Annual Report 2009

Zapf Creation AG
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Group Key Performance Indicators (IFRS)	2009 € million	2008 € million	+ / - %
Adjusted earnings situation (excluding restructuring expenses and one-off effects)			
Continuing operations			
EBITDA	-0.6	5.1	-
EBIT	-4.5	1.1	-
EBIT-Margin (in %)	-5.6	1.1	-
EBT	-9.5	-4.9	-95
Results of continuing operations	-11.0	-6.5	-69
Discontinued operations			
Result from discontinued operations	0.0	0.0	-
Group			
Result for the period	-10.9	-6.4	-69
Result per share (in €) 1)	-0.58	-0.38	-55
Earinings situation according to the Income Statement (including restructuring expenses and one-off effects)			
Continuing activities			
Sales	79.3	104.4	-24
Gross profit margin (in %)	37.1	38.7	-
EBITDA	-0.8	5.3	-
EBIT	-4.6	1.3	-
EBIT-Margin (in %)	-5.8	1.2	-
EBT	-9.6	-4.7	-105
Results of continuing operations	-11.1	-6.3	-76
Included restructuring expenses and one-off effects	0.1	-0.2	-
Included depreciation of property, plant and equipment and amortization of intangible assets	3.8	4.0	-4
Discontinued operations			
Result from discontinued operations	0.0	0.0	-
Included restructuring expenses and one-off effects	0.0	0.0	-
Included depreciation of property, plant and equipment and amortization of intangible assets	0.0	0.0	-
Group			
Result for the period	-11.1	-6.3	-76
Result per share (in €) 1)	-0.59	-0.37	-61
Balance Sheet			
Balance sheet total	75.7	94.4	-20
Noncurrent assets	18.8	21.9	-14
Investment	1.2	5.5	-79
Current assets	56.9	72.6	-22
Shareholders' equity	12.5	22.6	-45
Equity ratio (in %)	16.5	23.9	-
Liabilities to banks	33.3	35.4	-6
Net debt	25.3	28.0	-10
Cash flow			
Operating cash flows	8.4	1.1	>+100%
Operating cash flow per share (in €)	0.45	0.07	>+100%
Net cash flows	0.5	-15.9	-
Employees			
Number as of the balance sheet date 2)	224	242	-7

The key performance indicators are based on rounded figures in € million. In computing totals and ratios, differences can therefore result in comparison to the financial statements.
1) basic = diluted; 2) without Management Board and trainees

Dear Shareholders,

Fiscal 2009 was to a large extent characterized by the effects of the financial and economic crisis. Following the apex of the crisis in the spring, the economy finally stabilized during the remainder of the year, but did not return to pre-crisis levels. Consequently, the entire market that is of relevance to us, play and functional dolls, has continued to face major challenges. The market exhibited a sometimes dramatic decline in demand that significantly impacted the operational development of the Zapf Creation Group. The poor performance of our critical year-end business turned out to be the most important negative factor in 2009, forcing the Zapf Creation Group to accept significant sales losses which ultimately resulted in a net loss for 2009 in the amount of €11.1 million.

Against this background, we consistently pushed forward with our initiatives launched in 2008 to improve cost structures and managed to halt our downward earnings trend in the second half of 2009. Fourth quarter results showed a year-on-year improvement in the gross margin. In addition, our strict management of receivables and inventories allowed us to generate comparatively high cash inflows from operating activities, enabling us to repay further loans.

These successes improved our position in the negotiations with our banking syndicate on an adjustment of our financing conditions. We had taken up these negotiations in the spring of 2009 since we had been unable to satisfy the financial covenants due to our weak 2008 Christmas business. In the fall of 2009, we reached an understanding on the provisional continuance of our financing. The ensuing standstill agreement was extended to June 30, 2010 during the course of the constructive negotiations.

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. Investors have been found who had agreed to take over a bank loan in the amount of € 20.1 million (Second Lien Loan). The financing contracts were signed in December 2010 and implemented with corresponding payments in January 2011.

Our confidence for the future is based on several factors:

- We have continued to optimize our distribution network and discontinued the operational business of our French and Polish subsidiaries during the first half of 2010. We have since been serving both of these markets with highly effective distributors and, as a consequence, have further increased the efficiency of our distribution processes.

- We are gradually expanding our product range to include toys for girls rather than focusing exclusively on the manufacture of dolls. This decision is of strategic relevance to us as it allows us to considerably broaden our existing, excellent market position in the play and functional dolls sector.

- Since the second half of 2009, we have been taking advantage of the prospects offered by the royalty business. In September, we acquired the global marketing rights to produce girls’ toy concepts based on the bestselling children’s books featuring Lilly the Witch. We are introducing our new Disney Princess series of large dolls on the European market under a licensing agreement concluded in December with the Disney Group. In mid-2010, we also expanded our activities in the co-branding products sector by acquiring the license for a new series of collectible figurines based on the popular Hello Kitty brand.

- In the future, we intend to profit more effectively from international growth opportunities. While in Germany the Zapf Creation Group’s market share in the play and functional dolls sector has exceeded 50 percent for many years, the Group’s market penetration in the rest of western and central Europe is considerably lower. The same is true for the growth markets in eastern Europe and Asia. Our objective is to capitalize on the opportunities in these regions and generate additional sales volumes through accelerated and focused global expansion.

Due to the favorable economic conditions, we were largely able to sustain Group sales of the prior year in fiscal 2010. The measures implemented to reduce costs and boost efficiency had a positive effect on the development of operating expenses. Accordingly, EBIT and net income are likely to improve significantly.

We would like to thank you, our shareholders, for the trust you have placed in us during the difficult period that is now behind us. Our gratitude also extends to our employees. Without their dedication and commitment the Zapf Creation Group would not have been able to hold its ground. We assure you that we will continue to focus on the strategic development of the Group, building on the newly established financing structure. We would be pleased if you, as our shareholders, continue to accompany us on this path.

Rödental, Germany, January 27, 2011

Ron Oboler	Jaime Ferri Llorens	José Antonio Santana
Chairman of the Management Board	Member of the Management Board	Member of the Management Board

Zapf Creation AG

Rödental

Corporate Governance Report for 2009

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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 2009 financial year are listed below.

We also refer to the report of the Supervisory Board for the 2009 financial year.

2. Shareholders and Annual Shareholders' Meeting

As a result of the resolution of the Company's 10th Annual Shareholders' Meeting on December 15, 2009 regarding the authorization for the issuance of stock options and the creation of new conditional capital (Conditional Capital 2009), Article 5 of the Articles of Incorporation was amended and revised as follows (Articles of Incorporation of Zapf Creation AG as amended as of December 15, 2009; entry in the trade register on December 23, 2009):

Article 5 of the Articles of Incorporation ("Amount and Classification of Share Capital")

„1. The share capital is € 19,295,853.00 (nineteen million two hundred ninety-five thousand eight hundred and fifty-three euro).

It is divided into 19,295,853 no-par shares.

2. The Management Board is authorized, subject to the approval of the Supervisory Board, to increase the Company's share capital until May 26, 2013, once or repeatedly, by up to

€ 9,000,000.00 in return for cash or in-kind contributions by issuing new no-par bearer shares (Authorized Capital 2008). The Management Board is also authorized, subject to the approval of the Supervisory Board, to exclude the shareholders' statutory subscription right in the following cases:

- In connection with fractional shares;

- If the capital increase is executed in return for cash contributions and if the pro rata amount of the share capital allocable to the new shares in regards to which shareholders' subscription right has been excluded does not exceed the lesser of € 1,800,000.00 million or 10% of the Company's share capital existent at the time the new shares are issued and if the issue price for the new shares is not substantially lower — in the sense of Section 203 (1) and (2) and Section 186 (3) Sent. 4 German Stock Corporation Act — than the exchange price of previously listed shares of the same class at the time the Management Board finally fixes the issue price; the authorized volume is reduced by the pro rata interest in the share capital allocable to those shares that are issued or sold starting on May 27, 2008, subject to the exclusion of shareholders' subscription right, in connection with the direct or analogous application of Section 186 (3) Sent. 4 German Stock Corporation Act;

- In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in connection with the acquisition of companies, business units, or stakes in companies;

- In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in connection with the acquisition of companies, business units, or stakes in companies.

The Management Board is authorized, subject to the approval of the Supervisory Board, to determine additional details pertaining to the execution of the capital increases under Authorized Capital 2008. The Supervisory Board is authorized to amend the Articles of Incorporation subsequent to the full or partial execution of such capital increase under Authorized Capital 2008 or following the expiration of the authorization deadline in accordance with the scope of the capital increase under Authorized Capital. After the execution of a capital increase from Authorized Capital 2008, the Authorized Capital 2008 amounts to € 7,704,147.00.

3. 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, to the extent that owners of stock options that 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.

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

As a result of the resolution of the Company's 10th Annual Shareholders' Meeting on December 15, 2009 regarding the amendment to the Articles of Incorporation to conform to the Law implementing the Investors' Rights Directive, Article 21 (4) and Articles 22 and 23 of the Articles of Incorporation were amended and revised; they are now worded as following (Articles of Incorporation of Zapf Creation AG as amended as of December 15, 2009; entry in the trade register on December 23, 2009):

<u>Article 21 (4) of the Articles of Incorporation ("Invitation")</u>

„4. In the event that all shareholders are not known by name to the Company, the invitation to the Annual Shareholders Meeting is carried out by announcement in the electronic Federal Gazette with the legally required disclosures at least thirty days prior to the day up until when the shareholders are required to register before the meeting. In this connection, the day of announcement and the day up until when the shareholders are required to register are not included.

<u>Article 22 of the Articles of Incorporation („Right of Participation in the Annual Shareholders Meeting")</u>

„1. Only those shareholders are authorized to participate in and exercise voting rights at the Annual Shareholders Meeting who have registered prior to the Annual Shareholders Meeting and who have verified their authorization to participate in the Annual Shareholders Meeting and to exercise voting rights. The registration must be received at least six days before the day of the Annual Shareholders Meeting at the address announced in the invitation. In this connection, the day of announcement and the day up until when the shareholders are required to register are not included. The verification of authorization to participate in the Annual Shareholders Meeting and to exercise voting rights must be made in a special written evidence of the shareholding that was issued by the depositary institution. The verification must relate to beginning of the 21st day prior to the Annual Shareholders Meeting and must be received at least six days before the day of the Annual Shareholders Meeting at the address announced in the invitation. In this connection, the day of announcement and the day up until when the shareholders are required to register are not included. In terms of the relationship to the Company, the participation in the Annual Shareholders Meeting and the exercise of voting rights is only authorized for individuals who have provided the verification.

2. The Management Board is authorized to provide that video and audio transmission of the Annual Shareholders Meeting is permitted.

3. Members of Supervisory Board whose residence and/or regular place of work is not located in Germany, or due to a stay abroad cannot be in attendance, can participate in the Annual Shareholders Meeting via video and audio transmission. Exempted from this are members of the Advisory Board, who according to Article 24 of the Articles of Incorporation chair the Annual Shareholders Meeting.

Article 23 of the Articles of Incorporation („Voting Right")

„1. Each no-par share is granted one vote.

2. The voting right can be exercised by authorized representatives. As to the form of granting proxy, its cancellation and the verification of proxy authorization to the Company, the legal provisions apply.

As a result of the resolution of the Company's 10th Annual Shareholders' Meeting on December 15, 2009 regarding the amendment of the Articles of Incorporation to conform to the German Accounting Law Modernization Act, Article 28 of the Articles of Incorporation was amended and revised; it is now worded as following (Articles of Incorporation of Zapf Creation AG as amended as of December 15, 2009; entry in the trade register on December 23, 2009):

Article 28 of the Articles of Incorporation ("Declaration of Compliance with the Corporate Governance Code")

„The Management Board and Advisory Board provide a declaration on an annual basis that recommendations of the "Government Commission's [German] Code of Corporate Governance", as published by the Ministry of Justice in the official section of the electronic Federal Gazette, have been and are being observed and which recommendations have not been and are not being observed. The declaration is available to the public at all times on internet site of the Company."

Voting Right Notifications

The voting right notifications received in the 2009 reporting period and/or investor statements received in this period pertain solely to the members of the Management Board and Supervisory Board of the Company or individuals who were members of these at December 31, 2009. 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 January 1, 2011 the Company's Management Board comprises Ron Oboler, Chairman, Jaime Ferri Llorens, regular member and José Antonio Santana, regular member.

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 January 18, 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:

Mr. Oboler is responsible for the areas sales, sales international, budget (partial), human resources, legal, subsidiaries, finance, investor relations, IT, public relations (excluding products), supply chain operations, logistics, risk management, compliance & corporate governance and, in addition, assumes group wide tasks in his capacity as chairman of the Management Board.

Mr. Ferri Llorens is responsible for product research & development and budget (partial).

Mr. Santana is responsible for marketing, quality management, Zapf Creation Hong Kong, public relations (products), intellectual property, budget (partial) and sales (partial).

Changes

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

Effective March 1, 2009, the Supervisory Board of Zapf Creation AG appointed José Antonio Santana 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 resolved the early reappointment of Jens U. Keil as Chief Financial Officer of the Company. Since then, Mr. Keil had the responsibility, unchanged, for finance, investor relations, IT, logistics and risk management.

On January 29, 2010, the Supervisory Board of Zapf Creation AG appointed Ron Oboler as a member and Chairman of the Management Board, effective February 1, 2010. Since then, Ron Oboler has been leading the Company on an interim basis. As Executive Vice President International at MGA Entertainment, Inc., he has extensive experience in the toy industry. The Advisory Board was endeavoring to make a long-term appointment as Chairman of the Management Board during the course of the year. 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 Advisory 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 has resigned as member of 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 professional ambitions. Since March 1, 2007 Mr. Keil was on the Management Board and was responsible for finance, investor relations, IT, logistics and risk management, among other things.

On August 6, 2010 Zapf Creation announced that the Supervisory Board appointed Hannelore Schalast, head of corporate finance & controlling, to the Management Board as Chief Financial Officer of the Company, effective February 1, 2011. Until then, Ms. Schalast will act as chief representative in the general area of finance. Also as of February 1, 2011, Josef Lukas, who is currently acting in an advisory function in sales for Germany/Austria/Switzerland, will take 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, will relinquish their temporally assumed Management Board responsibilities. Mr. Oboler will resign from the Management Board as of February 15, 2011; Mr. Brawer did resign as of December 31, 2010.

On November 2, 2010, Zapf Creation AG announced that the Company's Supervisory Board has 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 will be replacing Mr. Ron Oboler, who has been leading the Company on a temporary basis since February 2010.

Article 1 (3) of the Rules of Procedure of Management Board for the allocation of duties in the Management Board was changed in March 2009, March 2010, in July 2010 and most recently in January 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.

Voting Right Notifications

No further information is available to the Company regarding the percentage of shares issued that are attributable to members of the Management Board as of December 31, 2009. All members of the Management Board have been informed in detail regarding the disclosure requirement.

5. Supervisory Board

Composition

The Company's Supervisory Board is comprised as follows: Dr. Harald Rieger, 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:

With a resolution dated July 30, 2009, the local court of Coburg appointed 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.

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

The Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 4, 2009, in accordance with Section 15a German Securities Trading Act that on September 26, 2008, it had purchased a total of 20,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.42 per share for a total transaction volume of € 48,460.00.

The Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 4, 2009, in accordance with Section 15a German Securities Trading Act that on October 9, 2008, it had purchased a total of 6,126 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.03 per share for a total transaction volume of € 12,441.91.

The Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 17, 2009 through its legal representatives, in accordance with Section 15a German Securities Trading Act that on November 16, 2009, it had purchased a total of 3,955,789 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 1.00 per share for a total transaction volume of € 3,955,789.00.

Mr. Nicolas Mathys, member and Vice-Chairman of the Supervisory Board, notified Zapf Creation AG on November 17, 2009, in accordance with Section 15a German Securities Trading Act that on November 17, 2009, he had purchased a total of 3,955,789 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 1.00 per share for a total transaction volume of € 3,955,789.00.

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

Voting Right Notifications

The information available to the Company regarding the percentage of shares issued that are attributable to members of the Supervisory Board or to companies related to them as of December 31, 2009, is based on the following voting right notifications concerning members of the Supervisory Board or companies related to them, which the Company received in the year under review.

On November 20, 2009, Zapf Creation AG was notified 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:

“Mr. Nicolas Mathys notified us on November 20, 2009, pursuant to Section 21 (1) German Securities Trading Act that his interest in Zapf Creation AG as of November 20, 2009 was below the threshold of 20%, 15%, 10%, 5% and 3% and amounted to 0% (0 voting rights) as of this date”.

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.

e) 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) Alloccated 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%, 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 as a member of the Advisory Board of Zapf Creation AG.

No further information is available to the Company regarding the percentage of shares issued that are attributable to members of the Supervisory Board as of December 31, 2009. All members of the Supervisory Board have been informed in detail regarding the disclosure requirement.

Statement of the investors

On November 26, 2009, Zapf Creation AG was notified 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.

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 Financial Statements

Accounting

The consolidated financial statements of Zapf Creation AG are prepared by applying Article 314 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 Article 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 payment

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 2009 financial year. In this connection, additional phantom stock options at defined base prices were allocated under this plan in 2009; 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"). The Company's shares are granted as either fixed or variable share-based compensation contingent on the achievement of specific performance targets.

- 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; reference is additionally made Section A No. 2. Through December 31, 2009 the potential to issue stock options has not been utilized by the Company.

<u>Audit of Financial Statements</u>

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, 2009.

B. Corporate Governance Statement according to Article 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 2009 Annual Report as well as the Corporate Governance Report also included in the Annual Report, both for the 2009 financial year. The 2009 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:

Corporate planning and control

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.

Risk Management

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 2009 and 2010 Declarations of Compliance required under Section 161 German Stock Corporation Act regarding the recommendations of the Government Commission on the German Corporate Governance Code were jointly issued by the Management Board and the Supervisory Board and are permanently available to the Company's shareholders on its website.

The declarations follow below verbatim.

2.2. Declaration of Compliance 2009

(Beginning of the Declaration of Compliance)

Declaration of the Management Board and the Supervisory Board of Zapf Creation AG regarding the German Corporate Governance Code as amended on June 18, 2009, pursuant to Section 161 German Stock Corporation Act

Both the Management Board and the Supervisory Board of Zapf Creation AG declare pursuant to Section 161 German Stock Corporation Act that the Company, after having issued last year's declaration of conformity on December 16, 2008, has been and is 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, para 2)

The existing D&O insurance purchased by Zapf Creation AG does 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 will be 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 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 were 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 yet included, such a cap shall 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)

  There is currently no long-term succession planning in place for the members of the Management Board. Given the size of the Company, internal succession planning for the Management Board is 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 Annual Shareholders' Meeting." (Item 5.3.3)

  Given the size of the Company and its Supervisory Board, the formation of a nomination committee is 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 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.

