



**Zapp**  
Creation®

## AT A GLANCE

Zapf Creation AG

Consolidated Key Figures	Q2 / 2004	Q2 / 2005	H1 / 2004	H1 / 2005	H1 +/- in % <sup>1)</sup>
<b>Income statement</b>					
Net sales in K€	30,577	18,469	49,712	36,754	- 26
EBITDA in K€	4,256	- 8,825	3,792	- 12,337	n/a
EBIT in K€	2,513	- 10,524	446	- 15,709	n/a
Net income (loss) in K€	1,198	- 11,425	- 629	- 17,335	•
Earnings per share <sup>2)</sup> in €	0.16	- 1.54	- 0.08	- 2.33	•
<b>Balance sheet</b>					
Total assets (as of June 30) in K€	142,041	119,780	142,041	119,780	- 16
Investments in K€	1,647	558	3,309	1,380	- 58
<b>Cash flow</b>					
Net cash flow per share in €	- 2.23	- 1.00	- 2.71	- 0.60	- 78
<b>Stock</b>					
Stock price, high (Xetra) in €	21.74 (April 19)	11.20 (May 13)	23.79 (Feb. 18)	18.03 (Feb. 1)	- 24
Stock price, low (Xetra) in €	17.10 (June 1)	8.80 (June 27)	17.10 (June 1)	8.80 (June 27)	- 49
Stock price, end of period (Xetra) in €	19.35	9.71	19.35	9.71	- 50
Stock price, average (Xetra) in €	19.14	10.27	20.38	12.44	- 39
Average daily trading volume (Xetra, number of shares)	30,559	52,220	38,226	65,137	70
Market capitalization (Base: end of period) in € million	155	78	155	78	- 50
Number of employees at the closing date (as of June 30) <sup>3)</sup>	484	476	484	476	- 2

1) rounded

2) 2005: basic = diluted; 2004: basic

3) not including Management Board and trainees

### Financial Calendar

Date	Event	Place
July 26, 2005	Results Q2 / half-year 2005	Roedental
July 26, 2005	Analyst Conference	Frankfurt / Main
July 26, 2005	Global Conference Call	
July 29, 2005	Roadshow	Copenhagen
September 5 to 9, 2005	Roadshow	North America
November 16, 2005	Results Q3 / 9 months 2005	Roedental
November 16, 2005	Global Conference Call	
November 21 to 23, 2005	German Equity Capital Forum	Frankfurt / Main

- Decline in sales by 26% in line with expectations
- € 6 million one-off charge related to the realignment program has extraordinary impact on earnings for the first half of the year
- Change in method of allocating costs results in shift of margins and earnings during the course of the year
- Business is expected to stabilize in the second half of the year

In the first six months of the year, Zapf Creation AG recorded sales of € 36.8 million, down 26% from the same period last year. At 48%, the gross margin was about 9% below the previous year's level. If the gross margin is considered using the historical method of allocating costs, it would be 55%, close to the level for the previous year's comparable period. Earnings before income and taxes (EBIT) for the first six months of 2005 were € – 15.7 million and were impacted by an extraordinary charge of € 6 million from the full accrual of the realignment costs. The net loss for the period was € 17.3 million. Earnings per share were thus € – 2.33.

The negative cash flow from operating activities declined significantly compared to the first six months of 2004. Improved receivables management and more cautious procurement behavior with regard to Far Eastern suppliers have already shown positive results. However, the redemption of liabilities toward banks in the amount of € 11.5 million and a decline in sales of about € 13 million in the first six months of 2005 reduced liquidity.

Net debt fell from € 70.1 million to € 61.3 million compared to the first six months of 2004. The improved management of working capital had a positive effect even though this effect was reduced by the net loss of € 17.3 million for the period.

### Weak performance in Central Europe and the Americas

At € 9.6 million, sales in Central Europe were significantly below the previous year's level of € 18.1 million. This is due primarily to the decline in the German market for play and functional dolls, in which Zapf Creation has a market share of about 61% as of the end of the second quarter. In addition, the trade continued to reduce inventories. The planned discontinuation of the BABY born® miniworld brand and the related product sell-off also contributed to the sales decline. Weak sell-throughs of My Model accessories continued in the second quarter. We expect the market launch of the new My Model PROFESSIONAL styling heads in the second half of the year to provide new momentum for this brand concept. Furthermore, the sales figures for the first six months of 2004 already contained the effect of the market launch of the New BABY born® (with bathing function), which in Germany had already taken place in the second quarter of 2004 due to the significance of the brand concept in that market. This year, however, all major worldwide product launches will occur in the second half of the year.

