josef Lukas	Hannelore Schalast
Member of the Management Board	Member of the Management Board

Zapf Creation AG

Rödental

Corporate Governance Report for 2010

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A. Corporate Governance

1. Preliminary remark

The Management Board and the Supervisory Board of Zapf Creation AG attach great importance to compliance with and implementation of the principles enshrined in the German Corporate Governance Code with regard to good and responsible management within the Zapf Creation Group.

These principles determine corporate communications and efforts to maintain transparency in corporate affairs in the interest of shareholders, business partners, and employees. It is in this sense that both the Management Board and the Supervisory Board of the Company regularly review the management principles with the goal of exercising and developing the Company's corporate governance in the long term.

Important matters related to corporate governance in the 2010 financial year are listed below.

We also refer to the report of the Supervisory Board for the 2010 financial year.

2. Shareholders and Annual Shareholders' Meeting

<u>Convening of the Annual Shareholders’ Meeting</u>

In January 2011 the signed financing agreements for the long-term Group financing were implemented through the corresponding loan disbursements. The financial restructuring of the Zapf Creation Group was thus concluded. Due to the open question of the “going concern” of Zapf Creation AG and the Zapf Creation Group up until successful conclusion of the financing negotiations, it was not possible for KPMG AG, Wirtschaftsprüfungsgesellschaft, Nuremberg, to issue an opinion on the 2009 annual financial statements. An assessment was not possible within the 2010 calendar year. Therefore, the convening of the 2010 Annual Shareholders’ Meeting was first able to take place in calendar year 2011.

Voting Right Notifications

The Company received no new voting right notifications or investor statements in the 2010 reporting period. In this regard, reference is made to disclosures under Items No. 4 and No. 5 in Section A.

3. Collaboration of the Management Board and the Supervisory Board

The Zapf Creation Group uses the dual management system under German corporate law that assigns responsibility for managing the Company to its Management Board and for monitoring the Company's management by the Management Board to its Supervisory Board. These two boards jointly coordinate the Company's strategic direction, and the Supervisory Board regularly reviews its implementation by the Management Board. The Management Board provides comprehensive and timely information to the Supervisory Board on all issues relevant to the Company in terms of planning, development of the business, as well as risks and risk management and compliance. Both corporate bodies work closely with each other in the Company's interest but are strictly separated from each other in terms of both their personnel composition and the responsibilities assigned to the relevant board members.

If there are conflicts of interest with regard to pending decisions due to overlapping membership on the corporate bodies of Zapf Creation AG and its shareholder MGA Entertainment, Inc., Van Nuys, California, USA, including its affiliates, the relevant boards are immediately notified thereof on a case-by-case basis by means of a formal statement; the relevant board members are asked to recuse themselves from the discussion and decision. In this regard, please also see the Company's Report on Dependent Companies and Relations with Affiliates.

4. Management Board

Composition

Since March 1, 2011 the Company's Management Board comprises Josef Lukas, member of the Management Board and Hannelore Schalast, member of the Management Board. The members of the Management Board lead the Company as a whole in accordance with Article 77 German Stock Corporation Act (AktG).

In compliance with Section 77 German Stock Corporation Act, each Management Board member's sphere of responsibility follows from the Company's schedule of responsibilities in the version from March 2, 2011, which is an integral part of the Company's internal rules of procedure.

The members of the Company's Management Board have the following main responsibilities — notwithstanding their rights and duties under the law, the Articles of Incorporation and internal rules of procedure, as well as their overarching responsibility and their obligations to cooperate with each other, and notify and monitor each other:

The division of responsibilities within the Management Board is presented below:

Josef Lukas, member of the Management Board

- Logistics, restructuring, sales (leadership), planning, budget (partial responsibility), product research & development, subsidiaries (sales, marketing, operations), trademark law, marketing, quality management, public relations (products)

Hannelore Schalast, member of the Management Board

- Investor relations, EDP, finance, budget (leadership), legal, personnel, public relations (excluding products), risk management, compliance and corporate governance, subsidiaries (finance)

<u>Changes</u>

The following changes with regard to the composition of the Management Board of Zapf Creation AG occurred during the reporting period:

On January 29, 2010 the Supervisory Board of Zapf Creation AG appointed Mr. Ron Oboler as a member and Chairman of the Management Board, effective February 1, 2010. Ron Oboler, who as Director of International Sales of MGA Entertainment, Inc. has extensive experience in the toy industry, has temporarily led the Company since then. The Supervisory Board strived to fill the position of Management Board Chairman on a long-term basis. Stephan F. Brune, who held the position of member and Management Board Chairman of Zapf Creation AG since October 1, 2008, left the Company on January 31, 2010. In addition, on January 29, 2010, Ron Brawer, a member of the Supervisory Board, was delegated to the Management Board in accordance with Article 105 (2) of the Stock Corporation Act. Since then, Ron Brawer was responsible in particular for streamlining the Group structure and thereby realizing the related savings potential. His appointment to the Management Board ended on December 31, 2010. Ron Brawer resigned from his post on the Supervisory Board, effective December 31, 2010.

Effective June 30, 2010, the Management Board member Jens U. Keil has left the Company in order to pursue other career ambitions. Since March 1, 2007 Mr. Keil was on the Management Board and was responsible for finance, investor relations, EDP, logistics and risk management.

On August 6, 2010 Zapf Creation announced that the Supervisory Board member Hannelore Schalast, head of corporate finance & controlling, was appointed to the Management Board as Chief Financial Officer of the Company, effective February 1, 2011. Until then, Ms. Schalast acted as chief representative in the general area of finance. Also as of February 1, 2011, Josef Lukas, who previously acted in an advisory function in sales for Germany/Austria/Switzerland, took over as Management Board member for sales. Ron Oboler, Chairman of the Management Board, and Ron Brawer, the Supervisory Board member delegated to the Management Board, relinquished their temporarily assumed Management Board responsibilities. Mr. Oboler retired from the Management Board as of February 15, 2011; the appointment of Mr. Brawer to Management Board ended on December 31, 2010.

On November 2, 2010 Zapf Creation AG announced that the Supervisory Board of the Company appointed Mr. Jaime Ferri Llorens as a member of the Management Board, effective January 1, 2011, and as Chairman of the Management Board, effective February 16, 2011. Mr. Jaime Ferri Llorens replaced Mr. Ron Oboler, who led the Company on a temporary basis since February 2010.

On February 28, 2011, Zapf Creation AG announced that Jaime Ferri Llorens, member and Chairman of the Management Board of Zapf Creation AG is resigning from his post for health reasons.

At the close of February 28, 2011, the contract with José Antonio Santana, member of the Management Board of Zapf Creation AG, terminated: therefore, since this time Mr. Santana is no longer a member of the Management Board of the Company.

On March 14, 2011, the Supervisory Board of Zapf Creation AG appointed Mr. Thomas Eichhorn as a member of the Management Board of the Company, effective April 1, 2011.

Article 1 (3) of the Rules of Procedure of the Management Board concerning the allocations of responsibilities in the Management Board was amended in March 2010, July 2010, January 2011 and most recently in March 2011.

Directors’ Dealings

The Company was notified of the following transactions made by members of the Management Board, their spouses or immediate relatives requiring disclosure pursuant to Section 15a German Securities Trading Act:

Mr. Stephan F. Brune, member of the Management Board, notified Zapf Creation AG on January 12, 2010, in accordance with Section 15a German Securities Trading Act that on January 11, 2010, he had sold a total of 80,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of €1.15 per share for total transaction volume of €92,000. The sale of the shares, which were guaranteed in his employment contract and transferred to the Company, was purportedly made for personal reasons.

Further transactions that were carried out by members of the Management Board and by their spouses or immediate relatives and are subject to publication were not made know to the Company. All members of the Management Board are informed in detail regarding the disclosure requirement.

Shareholdings of the Management Board

No notifications have been made to the Company regarding the portion of shares issued by the Company that apply to members of the Management Board or that are to be allocated to these individuals as of December 31, 2010. All members of the Management Board are informed in detail regarding the disclosure requirement.

With regards to the portion of shares held by Ron Brawer, who in the 2010 financial year in accordance with Sec. 105 (2) of the German Stock Corporation Act was a temporarily delegated member of the Supervisory Board, reference is made to the comments und Item No. 5.

5. Supervisory Board

Composition

The Company's Supervisory Board is comprised as follows: Dr. Harald Rieger, member and Chairman of the Supervisory Board; Mr. Isaac Larian, member of the Supervisory Board; Mr. Miguel Perez-Carballo Villar, member of the Supervisory Board; and Mr. Manfred Schneider, member of the Supervisory Board.

Changes

The following changes with regard to the composition of the Supervisory Board occurred during the reporting period:

On January 11, 2010, Mr. Nicolas Mathys, member and Vice-Chairman of the Supervisory Board, by reference to Article 11(4) of the Articles of Incorporation of the Company, announced that he is resigning from his position as a member and Vice-Chairman in accordance with the four-week notification period.

On January 29, 2010, the Supervisory Board of Zapf Creation AG delegated Mr. Ron Brawer, member of the Supervisory Board in accordance with Article 105 (2) German Stock Corporation Act. Since then, Ron Brawer was particularly responsible for streamlining the Group structure and thereby realizing the related savings potential. His appointment to the Management Board ended on December 31, 2010. Ron Brawer has resigned as member of the Supervisory Board effective December 31, 2010.

Effective April 26, 2010, Mr. Jaime Ferri Llorens was appointed by the Supervisory Board as a consultant of the Company regarding all questions of the business focus, especially in the area of product development and marketing, as well as the handling of Spanish market. Therefore, Mr. Jaime Ferri Llorens, in agreement with the Supervisory Board, resigned his seat on the Supervisory Board in accordance with Article 11(4) of the Articles of Incorporation of the Zapf Creation AG.

With a resolution dated September 13, 2010, the local court of Coburg appointed Mr. Manfred Schneider as member of the Supervisory Board of Zapf Creation AG in accordance with Article 104 of the German Stock Corporation Act.

Directors' Dealings

The Company was not informed of any transactions carried out by members of the Supervisory Board, their spouses or immediate relatives that require disclosure pursuant to Section 15a German Securities Trading Act. All members of the Supervisory Board have been informed in detail regarding the disclosure requirement.

Portion of shares attributed to Supervisory Board

The percentage of shares issued that are attributable to members of the Supervisory Board or to companies related to them as of December 31, 2010 was already provided to the Company in calendar year

2009 in the form of voting right notifications concerning members of the Supervisory Board or companies related to them, as follows:

On November 26, 2009, Zapf Creation AG was informed of the existence of the following shareholding pursuant Section 26 (1) Sent. 1 German Securities Trading Act by the law firm of Voller Rechtsanwälte [Voller Attorneys] and it was published by the Company as follows:

“We represent the Issac Larian Annuity Trust, Van Nuys, California, USA, the Issac and Angela Larian Living Trust, Van Nuys, California, USA, the Angela Larian Annuity Trust, Van Nuys, California, USA, the Shirin Larian Makabi Annuity Trust, Van Nuys, California, USA, the Jahangir Eli Makabi Annuity Trust, Van Nuys, California, USA, the Shirin and Jahangir Eli Makabi Trust, Van Nuys, California, USA, Mr. Issac Larian, USA, Ms. Angela Larian, USA, Ms. Shirin Larian Makabi, USA, Mr. Jahangir Eli Makabi, USA and MGA Entertainment Inc., Van Nuys, California, USA (collectively, the “Represented Parties”).

Our power of attorney for the above Represented Parties has been affirmed by the lawyers.

In the name of and at the request of the above-mentioned represented we are informing you pursuant to Section 21 (1) German Securities Trading Act that the share of voting rights of the above-mentioned represented in Zapf Creation, AG, Rödental, Germany as of November 20, 2009 exceed the threshold of 50% and at this date amounts to 65.29% of the voting shares in Zapf Creation AG. This represents 12,598,782 voting shares in Zapf Creation AG.

The 65.29% of voting shares in Zapf Creation AG held on November 20, 2009 are held by or allocated to the above-mentioned Represented Parties as follows:

a) The Issac Larian Annuity Trust, Van Nuys, California, USA holds 23.97% of the voting shares pursuant to Section 21 (1) German Securities Trading Act (this represents 4,624,992 of the voting shares). 41.32% of the voting shares (this represents 7.973.789 voting shares) are allocated to it pursuant to Section 22 (2) German Securities Trading Act. Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to it pursuant to Section 22 (1) No. 1 German Securities Trading Act.

b) The Isaac and Angela Larian Living Trust, Van Nuys, California, USA, holds 33.61% of the voting shares pursuant to Section 21 (1) German Securities Trading Act (this represents 6,484,666 of the voting shares). 31.69% of the voting shares (this represents 6,114,115 voting shares) are allocated to it pursuant to Section 22 (2) German Securities Trading Act. Included therein are 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to it pursuant to Section 22 (1) No. 1 German Securities Trading Act.

c) The Shirin Larian Makabi Annuity Trust, Van Nuys, California, USA, holds 2.75% of the voting shares pursuant to Section 21 (1) German Securities Trading Act (this represents 531,305 of the voting shares). 62.54% of the voting shares (this represents 12,067,476 voting shares) are allocated to it pursuant to Section 22 (2) German Securities Trading Act. Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to it pursuant to Section 22 (1) No. 1 German Securities Trading Act.

d) The Jahangir Eli Makabi Annuity Trust, Van Nuys, California, USA, holds 2.75% of the voting shares pursuant to Section 21 (1) German Securities Trading Act (this represents 531,305 of the voting shares). 62.54% of the voting shares (this represents 12,067,476 voting shares) are allocated to it pursuant to Section 22 (2) German Securities Trading Act. Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to it pursuant to Section 22 (1) No. 1 German Securities Trading Act.

The Shirin and Jahangir Eli Makabi Trust, Van Nuys, California, USA, holds 2.21% of the voting shares pursuant to Section 21 (1) German Securities Trading Act (this represents 426,513 of the voting shares). 63.08% of the voting shares (this represents 12,172,268 voting shares) are allocated to it pursuant to Section 22 (2) German Securities Trading Act. Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to it pursuant to Section 22 (1) No. 1 German Securities Trading Act.

f) Allocated to Mr. Issac Larian, USA are 57.58% of the voting shares pursuant to Section 22 (1) No. 2 German Securities Trading Act (this represents 11,109,658 of the voting shares). Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. 7.72% of the voting shares (this represents 1,489,123 of the voting shares are allocated to him pursuant to Section 22 (2) No. 1 German Securities Trading Act. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to him pursuant to Section 22 (1) No. 1 German Securities Trading Act.

g) Allocated to Ms. Angela Larian, USA, are 33.61% of the voting shares pursuant to Section 22 (1) No. 2 German Securities Trading Act (this represents 6,484,666 of the voting shares). Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds. 31.69% of the voting shares (this represents 6,114,115 of the voting shares) are allocated to her pursuant to Section 22 (2) German Securities Trading Act. Included therein are 23.97% of the voting shares that the Isaac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to her pursuant to Section 22 (1) No. 1 German Securities Trading Act.

h) Allocated to Ms. Shirin Larian Makabi, USA, are 4.96% of the voting shares pursuant to Section 22 (1) No. 2 German Securities Trading Act (this represents 957,818 of the voting shares), and 60.33% of the voting shares (this represents 11,640.963) are allocated to her pursuant to Section 22 (2) German Securities Trading Act. Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to her pursuant to Section 22 (1) No. 1 German Securities Trading Act.

i) Allocated to Mr. Jahangir Eli Makabi, USA, 4.96% of the voting shares pursuant to Section 22 (1) No. 2 German Securities Trading Act (this represents 957,818 of the voting shares), and 60.33% of the voting shares (this represents 11,640.963) are allocated to him pursuant to Section 22 (2) German Securities Trading Act. Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to him pursuant to Section 22 (1) No. 1 German Securities Trading Act.

j) MGA Entertainment, Inc., Van Nuys, California, USA, holds one voting share to Section 21 (1) German Securities Trading Act. 65.29% of the voting shares (this represents 12,598,781 voting shares) are allocated to it pursuant to Section 22 (2) German Securities Trading Act. Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds.

k) Allocated to Larian Annuity Trust, USA, are 65.29% of the voting shares pursuant to Section 22 (2) German Securities Trading Act (this represents 12,598,781 of the voting shares). Included therein are 33.61% of the voting shares that the Issac and Angela Larian Living Trust, Van Nuys, California, USA holds and 23.97% of the voting shares that the Issac Larian Annuity Trust, Van Nuys, California, USA holds. One voting share held by MGA Entertainment, Inc., Van Nuys, California, USA is allocated to it pursuant to Section 22 (1) No. 1 German Securities Trading Act."

On November 26, 2009, Zapf Creation AG was notified by the law firm of Voller Rechtsawälte of the existence of the following shareholding pursuant to Section 26 (1) Sent. 1 German Securities Trading Act. It was published by the Company as follows:

"We represent Mr. Ron Brawer, USA. Our power of attorney for Mr. Brawer has been affirmed by the lawyers.

In the name of and at the request of Mr. Brawer we hereby inform you pursuant to Section 21 (1) German Securities Trading Act that the voting shares of Mr. Brawer in Zapf Creation AG, Mönchrödener Straße 13, 96471 Rödental, as of November 20, 2009 was below the threshold of 30%, 25%, 20%, 15%, 10%, 5% and 3% and amounted to 0.18% (34,617 voting rights) as of this date".

At the time of the voting rights announcement Mr. Brawer was a member of the Supervisory Board of Zapf Creation AG.

Zapf Creation AG was also already notified in the 2009 calendar year by the law firm of Voller Rechtsawälte of the existence of the following statement of the investors pursuant to Section 27a (2) Sent. 1 German Securities Trading Act. It was published by the Company as follows:

"We represent the Isaac Larian Annuity Trust, the Isaac and Angela Larian Living Trust, the Angela Larian Annuity Trust, the Shirin Larian Makabi Annuity Trust, the Jahangir Eli Makabi Annuity Trust, the Shirin and Jahangir Eli Makabi Trust, Mr. Isaac Larian, Ms. Angela Larian, Ms. Shirin Larian Makabi, Mr. Jahangir Eli Makabi and MGA Entertainment, Inc. (collectively the "Represented Parties").

Our power of attorney for the above Represented Parties has been affirmed by the lawyers.

In a letter dated November 26, 2009 the Represented provided notification that on November 20, 2009 they exceeded the threshold of 50% and hold a voting share of 65.29% (this represents 12,598,782 voting shares) in Zapf Creation AG. With respect to the pursued goals and the source of the funds for the acquisition, the following is disclosed pursuant to Section 27a German Securities Trading Act:

1. The Represented Parties consider their holdings in Zapf Creation AG to be a long-term investment for the purpose of implementing strategic goals.

2. It is the intent of the Represented Parties, depending upon the development of the market within the next 12 months, to acquire additional voting shares.

3. The Represented Parties, as in the past, intend to exercise influence on the composition of the Management Board and Supervisory Board.

4. The Represented Parties are not seeking a significant change in the capital structure of Zapf Creation AG, especially with respect to relationship of equity and liabilities and the dividend policy.

5. The acquisition of voting shares which led to exceeding the threshold of 50% was made by the Isaac and Angela Larian Living Trust. The acquisition was financed entirely by own resources."

No further information is available to the Company regarding the percentage of shares issued that are held by or attributable to members of the Supervisory Board as of December 31, 2010. All members of the Supervisory Board have been informed in detail regarding the disclosure requirement.

6. Transparency

Zapf Creation values active corporate communications. New and significant information is made available to shareholders, analysts, employees and the public immediately and comprehensively. In its corporate communications, the Management Board is guided by principles of transparency, timeliness, openness, comprehensibility, and equal treatment for all. All such information is transmitted via electronic media, in particular, the Internet, and is available in English as well.

7. Accounting and audit of the financial statements

<u>Accounting</u>

The consolidated financial statements of Zapf Creation AG are prepared by applying Sec. 315 a of German Commercial Code ("Consolidated financial statements according to International Financial Reporting Standards") in accordance with International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) and the related pronouncements of the International Financial Reporting Interpretations Committee (IFRIC), as they are to be applied according to Article

4 of the EU Directive No. 1606/2002 of the European Parliament and Council, dated July 19, 2002. In addition, the provisions of Sec. 315 a (1) German Commercial Code are observed in the preparation of the consolidated financial statements.

The separate annual financial statements of Zapf Creation AG are based on the German Commercial Code.

Share-based compensation

Considering that the operations are directed towards a long-term and sustainable increase in the value of the Company for the shareholders, compensation systems based on company value in the form of share-based payment systems are utilized.

- Phantom stock option programs

  The compensation system based on phantom shares that was launched in 2006 for the members of the Zapf Creation AG's Management Board remained in place in the 2010 financial year and was expanded regarding the group of beneficiaries. In this connection, additional phantom stock options at defined base prices were allocated under this plan in 2010; the exercise of these options is not linked to achievement of specific performance targets. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date on which the phantom stock options are exercised. In contrast to employee stock option plans, compensation based on phantom shares does not constitute real equity interests but rather salary and/or bonus payments that are contingent on the development of the Company's stock. The initial measurement of the liability of the Zapf Creation Group from phantom stock option programs is in accordance with IFRS 2 ("Share-based Payments") on the basis of the fair value. The effects of periodic remeasurement of the fair value are recognized in the income statement.

- Issuance of own shares

  In addition to the above-described phantom stock option programs, in the Zapf Creation Group the possibility is used to create a long-term incentive through the issuance of own shares in connection with a share-based compensation system. The accounting is carried out in accordance with IFRS 2 ("Share-based Payments").

- Stock option plans

  In the Annual Shareholders' Meeting of December 15, 2009 the Company was authorized to establish one or more stock option plans, under which up to and including December 14, 2014 once or several times stock options up to a total of 500,000 no-par bearer shares ("shares") of Zapf Creation AG can be issued. Through December 31, 2010 the potential to issue stock options has not been utilized by the Company.

Audit of Financial Statements

As in the previous year, KPMG AG, Wirtschaftsprüfungsgesellschaft, Nuremberg, Germany, is the auditor of the separate annual and the consolidated financial statements of Zapf Creation AG as of December 31, 2010.

B. Corporate Governance Statement according to Sec. 289 a German Commercial Code

(Start of the Corporate Governance Statement according to Article 289 a German Commercial Code)

1. Corporate Governance

1.1. Preliminary remark

The Principles of the German Corporate Governance Code for a good and responsible corporate governance and their implementation in the Zapf Creation Group are given a high priority by the Management Board and Supervisory Board of Zapf Creation AG.

In the interest of shareholders, business partners and employees, these principles determine the corporate communication and the endeavor to provide transparency. With this in mind, the Management Board and the Supervisory Board of the Company regularly review the principles of its corporate governance with the goal of continually exercising and developing the corporate governance of the Company.

1.2. Working method of the Management Board and Supervisory Board

The Zapf Creation Group uses the dual management system under German corporate law that assigns responsibility for managing the Company to its Management Board and for monitoring the Company's management by the Management Board to its Supervisory Board. These two boards jointly coordinate the Company's strategic direction, and the Supervisory Board regularly reviews its implementation by the Management Board. The Management Board provides comprehensive and timely information to the Supervisory Board on all issues relevant to the Company in terms of planning, development of the business, as well as risks and risk management and compliance. Both corporate bodies work closely with each other in the Company's interest but are strictly separated from each other in terms of both their personnel composition and the responsibilities assigned to the relevant board members.

If there are conflicts of interest with regard to pending decisions due to overlapping membership on the corporate bodies of Zapf Creation AG and its shareholder MGA Entertainment, Inc., Van Nuys, California, USA, including its affiliates, the relevant boards are immediately notified thereof on a case-by-case basis by means of a formal statement; the relevant board members are asked to recuse themselves from the discussion and decision. In this regard, please also see the Company's Report on Dependent Companies and Relations with Affiliates.

With respect to further information regarding the Management Board and the Supervisory Board of Zapf Creation AG reference is made to published report of the Supervisory Board in connection with the 2010 Annual Report as well as the Corporate Governance Report also included in the Annual Report, both for the 2010 financial year. The 2010 Annual Report of the Company is available on the Website of Zapf Creation AG. All information is also available in English language.

1.3. Disclosures regarding corporate governance practices

With respect to disclosures of corporate practices that go beyond the minimum extent required by law, the following matters are to be mentioned in particular:

<u>Corporate planning and control</u>

The strategic and operative management of the Zapf Creation Group is carried out on the basis of a comprehensive internal corporate planning. In connection with the existing control processes, this planning analytically developed and validated. In connection with the ongoing internal reporting the analyses developed are subsequently communicated to the Management Board and further responsible specialists within the Company.

<u>Risk Management</u>

The responsible and consistent management of corporate risks is a part of the corporate governance that is practiced by the Zapf Creation Group. With respect to the definition of risk areas and risk management system built upon this, in the Zapf Creation Group a systematic identification, assessment, and documentation of existing strategic and operating risks is carried out. The internal risk reporting, which with regards to the risk description and level of detail also lists and communicates operating, non-existence threatening individual risks, is an integral part of the planning, control and reporting process in the Zapf Creation Group.

2. Declaration of Compliance regarding the German Corporate Governance Code

2.1. Preliminary remark

The Company's 2010 Declaration of Compliance required under Section 161 German Stock Corporation Act regarding the recommendations of the Government Commission on the German Corporate Governance Code was jointly issued by the Management Board and the Supervisory Board and is permanently available to the Company's shareholders on its Website.

The declarations follow below verbatim.

2.2. Declaration of Compliance 2010

(Start of the Declaration of Compliance)

Declaration of the Management Board and the Supervisory Board of Zapf Creation AG regarding the German Corporate Governance Code

The Management Board and the Supervisory Board of Zapf Creation AG hereby declare pursuant to Section 161 of the German Stock Corporation Act (AktG) that after issuing last year's declaration of conformity on December 11, 2009 and until the new version of the Code dated May 26, 2010 took effect on July 2, 2010, the Company was in compliance with the recommendations of the Government Commission on the German Corporate Governance Code as amended on June 18, 2009 and as published by the German Ministry of Justice on August 5, 2009 in the official section of the electronic Federal Gazette, with the exception of the following:

- "If the Company takes out a D&O (directors' and officers' liability insurance) policy for the Management Board, a deductible of at least 10% of the loss up to at least the amount of one and a half times the fixed annual compensation of the Management Board member must be agreed upon. A similar deductible must be agreed upon in any D&O policy for the Supervisory Board." (Item 3.8, Paras. 2 and 3)

The D&O insurance purchased by Zapf Creation AG did not require the members of the Company's Management and Supervisory Boards to pay a deductible. Deductibles are usually unsuitable for preventing losses and thus are generally taken into account by the insurance industry only in the calculation of premiums. The legally required deductible for members of the Management Board was taken into account within the period specified.

- "For instance, share or index-based compensation elements related to the enterprise may come into consideration as variable components. These elements shall be related to demanding, relevant comparison parameters. Changing such performance targets or the comparison parameters retroactively shall be excluded. For extraordinary developments a possibility of limitation (cap) must in general be agreed upon by the Supervisory Board." (Item 4.2.3, Para. 3)

  In principle, the Company intended to follow these recommendations in future contractual agreements. However, a share-based compensation system involving phantom options, which does not take into account these recommendations, is still in place for the current members of the Management Board of Zapf Creation AG. Exercising the phantom options is not tied to the fulfillment of specific performance targets. At the time the options were granted, this did not seem necessary given the limited number of phantom options. Furthermore, demanding, relevant performance targets are defined in connection with the variable compensation of the Management Board members. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the exercise date. There is no explicit regulation excluding the retroactive change of the comparison parameters. While a cap for extraordinary developments is not included in existing agreements, it was intended for such a cap to be stipulated in newly concluded director's contracts.

- "Together with the Management Board it shall ensure that there is a long-term succession planning." (Item 5.1.2, Para. 1, Sentence 3)

Long-term succession planning for the members of the Management Board was implemented in August 2010 upon publication of the long-term Management Board concept. Accordingly, up until July 2, 2010, long-term succession planning was not in place in its final form. Given the size of the Company, internal succession planning for the Management Board was only possible to a limited extent.

- "The Supervisory Board shall form a nomination committee composed exclusively of shareholder representatives which proposes suitable candidates to the Supervisory Board for recommendation to the General Meeting." (Item 5.3.3)

  Given the size of the Company and its Supervisory Board, the formation of a nomination committee was not appropriate.

- "Furthermore, attention shall also be paid to [...] an age limit to be specified for the members of the Supervisory Board [...]." (Item 5.4.1, Sentence 2)

  No age limit was set for members of the Supervisory Board because we do not believe that the age of a Supervisory Board member is a key criterion for his or her qualification.

- "Proposed candidates for the Supervisory Board chair shall be announced to the shareholders." (Item 5.4.3, Sentence 3)

  The current chairman of the Supervisory Board was elected without it having been possible to announce proposed candidates to the shareholders because the Supervisory Board's election of its chairman took place shortly after the members of the Supervisory Board were elected by the Annual Shareholders' Meeting on May 27, 2008, and the current chairman of the Supervisory Board had already held this position prior to his election to the Supervisory Board during the aforementioned Annual Shareholders' Meeting.

- "The Consolidated Financial Statements shall be publicly accessible within 90 days of the end of the financial year [...]" (Item 7.1.2, Sentence 4)

  The Company was unable to make its consolidated financial statements for fiscal years 2008 and 2009 publicly accessible within the required periods because the negotiations with the banking syndicate regarding the Company's long-term financing were not concluded in time.

The Management Board and the Supervisory Board of Zapf Creation AG hereby declare pursuant to Section 161 of the German Stock Corporation Act (AktG) that since having issued last year's declaration of conformity on December 11, 2009 and since the effective date of the recommendations of the Government Commission on the German Corporate Governance Code as amended on May 26, 2010 and as published by the German Ministry of Justice on July 2, 2010 in the official section of the electronic Federal Gazette, the Company has been in compliance with such recommendations, with the exception of the following:

- "A similar deductible shall be agreed upon in any D&O policy for the Supervisory Board." (Item 3.8, Para. 3)

  The existing D&O insurance purchased by Zapf Creation AG does not require the members of the Company's Supervisory Board to pay a deductible. Deductibles are usually unsuitable for preventing losses and thus are generally taken into account by the insurance industry only in the calculation of premiums.

- "For instance, share or index-based compensation elements related to the enterprise may come into consideration as variable components. These elements shall be related to demanding, relevant comparison parameters. Changing such performance targets or the comparison parameters retroactively shall be excluded. For extraordinary developments a possibility of limitation (cap) must in general be agreed upon by the Supervisory Board." (Item 4.2.3, Para. 3)

In principle, the Company intends to follow these recommendations in future contractual agreements. However, a share-based compensation system involving phantom options, which does not take into account these recommendations, is still in place for the current members of the Management Board of Zapf Creation AG. Exercising the phantom options is not tied to the fulfillment of specific performance targets. This did not seem necessary given the limited number of phantom options. Furthermore, demanding, relevant performance targets are defined in connection with the variable compensation of the Management Board members. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the exercise date. There is no explicit regulation excluding the retroactive change of the comparison parameters. While a cap for extraordinary developments is not presently included, it is intended that such a cap be stipulated in newly concluded director's contracts.

- "When appointing the Management Board, the Supervisory Board shall also respect diversity and, in particular, aim for an appropriate consideration of women. Together with the Management Board it shall ensure that there is a long-term succession planning." (Item 5.1.2, Para. 1, Sentences 2 and 3)

  Long-term succession planning for the members of the Management Board with an appropriate consideration of women was implemented in August 2010 upon publication of the long-term Management Board concept. Given the size of the Company, internal succession planning for the Management Board was only possible to a limited extent.

- "Formation of Committees" (Item 5.3)

  The Supervisory Board of the Company resolved to no longer form committees as of September 22, 2010. Given the size of the Company and its Supervisory Board, the formation of committees is not viewed as appropriate. Therefore, since the above date the Company has not followed the recommendation to form committees set forth in Item 5.3 of the German Corporate Governance Code or the ensuing recommendations regarding their composition. Given the size of the Company and its Supervisory Board, the formation of a nomination committee was not viewed as appropriate in the past either.

- "The Supervisory Board shall specify concrete objectives regarding its composition which [...] take into account [...] an age limit to be specified for the members of the Supervisory Board [...]." (Item 5.4.1, Para. 2, Sentence 1)

  No age limit for members of the Supervisory Board has been set because we do not believe that the age of a Supervisory Board member is a key criterion for his or her qualification.

- "An application for the judicial appointment of a Supervisory Board member shall be limited in time up to the next General Meeting." (Item 5.4.3, Sentence 2)

  The Company's application for the judicial appointment of a Supervisory Board member, which was submitted in September 2010 and approved due to the urgent nature of the situation, was not limited in time until the next Annual Shareholders' Meeting. It is intended for the Supervisory Board member concerned to be elected to the Supervisory Board by the Company's shareholders at the next Annual Shareholders' Meeting.

- "Proposed candidates for the Supervisory Board chair shall be announced to the shareholders." (Item 5.4.3, Sentence 3)

  The current chairman of the Supervisory Board was elected without it having been possible to announce proposed candidates to the shareholders because the Supervisory Board's election of its chairman took place shortly after the members of the Supervisory Board were elected by the Annual Shareholders' Meeting on May 27, 2008, and the current chairman of the Supervisory Board had already held this position prior to his election to the Supervisory Board during the aforementioned Annual Shareholders' Meeting.

- "The Consolidated Financial Statements shall be publicly accessible within 90 days of the end of the financial year [...]" (Item 7.1.2, Sentence 4)

The Company was unable to make its consolidated financial statements for fiscal 2009 publicly accessible within the required periods because the negotiations with the banking syndicate regarding the Company's long-term financing were not concluded in time.

