

Quarterly Report 1/2003



At a Glance

Consolidated key figures	Q1/2003	Q1/2002	Change in % ²⁾
Net sales in K€	29,092	29,401	- 1
EBITDA in K€	3,723	3,073	21
EBIT in K€	2,131	1,865	14
EPS (undiluted) in €	0.13	0.13	3
CFPS (operative cash flow per share) in €	0.39	- 1.55	n/a
Number of employees as of 31 March ¹⁾	512	509	1
Stock price, high (Xetra) in €	30.00 (3/21)	26.40 (3/28)	n/a
Stock price, low (Xetra) in €	24.02 (3/11)	21.20 (2/12)	n/a
Stock price, end of quarter (Xetra) in €	27.31 (3/31)	26.40 (3/28)	n/a
Stock price, average (Xetra) in €	26.265	23.274	n/a
Average daily trading volume (Xetra) no. of shares	16,138	12,139	33
Market capitalization (base: end of quarter) in million €	218	211	3

¹⁾ not including Management Board and trainees

²⁾ rounded

Financial Calendar

Event	Date	Place
4th Annual Stockholders' Meeting	May 7, 2003	Roedental
Results Q1/2003	May 7, 2003	
Global conference call	May 7, 2003	
Dividend payment ¹⁾	May 8, 2003	
European smaller companies conference	May 8, 2003	London
Roadshow	May 9, 2003	London
Press conference H1/2003	End of July 2003	
Global conference call	End of July 2003	
Results Q3/2003	End of October 2003	
Global conference call	End of October 2003	

¹⁾ subject to approval by the Annual Stockholders' Meeting

First Quarter Report 2003

- Currency-adjusted sales increase by 3 %
- EBIT up 14 % to € 2.1 million
- Guidance for full fiscal year 2003 remains unchanged

Zapf Creation AG recorded sales of € 29.1 million in the first quarter of fiscal year 2003, down slightly by € 0.3 million or 1 % compared to last year's figure of € 29.4 million. This is due to the discontinued Maritim business, which accounted for € 0.3 million in the first quarter of fiscal year 2002, and the late Easter business, which resulted in a partial shift of sales to the second quarter of 2003. Adjusted for currency translation effects, sales for the first three months of 2003 were up 3 % compared to the figure reported for the same period last year.

At approximately 56 %, the gross margin in the first three months of 2003 remained at the high level achieved during the second half of 2002 and was almost five percentage points higher than in the first quarter of 2002. This development benefited from the traditionally high share of sales recorded in the euro zone in the first quarter. At the same time, cost of goods sold decreased due to the persistent weakness of the dollar in the past months.

Operating expenses were approximately € 1 million higher than in the same period last year, which is exclusively due to planned increases in depreciation (€ 0.4 million) and personnel expenses (€ 0.7 mil-

lion). These gross margin and cost effects caused earnings before interest and taxes (EBIT) to increase by 14 % from € 1.9 million to € 2.1 million. The EBIT margin improved by one percentage point from 6.3 % to 7.3 %.

Continued strong growth in Great Britain and the USA

The slight decline of 2 % in Central Europe is mainly due to the weak consumer climate and the partial shift of Easter sales to the second quarter. Despite these factors, sales in Germany remained at last year's level. This is mainly due to the highly promising market introduction of the new My Model concept, which has been expanded by numerous accessories.

Sales by business units

	Q1/2003 K€	Q1/2002 K€	Change in %
Europe	25,074	24,819	1.0
Central Europe	17,135	17,503	- 2.1
Northern Europe	4,887	3,716	31.5
Southern Europe	2,333	3,200	- 27.7
Eastern Europe	719	400	79.8
The Americas	3,484	3,502	- 0.5
Asia/Australia	534	1,080	- 50.6
Net sales	29,092	29,401	- 1.1

The Northern Europe operating business unit boosted sales significantly in all markets and achieved growth of 32 %. In Great Britain, which is an important market for Zapf Creation, sales were up 24 %, or more than 35 % in sterling terms. This development was primarily due to the substantial increase in sales of Baby Annabell accessories.