At € 11.8 million (previous year: € 12.6 million), sales in Northern Europe were as expected. In Great Britain, the market launch of the new Baby Annabell, which can shed real tears, will stimulate growth in the second half of the year due to the concept's high popularity. In a stable market environment, Zapf Creation succeeded in increasing its market share for play and functional dolls in Great Britain to about 36% in the first half of 2005.

At € 5.8 million (previous year: € 5.9 million), sales in Southern Europe were also within planned targets. In Italy, Zapf Creation achieved the largest growth in the play and functional doll segment and was the third-largest provider in this category with a market share of 6.5% as of the end of June 2005. Zapf Creation's core business also grew in Spain, where the company has a market share of 21% as of the end of June and is in second place in this market segment.

Due to ongoing positive developments in Russia, sales in Eastern Europe increased to € 4.2 million (previous year: € 1.9 million).

(Source for market share and rankings: NPD/Eurotoys June 2005)

## REPORT FOR THE FIRST HALF-YEAR 2005

Zapf Creation AG

At sales of € 4.2 million (previous year: € 8.2 million), the Americas performed below expectations. This is due primarily to the continued aggressive reduction of the company's own inventories. Expressed in the local currency, sales were \$ 5.4 million (previous year: \$ 10.1 million).

The expected decline in sales in Asia/Australia to € 1.1 million (previous year: € 3.0 million) occurred mainly on the Australian market, where Zapf Creation has been cooperating with a distribution partner since November 2004. This partner took over the entire inventory of the company's former Australian subsidiary, which lasted far into the first six months of the current year.

### Breakdown of Sales by Business Unit

	H1/2004	H1/2005	+/-	+/-
	K€	K€	% <sup>1)</sup>	K€
<b>Europe</b>	<b>38,495</b>	<b>31,421</b>	<b>- 18</b>	<b>- 7,074</b>
Central Europe	18,112	9,601	- 47	- 8,511
Northern Europe	12,612	11,800	- 6	- 812
Southern Europe	5,875	5,786	- 2	- 89
Eastern Europe	1,896	4,234	123	2,338
<b>The Americas</b>	<b>8,212</b>	<b>4,229</b>	<b>- 49</b>	<b>- 3,983</b>
<b>Asia/Australia</b>	<b>3,005</b>	<b>1,104</b>	<b>- 63</b>	<b>- 1,901</b>
<b>Net sales</b>	<b>49,712</b>	<b>36,754</b>	<b>- 26</b>	<b>- 12,958</b>

1) rounded

### Baby Annabell is the most popular doll in Great Britain

The BABY born® brand posted a decline in sales of 17% to € 18.0 million (previous year: € 21.7 million). This is due primarily to the fact that positive sales momentum was achieved in the same period of the previous year through the launch of the New BABY born® with bathing function in Germany.

Baby Annabell sales declined to € 9.6 million (previous year: € 12.8 million), as anticipated, in light of the planned worldwide market launch of the new Baby Annabell in the second half of the year. This is due to the trade's restraint in ordering

the doll's predecessor generation. The new Baby Annabell will stimulate sales especially in Great Britain, because this popular functional doll once again was the number one on the British doll market as of the end of June 2005.

The decline in the CHOU CHOU concept stems mainly from the fact that sales from advertising campaigns aimed at selling Rock-a-bye CHOU CHOU were contained in the results for the first six months of 2004. This campaign served to sell off existing inventories of this doll faster in view of preparing the market for the launch of Love me CHOU CHOU, the new functional doll, during the Christmas season. As of the end of June 2005, sales of € 6.8 million (previous year: € 9.2 million) were achieved here.

The decline in sales for mini dolls to K€ 926 (previous year: € 2.0 million) is within the targeted range. BABY born® miniworld is currently being sold off, especially in Germany, as this product line will be discontinued at the end of the current fiscal year.

Weak My Model accessories business is the main reason for the decline to K€ 389 (previous year: € 2.2 million) in the Others category. Fresh momentum is expected from the market launch of the new My Model PROFESSIONAL heads in the second half of 2005.

