ANNUAL REPORT 2007

Zapf Creation is on the right track…

Consolidated Key Figures of Zapf Creation

in € million	2007	2006	+/–%
Adjusted earnings situation			
(without restructuring costs and one-off effects)			
Continued operations			
EBITDA	10.2	10.7	–5
EBIT	6.0	5.4	11
EBIT margin (in %)	5.5	4.7	—
EBT	2.6	–0.9	—
Result from continued operations	–2.2	–0.6	—
Discontinued operations			
Result from discontinued operations	–0.1	–4.9	98
Group			
Net profit or loss for the period	–2.4	–5.6	57
Earnings per share (in €) 1)	–0.27	–0.74	63
Earnings situation according to the income statement			
(including restructuring costs and one-off effects)			
Continued operations			
Net sales	110.5	116.1	–5
Gross margin (in %)	43.7	45.4	—
EBITDA	9.8	4.8	104
EBIT	5.7	–0.5	—
EBIT margin (in %)	5.2	–0.4	—
EBT	2.2	–6.8	—
Result from continued operations	–2.6	–6.5	60
Included restructuring costs and one-off effects	0.4	5.9	–93
Included depreciation and amortization	4.1	5.3	–23
Discontinued operations			
Result from discontinued operations	–0.1	–6.1	98
Included restructuring costs and one-off effects	0.0	1.2	–100
Included depreciation and amortization	0.0	0.0	—
Group			
Net profit or loss for the period	–2.7	–12.7	79
Earnings per share (in €) 1)	–0.31	–1.67	81

1) undiluted = diluted

in € million	2007	2006	+/− %
Balance sheet			
Total assets	115.1	115.6	0
Non-current assets	19.5	26.3	−26
Investments	1.7	1.8	−6
Current assets	95.6	89.3	7
Equity	14.4	3.6	—
Equity ratio (in %)	12.5	3.1	—
Liabilities to banks and loans granted by shareholders	56.2	65.1	−14
Net debts (including shareholder loans)	32.9	53.3	−38
Cash flow			
Cash flow from operating activities	28.8	20.3	42
Cash flow from operating activities per share (in €) 1)	3.26	2.68	22
Net cash flow	11.6	2.4	—
Employees			
Number as of the closing date 2)	226	322	−30

1) undiluted = diluted
2) excluding Management Board and trainees

The key figures are based on rounded values in € million. The calculation of sums and ratios can therefore result in differences when compared to the annual financial statements.

Zapf creation®

Contents

Dear Shareholders,

In 2007, our Group made further important advances on the road back to profitable growth. The "new" Zapf Creation that emerged from the Group's fundamental restructuring is gathering speed, slowly but steadily, even though it certainly must move faster in regards to its market prowess. What matters most, however, is that the Group moved in the right direction in the financial year just ended – despite the continued restraint in the market for play and functional dolls and substantial delays in arranging the Group's long-term follow-up financing.

At € 110.5 million, in 2007 consolidated sales remained 4.9 % below the previous year's level while revenue development clearly followed an upward trend. Sales grew by 15.1 % year on year in the most important fourth quarter during which the toy industry generates the lion's share of its business.

Earnings improved yet again as well. Earnings before interest and taxes (EBIT) excluding restructuring and one-off expenses rose by 11.2 % to € 6.0 million. While the Group's net result after taxes of € –2.7 million means that the Group has not quite returned to the profit zone, it has made significant year-on-year progress (2006: € –12.7 million).

A number of factors are responsible for this upward trend, chiefly among them:

- We have put a great deal of work into streamlining, adapting, and supplementing our brand portfolios by new innovations – and thus making them more attractive. Our product range had to be streamlined in order to reduce its complexity on all levels: in design, in the supply chain, and in sales. This required detailed analyses of each and every brand portfolio and the removal of specific articles with weak sales and unacceptable margins. As a result, the overall portfolio was reduced by 15 % to 20 % relative to the number of articles.

- Zapf Creation has found a strong cooperation partner in MGA Entertainment, Inc., the US toy manufacturer. This collaboration has not only made it possible to tap into our brands' unused potentials but has also given us a major shareholder that supports us.

- Our sales organizations in all countries were adjusted to the needs of the relevant market and reorganized, as in Spain, for example. Hence we now maintain conventional sales structures with key account managers and our own sales staff in all markets where we have subsidiaries. Experienced distributors help us to work new markets and regions such as Eastern Europe, Scandinavia, Asia/Pacific, the Middle East, and South Africa. Overall, Zapf Creation's sales and distribution have become more powerful. We are working intensely on a new long-term distribution concept for France, where our subsidiary had to accept a substantial decrease in sales.

Jens U. Keil
Member of the Management Board
Finance, Capital Market (Investor Relations), Human Resources, IT, Logistics, Internal Audit, Risk Management, Legal Affairs and Organization

Thomas Pfau
Member of the Management Board
Marketing, Sales, Design and Product Development, Supply Chain Operations, Quality Management, Strategy and Corporate Development

- All of Zapf Creation's activities are now rooted in an organization that provides the appropriate framework for the Group's business. Our structures have been streamlined, our processes have become more effective, and responsibilities have been clarified. In turn, this has helped us to substantially reduce the cost base to a competitive level.

- The Group's market position in Europe remains excellent, notwithstanding all the turmoil it experienced in recent years. In 2007, Zapf Creation succeeded in stabilizing its leading position in the European market for play and functional dolls. Market share in Germany was 58.5 %, again making us the number one by far in this market.

- Last but not least, the Group's sustainable and long-term financing (which included strengthening our equity base) has enabled us to regain a measure of entrepreneurial freedom. Zapf Creation now possesses a sufficient financial base for expanding and enhancing its operations.

The lengthy and complex negotiations with banks and major shareholders undoubtedly cast a shadow over the financial year just ended and tied up a not inconsiderable amount of the Company's resources. This follow-up financing had become necessary because the term of the € 90 million syndicated loan that had been obtained in the spring of 2006 expired on April 30, 2007.

On July 20, 2007, we finally managed to bring about an agreement between all participants with respect to a new, long-term financing concept. This financing concept essentially comprises new loans of € 65 million with maturities between three and five and one half years that were made available by an international banking syndicate. The Company also received cash infusions of equity or quasi equity totaling € 30 million from two cash capital increases and subordinated shareholder loans. At the same time the previous banking syndicate agreed to grant a grace period for the repayment of roughly € 45 million in funds that had been drawn from the former syndicated loan until the new financing concept was in place. Yet the financing concept could not be fully implemented until December 7, 2007, due to unforeseen delays that made additional negotiations necessary.

The Management Board wishes to thank all participants for their constructive and responsible actions, despite all the delays and difficulties that occurred. It goes without saying, of course, that it would have been impossible to put the follow-up financing in place without the broad financial commitment of the family trusts associated with MGA Entertainment, Inc. and Mr. Nicolas Mathys as major shareholders of Zapf Creation AG.

The equity ratio of 12.5 % as of the close of the 2007 financial year shows that the Group's capital has improved but remains insufficient. We were able to further fortify our equity base in the first quarter of 2008 by converting a large portion of the subordinated shareholder loans into share capital and, at the same time, substantially reduce future interest payments but there is still a pressing need to continue strengthening the equity of both Zapf Creation AG and the Zapf Creation Group.

The Group's far-reaching reorganization provides it with a solid platform for future sales and earnings growth. Market proximity to dealers and end customers alike, innovative toy concepts, quality assurance, the ability to make deliveries and compliance with delivery deadlines, as well as targeted marketing will be instrumental to the Company's success.

But consumers' confidence in the Company is equally necessary. In 2007, competitors had to recall several products because they were defective or posed a hazard to children's health, setting off a very intense public debate on the safety of toys produced in China. We take this debate very seriously as every product recall – even if carried out by a competitor – can undermine customers' confidence. While we further intensified the quality assurance we carry out both on site in China and in Roedental, we have had no cause to date to doubt the reliability of our suppliers. Yet we also believe that it is inappropriate to use individual design defects to spur a fundamental debate on China as a location of production that is critical to the survival of our industry.

We are cautiously optimistic as far as the development of our business in 2008 is concerned and hope that a number of innovations we developed will stimulate business. Both the satisfactory 2007 Christmas season and the market's positive response at the start of the current year to the products we introduced at the Nuremberg Toy Fair underscore this assessment. The licensing business for products other than toys, which we are pursuing in cooperation with MGA Entertainment, Inc., is expected to provide the first appreciable revenues in 2008 even though establishing this business naturally requires some time.

We expect our broad strategic cooperation with MGA Entertainment, Inc. – which was established in early 2007 in regards to worldwide sales, procurement, licensing, and logistics – to bear fruit for the first time in 2008, given the need to overcome a few start-up difficulties in the first year. Zapf Creation thus expects this partnership to generate efficiency gains and, in turn, substantially higher earnings contributions than a year ago.

We are determined to achieve the turnaround in consolidated sales this year and to post revenue growth for the first time in years, provided general economic conditions in the toy industry do not deteriorate significantly. Consolidated EBIT should continue to improve. Based on these assumptions, the Group should also be able to turn the corner in after-tax income.

Even though we still have quite a bit of ground to cover, Zapf Creation undoubtedly is back on a solid foundation. Our strong, well-positioned brands have enabled the Company to regain its competitiveness and develop attractive strategic perspectives in the process. Please be assured that our planning is not based on wishful thinking but rather on realistic assessments.

Our heartfelt thanks are due to all employees for their committed and successful work. We are aware of the fact that the Company's profound restructuring and realignment demanded an extraordinary level of commitment from our staff.

And we thank our shareholders for supporting Zapf Creation AG during a very difficult phase. We are certain that your confidence in us has paid off.

Roedental, Germany, March 12, 2008

Jens U. Keil
Member of the Management Board

Thomas Pfau
Member of the Management Board

Europe's Leading Doll Manufacturer

Zapf Creation AG is Europe's leading manufacturer of play and functional dolls and accessories. The Company markets branded play concepts that consist of a doll and a world of matching accessories that are developed to a high standard of quality, design, safety and play value.

The Company's most popular brands include BABY born®, Baby Annabell® and CHOU CHOU. The My Model branded play concept complements the Company's product portfolio for additional target groups. These globally successful play concepts have been conceived particularly for the Company's core target group – girls between three and eight years of age. In designing doll accessories and clothes, Zapf Creation takes its lead from trends in children's fashions and general lifestyle topics and incorporates them into the roughly 70 % of new products that are launched each year. The dolls' soft bodies also conceal innovative technology used in creative ways to enable diverse functions.

The branded play concepts of Zapf Creation place no limits on a girl's imagination, following the Company's philosophy, "Setting free a child's imagination". Playing with dolls also addresses social skill such as loving, caring, empathy and accepting responsibility, thereby supporting a child's personal development.

Endless possibilities…

BABY born® is the successful functional doll for children between three and eight years of age that does not require any batteries. Being doll babies, they need their doll mothers' care but they also accompany the kids as a friend in many activities. The new little doll brother – BABY born® BOY – offers a continuously expanding range of accessories for mother-child role playing. These little boys also accompany the kids – on bike or boat rides, while horseback riding, or as princes at the side of BABY born® Princess. The princess arrives in her magic sleigh that's drawn by a reindeer with a glowing nose. She's heading for the dream castle that has two floors and contains a broad range of furnishings. The smaller, »my little BABY born®, Mommy, I can swim« doll means summer can come because it allows kids to learn swimming along with their favorite doll! The »my little BABY born® interactive twin« baby dolls are the big innovation of 2008. This is the first time dolls can act together by turning to each other, laughing together, crying, and engaging in baby talk.


BABY
born

The loveable baby doll…

Baby Annabell® is based on an infant up to twelve months and reacts like a real baby thanks to its lifelike functions. She makes babbling sounds, sucks on her pacifier, laughs, sheds real tears, yawns, sleeps, or drinks from her little water bottle – and turns her head in the direction of the person speaking to her. The new feeding and activity center offers multifunctional options for playing. Baby Annabell® also responds to the music in the integrated sheep pillow and interacts with the new sheep rocker. The accessories that were newly introduced in 2008 are based on a real baby's daily routine, thus enabling highly realistic mother-baby role play for the core target group of young girls aged three to six years. Doll mothers can take Baby Annabell® out for a stroll in the new baby doll carriage that features a retro design, use music to teach them to walk in the baby walker, or go on hikes wearing the new trekking backpack. The doll's small, soft sister – »My first Baby Annabell®« – is suitable for children from the age of one. A large number of new accessories will continue to expand the »My first Baby Annabell®« segment.

Like a real baby…

CHOU CHOU dolls are soft and flexible cuddle or functional dolls with or without hair. They are designed for children between one and eight years of age. Fashionable clothing and well thought-out accessories complete CHOU CHOU's colorful world. But CHOU CHOU can also get sick, just like a real baby. Her cheeks turn red and she develops a fever. She doesn't feel well and starts to cry but recovers quickly once she's been given her medicine with a tiny little spoon. CHOU CHOU's fever falls and her red cheeks disappear. The heart-shaped stethoscope can be used to check her heartbeat. The functional doll, »CHOU CHOU, Mommy, my first tooth« will be introduced in 2008. Just as in real life, the right treatment and care makes the first toothache go away and her smile reappears. A diverse range of new accessories, from a little bed to a bag, will be available in the future featuring the new original elephant design!


CHOU CHOU


70
FREE

Fashionable styling and design…

My Model is the suitable play concept for creative girls. With their natural appearance, the »My Model Make-Up and Hairstyling Heads« offer many options for hours of fun based on the playing patterns of girls aged three to eleven years. The girls can also use the cosmetics and hairstyling products on themselves, providing yet more opportunities for creative styling and for trying out new beauty trends. The »My Model Trendy Styling Head« was a true innovation in the market because her hair can be cut. As a result, girls can not only style long hair but also experiment with the most recent short hairstyles! And the »My Model Basic Make-Up Heads« – two newly designed styling heads with quality hair and accessories – will introduce a functional toy in the entry-price segment throughout the year.

Zapf Creation – More Efficient than Ever

The Value Chain of Zapf Creation

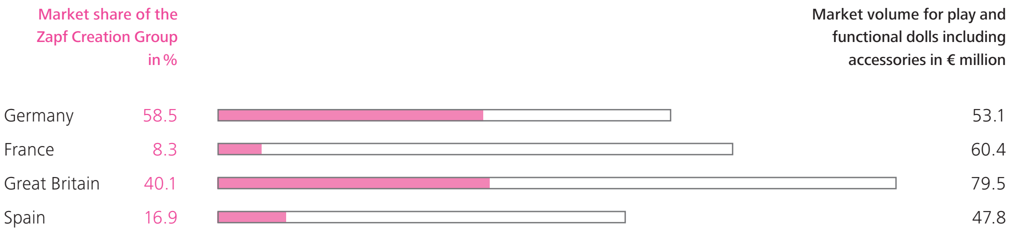
Value chain level	Description	Place	Initial successes
1. Strategic corporate and product planning	Strategic management, including definition of both brand and product strategies, as well as of the structural and process organization	Roedental	Clear strategic alignment and early product planning (18 months prior to product launch)
2. Shared Services	Ensuring all overriding functions (Finance/Controlling, IR, PR, IT, Human Resources)	Roedental	Complete execution of the restructuring
3. Marketing and product development	Brand management, product planning, marketing and advertising, pricing	Roedental, Darmstadt	Stronger focus on customer needs through comprehensive tests (focus groups)
4. Purchasing and technical product development	Technology and engineering, selection of suppliers, product procurement	Hong Kong, Roedental	Enhanced quality assurance (tight integration of suppliers and final acceptance by quality assurance in Germany)
5. Logistics	Ensuring the best possible physical movement of the goods from the manufacturer to the end customer	Roedental, UK, Spain, Poland	Reduction of logistics costs, improvement of supplies
6. Sales and distribution	Sales and distribution strategy and planning, customer service, and key accounting	Worldwide (via the Group's own sales offices and distributors)	Adjustment of the structures to customers' demands
7. Aftersales	Customer service to both trade customers and end consumers, quality assurance	Worldwide (via the Group's own sales offices and distributors)	Ongoing reduction of returns for defects

Zapf Creation Remains the Leading Doll Brand!

Zapf Creation's market shares in European core markets prove that its international market position is as strong as ever. Trends in the doll market show that the Company's clear marketing concept coupled with high efficiency will generate a number of opportunities for gaining and expanding market share.

Market Overview of Selected European Core Markets

Market Share in the Segment of Play and Functional Dolls Including Accessories Top 4 Europe 2007



Source: NPD/Eurotoys 2007, projection by Zapf Creation AG

Market Trends

- Declining birth rates as well as "age compression"
- Strong competition from substitutes (especially electronic toys)
- A return to traditional and conservative values and toys
- Rising brand awareness, even among children
- Growing demand in Eastern European markets

Highest Safety for Our Children

Quality Assurance is One of Zapf Creation's Central Tasks

As the leading manufacturer of play and functional dolls, Zapf Creation AG gives top priority to the safety and quality of its products.

"Suppliers' commitment to safety is important but verification is always better."

Our high-value branded play concepts – BABY born®, Baby Annabell®, and CHOU CHOU, including a broad range of accessories – are subject to continuous quality and safety controls, both internal and external, because children's safety is of paramount importance to us.

Indeed, some of the consistent control mechanisms that we have instituted pursuant to our own quality and safety specifications substantially exceed statutory requirements.

How do We Ensure the Quality of Our Products?

Zapf Creation AG, like many other toy manufacturers, has Asian suppliers produce its high-value branded play concepts. Many years of continued collaboration have resulted in a partnership relationship between Zapf Creation and its suppliers. This relationship is based on trustful cooperation and uniform quality and safety standards.

What is Tested?

The dolls' mechanical and physical properties are tested in our own labs during product development and again by accredited organizations before series production starts. Solely independent, accredited organizations are responsible for verifying compliance with standards pertaining to the safety of electrical components, electromagnetic compatibility, and health requirements (resistance to saliva and perspiration; tests related to hygiene and microbiology), as well as for conducting all chemical tests (migration of specific elements, requirements related to organic chemical compounds). Compliance with the Company's own specifications, as well as with all standards and statutory requirements, is verified by means of regular quality inspections, both announced and unannounced.

This entails inspecting not just the entire production process (from controls of incoming raw materials, to production itself, all the way to packaging) but also the storage and shipment of all goods. Accredited organizations test all Zapf Creation products prior to the relevant market launch for compliance with all statutory requirements, as well as both customer-specific and corporate standards.

Zapf Creation AG is in possession of the relevant certificates and test reports for each and every one of its products. Consumers who buy a Zapf Creation product can be certain that all requirements under the European Toy Standard EN 71 regarding the chemical and mechanical safety of toys, as well as all additional relevant statutory requirements, have been satisfied in full.

Investor Relations

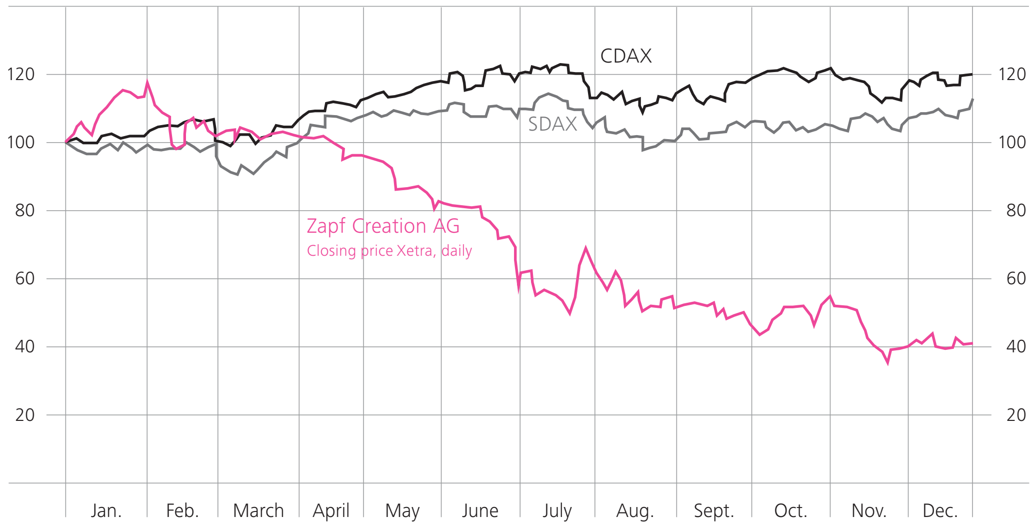
The Share

The 2007 financial year was the most difficult year for the shares of Zapf Creation AG since its IPO. The shares started the year at a price of € 9.28 (adjusted for the capital increase) on January 2, 2007, and began to soar the same month. The appointment effective March 1, 2007, of the Company's new Chief Financial Officer, Mr. Jens U. Keil, was announced on January 16, 2007. Zapf Creation shares reached € 10.50 and thus its high for the year on January 30, 2007, clearly outperforming both the CDAX and the Consumer Performance Index (CXPY). However, the trend reversed in April and the price gradually began to slide against the backdrop of the expiration of the Company's financing on April 30, 2007, the delay in the publication of its annual report for 2006, as well as the ongoing negotiations with respect to follow-up financing.

While the clear downward trend was interrupted for a short time by the announcement that Zapf Creation had concluded a financing agreement on July 20, 2007, it resumed again at the end of July 2007. The first capital increase from authorized capital that entailed issuing 3,200,002 no-par bearer shares as of the end of October 2007 briefly lifted the share price to € 4.93 but it dropped yet again thereafter. A second capital increase involving 1,200,000 no-par bearer shares in return for contributions in cash was executed in December. During this time, the share price ranged around € 3.74, closing the year at € 3.71 on December 28, 2007.

While the comparative indexes, the CDAX and the Consumer Performance Index, showed considerable gains of 20.42 % and 14.04 %, respectively, the share of Zapf Creation AG lost 58.26 % during the course of the year. The daily trading volume decreased to 31,436 shares (previous year: 53,774 shares). The market capitalization based on the share's year-end price decreased to approximately € 49 million.

Share Price Performance 2007



Annual Shareholders' Meeting

The Eighth Annual Shareholders' Meeting of Zapf Creation AG was held on November 20, 2007, in Roedental, Germany. A total of 101 shareholders, as well as 22 proxies – i. e. 123 shareholders and proxies in all – were present. These persons represented 3,282,806 shares or € 3,282,806 (37.3 %) of the Company's share capital of € 8,799,998.

Key Share Figures

	2003	2004	2005	2006	2007
Number of shares (at year's end)	8,000,000	8,000,000	8,000,000	8,799,998	13,200,000
Market capitalization (based on the year-end price) in € million	153	117	63	78	49
High (Xetra) in €	37.65	23.79	18.24	11.10	10.50
	(Sep. 5)	(Feb. 18)	(Feb. 1)	(July 7)	(Jan. 30)
Low (Xetra) in €	17.18	14.25	7.05	7.11	3.31
	(Nov. 26)	(Dec. 21)	(Dec. 15)	(Aug. 18)	(Nov. 21)
Year-end price (Xetra) in €	19.13	14.60	7.83	8.90	3.71
Daily trading volume (average no. of shares)	47,180	33,508	49,918	53,774	31,436
P/E ratio (Xetra, at year's-end) in €	12.5	—	—	—	—
Basic EPS in €	1.53	−3.73	−3.73	−1.67	−0.31
CFPS in €	1.61	−1.14	−1.14	2.68	3.26
Dividend per share in €	1.00	0.00	0.00	0.00	0.00
Dividend yield (Xetra, at year's end) in %	5.2	—	—	—	—

Capital Measures

Two capital increases were executed in the 2007 financial year under Zapf Creation AG's overall financing concept.

A total of 3,200,002 no-par bearer shares were issued in connection with the capital increase that was resolved by the Management Board on October 2, 2007 (with the approval of the Supervisory Board on October 7, 2007) and recorded in the Commercial Register of the Coburg District Court on October 31, 2007, in return for cash contributions under authorized capital pursuant to Article 5 para 2 of the Company's Articles of Incorporation subject to shareholders' subscription rights. The new shares fully participate in profits as of the 2007 financial year, and the subscription right that was granted at a ratio of 13:5 relative to the subscription price of € 3.16 per share applied to all shareholders. The share capital rose to € 12,000,000 as a result of this capital increase.

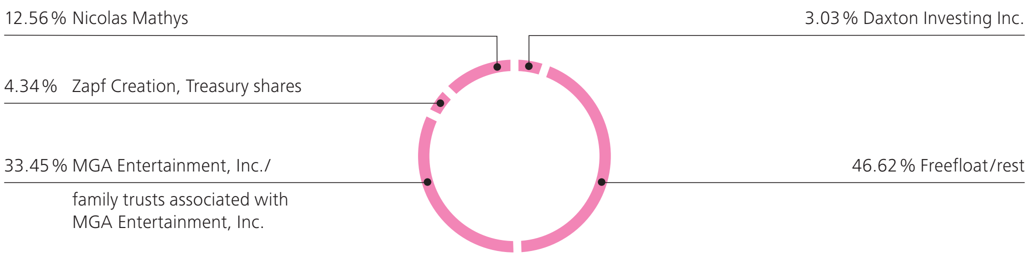
The second capital increase entailed the issuance of 1,200,000 no-par bearer shares in accordance with the capital increase that was resolved by the Management Board on November 26, 2007 (with the approval of the Supervisory Board on November 27, 2007) and recorded in the Commercial Register of the Coburg District Court on December 10, 2007, in return for cash contributions under the authorized capital that was adopted by the Annual Shareholders' Meeting on November 20, 2007, pursuant to Article 5 para 1a of the Company's Articles of Incorporation and subject to the exclusion of shareholders' subscription rights. The new shares were acquired by the Company's major shareholders – various trusts, whose voting shares are attributed to MGA Entertainment, Inc. and Mr. Isaac Larian (Larian Trusts), as well as Mr. Nicolas Mathys – in OTC trading. The new shares were issued at a price of € 3.10. The share capital rose to € 13,200,000 as a result of this capital increase.

Overall, the company received proceeds of € 13.83 million from these two capital increases.

Treasury Shares

Zapf Creation AG is holding a portfolio of 572,678 treasury shares, which corresponds to 4.34 % of the Company's total share capital of € 13,200,000 in no-par bearer shares since the recent capital increases.

Shareholder Structure



As of December 31, 2007

Investor Relations Activities

Zapf Creation AG aims to maintain intensive contacts to institutional and private investors, as well as analysts. Due to the lengthy negotiations in 2007 with regard to the Company's refinancing, its corporate communications messages were not as clear as would have been essential in order to carry out larger shareholder meetings and presentations in connection with the Company's investor relations activities. The Company's actions in this area thus focused on numerous, intense conversations and negotiations – both face-to-face and over the telephone – with major investors, analysts, and bankers, which finally led to an agreement on its long-term financing concept. Zapf Creation AG was not in a position to present itself as a clearly aligned company – financially secure, restructured, and linked to MGA Entertainment, Inc. via a long-term cooperation agreement – until the German Equity Forum on November 12, 2007, in Frankfurt/Main.

Detailed information concerning the Company's shares, current developments, strategy, as well as financial results, are available at www.zapf-creation.com/com/english/investors as part of ongoing investor relations activities. The financial calendar shows all conferences that Zapf Creation AG will attend. All data relevant to the financial markets may also be downloaded from the Company's website.

Aiming to support the positive development of its share price, Zapf Creation AG plans to resume its previous level of investor relations activities in 2008, now that its long-term financing provides it with the necessary security and both its restructuring and realignment have been completed.

Corporate Governance Report

A. Corporate Governance

1. Preliminary Remark

The Zapf Creation Group attaches great importance to compliance with and implementation of the principles enshrined in the Corporate Governance Code with regard to good and responsible management.

They determine corporate communications and efforts to maintain transparency in corporate affairs in the interest of shareholders, business partners, and employees. It is in this sense that both the Management Board and the Supervisory Board of the Company regularly review the management principles with the goal of exercising and developing the Company's corporate governance in the long term.

Below, important activities related to corporate governance in the 2007 financial year are listed.

We also refer to the report of the Supervisory Board for the 2007 financial year.

2. Shareholders and Annual Shareholders' Meeting

At the 8th Annual Shareholders' Meeting of the Company on November 20, 2007, the following articles of the Articles of Incorporation were amended; They now read as follows:

Article 4 of the Articles of Incorporation ("Notifications and Transmission of Information")

"1. Public announcements by the Company shall be made exclusively by means of publication in the electronic Federal Gazette ("Bundesanzeiger"), unless expressly provided otherwise by law.

2. Information to be furnished to the Company's shareholders may also be disseminated by means of remote data transmission as allowed by law."

Article 5 of the Articles of Incorporation ("Amount and Breakdown of Share Capital")

"1. The share capital is € 12,000,000 (twelve million euros).
It is divided into 12,000,000 no-par shares.

1a. The Management Board is authorized, subject to the approval of the Supervisory Board, to increase the Company's share capital until November 19, 2012 once or repeatedly, by up to € 6,000,000.00 in return for cash or in-kind contributions by issuing new no-par bearer shares (Authorized Capital 2007).