Zapf Creation AG,
Rödental, October 15, 2010

Ron Oboler	Ron Brawer	José Antonio Santana
Chairman of the Management Board	Member of the Management Board	Member of the Management Board

Dr. Harald Rieger
Chairman of the Supervisory Board

(End of the Declaration of Compliance)

The Corporate Governance Statement pursuant to Section 289 a German Commercial Code is available at all times on the Website of Zapf Creation AG.

Rödental, March 15, 2011

Josef Lukas	Hannelore Schalast
Member of the Management Board	Member of the Management Board

(End of the Corporate Governance Statement according to Article 289 a German Commercial Code)

C. Compensation Report

1. Preliminary remark

In accordance with the requirements of the German Commercial Code and the German Management Board Compensation Disclosure Act, this report contains disclosures that are an integral part of both the single-entity and consolidated financial statements of Zapf Creation AG.

Hence please also see all disclosures on the compensation paid to the members of the Management Board and the Supervisory Board in the separate annual financial statements and in the consolidated financial statements of Zapf Creation AG.

2. Management Board

The compensation paid to the members of the Company's Management Board in the 2010 financial year comprised both fixed and performance-based components. In particular, the responsibilities of the relevant Management Board members and their personal performance are the criteria that govern the suitability of the compensation paid.

With regard to its compensation components, the compensation system for the Company's Management Board was as follows in 2010:

	Short-term compensation		Share-based compensation
	Fixed compensation	Bonus	
	K€	K€	K€
Ron Oboler	Yes	Yes	No
José Antonio Santana	Yes	Yes	Yes
Jens U. Keil	Yes	Yes	Yes
Ron Brawer	Yes	Yes	No
Stephan F. Brune	Yes	Yes	Yes

The total compensation of K€1,008 (previous year: K€965) paid to the Management Board comprises all cash compensation due, as well as all monetary benefits from in-kind compensation. It includes both fixed and variable components but excludes the one-time consideration paid to former members of the Management Board.

Below is an overview of the compensation paid to each individual member of the Management Board in the 2010 financial year (IFRS):

	Short-term compensation		Share-based compensation	Total compensation
	Fixed compensation	Bonus		
	K€	K€	K€	K€
Ron Oboler	290	88	0	378
José Antonio Santana	233	0	31	264
Jens U. Keil	118	112	0	230
Ron Brawer	110	0	0	110
Stephan F. Brune	26	0	0	26
Total	777	200	31	1,008
		%	%	%
Percentage in 2010		96.92	3.08	100.00

	Short-term compensation		Share-based compensation	Total compensation
	Fixed compensation	Bonus		
	K€	K€	K€	K€
Total compensation in 2009	771	20	174	965

The expenditure for share-based payment to the members of the Management Board under the German Commercial Code in the 2010 financial year was K€31 (prior year K€104);); the expenditure for the total compensation paid to the members of the Management Board in the 2010 financial year pursuant to the German Commercial Code was K€1,243 taking into consideration a one-time payment in the amount of K€235 recognized in the income statement in the 2010 financial year in connection with the termination of the Management Board membership of Mr. Brune (prior year: K€1,225, taking into consideration a one-time payment in the amount of K€360 recognized in the income statement in the 2009 financial year in connection with the termination of the Management Board membership of Mr. Brune).

In addition to the monetary base compensation, the fixed compensation granted to the members of the Company's Management Board also comprises benefits such as the use of company cars and allowances for accident insurance, individual pension plan, and other insurance policies. Mr. Stephan F. Brune was reimbursed in agreed amount for flights home; additionally, the Company also reimbursed

Mr. Brune on the basis of documented costs for relocation expenses, realtor fees as well as matriculation fees. The Company had promised Mr. Brune that it would purchase life and accident insurance for him; however up until his retirement from the Management Board in January 2010 this had not occurred. In addition, the Company is taking over the costs of a German instructor for Mr. Santana under conditions that have not been finalized.

The compensation system based on phantom shares that was launched in 2006 for the members of Zapf Creation AG's Management Board remained in place in the 2010 financial year. In this connection, a further 27,000 phantom stock options were issued in 2010 entirely to Mr. Santana at a base price of €1.00, the exercise of which is dependent on the achievement of specific performance targets. In the prior year's comparative period 25,000 phantom shares were issued to Mr. Stephan F Brune at a base price of K€0.79, 10,000 were issued to Mr. Jens U. Keil at a base price of €0.87 and a further 27,000 phantom stock options at a base price of €0.79, and to Mr. José Antonio Santana were 27,000 phantom stock options at a basis price of €0.81. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date on which the phantom stock options are exercised. The increase to the provision for obligations in connection with phantom share-based compensation system, which is recognized in the income statement, amounted to K€75 (prior year: K€67) in the 2010 financial year for members of the Management Board. Due to the retirement from the Company on the part of Mr. Brune, a reduction in the provision was recognized in the 2010 financial year in the amount of K€24 (prior year: reduction of K€2) through the income statement. The provision for liabilities under the aforementioned phantom options as of December 31, 2010, was K€134 (previous year: K€83); of this amount K€59 (prior year: K€17) relates to Mr. Santana. K€63 (prior year: K€36) relates to the former Management Board member Jens U. Keil; K€12 (prior year: K€6) relates to the former Management Board member Thomas Pfau. Regarding the former Management Board member Stephan F. Brune, there is no longer any obligation (prior year: K€24).

In the 2010 reporting period a tranche of 30,000 phantom options issued to the former Management Board member Thomas Pfau at a base price of €8.60 as well as a tranche of 33,000 phantom options issued to Mr. Pfau at a base price of €4.67 expired. In the prior year's comparable period, phantom options issued to the former Management Board member Dr. Georg Kellinhusen as well as a tranche issued to the former Management Board member Thomas Pfau expired. In accordance with an agreement, a tranche issued to Mr. Keil was discontinued at the end of September 2009. The rights granted to Mr. Stephan F. Brune were cancelled in connection with compensatory agreement, dated March 4, 2010, with the former member and chairman of the Management Board of Zapf Creation AG.

The options issued to Mr. José Antonio Santana expire if they are not exercised by March 1, 2012 and March 1, 2013, respectively. The phantom options granted to Mr. Jens U. Keil expire if they are not exercised by April 1, 2012, July 1, 2012, April 1, 2013 and October 1, 2015, respectively. The remaining rights of Mr. Thomas Pfau cease to be valid on September 1, 2011, if no exercise has been made with respect to the last tranche by that date. The exercise periods, as in the prior period, was extended for individual tranches by way of contractual agreement.

As an additional form of share-based compensation, Mr. José Antonio Santana was promised a direct grant of shares; this is strictly arranged as a variable compensation component, the amount of which is dependent upon achievement of specific performance targets. Regarding the bonus payment to Mr. Jens U. Keil, the possibility also existed for the Company to pay a portion in shares; a similar form of compensation existed in the prior year for Mr. Stephan F. Brune. In the 2010 financial year no share-based compensation resulted from this compensation component, which now pertains only to variable compensation (prior year: K€106 – fixed and variable).

On March 4, 2010 the Company entered into a compensatory arrangement with the former member and chairman of the Management Board of Zapf Creation AG, Stephan F. Brune, under which all claims and obligations of both parties resulting from the employee relationship were discharged and thereby finally settled. In this connection, a one-time compensation payment in the amount of K€550 (gross) was finally concluded. In addition, existing receivables due from Mr. Brune in the amount of K€25 were waived; the payroll tax resulting from this waiver of the receivables was completely taken over by the Company. Of this amount, K€360 was already recognized as expense in the prior year in connection with the recognition of provisions.

One former member of the Management Board was granted a variable credit line in the maximum amount of K€625 until December 31, 2007, which was fully used as of December 31, 2007. The agreed interest rate was 4.25%. It was fixed until December 31, 2007, the loan's due date. Under a settlement reached in the 2008 financial year, Zapf Creation AG waived repayment of a loan in the amount of K€175 provided certain conditions are met; the Company will be responsible for any tax expense arising from non-cash advantages. The interest rate has been 5% per annum effective January 1, 2008; the parties agreed to a payment plan regarding the remaining residual liabilities including interest thereon. A payment of K€100 on this liability was made in the 2008 financial year; as in the previous year, no new loans were made in 2008. In 2008, the Company received K€49 in full payment of both K€46 in interest receivables outstanding as of December 31, 2007, and K€3 in interest on arrears that had been billed; the total of K€23 in interest for the 2008 interest period were also paid in full. In the 2009 financial year there was no repayment of the outstanding loans; in the 2010 reporting period a principal amount of K€15 was repaid. Interest was paid in the agreed-upon amount. As a result of the mentioned waiver of receivables, the principle and interest payments received, and in consideration of the interest receivable for the fourth quarter of 2010, the total receivable of the Company amounts at the December 31, 2010 balance sheet date to K€339 (prior year: K€354). The loan granted remains secured by a land charge in the amount of K€200 (previous year: K€200). The remaining amount due has been written down in the amount K€335 (prior year: K€350); the interest receivable the fourth quarter of 2010 in the amount of K€4 was paid in January 2011.

3. Supervisory Board

The compensation of the Supervisory Board is determined by the Annual Shareholders' Meeting, on recommendation of the Management Board and the Supervisory Board. It is regulated by Article 20 of the Articles of Incorporation of Zapf Creation AG. The cash compensation includes a fixed and a dividend-based component, as well as compensation linked to the long-term success of the Company.

According to the Articles of Incorporation, the fixed compensation component for the full financial year is K€35 net for the chairman of the Supervisory Board, K€26.25 for the vice chairman of the Supervisory Board, and K€17.50 net each for all other members of the Supervisory Board. The compensation paid to Supervisory Board members who were not in office for a full financial year is prorated in accordance with the duration of their membership on the Supervisory Board. The most recent change to the fixed component of the compensation paid to the members of the Supervisory Board was made by resolution dated August 29, 2006. Any withholding taxes payable on compensation paid to members of the Supervisory Board domiciled abroad are paid by the Company.

As before, under the resolution adopted May 7, 2003, the variable compensation paid to the Supervisory Board members will be €100.00 for each €0.01 in excess of €0.50 in dividends per no-par value share distributed to the shareholders for the financial year just ended. In addition, the members of the Supervisory Board are entitled to annual compensation based on the Company's long-term performance. This compensation entails payment of K€1 per K€1,000 in consolidated net annual profit that exceeds an average consolidated annual profit of K€22,237 for the last three financial years. As in the previous year, in the financial year just ended no provisions for the variable component of the compensation were recognized because no payment obligation arises from the Company's performance.

The total obligation for the compensation of the Supervisory Board in the 2010 financial year was K€85 excluding and including K€106 of withholding taxes payable (previous year: excluding K€125 and including K€166 withholding taxes payable).

In addition to his Supervisory Board activities, on October 26, 2009 a consulting contract was entered into with the Supervisory Board member Ron Brawer, in which Mr. Brawer was named as consultant to the Management Board of Zapf Creation AG. The consulting contract, which begins October 26, 2009 was limited to a maximum of twelve months and was ended, effective January 29, 2010. At that time, Mr. Brawer was delegated to the Management Board pursuant to Article 105 (2) Stock Corporations Act. Compensation granted under the consulting contract amounted to K€10 per month; outlays were reimbursed.

As in the previous year, there were no loans to members of the Supervisory Board as of the balance sheet date.

Report of the Supervisory Board for Fiscal Year 2010

During the year under review, the Supervisory Board performed the duties required of it in accordance with the law, the Company's Articles of Incorporation, and the Supervisory Board's Rules of Procedure. It carefully reviewed and monitored the Management Board and advised and supported it in managing the Company. In monitoring the Management Board's activities, particular attention was paid to standards of legality, propriety, utility, and cost-effectiveness. Moreover, the Management Board and the Supervisory Board coordinated with each other on an ongoing basis regarding the strategic direction and the further financial stabilization of the Zapf Creation Group. The Supervisory Board was directly involved in all decisions of fundamental importance for Zapf Creation AG and the Zapf Creation Group.

The activities of the Supervisory Board were based on regular reports from the Management Board on corporate planning, the business development and the current business situation, the Company's strategic development, and the risk position of the Zapf Creation Group as well as its financing. These reports were made both in writing and verbally in a timely and comprehensive manner. In its reports, the Management Board also addressed any deviation in performance from the projections and targets and explained such deviations. Moreover, the Supervisory Board ensured that the Management Board kept it informed also outside of the Supervisory Board’s meetings of all significant transactions and developments, again both in writing and verbally. The Supervisory Board carefully reviewed all reports submitted to it for plausibility and discussed them with the Management Board in detail insofar as necessary. The Supervisory Board also had the Management Board supply it with supplementary information. In particular, the Management Board was available to the Supervisory Board at its meetings in order to discuss and respond to the Supervisory Board's questions. The chairman of the Supervisory Board was also in regular contact with the Management Board outside of the Supervisory Board's meetings, thus staying abreast of the current business situation and all significant transactions, which the chairman discussed with the Management Board in detail.

OVERVIEW OF THE ACTIVITIES OF THE SUPERVISORY BOARD

In addition to overseeing the Company's business development and corporate planning, the activities of the Supervisory Board in fiscal year 2010 consisted in particular of monitoring the process of securing the Company's long-term financing. In this regard, the Supervisory Board particularly ensured that the budget presented for 2010 was revised. The Supervisory Board also ensured that it received regular reports on the negotiations of the Zapf Creation Group with its banks, which it followed in an advisory capacity while keeping abreast of developments.

Another focus of the Supervisory Board's activities was personnel issues relating to the Management Board. This involved the Supervisory Board making a detailed review of the composition of the Management Board and the distribution of responsibilities among individual Management Board members as well as the conclusion of settlement agreements with former Management Board members. Moreover and along with additional reorganization and restructuring measures, particularly in France and Poland, the Supervisory Board dealt with a possible change of the listing segment of the Company, a detailed review of the Governance & Compliance of Zapf Creation AG as well as the agreements concluded with the MGA Group companies.

In addition, the Supervisory Board dealt with issues related to the addition of an independent financial expert to the Supervisory Board, a review of its efficiency, the audit of the annual financial statements, preparations for the Annual Shareholders' Meeting, and the implementation of an approval requirement for bonus policies.

The Supervisory Board of Zapf Creation AG held a total of nine plenary sessions in fiscal year 2010, either by physical meetings or via telephone conferences. These meetings took place on January 19 and 29, February 23, April 19, June 7 and 30, July 23, September 22 and November 30, 2010. Furthermore, the Supervisory Board adopted resolutions outside of Supervisory Board meetings during the reporting year on January 6 and 16, February 15, March 4, July 22, September 22, October 15 and 25 and November 1, 2010. These resolutions particularly concerned the conclusion of a settlement agreement with the former chairman of the Management Board, Mr. Stephan F. Brune, the liquidation of Zapf Creation (Polska), Sp. z o.o., the declaration of conformity 2010, the financing agreements with the banks, the appointment of Mr. Jaime Ferri Llorens as member and chairman of the Management Board of the Company and the allocation of responsibilities of the Management Board.

CHANGES IN PERSONNEL

Changes on the Management Board

Mr. Stephan F. Brune, chairman of the Management Board of Zapf Creation AG since October 1, 2008, left the Company as of January 31, 2010.

The Supervisory Board appointed Mr. Ron Oboler as member and chairman of the Management Board on an interim basis effective February 1, 2010 until February 15, 2011. Mr. Oboler was at last responsible for Sales, International Sales, Budgeting (shared), Human Resources, Legal Affairs, Subsidiaries, Finance, Investor Relations, IT, Public Relations (excluding products), Supply Chain Operations, Logistics, Risk Management, Compliance & Corporate Governance.

In addition, Mr. Ron Brawer, member of the Supervisory Board, was delegated to the Management Board on January 29, 2010 until December 31, 2010 on an interim basis pursuant to Section 105 (2) of the German Stock Corporation Act (Act). Mr. Brawer had at last been responsible for Supply Chain Operations, Logistics, Restructuring, Budgeting (shared), and Risk Management.

Mr. Jens U. Keil ceased to be a member of the Management Board effective June 30, 2010. He had been a Management Board member since March 1, 2007 and was responsible for Finance, Investor Relations, IT, Logistics, and Risk Management, among other things.

Ms. Hannelore Schalast, head of Corporate Finance and Controlling, was appointed CFO of the Company as of February 1, 2011 upon Supervisory Board resolution of July 23, 2010. Until her appointment took effect, Ms. Schalast acted as general agent and chief representative, Finance.

At its meeting on July 23, 2010, the Supervisory Board also resolved that Mr. Josef Lukas, so far working in Sales Germany/Austria/Switzerland in an advisory capacity, assumes responsibility for Sales and Distribution as a Management Board member effective February 1, 2011.

The mandate of Mr. José Antonio Santana, who has been a member of the Management Board since March 1, 2009 and who was at last in charge of Marketing, Quality Management, Zapf Creation Hongkong, Public Relations (products), Trademark Rights, Budgeting (shared) and Sales (shared), ended on February 28, 2011.

Upon resolution of the Supervisory Board dated November 1, 2010, Mr. Jaime Ferri Llorens was appointed member of the Management Board with effect as of January 1, 2011 and chairman of the Management Board with effect as of February 16, 2011. Mr. Jaime Ferri Llorens resigned upon declaration of March 1, 2011 with immediate effect for health reasons. He was at last responsible for Product Research & Development and Budgeting (shared).

Furthermore, on March 14, 2011 the Supervisory Board appointed Mr. Thomas Eichhorn as member of the Management Board of the Company with effect of April 1, 2011.

Changes on the Supervisory Board

Supervisory Board member Jaime Ferri Llorens resigned from the Supervisory Board on April 26, 2010 and was appointed member of the Management Board with effect as of January 1, 2011.

Mr. Nicolas Mathys resigned from the Supervisory Board upon declaration dated January 11, 2010; he adhered to the four-week notice period as stipulated in the Articles of Incorporation.

On January 29, 2010, Mr. Ron Brawer was delegated to the Management Board on an interim basis until December 31, 2010 pursuant to Section 105 (2) of the German Stock Corporation Act (Act). He resigned from the Supervisory Board with effect as of December 31, 2010.

Upon resolution of September 13, 2010, the Local Court of Cobourg appointed Mr. Manfred Schneider as member of the Supervisory Board of Zapf Creation AG pursuant to Section 104 of the German Stock Corporation Act (Act). Since such date, he acts as an independent financial expert on the Supervisory Board of Zapf Creation AG pursuant to Section 100 (5) of the German Stock Corporation Act (Act). Mr. Schneider is a qualified bank officer/certified banking specialist (*Bankkaufmann/Bankfachwirt*) and has specialist knowledge in the field of accounting based on his previous career positions.

No changes were made in the seats held by the other Supervisory Board members – Dr. Harald Rieger, Isaac Larian, and Miguel Perez-Carballo Villar – who were appointed to the Supervisory Board by the Annual Shareholders' Meeting in 2008 under recognition of their previous terms of office. The term of office of Supervisory

Board member Mr. Miguel Perez-Carballo Villar will expire at the end of the Annual Shareholders' Meeting on April 6, 2011.

COMPOSITION OF THE COMMITTEES AND COMMITTEE ACTIVITIES

In the year under review, the Audit Committee consisted of Mr. Nicolas Mathys as chairman, Mr. Ron Brawer, and Dr. Harald Rieger. Following the resignation of Mr. Nicolas Mathys from the Supervisory Board, the Audit Committee was temporarily not complete. The composition of the Personnel Committee, which was established by the Supervisory Board with decision-making power, remained the same in the reporting year. The Personnel Committee consisted of Dr. Harald Rieger (chairman), Mr. Isaac Larian, and Mr. Miguel Perez-Carballo Villar. At its meeting of September 22, 2010, the Supervisory Board resolved to dissolve the Audit Committee and the Personnel Committee. The duties of the Audit Committee and the Personnel Committee were performed by the Supervisory Board as a whole during the reporting year.

REVIEW OF THE MANAGEMENT BOARD'S ACTIVITIES

The Supervisory Board's review of the Management Board's activities focused primarily on the following areas:

Group financing

In the reporting year, one focus of the Supervisory Board was to monitor and support the Management Board in its ongoing negotiations with the Company's financing banks, who finally had waived adherence to certain financial covenants until June 30, 2010. For this reason, the Supervisory Board also dealt in depth with the question of the 2010 budget, particularly at its meeting on January 19, 2010. Furthermore, the Supervisory Board ensured that it was provided with regular reports on the Group's negotiations with its banks, which it followed in an advisory capacity.

In October 2010, agreement was reached regarding the future financing structure of the Zapf Creation Group. The negotiations with respect to securing the long-term Group financing were successfully concluded with the signing of an agreement in principle (termsheet). The financing contracts were signed in December 2010 and implemented with corresponding payments in January 2011.

Moreover, particularly in its meeting on June 7, 2010, the Supervisory Board dealt with the accounts receivable management of the Company by means of a sale of accounts receivable from deliveries of goods to a factor, which was part of the overall financing concept of the Zapf Creation Group.

Personnel matters

The Supervisory Board's work also focused on numerous personnel issues at Management Board level during the year under review.

The Supervisory Board dealt in detail with the composition of the Company's Management Board and the distribution of responsibilities among individual Management Board members. At first, two Management Board positions were filled on an interim basis in preparation for a long-term change in the composition of the Management Board with the appointments of Ron Oboler and Ron Brawer on January 29, 2010. Ron Oboler was replaced by Jaime Ferri Llorens, who was appointed member of the Management Board with effect as of January 1, 2011 and chairman of the Management Board with effect as of February 16, 2011. In view of the early departure of Mr. Jens U. Keil (effective June 30, 2010), the Supervisory Board also dealt with appointing his successor. The issue was resolved with the appointment of Ms. Hannelore Schalast, head of Corporate Finance and Controlling. She took over the position of CFO as of February 1, 2011 and by then acted as general agent and chief representative, Finance. The Supervisory Board also appointed Mr. Josef Lukas as Management Board member responsible for Sales and Distribution effective February 1, 2011.

The Supervisory Board additionally concluded a settlement agreement with Mr. Stephan F. Brune on March 4, 2010 in connection with his departure from the Company as of January 31, 2010. Moreover, following the proposal of the District Court of Cobourg, the Supervisory Board accepted a settlement according to § 278 para 6 Code of Civil Procedure (ZPO) with former members of the Management Board Rudolf Winning, Thomas Eichhorn und Dr. Peter Klein in order to put an end to the law suit regarding the assertation of a damage claim of Zapf Creation AG against the former members of the Management Board in connection with the preparation of the annual financial statements for the financial year 2004. With a ruling of the District Court of Cobourg dated January 11, 2011, the conclusion of the settlement was ascertained. According to § 93 para 4 sentence 3 German Stock Corporation Act, the settlement has to be approved by the Shareholders' Meeting in order to become effective. Furthermore, the Supervisory Board currently deals with a law suit of Mr. Jens U. Keil on salary claims in the context of his leave of the Company.

Change of Listing Segments

The Supervisory Board also dealt with a change of Zapf Creation AG from the Regulated Market (General Standard/Prime Standard) to either the Entry Standard at the Frankfurt Stock Exchange as a segment of the Open Market (Freiverkehr) or the m:access as a segment of the Freiverkehr at the Munich Stock Exchange and agreed on the proposal of the Management Board to make a corresponding proposal to the Annual General Shareholders' Meeting on April 6, 2011 as the costs of a listing in the Prime Standard appear to be no longer in an adequate proportion to the advantages.

Review of Governance & Compliance

Moreover, the Supervisory Board dealt with the Governance & Compliance of Zapf Creation AG in its meetings on February 23, 2010 and July 23, 2010 and initiated a corresponding review by independent advisors.

Agreements with MGA

Agreements with MGA Group companies constituted another important element of the Supervisory Board's monitoring activities in fiscal year 2010.

At its meeting on January 19, 2010, the Supervisory Board discussed the conclusion of an agreement concerning deliveries by MGA Entertainment (HK) Ltd., which provides an advanced payment obligation of Zapf Creation AG. Also in its meeting on January 19, 2010, the Supervisory Board read up on the status of the approval of the financing banks to the Inventions License Agreement with MGA Entertainment, Inc.

In addition, the Supervisory Board discussed in its meeting on November 30, 2010 the proposal of the Management Board to change the agreements of Zapf Creation AG respectively its related companies with MGA Entertainment, Inc. respectively its related companies, particularly for simplifying purposes. This project was approved by the Supervisory Board in principle. Supervisory Board member Isaac Larian abstained from voting in this regard.

CORPORATE GOVERNANCE

Attendance

None of the Supervisory Board members attended less than one-half of its meetings in the year under review.

Composition of the Supervisory Board

The Supervisory Board has resolved to propose the appointment of Mr. Manfred Schneider to the Supervisory Board at the Annual Shareholders' Meeting on April 6, 2011 who shall resume the position of an independent financial expert in the Supervisory Board. The Supervisory Board also resolved to propose to the Annual Shareholders' Meeting on April 6, 2011 that the number of the Supervisory Board Members shall be reduced from six to three members.

The term of office of Supervisory Board member Miguel Perez-Carballo Villar will expire at the end of the Annual Shareholders' Meeting on April 6, 2011. Since Mr. Ron Brawer resigned from the Company's Supervisory Board with effect as of December 31, 2010, and assuming that Mr. Manfred Schneider is elected, the Supervisory Board consists of Dr. Harald Rieger (chairman), Mr. Isaac Larian, and Mr. Manfred Schneider following the departure of Mr. Miguel Perez-Carballo Villar and Mr. Ron Brawer.

The Supervisory Board believes that this composition of its members on the whole offers the necessary knowledge, skills, and specialist experience required for the proper execution of its duties. Moreover, alongside the Company's specific situation, the Supervisory Board has in particular taken the international activities of the Company and the independence of the majority of the Supervisory Board members into account in proposing this composition. Should a Supervisory Board member need to be replaced in the future, the Supervisory Board plans to also take diversity aspects into consideration, particularly an appropriate level of female participation. However, the Supervisory Board does not believe that it makes sense to set an age limit for Supervisory Board members.

Conflicts of interest

Given the dependent nature of Zapf Creation AG's relationship with the MGA Group, the Supervisory Board has afforded special attention to possible conflicts of interest on the part of Supervisory Board members Isaac Larian and Ron Brawer, who hold (respectively held) positions of responsibility at the MGA Group. They were excluded from the discussions in the meeting of the Supervisory Board on January 19, 2010 with respect to the conclusion of an agreement regarding deliveries of MGA Entertainment (HK) Ltd. as well as regarding the Inventions License Agreement with MGA Entertainment, Inc. No resolutions were made in this respect. Moreover, the Supervisory Board member Isaac Larian abstained from voting in respect of the discussion of a possible change of agreements with MGA Entertainment, Inc. respectively its related companies.

Efficiency review

The Supervisory Board conducted the efficiency review required under the German Corporate Governance Code on a regular basis. The Supervisory Board came to a generally positive conclusion regarding the results of its efficiency.

Declaration of conformity

The Management Board and the Supervisory Board at last issued a joint declaration of conformity pursuant to Section 161 of the German Stock Corporation Act (Act) on October 15, 2010 stating that the Company had implemented most of the recommendations of the German Corporate Governance Code. For further details, please refer to the Corporate Governance Report in the 2010 Annual Report.

ACCOUNTING AND FINANCIAL STATEMENTS

Review and adoption of the financial statements and the consolidated financial statements

KPMG AG Wirtschaftsprüfungsgesellschaft, Nuremberg, which was appointed auditor and group auditor of Zapf Creation AG for the business year 2010 by a ruling of the Local Court of Cobourg of January 4, 2011, audited the financial statements for the fiscal year from January 1 to December 31, 2010, prepared in accordance with the German Commercial Code [Handelsgesetzbuch (HGB)] and the consolidated financial statements prepared for the same fiscal year in accordance with International Financial Reporting Standards (IFRS) and issued unqualified auditor's reports for each.

The auditor's report for the Group reads as follows:

“We have audited the consolidated financial statements comprising the consolidated balance sheet, consolidated income statement, consolidated statement of comprehensive income, consolidated statement of cash flows, consolidated statement of changes in equity and notes to the consolidated financial statements, of Zapf Creation AG, Rödental, and their report on the position of the Company and the Group for the financial year from January 1 to December 31, 2010. The preparation of the consolidated financial statements and group management report in accordance with IFRS, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a (1) HGB are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch: German Commercial Code] and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the financial statements of the companies included in consolidation, the determination of the companies to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the legal representatives, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRS, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development."

The annual financial statements and management report, the consolidated financial statements and Group management report, and the audit reports were made available to all members of the Supervisory Board. When it commissioned the audit, the Supervisory Board requested that the auditors focus in particular on the completeness and correctness of the accounting of relations to companies of the MGA Group, the review of deferred taxes as well as evaluation questions. During the preliminary stages of preparing the documentation for the financial statements, the Supervisory Board was consulted with respect to individual facts and circumstances. These specifically related to the long-term business strategy of the Company, business relations with companies of the MGA Group and the strengthening of the Company's equity by the appointment of the Company as distributor for MGA Entertainment, Inc. in Europe. Finally, the documentation for the financial statements was discussed in detail by the Supervisory Board at its financials meeting on March 21, 2011, in the presence and following the reports of the auditor. The discussion focused especially on accounting issues and the accounts receivable management of Zapf Creation (España) S.L. On the basis of these deliberations, the Supervisory Board approved the audit findings and the opinion of the auditing firm by way of a resolution dated March 21, 2011 and accepted the auditor's reports for both the annual financial statements and the consolidated financial statements.

The Supervisory Board also reviewed the annual financial statements and management report prepared by Zapf Creation AG in accordance with the German Commercial Code for fiscal year 2010 at its meeting held on March 21, 2011. The review focused in particular on the equity situation of the Company. Based on the final results of this examination, the Supervisory Board saw no need to raise any objections. The Supervisory Board approved the 2010 financial statements by way of a resolution dated March 21, 2011. The annual financial statements were thus formally adopted.

The Supervisory Board also reviewed the consolidated financial statements and Group management report prepared in accordance with IFRS for fiscal year 2010. This review focused in particular on the sales organization. The outcome of the review did not give rise to any objections either. The consolidated financial statements and the Group management report were also approved by the Supervisory Board by way of a resolution dated March 21, 2011.

Proposal for the appropriation of profits

Regarding the appropriation of profits, the Management Board proposed to the Supervisory Board that the accumulated deficit of EUR 38,876,548.94 be carried forward. Absent any other options, the Supervisory Board agreed with the Management Board's proposal regarding the handling of the accumulated deficit.

Remarks on the review of the dependent company report pursuant to Section 314 (2) and (3) of the German Stock Corporation Act

The Supervisory Board also reviewed the Report of the Management Board of Zapf Creation AG on Relationships with Affiliated Companies pursuant to Section 312 of the German Stock Corporation Act (Act) for fiscal year 2010 (dependent company report).

In its Report on Relationships with Affiliated Companies pursuant to Section 312 of the Act for fiscal year 2010, the Management Board made the following statement:

“We declare that our Company, in connection with the legal transactions and measures described in the report on relationships with affiliated companies, according to the circumstances of which we were aware of at the time the legal transactions were entered into or measures were taken, received an appropriate consideration in the case of each legal transaction and by the fact that measures that were taken or not taken, was not disadvantaged.“

The Supervisory Board's review of this report did not give rise to any objections. In conducting its review, the Supervisory Board asked the Management Board to indicate both the benefits and potential risks arising from the transactions described in the Report on Relationships with Affiliated Companies and then weighed these factors on its own. The Supervisory Board also asked the Management Board to explain the principles applied to the determination of the Company's services and the consideration it received in return. The Supervisory Board concurred with the auditor's findings. Based on the audit review and the final results of its own examination, the

Supervisory Board has no objections to the declaration made by the Management Board at the end of the Report on Relationships with Affiliated Companies.

The Supervisory Board would like to thank the Management Board and all employees of the Zapf Creation Group for their commitment in fiscal year 2010.

Bad Homburg, March 24, 2011

Dr. Harald Rieger
Chairman of the Supervisory Board

Zapf Creation AG, 2010 Annual Report
Company and Group Management Report

I. General

Business concept and corporate structure

The Zapf Creation Group sees itself as a worldwide brand-name supplier of toys for girls. The Company develops and markets high quality toy concepts, including, in addition to play dolls and functional dolls having broad international recognition and extensive accessories, an increasing selection of products in other toy categories. All Zapf Creation brands have in common high standards of quality, design, safety and play value. The primary target group represents girls between the ages of three and eight years old. Based on sales, the Zapf Creation Group is the largest manufacturer of play and functional dolls in Europe.

The Group consists of the parent company Zapf Creation AG with its registered location in Rödental (Bavaria) as well as subsidiaries in Germany and abroad. Zapf Creation AG holds directly or indirectly 100% of the shares in all subsidiaries.

As Group parent company, Zapf Creation AG is responsible for extensive central functions. These include finance, accounting and reporting, controlling, IT, personnel, general administration, strategic marketing, product development and design. Furthermore, sales for Central Europe is situated with Zapf Creation AG. As a result of the decision in 2010 to carry out the France business using a distributor, which was made in connection with strategic direction, the subsidiary Zapf Creation (France) S.à.r.l., France, was integrated into Zapf Creation AG as of August 31, 2010.

The subsidiaries are primarily responsible for the marketing and sales of the product portfolio. For this purpose, in the 2010 financial year the Zapf Creation Group maintained subsidiaries in the UK, Hong Kong, Poland, France and Spain. In the first half of 2010 the operations of the French and Polish subsidiaries were terminated. Since then, capable distributors are serving the French and Polish market.

At the end of the 2010 financial year four subsidiaries exist with registered locations in Germany: Zapf Creation Logistics GmbH & Co. KG, Zapf Creation Logistics Beteiligungs GmbH, Zapf Creation (Central Europe) Verwaltungs GmbH and Zapf Creation Auslandsholding GmbH.

Zapf Creation AG is listed on the Frankfurt Stock Exchange. The shares are included in the Prime Standard segment of the Frankfurt Stock Exchange.