- "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 having announced 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 the 2008 financial year 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, Germany, December 11, 2009

Stephan F. Brune	Jens U. Keil	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)

2.3. Declaration of Compliance 2010

(Beginning 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, January 25, 2011

Ron Oboler	Jaime Ferri Llorens	José Antonio Santana
Chairman of the Management Board	Member of the Management Board	Member of the Management Board

(End of the Corporate Governance Statement pursuant 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 single-entity and consolidated financial statements of Zapf Creation AG.

2. Management Board

The compensation paid to the members of the Company's Management Board in the 2009 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 2009:

	Short-term compensation		Share-based compensation
	Fixed compensation	Bonus	
	K€	K€	K€
Stephan F. Brune	Yes	Yes	Yes
Jens U. Keil	Yes	Yes	Yes
José Antonio Santana	Yes	Yes	Yes

The total compensation of K€ 965 (previous year: K€ 765) 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 2009 financial year (IFRS):

	Short-term compensation		Share-based compensa-	Fixed compensa-
	Fixed compensa-	Bonus		
	K€	K€	K€	K€
Stephan F. Brune	353	20	124	497
Jens U. Keil	224	0	33	257
José Antonio Santana	194	0	17	211
Total	771	20	174	965
		%	%	%
Percentage in 2009		81.97	18.03	100.00

	Short-term compensation		Share-based compensa-	Fixed compensa-
	Fixed compensa-	Bonus		
	K€	K€	K€	K€
Total compensation in 2008	463	120	173	756

The expenditure for share-based payment to the members of the Management Board under the German Commercial Code in the 2009 financial year was K€ 104 (prior year K€ 36); the expenditure for the total compensation paid to the members of the Management Board in the 2009 financial year pursuant to the German Commercial Code was K€ 1,225 (prior year K€ 619), as a consequence of and taking into consideration a one-time payment in the amount of K€ 360 recognized in the income statement in connection with the termination of the Management Board membership of Mr. Brunes.

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 the Company's Management Board remained in place in the 2009 financial year. In this connection, 25,000 phantom stock options were issued in 2009 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 were 27,000 phantom stock options at a basis price of € 0.81, the exercise of which in each case is not conditional on achieving specific performance goals. In the comparable period in the prior year Mr. Stephan Brune was granted 25,000 phantom options at a base price of € 2.15; Mr. Jens U. Keil was granted 10,000 phantom options at a base price of € 3.59 and 15,000 phantom options at a base price of € 3.50; Mr. Thomas Pfau was granted 34,000 phantom options in the 2009 financial year at a base price of € 2.99. 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. A total of K€ 67 (prior year: K€ 15) was expensed for options granted in the 2009 financial year in connection with provisions for liabilities under this compensation system based on phantom shares; due to the development of the share price, the provision was reduced in the 2009 financial year by an amount K€ 2 (prior year: K€ 62) through the income statement. The provision for liabilities under the aforementioned phantom options as of December 31, 2009, was K€ 83 (previous year: K€ 18); of this amount, K€ 24 (previous year: K€ 7) is attributable to Mr. Stephan F. Brune, K€ 36 (previous year: K€ 3) to Mr. Jens U. Keil, K€ 17 (previous year: K€ 0) to Mr. Santana and K€ 6 (previous year: K€ 8) to Mr. Thomas Pfau, former member of the Management Board.

By arrangement in individual contracts with the Management Board member Jens U. Keil, a tranche of 15,000 phantom stock options with a base price of € 9.16 with an exercise period to April 1, 2010 were waived. The phantom stock options granted to the former Management Board member Dr. Georg Kellinghusen expired completely on February 15, 2009. A tranche granted to the former Management Board member Thomas Pfau of 33,000 phantom stock options with a base price of € 7.29 expired on September 1, 2009 and a further tranche issued to Mr. Pfau of 30,000 phantom stock options with a base price of € 8.60 expired on January 2, 2010.

The option rights originally issued to Mr. Stephan F. Brune would have expired on October 1, 2011, respectively October 2012 to the extent no exercise were made up to the respective date; all rights expired in connection with a compensatory arrangement entered into with Mr. Brune on March 4, 2010. The phantom stock options issued 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 options granted to Mr. José Antonio Santana will expire if they are not exercised by March 1, 2012. The rights granted to Mr. Thomas Pfau expired on September 1, 2010 and will be void on September 1, 2011, respectively, if not exercised by that date. The exercise periods regarding individual tranches were expanded during the 2009 financial year based on individual agreements.

During the 2008 financial year, Mr. Stephan F. Brune was also granted additional share-based compensation above and beyond the aforementioned compensation system entailing phantom stock options. Mr. Brune is granted 40,000 shares of Zapf Creation AG stock annually as part of his fixed share-based compensation. In addition, the variable compensation paid to Mr. Brune is structured as a share-based payment. In this regard, Mr. Brune is paid variable compensation comprising no more than 32,000 shares per annum contingent on the achievement of specific performance targets. A fixed number of 8,000 shares was granted for the 2008 financial year; the respective amount of K€ 20 was paid in cash in the 2009 financial year. In the 2009 reporting period Mr. José Antonio Santana was granted a similar form of stock-based compensation; this, however, is arranged solely as a variable compensation component, the amount of which is dependent on the achievement of certain performance targets. Likewise, the possibility exists for the Company for the bonus payment to Mr. Jens U. Keil to pay this partly in shares. From both components (fixed and variable) a stock-based compensation from stock issuance resulted in 2009 in the amount of K€ 106 (prior year: K€ 158).

One-time compensation amounts to former members of Company bodies were made in the 2009 financial year to Mr. Stephan F. Brune in the amount of K€ 360 and recognized through the income statement. In the 2008 financial year and amount of K€ 15 was paid as a one-time compensation to Mr. Thomas Pfau. In addition, in the 2008 financial year a one-time compensation in the amount of K€ 18 was granted to Mr. Stephan F Brune for services rendered in the run-up to his Management Board membership.

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. Interest was paid in the agreed-upon amount. As a result of the mentioned waiver of receivables, the principle and interest payments received in 2008, the interest payments in the first thee quarters of 2009 and in consideration of the interest receivable for the fourth quarter of 2009, the total receivable of the Company amounts at the December 31, 2009 balance sheet date to K€ 354 (prior year: K€ 350). The loan granted remains secured by a land charge in the amount of K€ 200 (previous year: K€ 200); the remaining liability has been written down in full, analogous to the previous year, in the amount of K€ 350; the interest receivable the fourth quarter of 2009 in the amount of K€ 4 was paid in January 2010.

On March 4, 2010, the Company reached a compensatory arrangement with the former member of the Management Board of Zapf Creation AG, Stephan F. Brune, under which all claims and liabilities of both parties resulting from the employment relationship are settled and therefore resolved.

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 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 2009 financial year was K€ 125 excluding and K€ 166 including withholding taxes payable (previous year: K€ 149 excluding and K€ 201 including withholding taxes payable). The amount in the prior year also includes the compensation paid to the Supervisory Board member, Mr. Isaac Larian, for his service in 2007.

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) German Stock Corporation Act. Compensation made 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. The subordinate shareholder loans included in the Company's financing concept, including pro rated interest owed, were already fully converted into equity in the 2008 financial year.

Report of the Supervisory Board for Fiscal Year 2009

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 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 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 2009 consisted in particular of monitoring the process of securing the Company's long-term financing. In this regard, the Supervisory Board advised the Management Board of where it believed additional substantial cost savings were required as well as of the necessity of increasing revenue, and ensured that the budget presented for 2009 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 appropriateness of the remuneration paid to the Management Board members. Moreover and along with additional reorganization and restructuring measures, the Supervisory Board dealt with the agreements concluded with the MGA Group companies.

In addition, the Supervisory Board dealt with issues related to corporate governance and compliance as well as the budgeting, the composition of the Supervisory Board, a review of its efficiency, the audit of the annual financial statements, preparations for the Annual Shareholders' Meeting, and the liability proceeding against former members of the Management Board.

The Supervisory Board of Zapf Creation AG held a total of six plenary sessions in fiscal year 2009, either by physical meetings or via telephone conferences. These meetings took place on January 19, March 26/April 2, April 29, September 16, October 27, and December 15, 2009. Furthermore, the Supervisory Board adopted two resolutions during the reporting year by means of circular proceedings. The resolutions concerned the appointments of Mr. José Antonio Santana on February 16, 2009 and Mr. Ron Brawer on October 23, 2009.

CHANGES IN PERSONNEL

Changes on the Management Board

At its meeting on January 29, 2010, the Supervisory Board appointed Mr. Ron Oboler as member and chairman of the Management Board on an interim basis effective February 1, 2010. At present, Mr. Oboler is 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. Mr. Oboler's appointment ends by February 15, 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. As scheduled, Jaime Ferri Llorens replaces Mr. Ron Oboler, who will resume his previous position at MGA Entertainment Inc. as of February 16, 2011. Since then, Mr. Jaime Ferri Llorens is responsible for Product Research & Development and Budgeting (shared).

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

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.

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 responsibilities of Mr. José Antonio Santana, who has been a member of the Management Board since March 1, 2009 and who is currently in charge of Marketing, Quality Management, Zapf Creation Hongkong, Public Relations (products), Trademark Rights, Budgeting (shared) and Sales (shared), have not changed.

Changes on the Supervisory Board

Upon application by the Supervisory Board, Supervisory Board member Gustavo Perez was recalled from the Supervisory Board of the Company upon resolution of the Local Court of Coburg dated July 30, 2009. Instead and for the rest of the term of office, for which Mr. Gustavo Perez originally had been appointed, Mr. Jaime Ferri Llorens was appointed member of the Supervisory Board by the Annual Shareholders' Meeting on December 15, 2009. Mr. 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 (AktG). He resigned from the Supervisory Board with effect as of December 31, 2010.

Upon resolution of September 13, 2010, the Local Court of Coburg appointed Mr. Manfred Schneider as member of the Supervisory Board of Zapf Creation AG pursuant to Section 104 of the German Stock Corporation Act (AktG). 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 (AktG). 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 Pérez-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 Pérez-Carballo Villar will expire at the end of the Annual Shareholders' Meeting in April 2011.

COMPOSITION OF THE COMMITTEES AND COMMITTEE ACTIVITIES

Composition of the committees

In the year under review, the Audit Committee consisted of Mr. Nicolas Mathys as chairman, Mr. Ron Brawer, and Dr. Harald Rieger. Dr. Rieger rejoined the Audit Committee after Gustavo Perez left the committee. At its meeting of September 22, 2010, the Supervisory Board resolved to dissolve the Audit Committee. The duties of the Audit Committee will be performed by the Supervisory Board as a whole in the future.

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 Pérez-Carballo Villar. At its meeting of September 22, 2010, the Supervisory Board resolved to dissolve the Personnel Committee. The duties of the Personnel Committee will be performed by the Supervisory Board as a whole in the future.

Committee activities

Aside from commissioning the auditor of the financial statements, the members of the Audit Committee mainly dealt with issues related to the Company's accounting during the year under review. The Audit Committee's audit activities primarily focused on preparing the Supervisory Board's plenary financials meeting on October 27, 2009, at which it adopted the 2008 financial statements, as well as conducting a detailed review of possibilities for additional cost savings and the Company's relationships with the MGA Group pursuant to the dependent company report. In the reporting year, the Audit Committee met once prior to the plenary financials meeting on October 27, 2009. Given the significance of the audits for securing the Group's financing and in order to make maximum use of time, the Audit Committee also worked continuously together with the other members of the Supervisory Board at the Supervisory Board's plenary sessions to deal with the responsibilities entrusted to it.

The Personnel Committee met once during the year under review at a meeting held on December 15, 2009. Various matters pertaining to the Management Board were discussed at the meeting, particularly the review of the appropriateness of Management Board remuneration and preparations for the long-term restructuring of the Management Board. Given the importance to the Company of key personnel decisions, the Personnel Committee also discussed additional personnel issues with the other Supervisory Board members at several plenary sessions of the Supervisory Board. The full Supervisory Board was informed by the committee chairmen of the committees' work in a timely and comprehensive manner.

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 2009 budget at its meeting on March 26 and April 2, 2009. 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). Investors had been found who were willing to take over part of the bank loans in the amount of € 20.1 million (Second Lien Loan).

The financing contracts were signed in December 2010 and implemented with corresponding payments in January 2011. The loan taken over, which was revised to meet the requirements of the Company, has an unchanged term until 2013. The financial restructuring of the Zapf Creation Group has thus been completed. In consideration of payments made, the remaining utilized credit volume with the syndicated banks has now been reduced to € 6.8 million (Term Loan); this amount was fully repaid prior to maturity on January 31, 2011. Based on the information provided by the Management Board, the Supervisory Board assumes that payments of principal and interest are assured and that the financing of Zapf Creation AG and the Zapf Creation Group is therefore guaranteed in an adequate amount.

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 initially dealt in detail with the composition of the Company's Management Board and the distribution of responsibilities among individual Management Board members. In addition to appointing Mr. José Antonio Santana as Management Board member in charge of Marketing, Product Development, Design, and Quality Management on February 16, 2009 (effective March 1, 2009), Mr. Jens U. Keil was reappointed as a member of the Company's Management Board in his capacity of CFO on September 16, 2009 (effective from March 1, 2010 to April 30, 2011). Moreover, 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 is 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. 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 conducted a detailed review of the remuneration paid to active Management Board members and new Management Board members in view of the stipulations of the Act on the Appropriateness of Management Board Remuneration (VorstAG) and implemented the legal requirements. Moreover, on March 4, 2010 the Supervisory Board concluded a settlement agreement with Mr. Stephan F. Brune in connection with his departure from the Company as of January 31, 2010.

Agreements with MGA

Agreements with MGA Group companies constituted another important element of the Supervisory Board's monitoring activities in fiscal year 2009.

At its meeting on January 19, 2009, the Supervisory Board discussed the possibility of concluding an inventions license agreement with MGA Entertainment, Inc. The agreement, which was concluded effective January 1, 2009 and which was initially subject to approval from the Company's financing banks, entitles Zapf Creation AG to use and realize defined intellectual property of MGA Entertainment, Inc. in return for payment of a license fee.

In addition, the Supervisory Board discussed changes to the Hong Kong/China Services Agreement with MGA Entertainment, Inc. at its meeting on September 16, 2009. The changes were rejected in a vote in which Supervisory Board members Isaac Larian and Ron Brawer abstained.

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 in April 2011. The proposal is being made with consideration to the Company's specific business situation and particularly in light of Mr. Schneider's expertise and his independent and international standing.

The term of office of Supervisory Board member Miguel Pérez-Carballo Villar will expire at the end of the Annual Shareholders' Meeting in April 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 Pérez-Carballo Villar and Mr. Ron Brawer. The Supervisory Board intends to maintain this composition and accordingly plans to propose to the Annual Shareholders' Meeting in April 2011 together with the Management Board to reduce the number of Supervisory Board members from six to three.

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 and took part in the discussions on agreements with MGA Entertainment, Inc. However, Supervisory Board members Isaac Larian and Ron Brawer abstained from voting on the changes to the Hong Kong/China Services Agreement.

Efficiency review

The Supervisory Board conducted the efficiency review required under the German Corporate Governance Code on a regular basis. The last review was carried out at its meeting on December 15, 2009. The Supervisory Board came to a generally positive conclusion regarding the results of its efficiency. Nonetheless, the Supervisory Board decided to increase the number of physical meetings.

Declaration of conformity

The Supervisory Board has undertaken a detailed review of the German Corporate Governance Code. Based on its review on December 11, 2009 and October 15, 2010 the Management Board and the Supervisory Board issued joint declarations of conformity pursuant to Section 161 of the German Stock Corporation Act (AktG) 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 2009 Annual Report.

ACCOUNTING AND FINANCIAL STATEMENTS

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

KPMG AG Wirtschaftsprüfungsgesellschaft, Nuremberg, audited the financial statements for the fiscal year from January 1 to December 31, 2009, 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, 2009. 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 Company's relationships with MGA with respect to the existence of agreements and invoices as well as their reconciliation as of the balance sheet date, any sales-related provisions recognized, and liquidity planning. 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 securing the financing for the

Zapf Creation Group, the continuing restructuring of the Group, and its relations with affiliated companies, including the MGA Group. Finally, the documentation for the financial statements was discussed in detail by the Supervisory Board at its financials meeting on September 22, 2010, in the presence and following the reports of the auditor. The discussion focused especially on the revenue and cost trends in fiscal 2009. 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 February 10, 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 2009 at its meeting held on September 22, 2010. The review focused in particular on the cost trend in fiscal 2009. Based on the final results of this examination, the Supervisory Board saw no need to raise any objections. The Supervisory Board approved the 2009 financial statements by way of a resolution dated February 10, 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 2009. 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 February 10, 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 36,993,185.64 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 (AktG) for fiscal year 2009 (dependent company report).

In its Report on Relationships with Affiliated Companies pursuant to Section 312 of the AktG for fiscal year 2009, 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 2009.

Bad Homburg, February 14, 2011

Dr. Harald Rieger
Chairman of the Supervisory Board

Zapf Creation AG, 2009 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, marketing for Central Europe is situated with Zapf Creation AG.

The subsidiaries are primarily responsible for the marketing and sales of the product portfolio. For this purpose the Zapf Creation Group in the 2009 financial year maintained subsidiaries in Great Britain, 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 2009 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

In the first half of 2009 the world economy underwent the worst recession in post-war history. Following the insolvency of the Lehman Brothers investment bank in September 2008, the interbank market came temporarily to a standstill, and the credit supply to business became stalled. In almost all industrial and emerging countries the demand for goods declined significantly. Share prices on all world stock exchanges showed significant losses in value. The outlook of companies was determined by uncertainty and pessimism.

Only a concerted intervention of governments and central banks in the early summer of 2009 induced a change in the trend. Through comprehensive economic stimulus programs there was success in stabilizing the overall economic demand in all important economic regions in the second half of 2009. Support measures for the banking sector, lower key interest rates and an expansionary monetary policy revived the financial markets. Confidence and cautious optimism returned surprisingly quickly to the markets. Especially in the emerging countries the economic situation quickly recovered by the end of the year.

According to the International Monetary Fund (IMF), the global gross domestic product declined by 0.6% in 2009 (2008): +3.0%). While the emerging Asian countries proved to be growth motors for the global economy, the GDP in the euro area declined significantly by 4.1% (2008: +0.6%). In Germany, growth was sluggish especially due to the strongly declined export demand. According to calculations of the German Federal Bureau of Statistics, GDP in 2009 was 4.9% lower than the level in the prior year (2008: +1.3%).