The Management Board is also authorized, subject to the approval of the Supervisory Board, to exclude shareholders' statutory subscription right in the following cases:

– In connection with fractional shares;

– If the capital increase is executed in return for cash contributions and if the pro rata amount of the share capital allocable to the new shares in regards to which shareholders' subscription right has been excluded does not exceed the lesser of [1] € 1,200,000.00 million or [2] 10 % of the

Company's share capital extant at the time the new shares are issued and if the issue price for the new shares is not substantially lower – in the sense of Section 203 paras 1 and 2 and Section 186 para 3 sentence 4 German Stock Corporation Act – than the exchange price of previously listed shares of the same class at the time the Management Board finally fixes the issue price; the authorized volume is reduced by the pro rata amount of the share capital allocable to those shares that are issued or sold starting on November 20, 2007, subject to the exclusion of shareholders' subscription right, in connection with the direct or analogous application of Section 186 para 3 sentence 4 German Stock Corporation Act;

– In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in connection with the acquisition of companies, business units, or stakes in companies;

– In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in return for the transfer to the Company of loan and/or interest receivables from the Company under loans granted to it.

The Management Board is authorized, subject to the approval of the Supervisory Board, to determine additional details pertaining to the execution of the capital increases under Authorized Capital 2007. The Supervisory Board is authorized to amend the Articles of Incorporation subsequent to the full or partial execution of such capital increase under Authorized Capital 2007 or following the expiration of the authorization deadline in accordance with the scope of the capital increase under Authorized Capital 2007.

2. Participation of new shares in the Company's profit may be determined in derogation of Section 60 para 2 German Stock Corporation Act."

By resolution of the Management Board on November 26, 2007, and with the approval of the Supervisory Board on November 27, 2007, the issued capital of Zapf Creation AG was increased in the 2007 financial year by an additional 1,200,000 new shares from new capital authorized by the Annual Shareholders' Meeting on November 20, 2007 (Authorized Capital 2007) pursuant to Article 5 para 1a of the Company's Articles of Incorporation, subject to the exclusion of shareholders' subscription right. The issue price for the new shares was € 3.10 and the capital increase was recorded in the Commercial Register on December 10, 2007.

The contingent capital increase adopted by the Annual Shareholders' Meeting on April 26, 2000 (Contingent Capital I), the contingent capital increase adopted by the Annual Shareholders' Meeting on July 31, 2001 (Contingent Capital II), and the contingent capital increase adopted by the Annual Shareholders' Meeting on May 7, 2003 (Contingent Capital III) were rescinded in full by the Annual Shareholders' Meeting on November 20, 2007.

Article 26 para 4 of the Articles of Incorporation ("Financial Year, Annual Financial Statements, Management Report")

"The annual financial statements, the management report, the report of the Supervisory Board and the Management Board's proposal for the appropriation of accumulated profits shall be made available for inspection by shareholders on the Company's premises from the date on which the Annual Shareholders' Meeting is convened; in the case of a parent company as defined in Section 290 paras 1 and 2 HGB, the previous sentence shall also apply mutatis mutandis for the consolidated financial statements, the Group management report and the report of the Supervisory Board. The obligations under sentence 1 do not apply if the documents specified therein are available on the Company's website during the same period."

3. Collaboration of the Management Board and the Supervisory Board

As required under the German Stock Corporation Act (Aktiengesetz), the Zapf Creation Group uses a dual management system that assigns the management of the Company to the Management Board and supervisory authority to the Supervisory Board. These two boards jointly coordinate the Company's strategic orientation and the Supervisory Board regularly reviews its implementation by the Management Board. The Management Board provides comprehensive and timely information to the Supervisory Board on all issues relevant to the Company in terms of planning, development of the business, as well as risks and risk management. Both corporate bodies work closely with each other in the Company's interest but are strictly separated from each other in terms of both their personnel composition and the responsibilities assigned to the relevant board members.

If there are conflicts of interest with regard to pending decisions due to overlapping membership on the corporate bodies of Zapf Creation AG and its shareholder MGA Entertainment, Inc., Van Nuys, California, USA, including the family trusts associated with MGA Entertainment, Inc., the relevant boards are immediately notified thereof on a case-by-case basis by means of a formal statement, and the relevant board members are asked to recuse themselves from the discussion and decision.

4. The Management Board

Composition

As of March 1, 2007, the Management Board of Zapf Creation AG was composed of Messrs. Jens U. Keil and Thomas Pfau; these two Management Board members jointly manage the Company in accordance with Section 77 German Stock Corporation Act. The tasks of each of them follow from the Company's distribution of responsibilities, which is defined as follows: Mr. Jens U. Keil is responsible for Finance, Capital Market (Investor Relations), Human Resources, IT, Logistics, Risk Management, Legal Affairs and Organization. Mr. Thomas Pfau is responsible for Marketing, Sales, Design and Product Development, Supply Chain Operations, Quality Management, Strategy and Corporate Development. In addition, these two members of the Management Board are responsible for the following tasks above and beyond the areas specifically assigned to them: Manage both the independent and the dependent offices of Zapf Creation AG; coordinate the Company's strategic business goals; control and monitor the offices' business activities; and manage both corporate data protection policies and public relations.

Changes

The following changes with regard to the composition of the Management Board occurred during the period under review: On January 16, 2007, the Supervisory Board of Zapf Creation AG appointed Mr. Jens U. Keil as the Company's new chief financial officer for a term of three years. Mr. Keil took over as CFO effective March 1, 2007.

Directors' Dealings

The Company was not notified of any transactions made by members of the Management Board, their spouses or immediate relatives requiring disclosure pursuant to Section 15 a German Securities Trading Act. All members of the Management Board have been informed in detail regarding the disclosure requirement.

Voting Right Notifications

As of December 31, 2007, the Management Board does not hold any shares issued by the Company. All members of the Management Board have been informed in detail regarding the disclosure requirement.

5. Supervisory Board

Composition

Since February 12, 2007, the Supervisory Board has been composed as follows: Dr. Harald Rieger, chairman of the Supervisory Board since February 27, 2007, member since February 12, 2007; Francesc Robert, vice chairman since July 28, 2006, member since May 11, 2005; Gustavo Perez, regular member, vice chairman until July 28, 2006, member since May 11, 2005; Miguel Perez-Carballo Villar, regular member, chairman of the Supervisory Board from July 28, 2006, to February 27, 2007, member since September 14, 2005; Isaac Larian, regular member, and Ron Brawer, regular member, both members of the Supervisory Board since August 24, 2006.

Changes

The following changes with regard to the composition of the Supervisory Board occurred during the period under review: On February 27, 2007, Dr. Harald Rieger, who had been appointed a regular member of the Supervisory Board by order dated February 12, 2007, of the Coburg local court, was elected chairman of the Supervisory Board. The previous chairman of the Supervisory Board, Mr. Miguel Perez-Carballo Villar, has been serving as a regular member of Supervisory Board since that date.

Directors' Dealings

The Company was notified of the following transactions made by members of the Supervisory Board, their spouses or immediate relatives requiring disclosure pursuant to Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz):

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2007, in accordance with Section 15 a German Securities Trading Act that on March 5, 2007, it had purchased a total of 2,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 9.00 per share for a total transaction volume of € 18,000.00.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 21, 2007, in accordance with Section 15 a German Securities Trading Act that on March 19, 2007, it had purchased a total of 751 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 8.95 per share for a total transaction volume of € 6,721.45.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 21, 2007, in accordance with Section 15 a German Securities Trading Act that on March 20, 2007, it had purchased a total of 3,586 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 9.05 per share for a total transaction volume of € 32,453.30.

Attorneys for the Isaac and Angela Larian Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on July 23, 2007, in accordance with Section 15 a German Securities Trading Act that on July 18, 2007, it had purchased a total of 119,988 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.593 per share for a total transaction volume of € 551,104.88.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 12, 2007, in accordance with Section 15 a German Securities Trading Act that on October 8, 2007, it had purchased a total of 10,487 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.23 per share for a total transaction volume of € 44,360.01.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 15, 2007, in accordance with Section 15 a German Securities Trading Act that on October 10, 2007, it had purchased a total of 11,500 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.25 per share for a total transaction volume of € 48,875.00.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 16, 2007, in accordance with Section 15 a German Securities Trading Act that on October 11, 2007, it had purchased a total of 67,769 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.50 per share for a total transaction volume of € 304,960.50.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 492,585 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 1,556,568.60.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 9 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 28.44.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 249,250 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 787,630.00.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 8 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 25.28.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 39,050 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 123,398.00.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 39,050 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 123,398.32.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 31,345 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 99,050.20.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for Ron Brawer, a member of the Supervisory Board, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 9,615 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 30,383.40.

Attorneys for Ron Brawer, a member of the Supervisory Board, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 26, 2007, it had purchased a total of 171,751 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 542,733.16.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 26, 2007, it had purchased a total of 86,911 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 274,638.76.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 26, 2007, it had purchased a total of 91,644 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 289,595.04.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 26, 2007, it had purchased a total of 91,644 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 289,595.04.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act that on October 26, 2007, it had purchased a total of 73,574 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 232,493.84.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 21, 2007, in accordance with Section 15 a German Securities Trading Act that on November 16, 2007, it had purchased a total of 1,904 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.15 per share for a total transaction volume of € 5,997.60.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 21, 2007, in accordance with Section 15 a German Securities Trading Act that on November 19, 2007, it had purchased a total of 7,963 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.15 per share for a total transaction volume of € 25,083.45.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act that on December 7, 2007, it had purchased a total of 434,624 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 1,347,334.40.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act that on December 7, 2007, it had purchased a total of 219,904 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 681,702.40.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act that on December 7, 2007, it had purchased a total of 51,904 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 160,902.40.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act that on December 7, 2007, it had purchased a total of 51,904 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 160,902.40.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act that on December 7, 2007, it had purchased a total of 41,664 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 129,158.40.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15 a German Securities Trading Act that on January 21, 2008, it had purchased a total of 63,335 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.7255 per share for a total transaction volume of € 172,619.54.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15 a German Securities Trading Act that on January 22, 2008, it had purchased a total of 29,938 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.59 per share for a total transaction volume of € 77,539.42.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15 a German Securities Trading Act that on January 23, 2008, it had purchased a total of 29,730 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.612 per share for a total transaction volume of € 77,654.76.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 28, 2008, in accordance with Section 15 a German Securities Trading Act that on January 25, 2008, it had purchased a total of 3,568 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.70 per share for a total transaction volume of € 9,633.60.

The Company was not notified of any other transactions made by members of the Supervisory Board, their spouses or immediate relatives requiring disclosure pursuant to Section 15 a German Securities Trading Act.

Voting Right Notifications

The information available to the Company regarding the percentage of shares issued that are attributable to members of the Supervisory Board, or companies related to them, as of December 31, 2007 is based on the following voting right notifications concerning members of the Supervisory Board or parties related to them, which were received by the Company in the year under review.

On February 7, 2007, Zapf Creation AG was notified of the existence of the following shareholdings pursuant to Section 41 para 4 a German Securities Trading Act. It was published by the Company as follows:

"Isaac Larian Annuity Trust, Isaac and Angela Larian Trust, Shirin Larian Makabi Annuity Trust, Jahangir Eli Makabi Annuity Trust , Shirin and Jahangir Eli Makabi Trust, Mr. Isaac Larian, Ms. Angela Larian, Ms. Shirin Larian Makabi, Mr. Jahangir Eli Makabi, Mr. Ron Brawer, and MGA Entertainment, Inc., notified us in accordance with Section 41 para 4 a German Securities Trading Act that their combined voting share in Zapf Creation AG, Moenchroedener Strasse 13, 96472 Roedental, Germany, on January 20, 2007, as of that dated equaled 22.98 % of the voting shares of Zapf Creation AG (equaling 2,022,318 voting shares).

The 22.98 % of the voting shares in Zapf Creation AG are held by and attributed to those represented above as follows:

a) Isaac Larian Annuity Trust, Van Nuys, California, USA, holds 13.71 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 1,206,644 voting shares). 9.27 % of the voting shares (equaling 815,674 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA.

b) Isaac and Angela Larian Trust, Van Nuys, California, USA, holds 5.75 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 506,103 voting shares). 17.23 % of the voting shares (equaling 1,516,215 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 13.71 % of the voting shares held by Isaac and Angela Larian Trust, USA.

c) Shirin Larian Makabi Annuity Trust, Van Nuys, California, USA, holds 1.15 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 101,531 voting shares). 21.83 % of the voting shares (equaling 1,920,787 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA.

d) Jahangir Eli Makabi Annuity Trust, Van Nuys, California, USA, holds 1.15 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 101,531 voting shares). 21.83 % of the voting shares (equaling 1,920,787 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA.

e) Shirin and Jahangir Eli Makabi Trust, Van Nuys, California, USA, holds 0.93 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 81,509 voting shares). 22.05 % of the voting shares (equaling 1,940,809 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA.

f) Mr. Ron Brawer holds 0.28 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 25,000 voting shares). 22.70 % of the voting shares (equaling 1,997,318 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA.

g) 19.46 % of the voting shares are attributable to Mr. Isaac Larian, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 1,712,747 voting shares). This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA. 3.52 % of the voting shares (equaling 309,571 voting shares) are attributable to him in accordance with Section 22 para 2 German Securities Trading Act.

h) 5.75 % of the voting shares are attributable to Ms. Angela Larian, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 506,103 voting shares). This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA. 17.23 % of the voting shares (equaling 1,516,215 voting shares) are attributable to her in accordance with Section 22 para 2 German Securities Trading Act. This includes 13.71 % of the voting shares held by Isaac and Angela Larian Trust, USA.

i) 2.08 % of the voting shares are attributable to Ms. Shirin Larian Makabi, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 183,040 voting shares), and 20.90 % of the voting shares are attributable to her in accordance with Section 22 para 2 German Securities Trading Act (equaling 1,839,278 voting shares). This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA.

j) 2.08 % of the voting shares are attributable to Mr. Jahangir Eli Makabi, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 183,040 voting shares), and 20.90 % of the voting shares are attributable to him in accordance with Section 22 para 2 German Securities Trading Act (equaling 1,839,278 voting shares). This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA.

k) 22.98 % of the voting shares are attributable to MGA Entertainment, Inc., Van Nuys, California, USA, in accordance with Section 22 para 2 German Securities Trading Act (equaling 2,022,318 voting shares). This includes 5.75 % of the voting shares held by Isaac and Angela Larian Trust, USA, and 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA."

On October 18, 2007, Zapf Creation AG received and published an amendment of the notification of shareholding that had been published on February 7, 2007, pursuant to Section 41 para 4 a German Securities Trading Act:

"The notification of shareholding that was published on February 7, 2007, pursuant to Section 41 para 4 a German Securities Trading Act on behalf of, among others, the Isaac and Angela Larian Trust, was incorrect. The correct name of the trust is Isaac and Angela Larian Living Trust. Hence any references in the notification of shareholding to the Isaac and Angela Larian Trust actually concern the Isaac and Angela Larian Living Trust. The notification of shareholding pursuant to Section 41 para 4 a German Securities Trading Act is thus amended as follows: The Isaac and Angela Larian Living Trust notified us pursuant to Section 41 para 4 a German Securities Trading Act that it was holding a total of 22.98 % of the voting shares (i. e. 2,022,318 voting shares) in Zapf Creation AG, Moenchroedener Strasse 13, 96472 Roedental, Germany, as of January 20, 2007. The 22.98 % of the voting shares in Zapf Creation AG are held by and attributed to the above trust as follows: Isaac and Angela Larian Living Trust, van Nuys, California, USA, holds 5.75 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 506,103 voting shares). 17.23 % of the voting shares (equaling 1,516,215 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 13.71 % of the voting shares held by Isaac Larian Annuity Trust, USA. To the extent that the voting shares of the Isaac and Angela Larian Trust are included in the voting shares of the other notifying parties enumerated in the notification of shareholding, then such reference properly concerns the Isaac and Angela Larian Living Trust."

On October 18, 2007, Zapf Creation AG was notified of the existence of the following shareholdings pursuant to Section 41 para 4 a German Securities Trading Act. It was published by the Company as follows:

"The Angela Larian Annuity Trust, Van Nuys, California, USA, notified us pursuant to Section 41 para 4 a German Securities Trading Act that it was holding a total of 22.98 % of the voting shares (i. e. 2,022,318 voting shares) in Zapf Creation AG, Moenchroedener Strasse 13, 96472 Roedental, Germany, as of January 20, 2007. A stake of 22.98 % in the voting shares was thus attributed to the aforementioned trust pursuant to Section 22 para 2 German Securities Trading Act. This interest includes 13.71 % of the voting shares held by the Isaac Larian Annuity Trust, USA, and 5.75 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA."

On October 18, 2007, Zapf Creation AG received and published an amendment of the notification of shareholding dated July 19, 2006 that had been published on July 21, 2006, and August 8, 2006, under Section 21 para 1 German Securities Trading Act:

"The notifications of shareholding that were published on July 21, 2006, and August 8, 2006, pursuant to Section 21 para 1 German Securities Trading Act on behalf of the Isaac and Angela Larian Trust were incorrect. The correct name of the trust is Isaac and Angela Larian Living Trust. Hence any references in the notification of shareholding to the Isaac and Angela Larian Trust actually concern the Isaac and Angela Larian Living Trust. The notification of shareholding dated July 19, 2006, is thus amended as follows: The Isaac and Angela Larian Living Trust notified us pursuant to Section 21 para 1 German Securities Trading Act that the interest of the aforementioned trust in Zapf Creation AG, Moenchroedener Strasse 13, 96472 Roedental, Germany, exceeded the threshold of 5 % and 10 % of all voting shares on July 3, 2006, and thus that the aforementioned trust held 11.61 % of the voting shares (i. e. 929,200 voting shares) in Zapf Creation AG. The stake of 11.61 % in Zapf Creation AG as of July 3, 2006, is being held by and/or attributable to the Isaac and Angela Larian Living Trust as follows: 11.61 % of the voting shares are attributed to Isaac and Angela Larian Living Trust, van Nuys, California, USA, in accordance with Section 22 para 2 German Securities Trading Act (equaling 929,200 voting shares). This includes 8.90 % of the voting shares held by the Isaac Larian Annuity Trust, USA. As of July 6, 2006, the Isaac and Angela Larian Living Trust held 18.05 % of the voting shares (i. e. 1,444,200 voting shares) in Zapf Creation AG. The stake of 18.05 % in Zapf Creation AG is being held by and/or attributable to the Isaac and Angela Larian Living Trust as follows: Isaac and Angela Larian Living Trust, van Nuys, California, USA, holds 4.37 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 350,000 voting shares). 13.68 % of the voting shares (equaling 1,094,200 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 10.39 % of the voting shares held by Isaac Larian Annuity Trust, USA."

On October 18, 2007, Zapf Creation AG was notified of the existence of the following shareholdings pursuant to Section 21 para 1 German Securities Trading Act. It was published by the Company as follows:

"The Angela Larian Annuity Trust, Van Nuys, California, USA, notified us pursuant to Section 21 para 1 German Securities Trading Act that on July 3, 2006, the interest of the aforementioned trust in Zapf Creation AG, Moenchroedener Strasse 13, 96472 Roedental, Germany, exceeded the threshold of 5 % and 10 % of all voting shares and thus that the aforementioned trust held 11.61 % of the voting shares (i. e. 929,200 voting shares) in Zapf Creation AG as of said date. A stake of 11.61 % in the voting shares was thus attributed to the aforementioned trust pursuant to Section 22 para 2 German Securities Trading Act. This includes 8.90 % of the voting shares held by Isaac Larian Annuity Trust, USA. As of July 6, 2006, the trust held 18.05 % of the voting shares (i. e. 1,444,200 voting shares) in Zapf Creation AG. A stake of 18.05 % in the voting shares was thus attributed to the trust pursuant to Section 22 para 2 German Securities Trading Act. This interest includes 10.39 % of the voting shares held by the Isaac Larian Annuity Trust, USA, and 4.37 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA."

On November 19, 2007, Zapf Creation AG was notified of the existence of the following shareholdings pursuant to Section 21 para 1 German Securities Trading Act. It was published by the Company as follows:

"Isaac Larian Annuity Trust, Isaac and Angela Larian Living Trust, Angela Larian Annuity Trust, Shirin Larian Makabi Annuity Trust, Jahangir Eli Makabi Annuity Trust , Shirin and Jahangir Eli Makabi Trust, Mr. Isaac Larian, Ms. Angela Larian, Ms. Shirin Larian Makabi, Mr. Jahangir Eli Makabi, Mr. Ron Brawer, and MGA Entertainment, Inc., notified us in accordance with Section 21 para 1 German Securities Trading Act that their combined voting share in Zapf Creation AG, Moenchroedener Strasse 13, 96472 Roedental, Germany, on November 19, 2007, as of that dated had exceeded the 30 % threshold and at that date equaled 30.12 % of the voting shares of Zapf Creation AG (equaling 3,614,843 voting shares). The 30.12 % of the voting shares in Zapf Creation AG are held by and attributed to the above as follows:

a) Isaac Larian Annuity Trust, Van Nuys, California, USA, holds 16.21 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 1,945,094 voting shares). 13.91 % of the voting shares (equaling 1,669,748 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 8.20 % of the voting shares held by Isaac and Angela Larian Living Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to it according to Section 22 para 1 no. 1 German Securities Trading Act.

b) Isaac and Angela Larian Living Trust, van Nuys, California, USA, holds 8.20 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 984,247 voting shares). 21.92 % of the voting shares (equaling 2,630,595 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This includes 16.21 % of the voting shares held by Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to it according to Section 22 para 1 no. 1 German Securities Trading Act.

c) Shirin Larian Makabi Annuity Trust, Van Nuys, California, USA, holds 1.94 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 232,227 voting shares). 28.18 % of the voting shares (equaling 3,382,615 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to it according to Section 22 para 1 no. 1 German Securities Trading Act.

d) Jahangir Eli Makabi Annuity Trust, Van Nuys, California, USA, holds 1.94 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 232,227 voting shares). 28.18 % of the voting shares (equaling 3,382,615 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to it according to Section 22 para 1 no. 1 German Securities Trading Act.

e) Shirin and Jahangir Eli Makabi Trust, Van Nuys, California, USA, holds 1.55 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 186,430 voting shares). 28.57 % of the voting shares (equaling 3,428,412 voting shares) are attributable to it in accordance with Section 22 para 2 German Securities Trading Act. This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to it according to Section 22 para 1 no. 1 German Securities Trading Act.

f) Mr. Ron Brawer holds 0.29 % of the voting shares in accordance with Section 21 para 1 German Securities Trading Act (equaling 34,617 voting shares). 29.83 % of the voting shares (equaling 3,580,226 voting shares) are attributable to him in accordance with Section 22 para 2 German Securities Trading Act. This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA.

g) 24.41 % of the voting shares are attributable to Mr. Isaac Larian, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 2,929,341 voting shares). This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA. 5.71 % of the voting shares (equaling 685,501 voting shares) are attributable to him in accordance with Section 22 para 2 German Securities Trading Act. A voting right held by MGA Entertainment, Inc. is attributable to him according to Section 22 para 1 no. 1 German Securities Trading Act.

h) 8.20 % of the voting shares are attributable to Ms. Angela Larian, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 984,247 voting shares). This includes 8.20 % of the voting shares held by Isaac and Angela Larian Living Trust, USA. 21.92 % of the voting shares (equaling 2,630,595 voting shares) are attributable to her in accordance with Section 22 para 2 German Securities Trading Act. This includes 16.21 % of the voting shares held by Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to her according to Section 22 para 1 no. 1 German Securities Trading Act.

i) 3.49 % of the voting shares are attributable to Ms. Shirin Larian Makabi, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 418,657 voting shares), and 26.63 % of the voting shares are attributable to her in accordance with Section 22 para 2 German Securities Trading Act (equaling 3,196,185 voting shares). This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to her according to Section 22 para 1 no. 1 German Securities Trading Act.

j) 3.49 % of the voting shares are attributable to Mr. Jahangir Eli Makabi, USA, in accordance with Section 22 para 1 item 2 German Securities Trading Act (equaling 418,657 voting shares), and 26.63 % of the voting shares are attributable to him in accordance with Section 22 para 2 German Securities Trading Act (equaling 3,196,185 voting shares). This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to him according to Section 22 para 1 no. 1 German Securities Trading Act.

k) MGA Entertainment, Inc., Van Nuys, California, USA, holds a voting right pursuant to Section 21 para 1 German Securities Trading Act. A total of 30.12 % of the voting shares (i. e. 3,614,842 voting shares) are attributed to it pursuant to Section 22 para 2 German Securities Trading Act. This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA.

l) A total of 30.12 % of the voting shares (i. e. 3,614,842 voting shares) are attributed to the Angela Larian Annuity Trust, Van Nuys, California, USA, pursuant to Section 22 para 2 German Securities Trading Act. This interest includes 8.20 % of the voting shares held by the Isaac and Angela Larian Living Trust, USA, and 16.21 % of the voting shares held by the Isaac Larian Annuity Trust, USA. A voting right held by MGA Entertainment, Inc. is attributable to it according to Section 22 para 1 no. 1 German Securities Trading Act.“

The Company has no further information available regarding the percentage of shares issued that are attributable to members of the Supervisory Board, or companies related to them, as of December 31, 2007. All members of the Supervisory Board have been informed in detail regarding the disclosure requirement.

6. Transparency

Zapf Creation values active corporate communications. New and significant information is made available to shareholders, analysts, employees, and the public immediately and comprehensively. In its corporate communications, the Management Board is guided by principles of transparency, timeliness, openness, comprehensibility, and equal treatment for all. All such information is transmitted via electronic media, in particular, the Internet, and is available in English as well.

7. Accounting and Audit of Financial Statements

Share-based Payment

The Zapf Creation Group employs compensation systems based on the performance of its shares, given its orientation toward activities designed to ensure that the enterprise value is increased in the long term in shareholders' interests. In contrast to employee stock option plans (ESOPs), compensation based on phantom shares does not constitute real equity interests but rather salary and/or bonus payments that are contingent on the development of the Company's shares. Cash compensation claims are granted to the beneficiaries during specific periods based on the difference between the underlying share's current price and the base price of the stock appreciation rights assigned.

The compensation system based on phantom shares that was launched in 2006 for the members of the Company's Management Board remained in place in the 2007 financial year. Additional phantom stock options at defined base prices were allocated under this plan in 2007; the exercise of these options is not linked to achievement of specific performance targets. At the time they exercise their options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date the phantom stock option is exercised.

As of December 31, 2007, the Company maintained two other compensation schemes based on phantom shares for executives of Zapf Creation AG and its affiliates, in addition to the compensation system that was newly established in the 2006 financial year and outlined above. The 2001/2003 Bonus Plan was set up in the 2001 financial year and the 2003/2005 Bonus Plan in the 2003 financial year. These two additional compensation systems provide for allocation of phantom stock options to the relevant beneficiaries in several tranches pursuant to individual contracts. Depending on whether performance targets linked to the share price have been achieved and following the expiration of waiting periods contingent on the relevant tranches, the beneficiaries are paid one-time cash consideration per phantom stock option that reflects a particular percentage (20% for the 2001/2003 Bonus Plan and 30% for the 2003/2005 Bonus Plan) of the performance target as an additional component of their cash compensation.

Audit of Financial Statements

As in the previous year, KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Nuremberg, Germany, is the auditor of the annual and the consolidated financial statements as of December 31, 2007, of Zapf Creation AG.

B. Declaration of Compliance Regarding the German Corporate Governance Code

1. Preliminary Remark

The Company's 2007 Declaration of Compliance required under Section 161 German Stock Corporation Act regarding the recommendations of the Government Commission on the German Corporate Governance Code was jointly issued by the Management Board and the Supervisory Board and is permanently available to the Company's shareholders on its website.

The declaration follows below verbatim.

2. Declaration of Compliance 2007

(Beginning of the Declaration of Compliance)

Declaration of the Management Board and the Supervisory Board of Zapf Creation AG regarding the German Corporate Governance Code as amended on June 14, 2007, pursuant to Section 161 German Stock Corporation Act

Both the Management Board and the Supervisory Board of Zapf Creation AG declare pursuant to Section 161 German Stock Corporation Act that the Company, after having issued last year's declaration of conformity on December 12, 2006, has been and is in compliance with the recommendations of the Government Commission on the German Corporate Governance Code as amended on June 14, 2007, and as published by the German Ministry of Justice on July 20, 2007, in the official section of the electronic Federal Gazette, with the exception of the following:

- "If the company takes out a D&O (directors' and officers' liability insurance) policy for the Management Board and Supervisory Board, a suitable deductible shall be agreed." (Item 3.8, para 2)

  The D&O insurance purchased by Zapf Creation AG does not require the members of the Company's Management and Supervisory Boards to pay a deductible. Deductibles are usually unsuitable for preventing losses and thus are generally taken into account by the insurance industry only in the calculation of premiums.