### Breakdown of Sales by Product Group

	H1/2004	H1/2005	+/-	+/-
	K€	K€	% <sup>1)</sup>	K€
<b>Play and functional dolls</b>	<b>45,539</b>	<b>35,439</b>	<b>- 22</b>	<b>- 10,100</b>
BABY born®	21,667	18,045	- 17	- 3,622
Baby Annabell	12,782	9,631	- 25	- 3,151
CHOU CHOU	9,245	6,754	- 27	- 2,491
Others	1,845	1,009	- 45	- 836
<b>Mini dolls</b>	<b>1,981</b>	<b>926</b>	<b>- 53</b>	<b>- 1,055</b>
<b>All others</b>	<b>2,192</b>	<b>389</b>	<b>- 82</b>	<b>- 1,803</b>
<b>Net sales</b>	<b>49,712</b>	<b>36,754</b>	<b>- 26</b>	<b>- 12,958</b>

1) rounded

(Source for market share and rankings: NPD/Eurotoys June 2005)

## OUTLOOK

Zapf Creation AG

### **Zapf Creation is making rapid advances in the implementation of its realignment program**

Roughly three months after Zapf Creation initiated its realignment program, major initiatives have already been implemented. For example, the desired savings in both personnel and operating expenses have been achieved almost entirely. In addition, the conclusion of a structured financing agreement in July 2005 for € 112 million per year until 2007 represented a major milestone in the program's implementation. The credit lines and temporary loans thus made available will also secure peak capital needs in the third quarter required for financing operations.

### **New strategy for the US market has been defined**

In the United States, the company is making a new start by streamlining its organization and launching a lean product portfolio that has been adapted to market requirements. Under its new strategy for the US market, Zapf Creation will launch the 2006 season with two branded play concepts that include a lean range of accessories adapted to local requirements in terms of both prices and quality. Focusing on two concepts offers Zapf Creation the ability to market and advertise varying functional dolls with shorter product life cycles and specific themes in the accessories segment.

In addition, a more aggressively priced play doll product line without accessories will generate sales in the private label segment. We will continue to focus on the largest US distributors of toys and on online shops. In that connection, we are also intensifying our reliance on direct business with deliveries from Hong Kong, in order to minimize our US subsidiary's risks from goods and inventories. These fundamental changes will allow Zapf Creation to achieve modest sales growth starting in 2006 and to post a positive contribution to earnings by boosting efficiency, especially in marketing.

### **Stabilization of business in the second half of the year – positive EBIT expected for 2005**

The introduction of product highlights such as, for example, the new Baby Annabell, which can shed real tears, will generate sales momentum worldwide in the second half of the year. In terms of earnings, the measures initiated in the realignment program to reduce personnel and operating expenses will increase profitability. Measures implemented in the first six months of the year will yield cost savings of € 6 million in 2005.

In 2005, Zapf Creation expects sales to decline by about 10% to € 160 million, as well as an operating profit (EBIT) of € 5 million before one-off charges. The net loss forecast for the year, after one-off realignment charges of € 6.0 million, will be around € – 4.7 million.

## THE STOCK

Zapf Creation AG

### Zapf Creation stock

Zapf Creation stock continued its downward trend in the second quarter and reached its quarterly low of € 8.80 on June 27, 2005. The price recovered temporarily to € 11.20 on May 13, 2005, which was shortly after the Annual Stockholders' Meeting on May 11, 2005. This was certainly due to stockholder expectations in view of the majority decision to change the composition of the Supervisory Board of Zapf Creation AG that was taken at the Annual Stockholders' Meeting. As a result of the votes, Messrs. Martin Gruschka, Gustavo Perez and Francesc Robert were newly elected to the Supervisory Board.

The request to change the composition of the Supervisory Board was presented to the company by Heritage Bank & Trust on April 26, 2005 by way of a counter-motion regarding item no. 5 on the agenda of the Annual Stockholders' Meeting. This resulted in a presence of approximately 36% at this year's Annual Stockholders' Meeting, far above the average of previous years, which was approximately 20%.

