

# Quarterly Report 3/2003



**Zapp**  
creation®

## At a Glance

| Consolidated key figures                                     | Q3/2003         | Q3/2002         | Q1-Q3/2003      | Q1-Q3/2002      | +/- Q1-Q3<br>in % <sup>2)</sup> |
|--|-----------------|-----------------|-----------------|-----------------|---------------------------------|
| Net sales in K€  | 79,058          | 78,891          | 139,072         | 139,053         | 0                               |
| EBITDA in K€   | 17,310          | 16,420          | 25,337          | 22,432          | 13                              |
| EBIT in K€   | 15,661          | 15,060          | 20,454          | 18,561          | 10                              |
| EPS (undiluted) in €   | 1.30            | 1.25            | 1.66            | 1.49            | 11                              |
| CFPS (operative cash flow per share) in €                    | n/a             | n/a             | - 1.16          | - 4.29          | n/a                             |
| Number of employees as<br>of September 30 <sup>1)</sup>      | 545             | 528             | 545             | 528             | 3                               |
| Stock price, high (Xetra) in €                               | 36.46<br>(9/8)  | 27.00<br>(7/1)  | 36.46<br>(9/8)  | 29.50<br>(6/21) | n/a                             |
| Stock price, low (Xetra) in €                                | 29.70<br>(7/31) | 19.58<br>(9/30) | 24.02<br>(3/11) | 19.58<br>(9/30) | n/a                             |
| Stock price, end of quarter (Xetra) in €                     | 32.99           | 19.58           | 32.99           | 19.58           | 68                              |
| Stock price, average (Xetra) in €                            | 32.62           | 22.73           | 30.37           | 24.26           | 25                              |
| Average daily trading volume (Xetra)<br>no. of shares        | 23,583          | 10,106          | 22,558          | 11,013          | 105                             |
| Market capitalization<br>(base: end of quarter) in million € | 263.92          | 156.64          | 263.92          | 156.64          | 68                              |

<sup>1)</sup> not including management board and trainees

<sup>2)</sup> rounded

## Financial Calendar

| Event  | Date                  | Place       |
|--|-----------------------|-------------|
| Roadshow   | October 30/31, 2003   | London      |
| Roadshow   | November 3 to 7, 2003 | USA         |
| Consumer Conference HSBC                           | November 19, 2003     | Duesseldorf |
| Press Conference Preliminary Figures FY 2003       | February 3, 2004      | Nuremberg   |
| Global Conference Call                             | February 3, 2004      |             |
| Press Conference Annual Accounts 2003              | March 25, 2004        | Munich      |
| Analysts' Meeting (DVFA)                           | March 25, 2004        | Frankfurt   |
| Global Conference Call                             | March 25, 2004        |             |
| 5 <sup>th</sup> Annual Shareholders' Meeting (AGM) | May 11, 2004          | Roedental   |
| Results Q1/2004                                    | May 11, 2004          |             |
| Global Conference Call                             | May 11, 2004          |             |

# 9-month report 2003

- Sales at previous year's level, currency-adjusted sales up 7 %
- Double-digit earnings growth
- Improved EBIT margin

Zapf Creation AG posted sales of € 139.1 million in the first nine months of fiscal year 2003, equivalent to last year's figure. Adjusted for currency effects, sales were up 7 %. Earnings before interest and taxes (EBIT) grew by 10 % to € 20.5 million. The EBIT margin increased by two percentage points to 15 % compared to the first nine months of fiscal year 2002.

Benefiting from the continued weakness of the dollar, the gross margin improved three percentage points to 58 % versus the same period of last year.

At € 9.2 million, the negative net cash flow from operating activities, which is characteristic of this period, improved by € 24.5 million versus the same period of last year (€ 33.7 million).

## Thoroughly positive development in Europe

Within the Central Europe business unit, sales in Germany picked up considerably, resulting in sales growth of approximately 4 % for the first nine months. At the half-year point, sales performance in Germany had still been negative. Growth was primarily based on the My Model concept, which fits the taste of the target group in Germany.