- "The Management Board shall be comprised of several persons and have a Chairman or Spokesman." (Item 4.2.1, sentence 1)

  From December 20, 2006 to February 28, 2007, the Management Board of Zapf Creation AG had just one member. The Management Board has had two members since March 1, 2007. The Company currently does not have a Management Board chairman or spokesman. Both Management Board members jointly manage the Company in accordance with Section 77 German Stock Corporation Act. We believe that it is not necessary to appoint a chairman of a two-person Management Board.

- "By-Laws shall govern the work of the Management Board, in particular the allocation of duties among individual Management Board members, matters reserved for the Management Board as a whole, and the required majority for Management Board resolutions (unanimity or resolution by majority vote)." (Item 4.2.1, sentence 2)

  The Management Board's by-laws currently do not specify an allocation of duties for individual members of the Management Board. Neither do they contain regulations regarding decision-making if there is a tie vote on the two-person Management Board without chairman. However, the Supervisory Board by resolution has defined the duties of the Management board members outside the by-laws.

- "Stock options and comparable instruments shall be related to demanding, relevant comparison parameters. Changing such performance targets or the comparison parameters retroactively shall be excluded. For extraordinary, unforeseen developments a possibility of limitation (Cap) shall be agreed for by the Supervisory Board." (Item 4.2.3, para 3, sentence 2 et seq.)

  A share-based compensation system involving phantom options is in place for the Management Board of Zapf Creation AG. Exercising the phantom options is not tied to the fulfillment of specific performance targets. This did not seem necessary given the limited number of phantom options. Furthermore, demanding, relevant performance targets were defined in connection with the variable compensation of the Management Board members. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date the phantom stock option is exercised. There is no explicit regulation excluding the retroactive change of the comparison parameters. A cap for extraordinary, unforeseen developments is currently not in place.

- "The compensation report shall also include information on the nature of the fringe benefits provided by the company." (Item 4.2.5, para 3, sentence 2)

  The compensation report published as part of the Corporate Governance Report does not yet include information on the nature of the fringe benefits provided by the Company; we will follow this recommendation in the future.

- "Together with the Management Board it shall ensure that there is a long-term succession planning." (Item 5.1.2, para 1, sentence 2)

  No long-term succession planning exists within the Company because such planning is not necessary yet.

- "An age limit for members of the Management Board shall be specified." (Item 5.1.2, para 2, sentence 3)

  No age limit for members of the Management Board has been set because we do not believe that the age of a Management Board member is a key criterion for his or her qualification.

- "The chairman of the Audit Committee shall have specialist knowledge and experience in the application of accounting principles and internal control processes." (Item 5.3.2, sentence 2)

  The Company currently does not follow this recommendation because no such person is available on the Supervisory Board.

- "The Supervisory Board shall form a nomination committee composed exclusively of shareholder representatives which proposes suitable candidates to the Supervisory Board for recommendation to the General Meeting." (Item 5.3.3)

  Given the size of the Company and its Supervisory Board, the formation of a nomination committee is not appropriate.

- "… an age limit to be specified for the members of the Supervisory Board shall be taken into account." (Item 5.4.1, sentence 2)

  No age limit for members of the Supervisory Board has been set because we do not believe that the age of a Supervisory Board member is a key criterion for his or her qualification.

- "Elections to the Supervisory Board shall be made on an individual basis. An application for the judicial appointment of a Supervisory Board member shall be limited in time up to the next annual shareholders' meeting. Proposed candidates for the Supervisory Board chair shall be announced to the shareholders." (Item 5.4.3)

  Given the Company's special circumstances, most members of the current Supervisory Board were appointed by a court. To ensure continuity on the Supervisory Board, the judicial appointments are not limited in time. The prior announcement of candidates to the shareholders in connection with the election of the current chairman was not possible because the election took place shortly after a judicial appointment.

- "Beyond the statutory obligation to report and disclose dealings in shares of the company without delay, the ownership of shares in the company or related financial instruments by Management Board and Supervisory Board members shall be reported if these directly or indirectly exceed 1 % of the shares issued by the company. If the entire holdings of all members of the Management Board and Supervisory Board exceed 1 % of the shares issued by the company, these shall be reported separately according to Management Board and Supervisory Board. The aforesaid disclosures shall be included in the Corporate Governance Report." (Item 6.6)

  Until now, the aforesaid disclosures have not been included in the Corporate Governance Report. We will follow this recommendation in the future.

- "The Consolidated Financial Statements shall be publicly accessible within 90 days of the end of the financial year; interim reports shall be publicly accessible within 45 days of the end of the reporting period." (Item 7.1.2, sentence 3)

  The Company was unable to make its consolidated financial statements for the 2006 financial year, its financial report on the first quarter of 2007 and its half-yearly financial report as of June 30, 2007, publicly accessible within the required periods because the negotiations with the banking syndicate regarding the Company's long-term financing were not concluded in time. The Company met the deadline for the publication of its interim financial report on the third quarter of 2007.

Zapf Creation AG

Roedental, Germany, December 12, 2007

Jens U. Keil Member of the Management Board	Thomas Pfau Member of the Management Board	Dr. Harald Rieger Chairman of the Supervisory Board

(End of the Declaration of Compliance)

C. Compensation Report

1. Preliminary Remark

In accordance with the requirements of the German Commercial Code and the German Management Board Compensation Disclosure Act, this report contains disclosures that are an integral part of both the single-entity and consolidated financial statements of Zapf Creation AG.

Hence please also see all disclosures on the compensation paid to the members of the Management Board and the Supervisory Board in the single-entity and consolidated financial statements of Zapf Creation AG.

2. The Management Board

The compensation paid to the members of the Company's Management Board in the 2007 financial year comprised both fixed and performance-based components. The responsibilities of the relevant board members and their personal performance are the criteria that govern the suitability of the compensation paid.

With regard to its compensation components, the compensation system for the Company's Management Board was as follows in 2007:

	Short-term compensation		Share-based
	Fixed compensation	Bonus	compensation
	K€	K€	K€
Thomas Pfau	Yes	Yes	Yes
Jens U. Keil	Yes	Yes	Yes

The total compensation of K€ 503 (previous year: K€ 976) paid to the Management Board comprises all cash compensation due, as well as all monetary benefits from in-kind compensation. It includes both fixed and variable components but excludes the one-time consideration paid to former members of the Management Board.

Below is an overview of the compensation paid to each individual member of the Management Board in the 2007 financial year:

	Short-term compensation		Share-based	Total
	Fixed compensation	Bonus	compensation	compensation
	K€	K€	K€	K€
Thomas Pfau	200	63	36	299
Jens U. Keil	161	41	2	204
Total	361	104	38	503
Percentage in 2007		92.44 %	7.56 %	100.00 %

	Short-term compensation	Share-based compensation	Total compensation
	K€	K€	K€
Total compensation in 2006	658	318	976

In addition to the monetary base compensation, the fixed compensation granted to the members of the Company's Management Board also comprises benefits such as the use of company cars and allowances for accident insurance, individual pension plan, and other insurance policies.

The compensation system based on phantom shares that was launched in 2006 for the members of the Company's Management Board remained in place in the 2007 financial year. A total of 78,000 (previous year: 113,000) phantom stock options at base prices of € 9.16, € 8.60 and € 4.67 (previous year: € 7.49 and € 7.29) were allocated to these board members in 2007 under this plan; the exercise of these options is not linked to the achievement of specific performance targets. At the time they exercise their options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date the phantom stock option is exercised. Mr. Thomas Pfau was granted 30,000 phantom options at a base price of € 8.60 and 33,000 phantom options at a base price of € 4.67. Mr. Jens U. Keil was granted 15,000 phantom options at a base price of € 9.16. A total of K€ 38 was expensed for options granted in the 2007 financial year in connection with provisions for liabilities under this compensation system based on phantom shares; K€ 291 of the provision was reversed to profit and loss during the reporting year. The provision for liabilities under the aforementioned phantom options as of December 31, 2007, was K€ 65 (previous year: K€ 318); of this amount, K€ 48 (previous year: K€ 101) is attributable to Mr. Thomas Pfau and K€ 2 (previous year: K€ 0) to Mr. Jens U. Keil. Provisions of K€ 15 (previous year: K€ 217) were attributable to the former Management Board member, Dr. Georg Kellinghusen, as of December 31, 2007. The rights granted to Mr. Thomas Pfau will be void on September 1, 2009, or January 2, 2010, respectively, if none of them are exercised by that date. The options granted to Mr. Jens U. Keil will be canceled unless they are exercised by April 1, 2009. The phantom options granted to Dr. Georg Kellinghusen will be canceled unless they are exercised by February 15, 2009.

No one-off compensation was paid to former board members in the 2007 financial year (previous year: K€ 313).

One former member of the Management Board was granted a variable credit line in the maximum amount of K€ 625 (previous year: K€ 625) until December 31, 2007, which had already been fully utilized as of the previous year's balance sheet date. The agreed interest rate is 4.25 %. It was fixed until December 31, 2007, the loan's due date. As in the previous year, no repayments were made and no new loans were extended in the 2007 financial year. Because of interest receivables totaling K€ 46, the total amount due to the Company as of the December 31, 2007 balance sheet date increased to K€ 671 (previous year: K€ 645). The loan is secured by a mortgage in the amount of K€ 200 (previous year: K€ 200); as in the previous year, it was written off including the interest receivables.

3. Supervisory Board

The compensation of the Supervisory Board is determined by the Annual Shareholders' Meeting, on recommendation of the Management Board and the Supervisory Board. It is regulated by Article 20 of the Articles of Incorporation of Zapf Creation AG. The cash compensation includes a fixed and a dividend-based component, as well as compensation linked to the long-term success of the Company.

The fixed component of the compensation paid to the members of the Supervisory Board was modified most recently as follows by resolution dated August 29, 2006: The chairman of the Supervisory Board will be paid fixed annual compensation of K€ 35 net (previously: K€ 28), the vice chairman K€ 26.25 net (previously: K€ 21), and all other members of the Supervisory Board K€ 17.50 net (previously: K€ 14).

The compensation paid to Supervisory Board members who were not in office for a full financial year is pro rated in accordance with the duration of their membership on the Supervisory Board. No change was made to the compensation of the Supervisory Board in the 2007 financial year. The two Supervisory Board members Mr. Isaac Larian and Mr. Ron Brawer waived the compensation to which they are entitled under the Articles of Incorporation in the 2006 financial year; expenses were reimbursed. In the 2007 financial year, Mr. Isaac Larian and Mr. Ron Brawer continued to waive the compensation to which they are entitled under the Articles of Incorporation; expenses were reimbursed.

As before, under the resolution adopted May 7, 2003, the variable compensation paid to the Supervisory Board members will be € 100.00 for each € 0.01 in excess of € 0.50 in dividends per no-par value share distributed to the shareholders for the financial year just ended. In addition, the members of the Supervisory Board are entitled to annual compensation based on the Company's long-term performance. This compensation entails payment of K€ 1 per K€ 1,000 in consolidated net annual income that exceeds an average consolidated annual income of K€ 22,237 for the last three financial years. As in the previous year, in the financial year just ended no provisions for the variable component of the compensation were recognized because no payment obligation arises from the Company's performance.

The total obligation for the compensation of the Supervisory Board in the 2007 financial year was K€ 112 (previous year: K€ 97).

There were no loans to members of the Supervisory Board in the past two financial years.

Report of the Supervisory Board for the 2007 Financial Year

In the 2007 financial year, the Supervisory Board diligently supervised the activities of the Management Board, providing advice and support as needed. This work was based on the regular written and oral reports of the Management Board. Given the economic difficulties of the Company and its affiliates, the Supervisory Board ensured that the Management Board kept it abreast – even outside its meetings – in both writing and verbally, of current and strategic developments in the Company's condition, as well as of important business events. The Supervisory Board thoroughly reviewed the reports that were submitted to it and discussed them with the Management Board in detail, as necessary. The Supervisory Board was involved in all decisions that were of material importance for Zapf Creation AG or the Zapf Group.

Overview of the Activities of the Supervisory Board

In addition to overseeing the Company's development and planning, the activities of the Supervisory Board in the 2007 financial year especially comprised monitoring its financial stabilization on the basis of a long-term Group financing concept that included infusions of fresh equity from capital increases. Besides discussing additional restructuring measures in connection with the legal consequences of the special audit, the Supervisory Board also focused on: modifying its own rules of procedure with the aim of simplifying the way resolutions are adopted; corporate governance; preparing the Annual Shareholders' Meeting; the Company's risk situation and risk management; the allocation of responsibilities among individual Management Board members; litigation involving the Company as a respondent; the efficiency review of the Supervisory Board itself; as well as the review and adoption of the 2006 annual financial statements. Some of the other material activities of the Supervisory Board and its Personnel Committee arose, furthermore, from a variety of issues related to former, current, and future members of the Management Board of Zapf Creation AG.

Given the special situation of Zapf Creation AG in the 2007 financial year, overall the Supervisory Board held a total of 15 plenary sessions, either in person or by means of telephone conferences. These meetings took place on January 16, February 7 and 27, July 4, 9, 12, 18, 19 and 20, September 18, October 7 and 26, November 8 and 20, as well as on December 5, 2007. In addition, the Supervisory Board also adopted four resolutions by circular letter.

Changes in Personnel

Changes on the Management Board

On January 16, 2007, the Supervisory Board of Zapf Creation AG appointed Mr. Jens Ulrich Keil the Company's new Chief Financial Officer effective March 1, 2007. Since then, he has been responsible for Finance, Capital Market, Restructuring, HR, IT, and Logistics. Until September 18, 2007, his responsibilities also included Supply Chain Operations. Responsibility for Supply Chain Operations was assigned to the Management Board member, Mr. Thomas Pfau, at the request of members of the Management Board and pursuant to a resolution of the Supervisory Board dated September 18, 2007, because it is related to Marketing and Sales, two areas for which Mr. Pfau was already responsible.

Changes on the Supervisory Board

At its meeting on February 27, 2007, the Supervisory Board of Zapf Creation AG elected Dr. Harald Rieger chairman of the Supervisory Board. Dr. Rieger has been a court-appointed member of the Supervisory Board since February 12, 2007. The previous chairman of the Supervisory Board, Mr. Miguel Perez-Carballo Villar, has since then remained on the Supervisory Board as a regular member. Mr. Francesc Robert continues to serve as deputy chairman of the Supervisory Board. The Supervisory Board members, Gustavo Perez, Isaac Larian and Ron Brawer also retained their positions and responsibilities.

Composition of the Committees and Their Activities

Composition of the Committees

Following the resignation of Mr. Martin Gruschka from the Company's Supervisory Board, his seat on the Audit Committee (finance and audit committee) was reassigned to Dr. Harald Rieger pursuant to a resolution of the Supervisory Board dated February 27, 2007. Both Mr. Gustavo Perez, Chairman of the Audit Committee, and Francesc Robert, retained their positions and responsibilities.

Pursuant to a Supervisory Board resolution dated February 27, 2007, Dr. Harald Rieger took over the chairmanship of the Personnel Committee – which had been established by the Supervisory Board on March 16, 2006, and had been vested with decision-making power – from Mr. Miguel Perez-Carballo Villar. Mr. Francesc Robert was appointed to the Personnel Committee while Mr. Gustavo Perez remained Deputy Chairman of the Personnel Committee.

Activities of the Committees

Aside from commissioning the auditor of the annual financial statements, in the reporting year the members of the Audit Committee also dealt with issues related to the Company's accounting and risk management. The Audit Committee conducted one meeting during the financial year just ended, specifically, on September 18, 2007, in connection with the Supervisory Board's plenary financials meeting at which it adopted the Company's annual financial statements. Given the significance of audits for securing the Group's financing and to make efficient use of time, the Audit Committee also dealt with its responsibilities at the Supervisory Board's plenary sessions, working with the other members of the Supervisory Board.

The Personnel Committee met twice during the reporting year, specifically, on January 16, 2007, and August 31, 2007. Its activities were focused on issues involving Management Board personnel, in particular, negotiating and concluding a director's contract with Mr. Jens Ulrich Keil, as well as the severance agreements with both Ms. Angelika Marr and Dr. Georg Kellinghusen.

The work of the Personnel Committee also focused on bringing claims for damages against former Management Board members in connection with the findings of the special audit. Additionally, the Personnel Committee also itself to bringing about the dismissal of a lawsuit that Mr. Rudolf Winning had filed against the Company with the aim of obtaining protection from prosecution in connection with the investigations that the district attorney had initiated against him. The Company prevailed against Mr. Winning, both initially and on appeal. In this connection, the auditor that had been commissioned by the Company in connection with the special audit again presented its results in detail and subjected them to another more extensive review. This review confirmed the need to bring claims for damages against former Management Board members.

The Personnel Committee also dealt with the repayment of the loan (including interest) that had been granted to the former Management Board member, Thomas Eichhorn. External counsel conducted negotiations to this end but they had not yet been concluded as of the close of the reporting year.

The Personnel Committee also dealt with the variable compensation of current Management Board members, Jens Ulrich Keil and Thomas Pfau, which must be renegotiated each year under their employment contracts. Finally, the Personnel Committee addressed the issue of granting phantom stock to Mr. Thomas Pfau, with the aim of honoring him for his special commitment to the Company, and with the individual responsibilities of Management Board members.

Review of the Management Board's Activities

In the main, the Supervisory Board's review of the Management Board's activities focused on the following areas:

Group Financing

During the entire reporting period, but especially at its meetings in July 2007, the Supervisory Board dealt extensively with the Zapf Creation Group's need for additional funds because its financing had been assured only through April 2007 (and June 30, 2007, once the syndicated loan had been extended), provided the Group complied with the terms of the loan and because it was clear that fresh equity capital would be required to ensure the Group's restructuring. Hence the Supervisory Board discussed the Group's financing needs with the Management Board on an ongoing basis, including various financial scenarios, among them the possibility of raising capital from the Company's major shareholders and of having Mr. Isaac Larian, Chief Executive Officer of MGA Entertainment, Inc., which is the largest single shareholder of Zapf Creation AG and serves on its Supervisory Board, acquire the Company's liabilities to banks.

The Supervisory Board worked closely with the Management Board to secure the Group's long-term financing – in regards to which an agreement was reached with both the banks and its major shareholders on July 20, 2007 – and ensured that it was kept abreast of all developments and negotiations. The stipulated financing concept provided for a new syndicated loan of € 65 million from the banks, as well as an infusion of € 30 million in equity, which was guaranteed by companies affiliated with MGA Entertainment, Inc., and by Mr. Nicolas Mathys. The Supervisory Board approved both the financing concept as a whole and the individual agreements required to that end because it believed that this approach was necessary for maintaining the Company as a going concern. In the Supervisory Board's view, the long-term and sustained nature of the financing are particularly advantageous for the Company.

According to the financing concept, equity was raised by issuing 3.2 million new shares under the extant authorized capital; shareholders were able to exercise their subscription right. To implement the Group's long-term financing concept, the Supervisory Board therefore decided on October 7, 2007, to carry out a cash capital increase from authorized capital, which the Company's Management Board had resolved on October 2, 2007. The Supervisory Board believed the capital inflow from this capital increase to bring an important boost to the Company's equity base. As a result of this capital increase, the Company's share capital was increased from € 8,799,998 by € 3,200,002 to € 12,000,000 in return for contributions in cash by issuing 3,200,002 no-par bearer shares. The Company's shareholders were entitled to exercise their subscription right between October 12, 2007, and October 26, 2007, at a subscription price of € 3.16 per new no-par bearer share. To secure the capital increase, the Supervisory Board gave its stamp of approval to an agreement with MGA Entertainment, Inc. (or any of its affiliates, including the shareholders of MGA Entertainment, Inc.) and Mr. Nicolas Mathys pursuant to which both of these shareholders undertook to guarantee the capital increase by up to 3,200,002 new no-par shares, subject to certain conditions precedent, and to take over any unsubscribed no-par bearer shares at a price equivalent to the subscription price, if necessary. Given the necessary equity infusion, the Supervisory Board thus accepted that utilizing the existing authorized capital of € 3.2 million in full would mean that MGA Entertainment, Inc., which Mr. Isaac Larian and Ron Brawer represent on the Supervisory Board, would gain a controlling interest of more than 30% of the Company's voting shares. The Supervisory Board was aware of the fact that MGA Entertainment, Inc. had agreed to participate in the Company's financing only if the Federal Financial Supervisory Authority (BaFin) exempted MGA from submitting a takeover offer for the Company under Section 37 German Securities Acquisition and Takeover Act (in conjunction with Section 9 Offer Regulations of the German Securities Acquisition and Takeover Act). BaFin issued such an exemption from the obligation to issue a takeover offer, on condition, among others, that the planned restructuring measures were actually implemented. The exemption became necessary after MGA Entertainment, Inc. had agreed to take over that part of the financing package to which Betham Ltd., whose chief executive officer Gustavo Perez is a member of Zapf Creation's Supervisory Board, had originally committed itself. The assumption of this additional obligation became necessary because the statutes of Betham Ltd. were unable to meet its obligations for legal reasons.

Because the financing concept aimed at fortifying the Company's equity base also called for utilizing the Authorized Capital 2007 that the Annual Shareholders' Meeting had adopted on November 20, 2007, on November 27, 2007, the Supervisory Board approved yet another capital increase from authorized capital. This one entailed boosting the Company's share capital from € 12,000,000 by € 1,200,000 to € 13,200,000 by issuing 1,200,000 new no-par shares at a subscription price of € 3.10 per share to the Company's major shareholders (Mr. Nicolas Mathys and trusts affiliated with Mr. Isaac Larian), subject to the exclusion of all other shareholders' subscription rights, in return for cash contributions. In this context, the Supervisory Board agreed with the Management Board's opinion that issuing new shares from Authorized Capital 2007, was in the Company's interest – given the conditions the banks want fulfilled before granting new loans for refinancing the Company, as well as given the financing agreement entered into with both MGA Entertainment, Inc. and Mr. Mathys in connection with this refinancing – and the Management Board believes that the stated goal of restructuring the Company sufficiently justifies such an approach.

Special Audit

During the reporting year, the Supervisory Board also dealt exhaustively with facts relevant to the Company's consolidated financial statements and the single-entity financial statements of its subsidiaries for 2004 and 2005 that the special audit, which had already been initiated in 2005, had brought to light. Because the special audit of the Company had led to the conclusion that intentional violations of statutory requirements had occurred, in March 2006 the Supervisory Board had extended the special audit through April 2006, adding a forensic audit aimed, in particular, at unearthing facts related to the personal responsibility of individual members of the Management Board. The results of the special audit were subjected to an extensive review by external counsel. The relevant members of the Management Board were given an opportunity in that connection to state their position on the facts in detail. In addition, the Company has also cooperated with the relevant investigatory and regulatory authorities regarding the facts that the special audit brought to light.

Because the facts and circumstances underlying the special audit indicated that it was more likely than not that former Management Board members had breached (some of) their duties, the Supervisory Board had initiated claims for damages against the affected former Management Board members, particularly in connection with the costs arising from the special audit, and had notified the D&O insurer accordingly. However, to date we have been unable to arrive at an amicable settlement with the insurer and/or the relevant former members of the Management Board. The Supervisory Board has thus resolved to bring claims for damages against the former Management Board members, Rudolf Winning, Thomas Eichhorn, and Dr. Peter Klein. Corresponding complaints will be filed shortly.

Shareholder Lawsuit Against Resolution of the Annual Shareholders' Meeting

One shareholder has filed suit against the resolution of the Annual Shareholders' Meeting on August 29, 2006, regarding the approval of the Supervisory Board's actions in the 2005 financial year, on grounds that the resolution was defective. The suit was dismissed in the first instance by the Regional Court [Landgericht] in Nuremberg-Fuerth, Germany. The plaintiff has not appealed the judgment.

Corporate Governance

Attendance

All members of the Supervisory Board attended more than one half of its meetings.

Conflicts of Interest

Once Zapf Creation AG had achieved an agreement with MGA Entertainment, Inc. on August 11, 2006, based on a Letter of Intent regarding the companies' long-term cooperation in marketing and sales, a service contract was to be concluded with MGA Entertainment (HK) Ltd. in early 2007. The only active member of the Management Board at the time, Mr. Thomas Pfau, who is also responsible for the management of the German subsidiary of the MGA Group, had recommended entering into this agreement, taking all risks and rewards into account, but had asked the Supervisory Board to provide its approval, given a potential conflict of interest on his part in this matter. Two Supervisory Board members, Isaac Larian and Ron Brawer, abstained from participating in the deliberations on this issue and from approving the service contract with MGA Entertainment (HK) Ltd. because both of them are also high-level executives of the MGA Group. Using counsel, the remaining Supervisory Board members reviewed and extensively discussed the contract that had been submitted to them, weighing its possible advantages and disadvantages for the Company. In the end, the Supervisory Board came to the conclusion that the service contract with MGA Entertainment (HK) Ltd. would benefit the Company because it would provide a good opportunity for boosting its business once the massive cost-cutting measures in connection with the restructuring had been completed. Hence the Supervisory Board approved the service contract with MGA Entertainment (HK) Ltd. on February 7, 2007, after the amendments it had requested had been made.

Additional conflicts of interest arose on the Supervisory Board in connection with the financing arrangements and loan agreements to be concluded between the Company and MGA Entertainment, Inc. (or its affiliates), Nicolas Mathys, and Betham Ltd. Owing to their positions with the MGA Group and Betham Ltd., respectively, Supervisory Board members Isaac Larian and Ron Brawer, as well as Gustavo Perez, abstained from the Supervisory Board's resolutions approving the relevant contracts.

Efficiency Review

The Supervisory Board conducted the efficiency review required under the Corporate Governance Code at its meeting on September 18, 2007. Measures designed to improve efficiency, among other things, were discussed at this meeting.

Declaration of Compliance

The Management Board and the Supervisory Board jointly issued a declaration of compliance in accordance with Section 161 German Stock Corporation Act (AktG) on December 12, 2007. For further details, we refer to the corporate governance report that is included in the 2007 annual report.

Accounting and Annual Financial Statements

Review and Adoption of both the Single-Entity and Consolidated Financial Statements

KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft, Wirtschaftsprüfungsgesellschaft, Nuremberg, Germany, audited the annual financial statements that were prepared for the financial year from January 1 through December 31, 2007, in accordance with the German Commercial Code [Handelsgesetzbuch (HGB)] and the consolidated financial statements for the same financial year that were prepared in accordance with the International Financial Reporting Standards (IFRS). KPMG issued unqualified auditor's opinions for each.

The annual financial statements and the management report, the consolidated financial statements and the Group management report, as well as the audit reports, were made available to all members of the Supervisory Board. The audit particularly paid close attention to the audit of the relations with MGA Entertainment, Inc., the recoverability of participations in affiliated companies, the follow-up of the issues contained in the Management Letter issued in the previous audit and the audit of the capital increases, in particular with respect to the transaction costs. The Supervisory Board was consulted in regards to individual facts and circumstances during preliminary stages of the preparation of the financial statements' documentation. These concerned in particular the financing of Zapf Group, including the execution of measures to increase the share capital, as well as the relations with affiliated companies, including MGA Group. Finally, the financial statements documents were discussed in detail by the Supervisory Board in its financials meeting on March 12, 2008, in the presence of the auditor. These discussions focused especially on the use of the authorized capital in the amount of 3.2 million shares, the shareholder loans of Isaac Larian family trusts associated with MGA and of Nicolas Mathys, the syndicated loan of € 65 million and the development of Zapf Creation (France) S.à.r.l. The Supervisory Board approved the results of the audit and the opinion of the auditing firm on the basis of these deliberations and accepted the audit reports for both the annual financial statements and the consolidated financial statements.

The Supervisory Board reviewed both the annual financial statements and the management report that were prepared in accordance with HGB for the 2007 financial year. In particular, this review focused on the mutually provided services between Zapf Creation AG and MGA Entertainment, Inc. (Cross Charges), budget issues and the contribution of shareholder loans in the amount of € 12.9 million. There was no reason to raise any objections based on the final result of this examination. The Supervisory Board approved the annual financial statements for 2007 at its meeting on March 12, 2008. The annual financial statements are thus formally adopted.

The Supervisory Board reviewed both the consolidated financial statements and the Group management report that were prepared in accordance with IFRS/IAS for the 2007 financial year. The Supervisory Board particularly reviewed in this connection budget issues, relations with affiliated companies and the development of Zapf Creation (France) S.à.r.l. The final outcome of this review did not give rise to any objections either. The consolidated financial statements and the Group management report were also approved by the Supervisory Board at its meeting on March 12, 2008.

Proposal for the Appropriation of Profits

Regarding the appropriation of profits, the Management Board proposed to the Supervisory Board that the net loss of € 22,627,557.69 be carried forward. Absent any other options, the Supervisory Board agreed with the Management Board's proposal in regards to the utilization of the Company's loss for the period.

Remarks on the Review of the Report on Relations with Affiliated Parties Pursuant to Section 314 Para 2 and 3 German Stock Corporation Code

The Supervisory Board also reviewed the report of the Management Board of Zapf Creation AG under Section 312 German Stock Corporation Act regarding the Company's relations with affiliates in the 2007 financial year.

