



Zapp
creation

At a Glance

Consolidated Key Figures

	Q1/2004	Q1/2003	+/- in % ¹⁾
Income Statement			
Net sales in K€	19,135	29,092	- 34
EBITDA in K€	- 464	3,723	n/a
EBIT in K€	- 2,067	2,131	n/a
Net income in K€	- 1,827	1,051	n/a
Basic earnings per share in €	- 0.25	0.13	n/a
Balance sheet			
Total assets as of March 31 in K€	127,171	125,151	2
Investments in K€	1,662	2,696	- 38
Cash flow			
Net cash flow per share in €	- 0.48	0.39	n/a
Stock			
Stock price, high (Xetra) in €	23.79 (Feb. 18)	30.00 (Mar. 21)	n/a
Stock price, low (Xetra) in €	19.18 (Mar. 26)	24.02 (Mar. 11)	n/a
Stock price, end of quarter (Xetra) in €	19.70	27.31	- 28
Stock price, average (Xetra) in €	21.60	26.27	- 18
Average daily trading volume (number of shares)	45,773	16,138	184
Market capitalization (base: end of quarter) in € million	158	218	- 28
Number of employees at the closing date (March 31) ²⁾	525	512	3

¹⁾ rounded

²⁾ not including management board and trainees

First Quarter Report 2004

Declining sales place strain on first quarter earnings

Zapf Creation AG recorded sales of € 19.1 million in the first quarter of 2004. Adjusted for currency translation effects, sales came to € 19.8 million. The decline in sales by just under € 10 million compared to the same quarter of last year is primarily attributable to the Central Europe operating business unit, which is a major contributor to sales from January to March. Especially in Germany, the seasonally weak first quarter is impacted by the fact that major new product launches will take place in the second half of the year. Furthermore, the conversion of IT systems in the logistics center has resulted in a reduced delivery capability in the Central Europe region and thus to a loss of Easter sales.

The gross margin in the first quarter was down approximately 110 basis points to 54.8 percent, primarily because of an increase in logistics costs. Although amortization and depreciation in the first quarter remained at the previous year's level and personnel expenses were down by approximately 4 percent to € 5.3 million, comparatively high fixed costs combined with the lower sales volume from January to March resulted in a negative operating result of minus € 2.1 million.

Equity ratio remains high

After two consecutive quarters with negative sales development, the operating cash flow decreased by approximately € 6.7 million due to a declining volume of payments received in the first quarter of 2004. The net cash used for operating activities amounted to approximately € 3.6 million. The Company's net debt increased by € 16.4 million to € 44.7 million compared to the first quarter of 2003. However, € 7.2 million of this amount is attributable to the purchase of treasury stock. The equity to assets ratio, less cash and cash equivalents, is about 47 percent.

Business development in the US is back on track

In Central Europe, first-quarter sales were € 8.5 million, down 50 percent compared to the previous year. In recent years, Germany in particular profited from new product launches in the first quarter, such as My Model (2003) and BABY born® miniworld (2002). Given that the BABY born® brand has reached a high maturity in Germany, the launch of the New BABY born® will be the most significant product innovation in this market. This product launch will take place in the second quarter of 2004 so that the additional eighth function of the doll, "bathing", will address the water fun theme in time for the spring and summer season. Zapf Creation expects the New BABY born® and its new range of swimming and bathing accessories to generate additional sales momentum.

Breakdown of net sales by business unit

	Q1/2004	Q1/2003	+/-
	K€	K€	in %
Europe	15,196	25,074	- 39
Central Europe	8,488	17,135	- 50
Northern Europe	3,717	4,887	- 24
Southern Europe	2,402	2,333	3
Eastern Europe	589	719	- 18
The Americas	3,457	3,484	- 1
Asia/Australia	482	534	- 10
Net sales	19,135	29,092	- 34

The sales contribution of the Northern Europe operating business unit decreased by 24 percent to € 3.7 million. This is due to the fact that the figures for the first quarter of 2003 for the first time included sales to a new major customer in Scandinavia. Sales development in Scandinavia lagged behind expectations in 2003, a trend which continued in the first quarter of 2004. Sales in Great Britain/Ireland in local currency terms came in 2 percent below the previous year's figure, mainly because of a shift of sales to the second quarter.