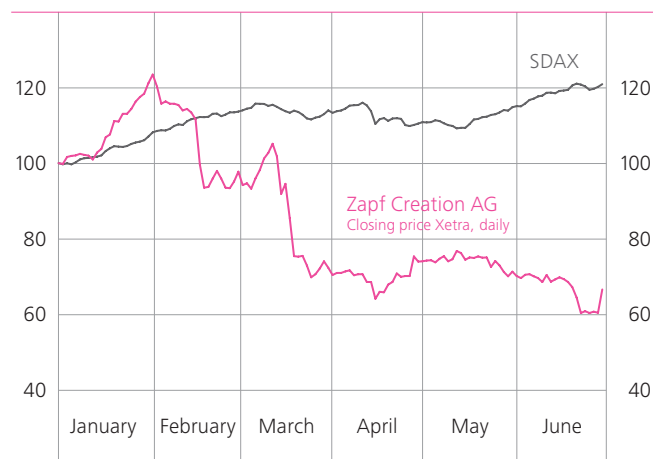
Dr. Dietmar Scheiter, who had chaired the Supervisory Board of Zapf Creation AG since April 1999, announced his resignation from the Supervisory Board on July 7, 2005. He will leave the Supervisory Board effective August 5, 2005. Also on July 7, 2005, Martin Gruschka was elected new chairman of the Supervisory Board.

### Changes to the Supervisory Board

Supervisory Board	Occupation
Martin Gruschka (elected on May 11, 2005; chairman since July 7, 2005)	Member, Springwater Capital LLC
Gustavo Perez (elected on May 11, 2005; deputy chairman)	Chief executive officer, Betham Capital Investment
Dr. Peter Klein (reelected on May 11, 2005, membership temporarily non-active since February 22, 2005)	Managing partner, Klein & Company GmbH
Francesc Robert (elected on May 11, 2005)	Deputy chief executive officer, La Seda de Barcelona S.A.
Dr. Dietmar Scheiter (will leave the Supervisory Board effective August 5, 2005)	Chief executive officer, TA Triumph-Adler AG
Arndt Wolpers (reelected on May 11, 2005)	Managing director, Capital Management Wolpers GmbH
Dr. Petra Wibbe (left the Supervisory Board on May 11, 2005)	Lawyer
Hans-Gerd Füchtenkort (left the Supervisory Board on May 11, 2005)	Managing partner, Dr. Rochus Mummert & Partner

### Stock Performance

January 1 to June 30, 2005 (Index)



ISIN	DE 000 780 6002
Reuters code	ZPF.ETR
Bloomberg code	ZPF GR
Number of shares	8 million

## THE STOCK

Zapf Creation AG

### Research Coverage

Analyst	Date	Recommendation
Berenberg Bank	July 2005	Hold
Cazenove	July 2005	Hold
Deutsche Bank	July 2005	Sell
Bankhaus Lampe	May 2005	Hold
ABN Amro	April 2005	Sell
Bayerische Landesbank	April 2005	Buy
DZ Bank	April 2005	Sell
HypoVereinsbank	April 2005	Sell
Commerzbank	March 2005	Sell
Hamburger Sparkasse	March 2005	Sell

### Directors' dealing

During the period from April 1 to June 30, 2005, the officers and directors of the Company did not engage in any directors' dealings as defined by § 15a of the German Securities Trading Act (WpHG).

### Treasury stock

Zapf Creation AG owns two separate securities portfolios, which are used in different ways:

Portfolio No. 1 exclusively serves to back the stock option plan. All previously existing stock option plans have been cancelled. The company is currently developing a new management incentive plan which could take effect 2006. Until that time, no changes are expected to occur in connection with this portfolio.

Portfolio No. 2 includes shares which in the past were frequently offered to employees at preferred prices because of the positive development of the Company's business or in connection with successfully completed projects.

There were no changes regarding the securities portfolios as compared to March 31, 2005.

	Stock Number	Book value K€	Capital share %
Portfolio No. 1	569,593	11,262	7.12
Portfolio No. 2	3,085	96	0.04
<b>Total</b>	<b>572,678</b>	<b>11,358</b>	<b>7.16</b>



