QUARTERLY REPORT 1/2005

Zapf Creation®

Consolidated Key Figures	Q1/2004	Q1/2005	+/− in % [1]
Income statement			
Net sales in K€	19,135	18,285	− 4
EBITDA in K€	− 464	− 3,512	657
EBIT in K€	− 2,067	− 5,185	151
Net income (loss) in K€	− 1,827	− 5,910	223
Earnings per share [2] in €	− 0.25	− 0.80	223
Balance sheet			
Total assets in K€	127,171	126,665	0
Investments in K€	1,662	822	− 51
Cash flow			
Net cash flow per share in €	− 0.48	0.40	n/a
Stock			
Stock price, high (Xetra) in €	23.79 (Feb. 18)	18.03 (Feb. 1)	—
Stock price, low (Xetra) in €	19.18 (Mar. 26)	10.18 (Mar. 24)	—
Stock price, end of period (Xetra) in €	19.70	10.80	− 45
Average daily trading volume (Xetra, number of shares)	45,773	78,679	72
Market capitalization (Base: end of period) in € million	158	86	− 46
Number of employees at the closing date (March 31) [3]	537	494	− 8

1) rounded
2) basic = diluted
3) not including Management Board and trainees

Financial Calendar

Date	Event	Place
April 27, 2005	Results Q1/3 months 2005	Roedental
May 11, 2005	6th Annual Shareholders´ Meeting (AGM)	Roedental
May 23 to 24, 2005	Roadshow UK	London
May 31, 2005	8th German Corporate Conference (GCC)	Frankfurt/Main
July 2005	Roadshow USA	—
July 27, 2005	Results Q2/half-year 2005	Roedental
July 27, 2005	Global Conference Call	Roedental
November 16, 2005	Results Q3/9 months 2005	Roedental
November 16, 2005	Global Conference Call	Roedental
November 21 to 23, 2005	German Equity Capital Forum	Frankfurt/Main

- **First-quarter sales show slight decline of 4 %**
- **New method of allocating costs results in shift of margins and earnings during the course of the year**
- **Swift implementation of structural and organizational measures**

Zapf Creation AG recorded sales of about € 18.3 million in the first quarter, down 4 % compared to the same period last year. At 47.1 %, the gross margin was approximately 8 percentage points lower than in the first quarter of 2004. Earnings before interest and taxes (EBIT) came in at approximately € – 5.2 million, which is € 3.1 million below the previous year's first-quarter EBIT. This figure includes one-off restructuring charges of approximately € 260,000.

The decline in both gross margin and earnings results exclusively from a change in the method of allocating costs. Costs are now allocated to the accounting period in which they are incurred, enabling results to be presented in a timely manner. This change only affects the presentation of earnings during the course of the year. Net result for the period was € – 5.9 million. This resulted in negative earnings per share of € 0.80.

BABY born® concept profits from growing accessories business

Zapf Creation boosted sales of the BABY born® concept by 31 % to € 9.4 million in the first quarter. This increase is a result of the successful launch of the new BABY born® with a bathing function in the second half of 2004, which also provided positive momentum for accessories sales in the first quarter of 2005.

The market launch of the new Baby Annabell with its ability to shed tears, which is scheduled for the second half of this year, caused an expected sales decline to € 3.6 million (previous year: € 5.8 million). This is due to planned sales of the predecessor model and the trade's resulting reluctance to order merchandise.

In the “Others” category, a declining My Model accessories business is the primary reason for this development. The new My Model PROFESSIONAL heads will be introduced on the German market at the beginning of the second half of 2005.

Breakdown of Sales by Product Group

	Q1/2004 K€	Q1/2005 K€	+/– in % 1)
Play and functional dolls	**17,054**	**17,638**	**3**
BABY born®	7,230	9,443	31
Baby Annabell	5,856	3,619	– 38
CHOU CHOU	3,280	3,988	22
Others	688	588	– 15
Mini dolls	**891**	**409**	**– 54**
All others	**1,190**	**238**	**– 80**
Net sales	19,135	18,285	– 4

1) rounded

Growing business with play and functional dolls in Europe

At € 6.9 million, sales in Central Europe were down 19 % compared to the previous year (€ 8.5 million), which can be attributed primarily to business in Germany. The discontinuation of the BABY born® miniworld brand and weak sales for My Model accessories were the prime reasons for this development. In Germany, the market for play and functional dolls continued its slight decline in the first quarter. Zapf Creation was able to buck this trend and increase its market share from 61 % to 65 % (NPD/Eurotoys: 3/2005).

In Northern Europe, the company continued its positive performance by achieving sales growth of 9 % and sales of about € 4.0 million (previous year: € 3.7 million). In Great Britain, the largest European toy market, Zapf Creation was able to boost market share in its core business of play and functional dolls to about 39 % (NPD/Eurotoys: 3/2005).