Sources:
Federal Association of German Banks, Economic Report January 2010
European Central Bank, Monthly Report January 2010
Press release of the German Federal Bureau of Statistics from May21, 2010
International Monetary Fund, World Economic Outlook, April 2010

Development in the sector

In 2009 the most important toy markets in Germany, France, Great Britain and Spain showed different results in the development of sales. The market segment for play dolls and functional dolls in which the Zapf Creation Group is primarily engaged was mainly characterized by weakened demand and declining sales.

Despite the difficult market environment, the Zapf Creation Group in 2009 was able to maintain its position as leading supplier of play dolls and functional dolls in Europe.

Top 4 toy markets in Europe, based on sales prices, currency adjusted

	2009 in million €	**2008 in million €**
Germany	1,683.1	1,599.1
France	2,133.2	2,031.9
Great Britain	1,741.3	1,899.4
Spain	830.9	818.6
Total	**6,388.5**	**6,349.0**

Source: NPD/Eurotoys 2009

II. Significant events in the financial year

Changes in the Management Board

On February 17, 2009 Zapf Creation AG announced that the Supervisory Board member José Antonio Santana had been appointed, effective March 1, 2009, as Management Board member 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.

On September 16, 2009, the Supervisory Board of Zapf Creation AG resolved the early reappointment of Jens U. Keil as Chief Financial Officer of the Company.

For further changes in the Management Board in the 2010 financial year, reference is made to the report on subsequent events (Section IV).

Securing group financing

Following the weak development in the business in the fourth quarter of 2008 due to the economic situation, the Zapf Creation Group was not able to fulfill the financial covenants originally agreed to with the consortium banks. Therefore, in the course of 2009 it was necessary to negotiate the structure of the long-term Group financing agreed to in 2007 and the revision of the covenants.

On October 12, 2009, Zapf Creation AG announced that the Company had come to an agreement with the banks regarding the continuation of the syndicated loan. It was agreed to reexamine the structure of the long-term Group financing in the spring of 2010 with the syndicate banks and to decide regarding a revision of the covenants. Until then, the banks agreed not to enforce the significant covenants.

Regarding developments in the 2010 financial year in connection with the Group financing, reference is made to report on subsequent events (Section IV).

Entry into the licensing business

In the reporting period, the Zapf Creation Group actively engaged itself for the first time in the market for licensed products. On September 23, 2009 the Company announced the acquisition of the worldwide marketing rights for girls' toy concepts for the children's bestseller book "Lilli the Witch".

On December 11, 2009 the Group announced that, in connection with a licensing agreement with the Disney group, it will bring the new large doll series "Disney Princesses" to the European market. The products are now available in stores.

The Management Board intends to systematically expand the licensing business.

Changes in the shareholder structure

On November 17, 2009, Nicolas Mathys informed the Company of the complete sale of his shares and therefore, his withdrawal as a shareholder. In a countermove, Isaac Larian, with the trusts assigned to him, acquired the equity share from Mr. Mathys and thereby increased his shareholding in Zapf Creation AG to 65.29%.

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

The consolidated financial statements of Zapf Creation AG, as well as the comparative financial statements for the prior year, were prepared applying § 315 German Commercial Code (HGB) 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 separate financial statements of Zapf Creation AG were prepared according to German accounting principles and the provisions of German Commercial Code (HGB).

Subsequent income and expense effects from the discontinuance of the Zapf Creation Group operations in the American markets as of December 31, 2006 are shown in the reporting period separately in results of discontinued operations. This presentation is based the provisions of IFRS 5. The consolidated balance sheet was not required to be changed.

Revenue trends

Revenue trends of the Zapf Creation Group

The revenues of the Zapf Creation Group in the 2009 financial year, with € 79.3 million, remained 24.0% lower than the comparable figure in the prior year (€ 104.4 million). The primary reason lies in the weak demand for dolls in the key European markets, especially in the important last quarter of 2009.

Development of revenue of the Zapf Creation Group (in million €)

	2009	**2008**
Revenue	79.3	104.4

Revenue trends by major regions

In Europe the Zapf Creation Group generated sales revenues in 2009 of € 77.2 million. The significant weakness in demand in key markets is reflected in the decline of 23.8% compared to the comparable amount in 2008 (€ 101.3 million).

In Central Europe with the country markets Germany, Austria, Switzerland, Netherlands and Luxemburg, sales revenues of € 31.3 million were 9.3% below the prior year's level (2008: € 34.5 million). The region's share of the total Group sales amounted to 39.5% (2008: 33.1%).

The sales segment Northern Europe, which includes Great Britain, Ireland and Scandinavia, showed a decline in sales revenues of 26.7% to € 21.0 million (2008: € 28.7 million). The sales segment contributed 26.5% to the total sales revenues (2008: 27.5%).

In the Southern Europe region including Spain, Italy, France, and Belgium, sales revenues of € 14.6 million in 2009 were slightly over the prior year's amount (2008: € 13.9 million) due to increased sales in Italy resulting from the expansion of the distributer business. With this, 18.3% of the Group sales revenues were in Southern Europe (2008: 13.3%).

In Eastern Europe sales revenues declined to € 10.3 million after revenues of € 24.2 million in 2008. This was due primarily to restrained orders of distributors in the course of portfolio pruning. The region's share of total Group sales revenues decreased to 13.0% (2008: 23.2%).

Revenue trends by major product lines

With the Baby born® brand toy concept the Zapf Creation Group generated sales revenues in 2009 of € 36.4 million. In the prior year, revenues were still at a level of € 60.4 million. Contributing to the significant decline of 39.7%, in addition to the overall weak economic development, was a shift in the product portfolio of the Zapf Creation Group.

In the reporting period, the doll series Baby Annabell® showed sales revenues of € 16.1 million after € 18.9 million in 2008.

With the dolls in the CHOU CHOU family, Zapf Creation realized revenues of € 9.1 million (2008: € 13.6 million).

The play and functional dolls and the mini dolls newly introduced in 2009 are receiving an overall positive response in the market.

Revenue trends of Zapf Creation AG

Zapf Creation AG was showing sales revenues of € 44.9 million for the 2009 financial year. Included therein were primarily revenues from operations in Central Europe, which have been presented in the AG since the beginning of 2007. The increase of 14.4% compared to the comparable figure in the prior year (€ 39.2 million) resulted especially from positive sales development at the AG level in Northern Europe (+ € 2.2 million to € 3.1 million) and in Eastern Europe (+ € 2.9 million to € 6.4 million), as well as from increased direct deliveries out of Hong Kong that in the prior year had been attributed largely to a subsidiary.

Profit situation

Profit situation of the Zapf Creation Group

In 2009 gross profit of the Zapf Creation Group reached € 29.4 million, after € 40.4 million in the prior year. The gross profit margin of 37.1% was slightly under the prior year’s figure of 38.7%. While the margin in the first six months of 2009 still declined, targeted measures in the further course of the year to reduce procurement costs led to a stabilization of the margin. In the fourth quarter of 2009 gross profit reached 35.1% (Q4 2008: 34.1%).

The operating costs in 2009 were able to be reduced through strict cost management by 13.2% compared to the prior year. The expenses of sales and distribution declined to € 11.5 million, after € 13.3 million in the prior year (-13.3%). With € 9.9 million, the Group spent 25.2% less for marketing than in 2008 (€ 13.2 million), among other reasons due to lower prices for media services. The administrative expenses decreased by 3.6% to € 14.9 million (2008: € 15.4 million).

Other income in 2009 amounted to € 3.5 million, after € 4.0 million in the prior year (-12.7%), due to declined logistics and distribution business with third parties. On the other hand, other expenses of € 1.2 million – especially for exchange rate losses and risk provisioning – remained almost unchanged from the prior year.

Strict cost management was nevertheless only able to partially offset the decline in sales. The Group operating result before interest and taxes (EBIT) amounted to € -4.6 million (2008: € 1.3 million). Taking into restructuring-related one-time expenses of € 0.1 million, an adjusted Group-EBIT is calculated to be € -4.5 million (2008: € 1.1 million).

Financing expenses declined in 2009 to € 5.1 million. The prior year's figure of € 6.6 million was affected by high interest expenses for subordinated shareholder loans, which was incurred until complete conversion into equity in June 2008. On a net basis the financial result was € 5.0 million, compared to € 6.0 million in the prior year.

The result from continuing operations before taxes amounted to € -9.6 million compared to € -4.7 in the prior year.

Income tax expense amounted to € 1.5 million compared to € 1.6 million in the prior year.

In 2009 the Zapf Creation Group realized a result from continuing operations after taxes of € -11.1 million. This compares to € -6.3 million in the prior year.

In accordance with the provisions of IFRS 5, the US business of the Zapf Creation Group, which was discontinued as of December 31, 2006, is shown in discontinued operations. In 2009, as in the prior period, there was an almost break-even result.

The result for the year in 2009 amounted to € -11.1 million, after a loss of € 6.3 million in 2008.

Based on the result for year, the amount of earnings per share amount is calculated to be € -0.59 (2008: € -0.37). To be taken into consideration is that the average number of shares in 2009 was 18.7 million shares. In the prior year the comparable number was 17.1 million shares. The increase results from effects from capital measures carried out in 2008.

Development of results (EBIT)* of the Zapf Creation Group (in € million)

	2009	**2008**
EBIT	-4.6	1.3

** including restructuring costs and one-time effects*

Profit situation by major regions

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 2009 financial year amounted to € -4.8 million. In the prior year this amount was € 2.1 million. In Central Europe the result amounted to € -10.4 million, compared to € -7.9 million in 2008. This result was due to decreased sales. In Northern Europe, EBIT of € 3.4 million was slightly higher than the comparable figure in 2008 (€ 3.3 million). In Southern Europe, the result in the reporting period of € 1.3 million also exceeded the prior year's level (2008: € 1.1 million). On the other hand, in Eastern Europe the Zapf Creation Group showed a result of € 0.9 million, which was significantly lower than in the prior year (2008: € 5.6 million) due to strongly decreased sales.

Profit situation of Zapf Creation AG

In 2009, gross profit of Zapf Creation AG was € 19.1 million, € 1.5 million higher than 2008 (€ 17.6 million).

Cost management continued to reduce the key cost positions. Sales expenses decreased by € 2.9 million to € 17.0 million (2008: € 19.9 million). Administrative expenses declined to € 13.5 million (2008: € 14.4 million; € -0.9 million).

Other operating income declined significantly to € 10.3 million due to lower income from cooperations. (2008: € 19.7 million; € -9.4 million).

In 2009, Zapf Creation AG recognized write-downs of financial assets and securities included in current assets in the amount of € 0.4 million. The prior year amount of € 1.6 million was significantly affected by the write-down of treasury shares in Zapf Creation AG.

Interest expense decreased in 2009 by € 1.6 million to € 4.4 million. Included in 2008 (€ 6.0 million) were higher interest costs paid to subordinated shareholder loans.

In 2009, Zapf Creation AG showed a result of ordinary operations of € -7.4 million, compared to € -6.4 in the prior year. The extraordinary result amounted to € 0.1 million. The amount in the prior year (€ -0.4 million) was affected by restructuring expenses. Tax expense decreased to € 0.5 million (2008: € 1.2 million).

For the 2009 financial year Zapf Creation AG is showing a net loss of € 7.8 million (2008: € -7.9 million).

Financial and assets position

Financial and assets position of the Zapf Creation Group

As of the December 31, 2009 balance sheet date, the Zapf Creation Group is showing a balance sheet total of € 75.7 million. The decrease of € 18.8 million compared to the prior year (€ 94.4 million) reflects the lower sales. In addition, effects from continued progress in the working capital management have reduced the balance sheet total.

Current assets decreased by € 15.7 million to € 56.9 million (December 31, 2008: € 72.6 million). Significant factors influencing this were the trade receivables, which reduced to € 35.7 million through the strict working capital management (December 31, 2008: € 47.0 million; € -11.3 million), and inventories, which reduced by € 6.7 million to € 5.7 million (December 31, 2008: € 12.4 million). 2009 year end liquid funds were € 8.0 million (December 31, 2008: € 7.4 million). The increase in other assets by € 1.7 million to € 6.9 million (December 31, 2008: € 5.2 million) resulted primarily from increased receivables from MGA Group companies.

Total noncurrent assets decreased by € 3.1 million to € 18.8 million compared to € 21.9 million 2008. The primary reason was a decrease in property, plant and equipment, which as a result of scheduled depreciation and considering investments made in 2009, declined by € 2.0 million to € 13.3 million (December 31, 2008: € 15.3 million).

Current liabilities as of December 31, 2009 of the Zapf Creation Group decreased by € 8.6 million to € 63.2 million (2008: € 71.8 million). Current bank liabilities decreased in total by € 2.1 million to € 33.3 million (2008: € 35.4 million); trade payables declined significantly by € 7.1 million and amounted at the 2009 year end to € 21.8 million (2008: € 28.9 million).

Noncurrent consolidated liabilities as of December 31, 2009 were close to zero, due to the reclassification according to IFRS of noncurrent bank liabilities to current bank liabilities.

The net indebtedness of the Zapf Creation Group decreased at the 2009 year-end to € 25.3 million, compared to amount of € 28.0 million at December 31, 2008.

As of December 31, 2009, the Group is showing shareholders' equity of € 12.5 million. The net loss for 2009 is responsible for decrease of € 10.1 million compared to the amount at the same balance sheet date in 2008 (€ 22.6 million). The equity ratio of 16.5% at the end of the year was below the comparable figure in the prior year (December 31, 2008: 23.9%).

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

	2009	**2008**
Noncurrent assets	18.8	21.9
Current assets	56.9	72.6
Assets	**75.7**	**94.4**
Shareholders' equity	12.5	22.6
Noncurrent liabilities	0	0
Current liabilities	63.2	71.8
Shareholders' equity and liabilities	**75.7**	**94.4**

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, 2009 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 2009 financial year.

Financial and assets position of Zapf Creation AG

As of the December 31, 2009 balance sheet date the balance sheet total of Zapf Creation AG amounted to € 81.2 million. This represented a decrease of € 9.5 million compare to the amount on same balance sheet date in the prior year (€ 90.7 million).

Noncurrent assets of € 45.4 million at the end of 2009 are at approximately the level of the prior year (December 31, 2008: € 46.5 million).

In contrast, current assets decreased between the balance sheet dates by € 8.2 million to € 35.2 million (December 31, 2008: € 43.4 million). Contributing to this was the reduction in inventories to € 4.4 million (2008: € 6.5 million; € -2.1 million) as well as the decline in receivables. Trade receivables decreased at December 31, 2009 by € 4.4 million to € 10.7 million (2008: € 15.1 million). Furthermore, receivables from affiliated companies decreased by € 3.7 million to € 12.5 million (2008: € 16.2 million) due to lower volume of business between the Group companies and the higher liquidity infusions into the subsidiaries of Zapf Creation AG in the prior year.

On the shareholders' equity and liabilities side of the balance sheet, shareholders' equity of Zapf Creation AG amounted to € 18.6 million at December 31, 2009. The decline of € 7.8 million compared to the prior year (2008: € 26.4 million) was affected by the loss for the 2009 financial year. The equity ratio of Zapf Creation AG amounted to 22.9% (December 31, 2008: 29.1%).

Due to effects of the balance sheet date, provisions of € 16.2 million at the end of 2009 were slightly higher than in the prior year (2008: € 14.6 million). Important reasons for the increase are effects of the first-time recognition of provisions for license fess to MGA Entertainment, Inc., Van Nuys, California, USA, in the amount of € 0.8 million and for the recording of provisions for a retired Management Board member in the amount of € 0.4 million.

As of December 31, 2009, liabilities of Zapf Creation AG declined in total by € 3.3 million to € 46.4 million (December 31, 2008: € 49.7 million). This reflects offsetting effects: While the bank liabilities declined to € 33.6 million (December 3, 2008: € 35.3 million; € -1.7 million) and the trade payables decreased by € 3.3 million to € 5.3 million (December 31, 2008: € 8.6 million), liabilities to affiliated companies rose between balance sheet dates by € 1.3 million to € 6.8 million (December 31, 2008: € 5.5 million).

Investments

Investments of the Zapf Creation Group

In the 2009 financial year the Zapf Creation Group made investments in the total amount of € 1.2 million (2008: € 5.5 million). Investments in intangible assets amounted to € 0.1million, compared to € 3.2 million in 2008. An amount of € 1.0 million was invested in plant and equipment such as forms, machines and technical equipment in the reporting period (2008: € 2.3 million).

Investments of Zapf Creation AG

Investments of Zapf Creation AG in 2009 amounted in total to € 2.6 million (2008: € 7.4 million). Thereof, € 1.0 million (2008: € 2.1 million) was for property, plant and equipment. An amount of € 0.1 million was invested in intangible assets (2008: € 3.2 million). Investments in financial assets amounted to € 1.5 million, compared to € 2.1 million in the prior year.

Cash flow

Cash flow of the Zapf Creation Group

In the 2009 financial year the Zapf Creation Group generated cash flows from operations of € 8.4 million. The increase compared to the prior year (€ 1.1 million) reflected a successful receivables management, from which cash flows of € 11.8 million (2008: + € 2.0 million) resulted. In addition, the reduction of inventories in the financial period affected the operating cash flow in the amount of € 6.7 million (2008: € 1.2 million).

Cash inflows of € 1.1 million resulted from investment activities in 2009. The amount in the prior period (€ -5.4 million) was affected by the acquisition of rights and licenses for the Baby Annabell® und CHOU CHOU product lines.

Cash outflows from financing activities of € 7.1 million in the reporting period were lower than in the 2008 financial year (€ -10.2 million). Significant cash outflows occurred in connection with the repayment of bank loans (€ -4.0 million) as well from interest payments (€ -3.2 million).

As a result of the total cash flows, cash and cash equivalents of € 8.0 million increased slightly from the prior year (2008: € 7.4 million).

Employees

Employees of the Zapf Creation Group

As of the December 31, 2009 balance sheet date the Zapf Creation Group had 224 employees worldwide (not including Management Board members and trainees). At the same date in the prior year there were 242 employees.

The average number of employees during the year was as follows:

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

	2009	**2008**
Salaried	204	211
Non-salaried	26	29
Total employees	**230**	**240**

At the end of 2009 a total of 142 individuals were employed for the Zapf Creation Group in Germany, thereof 118 employees at the Rödental location, 24 employees at the Darmstadt location. At the end of 2008, the Group had 153 employees in Germany. Thereof, 126 individuals were employed in Rödental and 27 in Darmstadt.

The development of personnel in the 2009 financial year was in line with the planning. It is anticipated that additional selected positions will be eliminated in the 2010 financial year.