Sales in the growth market of UK/Ireland in the Northern Europe business unit developed positively, improving by 33 %, or 47 % in local currency terms. This increase in sales was primarily driven by the market launch of the new Baby Annabell doll and business development that exceeded expectations.

France and Spain, two key markets in the Southern Europe business unit, performed as planned. In France especially, Zapf Creation was able to increase sales by expanding listings among the important hypermarkets.

Business development in Eastern Europe did not change significantly compared to the first six months of 2003. The sales increase of 37 % after nine months was solely due to the Russian market.

The Americas business unit lags behind expectations and recorded a sales decline of 5 %, or 21 % in euro terms. This is due to the fact that business with TOYS"R"US, which had developed very positively for three years, could not be continued as expected in 2003. Instead, the Company has recorded reduced order volumes, especially for the upcoming holiday season. Sales with other minor customers also did not develop according to plan.

The aggressive competition in the fashion doll market – a segment in which Zapf Creation does not operate – increasingly impacts the large doll segment as well, making business more difficult.

This trend also continues in Australia, resulting in a sales decline of 27 % in Asia/Australia.

|                       | Q1-Q3<br>2003<br>K€ | Q1-Q3<br>2002<br>K€ | +/-<br>in % |
|-----------------------|---------------------|---------------------|-------------|
| <b>Europe</b>         | <b>108,703</b>      | <b>99,996</b>       | <b>9</b>    |
| Central Europe        | 59,460              | 59,750              | 0           |
| Northern Europe       | 30,952              | 24,517              | 26          |
| Southern Europe       | 15,332              | 13,569              | 13          |
| Eastern Europe        | 2,959               | 2,160               | 37          |
| <b>The Americas</b>   | <b>24,979</b>       | <b>31,631</b>       | <b>- 21</b> |
| <b>Asia/Australia</b> | <b>5,390</b>        | <b>7,426</b>        | <b>- 27</b> |
| <b>Net sales</b>      | <b>139,072</b>      | <b>139,053</b>      | <b>0</b>    |

### The trendy topic of fashion has led to a very positive performance of the My Model concept

Compared to the same period of last year, sales of the BABY born® branded play concept decreased by approximately 7 %. This is primarily due to a decline in sales of BABY born® mineworld, which is operating in the significantly more aggressive competitive environment of mini dolls.

The Baby Annabell branded play concept recorded a considerable increase in sales of 54 % to € 29.0 million compared to the same period of last year (Q1–Q3/2002: € 18.8 million). This can be attributed to the successful launch of the new Baby Annabell doll in Europe. In the UK, where Baby Annabell has been extremely popular among little girls since its market launch, the second generation of the functional doll was voted into the “Top 10 Girls Toys 2003” list by the British toy association.

|                    | Q1-Q3<br>2003<br>K€ | Q1-Q3<br>2002<br>K€ | +/-<br>in % |
|--------------------|---------------------|---------------------|-------------|
| BABY born® concept | 68,518              | 73,388              | - 7         |
| Baby Annabell      | 29,001              | 18,824              | 54          |
| CHOU CHOU          | 27,499              | 31,445              | - 13        |
| Others             | 14,056              | 15,123              | - 7         |
| <b>Dolls total</b> | <b>139,074</b>      | <b>138,780</b>      | <b>0</b>    |
| Maritim/other      | - 2                 | 273                 | n/a         |
| <b>Net sales</b>   | <b>139,072</b>      | <b>139,053</b>      | <b>0</b>    |

Fashion continues to be a trendy topic that is of great importance to little girls. As a result, the My Model concept experienced sales growth. The styling head fits the taste of the target group especially in Germany. My Model was successful on a European scale as well: It was voted second by 900 children from nine countries in the European Duracell Toy Survey 2003.



### Measures for protection against SARS can be reinstated at any time

Initial information indicates that there could be another outbreak of SARS. The management board is therefore again devoting more attention to this topic. Should there be more reason to expect a return of SARS, the proven action plan with additional office premises, an organizational separation of the employees in Hong Kong and stricter travel guidelines will once again take effect.