The corporate structure is significantly affected by the strategic cooperation with the American toy manufacturer MGA Entertainment, Inc., located in Van Nuys, California. The cooperation became effective on January 1, 2007 and governs the working relationship in the areas of sales, procurement, licensing and logistics.

Corporate management and control

The Zapf Creation Group has a dual management system according to German law for stock companies, whereby the Management Board is assigned to manage the Company, and the Supervisory Board is assigned to monitor the Company's management carried out by the Management Board. In the corporate governance statement and in the corporate governance report, which forms a part of the annual report and is available on the Website of Zapf Creation AG, the workings of the Management Board and the Supervisory Board, as well as the compensation system of the Management Board, are described and the declaration of conformity is presented.

Control parameters and performance indicators

The Zapf Creation Group manages the operations according to the regions and product lines presented in the segment reporting. In addition, the following key financial figures, among others, represent important parameters for the evaluation and management of the business activities:

- Sales
- Sales by region and product lines
- Result before interest, income taxes and intercompany clearing (EBIT before intercompany clearing)
- Result before interest and income taxes (EBIT)

Non-financial performance indicators include especially:

- **Strength of the brands:** For many years the play concepts of the Zapf Creation Group have been combined with high standards of design, quality, safety and play value. These qualities constitute the core of the brands. To maintain the brand core, active marketing and communications measures and a comprehensive quality management are indispensible. The targeted brand maintenance creates the conditions to permanently ensure the trust of the customer.
- **Product innovation:** Economic success in the toy business is to a great extent dependent on new products. As a manufacturer of toys for girls, the Zapf Creation Group is required to develop innovative play concepts, new technical functions relating to the dolls, as well as educational accessories. As a result, the creativity and product know-how of employees, in particular regarding functionality and design, is a deciding success factor in competing.
- **Retail presence:** For the Zapf Creation Group, the strong presence in retail stores in the European markets is of vital importance. The maintenance of good and trusting relationships with the retail toy trade as well as the orientation of sales and logistics to changed buying habits of consumers and/or the constantly changing order behavior of the trade are important conditions to maintain market shares and strengthen them in the future.
- **International expansion:** The market share of the Zapf Creation Group in Germany in the established segment of play and functional dolls has been over 50% for years. At this high level, additional growth

in the home market is subject to limits. On the other hand, the market share in other European foreign markets is substantially lower. This is also the case for growth markets in Eastern Europe and Asia. Therefore, an aggressive international expansion in selected markets – coupled with an expansion of the product portfolio – is an important step for growth in sales.

Overall economic situation

The recovery of the worldwide economy slowed down in the course of 2010. Compared to the high level of growth in the first quarter, the recovery lost its pace. Among the industrial countries, the economies in the USA and Japan already lost momentum in the spring. On the other hand, the dynamic of the economic development in the emerging Asian countries has so far hardly diminished. After a rather high level growth in productivity, the euro zone displayed a noticeable slowdown in the recovery in the second quarter. Here, according to Eurostat, the economy grew by 1.7% in 2010.

Compared to the euro countries, the development of the German economy was above average. According to the Federal Bureau of Statistics, the gross domestic product increased by 3.6% in the reporting period after decreasing by 4.7% in the prior year. This growth was supported in particular by investment in equipment, which rose by 10.9%. A growth in exports of 14.1% stood opposite a growth in imports that was almost as strong at 12.6%. Consumer spending increased by 0.4%.

The UK market, which is strategically important for Zapf Creation, exhibited a somewhat smaller growth in economic performance compared to the euro zone. According to Eurostat the gross domestic product there rose by 1.3% in the 2010 reporting year. Consumer spending increased by 0.8%

Sources:
International Monetary Fund, World Economic Outlook, October 2010
The fall report of the leading German economic research institutes, October 2010
Eurostat, Luxembourg
Federal Bureau of Statistics, Wiesbaden

Development within the industry

In 2010 the economic sector "traditional toys" made an above-average contribution to consumer spending, both in the UK and in Germany. According to NPD/Eurotoys, the business volume in the UK rose by 9.1% to £1,716 million. In Germany, a growth was seen of 6.1% to €1,818 million

Source: NPD/Eurotoys

II. Significant events in the financial year

Changes in the Management Board

On January 29, 2010 the Zapf Creation Group announced that the Supervisory Board of Zapf Creation AG appointed Mr. Ron Oboler as Chairman of the Management Board, effective February 1, 2010.

Mr. Stephan F. Brune, who held this position since October 1, 2008, left the Company as of January 31, 2010.

Mr. Ron Brawer, member of the Supervisory Board, was temporarily delegated to the Management Board of Zapf Creation AG.

On July 8, 2010 Zapf Creation announce that Mr. Jens U. Keil, since March 1, 2007 responsible on the Management Board for, among others, the areas of finance, investor relations, EDP, logistics and risk management, resigned from the firm, effective June 30, 2010. His responsibilities were temporarily taken over by the Chairman of the Management Board, Mr. Ron Oboler.

On August 6, 2010 Zapf Creation announced that the Supervisory Board member Hannelore Schalast, head of corporate finance & controlling, was appointed to the Management Board as Chief Financial Officer of the Company, effective February 1, 2011. Until then, Ms. Schalast acted as chief representative in the general area of finance. Also as of February 1, 2011, Josef Lukas, who previously acted in an advisory function in sales for Germany/Austria/Switzerland, took over as Management Board member responsible for sales.

Mr. Ron Oboler, Chairman of the Management Board, relinquished his temporarily assumed Management Board responsibilities as of February 15, 2011. The appointment of Mr. Brawer to Management Board ended on December 31, 2010.

On November 2, 2010 Zapf Creation AG announced that the Supervisory Board of the Company appointed Mr. Jaime Ferri Llorens as a member of the Management Board, effective January 1, 2011, and as Chairman of the Management Board, effective February 16, 2011. Mr. Jaime Ferri Llorens replaced Mr. Ron Oboler, who led the Company on a temporary basis since February 2010.

On February 28, 2011, Zapf Creation AG announced that Jaime Ferri Llorens, member and Chairman of the Management Board of Zapf Creation AG would resign from his post for health reasons.

At the close of February 28, 2011, the contract with José Antonio Santana, member of the Management Board of Zapf Creation AG terminated: therefore, since this time Mr. Santana is no longer a member of the Management Board of the Company.

On March 14, 2011, the Supervisory Board of Zapf Creation AG appointed Mr. Thomas Eichhorn as a member of the Management Board of the Company, effective April 1, 2011.

Realignment of the Group financing

After noncompliance with the financial covenants originally agreed with the syndicated banks as of December 31, 2008, the Company negotiated with the bank syndicate in the spring of 2009 regarding the realignment of the financing conditions, and in the fall of 2009 agreement was reached as to the temporary continuation of the financing without significant new covenants up until the time of a renewed audit in February 2010.

On June 9, 2010 the syndicated banks agreed to extend the waiver agreement until June 30, 2010.

In October 2010 agreement was reached regarding the future financing structure of the Zapf Creation Group. The negotiations to ensure the long-term Group financing were concluded with the signing of a letter of agreement. Investors were found who would take over a bank loan in the amount of €20.1 million (second lien loan).

In December 2010 the financing agreements were signed and in January 2011 were implemented through the corresponding loan disbursements. The transferred loan, the conditions of which were realigned to the needs of the Company, continues to have a remaining term until 2013. With this, the financial restructuring of the Zapf Creation Group was concluded. As a result, at that point in time, considering loan repayments made, the remaining utilized credit volume with the syndicated banks was reduced to only €6.8 million (Term Loan); in the meantime this was fully repaid ahead of schedule on January 31, 2011. In connection with the transfer of the mentioned loan, in January 2011 the existing mortgages were released; these no longer form a part of the existing security documents. The Management Board assumes that the future payments of principle and interest are assured and therefore the financing of the Zapf Creation and the Zapf Creation Group is guaranteed in a sufficient amount.

Additionally, and in connection with the existing financing agreement, in March 2011the possibility of factoring was agreed for the Group subsidiary Zapf Creation (U.K.) Ltd. In this connection, first priority was provided to the factoring company relating to the existing collateralization in connection with the Group financing, to the extent such security was provided by Zapf Creation (U.K.) Ltd.

III. Results of operations, net assets and financial position (financial report)

The consolidated 2010 financial statements of Zapf Creation AG, as well as the comparative financial statements for the prior year, were prepared applying Sec. 315a HGB [German Commercial Code] in accordance with International Financial Reporting Standards (IFRS) and the relevant pronouncements of the International Financial Reporting Committee (IFRIC), as they are to be applied in EU according to Article 4 of the Directive (EG) No. 1606/2002 of the European Parliament and the Council from July 19, 2002.

The 2010 separate financial statements of Zapf Creation AG were prepared according to German accounting principles and the provisions of HGB.

The operations of the Zapf Creation Group in the American markets, which were discontinued as of December 31, 2006, is presented in the reporting period in the consolidated income statement separately in the result of discontinued operations. This presentation is based the provisions of IFRS 5. The consolidated balance sheet was not required to be changed.

Sales trends

Sales trends of the Zapf Creation Group

Sales revenues of the Zapf Creation Group were able to be largely maintained in the 2010 financial year. They amounted to €79.3 million, compared to €79.3 million in the prior year.

Sales trends by regions

In Europe in 2010, the Zapf Creation Group showed a slight decline in sales revenues by 1.9% to €75.7 million, compared to €77.2 million in the prior year. In arriving at this, the development in the individual markets was differentiated.

With the country markets of Germany, Austria, Switzerland, Netherlands and Luxembourg, Central Europe reached sales revenues in the amount of €31.0 million and with this was slightly below, by 0.9%, the prior year’s level of €31.3 million. The region’s share of the total Group sales amounted to 39.1% (2009: 39.5%).

The sales segment Northern Europe, which includes Great Britain, Ireland and Scandinavia, was able to realize a strong growth in sales, by 11.9% to €23.5 million, compared to €21.0 million in sales in the prior year. This growth in sales results primarily from an improved and focused key account management. As a result, the region’s share of the total Group sales increased to 29.7% (2009: 26.5%).

In the Southern Europe region, which combines Spain, Italy, France, and Belgium, sales declined in the reporting year by 8.5% to €13.3 million (2009: €14.5 million). The decrease in sales is due primarily to the closure of Zapf Creation (France) S.à.r.l. and to declines in sales to consumers in individual areas with the region. With these sales, only 16.8% of the Group sales were still in Southern Europe (2009: 18.3%).

The downward trend continued in Eastern Europe. Sales revenues declined there by 24.1% to €7.8 million (2009: €10.3 million). The decline in sales can be primarily attributed to closure of Zapf Creation (Polska) Sp. z o.o. This region’s share of the total Group sales decreased to 9.9% (2009: 13.0%).

Noticeable growth was achieved outside of Europe. Here, the Asian/Australia region advanced by 29.6% to €2.8 million (2009: €2.1 million). Increased close cooperation with the distributors and key customers led to this positive development.

Sales trends by significant product lines

In the 2010 financial year the Baby born® brand toy concept was able to expand its position as the strongest sales product line. The sales volume here increased strongly by 13.4% to €41.3 million. In the prior year sales amounted to €36.4 million. Its share of total Group sales increased to 52.1% (2009: 45.9%).

On the other hand, the remaining product lines in the area of play and functional dolls had to face declines. Sales of the doll series Baby Annabell® in the reporting period amounted to €11.3 million (2009: €16.1 million). With the dolls in the CHOU CHOU family, Zapf Creation realized sales of €7.3 million (2009: €9.1 million). Sales of other play and functional dolls totaled €6.0 million (2009: €8.9 million).

A sales increase to €3.3 million (2009: €2.8 million) was achieved with the mini-dolls introduced to the market in 2009. The license business carried out since the second half of the year has provided impetus. Though this the other sales increased to €10.0 million (2009: €6.0 million). Significant sources or revenue in the "Other" segment in the reporting period were Chiqui with sales of €3.3 million (2009: €0.0 million), Magic Krysalix with €1.2 million (2009: €0.0 million) and Disney with €2.6 million (2009: €0.1 million).

Sales trends of Zapf Creation AG

The separate financial statements of Zapf Creation AG show sales of €50.5 million (2009: €44.9 million). Included therein were almost exclusively revenues from the operating business in Europe. The increase of 12.6% compared to the prior year resulted especially from positive sales development in Northern Europe at the level of the AG (+36.2 to €4.2 million) and in Southern Europe (+42.8% to €6.4 million). In Eastern Europe a sales increase of 16.6% to €7.4 million was achieved. The region with the highest turnover remained Central Europe with a sales volume of €32.4 million (+4.9%).

Profit situation

Profit situation of the Zapf Creation Group

In the 2010 financial year gross profit of the Zapf Creation Group amounted to €28.2 million, compared to €29.4 million in the prior year. The resulting gross profit margin decreased to 35.5% compared to 37.1% in the prior year. The decline was caused among other things by the sale of items actually not listed to special conditions.

The strict cost management had a positive effect on the development of the operating costs, which compared to the prior year were able to be reduced in all areas. Selling and distribution expenses declined by 9.6% to €10.4 million (2009: €11.5 million). Marketing expenses amounted to €8.1 million. Compared to the €9.9 million in the prior year, this represents a savings of 17.7%. Administrative expenses were reduced by 8.1% to €13.7 million (2009: €14.9 million).

Other income increased by 23.5% to €4.3 million (2009: €3.5 million). The increase results primarily from the cooperation agreement entered into with MGA Entertainment (H.K.) Ltd., Hong Kong, (€0.4 million), from mark-up and royalties for the sales of Zapf products in the Northern, Middle and South American markets and increased exchange gains in the amount of €0.4 million. In comparison, other expenses decreased by 72.6% to €0.3 million (2009: €1.2 million). In this case there were larger exchange losses and expenses for provisions included in the prior year.

Against this background, the consolidated result from operations before interest and taxes (EBIT) improved substantially to €-0.1 million (2009: €-4.6 million). Excluding special expenses due to restructuring of €1.9 million, which relate primarily to terminations and personnel measures, there was an adjusted consolidated EBIT of €1.8 million for 2010. In 2009 the restructuring costs were €0.1 million, so that the adjusted EBIT amounted to €-4.5 million.

Due to the significantly improved liquidity position, the finance costs declined in the 2010 financial year to €4.6 million, compared to €5.1 million in the prior year. Financial income at a low level increased slightly. As a result, the financial result amounted to €-4.5 million, compared to €-5.0 million in 2009.

The result before tax from continuing operations was €-4.5 million. With this, the loss compared to the prior year's amount of €-9.6 million decreased by more than a half.

After income taxes of €0.1 million (2009: €1.5 million), the consolidated result from continuing operations amounted to €-4.6 million. In the prior year this result amounted to €-11.1 million.

In accordance with the provisions of IFRS 5, the US business discontinued as of December 31, 2006 is recognized in discontinued operations of the Zapf Creation Group. The result before tax of discontinued operations in the 2010 financial year amounted to €0.4 million, compared to €0.05 million in the prior year.

On the bottom line, a result of €-4.2 million was shown for the 2010 financial year. In the prior year, a loss of €11.1 was reported.

The average number of outstanding shares increased in the reporting period to 18.8 million shares (2009: 18.7 million). On this basis, earnings per share is calculated to be €-0.22 (2009: €-0.59). Included therein was a result from discontinued operations of €0.02 (2009: €0.00).

Profit situation by region

The Zapf Creation Group reports on the profit situation by region on the basis of operating results before interest, income taxes and intercompany clearing (EBIT before intercompany clearing), as well as operating results before interest and income taxes (EBIT).

In all of Europe, EBIT before intercompany clearing in the 2010 financial year improved significantly to €-1.0 million (2009: €-4.8 million). Central Europe reached a result of €-8.6 million, compared to €-10.4 million in 2009. In Northern Europe, EBIT increased to €4.4 million (2009: €3.4 million) and advanced in Eastern Europe to €2.5 million (2009: €0.9 million). On the other hand, Southern Europe suffered a decline in the result to €0.7 million (2009: €1.3 million). Outside of Europe, noticeably higher contributions to the results were generated.

Profit situation of Zapf Creation AG

In the separate financial statements of Zapf Creation AG gross profit increased in the 2010 financial year by €1.6 million to €20.6 million, compared to €19.1 million in the prior year.

Though strict cost management, further savings were achieved relating to the significant expense captions. Selling expenses were reduced by €0.9 million to €16.1 million (2009: €17.0 million). Administrative expenses declined by €0.7 million to €12.8 million (2009: €13.5 million).

Included in other operating income (up €1.8 million from €10.3 million to €12.0 million) is the reversal of a write-down regarding the shares of Zapf Creation Logistics GmbH & Co. KG in the amount of €1.4 million on the basis of a current earnings-rate calculation. Opposite this were other operating expenses, which were able to be reduced by €3.0 million to €2.1 million (2009: €5.1 million). The decrease results primarily from the eliminated provision for contingencies relating to the negative capital, which was no longer required due to the integration of Zapf Creation (France) S.à.r.l., France, (prior year: €1.1 million) and a write-off made in the prior year to receivables from our Polish subsidiary in the amount of €0.8 million.

Write-downs of financial assets amounted to €0.3 million (2009: 0.4 million). The interest result in the reporting year was €-4.0 million (2009: €-3.6 million).

With this, Zapf Creation AG had a result from ordinary activities of €-0.1 million, compared to €-7.4 million in the prior year. The extraordinary result amounted to €-1.7 million. In the prior year this amount was €0.1 million. The primary reason for the extraordinary charge had to do on the one hand in connection with the strategic direction-related decision in 2010 to carry out the French business using a distributor and to have the subsidiary Zapf Creation (France) S.à.r.l., France, into Zapf Creation integrated. The negative result of the integration amounted to €0.7 million as of August 31, 2010. An additional portion of the restructuring expenses related to termination payments in the amount of €0.8 million and for personnel measures carried out during the financial year and planned for the following financial year.

After marginal tax payments, Zapf Creation AG is showing a loss of €1.9 million in the 2010 financial year (2009: €-7.8 million).

Financial and assets position

Financial and assets position of the Zapf Creation Group

As of the December 31, 2010 balance sheet date, the Zapf Creation Group's total assets declined to €67.1 million compared to the same reporting date in the prior year (December 31, 2009: €75.7 million). Contributing to the lower balance sheet total was on the one hand progress relating to the working capital* management (December 31, 2010: €5.6 million; December 31, 2009: €19.6 million) and on the other significantly reduced net liabilities** (December 31, 2010: €13.6 million; December 31, 2009: €25.3 million).
**Trade receivables + inventories – trade payables*
*** Liabilities to banks – cash on hand and cash at banks*

Current assets declined as of December 31, 2010 by €5.6 million to €51.3 million (December 31, 2009: €56.9 million). In this connection, trade receivables were able to be decreased by €9.4 million to €26.3 million (December 31, 2009: €35.7 million) as were inventories, by €0.9 million to €4.8 million (December 31, 2009: €5.7 million). Cash and cash equivalents increased as of year end by €5.6 million to €13.5 million (December 31, 2009: €8.0 million). Other assets changed only slightly at €6.6 million (December 31, 2009: €6.9 million).

Non-current assets decreased by €3.0 million to €15.8 million, compared to €18.8 million at year end 2009. Property, plant and equipment declined by €1.9 million to €11.4 million (2009: €13.3 million) following scheduled depreciation and considering investments made in the 2010 financial year.

Current liabilities of the Zapf Creation Group decreased as of December 31, 2010 by €4.1 million to €59.1 million (December 31, 2009: €63.2 million). This decrease relates primarily to the short-term bank liabilities, which were reduced by €6.2 million to €27.1 million (December 31, 2009: €33.3 million). The trade payables increased again following a strong decline in the prior year, by €3.7 million to €25.5 million (December 31, 2009: €21.8 million). In addition, income tax liabilities of €1.4 million (December 31, 2009: €2.5 million) declined by €1.1 million, while other liabilities increased by €0.2 million to €3.4 million (December 31, 2009: €3.2 million). Provisions decreased by €0.9 million to €1.6 million (December 31, 2009: €2.4 million).

Non-current liabilities represent once again only deferred tax liabilities, which at €0.1 million as of December 31, 2010 (December 31, 2009: €0.0 million) were relatively insignificant.

As of December 31, 2010 the Zapf Creation Group is showing equity of €8.0 million. Compared to the equity amount in the prior year of €12.5 million, this represents a decline of €4.4 million. This reflects in large part the loss for the 2010 financial year. The equity ratio amounted to 11.9% and the end of 2010 (December 31, 2009: 16.5%).

Balance sheet structure of the Zapf Creation Group as of December 31 (in € million)

	2010	**2009**
Noncurrent assets	15.8	18.8
Current assets	51.3	56.9
Assets	**67.1**	**75.7**
Equity	8.0	12.5
Noncurrent liabilities	0.1	0.0
Current liabilities	59.1	63.2
Equity and liabilities	**67.1**	**75.7**

Disclosures regarding derivative financial instruments

In the Zapf Creation Group derivative financial instruments are primarily used for hedging purposes (exchange rate and interest rate risks). Cash flow hedges for hedging interest rate and exchange rate risks are only utilized if this is required by the financing structure. A cash flow hedge refers to a transaction to hedge future variable cash flows against fluctuation. Changes in the fair value of derivative financial instrument that serves hedge cash flow risks are documented. If the requirements for hedge accounting are met, the changes in the fair value are recognized directly in equity. If this is not the case, the measurement fluctuation is recognized in the income statement.

Accumulated other comprehensive income as of December 31, 2010 results entirely from translation differences that are recognized directly in equity. The changes in value of derivative financial instruments existing in Company were recognized entirely in the income statement in the 2010 financial year.

Financial and assets position of Zapf Creation AG

In the separate financial statements of Zapf Creation AG the balance sheet total as of the December 31, 2010 balance sheet date declined to €78.7 million (December 31, 2009: €81.2 million). The balance sheet thereby decreased by €2.5 million. Structurally, the balance sheet of the separate financial statements shows similar changes as in the consolidated balance sheet. The working capital declined as of December 31, 2010 to €4.3 million (December 31, 2009: €9.9 million), and the net liabilities were able to be reduced to €17.2 million (December 31, 2010: €30.2 million).

Noncurrent assets declined to €40.3 million (December 31, 2009: €45.4 million) due to decreased loans to affiliated companies and due to depreciation.

On the other hand, current assets increased by €2.5 million to €37.7 million (December 31, 2009: €35.2 million). The main reason was cash and cash equivalents, which increased to €10.0 million in the reporting year. At the end of 2009 the total balance was €3.4 million. Inventories were able to be further reduced, by €1.8 million to €2.6 million (December 31, 2009: €4.4 million). Trade receivables increased slightly as of December 31, 2010 by €0.3 million to €11.0 million (December 31, 2009: €10.7 million), while receivables from affiliated companies decreased by €2.9 million to €9.5 million (December 31, 2009: €12.5 million). Other assets grew by €1.0 million to €4.6 million (December 31, 2009: €3.6 million).

Equity of Zapf Creation AG declined as of December 31, 2010 by €2.4 million to €16.2 million (December 31, 2009: €18.6 million) due to the loss for the period. This results in an equity ratio of 20.5% (December 31, 2009: 22.9%).

As of the 2010 year end, provisions in the amount of €14.2 million were lower than the prior year's amount of €16.2 million.

The liabilities of Zapf Creation AG increased in total by €1.9 million to €48.3 million (December 31, 2009: €46.4 million). In this development there are opposing effects: while bank liabilities decreased by €6.5 million to €27.1 million (December 31, 2009: €33.6 million), there was an increase in trade payables of €4.0 million to €9.3 million (December 31, 2009: €5.3 million) as well as an increase in liabilities to affiliated companies of €2.7 million to €9.5 million (December 31, 2009: €6.8 million).

Investments

Investments of Zapf Creation Group

In the 2010 financial year the Zapf Creation Group made investments in the total amount of €0.9 million (2009: €1.2 million). As in the prior year, investments in intangible assets amounted to €0.1 million. An amount of €0.8 million was invested in the reporting year in property, plant and equipment such as forms, machines and technical equipment (2009: €1.0 million).

Investments of Zapf Creation AG

Investments of Zapf Creation AG in 2010 totaled €0.9 million (2009: €2.6 million). Of this amount, €0.8 million (2009: €1.0 million) related to property, plant and equipment. Investments in intangible assets amounted to €0.1 million (2009: €0.1 million). With respect to the shares of Zapf Creation Logistics GmbH & Co. KG, a current earning-rate calculation furthermore led to the reversal of a write-down in the amount of €1.4 million. In the prior year, the reclassification of a loan from current assets led to an increase in financial assets of €1.5 million.

Cash flow

Cash flow of the Zapf Creation Group

The consolidated cash flow statement of the Zapf Creation Group in the 2010 financial year is showing cash flows from operating activities of €16.8 million, which compared to the prior year's figure of €8.4 million almost doubled. In addition to the improved result, this increase is due in particular to an increase in the trade payables, which resulted from the granting of extended payment terms by MGA.

Cash outflows resulted from investing activities in the amount of €0.5 million (2009: €-1.1 million).

Due to the positive liquidity situation, debt in the reporting period was able to be reduced more than in the prior year. This can be seen in the cash outflows from financing activities of €10.9 million (2009: €-7.1 million).

In total, cash and cash equivalents, including a small positive effect from exchange rate changes, increased by €5.6 million to €13.5 million (2009: €8.0 million).

Employees

Personnel development of the Zapf Creation Group

The Zapf Creation Group had a worldwide total of 159 employees as of December 31, 2010 (excluding members of the Management Board and trainees). As of last year's balance sheet date there were 224 employees.

The average staff size for the year is shown below:

Average number of employees of the Zapf Creation Group during the year

	2010	**2009**
Salaried	157	204
Non-salaried	26	26
Total employees	**183**	**230**

As of the 2010 year end, in Germany there were a total of 119 individuals employed by the Zapf Creation Group at the Rödental location. At the end of December 2009, the Group had 142 employees in Germany. Thereof, 118 individuals were employed in Rödental and 24 were located in Darmstadt. The office in Darmstadt has been closed in the meantime.

The personnel development in the 2010 financial year was in line with the planning. In the 2011 financial year, additional selective staff reductions are expected.

Regarding the compensation system for the Management Board and senior executives reference is additionally made to the presentation in the notes to the consolidated financial statements and in the notes to the separated financial statements of Zapf Creation AG.

Personnel development of Zapf Creation AG

Zapf Creation AG had a worldwide total of 83 employees as of December 31, 2010 (excluding members of the Management Board and trainees). As of last year's balance sheet date there were 109 employees.

Average number of employees of Zapf Creation AG during the year

	2010	**2009**
Salaried	90	113
Total employees	**90**	**113**

Research and development

In the toy industry, innovation relating to products and toy concepts are a motor of the business development. Accordingly, innovation is of great importance in the Zapf Creation Group. Against the background of the goal of expansion of the existing product and brand name portfolios to include internationally marketable toys for girls that are not included in the play doll sector, much importance is attached to Group's activities in research and development.

The further development of the product range through research, development and design are the responsibility of Zapf Creation AG. The subsidiaries do not carry out research and development of their own but are primarily responsible for the marketing and distribution of the product portfolio. In connection with the strategic cooperation, MGA Entertainment, Inc. is responsible for technical product development, carried out in Hong Kong. The design and the creative services of the product development are the responsibility of the Zapf Creation Group. In the area of product development, design, marketing, both companies work together at the locations in Germany, Hong Kong and Los Angeles.

Quality management

A high level of product quality is part of the core of Zapf Creation brands. The quality management department located at the headquarters in Rödental and in Hong Kong occupies an important position.

In quality management, full compliance with national and international laws and regulations is monitored for all Zapf creation products. The compliance with legal regulations and standard was effectively controlled on site for all Asian suppliers in 2010.

No complaints regarding product deficiencies arose in 2010. Zapf Creation and MGA Entertainment, Inc. have implemented a number of measures aimed at processes, personnel recourses and reporting in order to continually ensure the quality of Zapf Creation products. In the 2010 financial year there were again no indications of any fundamental quality problems.

Compliance with ethical standards in production and procurement

All Zapf Creation products are produced completely by selected suppliers in China. In this connection, Zapf Creation is committed to a long-term and partnership-based working relationship as well as to ensuring appropriate working hours and social standards. The Group works with suppliers who meet its high quality standards and who are committed to adherence with uniform social standards in accordance the Code of Conduct, in effect since 2002, of the International Council of Toy Industries (ICTI). Suppliers that are committed to this Code are subjected to an audit process, which is concluded by the issuance of an ICTI certificate. Continuous compliance with the Code of Conduct is regularly audited, both by independent institutions and employees of the Zapf Creation Group.

As of the end of 2010 all suppliers of the Group were ICTI certified or were undergoing the audit process.

Compliance with international norms and regulations

The quality specifications define all relevant regulations, norms and standards as well as customer-specific requirements and establish these as mandatory for the entire product portfolio.

IV. Subsequent events

With respect to the Group financing, in December 2010 the financing agreements were signed and in January 2011 were implemented through the corresponding loan disbursements. Furthermore, in the course of the 2011 calendar year to date, existing mortgages were released, and the possibility for factoring was introduced. In this regard, reference is made to the comments on the realignment of the Group financing.

On February 28, 2011, Zapf Creation AG announced that the Chairman of the Management Board, Jaime Ferri Llorens, will be resigning from his post for health reasons.

At the close of February 28, 2011, the contract with José Antonio Santana, member of the Management Board of Zapf Creation AG terminated: therefore, since this time Mr. Santana is no longer a member of the Management Board of the Company.

On March 14, 2011, the Supervisory Board of Zapf Creation AG appointed Mr. Thomas Eichhorn as a member of the Management Board of the Company, effective April 1, 2011.

V . Risk report

The monitoring, control and analysis of risks is part of the core management duties of Zapf Creation AG and the Zapf Creation Group. The Group has a risk management system in accordance with Art. 91 (2) AktG.

Risk management system

The Group adheres to business principles that comprise the identification, assessment, control and documentation of risks in a risk management system. The system promptly and directly informs the decision maker of the Company regarding existing or newly arising risks for the Group. The identification of potential risk is carried out continually. The analyses take place regularly and are monitored by a representative for the risk management. Should individually significant risks increase or potentially even threaten the Company, the representative immediately and directly informs the Management Board.

The relevant risks for the Zapf Creation Group and Zapf Creation AG can be classified into the following categories: external risks, operating risks, financial risks and strategic risks. Analysis and presentation in connection with the risk management system are not limited to existing risks. As a basis for the control of the Group, arising risks are additionally analyzed and presented.

Disclosures according to Sec. 289 (5) HGB

The internal control system ("ICS") and the risk management system ("RMS") of Zapf Creation AG and the Zapf Creation Group include organizational rules and professional guidelines for the risk control in the accounting and financial reporting process.

Internal control system

The existing ICS exhibits the following features regarding the Group accounting and financial reporting process:

- The accounting departments established in Zapf Creation AG and its subsidiaries are clearly structured with respect to the areas of responsibility and leadership;

- The departments involved in the accounting and financial reporting process are adequately equipped in terms of personnel and equipment and responsible individuals have the required qualifications for their respective duties;

- With respect to significant installed processes that are relevant to accounting and financial reporting, especially in connection with the preparation of the consolidated financial statements of the Zapf Creation Group, extensive analytical tests are carried out in accordance with the dual control principle;

- In the Zapf Creation Group, a central reporting and accounting organization exists; and

- The EDP systems applied in the area of accounting and financial reporting are safeguarded against unauthorized access by safety installations.

Internal risk management system

The existing RMS exhibits the following features regarding the consolidated accounting and financial reporting process:

- The goal of the RMS is the early detection of potential risks and the early initiation of appropriate countermeasures;

- The RMS is a part of the planning, controlling and reporting processes of the Zapf Creation Group;

- Responsibilities for the various risk areas are clearly defined; and

- The accounting and financial reporting process in the Zapf Creation Group is under the responsibility of division managers who report directly to the Management Board.

ICS and RMS ensure that the accounting and financial reporting of Zapf Creation AG and the Zapf Creation Group are carried out in accordance with legal requirements and German principles of proper accounting and that the business transactions are uniformly recognized and measured according to International Financial Reporting Standards (IFRS) and in accordance with national financial reporting standards in the individual countries.

External risks

General business risks

Despite the forecasted growth of the world economy of approximately four percent in 2011, the German Institute for Economic Research (DIW) assesses the economic risks to be high in light of the weak financial markets. In the event that the crisis intensifies, sudden movements in the capital markets could lead to intense exchange rate fluctuations and disturbances in foreign trade as well as significantly declining consumer spending. A spread to non-European markets cannot be ruled out, and here the USA is explicitly emphasized. As a result, internationally restrained consumer spending could result in the toy industry. This could have a negative effect on the demand for Zapf Creation Group products.

Industry-specific risks

The business climate in the toy market, consumer spending and demographic development are important indicators for sales success. The challenge for the Company's management is, taking into consideration the demographic development, to recognize trends in toy market and changes in consumer spending as quickly and precisely as possible and to be in the position to react to these with new products.

Legal risks

The international activities of Zapf Creation require that the Group consider and comply with international norms and regulations. With the assistance of external lawyers, the Management Board of Zapf Creation AG continually monitors the legal situation of the Company. Currently, no legal risks are foreseen. Furthermore, to the Company's knowledge, neither Zapf Creation AG nor its subsidiaries are parties to legal or arbitration proceedings or actions before administration authorities that could have a significant effect on the Group's economic situation. To the Company's knowledge, such proceedings are also not threatened. For existing risks relating to legal disputes, adequate provisions have been recognized.

Ethical and environmental risks

In connection with a comprehensive quality management, the Zapf Creation Group attaches great value to compliance with ethical and ecological standards in the procurement and production. On this basis, the Zapf Creation Group has committed itself to strict and lasting compliance with the ICTI Code of Conduct, with which the International Council of Toy Industries endeavors to ensure reasonable working hours and adherence to social and environmental standards on the part of suppliers. In this connection, there are no identifiable risks for the Zapf Creation Group.