Disclosures regarding the compensation system for the Management Board and management members are provided in the notes to the consolidated financial statements in the Sections A.2.3.13., B.2.5.6., C.3.1. and C.5.2.

Development of personnel of Zapf Creation AG

As of December 31, 2009 Zapf Creation AG had 109 employees (not including Management Board members and trainees). As of the same balance sheet date in the prior year there were 116 employees.

Average number of employees of Zapf Creation AG during the year

	2009	**2008**
Salaried	113	119
Non-salaried	0	0
Total employees	**113**	**119**

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.

In 2009, Zapf Creation AG developed a number of novelties in the toy doll sector and introduced them to the market. In addition to new themes and accessories for the classic brands these included new dolls and additional novelties. Also in 2009 the Group accelerated the creation of girls' dolls in new categories. The products developed in the reporting period were introduced to the trade at the Nuremberg toy trade show in February 2010 and received a very positive response from customers.

Quality management

A high level of product quality is part of the core of Zapf Creation brands. 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 2009.

No complaints regarding product deficiencies arose in 2009. Zapf Creation and MGA Entertainment, Inc. have implemented measures aimed at processes, personnel recourses and reporting in order to continually ensure the quality of Zapf Creation products. In the 2009 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 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, namely the Code of Conduct of the International Council of Toy Industries (ICTI), in effect since 2002. Suppliers that are committed to this Code are subjected to an audit process, which is completed by the issuance of an ICTI certificate by the International Council of Toy Industries. 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 2009 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

Changes in the Management Board

On January 29, 2010, the Zapf Creation Group announced that the Supervisory Board member Ron Oboler, effective February 1, 2010, was appointed Chairman of the Management Board of the Company.

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

Ron Brawer, member of the Supervisory Board, was appointed to the Management Board of Zapf Creation AG on a temporary basis.

On July 8, 2010, Zapf Creation announced that Jens U. Keil, since March 1, 2007 on the Management Board and responsible for the areas of finance, investor relations, EDP, logistics and risk management, retired from the Company, effective June 30, 2010. His responsibilities were taken over on a temporary basis by the Chairman of the Management Board, 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 will act as chief representative in the general area of finance. Also as of February 1, 2011, Josef Lukas, who is currently acting in an advisory function in sales for Germany/Austria/Switzerland, will take over as Management Board member for sales.

Ron Oboler, Chairman of the Management Board, will relinquish his temporally assumed Management Board responsibilities on February 15, 2011. The appointment of Ron Brawer to the Management Board ended on December 31, 2010.

On November 2, 2010, Zapf Creation AG announced that the Company's Supervisory Board had appointed 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. Jaime Ferri Llorens will be replacing Ron Oboler, who has been leading the Company on a temporary basis since February 2010.

Realignment of the Group financing

In the spring of 2009 the Company negotiated with the consortium regarding the revision of the financial covenants and in the fall of 2009 an agreement was reached which agreed provisional continuation of the financing, with no significant new covenants, until a new review in the spring of 2010.

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

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. Investors have been found who will take over a bank loan in the amount of € 20.1 million (Second Lien Loan).

The financing contracts were signed in December 2010 and implemented with corresponding payments in January 2011. The loan taken over, which was revised to meet the requirements of the Company, has an unchanged term until 2013. The financial restructuring of the Zapf Creation Group has thus been completed. In consideration of payments made, the remaining utilized credit volume with the syndicated banks has now been reduced to € 6.8 million (Term Loan); this amount will be completely repaid prior to maturity by January 31, 2011. The Management Board assumes that payments of principal and interest are assured and that the financing of Zapf Creation AG and the Zapf Creation Group is therefore guaranteed in an adequate amount.

Business performance in the first nine months of 2010

For a detailed discussion of the Company's performance in the first nine months of 2010, please refer to the Group interim report for the period ended September 30, 2010.

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 § 91 (2) German Stock Corporation Act.

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 § 289 (5) of the German Commercial Code (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 consolidated 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 "second set of eyes" 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

After the slump in the economy in the first half of 2009 following the international financial market crisis, the world economy recovered in the remaining course of the year surprisingly quickly. Under the effects of comprehensive stimulation packages and governmental support measures for the banking sector, the markets once again showed increasing optimism and trust. In the course of 2010, the global economy recovered robustly, with the emerging markets developing significantly more dynamically than the key industrial states. In the eurozone, where the Zapf Creation Group's core markets lie, Germany proved to be the growth driver.

In spite of the forecasted growth of the world economy in 2010 by 4.8%, the International Monetary Fund does not exclude the possibility of market fluctuations and economic setbacks. Certain markets could experience consumer restraint again as a consequence, perhaps including the toy industry. This could have a negative effect on the demand for the Zapf Creation Group's products.

Industry-specific risks

Business climate in the toy market, consumer behavior and demographic developments are important indicators for sales success. The challenge for the Company's management is, taking into consideration the demographic development, to anticipate trends in the toy market as well as changes in consumer behaviour as soon and as exactly as possible in order to be able to react with product novelties.

Legal risks

The international business of Zapf Creation requires the Group to take a multitude of international standards and regulations into consideration and abide by them. With the help of external attorneys at law Zapf Creation's Management Board monitors the legal situation of the Company frequently. 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 Group 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 § 92 German Stock Corporation Act 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 consortium agreement; it is referred to Section IV. “Subsequent Events”.

Currency and interest rate risks

Currency and interest rate are market risks affecting income, costs and the value of holdings of financial instruments. The objective of management is to manage and control these risks with acceptable parameters, while optimising the return. 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, 2009 with a nominal volume of € 26.0 million (prior year: € 29.0 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 completed and final results in both cases have not been determined.

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

Strategic risks

Brand image and sales 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 in place. Currently no significant legal disputes are pending.

Sales risks

The Management Board sees the existing sales risk in the major brands BABY born®, Baby Annabell® and CHOU CHOU in decline.

Zapf Creation has contractually mutually agreed with the MGA Group that neither company develops competitive products of each other. This can potentially lead to the situation where the Company cannot respond to new market trends.

Development and quality risks

The quality management system of the Group deals with 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 thoroughly carried out the controls over the products in 2009. 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. The Management Board of the Zapf Creation Group has no significant new information regarding the litigation between MGA and Mattel. The Management Board discussed possible measures with the Supervisory Board to eliminate serious consequences to Zapf Creation of the litigation.

Overall risk

There are no risks known or recognizable to management that individually or in combination 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. 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 holds a dominant position in major toy markets in the play and functional doll segment, and will continue to profit from its expertise in multiple product categories.

The expansion of the product portfolio will lead to growth in terms of product categories and volume as well. In this area, high brand recognition and the Group’s extensive experience in product development and design are key factors in its ability to create attractive products for girls.

Zapf Creation is also actively working on achieving a better balance in the non-Christmas portfolio.

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

The recovery of the world economy slowed down in the course of the year 2010. The rebound lost the momentum it had picked up with the high growth rates in the first quarter. Among the industrial states, the economies in the USA and Japan already slowed down significantly in the spring. In contrast, the dynamic growth in the emerging Asian countries has not slackened. In the eurozone, the upswing waned noticeably after fairly high production growth in the second quarter.

The German economy performed exceptionally well compared to other euro countries. For the year 2010 as a whole, the leading German economic research institutes forecasted a rise of the gross domestic product by 3.5% in their fall reports. This growth is largely carried by investments in equipment and exports. A noticeable rise in private consumption is anticipated for the first time in several years.

The dynamic growth of the global economy is expected to lose steam in 2011.

Sources:
International Monetary Fund, World Economic Outlook, October 2010
Herbstgutachten der führenden deutschen Wirtschaftsforschungsinstitute, [Fall appraisal of leading German economic research institutions], October 2010

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.

A sustainable recovery of the propensity to consume could have positive effects on the demand for toys.

Strategic focus

In an effort to maximize the performance of the Zapf Creation Group, the Management Board plans to focus on accelerating the time to market of new releases. Management is stepping up investment in the development and worldwide marketing of high-quality toys and will also continue to expand the Zapf Creation product range beyond the play and functional doll segment.

The Group already introduced several innovative toy brand concepts in 2010. These products are clearly positioned in the low price segment and facilitate the entry into new country markets. The Group is also planning attractive new products for its world famous play doll brands. In this context, it launched the Disney doll line with retailers in fall 2010.

In addition to promoting sales with an attractive product pipeline and further geographic expansion, ensuring a competitive cost basis is another important priority for the Management Board. With this objective in mind, the structural optimization of all Group divisions will continue. The related measures are intended to increase efficiency while reducing operating costs.

Despite the challenge presented by rising costs in China, Zapf Creation is also working on stabilizing its gross margin sustainably. Sales top line values could decrease as the Group drives more business direct to distributor markets; however, this decrease will be offset by improved EBIT. The range of related measures spans 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. Accordingly, the Group will make further efforts to improve its working capital management.

Forecast

Forecast Zapf Creation Group

Due to the favorable economic conditions, Zapf Creation was largely able to sustain Group sales of the prior year in fiscal 2010. The measures implemented to reduce costs and boost efficiency had a positive effect on the development of operating expenses. Accordingly, EBIT and net income are likely to improve significantly.

The Management Board anticipates the noticeable improvement in earnings to continue in fiscal 2011.

Forecast Zapf Creation AG

Zapf Creation AG significantly raised sales in the fiscal year 2010 in response to higher sales achieved by distributors in certain sales areas. In addition, the French and Polish markets were also supplied by distributors following the discontinuation of operations of the Zapf Creation Group’s own sales subsidiaries in those countries. Due to the cost cutting measures implemented in 2010, a significant increase in EBIT and net income for the year is expected for Zapf Creation AG.

The forecast for Zapf Creation AG for the fiscal year 2011 as a whole is identical to the forecast for the Zapf Creation Group.

VIII. Other

Disclosures according to § 289 (4) and § 315 (5) of the German Commercial Code (HGB)

Share capital

As of December 31, 2009 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 § 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 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 partial 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 §§ 203 (1) and (2), 186 (3) Sent. 4 German Stock Corporation Act at the time the final determination of the issuance amount by the Executive Committee; 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 German Stock Corporation Act.

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 § 60 (2) German Stock Corporation Act.

Regarding the Company's ability to issue stock options, reference is additionally mad to the presentation of stock-based remuneration systems in Section B Nr. 2.5.6 of the notes to the consolidated financial statements.

In the 2009 financial year no capital measures took place. In the prior year's comparative period, Zapf Creation AG announced on February 28, 2008 that on February 22, 2008 the Management Board, with the approval of the Supervisory Board on February 27, 2008, resolved the conversion of the then existing subordinated shareholder loans, including accrued interest in the amount of € 12.9 million, into equity in connection with a non-cash capital increase. For this purpose, the Company, with the use of the at that time existing authorized capital (Authorized Capital 2007) – in this respect reference is also made to the consolidated financial statements as of December 31, 2008 – issued 4.8 million new shares. For each of the new shares a partial amount of € 2.69 was contributed from the shareholder loan. The share capital of Zapf Creation increased as a result from € 13.2 million by € 4.8 million to € 18.0 million; the entry in the trade register was made on March 19, 2008. On June 5, 2008 Zapf Creation announced that on May 29, 2008 the Management Board, with approval of the Supervisory Board on June 5, 2008, as planned and announced, resolved to convert the still outstanding subordinated shareholder loans, including accrued interest in the amount of € 5.0 million, in connection with a capital increase against non-cash contributions into equity. For this, under partial use of the newly authorized capital (Authorized Capital 2008), established at the general shareholders' meeting on May 27, 2008 – in this respect reference is also made to the comments under Authorized Capital 2008 – 1,295,853 new shares were issued. Per new share a partial amount of € 3.86 was contributed from the mention shareholder loan; as a result, these were fully converted to equity. Through the non-cash contribution the share capital of Zapf Creation AG was increased by € 1,295,583 from € 18.0 million to approximately € 19.3 million. The entry in the trade register was made on June 11, 2008.

The share of MGA Entertainment, Inc. and its shareholders ("trusts") in the share capital of the Company increased in the course of the conversion to 44.44%, the shares of Nicolas Mathys to 19.45%. Up to December 31, 2009 the share of MGA Entertainment, Inc. and its shareholders ("trusts"), due to further share acquisitions in the years 2008 and 2009, increased in total to 65.29%; at December 31, 2009 Nicolas Mathys no longer holds any shares in Zapf Creation AG.

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
§§ 15 ff. German Stock Corporation Act 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 §§ 71a ff.

German Stock Corporation Act. 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 § 17 German Stock Corporation Act or on account of the Company or a Group company in the context of § 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, 2009 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 of the notes to the consolidated financial statements.

The authorization for the acquisition of treasury shares resolved by the general shareholders meeting on May 27, 2008 – in this respect we refer 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.

Investments

As of December 31, 2009 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 increased to 65.29% as a result of the complete takeover of the shares of Nicolas Mathys.

Appointment and withdrawal of members of the Management Board

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

Changes to the Articles of Association

For changes to the Articles of Association, Paragraphs 133 and 179 of German Stock Corporation Act 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.

Furthermore, there is a “change of control” clause in the employment contract of one Management Board member, which upon the occurrence of certain conditions provides for a special cancellation right.

Disclosures according to § 289 a German Commercial Code (HGB)

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

Report of the Management Board on relationships with affiliated companies

In its report according to § 312 Act on relationships with affiliated companies in the 2009 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, January 25, 2011

Ron Oboler	Jaime Ferri Llorens	José Antonio Santana
Chairman of the Management Board	Member of the Management Board	Member of the Management Board

Zapf Creation AG

Rödental

Consolidated Financial Statements

of Zapf Creation

Zapf Creation AG
Rödental

Consolidated Income Statement
for the financial year from January 1, 2009 to December 31, 2009

	Section in Notes	2009 K€	2008 K€
Sales revenues	B Nr. 1.1.	79,331	104,365
Cost of sales	B Nr. 1.2.	-49,936	-63,935
Gross profit		**29,395**	**40,430**
Selling and distribution expenses	B Nr. 1.3.	-11,520	-13,291
Marketing expenses	B Nr. 1.4.	-9,882	-13,220
General and administrative expenses	B Nr. 1.5.	-14,890	-15,442
Other income	B Nr. 1.6.	3,495	4,003
Other expenses	B Nr. 1.7.	-1,195	-1,197
Results of operations		**-4,597**	**1,283**
(included therein, restructucturing expenses	*B Nr. 1.8.*	*-137*	*159)*
(included therein, one-time expenses, primarily consulting	*B Nr. 1.8.*	*0*	*0)*
Results of operations, adjusted by the above		*-4,460*	*1,124)*
Financial income	B Nr. 1.9.	64	591
Financial expenses	B Nr. 1.9.	-5,076	-6,571
Results of continuing operations, before income taxes		**-9,609**	**-4,697**
Income taxes	B Nr. 1.10.	-1,504	-1,628
Results of continuing operations		**-11,113**	**-6,325**
Results of discontinued operations, before income taxes	B Nr. 1.11.	47	21
Income taxes on discontiued operations	B Nr. 1.10.	0	14
Net rsults for the perios		**-11,066**	**-6,290**

		2009 €	2008 €
Average shares outstanding, in thousands	B Nr. 1.12.	18,725	17,115
Results per share for continuing operations	B Nr. 1.12.	-0.59	-0.37
Results per share for discontinued operations	B Nr. 1.12.	0.00	0.00
Net results per share (basic / diluted)	**B Nr. 1.12.**	**-0.59**	**-0.37**

The acompanying Notes are an integral part of the consolidatied financial statements.

Zapf Creation AG
Rödental

Consolidated Statement of Comprehensive Income
for the financial year from January 1, 2009 to December 31, 2009

	Section in Notes	2009 K€	2008 K€
Net results for the period		**-11,066**	**-6,290**
Currency translation adujustments	B Nr. 2.5.4.	1,125	-4,270
Deferred taxes	B Nr. 2.5.4.	-296	1,081
Derivative financial instruments	B Nr. 2.5.4.	0	0
Income and expense recognised directly in shareholders' equity in the period		**829**	**-3,189**
Total income and expensed recognized in shareholders' equity in the period		**-10,237**	**-9,479**

The accompanying Notes are an integral part of the consolidatied financial statements.

Zapf Creation AG
Rödental

Consolidated Balance Sheet as of December 31, 2009

Assets	Section in Notes	31.12.2009 K€	31.12.2008 K€
Current assets		**56,877**	**72,573**
Cash and cash equivalents	B no. 2.1.1.	7,971	7,425
Trade receivables	B no. 2.1.2.	35,746	47,024
Inventories	B no. 2.1.3.	5,668	12,363
Tax receivables	B no. 2.1.4.	627	547
Other assets	B no. 2.1.5.	6,865	5,214
Noncurrent assets		**18,803**	**21,861**
Property, plant and equipment	B no. 2.2.1.	13,315	15,272
Intangible assets	B no. 2.2.2.	4,692	5,517
Other assets	B no. 2.2.3.	0	5
Deferred tax assets	B no. 2.2.4.	796	1,067
Total assets		**75,680**	**94,434**

Liabilities and Shareholders' Equity	Section in Notes	31.12.2009 K€	31.12.2008 K€
Current liabilities		**63,209**	**71,812**
Liabilities to banks	B no. 2.3.1.	33,311	35,430
Trade payables	B no. 2.3.2.	21,806	28,868
Income taxes payable	B no. 2.3.3.	2,464	1,663
Other liabilites	B no. 2.3.4.	3,204	2,729
Provisions	B no. 2.3.5.	2,424	3,122
Noncurrent liabilities		**18**	**38**
Liabilities to banks	B no. 2.4.1.	0	0
Deferred tax liabilities	B no. 2.4.2.	18	38
Shareholders' equity		**12,453**	**22,584**
Authorized capital	B no. 2.5.1.	19,296	19,296
Capital reserve	B no. 2.5.2.	31,759	33,240
Result for the year and accumulated deficit	B no. 2.5.3.	-27,213	-16,147
Cumulative other comprehensive income	B no. 2.5.4.	-1,618	-2,447
Treasury shares	B no. 2.5.5.	-9,771	-11,358
Total liabilities and shareholders' equity		**75,680**	**94,434**

The accompanying Notes are an integral part of the consolidatied financial statements.