### Guidance for 2003: reduction of EBIT growth with sales at previous year's level

Due to the fact that business in The Americas has failed to meet expectations and because reduced order volumes, tighter competition caused by new product launches in the fashion doll segment and continuing currency translation effects, Zapf Creation AG adjusts the guidance it published after six months. The management board now expects sales for the full fiscal year 2003 to come in at previous year's level with a currency-adjusted sales growth of 7%. Earnings before interest and taxes (EBIT) are expected to increase 7% in fiscal year 2003.

In order to follow up on the previously positive development in America, Zapf Creation AG will adopt a considerably more aggressive pricing and marketing strategy next year. A new functional doll under the CHOU CHOU brand whose functionality exceeds everything Zapf Creation has introduced to the market so far, will also contribute to boosting sales on the American continent and worldwide.

For Zapf Creation, 2004 will also be the "Year of BABY born®". After twelve years, Zapf Creation will breathe new life into its most successful and established branded play concept by adding a new function to BABY born®: As of next year, the doll can also be bathed. This extended functionality enables Zapf Creation to introduce a new range of accessories based on the "water" theme. A slightly modified brand presentation and increased marketing, PR and POS activities in line with the new strategy are intended to provide additional momentum to the relaunch of the concept.

### Stock price stabilizes at around € 35

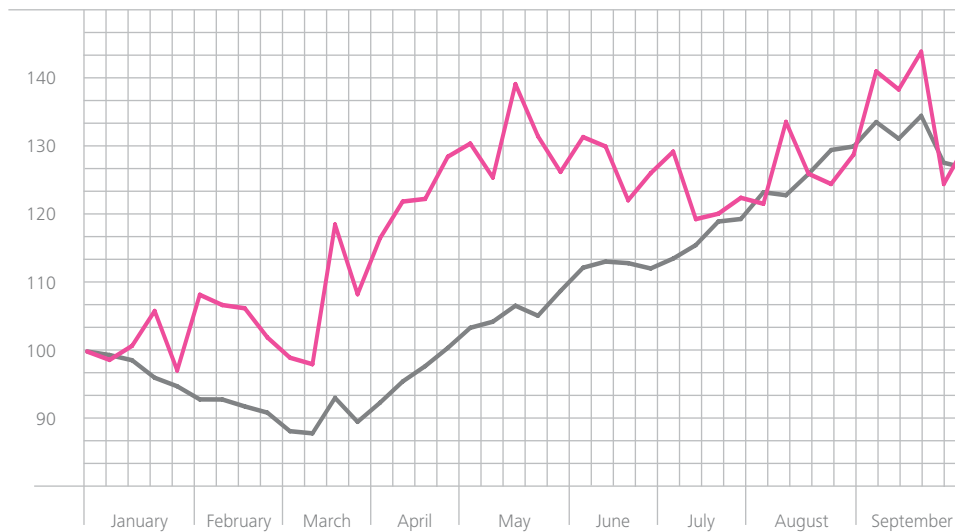
In the third quarter, the price of Zapf Creation stock again improved slightly to € 36.46. At the end of the quarter, the stock sold at € 32.99 a share.

The average daily trading volume in the third quarter was 23,583 shares, which again exceeded the volumes recorded in previous years.

This clearly shows that the liquidity of the stock has improved and that the Company has been able to expand its investor base gradually.

At the occasion of presenting its nine-month results, Zapf Creation will host its first international investor conference in Nuremberg. The Company will also present its complete 2004 product range to the investors at this event.

