Quarterly Report 3/2008

Consolidated key figures (IFRS)

in € million	Q3/2008	Q3/2007	Q1–Q3/ 2008	Q1–Q3/ 2007	Q1–Q3 +/– in %	FY/2007
Adjusted earnings situation (without restructuring costs and one-off effects)						
Continuing operations						
EBITDA	8.6	9.4	6.2	3.1	100	10.2
EBIT	7.6	8.4	3.4	0.0	—	6.0
EBIT margin (in %)	22.0	24.3	5.4	0.0	—	5.5
EBT	6.2	7.2	– 0.9	– 3.3	72	2.6
Result from continuing operations	4.3	4.7	– 1.0	– 4.0	76	– 2.2
Discontinued operations						
Result from discontinued operations	0.5	– 0.2	– 0.1	0.0	—	– 0.1
Group						
Net profit or loss for the period	4.8	4.6	– 1.0	– 3.9	73	– 2.4
Earnings per share (in €) 1)	0.25	0.55	– 0.06	– 0.48	87	– 0.27
Earnings situation according to the income statement (including restructuring costs and one-off effects)						
Continuing operations						
Net sales	34.6	34.5	63.0	57.6	9	110.5
Gross margin (in %)	43.5	47.9	41.8	44.8	—	43.7
EBITDA	8.6	9.1	6.4	2.7	135	9.8
EBIT	7.6	8.1	3.5	– 0.4	—	5.7
EBIT margin (in %)	22.0	23.5	5.6	– 0.7	—	5.2
EBT	6.2	6.9	– 0.8	– 3.7	79	2.2
Result from continuing operations	4.3	4.4	– 0.8	– 4.4	81	– 2.6
Included restructuring costs and one-off effects	0.0	0.3	– 0.2	0.4	—	0.4
Included depreciation and amortization	1.0	1.0	2.8	3.1	– 9	4.1
Discontinued operations						
Result from discontinued operations	0.5	– 0.2	– 0.1	0.0	—	– 0.1
Included restructuring costs and one-off effects	0.0	0.0	0.0	0.0	—	0.0
Included depreciation and amortization	0.0	0.0	0.0	0.0	—	0.0
Group						
Net profit or loss for the period	4.8	4.3	– 0.9	– 4.3	79	– 2.7
Earnings per share (in €) 1)	0.25	0.51	– 0.05	– 0.53	90	– 0.31

The key figures are based on rounded values in € million. The calculation of sums and ratios can therefore result in differences when compared to the annual financial statements.
1) undiluted = diluted

Consolidated key figures (IFRS)

in € million	Q3/2008	Q3/2007	Q1–Q3/ 2008	Q1–Q3/ 2007	Q1–Q3 +/– in %	FY/2007
Balance sheet						
Total assets	—	—	104.0	96.5	8	115.1
Non-current assets	—	—	22.6	23.9	– 5	19.5
Investments	3.6	0.4	5.0	1.1	353	1.7
Current assets	—	—	81.4	72.7	12	95.6
Equity	—	—	29.9	– 0.8	—	14.4
Equity ratio (in %)	—	—	28.7	– 0.8	—	12.5
Liabilities to banks and loans granted by shareholders	—	—	35.3	44.9	– 21	56.2
Net debt (including shareholder loans)	—	—	21.9	39.5	– 44	32.9
Cash flow						
Cash flow from operating activities	– 4.3	2.3	4.5	18.3	– 75	28.8
Cash flow from operating activities per share (in €)	– 0.23	0.28	0.27	2.23	– 88	3.26
Net cash flow	– 8.7	1.5	– 10.0	– 6.3	– 58	11.6
Employees						
Number as at the closing date [2)]	—	—	250	225	11	226

2) excluding Management Board and trainees

Financial Report on the first nine months of 2008

- **Business development in line with expectations**
- **Consolidated sales up 9.3 % year on year**
- **Clearly positive consolidated operating result (EBIT) of € 3.5 million**
- **Business conditions again aggravated by economic downturn**

1. Summary

The Zapf Creation Group, Europe's leading manufacturer of play and functional dolls, today announced that its operating business improved considerably compared to the previous year and developed in line with expectations in the first nine months of 2008. Although the economy slowed down in key European countries, Zapf Creation's consolidated sales rose by 9.3 % year on year. This growth was essentially the result of the encouraging demand for BABY born® products and the renewed efficiency of sales and marketing activities in core European markets and growth markets such as eastern Europe.

In Germany, the market share of the Zapf Creation Group in the segment of play and functional dolls in the first nine months of 2008 increased to 55.2 %, up 2.6 percentage points year on year (52.6 %).

Consolidated earnings continued to improve in the first three quarters. The Group managed to reduce important cost items such as administrative expenses, some of them considerably. After nine months, the Group reports clearly positive earnings before interest and taxes (EBIT) of € 3.5 million (Q1–Q3/2007: € –0.4 million). At € –0.9 million, the net result for the period was only slightly negative, which is a significant improvement compared to the previous year (Q1–Q3/2007: € –4.3 million).

Business in the final quarter of 2008 will determine whether the Zapf Creation Group, and the toy industry as a whole, can achieve its goals for the year. A number of partially contradictory factors will influence this development. Retailers apparently are placing a larger number of Christmas orders later in the fourth quarter this year than they did last year in order to minimize their sales risk toward the end of the year. The popularity of Zapf Creation's branded play concepts among retailers and consumers and greatly improved product availability have a positive effect in this context.

However, the economies in many important sales markets are continuing to lose momentum in the wake of the worldwide financial crisis. This has made economic conditions more difficult for the toy industry in what is by far the most important sales period of the year.

Regardless of this, the Management Board of the Zapf Creation Group will continue to strive to meet the goals for 2008 which were set out in the half-year report. The Management Board expects consolidated sales to increase slightly. Group EBIT should continue to improve year on year. Furthermore, the Group's aim is to report positive consolidated after-tax earnings.

2. Significant events during the reporting period

2.1. Changes in Management Board personnel

Zapf Creation AG announced on September 11, 2008, that the Supervisory Board had appointed Mr. Stephan F. Brune (44) Chairman of the Management Board and Chief Executive Officer effective October 1, 2008. In particular, Mr. Brune is responsible for Strategic and Corporate Development, Human Resources, and Public Relations. He previously worked for the Saga Group, a global manufacturer and distributor of luxury goods such as jewelry, watches, and accessories, as well as for the British consumer goods manufacturer, Reckitt Benckiser.

Zapf Creation AG announced on the same date that Mr. Thomas Pfau, who has been responsible for Marketing, Sales, Design, and Product Development since August 28, 2006, in his capacity as member of the Management Board will resign from the Company at his own request effective November 30, 2008, in order to take on new professional challenges. The Group's CEO will take over his responsibilities until further notice.

3. Economic conditions

3.1. Business environment

The intensifying crisis in the financial markets, which triggered extensive governmental interventions aimed at supporting the financial sectors in major economies, the declining confidence of investors and consumers alike, as well as highly fluctuating commodities prices, had a negative effect on the development of the global economy in the third quarter of 2008. Rising inflation rates also dampened the economic outlook in numerous countries. The euro's strength put a break on exports in the euro zone.

All of this prompted economists to lower their economic forecasts for 2008. They now expect economic growth to stagnate in the second half of the year – both in the euro zone as a whole and in Germany. However, thanks to the continued economic momentum of major emerging economies, overall global growth in 2008 is predicted to decline only to about 4 % (2007: 4.9 %). The forecasts for Germany call for GDP growth of 1.9 % (2007: 2.5 %).