Zapf Creation AG
Rödental

Changes in Shareholders' Equity for the period from January 1, 2009 to December 31, 2009

					Cumulative other comprehensive income			
	Outstanding shares thsds	**Authorizedl capital K€**	**Capital reserve K€**	**Result for the period and Accumulated deficit K€**	**Currency Translation Adjustment K€**	**Derivative financial instruments K€**	**Treasury Shares K€**	**Total Shareholders' equity K€**
Balance as of January 1, 2008	**12,627**	**13,200**	**21,703**	**-9,857**	**742**	**0**	**-11,358**	**14,430**
Result for the period				-6,290				-6,290
Change in other comprehensive income					-3,189	0		-3,189
Comprehensive income for the period				**-6,290**	**-3,189**	**0**		**-9,479**
Share-based compensation			158					158
Issuance of own shares	6,096	6,096	11,379					17,475
Balance as of December 31, 2008	**18,723**	**19,296**	**33,240**	**-16,147**	**-2,447**	**0**	**-11,358**	**22,584**
Balance as of January 1, 2009	**18,723**	**19,296**	**33,240**	**-16,147**	**-2,447**	**0**	**-11,358**	**22,584**
Result for the period				-11,066				-11,066
Change in other comprehensive income					829	0		829
Comprehensive income for the period				**-11,066**	**829**	**0**		**-10,237**
Share-based compensation	80		-1,481				1,587	106
Balance as of December 31, 2009	**18,803**	**19,296**	**31,759**	**-27,213**	**-1,618**	**0**	**-9,771**	**12,453**

Reference is also made to diclosures in the notes (Section B No. 2.5); the accompanying notes are and integral part of the consolidated financial statements.

Zapf Creation AG
Rödental

Consolidated Statement of Cash Flows
for the period from January 1, 2009 to December 31, 2009

	2009 K€	2008 K€
Cash flows from operating activities		
Profit before income taxes	-9,562	-4,676
Impairment losses on noncurrent assets	3,821	3,995
Losses/gains on the disposal of noncurrent assets	99	4
Financing expenses/income	5,011	5,980
Share-based compensation	106	158
Other non-cash income and expenses	0	224
Incerease/decrease of assets and liabilities:		
Trade receivables	11,793	1,980
Inventories	6,740	1,176
Other assets	-1,698	2,814
Liabilities and provisions	-7,051	-9,730
Income tax payments	-827	-780
Cash flows from operating activies	**8,432**	**1,145**
Cash flows from investing activities		
Proceeds from the disposal of property, plant and equipment and intangible assets	30	132
Disbursements for investments in property, plant and equipment and intangible assets	-1,163	-5,511
Cash flows from investing activities	**-1,133**	**-5,379**
Cash flows from financing activities		
Proceeds from securing of liabilities to banks	0	0
Disbursements for the securing of liabilties to banks and for other fees	-522	-1,069
Proceeds from the securing of liabilties to banks	-4,000	-5,000
Changes in liabilities relating to short-term loans	626	817
Interest paid	-3,235	-4,923
Interest received	61	653
Issuance of treasury shares	0	-719
Cash flows from investing activites	**-7,070**	**-10,241**
Effect of exchange rate fluctuations	317	-1,382
Net change in cash and cash equivalents	**546**	**-15,857**
Cash and cash equivalents at beginning of period	7,425	23,282
Cash and cash equivalents at end of period	7,971	7,425

Reference is also made to diclosures in the notes (Section B No. 3); the accompanying Notes are an integral part of these consolidated financial statements.

Zapf Creation AG

Rödental

Notes to the Consolidated Financial Statements

for the Financial Year from January 1, 2009 to December 31, 2009

Summary of Contents

Table of Contents

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 a world of matching 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.

Zapf Creation AG, as the Company is currently known, was originally established 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, as well as all attendant Interpretations, applicable to the financial year just ended were used in the preparation of the consolidated financial statements of Zapf Creation AG as of December 31, 2009, provided that they were adopted by the EU.

The following standards and interpretations, or amendments to standards, were applied for the first time in the 2009 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”) and IAS 27 (“Consolidated and Separate Financial Statements”); in this case, changes regarding the acquisition costs of a subsidiary
- IFRS 2 (“Share-Based Payment: Vesting Conditions and Cancellations”); in this case, a clarification of the terms ”vesting conditions” and “cancellations”
- IFRS 7 (“Financial Instruments: Disclosures”) and IFRS 4 (“Insurance Contracts”); these deal with changes in disclosures of the determination of fair value and of liquidly risks of financial instruments in reaction to the financial market crisis.
- IFRS 8 (“Operating Segments”); IFRS 8 replaces IAS 14 (“Segment Reporting”) and governs the reporting of operating segments on the basis of the so-called “management approach”.
- IAS 1 (“Presentation of Financial Statements”); changes to this standard were made to improve the ability of users to analyze and compare the information presented in the financial statements.
- IAS 23 (“Borrowing Costs”); this sets forth the requirement to recognize borrowing costs under certain circumstances.
- IAS 32 (“Financial Instruments: Presentation”) and IAS 1 (“Presentation of Financial Statements”); changes to these standards relate to classification in the financial statements of puttable financial instruments and liabilities that only arise upon liquidation.
- IAS 39 (“Financial Instruments: Recognition and Measurement”; “Reclassification of Financial Assets: Effective Date and Transition”) and IFRS 7 (“Financial Instruments: Disclosures”; “Reclassification of Financial Assets: Effective Date and Transition”); these changes deal with the period of validity and the conditions for reclassification of certain financial instruments.
- IFRIC 9 (“Reassessment of Embedded Derivatives”) and IAS 39 (“Financial Instruments: Recognition and Measurement”); this clarifies the accounting treatment of embedded derivatives in certain cases.

- IFRIC 13 (“Customer Loyalty Programmes”); IFRIC 13 governs the recognition and measurement of customer loyalty programs.
- IFRIC 14 (“The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction”); This provides guidance on how to determine the limit for a net pension asset under IAS 19 and what effects result from a legal obligation for minimum funding on the assets and liabilities in connection with a defined benefit plan.
- Annual revisions published in May 2008 in connection with the Annual Improvements project of the IASB.

Initial application of 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 drawn up based on historical costs.

The euro (€) is the reporting currency, because it is the currency used in the great 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.

The Management Board of Zapf Creation AG released the consolidated financial statements as of December 31, 2009, to the Supervisory Board on January 25, 2011. 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

As outlined below, 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 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 2008 a newly structured version of IFRS 1 ("First-time Adoption of IFRS") was issued. The standard, published for the first time in June 2003, was amended to improve the understandability and to organize it in such a manner that future changes can be more easily incorporated. The now published version of IFRS retains the content of the previous version in a changed structure; it replaces the previous version. The European Union endorsed the amended standard in November 2009; according to the regulation for the adoption of the standard by the European Union, the newly structured standard is to be applied for entities that adopt IFRS for the first time, for periods beginning on or after July 1, 2009. The amended standard is not relevant for the Zapf Creation Group, since the first-time adoption of IFRS has already taken place.

In January 2008 the IASB issued a revised version of IFRS 3 ("Business Combinations") and consequential amendments to IAS 27 ("Consolidated and Separate Financial Statements"). IFRS 3 and the consequential amendments to IAS 27 were endorsed by the European Union in June 2009. The amended version of IFRS 3 and the consequential changes to IAS 27 become effective for periods beginning on or after July 1, 2009. Earlier application is permitted, with restrictions. At the moment, there do not appear to be any significant effects on the future consolidated financial statements of the Zapf Creation Group.

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

IFRIC 12 ("Service Concession Arrangements") was issued at the end of 2006. The interpretation deals with the treatment in the financial statements of infrastructure services provided by private entities. The application of IFRIC 12, according to the interpretation, is mandatory for periods beginning on or after January 1, 2008. Early adoption of IFRIC 12 is permitted. The endorsement of the interpretation by the European Union took place in March 2009; according to the regulation for adoption of the interpretation by the European Union, IFRIC 12 is to be applied at the latest at the beginning of the first financial year after the effective date of the endorsement regulation. From the current point of view there will be no effects on the consolidated financial statements of the Zapf Creation Group in the future.

In July 2008 IFRIC 15 ("Agreements for the Construction of Real Estate") was issued. The interpretation provides information as to under what circumstances revenues are to be reported in connection with the construction of real estate and whether a contract for the construction of real estate lies within the scope of IAS 11 ("Construction Contracts") or IAS 18 ("Revenue"). According to the interpretation, IFRIC 15 is to be applied for periods beginning on or after January 1, 2009. Earlier adoption is permitted. The endorsement by the European Union took place in July 2009. According to the regulation for endorsement of the interpretation by the European Union, IFRIC 15 is to be applied at the latest at the start of financial years beginning after December 31, 2009. Currently, there do not appear to be any effects on the consolidated financial statements of the Zapf Creation Group in the future.

In July 2008 IFRIC 16 ("Hedges of a Net Investment in a Foreign Operation") was issued. IFRIC 16 clarifies questions regarding the accounting for hedging instruments in connection with the hedging of a net investment in a foreign operation. According to the interpretation, IFRIC 16 is effective for periods beginning on or after October 1, 2008. An earlier application is permitted. The interpretation was endorsed by the European Union in July 2009. According to the regulation for the endorsement of the interpretation by the European Union, IFRIC 16 is to be applied at the start of the first financial year which begins after June 30, 2009. At the current moment, there appear to be no effects on the future consolidated financial statements of the Zapf Creation Group.

IFRIC 17 ("Distributions of Non-Cash Assets to Owners") was issued in November 2008. IFRIC 17 deals with the accounting for non-cash distributions to shareholders and the related required disclosures. According to the interpretation, IFRIC 17 is effective for periods beginning on or after July 1, 2009. The endorsement by the European Union took place in November 2009. According to the regulation for the endorsement of the interpretation by the European Union, IFRIC 17 is to be applied at the start of the first financial year which begins after October 31, 2009. Earlier application is permitted. From the current point of view there are no effects on the future consolidated financial statements of the Zapf Creation Group.

In January 2009 IFRIC 18 (“Transfers of Assets from Customers”) was issued. IFRIC 18 is particularly for public utilities relevant. This IFRIC clarifies and explains the IFRS rules for agreements in which an entity receives an item of property, plant and equipment from a customer which the entity must either use to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services. According to the interpretation, IFRS 18 is effective for financial periods beginning on or after July 1, 2009. The endorsement by the European Union took place in November 2009. According to the regulation for the endorsement of the interpretation in the European law, IFRIC 17 is to be applied at the latest by the start of the first financial year which begins after October 31, 2009. From the current point of view there are no effects on the future consolidated financial statements of the Zapf Creation Group.

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 17 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 June 2009 the IASB published further amendments to IFRS 2 (“Share-based Payment”) whereby the accounting for share-based compensation settled in cash is clarified in the Group. The changes are effective for reporting periods that begin on or after January 1, 2010. The changes are to be retrospectively applied. Earlier adoption is permitted. The changes were adopted by the European Union in March 2010. From the current point of view there are no significant effects on the future consolidated financial statements of the Zapf Creation Group.

In October 2010, the IASB published an amendment to IFRS 7 ("Financial Instruments: Disclosures – Transfers of Financial Assets"). According to the amendment, an entity is required to make certain disclosures in the notes if financial assets are derecognized for which continuing involvement remains, e.g., through options, guarantees, etc. The changes required by the amendment are to be applied for financial years beginning on or after July 1, 2011. Comparable disclosures for reporting periods that begin prior to this date are not required. Earlier application is permissible. 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 July 2008 the IASB issued amendments to IAS 39 ("Financial Instruments: Recognition and Measurement"; in this case: "Eligible Hedged Items"). The objective of the amendments is to clarify questions regarding hedge accounting that relates to the inflation risk of an underlying transaction and to the one-sided risk of an underlying transaction. The amendments to IAS 39 are effective for reporting periods that begin on or after July 1, 2009. Earlier application is permitted. The amendments to the standard were endorsed by the European Union in September 2009. 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 April 2009 in connection with the regular annual improvements, which are intended to streamline and improve the understandability of the international accounting standards, twelve standards and interpretations were improved by the IASB. The majority of the changes are effective for reporting periods beginning on or after January 1, 2010. Earlier application is permitted. The changes were endorsed by the European Union in March 2010. The application of the changes will have no significant effects on the future consolidated financial statements of the Zapf Creation Group.

In May 2010 the IASB, in connection with its regular annual improvements, made improvements to 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.

Furthermore, in July 2009 the IASB issued the IFRS for SMEs. This deals with the first set of international accounting rules specially developed for small and middle-sized companies (SMEs). This set of rules was formulated on the basis of IFRS, but represents a stand-alone product that is uncoupled from the full set of IFRS. The IFRS for SMEs contain simplifications that reflect the needs of users of SME financial statements, as well as cost/benefit considerations. The IFRS for SMEs are not relevant for the Zapf Creation Group, since Zapf Creation AG is a listed company.

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., Corby, Northants, Great Britain, and Zapf Creation (España) S.L., Madrid, 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***.

There were no changes in the group of consolidated companies in the reporting period.

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, 2009. 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 purchase 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 during expense and income consolidation.

Intercompany profits and losses are eliminated.

The euro (€) is the reporting currency.

Currency translation within the Zapf Creation Group is executed 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 end of period exchange rates, and differences for 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 end of period 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, 2009:

	USD	HKD	GBP	PLN
Closing rate as of Dec. 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

Consolidation as of December 31, 2008:

	USD	HKD	GBP	PLN
Closing rate as of Dec. 31, 2008	0.7138	0.0922	1.0368	0.2394
Average exchange rate from Jan. 1 to Dec. 31, 2008	0.6834	0.0878	1.2597	0.2864
Historical average exchange rate since the Company's foundation	0.8925	0.1112	1.4991	0.2553

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 cumulative 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 before recognition 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.

Any dilution effect (existence of potential shares) is reported as diluted earnings per share; however, this 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

Accounting according to IFRS defines four categories of non-derivative financial instruments: credits 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 "Credits and receivables" and "Financial liabilities" categories.

- Financial assets

The balance sheet item "Cash and cash equivalents" includes cash and term deposits. Cash and cash equivalents also includes 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 2009 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 marketable.

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 impairments. Depreciation on property, plant and equipment is made on a straight-line basis according to the assets' estimated useful life using the following schedule:

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 uses under operating leases or in connection with rental agreements (leasehold improvements), always begins with the date the asset is put into service. The depreciation period corresponds to the duration of the rental or lease agreements if this is shorter than the asset's economic 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 the relevant leased property 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.

Under the components approach, substantial components of an asset classified as property, plant and equipment with different useful lives are depreciated over the useful life of the relevant component. Current maintenance and repair costs are expensed immediately unless they are capitalized in connection with the components approach.

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 property, plant and equipment is 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 its 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, 2009 the potential to issue stock options has not been utilized by the Company.

2.4. Use of Estimates

Consolidated financial statements require 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 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 pure selling prices for merchandise, the 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.

Please see Segment Reporting attached to these notes as ***Appendix 3***.

1.2. Cost of Sales

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

This item essentially contains the expenses for purchased merchandise. In addition to the pure cost, 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 sale 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€ 5,832 (prior year: K€ 7,335) and depreciation/amortization of the sales and distribution units totaling K€ 1,859 (prior year: K€ 2,190), 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 conducting advertisement measures of different kinds (promotional and marketing campaigns, TV ads, 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 ads 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€ 1,023 (prior year: K€ 1,054) and depreciation/amortization of the marketing unit totaling K€ 113 (prior year: K€ 315), 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 units as well as general administrative expenses. This includes staff costs totaling K€ 5,649 (prior year: K€ 5,263) and depreciation/amortization of these units totaling K€ 1,849 (prior year: K€ 1,490).

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 against corresponding exchange rate losses and reported under other income if the resulting balance shows income. As in the previous year, there was no income from exchange rate gains in the 2009 financial year.

The Company's miscellaneous other income totaling K€ 3,495 (prior year: K€ 4,003) essentially comprises income of K€ 2,872 (prior year: K€ 3,610) from the strategic partnership with related companies of the MGA Group. In addition, it comprises income from changes in fair value of derivative financial instruments used for hedging currency risks in the amount of K€ 120 (prior year: K€ 0), insurance recoveries in the amount of K€ 65 (prior year; K€ 22), income from the disposal on noncurrent assets in the amount of K€ 15 (prior year; K€ 31) and other income of K€ 423 (prior year: K€ 340).

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 totaling K€ 1,313 (prior year: K€ 1,778) are offset against corresponding exchange rate gains totaling K€ 542 (prior year: K€ 1,249) and reported under other expenses if the resulting balance shows an expense. In the 2009 financial year, reportable expense from changes in foreign exchange rates was K€ 771 (prior year: K€ 529).

Miscellaneous other expenses of the Company totaling K€ 424 (previous year: K€ 668) comprise expenses from the hedging of currency risks in the amount of K€ 160 (prior year: K€ 143), losses on the disposal of noncurrent assets in the amount of K€24 (prior year: K€ 36), and other expenses in the amount of K€ 240 (prior year: K€ 99). In the prior year, allowances on trade receivables of K€ 220 and expenses of K€ 170 for contingencies for tax liabilities from in kind payments were included.

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 in connection the presentation of the adjusted operating result are separately shown. The expenses and proceeds from the Company's restructuring resulted in total expense of K€ 137 in the 2009 reporting period (prior year: income of K€ 159) resulting from personnel measures. The income in the prior year was due primarily to provisions no longer required for risks in connection with personnel measures. In the 2009 financial year there were no one-off items as in the prior year.

1.9. Finance income and costs

Finance income totaling K€ 64 (prior year: K€ 591) concerns interest income from current liquid assets in connection with cash management.

Finance costs totaling K€ 5,076 (prior year: K€ 6,571) in the 2009 financial year include interest on loans and interest on current borrowings totaling K€ 3,315 (prior year: K€ 5,512). The finance costs also contain K€ 54 (prior year: K€ 318) in expenses arising from the changes in the market value of derivative financial instruments. As in the previous year, this item also includes primarily the fees paid by the Company under financing agreements.

1.10. Income taxes

The tax expenses recognized in the consolidated financial statements of Zapf Creation AG are comprised as follows:

	2009 K€	2008 K€
Current taxes		
Domestic	582	1,070
Abroad	920	985
Total	1,502	2,055
Deferred taxes		
Domestic	- 4	- 3
Abroad	6	- 438
Total	2	- 441
Income tax expense	1,504	1,614

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.

The profit of K€ 47 from discontinued operations in the 2009 financial year (prior year: K€ 35) contains no income or expense from income taxes (prior year: income of K€ 14).