Southern Europe recorded sales of € 2.4 million, which is an increase of 3 percent. The positive business performance in France/Belgium was a key contributor to this development.

First Quarter Report 2004

In the important growth market of the Americas, Zapf Creation boosted sales in local currency terms by 16 percent to \$ 4.3 million. This translates to sales of € 3.5 million, which is almost on par with the previous year.

The Baby Annabell branded play concept continues to show dynamic growth

From January to March, sales of the successful branded play concept BABY born® declined by 46 percent to € 8.1 million. The loss of Easter sales mentioned before resulted in substantially lower sales of BABY born® accessories, especially in Germany where BABY born® has a brand recognition of more than 95 percent. This decline also reflects the sales of BABY born® miniworld, which decreased as planned. After sell-through weaknesses became apparent in connection with BABY born® miniworld in 2003, the Company has made adjustments in its sales and marketing strategy in 2004, which includes the introduction of new products and changes in the doll's packaging. However, product development and marketing are currently focused on repositioning the mini doll business in 2005.

Breakdown of net sales in the different product lines

	Q1/2004	Q1/2003	+/-
	K€	K€	in %
BABY born® concept	8,122	15,159	- 46
Baby Annabell	5,856	3,385	73
CHOU CHOU	3,280	6,334	- 48
Other branded play concepts	1,877	4,215	- 55
Dolls total	19,135	29,093	- 34
Maritim/other	0	- 1	n/a
Net sales	19,135	29,092	- 34

Sales of the BABY Annabell concept grew by 73 percent to € 5.9 million in the first quarter of 2004. The successful introduction of the new Baby Annabell doll in Europe in the second half of 2003 has resulted in a further expansion of the accessories business in the first quarter of 2004. This highly

positive development of Baby Annabell has led to a substitution effect within the CHOU CHOU line. This effect, which for the most part was planned, caused sales of the CHOU CHOU concept to decrease to € 3.3 million.

Outlook

The past fiscal year certainly was not an easy one and the new fiscal year probably will not be any easier. In Europe in particular, we expect increased competition from the fashion doll segment.

In order to secure the profitability of the Zapf Creation Group for the overall fiscal year, a cost cutting program was implemented in the 2004 budgeting period, which will result in operating expenses to be significantly below the previous year's level if 2004 sales are on par with the prior year.

As trading partners do not make key listing decisions for the second half of the year until late April/early May, visibility at this point in time is too low to provide reliable guidance for fiscal year 2004 as a whole.

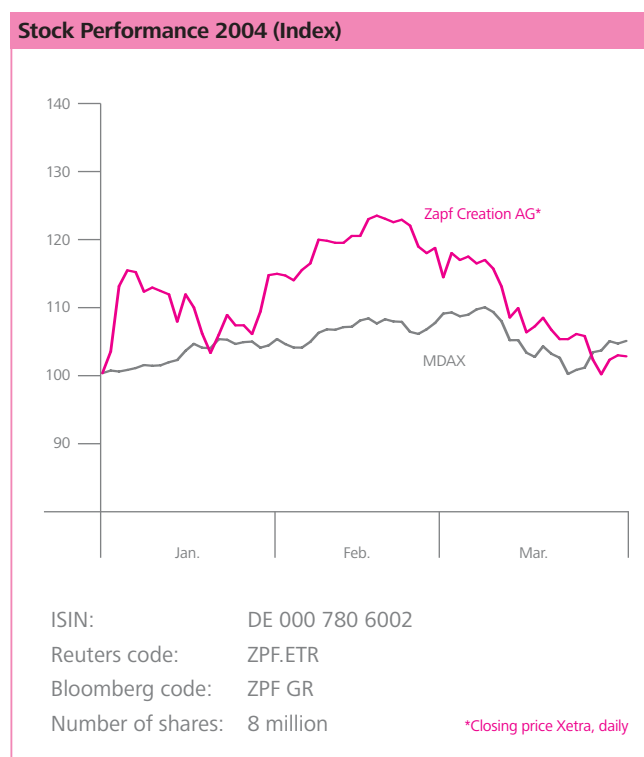
However, the Management Board expects business development to stabilize at the previous year's level as early as the second quarter. This should enable the Zapf Creation Group to report a positive operating result at the half-year mark.