Southern Europe, on the other hand, came in at 27 % below last year's figures. The main reason for this is a disappointing first quarter in Belgium. In absolute terms, however, the sales decline is relatively small so that it is still too early to determine a trend.

Due to extraordinarily high sales in Russia, Eastern Europe recorded sales revenues of just over € 0.7 million in the first quarter, up 80 % compared to last year. In past years, this business unit recorded more than 80 % of annual sales in the fourth quarter.

US dollar sales revenues in the Americas increased by just over 20 %. In euro terms, however, sales were flat compared to last year.

Asia/Australia also had a relatively slow start into the new fiscal year. Given that significantly less than 10 % of annual sales are recorded in the first quarter, it is still too early to deduce a trend from these figures.

Baby Annabell concept and My Model are the growth drivers in the first quarter

At € 15.2 million (Q1/2002: € 16.3 million), the successful BABY born® concept continued to contribute more than half of the sales revenues of the Zapf Creation Group in the first quarter of 2003. The slight decline in sales is primarily due to the German market, where the minor shift in Easter business had the biggest impact.

The branded play concept Baby Annabell boosted sales by almost 35 % from January to March 2003, which had a significant impact on the positive business development in Great Britain. Accessories are particularly in demand.

Sales by product lines

	Q1/2003 K€	Q1/2002 K€	Change in %
BABY born® concept	15,159	16,311	- 7.1
Baby Annabell	3,385	2,513	34.7
CHOU CHOU	6,334	7,100	- 10.8
Others	4,215	3,202	31.6
Dolls total	29,093	29,126	- 0.1
Maritim/other	- 1	275	n/a
Net sales	29,092	29,401	- 1.1

In the first quarter of 2003, large dolls accounted for approximately 80 % of global consolidated sales. As is typical of this period, 64 % of sales were attributable to accessories and only 36 % to dolls. Mini dolls had an 11 % share in total sales.

Positive cash flow

As expected, the strong fourth quarter of 2002 led to a significant increase in payments received during the first three months of the current fiscal year and thus to a net cash flow from operating activities of € 3.1 million. This compares to a net decrease in cash of € 12.3 million in the same period of last year.

Guidance for full fiscal year remains unchanged

Despite the rather modest first quarter and the weak consumer environment, the management board of Zapf Creation AG expects sales for the first six months of 2003 to reach approximately € 63 million, based on current exchange rates, and earnings before interest and taxes to come in at just over € 5 million. This compares to sales of € 60.2 million and an EBIT of € 3.5 million for last year.

In line with the guidance that was published in March, the Company continues to expect sales for the full fiscal year to grow by approximately 10 % and EBIT to increase by some 15 %.

Preventative measures implemented for protection against SARS

Zapf Creation has around 95 % of its products manufactured in China, and it maintains an office in Hong Kong that is of prime importance for the procurement process of the entire Group. The Company thus sees itself confronted with the problem of the infectious disease known as SARS that is currently circulating in Asia.

As an immediate preventative measure, additional office space was rented in Hong Kong and, by dividing up the employees, two organizationally similar units were created which can carry out all critical functions independently of one another. In the event that one office is forced to close, Zapf Creation will be able to remain active without any major limitations.

Together with the suppliers in China, the management of Zapf Creation Hong Kong has established preventative measures and drawn up recommendations for conduct. The paper includes measures for protecting the employees in production and administration, as well as for protecting factory visitors. The management of Zapf Creation AG will continue to monitor the situation in close coordination with the suppliers. Special contingency plans have already been discussed with, and made available to, all suppliers.