Operating risks

Procurement risks

Procurement risks result from the specific features in China. These include the unchanged existing shortage of workers in the Southern Chinese Perl River Delta, where a significant portion of worldwide toys are manufactured. The Zapf Creation Group utilizes short-term order cycles with its suppliers, in order to minimize the inventory risks. Thus, a low minimum order volume could cause a procurement risk, if a higher market demand would arise unexpectedly. However, the Company counteracts this potential risk by using a professional order volume management.

Risks relating to operating processes

There are currently no risks in connection with the operating processes that could threaten the existence of the Company.

Financial risks

Equity risks

The equity situation of the Zapf Creation Group is significantly affected by the equity of Zapf Creation AG as presented in financial statements under commercial law. Losses resulting from operating activities have a direct or indirect effect on the equity of Zapf Creation AG. Currently, no acute risk exists for the Zapf Creation AG that, in the event of losses from operations or due to balance-sheet risks, the equity of the Company would be reduced to such an extent, that a notice of loss in accordance with Art. 92 AktG and corresponding capital measures to restore an adequate equity basis would be required.

Liquidity and financing risks

Zapf Creation AG is subject to the risk of joint and several liability for the bank loans of all included Group companies in connection with the existing financing agreement.

Currency and interest rate risks

Currency and interest rate risks are market risks that affect income, expenses and value of currently held financial instruments. The goal of the Company is to manage and control these risks with acceptable parameters, while optimizing income. The Group limits or avoids such risks by entering into hedging transactions. All hedging measures are coordinated and carried out centrally at the parent company level. Derivative financial instruments are especially utilized as hedging measures. Clear guidelines for the Group-wide foreign currency and interest policy minimize the risks that arise from the use of financial instruments. These guidelines include the functional separation of trading, execution, and accounting, the self-limitation to a clearly defined group of banks with high credit ratings and the authorization of only a few appropriately qualified employees. All derivatives entered into serve solely as hedges (refer also to a detailed presentation in the notes to the consolidated financial statements, Sections A 2.3.7., B 2.6.1 and B 2.6.4. and in the notes to the financial statements of the AG under Section B.12.). In order to hedge interest rate risks, there were interest-rate swaps at December 31, 2010 with a nominal volume of €23.0 million (prior year: €26.0 million).

Risks from ongoing external tax audits

External tax audits taking place relating to Zapf Creation AG and Zapf Creation (H.K.) Ltd. are not finally completed; however, the reports of the respective auditors are already available.

For justified claims already known, provisions were recognized by the respective companies.

Strategic risks

Brand image risks

The strength of the Zapf Creation Group's brands is a primary value driver. For this reason, an effective trademark protection is essential and has been established. There are currently no significant legal disputes pending.

Sales risks

In the opinion of the Management Board, a certain risk continues to exist due to changes in toy behavior in the core target group of the Zapf Creation Group.

Zapf Creation and the MGA Group have mutually agreed not to develop competitive products. This can potentially lead to the situation where the Company cannot respond to new market trend.

Development and quality risks

The quality management system of the Group addresses the relevance as well as the practical and strategic consequences of national and international laws and regulations. The quality management system in Hong Kong concentrates on practical implementation as well as the strict control over compliance with the norms on site at the manufacturers and thereby works closely with MGA Entertainment (HK) Ltd., which has the responsibility for the entire procurement activities for the Group. Zapf Creation rigorously carried out the controls over the products in 2010. The cooperation between the Zapf Creation Group and MGA Entertainment (HK) Ltd. functioned smoothly.

Litigation between MGA and Mattel

In the litigation between MGA and Mattel regarding the copyrights for the "Bratz" doll and eventual damage payments, there has not been a final judgment. In July 2010 a North American appeals court reversed the earlier judgment of a lower court against MGA. In the event of a negative outcome of the procedure from MGA's point of view, the risk exists that the cooperation between Zapf Creation and MGA could become impaired. The Management Board of the Zapf Creation Group has no significant new information regarding the litigation between MGA and Mattel.

Overall risk

There are no risks known or recognizable to the Company that individually or in combination which might lead to direct impairment of the development or threaten the existence of Zapf Creation AG or the Group.

VI. Opportunity report

The Zapf Creation Group, on the way to becoming an international brand-name company for girls' toys, enjoys a strong position to return to stable growth and a sustainable profitability in the medium term. Additional plus points are the lean, cost-efficient Group structure and well established processes in all functional areas. Strategic opportunities, in the opinion of the Management Board, exist in all of the following areas:

Further development of the product portfolio

Zapf Creation continues to hold a key position in the important toy markets in the play and functional doll segment. The Group will intensify and further exploit its expertise in its established segment.

Furthermore, Zapf Creation is working on achieving a better balance of the product portfolio outside of the Christmas business.

Expansion of the licensing business

Through entry in the licensing business, the Zapf Creation Group is presented a further opportunity to successfully market toys for girls. In Europe, approximately 30% of all toy sales are generated by licensed products. Zapf Creation undertook the first step to enter this market in 2009 with licensed production around the internationally successful film and book figure "Lilly the Witch". In addition, the Group acquired the license for the development and European marketing of play dolls of the popular Disney princesses. It is intended to significantly expand the licensing business.

Furthermore, the cooperation with MGA Entertainment, Inc. affords the possibility to use the brands of Zapf Creation for products outside of the toy segment, as MGA Entertainment, Inc. can issue appropriate licenses to external companies. Through the licensing business the Zapf Creation Group can fundamentally expand its product range and develop new target groups without the exposure to risks of independently developing markets.

Geographical Expansion

Zapf Creation maintains traditionally close relations with its worldwide trading partners. The Group will build on this in order to expand the businesses in the existing countries and to develop new country markets. This relates in all cases to a targeted geographical expansion with manageable risks.

In Europe the focus will especially be on increasing the market share in countries such as Italy through ongoing distribution efforts and to increase the profitability in counties such as France and Poland.

In Asia, the Group has already reached a level of market saturation. Nevertheless, selected emerging country markets will be worked on more intensively.

Latin America will also develop into an interesting sales market in the middle term. Since the preferences of the consumers there are somewhat different than in the core markets of the Group and incomes are at a low level, the described expansion of the product and price range is especially important. With attractive products at entry-level prices Zapf Creation can also provide an attractive offer to consumers with low incomes.

VII. Forecast report

Overall economic forecast

Based on the forecast of the German Institute for Economic Research (DIW) in Berlin, the recovery of the worldwide economy will continue at a reduced speed. In so doing, the development will be extremely mixed. While the business performance in the large emerging countries has risen sharply since the middle of 2009 and already lies significantly over the prior year's level, of the developed economies, according to DIW, up until now only the USA has offset the decline in gross national product that resulted from the economic and financial crisis. Germany will not make up for its massive production losses until sometime near the end of this year, and the euro zone will first accomplish this in the course of 2012. For Japan, the recovery of production to pre-crisis levels is not expected by the end of 2012. Against this background, a moderate expansion of the global economy of somewhat over four percent is expected for 2011.

According to the forecast of the DIW, the economic risks remain high due to the weakness in the financial markets. The markets are extremely unsettled, which is evidenced by very high risk premiums of the countries in the euro zone threatened by insolvency. Despite extensive governmental rescue packages, which at best have brought temporary relief, the mood continues to be nervous. In the event that the crisis becomes more intense, sudden reactions in the capital markets could lead to strong exchange rate fluctuations and to disturbances in foreign trade and significantly declining customer spending. According to DIW, a spill over to non-European areas cannot be ruled out, whereby the USA is explicitly emphasized. Negative for the euro area would be a resurgence of competitive devaluations between China and the USA, which ultimately would entail a higher valuation of the euro.

Against this background, the DIW expects economic growth of 1.5% for the euro area in 2011. For Germany, an overall positive economic development is expected. Gross national product might increase by 2.2% with some slight weakness in the summer months. In light of the positive development in the labor markets, rising consumer spending is especially expected in 2011. Eurostat is forecasting a growth in consumer spending of private households in Germany of 1.4%, which represents a noticeable upturn compared to the prior year. For the UK, with an expected gross domestic product growth of 2.2%, growth in consumer spending of private households of 1.6% expected.

Sources:
German Institute for Economic Research (DIW), Berlin
Eurostat, Luxembourg

Anticipated industry environment

In the opinion of the Management Board, the traditional toy markets, in which the play and functional doll segment is included, will partly stagnate or even decline in the coming years in Western Europe due to the influence of the demographic developments. As a result, for manufacturers of classical toys, the competitive pressure in Western Europe further increase. Additional market shares will be achieved primarily through predatory competition.

Positive effects on the demand for toys could result from a continuing positive trend of consumer spending.

Strategic focus

In order to further increase the performance of the Zapf Creation Group, the Management Board plans to substantially increase the rate of investment in the development and worldwide marketing of high-value toys.

The Group in 2010 already introduced several innovative toy brand concepts to the market. These are products that are clearly positioned for the entry price segment and make it possible to get a foothold in new country markets. Also for the worldwide famous brand families in the play doll segment the Group is planning new attractive products. An example is the line of Disney Princess play dolls, which have been available in retail stores since the fall of 2010.

In addition to an attractive product pipeline and the further geographic expansion, which should support sales growth, the Management Board will focus in the future on ensuring a competitive cost basis. Therefore, the structure in all Group divisions will be further optimized. The related measures are intended to increase the efficiency and at the same time to further reduce the operating costs.

Furthermore, despite difficulties in connection with increasing costs in China, gross profit is to be stabilized on a sustainable basis and also improved. As a result of the increasing transfer of business directly to distributors, revenues could decline. This decrease, however, would be compensated by and improved EBIT. The range of measures reaches from further developments in product design to more intensive cooperation with the Group’s suppliers.

In view of the significant seasonal fluctuations in the toy business it is of great importance for the Zapf Creation Group to deploy its liquidity as efficiently as possible. Therefore, further the Group will make further efforts to improve the working capital management.

Forecast

Forecast Zapf Creation Group

After somewhat declining sales revenues in 2011, the Management Board assumes that the development in 2012 will once again be positive. As a result of the continuing strict cost management, a further improvement in the result is expected.

Forecast Zapf Creation AG

With respect to the forecast for the 2011 and 2012 financial years for Zapf Creation AG, no other forecasts are made beyond those for the Zapf Creation Group.

VIII. Other

Disclosures according to Sec. 289 (4) and Sec. 315 (4) of the German Commercial Code (HGB)

Share capital

As of December 31, 2010 the share capital of the Company amounted to €19,295,853.00 (prior year: €19,295,853.00). It is divided into 19,295,853 (prior year: 19,295,853) no-par-value bearer shares; at the balance sheet date, as in the prior year, all outstanding shares are fully paid in.

Authorized capital

On May 27, 2008 the ordinary general shareholder meeting resolved to establish a new authorized capital (Authorized Capital 2008) and the revision of Art. 5 (amount and classification of share capital) of the articles of incorporation; on December 15, 2009 the ordinary general shareholder meeting resolved to establish a new conditional capital (Conditional Capital 2009) and the new revision to Art. 5 (amount and classification of share capital) of the articles of incorporation. Following these resolutions, the articles of incorporation of Zapf Creation AG govern the following possibilities for the execution of capital measures:

The Management Board is authorized, upon approval of the Supervisory Board, until May 26, 2013 once or several times to increase the share capital by up to a total of €9,000,000.00 against a cash and/or non-cash contribution through the issuance of new no-par-value bearer shares (Authorized Capital 2008).

The Management Board is authorized, upon approval of the Supervisory Board, to exclude the legal subscription right of shareholders in the following cases:

a) for fractional amounts;

b) if the capital increase is made against a cash contribution and the total share of share capital relating to the new shares, for which the subscription rights were excluded, does not exceed €1,800,000.00 or – in the event this amount is lower – 10% of the existing share capital at the time of issuance of the new shares and the issuance amount of the new shares is not significantly below the exchange price of the already listed shares of the same type and class in the context of Art. 203 (1) and (2), 186 (3) Sent. 4 AktG at the time the final determination of the issuance amount by the Management Board; the authorized volume decreases by the proportional amount of share capital that relates to shares that have been issued or sold since May 27, 2008 under exclusion of subscription rights directly or indirectly pursuant to Art. 186 (3) Sent. 4 AktG.

c) in the case of capital increase against non-cash contributions through the issuance of shares in connection with the acquisition of companies, portions of companies or investments in companies;

d) in the case of capital increase against non-cash contributions through the issuance of shares in connection with the acquisition of repayment and/or interest claims against the Company in connection with loan agreements;

The Management Board is authorized, upon approval of the Supervisory Board, to determine the further details of the execution of the capital increases from Authorized Capital 2008. The Supervisory Board is authorized to revise the articles of incorporation upon the complete or partial execution of the increase in the share capital from authorized capital 2008 or upon expiration of the authorization according to the amount of the capital increase from authorized capital 2008. Upon execution of a capital increase from Authorized Capital 2008, this exists in the amount of €7,704,147.00 going forward.

The share capital of the Company is conditionally increased by up to €500,000.00 through the issuance of up to 500,000 of no-par-value bearer shares (Conditional Capital 2009).The conditional capital increase is to only be carried out, as owners of stock options, which are issued by the Company from December 15, 2009 to December 14, 2014 according to the resolution of the general shareholders' meeting, exercise their option rights and new shares are issued according to the option conditions. The new shares resulting from the exercise of the these option rights participate in earnings of the year from the beginning of the financial year for which at the time of the exercise of the option right, there has been no resolution of the general shareholder' meeting as to the appropriation of earnings.

In connection with the issuance of new shares, the beginning of the profit participation can be established at variance to Art. 60 (2) AktG.

Regarding the Company's ability to issue stock options, reference is additionally made to the presentation of stock-based remuneration systems in the notes to the consolidated financial statements and in the notes to the separate financial statements of Zapf Creation AG.

In the 2010 financial year, as in the prior year, no capital measures were carried out.

The share of MGA Entertainment, Inc. and its shareholders ("trusts") in the share capital of the Company at December 31, 2010 amounted, unchanged, to 65.29%.

Treasury shares

With a resolution of the General Shareholders' Meeting on December 15, 2009, the Company is authorized to acquire treasury shares, in order for these

a) to be able to be used as consideration in connection with business combinations or in connection with the acquisition of companies or portions of companies or investments in companies or

b) to be issued as consideration for the release of one or more for repayment or interest claims against the Company in connection with loan agreements or

c) to be offered as employee shares to employees of the Company and of affiliated companies in the context of Art. 15 ff. AktG to be acquired, or in the event the employee shares were acquired through a securities loan /securities lending, to be used to settle those liabilities or

d) to give these to members of the Management Board as a portion of their remuneration or

e) to be used to service option rights which are granted due to the authorization resolved by the general shareholders meeting on December 15, 2009 for the issuance of stock options or

f) to be sold in some other way as on the stock exchange or through an offer to all shareholders against a cash payment at a price that is not significantly below the exchange price for shares of the company of the same type and class at the date of the sale or

g) to reduce the share capital without an additional resolution of the general shareholders meeting.

The authorization is limited to the purchase of treasury shares in an amount relating to these shares of 10% of the existing share capital at the time of the resolution by the general shareholders meeting on December 15, 2009 (€19,295,853.00). No more than 10% of the share capital can pertain to the acquired treasury shares together with other shares that are in possession of the Company or attributable to the Company according to Art. 71a ff. AktG. The purchase is additionally only permitted if the Company at the time of the purchase is able to recognize a reserve in the amount of costs for the purchase, without reducing the share capital or other reserve recorded according the law or the articles of association that is not available for payment to shareholders.

The authorization for the purchase of treasury shares is in force up to and including December 14, 2014. The authorization resolved by the general shareholder meeting on May 27, 2008 for the appropriation of treasury shares that are already held by the Company at the time of the resolution by the general shareholders meeting on May 27, 2008 terminates with the effective date of this new authorization. To the extent the Company has repurchased shares based on the authorization of May 27, 2008 to purchase treasury shares, the authorization for appropriation from the resolution of May 27, 2008 remains intact for these shares.

The purchase based on the authorization granted by the resolution of the general shareholders meeting on December 15, 2009 can also be carried out by a Group company affiliated with the Company in the context of Art. 17 AktG or on account of the Company or a Group company in the context of Art. 17 AktG.

The defined purposes a) to f) in the mentioned authorization are only to be applied under consideration of the provisions contained therein and within the existing authorization framework likewise to treasury shares already held by the Company as of December 15, 2009.

Use was made up to and including December 31, 2010 of the authorization resolved by the general shareholders meeting on December 15, 2009 for the purchase of treasury shares and/or for the appropriation of treasury shares already held such that in the 2009 financial year 80,000 treasury shares were transferred to a member of the Management Board in connection with his share-based compensation.

Investments

As of December 31, 2010 the following investments in Zapf Creation AG exist that exceed 10% of the voting shares:

The shares of MGA Entertainment, Inc. and its shareholders (“trusts”) in the share capital of the Company amounted to 65.29%.

Appointment and withdrawal of members of the Management Board

The appointment and withdrawal of members of the Management Board is governed by Articles 84 and 85 of the German Stock Companies Act (AktG).

Changes to the Articles of Association

For changes to the Articles of Association, Articles 133 and 179 of AktG apply.

"Change of Control" clause

In the contracts with affiliated companies of the MGA Group that are important for the Company there is a so-called “change of control” clause, which provides for special cancellation rights upon a significant change in the shareholder structure.

Disclosures in accordance with Sec. 289 a German Commercial Code (HGB)

The corporate governance statement in accordance with Sec. 289 a HGB is made publicly available on the website of Zapf Creation AG.

Report of the Management Board on relationships with affiliated companies

In its report according to Art. 312 Act on relationships with affiliated companies in the 2010 financial year, the Management Board provided the following declaration:

“We declare that our Company, in connection with the legal transactions and measures described in the report on relationships with affiliated companies, according to the circumstances of which we were aware of at the time the legal transactions were entered into or measures were taken, received an appropriate consideration in the case of each legal transaction, and by the fact that measures that were taken or not taken, was not disadvantaged.”

Rödental, March 15, 2011

Josef Lukas
Management Board member

Hannelore Schalast
Management Board member

Zapf Creation AG

Rödental

Consolidated Financial Statements

of Zapf Creation

Zapf Creation AG
Rödental

Consolidated Income Statement
for the Period January 1, 2010 to December 31, 2010

	Section in Notes	2010 €'000	2009 €'000
Sales revenue	B Nr. 1.1.	79,286	79,331
Cost of sales	B Nr. 1.2.	-51,133	-49,936
Gross profit		**28,153**	**29,395**
Sales and distribution expenses	B Nr. 1.3.	-10,363	-11,520
Marketing expenses	B Nr. 1.4.	-8,131	-9,882
Administrative expenses	B Nr. 1.5.	-13,705	-14,890
Other income	B Nr. 1.6.	4,317	3,495
Other expenses	B Nr. 1.7.	-328	-1,195
Profit (loss) from operations		**-57**	**-4,597**
(of which restructuring costs	*B Nr. 1.8.*	*-1,862*	*-137)*
(of which one-off costs, mainly consultancy	*B Nr. 1.8.*	*0*	*0)*
(resulting adjusted profit (loss) from operations		*1,805*	*-4,460)*
Financial income	B Nr. 1.9.	113	64
Finance costs	B Nr. 1.9.	-4,568	-5,076
Profit (loss) before tax from continuing operations		**-4,512**	**-9,609**
Income taxes	B Nr. 1.10.	-124	-1,504
Profit (loss) after tax from continuing operations		**-4,636**	**-11,113**
Profit (loss) before tax from discontinued operations	B Nr. 1.11.	431	47
Income taxes on discontinued operations	B Nr. 1.10.	0	0
Net profit (loss) for the period		**-4,205**	**-11,066**

		2010 €	2009 €
Average number of shares outstanding (thousands)	B Nr. 1.12.	18,803	18,725
Earnings per share from continuing operations	B Nr. 1.12.	-0.25	-0.59
Earnings per share from discontinued operations	B Nr. 1.12.	0.02	0.00
Earnings per share (basic/diluted)	**B Nr. 1.12.**	**-0.22**	**-0.59**

The Notes form an integral part of the Consolidated Financial Statements.

Zapf Creation AG
Rödental

Consolidated Statement of Comprehensive Income
for the Period January 1, 2010 to December 31, 2010

	Section in Notes	2010 €'000	2009 €'000
Net profit (loss) for the period		**-4,205**	**-11,066**
Adjustment from currency translation	B Nr. 2.5.4.	-62	1,125
Deferred taxes	B Nr. 2.5.4.	-110	-296
Derivative financial instruments	B Nr. 2.5.4.	0	0
Other comprehensive income (loss)		**-172**	**829**
Comprehensive income (loss) for the period		**-4,377**	**-10,237**

The Notes form an integral part of the Consolidated Financial Statements.

Zapf Creation AG

Rödental

Consolidated Balance Sheet as of December 31, 2010

Assets	Section in Notes	Dec. 31, 2010 €'000	Dec. 31, 2009 €'000
Current assets		**51,343**	**56,877**
Cash and cash equivalents	B no. 2.1.1.	13,532	7,971
Trade receivables	B no. 2.1.2.	26,315	35,746
Inventories	B no. 2.1.3.	4,817	5,668
Income tax receivables	B no. 2.1.4.	121	627
Other assets	B no. 2.1.5.	6,558	6,865
Non-current assets		**15,800**	**18,803**
Property, plant and equipment	B no. 2.2.1.	11,372	13,315
Intangible assets	B no. 2.2.2.	3,839	4,692
Other assets	B no. 2.2.3.	0	0
Deferred tax assets	B no. 2.2.4.	589	796
Total assets		**67,143**	**75,680**

Equity and liabilities	Section in Notes	Dec. 31, 2010 €'000	Dec. 31, 2009 €'000
Current liabilities		**59,076**	**63,209**
Liabilities to banks	B no. 2.3.1.	27,144	33,311
Trade payables	B no. 2.3.2.	25,528	21,806
Income tax liabilities	B no. 2.3.3.	1,390	2,464
Other liabilities	B no. 2.3.4.	3,449	3,204
Provisions	B no. 2.3.5.	1,565	2,424
Non-current liabilities		**52**	**18**
Liabilities to banks	B no. 2.4.1.	0	0
Deferred tax liabilities	B no. 2.4.2.	52	18
Equity		**8,015**	**12,453**
Subscribed capital	B no. 2.5.1.	19,296	19,296
Capital reserve	B no. 2.5.2.	31,698	31,759
Profit (loss) for the period and profit (loss) brought forward	B no. 2.5.3.	-31,418	-27,213
Accumulated other comprehensive income (loss)	B no. 2.5.4.	-1,790	-1,618
Treasury shares	B no. 2.5.5.	-9,771	-9,771
Total equity and liabilities		**67,143**	**75,680**

The Notes form an integral part of the Consolidated Financial Statements

Zapf Creation AG
Rödental

Consolidated Statement of Changes in Equity for the Period January 1, 2010 to December 31, 2010

	Outstanding shares (thousands)	Subscribed capital €'000	Capital reserves €'000	Net profit (loss) for the period and profit (loss) brought forward €'000	Accumulated other comprehensive income (loss): Adjustment from currency translation €'000	Accumulated other comprehensive income (loss): Derivative financial instruments €'000	Treasury shares €'000	Total equity €'000
Balance as at January 1, 2009	**18,723**	**19,296**	**33,240**	**-16,147**	**-2,447**	**0**	**-11,358**	**22,584**
Net profit (loss) for the period				-11,066				-11,066
Change in other comprehensive income					829	0		829
Comprehensive income (loss) for the period				**-11,066**	**829**	**0**		**-10,237**
Share-based payment	80		-1,481				1,587	106
Balance as at December 31, 2009	**18,803**	**19,296**	**31,759**	**-27,213**	**-1,618**	**0**	**-9,771**	**12,453**
Balance as at January 1, 2010	**18,803**	**19,296**	**31,759**	**-27,213**	**-1,618**	**0**	**-9,771**	**12,453**
Net profit (loss) for the period				-4,205				-4,205
Change in other comprehensive income					-172	0		-172
Comprehensive income (loss) for the period				**-4,205**	**-172**	**0**		**-4,377**
Share-based payment			-61					-61
Balance as at December 31, 2010	**18,803**	**19,296**	**31,698**	**-31,418**	**-1,790**	**0**	**-9,771**	**8,015**

The Notes form an integral part of the Consolidated Financial Statements.

Zapf Creation AG

Rödental

Consolidated Cash Flow Statement
for the Period January 1, 2010 to December 31, 2010

	2010 €'000	2009 €'000
Cash flow from operating activities:		
Operating loss before tax	-4,081	-9,562
Depreciation and amortization expense	3,336	3,821
Gains/losses from the disposal of non-current assets	-68	99
Net finance costs	4,455	5,011
Share-based payment	-61	106
Other non-cash income and expenses	0	0
Increase/decrease in assets and liabilities:		
Trade receivables	9,297	11,793
Inventories	851	6,740
Other assets	220	-1,698
Liabilities and provisions	2,965	-7,051
Income taxes paid	-141	-827
Cash flow from operating activities	**16,773**	**8,432**
Cash flow from investing activities:		
Proceeds from the disposal of property, plant and equipment, and intangible assets	423	30
Payments to acquire property, plant and equipment, and intangible assets	-893	-1,163
Cash flow from investing activities	**-470**	**-1,133**
Cash flow from financing activities:		
Proceeds from bank borrowings	0	0
Payments in connection with liabilities to banks and other fees	-809	-522
Repayments of liabilities to banks	-4,247	-4,000
Changes in liabilities related to drawdowns under short-term borrowing facilities	-2,432	626
Interest paid	-3,454	-3,235
Interest received	77	61
Issuance of treasury shares	0	0
Cash flow from financing activities	**-10,865**	**-7,070**
Effects of changes in exchange rates	123	317
Net change in cash and cash equivalents	**5,561**	**546**
Cash and cash equivalents at the beginning of the period	7,971	7,425
Cash and cash equivalents at the end of the period	13,532	7,971

The Notes form an integral part of the Consolidated Financial Statements.

Zapf Creation AG

Rödental

Notes to the Consolidated Financial Statements

for the Financial Year from January 1, 2010 to December 31, 2010

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A. General Disclosures regarding the Consolidated Financial Statements

1. Information on the Company

Zapf Creation AG - hereinafter also referred to as "the Company" or "Zapf Creation" - is Europe's leading brand manufacturer of play and functional dolls, including accessories.

The Company markets branded play concepts that consist of a doll and an extensive world of accessories, as well as themed play sets and collectible figures that are developed to a high standard of quality, design, safety and play value. The Company's most popular brands include BABY born®, Baby Annabell® and CHOU CHOU. With these globally successful concepts, Zapf Creation is aiming particularly at the core target group of girls between the ages of three and eight.

The present Zapf Creation AG was originally established in Rödental in 1932 by Max Zapf and his wife Rosa as "Max Zapf Puppen- und Spielwarenfabrik." The Company went public on April 26, 1999. Zapf Creation AG is listed on the Official Market of the Frankfurt Stock Exchange. Its shares are traded in the Prime Standard segment.

Zapf Creation AG is headquartered in Moenchroedener Strasse 13, 96472 Roedental, Germany.

2. Accounting policies

2.1. Overview

2.1.1. General

These consolidated financial statements of Zapf Creation AG were prepared in accordance with Section 315a German Commercial Code ("Consolidated Financial Statements According to International Accounting Principles") and in compliance with both the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) and the relevant interpretations of the International Financial Reporting Interpretations Committee (IFRIC), as applicable within the European Union under Article 4 of EC Directive 1606/2002 dated July 19, 2002, of the European Parliament and the European Council.

The provisions of Section 315a (1) German Commercial Code were also observed in preparing the consolidated financial statements. Reference is made to Section C, no. 5, for the disclosures required under Section 315a German Commercial Code.

All IFRS and related Interpretations that are mandatory for the financial year were applied in the preparation of the consolidated financial statements of Zapf Creation AG as of December 31, 2010, if they were adopted by the European Union.

The following standards and interpretations, or amendments to standards, were applied for the first time in the 2010 financial year in so far as they are of significance for the operations of Zapf Creation AG and the Group's consolidated subsidiaries:

- IFRS 1 (“First Time Adoption of IFRS”); in this case: structural changes to improve understandability and to simplify the incorporation of changes
- IFRS 2 (“Share-based Payment”); in this case: clarification of the accounting of cash-settled share-based compensation in the Group
- IFRS 3 (“Business Combinations”) and consequential changes to IAS 27 (“Consolidated and Separate Financial Statements”)
- IAS 39 (“Financial Instruments: Recognition and Measurement”; in this case: “Eligible Hedged Items”): this deals with the clarification of questions regarding hedge accounting that relates to the inflation risk of an underlying financial transaction and the one-sided risk of an underlying transaction
- IFRIC 12 (“Service Concession Arrangements”); accounting for infrastructure services performed by private enterprises
- IFRIC 15 (“Agreements for the Construction of Real Estate”); accounting for the construction of real estate properties
- IFRIC 16 (“Hedges of a Net Investment in a Foreign Operation”); accounting for hedging instruments in connection with the hedge of a net investment in a foreign operation
- IFRIC 17 (“Distributions on Non-Cash Assets to Owners”); accounting for non-cash distributions to owners and the related required disclosures
- IFRIC 18 (“Transfer of Assets from Customers”); accounting for the transfer of property, plant and equipment from customers (utilities industry)
- Annual amendments published in May 2008 (in this case: amendments to IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations“) and April 2009 in connection with the “Annual Improvements Project” of the IASB (“International Accounting Standards Board”)

Initial application of these standards and interpretations or application of amendments to these standards and interpretations does not have significant effects on the consolidated financial statements of Zapf Creation AG.

With the exception of certain financial instruments that are reported using fair values, the consolidated financial statements of Zapf Creation AG were prepared based on historical costs.

The euro (€) is the reporting currency, because it is the currency used in the majority of the Group's financial transactions. Unless otherwise indicated, all amounts are stated in thousands of euro (K€). Deviations from amounts that have not been rounded up or down may occur.

On March 15, 2011 the Management Board of Zapf Creation AG released the consolidated financial statements as of December 31, 2010 to the Supervisory Board. The Supervisory Board is tasked with reviewing the consolidated financial statements and declaring whether or not it approves them.

2.1.2. Published Standards, Interpretations and Amendments not yet applied

The IASB (International Accounting Standards Board) and the IFRIC (International Financial Reporting Interpretations Committee) have published standards, interpretations, and amendments of existing standards and interpretations as outlined below that are not yet subject to mandatory application. There has been no voluntary early application of these requirements on the part of the Zapf Creation Group.

Standards

In November 2009 the IASB issued IFRS 9 ("Financial Instruments: Classification and Measurement"), which covers the classification and measurement of financial instruments. IFRS 9 concludes the first phase of the three-part IASB project for the complete revision of the accounting and reporting for financial instruments and thereby the revision of IAS 39 ("Financial Instruments: Recognition and Measurement"). IFRS 9 is effective for periods beginning after December 31, 2012. Early application is permitted. So far, the standard has not been endorsed by the European Union. Effects of the standard on the consolidated financial statements of the Zapf Creation Group are being assessed.

Interpretations

In November 2009 IFRIC 19 (“Extinguishing Financial Liabilities with Equity Instruments”) was issued. The interpretation covers the complete or partial repayment of financial liabilities using equity instruments. Application of IFRIC 19 is mandatory for financial periods beginning on or after July 1, 2010. IFRIC 19 permits earlier application. The endorsement by the European Union took place in July 2010. According to the regulation for the endorsement of the interpretation by the European Union, IFRIC 19 is to be applied at the start of the first financial year which begins after June 30, 2010. Effects of the interpretation on the consolidated financial statements of the Zapf Creation Group are being assessed.

Amendments to Existing Standards and Interpretations

In July 2009 and January 2010 further changes were issued by the IASB to IFRS 1 (“First Time Adoption of IFRS”; in this case “Additional Exemptions for First-time Adopters” and “Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters”). The changes were endorsed by the European Union in June 2010. The changes are not relevant for the Zapf Creation Group, since the first-time adoption of IFRS has already taken place.

In December 2010, minor amendments were once again made to IFRS 1 (“First Time Adoption of IFRS”; in this case: “Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters”). Up until now, the amendments to the Standard have not yet been endorsed by the European Union. The amendments are not relevant for the Zapf Creation Group, since the first-time adoption of IFRS has already taken place.

In October 2010 the IASB published amendments to IFRS 7 (“Financial Instruments: Disclosures - Transfers of Financial Assets”). According to these amendments, if an entity derecognizes financial asset where it has continuing involvement in the asset, e.g. through options, guarantees, etc., the entity is required to make defined explanatory disclosures. The amendments to IFRS 7 are to be applied for financial periods beginning on or after July 1, 2011. Comparative information for periods beginning before this date is not required. Earlier adoption is permitted. The amendments to the Standard have not yet been endorsed by the European Union. Potential effects on the consolidated financial statements of the Zapf Creation Group are being assessed.

In December 2010 the IASB issued amendments to IAS 12 (“Deferred Tax on Investment Property”). The amendment to the standard clarifies that the reversal of certain existing temporary tax differences in connection with investment property generally occurs upon sale. According to the IASB, the revised IAS 12 is to be retrospectively applied for the first time for financial years beginning on or after January 1, 2012. The changes have not yet been endorsed by the European Union. Potential effects on the consolidated financial statements of the Zapf Creation Group are being assessed.

