

# Half-year report 2003



## At a Glance

Consolidated key figures	H1/2003	H1/2002	Change in % <sup>2)</sup>
Net sales in K€	60,014	60,162	0
EBITDA in K€	8,027	6,012	34
EBIT in K€	4,793	3,501	37
EPS (undiluted) in €	0.35	0.24	46
CFPS (operative cash flow per share) in €	- 0.61	- 1.70	n.a
Number of employees as of June 30 <sup>1)</sup>	529	514	3
Stock price, high (Xetra) in €	35.20 (5/16)	29.50 (6/21)	n.a.
Stock price, low (Xetra) in €	24.02 (3/11)	21.20 (2/12)	n.a.
Stock price, end of quarter (Xetra) in €	32.40 (6/30)	26.50 (6/28)	n.a.
Stock price, average (Xetra) in €	29.184	25.067	n.a.
Average daily trading volume (Xetra) no. of shares	22,017	11,491	92
Market capitalization (base: end of quarter) in million €	259	212	22

<sup>1)</sup> not including Management Board and trainees

<sup>2)</sup> rounded

## Financial Calendar

Event	Date	Place
Results Q2/2003 + H1/2003	July 24, 2003	
Global Conference Call	July 24, 2003, 04:00 p.m. CET	
Roadshow Europe	July 25 to August 1, 2003	
Consumer Conference HVB	October 2, 2003	Munich
Capital Markets Day	October 29, 2003	Nuremberg
Results Q3/2003	October 29, 2003	Nuremberg
Roadshow London	October 30/31, 2003	
Roadshow USA	November 3 to 7, 2003	
Consumer Conference HSBC	November 19, 2003	Duesseldorf

# Report for the first half-year 2003

- Currency-adjusted sales growth by 6 %
- Considerable increase in profitability
- Forecast of sales in real terms adjusted to reflect current exchange rates

Posting sales of € 60 million in the first six months of fiscal year 2003, Zapf Creation AG has remained stable at previous year's level. Adjusted for currency effects, sales were actually up 6 % compared to the figure reported for the same period of last year. Of these sales, 65 % were generated in foreign markets.

The downward trend of the US dollar against the euro accelerated in the second quarter. In the first six months of the current fiscal year this led to a significant increase of over 6 percentage points in the gross margin as compared with the same period of last year. At over 60 %, the proportion of sales in the euro area, which benefited the most from this development, was much higher in the first half-year than in the fiscal year as a whole.

With nearly steady sales, this gross margin effect led to an absolute increase of € 3.5 million in gross profit, which clearly overcompensates for the planned rise in operating expenses in the amount of € 2.2 million. Increases in amortization and depreciation (€ 0.7 million), higher personnel expenses (€ 0.6 million) and the SAP system integration of the Polish subsidiary, which began operations at the start of July 2003, particularly affected administrative costs in the first half-year.

Earnings before interest and taxes (EBIT) even rose 37 % to € 4.8 million in the first half of 2003. The EBIT margin improved by over two percentage points, from 5.8 % to 8.0 %, in comparison with the first six months of 2002.

## Cash flow performance remains positive

At minus € 4.8 million, the negative net cash flow from operating activities, which is characteristic of the first half-year, was around € 8.5 million lower than in the same period of last year (minus € 13.3 million). This can be attributed primarily to the high number of payments received from customer receivables in the first quarter.

The net debt improved from € 47.8 million as of June 30, 2002 to € 43.3 million in the first half of 2003.

## Development characterized by geographic variations

The sales volume of € 60 million represents around 25 % of planned sales for the entire fiscal year and is therefore statistically not very significant. However, strong competition is apparent in the fashion doll segment in all markets, with the exception of Central Europe. This competition has revealed itself primarily through aggressive marketing campaigns from competitors. This development can also be seen in the segment for play and functional dolls with accessories due to the intersection of the target group of girls between the ages of five and seven.

With a 6 % decline, sales in the Central Europe operating business unit have fallen behind plan. This decrease in sales was caused by the ongoing purchasing restraint among consumers and by Easter sales which failed to meet expectations, particularly in Germany.

The Northern Europe operating business unit grew considerably in all markets. In the growth market of Great Britain, sales rose by 6 %; this corresponds

to a sales increase of 18 % in pounds sterling. Expanded listings for the Baby Annabell branded play concept and an extended customer base will continue to support the successful development of this market in the future.

By the half-year mark, Southern Europe was able to turn around its negative development in the first quarter of 2003, and its sales are now up 10 % from the same period of last year.