## FINANCIAL STATEMENTS

Zapf Creation AG

<b>Consolidated Income Statement</b>	<b>Q2/2004</b>	<b>Q2/2005</b>	<b>H1/2004</b>	<b>H1/2005</b>	<b>H1 +/-</b>
	<b>K€</b>	<b>K€</b>	<b>K€</b>	<b>K€</b>	<b>%<sup>1)</sup></b>
Net sales	30,577	18,469	49,712	36,754	- 26
Cost of goods sold	- 12,799	- 9,577	- 21,456	- 19,252	- 10
<b>Gross profit</b>	<b>17,778</b>	<b>8,892</b>	<b>28,256</b>	<b>17,502</b>	<b>- 38</b>
Selling and distribution expenses	- 6,201	- 5,445	- 10,155	- 10,917	8
Marketing expenses	- 4,496	- 2,614	- 7,310	- 5,619	- 23
Administrative expenses, net	- 4,568	- 5,614	- 10,345	- 10,675	3
Restructuring costs	0	- 5,743	0	- 6,000	n/a
<b>EBIT – Operating profit before interest and taxes</b>	<b>2,513</b>	<b>- 10,524</b>	<b>446</b>	<b>- 15,709</b>	<b>n/a</b>
Interest income	80	58	129	158	22
Interest expense	- 743	- 998	- 1,485	- 1,702	15
<b>EBT – Profit before income tax expense</b>	<b>1,850</b>	<b>- 11,464</b>	<b>- 910</b>	<b>- 17,253</b>	<b>•</b>
Income tax expense	- 652	39	281	- 82	n/a
<b>Net income (loss)</b>	<b>1,198</b>	<b>- 11,425</b>	<b>- 629</b>	<b>- 17,335</b>	<b>•</b>
Gross margin in %	58.1	48.1	56.8	47.6	- 16

<b>Breakdown of personnel expenses<sup>2)</sup></b>	<b>Q2/2004</b>	<b>Q2/2005</b>	<b>H1/2004</b>	<b>H1/2005</b>	<b>H1 +/-</b>
	<b>K€</b>	<b>K€</b>	<b>K€</b>	<b>K€</b>	<b>%<sup>1)</sup></b>
Sales and distribution department	1,666	2,286	3,972	4,640	17
Marketing department	1,043	726	1,645	1,391	- 15
Administration department	3,277	2,053	5,661	4,728	- 16
<b>Total</b>	<b>5,986</b>	<b>5,065</b>	<b>11,278</b>	<b>10,759</b>	<b>- 5</b>

1) rounded

2) already included in operating expenses



## FINANCIAL STATEMENTS

Zapf Creation AG

Consolidated Balance Sheet	June 30, 2004	Dec. 31, 2004	June 30, 2005
	K€	K€	K€
<b>Assets</b>			
Cash and cash equivalents	8,069	17,041	5,498
Accounts receivable	42,060	53,861	32,333
Inventories	42,866	28,283	32,423
Prepaid expenses	6,363	4,970	6,139
Other currents assets	6,929	6,692	7,815
Deferred tax assets (short-term)	4,815	798	894
<b>Total current assets</b>	<b>111,102</b>	<b>111,645</b>	<b>85,102</b>
Property, plant, equipment and software, net	28,179	26,853	24,935
Intangible assets, net	2,304	5,314	4,944
Deferred tax assets (long-term)	406	3,897	4,489
Other long-term receivables	50	40	310
<b>Total long-lived assets</b>	<b>30,939</b>	<b>36,104</b>	<b>34,678</b>
	<b>142,041</b>	<b>147,749</b>	<b>119,780</b>
<b>Liabilities and stockholders' equity</b>			
Current portion of long-term debt and short-term borrowings	65,734	62,689	58,570
Accounts payable	11,087	13,148	10,356
Accrued liabilities	2,667	8,623	8,765
Income taxes payable	1,744	2,574	1,023
Deferred tax liabilities (short-term)	501	1,387	1,387
<b>Total current liabilities</b>	<b>81,733</b>	<b>88,421</b>	<b>80,101</b>
Long-term debt	12,480	10,604	8,227
Other long-term liabilities	47	0	0
Deferred tax liabilities (long-term)	585	684	706
<b>Total long-term liabilities</b>	<b>13,112</b>	<b>11,288</b>	<b>8,933</b>
Common stock	8,000	8,000	8,000
Additional paid-in capital	8,052	7,998	7,998
Treasury stock	– 11,358	– 11,358	– 11,358
Accumulated other comprehensive income (loss)	– 4,143	– 4,829	– 4,788
Retained earnings	46,645	48,229	30,894
<b>Total stockholders' equity</b>	<b>47,196</b>	<b>48,040</b>	<b>30,746</b>
	<b>142,041</b>	<b>147,749</b>	<b>119,780</b>