But the perspectives for 2009 have also clouded over. The crisis in the financial markets is expected to have an increasingly dampening effect on the development of other sectors as well. Signs of a downturn in emerging markets such as China, Brazil, and Russia are multiplying. As a whole, the global economy is expected to weaken further in the coming year. Consumers' insecurity will continue to undermine private consumption in the entire euro zone. However, there are differences of opinion as to the outlook for growth, given the uncertainties surrounding economic developments. At best, global GDP growth is expected to reach 3.5 % in 2009, while the forecasts for the euro zone call for growth of up to 1.25 %. In Germany, GDP growth is projected to fall within a range of + 0.2 % to – 0.8 %.

Sources:
Association of German Banks, Monthly Report, October 2008
European Central Bank, Monthly Report, October 2008
Fall opinion of Germany's leading economic research institutes, October 2008

3.2. Industry environment in Europe

Europe's largest toy markets developed unevenly in the first nine months of 2008. The market volume in Germany declined by 1.3 % year on year relative to selling prices. In contrast, there were slight gains in market volume in the United Kingdom (+ 4.2 %), France (+ 4.7 %), and Spain (+ 5.8 %).

The market segment that is relevant to Zapf Creation AG – play and functional dolls – was impacted largely by negative trends. Both Germany (– 3.1 %) and Spain (– 2.0 %) remained on a downward trajectory, posting negative growth rates in the third quarter as well. While the French market shrank in the third quarter, ending on – 2.7 % as of September 30, 2008, the British market was the only one that grew during the reporting period.

Source:
NPD Retail Panel

4. Development of sales

4.1. Consolidated sales

The Zapf Creation Group posted sales of € 63.0 million in the first nine months of 2008, an increase of 9.3 % year on year (Q1 – Q3/2007: € 57.6 million). The high euro exchange rate versus other currencies that are relevant for the business of the Zapf Creation Group had a dampening effect on sales. Adjusted for currency effects (i.e. based on unchanged currency relations compared to the previous year), revenue rose by 21.0 % in the first nine months.

At € 34.6 million, consolidated sales in the third quarter of 2008 reached the previous year's level (Q3/2007: € 34.5 million). As expected and previously announced, sales momentum from July to September thus weakened compared to the first six months of the year.

4.2. Development of sales by region

In Europe, the Zapf Creation Group lifted sales by 8.2 % to € 60.6 million in the first nine months of 2008 (Q1 – Q3/2007: € 56.0 million).

In Central Europe (Germany, Austria, Switzerland, the Netherlands and Luxembourg), consolidated sales increased by 8.4 % to € 21.3 million (Q1 – Q3/2007: € 19.7 million). In contrast, revenue in Northern Europe, which comprises the UK, Ireland and Scandinavia, declined by 8.6 % to € 15.1 million (Q1 – Q3/2007: € 16.6 million). In Southern Europe (Spain, France, Belgium and Italy), the Group boosted its consolidated sales by 17.6 % from € 7.0 million to € 8.2 million following the realignment of its French and Spanish sales operations.

Business showed a positive development in the growing markets of Eastern Europe and Asia/Australia. In Eastern Europe, revenue increased considerably by 25 % to € 15.9 million (Q1 – Q3/2007: € 12.7 million). In Asia/Australia, consolidated sales came in at € 2.4 million after € 1.6 million in the previous year.

*Breakdown of sales (external sales) by region**

	Q1–Q3/2008 K€	Q1–Q3/2007 K€	+/– in %
Europe	**60,602**	**55,995**	**8**
Central Europe	21,341	19,694	8
Northern Europe	15,129	16,552	– 9
Southern Europe	8,249	7,014	18
Eastern Europe	15,883	12,735	25
Asia/Australia	**2,370**	**1,611**	**47**
Total sales	62,972	57,606	9

* In accordance with IFRS 5

*Breakdown of sales by product line**

	Q1–Q3/2008 K€	Q1–Q3/2007 K€	+/– in %
Play and functional dolls	**57,050**	**54,172**	**5**
Baby born®	38,173	32,701	17
Baby Annabell®	10,762	14,855	– 28
CHOU CHOU	7,589	6,568	16
Other play and functional dolls	526	48	—
Mini dolls	**0**	**355**	**– 100**
Other products	**5,922**	**3,079**	**92**
Total sales	62,972	57,606	9

* In accordance with IFRS 5

4.3. Development of sales by product line

The Zapf Creation Group posted sales of € 57.1 million in the first nine months of 2008 in its core segment of play and functional dolls, which represents a year-on-year increase of 5.3 % (Q1–Q3/2007: € 54.2 million).

The largest increase was recorded by the BABY born® product line, which lifted sales by 16.7 % to € 38.2 million (Q1–Q3/2007: € 32.7 million). Significant momentum was provided not only by the new BABY born® doll but also by this year's product innovations, "my little BABY born® Mummy, Look I Can Swim" and "my little BABY born® Interactive Twins."

The Zapf Creation Group generated sales of € 10.8 million with its Baby Annabell® doll concept (previous year: € 14.9 million). This concept is in its second year of production, which usually produces weaker sales than the first year. The successor model to Baby Annabell® will be launched in the second half of 2009.

The sales of the CHOU CHOU series totaled € 7.6 million, up 15.5 % from € 6.6 million in the previous year.

The "Other products" segment includes the My Model make-up and hairstyling heads as well as the distributor business in Poland. The latter made a significant contribution to the considerable increase of this segment's sales to € 5.9 million in the reporting period (Q1–Q3/2007: € 3.1 million).

5. Development of earnings

5.1. Development of the Group

The gross profit margin of the Zapf Creation Group for the first nine months of 2008 was 41.8 %. Among others, the decline compared to the prior-year period (44.8 %) is due to structural effects such as the increase in freight costs as well as to higher prices on procurement markets, particularly for wages, raw materials and energy. Advertising cost subsidies paid out early in the UK also had an impact.

In the third quarter, the gross profit margin fell to 43.5 % (Q3/2007: 47.9 %).

Critical cost accounts continued to improve, given the streamlining of the Group's structure. Administrative costs, in particular, fell substantially by 16.4 % to € 10.6 million during the reporting period (Q1–Q3/2007: € 12.7 million). Selling and distribution expenses declined by 5.3 % to € 9.5 million (Q1–Q3/2007: € 10.0 million).

Marketing expenses fell from € 5.3 million a year ago by 3.7 % to € 5.1 million due to temporal shifts.

Among other things, the reduction in selling and distribution expenses in the third quarter of 2008 (€ 2.9 million, down from € 4.0 million in the third quarter of 2007) resulted from the reversal of provisions for licensing and patent fees, which the Zapf Creation Group had been paying to third parties for its Baby Annabell® and CHOU CHOU product families. The Zapf Creation

Group purchased these licenses and patents outright during the reporting period.

Marketing expenses climbed to € 2.1 million between July and September 2008 (up from € 1.4 million in the same quarter the previous year), particularly due to the early onset of TV advertising.

At € 3.5 million, consolidated EBIT for the first nine months was clearly positive. This compares to EBIT of € – 0.4 million in the same period of the previous year. EBIT for the third quarter of 2008 came in at € 7.6 million, which was slightly lower than the previous year (Q1–Q3/2007: € 8.1 million).