In November 2009 the IASB issued amendments to IAS 24 (“Related Party Disclosures”). Through the revisions, the reporting requirements of entities in which the state holds interests (so-called “state-controlled entities”) are simplified. Furthermore, the definition of related entities and individuals has been fundamentally revised. The application of the standard is mandatory for financial periods that begin on or after January 1, 2011. Earlier adoption is permitted. The changes were endorsed by the European Union in July 2010. Effects of the amendments on the consolidated financial statements of the Zapf Creation Group are being assessed.

In October 2009 amendments were issued by the IASB to IAS 32 (“Financial Instruments: Presentation”) regarding the classification of subscription rights. The standard clarifies those instances in which subscription rights are denominated in a currency that is other than the functional currency of the entity. Subscription rights that were previously classified as financial liabilities are now, under certain conditions, to be classified as equity. The amendments to IAS 32 were adopted by the European Union in December 2009. The application of the amendments is mandatory for financial periods that begin on or after January 31, 2010. From the current point of view there are no significant effects on the future consolidated financial statements of the Zapf Creation Group.

In November 2009 the IASB issued amendments to IFRIC 14 (“The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction”; in this case: “Prepayments of a Minimum Funding Requirement”). The amendments relate to the provisions regarding the accounting for pension plans that are relevant when an entity, which has minimum funding requirements in connection with its pension plans, makes prepayments on such funding requirements. The amendments are effective for reporting periods that begin on or after January 1, 2011. Earlier application is permitted. The amendments to the standard were endorsed by the European Union in July 2010. From the current point of view there are no effects on the future consolidated financial statements of the Zapf Creation Group.

In connection with its annual updates, the IASB in May 2010 made improvements to a total of seven standards and interpretations. The changes are effective for reporting periods beginning on or after January 1, 2011. Earlier application is permitted. To date, the changes have not been endorsed by the European Union. Potential effects on the consolidated financial statements of the Zapf Creation Group are being assessed.

2.2. Consolidation

2.2.1. General

The consolidated financial statements of Zapf Creation AG are prepared based on IFRS accounting methods in accordance with the following consolidation principles.

The financial statements of the companies included in the consolidated financial statements are prepared using uniform accounting principles.

In accordance with the control concept, the consolidated financial statements include all companies which are directly or indirectly controlled by Zapf Creation AG, the Group's parent company. Control exists when the parent company has the possibility to determine a company's financial and business policy so as to obtain benefits from its activities.

The financial year of Zapf Creation AG and its subsidiaries included in the consolidated financial statements corresponds to the calendar year.

2.2.2. Consolidated companies

In addition to Zapf Creation AG, the Group's parent company, all direct and indirect subsidiaries of the Group are included in the consolidated financial statements. With the exception of Zapf Creation (U.K.) Ltd., Milton Keynes, Great Britain, and Zapf Creation (España) S.L., Ibi (Alicante), Spain, Zapf Creation AG directly holds a 100% stake in all of its subsidiaries. Since September 2006, Zapf Creation AG has held its shares in these two subsidiaries in the UK and Spain through its subsidiary Zapf Creation Auslandsholding GmbH, Roedental, Germany. Zapf Creation AG holds a 100% stake in Zapf Creation Auslandsholding GmbH, which in turn holds a 100% stake in each of the two sales subsidiaries mentioned above.

An overview of the subsidiaries affiliated with Zapf Creation AG is presented in the table attached to these notes as ***Appendix 1***.

In the reporting period there were changes in the consolidated entities, as follows: As of the end of the day on August 31, 2010, the integration of the French subsidiary Zapf Creation (France)

S.à.r.l. into Zapf Creation AG became effective. Zapf Creation (France) S.à.r.l. was dissolved at that time. The universal succession of the subsidiary is taken over by Zapf Creation AG.

In the course of the 2010 financial year, the sales activities of Zapf Creation (Polska) Sp. z o.o. were discontinued; the Polish subsidiary continues to be included within the consolidated subsidiaries. The sales responsibility for the markets of Zapf Creation (Polska) Sp. z o.o. was taken over by Zapf Creation AG.

The Group subsidiary, Zapf Creation (U.S.) Inc., discontinued its operations as of December 31, 2006. MGA Entertainment Inc., Van Nuys, California, USA, alone has been in charge of the entire American market via a strategic partnership effective January 1, 2007. However, Zapf Creation (U.S.) Inc. has still been treated as a consolidated company as of December 31, 2010. As in the prior year's comparative period, the treatment of the discontinuation of the activities of the Group subsidiary, Zapf Creation (U.S.) Inc., is subject to IFRS 5 ("Non-current Assets Held for Sale and Discontinued Operations").

2.2.3. Consolidation methods

All companies are fully consolidated.

The financial statements of each subsidiary are included in the consolidated financial statements of Zapf Creation under the acquisition method by offsetting acquisition costs against pro-rated, newly measured equity as of the respective purchase date.

Loans, receivables and liabilities between the consolidated companies are offset in the course of debt consolidation.

Revenue generated with affiliated companies and other intra-Group income is offset against the respective expenses in connection with the intercompany expense and income elimination.

Intercompany profits and losses are eliminated.

The euro (€) is the reporting currency.

Currency translation within the Zapf Creation Group is performed in accordance with the functional currency method. The Group's functional currency also is its reporting currency.

Any transaction in a foreign currency is initially accounted for in the functional currency by translating it at the exchange rate on the transaction date. During subsequent measurement, assets and liabilities denominated in foreign currencies are translated into the reporting currency at exchange rates as of the balance sheet date, and differences resulting from currency translation are recognized in the income statement.

Gains and losses from currency translation are reported in the consolidated income statement under the expense and income items under which the transaction triggering the exchange rate effect is reported.

The financial statements for the foreign subsidiaries that are included in the consolidated financial statements but whose functional currency is not the euro are translated from their respective functional currency (local currency) into the Group's functional currency, i.e. into euro. Assets and liabilities are translated at the applicable balance-sheet exchange rate while income and expense items are translated at average exchange rates during the reporting period. All differences from currency translation are recognized directly in equity.

Currency translation differences arising from consolidation are recognized directly in equity.

The exchange rates for the currencies relevant to the Zapf Creation Group have changed as shown below (one foreign currency unit = x euro units (€)):

Consolidation as of December 31, 2010:

	USD	HKD	GBP	PLN
Closing rate as of December 31, 2010	0.7468	0.0962	1.1601	0.2524
Average exchange rate from Jan. 1 to Dec. 31, 2010	0.7549	0.0973	1.1661	0.2510
Historical average exchange rate since the Company's foundation	0.8666	0.1096	1.4400	0.2525

Consolidation as of December 31, 2009:

	USD	HKD	GBP	PLN
Closing rate as of December 31, 2009	0.6940	0.0896	1.1249	0.2435
Average exchange rate from Jan. 1 to Dec. 31, 2009	0.7192	0.0929	1.1230	0.2322
Historical average exchange rate since the Company's foundation	0.8767	0.1102	1.4649	0.2527

2.3. Accounting principles

2.3.1. Revenue recognition

IAS 18 ("Revenue") prescribes the accounting treatment of revenue arising from the sale of goods, the rendering of services, and the use by others of enterprise assets yielding interest, rent or other royalties. The Company recognizes revenue and other income in accordance with IAS 18 ("Revenue") at the time the services are rendered or the goods are delivered, significant risks and rewards of ownership have been transferred to the customer, and the amount of the realizable revenue can be measured reliably.

Interest income is recognized on a pro rata temporis basis, taking both the unpaid principal and the applicable interest rate into account.

2.3.2. Research and development

Development expenses are capitalized as internally generated intangible assets if the applicable requirements of IAS 38 ("Intangible Assets") have been cumulatively satisfied. These requirements include the technical feasibility of completion, the intended completion and realization of the project, as well as evidence that the outcome of the project is suitable for the company's own use or for sale as an asset. In addition, both the future economic benefits flowing from the project and the availability of the resources needed to complete the project must also be shown. Finally, development expenses may be capitalized only if the costs allocable to the intangible asset in question during the development phase can be measured reliably. Capitalized development expenses related to a completed project are recognized at cost less accumulated amortization. If a project has not yet been completed, the capitalized amounts are subject to an annual impairment test unless there are indications of an impairment at other times.

Development expenses are recognized as an expense in the income statement analogous to research expenses if the requirements of IAS 38 have not been met.

2.3.3. Defined contribution plans

The Zapf Creation Group's reinsured pension plan must be classified as a defined contribution plan pursuant to IAS 19. Mandatory contributions thus are recognized as an expense and offset directly against the corresponding liability.

2.3.4. Adjusted operating income

In addition to reporting its operating income, the Zapf Creation Group also reports "adjusted operating income" in its consolidated income statement.

The adjusted operating income is based on the Group's internal key performance indicators and adjusts the Group's operating income by the restructuring expenses and one-off items shown in the income statement. Reporting this accounting parameter in the consolidated income statement serves to increase transparency in terms of the sustainability of the income the Company achieves from its current operating processes.

2.3.5. Taxes on income

Income tax expenses include both current and deferred income taxes. In accordance with IFRS 5, income taxes related to operations not to be continued are reported in the income statement as income taxes on discontinued operations.

Current income taxes are determined based on the respective national tax regulations.

Deferred income taxes are recognized using the liability method for all temporary differences between the amounts of assets and liabilities recognized in the consolidated financial statements and the amounts recognized in tax accounts. Deferred tax assets on taxable loss carryforwards are also taken into account. Deferred taxes are measured on the basis of all tax regulations applicable or enacted as of the closing date.

Deferred tax assets from deductible temporary differences and from tax loss carryforwards, the total of which exceeds the deferred tax liabilities from taxable temporary differences, are recognized only to the extent that it can be assumed with sufficient probability that the respective company of the Zapf Creation Group will generate sufficient taxable income in the future to realize the corresponding benefit.

Deferred tax assets and deferred tax liabilities are offset in the balance sheet if they pertain to the same taxation authority. Deferred tax items are not discounted.

2.3.6. Earnings per Share

Basic earnings per share are calculated by dividing the net annual result available to shareholders by the weighted average of all shares outstanding; changes in the number of shares outstanding are considered on a pro rata temporis basis.

If a dilutive effect arises (existence of potential shares), a diluted earnings per share is additionally presented; this case does not apply to the Zapf Creation Group at present.

2.3.7. Financial instruments

According to IAS 32 ("Financial Instruments: Presentation"), which in part has been superseded by IFRS 7 („Financial Instruments: Disclosures”), and according to IAS 39 ("Financial Instruments: Recognition and Measurement"), financial instruments are agreements that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Pursuant to IAS 32, this includes non-derivative financial instruments such as cash, trade receivables and trade payables, as well as financial receivables and financial liabilities. Furthermore, derivative financial instruments such as options or interest rate cap transactions must also be subsumed under financial instruments. The Zapf Creation Group uses these instruments as hedging transactions to hedge against risks from changes in foreign currency and interest rates.

Non-derivative financial assets, non-derivative financial liabilities and derivative financial instruments are recognized in the consolidated financial statements from the point in time at which the Group becomes a party to the agreement.

The fair value of the financial assets and financial liabilities correspond generally to the market value or stock exchange price as of the balance sheet date. When no active market exists, fair value is verified using mathematical valuation techniques and through confirmations by the banks that carry out the transactions.

Non-derivative financial instruments

For accounting purposes, IFRS defines four categories of non-derivative financial instruments: loans and receivables, financial investments held to maturity, financial assets or liabilities held for trading or speculation purposes, and financial assets available for sale. In the Zapf Creation Group, existing non-derivative financial instruments are currently attributable exclusively to the "Loans and receivables" and "Financial liabilities" categories.

- Financial assets

The balance sheet item "Cash and cash equivalents" includes, in addition to currency, highly liquid financial investments with an original maturity of up to 90 days. Cash and cash equivalents are measured at nominal value.

Loans, trade receivables, and other receivables are initially recognized at fair value, including transaction costs. Non- or below-market interest-bearing receivables with an expected maturity of more than one year are discounted. Subsequent measurements of loans, trade receivables, and other receivables are made in accordance with the effective interest method at amortized cost. Allowances for doubtful credits and receivables are shown in separate items based on the past due status of the credits and receivables, the customers' credit rating, and past experience in order to take estimated losses from customers' possible insolvency into account. The relevant loans and receivables are derecognized if, based on an assessment of the individual customer taking into consideration payment default and other evidence, it is considered unlikely that payment will be received.

The Zapf Creation Group sells receivables as part of its receivables management. Such factoring is treated in accordance with IAS 39 ("Financial Instruments: Recognition and Measurement"). This means that a financial asset is generally recognized by the entity assuming the main related risk. The non-payment risk is the key criterion for recognizing receivables in connection with factoring. If the factor purchasing the receivables assumes the entire non-payment risk, then the receivable is recognized by such factor (non-recourse factoring). If not, the receivable is still recognized by the company selling it (recourse factoring). Under the factoring program the Zapf Creation Group uses, the factor purchases the receivables and assumes the entire non-payment risk for them. These transactions are accounted for analogous to the procedure outlined in the preceding paragraph.

In accordance with the requirements of IAS 39, an impairment test is conducted at each balance sheet date on the basis of both internal and external evidence to assess whether objectives indications of impairment of the financial assets exist. If the present value of the relevant financial asset is less than its carrying amount, then the impairment loss is recognized in income and the financial instrument is reported at cost less impairment adjustments. Such adjustments are also reversed in income if the impairment has declined due to an event that occurred subsequent to the recognition of the impairment loss. If the reasons for the adjustment no longer exist, a write-up to no more than the cost is made.

Net gains or losses from financial assets contain changes in the allowances, gains or losses from the derecognition or disposal (factoring) of financial assets, payments received, and reversals of write-downs on credits and receivables, as well as currency effects. They are shown in the income statement under the items, revenue, cost of sales, and other income/other expenses.

- Financial liabilities

Financial liabilities contain interest-bearing liabilities of a financing nature, in particular, loans from banks and other lenders, as well as other interest-bearing liabilities. Non-interest-bearing liabilities and liabilities subject to low interest rates are measured at their present value. All subsequent measurements are made at amortized cost using the effective interest method. Any difference between the net loan amount and the repayment value is distributed over the term of the financial liabilities and recognized in the income statement.

Both trade liabilities and other liabilities are measured at their repayment amount. Non- or low-interest-bearing non-current liabilities are discounted and measured at their present value if the discounted amount is substantial.

An equity instrument is any contractual agreement that represents a residual interest in the Company's assets after deducting all liabilities. Equity is the residual amount after liabilities are deduced from assets.

In addition to currency effects, the net gains or losses from financial liabilities also comprise gains or losses from the derecognition of such financial liabilities. They are shown in the income statement under the items, revenue, cost of sales, and other income/other expenses.

Derivative financial instruments

As a rule, the Group only employs derivative financial instruments for hedging purposes (currency and interest rate risks). Please see Section B, no. 2.6, for additional information on derivative financial instruments and their measurement.

Depending on the nature of the underlying transactions being hedged, IFRS accounting distinguishes between fair value hedges, cash flow hedges, and hedges of a net investment in a foreign operation. The Zapf Creation Group uses cash flow hedges to hedge the risk of fluctuations in future cash flows related to already recognized transactions or anticipated transactions if the structure of the financing so requires. Changes in the fair value of derivative financial instruments intended for hedging a cash flow risk are documented. If the requirements for hedge accounting are met, the changes in the fair value are recognized directly in equity; if this is not the case, value changes are recognized directly in the income statement. For more information on hedge accounting in the 2010 financial year and in the prior year, please see Section B, no. 2.5.4.

2.3.8. Inventories

Additions to goods, raw materials, and consumables are measured at cost in accordance with IAS 2 using moving average prices.

The cost of inventories includes all acquisition costs, as well as all costs incurred in bringing the inventories to their current storage location and current condition. For purchased merchandise, this comprises in particular the purchase price, freight and customs duties. Discounts, rebates and similar amounts are deducted when determining the acquisition costs.

In subsequent measurements, if necessary, inventory assets are written down to their net realizable value. The net realizable value of the goods corresponds to the estimated selling price of the item that is achievable in the course of ordinary business less estimated selling costs.

All identifiable risks related to inventory assets resulting from the inventories' reduced marketability or obsolescence are taken into account; analogous adjustments are made for items that are no longer salable.

2.3.9. Property, plant and equipment

The Group measures all property, plant and equipment subject to wear and tear at cost less cumulative depreciation, i.e. both normal depreciation and any impairment write-downs. Depreciation on property, plant and equipment is recognized on a straight-line basis according to the assets' estimated useful life, using the following useful lives:

Buildings and building equipment	3 to 50 years
Machinery and technical equipment	2 to 10 years
Motor vehicles, furniture and fixtures, and office equipment	2 to 20 years

The useful life of property, plant and equipment subject to depreciation is reviewed annually; if necessary, the remaining useful life is adjusted based on the changed estimate.

The depreciation period for property, plant and equipment, which the Group recognizes as leasehold improvements, begins with the date the asset is put into service. The depreciation period corresponds to the duration of the rental agreements if this is shorter than the economic useful life.

Leases are accounted for in accordance with IAS 17 ("Leases"). IAS 17 makes a fundamental distinction between finance leases and operating leases. Under IAS 17, whether the leased property is recognized by the lessor or the lessee depends on who assumes the substantial risks and rewards associated with such leased property. The Zapf Creation Group is a lessee under operating leases. This means that its leased property is accounted for by the lessor; regular lease payments are recognized as a lease expense in the income statement.

If an item of property, plant and equipment is scrapped or disposed of, the costs of the relevant asset and the cumulative depreciation are written off; any resulting gain or loss is shown in the income statement under other income or expenses.

Depreciation is reported in the income statement as a cost of the relevant operational function to which the underlying property, plant and equipment is allocable.

2.3.10. Intangible assets

All intangible assets of the Zapf Creation Group have a determinable expected useful life and are measured at cost less straight-line amortization, whereby the following estimated useful lives are applied:

Patents, brand names and licenses	5 to 10 years
Computer software	2 to 5 years

The useful life of an intangible asset is reviewed annually; if necessary, the remaining useful life is adjusted based on the changed estimate.

Amortization is reported in the income statement as a cost of the relevant operational function to which the underlying intangible assets are allocable.

If the requirements of IAS 38 ("Intangible Assets") are satisfied, portions of the Company's own costs for customizing SAP's ERP software are capitalized. Intangible assets are amortized starting as of their completion date.

Borrowing costs are included in the costs of an intangible asset in accordance with IAS 23 if the asset is considered a qualifying asset.

2.3.11. Impairment

Intangible assets, as well as property, plant and equipment, are tested as of each balance sheet date to assess whether any triggering events exist that indicate an impairment as defined in IAS 36 ("Impairment of Assets") might have occurred. Intangible assets under construction, i.e. assets that are not subject to normal amortization, are reviewed for impairment annually. An adjustment is required if the recoverable amount of the relevant asset is less than its carrying amount.

The recoverable amount is the higher of the asset’s fair value less costs of disposal and its value in use.

If it is not possible to determine the recoverable amount of an individual asset, then the recoverable amount is determined for the smallest identifiable cash generating unit that can be attributed to the relevant asset. In such cases, the impairment test is shifted from the individual asset to the cash generating unit.

The recognizable fair value is the amount that could be achieved by disposing of an asset in an arm's length transaction between knowledgeable, willing parties after deducting the costs to sell.

The value in use results from the present value of future cash flows that are expected to be derived from the asset. Determination of the present value is based on an interest rate reflecting market conditions.

Valuation allowances in an amount equivalent to the amount by which the carrying amount of the asset exceeds its recoverable amount are recognized in income. If, following the recognition of an allowance, the recoverable amount increases, then a write-up to no more than such recoverable amount is made in the income statement. The write-up is limited to the asset's adjusted carrying amount which would have been obtained in the past absent the allowance.

2.3.12. Provisions

Provisions are recognized as a liability in accordance with IAS 37 ("Provisions, Contingent Liabilities and Contingent Assets") if the Group has a current legal or constructive obligation to third parties resulting from a past event and if it is probable (more likely than not) that this past event will result in an outflow of resources embodying economic benefits that can be measured reliably; no provisions are recognized for internal obligations. The disclosure as a provision in the balance sheet is oriented on the extent of the uncertainty with regard to the timing and/or the amount of the future outlays required to fulfill the obligation. Obligations that do not meet the requirements for provisions under IFRS (in particular outstanding invoices and current personnel liabilities) are not recognized as provisions, but rather as liabilities. If the interest rate effect related to the provisions is material, they are discounted by a market interest rate adequate to their risk.

2.3.13. Share-based compensation systems

Considering that the operations are directed towards a long-term and sustainable increase in the value of the Company for the shareholders, compensation systems based on company value in the form of share-based payment systems are utilized in the Zapf Creation Group.

Phantom share-based compensation systems

As distinguished from stock option plans, so-called phantom share-based compensation systems do not concern actual shareholding, but rather salary or bonus payments that are dependent on the development of the share price. In this connection, within a specific time period the entitled individual is granted a claim to cash payment that is determined by the difference between current market price of the underlying share and the base price of the assigned appreciation rights. The initial measurement of the liabilities of the Zapf Creation Group in connection with phantom share-based compensation is made in accordance with IFRS 2 ("Share-based Payment") on the basis of the fair value. The fair value is determined with reference to an option pricing model, taking into consideration the individual grant conditions and personnel fluctuation. The compensation to be paid in cash in connection with phantom share-based compensation systems is recorded to expense and recognized as a liability. The liability recognized at subsequent balance sheet dates reflects the respective newly determined fair value of the phantom equity instrument. The effects of the periodic remeasurement of the fair value are recognized in the income statement.

Issuance of own shares

In addition to the above-described phantom stock option programs, in the Zapf Creation Group the possibility is used to create a long-term incentive through the issuance of own shares in connection with a share-based compensation system. The accounting is carried out in accordance with IFRS 2 ("Share-based Payments").

Stock option plans

In the Annual Shareholders' Meeting of December 15, 2009 the Company was authorized to establish one or more stock option plans, under which up to and including December 14, 2014 once or several times stock options up to a total of 500,000 no-par bearer shares of Zapf Creation AG can be issued; reference is additionally made Section B No. 2.5.6. Through December 31, 2010 the potential to issue stock options has not been utilized by the Company.

2.4. Use of Estimates

The preparation of consolidated financial statements requires management to make assumptions and perform estimates, which might affect the application of accounting standards in the Group, as well as both the amount and the disclosure of recognized assets, liabilities, income, expenses, and contingent liabilities.

The Company's management regularly reviews both the estimates and the underlying assumptions. Although the estimates are made to the best of management's knowledge based on current events and measures, actual amounts may deviate from these estimates. Adjustments related to the estimates relevant to the accounting are considered in the period in which the adjustment was made if it concerns only the period in question. If an adjustment concerns both the reporting period and later periods, then it is accounted for in both.

The assumptions and estimates relate primarily to the evaluation of the recoverability of intangible assets, the uniform determination of useful lives within the Group for property, plant and equipment, the collectability of receivables and the recognition and measurement of provisions.

B. Explanation of items in the consolidated financial statements

1. Explanation of income statement items

The Company's consolidated income statement is prepared in accordance with the cost of sales method.

Income and expenses that are attributable to the Group subsidiary Zapf Creation (U.S.) Inc. are reported separately under the result from discontinued operations in accordance with IFRS 5 ("Non-current Assets Held for Sale and Discontinued Operations").

1.1. Revenue

In addition to the actual selling prices for merchandise, gross revenue contains the shipping and handling fees billed to the customer. Net revenue is the gross amount less, essentially, cash discounts, bonuses, rebates, advertising cost subsidies, sales promotion fees and freight reimbursements.

Gains and losses on changes in exchange rates realized on sales transactions and those arising from measurement of trade receivables on the closing date are recognized under revenue. In addition, please see the table of exchange rates in Section A, no. 2.2.3.

Reference is made to Segment Reporting attached as Appendix 3 to these notes.

1.2. Cost of Sales

Expenses directly allocable to revenue are recognized as cost of sales.

This item contains primarily the expenses for purchased merchandise. In addition to the purchase cost itself, all incidental acquisition costs of the merchandise sold in the reporting period are reported here. These costs primarily comprise freight and customs duties.

Cost of sales also includes the cost of transporting goods to customers, as well as the Group's other logistics costs that can be directly allocated to revenue.

Gains and losses on changes in exchange rates realized on purchase transactions and those arising from measurement of trade payables on the closing date are recognized under cost of sales. In addition, please see the table of exchange rates in Section A no. 2.2.3.

1.3. Selling and distribution expenses

The Company's selling expenses comprise all costs directly resulting from measures aimed at supporting and maintaining its sales network.

Distribution expenses include costs related to the Company's own logistics center.

The following are also recognized in selling and distribution expenses: staff costs totaling K€4,578 (prior year: K€5,832) and depreciation/amortization of the sales and distribution units totaling K€1,817 (prior year: K€1,859), as well as license fees, activities at the point-of-sale for the end consumer, and expenses resulting from the Company's receivables management.

1.4. Marketing expenses

Marketing expenses include the Company's expenses for carrying out advertisement measures of different kinds (promotional and marketing campaigns, TV advertisements, etc.), as well as expenses underlying the Company's comprehensive communications strategy, the production and design of sales catalog and brochure content, and the target-group related placement of advertisements in trade journals and magazines.

Expenses for advertising, promotional, and marketing campaigns as well as expenses for producing and broadcasting TV advertisements are recognized as an expense in the financial year in which the respective goods and services are used. The remaining advertising expenses are posted as an expense when they arise. Advance payments made are deferred and recognized under current assets.

The following are also recognized under marketing expenses: staff costs totaling K€369 (prior year: K€1,023) and depreciation/amortization of the marketing unit totaling K€48 (prior year:

K€113), as well as those expenses resulting from communication with end customers. Among others, this concerns expenses for the design of mini catalogs, for conducting sweepstakes and competitions, as well as the BABY born® CLUB, a tool for creating customer loyalty and maintaining customer contact.

1.5. Administrative expenses

The Company's other administrative expenses include expenses incurred by the finance, controlling and IT divisions, as well as general administrative expenses. This includes staff costs totaling K€5,125 (prior year: K€5,649) and depreciation/amortization of these units totaling K€1,471 (prior year: K€1,849).

In addition, other administrative expenses also include development and design expenses if such expenses do not qualify for capitalization under IAS 38. Product development is the responsibility of both the Company's development department at the Company's headquarters in Roedental, and external developers and designers, primarily those of the strategic partner MGA Entertainment, Inc.

1.6. Other income

Exchange rate gains realized on transactions that are not directly allocable to the purchasing and sales process, and exchange rate gains arising from the measurement of assets and liabilities on the closing date that are not directly allocable to the purchasing and sales process, are offset in the amount of K€1,311 against corresponding exchange rate losses of K€848 and reported under other income if the resulting balance shows income, since the resulting net balance amounts to a gain of K€463 (prior year: losses on exchange rate development in the amount of K€771).

The Company's miscellaneous other income totaling K€3,854 (prior year: K€3,495) essentially comprises income of K€3,239 (prior year: K€2,872) from the strategic partnership with related companies of the MGA Group. In addition, it includes gains on the disposal of non-current assets in the amount of K€152 (prior year: K€15), insurance recoveries in the amount of K€13 (prior year; K€65), and other income of K€450 (prior year: K€423). In the prior year it also included gains on changes in fair value of derivative financial instruments used to hedge currencies in the amount of K€120.

1.7. Other expenses

Exchange rate losses realized on transactions that are not directly allocable to the purchasing and sales process, and exchange rate losses arising from the measurement of assets and liabilities on the closing date that are not directly allocable to the purchasing and sales process were offset in the prior year in the amount of K€1,313 with against corresponding exchange rate gains totaling K€542 and shown under other expenses, since the resulting net amount was an expense of K€771. In the 2010 financial year, there is a net gain to be reported on exchange rate changes in the amount of K€463.

Miscellaneous other expenses of the Company totaling K€328 (prior year: K€424) comprise expenses from the hedging of currency risks in the amount of K€120 (prior year: K€160), losses on the disposal of noncurrent assets in the amount of K€85 (prior year: K€24), and other expenses in the amount of K€123 (prior year: K€240).

1.8. Restructuring costs and one-off items

Expenses from the restructuring of the Zapf Creation Group, as well as other extraordinary one-off expenses, are shown in the income statement under the operational areas giving rise to such expenses.

In addition, these expenses are separately shown in connection with the presentation of the adjusted operating result. The expenses and proceeds from the Company's restructuring resulted in total expense of K€1,862 in the 2010 reporting period (prior year: expense of K€137) resulting primarily from personnel measures. As in the prior year, there were no one-off effects in the 2010 financial year.

1.9. Finance income and costs

Finance income totaling K€113 (prior year: K€64) concerns interest income from current liquid assets in connection with cash management.

Finance costs totaling K€4,568 (prior year: K€5,076) in the 2010 financial year include interest on loans and interest on current borrowings totaling K€3,335 (prior year: K€3,315). The finance costs also contain K€68 (prior year: K€54) in expenses arising from the changes in the market value of derivative financial instruments regarding the interest cap. As in the previous year, this item also includes primarily the fees paid by the Company under financing agreements.

1.10. Income taxes

Income tax expense recognized in the consolidated financial statements of Zapf Creation AG is comprised as follows:

	2010 K€	2009 K€
Current taxes		
Domestic		
Current year	177	290
Prior years	- 139	292
Abroad		
Current year	22	112
Prior years	- 90	808
Total	- 30	1,502
Deferred taxes		
Domestic	34	- 4
Abroad	120	6
Total	154	2
Income tax expense	124	1,504

A portion of the addition to receivables from current and deferred income taxes was recognized directly in equity. Please also see Section B, no. 2.5.4.

As in the previous year, the profit of K€431 from discontinued operations in the 2010 financial year (prior year: K€47) contains no income or expense from income taxes.

Depending on their respective legal form, Zapf Creation AG and its subsidiaries in Roedental are subject to German corporation tax and trade tax.

The corporation tax rate applicable during the reporting period as in the prior year was 15% plus the solidarity surcharge of 5.5%. The trade tax as in the prior year is 12.60% of taxable income. As a result, the nominal tax rate in the 2010 financial year as in the prior year was 28.43%.

The effective tax expense reported in the Zapf Creation Group differs from the expected tax expense based on the nominal tax rate of 28.43%. The following reconciliation shows the main deviation factors in the reporting period:

	2010	2009
	K€	K€
Earnings before income taxes	- 4,081	- 9,562
Expected income tax refund / expected income tax expense	1160	2,719
Different tax assessment basis	- 891	- 1,045
Different tax rate	318	- 131
Unrecognized deferred taxes on loss carryforwards	- 809	- 1,366
Deferred taxes loss carryforwards, subsequently capitalized / Use of existing loss carryforwards	0	231
Valuation allowance on deferred taxes capitalized in previous years	- 30	- 655
Tax expense/-income, previous years	237	- 1,101
Foreign withholding taxes	- 94	- 119
Other	- 15	- 37
Recognized income tax income/expense	- 124	- 1,504

The Zapf Creation Group recognizes the following loss carryforwards as of the balance sheet date of the respective reporting period:

	31.12.2010	31.12.2009
	K€	K€
Corporation tax		
Domestic	45,905	44,759
Abroad	10,403	11,593
Total	56,308	56,352
Trade tax (domestic only)		
Total	45,529	44,455

Of the corporation tax loss carryforwards, K€45,864 relate to Zapf Creation AG (prior year: K€44,723); K€1,570 relate to Zapf Creation (U.K.) Ltd. (prior year: K€2,304);; K€1,568 relate to Zapf Creation (Polska) Sp. z o.o. (prior year: K€1,354); K€854 relate to Zapf Creation (Italia) S.R.L. (prior year: K€1,215); and K€1,212 relate to Zapf Creation (España) S.L. (prior year: K€426). Further corporation tax loss carryforwards totaling K€41 relate to Zapf Creation (Central Europe) Verwaltungs GmbH, Zapf Creation Logistics Beteiligungs GmbH, and Zapf Creation Auslandsholding GmbH (prior year: K€36). There is no longer a tax loss carryforward attributable to the Group subsidiary Zapf Creation (France) S.à.r.l. as of the December 31, 2010 balance sheet date (prior year: K€1,830), since the integration of the company into Zapf Creation AG was effective August 31, 2010. In this regard, reference is additionally made to Section A no. 2.2.2.

A loss carryforward for corporation tax relates to Zapf Creation (U.S.) Inc. at December 31, 2010 in the amount of K€5,199 (prior year: K€4,464) which can be carried forward to the years 2027 to 2030,(prior year: 2028 and 2029); the increase in the corporation tax loss carryforward of Zapf Creation (U.S.) results from the reversal of temporary differences on which no deferred tax assets were recognized in prior years.

Of the corporation tax loss carryforwards of K€56.308 (prior year: K€56,352), an amount of K€ 48,088 (prior year: K€49,506) may be carried forward indefinitely; K€5,199 in tranches can be carried forward at the longest up to 2030 (prior year: K€4,464 up to 2029); K€1,568 in tranches can be carried forward at the longest up to 2015 (prior year: K€1,354 up to 2014); K€1,212 in tranches can be carried forward at the longest up to 2025 (prior year: K€ 426 up to 2023) and K€241 in tranches can be carried forward at the longest up to 2015 (prior year: K€602 in tranches can be carried forward at the longest up to 2014).

The trade tax loss carryforwards relate in the amount of K€45,478 to Zapf Creation AG (prior year; K€44,413); additional trade tax loss carryforwards relate in the total amount of K€ 51 to Zapf Creation (Central Europe) Verwaltungs GmbH, Zapf Creation Logistics Beteiligungs GmbH as well as Zapf Creation Auslandsholding GmbH (prior year K€42).

The trade tax loss carryforwards can be carried forward indefinitely.

Due to the insufficient probability of an earnings turnaround in future accounting periods, no deferred taxes were recognized on corporation tax loss carryforwards totaling K€53.596 (prior year: K€52,805) and on trade tax loss carryforwards totaling K€ 44,807 (prior year: K€43,621).