The second half of the year will see the launch of two key product innovations. The New BABY born® and Love me CHOU CHOU will be introduced worldwide in the third quarter. The only exception will be Germany where the New BABY born® will be launched in late June because of its high brand recognition factor. These product innovations will generate new sales momentum.

The Stock

Zapf Creation stock

Zapf Creation stock entered the first quarter of fiscal year 2004 at a price of € 19.21 (January 2, 2004) and gained approximately 24 percent until February 18, 2004 when it reached € 23.79. After an impending loss was announced for the first quarter of 2004 at the financial statements press conference on March 25, the stock price hit a low of € 19.18 on the next day. By the end of the quarter, the price recovered to € 19.70, which is a slight increase of 2.5 percent compared to the beginning of the year.



Despite the generally weaker business development in 2003, the Management Board and Supervisory Board will propose a dividend of € 1.00 per no-par value share for the past fiscal year to the Annual Stockholders' Meeting in Roedental on May 11, 2004.

Subject to the approval of the Annual Stockholders' Meeting, the dividend payment will be made on May 12, 2004. For many investors, this attractive dividend yield of more than 5 percent is a key reason to purchase Zapf Creation stock.

Directors' Dealing

During the period from January 1 to March 31, 2004, the officers and directors of the Company did not engage in any 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.

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, 2003.

	Stock Number	Book value K€	Percentage of share capital 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

The Stock

Research Coverage/Analyst recommendations

Analyst	Date	Recommendation
ABN Amro	April 2004	Reduce
Bankhaus Lampe	April 2004	Sell
Berenberg Bank	April 2004	Buy
CAI Cheuvreux	April 2004	Underperform
Commerzbank	April 2004	Equal weight
Deutsche Bank	April 2004	Buy
Dresdner Kleinwort Wasserstein	April 2004	Hold
DZ Bank	April 2004	Buy
Hamburger Sparkasse	April 2004	Hold
HSBC Trinkaus & Burkhardt	April 2004	Reduce
HypoVereinsbank	April 2004	Underperform
Cazenove	January 2004	Hold

Financial Calendar

Date	Event	Place
April 22, 2004	Results Q1/2004	
April 22, 2004	Global conference call	
May 11, 2004	5th Annual Stockholders' Meeting	Roedental
May 12, 2004	Dividend payment ¹⁾	
July 21, 2004	Results Q2/half-year 2004	
October 26, 2004	Results Q3/9 months 2004	

¹⁾ Subject to approval by the Annual Stockholders' Meeting

Financial Statements

Consolidated Income Statement

of Zapf Creation AG, Roedental, for the period from January 1 through March 31, 2004 (US GAAP)

	Q1/2004 K€	Q1/2003 K€	+/- in % ¹⁾
Net sales	19,135	29,092	- 34
Cost of goods sold	- 8,657	- 12,829	- 33
Gross profit	10,478	16,263	- 36
Selling and distribution expenses	- 3,954	- 5,365	- 26
Marketing expenses	- 2,814	- 2,712	4
Administrative expenses, net	- 5,777	- 6,055	- 5
EBIT – Operating profit before interest and taxes	- 2,067	2,131	n/a
Interest income	49	39	26
Interest expense	- 742	- 685	8
EBT – Profit before income tax expense	- 2,760	1,485	n/a
Income tax expense	933	- 434	n/a
Net income	- 1,827	1,051	n/a
Gross margin in %	54.8	55.9	- 2

	Q1/2004 K€	Q1/2003 K€	+/- in % ¹⁾
Breakdown of personnel expenses²⁾			
Sales and distribution department	2,306	2,121	9
Marketing department	602	633	- 5
Administrative department	2,384	2,771	- 14
Total	5,292	5,525	- 4

¹⁾ rounded

²⁾ already included in operating expenses

Financial Statements

Consolidated Balance Sheet

of Zapf Creation AG, Roedental, as of March 31, 2004 (US GAAP)