The increase in finance costs to € 4.9 million (Q1–Q3/2007: € 3.7 million) is primarily the result of interest paid on subordinated shareholder loans, which were fully converted into equity in the first half of 2008. As a result, expenses in the third quarter of 2008 were € 1.2 million, which is below the previous year's figure (Q3/2007: € 1.6 million). The third-quarter loss in finance income was due to the reporting date market valuation of the derivatives the Company uses to hedge interest rates.

The Zapf Creation Group's earnings before taxes from continuing operations improved to € – 0.8 million as of the close of the third quarter of 2008. A year ago, it had been € – 3.7 million.

Nine-month earnings after taxes from continuing operations were € – 0.8 million (Q1–Q3/2007: € – 4.4 million). The third-quarter result was € 4.3 million (Q3/2007: € 4.4 million).

Consolidated earnings from discontinued operations of € – 0.1 million are due to the closing-date measurement of a loan granted by Zapf Creation AG to its US subsidiary, which is no longer operating. Zapf Creation AG has fully written off this loan, which served to repay a previous loan. The Zapf Creation Group discontinued its US operations as of December 31, 2006.

The net loss of the Zapf Creation Group for the first nine months of 2008 was € 0.9 million. This compares to a net loss of € 4.3 million in the same period of the previous year. Earnings per share were € – 0.05 compared to € – 0.53 in the previous year. The significant increase in the average number of shares outstanding from 8.23 million shares to 16.58 million shares has to be taken into account in this context.

Net profit in the third quarter was € 4.8 million (Q3/2007: € 4.3 million). Earnings per share were € 0.25, down from € 0.51 the previous year, based on a substantially greater number of shares.

5.2. Development of earnings by segment

The Zapf Creation Group reports on its sales regions based on earnings before interest, taxes, depreciation, and amortization (EBITDA). In Central Europe, the segment result at the end of the first nine months of 2008 was € 6.7 million, just falling short of the previous year's level of € 7.0 million. In Northern Europe, EBITDA improved substantially to € 0.3 million (Q1–Q3/2007: € – 3.3 million). Southern Europe also posted improved earnings of € 0.4 million, up from € – 1.6 million a year earlier.

In the growing Eastern European market, EBITDA rose substantially to € 5.3 million over € 3.6 million at the end of the first nine months of 2007. In Asia/Australia, the segment result was € – 6.4 million (Q1–Q3/2007: € – 2.7 million), due solely to an intercompany billing price model.

6. Assets

The total assets of the Zapf Creation Group as of September 30, 2008, were € 104.0 million. This compares to total assets of € 115.1 million as of December 31, 2007, and € 96.5 million at the close of the third quarter of 2007. The year-on-year increase essentially reflects the Group's expanded business volume.

Current assets were € 81.4 million, compared to € 95.6 million at the end of December 2007 and € 72.7 million as of September 30, 2007.

In keeping with the customary seasonal trend of Zapf Creation's business, cash and cash equivalents were € 13.3 million, down from € 23.3 million at the close of 2007. However, the considerable increase relative to the end of the same quarter the previous year (€ 5.4 million) reflects the inflow of funds from the capital increases that have taken place in the meantime.

The year-on-year increase in trade receivables by € 4.0 million to € 40.4 million (September 30, 2007: € 36.4 million; December 31, 2007: € 49.9 million) stems from the expansion of the Group's operating business. And the increase in inventories to € 21.1 million from € 13.5 million as of the close of December 2007 reflects the enhanced availability of goods ahead of the all-important year-end business. Bear in mind when comparing this with the level as of September 30, 2007 (€ 18.8 million) that the previous year's figure was impacted by delays in deliveries caused by the change in the Group's procurement organization in Asia.

Non-current assets as of the reporting date were € 22.6 million compared to € 19.5 million as of December 31, 2007, and € 23.9 million as of September 30, 2007. This was mainly due to the increase in intangible assets to € 5.7 million (December 31, 2007: € 3.5 million; September 30, 2007: € 3.9 million) as a result of the acquisition of the licenses and patents for Baby Annabell® and CHOU CHOU.

7. Financial position

In terms of liabilities and equity, year-on-year figures largely reflect the execution of the Group's long-term financing strategy, which was completed in the first half of 2008.

At € 42.5 million, current liabilities as of September 30, 2008, declined substantially from both year-end (€ 67.2 million) and third-quarter levels (€ 97.2 million) in 2007. Current liabilities to banks fell to € 3.6 million, down from € 5.9 million at the end of December 2007 and € 44.9 million at the end of the third quarter of 2007. Other liabilities were € 2.3 million. The figure of € 19.4 million as of December 31, 2007 contained the subordinated shareholder loans that were converted into equity in 2008.

Non-current liabilities of the Zapf Creation Group as of the reporting date were € 31.7 million, down from € 33.5 million at the end of the previous year; they include drawdowns from the long-term syndicated loan that was obtained in 2007.

The net liabilities of the Zapf Creation Group at the end of the third quarter of 2008 totaled € 21.9 million. This compares to net liabilities (including shareholder loans) of € 32.9 million at the end of 2007 and € 39.5 million as of September 30, 2007.

The successful restructuring of the Group's financing in 2007 and the first half of 2008 lifted equity to € 29.9 million as of September 30, 2008 (December 31, 2007: € 14.4 million; September 30, 2007: € −0.8 million). The equity ratio rose to a solid 28.7 % as of the end of September. This compares to an equity ratio of 12.5 % at the end of 2007. The subscribed capital rose from € 13.2 million at the end of 2007 to € 19.3 at the end of September 2008 due to the conversion of shareholder loans into equity.

8. Liquidity

In the first nine months of 2008, the Zapf Creation Group recorded an inflow of funds from operating activities of € 4.5 million. The previous year's figure of € 18.3 million was impacted by an inflow of funds of € 7.5 million from shareholder loans.

A total of € 4.9 million were used for investing activities, up from € 0.9 million in the same period the previous year. In particular, this reflects the acquisition of licenses and patents for Baby Annabell® and CHOU CHOU, as well as increased investments in forms and tools for new products.

The outflow of funds in connection with financing activities was € 9.1 million, essentially due to loan and interest payments. The previous year's figure of € 23.6 million had resulted from the repayment of the old loan, as well as one-off items related to the restructuring of the Group's financing.

Taking currency effects in the reporting period into account, overall the Zapf Creation Group used funds of € 10.0 million, compared to a negative cash flow of € 6.3 million in the first nine months of 2007.

9. Employees

The Group had a total of 250 employees (excluding both the Management Board and trainees) as of the September 30, 2008, reporting date. This reflects an increase of 25 employees (September 30, 2007: 225 employees) over the same period the previous year. The increase affected mainly the design and marketing departments, as well as individual country organizations. As a result, the Zapf Creation Group now possesses the number of employees it needs in order to be able to effectively tap into market potentials worldwide.

10. Events after the close of the reporting period

There were no events of particular significance to the Zapf Creation Group after the September 30, 2008 reporting date.

11. Opportunities and risks

The combined management report of Zapf Creation AG and the Group for the 2007 financial year provides detailed disclosures on the Zapf Creation Group's opportunities and risks. There were no material changes in the Group's risk and opportunities profile during the first nine months of 2008 compared to the aforementioned disclosures. Insofar, please see the combined management report in the 2007 annual report.