### Stock Performance 2003 (Index)



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

— Zapf Creation AG (Closing price Xetra, weekly)  
 — MDAX

### Research coverage/Analyst recommendations

|                                |              |               |
|--------------------------------|--------------|---------------|
| ABN Amro                       | October 2003 | Buy           |
| Commerzbank                    | October 2003 | Accumulate    |
| Bankhaus Lampe                 | July 2003    | Marketperform |
| Berenberg Bank                 | July 2003    | Buy           |
| CAI Cheuvreux                  | July 2003    | Outperform    |
| Deutsche Bank                  | July 2003    | Hold          |
| Dresdner Kleinwort Wasserstein | July 2003    | Buy           |
| HSBC Trinkaus & Burkhardt      | July 2003    | Buy           |
| HypoVereinsbank                | July 2003    | Outperform    |
| Cazenove                       | May 2003     | Buy           |

## Consolidated Income Statement

of Zapf Creation AG, Roedental, for the period from January 1 through September 30, 2003 (US GAAP)

|  | Q3/2003<br>K€ | Q3/2002<br>K€ | Q1-Q3/2003<br>K€ | Q1-Q3/2002<br>K€ | +/- Q1-Q3<br>in % <sup>2)</sup> |
|--|---------------|---------------|------------------|------------------|---------------------------------|
| <b>Net sales</b>   | 79,058        | 78,891        | 139,072          | 139,053          | 0                               |
| Cost of goods sold <sup>1)</sup>                             | - 33,138      | - 34,037      | - 58,420         | - 63,010         | - 7                             |
| <b>Gross profit</b>  | <b>45,920</b> | <b>44,854</b> | <b>80,652</b>    | <b>76,043</b>    | <b>6</b>                        |
| Selling and distribution expenses <sup>1)</sup>              | - 11,128      | - 10,664      | - 20,990         | - 21,147         | - 1                             |
| Marketing expenses <sup>1)</sup>                             | - 11,667      | - 11,485      | - 18,853         | - 19,177         | - 2                             |
| Administrative expenses, net <sup>1)</sup>                   | - 7,464       | - 7,645       | - 20,355         | - 17,158         | 19                              |
| <b>EBIT – Operating profit before<br/>interest and taxes</b> | <b>15,661</b> | <b>15,060</b> | <b>20,454</b>    | <b>18,561</b>    | <b>10</b>                       |
| Interest income  | 31            | 6             | 101              | 230              | - 56                            |
| Interest expense   | - 926         | - 512         | - 2,222          | - 1,839          | 21                              |
| <b>EBT – Profit before income<br/>tax expense</b>            | <b>14,766</b> | <b>14,554</b> | <b>18,333</b>    | <b>16,952</b>    | <b>8</b>                        |
| Income tax expense   | - 4,413       | - 4,724       | - 5,211          | - 5,218          | 0                               |
| <b>Net income</b>  | <b>10,353</b> | <b>9,830</b>  | <b>13,122</b>    | <b>11,734</b>    | <b>12</b>                       |
| Gross margin in %  | 58            | 57            | 58               | 55               | 5                               |

| Breakdown of personnel expenses <sup>3)</sup>   | Q3/2003<br>K€ | Q3/2002<br>K€ | Q1-Q3/2003<br>K€ | Q1-Q3/2002<br>K€ | +/- Q1-Q3<br>in % <sup>2)</sup> |
|---|---------------|---------------|------------------|------------------|---------------------------------|
| Sales and distribution department <sup>1)</sup> | 1,967         | 1,915         | 6,120            | 6,100            | 0                               |
| Marketing department                            | 497           | 512           | 1,693            | 1,583            | 7                               |
| Administrative department                       | 3,413         | 3,015         | 9,080            | 8,152            | 11                              |
| <b>Total</b>                                    | <b>5,877</b>  | <b>5,442</b>  | <b>16,893</b>    | <b>15,835</b>    | <b>7</b>                        |