	Mar. 31, 2004	Mar. 31, 2003	Dec. 31, 2003
	K€	K€	K€
Assets			
Cash and cash equivalents	13,761	14,674	15,342
Accounts receivable	31,002	37,632	47,899
Inventories	33,047	32,885	29,118
Prepaid expenses	6,936	1,939	5,700
Other current assets	6,956	4,213	3,470
Deferred tax assets (short-term)	4,181	2,737	1,625
Total current assets	95,883	94,080	103,154
Property, plant, equipment and software, net	28,539	28,119	28,428
Intangible assets, net	2,415	2,746	2,494
Deferred tax assets (long-term)	284	206	347
Other long-term receivables	50	0	0
Total long-lived assets	31,288	31,071	31,269
	127,171	125,151	134,423
Liabilities and stockholders' equity			
Current portion of long-term debt and short-term borrowings	45,067	22,649	40,506
Accounts payable	9,206	11,618	10,088
Accrued liabilities	4,106	4,397	11,346
Income taxes payable	824	2,718	1,463
Deferred tax liabilities (short-term)	500	1,319	497
Total current liabilities	59,703	42,701	63,900
Long-term debt	13,493	20,295	14,780
Other long-term liabilities	59	54	67
Deferred tax liabilities (long-term)	585	973	585
Total long-term liabilities	14,137	21,322	15,432
Common stock	8,000	8,000	8,000
Additional paid-in capital	8,052	8,406	8,052
Treasury stock	- 11,358	- 4,178	- 11,358
Accumulated other comprehensive income (loss)	- 4,237	- 2,700	- 4,304
Retained earnings	52,874	51,600	54,701
Total stockholders' equity	53,331	61,128	55,091
	127,171	125,151	134,423

Financial Statements

Consolidated Statement of Cash Flows

of Zapf Creation AG, Roedental (US GAAP)

	Q1/2004 K€	Q1/2003 K€
Cash flow from operating activities:		
Net income	- 1,827	1,051
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation and amortization	1,603	1,644
Loss (gain) on sale of property, plant, equipment and software	- 10	0
Stock-based compensation expense	0	34
Increase (decrease) from changes in assets and liabilities:		
Accounts receivable	16,731	19,904
Inventories	- 3,934	- 3,218
Prepaid expenses and other assets	- 4,772	- 1,091
Accounts payable, accrued liabilities and other liabilities	- 8,241	- 12,813
Income taxes payable	- 643	- 2,129
Deferred taxes	- 2,490	- 275
Net cash flow from operating activities	- 3,583	3,107
Cash flow from investing activities:		
Proceeds from sale of property, plant, equipment and software	121	83
Capital expenditures	- 1,662	- 2,696
Net cash flow from investing activities	- 1,541	- 2,613
Cash flow from financing activities:		
Net borrowings under short- and long-term debt agreements	3,266	- 300
Purchases of treasury stock/proceeds from issuance of treasury stock	0	3
Net cash flow from financing activities	3,266	- 297
Effect of foreign exchange rate changes on cash	277	- 373
Net increase in cash	- 1,581	- 176
Cash at beginning of period	15,342	14,850
Cash at end of period	13,761	14,674

Financial Statements

Consolidated Statement of Stockholders' Equity

of Zapf Creation AG, Roedental (US GAAP)

	Shares outstanding number (thsd.)	Common stock K€	Additional paid-in capital K€
Balance at December 31, 2002:	7,874	8,000	8,406
Net income			
Other comprehensive income (loss)			
Total comprehensive income (loss)			
Dividend payments			
Purchase of treasury stock			
Issuance of treasury stock			
Balance at March 31, 2003:	7,874	8,000	8,406
Net income			
Other comprehensive income (loss)			
Total comprehensive income (loss)			
Dividend payments			
Purchase of treasury stock	- 542		
Issuance of treasury stock	95		- 354
Balance at December 31, 2003:	7,427	8,000	8,052
Net income			
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

Notes

The Consolidated Financial Statements of the Company 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, 2004, 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 2003. 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.

Accumulated other comprehensive income (loss)					
Treasury stock K€	Retained earnings K€	Adjustments to currency translation K€	Derivative financial instruments K€		Total equity K€
- 4,181	50,549	- 1,987	0		60,787
	1,051				1,051
		- 713			- 713
	1,051	- 713	0		338
					0
					0
3					3
- 4,178	51,600	- 2,700	0		61,128
	11,025				11,025
		- 1,618	14		- 1,604
	11,025	- 1,618	14		9,421
	- 7,924				- 7,924
- 10,415					- 10,415
3,235					2,881
- 11,358	54,701	- 4,318	14		55,091
	- 1,827				- 1,827
		288	- 221		67
	- 1,827	288	- 221		55,158
					0
					0
					0
- 11,358	52,874	- 4,030	- 207		53,331



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