Deferred tax assets on loss carryforwards are recognized only if it is probable that future taxable income will be available and there are substantive indications as to the Company's corresponding future income. Deferred tax assets are recognized for loss-making companies belonging to the Zapf Creation Group only to the extent that taxable temporary differences exist with regard to the same taxation authority and the same taxable entity.

As was the case as of the previous year's balance sheet date, no deferred tax assets are shown for the Group subsidiaries, Zapf Creation (U.S.) Inc., Zapf Creation (Polska) Sp. z o.o. and Zapf Creation (Italia) S.R.L. in the consolidated financial statements as of December 31, 2010 relating to temporary differences between the carrying amounts of assets/liabilities and amounts recognized for tax purposes. As of December 31 in the prior year, there were additionally no deferred tax assets recognized for the Group subsidiary Zapf Creation (France) S.à.r.l., which has been merged in the meantime.

1.11. Discontinued operations

Under IFRS 5 ("Non-current Assets Held for Sale and Discontinued Operations"), a discontinued operation constitutes a component of the company that will be discontinued in accordance with a single coordinated plan. The discontinued operations must be identifiable and distinct from the continuing operations. If a component is to be classified as a discontinued operation pursuant to IFRS 5, then the income from such discontinued operations must be shown separately in the consolidated income statement.

In the 2010 financial year, as in the previous year, IFRS 5 was applied to the Group subsidiary, Zapf Creation (U.S.) Inc., whose operating business was discontinued as of December 31, 2006. The discontinued operation constitutes a geographical area or segment as defined in IFRS 8 (“Operating Segments”) which means that the requirements of IFRS 5 regarding both the identifiably of the given operations and their delineation from ongoing operations have been met.

The income and expenses attributable to discontinued operations are as follows:

	2010	2009
	K€	K€
Revenue	0	1
Cost of sales	0	0
Selling and distribution expenses	0	0
Marketing expenses	0	0
Administrative expenses	- 28	- 25
Other income	459	70
Other expenses	0	0
Finance income	0	1
Finance costs	0	0
Result from discontinued operations before income taxes	431	47
Income taxes on discontinued operations	0	0
Result from discontinued operations	431	47

The result from discontinued operations in the 2010 financial year, as in the prior year, essentially results from exchange rate effects.

In the 2010 financial year as in the prior year, no personnel expenses or depreciation/amortization was incurred in connection with the discontinued operations.

Exchange rate gains realized on transactions not directly allocable to the purchasing and sales process, as well as exchange rate gains resulting from the measurement on the closing date of the assets and liabilities arising from these events, are to be reported under other income. In the 2010 financial year, this resulted in exchange gains of K€459 related to discontinued operations (prior year: K€70).

As in the previous year, no restructuring costs and one-off items resulting from the discontinued operations of Zapf Creation (U.S.) Inc. as of December 31, 2006, were recognized in the 2010 reporting period. Please also see Section B, no. 1.8.

Please see the disclosures in Section B, no. 1.10, with regard to income taxes on discontinued operations.

The earnings per share attributable to the discontinued operations are shown in Section B, no. 1.12.

The cash flow from operating, investing and financing activities attributable to discontinued operations is as follows:

	2010	2009
	K€	K€
Cash flow from operating activities	0	- 28
Cash flow from investing activities	0	0
Cash flow from financing activities	0	1
Effects of exchange rate changes	1	0
Cash flow from discontinued operations	1	- 27

1.12. Earnings per share

As of December 31, 2010, and as of the balance sheet date of the previous year, no options and subscription rights to purchase common shares were outstanding. This means that basic and diluted earnings per share are identical in the reporting periods.

The basic earnings per share are determined in accordance with IAS 33 ("Earnings per Share") by dividing the net profit or loss for the period by the average number of shares outstanding during the relevant period.

The calculation of the basic earnings per share is based on the following parameters:

Basic earnings per share:

	2010	2009
	K€	K€
Result for the period	- 4,205	- 11,066
	thousands	thousands
Average number of shares outstanding	18,803	18,725
	€	€
Earnings per share	- 0.22	- 0.59

Basic earnings per share from continuing operations:

	2010	2009
	K€	K€
Result from continuing operations	- 4,636	- 11,113
	€	€
Earnings per share from continuing operations	- 0.25	- 0.59

Basic earnings per share from discontinued operations:

	2010	2009
	K€	K€
Result from discontinued operations	431	47
	€	€
Earnings per share from discontinued operations	0.02	0.00

1.13. Disclosures regarding financial instruments

Net income (+) and net loss (-) from financial instruments in the reporting period was as follows:

	2010	2009
	K€	K€
Credits and receivables	132	- 996
Financial liabilities	679	- 348
Total	811	- 1,344

Net income and net loss from financial instruments include the expenses and income attributable to the discontinued operation of the Group's subsidiary Zapf Creation (U.S.) Inc.; please also see Section B, no. 1.11.

The impairment losses recognized on financial assets in the reporting period were as follows:

	2010 K€	2009 K€
Trade receivables	309	533
Other assets	0	0
Total	309	533

The impairment losses shown include the losses attributable to the discontinued operation of the Group's subsidiary Zapf Creation (U.S.) Inc.; please also see Section B, no. 1.11.

1.14. Other disclosures regarding the income statement

Staff costs included in the operating expenses of the Zapf Creation totaled K€10,072 (prior year: K€12,504) in the 2010 financial year.

Staff costs by functional areas are comprised as follows:

	2010 K€	2009 K€
Sales and distribution	4,578	5,832
Marketing	369	1,023
Other administration	5,125	5,649
Staff costs	10,072	12,504

With regard to the expenses related to the operation of the subsidiary Zapf Creation (U.S.) Inc., which are shown separately, please also see Section B, no. 1.11.

The following table shows the average number of employees of the Group:

	2010	2009
Salaried employees	157	204
Hourly workers	26	26
Employees	183	230

Expenses for defined contribution pension plans in the 2010 financial year totaled K€1,429 (prior year: K€1,859). This includes the Company's contributions to the statutory pension scheme totaling K€1,287 (previous year: K€1,712).

In the 2010 financial year, expenses under operating leases totaling K€1,672 (prior year: K€2,228) were recognized. These comprise primarily leases for IT hardware, software and passenger cars, as well as lease payments made by the Zapf Creation Group for external warehouse, office and presentation space. Please also see Section C, no. 1.

2. Explanation of balance sheet items

2.1. Current assets

2.1.1. Cash and cash equivalents

Cash and cash equivalents comprise the following items:

	31.12.2010 K€	31.12.2009 K€
Cash on hand	6	16
Bank balances	13,526	7,955
Cash	13,532	7,971

Cash and cash equivalents includes an offsetting of current liabilities to banks totaling K€8 (previous year: K€4), since the conditions for offsetting according to IFRS are fulfilled.

2.1.2. Trade receivables

Trade receivables, all of which are due within less than one year, as of the balance sheet are comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Trade receivables before valuation allowance	27,538	37,870
Valuation allowance	- 1,223	- 2,124
Trade receivables	26,315	35,746

Please also see Section B, no. 2.6.3, in regards to maturity ranges.

The valuation allowances on trade receivables developed as follows in the reporting period:

	2010 K€	2009 K€
Valuation allowance at the beginning of the period	2,124	3,652
Additions	309	533
Reversals and utilization	- 1,282	- 2,130
Currency effects	72	69
Valuation allowance at the end of the period	1,223	2,124

The total amount of assigned or transferred Company receivables is comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Domestic	2,571	2,720
Abroad	0	0
Factoring	2,571	2,720

Please also see the remarks in Section A, no. 2.3.7.

2.1.3. Inventories

The Company's inventories are divided into the following main categories:

	31.12.2010 K€	31.12.2009 K€
Goods	4,752	5,613
Raw materials and supplies	65	55
Inventories	4,817	5,668

The following valuation allowances were recognized with regard to inventories:

	31.12.2010 K€	31.12.2009 K€
Inventories before valuation allowance	5,243	6,754
Valuation allowance	- 426	- 1,086
Inventories	4,817	5,668

Inventory and sales risks resulting from the reduced marketability of inventories are taken into account by recognizing appropriate valuation allowances.

Accordingly, reasonable allowances on goods were made as of December 31, 2010 and as of the previous year's balance sheet date, taking into account their future marketability.

2.1.4. Income tax receivables

Income tax receivables are comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Domestic	52	104
Abroad	69	523
Income tax receivables	121	627

A portion of the change in income tax receivables was recognized directly in equity. Please also see Section B, no. 2.5.4.

2.1.5. Other assets

Other current assets as of the balance sheet date are comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Non-derivative financial assets		
Receivables from shareholders	4,492	4,113
Advances and funds in transfer	43	376
Loans to members of corporate boards	339	354
Other	448	735
Valuation allowance on loans granted	- 335	- 350
Total	4,987	5,228
Derivative financial assets	22	210
Other assets		
Other tax assets	836	1,126
Other	713	301
Total	1,549	1,427
Other assets	6,558	6,865

Please also see Section B, no. 2.6.3, in regards to maturity ranges.

Receivables of K€4,492 (prior year: K€4,113) from shareholders relate entirely to MGA Group companies that are related parties of Zapf Creation AG.

The loan that was granted to a former member of the Management Board had an outstanding balance as of December 31, 2010 of K€335 (prior year: K€350); it was already fully reserved in the 2005 financial year. The interest receivable in the amount of K€4 as of the December 31, 2010 balance sheet date (prior year: K€4) relates to the fourth quarter of 2010; the interest payment was made in January 2011. Repayments were made in the 2010 financial year in the amount of K€15. Please also see Section C, no. 3.1.

The valuation allowance on loans granted developed as follows in the reporting period:

	2010 K€	2009 K€
Valuation allowance at the beginning of the period	350	350
Additions recognized in income in the reporting period	0	0
Derecognitions reducing the valuation allowance, made in the reporting period	0	0
Payments received on receivables previously written down	- 15	0
Valuation allowance at the end of the period	335	350

In connection with barter transactions, the Company sells its merchandise at fair value within the normal dealer price range to trade partners, who pay for the merchandise partly in cash and partly in "barter points”. The barter points received as compensation can be exchanged by the Company, for example in exchange for broadcast minutes at television companies. The “barter points” existing as of the prior year’s balance sheet date basically completely expired in the course of the 2009 reporting period; a theoretical further use is only possible under certain conditions. The inventory of barter points was already fully reserved in the 2008 financial year in the amount of K€220. In the 2010 financial year no barter points were used by the Company; in the comparable prior year period barter points amounting to K€14 were used.

2.2. Non-current assets

2.2.1. Property, plant and equipment

Property, plant and equipment as of the balance sheet date is comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Land and buildings	5,075	5,475
Machinery and technical equipment	671	1,083
Motor vehicles, furniture and fixtures, and office equipment	5,523	6,706
Assets under construction	103	51
Property, plant and equipment	11,372	13,315

Depreciation in the 2010 financial year totaled K€2,410 (prior year: K€2,860). As in the previous year, depreciation in the 2010 financial year does not include any impairment losses.

For information on individual items of property, plant and equipment, please see the statement of changes in non-current assets, which is attached to these consolidated notes as ***Appendix 2***.

Regarding the Company's operating leases, we refer to Section B, no. 1.14, and Section C, no. 1.

2.2.2. Intangible assets

The intangible assets of the Company as of the balance sheet are comprised of the following items:

	31.12.2010 K€	31.12.2009 K€
Patents, brand names and licenses	3,624	4,437
Computer software	166	225
Assets under development	49	30
Intangible assets	3,839	4,692

Amortization in the 2010 financial year totaled K€926 (prior year: K€961). As in the previous year, amortization in the 2010 financial year does not include any impairment losses.

The average remaining useful life of patents, licenses and brand names is four years (prior year: four years).

In 2008 financial year Zapf Creation AG acquired licenses that had been held by third parties relating primarily to the dolls Baby Annabell® and Rock-A-Bye Chou Chou. The net carrying amount of the acquired licenses amounts to K€2,295 at December 31, 2010 (prior year: K€2,601); the remaining useful life as of the December 31, 2010, balance sheet date was seven years and six months (prior period; eight years and six months).

Internally generated intangible assets that are not under development amount to K€1 as of December 31, 2010 (prior year; K€0). The intangible assets under development comprise, as at the balance sheet date in the prior year, among other items, capitalized portions of the Company's own costs for customizing SAP's ERP software (computer software).

For information on individual intangible assets, please see the statement of changes in non-current assets, which is attached to these consolidated notes as ***Appendix 2***.

2.2.3. Other Assets

At December 31, 2010, as was the case at the prior year's balance sheet date, there were no other noncurrent assets.

Please also see Section B, no. 2.6.3, in regards to maturity ranges.

2.2.4. Deferred tax assets

The deferred tax assets as of the balance sheet date result from the following items:

	31.12.2010 K€	31.12.2009 K€
Loss carryforwards	771	1,006
Property, plant and equipment and intangible assets	38	36
Provisions	20	237
Other assets	0	31
Deferred tax assets before offsetting	829	1,310
Offsetting with deferred tax liabilities	-240	- 514
Deferred tax assets	589	796

A portion of the changes in deferred tax assets was recognized directly in equity. Please also see Section B, no. 2.5.4.

Regarding the change in deferred tax assets, please see Section B, no. 1.10.

2.3. Current liabilities

2.3.1. Liabilities to banks

The current liabilities to banks are comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Current liabilities to banks	27,144	33,311
Current portion of non-current bank loans	0	0
Liabilities to banks	27,144	33,311

On the basis of a financing agreement dated November 30, 2007, a syndicated loan in the amount of € 65 million was made available to Zapf Creation AG on December 7, 2007, for the purpose of financing its operating business in the short and medium term.

On October 1, 2009 the financing agreement as of November 30, 2007 was modified and insofar replaced, to the effect that Zapf Creation AG was extended a sufficient credit volume by the participating banks, however, initially limited until the end of April, 2010 (limited period waiver). In this connection, the available credit volume was reduced by € 8 million. During the period of the waiver, the participating banks performed no test of compliance with the agreed-upon financial covenants. In agreement with Zapf Creation, the banks refrained from establishing new convents based on the changed overall situation until the end of April 2010.

As agreed, at the end of April 2010 a new review of the overall situation of the Company was carried out by the participating banks. In the course of the resulting negotiations of the Zapf Creation Group with the syndicated banks regarding the long-term Group financing, the banks remaining in the syndication continued to declare their willingness, with a respective one-month notification, to waive compliance with the financial covenants at the latest until June 30, 2010; in this connection, the granted credit volume was reduced by an additional € 17 million at the close of the day on April 30, 2010. From that date it continued in an adequate amount.

As of June 30, 2010, after taking into consideration repayments, the remaining bank loans (excluding interest payable and transaction costs) amounted to € 29.1 million. The waiver, which expired on June 30, 2010, was not extended by the banks. Nevertheless, from this point constructive negotiations continued to be carried out by the Group with the banks.

In October 2010, agreement was reached regarding the future financing structure of the Zapf Creation Group; the negotiations to secure the long-term Group financing were successfully concluded with the signing of a letter of intention. Investors were found who in the meantime have redeemed a bank loan in the amount € 20.1 million (Second Lien Loan).

In December 2010 the financing agreements were signed and in January 2011 were implemented through the disbursement of the corresponding loans. The redeemed loan, whose conditions were realigned to the needs of the Company, continues to have a remaining term until 2013. In this regard, reference is additionally made to Section C. no. 4.

Due to the redemption of the bank financing in January 2011, the existing bank liabilities as of the December 31, 2010 balance sheet date were classified entirely as current liabilities. In the prior year, due to the Company's non-compliance with the agreed-upon financial covenants in connection with the existing financing, the existing bank liabilities were also entirely classified as short-term bank liabilities. The following covenants were not able to be met: the "Total Leverage Covenant", a ratio resulting from the relationship of net indebtedness to EBITDA, the "Interest Coverage Covenant", a ratio that relates EBITDA to net interest expense and the "Equity Capital Covenant", a ratio that compares the shareholders' equity of the Zapf Creation Group to the balance sheet total. The "Capital Expenditure Covenant", which is a ratio relating to investment volume, was able to be met.

The following security documents, each duly executed by the parties to it and notarized to the extent required by applicable law, exist to secure this loan agreement:

Germany

- Share pledge agreement regarding the pledge of shares in Zapf Creation Auslandsholding GmbH entered into between Zapf Creation AG as pledgor, Commerzbank Aktiengesellschaft as security agent and the other finance parties

- Share and interest pledge agreement regarding the pledge of shares in Zapf Creation Logistics GmbH and the pledge of the partnership interest (Kommanditanteile) in Zapf Creation Logistics GmbH & Co. KG entered into between Zapf Creation AG as pledgor, Commerzbank Aktiengesellschaft as security agent and the other finance parties

- Pledge agreement regarding the pledge of bank accounts entered into between Zapf Creation AG and Zapf Creation Logistics GmbH & Co. KG as pledgors, Commerzbank Aktiengesellschaft as security agent and the other finance parties

- Global assignment agreement regarding the assignment of trade receivables entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Global assignment agreement regarding the assignment of trade receivables entered into between Zapf Creation Logistics GmbH & Co. KG as assignor and Commerzbank Aktiengesellschaft as security agent

- Assignment agreement regarding the assignment of trade credit insurance (Warenkreditversicherung) receivables entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Assignment agreement regarding the assignment of export credit insurance receivables entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Global assignment agreement regarding the assignment of present and future receivables arising from central regulation contracts, debt collection contracts and supply contracts entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of movable assets entered into between Zapf Creation AG as transferor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of movable assets entered into between Zapf Creation Logistics GmbH & Co. KG as transferor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of fixed assets entered into between Zapf Creation AG as transferor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of fixed assets entered into between Zapf Creation Logistics GmbH & Co. KG as transferor and Commerzbank Aktiengesellschaft as security agent

- Pledge agreement regarding the pledge of intellectual property rights entered into between Zapf Creation AG as pledgor and Commerzbank Aktiengesellschaft as security agent

- Pledge agreement regarding the pledge of patent rights entered into between Zapf Creation AG as pledgor and Commerzbank Aktiengesellschaft as security agent

- Land charge of € 4,601,626.92 over the property registered with the land register of the local court of Coburg of Moenchroeden, folio 3657 granted by Zapf Creation Logistics GmbH & Co. KG in favor of Commerzbank Aktiengesellschaft as security agent

- Joint land charge of € 5,000,000.00 registered with the land register of the local court of Coburg of Moenchroeden, folio 2900, 3094, 3527, 3656 and 3657 granted by Zapf Creation AG and Zapf Creation Logistics GmbH & Co. KG in favor of Commerzbank Aktiengesellschaft as security agent

- Undertaking regarding the granting of security rights over movable assets granted by Zapf Creation Auslandsholding GmbH

- Undertaking regarding the granting of security rights over fixed assets granted by Zapf Creation Auslandsholding GmbH

- Undertaking regarding the granting of security rights over receivables granted by Zapf Creation Auslandsholding GmbH

Hong Kong

- Charge of shares regarding the shares in Zapf Creation (H.K.) Ltd. entered into between Zapf Creation AG as chargor and Commerzbank Aktiengesellschaft as chargee

- Debenture granted by Zapf Creation (H.K.) Ltd. as chargor and Commerzbank Aktiengesellschaft as chargee regarding all assets referred to therein

Poland

- Agreement for registered pledge over shares in Zapf Creation (Polska) Sp. z.o.o. entered into between Zapf Creation AG as pledgor and Commerzbank Aktiengesellschaft as security agent

- Agreement for the registered pledge over assets and financial pledges over bank accounts entered into between Zapf Creation (Polska) Sp.z.o.o. as pledgor and Commerzbank Aktiengesellschaft as security agent

- Statement of submission to enforcement pursuant to Article 777 section 1 para 5 of the German Civil Procedure Code

Spain

- Share pledge agreement regarding the pledge of shares in Zapf Creation (España) S.L. entered into between Zapf Creation Auslandsholding GmbH as pledgor and Commerzbank Aktiengesellschaft as security agent

- Pledge agreement regarding the pledge of receivables against third-party debtors entered into between Zapf Creation (España) S.L. as pledgor and Commerzbank Aktiengesellschaft as security agent

- Negative-/positive pledge regarding the granting of security rights over movable assets granted by Zapf Creation (España) S.L.

- Negative-/positive pledge regarding the granting of security rights over fixed assets granted by Zapf Creation (España) S.L.

United Kingdom

- Mortgage of shares regarding the shares in Zapf Creation (U.K.) Ltd. entered into between Zapf Creation Auslandsholding GmbH as pledgor and Commerzbank Aktiengesellschaft as security agent

- Security agreement regarding security over real property, bank account, plant and machinery, credit balances, book debts, insurances and other contracts entered into between

Zapf Creation (U.K.) Ltd. as chargor and Commerzbank Aktiengesellschaft as security agent

- Undertaking regarding the granting of security rights over fixed assets granted by Zapf Creation (U.K.) Ltd.

<u>United States</u>

- Undertaking regarding the granting of security rights over movable assets granted by Zapf Creation (U.S.) Inc.

- Undertaking regarding the granting of security rights over fixed assets granted by Zapf Creation (U.S.) Inc.

Furthermore – unless already contained in the above security documents – pledge agreements or equivalent security documents exist with regard to each bank account of any member of the Zapf Creation Group. This excludes bank accounts of the Group subsidiary Zapf Creation (U.S.) Inc.

With respect to the mentioned mortgages, reference is made to the comments on events subsequent to the balance sheet date (Section C. no. 4).

The carrying amounts of the securities pledged are as follows as of the balance sheet date:

	31.12.2010 K€	31.12.2009 K€
Cash and cash equivalents	13,532	7,971
Trade receivables	26,315	35,746
Inventories	4,817	5,668
Income tax receivables	121	627
Other current assets	6,558	6,865
Property, plant and equipment	11,372	13,315
Intangible assets	3,839	4,692
Other non-current assets	0	0
Total	66,554	74,884

The average interest rate for the utilization of current liabilities to banks in 2010 was 10.52% (prior year: 9.16%).

2.3.2. Trade payables

Trade payables as of the December 31, 2010, balance sheet date totaled K€25,528 (prior year: K€21,806). They are essentially comprised of vendor invoices already submitted and still outstanding as of the balance sheet date as well as obligations of the Company from sales deductions granted.

Please also see Section B, no. 2.6.3, in regards to maturity ranges.

2.3.3. Income tax liabilities

Income tax liabilities are comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Domestic	508	925
Abroad	882	1,539
Income tax liabilities	1,390	2,464

2.3.4. Other liabilities

Other current liabilities are comprised as follows:

	31.12.2010 K€	31.12.2009 K€
Non-derivative financial liabilities		
Financial liabilities to employees	1,514	629
Other	1,015	1,360
Total	2,529	1,989
Derivative financial liabilities	0	0
Other liabilities		
Other taxes and social security payments	848	1,010
Non-cash benefits owing to employees	62	205
Sundry	10	0
Total	920	1,215
Other liabilities	3,449	3,204

Please also see Section B, no. 2.6.3, in regards to maturity ranges.

Financial obligations to employees as of December 31, 2010 comprise primarily severance pay of K€998 (prior year: K€222) in connection with ongoing personnel measures of the Zapf Creation Group which do not meet the recognition criteria for provisions under IFRS, but instead are obligations to be recognized as other liabilities. In addition, included in particular are outstanding bonus payments in the amount of K€206 (prior year: K€377). As of the December 31, 2010 balance sheet date, outstanding payments in connection with Management Board member compensation are included in the amount of K€306.

Non-cash benefits owing to employees in the amount of K€62 (prior year: K€205) result primarily from their vacation claims as of the reporting date.

2.3.5. Provisions

Provisions in the reporting period developed as follows:

	01.01.2010	Use	Reversal	Addition	31.12.2010
	K€	K€	K€	K€	K€
Returned goods	1,917	1,898	27	1,049	1,041
Other	507	94	9	120	524
Provisions	2,424	1,992	36	1,169	1,565

<u>Returned goods</u>

The provisions for returned goods result from the obligation to take back merchandise that has not been sold by customers.

<u>Other</u>

Other provisions relate primarily to personnel obligations in the amount of K€318 (prior year: K€311), e.g., obligations arising from the granting of share-based compensation, and risk provisions for ongoing processes.

2.4. Noncurrent liabilities

2.4.1. Liabilities to banks

As in the prior year, the existing liabilities to banks as of December 31, 2010 were recognized in full as current liabilities to banks.

Reference is also made to Section B no. 2.3.1.

2.4.2. Deferred tax liabilities

The deferred tax liabilities as of the balance sheet date result from the following items:

	31.12.2010 K€	31.12.2009 K€
Property, plant and equipment and intangible assets	62	23
Trade receivables	19	19
Trade payables	16	236
Liabilities to banks	0	213
Other	195	41
Deferred tax liabilities before offsetting	292	532
Offsetting with deferred tax assets	- 240	- 514
Deferred tax liabilities	52	18

Regarding the changes in deferred tax liabilities reference is also made to Section B No. 1.10.

2.5. Equity

The statement of changes in equity shows the development of each item of equity for the 2010 and 2009 financial years; it also reports on the change in outstanding shares in both the reporting period and the same period the previous year.

The individual items of shareholders' equity are explained in detail below:

2.5.1. Subscribed Capital

The Company's share capital as of December 31, 2010 was € 19,295,853.00 (prior year: € 19,295,853.00). It is divided into 19,295,853 (prior year: 19,295,853) bearer shares of no par value. As in the previous years, all shares issued have been fully paid up as of the balance sheet date.

On May 27, 2008 the ordinary general shareholder meeting resolved to establish a new authorized capital (Authorized Capital 2008) and the revision of § 5 (amount and classification of share capital) of the articles of incorporation; on December 15, 2009 the ordinary general shareholder meeting resolved to establish a new conditional capital (Conditional Capital 2009) and the new revision to § 5 (amount and classification of share capital) of the articles of incorporation. Following these resolutions, the articles of incorporation of Zapf Creation AG in § 5 govern the following possibilities for the execution of capital measures:

The Management Board is authorized, upon approval of the Supervisory Board, until May 26, 2013 once or several times to increase the share capital by up to a total of €9,000,000.00 against cash and/or non-cash contributions through the issuance of new no-par-value bearer shares (Authorized Capital 2008).

The Management Board is authorized, upon approval of the Supervisory Board, to exclude the legal subscription right of shareholders in the following cases:

a) for fractional shares;

b) if the capital increase is made through a cash contribution and the total share of share capital relating to the new shares, for which the subscription rights were excluded, does not exceed €1,800,000.00 or – in the event this amount is lower – 10% of the existing share capital at the time of issuance of the new shares and the issuance amount of the new shares is not significantly below the exchange price of the already listed shares of the same type and class in the context of §§ 203 (1) and (2), 186 (3) Sent. 4 AktG at the time the final determination of the issuance amount by the Management Board; the authorized volume decreases by the proportional amount of share capital that relates to shares that have been issued or sold since May 27, 2008 under exclusion of subscription rights directly or indirectly pursuant to § 186 (3) Sent. 4 AktG;

c) in the case of capital increases against non-cash contributions through the issuance of shares in connection with the acquisition of companies, portions of companies or investments in companies;

d) in the case of capital increases against non-cash contributions through the issuance of shares in connection with the acquisition of repayment and/or interest claims against the Company in connection with loan agreements.

The Management Board is authorized, upon approval of the Supervisory Board, to determine the further details of the execution of the capital increases from Authorized Capital 2008. The Supervisory Board is authorized to revise the articles of incorporation upon the complete or partial execution of the increase in the share capital from Authorized Capital 2008 or upon expiration of the authorization according to the amount of the capital increase from Authorized Capital 2008. After execution of a capital increase from Authorized Capital 2008, this now exists in the amount of € 7,704,147.00.

The share capital of the Company is conditionally increased by up to € 500,000.00 through the issuance of up to 500,000 of no-par-value bearer shares (Conditional Capital 2009). The conditional capital increase is to only be carried out, as owners of stock options, which are issued by the Company from December 15, 2009 to December 14, 2014 according to the resolution of the general shareholders' meeting, exercise their option rights and new shares are issued according to the option conditions. The new shares resulting from the exercise of these option rights participate in earnings of the year from the beginning of the financial year for which at the time of the exercise of the option right, there has been no resolution of the general shareholders' meeting as to the appropriation of earnings.

In connection with the issuance of new shares, the beginning of the profit participation can be established at variance to Sec. 60 (2) German Stock Corporation Act.

Regarding the Company’s ability to issue stock options, reference is additionally made to the presentation of stock-based remuneration systems in Section B no. 2.5.6.

As in the prior year, in the 2010 financial year no capital measures were carried out.

2.5.2. Capital reserves

The capital reserve results from the premium realized on the issuance of the shares in connection with the initial public offering in 1999, less the one-time direct expenses caused by the initial public offering after considering income tax consequences, as well as capital increases that have taken place in the meantime. The capital reserve was reduced by the issuance of treasury shares in connection with share-based compensation.

In the 2010 financial year, the Company's capital reserves decreased by K€61. In the comparable prior-year period the Company's capital reserves decreased by K€1,481, from K€33,240 to K€31,579. The change in the capital reserves in the 2009 reporting period resulted primarily from the issuance of 80,000 shares of treasury stock to a member of the Management Board in connection with his share-based compensation. Regarding the compensation of the Management Board reference is made to Section C no. 3.1.

2.5.3. Net profit or loss for the period and profit or loss brought forward

As in the previous year, in the 2010 financial year this item includes the net profit or loss for the period and the profit or loss brought forward from the previous year.

As in the previous year, there were no dividend distributions in the 2010 reporting period.

2.5.4. Cumulative other comprehensive income

Cumulative other comprehensive income as of December 31, 2010 results exclusively from the adjustments from currency translation.

The adjustments from foreign currency translation basically result from the translation of foreign financial statements from the respective functional currency into the Group's functional and reporting currency, the euro (€). The currency translation differences arising from this process are allocated directly to equity in adjustments from foreign currency translation. Following the disposal of a foreign business, the currency translation differences that have accumulated until such time are either recognized in income or included in income from disposals.

As of the December 31, 2010 reporting date, a currency effect in the amount of K€2,332 (prior year: K€2,725) arising from a long-term working capital loan that Zapf Creation AG made to its Group subsidiary, Zapf Creation (U.K.) Ltd. negatively affected the adjustment from currency translation; Zapf Creation AG (U.K.) Ltd. must repay the loan in euro. The tax effect in the amount of K€675 (prior year: K€785) resulting from the recognition in equity of the aforementioned currency effect is contained in an offsetting entry. Since repaying the loan in the foreseeable future is neither planned nor likely, it is part of Zapf Creation AG's net investment in its Group subsidiary, Zapf Creation (U.K.) Ltd.

As in the previous year, there was no need for recognizing adjustment items from derivative financial instruments because the requirements for hedge accounting were not fulfilled; both the change in the value of an existing derivative financial instrument used to hedge interest rate risks and changes in the value of foreign exchange options used as hedging instruments are recognized in income.

2.5.5. Treasury shares

By resolution of the Annual Shareholders' Meeting dated December 15, 2009, the Company is authorized to purchase treasury shares in order to:

a) Be able to offer such shares as consideration or part of the consideration in connection with business combinations or the acquisition of companies, business units or participating interests in companies; or

b) Issue such shares in return for the transfer to the Company of one or more loan and/or interest payables under loans granted to it; or

c) Offer such shares as employee shares to employees of the Company or companies considered its affiliates under Section 15 German Stock Corporation Act for purchase or, if employee shares were acquired by way of loans to purchase securities or loans of securities, for purposes of satisfying obligations thereunder; or

d) Issue such shares to members of the Management Board as a part of their compensation; or

e) To use to service option rights that are issued in connection with the authorization resolved by the Annual Shareholders’ Meeting on December 15, 2009 to issue stock options; or

f) Sell repurchased treasury shares in ways other than on the stock exchange or by means of an offering to all shareholders in return for cash at a price that is not substantially lower than the exchange price of the Company's shares of the same class at the time of the disposal; or

g) Retire such shares by reducing share capital, without a further resolution of the Annual Shareholders Meeting.

The authorization is limited to the purchase of treasury shares having a pro rata share of 10% in the Company's share capital existing on December 15, 2009 (€ 19,295,853.00), the day on which the Annual Shareholders' Meeting adopts the resolution. The treasury shares so acquired — along with other treasury shares that are in the Company's possession or are allocable to it under Section 71a et seq. German Stock Corporation Act — may not, at any time, exceed 10% of the share capital. Furthermore, the purchase is only permitted if the Company at the time of the purchase can establish a reserve in the amount of the cost of the purchase without reducing the share capital or a reserve required by law or the articles of incorporation that is not allowed to be used for distributions to shareholders.

The authorization to purchase treasury shares is in force up to and including December 14, 2014. The authorization resolved in the General Shareholders’ Meeting of the Company on May 27, 2008 for the disposition of the treasury shares already held by the Company at the time of the resolution by the General Shareholders' Meeting of May 27, 2008 terminates with the effectiveness of the new authorization. To the extent the Company repurchased treasury shares based on the authorization to acquire treasury shares of May 27, 2008, the resolution of May 27, 2008 as to their disposition remains in force for those shares.

The repurchase pursuant to authorization resolved by the Annual Shareholders' Meeting of December 15, 2009 may also be executed by Group entities dependent on the Company within the meaning of Section 17 German Stock Corporation Act, or for the account of the Company or a Group entity dependent on it within the meaning of Section 17 German Stock Corporation Act.

The defined purposes a) to f) in the mentioned authorization are only to be applied under consideration of the provisions contained therein and within the existing authorization framework likewise to treasury shares already held by the Company as of December 15, 2009.

Use was made up to and including December 31, 2010 of the authorization resolved by the general shareholders meeting on December 15, 2009 for the purchase of treasury shares and/or for the appropriation of treasury shares already held; 80,000 treasury shares were transferred to a member of the Management Board in connection with his share-based compensation. Regarding the compensation of the Management Board reference is made to Section C no. 3.1.