However, please note the following risk:

During the reporting period, the collapse of the North American real estate sector due to subprime mortgages sparked an all-encompassing international crisis in the financial markets. The distortions in the financial industry continued to intensify both in the third quarter and in the fourth quarter to date, prompting the governments of major countries to initiate broad support and stabilization measures. This could also cause a worldwide downturn on the macroeconomic level. The falling confidence of investors and consumers alike, the declining growth rates of numerous industrial countries and industries, many companies' lowered outlook for both growth and profits, as well as highly fluctuating commodities prices, are the first indicators of such a development. We can not preclude that it will result in a substantial decline overall in consumer demand – not just in Europe and North America but also in the emerging economies of Asia, South America, and Eastern Europe. While any decrease in consumer demand would increase the risk of declining sales of Zapf Creation Group products, this risk falls at the same rate at which the negative ramifications of the crisis in the financial markets on the economy as a whole are reduced.

Please also note the following:

As far as the Management Board knows, at the present time MGA Entertainment, Inc. – the company to which Zapf Creation AG is closely linked by means of a comprehensive strategic co-operation – is currently reviewing its sales structures and strategy in Europe. Any resulting actions on the part of MGA could have both positive and negative effects on the Zapf Creation Group. This applies to the Group's cooperation with MGA Entertainment, Inc. in sales, given that Zapf is currently marketing the products of MGA Entertainment, Inc. in important European markets. Yet any such changes might also impact the two companies' cooperation in regards to logistics given that the Zapf Creation Group is currently providing logistics services for MGA Entertainment, Inc. in some continental European markets. However, we are unable at this time to provide a conclusive assessment of the opportunities and risks for the Zapf Creation Group.

12. Outlook

Business development in the current financial year shows that Zapf Creation Group has established a solid foundation from which to consolidate its competitive position and utilize additional growth opportunities in the medium term. The Group's brands retain their high value for dealers and consumers alike. Moreover, its sales organizations in its European core markets, as well as increasingly in growth regions such as Eastern Europe, have enhanced both their efficiency and power compared to the time prior to the restructuring. Additionally, given the Zapf Creation Group's fundamental realignment, its operations are now rooted in streamlined and viable structures and processes. As a result, the availability of the Group's products has greatly improved in the long term.

However, macroeconomic developments pose some heightened risks. The crisis in the financial markets still threatens to spill over to the real economy, and continued widespread uncertainty among consumers is currently dampening demand for the play concepts of the Zapf Creation Group.

Regardless of this environment, the Management Board continues to strive to meet the goals for the current financial year. Consolidated sales are expected to increase slightly in 2008. Group EBIT should continue to improve year on year. The Zapf Creation Group expects earnings after taxes to return to the black in the 2008 financial year.

Roedental, Germany, November 7, 2008

The Management Board

Stephan F. Brune
Chairman of the
Management Board

Jens U. Keil
Member of the
Management Board

Thomas Pfau
Member of the
Management Board

Interim consolidated financial statements as of September 30, 2008

Consolidated income statement for the period from January 1, 2008 to September 30, 2008	Q3/2008 K€	Q3/2007 K€	Q1–Q3/2008 K€	Q1–Q3/2007 K€	FY/2007 K€
Revenue	34,573	34,483	62,972	57,606	110,457
Cost of sales	– 19,525	– 17,958	– 36,643	– 31,815	– 62,149
Gross profit	**15,048**	**16,525**	**26,329**	**25,791**	**48,308**
Selling and distribution expenses	– 2,915	– 4,017	– 9,505	– 10,032	– 14,250
Marketing expenses	– 2,086	– 1,366	– 5,100	– 5,294	– 14,423
Administrative expenses	– 3,572	– 4,181	– 10,616	– 12,699	– 17,137
Other income	1,219	1,605	2,587	2,787	4,686
Other expenses	– 102	– 474	– 146	– 957	– 1,504
Operating result	**7,592**	**8,092**	**3,549**	**– 404**	**5,680**
(Restructuring costs included therein	*– 1*	*– 283*	*159*	*– 396*	*– 645)*
(One-off costs, mainly consultancy, included therein	*0*	*0*	*0*	*0*	*280)*
(Adjusted operating result derived therefrom	***7,593***	***8,375***	***3,390***	***– 8***	***6,045)***
Finance income	– 178	333	594	499	863
Finance costs	– 1,214	– 1,563	– 4,914	– 3,746	– 4,393
Result from continuing operations before income taxes	6,200	6,862	– 771	– 3,651	2,150
Taxes on income	– 1,929	– 2,431	– 49	– 723	– 4,799
Result from continuing operations	4,271	4,431	– 820	– 4,374	– 2,649
Result from discontinued operations before income taxes	467	– 160	– 78	50	– 147
Income taxes on discontinued operations	19	0	14	0	48
Net profit or loss for the period	4,757	4,271	– 884	– 4,324	– 2,748

	Q3/2008 K€	Q3/2007 €	Q1–3/2008 €	Q1–Q3/2007 €	FY/2007 €
Average number of shares outstanding (in thousands)	18,723	8,227	16,579	8,227	8,840
Earnings per share, continuing operations (in €)	0.23	0.53	– 0.05	– 0.54	– 0.30
Earnings per share, discontinued operations (in €)	0.03	– 0.02	0.00	0.01	– 0.01
Earnings per share (basic/diluted) in €	0.25	0.51	– 0.05	– 0.53	– 0.31

The included notes are an integral part of the consolidated financial statements.

Breakdown of staff costs	Q3/2008 K€	Q3/2007 €	Q1–Q3/2008 €	Q1–Q3/2007 €	FY/2007 €
Sales & distribution	1,912	2,067	6,129	5,342	7,138
Marketing	280	193	813	814	987
Other administration	1,367	677	3,854	3,606	4,617
Total	3,559	2,937	10,796	9,762	12,742

Consolidated balance sheet as of September 30, 2008	Sep. 30, 2008 K€	Dec. 31, 2007 K€	Sep. 30, 2007 K€
Assets			
Current assets	**81,423**	**95,589**	**72,655**
Cash	13,319	23,282	5,395
Trade receivables	40,354	49,904	36,381
Inventories	21,142	13,473	18,839
Income tax receivables	298	341	3,162
Other assets	6,310	8,589	8,878
Non-current assets	**22,587**	**19,548**	**23,892**
Property, plant and equipment	15,760	15,883	16,017
Intangible assets	5,729	3,545	3,863
Other assets	10	10	20
Deferred tax assets	1,088	110	3,992
Total assets	104,010	115,137	96,547
Equity and liabilities			
Current liabilities	**42,466**	**67,242**	**97,176**
Liabilities to banks	3,609	5,874	44,875
Trade payables	34,136	37,686	38,057
Income tax liabilities	1,100	701	1,831
Other liabilities	2,269	19,394	10,491
Provisions	1,352	3,587	1,922
Non-current liabilities	**31,665**	**33,465**	**130**
Liabilities to banks	31,642	33,381	0
Deferred tax liabilities	23	84	130
Equity	**29,879**	**14,430**	**−759**
Issued capital	19,296	13,200	8,800
Capital reserve	33,082	21,703	12,469
Net profit or loss for the period and retained earnings brought forward	−10,741	−9,857	−11,433
Other recognized income and expense	−400	742	763
Treasury shares	−11,358	−11,358	−11,358
Total equity and liabilities	104,010	115,137	96,547

The included notes are an integral part of the consolidated financial statements.