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 12.6% of taxable income. As a result, the nominal tax rate in the 2009 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:

	2009	2008
	K€	K€
Earnings before income taxes	- 9,562	- 4,676
Expected income tax refund / expected income tax expense	2,719	1,329
Different tax assessment basis	- 1,045	- 1,691
Different tax rate	- 131	90
Unrecognized deferred taxes on loss carryforwards	- 1,366	- 401
Deferred taxes loss carryforwards, subsequently capitalized / Use of existing loss carryforwards	231	339
Valuation allowance on deferred taxes capitalized in previous years	- 655	- 49
Tax expense, previous years	- 1,101	- 740
Foreign withholding taxes	- 119	- 449
Other	- 37	- 42
Recognized income tax income/expense	- 1,504	- 1,614

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

	31.12.2009 K€	31.12.2008 K€
Corporation tax		
Domestic	44,759	61,951
Abroad	11,593	8,565
Total	56,352	70,516
Trade tax (domestic only)		
Total	44,455	60,869

Of the corporation tax loss carryforwards, K€ 44,723 relate to Zapf Creation AG (prior year: K€ 61,921); K€ 2,034 relate to Zapf Creation (U.K.) Ltd. (prior year: K€ 2,239); K€ 1,830 relate to Zapf Creation (France) S.à.r.l. (prior year: K€ 2,522); K€ 1,354 relate to Zapf Creation (Polska) Sp. z o.o. (prior year: K€ 0); K€ 1,215 relate to Zapf Creation (Italia) S.R.L. (prior year: K€ 1,552); and K€ 426 relate to Zapf Creation (España) S.L. (prior year: K€ 416). Further corporation tax loss carryforwards totaling K€ 36 relate to Zapf Creation (Central Europe) Verwaltungs GmbH, Zapf Creation Logistics Beteiligungs GmbH, and Zapf Creation Auslandsholding GmbH (prior year: K€ 30). The decrease in the existing carryforwards for corporation tax and trade tax of Zapf Creation AG is results from the loss of carryforwards due to change in ownership in the context of Article 8c Corporate Tax Law; this resulted in a partial loss of the corporation tax loss carryforward in the amount of K€ 20,704 and of the trade tax carryforward in the amount of K€ 20,517.

A loss carryforward for corporation tax relates to Zapf Creation (U.S.) Inc. at December 31, 2009 in the amount of K€ 4,464 (prior year: K€ 1,836) which can be carried forward to 2028 and 2029, respectively (prior year: 2028); the increase in the corporation tax loss carryforward of Zapf Creation (U.S.) Inc. results from the reversal of temporary tax differences from previous years for which no deferred tax assets were recognized.

Of the corporation tax loss carryforwards of K€ 56,352 (prior year: K€ 70,516), an amount of K€ 49,506 (prior year: K€ 67,325) may be carried forward indefinitely; K€ 4,464 in tranches can be carried forward at the longest up to 2029 (prior year: K€ 1,836 up to 2028); K€ 1,354 (prior year K€ 0) up to 2014; K€ 426 up to 2023 (prior year: K€ 416 up to 2023); and K€ 602 in tranches up to 2014 (prior year: K€ 939 in tranches up to 2013).

The trade tax loss carryforwards relate in the amount of K€ 44,413 to Zapf Creation AG (prior year; K€ 60,833); additional trade tax loss carryforwards relate in the total amount of K€ 42 to Zapf Creation (Central Europe) Verwaltungs GmbH, Zapf Creation Logistics Beteiligungs GmbH as well as Zapf Creation Auslandsholding GmbH (prior year K€ 36).

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€ 52,805 (prior year: K€ 65,719) and on trade tax loss carryforwards totaling K€ 43,621 (prior year: K€ 58,726).

Deferred tax assets on loss carryforwards are recognized only if it is probable that future taxable income will be available, as well as if 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 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 (France) S.à.r.l. and Zapf Creation (Italia) S.R.L. in the consolidated financial statements as of December 31, 2009, in regards to temporary

differences between the carrying amounts of assets/liabilities and amounts recognized for tax purposes. Furthermore, as of December 31, 2009 no deferred tax assets were recognized of the Group subsidiary Zapf Creation (Polska) Sp. z o.o.

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 2009 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:

	2009	2008
	K€	K€
Revenue	1	- 51
Cost of sales	0	0
Selling and distribution expenses	0	- 168
Marketing expenses	0	0
Administrative expenses	- 25	- 22
Other income	70	262
Other expenses	0	0
Finance income	1	0
Finance costs	0	0
Result from discontinued operations before income taxes	47	21
Income taxes on discontinued operations	0	14
Result from discontinued operations	47	35

The result from discontinued operations in the 2009 financial year essentially results from exchange rate effects; in the prior year the results were significantly influenced by exchange rate effects as well as by allowances for trade receivables.

In the 2009 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 2009 financial year, this resulted in exchange rate gains of K€ 70 related to discontinued operations (prior year: K€ 262).

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 2009 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:

	2009	2008
	K€	K€
Cash flow from operating activities	- 28	- 163
Cash flow from investing activities	0	0
Cash flow from financing activities	1	0
Effects of exchange rate changes	0	1
Cash flow from discontinued operations	- 27	- 162

1.12. Earnings per share

As of December 31, 2009, 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:

	2009	2008
	K€	K€
Net profit or loss for the period	- 11,066	- 6,290
	thousands	thousands
Average number of shares outstanding	18,725	17,115
	€	€
Earnings per share	- 0.59	- 0.37

Basic earnings per share from continuing operations:

	2009	2008
	K€	K€
Result from continuing operations	- 11,113	- 6,325
	€	€
Earnings per share from continuing operations	- 0.59	- 0.37

Basic earnings per share from discontinued operations:

	2009	2008
	K€	K€
Result from discontinued operations	47	35
	€	€
Earnings per share from discontinued operations	0.00	0.00

1.13. Disclosures regarding financial instruments

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

	2009 K€	2008 K€
Credits and receivables	- 996	- 202
Financial liabilities	- 348	- 1,711
Total	- 1,344	- 1,913

The net income and net loss from financial instruments shown 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:

	2009 K€	2008 K€
Trade receivables	533	1,432
Other assets	0	0
Total	533	1,432

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€ 12,054 (prior year: K€ 13,652) in the 2009 financial year.

Staff costs by functional areas are comprised as follows:

	2009 K€	2008 K€
Sales and distribution	5,832	7,335
Marketing	1,023	1,054
Other administration	5,649	5,263
Staff costs	12,504	13,652

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:

	2009	2008
Salaried employees	204	211
Hourly workers	26	29
Employees	230	240

Expenses for defined contribution pension plans in the 2009 financial year totaled K€ 1,859 (prior year: K€ 1,932). This includes the Company's contributions to the statutory pension scheme totaling K€ 1,712 (previous year: K€ 1,761).

In the 2009 financial year, expenses under operating leases totaling K€ 2,228 (prior year: K€ 3,483) were recognized. They essentially comprised 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.

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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:

	31.12.2009 K€	31.12.2008 K€
Cash on hand	16	25
Bank balances	7,955	7,400
Cash	7,971	7,425

Cash and cash equivalents includes an offsetting of current liabilities to banks totaling K€ 4 (previous year: K€ 75), 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:

	31.12.2009 K€	31.12.2008 K€
Trade receivables before valuation allowance	37,870	50,676
Valuation allowance	- 2,124	- 3,652
Trade receivables	35,746	47,024

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:

	2009 K€	2008 K€
Valuation allowance at the beginning of the period	3,652	2,913
Additions	533	1,432
Reversals and utilization	- 2,130	- 626
Currency effects	69	- 67
Valuation allowance at the end of the period	2,124	3,652

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

	31.12.2009 K€	31.12.2008 K€
Domestic	2,720	2,128
Abroad	0	0
Factoring	2,720	2,128

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:

	31.12.2009 K€	31.12.2008 K€
Goods	5,613	12,294
Raw materials and supplies	55	69
Inventories	5,668	12,363

The following valuation allowances were recognized with regard to inventories:

	31.12.2009 K€	31.12.2008 K€
Inventories before valuation allowance	6,754	13,727
Valuation allowance	- 1,086	- 1,364
Inventories	5,668	12,363

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

As a result, reasonable allowances on goods were made as of December 31, 2009 and as of the previous year's balance sheet date, taking their future marketability into account.

2.1.4. Income tax receivables

Income tax receivables are comprised as follows:

	31.12.2009 K€	31.12.2008 K€
Domestic	104	65
Abroad	523	482
Income tax receivables	627	547

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:

	31.12.2009 K€	31.12.2008 K€
Non-derivative financial assets		
Receivables from shareholders	4,113	2,720
Advances and funds in transfer	376	556
Loans to members of corporate boards	354	350
Other	735	454
Valuation allowance on loans granted	- 350	- 350
Total	5,228	3,730
Derivative financial assets	210	145
Other assets		
Other tax assets	1,126	963
Other	301	376
Total	1,427	1,339
Other assets	6,865	5,214

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

Receivables of K€ 4.113 (prior year: K€ 2,720) 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, 2009 of K€ 350 (prior year: K€ 350); it was already written off wholly in the 2005 financial year. The interest receivable in the amount of K€ 4 as of the December 31, 2009 balance sheet date (prior year: K€ 0) relates to the fourth quarter of 2009; the interest payment was made in January 2010. There were no repayments made in the 2009 financial year. Please also see Section C, No. 3.1.

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

	2009 K€	2008 K€
Valuation allowance at the beginning of the period	350	671
Additions recognized in income in the reporting period	0	0
Derecognitions reducing the valuation allowance, made in the reporting period	0	- 175
Payments received on receivables previously written down	0	- 146
Valuation allowance at the end of the period	350	350

As of the December 31, 2009 balance sheet date the Company continues to hold an inventory of “barter points”, which were fully written down in the amount of K€ 220 in the prior year. The impairment loss was recognized in the Central Europe segment. Please also see Section B, no. 4. 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 Company utilized K€ 14 worth of barter points in the 2009 reporting period (prior year: K€ 4).

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:

	31.12.2009 K€	31.12.2008 K€
Land and buildings	5,475	5,719
Machinery and technical equipment	1,083	1,506
Motor vehicles, furniture and fixtures, and office equipment	6,706	7,805
Assets under construction	51	242
Property, plant and equipment	13,315	15,272

Depreciation in the 2009 financial year totaled K€ 2,860 (prior year: K€ 2,777). As in the previous year, depreciation in the 2009 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 has been 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:

	31.12.2009 K€	31.12.2008 K€
Patents, brand names and licenses	4,437	5,254
Computer software	225	195
Assets under development	30	68
Intangible assets	4,692	5,517

Amortization in the 2009 financial year totaled K€ 961 (prior year: K€ 1,218). As in the previous year, amortization in the 2009 financial year does not include any impairment losses.

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

In the prior 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 value of the licenses acquired in 2008 as of December 31, 2009, was K€ 2,601 (prior year K€ 2,907); the remaining useful life as of the December 31, 2009, balance sheet date was eight years and six months (prior period; nine years and six months).

As in the prior year, as of December 31, 2009 there were no internally-created intangible assets which are not under development. 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 has been attached to these consolidated notes as ***Appendix 2***.

2.2.3. Other Assets

As of the December 31, 2009 balance sheet date there were no other noncurrent assets. In the prior year this item comprised solely non-current financial assets consisting of a loan from the Company in the amount of K€ 5.

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:

	31.12.2009 K€	31.12.2008 K€
Loss carryforwards	1,006	1,361
Provisions	237	58
Property, plant and equipment and intangible assets	36	43
Other assets	31	73
Trade payables	0	60
Inventories	0	32
Other liabilities	0	1
Other	0	140
Deferred tax assets before offsetting	1,310	1,768
Offsetting with deferred tax liabilities	- 514	- 701
Deferred tax assets	796	1,067

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:

	31.12.2009 K€	31.12.2008 K€
Current liabilities to banks	33,311	35,430
Current portion of non-current bank loans	0	0
Liabilities to banks	33,311	35,430

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.

As a result of the Company’s non-compliance with financial covenants in connection with the financing described above, the existing bank liabilities as of December 31, 2009, were classified entirely as current amounts due to banks, as in the prior year. The following covenants were not met: the “Total Leverage Covenant”, a ratio comparing net indebtedness to EBITDA; the “Interest Coverage Covenant”, a ratio that compares EBITDA to the net interest charge; and the “Equity Capital Covenant”, a ratio comparing the 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.

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. At that date, as agreed, the banks performed a new review of the overall situation of the Company. Reference is also made to Section C. No. 4.

As in the prior year, at December 31, 2009, the Company had made only partial use of the remaining credit volume after taking into consideration loan repayments.

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:

France

- Share pledge agreement regarding shares in Zapf Creation (France) S.à.r.l. entered into between Zapf Creation AG as pledgor and Commerzbank Aktiengesellschaft as security agent

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 (Warenkredit-versicherung) 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

<u>Hong Kong</u>

- 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

<u>Poland</u>

- 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.

United States

- 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 two Group subsidiaries Zapf Creation (France) S.à.r.l. and Zapf Creation (U.S.) Inc.

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

	31.12.2009 K€	31.12.2008 K€
Cash	7,971	7,425
Trade receivables	35,746	47,024
Inventories	5,668	12,363
Income tax receivables	627	547
Other current assets	6,865	5,214
Property, plant and equipment	13,315	15,272
Intangible assets	4,692	5,517
Other non-current assets	0	5
Total	74,884	93,367

The average interest rate for the utilization of current liabilities to banks in 2009 was 9.16% (prior year: 11.4%).

2.3.2. Trade payables

Trade payables as of the December 31, 2009, balance sheet date totaled K€ 21,806 (prior year: K€ 28,868). 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:

	31.12.2009 K€	31.12.2008 K€
Domestic	925	731
Abroad	1,539	932
Income tax liabilities	2,464	1,663

2.3.4. Other liabilities

Other current liabilities are comprised as follows:

	31.12.2009 K€	31.12.2008 K€
Non-derivative financial liabilities		
Financial liabilities to employees	629	765
Other	1,360	394
Total	1,989	1,159
Derivative financial liabilities	0	0
Other liabilities	1,010	1,311
Other taxes and social security payments	205	259
Total	1,215	1,570
Other liabilities	3,204	2,729

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

Financial obligations to employees as of December 31, 2009, comprise primarily outstanding bonus payments in the amount of K€ 377 (prior year: K€ 714). Also included is severance pay of K€ 222 (prior year: K€ 29) 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-kind obligations to employees in the amount of K€ 205 (prior year: K€ 259) result primarily from their vacation claims as of the reporting date.

2.3.5. Provisions

Provisions in the reporting period developed as follows:

	01.01.2009	Use	Reversal	Addition	31.12.2009
	K€	K€	K€	K€	K€
Returned goods	2,771	2,665	106	1,917	1,917
Other	351	13	9	178	507
Provisions	3,122	2,678	115	2,095	2,424

Returned goods

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

Other

Other provisions essentially concern personnel obligations in the amount of K€ 311, e.g. obligations arising from the granting of share-based compensation, and risk provisions for ongoing processes.

2.4. Non-Current Liabilities

2.4.1. Liabilities to Banks

Owing to the Company's non-compliance with financial covenants stipulated as part of the aforementioned financing, at December 31, 2009, as in the prior year, the existing liabilities to banks 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:

	31.12.2009 K€	31.12.2008 K€
Liabilities to banks	213	470
Trade payables	236	18
Property, plant and equipment and intangible assets	23	61
Trade receivables	19	35
Provisions	0	35
Other	41	120
Deferred tax liabilities before offsetting	532	739
Offsetting with deferred tax assets	- 514	- 701
Deferred tax liabilities	18	38

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 shareholders' equity for the 2009 and 2008 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, 2009 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 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 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 § 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 Section B No. 2.5.6.

In the 2009 financial year no capital measures were carried out. In the prior year's comparative period, Zapf Creation AG announced on February 28, 2008 that on February 22, 2008 the Management Board, with the approval of the Supervisory Board on February 27, 2008, resolved the conversion of the then existing subordinated shareholder loans, including accrued interest, in the amount of € 12.9 million into equity in connection with a non-cash capital increase. For this purpose, the Company, with the full use of the authorized capital existing at that time (Authorized Capital 2007) – in this regard reference is made to the financial statements as of December 31, 2008 – issued 4.8 million new shares. For each of the new shares a partial amount of € 2.69 was contributed from the shareholder loan. The share capital of Zapf Creation increased as a result from € 13.2 million by € 4.8 million to € 18.0 million; the entry in the trade register was made on March 19, 2008. On June 5, 2008 Zapf Creation announced that on May 29, 2008 the Management Board, with approval of the Supervisory Board on June 5, 2008, as planned and announced, resolved to convert the still outstanding subordinated shareholder loans, including accrued interest in the amount of € 5.0 million, in connection with a capital increase against non-cash contributions into equity. For this, under partial use of the newly authorized capital (Authorized Capital 2008), established at the general shareholders' meeting on May 27, 2008 – in this respect reference is also made to the comments under Authorized Capital 2008 – 1,295,853 new shares were issued. Per new share a partial amount of € 3.86 was contributed from the mentioned shareholder loan; as a result, these were fully converted to equity. Through the non-cash contribution, the share capital of Zapf Creation AG was increased by € 1,295,583 from € 18.0 million to approximately € 19.3 million. The entry in the trade register was made on June 11, 2008.

The share of MGA Entertainment, Inc. and its shareholders ("trusts") in the share capital of the Company increased in the course of the conversion to 44.44%, the shares of Nicolas Mathys to 19.45%. Up to December 31, 2009 the share of MGA Entertainment, Inc. and its shareholders ("trusts"), due to further share acquisitions in the years 2008 and 2009, increased in total to 65.29%; at December 31, 2009 Nicolas Mathys no longer holds any shares in Zapf Creation AG.

2.5.2. Capital reserve

The capital reserves resulted from the premium received from the initial public offering in 1999 upon issuance of the shares less the one-off costs incurred by the initial public offering, taking the income tax consequences into account, as well as from the issuance of treasury shares in connection with share-based compensation.

In the 2009 financial year, the Company's capital reserves decreased by K€ 1,481, from K€ 33,240 to K€ 31,759. The change in the capital reserves in the 2009 reporting period results 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.

In the prior period, the Company's capital reserves increased by K€ 11,537 from K€ 21,703 to K€ 33,240. Of the change in the capital reserves K€ 11,818 results from the capital increases carried out in the reporting period, which were recorded in the Commercial Register on March 19 and June 11, 2008, and from a reduction in the capital reserves by K€ 439, which was expensed for the preparation of capital increases during the reporting period. In the prior year, an amount of K€ 158 was additionally added to capital reserves in connection with the share-based compensation to a member of the Management Board; there was no issuance of treasury shares in the 2008 reporting period .

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

As in the previous year, in the 2008 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 2009 reporting period.

2.5.4. Cumulative other comprehensive income

Cumulative other comprehensive income as of December 31, 2009 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, 2009 reporting date, a currency effect in the amount of K€ 2,725 (prior year: K€ 3,782) 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€ 785 (prior year: K€ 1,081) 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 effective 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, 2009 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, the intended use of which differs as follows:

a) Account no. 1 holds 489,593 treasury shares as of the balance sheet date (prior year: 569,593). This corresponds to 2.54% of the share capital reported as of the balance sheet date (prior year: 2.95%). The carrying amount as of December 31, 2009, was K€ 9,675 (prior year: K€ 11,262).