The ongoing positive business development in Russia was mainly responsible for the sales growth of 52 % in Eastern Europe.

In North America, sales in US dollars grew by 21 %. Calculated in euros, however, there was a slight decrease of 0.5 % to € 8.6 million. In North America, too, Zapf Creation was able to broaden its customer base once again and to obtain more accessory listings for the three strong branded play concepts: Baby Annabell, BABY born® and CHOU CHOU.

Development remained weak in Asia/Australia in the first half-year. This was due both to higher amounts of stock on the side of wholesalers and retailers and to an increased demand among little girls for fashion dolls.

#### Sales by business units

	H1/2003 K€	H1/2002 K€	Change in %
<b>Europe</b>	<b>48,770</b>	<b>47,347</b>	<b>3</b>
Central Europe	27,676	29,442	- 6
Northern Europe	13,395	11,195	20
Southern Europe	6,494	5,919	10
Eastern Europe	1,205	791	52
<b>The Americas</b>	<b>8,568</b>	<b>8,607</b>	<b>0</b>
<b>Asia/Australia</b>	<b>2,676</b>	<b>4,208</b>	<b>- 36</b>
<b>Net sales</b>	<b>60,014</b>	<b>60,162</b>	<b>0</b>

#### Sales by branded play concepts vary greatly

The BABY born® branded play concept recorded a decrease in sales of 14 % compared with the year before. This is primarily due to the BABY born® miniworld segment introduced last year and, to a lesser extent, to the successful BABY born® play concept. With growing success and the expansion of the strong Baby Annabell and CHOU CHOU brands, the BABY born® accessories business has revealed a slight cannibalization effect. After the successful entrance into the mini doll segment in 2002 with the introduction of BABY born® miniworld, this segment has not been able to follow up on this success and thus remains behind expectations. Adjustments in the sales and marketing strategy have already been initiated to address this.

The introduction of the Baby Annabell concept in North America in 2002 and the further expansion of the Baby Annabell range of accessories brought about a welcome increase in sales of € 4.3 million in absolute terms.

The My Model concept, which was expanded to include numerous accessories and which should appeal to the styling creativity of girls between the ages of 5 and 10, has obviously addressed the current trend which is also apparent in the segment of fashion dolls. Here, too, there was a welcome increase in sales at the half-year mark.

#### Sales by product lines

	H1/2003 K€	H1/2002 K€	Change in %
BABY born® concept	30,037	35,004	- 14
Baby Annabell	9,857	5,567	77
CHOU CHOU	12,462	13,109	- 5
Others	7,658	6,212	23
<b>Dolls total</b>	<b>60,014</b>	<b>59,892</b>	<b>0</b>
Maritim/other	0	270	- 100
<b>Net sales</b>	<b>60,014</b>	<b>60,162</b>	<b>0</b>

### **Discontinuation of the Designer Collection product line**

Zapf Creation will withdraw from the niche segment for high-quality designer and collector dolls and will not develop a new line of Designer Collection dolls for fiscal year 2004.

This decision was made in light of the fact that the involvement of Zapf Creation in the area of high-quality designer and collector dolls, which are sold primarily in Germany and the USA, has suffered considerably in the past three years from consumer restraint, particularly with regard to high-priced items. Furthermore, on the customer side, there has been a distinct concentration on just a few stores which still sell designer dolls. Because of this, the Designer Collection product line is increasingly losing its sales platform.

The production site in Roedental can therefore no longer be maintained. The resultant personnel measures and the related socially acceptable staff reductions are currently being negotiated with the works council.

### **Preventative measures for protection against SARS have been lifted**

After the World Health Organization announced on July 5, 2003 that the SARS chain of infection appeared to be broken, the last remaining travel warnings for countries affected by SARS were also lifted.

On the basis of these developments, the additional office space that Zapf Creation had rented in Hong Kong as a preventative measure was given up, and the employees were organizationally reunited.

### **Optimistic outlook for Christmas sales**

Despite a consumer environment which remains restrained, Zapf Creation AG is encouraged by the basic factors underlying the important second half of the year and the upcoming Christmas season.

The Baby Annabell branded play concept, which already demonstrated strong sales in the first half of the year, will certainly bring about another boost in sales with the Europe-wide introduction of the new Baby Annabell doll. Expanded listings for accessories will further strengthen this effect.

New customers in the growth markets of Great Britain and the USA, as well as expanded listings among existing French customers, will ensure additional sales growth.