<sup>1)</sup> see notes

<sup>2)</sup> rounded

<sup>3)</sup> already included in operating expenses



## Consolidated Balance Sheets

of Zapf Creation AG, Roedental, as of September 30, 2003 (US GAAP)

| Assets  | 9/30/2003<br>K€ | 9/30/2002<br>K€ | 12/31/2002<br>K€ |
|---|-----------------|-----------------|------------------|
| Cash and cash equivalents                                   | 20,903          | 4,234           | 14,850           |
| Accounts receivable   | 74,722          | 81,553          | 57,674           |
| Inventories   | 43,268          | 43,268          | 29,682           |
| Prepaid expenses  | 3,901           | 249             | 2,444            |
| Other current assets  | 3,083           | 1,939           | 2,618            |
| Deferred tax assets (short term)                            | 2,378           | 883             | 2,487            |
| <b>Total current assets</b>                                 | <b>148,255</b>  | <b>132,126</b>  | <b>109,755</b>   |
| Property, plant, equipment and software, net                | 27,817          | 28,701          | 28,523           |
| Intangible assets, net                                      | 2,580           | 1,487           | 1,425            |
| Deferred tax assets (long term)                             | 259             | 606             | 182              |
| <b>Total long-lived assets</b>                              | <b>30,656</b>   | <b>30,794</b>   | <b>30,130</b>    |
|   | <b>178,911</b>  | <b>162,920</b>  | <b>139,885</b>   |
|   |                 |                 |                  |
| Liabilities and stockholders' equity                        | 9/30/2003<br>K€ | 9/30/2002<br>K€ | 12/31/2002<br>K€ |
| Current portion of long-term debt and short-term borrowings | 53,141          | 52,726          | 22,914           |
| Accounts payable  | 19,877          | 18,097          | 15,689           |
| Accrued liabilities   | 15,824          | 14,265          | 12,998           |
| Income taxes payable  | 3,682           | 1,926           | 4,819            |
| Deferred tax liabilities (short term)                       | 1,370           | 275             | 1,320            |
| <b>Total current liabilities</b>                            | <b>93,894</b>   | <b>87,289</b>   | <b>57,740</b>    |
| Long-term debt  | 16,831          | 21,748          | 20,317           |
| Other long-term liabilities                                 | 54              | 80              | 68               |
| Deferred tax liabilities (long term)                        | 973             | 1,103           | 973              |
| <b>Total long-term liabilities</b>                          | <b>17,858</b>   | <b>22,931</b>   | <b>21,358</b>    |
| Common stock  | 8,000           | 8,000           | 8,000            |
| Additional paid-in capital                                  | 8,816           | 8,375           | 8,406            |
| Treasury stock  | - 1,829         | - 4,269         | - 4,181          |
| Accumulated other comprehensive income                      | - 3,575         | - 451           | - 1,987          |
| Retained earnings   | 55,747          | 41,045          | 50,549           |
| <b>Total stockholders' equity</b>                           | <b>67,159</b>   | <b>52,700</b>   | <b>60,787</b>    |
|   | <b>178,911</b>  | <b>162,920</b>  | <b>139,885</b>   |



## Consolidated Statement of Cash Flows

of Zapf Creation AG, Roedental

|   | Q1–Q3/2003<br>K€ | Q1–Q3/2002<br>K€ |
|---|------------------|------------------|
| <b>Cash flow from operating activities:</b>                                     |                  |                  |
| Net income  | 13,122           | 11,734           |
| Adjustments to reconcile net income to net cash flow from operating activities: |                  |                  |
| Depreciation and amortization   | 5,035            | 4,141            |
| Loss (gain) on sale of property, plant, equipment and software                  | – 3              | – 27             |
| Stock-based compensation expense  | 309              | 0                |
| Increase (decrease) from changes in assets and liabilities:                     |                  |                  |
| Accounts receivable   | – 17,280         | – 40,070         |
| Inventories   | – 13,623         | – 17,989         |
| Prepaid expenses and other assets   | – 1,922          | 3,253            |
| Accounts payable and accrued liabilities and other liabilities                  | 6,224            | 7,422            |
| Income taxes payable  | – 1,146          | – 1,943          |
| Deferred taxes  | 81               | – 222            |
| <b>Net cash flow from operating activities</b>                                  | <b>– 9,203</b>   | <b>– 33,701</b>  |
| <b>Cash flow from investing activities:</b>                                     |                  |                  |
| Proceeds from sale of property, plant, equipment and software                   | 363              | 465              |
| Capital expenditures  | – 5,942          | – 8,571          |
| <b>Net cash flow from investing activities</b>                                  | <b>– 5,579</b>   | <b>– 8,106</b>   |
| <b>Cash flow from financing activities:</b>                                     |                  |                  |
| Net borrowings under short- and long-term debt agreements                       | 26,727           | 39,959           |
| Proceeds from issuance of treasury stock  | 2,762            | 429              |
| Payment of dividends  | – 7,924          | – 5,107          |
| <b>Net cash flow from financing activities</b>                                  | <b>21,565</b>    | <b>35,281</b>    |
| Effect of foreign exchange rate changes on cash                                 | – 730            | – 474            |
| <b>Net increase in cash</b>   | <b>6,053</b>     | <b>– 7,000</b>   |
| Cash at beginning of period   | 14,850           | 11,234           |
| Cash at end of period   | 20,903           | 4,234            |