In its report on relations with affiliates in the 2007 financial year in accordance with Section 312 German Stock Corporation Act, the Management Board has issued the following statement:

"We declare that our Company was paid appropriate consideration in connection with the legal transactions and measures described in this report on relations with affiliates, given the circumstances known to us at the time the relevant legal transactions or measures were executed or omitted, and that the execution or omission of any such measures did not cause the Company to suffer any disadvantage."

The Supervisory Board's review of this report did not give rise to any objections. In conducting its review, the Supervisory Board asked the Management Board to discuss both the benefits and potential risks arising from the transactions described in the report on relations with affiliates and weighed these factors on its own. The Supervisory Board also asked the Management Board to explain the principles that were applied to the determination of the Company's services and the consideration it received in return. The Supervisory Board agrees with the audit findings of the auditing firm. In light of the audit report and the final results of its own review, the Supervisory Board does not raise any objections to the Management Board's declaration at the end of the report on relations with affiliates.

The Supervisory Board thanks the Management Board, as well as the staff of the Zapf Creation Group, for their commitment in the 2007 financial year.

Frankfurt/Main, Germany, March 19, 2008

Dr. Harald Rieger
Chairman of the Supervisory Board

Management Report of the Company and the Group

I. General

Business Concept and Corporate Structure

The Zapf Creation Group develops and markets high-value branded play concepts comprising its internationally known play and functional dolls that are supplemented by a comprehensive world of matching accessories. The Group's most popular brands and concepts are BABY born®, Baby Annabell® and CHOU CHOU. High standards in terms of quality, design, safety, and play value are common to all of these play concepts. Girls aged three to eight years are our core target group. In terms of sales, Zapf Creation is the largest producer of play and functional dolls in Europe.

The Zapf Creation Group consists of the parent company, Zapf Creation AG, which is headquartered in Roedental, Germany, as well as wholly-owned subsidiaries both in Germany and abroad whose main task is to market and sell the Group's product portfolio.

Zapf Creation AG is listed on the Frankfurt/Main Stock Exchange in the Prime Standard segment of Deutsche Börse AG. Due to the integration of its former subsidiary, Zapf Creation (Central Europe) GmbH & Co. KG, into the Company by way of accrual effective January 1, 2007, as the parent company Zapf Creation AG is no longer responsible just for central functions such as financing, IT, personnel, accounting, controlling, and general administration but also for sales in Central Europe, as well as for strategic marketing, product development, and design.

As of the end of the 2007 financial year, the Company had four subsidiaries that are domiciled in Germany: Zapf Creation Logistics GmbH & Co. KG, Zapf Creation Logistics Beteiligungs GmbH, Zapf Creation (Central Europe) Verwaltungs GmbH and Zapf Creation Auslandsholding GmbH. There were also foreign subsidiaries in Hong Kong, France, Great Britain, Italy, Poland, Spain, and the US.

In 2006, Zapf Creation AG entered into a comprehensive strategic cooperation with the American toy manufacturer MGA Entertainment, Inc., Van Nuys, California, USA, which has been operational since January 1, 2007. The cooperation comprises the following:

- Distribution of Zapf Creation products by MGA Entertainment, Inc. in the Americas ("Distribution Agreement");
- Distribution of MGA Entertainment, Inc. products in key European markets by using the distribution network of Zapf Creation ("Consignment und Services Agreement");
- Procurement services provided by MGA Entertainment, Inc. for Zapf Creation in Hong Kong ("Hongkong/China Services Agreement");
- Licensing of products of the Zapf Creation Group outside the toy sector by MGA Entertainment, Inc. ("Merchandising Licence Agreement");
- Logistics services provided by Zapf Creation Logistics for MGA Entertainment, Inc. ("Logistics Service Agreement").

With the exception of the cooperation in logistics, which was put in place in 2007 for a term of three years, all other agreements are long term, with terms of ten years. The Group's collaboration with MGA Entertainment, Inc. is a material component of its restructuring and reorientation in recent years.

Key Performance Indicators

The Zapf Creation Group manages its business through the segments discussed in the Segment Report. The following financial indicators constitute important parameters for measuring and managing the Group's operating business:

- Sales by product line
- Earnings before interest, taxes, depreciation and amortization (EBITDA)
- Earnings before interest and taxes (EBIT)

Non-financial performance indicators essentially include the following:

- **Brand Strength:** For many years, the play concepts of the Zapf Creation Group have stood for high standards in design, quality, safety, and play value. These properties are the core of the Zapf Creation Group's brands. Maintaining this core brand competence – for instance through comprehensive quality management and marketing approaches aimed at highlighting the products' advantages – is key to gaining and securing customers' trust. This applies all the more these days, given consumers' mounting insecurity as exemplified in 2007 by the public debate regarding the safety of toys produced in China.
- **Product Innovation:** The toy business is largely driven by novelty and innovation. In particular, this includes new play concepts, as well as new technical functions for the dolls and corresponding accessories. Hence our employees' creativity and product know-how, especially in design, are decisive factors in our ability to remain competitive.
- **Retail Presence:** A strong presence in European retail markets is equally decisive to the success of the Zapf Creation Group. Maintaining good and trusting relationships to toy stores and orienting sales on consumers' changing purchasing patterns thus are critical factors in our ability to maintain and expand our market share.

Economic Situation Overall

The global economy remained robust in 2007 and continued to grow as in previous years. Analysts expect it to expand by about 5 %, given positive economic developments in both Europe and the United States and, increasingly, the prospering of such major emerging economies as China and India as well.

However, the economic momentum slowed during the year amid growing signs of a looming crisis. The collapse of the real estate sector in the United States in the wake of the subprime mortgage crisis has caused sustained disruptions in the international financial markets since the summer of 2007 and the prices for commodities such as oil rose substantially in the second half of the year. Consequently, the fear of a significant economic downturn worldwide grew toward year's end, fueled especially by fears of a recession in the United States.

But the fundamentals of the economies in the euro zone held steady at the close of the reporting year, notwithstanding signs that the crisis was intensifying. Companies' earnings continued to develop along a positive trajectory and job growth was robust. Germany's GDP grew for the fourth consecutive year, expanding by 2.5 %. Solid order levels drove companies' growth but consumer spending did not satisfy expectations despite the growth in employment.

Sources:
Bundesverband Deutscher Banken e.V. (Association of German Banks), Economic Report, February 2007
European Central Bank, Monthly Report, February 2007

Development of the Industry

In 2007, the traditional European toy market – the top four markets are Germany, France, Great Britain, and Spain – attained sales growth of 1.4 % overall but the dynamics in each country were different. While the markets in Germany (+ 1.0 %) and France (+ 1.9 %) grew at a moderate pace year on year, the Spanish market recorded substantial growth of 8.8 %. The market in Great Britain declined slightly compared to the previous year (– 1.0 %). We are pleased that the German market achieved the turnaround after shrinking for five consecutive years.

According to Zapf Creation's analyses, the toy markets in Eastern Europe continued to develop at a dynamic pace, in part achieving double-digit growth rates.

Toy Market Top 4 Europe, Based on Sales Prices

	2007 in € million	2006 in € million
Germany	2,217.3	2,195.5
France	2,642.0	2,592.3
Great Britain	3,350.1	3,383.2
Spain	1,142.3	1,050.2
Total	**9,351.7**	**9,221.2**

Source: NPD/Eurotoys 2007, projection by Zapf Creation AG

The play and functional doll segment, including accessories – the core market of the Zapf Creation Group – developed unevenly throughout Europe in 2007.

While the market volume declined by 5.2 % in Germany, 5.1 % in Great Britain, and 3.5 % in France, it grew at a robust pace of 7.6 % in Spain.

The Zapf Creation Group succeeded more or less in stabilizing its leading position in the European market for play and functional dolls in 2007. At 58.5 %, its market share in Germany was slightly below the previous year's level of 59.4 %, making Zapf Creation the undisputed market leader by far yet again. In France, the Company's market share fell from 9.6 % to 8.3 % chiefly due to the restructuring of our French subsidiary. The Group's market share in Great Britain again surpassed 40 % (specifically, 40.1 % compared to 40.3 % the previous year). In Spain, the market share was 16.9 %, down from 21.3 % a year ago.

II. Noteworthy Occurrences during the Financial Year

Changes in the Management Board and the Supervisory Board

The following changes took place in the reporting year with regard to the composition of both the Management Board and the Supervisory Board of Zapf Creation AG:

Effective March 1, 2007, Mr. Jens Ulrich Keil took over as Management Board member responsible for finance, capital market, restructuring, human resources, IT, and logistics. Mr. Keil had previously been responsible for controlling and accounting at Wal-Mart Germany beginning in 2005.

The Supervisory Board elected Dr. Harald Rieger its chairman on February 27, 2007. Dr. Rieger had been a court-appointed member of the Supervisory Board since February 12, 2007. Dr. Rieger succeeded the previous chairman of the Supervisory Board, Mr. Miguel Perez-Carballo Villar, who remained on the Supervisory Board as a regular member.

Securing the Group's Financing

Obtaining and implementing long-term follow-up financing was the single most important issue for the Zapf Creation Group in the 2007 financial year. This financing had become necessary because the € 90 million syndicated loan that had been obtained in the spring of 2006 was due to expire April 30, 2007.

Given Zapf Creation AG's tight equity situation, the Management Board's follow-up financing concept envisioned strengthening the Company's capital base from the outset. It was clear from the Group's economic difficulties that its capital base could be fortified only if the major shareholders of Zapf Creation AG made a special financial commitment to the Company.

On May 9, 2007, the Management Board announced that the banks had granted the Company a grace period of two months until June 30, 2007, for repaying the syndicated loan that had expired on April 30, 2007, because the negotiations between the banks, the major shareholders, and the Management Board had not yet produced an agreement on the financing concept.

In subsequent weeks, different Group financing models were discussed in intense negotiations between various banks, the Company, and its major shareholders.

On July 20, 2007, Zapf Creation AG announced that it had reached agreement regarding the Company's long-term follow-up financing with an international banking syndicate and major shareholders (MGA Entertainment, Inc. and its CEO, Mr. Isaac Larian, Mr. Nicolas Mathys and Mr. Gustavo Perez). According to the agreement, the financing concept includes a new, long-term syndicated € 65 million loan. The loan is divided into three tranches with terms ranging from three to five-and-a-half years.

This loan was contingent on an equity contribution in the amount of € 30 million by October 31, 2007 (in a form to be determined by the shareholders), as well as the issuing of the auditor's report for the 2006 annual and consolidated financial statements. The Company's major shareholders assured the Company in writing that they guarantee this equity contribution. Among other things, there was agreement that the authorized capital of up to € 3.2 million existing at the time would be utilized in full on short notice.

Interim financing that comprised a bridge loan of up to € 20 million was obtained from Commerzbank AG in order to ensure the Company's liquidity until these agreements were executed. The previous syndicate of banks of Zapf Creation AG agreed to grant a grace period until October 31, 2007, for the repayment of the previous syndicated loan with credit lines used in the amount of approx. € 45 million, which had been due since June 30, 2007.

Also on July 20, 2007, the shareholders MGA Entertainment, Inc., Mr. Nicolas Mathys and Betham Ltd., which is represented by the Supervisory Board member Mr. Gustavo Perez, and Zapf Creation AG concluded Financing Agreement I in order to ensure both the equity infusion of € 30 million and the required interim financing. These shareholders undertook thereunder to make available up to € 10 million to Zapf Creation AG, among other things, by means of a cash capital increase and subordinated shareholder loans. The subordinated loans were to be granted prior to the capital increase in order to guarantee additional interim financing.

At the end of July 2007, Betham Ltd. announced that its Articles of Incorporation prevented it from granting loans and, therefore, that it was unable to meet its obligations under the agreement. This led to further delays and yet more intense negotiations, at the end of which MGA Entertainment, Inc. agreed to assume the obligations of Betham Ltd. However, the agreement ("Financing Agreement II") that had been concluded between MGA Entertainment, Inc., Mr. Mathys, and the Company on September 5, 2007, could take effect only if the Federal Financial Supervisory Authority ("BaFin") exempted both MGA Entertainment, Inc. and its affiliates from the obligation to make an offer to take over all of the shares of Zapf Creation AG if MGA were to exceed the relevant threshold of 30% of the Company's voting rights in connection with the execution of the capital measures. By notice dated September 14, 2007, BaFin released MGA Entertainment, Inc. from its obligation to submit such a takeover offer.

Given all the delays, all participants agreed to extend the period for putting both the refinancing and the interim financing into place by one month until November 30, 2007.

On September 26, 2007, the Company's auditor issued its auditor's report for the 2006 annual and consolidated financial statements so that the Company was able to publish both the consolidated financial statements for the 2006 financial year and the figures for the first six months of 2007 on October 2, 2007.

The financing concept that was concluded on July 20, 2007, was essentially executed as follows:

- The Management Board resolved on October 2, 2007, with the approval of the Supervisory Board on October 7, 2007, to raise the Company's share capital to € 12.0 million by issuing up to 3,200,002 no-par bearer shares. The new no-par shares were offered to the Company's shareholders between October 12, 2007, and October 26, 2007, at a subscription price of € 3.16 per share, yielding an inflow of funds of about € 10 million for Zapf Creation AG. As stipulated in Financing Agreement II, the shareholders, MGA Entertainment, Inc. and Mr. Nicolas Mathys, exercised not just the subscription rights allocable to them but also those not exercised by other shareholders.

- Pursuant to this financing concept, in their capacity as investors these two shareholders made up for the shortfall in the required equity infusion of € 30 million by granting subordinated loans in several steps. The Management Board drew on a total of € 16.2 million in cash infusions.

- The Company's shareholders agreed at its regular Annual Shareholders' Meeting on November 20, 2007, to create new authorized capital in return for cash or in-kind contributions, subject to the option of excluding shareholders' subscription right.

- The Company increased its share capital from € 12.0 million to € 13.2 million immediately after the Annual Shareholders' Meeting. This additional capital increase, which corresponded to 10 % of the Company's share capital, was executed to the exclusion of shareholders' subscription right pursuant to Section 186 para 3 sentence 4 German Stock Corporation Act (Aktiengesetz); all shares were subscribed by the major shareholders MGA Entertainment, Inc. or companies affiliated with it, and Mr. Nicolas Mathys. The capital increase was recorded in the Commercial Register on December 10, 2007.

This completed the infusion of equity and similar funds stipulated as part of the long-term financing concept. At the same time, the banks participating in the loan syndicate made the new syndicated loan of € 65 million available to Zapf Creation AG on December 7, 2007.

It is the view of the Management Board that this equity and debt structure provides a sufficient financial foundation for the Group to continue developing and expanding its operations.

III. Economic Report

The consolidated financial statements for 2007 of Zapf Creation AG, as well as the comparative figures for the previous year, were prepared in accordance with Section 315 a German Commercial Code (HGB) and in compliance with both the International Financial Reporting Standards (IFRS) and the relevant interpretations of the International Financial Reporting Interpretations Committee (IFRIC) – as applicable within the European Union under Article 4 of EC Regulation 1606/2002 dated July 19, 2002, of the European Parliament and the European Council.

The 2007 annual financial statements for Zapf Creation AG were prepared according to German accounting standards and the requirements of the German Commercial Code.

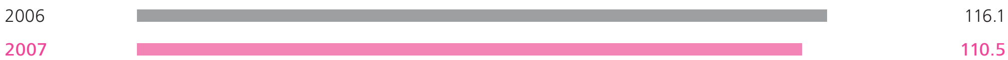
In accordance with the specific requirements of IFRS 5, the operations of the Zapf Creation Group in the Americas that were discontinued as of the end of December 31, 2006, are shown separately in the consolidated income statement under the result from discontinued operations. No adjustments were necessary in the consolidated balance sheet.

Development of Sales

Development of Sales within the Zapf Creation Group

In 2007, the Zapf Creation Group posted revenue of € 110.5 million, down 5 % versus the previous year (2006: € 116.1 million). This development is mainly due to the subdued development of business in important Central European markets: While sales were sluggish in the first half of the year, business picked up considerably in the third and fourth quarter.

Development of Sales of the Zapf Creation Group (in € million)



Development of Sales by Region

In Central Europe – which includes Germany, Austria, Switzerland, the Netherlands, and Luxemburg – the sales of the Zapf Creation Group in 2007 fell by 5 % to € 36.2 million (2006: € 38.2 million).

Essentially, this is due to the continued weakness of the market for girls' toys overall but, in particular, the play and functional doll segment in Germany, Austria, and Switzerland.

In Northern Europe – which comprises Great Britain, Ireland, and Scandinavia – sales in 2007 were € 34.9 million, down 8 % from € 37.9 million the previous year. This was largely due to the continuing decline in demand in the play and functional doll segment, particularly in Great Britain, an important market.

In 2007, the Zapf Creation Group posted total sales of € 16.2 million in Southern Europe – which encompasses Spain, France, Belgium, and Italy – down 23 % from € 21.0 million in 2006. In addition to the fact that a portion of the market for play and functional dolls is shrinking (notably France), this development resulted especially from the restructuring of the Group's sales organizations in both France and Spain, which made it impossible to work the market consistently throughout the year under review.

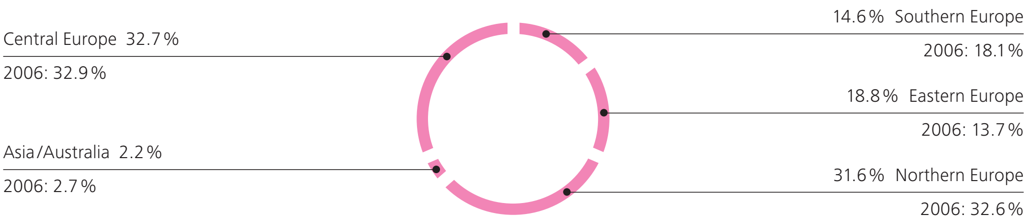
Development of Sales of the Zapf Creation Group by Region

	Sales 2007 € million	Sales 2006 € million
Europe	**108.0**	**113.0**
Central Europe	36.2	38.2
Northern Europe	34.9	37.9
Southern Europe	16.2	21.0
Eastern Europe	20.8	15.9
Asia/Australia	**2.5**	**3.1**
Total	110.5	116.1

In Eastern Europe, the Zapf Creation Group recorded strong sales growth in 2007 yet again. At € 20.8 million, revenue was 31 % higher than in 2006 (€ 15.9 million). This was the first time sales in Eastern Europe surpassed the results achieved in Southern Europe. We are particularly pleased by the development in both Russia and Poland.

In Asia/Australia, sales in 2007 were € 2.5 million after € 3.1 million in 2006.

Breakdown of Sales of the Zapf Creation Group by Region 2007



Development of Sales by Product Line

With sales growth of 11 %, the BABY born® play concept performed well in 2007. This was due, in particular, to the expansion of the product line by the BABY born® boy and the "Horse & Princess" series. The "Mommy, I can swim" doll, which was newly introduced as part of the My little BABY born® product line, was highly successful in both the US and Great Britain; its market launch in Germany is scheduled for 2008.

The Baby Annabell® concept had to contend with a downturn in sales of 22 % in 2007. The doll's successor model – new Baby Annabell – was launched in the middle of the year. The new doll replaced the first generation of Baby Annabell® three years after the latter's market launch but did not enjoy the kind of success the Company had expected, especially in Great Britain.

Sales of the CHOU CHOU play concept fell by 18 % in 2007. While the "Talking CHOU CHOU" doll (which was launched in 2006) failed to meet our expectations, market response to the CHOU CHOU "Mommy, make me better" line (which was introduced in September 2007) was very positive but unable to offset the product line's overall decline in sales.

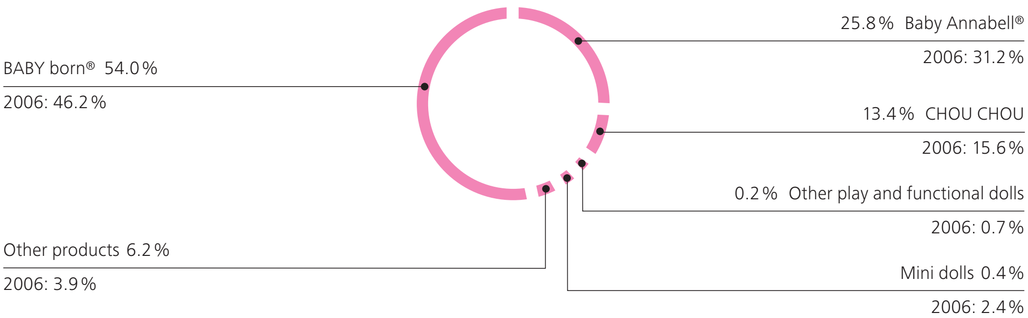
Development of Sales of the Zapf Creation Group by Product Line

	2007 € million	2006 € million
Play and functional dolls	**103.1**	**108.9**
BABY born®	59.7	53.7
Baby Annabell®	28.5	36.3
CHOU CHOU	14.8	18.1
Other play and functional dolls	0.2	0.8
Mini dolls	**0.5**	**2.8**
Other products	**6.9**	**4.5**
Total	110.5	116.1

The item "other play and functional dolls" includes discontinued product lines such as Maggie Raggie where just the remaining inventories are being sold off. Revenues fell substantially in the reporting year. The decline in mini doll sales is due to the termination of the Missy Milly® mini doll line in 2007.

In contrast, sales of the "other products" category grew at a robust pace, essentially driven by growth in the My Model line and sales of Mega Brands, MGA, and Little Tikes in Poland.

Breakdown of Sales of the Zapf Creation Group by Product Line 2007



Sales Development of Zapf Creation AG

In 2007, Zapf Creation AG posted sales of € 48.9 million, up from € 0.5 million the previous year. This large increase was due to the integration by accrual (effective January 1, 2007) of our former subsidiary, Zapf Creation (Central Europe) GmbH & Co. KG; as a result, in the future the sales revenue from the operating business of the Zapf Creation Group in Central Europe will be posted at the parent company.

By themselves, total sales of the Central European sales organization within Zapf Creation AG in the reporting year were € 43.4 million, compared to sales of € 45.4 million generated the previous year by Zapf Creation (Central Europe) GmbH & Co. KG. This decline is essentially due to the continued weakness in the year just ended of the market for play and functional dolls in Germany, Austria, and Switzerland.

Profit or Loss

Profit or Loss of the Zapf Creation Group

The Zapf Creation Group posted gross profits of € 48.3 million in 2007, down from € 52.8 million in 2006 (–8.5%). Year-on-year, the gross profit margin fell 1.7%, from 45.4% in 2006 to 43.7% in 2007. Bear in mind that the strategic cooperation with MGA Entertainment, Inc. in procurement has not yet fully borne fruit due to the complexity of the organizational changes involved, especially in Asia.

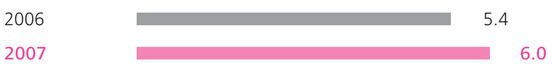
There was a sharp year-on-year decline in operating costs yet again due to the effects of the comprehensive restructuring measures that were stipulated and carried out in 2006. Administrative expenses fell from € 23.6 million in 2006 by 27.5 % to € 17.1 million in 2007. At € 14.3 million, selling and distribution expenses were 3.4 % below the previous year's level of € 14.8 million. Marketing expenses declined from € 15.9 million in 2006 by 9.4 % to € 14.4 million in 2007.

Other income rose to € 4.7 million in 2007, up from € 1.5 million the previous year, due mainly to income from our strategic cooperation with MGA Entertainment, Inc.

Other expenses in the amount of € 1.5 million (2006: € 0.6 million) arose particularly from changes in exchange rates.

The consolidated earnings before interest and taxes (EBIT) of the Zapf Creation Group – before restructuring costs and one-off items – rose by 11.2 % to € 6.0 million in 2007, up from € 5.4 million in 2006, further supporting earnings growth which had started the previous year.

Development of Earnings (EBIT) of the Zapf Creation Group (in € million)*



*before restructuring costs and one-off items, without sales region North, Central and South America, previous year's figures adjusted

This includes restructuring costs of € 0.6 million (2006: € 3.4 million), largely for consulting/attorneys' fees and measures taken in connection with the Group's reorganization, as well as non-recurring income of € 0.3 million (2006: € –2.6 million) from an out-of-court settlement related to Namco Bandai GmbH's failed takeover attempt in 2006.

Adjusted for restructuring costs and one-off items, the operating result (EBIT) of the Zapf Creation Group improved year on year, rising from € –0.5 million in 2006 to € 5.7 million in 2007.

Net finance income was € –3.5 million, compared to € –6.3 million in 2006. At € 4.4 million, finance costs were also substantially below the previous year's level (2006: € 7.0 million). This item includes interest expenses related especially to the old syndicated loan. The substantial increase in expenditures arising from the lengthy negotiations with respect to the new financing concept were partially offset by income of € 1 million from success fees not payable for the Company's refinancing and the related waiver by the banks belonging to the old syndicate, and from the lower average use of credit lines in the 2007 financial year.

Consolidated earnings before taxes from continued operations in 2007 rose substantially to € 2.2 million, up from a loss of € 6.8 million the previous year.

Expenses on income taxes were € 4.8 million in 2007. They are due on the one hand to valuation adjustments on deferred tax assets capitalized in previous years and a reduced recognition of deferred taxes as a result of the German Corporate Tax Reform Act on the other.

The after-tax result from continued operations was € −2.6 million, up from € −6.5 million in 2006.

Discontinued operations generated a net after-tax result of € −0.1 million in 2007, compared to € −6.1 million in 2006, largely due to the sale of the inventories of our US business (which was discontinued as of December 31, 2006) to MGA Entertainment, Inc.

The Zapf Creation Group's net result for 2007 was € −2.7 million – a substantial year-on-year improvement over the previous year's net result of € −12,7 million.

Earnings per share for the year thus were € −0.31, compared to € −1.67 per share a year earlier. The net earnings per share in 2007 from continued operations were € −0.30, after € −0.86 per share in 2006.

Profit or Loss by Region

The Zapf Creation Group reports on profit or loss by region based on earnings before interest, taxes, depreciation, and amortization (EBITDA).

EBITDA for Europe as a whole in the reporting year climbed from € 12.0 million in 2006 by € 2.2 million to € 14.3 million in 2007. Central Europe achieved EBITDA of € 4.7 million, up from € 4.5 million the previous year. Among other things, this was due to the reduction in administrative expenses, as well as to income from licenses and selling fees related to our strategic cooperation with MGA Entertainment, Inc. While EBITDA in Northern Europe improved by € 0.4 million to € 4.0 million year on year, in Southern Europe EBITDA was € 0.5 million, approximating the previous year's level (€ 0.6 million). In contrast, the positive development of sales in Eastern Europe caused EBITDA to climb substantially yet again, from € 3.4 million in 2006 by € 1.7 million to € 5.1 million in 2007.

In Asia and Australia, however, EBITDA fell to € −4.2 million, after € 1.7 million in 2006. This development is related to the full transfer of both procurement and technical product development to MGA Entertainment, Inc., which eliminated the income previously recorded for the Groupwide provision of these services.

Development of Earnings (EBITDA) of the Zapf Creation Group by Region

	2007 € million	2006 € million
Europe	**14.3**	**12.0**
Central Europe	4.7	4.5
Northern Europe	4.0	3.5
Southern Europe	0.5	0.6
Eastern Europe	5.1	3.4
Asia / Australia	**−4.2**	**1.7**
Total	10.2	13.8

Profit or Loss of Zapf Creation AG

In 2007, Zapf Creation AG posted a result from ordinary activities of € −12.7 million (2006: € −0.5 million). Just as in the two preceding years, various extraordinary items had a substantial impact on the result in the year just ended as well.

The integration of Central European sales caused Zapf Creation AG’s selling costs to increase by € 19.7 million, from € 6.4 million in 2006 to € 26.1 million in 2007. As a result, general administrative expenses climbed to € 15.2 million, an increase of € 4.0 million from € 11.2 million in 2006.

Other operating expenses were € 11.2 million, up from € 4.0 million the previous year. This is essentially due to the impairment of other receivables and the non-current loan for Zapf Creation (France) S.à.r.l. in the amount of € 6.7 million, the waiver of other receivables vis-à-vis Zapf Creation (France) S.à.r.l. in the amount of € 0.3 million, and the waiver of other receivables vis-à-vis Zapf Creation (Italia), S.R.L. in the amount of € 0.1 million.

The item, write-downs on current financial assets and marketable securities, mainly includes write-downs of € 3.2 million on treasury shares of Zapf Creation AG recognized as a result of the share price decline during the year.

Extraordinary profit from income related to the restructuring was € 1.6 million. As a result of the credit commitments made by the banks, a success fee of € 2.0 million was recognized in the annual financial statements as of December 31, 2006 in accordance with supplement two of the syndicated loan agreement. The subsequent reduction resulted in income of € 1.0 million.

As part of the restructuring, the Company decided in 2006 to handle its US business through MGA Entertainment, Inc., USA and to close the sales subsidiary Zapf Creation (U.S.) Inc., Orlando, in 2007. The assumption of the negative equity of Zapf Creation (U.S.) Inc. totaled € 4.7 million. This amount was reduced by € 0.4 million in 2007.