Breakdown of Sales by Business Unit

	Q1/2004 K€	Q1/2005 K€	+/−1) in %
Europe	**15,196**	**15,099**	**− 1**
Central Europe	8,488	6,875	− 19
Northern Europe	3,717	4,055	9
Southern Europe	2,402	2,290	− 5
Eastern Europe	589	1,879	219
The Americas	**3,457**	**3,048**	**− 12**
Asia/Australia	**482**	**138**	**− 71**
Net sales	19,135	18,285	− 4

1) rounded

In the Southern Europe business unit, delayed order intake in the first quarter led to a marginal decline in sales to € 2.3 million (previous year: € 2.4 million).

In Eastern Europe, the continued positive development in Russia contributed to an increase in sales to € 1.9 million (previous year: K€ 589).

In the Americas, sales in local currency terms came in at approximately $ 4 million, which is slightly below the previous year's figure ($ 4.3 million). In euro terms, sales in the first quarter of 2005 were € 3.0 million, down 12 % compared to the year before (€ 3.4 million).

The decline in sales in Australia was according to plan and resulted from an October 2004 decision to cooperate with a distribution partner, Funtastic Ltd., from November 2004. Funtastic took over Zapf Creation's entire stock of merchandise in Australia, which lasts well into the first half of 2005.

Outlook: Systematic implementation of operative and structural realignment measures

Launched in mid-March 2005, the realignment program of Zapf Creation includes operative and structural as well as strategic measures aimed at achieving cost savings of approximately € 17 million (fully effective in 2007) and at enabling the company to return to its historic operating earnings margin of about 13 % in 2007.

The initiated measures to reduce personnel and operating expenses will result in cost savings of about € 6 million (before one-off charges) as early as 2005.

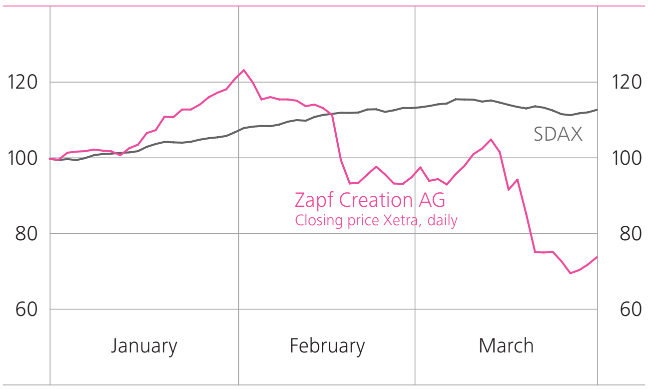
The planned reduction of operating expenses, which will make up around 60 % of overall savings, has already been fully integrated into the plan for 2005 and has been specified in detail on a country and product level. The planned reduction of around 135 jobs worldwide, which will contribute about 40 % to overall savings in 2005, has now begun. The first redundancy notices were sent out in America at the start of April 2005. The ongoing negotiations in Germany regarding a reconciliation of interests and a redundancy payment scheme will be concluded in May. The personnel reduction measures should be completed worldwide in June.

The impending decisions regarding all strategic measures such as the internationalization and market development strategy, especially relating to the United States, or the orientation of the brand portfolio will be announced together with the half-year results on July 27, 2005.

Zapf Creation stock

Zapf Creation stock began the new year at a price of € 15.75 on January 3, 2005, and reached its high of € 18.03 on February 1, 2005. The publication of initial, unaudited results for the 2004 fiscal year on February 16, 2005, which, in terms of earnings, came as a negative surprise for the capital markets, resulted in a drop to below € 15. With the announcement of the resignation of Rudolf Winning, CFO of Zapf Creation AG, on February 23, and the announcement, on March 16, not to propose a dividend payment for fiscal year 2004 to the Annual Stockholders' Meeting on May 11, 2005, the downward trend of the stock price continued. One day after the financial statements press conference, the price reached a historic low of € 10.18 on March 24, 2005.

Stock Performance
January 1 to March 31, 2005 (Index)



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

Directors' Dealing

Between January 1 and March 31, 2005, members of the family of Arndt Wolpers, member of the Supervisory Board of Zapf Creation AG, engaged in directors' dealings as defined by § 15a of the German Securities Trading Act (WpHG). The transactions took place on February 16, 2005. A total of 24,500 shares were sold at prices between € 14.63 and € 14.80.

Research Coverage

Analyst	Date	Recommendation
Bayerische Landesbank	April 2005	Buy
ABN Amro	March 2005	Sell
Bankhaus Lampe	March 2005	Sell
Berenberg Bank	March 2005	Buy
CAI Cheuvreux	March 2005	Underperform
Deutsche Bank	March 2005	Sell
DZ Bank	March 2005	Sell
Hamburger Sparkasse	March 2005	Sell
HypoVereinsbank	March 2005	Sell
Commerzbank	February 2005	Sell
Cazenove	July 2004	Hold

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.

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 December 31, 2004.