Consolidated statement of changes in equity for the period from January 1, 2008 to September 30, 2008

	Shares outstanding	Issued capital	Capital reserves	Net profit/loss for the period and retained earnings brought forward	Other recognized income and expense: Adjustments from currency translations	Other recognized income and expense: Derivative financial instruments	Treasury shares	Total equity
	(thsds.)	K€	K€	K€	K€	K€	K€	K€
Balance at January 1, 2007:	8,227	8,800	12,961	– 7,109	284	0	– 11,358	3,578
Net profit or loss for the period				– 4,324				– 4,324
Change in other recognized income and expense					479	0		479
Total net income or loss for the period				– 4,324	479	0		– 3,845
Issuance of treasury shares			– 492					– 492
Balance at September 30, 2007:	8,227	8,800	12,469	– 11,433	763	0	– 11,358	– 759
Balance at January 1, 2008:	12,627	13,200	21,703	– 9,857	742	0	– 11,358	14,430
Net profit or loss for the period				– 884				– 884
Change in other recognized income and expense					– 1,142	0		– 1,142
Total net income or loss for the period				– 884	– 1,142	0		– 2,026
Issuance of treasury shares	6,096	6,096	11,379					17,475
Balance at September 30, 2008:	18,723	19,296	33,082	– 10,741	– 400	0	– 11,358	29,879

The included notes are an integral part of the consolidated financial statements.

Consolidated cash flow statement for the period from January 1, 2008 to September 30, 2008	Q1–Q3/2008 K€	Q1–Q3/2007 K€
Cash flow from operating activities:		
Earnings before income taxes	– 849	– 3,601
Depreciation of non-current assets	2,809	3,102
Losses/gains from the disposal of non-current assets	10	89
Finance costs/income	4,320	3,372
Other non-cash income/expenses	3	15
Increase/decrease in assets and liabilities:		
Trade receivables	9,483	20,973
Inventories	– 7,529	– 6,354
Other assets	2,142	– 4,933
Liabilities and reserves	– 5,344	5,710
Income tax payments	– 553	– 67
Cash flow from operating activities	**4,492**	**18,306**
Cash flow from investing activities:		
Cash receipts from sales of property, plant and equipment and intangible assets	97	196
Cash payments for investments in property, plant and equipment and intangible assets	– 4,983	– 1,077
Cash flow from investing activities	**– 4,886**	**– 881**
Cash flow from financing activities:		
Cash receipts from non-current bank borrowings	0	0
Cash payments for non-current bank borrowings	– 1,069	0
Cash payments for the repayment of non-current bank borrowings	– 3,000	– 6,377
Change in liabilities due to current borrowings	– 989	– 13,803
Interest paid	– 3,882	– 3,418
Interest received	584	242
Cash payments for the issuance of treasury shares	– 719	– 236
Cash flow from financing activities	**– 9,075**	**– 23,592**
Effects of exchange rate changes	– 494	– 148
Net change in cash and cash equivalents	**– 9,963**	**– 6,315**
Cash and cash equivalents at the beginning of the period	23,282	11,710
Cash and cash equivalents at the end of the period	13,319	5,395

The included notes are an integral part of the consolidated financial statements.

Consolidated segment reporting as of September 30, 2008

	Central Europe		Northern Europe		Southern Europe		Eastern Europe		The Americas		Asia/ Australia	
Q1–Q3/	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€
External sales	21,341	19,694	15,129	16,552	8,249	7,014	15,883	12,735	– 15	1,957	2,370	1,611
Internal sales	1,921	1,011	788	1,638	1,242	999	471	264	0	0	0	0
Segment sales, total	23,262	20,705	15,917	18,190	9,491	8,013	16,354	12,999	– 15	1,957	2,370	1,611
Earnings before interest, taxes, depreciation and amortization (EBITDA)	6,729	7,022	320	– 3,254	397	– 1,634	5,310	3,636	– 78	175	– 6,398	– 2,676

	Other		Consolidation		Group total		Discontinued operations		Continued operations	
Q1–Q3/	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€
External sales	0	0	0	0	62,957	59,563	– 15	1,957	62,972	57,606
Internal sales	0	0	– 4,422	– 3,912	0	0	0	0	0	0
Segment sales, total	0	0	– 4,422	– 3,912	62,957	59,563	– 15	1,957	62,972	57,606
Earnings before interest, taxes, depreciation and amortization (EBITDA)	0	– 396	0	0	6,280	2,873	– 78	175	6,358	2,698

The segment reporting is part of the notes.

Notes to the interim consolidated financial statements as of September 30, 2008

Notes to the interim consolidated financial statements as of September 30, 2008

1. General information

1.1. 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 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. These globally successful play concepts have been conceived particularly for the Company's core target group – girls between three and eight years of age.

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.

1.2. Principles of preparation

The interim consolidated financial statements of Zapf Creation AG as of September 30, 2008 were prepared on the basis of IAS 34 ("Interim Financial Reporting"). They were not reviewed or audited in accordance with Section 317 German Commercial Code.

The interim consolidated financial statements do not include all notes and disclosures required for consolidated financial statements and must thus be read in connection with the consolidated financial statements as of December 31, 2007, which 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) – all of them 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 para 1 German Commercial Code were also observed in preparing the consolidated financial statements. All IFRS, as well as all attendant Interpretations, applicable to the financial year were used in the preparation of the consolidated financial statements of Zapf Creation AG as of December 31, 2007, inasmuch as they were adopted by the EU.

1.3. Consolidation

The interim consolidated financial statements as of September 30, 2008 follow the same consolidation methods as the consolidated financial statements as of December 31, 2007. Reference is also made to the existing consolidated financial statements as of December 31, 2007.

In addition to Zapf Creation AG, the Group's parent company, all direct and indirect subsidiaries of the Group are included in the basis of consolidation. The were no changes in the group of consolidated companies in the first nine months of the 2008 financial year.

1.4. Accounting methods

The interim consolidated financial statements as of September 30, 2008 follow the same accounting methods as the consolidated financial statements as of December 31, 2007. Reference is also made to the existing consolidated financial statements as of December 31, 2007.

In addition to reporting its operating income, the Zapf Creation Group therefore also reports "adjusted operating income" in its consolidated income statement in the interim consolidated financial statements as of September 30, 2008. The adjusted operating income is based on the Group's internal key performance indicators and adjusts the Group's operating income by the restructuring costs and one-off items shown in the income statement. Showing this item in the presentation of the consolidated income statement serves to increase transparency with regard to the sustainability of the earnings generated by the company through its ongoing operating process. 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.

1.5. Use of estimates

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

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

2. Explanations of items in the consolidated financial statements

2.1. General

The presentation of items in the interim consolidated financial statements as of September 30, 2008 follows the same structure as the consolidated financial statements as of December 31, 2007.

The development of the individual items of the interim consolidated financial statements in the first nine months of the 2008 financial year, specifically revenue, is characterized by the typical, seasonal nature of the Company's business. In this context, we also refer to the consolidated financial statements as of December 31, 2007, and the interim management report of the Group as of the end of the third quarter of 2008.

The segment report is attached to these notes as Appendix.

2.2. Discontinued operations

As in the previous year, 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").

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

	Q1–Q3/2008 K€	Q1–Q3/2007 K€
Revenues	– 15	1,957
Cost of sales	0	– 1,721
Selling and distribution expenses	– 163	0
Administrative expenses	4	0
Other income	96	0
Other expenses	0	– 61
Finance costs	0	– 125
Income taxes on discontinued operations	14	0
Result from discontinued operations	– 64	50

The result from discontinued operations in the first nine months of the 2008 financial year essentially resulted from exchange rate effects as well as from allowances for trade receivables. The revenue disclosed separately in the previous year is directly related to the discontinuation of the operations of Zapf Creation (U.S.) Inc. as of the end of December 31, 2006. This essentially concerned income from the sale of the remaining inventories of the US subsidiary to MGA Entertainment, Inc., Van Nuys, California, USA, which has been responsible for the American market under a strategic partnership since January 1, 2007.