A fee of € 1.0 million became due and payable in 2006 in connection with the takeover bid from Bandai GmbH. A settlement concluded in 2007 resulted in income of € 0.3 million.

Taking the extraordinary result into account, in 2007 Zapf Creation AG incurred a net loss for the period of € 11.5 million (2006: € −7.2 million).

Net Assets and Financial Position

Net Assets and Financial Position of the Zapf Creation Group

Balance Sheet Structure of the Zapf Creation Group as of December 31 (in € million)

Assets	2007	2006	Equity and liabilities	2007	2006
Non-current assets	19.5	26.3	Equity	14.4	3.6
			Non-current liabilities	33.5	0.2
Current assets	95.6	89.3			
			Current liabilities	67.2	111.8
Total assets	115.1	115.6	Total equity and liabilities	115.1	115.6

Total assets of the Zapf Creation Group as of December 31, 2007, were € 115.1 million, roughly corresponding to the previous year's level (December 31, 2006: € 115.6 million).

Cash and cash equivalents doubled to just under € 23.3 million, due essentially to both the equity infusion and the borrowings obtained under the financing concept stipulated on July 20, 2007. In contrast, further improvements in the management of working capital caused trade receivables to decline by € 7.5 million to € 49.9 million. The increase in other assets by € 4.9 million to € 8.6 million largely reflects receivables from MGA Entertainment, Inc. for services rendered in connection with our strategic cooperation. Overall, current assets rose by € 6.3 million (7.0 %) to € 95.6 million.

At € 19.5 million, non-current assets as of the reporting date were € 6.7 million (25.6 %) lower than the previous year (€ 26.3 million). This is due especially to the reduction in deferred tax receivables by € 3.9 million to € 0.1 million mainly as a result of write-downs on domestic tax assets.

In terms of liabilities and equity, shareholders' equity rose substantially by € 10.9 million to € 14.4 million due to the two capital increases that were executed in the reporting year as part of the long-term financing concept. This lifted the equity ratio to 12.5 % by year's end (December 31, 2006: 3.1 %).

Current liabilities to banks declined by € 59.2 million to € 5.9 million because the old syndicated loan was repaid during the reporting year.

The other liabilities, which rose by € 16.4 million to € 19.4 million, largely comprise the shareholder loans from the Company's major shareholders (MGA Entertainment, Inc. and Mr. Nicolas Mathys) that were made available under the long-term financing concept.

Non-current liabilities of € 33.4 million to banks as of the close of the 2007 financial year comprise the drawdowns from the new syndicated loan. The Company did not have any non-current liabilities to banks as the previous year's balance sheet date.

Net liabilities declined significantly by € 37.4 million year on year – from € 53.3 million at the close of the 2006 financial year to a mere € 16.0 million as of December 31, 2007. It even fell by € 20.5 million, if the subordinated shareholder loans of € 16.9 million including interest that were granted in the reporting year are taken into account.

Disclosures Regarding Derivative Financial Instruments

As a rule, the Group only employs derivative financial instruments (forward exchange transactions and options as well as interest rate swaps) for hedging purposes (currency and interest rate risks). Cash flow hedging to hedge interest and currency risks is only performed when required by the financing structure. The process of hedging future variable cash flows against fluctuations is called cash flow hedging. Changes in the fair value of derivative financial instruments intended for hedging a cash flow risk are documented. If the hedging relationships are classified as effective, the changes in the fair value are recognized directly in equity. Fluctuations in value from financial instruments classified as ineffective are recognized directly in the income statement.

As of December 31, 2007, the other recognized income results exclusively from currency translation differences recognized in equity. In the 2007 financial year, the current value of the derivative financial instruments held by the Company is fully recognized in the income statement.

Net Assets and Financial Position of Zapf Creation AG

As of the end of 2007, the total assets of Zapf Creation AG were € 102.0 million. This is an increase of 3.9 % compared to the total assets shown on December 31, 2006 (€ 98.2 million).

Fixed assets declined from € 74.0 million at the end of 2006 by € 32.3 million to € 41.7 million at the end of 2007, essentially due to the reduction, by € 30.0 million, of the Company's investments in affiliates to € 13.1 million in connection with the integration by accrual of the former wholly-owned subsidiary, Zapf Creation (Central Europe) GmbH & Co. KG, into the parent company effective January 1, 2007.

Current assets climbed by € 35.9 million to € 59.9 million as of the reporting date (December 31, 2006: € 24.0 million). Aside from the increase in both inventories (+ € 6.4 million) and trade receivables (+ € 14.4 million) resulting from the integration of the Central European sales organization, this also reflects the greater liquidity from the execution of the long-term financing concept. Cash and cash equivalents (cash at bank and on hand) thus rose by € 11.7 million to € 13.1 million.

In terms of liabilities and equity, shareholders' equity rose by € 2.3 million to € 16.4 million at the close of the 2007 financial year (December 31, 2006: € 14.1 million). The two capital increases that were executed pursuant to the long-term financing concept had positive effects. As of December 31, 2007, the equity ratio rose to 16.1 % from 14.3 % the previous year despite the increase in the Company's loss for the year.

Liabilities to banks fell by € 11.9 million to € 40.3 million (December 31, 2006: € 52.2 million). Full repayment of the old syndicated loan was offset by drawdowns from the new syndicated loan that was obtained under the long-term refinancing concept. While operations in Central Europe caused trade payables to increase by € 11.3 million to € 12.9 million, liabilities to affiliates fell to € 1.6 million (down € 15.0 million) due to the integration by accrual of the Central European sales organization into the parent company. Other liabilities were € 17.1 million (previous balance sheet date: 0), essentially containing subordinated shareholder loans and accrued interest.

Investments

Investments by the Zapf Creation Group

Total investments by the Zapf Creation Group in 2007 were € 1.7 million, a decline of € 0.1 million from € 1.8 million in 2006. Investments in intangible assets were € 0.2 million (2006: € 0.1 million). Of the total € 1.5 million investment in property, plant and equipment (2006: € 1.7 million), € 0.9 million were invested in molds and tools for manufacturing our products.

Investments by Zapf Creation AG

The additions to assets comprised € 9.2 million from the accrual of Zapf Creation (Central Europe) GmbH & Co. KG to the parent company, as well as € 1 million in actual investments (2006: € 0.1 million). As in the previous year, € 0.1 million were invested in intangible assets and € 0.9 million in property, plant and equipment (2006: € 0.1 million).

Cash Flow

Cash Flow of the Zapf Creation Group

The Zapf Creation Group posted cash flow of € 28.8 million from operating activities in the 2007 financial year, up from € 20.3 million the previous year. This increase is due, in particular, to the improvement in the consolidated operating result, as well as the reduction in both liabilities and provisions.

Cash used in investing activities was € 1.5 million, just as in the previous year. At € 15.0 million, cash flow used for financing activities was below the previous year's level of € 16.3 million. The inflows from both the drawdowns on the new syndicated loan and the two capital increases pursuant to the long-term financing concept were offset by the outflows for repaying both the old syndicated loan and bank liabilities during the year. Taking effects from changes in foreign exchange rates into account, overall cash and cash equivalents increased strongly by € 11.6 million year-on-year, from € 11.7 million in 2006 to € 23.3 million in 2007.

Employees

Development of Employee Figures of the Zapf Creation Group

As of the December 31, 2007, cut-off date, the Zapf Creation Group had 226 employees worldwide (excluding the members of the Management Board and trainees), 69 of which worked for the Group's foreign subsidiaries. This compares to 322 employees in the previous year.

The development of the annual average number of employees is as follows:

Annual Average Number of Employees of the Zapf Creation Group

	2007	2006
Salaried employees	199	297
Hourly workers	31	39
Employees	**230**	**336**

Developments in regards to our labor force were roughly as planned. The substantial reduction in personnel arises from the execution of the measures adopted back in 2006 that were aimed at restructuring and repositioning the Group. Note that some jobs were transferred. MGA Entertainment, Inc. took over roughly one half of the 90 employees of Zapf Creation Hong Kong, in connection with the transfer of procurement and technical product development to MGA Entertainment (HK) Ltd.

In Germany, the Zapf Creation Group had a total of 150 employees as of December 31, 2007. Of these, 124 worked in Roedental (December 31, 2006: 166) and 26 at our Darmstadt office, which was newly established in 2007.

Our employee turnover rate, which is already very high, was intensified by employees' voluntary resignations in the wake of the Company's difficult and uncertain economic situation. While we were able to limit the overall fallout from the loss of both know-how and expertise because we largely succeeded in recruiting qualified new employees, recruiting and training suitable professionals remains a critical task, given the substantial changes in the structure of our personnel.

The major changes in personnel, which affected almost all of the Group's divisions and departments, required a greater level of commitment from all executives in order to minimize the negative consequences on the Group's operations. The Group's executive development program, which aims to ensure successful personnel management in the future as well, is being maintained.

Disclosures regarding the compensation system for executives are included in the notes to the consolidated financial statements, specifically in section A, item 2.3.13., section B, item 2.5.6. and section C, item 3.1.

Development of Employee Figures at Zapf Creation AG

Zapf Creation AG had 110 employees (excluding the members of the Management Board and trainees) as of December 31, 2007 (previous year: 71 employees).

Annual Average Number of Employees of Zapf Creation AG

	2007	2006
Salaried employees	110	80
Hourly workers	0	0
Employees	**110**	**80**

The increase in the number of employees at the parent company is essentially due to the integration of Zapf Creation (Central Europe) GmbH & Co. KG as of January 1, 2007.

Research and Development

Research and Development Activities of the Zapf Creation Group

Innovations in products and play concepts alike are the driving force in the toy industry and thus have a very important role to play in the Zapf Creation Group. Zapf Creation AG is responsible for the continued development of the Group’s product portfolio through suitable research, development, and design. The subsidiaries themselves do not engage in any research and development; instead, they are largely responsible for marketing and sales.

Research and Development Activities of Zapf Creation AG

In 2007, Zapf Creation once again developed or launched several new product innovations. This included a new Baby Annabell®; new BABY born® themes (such as, for instance, the “Horse & Princess” series); the “Mommy, make me better” CHOU CHOU doll; and the “Mommy, I can swim” doll in the My little BABY born® line. These new products elicited a good – sometimes even excellent – response from customers.

The strategic cooperation with MGA Entertainment, Inc. had a positive effect on the Group’s innovative power in the reporting year, for example, with respect to improvements in doll technology. While MGA Entertainment, Inc. is responsible for technical product development, Zapf Creation is closely integrated into all relevant processes.

Groupwide product design was bundled in Roedental and enhanced by the addition of new personnel in connection with the implementation of the strategic cooperation with MGA Entertainment, Inc. The close collaboration between the two companies’ design and marketing departments in Germany, Hong Kong and Los Angeles has resulted in initial synergy effects.

Quality Management

Using proactive measures to ensure that our products satisfy highest quality standards is fundamental to gaining customers’ trust in the Zapf Creation Group. A new team was put in charge of quality management at our Roedental offices in the year just ended. While this team focuses on compliance with national and international laws and regulations, the quality management department in Hong Kong is tasked with implementing these requirements and consistently monitoring compliance by local manufacturers.

MGA Entertainment, Inc. has been responsible for ensuring overall compliance with our strict quality standards since all activities related to procurement and technical product development were transferred to MGA Entertainment (HK) Ltd. in 2007. Close collaboration with our cooperation partner is assured because Zapf Creation maintains own personnel in Hong Kong as well. The Roedental-based quality management department also works closely with the responsible individuals in the Far East in order to ensure overall and timely execution of customer and market requirements in the production process. Switching procurement to MGA Entertainment, Inc. caused the number of claims for defects to increase temporarily in 2007. Zapf Creation and MGA Entertainment, Inc. consequently agreed to several targeted measures related to processes, human resources, and reporting channels with the aim of ensuring that Zapf Creation’s products will satisfy high quality standards in the future as well.

Indeed, Zapf Creation AG has tightened its quality management programs yet again in response to the public debate in 2007 concerning the safety and quality of toys produced in China that was triggered by several competitors' product recalls. There were no fundamental problems in regards to the quality of Zapf Creation's products in 2007.

Compliance with Ethical Standards in both Production and Procurement

The Zapf Creation Group has completely outsourced the production of its play and functional dolls, including accessories, to select suppliers in China. Zapf Creation is committed to a long-term and partnership-based collaboration and to ensuring appropriate working hours and social standards.

High claims to quality, safety, design, and play value are key to absolutely all of the Group's branded play concepts. The Company therefore collaborates solely with suppliers that satisfy these high quality requirements and undertake to comply with uniform social standards.

The Group's business relationships with suppliers have been subject to the Code of Conduct of the International Council of Toy Industries (ICTI) that has been in place since 2002. This Code defines binding social principles and provides a system for independent reviewing of these principles. Suppliers that undertake to abide by this Code are subject to an auditing process that leads to an ICTI certificate issued by the International Toy Association. Sustained compliance with the Code of Conduct is regularly reviewed, by both independent institutes and the staff of the Zapf Creation Group.

As of the end of 2007, about 90% of the Group's suppliers were either ICTI-certified or undergoing the audit process. This means that the Group's product portfolio was manufactured almost entirely in accordance with safe and social work standards. MGA Entertainment, Inc. has ensured Zapf Creation that it will ask non-certified manufacturers in the course of the procurement process to speed up auditing.

Compliance with International Standards and Regulations

The Group's quality specifications define all relevant guidelines, norms, and standards – as well as customer-specific requirements – that apply to its entire product portfolio. This essentially includes:

- EC Directive 88/378/EC (Toy Safety Directive – transposed into German law through the second directive regarding the German Equipment Safety Act – GPSG);
- The series of European EN 71 standards (safety of toys);
- European standard EN 62115 (safety of electric toys);
- EC Directive 2004/108/EC (Electromagnetic Compatibility Directive);
- EC Directive 76/768/EC (Cosmetic Directive);
- EC Directive 2005/84/EC (Directive banning the use of phthalates in toys and childcare articles);
- The Food and Consumers Products Code (LFBG);
- EC Directive 2002/96/EC (Waste Electrical and Electronic Equipment Directive, transposed into German law through the Electrical and Electronic Equipment Act);
- as well as the US toy standard ASTM F963 and other national standards (e.g. AS/NZS ISO 8124).

Shifting Production to Phthalate-free Plasticizers

Under the relevant EU regulation, as of January 14, 2007, toys containing phthalates may no longer be sold in EU member states. The Zapf Creation Group had already shifted its entire product portfolio to phthalate-free plasticizers in 2006.

IV. Events after the Balance Sheet Date

Zapf Creation AG announced on February 28, 2008, that the Management Board had resolved on February 22, 2008, with the approval of the Supervisory Board on February 27, 2008, to convert € 12.9 million of the subordinated shareholder loans into equity by means of a non-cash capital contribution, as planned and previously announced. The Company will issue 4.8 million new shares to this end, fully utilizing authorized capital. The amount in shareholder loans to be contributed per new share is € 2.69.

This non-cash capital increase will further enhance the Company's equity base. As a result, the share capital of Zapf Creation AG will rise from € 13.2 million by € 4.8 million to € 18.0 million. In addition, this measure will help to significantly reduce the Group's future interest expense.

The Roedental warehouse of the French subsidiary of Zapf Creation AG was eliminated completely in connection with the security provided for the new syndicated loan. The existing inventory of goods of Zapf Creation France was sold in its entirety to Zapf Creation AG as of January 31, 2008. The inventory was sold at its net carrying amount.

V. Risk Report

Monitoring, controlling, and analyzing risks is one of the key management tasks of Zapf Creation AG and the Zapf Creation Group.

The Group utilizes a risk management system that was established in accordance with Section 91 para 2 German Stock Corporation Act.

Risk Management System

The Zapf Creation Group has developed parameters for doing business that include the identification, measurement, controlling, and documentation of risks in a risk management system. This system serves to ensure that the Company's decision makers are notified of existing and newly occurring risks, directly and immediately. Zapf Creation AG also uses software that systematically records and analyzes individual risks, the probabilities of their occurring, as well as the potential extent of any resulting damage.

Possible risks are identified on an ongoing basis. Risk analysis is performed monthly under the supervision of a risk management officer. The officer immediately and directly notifies the Management Board of any significant increase in individual risks or even possible threats to the Company from them.

Risks relevant to both the Zapf Creation Group and Zapf Creation AG can be divided into the following categories:

External Risks
- Economic risks
- Industry-specific risks
- Legal risks
- Ethical and environmental risks

Operational Risks
- Procurement risks
- Risks from operational processes

Financial Risks
- Equity risks
- Liquidity and financing risks
- Currency and interest rate risks

Strategic Risks
- Brand image risks
- Sales risks
- Development and quality risks
- Personnel risks

The analysis and representation of risks within the risk management system is not limited to existing risks. For purposes of Group controlling, the risk management system also analyzes and represents opportunities as they arise.

Given the interdependence of individual risks, the risk management system does not entail producing isolated analyses of individual risk types but rather an integrated risk portfolio for the Zapf Creation Group. This portfolio is differentiated according to risks "before countermeasures" and "after countermeasures" and is measured, documented, and communicated to the responsible corporate bodies.

External Risks

Economic Risks
Signs of a looming crisis in the global economy rose considerably in 2007. Evident disruptions in the international capital markets that were triggered by the collapse of the subprime mortgage industry in the US were major factors in this development from mid-2007 onward. The resulting instability of the international financial system intensified fears of a downturn in the global economy but particularly the US economy. Experts' economic forecasts for Europe and Germany at the start of 2008 were also more restrained than they had been just a year ago. Any significant and sustained weakening of the economy in 2008 could also negatively affect general attitudes toward spending, in turn negatively impacting the Zapf Creation Group's ability to sell its products.

Industry-specific Risks
The international toy market largely depends on demographic developments. The overall toy market – particularly in Germany, the Group's core market – has been shrinking due to declining birth rates in recent years. While the Federal Statistical Office expected the birth rate to rise slightly to between 680,000 and 690,000 children in 2007 (the number of births in 2006 was 673,000), this number is still far below the long-term average. Declining population growth could lead, in the medium and long

term, to a substantially reduced demand for play and functional dolls and corresponding declines in sales for the Zapf Creation Group.

In contrast, birth rates in France, Great Britain, Italy and Spain – important toy markets all – are higher than the German average. Measured against population figures, demographic developments in France and Great Britain are particularly positive.

In addition to the negative demographic development, consumer spending patterns have also changed. The number of spontaneous purchases in the low-price segment has risen, evidencing consumers' increased sensitivity to prices. This trend could also negatively impact the sales of the Zapf Creation Group. Moreover, the significance of the Christmas season to the industry continues to grow. Hence an ever increasing portion of sales and earnings is generated in the fourth quarter. Negative developments internal or external to the Zapf Creation Group (such as, for instance, delivery bottlenecks) during this period could trigger an increased risk of corresponding declines in sales and earnings.

The ratio of dolls to other toys will decline in the long term due to new play trends such as electronic toys. In addition, girls tend to develop, i. e. grow up, faster these days, which affects their playing habits. Over time, both of these developments could lead to a decline in purchases of Zapf Creation products.

Notwithstanding these industry-wide developments and the Company's difficulties in recent years, in 2007 the Zapf Creation Group has maintained its leading position in its European core markets (Germany and Great Britain) in the play and functional doll segment. Besides, our broad strategic cooperation with the US toy manufacturer, MGA Entertainment, Inc., which took effect in 2007, has further enhanced our ability to reliably and rapidly identify and assess industry changes in the relevant local markets and initiate suitable measures aimed at minimizing any negative impact on the Zapf Creation Group.

Legal Risks

The international business of the Zapf Creation Group requires the Group to take a multitude of international standards and regulations into consideration and abide by them. Tax rules and regulations in individual countries usually have a direct effect – either positive or negative – on the profit or loss and assets of both Zapf Creation AG and the Group as a whole.

The German Corporate Tax Reform Act that became effective on January 1, 2008, reduces the nominal corporation tax rate from 25 % to 15 %.

The Group's various quality specifications contain binding definitions of all relevant guidelines, norms, and standards – as well as customer-specific requirements – that apply to its entire product portfolio. No legal risks are currently discernible in that regard.

To the best of our knowledge, neither Zapf Creation AG nor any of its subsidiaries are party to any other proceedings before regular courts, arbitral tribunals, or administrative agencies that could have a significant impact on the financial situation of the Zapf Creation Group, and no such proceedings have been threatened. The Company has recognized provisions which are sufficient to cover the extant risks from the legal disputes. The Company is currently involved in one legal dispute that entails a claim of more than € 1 million against it.

Ethical and Environmental Risks

As part of its comprehensive quality management, the Zapf Creation Group accords great significance to compliance with ethical standards in both procurement and production; for more detail, please see the disclosures on quality management in the "quality management" paragraph. Hence the Zapf Creation Group is committed to maintaining strict and ongoing compliance with the ICTI Code of Conduct through which the international toy association works toward getting suppliers to institute reasonable working hours, as well as comply with both social and environmental standards. No material risks to the Zapf Creation Group are discernible in this connection.

Operational Risks

Procurement Risks

As in previous years, all of the goods sold by the Zapf Creation Group were procured and produced in China in 2007. Procurement and production is distributed among several business partners, mostly of long standing. In addition, most of them maintain physically separated manufacturing sites. This limits the risk of losing several suppliers simultaneously.

All procurement and technical product development of the Zapf Creation Group have been bundled at MGA Entertainment (HK) Ltd. since 2007. MGA Entertainment (HK) Ltd. is tasked with ensuring a highly efficient and secure procurement process so that we can manage the worldwide availability of Zapf Creation products via purchasing and shipment. Zapf Creation then cannot directly influence the prices paid to suppliers, and it can no longer select suppliers itself. Zapf Creation would have to completely rebuild and reorganize its procurement system in China within a very short time if the strategic cooperation with MGA Entertainment, Inc. were to be terminated early. Any reorganization of the procurement system that is carried out too quickly and not up to standard could result in declining sales for the Zapf Creation Group.

The transfer of procurement to MGA in 2007 caused delays in product deliveries and, consequently, bottlenecks in the availability of our products in important markets. These delays noticeably affected the Zapf Creation Group's sales and earnings. Clearly defined countermeasures on the part of MGA Entertainment, Inc. will improve compliance with delivery deadlines in 2008.

The specificities of the Chinese environment could give rise to procurement risks, including the ongoing labor shortages in Southern China's Pearl River Delta where 70 % of the world's toys are produced. The cost of both labor and commodities continued to trend higher in 2007 as well, leading to corresponding increases in procurement prices for Zapf Creation. However, the continued decline of the US dollar in 2007 benefits gross profits earned in the euro zone, thus mitigating the cost increases in procurement. Similar trends are discernible for 2008 as well.

The intensifying bottlenecks in China's power supply also constitute a risk. Moreover, the Chinese government has withdrawn the export licenses of about 700 manufacturers in response to the debate regarding the safety of toys produced in China. While none of the manufacturers supplying the Zapf Creation Group were affected by this measure, the subsequent institution of additional controls at the time goods are shipped led in part to considerable delays in Zapf Creation's supply situation as well. We can not preclude that these factors or other circumstances beyond the Company's control might trigger delivery bottlenecks. As a rule, basing all production in a single supplier country does pose a latent risk.

MGA Entertainment, Inc. has decided to transfer the production of the BABY born® dolls to two new manufacturers effective March 2008 with the aim of diversifying its risk and thus to terminate our long-standing collaboration with this brand's sole supplier to date. We can not preclude that this change will have a temporary negative impact on production quality, production processes, and compliance with delivery deadlines. Zapf Creation and MGA Entertainment, Inc. have ensured – through diligent preparations and a targeted set of measures – that any problems arising from the switch to the new suppliers will be minimized to the greatest extent possible, both timewise and in material terms.

The Zapf Creation Group takes advantage of short-term order cycles among its suppliers in order to minimize inventory risks. Significantly lower minimum order amounts tend to generate procurement risks whenever sudden spikes in market demand must be satisfied. But the Group counters this risk through its just-in-time order volume management system.

Nonetheless, supplying the Zapf Creation Group with the goods that have been produced on its behalf requires a substantial amount of time. A total of 12 to 16 weeks can elapse between order placement and availability of the relevant goods on the German market. This basically means that Zapf Creation is unable to respond to short-term, unplanned orders from its business partners. This is all the more true because Zapf Creation has no or only limited influence on production and delivery planning and the scheduling of goods shipments as a result of transferring its procurement activities to MGA Entertainment (HK) Ltd.

Risks from Operational Processes

Several insurance policies – such as, for instance, business interruption insurance, fire insurance, and liability insurance – were purchased to protect the Company from operational disruptions of any kind.

Currently, operational risks are not generating risks that might threaten the Company's existence.

Financial Risks

Equity Risks

The equity situation of the Zapf Creation Group depends substantially on the equity of Zapf Creation AG recognized under German accounting standards and legislation.

The losses incurred from the operating business, as well as from extraordinary effects in the past, directly or indirectly affected the equity of Zapf Creation AG. While the completion of the restructuring in 2007 gave rise to only minor extraordinary charges, the net losses reported by both the Zapf Creation Group and Zapf Creation AG for the year nonetheless undermined both entities' equity base.

Following the capital increase that had already been executed in October 2006, as well as fair value adjustments in the 2006 annual financial statements, the Group's equity was fortified yet again in 2007 through two additional capital increases pursuant to the financing concept that was stipulated in July 2007. The Company's major shareholders also contributed subordinated shareholder loans, resulting in a total infusion of equity and quasi equity of € 30 million.

The Management Board of Zapf Creation AG decided on February 22, 2008, to convert a major portion of the subordinated shareholder loans into equity by way of a non-cash capital increase and to issue new shares for this purpose (also see the section, Events After the Balance Sheet Date, p. 29).

These equity-enhancing measures notwithstanding, the risk remains that additional losses from the Company's operations or from financial risks might lower its equity to such an extent that both a notice of loss pursuant to Section 92 German Stock Corporation Act and corresponding capital measures would be required to restore its equity base to a sufficient level. This would be the case if more than 50 % of the Company's share capital were used up. As of December 31, 2007, Zapf Creation AG had equity of € 16.4 million relative to a share capital of € 13.2 million.

Note, in particular, the following facts and risks in this connection:

Zapf Creation AG's current income stems not just from investment income but especially from its operating business in Central Europe and license income contingent on sales that Zapf Creation receives from its subsidiaries for creating and maintaining both the brands and the corporate name. This means that the development of Zapf Creation AG's equity as recognized under German accounting standards and legislation is contingent, directly and indirectly, on developments in subsidiaries' sales and earnings. There also is the risk, moreover, that the carrying amount of investments in subsidiaries and affiliates recognized in the balance sheet of Zapf Creation AG might also have to be written down. This risk also concerns the recoverability of intercompany loans granted by and between Zapf Creation AG and its subsidiaries. Furthermore, Zapf Creation AG has been receiving income from the cooperation with MGA Entertainment, Inc. since 2007 which also supports its equity base further.

Zapf Creation (France) S.à.r.l. as of December 31, 2007, reported negative equity of € 3.2 million as a result of continued significant losses. There are no control and profit and loss transfer agreements between Zapf Creation AG (the Group parent company) and its subsidiaries pursuant to Section 291 German Stock Corporation Act. Hence the Company is not obligated under Section 302 German Stock Corporation Act to absorb any losses its subsidiaries might incur. However, Zapf Creation AG, in its capacity as the Group's parent company, is required under French law to offset a loss of equity incurred by its French subsidiary, Zapf Creation (France) S.à.r.l., by up to one half of the latter's issued capital. Such obligation commences no later than after the close of the second financial year after the financial year for which the losses were recognized. In December 2007, the Company waived receivables of K€ 344 from Zapf Creation (France) S.à.r.l. to this end and issued a debtor's warrant.

We can not preclude – given the restrained development of this subsidiary's business, which is not expected to improve significantly in the short term – that Zapf Creation AG will have to carry out additional financial support measures for its French subsidiary which, in turn, would weaken its own equity base.

As of December 31, 2007, Zapf Creation AG held 572,678 treasury shares which must be recognized at their market value in accordance with the provisions of the German Commercial Code (HGB). The decline in the value of Zapf Creation's shares in 2007 made a € 3.2 million write-down on its treasury shares necessary. We can not preclude the need for future write-downs on the treasury shares, which would further weaken the Company's equity base.

Liquidity and Financing Risks

The execution in the second half of 2007 of the long-term financing concept dated July 20, 2007, once again placed the Zapf Creation Group on a financial foundation that is sufficient for continuing to develop its operating business in the years to come. A long-term syndicated loan of € 65 million was made available by an international banking syndicate as part of this financing concept. The Company also raised € 30 million in equity through capital increases and subordinated shareholder loans (for details, please see section II, p. 54).

Compliance with the covenants stipulated with the banks is critical to ensuring the Company's financing in the long term. Non-compliance with these covenants due to a dramatic deterioration in the development of its business could trigger financing problems because this would give the banks the right to call their credit lines. In turn, this could put the Company's existence as a going concern at risk.