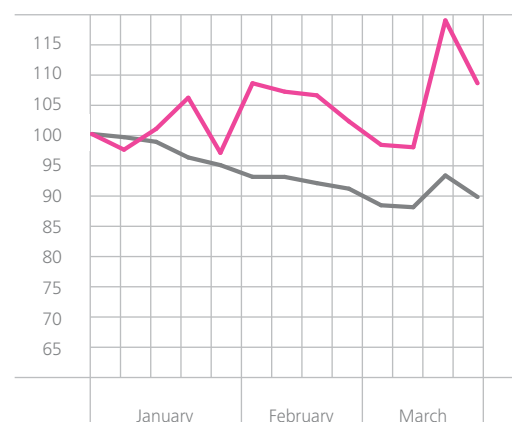
Listing on the MDAX50

Zapf Creation stock entered the first quarter of fiscal year 2003 at a price of € 25.18 (January 1, 2003) and experienced a pleasant increase of some 20 % to € 30 until March 21, 2003. At the same time, the daily trading volume in Zapf Creation stock also was up. This means that Zapf Creation stock was able to clearly distance itself from the general weakness of the stock markets, which at the time were impacted by the impending war in Iraq.

In the course of restructuring the German stock market, Deutsche Börse AG reduced the MDAX, the index for medium-sized businesses, from previously 70 companies to 50 companies. The new index structure became effective on March 24, 2003. From day one, Zapf Creation stock was a member of this more prestigious MDAX index, thus continuing its successful stock market history.

At the 4th Annual Stockholders' Meeting on May 7, 2003, in Roedental, the management board and the supervisory board will propose to once again increase the dividend for fiscal year 2002 by 54 % to € 1.00 per share. The dividend payment is subject to the approval of the Annual Stockholders' Meeting on May 8, 2003.

Stock Performance 2003 (Index)



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

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

Directors' dealings

During the period from January 1 to March 31, 2003, the officers and directors of the Company did not engage in any dealings as defined by § 15 a of the German Securities Trading Act (WpHG).

Research coverage/Analyst recommendations

Cazenove	May 2003	Buy
Dresdner Kleinwort Wasserstein	April 2003	Buy
Berenberg Bank	March 2003	Buy
CAI Cheuvreux	March 2003	Outperform
Commerzbank	March 2003	Buy
Deutsche Bank	March 2003	Buy
Bankhaus Lampe	January 2003	Outperform

Consolidated Income Statement

of Zapf Creation AG, Roedental, for the period from January 1 through March 31, 2003 (US GAAP)

	Q1/2003 K€	Q1/2002 K€	Change in % ²⁾
Net sales	29,092	29,401	- 1
Cost of goods sold ¹⁾	- 12,829	- 14,329	- 10
Gross profit	16,263	15,072	8
Selling and distribution expenses ¹⁾	- 5,365	- 4,911	9
Marketing expenses ¹⁾	- 2,712	- 3,395	- 20
Administrative expenses, net ¹⁾	- 6,055	- 4,901	24
EBIT – Operating profit before interest and taxes	2,131	1,865	14
Interest income	39	37	5
Interest expense	- 685	- 558	23
EBT – Profit before income tax expense	1,485	1,344	10
Income tax expense	- 434	- 327	33
Net income	1,051	1,017	3
Gross margin in %	56	51	9

Breakdown of personnel expenses (already included in operating expenses)	Q1/2003 K€	Q1/2002 K€	Change in % ²⁾
Sales and distribution department ³⁾	2,121	1,992	6
Marketing department	633	467	36
Administrative department	2,771	2,366	17
Total	5,525	4,825	15

¹⁾ 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 the first quarter of fiscal year 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.

²⁾ rounded

³⁾ see footnote 1

Consolidated Balance Sheets

of Zapf Creation AG, Roedental, as of March 31, 2003 (US GAAP)

Assets	3/31/2003 K€	3/31/2002 K€	12/31/2002 K€
Cash and cash equivalents	14,674	8,757	14,850
Accounts receivable	37,632	38,375	57,674
Inventories	32,885	28,764	29,682
Prepaid expenses	1,939	160	2,444
Other current assets	4,213	6,892	2,618
Deferred tax assets (short term)	2,737	949	2,487
Total current assets	94,080	83,897	109,755
Property, plant, equipment and software, net	28,119	24,890	28,523
Intangible assets, net	2,746	1,621	1,425
Deferred tax assets (long term)	206	617	182
Total long-lived assets	31,071	27,128	30,130
	125,151	111,025	139,885