In light of this, the management board of Zapf Creation AG continues to anticipate a currency-adjusted increase in sales of 15 %. Due to the continuing weakness of the dollar and changing exchange rates, however, this corresponds to sales growth of only 7 % in real terms. In May 2003, when the management board confirmed this forecast at the Annual Stockholders' Meeting, this corresponded to real sales growth of 10 %. The 15 % increase in earnings before interest and taxes has also been reaffirmed by the management board.

### More analysts discover Zapf Creation stock

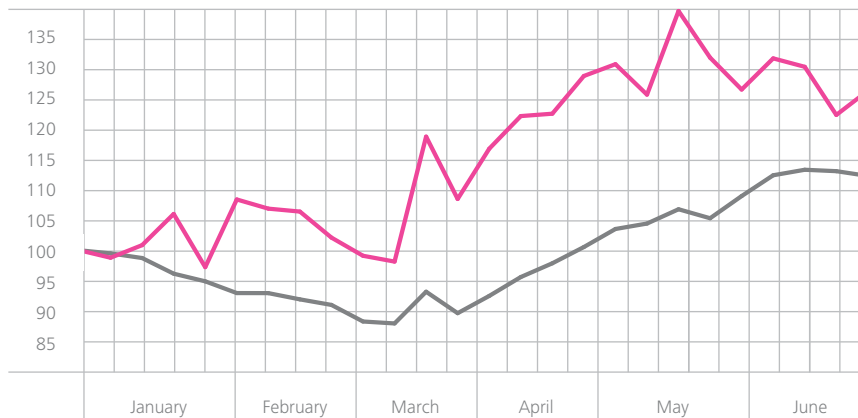
Zapf Creation stock has been added to the coverage lists of HypoVereinsbank and HSBC. Both institutions have recently recommended the purchase of the stock. Zapf Creation is now being actively evaluated by nine analysts.

The stock price continued to perform positively in the second quarter. Following a high of € 30 in the

first quarter of 2003, Zapf Creation stock rose again by 16% to € 35.20.

In addition to this positive stock price performance, Zapf Creation also pleased its investors with an attractive dividend of € 1 per share. This equates to a dividend yield of 3.9%. A dividend proposal to that effect was accepted by the majority at the Annual Stockholders' Meeting on May 7, 2003.

### 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

Bankhaus Lampe	July 2003	Marketperformer
Berenberg Bank	July 2003	Buy
CAI Cheuvreux	July 2003	Outperform
Commerzbank	July 2003	Accumulate
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 June 30, 2003 (US GAAP)

	Q2/2003 K€	Q2/2002 K€	H1/2003 K€	H1/2002 K€	Change H1 in % <sup>2)</sup>
<b>Net sales</b>	<b>30,922</b>	<b>30,761</b>	<b>60,014</b>	<b>60,162</b>	<b>0</b>
Cost of goods sold <sup>1)</sup>	- 12,453	- 14,644	- 25,282	- 28,973	- 13
<b>Gross profit</b>	<b>18,469</b>	<b>16,117</b>	<b>34,732</b>	<b>31,189</b>	<b>11</b>
Selling and distribution expenses <sup>1)</sup>	- 4,497	- 5,572	- 9,862	- 10,483	- 6
Marketing expenses <sup>1)</sup>	- 4,474	- 4,297	- 7,186	- 7,692	- 7
Administrative expenses, net <sup>1)</sup>	- 6,836	- 4,612	- 12,891	- 9,513	36
<b>EBIT – Operating profit before interest and taxes</b>	<b>2,662</b>	<b>1,636</b>	<b>4,793</b>	<b>3,501</b>	<b>37</b>
Interest income	31	187	70	224	- 69
Interest expense	- 611	- 769	- 1,296	- 1,327	- 2
<b>EBT – Profit before income tax expense</b>	<b>2,082</b>	<b>1,054</b>	<b>3,567</b>	<b>2,398</b>	<b>49</b>
Income tax expense	- 364	- 167	- 798	- 494	62
<b>Net income</b>	<b>1,718</b>	<b>887</b>	<b>2,769</b>	<b>1,904</b>	<b>45</b>
Gross margin in %	60	52	58	52	12

Breakdown of personnel expenses <sup>3)</sup>	Q2/2003 K€	Q2/2002 K€	H1/2003 K€	H1/2002 K€	Change H1 in % <sup>2)</sup>
Sales and distribution department <sup>4)</sup>	2,032	2,193	4,153	4,185	- 1
Marketing department	563	604	1,196	1,071	12
Administrative department	2,896	2,771	5,667	5,137	10
<b>Total</b>	<b>5,491</b>	<b>5,568</b>	<b>11,016</b>	<b>10,393</b>	<b>6</b>