Zapf Creation AG bears the joint and several risk for all consolidated Group companies' liabilities to banks under the syndicated loan agreement.

Zapf Creation AG has purchased comprehensive insurance from a well-known credit insurance company that covers non-payment risks from receivables in relation to the large majority of our customers. Non-payment risks thus have been minimized.

Currency and Interest Rate Risks

In connection with its operating and financing activities, the Zapf Creation Group is exposed to risks, in particular from fluctuations in foreign exchange and interest rates. The Group's policy is to exclude or limit these risks altogether by concluding hedging transactions. All hedging measures are coordinated and conducted centrally at the Group's parent company. Primarily derivative financial instruments are employed as hedging measures.

Corporate guidelines for the foreign exchange and interest rate hedging policies minimize the risks resulting from the use of financial instruments. These include the separation of the trading, processing, and bookkeeping functions, as well as the voluntary restriction to a small defined group of banks with high creditworthiness and the authorization of only a few qualified employees. All derivatives entered into exclusively serve hedging purposes. (Please also see the detailed presentation in the notes to the consolidated financial statements, section B, item 2.6.4. and in the notes to the financial statements of the parent company, section B, item 12.)

Interest risks were hedged in connection with the repaid syndicated loan. As of December 31, 2007, the Zapf Creation Group held interest rate swaps with a nominal volume of K€ 24,801 (previous year: K€ 36,741); this includes USD-denominated interest rate swaps with a nominal volume of K$ 10,000 (previous year: K$ 8,750). The decline of K€ 11,940 in the nominal volume as of December 31, 2007, as compared to the previous year, results from the expiration (K€ 7,100) and contractually agreed reductions (K€ 4,840) of existing financial instruments in the 2007 financial year.

As part of its new financing concept, Zapf Creation AG has been hedging interest rate risks by means of derivative financial instruments from the 2008 financial year.

As in the previous year, no option transactions were carried out to hedge currency risks in the 2007 financial year.

As part of its new financing concept, Zapf Creation AG has been hedging selected currency risks by means of derivative financial instruments from the 2008 financial year.

Strategic Risks

Brand Image Risks

Protecting the brands of the Zapf Creation Group is indispensable, given that they are one of the Group's key value drivers. Zapf Creation AG repeatedly engages in litigation in order to protect itself from breaches of patents and brands. No significant litigation is pending at the present time. However, the Company has noted that there is a growing number of counterfeit BABY born® products, especially in the emerging markets of Eastern Europe.

Sales Risks

Changes in consumers' spending patterns – a growing sensitivity to prices, restrained spending, and a decline in spontaneous purchasing decisions – have compelled the trade to adapt their ordering policies accordingly. In order to minimize inventory risks, orders for products are being placed as closely as possible to their expected sale date. This impacts the Zapf Creation Group's business because of the ever-increasing flexibility required within narrow time windows. The fact that production and delivery processes are subject to certain lead times (see the disclosures in the section "Procurement Risks") has magnified the risk that orders can not be fulfilled at all, not in full, or not in due time.

All of this has been compounded by a significant change in market structures. Large chains and aggressive discounters have been expanding both their private label product range and their presence in the toy segment. Traditional retail toy stores are faced with declining sales and market share. The market is essentially dominated by major toy chains, branch retailers, as well as purchasing associations, all of which exercise considerable buying power due solely to the sheer volume of their orders with the Company. This, in turn, might undermine prices and the margins Zapf Creation might be able to attain.

Given its tight finances, Zapf Creation is constrained in the amount of money it can spend on marketing activities. Costs of advertising, for instance for TV ads, have continued to rise in 2007, especially in Eastern Europe. The Company might be unable to increase its marketing budgets in order to advertise its products on a sufficient scale if the cost of marketing activities were to rise. This could reduce purchases of Zapf Creation products in these markets.

The Zapf Creation Group initiated a number of measures in recent years with the aim of being able to react flexibly to market changes. Our strategic cooperation with MGA Entertainment, Inc. – which serves to enhance the Group's ability to identify and respond more rapidly to new demand trends – is the key to this flexibility. But the Company also expects this collaboration to reduce the time it takes to develop new products and to stimulate the development of innovative marketing concepts.

Zapf Creation has contractually agreed with the MGA Group not to develop, sell, or otherwise dispose of dolls that the MGA Group would reasonably have to consider to be competing products. This could impede the Zapf Creation Group's product development in the future and possibly lead to a situation where it cannot respond to a new market trend because the new product would compete with products of the MGA Group. Such a development would have a negative impact on the Company's net assets, financial position, and profit or loss.

The success of Zapf Creation is largely based on the recognition enjoyed by its brands. While Zapf Creation has purchased the rights to the BABY born® brand in full, the use of its two other major brands, Baby Annabell® and Rock-A-Bye CHOU CHOU, is based on licensing agreements. We cannot exclude that underlying agreements might be terminated or that Zapf Creation might lose its right to use the brands due to infringement of third-party rights or on other grounds. In turn, this would have a significant negative impact on the Group's business. However, at present there are no indications that any such scenario will come to pass.

Development and Quality Risks

The toy market as a whole and hence the market for play and functional dolls is subject to pressure from customers to innovate. The development department of the Zapf Creation Group responds to this pressure by regularly launching product innovations.

As a supplier, the Zapf Creation Group is always subject to the risk of product defects. The Group's companies are insured against the financial risks of such defects. Nevertheless, it is necessary to improve the Company's quality management system continually to protect the Group from potentially negative repercussions of such defects for its brand image and reputation, which could negatively impact demand and sales.

In the year just ended, some of the Company's competitors had to issue several significant recalls of toys that had been produced in China due to safety concerns and product defects. This ignited an intense public debate on both the safety of toys and China as a location of production critical to the toy industry. Even though the Zapf Creation Group was not directly affected by these product defects, the debate does have the unfortunate consequence of undermining consumers' trust. We can not preclude that additional recalls and a continuation or intensification of this debate will not have a negative impact on the sales and earnings of the Zapf Creation Group.

The quality management of the Zapf Creation Group in Germany is focused on the relevance as well as the practical and strategic ramifications of national and international laws and regulations. Zapf Creation's own experts also participate in the development of relevant standards. Our quality management system in Hong Kong works closely with MGA Entertainment (HK) Ltd., the entity responsible for the Group's entire procurement. It focuses on translating all relevant requirements into practice and on ensuring at all times that local manufacturers comply with applicable standards. In 2007, Zapf Creation further tightened its quality assurance programs that are implemented by the relevant departments in both Germany and Hong Kong in close cooperation with each other.

Personnel Risks

The fundamental restructuring and reorientation of the Zapf Creation Group in the recent past, which entailed significant reductions in personnel, posed substantial challenges for our employees. To some extent, it also required a much greater commitment to the Company on their part. This resulted in a corresponding loss of know-how. Recruiting and developing qualified professionals and executives for the Company and ensuring their loyalty to it thus remains a critical task because not all employees possess the requisite qualifications.

Overall Risks

In addition to the risks described in the "Liquidity and Financing Risks" section, at the present time no risks that might undermine the development of or pose a direct threat, individually or jointly, to the existence of Zapf Creation AG or the Zapf Creation Group are known to the Company or presented in this risk report.

VI. Opportunities

In 2007, the Zapf Creation Group made further progress toward its goal of stopping the erosion of its sales in years past and once again returning to a positive growth trajectory and profitability.

The Management Board believes that the Company has a good chance of leveraging both the continued solidity of its market position and its strategic partnership with MGA Entertainment, Inc. (which has been in effect operationally since 2007) in order to use current industry trends to its advantage and lead the Group back to new growth.

Below an overview of key strategic opportunities:

Internationalization

The Zapf Creation Group will continue the process of internationalizing its business. Particularly the markets in Eastern Europe, but those in Northern Europe too, offer attractive growth potential. Domestic demand for consumer products such as toys is developing in dynamically growing emerging countries such as China or India. This could generate additional sales opportunities for the Zapf Creation Group in the long term. In the short term, however, business in these rising economies is still being hampered by an insufficient commercial infrastructure.

The North, Central and South American markets will once again turn into promising markets for the Group's products as a result of its strategic partnership with MGA Entertainment, Inc.

Product Innovation

In the past, the Zapf Creation Group was able to detect trends in the market for play and functional dolls early on and rapidly translated them into product innovations, especially in regards to functional dolls and accessories. Innovations are critical to kindling the interest of both the trade and customers in the Company's products.

The creative give and take with MGA Entertainment, Inc. offers additional possibilities for product design, as well as the opportunity to reduce development cycles and hence to bring new products and ideas to market at a more rapid pace.

Brand Strength

Zapf Creation's products – BABY born®, Baby Annabell®, and CHOU CHOU – are established brands with a positive image. Fortunately, the Company's difficulties in recent years did not damage these brands. Insofar as it helps to stabilize and possibly even expand the Group's market position, brand strength does offer an important competitive advantage in partly saturated European markets. A study published in March 2006 by NPD / Eurotoys shows that the Company's target group continues to enjoy playing with dolls and that mothers view such play as supporting their child's development in meaningful ways.

Optimizing Operational Processes

Both the far-reaching measures aimed at restructuring the Group and the implementation of its collaboration with MGA Entertainment, Inc. have once again given Zapf Creation streamlined and efficient structures in all areas that are appropriate to the Group's size. The sales organizations in all countries have been adjusted to the needs of the relevant market and restructured as necessary. With the exception of France, the Group now maintains conventional sales structures with key account managers and its own field staff in all markets where it has a subsidiary. The marketing department was also restructured in line with the needs of each individual brand and re-staffed in some cases.

Increased efficiency coupled with a line-up that is more in tune with market demands give Zapf Creation an opportunity to react more rapidly to market requirements and thus to become more competitive.

Opening up New Distribution Channels

In order to be able to supply its target markets comprehensively with its entire product portfolio, the Zapf Creation Group must establish new distribution channels and successfully manage customer relationships with its key accounts.

New sales potential can be derived especially from the mutual distribution cooperation between the Company and MGA Entertainment, Inc. This cooperation has already triggered a significant increase in sales of Zapf Creation products in the Americas in 2007. Zapf Creation AG benefits from these sales made by MGA Entertainment, Inc. in the form of royalties.

Launching the Licensing Business

The cooperation with MGA Entertainment, Inc. offers Zapf Creation the opportunity to utilize the Company's brands for products outside the framework of the traditional toy market. This is the reason why MGA Entertainment, Inc. has been allowed to grant licenses to third parties. The first licensed products were available in stores during the 2007 Christmas business. At the Nuremberg Toy Fair in February 2008, the Group presented its range of new licensed products. The licensing business will permit the Zapf Creation Group to expand its product range and gain access to new target groups without exposing itself to the risk of working these markets on its own.

VII. Anticipated Developments

Macroeconomic Prospects

At the start of 2008, the prospects for the future of the global economy have darkened, not least due to the ongoing turmoil in the international financial markets. The signs of a looming recession are growing, especially in the US. According to the experts, the countries in the euro zone will not be able to delink themselves entirely from an economic downturn in the United States even though the macroeconomic environment in Europe is still considered positive and stable. At the end of January, the German government reduced its forecast for German GDP growth in 2008 from 2.0 % to 1.7 % based on a rise in consumer spending but a substantial reduction in capital investments.

Sources: Association of German Banks, Economic Report, February 2008; Press Release of the German government dated January 23, 2008

Expected Industry Climate

Based on the data available to the Company, the Management Board expects the decline in Western European toy markets as a whole to continue in the next years. Competition will remain fierce, given that market share can only be gained by eliminating competitors. Innovative products and play concepts, rapid and efficient development, procurement, and sales processes, as well as creative marketing are key to any success in this environment.

While Eastern Europe and Russia continue to offer opportunities for growth, the high growth rates in recent years can not just be projected into the future.

Absent adequate sales structures, new markets such as China or India will provide an attractive market volume only in the medium term.

Strategic Focus

Our main goal in 2008 and 2009 will be to return the Zapf Creation Group to profitable growth based on a substantially reduced and competitive cost base and a clear focus on its core expertise – development, sales and distribution, and marketing.

Our broad collaboration with MGA Entertainment, Inc. in a variety of areas will bear fruit for the first time in 2008 if all goes as planned. This requires overcoming initial difficulties in the coordination of processes and responsibilities between the two companies. We will focus especially on ensuring that Zapf Creation's products are always available in sufficient quantities pursuant to market needs.

The Zapf Creation Group will present several product innovations in 2008 as well:
- The market launch of a new and innovative BABY born® doll is planned for the third quarter.
- The BABY born® "Horse & Princess" series that involves carriage rides or horseback riding in the park for these princesses and princes will be continued in new variations.
- The "Mommy, I can swim" doll in the My little BABY born® line, which has been available in the German market since December 2007, will be enhanced by an innovative twin concept.
- The range of accessories for Baby Annabell® will be expanded.
- We will build on the excellent market response to the "Mommy, make me better" CHOU CHOU doll by launching a successor product.

Plans are to promote the sales of our product innovations through meaningful advertising and marketing approaches, including ten television campaigns and eight print campaigns in Germany, Austria, and Switzerland.

Zapf Creation will also enhance its licensing business in 2008 based on branded non-toy products for children that will bear the logo of Zapf Creation. Over the medium term, in addition to sales reported by the Group, the expansion of the licensing business will also see an increasing importance of brand sales which, in addition to consolidated revenue, also include revenue from licensed products billed by licensees.

The strategic forecasts for Zapf Creation AG are identical to the ones for the Group.

Forecast

Forecast for the Zapf Creation Group

The Management Board's view of the 2008 financial year is cautiously optimistic.
Its assessment is based on

- economic conditions that are still positive;
- the efficiency gains achieved by the Group;
- numerous product innovations in 2008;
- the expected increase in the earnings contribution from the strategic cooperation with MGA Entertainment, Inc.; and on
- the fact that our operations have once again been placed on a solid financial foundation.

The Management Board has set the following goals for the Group under these conditions:

- growth turnaround in consolidated sales;
- further improvements in consolidated EBIT; and
- return to profitability of consolidated after-tax earnings.

This would permit the Zapf Creation Group to finally achieve the earnings turnaround in 2008. The Management Board believes that it will be possible to solidify the upward trend in both sales and earnings in 2009, provided no significant deterioration in both economic and industry-specific parameters occurs and absent unforeseen negative events that would have a major impact on the Group.

Forecast for Zapf Creation AG

The Management Board also expects the sales and earnings of Zapf Creation AG to improve in 2008 if the Group's operations develop as described above and if royalties from the cooperation with MGA Entertainment, Inc. continue to rise.

VIII. Other

Disclosures under Section 289 Para 4 and Section 315 Para 4 German Commercial Code

The Company's share capital as of December 31, 2007 was € 13,200,000.00 (previous year: € 8,799,998.00). It is divided into 13,200,000 (previous year: 8,799,998) bearer shares of no par value. As in the previous years, all shares issued have been fully paid up as of the balance sheet date.

Authorized Capital I

The Management Board of Zapf Creation AG is authorized, subject to the approval of the Supervisory Board, to increase the Company's share capital, on one or more occasions, until (and including) May 6, 2008, by issuing new shares without par value in exchange for contributions in cash or in kind, in a total amount not to exceed € 4,000,000.00 (Authorized Capital I).

The increase in the Company's issued capital by issuing 4,000,000 new shares from Authorized Capital I was initiated on September 28, 2006; the first stage of this capital increase in the amount of € 799,998.00 involving the issuance of 779,998 new shares at a price of € 7.45 per share was completed once it had been recorded in the Commercial Register on October 19, 2006.

The second stage of the capital increase from Authorized Capital I in the amount of € 3,200,002 was executed by issuing 3,200,002 new shares pursuant to the resolution of the Management Board on October 2, 2007, with the approval of the Supervisory Board on October 7, 2007; it was recorded in the Commercial Register on October 31, 2007. This capital increase was subject to shareholders' subscription right. The new shares fully participate in profits as of the 2007 financial year; the subscription right that was granted at a ratio of 13:5 relative to the subscription price of € 3.16 per share applied to all shareholders.

Following the complete utilization of Authorized Capital I, the Company's issued capital as of October 31, 2007, was € 12,000,000.00, denominated in 12,000,000 no-par bearer shares.

Authorized Capital 2007

Article 5 of the Articles of Incorporation of Zapf Creation AG authorizes the following options for executing capital measures once Authorized Capital I has been utilized in full, given the resolution of the Annual Shareholders' Meeting on November 20, 2007:

The Management Board is authorized, subject to the approval of the Supervisory Board, to increase the Company's share capital until November 19, 2012, once or repeatedly, by up to € 6,000,000.00 in return for cash or in-kind contributions by issuing new no-par bearer shares (Authorized Capital 2007).

The Management Board is also authorized, subject to the approval of the Supervisory Board, to exclude shareholders' statutory subscription right in the following cases:

a) In connection with fractional shares;

b) If the capital increase is executed in return for cash contributions and if the pro rata amount of the share capital allocable to the new shares in regards to which shareholders' subscription right has been excluded does not exceed the lesser of [1] € 1,200,000.00 or [2] 10 % of the Company's share capital extant at the time the new shares are issued and if the issue price for the new shares is not substantially lower – in the sense of Section 203 paras 1 and 2 and Section 186 para 3 sentence 4 German Stock Corporation Act – than the exchange price of previously listed shares of the same class at the time the Management Board finally fixes the issue price; the authorized volume is reduced by the pro rata amount of the share capital allocable to those shares that are issued or sold starting on November 20, 2007, subject to the exclusion of shareholders' subscription right, in connection with the direct or analogous application of Section 186 para 3 sentence 4 German Stock Corporation Act;

c) In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in connection with the acquisition of companies, business units, or stakes in companies; or;

d) In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in return for the transfer to the Company of loan and/or interest receivables from the Company under loans granted to it.

The Management Board is authorized, subject to the approval of the Supervisory Board, to determine additional details pertaining to the execution of the capital increases under Authorized Capital 2007. The Supervisory Board is authorized to amend the Articles of Incorporation subsequent to the full or partial execution of such capital increase under Authorized Capital 2007 or following the expiration of the authorization deadline in accordance with the scope of the capital increase under Authorized Capital 2007.

Participation of new shares in the Company's profit may be determined in derogation of Section 60 para 2 German Stock Corporation Act.

By resolution of the Management Board on November 26, 2007, and with the approval of the Supervisory Board on November 27, 2007, the issued capital of Zapf Creation AG was increased in the 2007 financial year by an additional 1,200,000 new shares from new capital authorized by the Annual Shareholders' Meeting on November 20, 2007 (Authorized Capital 2007) pursuant to Article 5 para 1a of the Company's Articles of Incorporation, subject to the exclusion of shareholders' subscription right. The issue price for the new shares was € 3.10, and the capital increase was recorded in the Commercial Register on December 10, 2007.

Contingent Capital I, II, and III

The contingent capital increase adopted by the Annual Shareholders' Meeting on April 26, 2000 (Contingent Capital I), the contingent capital increase adopted by the Annual Shareholders' Meeting on July 31, 2001 (Contingent Capital II), and the contingent capital increase adopted by the Annual Shareholders' Meeting on May 7, 2003 (Contingent Capital III) were rescinded in full by the Annual Shareholders' Meeting on November 20, 2007.

Zapf Creation AG was notified of an equity interest that exceeds 10 % of all voting rights. As of December 31, 2007, 33.45 % of the voting shares were attributable to MGA Entertainment, Inc., Van Nuys, California, USA, in accordance with Section 22 para 2 German Securities Trading Act (Wertpapierhandelsgesetz – WpHG); this corresponds to 4,414,843 voting shares. Furthermore, as of December 31, 2007, 12.56 % of the voting shares were attributable to Mr. Nicolas Mathys; this corresponds to 1,658,637 voting shares.

The nomination of Management Board members is governed by Sections 84 and 85 et seq. German Stock Corporation Act; amendments to the Company's Articles of Incorporation are subject to Section 133 and 179 et seq. German Stock Corporation Act.

Regarding important agreements with related companies such as MGA Entertainment, Inc., the employment contract concluded with a Management Board member contains a change of control provision that stipulates special termination rights in the event of a significant change in the Company's shareholder structure.

Report of the Management Board on Relations with Affiliates

In its report on relations with affiliates in the 2007 financial year in accordance with Section 312 German Stock Corporation Act, the Management Board has issued the following statement:

"We declare that our Company was paid appropriate consideration in connection with the legal transactions and measures described in this report on relations with affiliates, given the circumstances known to us at the time the relevant legal transactions or measures were executed or omitted, and that the execution or omission of any such measures did not cause the Company to suffer any disadvantage."

Roedental, Germany, February 28, 2008

Jens U. Keil Member of the Management Board	Thomas Pfau Member of the Management Board

Consolidated Financial Statements of Zapf Creation

Consolidated Income Statement of Zapf Creation

for the Financial Year from January 1 to December 31, 2007

	Note Section	2007 K€	2006 K€
Revenue	B no. 1.1.	110,457	116,106
Cost of sales	B no. 1.2.	–62,149	–63,348
Gross profit		**48,308**	**52,758**
Selling and distribution expenses	B no. 1.3.	–14,250	–14,768
Marketing expenses	B no. 1.4.	–14,423	–15,878
Administrative expenses	B no. 1.5.	–17,137	–23,573
Other income	B no. 1.6.	4,686	1,524
Other expenses	B no. 1.7.	–1,504	–559
Operating result		**5,680**	**–496**
(Restructuring costs included therein	*B no. 1.8.*	*–645*	*–3,357)*
(One-off costs, mainly consultancy, included therein	*B no. 1.8.*	*280*	*–2,576)*
(Adjusted operating result derived therefrom		***6,045***	***5,437)***
Finance income	B no. 1.9.	863	655
Finance costs	B no. 1.9.	–4,393	–6,961
Result from continued operations before income taxes		**2,150**	**–6,802**
Income taxes	B no. 1.10.	–4,799	276
Result from continued operations		**–2,649**	**–6,526**
Result from discontinued operations before income taxes	B no. 1.11.	–147	–6,093
Income taxes on discontinued operations	B no. 1.10.	48	–54
Net profit or loss for the period		–2,748	–12,673
Earnings per share (basic/diluted)	B no. 1.12.	–0.31 €	–1.67 €
Earnings per share, continued operations	B no. 1.12.	–0.30 €	–0.86 €
Earnings per share, discontinued operations	B no. 1.12.	–0.01 €	–0.81 €
Average number of shares outstanding, in thousands	B no. 1.12.	8,840	7,586

The included notes are an integral part of the consolidated financial statements.

Consolidated Balance Sheet of Zapf Creation

as of December 31, 2007

	Note Section	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Assets			
Current assets		95,589	89,300
Cash	B no. 2.1.1.	23,282	11,710
Trade receivables	B no. 2.1.2.	49,904	57,375
Inventories	B no. 2.1.3.	13,473	12,663
Income tax receivables	B no. 2.1.4.	341	3,824
Other assets	B no. 2.1.5.	8,589	3,728
Non-current assets		19,548	26,260
Property, plant and equipment	B no. 2.2.1.	15,883	17,475
Intangible assets	B no. 2.2.2.	3,545	4,785
Other assets	B no. 2.2.3.	10	20
Deferred tax assets	B no. 2.2.4.	110	3,980
Total assets		115,137	115,560

The included notes are an integral part of the consolidated financial statements.

	Note Section	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Equity and liabilities			
Current liabilities		**67,242**	**111,806**
Liabilities to banks	B no. 2.3.1.	5,874	65,055
Trade payables	B no. 2.3.2.	37,686	35,616
Income tax liabilities	B no. 2.3.3.	701	1,718
Other liabilities	B no. 2.3.4.	19,394	3,044
Provisions	B no. 2.3.5.	3,587	6,373
Non-current liabilities		**33,465**	**176**
Liabilities to banks	B no. 2.4.1.	33,381	0
Deferred tax liabilities	B no. 2.4.2.	84	176
Equity		**14,430**	**3,578**
Issued capital	B no. 2.5.1.	13,200	8,800
Capital reserves	B no. 2.5.2.	21,703	12,961
Net profit or loss for the period and profit or loss carried forward	B no. 2.5.3.	−9,857	−7,109
Other recognized income and expense	B no. 2.5.4.	742	284
Treasury shares	B no. 2.5.5.	−11,358	−11,358
Total equity and liabilities		**115,137**	**115,560**

Consolidated Statement of Changes in Equity of Zapf Creation

for the Financial Year from January 1 to December 31, 2007

	Shares outstanding thsds	Issued capital K€	Capital reserves K€
Balance at January 1, 2006:	7,427	8,000	8,052
Net profit or loss for the period			
Change in other recognized income and expense			
Total net income or loss for the period			
Issuance of treasury shares	800	800	4,909
Balance at December 31, 2006:	8,227	8,800	12,961
Balance at January 1, 2007:	8,227	8,800	12,961
Net profit or loss for the period			
Change in other recognized income and expense			
Total net income or loss for the period			
Issuance of treasury shares	4,400	4,400	8,742
Balance at December 31, 2007:	12,627	13,200	21,703

The notes are an integral part of the consolidated financial statements.

Net profit or loss for the period and retained earnings brought forward	Other recognized income and expense: Adjustments from currency translation	Other recognized income and expense: Derivative financial instruments	Treasury shares	Total equity
K€	K€	K€	K€	K€
5,564	−66	47	−11,358	10,239
−12,673				−12,673
	350	−47		303
−12,673	350	−47		−12,370
				5,709
−7,109	284	0	−11,358	3,578
−7,109	284	0	−11,358	3,578
−2,748				−2,748
	458	0		458
−2,748	458	0		−2,290
				13,142
−9,857	742	0	−11,358	14,430

Consolidated Cash Flow Statement of Zapf Creation

for the Financial Year from January 1 to December 31, 2007

	2007 K€	2006 K€
Cash flow from operating activities:		
Earnings before income taxes	2,003	−12,895
Depreciation of non-current assets	4,107	5,335
Losses/gains from the disposal of non-current assets	90	357
Finance costs/income	3,801	8,050
Other non-cash income/expenses	15	367
Increase/decrease in assets and liabilities:		
Trade receivables	4,021	10,751
Inventories	−2,828	4,324
Other assets	−4,925	1,327
Liabilities and provisions	21,020	3,133
Income tax payments	1,500	−448
Cash flow from operating activities	28,804	20,301
Cash flow from investing activities:		
Cash receipts from sales of property, plant and equipment and intangible assets	231	308
Cash payments for investments in property, plant and equipment and intangible assets	−1,692	−1,823
Cash flow from investing activities	−1,461	−1,515
Cash flow from financing activities:		
Cash receipts from non-current bank borrowings	40,000	0
Cash payments for non-current bank borrowings	−996	0
Cash payments for the repayment of non-current bank borrowings	−21,060	−6,400
Change in liabilities due to current borrowings	−42,751	−10,871
Interest paid	−4,358	−5,484
Interest received	803	488
Cash receipts from the issuance of treasury shares	13,367	5,933
Cash flow from financing activities	−14,995	−16,334
Effects of exchange rate changes	−776	−95
Net change in cash and cash equivalents	11,572	2,357
Cash and cash equivalents at the beginning of the period	11,710	9,353
Cash and cash equivalents at the end of the period	23,282	11,710

Please also see the disclosures in the notes (Section B no. 3.). The included notes are an integral part of the consolidated financial statements.

A. General Disclosures Regarding the Consolidated Financial Statements of Zapf Creation

1. Nature of the Business

Zapf Creation AG – hereinafter also referred to as "the Company" or "Zapf Creation" is Europe's leading brand manufacturer of play and functional dolls including accessories.

The Company markets branded play concepts that consist of a doll and a world of matching accessories that are developed to a high standard of quality, design, safety and play value. The Company's most popular brands include BABY born®, Baby Annabell® and CHOU CHOU. These globally successful play concepts have been conceived particularly for the Company's core target group – girls between three and eight years of age.

All these branded toys have in common the highest standards of design, quality, safety and play value. In designing doll accessories and clothes, Zapf Creation takes its lead from trends in children's fashions and general lifestyle products and incorporates them into new products. The dolls' bodies conceal cutting-edge and creatively applied technology. The branded play concepts of Zapf Creation place no limits on a girl's imagination. Playing with dolls also addresses and supports social skill such as loving, caring, empathy and accepting responsibility.

Zapf Creation AG, as the Company is currently known, was originally established in 1932 by Max Zapf and his wife Rosa in Roedental, Germany as "Max Zapf Puppen- und Spielwarenfabrik". The Company went public on April 26, 1999. Zapf Creation AG is listed on the Official Market of the Frankfurt Stock Exchange. Its shares are traded in the Prime Standard segment.

Zapf Creation AG is headquartered in Moenchroedener Strasse 13, 96472 Roedental, Germany.

2. Accounting Policies

2.1. Overview

2.1.1. General

These consolidated financial statements of Zapf Creation AG were prepared in accordance with Section 315 a German Commercial Code ("Consolidated Financial Statements According to International Accounting Principles") and in compliance with both the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) and the relevant interpretations of the International Financial Reporting Interpretations Committee (IFRIC) – all of them as applicable within the European Union under Article 4 of EC Directive 1606/2002 dated July 19, 2002, of the European Parliament and the European Council.