Liabilities and stockholders' equity	3/31/2003 K€	3/31/2002 K€	12/31/2002 K€
Current portion of long-term debt and short-term borrowings	22,649	29,045	22,914
Accounts payable	11,618	8,417	15,689
Accrued liabilities	4,397	3,090	12,998
Income taxes payable	2,718	3,802	4,819
Deferred tax liabilities (short term)	1,319	274	1,320
Total current liabilities	42,701	44,628	57,740
Long-term debt	20,295	16,436	20,317
Other long-term liabilities	54	33	68
Deferred tax liabilities (long term)	973	1,103	973
Total long-term liabilities	21,322	17,572	21,358
Common stock	8,000	8,000	8,000
Additional paid-in capital	8,406	8,375	8,406
Treasury stock	- 4,178	- 4,553	- 4,181
Accumulated other comprehensive income	- 2,700	1,568	- 1,987
Retained earnings	51,600	35,435	50,549
Total stockholders' equity	61,128	48,825	60,787
	125,151	111,025	139,885

Consolidated Statement of Cash Flows

of Zapf Creation AG, Roedental

	Q1/2003 K€	Q1/2002 K€
Cash flow from operating activities:		
Net income	1,051	1,017
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation and amortization	1,644	1,295
Loss (gain) on sale of property, plant, equipment and software	0	– 20
Stock-based compensation expense	34	– 73
Increase (decrease) from changes in assets and liabilities:		
Accounts receivable	19,904	3,993
Inventories	– 3,218	– 3,485
Prepaid expenses and other assets	– 1,091	– 1,493
Accounts payable and accrued liabilities and other liabilities	– 12,813	– 13,060
Income taxes payable	– 2,129	– 86
Deferred taxes	– 275	– 301
Net cash flow from operating activities	3,107	– 12,213
Cash flow from investing activities:		
Proceeds from sale of property, plant, equipment and software	83	120
Capital expenditures	– 2,696	– 1,535
Net cash flow from investing activities	– 2,613	– 1,415
Cash flow from financing activities:		
Net borrowings under short- and long-term debt agreements	– 300	10,950
Proceeds from issuance of treasury stock	3	145
Net cash flow from financing activities	– 297	11,095
Effect of foreign exchange rate changes on cash	– 373	56
Net increase in cash	– 176	– 2,477
Cash at beginning of period	14,850	11,234
Cash at end of period	14,674	8,757

Consolidated Statement of Stockholders' Equity

of Zapf Creation AG, Roedental

	Shares outstanding	Common stock
	number (thsd.)	K€
Balance at December 31, 2001:	7,852	8,000
Comprehensive income		
Net income		
Accumulated other comprehensive income		
Total comprehensive income		
Dividend payments		
Purchase of treasury stock		
Issuance of treasury stock	5	
Balance at March 31, 2002:	7,857	8,000
Comprehensive income		
Net income		
Accumulated other comprehensive income		
Total comprehensive income		
Dividend payments		
Purchase of treasury stock		
Issuance of treasury stock	17	
Balance at December 31, 2002:	7,874	8,000
Comprehensive income		
Net income		
Accumulated other comprehensive income		
Total comprehensive income		
Dividend payments		
Purchase of treasury stock		
Issuance of treasury stock		
Balance at March 31, 2003:	7,874	8,000

Notes

For the period from 1 January 2003 to 31 March 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 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.

Additional paid-in capital K€	Treasury stock K€	Retained earnings K€	Accumulated other comprehensive income K€	Total equity K€
8,437	- 4,698	34,418	1,530	47,687
		1,017		1,017
			38	38
		1,017	38	1,055
				0
				0
- 62	145			83
8,375	- 4,553	35,435	1,568	48,825
		20,220		20,220
			- 3,555	- 3,555
		20,220	- 3,555	16,665
		- 5,106		- 5,106
				0
31	372			403
8,406	- 4,181	50,549	- 1,987	60,787
		1,051		1,051
			- 713	- 713
		1,051	- 713	338
				0
				0
	3			3
8,406	- 4,178	51,600	- 2,700	61,128

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.

Portfolio	Book value K€	Number shares	Percentage of share capital %
No. 1	2,532	72,979	0.91
No. 2	1,646	53,085	0.66
Total	4,178	126,064	1.57



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