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, 2009, was K€ 96 (prior year: K€ 96).

The change in the amount of treasury shares in Account no. 1 in the 2009 reporting period results 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. In the prior year, there were no changes in either account.

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 2009 financial year. In this connection a total of 89,000 (previous year: 84,000) phantom stock options at base prices of € 0.87, € 0.81, and € 0.79 (prior year: € 3.59, € 3.50, € 2.99 and € 2.15) were allocated to these board members in 2009 under this plan; the exercise of these options 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:

	2009		2008	
	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	275,000	5.94	191,000	7.27
Options granted during the reporting period	89,000	0.81	84,000	2.90
Options exercised during the reporting period	0	-	0	-
Options expired during the reporting period	128,000	7.63	0	-
Options outstanding at the end of the reporting period	236,000	3.08	275,000	5.94
Options exercisable at the end of the reporting period	0	-	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:

	2009	2008
Risk-free interest rate	4.25 %	4.25 %
Expected volatility	80.18 %	81.65 %
Share price as of December 31	€ 1.11	€ 0.85
Weighted average base price as of December 31	€ 3.08	€ 5.94
Weighted average remaining life	770 days	470 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, 2009, this obligation was K€ 83 (previous year: K€ 18); the average fair value per option outstanding as of the balance sheet date was € 0.35 (previous year: € 0.07). Due to the negative share price performance during the reporting period, or as the case may be due existing holding periods, no options were exercisable as of the December 31, 2009 balance sheet date, as was the case in the prior year.

In the 2009 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. Shares of the Company are issued as both fixed stock-based compensation and also as variable compensation elements which are dependent on the achievement of specific performance targets. 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 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 Nr. 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, 2009 the Company did not take advantage of this possibility for share-based compensation.

As of the balance sheet date in the prior year, there was an additional phantom share-based compensation system for the management of Zapf Creation AG, as well as for management of companies affiliated with Zapf Creation AG, which was established in 2003 ("Bonus Program 2003/2005"). Existing rights in connection with this program expired in the 2009 reporting period as a result of the elapse of exercise periods and the failure to reach the respective exercise price.

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 Risks

Currency risks existence 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:

	31.12.2009 K€	31.12.2008 K€
Financial assets		
Cash	7,971	7,425
Trade receivables	35,746	47,024
Other financial assets	5,228	3,735
of which shown under other current assets	5,228	3,730
of which shown under other non-current assets	0	5
Total	48,945	58,184
Financial liabilities		
Liabilities to banks	33,311	35,430
Trade payables	21,806	28,868
Other financial liabilities	1,989	1,159
of which shown under other current liabilities	1,989	1,159
Total	57,106	65,457

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. On October 1, 2009 the existing financing agreement was aligned to the current market conditions. For this reason, the carrying value of the liabilities to banks at the balance sheet date represents approximately the fair value. The carrying amount of K€ 40,947 (December 31, 2008: K€ 50,759) 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 31.12.2009	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

		due in				
	As of 31.12.2008	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	58,184	45,398	7,874	3,900	730	282
Financial liabilities	65,457	60,273	2,632	2,331	0	221

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€ 64 (prior year: K€ 591); total interest expense on non-derivative financial liabilities in the 2009 financial year amount to K€ 3,315 (prior year: K€ 5,512).

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 31.12.2009	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

		Past due				
	As of 31.12.2008	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	21,917	10,091	6,379	1,573	1,965	1,909

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:

	31.12.2009		31.12.2008	
	Nominal volume	Market values = Carrying amounts	Nominal volume	Market values = Carrying amounts
	K€	K€	K€	K€
Interest rate cap (term > one year)	26,000	90	29,000	145

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, 2009, 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€ 26,000 (prior year: K€ 29,000) 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, 2009 balance sheet date the positive fair value of the interest rate cap derivative amounts to K€ 90 (prior year K€ 145).

<u>Currency Risks</u>

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

	31.12.2009		31.12.2008	
	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	5,855	120	0	0

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, as in the prior year, 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.

The existing derivative financial instruments used for hedging currency risks have a fair value of K€ 120 as of December 31, 2009 balance sheet date. At the balances sheet date in the prior year there were no derivative financial instruments for the hedging of currency risks.

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:

	31.12.2009	Level 1	Level 2	Level 3
	K€	K€	K€	K€
Derivative financial instruments that fulfill the requirement for hedge accounting	210	0	210	0

	31.12.2008	Level 1	Level 2	Level 3
	K€	K€	K€	K€
Derivative financial instruments that do not fulfill the requirement for hedge accounting	145	0	145	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 2009, the annualized cash flow interest rate risk is K€ 304 (prior year: K€ 340), 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 2010 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, 2009, net payments received would have fallen by K€ 90 (previous year: K€ 346); this would trigger a corresponding decline in the net profit of the Zapf Creation Group for the 2010 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:

	31.12.2009 K€	31.12.2008 K€	Change in %
Current liabilities	63,209	71,812	-
Non-current liabilities	18	38	-
Liabilities	63,227	71,850	- 12%
in percentage of total equity and liabilities	*84%*	*76%*	-
Equity	12,453	22,584	- 45%
in percentage of total equity and liabilities	*16%*	*24%*	-
Total equity and liabilities	75,680	94,434	-

The Company's liabilities declined by a total of 12% compared to the prior year's balance sheet date (previous year: decline of 29%).

The Company's equity decreased by 45% compared to the prior period due to the development of results in the 2009 financial year (prior year: increase of 57%). The increase in the prior year resulted primarily from the capital measures executed in the 2008 financial year, which raised the Company's subscribed capital and its capital reserves by € 17.6 million. In this connection we refer additionally to Section B No. 2.5.1. and No. 2.5.2.

As a result, equity decreased in the reporting period to 16% of the total assets compared to 24% as of the balance sheet date in the prior year. The percentage share of the Company's liabilities to total assets increased from 76% at December 31, 2008 to 84% as of the balance sheet date in the 2009 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 Company is subject to external minimum capital requirements in connection the financing agreement with the financing banks. In this connection, reference is made to the comments under Section B no. 2.3.1.

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. In the prior year the segment reporting was prepared in accordance with IAS 14 (“Segment Reporting”); the presentation has been accordingly revised.

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. and Zapf Creation (France) S.à r.l. Distribution in the Italian market was 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 basis of consolidation. Goods for the Eastern European market are primarily supplied through Zapf Creation (Polska) Sp. z o.o. and Zapf Creation AG. 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; 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 2009 financial year in the amount of K€ 79,332; of these K€ 21,525 were in Germany; K€ 57,807 were abroad. Significant external sales outside of Germany were generated in Great Britain in the amount of K€ 16,832 and in Spain in the amount of K€ 8,206. In the 2009 financial year, sales of the Zapf Creation Group were made to an individual customer in the amount of K€ 9,189, which represents more than 10% of the total Group sales; of this amount K€ 3,452 relates to the segment Central Europe; K€ 4,044 relates to the segment Northern Europe; and 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€ 17,795 in Germany and 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:

	31.12.2009 K€	31.12.2008 K€
< 1 year	6,328	5,989
2 up to 5 years	4,951	11,777
> 5 years	2,074	6,641
Financial obligations	13,353	24,407

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€ 1,606 (prior year: K€ 4,719). Of this amount K€ 952 is attributable to 2010 (prior year: to 2009: K€ 1,803); K€ 353 is attributable to 2011 (prior year: to 2010: K€ 1,152); K€ 211 is attributable to 2012 (prior year: to 2011: K€ 941); and K€ 90 is attributable to the years 2013 and beyond (prior year: to 2012 and beyond: K€ 823). The contractual obligations as of December 31, 2009, expire no later than in 2015 (prior year: 2014). Total commitments on operating leases comprise commitments for a period of up to one year in the amount of K€ 952 (prior year: K€ 1,803), for a period longer than one year and up to five years in the amount of K€ 651 (prior year: K€ 2,903) and for a period in excess of five years in the amount of K€ 3 (prior year: K€ 13).

As shown below, total liabilities from purchase order commitments were K€ 11,747 (prior year: K€ 19,688), 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, 2009, 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€ 7,259 (prior year: K€ 17,696). 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€ 1,037 in each year from 2010 to 2012, and K€ 4,148 in 2013 and beyond (previous year: K€ 2,212 in 2009 to 2011, and K€ 11,060 in 2012 and beyond).

As of December 31, 2009, 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, 2009, were K€ 3,914 (prior year: K€ 1,724).

As of December 31, 2009, the Company had a purchase obligation for ongoing maintenance services totaling K€ 517 (previous year: K€ 211) resulting from several maintenance contracts signed by the Company. Of the purchase obligation, K€ 368 relate to the 2010 calendar year and K€ 149 relate to the 2011 calendar year and beyond (previous year: 2009, K€ 194; 2011 calendar year and beyond K€ 17).

As of December 31, 2009, the Company had a purchase obligation for K€ 33 in consulting services attributable to the 2010 calendar year (prior year: K€ 33; the obligation had to be allocated to the 2009 calendar year in full). The Company also has K€ 24 in other financial obligations arising from orders placed (previous year: K€ 24), all of which must be allocated to 2010 (previous year: fully allocable to 2009).

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€ 965 (previous year: K€ 756) 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 2009 financial year:

	Short-term compensation		Share-based compensation	Fixed compensation
	Fixed compensation	Bonus		
	K€	K€	K€	K€
Stephan F. Brune	353	20	124	497
Jens U. Keil	224	0	33	257
José Antonio Santana	194	0	17	211
Total	771	20	174	965
		%	%	%
Percentage in 2009		81.97	18.03	100.00

	Short-term compensation		Share-based compensation	Fixed compensation
	Fixed compensation	Bonus		
	K€	K€	K€	K€
Total compensation in 2007	463	120	173	756

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 Sections C No. 4 and 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 the Company's Management Board remained in place in the 2009 financial year. In this connection, 25,000 phantom stock options were issued in 2009 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, the exercise of which in each case is not conditional on achieving specific performance goals. In the comparable period in the prior year Mr. Stephan Brune was granted 25,000 phantom options at a base price of € 2.15; Mr. Jens U. Keil was granted 10,000 phantom options at a base price of € 3.59 and 15,000 phantom options at a base price of € 3.50; Mr. Thomas Pfau was granted 34,000 phantom options in the 2008 financial year at a base price of € 2.99. 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. A total of K€ 67 (prior year: K€ 15) was expensed for options granted in the 2009 financial year in connection with provisions for liabilities under this compensation system based on phantom shares; due to the development of the share price, the provision was reduced in the 2009 financial year by an amount K€ 2 (prior year: K€ 62) through the income statement. The provision for liabilities under the aforementioned phantom options as of December 31, 2009, was K€ 83 (previous year: K€ 18); of this amount, K€ 24 (previous year: K€ 7) is attributable to Mr. Stephan F. Brune, K€ 36 (previous year: K€ 3) to Mr. Jens U. Keil, K€ 17 to Mr. Santana (prior year K€ 0) and K€ 6 (previous year: K€ 8) to Mr. Thomas Pfau.

By arrangement in individual contracts with the Management Board member Jens U. Keil, a tranche of 15,000 phantom stock options with a base price of €9.16 with an exercise period to April 1, 2010 was forfeited. The phantom stock options granted to the former Management Board member Dr. Georg Kellinghusen expired completely on February 15, 2009. A tranche granted to the former Management Board member Thomas Pfau of 33,000 phantom stock options with a base price of € 7.29 expired on September 1, 2009 and a further tranche issued to Mr. Pfau of 30,000 phantom stock options with a base price of € 8.60 expired on January 2, 2010.

The option rights originally issued to Mr. Stephan F. Brune would have expired on October 1, 2011, respectively October 2012 to the extent no exercise were made up to the respective date; all rights expired in connection with a compensatory arrangement entered into with Mr. Brune on March 4, 2010; reference is additionally made to Section C No. 4. The phantom stock options issued 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 options granted to Mr. José Antonio Santana will expire if they are not exercised by March 1, 2012. The rights granted to Mr. Thomas Pfau expired on September 1, 2010 and will be void on September 1, 2011, respectively, if not exercised by that date. The exercise periods regarding individual tranches were expanded during the 2009 financial year based on individual agreements.

In addition to the above mentioned compensation system using phantom stock options, during the 2008 financial year Mr. Stephan F. Brune was also granted additional share-based compensation. Mr. Brune is granted 40,000 shares of Zapf Creation AG stock annually as part of his fixed share-based compensation. This grant is not subject to any further conditions. Thus, the grant date is the closing date of the contract, September 16, 2008, and the valuation of the shares is therefore made at the market price on September 16, 2008 (Xetra: 2.54 EUR). In addition, the variable compensation paid to Mr. Brune is structured as a share-based payment. In this regard, Mr. Brune is paid variable compensation comprising no more than 32,000 shares per annum contingent on the achievement of specific performance targets. A fixed number of 8,000 shares was granted for the 2008 financial year; the respective amount of K€ 20 was paid in cash in the 2009 financial year. In the 2009 reporting period Mr. José Antonio Santana was granted a similar form of stock-based compensation; this, however, is arranged solely as a variable compensation component, the amount of which is dependent on the achievement of certain performance targets. Likewise, the possibility exists for the Company for the bonus payment to Mr. Jens U. Keil to pay this partly in shares. From both components (fixed and variable) a stock-based compensation from stock issuance resulted in 2009 in the amount of K€ 106 (prior year: K€ 158).

Reference is made to Sections A No. 2.3.13. and B No. 2.5.6. for additional disclosures regarding the programs.

One-time compensation amounts to former members of Company bodies were made in the 2009 financial year to Mr. Stephan F. Brune in the amount of K€ 360 and recognized through the income statement. In the 2008 financial year and amount of K€ 15 was paid as a one-time compensation to Mr. Thomas Pfau. In addition, in the 2008 financial year a one-time compensation in the amount of K€ 18 was granted to Mr. Stephan F. Brune for services rendered in the run-up to his Management Board membership.

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. Interest was paid in the agreed-upon amount. As a result of the mentioned waiver of receivables, the principle and interest payments received in 2008, the interest payments in the first thee quarters of 2009 and in consideration of the interest receivable for the fourth quarter of 2009, the total receivable of the Company amounts at the

December 31, 2009 balance sheet date to K€ 354 (prior year: K€ 350). The loan granted remains secured by a land charge in the amount of K€ 200 (previous year: K€ 200); the remaining liability has been written down in full, analogous to the previous year, in the amount of K€ 350; the interest receivable the fourth quarter of 2009 in the amount of K€ 4 was paid in January 2010.

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 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 2009 financial year was K€ 125 excluding and K€ 166 including withholding taxes payable (previous year: K€ 149 excluding and € 201 including withholding taxes payable). This figure also includes the compensation paid to the Supervisory Board member, Mr. Isaac Larian, for his service in 2007.

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. The subordinate shareholder loans included in the Company's financing concept, including pro rated interest owed, were fully converted into equity upon entry in the commercial register in the 2008 financial year; insofar please also see Section B, no. 2.5.1.

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 is 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; reference is additionally made to Section C No. 4.

The following income and expenses resulted from this partnership in the 2009 financial year:

Cooperation agreements	2009	2008
	K€	K€
Agreement 1: "Distribution Agreement"		
Income from Agreement 1	1,578	1,576
Agreement 2: "Consignment and Services Agreement"		
Income from Agreement 2	856	1,486
Agreement 3: "Logistics Service Agreement"		
Income from Agreement 3	814	1,751
Agreement 4: "Hong Kong / China Services Agreement"		
Expenses from Agreement 4	1,508	2,101
Agreement 5: "Merchandising License Agreement"		
Income from Agreement 5	62	0
Agreement 6: "UK Services Agreement"		
Income from Agreement 6	336	526
Expenses from Agreement 6	186	269
Agreement 7: „Inventions License Agreement”		
Expenses from Agreement 7	814	0

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	2009	2008
	K€	K€
Income from cross charges	1,354	2,584
Expenses from cross charges	1,670	2,558

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	2009	2008
	K€	K€
Merchandise procurement in the reporting period	30,033	41,301

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.

Other transactions took place in the 2009 financial period and in the prior year as follows:

At the beginning of the year in 2008, Zapf Creation AG had drawn a total of € 16.2 million from the subordinated shareholder loans; the share attributable to related parties as of the previous year's balance sheet date was € 10.8 million and was subject to interest of 22%. The shareholder loans, including accrued interest thereon, were converted fully into equity in the 2008 financial year through two capital increases against non-cash contributions; additional reference is made to Section B No. 2.5.

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, 2009 are as follows:

Balances as of the balance sheet date	31.12.2009	31.12.2008
	K€	K€
Receivables from related parties	5,320	4,191
Liabilities to related parties	5,946	7,290

4. Events after the balance sheet date

In IFRS accounting, the recording 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 January 25, 2011, the date on which the consolidated financial statements as of December 31, 2009, were disclosed by the Management Board to the Supervisory Board.

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 appointed Ron Oboler as a member and Chairman of the Management Board, effective February 1, 2010. Since then, Ron Oboler has been leading the Company on an interim basis. As Executive Vice President International at MGA Entertainment, Inc., he has extensive experience in the toy industry. The Advisory Board was endeavoring to make a long-term appointment as Chairman of the Management Board during the course of the year. 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 Advisory 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. Mr. Jaime Ferri Llorens, member of the Supervisory Board at that time, was to bring his extensive experience in the toy industry into the work of the Management Board on an intensified basis. Through these personnel decisions, which led to a strengthening of the industry competence on the Management Board, the new strategy of the Zapf Creation Group should be implemented on an accelerated basis.

The areas of focus continue to be the further development of the product portfolio and the geographical expansion.

On March 4, 2010, the Company entered into a compensatory agreement with the former member and Chairman of the Management Board of Zapf Creation AG, Stephan F. Brune, under which all claims and commitments of both parties under the employment arrangement are offset and thereby resolved.

Effective June 30, 2010, Jens U. Keil, member of the Management Board, left the Company to pursue other career responsibilities. Since March 1, 2007, Mr. Keil was responsible on the Management Board for the areas of finance, investor relations, IT, logistics and risk management, among other things.

On August 6, 2010 Zapf Creation announced that the Supervisory Board appointed Hannelore Schalast, head of corporate finance & controlling, to the Management Board as Chief Financial Officer of the Company, effective February 1, 2011. Until then, Ms. Schalast will act as chief representative in the general area of finance. Also as of February 1, 2011, Josef Lukas, who is currently acting in an advisory function in sales for Germany/Austria/Switzerland, will take 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, will relinquish their temporally assumed Management Board responsibilities. Mr. Oboler will resign from the Management Board as of February 15, 2011; Mr. Brawer did resign as of December 31, 2010.