The provisions of Section 315 a para 1 German Commercial Code were also observed in preparing the consolidated financial statements. Please see Section C, item 5. for the disclosures required under Section 315 a German Commercial Code.

All IFRS, as well as all attendant interpretations, applicable to the financial year just ended were used in the preparation of the consolidated financial statements of Zapf Creation AG as of December 31, 2007, inasmuch as they were adopted by the EU.

The following standards and interpretations were applied for the first time in the 2007 financial year to the extent that they are of significance for the business activities of Zapf Creation AG and the Group's consolidated subsidiaries:

- IAS 1 ("Presentation of Financial Statements"); specifically: Capital Disclosures
- IFRS 7 ("Financial Instruments: Disclosures")
- IFRIC 8 ("Scope of IFRS 2")
- IFRIC 9 ("Reassessment of Embedded Derivatives")
- IFRIC 10 ("Interim Financial Reporting and Impairment")

The initial application of the above standards and interpretations has resulted in extended disclosures in parts of the consolidated financial statements of Zapf Creation AG.

With the exception of certain financial instruments that are reported using fair values, the consolidated financial statements of Zapf Creation AG were drawn up based on historical costs.

The euro (€) is the reporting currency because it is the currency used in the great majority of the Group's financial transactions. Unless otherwise indicated, all amounts are stated in thousands of euros (K€). Deviations from amounts that have not been rounded up or down may occur.

The Management Board of Zapf Creation AG released the consolidated financial statements as of December 31, 2007, to the Supervisory Board on February 28, 2008. The Supervisory Board is tasked with reviewing the consolidated financial statements and declaring whether or not it approves them.

2.1.2. Published Standards, Interpretations and Amendments Not Yet Applied

As outlined below, the IASB (International Accounting Standards Board) and the IFRIC (International Financial Reporting Interpretations Committee) have published standards, interpretations, and amendments of existing standards and interpretations that are not yet subject to mandatory application. There has been no voluntary early application of these requirements on the part of the Zapf Creation Group:

IFRS 8 ("Operating Segments") was published in November 2006. The European Union adopted IFRS 8 in November 2007. Its mandatory application for financial years beginning on or after January 1, 2009, is planned. Earlier application is permitted. IFRS 8 entails changes with regard to the identification of segments in segment reporting. This standard completes the shift from a risk and reward approach to a management approach, which also entails shifting from a financial accounting approach to a management approach in the measurement of segments. Initial application of IFRS 8 will not have any substantial effects on future consolidated financial statements of the Zapf Creation Group.

On September 6, 2007, the IASB published an amended version of IAS 1 ("Presentation of Financial Statements: A Revised Presentation"). Application of the revised standard is mandatory for financial years beginning on or after January 1, 2009; it has not yet been endorsed by the European Union. The basic objective of the revision is to improve the ability of users of financial statements to analyze and compare the data provided. This is intended to separate changes in equity resulting from transactions with shareholders (in their capacity as owners) from other changes in equity. Possible effects on the consolidated financial statements of the Zapf Creation Group are currently being examined.

In March 2007, the IASB published a revision of IAS 23 ("Borrowing Costs"). Application of this amended standard is mandatory for financial years beginning on January 1, 2009. The current option to expense borrowing costs (benchmark treatment) or to capitalize them if they are directly attributable to the acquisition, construction, or production of a qualifying asset (alternative treatment) will be replaced by the obligation to capitalize interest on borrowings. This also entailed adopting a narrower definition of the qualifying asset. The application of the revised standard will not have any material effects on the consolidated financial statements of the Zapf Creation Group in the future.

IFRIC 11 ("IFRS 2 – Group and Treasury Share Transactions") addresses the accounting of group-wide share-based compensation and clarifies both questions related to personnel turnover within the Group and how to treat share-based compensation when the company issues treasury shares or must purchase stock from third parties. This interpretation was published in late 2006 and must be applied to financial years beginning on or after March 1, 2007. Earlier application is recommended. The EU adopted IFRIC 11 in June 2007. According to the knowledge currently available to us, application of IFRIC 11 will not have any effect on future consolidated financial statements of the Zapf Creation Group.

IFRIC 12 ("Service Concession Arrangements") was published at the end of 2006. This interpretation focuses on the treatment of infrastructure services by private companies. IFRIC 12 provides for mandatory application of its rules to financial years beginning on or after January 1, 2008. Earlier application of this interpretation is permitted but it has not yet been adopted by the European Union. Currently, we do not expect initial application of IFRIC 12 to have any consequences for future consolidated financial statements of the Zapf Creation Group.

In June 2007, the IASB published IFRIC 13 ("Customer Loyalty Programmes"). This interpretation addresses accounting of customer loyalty programs operated by manufacturers or service providers, or by third parties. IFRIC 13 must be applied to financial years beginning on or after July 1, 2008. The EU has not yet adopted this interpretation. Possible effects on the consolidated financial statements of the Zapf Creation Group are currently being examined.

In July 2007, the IASB published IFRIC 14 ("The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction"). This interpretation essentially addresses the interaction between the requirement as of a balance sheet date to pay additional amounts into a pension plan and the relevant provisions of IAS 19 regarding the maximum positive balance between plan assets and a defined-benefit obligation. Application of this IFRIC 14 is mandatory for financial years beginning on or after January 1, 2008. IFRIC 14 has not yet been adopted by the European Union. Initial application of IFRIC 14 is not expected to have any effects on the consolidated financial statements of the Zapf Creation Group.

2.2. Consolidation

2.2.1. General

The consolidated financial statements of Zapf Creation AG are prepared based on IFRS accounting methods in accordance with the following consolidation principles.

The financial statements of the companies included in the consolidated financial statements are prepared using uniform accounting principles.

In accordance with the control concept, the consolidated financial statements include all companies which are directly or indirectly controlled by Zapf Creation AG, the Group's parent company. Control exists when the parent company has the possibility to determine a company's financial and business policy with the aim of deriving a benefit from this.

The financial year of Zapf Creation AG and its subsidiaries included in the consolidated financial statements corresponds to the calendar year.

2.2.2. Basis of Consolidation

In addition to Zapf Creation AG, the Group's parent company, all direct and indirect subsidiaries of the Group are included in the consolidated financial statements. With the exception of Zapf Creation (U.K.) Ltd., Corby, Northants, Great Britain, and Zapf Creation (España) S.L., Madrid, Spain, Zapf Creation AG directly holds a 100 % stake in all of its subsidiaries. Since September 2006, Zapf Creation AG has held its shares in these two subsidiaries in Great Britain and Spain through its subsidiary Zapf Creation Auslandsholding GmbH, Roedental, Germany. Zapf Creation AG holds a 100 % stake in Zapf Creation Auslandsholding GmbH, which in turn holds a 100 % stake in each of the two sales subsidiaries mentioned above.

An overview of the subsidiaries affiliated with Zapf Creation AG is presented in the table attached to these notes as Appendix 1.

The following table shows changes in the group of consolidated subsidiaries in the reporting period:

	Domestic	Abroad	Total
December 31, 2006	5	7	12
Disposals in the 2007 financial year	1	0	1
Additions in the 2007 financial year	0	0	0
December 31, 2007	4	7	11

As of December 31, 2006, the Group subsidiary, Zapf Creation (Central Europe) GmbH & Co. KG, was reintegrated into the Group's parent company, Zapf Creation AG, by means of accrual. Zapf Creation AG has been directly responsible for carrying out the activities of Zapf Creation (Central Europe) GmbH & Co. KG effective January 1, 2007. In contrast to December 31, 2006, the Group subsidiary, Zapf Creation (Central Europe) GmbH & Co. KG, is no longer included in the group of consolidated companies as of the balance sheet date.

The Group subsidiary, Zapf Creation (U.S.) Inc., discontinued operations as of December 31, 2006. MGA Entertainment, Inc., Van Nuys, California, USA, alone has been in charge of the entire American market via a strategic partnership effective January 1, 2007. However, Zapf Creation (U.S.) Inc. was still treated as a consolidated company as of the balance sheet date. The treatment of the discontinuation of the activities of the Group subsidiary, Zapf Creation (U.S.) Inc., is subject to IFRS 5 ("Non-current Assets Held for Sale and Discontinued Operations"). Because the Group initiated key restructuring steps in 2006, in the consolidated financial statements for the 2006 financial year, the "Americas" segment already had to be treated as a "discontinued operation" pursuant to the definition in IFRS 5.

In September 2006, Zapf Creation Auslandsholding GmbH, Roedental, Germany, was included in the consolidated financial statements for the first time. The company has therefore been included in the comparative figures for the previous year only from that time on.

The Group subsidiary Zapf Creation (CZ) s.r.o., Prague, Czech Republic, was included in the previous year's comparative figures until June 30, 2006, since its deletion from the Commercial Register became effective in June 2006 and it was therefore deconsolidated as of June 30, 2006.

2.2.3. Consolidation Methods

All companies are fully consolidated.

The financial statements of each subsidiary are included in the consolidated financial statements of Zapf Creation under the purchase method by offsetting acquisition costs against pro-rated, newly measured equity as of the respective purchase date.

Loans, receivables and liabilities between the consolidated companies are offset in the course of debt consolidation.

Revenue generated with affiliated companies and other intra-Group income is offset against the respective expenses during expense and income consolidation.

Intercompany profits and losses are eliminated.

The euro (€) is the reporting currency.

Currency translation within the Zapf Creation Group is executed in accordance with the functional currency method. The Group's functional currency also is its reporting currency.

Any transaction in a foreign currency is initially accounted for in the functional currency by translating it at the exchange rate on the transaction date. During subsequent measurement, assets and liabilities linked to foreign currencies are translated into the reporting currency at end of period exchange rates, and differences for currency translation are recognized in the income statement.

Gains and losses from currency translation are reported in the consolidated income statement under the expense and income items under which the transaction triggering the exchange rate effect is subsumed.

The financial statements for the foreign subsidiaries that are included in the consolidated financial statements but whose functional currency is not the euro are translated from their respective functional currency (local currency) into the Group's functional currency, i. e. into euros. Assets and liabilities are translated at the applicable end of period exchange rate while income and expense items are translated at average exchange rates during the reporting period. All differences from currency translation are recognized directly in equity.

Currency translation differences arising from consolidation are recognized directly in equity.

The exchange rates for the currencies relevant to the Zapf Creation Group have changed as shown below (one foreign currency unit = x euro units [€]):

Consolidation as of December 31, 2007:

	USD	HKD	GBP	PLN
Closing rate as of Dec. 31, 2007	0.6793	0.0871	1.3596	0.2786
Average exchange rate from Jan. 1 to Dec. 31, 2007	0.7308	0.0937	1.4621	0.2653
Historical average exchange rate	0.9306	0.1132	1.5330	0.2508

Consolidation as of December 31, 2006:

	USD	HKD	GBP	PLN
Closing rate as of Dec. 31, 2006	0.7582	0.0978	1.4908	0.2608
Average exchange rate from Jan. 1 to Dec. 31, 2006	0.7970	0.1026	1.4673	0.2575
Historical average exchange rate	0.9388	0.1137	1.5336	0.2452

2.3. Accounting Principles

2.3.1. Revenue Recognition

IAS 18 ("Revenue") prescribes the accounting treatment of revenue arising from the sale of goods, the rendering of services, and the use by others of enterprise assets yielding interest, rent or other royalties. The Company recognizes revenue and other income in accordance with IAS 18 ("Revenue") at the time the services are rendered or the goods are delivered, significant risks and rewards of ownership have been transferred to the customer, and the amount of the realizable revenue can be measured reliably.

Interest income is recognized on a pro rata temporis basis, taking both the unpaid principal and the applicable interest rate into account.

2.3.2. Research and Development

Development expenses are capitalized as internally generated intangible assets if the applicable requirements of IAS 38 ("Intangible Assets") have been satisfied cumulatively. These requirements include the technical feasibility of production, the intended completion and realization of the project, as well as evidence that the outcome of the project is suitable for the Company's own use or for sale as an asset. In addition, both the future economic benefits flowing from the project and the availability of the resources needed to complete the project must also be shown. Finally, development expenses may be capitalized only if the costs allocable to the intangible asset in question during the development phase can be measured reliably. Capitalized development expenses related to a completed project are recognized at cost less cumulative amortization. If a project has not yet been completed, the capitalized amounts are subject to an annual impairment test unless there are indications of an impairment at other times.

Development expenses are recognized as an expense in the income statement analogous to research expenses if the requirements of IAS 38 have not been met.

2.3.3. Defined Contribution Plans

The Zapf Creation Group's reinsured pension plan must be classified as a defined contribution plan pursuant to IAS 19. Mandatory contributions thus are recognized as an expense and offset directly against the corresponding liability.

2.3.4. Adjusted Operating Income

In addition to reporting its operating income, the Zapf Creation Group also reports "adjusted operating income" in its consolidated income statement.

The "adjusted operating income" is based on the Group's internal key performance indicators and adjusts the Group's operating income by the restructuring expenses and one-off items shown in the income statement. Reporting this accounting parameter in the consolidated income statement serves to increase transparency in terms of the sustainability of the income the Company achieves from its current operating processes.

2.3.5. Taxes on Income

Income tax expenses include both current and deferred income taxes. In accordance with IFRS 5, income taxes related to operations not to be continued are reported in the income statement as income taxes on operations not to be continued.

Current income taxes are determined based on the respective national tax regulations.

Deferred income taxes are recognized using the liability method for all temporary differences between the amounts of assets and liabilities recognized in the consolidated financial statements and the amounts recognized in tax accounts. Deferred tax assets on taxable loss carryforwards are also taken into account. Deferred taxes are measured on the basis of all tax regulations applicable or enacted as of the closing date.

Deferred tax assets from deductible temporary differences and from tax loss carryforwards, the total of which exceeds the deferred tax liabilities from taxable temporary differences, are recognized only to the extent that it can be assumed with sufficient probability that the respective company of the Zapf Creation Group will generate sufficient taxable income in the future to realize the corresponding benefit.

Deferred tax assets and deferred tax liabilities are offset before recognition if they pertain to the same taxation authority. Deferred tax items are not discounted.

2.3.6. Earnings per Share

Basic earnings per share are calculated by dividing the net annual result available to shareholders by the weighted average of all shares outstanding; changes in the number of shares outstanding are considered on a pro rata temporis basis.

Any dilution effect (existence of potential shares) is reported as diluted earnings per share; however, this does not apply to the Zapf Creation Group at present.

2.3.7. Financial Instruments

According to IAS 32 (“Financial Instruments: Presentation”), which in part has been superseded by IFRS 7 (“Financial Instruments: Disclosures”), and according to IAS 39 (“Financial Instruments: Recognition and Measurement”), financial instruments are agreements that give rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Pursuant to IAS 32, this includes original financial instruments such as cash, trade receivables and trade payables, as well as financial receivables and financial liabilities. Furthermore, derivative financial instruments such as options or swaps must also be subsumed under financial instruments. The Zapf Creation Group uses these instruments as hedging transactions to hedge against risks from changes in foreign currency and interest rates.

Original financial assets and original financial liabilities are accounted for in the consolidated balance sheet as of the date on which at least one of the parties has rendered the services it has undertaken to render as part of the agreement: Derivative financial instruments are taken into account from the point in time at which the Group becomes a party to the agreement.

Original Financial Instruments

Accounting according to IFRS defines four categories of original financial instruments: loans and receivables, financial investments held to maturity, financial assets or liabilities held for trading or speculation purposes, and financial assets available for sale. In the Zapf Creation Group, existing original financial instruments are currently attributable exclusively to the “Loans and receivables” and “Financial liabilities” categories.

- *Financial Assets*

  The balance sheet item “Cash” includes cash and term deposits. Cash also includes highly liquid financial investments with an original maturity of up to 90 days. Cash is measured at nominal value.

  Loans, trade receivables, and other receivables are initially recognized at cost, including transaction costs. Non- or below-market interest-bearing receivables with an expected maturity of more than one year are discounted. Subsequent measurements of loans, trade receivables, and other receivables are made in accordance with the effective interest method at amortized cost. Allowances for doubtful loans and receivables are shown in separate items based on the maturity of the loans and receivables, the customers’ credit rating, and past experience in order to take estimated losses from customers’ possible insolvency into account. The relevant loans and receivables are derecognized if, based on an assessment of the individual customer, it is considered unlikely that payment will be received.

The Zapf Creation Group sells receivables as part of its receivables management. Such factoring is treated in accordance with IAS 39 ("Financial Instruments: Recognition and Measurement"). This means that a financial asset is generally recognized by the entity assuming the main related risk. The non-payment risk is the key criterion for recognizing receivables in connection with factoring. If the factor purchasing the receivables assumes the entire non-payment risk, then the receivable is recognized by such factor (non-recourse factoring). If not, the receivable is still recognized by the company selling it (recourse factoring). Under the factoring program the Zapf Creation Group uses, the factor purchases the receivables and assumes the entire non-payment risk for them. These transactions are thus accounted for analogous to the procedure outlined in the preceding paragraph.

In accordance with the requirements of IAS 39, an impairment test is conducted at each balance sheet date on the basis of both internal and external indicators to assess whether impairment of the financial assets is objectively indicated. If the present value of the relevant financial asset is less than its carrying amount, then the impairment loss is recognized in income and the financial instrument is reported at cost less adjustments. Such adjustments are also reversed in income if the impairment has declined due to an event that occurred subsequent to the recognition of the impairment loss. If the reasons for the adjustment no longer exist, a write-up to no more than the cost is made.

Net gains or losses from financial assets contain changes in the allowances, gains or losses from the derecognition or disposal (factoring) of financial assets, payments received, and reversals of write-downs on loans and receivables, as well as currency effects. They are shown in the income statement under the items, revenue, cost of sales, and other income/other expenses.

- *Financial Liabilities*

Financial liabilities contain interest-bearing liabilities of a financing nature, in particular, loans from banks and other lenders, as well as other interest-bearing liabilities. Non-interest-bearing liabilities and liabilities subject to low interest rates are measured at their present value. All subsequent measurements are made at amortized cost using the effective interest method. Any difference between the net loan amount and the repayment value is distributed over the term of the financial liabilities and recognized in the income statement.

Both trade liabilities and other liabilities are measured at their repayment amount. Non- or low-interest-bearing non-current liabilities are discounted and measured at their present value if the discounted amount is substantial.

An equity instrument is any contractual agreement that represents a residual interest in the Company's assets after deducting all liabilities. Equity is the residual amount after liabilities are deduced from assets.

The fair value of financial assets and financial liabilities usually corresponds to the (stock) market value as of the balance sheet date. If no active market exists, the fair value is determined by means of mathematical methods and checked against confirmations from the banks that handle the transactions.

In addition to currency effects, the net gains or losses from financial liabilities also comprise gains or losses from the derecognition of such financial liabilities. They are shown in the income statement under the items, revenue, cost of sales, and other income/other expenses.

Derivative Financial Instruments

As a rule, the Group only employs derivative financial instruments for hedging purposes (currency and interest rate risks). Please see Section B, item 2.6. for additional information on derivative financial instruments and their measurement.

Depending on the nature of the underlying transactions being hedged, IFRS accounting distinguishes between fair value hedges, cash flow hedges, and hedging of a net investment in a foreign operation. The Zapf Creation Group uses cash flow hedges to hedge the risk of fluctuations in future cash flows related to previously reported transactions or anticipated transactions if the structure of the financing so requires. Changes in the fair value of derivative financial instruments intended for hedging a cash flow risk are documented. If the hedging relationships are classified as effective, the changes in the fair value are recognized directly in equity. In contrast, fluctuations in value from financial instruments classified as ineffective are recognized directly in the income statement. For more information on hedge accounting in the 2007 financial year, please see Section B, item 2.5.4.

2.3.8. Inventories

Additions to goods, raw materials, and consumables are measured at cost in accordance with IAS 2 using sliding average prices.

The cost of inventories includes all acquisition costs, as well as all costs incurred for keeping the inventories at their current storage location and in their current state. For purchased merchandise, this comprises in particular the purchase price, freight and customs duties. Discounts, rebates and similar amounts are deducted when determining the acquisition costs.

In subsequent measurements, if necessary, inventory assets are written down to their net realizable value. The net realizable value of the goods corresponds to the estimated selling price of the item that is achievable in the course of ordinary business less estimated selling costs.

All identifiable risks related to inventory assets resulting from the inventories' reduced marketability or obsolescence are taken into account; analogous adjustments are made for items that are no longer marketable.

2.3.9. Property, Plant and Equipment

The Group measures all property, plant and equipment subject to wear and tear at cost less cumulative depreciation, i. e. both normal depreciation and any impairments. Depreciation on property, plant and equipment is made on a straight-line basis according to the assets' estimated useful life using the following schedule:

Buildings and building equipment	3 to 50 years
Machinery	2 to 20 years
Motor vehicles, furniture and fixtures, and office equipment	2 to 18 years

The useful life of property, plant and equipment subject to depreciation is tested annually; if necessary, the remaining useful life is adjusted based on the changed estimate.

The depreciation period for property, plant and equipment, which the Group uses under capital leases or in connection with rental agreements (leasehold improvements), always begins with the date the asset is put into service. The depreciation period corresponds to the duration of the rental or lease agreements if this is shorter than the asset's economic life.

Leases are accounted for in accordance with IAS 17 ("Leases"). IAS 17 makes a fundamental distinction between finance leases and operating leases. Under IAS 17, whether the leased property is recognized by the lessor or the lessee depends on who assumes the substantial risks and rewards associated with such leased property. The Zapf Creation Group is an operating lessee. This means that its leased property is accounted for by the lessor; regular lease payments are recognized as a lease expense in the income statement.

If the relevant leased property is scrapped or disposed of, the costs of the relevant asset and the cumulative depreciation are written off; any resulting gain or loss is shown in the income statement under other income or expenses.

Depreciation is reported in the income statement as a cost of the relevant operational area to which the underlying property, plant and equipment is allocable.

Under the components approach, substantial components of an asset classified as property, plant and equipment with different useful lives are depreciated over the useful life of the relevant component. Current maintenance and repair costs are expensed immediately unless they are capitalized in connection with the components approach.

Borrowing costs are included in the costs of fixed assets in accordance with IAS 23 if the asset is considered a qualifying asset.

2.3.10. Intangible Assets

All intangible assets of the Zapf Creation Group have a determinable expected useful life and are measured at cost less straight-line amortization, whereby the following estimated useful lives are applied:

Patents, brand names and licenses	5 to 10 years
Computer software	2 to 5 years

The useful life of an intangible asset is tested annually; if necessary, the remaining useful life is adjusted based on the changed estimate.

Depreciation is reported in the income statement as a cost of the relevant operational area to which the underlying property, plant and equipment is allocable.

If the requirements of IAS 38 ("Intangible Assets") are satisfied, portions of the Company's own costs for customizing SAP's ERP software are capitalized. Intangible assets are amortized as of their completion date.

Borrowing costs are included in the costs of an intangible asset in accordance with IAS 23 if the asset is considered a qualifying asset.

2.3.11. Impairment

Intangible assets, as well as property, plant and equipment, are tested as of each balance sheet date to assess whether any triggering events might have occurred that entail an impairment as defined in IAS 36 ("Impairment of Assets"). Intangible assets under construction, i. e. assets that are not subject to normal amortization, are reviewed for impairment annually. An adjustment is required if the recoverable amount of the relevant asset is less than its carrying amount.

The recoverable amount is the higher of its fair value less costs of disposal and its value in use.

If it is impossible to determine the recoverable amount of an individual asset, then the recoverable amount is determined for the smallest identifiable cash generating unit that can be attributed to the relevant asset. In such cases, the impairment test is shifted from the individual asset to the cash generating unit.

The recognizable fair value is the amount that could be achieved by disposing of an asset in an arm's length transaction between knowledgeable, willing parties after deducting the costs to sell.

The value in use results from the present value of future cash flows that are expected to be derived from the asset. Determination of the present value is based on an interest rate reflecting market conditions.

Valuation allowances in an amount equivalent to the amount by which the carrying amount of the asset exceeds its recoverable amount are recognized in income.

If, following an allowance, the recoverable amount increases, then a write-up to no more than such recoverable amount is made in the income statement. The write-up is limited to the asset's adjusted carrying amount which would have been obtained in the past absent the allowance.

2.3.12. Provisions

Provisions are recognized as a liability in accordance with IAS 37 ("Provisions, Contingent Liabilities and Contingent Assets") if the Group has a current legal or constructive obligation vis-à-vis third parties resulting from a past event and if it is probable (more likely than not) that this past event will result in an outflow of resources embodying economic benefits that can be measured reliably; no provisions are recognized for internal obligations. The disclosure as a provision in the balance sheet is oriented on the extent of the uncertainty with regard to the timing and/or the amount of the future outlays required to fulfill the obligation. Obligations that do not meet the requirements for provisions under IFRS (in particular outstanding invoices and current personnel liabilities) are not recognized as provisions, but rather as liabilities. If the interest rate effect related to the provisions is material, they are discounted by a market interest rate adequate to their risk.

2.3.13. Share-Based Compensation Systems

The Zapf Creation Group employs compensation systems based on the performance of its stock, given its orientation toward activities designed to ensure that the enterprise value is increased in the long term in shareholders' interests. In contrast to employee stock option plans (ESOPs), compensation based on phantom shares does not constitute real equity interests but rather salary and/or bonus payments that are contingent on the development of the Company's stock. Cash compensation claims are granted to the beneficiaries during specific periods based on the difference between the underlying share's current price and the base price of the stock appreciation rights assigned.

Additions to the liabilities of the Zapf Creation Group under compensation systems based on phantom shares are measured in accordance with IFRS 2 ("Share-based Payment") on the basis of the fair value. The latter is determined based on a stock option model, taking both the terms of each individual promise and personnel turnover into account. All consideration to be paid in cash in connection with compensation systems based on phantom shares must be shown as liabilities and charged against the corresponding costs.

The liability to be reported at the end of each subsequent period reflects the newly determined fair value of the virtual equity instruments at such date. The effects of such periodic fair value determinations must be recognized in the income statement.

2.4. Use of Estimates

Consolidated financial statements require management to make assumptions and perform estimates, which might affect the application of accounting standards in the Group, as well as both the amount and the disclosure of recognized assets, liabilities, income, expenses, and contingent liabilities.

The Company's management regularly reviews both the estimates and the underlying assumptions. Although the estimates are made to the best of management's knowledge based on current events and measures, actual amounts may deviate from these estimates. Adjustments related to the estimates relevant to the accounting are considered in the period in which the adjustment was made if it concerns only the period in question. If an adjustment concerns both the reporting period and later periods, then it is accounted for in both.

B. Explanations of Items in the Consolidated Financial Statements

1. Explanation of Income Statement Items

The Company's income statement is prepared in accordance with the cost of sales method.

Income and expenses that are attributable to the Group subsidiary Zapf Creation (U.S.) Inc. are reported separately under the result from discontinued operations in accordance with IFRS 5 ("Non-current Assets Held for Sale and Discontinued Operations").

1.1. Revenue

In addition to the pure selling prices for merchandise, the gross revenue contains the shipping and handling fees billed to the customer. Net revenue is the gross amount less, essentially, cash discounts, bonuses, rebates, advertising cost subsidies, sales promotion fees and freight reimbursements.

Gains and losses on changes in exchange rates realized on sales transactions and those arising from measurement of trade receivables on the closing date are recognized under revenue. In addition, please see the table of exchange rates in Section A, item 2.2.3.

Please see Segment Reporting attached to these notes as Appendix 3.

1.2. Cost of Sales

Expenses directly allocable to revenue are recognized as cost of sales.

This item essentially contains the expenses for purchased merchandise. In addition to the pure cost, all incidental acquisition costs of the merchandise sold in the reporting period are reported here. These costs primarily comprise freight and customs duties.

The cost of sales also includes the cost of transporting goods to customers, as well as the Group's other logistics costs that can be directly allocated to revenue.

Gains and losses on changes in exchange rates realized on purchase transactions and those arising from measurement of trade payables on the closing date are recognized under cost of sales. In addition, please see the table of exchange rates in Section A, item 2.2.3.

1.3. Selling and Distribution Expenses

The Company's sale expenses comprise all costs directly resulting from measures aimed at supporting and maintaining its sales network.

Distribution expenses include costs related to the Company's own logistics center.

The following are also recognized in selling and distribution expenses: staff costs totaling K€ 7,183 (previous year: K€ 6,066) and depreciation/amortization of the sales and distribution units totaling K€ 2,261 (previous year: K€ 2,455), as well as license fees, activities at the point-of-sale for the end consumer, and expenses resulting from the Company's receivables management.

1.4. Marketing Expenses

Marketing expenses include the Company's expenses for conducting advertisement measures of different kinds (promotional and marketing campaigns, TV ads etc.), as well as expenses underlying the Company's comprehensive communications strategy, the production and design of sales catalog and brochure content, and the target-group related placement of advertisements in trade journals and magazines.