Regarding the authorization for the acquisition of treasury shares resolved by the general shareholders meeting on May 27, 2008 – in this connection reference is made to the consolidated financial statements as of December 31, 2008 – no use was made up to and including the last possible date on November 26, 2009.

As of the balance sheet date, the Company continued to have two separate securities deposit accounts for treasury shares:

a) Account no. 1 holds 489,593 treasury shares as of the balance sheet date (prior year: 489,593). This corresponds to 2.54% of the share capital reported as of the balance sheet date (prior year: 2.54%). The carrying amount as of December 31, 2010, was K€9,675 (prior year: K€9,675).

b) Account no. 2 holds 3,085 treasury shares as of the balance sheet date (prior year: 3,085). This corresponds to 0.02% of the share capital reported as of the balance sheet date (prior year: 0.02%). The carrying amount as of December 31, 2010, was K€96 (prior year: K€96).

In the 2010 reporting period there were no changes in either deposit account. The change in the amount of treasury shares in Account no. 1 in the 2009 reporting period resulted completely from issuance of 80,000 no-par shares to a member of the Management Board in connection with his share-based compensation. Regarding compensation of the Management Board, reference is made to Section C no. 3.1.

Gains or losses from the sale of treasury shares are recognized directly in equity. The treasury shares acquired by the Company are measured at cost and deducted separately from equity. Cost is not adjusted to fair value.

2.5.6. Share-based compensation systems

The compensation system based on phantom shares that was launched in 2006 for the members of the Company's Management Board remained in place in the 2010 financial year and was expanded regarding the group of beneficiaries. In this connection, in 2010 a further 37,000 (prior year: 89,000) phantom stock options were issued at base prices of € 1.20 and € 1.00 (prior year: € 0.87, € 0.81 and €0.79), the exercise of which is not linked to the achievement of specific performance targets. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date on which the phantom stock options are exercised.

The following summary contains details regarding the number and weighted average base prices of the phantom stock options:

	2010		2009	
	Number of options	Weighted average base prices	Number of options	Weighted average base prices
	Number	€	Number	€
Options outstanding at the beginning of the reporting period	236,000	3.08	275,000	5.94
Options granted during the reporting period	37,000	1.05	89,000	0.81
Options exercised during the reporting period	0	-	0	-
Options expired during the reporting period	113,000	4.30	128,000	7.63
Options outstanding at the end of the reporting period	160,000	1.75	236,000	3.08
Options exercisable at the end of the reporting period	64,000	-	0	-

The weighted average of the fair value of the phantom stock options granted during the reporting period as of the measurement date is determined using the Black-Sholes option pricing model. The calculation is based on the following assumptions:

	2010	2009
Risk-free interest rate	3.25 %	4.25 %
Expected volatility	130.19 %	80.18 %
Share price as of December 31	1.54 €	1.11 €
Weighted average base price as of December 31	1.75 €	3.08 €
Weighted average remaining life	728 days	770 days

The expected volatility of the share price was ascertained based on its historical volatility in the previous 100 days before the respective balance sheet date.

The consideration payable by the Zapf Creation Group in connection with this compensation system, which is determined on the basis of the share price, must be recognized as an obligation and expensed over the term of the obligation. The obligation to be reported as of each balance sheet date reflects the newly determined fair value of the phantom options at such date. As of December 31, 2010, this obligation was K€145 (previous year: K€83; the average fair value per option outstanding as of the balance sheet date was € 0.91 (previous year: € 0.35). As of December 31, 2010, considering the development of the share price and the existing vesting periods, 64,000 options were exercisable (prior year: 0).

In the 2010 financial year, as in the prior year, in addition to the compensation system using phantom options, a further form of share-based compensation in the form of direct issuance of shares of Zapf Creation AG was used. The potential issuance of shares by the company now exists solely in connection with the variable share-based compensation dependent on the achievement of specific performance targets (prior year: fixed and variable). Reference is also made to Section B No. 2.5.2., Section B no. 2.5.5. and Section C no. 3.1.

By resolution of the Annual Shareholders Meeting of December 15, 2009 the Company is authorized to establish one or several stock option plans under which up to and including December 14, 2014 options rights with a maturity up to ten years can be issued once or several times up to a total of 500,000 no-par bearer shares to employees of Zapf Creation AG and members of management and employees of majority-owned or dependent affiliate companies ("affiliated companies"). A subscription right of shareholders does not exist. Of the total 500,000 option rights, up to 280,000 option rights can be issued to employees of Zapf Creation AG, 120,000 option rights can be issued to members of management of affiliated companies and 100,000 option rights can be issued to employees of affiliated companies. Based on this authorization, no option rights are permitted to be issued to members of the Management Board of Zapf Creation AG.

Every option right grants the holder of the right to subscribe to one share of Zapf Creation AG. With respect to the possibility of exercising the issued options, there are defined restrictions that must be observed; these comprise primarily a vesting period, exercise periods and blocking periods. The options model is set up with a 20% performance target as an issue premium, prior to the attaining of which, the exercise of the option is not sensible for the holder from an economic point of view. In addition, conditions exist regarding transferability, expiration and withdrawal of the option rights.

Regarding the existing possibilities for the Company to service the option holders in connection with the exercise of the issued option rights, reference is made to Section B no. 2.5.5. The possibility also exists for the Company, at its option, instead of delivering new shares (Conditional Capital 2009) or shares already held, in connection with the exercise of the option rights to pay the difference between the exercise price and actual exchange price at the date of the exercise declaration.

Up to December 31, 2010 the Company did not take advantage of this possibility for share-based compensation.

2.6. Disclosures regarding financial instruments

2.6.1. Risk management policies and hedging strategies

Cash and cash equivalents, trade receivables and payables, and liabilities to banks comprise the main non-derivative financial instruments the Zapf Creation Group uses in its operating business.

Existing risks from interest rate and foreign currency fluctuations constitute the principal risks the Zapf Creation Group encounters both in its operating business and with regard to its financing. Corporate policy is to exclude or limit these risks by concluding hedging transactions. All hedging measures are coordinated and conducted centrally at the Group's parent company. Primarily derivative financial instruments are employed as hedging measures.

There are corporate guidelines for the interest rate and foreign exchange hedging policies that minimize the risks resulting from the use of financial instruments. These include the separation of the trading, processing, and posting functions, as well as the voluntary restriction to a small defined group of banks with high creditworthiness and the authorization of only a few qualified employees. All derivatives are used solely for hedging purposes.

2.6.2. Explanation of the risks from financial instruments

Interest Rate Risk

Interest rate risks arise from possible fluctuations in the value of, and the resulting cash flows from, non-derivative financial instruments due to changes in market rates; this applies particularly to interest-bearing medium- and long-term receivables and liabilities subject to variable interest rates. The Zapf Creation Group employs interest hedging agreements as necessary, given the market situation, to hedge its interest rate risk position.

Currency Risk

Currency risks exist in that, over time, exchange rate fluctuations change the values of items posted in foreign currency. To hedge the currency risk, the Zapf Creation Group, as a rule, uses possibilities for balancing out currency risks naturally as well as forward exchange transactions and/or options. These transactions and/or options relate to the exchange rate hedging of significant items in foreign currency from the Company's operating activities.

Liquidity Risk

Liquidity risks exist in that the Company may not be able to acquire the funds necessary to pay the obligations entered into in connection with financial instruments. This risk is covered by a liquidity forecast based on a fixed planning horizon taking the existing financing of the Company into account (continuous planning).

Default Risk

The default risk from financial assets exists in that the contractual partner in a transaction involving a financial instrument may not meet its obligations or may not meet them on schedule. The maximum amount of this risk is the positive fair value of the claim from the financial instrument vis-à-vis the respective counterparty. The risk from primary financial instruments is taken into account by establishing an allowance for bad debts; in addition, the Company has an appropriate amount of credit insurance. With regard to derivative financial instruments, the actual default risk is low as these instruments are only concluded with selected banks and limits are set for each counterparty as part of the Company's risk management.

2.6.3. Non-derivative financial instruments

The carrying amounts of the non-derivative financial instruments of the Zapf Creation Group as of the balance sheet are as follows:

	31.12.2010 K€	31.12.2009 K€
Financial assets		
Cash	13,532	7,971
Trade receivables	26,315	35,746
Other financial assets	4,987	5,228
of which shown under other current assets	4,987	5,228
of which shown under other noncurrent assets	0	0
Total	44,834	48,945
Financial liabilities		
Liabilities to banks	27,144	33,311
Trade payables	25,528	21,806
Other financial liabilities	2,529	1,989
of which shown under other current liabilities	2,529	1,989
Total	55,201	57,106

The carrying amounts of cash and cash equivalents, trade receivables, other financial assets, trade payables, as well as other financial liabilities, represent a reasonable approximation of their fair values, given the financial instruments' short maturities. This applies also to the liabilities to banks. Based on the new finance regulation presented under Section C. No. 4. these had to be repaid on January 31, 2011 or were transferred to a group of investors in January 2011 and were insofar replaced. In the prior year the carrying value represented the fair value as on October 1, 2009 the existing financing agreement was aligned to the current market conditions. The carrying amount of K€31.302 (December 31, 2009: K€40,947) of financial assets excluding cash and cash equivalents represents the Zapf Creation Group's maximum credit risk position.

The maturity structure of the financial assets that were not impaired as of the reporting date, as well as the due dates of the financial liabilities that were stipulated by contract or based on historical data, follow from the table below, which is organized according to maturity ranges; financial assets already past due as of the reporting date are contained in the amount shown in the category "past due in less than 30 days":

		due in				
	As of 31.12.2010	less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Financial assets	44,834	29,109	8,134	5,633	1,796	162
Financial liabilities	55,201	43,275	4,319	4,197	628	2,782

		due in				
	As of 31.12.2009	less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Financial assets	48,945	28,652	8,573	6,716	2,745	2,259
Financial liabilities	57,106	46,696	3,280	1,430	642	5,058

With respect to the assets that have not already been reduced by impairment write-downs, as of the balance sheet date there are no indications of default on the part of the debtors.

Total interest income in the reporting period from non-derivative financial instruments amounts to K€113 (prior year: K€64); total interest expense on non-derivative financial liabilities in the 2010 financial year amounts to K€ 3,335 (prior year: K€3,315).

The aging structure of trade receivables that are past due and not impaired as of the reporting date is as follows:

		Past due				
	As of 31.12.2010	less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Trade receivables	978	- 35	141	487	- 528	913

		Past due				
	As of 31.12.2009	less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Trade receivables	4,173	2,352	231	- 52	140	1,502

2.6.4. Derivative financial instruments

Interest rate risk

The following derivative financial instruments exist as of the balance sheet date in connection with the hedging of interest rate risk:

	31.12.2010		31.12.2009	
	Nominal volume	Market values = Carrying amounts	Nominal volume	Market values = Carrying amounts
	K€	K€	K€	K€
Interest rate cap (term > one year)	23,000	22	26,000	90

In connection with the loan agreement dated November 30, 2007 – in this regard reference is also made to Section B No. 2.3.1 – interest rate risks were hedged in the 2008 reporting period for the 2008 financial period and subsequent periods. Consequently, as of December 31, 2010, as was already the case as of the balance sheet date in the prior year, the Company is party to an interest rate cap agreement for a nominal volume of K€23,000 (prior year: K€26,000) and an interest rate that is capped at 4.6% per annum. The nominal volume underlying the interest rate cap will be amortized by 2013 over the term of the agreement pursuant to an amortization schedule; the initial amount was K€32,000. As of the December 31, 2010 balance sheet date the positive fair value of the interest rate cap derivative amounts to K€22 (prior year K€90).

Currency Risks

As of the balance sheet date the following derivative financial instruments existed in connection with the hedging of currency risks:

	31.12.2010		31.12.2009	
	Nominal volume	Market values = Carrying amounts	Nominal volume	Market values = Carrying amounts
	K€	K€	K€	K€
Forward exchange contracts (term < one year) - Purchased currency: USD - Nominal volume: TUSD 8,600 - Traded price (rounded): 1 euro = 1.47 USD	0	0	5,855	120

In connection with the loan agreement dated November 30, 2007 – in this regard reference is also made to Section B no. 2.3.1. – in the 2009 reporting period the Company hedged selected currency risks by way of derivative financial instruments. The hedging in the 2009 financial year was carried out through forward currency transactions and was in existence up to and including April 2010; planned foreign currency needs in USD were hedged through August 2010.

As of the December 31, 2010 balance sheet date there are no derivative financial instruments for the purpose of hedging currency risks. The derivative financial instruments existing at the prior year's balance sheet date for hedging currency risks had a positive fair value of K€120.

Hierarchical differentiation

In the following, the fair values of the reported derivative financial instruments as of the balance sheet date are differentiated between each other according to their significance for the measurement of required input values. For this purpose, the carrying values are divided into three levels: quoted prices in active markets (level 1), observable inputs that are based on a valuation model for the determination of fair value (level 2) and inputs that are not based on observable market data (level 3).

The existing derivative financial instruments of the Zapf Creation Group are assigned to the hierarchical levels as follows:

	31.12.2010	Level 1	Level 2	Level 3
	K€	K€	K€	K€
Derivative financial instruments that do not fulfill the requirement for hedge accounting	22	0	22	0

	31.12.2009	Level 1	Level 2	Level 3
	K€	K€	K€	K€
Derivative financial instruments that do not fulfill the requirement for hedge accounting	210	0	210	0

2.6.5. Risk Sensitivities

As part of our risk management, risks are initially described in qualitative terms and subsequently subject to approximate quantification using sensitivity analyses. The relevant risk assessment assumes that a parallel shift of the interest rate curve by 100 basis points (one percentage point) has occurred, as well as a gain or loss of 10% in the euro (€) against the relevant foreign currency. The consequences deduced therefrom for the consolidated income statement as well as for Group equity might deviate substantially from the effects of actual market developments.

An interest rate sensitivity analysis must be performed for liabilities subject to variable interest rates. Liabilities to banks arising from the existing financing agreement were contractually subject to a fixed interest rate until May 30, 2008 (EURIBOR plus a fixed margin); the interest rate for these liabilities was reset on May 30, 2008, in accordance with the changes in the EURIBOR. As of 31 December 2010, the annualized cash flow interest rate risk is K€207 (prior year: K€304), assuming that the EURIBOR rises by 100 basis points; this would trigger a corresponding decline in the net profit of the Zapf Creation Group for the 2011 financial year and consequently Group equity. The Zapf Creation Group does not have any other liabilities that are subject to variable interest rates.

The foreign currency sensitivity analysis is performed by aggregating the Group's net currency position using the US dollar as the determinant. If the value of the US dollar had declined by 10% as of December 31, 2010, net payments received would have fallen by K€546 (previous year: K€90); this would trigger an increase in the net profit of the Zapf Creation Group for the 2011 financial year and consequently Group equity.

2.7. Capital management disclosures

The liabilities, equity and total assets of the Company as of the balance sheet date were as follows:

	31.12.2010 K€	31.12.2009 K€	Change in %
Current liabilities	59,076	63,209	-
Noncurrent liabilities	52	18	-
Liabilities	59,128	63,227	- 6 %
in percentage of total equity and liabilities	*88 %*	*84 %*	-
Equity	8,015	12,453	- 36 %
in percentage of total equity and liabilities	*12 %*	*16 %*	-
Total equity and liabilities	67,143	75,680	- 11 %

The Company's liabilities declined by a total of 6% compared to the prior year's balance sheet date (previous year: decline of 12%).

The Company's equity decreased by 36% compared to the prior period due to the development of results in the 2010 financial year (prior year: 45%).

As a result, equity decreased in the reporting period to 12% of the total assets compared to 16% as of the balance sheet date in the prior year. The percentage share of the Company's liabilities to total assets increased from 84% at December 31, 2009 to 88% as of the balance sheet date in the 2010 financial year.

The objectives of capital management are to ensure the continuance of the Company and to guarantee an adequate capital base in order to maintain the trust of investors, the markets, business partners and the employees and also to strengthen and ensure the development of the Company on a sustainable basis.

The Articles of Incorporation of Zapf Creation AG do not prescribe specific capital requirements.

3. Explanation of the items in the cash flow statement

The cash flow statement is broken down by cash flows from operating, investing and financing activities.

The cash flow from operating activities is determined using the indirect method.

Interest paid and received is allocated to cash flows from financing activities.

The cash funds in the cash flow statement comprise the cash and cash equivalents disclosed in the balance sheet.

The changes in the balance sheet items that are used to prepare the cash flow statement cannot be derived directly from the balance sheet because non-cash exchange rate effects must be eliminated.

Regarding cash flows from discontinued operations, please see Section B, no. 1.11.

4. Explanation of the items in segment reporting

The segment report is attached to these notes as ***Appendix 3***.

The activities of the Zapf Creation Group are described in the segment reporting, taking the requirements of IFRS 8 ("Operating Segments") into account.

The structure of segment reporting in the Zapf Creation Group arises from the Group's organizational structure and takes into account its internal reporting structure, both of which are oriented on the primary origin and type of the Company's risks and income. Therefore the format of the reporting is determined by geographical segments and the structure of the product programs (product lines); in accordance with the internal management and reporting the segments are defined as Central Europe, Northern Europe, Southern Europe, Eastern Europe, America and Asia/Australia.

The delineation of the European segments is based on the following allocation of countries (significant countries):

Central Europe	Germany, Austria, Switzerland, the Netherlands and Luxembourg
Northern Europe	Great Britain, Ireland and Scandinavia
Southern Europe	Spain, France, Belgium and Italy
Eastern Europe	Russia, Poland, Czech Republic and Slovakia

The Central Europe sales region is primarily supplied through the German parent company, Zapf Creation AG. The Northern European market is primarily serviced by the sales company Zapf Creation (U.K.) Ltd. The Southern European markets are primarily supplied through our own subsidiaries, Zapf Creation (España) S.L., which since the 2010 financial year also supplies the Latin American markets, and Zapf Creation (France) S.à.r.l. up to the time of its integration into Zapf Creation AG and thereafter through the Group parent company – in this regard reference is made to the disclosures relating to the consolidated companies in Section A no. 2.2.2. Distribution in the Italian market was already transferred back from Zapf Creation (Italia) S.R.L. to Zapf Creation AG in the 2007 financial year and has since been handled by the Group's parent company. Zapf Creation AG (Italia) S.R.L. is still being consolidated – in this regard please also see the disclosures in Section A, no. 2.2.2., regarding the consolidated companies. Goods for the Eastern European market are primarily supplied through Zapf Creation (Polska) Sp. z o.o. and Zapf Creation AG. Since the discontinuance of the operations of the Polish subsidiary in the 2010 financial year, the supply is carried out by Zapf Creation AG – in this regard please also see the disclosures in Section A, no. 2.2.2., regarding the consolidated companies. MGA Entertainment Inc., Van Nuys, California, USA, alone has been in charge of the American market via a strategic partnership effective January 1, 2007; reference is additionally made to Section B no. 1.11. The Asia/Australia region is serviced by Zapf Creation (H.K.) Ltd.

All disclosures in segment reporting are generally subject to the same recognition and measurement methods as the consolidated financial statements of the Zapf Creation Group. Inter-segment receivables and liabilities, provisions, as well as expenses and income, are eliminated in the segment reporting consolidation column. All transactions between segments are executed at market rates. The column “Other” contains figures not allocable to individual segments.

The sales generated by the relevant segments are separated into internal and external sales. This item includes revenue and other segment income allocable to the relevant segment's ordinary operating business. External sales are assigned to the segments based on the location of the customers.

Sales were made by the Zapf Creation Group to external customers in the 2010 financial year in the amount of K€79,286 (prior year: K€79,332); of these K€21,348 (prior year: K€21,525) were in Germany; K€57,938 (prior year: K€57,807) were abroad. Significant external sales outside of Germany were generated in Great Britain in the amount of K€18,441 (prior year: K€16,832) and in Spain in the amount of K€6,327 (prior year: K€8,206). In the 2010 financial year, sales of the Zapf Creation Group were made to an individual customer in the amount of K€8,189 (prior year: K€9,198), which represents more than 10% of the total Group sales; of this amount K€3,920 (prior year: K€3,452) relates to the segment Central Europe; K€3,690 (prior year: K€4,044) relates to the segment Northern Europe; and K€579 (prior year: K€1,702) relates to the segment Southern Europe.

Depreciation and amortization includes the amount of straight-line depreciation on property, plant and equipment, and straight-line amortization on intangible assets attributable to a particular segment.

Additions to the provisions constitute the main item under non-cash expenses.

In the Zapf Creation Group, revenues by sales regions and product lines as well as the result before interest, income taxes and intercompany clearing (EBIT before intercompany clearing) are utilized as key internal performance indicators.

Segment assets include the carrying amount of the assets that have contributed to achieving the segment result and are allocable to the segments, directly or reasonably. Noncurrent assets in the form of property, plant and equipment and intangible assets amounted to K€15,104 (prior year: K€17,795) in Germany and K€107 (prior year: K€212) outside of Germany.

The item "Investments" reflects investments in non-current segment assets, i.e. property, plant and equipment, as well as intangible assets.

The item "Segment liabilities" comprises all liabilities directly or reasonably allocable to the segments, inasmuch as they stem from the relevant segment's operating activities.

C. Other disclosures regarding the consolidated financial statements

1. Other financial obligations

The following table shows the Company's future minimum liabilities from financial obligations:

	31.12.2010 K€	31.12.2009 K€
< 1 year	4,463	6,328
2 to 5 years	5,656	4,951
> 5 years	1,331	2,074
Financial obligations	11,450	13,353

As of the balance sheet date, the Company had various lease and rental agreements (operating leases). The agreements cover the use of warehouse, office and presentation space as well as the use of furniture, fixtures and office equipment in connection with the Company's operations.

The obligations stemming from noncurrent lease and rental agreements total K€703 (prior year: K€1,606). The obligations on operating leases include an amount of K€ 380 (prior year: K€952) for leases having a term of less than one year, an amount of K€313 (prior year: K€651) having a term of longer than one year and up to five years and an amount of K€10 (prior year: K€3) having a term beyond five years. The contractual obligations as of December 31, 2010, expire no later than in 2019 (prior year: 2015).

As shown below, total liabilities from purchase order commitments were K€10,747 (prior year: K€11,747), mainly from purchase obligations for services under the agreements in connection with the strategic partnership with MGA Group companies that are related parties of the Company, from purchase obligations for goods, from obligations under maintenance contracts and from consulting services.

As of December 31, 2010, the Company had a purchase obligation for services in connection with the strategic partnership with MGA Group companies that are related parties of Zapf Creation AG totaling K€7,928 (prior year: K€7,259). The amount of the service fee is contingent on both the purchasing volume and the exchange rate between the HK-$ and the euro (€).Given an unchanged purchasing volume, Zapf Creation AG assumes that the Company's purchase obligation will be K€1,321 (prior year:

1,037) for an obligation period of up to one year, K€5,286 (prior year: K€4,151) for a period longer than one year up to five years and K€1,321 (prior year: K€2,071) for a period of more than five years.

As of December 31, 2010, the Company had a purchase obligation for goods, which is allocable to the ongoing purchasing process with suppliers in China. In this connection, the Company, beginning with the month of September of each reporting period, orders goods that are scheduled for delivery to customers in the first quarter of the respective following year. Total purchase order commitments as of December 31, 2010, were K€2,365 (prior year: K€3,914).

As of December 31, 2010, the Company had a purchase obligation for ongoing maintenance services totaling K€ 414 (previous year: K€517) resulting from several maintenance contracts signed by the Company. Of the purchase obligation, an amount of K€357 (prior year: K€368) relates to an obligation period of up to one year and K€57 (prior year: K€149) relates to a period longer than one year and up to five years. As was the case in the prior year, there are no purchase obligations as of the December 31, 2010 balance sheet date extending beyond five years.

As of December 31, 2010, the Company had a purchase obligation in the amount of K€40 for consulting services, which are completely within an obligation period of up to one year (prior year: K€33; the obligation was completely within an obligation period of up to one year).

In addition, as of the balance sheet date in the prior year there were other financial commitments of the Company for purchase orders entered into in the total amount of K€24, which entire related to the year 2010.

2. Litigation

The Company is involved in various lawsuits in connection with its business. However, the outcome of these lawsuits will probably not have any significant adverse effect on the Company's business, financial position or results of operations. The Company recognizes appropriate provisions for legal disputes pending beyond year's end.

As in the previous year, there were no other contingent liabilities requiring disclosure as of the balance sheet date.

3. Related party relationships

Disclosures of relationships and business transactions with related parties, as well as of open accounts with related parties, are all subject to IAS 24 ("Related Party Disclosures“).

IAS 24 defines a related party as a person capable of controlling or significantly influencing another person, either alone or together with a third party, or as a person on whom such control or significant influence can be exercised. This definition of related parties covers companies and natural persons. In our case, the Company's Management Board and Supervisory Board and the companies of the MGA Group that are related parties of the Company have been identified as related parties.

All transactions involving deliveries and services from and to related parties that occur in the ordinary course of Zapf Creation's business are executed at market rates.

3.1. Management Board

The total compensation of K€1,008 (previous year: K€965) paid to the Management Board comprises all cash compensation due, as well as all monetary benefits from in-kind compensation. It includes both fixed and variable components but excludes the one-time consideration paid to former members of the Management Board.

Below is an overview of the compensation paid to each individual member of the Management Board in the 2010 financial year:

	Short-term compensation			
	Fixed compensation	Bonus	Share-based compensation	Total compensation
	K€	K€	K€	K€
Ron Oboler	290	88	0	378
José Antonio Santana	233	0	31	264
Jens U. Keil	118	112	0	230
Ron Brawer	110	0	0	110
Stephan F. Brune	26	0	0	26
Total	777	200	31	1,008
		%	%	%
Percentage in 2010		96.92	3.08	100,.00

	Short-term compensation			
	Fixed compensation	Bonus	Share-based compensation	Total compensation
	K€	K€	K€	K€
Total compensation in 2009	771	20	174	965

In addition to the monetary base compensation, the fixed compensation granted to the members of the Company's Management Board also comprises benefits such as the use of company cars and allowances for accident insurance, individual pension plan, and other insurance policies. Mr. Stephan F. Brune was reimbursed in agreed amounts for flights home; additionally, the Company also reimbursed Mr. Brune on the basis of documented costs for relocation expenses, realtor fees as well as matriculation fees. The Company had promised Mr. Brune that it would purchase life and accident insurance for him; however up until his retirement from the Management Board in January 2010 this had not occurred; we refer additionally to Section C no. 5.2. In addition, the Company is taking over the costs of a German instructor for Mr. Santana under conditions that have not been finalized.

The compensation system based on phantom shares that was launched in 2006 for the members of Zapf Creation AG's Management Board remained in place in the 2010 financial year. In this connection, a further 27,000 phantom stock options were issued in 2010 entirely to Mr. Santana at a base price of € 1.00, the exercise of which is dependent on the achievement of specific performance targets. In the prior year's comparative period 25,000 phantom shares were issued to Mr. Stephan F Brune at a base price of € 0.79, 10,000 were issued to Mr. Jens U. Keil at a base price of € 0.87 and a further 27,000 phantom stock options at a base price of € 0.79, and to Mr. José Antonio Santana 27,000 phantom stock options were issued in the 2009 financial year at a basis price of € 0.81. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date on which the phantom stock options are exercised. The increase to the provision for obligations in connection with phantom share-based compensation system, which is recognized in the income statement, amounted to K€75 (prior year: K€67) in the 2010 financial year for members of the Management Board. Due to the retirement from the Company on the part of Mr. Brune, a reduction in the provision was recognized in the 2010 financial year in the amount of K€24 (prior year: reduction of K€2) through the income statement. The provision for liabilities under the aforementioned phantom options as of December 31, 2010, was K€134 (previous year: K€83); of this amount K€59 (prior year: K€17) relates to Mr. Santana. K€63 (prior year: K€36) relates to the former Management Board member Jens U. Keil; K€12 (prior year: K€6) relates to the former Management Board member Thomas Pfau. Regarding the former Management Board member Stephan F. Brune, there is no longer any obligation (prior year: K€24).

In the 2010 reporting period a tranche of 30,000 phantom options issued to the former Management Board member Thomas Pfau at a base price of € 8.60 as well as a tranche of 33,000 phantom options issued to Mr. Pfau at a base price of € 4.67 expired. In the prior year's comparable period, phantom options issued to the former Management Board member Dr. Georg Kellinghusen as well as a tranche issued to the former Management Board member Thomas Pfau expired. In accordance with an agreement, a tranche issued to Mr. Keil was discontinued at the end of September 2009. The rights granted to Mr. Stephan F. Brune were cancelled in connection with compensatory agreement with the former member and chairman of the Management Board of Zapf Creation AG; reference is additionally made to Section C no. 5.2.

The options issued to Mr. José Antonio Santana expire if they are not exercised by March 1, 2012 and March 1, 2013, respectively. The phantom options granted to Mr. Jens U. Keil expire if they are not exercised by April 1, 2012, July 1, 2012, April 1, 2013 and October 1, 2015, respectively. The remaining rights of Mr. Thomas Pfau cease to be valid on September 1, 2011, if no exercise has been made with respect to the last tranche by that date. The exercise periods, as in the prior period, was extended for individual tranches by way of contractual agreement.

As an additional form of share-based compensation, Mr. José Antonio Santana was promised a direct grant of shares; this is strictly arranged as a variable compensation component, the amount of which is dependent upon achievement of specific performance targets. Regarding the bonus payment to Mr. Jens U. Keil, the possibility also existed for the Company to pay a portion in shares; a similar form of compensation existed in the prior year for Mr. Stephan F. Brune. In the 2010 financial year no share-based compensation resulted from this compensation component, which now pertains only to variable compensation (prior year: K€106 – fixed and variable).

Reference is made to Sections A no. 2.3.13. and B no. 2.5.6. for additional disclosures regarding the programs.

On March 4, 2010 the Company entered into a compensatory arrangement with the former member and chairman of the Management Board of Zapf Creation AG, Stephan F. Brune, under which all claims and obligations of both parties resulting from the employee relationship were discharged and thereby finally settled. In this connection, a one-time compensation payment in the amount of K€550 (gross) was finally concluded. In addition, existing receivables due from Mr. Brune in the amount of K€25 were waived; the payroll tax resulting from this waiver of the receivables was completely taken over by the Company. Of this amount, K€360 was already recognized as expense in the prior year in connection with the recognition of provisions.

One former member of the Management Board was granted a variable credit line in the maximum amount of K€625 until December 31, 2007, which was fully used as of December 31, 2007. The agreed interest rate was 4.25%. It was fixed until December 31, 2007, the loan's due date. Under a settlement reached in the 2008 financial year, Zapf Creation AG waived repayment of a loan in the amount of K€175 provided certain conditions are met; the Company will be responsible for any tax expense arising from non-cash advantages. The interest rate has been 5% per annum effective January 1, 2008; the parties agreed to a payment plan regarding the remaining residual liabilities including interest thereon. A payment of K€100 on this liability was made in the 2008 financial year; as in the previous year, no new loans were made in 2008. In 2008, the Company received K€49 in full payment of both K€46 in interest receivables outstanding as of December 31, 2007, and K€3 in interest on arrears that had been billed; the total of K€23 in interest for the 2008 interest period were also paid in full. In the 2009 financial year there was no repayment of the outstanding loans; in the 2010 reporting period a principal amount of K€15 was repaid. Interest was paid in the agreed-upon amount. As a result of the mentioned waiver of receivables, the principle and interest payments received, and in consideration of the interest receivable for the fourth quarter of 2010, the total receivable of the Company amounts at the December 31, 2010 balance sheet date to K€200 (prior year: K€354). The loan granted remains secured by a land charge in the amount of K€339 (previous year: K€200). The remaining amount due has been written down in the amount K€335 (prior year: K€350); the interest receivable the fourth quarter of 2010 in the amount of K€4 was paid in January 2011.

3.2. Supervisory Board

The compensation of the Supervisory Board is determined by the Annual Shareholders' Meeting, on recommendation of the Management Board and the Supervisory Board. It is regulated by Article 20 of the Articles of Incorporation of Zapf Creation AG. The cash compensation includes a fixed and a dividend-based component, as well as compensation linked to the long-term success of the Company.

According to the Articles of Incorporation, the fixed compensation component for the full financial year is K€35 (net) for the Chairman of the Supervisory Board, K€26.25 net for the Vice Chairman of the Supervisory Board, and K€17.50 net each for all other members of the Supervisory Board. The compensation paid to Supervisory Board members who were not in office for a full financial year is pro rated in accordance with the duration of their membership on the Supervisory Board. The most recent change to the fixed component of the compensation paid to the members of the Supervisory Board was made by resolution dated August 29, 2006. Any withholding taxes payable on compensation paid to members of the Supervisory Board domiciled abroad are incurred by the Company.

As before, under the resolution adopted May 7, 2003, the variable compensation paid to the Supervisory Board members will be € 100.00 for each € 0.01 in excess of € 0.50 in dividends per no-par value share distributed to the shareholders for the financial year just ended. In addition, the members of the Supervisory Board are entitled to annual compensation based on the Company's long-term performance. This compensation entails payment of K€1 per K€1,000 in consolidated net annual profit that exceeds an average consolidated annual profit of K€22,237 for the last three financial years. As in the previous year, in the financial year just ended no provisions for the variable component of the compensation were recognized because no payment obligation arises from the Company's performance.

The total obligation for the compensation of the Supervisory Board in the 2010 financial year was K€85 excluding and K€106 including withholding taxes payable (previous year: K€125 excluding and K€166 including withholding taxes payable).