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

Consolidated Income Statement	Q1/2004 K€	Q1/2005 K€	+/– in % 1)
Net sales	19,135	18,285	– 4
Cost of goods sold	– 8,657	– 9,675	12
Gross profit	**10,478**	**8,610**	**– 18**
Selling and distribution expenses	– 3,954	– 5,472	38
Marketing expenses	– 2,814	– 3,005	7
Administrative expenses, net	– 5,777	– 5,061	– 12
Restructuring costs	0	– 257	n/a
EBIT – Operating profit before interest and taxes	**– 2,067**	**– 5,185**	**151**
Interest income	49	100	104
Interest expense	– 742	– 704	– 5
EBT – Profit before income tax expense	**– 2,760**	**– 5,789**	**110**
Income tax expense	933	– 121	n/a
Net income (loss)	– 1,827	– 5,910	223
Gross margin in %	54.8	47.1	– 14

Breakdown of personnel expenses 2)	Q1/2004 K€	Q1/2005 K€	+/– in % 1)
Sales and distribution department	2,306	2,354	2
Marketing department	602	665	10
Administration department	2,384	2,675	12
Total	5,292	5,694	8

1) rounded
2) already included in operating expenses

Consolidated Balance Sheet	Mar. 31, 2004	Dec. 31, 2004	Mar. 31, 2005
	K€	K€	K€
Assets			
Cash and cash equivalents	13,761	17,041	15,848
Accounts receivable	31,002	53,861	34,360
Inventories	33,047	28,283	27,032
Prepaid expenses	6,936	4,970	5,319
Other currents assets	6,956	6,692	7,655
Deferred tax assets (short-term)	4,181	798	838
Total current assets	**95,883**	**111,645**	**91,052**
Property, plant, equipment and software, net	28,539	26,853	26,217
Intangible assets, net	2,415	5,314	5,129
Deferred tax assets (long-term)	284	3,897	4,227
Other long-term receivables	50	40	40
Total long-lived assets	**31,288**	**36,104**	**35,613**
	127,171	147,749	126,665

Liabilities and stockholders' equity			
Current portion of long-term debt and short-term borrowings	45,067	62,689	60,628
Accounts payable	9,206	13,148	7,055
Accrued liabilities	4,106	8,623	4,050
Income taxes payable	824	2,574	1,441
Deferred tax liabilities (short-term)	500	1,387	1,387
Total current liabilities	**59,703**	**88,421**	**74,561**
Long-term debt	13,493	10,604	8,935
Other long-term liabilities	59	0	0
Deferred tax liabilities (long-term)	585	684	693
Total long-term liabilities	**14,137**	**11,288**	**9,628**
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)	– 4,237	– 4,829	– 4,483
Retained earnings	52,874	48,229	42,319
Total stockholders' equity	**53,331**	**48,040**	**42,476**
	127,171	147,749	126,665

Consolidated Statement of Cash Flows	Q1/2004 K€	Q1/2005 K€
Cash flow from operating activities:		
Net income (loss)	– 1,827	– 5,910
Adjustments to reconcile net income (loss) to net cash flow from operating activities:		
Depreciation and amortization	1,603	1,673
Loss (gain) on sale of property, plant, equipment and software	– 10	– 29
Increase (decrease) from changes in assets and liabilities:		
Accounts receivable	16,731	19,489
Inventories	– 3,934	1,248
Prepaid expenses and other assets	– 4,772	– 1,322
Accounts payable, accrued liabilities and other liabilities	– 8,241	– 10,674
Income taxes payable	– 643	– 1,131
Deferred taxes	– 2,490	– 361
Net cash flow from operating activities	– 3,583	2,983
Cash flow from investing activities:		
Proceeds from sale of property, plant, equipment and software	121	113
Capital expenditures	– 1,662	– 822
Net cash flow from investing activities	– 1,541	– 709
Cash flow from financing activities:		
Net borrowings under short- and long-term debt agreements	3,266	– 3,730
Net cash flow from financing activities	3,266	– 3,730
Effects of foreign exchange rate changes	277	263
Net increase in cash	– 1,581	– 1,193
Cash at beginning of period	15,342	17,041
Cash at end of period	13,761	15,848

Consolidated Statement of Stockholders' Equity

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

In the first quarter of 2005, forfaiting of trade receivables declined by about € 9 million compared to the first quarter of 2004. This difference is compensated for by an increase in short-term liabilities to banks.

		Accumulated other comprehensive income (loss)		
Treasury stock	Retained earnings	Adjustments to currency translation	Derivative financial instruments	Total equity
K€	K€	K€	K€	K€
– 11,358	54,701	– 4,318	14	55,091
	– 1,827			– 1,827
		288	– 221	67
	– 1,827	288	– 221	– 1,760
				0
				0
				0
– 11,358	52,874	– 4,030	– 207	53,331
	2,782			2,782
		– 652	60	– 592
	2,782	– 652	60	2,190
	– 7,427			– 7,427
				0
				0
				– 54
– 11,358	48,229	– 4,682	– 147	48,040
	– 5,910			– 5,910
		305	41	346
	– 5,910	305	41	– 5,564
				0
				0
				0
– 11,358	42,319	– 4,377	– 106	42,476

The cash flow from operating activities improved by more than € 6.5 million to € 3 million compared to the first quarter of 2004. This is essentially due to payments from Christmas 2004 sales, which were received in the first quarter, and to a further reduction of inventories.

No significant events took place after the closing date.

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