## Consolidated Statement of Stockholders' Equity

of Zapf Creation AG, Roedental

|  | Shares<br>outstanding | Common<br>stock |
|--|-----------------------|-----------------|
|  | number (thsd.)        | K€              |
| <b>Balance at December 31, 2002:</b>   | <b>7,874</b>          | <b>8,000</b>    |
| Comprehensive income                   |                       |                 |
| Net income                             |                       |                 |
| Accumulated other comprehensive income |                       |                 |
| <b>Total comprehensive income</b>      |                       |                 |
| Dividend payments                      |                       |                 |
| Purchase of treasury stock             |                       |                 |
| Issuance of treasury stock             | 91                    |                 |
| <b>Balance at September 30, 2003:</b>  | <b>7,965</b>          | <b>8,000</b>    |

### Treasury stock

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

Account No. 1 exclusively serves to back the stock option plan.

Account 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 deposit accounts as compared to June 30, 2003.

| Portfolio    | Book value   | Number<br>shares | Percentage of<br>share capital |
|--------------|--------------|------------------|--------------------------------|
|              | K€           |                  | %                              |
| No. 1        | 1,733        | 32,313           | 0.40                           |
| No. 2        | 96           | 3,085            | 0.04                           |
| <b>Total</b> | <b>1,829</b> | <b>35,398</b>    | <b>0.44</b>                    |

| Additional<br>paid-in<br>capital<br>K€ | Treasury<br>stock<br>K€ | Retained<br>earnings<br>K€ | Accumulated other<br>comprehensive<br>income<br>K€ | Total<br>equity<br>K€ |
|--|-------------------------|----------------------------|--|-----------------------|
| 8,406                                  | - 4,181                 | 50,549                     | - 1,987  | 60,787                |
|  |                         | 13,122                     |  | 13,122                |
|  |                         |                            | - 1,588  | - 1,588               |
|  |                         | 13,122                     | - 1,588  | 11,534                |
|  |                         | - 7,924                    |  | - 7,924               |
|  |                         |                            |  | 0                     |
| 410                                    | 2,352                   |                            |  | 2,762                 |
| 8,816                                  | - 1,829                 | 55,747                     | - 3,575  | 67,159                |

## Notes

For the period from 1 January 2003 to 30 September 2003, 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 2002. The accounting principles also remained the same.

The classification of items on the income statement was changed for the first time as per December 31, 2002. Freight (without internal freight), premium payments for transport insurance, penalties, order picking, agency logistics personnel and transport insurance payments are no longer comprised under "logistics expenses" but are included in the cost of goods sold. To enable a comparison with the previous year, the figures published for Q1/2002, Q2/2002, Q3/2002 and Q1-Q3/2002 were adjust-

ed accordingly. This resulted in a reduction of the margin for the previous year. The remaining logistics expenses (e.g. internal freight, warehouse rent, maintenance costs for logistics equipment, etc.) and the selling expenses now comprise the expense item "selling and distribution expenses". The Company now shows public relations activities under "other administrative expenses, net". Figures published for the previous year were adjusted accordingly.

The figures shown in the 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.



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