<sup>1)</sup> see notes

<sup>2)</sup> rounded

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

<sup>4)</sup> see notes

## Consolidated Balance Sheets

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

Assets	6/30/2003 K€	6/30/2002 K€	12/31/2002 K€
Cash and cash equivalents	6,111	7,050	14,850
Accounts receivable	35,527	37,580	57,674
Inventories	41,390	38,428	29,682
Prepaid expenses	4,033	100	2,444
Other current assets	8,421	5,355	2,618
Deferred tax assets (short term)	2,531	864	2,487
<b>Total current assets</b>	<b>98,013</b>	<b>89,377</b>	<b>109,755</b>
Property, plant, equipment and software, net	28,224	27,409	28,523
Intangible assets, net	2,670	1,552	1,425
Deferred tax assets (long term)	230	1,042	182
<b>Total long-lived assets</b>	<b>31,124</b>	<b>30,003</b>	<b>30,130</b>
	<b>129,137</b>	<b>119,380</b>	<b>139,885</b>
<b>Liabilities and stockholders' equity</b>	<b>6/30/2003 K€</b>	<b>6/30/2002 K€</b>	<b>12/31/2002 K€</b>
Current portion of long-term debt and short-term borrowings	30,824	39,327	22,914
Accounts payable	13,247	15,580	15,689
Accrued liabilities	3,329	3,779	12,998
Income taxes payable	3,630	895	4,819
Deferred tax liabilities (short term)	1,319	275	1,320
<b>Total current liabilities</b>	<b>52,349</b>	<b>59,856</b>	<b>57,740</b>
Long-term debt	18,598	15,498	20,317
Other long-term liabilities	42	42	68
Deferred tax liabilities (long term)	973	1,103	973
<b>Total long-term liabilities</b>	<b>19,613</b>	<b>16,643</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	- 3,206	- 441	- 1,987
Retained earnings	45,394	31,216	50,549
<b>Total stockholders' equity</b>	<b>57,175</b>	<b>42,881</b>	<b>60,787</b>
	<b>129,137</b>	<b>119,380</b>	<b>139,885</b>



## Consolidated Statement of Cash Flows

of Zapf Creation AG, Roedental

	H1/2003 K€	H1/2002 K€
<b>Cash flow from operating activities:</b>		
Net income	2,769	1,904
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation and amortization	3,348	2,695
Loss (gain) on sale of property, plant, equipment and software	- 22	- 33
Stock-based compensation expense	199	189
Increase (decrease) from changes in assets and liabilities:		
Accounts receivable	21,992	4,719
Inventories	- 11,738	- 13,149
Prepaid expenses and other assets	- 7,402	- 74
Accounts payable and accrued liabilities and other liabilities	- 12,646	- 5,994
Income taxes payable	- 1,203	- 2,957
Deferred taxes	- 94	- 639
<b>Net cash flow from operating activities</b>	<b>- 4,797</b>	<b>- 13,339</b>
<b>Cash flow from investing activities:</b>		
Proceeds from sale of property, plant, equipment and software	229	104
Capital expenditures	- 4,582	- 5,535
<b>Net cash flow from investing activities</b>	<b>- 4,353</b>	<b>- 5,431</b>
<b>Cash flow from financing activities:</b>		
Net borrowings under short- and long-term debt agreements	6,166	19,753
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>1,004</b>	<b>15,075</b>
Effect of foreign exchange rate changes on cash	- 593	- 489
<b>Net increase in cash</b>	<b>- 8,739</b>	<b>- 4,184</b>
Cash at beginning of period	14,850	11,234
Cash at end of period	6,111	7,050

## Consolidated Statement of Stockholders' Equity

of Zapf Creation AG, Roedental

	Shares outstanding	Common stock
	number (thds.)	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 June 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. As some of the options were exercised in the second quarter, the account balance was reduced correspondingly.

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. The company uses the positive stock price performance to reduce excess treasury stock holdings. As a result, the balance of this account has also been reduced.

Portfolio	Book value	Number	Percentage of
	K€	shares	share capital
			%
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 paid-in capital K€	Treasury stock K€	Retained earnings K€	Accumulated other comprehensive income K€	Total equity K€
8,406	- 4,181	50,549	- 1,987	60,787
		2,769		2,769
			- 1,219	- 1,219
		2,769	- 1,219	1,550
		- 7,924		- 7,924
				0
410	2,352			2,762
8,816	- 1,829	45,394	- 3,206	57,175

## Notes

For the period from 1 January 2003 to 30 June 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 and H1/2002 were adjusted 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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