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

	Q1–Q3/2008 K€	Q1–Q3/2007 K€
Cash flow from operating activities	97	4,662
Cash flow from investing activities	0	0
Cash flow from financing activities	0	– 4,955
Effects of exchange rate changes	10	– 4
Cash flow from discontinued operations	107	– 297

2.3. Equity

Capital measures

Zapf Creation AG announced on February 28, 2008, that the Management Board had resolved on February 22, 2008, with the approval of the Supervisory Board on February 27, 2008, to convert € 12.9 million of the subordinated shareholder loans into equity by means of a non-cash capital increase, as planned and previously announced. The Company issued 4.8 million new shares to this end, fully utilizing the authorized capital existing at that time. For more details, please see the consolidated financial statements as of December 31, 2007. The amount in shareholder loans contributed per new share was € 2.69. This non-cash capital increase further enhanced the Company's equity base. As a result, the share capital of Zapf Creation AG rose from € 13.2 million by € 4.8 million to € 18.0 million; it was recorded in the commercial register on March 19, 2008.

On May 27, 2008, the Annual Shareholders' Meeting resolved to create new authorized capital (Authorized Capital 2008) and amend Article 5 of the Articles of Incorporation (Amount and breakdown of share capital). As a result of this resolution, Article 5 of the articles of incorporation of Zapf Creation AG authorizes the following capital increases:

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 shareholders' statutory subscription right in the following cases:

a) In connection with fractional shares;

b) 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) of € 1,800,000.00 or (2) 10 % of the Company's share capital extant 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 para 1 and 2 and Section 186 para 3 sentence 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 para 3 sentence 4 German Stock Corporation Act;

c) 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; or

d) In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in return for the transfer to the Company of loan and/or interest payables under loans granted to it.

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 2008.

On June 5, 2008, Zapf Creation AG announced that its Management Board, as planned and previously announced, resolved to convert into equity all outstanding subordinate shareholder loans, including accrued interest, amounting to € 5.0 million by way of a capital increase against in-kind contributions. The Management Board's decision was made on May 29, 2008, and approved by the Supervisory Board on June 5, 2008. For this purpose, a total of 1,295,853 new shares were issued by utilizing part of the new authorized capital (Authorized Capital 2008) created at the Annual Shareholders' Meeting on May 27, 2008. The amount in shareholder loans contributed per new share was € 3.86. The non-cash capital increase lifted the share capital of Zapf Creation AG by € 1,295,853, from € 18.0 million to approximately € 19.3 million. The capital increase was recorded in the commercial register on June 11, 2008. The amendment of Article 5 of the Articles of Incorporation (Amount and breakdown of share capital) became effective through the resolution of the Supervisory Board on June 10, 2008. The full conversion of the shareholder loans into equity completed the implementation of the Group's long-term financing concept that was agreed between Zapf Creation, its major shareholders and an international consortium of banks on July 20, 2007. This measure significantly reduces the Group's future interest expense. After partial utilization, the remaining authorized capital from May 27, 2008 (Authorized Capital 2008) is € 7,704,147.00.

As a result of the conversion, the percentage of the share capital held by the Group's major shareholders MGA Entertainment, Inc. or its shareholders ("Trusts") and Mr. Nicolas Mathys increased to 44.44 % and 19.45 %, respectively. As a result of additional share purchases, their share has increased to 44.66 % and 20.50 %, respectively, by November 7, 2008.

Treasury shares

By resolution of the Annual Shareholders' Meeting dated May 27, 2008, 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) 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

e) retire such shares.

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 May 27, 2008, the day on which the Annual Shareholders' Meeting adopts the resolution (€ 18,000,000.00). 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.

The authorization to acquire treasury shares shall remain in effect until November 26, 2009 (inclusive). The authorization to purchase treasury shares that was adopted by the Company's Annual Shareholders' Meeting on November 20, 2007, and that was not exercised – as well as the authorizations, which were issued as part of this resolution to use the treasury shares that the Company is already holding at the time the Annual Shareholders' Meeting adopts its resolutions on November 20, 2007 – expire at the time this new authorization takes effect. The authorizations contained in the aforementioned resolution of the Company's Annual Shareholders' Meeting on November 20, 2007, regarding the utilization of treasury shares repurchased pursuant thereto remain in place.

The buyback pursuant to this new authorization 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.

As of September 30, 2008, the new authorization granted by the Annual Shareholders' Meeting on May 27, 2008, to acquire treasury shares had not been exercised.

3. Related party relationships

Disclosures of relationships and business transactions with related parties are made in accordance with IAS 24 ("Related Party Disclosures"), taking into account IAS 34 ("Interim Financial Reporting").

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 following change with regard to the composition of the Management Board occurred during the period under review: In September 2008, the Company's Supervisory Board appointed Mr. Stephan F. Brune member and chairman of the Management Board effective October 1, 2008. In particular, Mr. Brune is responsible for Strategic and Corporate Development, Human Resources, and Public Relations. He previously worked for the Saga Group, a global manufacturer and distributor of luxury goods such as jewelry, watches, and accessories, as well as for the British consumer goods manufacturer, Reckitt Benckiser.

Mr. Thomas Pfau, responsible for Marketing, Sales, Design, and Product Development, will resign from the Company at his own request effective November 30, 2008, in order to take on new professional challenges. The Group's CEO will take over his responsibilities until further notice.

The total compensation of K€ 422 (previous year: K€ 374) 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 one-time consideration paid to former members of the Management Board.

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.

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 first nine months of the 2008 financial year. Regarding details, please also see the consolidated financial statements as of December 31, 2007. From January 1 to September 30, 2008, members of the Management Board were granted 10,000 phantom options at a base price of € 3.59, 15,000 phantom options at a base price of € 3.50, and 34,000 phantom options at a base price of € 2.99. During the same period in the previous year, members of the Management Board were granted 30,000 phantom options at a base price of € 8.60, 15,000 phantom options at a base price of € 9.16, and 33,000 phantom options at a base price of € 4.67. Due to the development of the share price, until September 30, 2008, as in the previous year, an addition to the provision for obligations under phantom shares had to be recognized in income only with regard to options that were newly granted during the first nine months of the respective financial year.

As in the same period the previous year, no one-off compensation was paid to former Board members in the first nine months of the 2008 financial year.

One former member of the Management Board was granted a variable credit line in the maximum amount of K€ 625 until December 31, 2007. As of September 30, 2008, the loan continued to be fully utilized; as in the previous year, no repayments were made. The interest rate agreed for the loan was 4.25 %. It was fixed until December 31, 2007, the loan's due date. Because of interest receivables totaling K€ 80, the total amount due to the Company as of September 30, 2008 increased to K€ 705 (previous year: K€ 665). The loan is secured by a land charge in the amount of K€ 200 (previous year: K€ 200); as in the previous year, it was written off including interest receivables as of September 30, 2008.

3.2. Supervisory Board

The following change with regard to the composition of the Supervisory Board occurred during the period under review: Effective at the end of the Company's Annual Shareholders' Meeting on May 27, 2008, Mr. Francesc Robert, who had been vice chairman of the Supervisory Board since July 28, 2006, and a member of the Supervisory Board since May 11, 2005, resigned from the Supervisory Board. For the remainder of Mr. Robert's term of office, Mr. Nicolas Mathys, Baar, Switzerland, was elected to the Supervisory Board. Mr. Mathys has also been serving as vice chairman of the Supervisory Board since May 27, 2008.