## FINANCIAL STATEMENTS

Zapf Creation AG

<b>Consolidated Statement of Cash Flows</b>	<b>H1/2004</b>	<b>H1/2005</b>
	<b>K€</b>	<b>K€</b>
<b>Cash flow from operating activities:</b>		
Net income (loss)	– 629	– 17,335
Adjustments to reconcile net income (loss) to net cash flow from operating activities:		
Depreciation and amortization	3,348	3,372
Loss (gain) on sale of property, plant, equipment and software	– 36	201
Increase (decrease) from changes in assets and liabilities:		
Accounts receivable	5,749	21,192
Inventories	– 13,749	– 4,128
Prepaid expenses and other assets	– 4,173	– 2,819
Accounts payable, accrued liabilities and other liabilities	– 7,685	– 2,876
Income taxes payable	275	– 1,382
Deferred taxes	– 3,245	– 666
<b>Net cash flow from operating activities</b>	<b>– 20,145</b>	<b>– 4,441</b>
<b>Cash flow from investing activities:</b>		
Proceeds from sale of property, plant, equipment and software	497	367
Capital expenditures	– 3,309	– 1,380
<b>Net cash flow from investing activities</b>	<b>– 2,812</b>	<b>– 1,013</b>
<b>Cash flow from financing activities:</b>		
Net borrowings under short- and long-term debt agreements	22,907	– 6,496
Payment of dividends	– 7,427	0
<b>Net cash flow from financing activities</b>	<b>15,480</b>	<b>– 6,496</b>
<b>Effects of foreign exchange rate changes</b>	<b>204</b>	<b>407</b>
<b>Net change in cash</b>	<b>– 7,273</b>	<b>– 11,543</b>
Cash at beginning of period	15,342	17,041
Cash at end of period	8,069	5,498

## FINANCIAL STATEMENTS

Zapf Creation AG

### Consolidated Statement of Stockholders' Equity

	Shares outstanding number (thsd.)	Common stock K€	Additional paid-in capital K€
<b>Balance at December 31, 2003:</b>	7,427	8,000	8,052
Net income (loss)			
Other comprehensive income (loss)			
<b>Total comprehensive income (loss)</b>			
Dividend payments			
Purchase of treasury stock			
Issuance of treasury stock			
<b>Balance at June 30, 2004:</b>	7,427	8,000	8,052
Net income (loss)			
Other comprehensive income (loss)			
<b>Total comprehensive income (loss)</b>			
Dividend payments			
Purchase of treasury stock			
Issuance of treasury stock			
Deferred taxes not affecting income			- 54
<b>Balance at December 31, 2004:</b>	7,427	8,000	7,998
Net income (loss)			
Other comprehensive income (loss)			
<b>Total comprehensive income (loss)</b>			
Dividend payments			
Purchase of treasury stock			
Issuance of treasury stock			
<b>Balance at June 30, 2005:</b>	7,427	8,000	7,998

### Notes

The consolidated financial statements of the Zapf Creation Group and its subsidiaries were prepared in accordance with the "United States Generally Accepted Accounting Principles" (US GAAP). All amounts are stated in euros ("€").

For the period from January 1 to June 30, 2005, no changes regarding the scope of consolidation, the principles of consolidation and the currency translation have to be noted as compared to the consolidated financial statements for fiscal year 2004. The accounting principles also remained the same.

The figures shown in the consolidated balance sheet, income statement, cash flow statement and development of stockholders' equity reflect the ordinary course of business at Zapf Creation AG and do not include extraordinary items.

No significant events took place after the closing date.

## FINANCIAL STATEMENTS

Zapf Creation AG

Treasury stock	Retained earnings	Accumulated other comprehensive income (loss)		Total equity
		Adjustments to currency translation	Derivative financial instruments	
K€	K€	K€	K€	K€
- 11,358	54,701	- 4,318	14	55,091
	- 629			- 629
		255	- 94	161
	- 629	255	- 94	- 468
	- 7,427			- 7,427
				0
				0
- 11,358	46,645	- 4,063	- 80	47,196
	1,584			1,584
		- 619	- 67	- 686
	1,584	- 619	- 67	898
				0
				0
				0
				- 54
- 11,358	48,229	- 4,682	- 147	48,040
	- 17,335			- 17,335
		132	- 91	41
	- 17,335	132	- 91	- 17,294
				0
				0
				0
- 11,358	30,894	- 4,550	- 238	30,746



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