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); reference is additionally made to Section B No. 2.3.1. In the course of the negotiations of the Zapf Creation Group with the syndicated banks over the long-term Group financing, the banks remaining in the syndication agreed that going forward from that date, with a one month limit each month, to refrain from enforcing the financial covenants up until June 30, 2010; in this connection, the extended credit volume was reduced by € 17 million at the end of April 30, 2010, but up to then existed in an adequate volume. As of June 30, 2010, taking into consideration the principle payments made, the remaining bank liability (excluding interest payables and transaction costs) amounted to € 29.1 million; the expired waiver was not extended on the part of the bank. Not withstanding this, since that time constructive negotiations have continued between the Group and the banks.

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. Investors have been found who will take over a bank loan in the amount of € 20.1 million (Second Lien Loan).

The financing contracts were signed in December 2010 and implemented with corresponding payments in January 2011. The loan taken over, which was revised to meet the requirements of the Company, has an unchanged term until 2013. The financial restructuring of the Zapf Creation Group has thus been completed. In consideration of payments made, the remaining utilized credit volume with the syndicated banks has now been reduced to € 6.8 million (Term Loan); this amount will be completely repaid prior to maturity by January 31, 2011. The Management Board assumes that payments of principal and interest are assured and that the financing of Zapf Creation AG and the Zapf Creation Group is therefore guaranteed in an adequate amount.

On November 2, 2010, Zapf Creation AG announced that the Company's Supervisory Board has appointed 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. Jaime Ferri Llorens will be replacing Ron Oboler, who has been leading the Company on a temporary basis since February 2010.

The appointment of Ron Brawer to the Management Board ended on December 31, 2010. Ron Brawer has resigned as member of the Supervisory Board effective December 31, 2010.

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:

Ron Oboler, member and Chairman of the Management Board

- Sales, sales international, budget (partial), human resources, legal, subsidiaries, finance, investor relations, IT, public relations (excluding products), supply chain operations, logistics, risk management, compliance & corporate governance

Jaime Ferri Llorens, member of the Management Board

- Product research & development, budget (partial)

José Antonio Santana, member of the Management Board

- Marketing, quality management, Zapf Creation Hong Kong, public relations (products), intellectual property, budget (partial), sales (partial)

Changes

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

Effective March 1, 2009, the Supervisory Board of Zapf Creation AG appointed José Antonio Santana 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 resolved the early reappointment of Jens U. Keil as Chief Financial Officer of the Company. Since then, Mr. Keil had the responsibility, unchanged, for finance, investor relations, IT, logistics and risk management.

On January 29, 2010, the Supervisory Board of Zapf Creation AG appointed Ron Oboler as a member and Chairman of the Management Board, effective February 1, 2010. Since then, Ron Oboler has been leading the Company on an interim basis. As Executive Vice President International at MGA Entertainment, Inc., he has extensive experience in the toy industry. The Advisory Board was endeavoring to make a long-term appointment as Chairman of the Management Board during the course of the year. 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 Advisory 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 has resigned as member of 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, IT, logistics and risk management, among other things.

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 will act as chief representative in the general area of finance. Also as of February 1, 2011, Josef Lukas, who is currently acting in an advisory function in sales for Germany/Austria/Switzerland, will take over as Management Board member for sales. As announced, in connection with the replacements, Ron Oboler, Chairman of the Management Board, and Ron Brawer, the Supervisory Board member delegated to the Management Board, will relinquish their temporally assumed Management Board responsibilities. Mr. Oboler will resign from the Management Board as of February 15, 2011; Mr. Brawer did resign as of December 31, 2010.

On November 2, 2010, Zapf Creation AG announced that the Company’s Supervisory Board has 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 will be replacing Mr. Ron Oboler, who has been leading the Company on a temporary basis since February 2010.

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 2009, March 2010, in July 2010 and most recently in January 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 2009 financial year was K€ 104 (prior year; K€ 36); the expenditure for the total compensation paid to the members of the Management Board in the 2009 financial year pursuant to the German Commercial Code was K€ 1,225 (prior year K€ 619), as a consequence of and taking into consideration a one-time payment in the amount of K€ 360 recognized in the income statement 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, 2009 to January 25, 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 LLP, Bad Homburg, Germany
- No further offices

Isaac Larian, member and Vice Chairman 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: Banker / business administrator, SCHNEIDER & CIE. Structured Financial Solutions, Frankfurt am Main
- No further offices

The Company was not notified of further offices, changes in the offices listed above, or main occupations of the members of the Supervisory Board. All members of the Supervisory 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:

With a resolution dated July 30, 2009, the local court of Coburg appointed 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.

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 Advisory Board in accordance with Article 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 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 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 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.

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, 2009, to January 25, 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 Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 4, 2009, in accordance with Section 15a German Securities Trading Act that on September 26, 2008, it had purchased a total of 20,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.42 per share for a total transaction volume of € 48,460.00.

The Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 4, 2009, in accordance with Section 15a German Securities Trading Act that on October 9, 2008, it had purchased a total of 6,126 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.03 per share for a total transaction volume of € 12,441.91.

The Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 17, 2009 through its legal representatives, in accordance with Section 15a German Securities Trading Act that on November 16, 2009, he had purchased a total of 3,955,789 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 1.00 per share for a total transaction volume of € 3,955,789.00.

Mr. Nicolas Mathys, member and Vice-Chairman of the Supervisory Board, notified Zapf Creation AG on November 17, 2009, in accordance with Section 15a German Securities Trading Act that on November 17, 2009, he had purchased a total of 3,955,789 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 1.00 per share for a total transaction volume of € 3,955,789.00.

The Company was not notified of any other 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:

	2009 K€	2008 K€
Audits of financial statements	259	244
Other auditing and valuation services	0	70
Tax consultancy services	7	13
Other services	4	0
Auditor's fee	270	327

5.5. Declaration of compliance regarding the German Corporate Governance Code

The Company points out that it has issued the Declarations of Compliance 2009 and 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 these declarations 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 Roedental, 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 and a management report in accordance with the provisions of Section 264 ff. German Commercial Code governing stock corporations, and from having such annual financial statements and the management report audited.

Nevertheless, the company subjects itself to a voluntary audit of its annual financial statements.

Rödental, January 25, 2011

Ron Oboler	Jaime Ferri Llorens	José Antonio Santana
Chairman of the Management Board	Member of the Management Board	Member of the Management Board

Group subsidiaries as of December 31, 2009

Company	Registered location as of December 31, 2009	Date of foundation	Share of subscribed capital	Carrying amount of Zapf Creation AG at December 31, 2009 (after allowances)	Result for the 2009 period	Shareholder's Equity as of December 31, 2009
				€	Local currency	Local currency
Zapf Creation (H.K.) Ltd.	Kowloon, Hong Kong	April 30, 1991	100%	795,979.77	-6,246,085.21 HKD	-3,796,611.77 HKD
Zapf Creation (U.S.) Inc.	Atlanta, USA	April 15, 1999	100%	93.40	-78,502.12 USD	-6,744,704.92 USD
Zapf Creation (France) S.à.r.l.	Rungis, France	January 1, 2000	100%	0.00	267,973.42 €	-4,653,347.21 €
Zapf Creation (U.K.) Ltd.	Milton Keynes, GB	January 1, 2000	100%	0.00	68,922.83 GBP	-112,389.47 GBP
Zapf Creation (Italia) S.R.L.	Milan Italy	July 31, 2001	100%	0.00	992.59 €	72,879.35 €
Zapf Creation (Polska) Sp. z o.o.	Warsaw, Poland	August 9, 2001	100%	13,794.62	-6,771,602.88 PLN	-4,091,413.05 PLN
Zapf Creation (España) S.L.	Madrid, Spain	January 1, 2002	100%	0.00	-345,894.09 €	2,824,090.75 €
Zapf Creation (Central Europe) Verwaltungs GmbH	Rödental, Germany	March 24, 2003	100%	25,000.00	-1,237.01 €	13,350.82 €
Zapf Creation Logistics GmbH & Co. KG	Rödental, Germany	March 24, 2003	100%	2,965,852.09	-252,076.50 €	2,009,265.62 €
Zapf Creation Logistics Beteiligungs GmbH	Rödental, Germany	March 24, 2003	100%	25,000.00	-17.42 €	16,610.56 €
Zapf Creation Auslandsholding GmbH	Rödental, Germany	September 15, 2006	100%	9,227,600.00	-4,715.70 €	9,208,824.87 €
				13,053,319.88		

The results for the 2009 financial year and the resulting shareholder's equity as of December 31, 2009 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, 2009

	Acquisiton cost / production cost						Depreciation and amortization						Carrying amount	
	01.01.2009 K€	Addditions K€	Disposals K€	Reclassifications K€	Exchange effects K€	31.12.2009 K€	01.01.2009 K€	Addditions K€	Reclassifications 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 softwared	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

Changes in property, plant and equipment and intangible assets from January 1 to December 31, 2008

	Acquisiton cost / production cost						Depreciation and amortization						Carrying amount	
	01.01.2009 K€	Addditions K€	Disposals K€	Reclassifications K€	Exchange effects K€	31.12.2009 K€	01.01.2009 K€	Addditions K€	Reclassifications K€	Reclassifications K€	Exchange effects K€	31.12.2009 K€	31.12.2008 K€	31.12.2007 K€
Property, plant and equipment														
Land and buildings	13,251	22	0	0	8	13,281	7,297	257	0	0	8	7,562	5,719	5,954
Machinery and technical equipment	5,027	724	0	962	226	6,939	4,190	1,030	0	0	213	5,433	1,506	837
Vehicles, office furniture and equipment	21,837	418	589	148	-188	21,626	12,944	1,490	456	0	-157	13,821	7,805	8,893
Construction in progress	199	1,154	0	-1,110	-1	242	0	0	0	0	0	0	242	199
	40,314	**2,318**	**589**	**0**	**45**	**42,088**	**24,431**	**2,777**	**456**	**0**	**64**	**26,816**	**15,272**	**15,883**
Intangible assets														
Patents, trade name rights and licenses	7,177	3,060	0	0	-1	10,236	4,075	907	0	0	0	4,982	5,254	3,102
Computer softwared	10,157	84	0	5	5	10,251	9,739	311	0	0	6	10,056	195	418
Development in progress	25	49	3	-5	2	68	0	0	0	0	0	0	68	25
	17,359	**3,193**	**3**	**0**	**6**	**20,555**	**13,814**	**1,218**	**0**	**0**	**6**	**15,038**	**5,517**	**3,545**

Zapf Creation AG

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Group Segment Reporting as of December 31, 2009

Geographical segments

	Central Europe		Northern Europe		Southern Europe		Eastern Europe		America		Asia/Australia		Other		Consolidation		Consolidated Group		Discontinued operations		Continuing operations	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€
External sales revenues	31,323	34,524	21,018	28,685	14,546	13,901	10,299	24,187	1	-51	2,145	3,068	0	0	0	0	79,332	104,314	1	-51	79,331	104,365
Intercompany sales revenues	1,701	2,087	1,326	1,159	2,632	2,165	3,133	725	0	0	0	0	0	0	-8,792	-6,136	0	0	0	0	0	0
Total sales revenues	33,024	36,611	22,344	29,844	17,178	16,066	13,432	24,912	1	-51	2,145	3,068	0	0	-8,792	-6,136	79,332	104,314	1	-51	79,331	104,365
Depreciation and amortization	-3,568	-3,423	-27	-40	-54	-63	-33	-45	0	0	-139	-424	0	0	0	0	-3,821	-3,995	0	0	-3,821	-3,995
Non-cash expenses	980	1,165	272	840	431	737	412	172	0	397	0	0	0	0	0	-397	2,095	2,914	-	-	-	-
Result before interest, income taxes, and intercompany clearing (EBIT before intercompany clearing)	-10,400	-7,929	3,393	3,277	1,324	1,102	902	5,637	46	21	184	-804	0	0	0	0	-4,551	1,304	46	21	-4,597	1,283
Result before interest and income taxes (EBIT)	-7,306	-681	1,316	1,278	979	646	767	1,843	46	21	-353	-1,803	0	0	0	0	-4,551	1,304	46	21	-4,597	1,283
Segment assets	50,695	58,256	7,446	12,852	15,944	18,740	5,220	7,699	518	1,144	806	1,407	68,653	68,664	-73,602	-74,328	75,680	94,434	-	-	-	-
Investment in property, plant and equipment and intangible assets	1,151	5,423	3	34	5	27	4	21	0	0	0	6	0	0	0	0	1,163	5,511	-	-	-	-
Segment liabilities	16,564	19,831	4,649	4,393	9,738	9,280	6,622	5,431	5,204	5,935	497	4,100	71,326	74,956	-51,373	-52,076	63,227	71,850	-	-	-	-

Sales revenues by product lines

	Play and functional dolls														Mini-dolls		Other		Continuing operations	
	BABY born ®		Baby Annabell ®		CHOU CHOU		Little Sunshine		Jolina Ballerina		Sam & Sally		Other play and functional dolls							
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€
External sales revenues of coninuing operations	36,411	60,389	16,066	18,882	9,148	13,604	4,235	0	2,596	0	1,701	1,275	372	163	2,816	0	5,986	10,052	79,331	104,365

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, 2009. 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.

Nürnberg, January 26, 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, 2009, 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, January 25, 2011

Ron Oboler	Jaime Ferri Llorens	José Antonio Santana
Chairman of the Management Board	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, 2009 to December 31, 2009

		2009 €	2008 €
1.	Sales revenues	44,851,928.38	39,215,419.28
2.	Cost of sales	-25,775,458.77	-21,658,600.28
3.	**Gross profit**	**19,076,469.61**	**17,556,819.00**
4.	Selling expenses	-17,034,825.16	-19,947,277.62
5.	General and andministrative expenses	-13,473,525.20	-14,449,262.74
6.	Other operating income	10,296,396.38	19,666,964.51
7.	Other operaing expenses	-5,111,021.42	-4,479,107.88
8.	Income from long-term loans receivable - thereof from affiliatied companies: € 2,787,897.53 (prior year: € 1,840,205.94)	2,787,897.53	1,840,205.94
9.	Income from cooperative shares	16,081.00	10,796.76
10.	Other interest and similar income - thereof from affiliated companies: € 754,857.65 (prior year: € 720,401.32)	800,237.07	1,011,830.97
11.	Write-down of financial assets and of sccurites in current assets	-400,000.00	-1,561,474.88
12.	Interest and similar expenses - thereof to affiliatied companies: € 308,044.97 (prior year: € 98,764.16)	-4,396,391.63	-6,027,457.40
13.	**Result from ordinary actitities**	**-7,438,681.82**	**-6,377,963.34**
14.	Extraordinary result - thereof income: € 77,602.27 (prior year: € 10,850.00) - thereof expense: € 0 ,00 (prior year: € -397,212.11) - thereof from affiliated companies: € 77,602.27 (prior year: € -397,212.11)	77,602.27	-386,362.11
15.	Taxes on income	-434,144.86	-981,471.61
16.	Other taxes	-44,665.33	-174,446.99
17.	**Net loss for the year**	**-7,839,889.74**	**-7,920,244.05**
18.	Losses carried forward	-29,093,199.62	-22,627,557.69
19.	Appropriation/withdrawl from the reserve for treasury shares	-60,096.28	1,454,602.12
20.	**Accumulated deficit**	**-36,993,185.64**	**-29,093,199.62**

Zapf Creation AG
Rödental

Balance Sheet as of December 31, 2009

Assets	€	31.12.09 €	€	31.12.08 €
A. Noncurrent assets		**45,407,537.80**		**46,520,663.39**
I. Intangible assets				
1. Concessions, industrial property rights and similar rights and values, and licences and simelar rights an values	4,619,710.52		5,406,794.36	
2. Advance payments	29,956.25	**4,649,666.77**	68,538.17	**5,475,332.53**
II. Property, plant and equipment				
1. Land and buildings	1,208,857.62		1,300,056.05	
2. Technical equipment and machinery	4,672.50		5,292.50	
3. Other equimpment, office furniture and equipment	1,895,253.32		2,403,280.10	
4. Advance payments and contruction in progress	50,724.86	**3,159,508.30**	233,339.48	**3,941,968.13**
III. Financial assets				
1. Investments in affiliated companies	13,053,319.88		13,053,319.88	
2. Loans to affiliatied companies	24,544,522.85		24,044,522.85	
3. Investment in a coopertive society	520.00		520.00	
4. Other loans	0.00	**37,598,362.73**	5,000.00	**37,103,362.73**
B. Current assets		**35,172,141.05**		**43,443,030.83**
I. Inventories				
1. Raw materials and supplies	22,824.70		36,057.68	
2. Finished goods and merchandise	4,422,036.30	**4,444,861.00**	6,447,240.03	**6,483,297.71**
II. Receivables and other assets				
1. Trade receivables	10,696,459.90		15,131,805.61	
2. Due from affiliated companies	12,457,861.72		16,186,232.49	
3. Other assets	3,629,633.17	**26,783,954.79**	2,433,241.00	**33,751,279.10**
III. Marketable securities				
Treasury shares		**546,872.58**		**486,776.30**
IV. Cash on hand and cash at banks		**3,396,452.68**		**2,721,677.72**
C. Deferred expenses		**585,742.83**		**716,081.10**
Total assets		**81,165,421.68**		**90,679,775.32**

Liabilities and shareholders' equity	€	31.12.09 €	€	31.12.08 €
A. Shareholders' equity		**18,584,686.96**		**26,424,576.70**
I. Subscribed capital		**19,295,853.00**		**19,295,853.00**
II. Capital reserve		**35,735,147.02**		**35,735,147.02**
III. Revenue reserves				
Reserve for treasury shares		**546,872.58**		**486,776.30**
IV. Accumulated deficit		**-36,993,185.64**		**-29,093,199.62**
B. Provisions		**16,225,588.03**		**14,572,090.72**
1. Tax provisions	747,845.87		662,695.41	
2. Other provisions	15,477,742.16	**16,225,588.03**	13,909,395.31	**14,572,090.72**
C. Liabilities		**46,355,146.69**		**49,683,107.90**
1. Liabilities to banks	33,629,929.52		35,277,330.09	
2. Trade payables	5,268,487.26		8,586,582.40	
3. Due to affiliated companies	6,849,181.06		5,472,529.78	
4. Other liabilities	607,548.85	**46,355,146.69**	346,665.63	**49,683,107.90**
- thereof for taxes: € 298,186.48 (prior year € 160,295.29)				
- thereof for social security: € 19,583.37 (prior year: € 11,058.45)				
Total shareholders' equity and liabilities		**81,165,421.68**		**90,679,775.32**

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Hinweis:

Dieser Geschäftsbericht liegt auch in deutscher Sprache vor.

This Annual Report is also available in German