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. As in the previous year, the addition to the provision for the fixed component of the Supervisory Board compensation as of September 30, 2008 was made pro rata temporis.

Also 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. Regarding the details of the variable compensation component, please also see the consolidated financial statements as of December 31, 2007.

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 by way of two non-cash capital increases and upon entry in the commercial register on March 19, 2008 and June 11, 2008; insofar please also see Section 2.3.

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 Licence 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.

The following income and expenses resulted from this partnership in the first nine months of the 2008 financial year:

Cooperation agreements	Q1–Q3/2008 K€	Q1–Q3/2007 K€
Agreement 1: "Distribution Agreement" Income from Agreement 1	875	1,535
Agreement 2: "Consignment and Services Agreement" Income from Agreement 2	968	776
Agreement 3: "Logistics Service Agreement" Income from Agreement 3	1,262	1,252
Agreement 4: "Hong Kong / China Services Agreement" Expenses from Agreement 4	1,512	1,724
Agreement 5: "Merchandising Licence Agreement" Income from Agreement 5	0	0
Agreement 6: "UK Services Agreement" Income from Agreement 6	421	0
Expenses from Agreement 6	130	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	Q1–Q3/2008 K€	Q1–Q3/2007 K€
Income from cross charges	1,467	1,661
Expenses from cross charges	2,338	694

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	Q1–Q3/2008 K€	Q1–Q3/2007 K€
Merchandise procurement in the reporting period	30,546	30,238

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 services received directly	Q1–Q3/2008 K€	Q1–Q3/2007 K€
Income from direct services	0	1,866

The income of the Zapf Creation AG from other services received directly from or delivered directly to the related companies of the MGA Group in the previous year resulted from the sale of remaining inventories of the Company's US subsidiary to MGA Entertainment, Inc. Van Nuys, California, USA, which has been responsible for serving the American market under a strategic partnership since January 1, 2007; insofar please also see the disclosures regarding discontinued operations.

Other business transactions were as follows:

The subordinate shareholder loans included in the Company's financing concept, including pro rated interest owed, were fully converted into equity by way of two non-cash capital increases and upon entry in the commercial register on March 19, 2008 and June 11, 2008; insofar please also see Section 2.3.

The receivables and liabilities of the Zapf Creation Group that result from the partnership with related parties of the MGA Group as of September 30, 2008 are as follows:

Balances as of the balance sheet date	Sep. 30, 2008 K€	Sep. 30, 2007 K€
Receivables from related parties	4,566	4,855
Liabilities to related parties	16,283	19,866

4. Events after the close of the reporting period

For information regarding significant events after the close of the reporting period, with the exception of directors' dealings, please see the disclosures in the interim management report of the Group as of the end of the third quarter of 2008.

5. Directors' dealings

During the period from January 1 to November 7, 2008, the officers and directors of the Company reported the following securities dealings as defined by Section 15a of the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG):

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on January 21, 2008, it had purchased a total of 63,335 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.73 per share for a total transaction volume of € 172,619.54.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on January 22, 2008, it had purchased a total of 29,938 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.59 per share for a total transaction volume of € 77,539.42.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on January 23, 2008, it had purchased a total of 29,730 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.61 per share for a total transaction volume of € 77,654.76.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 28, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on January 25, 2008, it had purchased a total of 3,568 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.70 per share for a total transaction volume of € 9,633.60.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on February 13, 2008, it had purchased a total of 10 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.65 per share for a total transaction volume of € 26.50.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on February 29, 2008, it had purchased a total of 891,583 shares of Zapf Creation AG stock (ISIN DE 000A0SLRM6) at a price of € 2.69 per share for a total transaction volume of € 2,398,358.27.

Attorneys for the Isaac Larian Annuity Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on February 29, 2008, it had purchased a total of 1,762,065 shares of Zapf Creation AG stock (ISIN DE 000A0SLRM6) at a price of € 2.69 per share for a total transaction volume of € 4,739,954.85.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on February 29, 2008, it had purchased a total of 194,934 shares of Zapf Creation AG stock (ISIN DE 000A0SLRM6) at a price of € 2.69 per share for a total transaction volume of € 524,372.46.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on February 29, 2008, it had purchased a total of 156,484 shares of Zapf Creation AG stock (ISIN DE 000A0SLRM6) at a price of € 2.69 per share for a total transaction volume of € 420,941.96.

Attorneys for the Shirin Larian Makabi Annuity Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on February 29, 2008, it had purchased a total of 194,934 shares of Zapf Creation AG stock (ISIN DE 000A0SLRM6) at a price of € 2.69 per share for a total transaction volume of € 524,372.46.

Mr. Thomas Pfau, member of the Management Board, notified Zapf Creation AG on June 4, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on May 29, 2008, he had purchased a total of 5,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.98 per share for a total transaction volume of € 19,900.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on June 10, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 10, 2008, it had purchased a total of 238,936 shares of Zapf Creation AG stock (ISIN DE 000A0V9MG2) at a price of € 3.86 per share for a total transaction volume of € 922,295.65.

Attorneys for the Isaac Larian Annuity Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on June 10, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 10, 2008, it had purchased a total of 472,217 shares of Zapf Creation AG stock (ISIN DE 000A0V9MG2) at a price of € 3.86 per share for a total transaction volume of € 1,822,760.08.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on June 10, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 10, 2008, it had purchased a total of 52,240 shares of Zapf Creation AG stock (ISIN DE 000A0V9MG2) at a price of € 3.86 per share for a total transaction volume of € 201,649.96.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on June 10, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 10, 2008, it had purchased a total of 41,935 shares of Zapf Creation AG stock (ISIN DE 000A0V9MG2) at a price of € 3.86 per share for a total transaction volume of € 161,872.30.

Attorneys for the Shirin Larian Makabi Annuity Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on June 10, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 10, 2008, it had purchased a total of 52,240 shares of Zapf Creation AG stock (ISIN DE 000A0V9MG2) at a price of € 3.86 per share for a total transaction volume of € 201,649.96.

Mr. Nicolas Mathys, member and vice chairman of the Supervisory Board, notified Zapf Creation AG on June 10, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 10, 2008, he had purchased a total of 438,285 shares of Zapf Creation AG stock (ISIN DE 000A0V9MG2) at a price of € 3.86 per share for a total transaction volume of € 1,691,780.65.

Mr. Nicolas Mathys, member and vice chairman of the Supervisory Board, notified Zapf Creation AG on June 13, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 13, 2008, he had purchased a total of 50,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.98 per share for a total transaction volume of € 199,236.00.

Mr. Thomas Pfau, member of the Management Board, notified Zapf Creation AG on June 25, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on June 17, 2008, he had purchased a total of 4,600 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.95 per share for a total transaction volume of € 18,170.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on July 17, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on July 15, 2008, it had purchased a total of 20,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.12 per share for a total transaction volume of € 62,400.00.

Mr. Nicolas Mathys, member and vice chairman of the Supervisory Board, notified Zapf Creation AG on July 23, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on July 22, 2008, he had purchased a total of 50,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.37 per share for a total transaction volume of € 168,320.00.

Attorneys for the Isaac Larian Annuity Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on July 23, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on July 22, 2008, it had purchased a total of 1,125 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.12 per share for a total transaction volume of € 3,510.00.

Mr. Nicolas Mathys, member and vice chairman of the Supervisory Board, notified Zapf Creation AG on July 28, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on July 25, 2008, he had purchased a total of 15,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.20 per share for a total transaction volume of 47,986.50.