In addition to his Supervisory Board activities, on October 26, 2009 a consulting contract was entered into with the Supervisory Board member Ron Brawer, in which Mr. Brawer was named as consultant to the Management Board of Zapf Creation AG. The consulting contract, which begins October 26, 2009 was limited to a maximum of twelve months and was ended, effective January 29, 2010. At that time, Mr. Brawer was delegated to the Management Board pursuant to

Article 105 (2) Stock Corporations Act; reference is also made to Section C No. 4 and Section C no. 5.2. Compensation granted under the consulting contract amounted to K€10 per month; outlays were reimbursed.

As in the previous year, there were no loans to members of the Supervisory Board as of the balance sheet date.

3.3. Related companies of the MGA Group

The inclusion of MGA Group companies into the group of related parties of Zapf Creation AG is due to the close partnership that has been implemented on an operational level in several areas since the beginning of the 2007 financial year. The details of this partnership are as follows:

Since the beginning of 2007, MGA Entertainment, Inc., Van Nuys, California, USA, has been solely responsible as a licensee for selling Zapf Creation's products in the Americas (North, Central and South); MGA guarantees that the sales volume exceeds the revenue generated by Zapf Creation's own subsidiaries in this region by more than 50% (Agreement 1: "Distribution Agreement“). In return, the parties agreed that the Zapf Creation Group will sell MGA products in particular European markets in exchange for payment of a distribution fee (Agreement 2: "Consignment and Services Agreement“). Zapf Creation Logistics GmbH & Co. KG provides logistics services for the MGA Group (Agreement 3: "Logistics Service Agreement"). Furthermore, in 2007 MGA took over the entire process of selecting and monitoring the Asian suppliers of Zapf Creation products, the coordination and handling of merchandise shipments to the sales units, and technical product development (Agreement 4: "Hong Kong / China Services Agreement“). Also, Zapf Creation AG granted MGA Entertainment Inc., Van Nuys, California, USA, against payment of a license fee, the exclusive right and the exclusive license to utilize and exploit both the products and the intellectual property of Zapf Creation AG, including the right to grant sublicenses (Agreement 5: "Merchandising License Agreement“). Effective April 1, 2008, the partnership was extended through another agreement (Agreement 6: "UK Services Agreement"). Since this date, MGA Entertainment UK Ltd. has been providing full sales services for Zapf Creation (U.K.) Ltd. in that company's sales areas for an appropriate fee; in return, Zapf Creation (UK) Ltd. provides administrative services to MGA Entertainment UK Ltd. for an appropriate fee. In the 2009 financial year the strategic cooperation was expanded through an additional agreement (Agreement 7: “Inventions License Agreement”). The contract, which is effective as of January 1, 2009 and was initially subject to approval by the Company’s banks, contains the right of Zapf Creation AG for the payment of license fee to use and exploit defined intellectual property of MGA Entertainment, Inc., Van Nuys, California, USA.

The following income and expenses resulted from this partnership in the 2010 financial year:

Cooperation agreements	2010	2009
	K€	K€
Agreement 1: "Distribution Agreement"		
Income from Agreement 1	1,921	1,578
Agreement 2: "Consignment and Services Agreement"		
Income from Agreement 2	701	856
Agreement 3: "Logistics Service Agreement"		
Income from Agreement 3	397	814
Agreement 4: "Hong Kong / China Services Agreement"		
Expenses from Agreement 4	1,123	1,508
Agreement 5: "Merchandising License Agreement"		
Income from Agreement 5	62	62
Agreement 6: "UK Services Agreement"		
Income from Agreement 6	538	336
Expenses from Agreement 6	210	186
Agreement 7: „Inventions License Agreement”		
Expenses from Agreement 7	152	814

In connection with the distribution agreement there was interest income in the 2010 financial year in the amount of K€36 on the outstanding payment of existing receivables from the MGA Group.

In addition to the business transactions resulting from the cooperation agreements mentioned above (in the narrow sense), the following services were provided between the companies of the Zapf Creation Group and the related parties belonging to the MGA Group:

Cross charges	2010	2009
	K€	K€
Income from cross charges	806	1,354
Expenses from cross charges	1,676	1,670

Cross charges are charges between the companies of the Zapf Creation Group and the related companies belonging to the MGA Group that arise from the mutual provision of services - above and beyond the cooperation agreements mentioned above (in the narrow sense); this essentially concerns income and expenses from shared company resources (staff, offices, etc.).

Merchandise procurement	2010	2009
	K€	K€
Merchandise procurement in the reporting period	39,082	30,033

Merchandise procurement in the reporting period results from the purchase of goods at MGA Entertainment (HK) Ltd. made by the sales subsidiaries of the Zapf Creation Group. In connection with the merchandise procurement, interest expense was incurred by the Zapf Creation Group in the 2010 reporting period of K€63 (prior year: K€0), which was payable to the MGA group.

As in the prior year, there were no other direct service transactions with the related companies of the MGA group.

The receivables and liabilities of the Zapf Creation Group that result from the partnership with related parties of the MGA Group as of December 31, 2010 are as follows:

Balances as of the balance sheet date	31.12.2010	31.12.2009
	K€	K€
Receivables from related parties	4,772	5,320
Liabilities to related parties	10,824	5,946

4. Events after the balance sheet date

Under IFRS, the recognition and reporting of events after the balance sheet date is governed by IAS 10 ("Events after the Balance Sheet Date").

The following significant events occurred up to March 15, 2011, the date on which the consolidated financial statements as of December 31, 2010 were passed on by the Management Board to the Supervisory Board:

In January 2011 the financing agreements for the long-term Group financing signed in December 2010 were implemented by the disbursement of the corresponding loans. The transferred loan in the amount of € 20.1 million, the conditions of which were realigned to the needs of the Company, has an unchanged term until 2013. The financial restructuring of the Zapf Creation Group was thereby concluded. As a result, at that point in time, considering loan repayments made, the remaining utilized credit volume with the syndicated banks was reduced to only € 6.8 million (Term Loan); in the meantime this was fully repaid ahead of schedule on January 31, 2011. In connection with the transfer of the mentioned loan, in January 2011 the existing mortgages (mortgage of € 4,601,626.92 on properties that were entered in the land register at the local court of Coburg von Mönchröden, Folio 3657 for Zapf Creation Logistics GmbH & Co. KG for the benefit of Commerzbank Aktiengesellschaft as security agent and a mortgage of € 5,000,000 on properties that were entered in the land register at the local court of Coburg von Mönchröden, Folios 2900, 3094, 3527, 3656, and 3657 for Zapf Creation AG and Zapf Creation Logistics GmbH & Co. KG for the benefit of Commerzbank Aktiengesellschaft as security agent) were released; accordingly, these no longer form a part of the existing security documents. The Management Board assumes that the future payments of principle and interest are assured and therefore the financing of the Zapf Creation and the Zapf Creation Group is guaranteed in a sufficient amount.

On February 28, 2011 Zapf Creation announced that Mr. Jaime Ferri Llorens, member and Chairman of the Management Board of Zapf Creation will resign from his post for health reasons.

As of the close of February 28, 2011, the contract with José Antonio Santana, member of Management Board of Zapf Creation AG, ended. Since this time, Mr. Santana is no longer a member of the Management Board of the Company.

In March 2011, in an extension of and in connection with the existing financing agreement, the possibility to enter into factoring was agreed for the Group subsidiary Zapf Creation (U.K.) Ltd. In this connection, the factoring company was provided first place regarding the security in connection with the existing Group financing to the extent such security is provided by Zapf Creation (U.K.) Ltd.

On March 14, 2011, the Supervisory Board of Zapf Creation AG appointed Mr. Thomas Eichhorn as a member of the Management Board of the Company, effective April 1, 2011.

5. Disclosures pursuant to Section 315a German Commercial Code

5.1. Shareholdings

With regard to the investment structure in the Zapf Creation Group, please see the presentation of Group subsidiaries, which is attached to these notes as ***Appendix 1***.

5.2. Management Board

Composition

The Company's Management Board is comprised as follows:

Josef Lukas, member of the Management Board

- Logistics, restructuring, sales (leadership), planning, budget (partial responsibility), product research and development, subsidiaries (sales, marketing, operations), trademark law, marketing, quality management, public relations (products)

Hannelore Schalast, member of the Management Board

- Investor relations, EDP, finance, budget (leadership), legal, personnel, public relations (excluding products), risk management, compliance and corporate governance, subsidiaries (finance)

Changes

The following changes with regard to the composition of the Management Board of Zapf Creation AG occurred during the reporting period:

On January 29, 2010 the Supervisory Board of Zapf Creation AG appointed Mr. Ron Oboler as a member and Chairman of the Management Board, effective February 1, 2010. Ron Oboler, who as Director of International Sales of MGA Entertainment, Inc. has extensive experience in the toy industry, has temporarily led the Company since then. The Supervisory Board strived to fill the position of Management Board Chairman on a long-term basis. Stephan F. Brune, who held the position of member and Management Board Chairman of Zapf Creation AG since October 1, 2008, left the Company on January 31, 2010. In addition, on January 29, 2010, Ron Brawer, a member of the Supervisory Board, was delegated to the Management Board in accordance with Section 105 (2) of the Stock Corporation Act. Since then, Ron Brawer was responsible in particular for streamlining the Group structure and thereby realizing the related savings potential. His appointment to the Management Board ended on December 31, 2010. Ron Brawer resigned from his post on the Supervisory Board, effective December 31, 2010.

Effective June 30, 2010, the Management Board member Jens U. Keil has left the Company in order to pursue other career ambitions. Since March 1, 2007 Mr. Keil was on the Management Board and was responsible for finance, investor relations, EDP, logistics and risk management.

On August 6, 2010 Zapf Creation announced that the Supervisory Board member Hannelore Schalast, head of corporate finance & controlling, was appointed to the Management Board as Chief Financial Officer of the Company, effective February 1, 2011. Until then, Ms. Schalast acted as chief representative in the general area of finance. Also as of February 1, 2011, Josef Lukas, who previously acted in an advisory function in sales for Germany/Austria/Switzerland, took over as Management Board member for sales. , Ron Oboler, Chairman of the Management Board, and Ron Brawer, the Supervisory Board member delegated to the Management Board, relinquished their temporally assumed Management Board responsibilities. Mr. Oboler retired from the Management Board as of February 15, 2011; the appointment of Mr. Brawer to Management Board ended on December 31, 2010.

On November 2, 2010 Zapf Creation AG announced that the Supervisory Board of the Company appointed Mr. Jaime Ferri Llorens as a member of the Management Board, effective January 1, 2011, and as Chairman of the Management Board, effective February 16, 2011. Mr. Jaime Ferri Llorens replaced Mr. Ron Oboler, who led the Company on a temporary basis since February 2010.

On February 28, 2011 Zapf Creation announced that Mr. Jaime Ferri Llorens, member and Chairman of the Management Board of Zapf Creation will resign from his post for health reasons.

As of the close of February 28, 2011, the contract with José Antonio Santana, member of Management Board of Zapf Creation AG, ended. Since this time, Mr. Santana is no longer a member of the Management Board of the Company.

On March 14, 2011, the Supervisory Board of Zapf Creation AG appointed Mr. Thomas Eichhorn as a member of the Management Board of the Company, effective April 1, 2011.

In the prior year, the Supervisory Board of Zapf Creation AG appointed José Antonio Santana, effective March 1, 2009, as Management Board member responsible for marketing, design & product development and quality management. Mr. Santana took over this responsibility from the Management Board Chairman, Stephan F. Brune, who had temporarily looked after these areas. At that time, the Management Board of Zapf Creation AG included, unchanged, Stephan F. Brune as Chairman and Jens U. Keil as Chief Financial Officer. On September 16, 2009 the Supervisory Board of Zapf Creation AG had resolved the early reappointment of Jens U. Keil as Chief Financial Officer.

Article 1 (3) of the Rules of Procedure of the Management Board concerning the allocations of responsibilities in the Management Board was amended in March 2010, July 2010, January 2011 and most recently in March 2011.

Disclosures Regarding Compensation

Reference is made to the related party disclosures in Section C, no. 3.1. for information on the compensation of the Management Board. The expenditure for share-based payment to the members of the Management Board under the German Commercial Code in the 2010 financial year was K€31 (prior year; K€104); the expenditure for the total compensation paid to the members of the Management Board in the 2010 financial year pursuant to the German Commercial Code was K€1,243; taken into consideration the one-time payment in the amount of K€235 recognized in the income statement in connection with the termination of the Management Board membership of Mr. Brune (in prior year: K€1,255, considering the one-time payment in the amount of K€360 recognized in the income statement in the 2010 financial year in connection with the termination of the Management Board membership of Mr. Brune).

Disclosures Pursuant to Section 15a German Securities Trading Act

During the period from January 1, 2010 to March 15, 2011, the members of the Management Board reported the following securities dealings as defined by Section 15a of the German Securities Trading Act (WpHG):

Mr. Stephan F. Brune, at that time member and Chairman of the Management Board, notified Zapf Creation AG on January 12, 2010 pursuant to Section 15a of the German Securities Trading Act (WpHG) that on January 11, 2010 he sold a total of 80,000 shares of Zapf Creation AG – ISIN DE 0007806002 – at a price of € 1.15 per share (transaction volume; € 92,000). The sale of the shares, which were guaranteed in his employment contract and transferred to the Company, was purportedly made for personal reasons.

The Company was not notified of any other transactions requiring disclosure made by members of the Management Board, their spouses or immediate relatives. All members of the Management Board have been informed in detail regarding the disclosure requirement.

5.3. Supervisory Board

Composition

The Company's Supervisory Board is comprised as follows:

Dr. Harald Rieger, member and Chairman of the Supervisory Board

- Main occupation: Attorney, Bad Homburg, Germany
- Other offices: Chairman of the supervisory board of PIRONET NDH AG, Cologne, Germany

Isaac Larian, member of the Supervisory Board

- Main occupation: Chief Executive Officer, MGA Entertainment, Inc., Van Nuys, California, USA
- No further offices

Miguel Perez-Carballo Villar, member of the Supervisory Board

- Main occupation: Chief Executive Officer and Managing Director Norte Motor S.A. and Managing Director Uria Motor S.A., Oviedo, Spain
- No further offices

Manfred Schneider, member of the Supervisory Board

- Main occupation: banking professional (IHK), Managing Partner SCHNEIDER & CIE. Structured Financial Solutions, Frankfurt am Main, Germany
- No further offices

The Company was not notified of any other offices or changes in listed offices or main occupations of the members of the Management Board. All members of the Management Board have been informed in detail regarding the disclosure requirement.

Changes

The following changes with regard to the composition of the Supervisory Board of Zapf Creation AG occurred during the reporting period:

On January 11, 2010, Mr. Nicolas Mathys, member and Vice Chairman of the Supervisory Board, by reference to Article 11(4) of the Articles of Incorporation of the Company, announced that he was resigning from his position as a member and Vice Chairman in accordance with the four-week notification period.

On January 29, 2010, the Supervisory Board of Zapf Creation AG delegated Mr. Ron Brawer, member of the Supervisory Board to the Management Board in accordance with Section 105 (2) Stock Corporations Act. Since then, Ron Brawer was particularly responsible for streamlining the Group structure and thereby realizing the related savings potential. His appointment to the Management Board ended on December 31, 2010. Ron Brawer resigned from his post on the Supervisory Board, effective December 31, 2010.

Effective April 26, 2010, Mr. Jaime Ferri Llorens was appointed by the Supervisory Board as a consultant of the Company regarding all questions of management, especially in the area of product development and marketing, as well as the handling of the Spanish market. Therefore, Mr. Jaime Ferri Llorens, in agreement with the Supervisory Board, resigned his seat on the Supervisory Board in accordance with Article 11(4) of the Articles of Incorporation of the Zapf Creation AG.

With a resolution of September 13, 2010 the local court of Coburg appointed Mr. Manfred Schneider as a member of the Supervisory Board of Zapf Creation AG in accordance with Section 104 of the German Stock Corporation Act (AktG).

In the prior year, the following changes took place in Supervisory Board of Zapf Creation AG: With a resolution dated July 30, 2009, the local court of Coburg recalled Mr. Gustavo Perez, regular member and Vice Chairman until July 28, 2006, member since May 11, 2005, as member of the Supervisory Board of Zapf Creation AG. With a resolution of the Annual Shareholders' Meeting on December 15, 2009, Mr. Jaime Ferri Llorens, residing in Alicante, Spain, was appointed to the Supervisory Board of the Company, for a term beginning with the end of the Annual Shareholders' Meeting on December 15, 2009 and terminating at the end of the Annual Shareholders' Meeting that will vote on the formal approval of the actions of the Supervisory Board and Management Board for the 2009 financial year.

Disclosures Regarding Compensation

Please see the related party disclosures in Section C, no. 3.2. for information on the compensation of the Supervisory Board.

Disclosures Pursuant to Section 15a German Securities Trading Act

During the period from January 1, 2010, to March 15, 2011, the members of the Supervisory Board reported the following securities dealings as defined by Section 15a of the German Securities Trading Act (WpHG):

The Company was not notified of any transactions requiring disclosure made by members of the Supervisory Board, their spouses or immediate relatives. All members of the Supervisory Board have been informed in detail regarding the disclosure requirement.

5.4. Disclosure of the auditor's fee

As in the previous year, KPMG AG, Wirtschaftsprüfungsgesellschaft, Nuremberg, Germany, is the auditor of the annual financial statements of Zapf Creation AG.

The following auditor's fees were recognized as an expense in the reporting period:

	2010 K€	2009 K€
Audits of financial statements	208	259
Other auditing and valuation services	0	0
Tax consultancy services	6	7
Other services	0	4
Auditor's fee	214	270

The total fee shown for 2010 includes a remuneration amount of K€21 that relates to the auditor’s services for the year 2009.

5.5. Declaration of compliance regarding the German Corporate Governance Code

The Company points out that it has issued the Declaration of Compliance for 2010 regarding the recommendations of the Government Commission German Corporate Governance Code as required by Section 161 of the German Stock Corporation Act and made this declaration permanently available to the shareholders on the Company's Web site.

6. Disclosures Pursuant to Section 264b German Commercial Code

The Group subsidiary Zapf Creation Logistics GmbH & Co. KG, domiciled in Rödental, Germany, avails itself of the exemption provisions of Section 264b German Commercial Code. Under this provision, the company is exempt from preparing and publishing annual financial statements in accordance with the provisions of Sections 264 ff German Commercial Code governing stock corporations.

Nevertheless, the company subjects itself to a voluntary audit of its annual financial statements.

Rödental, March 15, 2011

Josef Lukas	Hannelore Schalast
Member of the Management Board	Member of the Management Board

Group subsidiaries as of December 31, 2010

Company	Registered location as of December 31, 2010	Date of foundation	Share of subscribed capital	Carrying amount of Zapf Creation AG at December 31, 2010 (after allowances)	Result for the 2010 period	Shareholder's Equity as of December 31, 2010
				€	Local currency	Local currency
Zapf Creation (H.K.) Ltd.	Kowloon, Hong Kong	April 30, 1991	100%	695,979.77 €	3,094,984.66 HKD	-701,627.11 HKD
Zapf Creation (U.S.) Inc.	Atlanta, USA	April 15, 1999	100%	93.40 €	82,035.36 USD	-6,662,669.56 USD
Zapf Creation (U.K.) Ltd.	Milton Keynes, GB	January 1, 2000	100%	0.00 €	467,428.51 GBP	355,039.04 GBP
Zapf Creation (Italia) S.R.L.	Milan, Italy	July 31, 2001	100%	0.00 €	93,597.72 €	166,477.07 €
Zapf Creation (Polska) Sp. z o.o.	Warsaw, Poland	August 9, 2001	100%	13,794.62 €	-655,311.69 PLN	-4,746,724.74 PLN
Zapf Creation (España) S.L.	Ibi (Alicante), Spain	January 1, 2002	100%	0.00 €	-1,086,296.85 €	1,737,793.90 €
Zapf Creation (Central Europe) Verwaltungs GmbH	Rödental, Germany	March 24, 2003	100%	25,000.00 €	-825.46 €	12,525.36 €
Zapf Creation Logistics GmbH & Co. KG	Rödental, Germany	March 24, 2003	100%	4,365,852.09 €	1,696,830.62 €	3,706,096.24 €
Zapf Creation Logistics Beteiligungs GmbH	Rödental, Germany	March 24, 2003	100%	25,000.00 €	284.50 €	16,895.06 €
Zapf Creation Auslandsholding GmbH	Rödental, Germany	September 15, 2006	100%	9,227,600.00 €	-2,987.93 €	9,205,836.94 €
				14,353,319.88 €		

The results for the 2010 financial year and the resulting shareholder's equity as of December 31, 2010 are according to IFRS.
Zapf Creation AG has held the Group subsidiaries Zapf Creation (U.K.) Ltd. and Zapf Creation (España) S.L. indirectly through Zapf Creation Auslandsholding GmbH, Rödental, Germany, since September 2006.

Zapf Creation AG
Rödental

Changes in property, plant and equipment and intangible assets from January 1 to December 31, 2010

	Acquisiton cost / production cost						Depreciation and amortization						Carrying amount	
	01.01.2010 K€	Additions K€	Disposals K€	Reclassifications K€	Exchange effects K€	31.12.2010 K€	01.01.2010 K€	Additions K€	Disposals K€	Reclassifications K€	Exchange effects K€	31.12.2010 K€	31.12.2010 K€	31.12.2009 K€
Property, plant and equipment														
Land and buildings	13,291	0	730	3	11	12,575	7,816	254	581	0	11	7,500	5,075	5,475
Machinery and technical equipment	7,769	123	2	527	291	8,708	6,686	1,061	2	0	292	8,037	671	1,083
Vehicles, office furniture and equipment	21,697	115	1,360	0	30	20,482	14,991	1,095	1,154	0	27	14,959	5,523	6,706
Construction in progress	51	582	0	-530	0	103	0	0	0	0	0	0	103	51
	42,808	**820**	**2,092**	**0**	**332**	**41,868**	**29,493**	**2,410**	**1,737**	**0**	**330**	**30,496**	**11,372**	**13,315**
Intangible assets														
Patents, trade name rights and licenses	10,264	0	0	0	0	10,264	5,827	813	0	0	0	6,640	3,624	4,437
Computer software	10,392	30	8	24	12	10,450	10,167	113	8	0	12	10,284	166	225
Development in progress	30	43	0	-24	0	49	0	0	0	0	0	0	49	30
	20,686	**73**	**8**	**0**	**12**	**20,763**	**15,994**	**926**	**8**	**0**	**12**	**16,924**	**3,839**	**4,692**

Zapf Creation AG
Rödental

Changes in property, plant and equipment and intangible assets from January 1 to December 31, 2009

	Acquisiton cost / production cost						Depreciation and amortization						Carrying amount	
	01.01.2009 K€	Additions K€	Disposals K€	Reclassifications K€	Exchange effects K€	31.12.2009 K€	01.01.2009 K€	Additions K€	Disposals K€	Reclassifications K€	Exchange effects K€	31.12.2009 K€	31.12.2009 K€	31.12.2008 K€
Property, plant and equipment														
Land and buildings	13,281	4	0	11	-5	13,291	7,562	259	0	0	-5	7,816	5,475	5,719
Machinery and technical equipment	6,939	172	0	771	-113	7,769	5,433	1,367	0	0	-114	6,686	1,083	1,506
Vehicles, office furniture and equipment	21,626	169	140	0	42	21,697	13,821	1,234	102	0	38	14,991	6,706	7,805
Construction in progress	242	682	91	-782	0	51	0	0	0	0	0	0	51	242
	42,088	**1,027**	**231**	**0**	**-76**	**42,808**	**26,816**	**2,860**	**102**	**0**	**-81**	**29,493**	**13,315**	**15,272**
Intangible assets														
Patents, trade name rights and licenses	10,236	28	0	0	0	10,264	4,982	845	0	0	0	5,827	4,437	5,254
Computer software	10,251	87	0	59	-5	10,392	10,056	116	0	0	-5	10,167	225	195
Development in progress	68	21	0	-59	0	30	0	0	0	0	0	0	30	68
	20,555	**136**	**0**	**0**	**-5**	**20,686**	**15,038**	**961**	**0**	**0**	**-5**	**15,994**	**4,692**	**5,517**

Zapf Creation AG
Rödental

Group Segment Reporting as of December 31, 2010

Geographical segments

	Central Europe		Northern Europe		Southern Europe		Eastern Europe		America		Asia/Australia		Other		Consolidation		Consolidated Group		Discontinued operations		Continuing operations	
	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€
External sales revenues	31,034	31,323	23,521	21,018	13,314	14,546	7,822	10,299	815	1	2,780	2,145	0	0	0	0	79,286	79,332	0	1	79,286	79,331
Intercompany sales revenues	431	1,701	1,640	1,326	183	2,632	183	3,133	0	0	0	0	0	0	-2,437	-8,792	0	0	0	0	0	0
Total sales revenues	31,465	33,024	25,161	22,344	13,497	17,178	8,005	13,432	815	1	2,780	2,145	0	0	-2,437	-8,792	79,286	79,332	0	1	79,286	79,331
Depreciation and amortization	3,261	3,568	18	27	42	54	14	33	0	0	1	139	0	0	0	0	3,336	3,821	0	0	3,336	3,821
Non-cash expenses	347	980	190	272	586	431	46	412	295	0	0	0	0	0	-295	0	1,169	2,095	-	-	-	-
Result before interest, income taxes, and intercompany clearing (EBIT before intercompany clearing)	-8,558	-10,400	4,351	3,393	705	1,324	2,456	902	709	46	711	184	0	0	0	0	374	-4,551	431	46	-57	-4,597
Result before interest and income taxes (EBIT)	-5,693	-7,306	2,387	1,316	522	979	2,454	767	709	46	-5	-353	0	0	0	0	374	-4,551	431	46	-57	-4,597
Segment assets	40,575	50,695	8,566	7,446	11,087	15,944	692	5,220	0	518	850	806	68,713	68,653	-63,340	-73,602	67,143	75,680	-	-	-	-
Investment in property, plant and equipment and intangible assets	874	1,151	6	3	0	5	13	4	0	0	0	0	0	0	0	0	893	1,163	-	-	-	-
Segment liabilities	23,557	16,564	4,924	4,649	4,359	9,738	1,991	6,622	4,981	5,204	1,093	497	58,005	71,326	-39,782	-51,373	59,128	63,227	-	-	-	-

Sales revenues by product lines

	Play and functional dolls										Other									
	BABY born ®		Baby Annabell ®		CHOU CHOU		Other		Mini-dolls		Chiqui		Magic Krysalix		Disney		Other		Continuing operations	
	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€	2010 K€	2009 K€
External sales revenues of coninuing operations	41,276	36,411	11,328	16,066	7,267	9,148	6,016	8,904	3,335	2,816	3,325	2	1,220	8	2,617	92	2,902	5,884	79,286	79,331

Auditors’ report

We have audited the consolidated financial statements comprising the consolidated balance sheet, consolidated income statement, consolidated statement of comprehensive income, consolidated statement of cash flows, consolidated statement of changes in equity and notes to the consolidated financial statements, of Zapf Creation AG, Rödental, and their report on the position of the Company and the Group for the financial year from January 1 to December 31, 2010. The preparation of the consolidated financial statements and group management report in accordance with IFRS, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a (1) HGB are the responsibility of the Company’s management. Our responsibility is to express an opinion on the consolidated financial statements and the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch: German Commercial Code] and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the financial statements of the companies included in consolidation, the determination of the companies to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the legal representatives, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRS, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group’s position and suitably presents the opportunities and risks of future development.

Nuremberg
March 16, 2011

KPMG AG
Wirtschaftsprüfungsgesellschaft

[Original German version signed by:]

Dankert	Dr. Kelle
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

Responsibility Statement

Responsibility Statement Regarding the Consolidated Financial Statements as of December 31, 2010, and the Group Management Report of Zapf Creation AG, Rödental

“To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the group, and the group management report includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal opportunities and risks associated with the expected development of the group“.

Rödental, March 15, 2011

Josef Lukas	Hannelore Schalast
Member of the Management Board	Member of the Management Board

Zapf Creation AG

Rödental

Financial Statements

of Zapf Creation AG

(HGB)

The full single-entity Financial Statements of Zapf Creation AG according to the German Commercial Code (HGB) are available on request.

Zapf Creation AG
Rödental

Income Statement
for the Financial Year from January 1, 2010 to December 31, 2010

		2010 €	2009 €
1.	Sales revenues	50,511,291.96	44,851,928.38
2.	Cost of sales	-29,875,274.49	-25,775,458.77
3.	**Gross profit**	**20,636,017.47**	**19,076,469.61**
4.	Selling expenses	-16,111,736.26	-17,034,825.16
5.	General and administrative expenses	-12,812,967.43	-13,473,525.20
6.	Other operating income - thereof from affiliated companies: € 6,009,873.58 (prior year: € 5,547,470.79)	12,047,793.18	10,296,396.38
7.	Other operating expenses	-2,116,499.69	-5,111,021.42
8.	Income from long-term loans receivable - thereof from affiliated companies: € 2,566,981.01 (prior year: € 2,787,897.53)	2,566,981.01	2,787,897.53
9.	Income from cooperative shares	18,015.40	16,081.00
10.	Other interest and similar income - thereof from affiliated companies: € 391,151.92 (prior year: € 754,857.65) - thereof from discounting of provisions € 40,827.00 (prior year: € 0.00)	502,964.64	800,237.07
11.	Write-down of financial assets	-333,000.00	-400,000.00
12.	Interest and similar expenses - thereof to affiliated companies: € 730,677.12 (prior year: € 308,044.97)	-4,536,795.01	-4,396,391.63
13.	**Result from ordinary activities**	**-139,226.69**	**-7,438,681.82**
14.	Extraordinary result - thereof income: € 176,844.61 (prior year: € 77,602.27) - thereof expense: € 1,888,389.26 (prior year: € 0.00) - thereof from affiliated companies: € -1,033,391.06 (prior year: € 77,602.27)	-1,711,544.65	77,602.27
15.	Taxes on income	35,123.69	-434,144.86
16.	Other taxes	-67,715.65	-44,665.33
17.	**Net loss for the year**	**-1,883,363.30**	**-7,839,889.74**
18.	Losses carried forward	-36,993,185.64	-29,093,199.62
19.	Appropriation/withdrawal from the reserve for treasury shares	0.00	-60,096.28
20.	**Accumulated deficit**	**-38,876,548.94**	**-36,993,185.64**

Zapf Creation AG
Rödental

Balance Sheet as of December 31, 2010

Assets	€	31.12.2010 €	€	31.12.2009 €
A. Noncurrent assets		**40,303,878.80**		**45,407,537.80**
I. Intangible assets				
1. Concessions, industrial property rights and similar rights and values, and licences on such rights and values	3,766,851.18		4,619,710.52	
2. Advance payments	48,888.58	**3,815,739.76**	29,956.25	**4,649,666.77**
II. Property, plant and equipment				
1. Land and buildings	945,312.75		1,208,857.62	
2. Technical equipment and machinery	4,051.50		4,672.50	
3. Other equipment, office furniture and equipment	1,171,122.25		1,895,253.32	
4. Advance payments and contruction in progress	102,289.81	**2,222,776.31**	50,724.86	**3,159,508.30**
III. Financial assets				
1. Investments in affiliated companies	14,353,319.88		13,053,319.88	
2. Loans to affiliated companies	19,911,522.85		24,544,522.85	
3. Investment in a coopertive society	520.00	**34,265,362.73**	520.00	**37,598,362.73**
B. Current assets		**37,684,115.76**		**35,172,141.05**
I. Inventories				
1. Raw materials and supplies	25,580.11		22,824.70	
2. Finished goods and merchandise	2,585,288.79	**2,610,868.90**	4,422,036.30	**4,444,861.00**
II. Receivables and other assets				
1. Trade receivables	10,954,503.77		10,696,459.90	
2. Due from affiliated companies	9,508,724.23		12,457,861.72	
3. Other assets	4,655,368.87	**25,118,596.87**	3,629,633.17	**26,783,954.79**
III. Marketable securities				
Treasury shares		**0.00**		**546,872.58**
IV. Cash on hand and cash at banks		**9,954,649.99**		**3,396,452.68**
C. Deferred expenses		**653,187.13**		**585,742.83**
D. Excess of plan assets over partial retirement obligation		**15,458.00**		**0.00**
Total assets		**78,656,639.69**		**81,165,421.68**

Liabilities and shareholders' equity	€	31.12.2010 €	€	31.12.2009 €
A. Shareholders' equity		**16,154,451.08**		**18,584,686.96**
I. Issued share capital				
Subscribed capital per Articles of Association	19,295,853.00			
Nominal amount of treasury shares	-492,678.00	**18,803,175.00**		**19,295,853.00**
II. Capital reserve		**35,735,147.02**		**35,735,147.02**
III. Revenue reserves				
Reserve for treasury shares		**0.00**		**546,872.58**
Other revenue reserves		**492,678.00**		**0.00**
IV. Accumulated deficit		**-38,876,548.94**		**-36,993,185.64**
B. Provisions		**14,217,088.27**		**16,225,588.03**
1. Tax provisions	431,471.23		747,845.87	
2. Other provisions	13,785,617.04	**14,217,088.27**	15,477,742.16	**16,225,588.03**
C. Liabilities		**48,285,100.34**		**46,355,146.69**
1. Liabilities to banks	27,144,237.70		33,629,929.52	
2. Advanced payments received on orders	1,683,666.97		0.00	
3. Trade payables	9,299,245.91		5,268,487.26	
4. Due to affiliated companies	9,528,427.30		6,849,181.06	
5. Other liabilities	629,522.46	**48,285,100.34**	607,548.85	**46,355,146.69**
- thereof for taxes: € 306,149.58 (prior year: € 298,186.48)				
- thereof for social security: € 12,397.85 (prior year: € 19,583.37)				
Total shareholders' equity and liabilities		**78,656,639.69**		**81,165,421.68**

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Hinweis:

Dieser Geschäftsbericht liegt auch in deutscher Sprache vor.

This Annual Report is also available in German