Attorneys for the Isaac and Angela Larian Living Trust, a trust related to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on September 22, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on September 18, 2008, it had purchased a total of 21,500 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.50 per share for a total transaction volume of € 53,750.00.

Mr. Nicolas Mathys, member and vice chairman of the Supervisory Board, notified Zapf Creation AG on September 29, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on September 26, 2008, he had purchased a total of 74,800 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.28 per share for a total transaction volume of € 170,454.24.

Mr. Nicolas Mathys, member and vice chairman of the Supervisory Board, notified Zapf Creation AG on September 30, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on September 30, 2008, he had purchased a total of 13,054 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.15 per share for a total transaction volume of € 28,107.87.

Mr. Jens U. Keil, member of the Management Board, notified Zapf Creation AG on October 10, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on October 8, 2008, he had purchased a total of 5,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 1.90 per share for a total transaction volume of € 9,500.00.

Mr. Thomas Pfau, member of the Management Board, notified Zapf Creation AG on October 23, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on October 14, 2008, he had purchased a total of 775 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.00 per share for a total transaction volume of € 1,550.00.

Mr. Thomas Pfau, member of the Management Board, notified Zapf Creation AG on October 23, 2008, in accordance with Section 15a German Securities Trading Act (WpHG) that on October 16, 2008, he had purchased a total of 10,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 1.80 per share for a total transaction volume of € 18,000.00).

The Company was not notified of any other transactions requiring disclosure made by members of the Management Board or the Supervisory Board, their spouses or immediate relatives. All members of the Management Board and the Supervisory Board have been informed in detail regarding the disclosure requirement.

Roedental, Germany, November 7, 2008

Stephan F. Brune
Chairman of the
Management Board

Jens U. Keil
Member of the
Management Board

Thomas Pfau
Member of the
Management Board

Responsibility statement

"To the best of our knowledge, and in accordance with the applicable reporting principles for interim financial reporting, the interim consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Zapf Creation Group, and the interim management report of the group 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 for the remaining months of the financial year."

Roedental, Germany, November 7, 2008

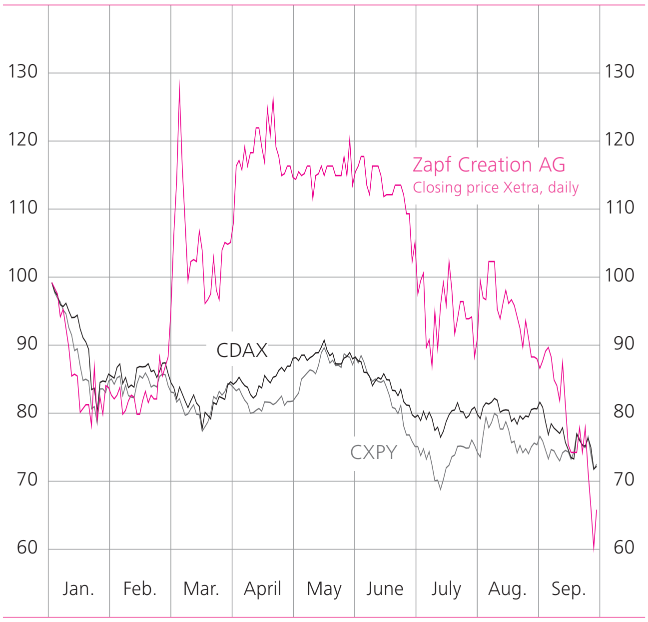
Stephan F. Brune
Chairman of the
Management Board

Jens U. Keil
Member of the
Management Board

Thomas Pfau
Member of the
Management Board

The share

Indexed share price performance, December 31, 2007 = 100



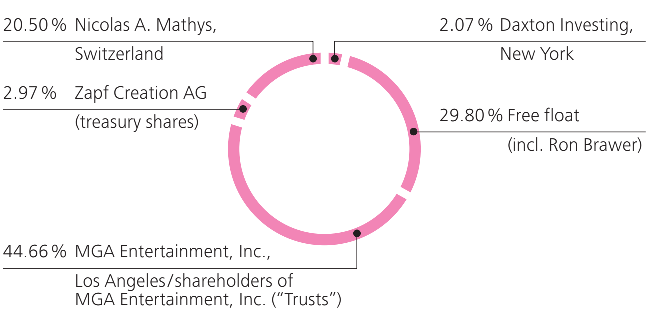
The shares of Zapf Creation AG opened the 2008 financial year at a price of € 3.36. By January 31, 2008, however, the shares had fallen by 18% from the year's opening price to € 2.78, largely paralleling both the CDAX Performance Index and the CXPY Consumer Performance Index. The share price then hovered around € 2.80 until the end of February 2008, rising to € 3.00 after the preliminary, unaudited figures for the 2007 financial year were announced on February 25, 2008. Registering high trading volumes on the most important stock exchanges, the share price gained substantially in the first week of March, reaching € 4.40 on March 5, 2008, its high for the year. From this high, it fell to € 3.28 on March 18, 2008, only to rise yet again to € 3.60 on March 31, 2008. The share price quickly rose to € 4.00 in the first week of April and remained at a level of around € 4.00 despite the capital increase in June. It fell to € 3.75 towards the of the second quarter, reflecting the general trend on the stock markets, thus closing the first half-year on June 30, 2008 with a gain of more than 10%. The performance of the Group's shares in the third quarter of 2008 was by no means satisfactory. While the share price fluctuated between € 2.95 and € 3.50 until August 11, 2008, it closed at € 2.50 on that day; this level marked the onset of an alarming downward spiral, which continued until September 29, 2008, when it reached its low for the third quarter (€ 2.00). The following day, it rose to € 2.20, closing the quarter at a price that was down 35% from the start of the year. This extremely negative performance in the second half of the third quarter does not reflect the operating performance of Zapf Creation AG but rather the extreme uncertainties currently impacting the financial and capital markets.

Financial calendar

Date	Event	Place
November 10–12, 2008	German Equity Forum 2008	Frankfurt am Main

Shareholder structure*

Share capital (no-par shares): 19,295,853



* The figures are based on the notifications under Sections 15a and 21 German Securities Trading Act received by Zapf Creation AG until October 1, 2008.

Directors' dealings

During the period from January 1 to November 7, 2008, the officers and directors of the Company reported the following securities dealings as defined by Section 15a of the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG).

Name, Function	Date	Transaction	Stock exchange	Number of shares	Price in €
Thomas Pfau, member of the Management Board	Oct. 16, 2008	Purchase	XETRA	10,000	1.80
Thomas Pfau, member of the Management Board	Oct. 14, 2008	Purchase	XETRA	775	2.00
Jens U. Keil, member of the Management Board	Oct. 08, 2008	Purchase	XETRA	5,000	1.90
Nicolas Mathys, member of the Supervisory Board	Sep. 30, 2008	Purchase	XETRA	13,054	2.1532
Nicolas Mathys, member of the Supervisory Board	Sep. 26, 2008	Purchase	XETRA	74,800	2.2788
Isaac Larian, member of the Supervisory Board	Sep. 18, 2008	Purchase	XETRA	21,500	2.5
Nicolas Mathys, member of the Supervisory Board	July, 25, 2008	Purchase	XETRA	15,000	3.1991
Isaac Larian, member of the Supervisory Board	July, 22, 2008	Purchase	XETRA	1,125	3.12
Nicolas Mathys, member of the Supervisory Board	July, 22, 2008	Purchase	XETRA	50,000	3.3664
Isaac Larian, member of the Supervisory Board	July, 15, 2008	Purchase	XETRA	20,000	3.12

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