Expenses for advertising, promotional, and marketing campaigns as well as expenses for producing and broadcasting TV ads are recognized as an expense in the financial year in which the respective goods and services are used. The remaining advertising expenses are posted as an expense when they arise. Advance payments made are deferred and recognized under current assets.

The following are also recognized under marketing expenses: staff costs totaling K€ 987 (previous year: K€ 1,733) and depreciation/amortization of the marketing unit totaling K€ 336 (previous year: K€ 641), as well as those expenses resulting from communication with end customers. Among others, this concerns expenses for the design of mini catalogs, for conducting sweepstakes and competitions, as well as the BABY born® CLUB, a tool for creating customer loyalty and maintaining customer contact.

1.5. Administrative Expenses

The Company's other administrative expenses include expenses incurred by the finance, controlling and IT units as well as general administrative expenses. This includes staff costs totaling K€ 4,617 (previous year: K€ 7,047) and depreciation/amortization of these units totaling K€ 1,510 (previous year: K€ 2,194).

In addition, other administrative expenses also include development and design expenses if such expenses do not qualify for capitalization under IAS 38. Product development is the responsibility of both the Company's development department, which was relocated to the Company's headquarters in Roedental in 2007, and external developers and designers, primarily those of the strategic partner MGA Entertainment, Inc.

1.6. Other Income

Exchange rate gains realized on transactions that are not directly allocable to the purchasing and sales process, and exchange rate gains arising from the measurement of assets and liabilities on the closing date that are not directly allocable to the purchasing and sales process, are offset against corresponding exchange rate losses and reported under other income if the resulting balance shows income. As in the previous year, there was no income from exchange rate gains in the 2007 financial year.

The Company's miscellaneous other income totaling K€ 4,686 (previous year: K€ 1,524) essentially comprises income of K€ 3,782 (previous year: K€ 0) from the strategic partnership with related companies of the MGA Group; income from the reversal of provisions no longer required which had been recognized in connection with the Company's restructuring; one-off income of K€ 478 (previous year: K€ 676); license income of K€ 97 (previous year: K€ 179) from the BABY born® brand; and income of K€ 75 (previous year: K€ 68) from disposals of fixed assets. The previous year's figures also included income of K€ 104 from expenses passed on to other parties for delayed deliveries.

1.7. Other Expenses

Exchange rate losses realized on transactions that are not directly allocable to the purchasing and sales process, and exchange rate losses arising from the measurement of assets and liabilities on the closing date that are not directly allocable to the purchasing and sales process totaling K€ 2,193 (previous year: K€ 4,283) are offset against corresponding exchange rate gains totaling K€ 1,036 (previous year: K€ 4,224) and reported under other expenses if the resulting balance shows an expense. In the 2007 financial year, reportable expenses from changes in foreign exchange rates were K€ 1,157 (previous year: K€ 59).

The Company's miscellaneous other expenses of K€ 347 (previous year: K€ 500) essentially comprise K€ 166 (previous year: K€ 142) in costs on disposals of non-current assets, as well as K€ 26 (previous year: K€ 20) in adjustments with regard to existing loan interest receivables. The previous year's comparative figures also contained K€ 184 in interest rate and currency hedging fees, as well as K€ 120 in expenses resulting from reviews in 2006 of non-current assets' useful lives.

1.8. Restructuring Costs and One-off Items

Expenses from the restructuring of the Zapf Creation Group, as well as other extraordinary one-off expenses, are shown in the income statement under the operational areas giving rise to such expenses.

In addition, these expenses are also reported separately in the adjusted operating income. Total expenses and proceeds from the Company's restructuring in the period presented were K€ 645 (previous year: K€ 3,357) while its one-off items in the financial year just ended were income of K€ 280 (previous year: expense of K€ 2,576).

The largest portion of restructuring costs is comprised of severance payments totaling K€ 599 (previous year: K€ 1,891) for personnel measures in connection with the Company's realignment, which were either conducted in the 2007 financial year or are pending for the 2008 financial year. Restructuring costs also include consultancy services totaling K€ 38 (previous year: K€ 1,278) that are also directly connected to the realignment program, as well as other costs incurred in connection with the restructuring totaling K€ 8 (previous year: K€ 188).

A settlement concluded in the 2007 financial year gave rise to one-off income of K€ 280; this settlement pertains to compensation related to the measures executed in 2006 with the aim of improving the Company's equity base (previous year: expense of K€ 1,006). The one-off expenses in the previous year further comprise expenses for consultancy services totaling K€ 1,570 which also resulted from the preparation of measures aimed at enhancing the Company's equity base.

1.9. Finance Income and Costs

The finance income totaling K€ 863 (previous year: K€ 655) concerns interest income from current liquid assets in connection with cash management.

Total finance costs of K€ 4,393 in the year just ended (previous year: K€ 6,961) comprise interest on bank accounts and loans in the amount of K€ 4,821 (previous year: K€ 3,895), less income of K€ 1,000 from success fees not payable in connection with the Company's refinancing and the related waiver by the previous financing banks. The finance costs also contain K€ 129 (previous year: K€ 172) in expenses arising from the changes in the market value of derivative financial instruments. Also included in this item are all syndication fees the Company paid.

1.10. Taxes on Income

The tax expenses recognized in the consolidated financial statements of Zapf Creation AG are comprised as follows:

	2007 K€	2006 K€
Current taxes		
Domestic	370	926
Abroad	591	1,102
Total	**961**	**2,028**
Deferred taxes		
Domestic	3,119	−2,797
Abroad	671	547
Total	**3,790**	**−2,250**
Income tax income/expense	4,751	−222

The loss of K€ 99 from discontinued operations in the 2007 financial year (previous year: loss of K€ 6,147) contains income from income taxes of K€ 48 (previous year: expenses of K€ 54).

Deferred tax liabilities of K€ 28 were reversed directly against equity at the level of Zapf Creation AG in the comparative period of 2006; please also see Section B, item 2.5.4.

Depending on their respective legal form, Zapf Creation AG and its subsidiaries in Roedental are subject to German corporation tax and trade tax.

The corporation tax rate applicable during the reporting period was 25 % plus the solidarity surcharge of 5.5 %. The trade tax is 15.25 % of taxable income. As a result, the nominal tax rate in the 2007 financial year was 37.61 %, just as in the previous year. The 2008 Corporate Tax Reform Act (Unternehmensteuerreformgesetz) was promulgated in the Federal Tax Gazette on August 17, 2007. A corporation tax rate of 15 % plus a solidarity surcharge of 5.5 % applies as of January 1, 2008. The trade tax rate is 12.60 %; we thus expect the nominal tax rate to fall to 28.43 % as a result.

The effective tax expense reported in the Zapf Creation Group differs from the expected tax expense based on the nominal tax rate (37.61 %). The following reconciliation shows the main deviation factors in the reporting period:

	2007 K€	2006 K€
Earnings before income taxes	**2,003**	**−12,895**
Expected income tax refund/ expected income tax expense	−753	4,850
Different tax assessment basis	813	−1,072
Different tax rate	−45	−93
Uncapitalized deferred taxes on loss carryforwards	−1,720	−4,991
Deferred taxes loss carryforwards, subsequently capitalized/ Use of existing loss carryforwards	80	2,146
Valuation allowance on deferred taxes capitalized in previous years	−2,919	−1,119
Tax expense/income, previous years	−52	500
Other	−155	1
Recognized income tax income/expense	−4,751	222

The Zapf Creation Group recognizes the following loss carryforwards as of the balance sheet date of the respective reporting period.

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Corporation tax		
Domestic	60,102	58,188
Abroad	9,436	5,809
Total	69,538	63,997
Trade tax (domestic only)		
Total	59,490	58,746

Of the corporation tax loss carryforwards, K€ 60,079 relate to Zapf Creation AG (previous year: K€ 58,176); K€ 5,411 relate to Zapf Creation (France) S.à.r.l. (previous year: K€ 2,944); K€ 1,514 relate to Zapf Creation (Italia) S.R.L. (previous year: K€ 1,503); and K€ 801 relate to Zapf Creation (H.K.) Ltd. (previous year: K€ 1,362); further corporation tax loss carryforwards totaling K€ 23 relate to Zapf Creation (Central Europe) Verwaltungs GmbH, Zapf Creation Logistics Beteiligungs GmbH, and Zapf Creation Auslands-holding GmbH (previous year: K€ 12). In contrast to the close of the 2006 financial year – at which time all existing loss carryforwards had been utilized in full – as of December 31, 2007, a loss carryforward of K€ 1,710 applies to Zapf Creation (U.S.) Inc. for corporation tax purposes; it may be carried forward until 2027.

Of the corporation tax loss carryforwards, K€ 66,927 (previous year: K€ 63,107) may be carried forward indefinitely, K€ 901 (previous year: K€ 890) may be carried forward until 2009, 2010 and 2012 (previous year: 2009 and 2010), and K€ 1,710 (previous year: K€ 0) may be carried forward until 2027.

A total of K€ 59,462 in loss carryforwards for municipal trade tax purposes concern Zapf Creation AG (previous year: K€ 53,121). Further trade tax loss carryforwards totaling K€ 28 relate to Zapf Creation (Central Europe) Verwaltungs GmbH, Zapf Creation Logistics Beteiligungs GmbH, and Zapf Creation Auslandsholding GmbH (previous year: K€ 16). The trade tax loss carryforwards of Zapf Creation AG (Central Europe) GmbH & Co. KG in the amount of K€ 4,725 as of December 31, 2006, were transferred to Zapf Creation AG by means of accrual as of January 1, 2007; insofar please also see Section A, item 2.2.2. A total of K€ 884 in additional trade tax loss carryforwards of Zapf Creation AG as of the close of the 2006 financial year were utilized in full during the reporting year.

The trade tax loss carryforwards may be carried forward indefinitely.

Due to the insufficient probability of an earnings turnaround in future accounting periods, no deferred taxes were recognized on corporation tax loss carryforwards totaling K€ 67,226 (previous year: K€ 54,025) and on trade tax loss carryforwards totaling K€ 57,174 (previous year: K€ 50,065).

Deferred tax assets on loss carryforwards are recognized only if it is probable that future taxable income will be available, as well as if there are substantive indications as to the Company's corresponding future income. Deferred tax assets are recognized for loss-making companies belonging to the Zapf Creation Group only to the extent that taxable temporary differences exist with regard to the same taxation authority and the same taxable entity.

As in the previous year, no deferred tax assets are shown for the Group subsidiary, Zapf Creation (U.S.) Inc., in the consolidated financial statements as of December 31, 2007, in regards to temporary differences between the carrying amounts of assets/liabilities and amounts recognized for tax purposes. In the consolidated financial statements as of December 31, 2007, no deferred taxes from temporary differences were recognized for the subsidiaries Zapf Creation (France) S.à.r.l. and Zapf Creation (Italia) S.R.L.

1.11. Discontinued Operations

Under IFRS 5 ("Non-current Assets Held for Sale and Discontinued Operations"), a discontinued operation constitutes a component of the company that will be discontinued in accordance with a single coordinated plan. The discontinued operations must be identifiable and distinct from the continued operations. If a component is to be classified as a discontinued operation pursuant to IFRS 5, then the income from such discontinued operations must be shown separately in the consolidated income statement.

In the 2007 financial year, as in the previous year, IFRS 5 was applied to the Group subsidiary, Zapf Creation (U.S.) Inc., whose operating business was discontinued as of December 31, 2006. The discontinued operation constitutes a geographical area or segment as defined in IAS 14 ("Segment Reporting"), which means that the requirements of IFRS 5 regarding both the identifiability of the given operations and their delineation from ongoing operations have been met.

The income and expenses attributable to discontinued operations are as follows:

	2007 K€	2006 K€
Revenue	1,915	10,610
Cost of sales	–1,686	–9,964
Selling and distribution expenses	0	–2,118
Marketing expenses	0	–1,498
Administrative expenses	0	–996
Other income	0	156
Other expenses	–105	–539
Finance income	0	0
Finance costs	–271	–1,744
Result from discontinued operations before income taxes	–147	–6,093
Income taxes on discontinued operations	48	–54
Result from discontinued operations	**–99**	**–6,147**

Neither staff costs nor impairment losses were incurred in the 2007 financial year in connection with discontinued operations.

In the previous year, selling and distribution expenses related to the discontinued operations contained staff costs of K€ 385 as well as depreciation, amortization and write-downs of K€ 29. Marketing expenses related to the discontinued operations in 2006 contained staff costs of K€ 50 and depreciation, amortization, and write-downs of K€ 5. In the 2006 financial year, administrative expenses related to the discontinued operations contained staff costs of K€ 226, as well as depreciation, amortization and write-downs of K€ 11.

Exchange rate losses realized on transactions not directly allocable to the purchasing and sales process, as well as exchange rate losses resulting from the measurement on the closing date of the assets and liabilities arising from these events, are to be reported under other expenses. In the 2007 financial year, this resulted in exchange rate losses of K€ 105 related to discontinued operations (previous year: K€ 483).

Restructuring costs and one-off items resulting from the discontinued operations of Zapf Creation (U.S.) Inc., which had totaled K€ 1,151 as of the end of December 31, 2006, were not recognized in the 2007 financial year. Please also see Section B, item 1.8.

Please see the disclosures in Section B, item 1.10. with regard to income taxes on discontinued operations.

The earnings per share attributable to the discontinued operations are shown in Section B, item 1.12.

The cash flow from operating, investing and financing activities attributable to discontinued operations is as follows:

	2007 K€	2006 K€
Cash flow from operating activities	11,114	3,441
Cash flow from investing activities	0	−3
Cash flow from financing activities	−11,194	−3,750
Effects of exchange rate changes	−24	−53
Cash flow from discontinued operations	−104	−365

1.12. Earnings per Share

As of December 31, 2007, and as of the balance sheet date of the previous year, no options and subscription rights to purchase common shares were outstanding. This means that basic and diluted earnings per share are identical in the reporting periods.

The basic earnings per share are determined in accordance with IAS 33 ("Earnings per Share") by dividing the net profit or loss for the period by the average number of shares outstanding during the relevant period.

The calculation of the basic earnings per share is based on the following parameters:

Basic earnings per share:

	2007	2006
Net profit or loss for the period (in K€)	−2,748	−12,673
Average number of shares outstanding (in thsds)	8,840	7,586
Earnings per share (in €)	−0.31	−1.67

Basic earnings per share from continued operations:

	2007	2006
Result from continued operations (in K€)	−2,649	−6,526
Earnings per share from continued operations (in €)	−0.30	−0.86

Basic earnings per share from discontinued operations:

	2007	2006
Result from discontinued operations (in K€)	−99	−6,147
Earnings per share from discontinued operations (in €)	−0.01	−0.81

1.13. Disclosures Regarding Financial Instruments

The net income (+) and net loss (–) from financial instruments in the reporting period was as follows:

	2007 K€	2006 K€
Loans and receivables	–1,296	–1,816
Financial liabilities	–456	298
Total	**–1,752**	**–1,518**

The impairment losses recognized on financial assets in the reporting period was as follows:

	2007 K€	2006 K€
Trade receivables	1,439	2,576
Other assets	26	20
Total	**1,465**	**2,596**

1.14. Other Disclosures Regarding the Income Statement

Staff costs included in the operating expenses of the Zapf Creation Group totaled K€ 12,742 (previous year: K€ 15,507) in the 2007 financial year.

Staff costs by functional areas are comprised as follows:

	2007 K€	2006 K€
Sales and distribution	7,138	6,451
Marketing	987	1,783
Other administration	4,617	7,273
Staff costs	**12,742**	**15,507**

With regard to the expenses related to the operation of the subsidiary Zapf Creation (U.S.) Inc. that was discontinued in the previous year, which are shown separately, please also see Section B, item 1.11.

The following table shows the average number of employees of the Group:

	2007	2006
Salaried employees	199	297
Hourly workers	31	39
Employees	**230**	**336**

Expenses for defined contribution pension plans in the 2007 financial year totaled K€ 1,921 (previous year: K€ 2,041). This includes the Company's contributions to the statutory pension scheme totaling K€ 1,732 (previous year: K€ 1,803).

In the 2007 financial year, expenses under operating leases totaling K€ 3,272 (previous year: K€ 3,246) were recognized. They essentially comprised leases for IT hardware, software and passenger cars, as well as lease payments made by the Zapf Creation Group for external warehouse, office and presentation space. Please also see Section C, item 1.

2. Explanation of Balance Sheet Items

2.1. Current Assets

2.1.1. Cash

Cash comprises the following items:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Cash on hand	11	40
Bank balances	23,271	11,670
Cash	23,282	11,710

Cash includes an offsetting of current liabilities from bank overdrafts totaling K€ 91 (previous year: K€ 1,024) as these represent an integral part of the Company's cash planning.

2.1.2. Trade Receivables

Trade receivables, all of which are due within less than one year, as of the balance sheet are comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Trade receivables before valuation allowance	52,817	59,771
Valuation allowance	−2,913	−2,396
Trade receivables	49,904	57,375

Please also see Section B, item 2.6.3. in regards to maturity ranges.

The valuation allowances on trade receivables developed as follows in the reporting period:

	2007 K€	2006 K€
Valuation allowance at the beginning of the period	2,396	1,029
Additions	1,439	2,576
Reversals and utilization	−719	−1,151
Currency effects	−203	−58
Valuation allowance at the end of the period	2,913	2,396

The total amount of assigned or transferred Company receivables is comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Domestic	2,907	1,975
Abroad	0	0
Factoring	2,907	1,975

Please also see the remarks in Section A, item 2.3.7.

2.1.3. Inventories

The Company's inventories are divided into the following main categories:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Goods	13,375	12,505
Raw materials and supplies	98	158
Inventories	13,473	12,663

The following valuation allowances were recognized with regard to inventories:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Inventories before valuation allowance	14,754	15,080
Valuation allowance	−1,281	−2,417
Inventories	13,473	12,663

Inventory and sales risks resulting from the reduced marketability of inventories are taken into account by recognizing appropriate valuation allowances.

As a result, reasonable allowances on goods were made as of December 31, 2007, taking their future marketability into account.

The Company's strategic reorientation, as well as the developments related to phthalates and the Electronic Waste Regulation (Elektroschrottverordnung), had already triggered significant write-downs of the Company's inventories at the close of the 2006 financial year.

2.1.4. Income Tax Receivables

Income tax receivables are comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Domestic	76	3,357
Abroad	265	467
Income tax receivables	341	3,824

2.1.5. Other Assets

The other current assets as of the balance sheet date are comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Original financial assets		
Receivables from shareholders	4,642	0
Advances and funds in transfer	1,341	415
Loans to members of corporate boards or employees	671	705
Other	461	621
Valuation allowance on loans granted	−671	−705
Total	**6,444**	**1,036**
Derivative financial assets	**0**	**120**
Other assets		
Other tax assets	1,343	1,731
Barter transactions	224	239
Other	578	602
Total	**2,145**	**2,572**
Other assets	8,589	3,728

Please also see Section B, item 2.6.3. in regards to maturity ranges.

Receivables of K€ 4,642 (previous year: K€ 0) from shareholders fully concern MGA Group companies that are related parties of Zapf Creation AG.

The loan of K€ 625 that was granted to a former member of the Management Board (previous year: K€ 625) was already written off in the 2005 financial year. Interest receivables of K€ 46 (previous year: K€ 20) that raised loan receivables as of December 31, 2007, were written off in full as of the balance sheet date. In contrast to December 31, 2006, there were no employee loans as of December 31, 2007; the K€ 60 employee loan that had been written off in full in 2006 was repaid in full in the 2007 financial year.

The valuation allowance on loans granted developed as follows in the reporting period:

	2007 K€	2006 K€
Valuation allowance at the beginning of the period	705	685
Additions recognized in income in the reporting period	26	20
Payments received on receivables previously written off	−60	0
Valuation allowance at the end of the period	671	705

In connection with barter transactions, the Company sells its merchandise at fair value within the normal dealer price range to trade partners, who pay for the merchandise partly in cash and partly in "barter points". The barter points received as compensation can be exchanged by the Company, for example in exchange for broadcast minutes at television companies.

2.2. Non-current Assets

2.2.1. Property, Plant and Equipment

Property, plant and equipment as of the balance sheet date is comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Land and buildings	5,954	6,230
Machinery	837	751
Motor vehicles, furniture and fixtures, and office equipment	8,893	10,227
Assets under construction	199	267
Property, plant and equipment	**15,883**	**17,475**

Depreciation in the 2007 financial year totaled K€ 2,696 (previous year: K€ 3,679). Depreciation in the 2007 financial year does not include impairment losses (previous year: K€ 59).

For information on individual items of property, plant and equipment, please see the statement of changes in non-current assets, which has been attached to these consolidated notes as Appendix 2.

Regarding the Company's operating leases, we refer to Section B, item 1.14. and Section C, item 1.

2.2.2. Intangible Assets

The intangible assets of the Company as of the balance sheet are comprised of the following items:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Patents, brand names and licenses	3,102	3,856
Computer software	418	894
Assets under construction	25	35
Intangible assets	**3,545**	**4,785**

Amortization in the 2007 financial year totaled K€ 1,411 (previous year: K€ 1,656). As in the previous year, amortization in the 2007 financial year does not include any impairment losses.

The average remaining useful life of patents, licenses and brand names is four years (previous year: five years).

As of December 31, 2007, there existed internally-created intangible assets worth K€ 7 (previous year: K€ 15), all of which concerns capitalized portions of the Company's own costs for customizing SAP's ERP software (computer software).

For information on individual intangible assets, please see the statement of changes in non-current assets, which has been attached to these consolidated notes as Appendix 2.

2.2.3. Other Assets

As in the previous year, in the 2007 financial year the other non-current assets comprise solely non-current financial assets consisting of a loan from the Company in the amount of K€ 10 (previous year: K€ 20).
Please also see Section B, item 2.6.3. in regards to maturity ranges.

2.2.4. Deferred Tax Assets

The deferred tax assets as of the balance sheet date result from the following items:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Loss carryforwards	658	3,672
Provisions	62	378
Property, plant and equipment and intangible assets	58	65
Trade payables	37	22
Inventories	17	78
Trade receivables	16	4
Other liabilities	0	21
Other	1	5
Deferred tax assets before offsetting	**849**	**4,245**
Offsetting with deferred tax liabilities	−739	−265
Deferred tax assets	110	3,980

For more information on deferred tax assets, please see Section B, item 1.10.

2.3. Current Liabilities

2.3.1. Liabilities to Banks

The current liabilities to banks are comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Overdrafts	1,244	43,995
Current portion of non-current bank loans	4,630	21,060
Liabilities to banks	5,874	65,055

In July 2005, the Company concluded a syndicated loan agreement for a total financing volume of € 112 million; this agreement was originally supposed to expire on March 31, 2008. The first supplement concluded in June 2006 (effective date: May 1, 2006) shortened the term of the loan agreement in regards to certain partial loans to February 16, 2007, and April 30, 2007, respectively, and reduced the total volume of the syndicated loan to € 90 million. The second supplement dated November 15, 2006 (effective date) served to make further adjustments, especially in regards to the stipulated terms. Finally, the third supplement to the existing syndicated loan agreement dated February 5, 2007, served to transfer the management of the syndicate from Deutsche Bank AG to Deloitte & Touche GmbH, Wirtschaftsprüfungsgesellschaft, Munich, Germany, as of February 13, 2007.

On May 9, 2007, the Company announced that repayment of the syndicated loan for about € 90 million, which had expired on April 30, 2007, had been deferred for two months until the end of June 2007.

After that, the repayment obligation existing under the syndicated loan agreement was deferred on several occasions and for the last time until November 30, 2007.

On July 20, 2007, Zapf Creation AG announced that it had reached an agreement regarding the Company's long-term follow-up financing with an international banking syndicate and the major shareholders of Zapf Creation AG (MGA Entertainment, Inc. and its chief executive officer, Mr. Isaac Larian, as well as Mr. Nicolas Mathys and Betham Ltd., represented by the Supervisory Board member Mr. Gustavo Perez). Besides granting a new long-term syndicated loan for € 65 million, the financing concept thus also entails enhancing the Company's equity base. The loan is divided into three tranches with terms ranging from three to five-and-a-half years.

The € 65 million loan was contingent on an equity contribution in the amount of € 30 million by October 31, 2007 (in a form to be determined by the shareholders), as well as the issuing of the auditor's report for the 2006 annual and consolidated financial statements. The Company's major shareholders assured the Company in writing that they guarantee this equity contribution. Among other things, there was agreement that the authorized capital of up to € 3.2 million existing at the time would be utilized in full on short notice.

Interim financing that comprised a bridge loan of up to € 20 million was obtained from Commerzbank AG in order to ensure the Company's liquidity until these agreements were executed.

The shareholders MGA Entertainment, Inc. and its Chief Executive Officer, Mr. Isaac Larian, as well as Mr. Nicolas Mathys and Betham Ltd., which is represented by the Supervisory Board member Mr. Gustavo Perez, concluded Financing Agreement I on July 20, 2007, in order to ensure both the equity infusion of € 30 million and the required interim financing. Each of these shareholders undertook thereunder to make available up to € 10 million to Zapf Creation AG, among other things, by means of a cash capital increase and subordinated shareholder loans. The subordinated loans were to be granted prior to the capital increase in order to guarantee additional interim financing.

On September 21, 2007, the existing financing agreement of July 20, 2007, was modified and replaced to the extent that the deadline agreed as a prerequisite to the agreements was changed from October 31, 2007 to November 30, 2007. The interim financing granted by Commerzbank AG was also extended until (and including) November 30, 2007. Furthermore, on September 4/5, 2007 ("Financing Agreement II"), the existing financing agreement of July 20, 2007 was modified and replaced to the extent that the share of the capital contribution to be made by the major shareholders that was to be provided by Betham Ltd. represented by Mr. Gustavo Perez now would also be provided by MGA Entertainment, Inc., or its chief executive officer, Mr. Isaac Larian, or companies affiliated with him, because the statutes of Betham Ltd. prevented it from granting such a loan and thus from meeting its obligations under the agreement. This modification was contingent upon the Federal Financial Supervisory Authority (BaFin) exempting MGA Entertainment, Inc. from the obligation to submit a takeover bid in case the relevant threshold of 30 % of the voting rights would be exceeded. This exemption was granted on September 14, 2007.

On September 26, 2007, the Company's auditor issued its auditor's report for the 2006 annual and consolidated financial statements so that the Company was able to publish both the consolidated financial statements for the 2006 financial year and the figures for the first six months of 2007 on October 2, 2007.

The stipulated financing concept was essentially executed as follows:

- The Management Board resolved on October 2, 2007, with the approval of the Supervisory Board on October 7, 2007, to raise the Company's share capital to € 12.0 million by issuing up to 3,200,002 no-par bearer shares. The new no-par shares were offered to the Company's shareholders between October 12, 2007, and October 26, 2007, at a subscription price of € 3.16 per share, yielding an inflow of funds of about € 10 million for Zapf Creation AG. As stipulated in "Financing Agreement II", the Company's shareholders, MGA Entertainment, Inc. or its Chief Executive Officer, Mr. Isaac Larian, or companies affiliated with either of them, and Mr. Nicolas Mathys, exercised not just the subscription rights allocable to them but also those not exercised by other shareholders.

- Pursuant to this financing concept, these two shareholders made up for the shortfall in the required equity infusion of € 30 million by granting subordinated loans in several steps. The Management Board drew on a total of € 16.2 million in cash infusions.

- The Company's shareholders agreed at its regular Annual Shareholders' Meeting on November 20, 2007, to create new authorized capital in return for cash or in-kind contributions, subject to the option of excluding shareholders' subscription right.

- The Company increased its share capital from € 12.0 million to € 13.2 million immediately after the Annual Shareholders' Meeting. This additional capital increase, which corresponded to 10 % of the Company's share capital, was executed to the exclusion of shareholders' subscription right pursuant to Section 186 para 3 sentence 4 German Stock Corporation Act (Aktiengesetz); all shares were subscribed by the Company's major shareholders, MGA Entertainment, Inc. or its Chief Executive Officer, Mr. Isaac Larian, or companies affiliated with either of them, and Mr. Nicolas Mathys. The capital increase was recorded in the Commercial Register on December 10, 2007.

This completed the capital infusion stipulated as part of the long-term financing concept in the 2007 financial year. At the same time, the banks participating in the loan syndicate made the new syndicated loan of € 65 million available to Zapf Creation AG on December 7, 2007.

The following security documents, each duly executed by the parties to it and notarized to the extent required by applicable law, exist to secure the new loan agreement for € 65 million:

France
- Share pledge agreement regarding shares in Zapf Creation (France) S.à.r.l. entered into between Zapf Creation AG as pledgor and Commerzbank Aktiengesellschaft as security agent

Germany
- Share pledge agreement regarding the pledge of shares in Zapf Creation Auslandsholding GmbH entered into between Zapf Creation AG as pledgor, Commerzbank Aktiengesellschaft as security agent and the other finance parties

- Share and interest pledge agreement regarding the pledge of shares in Zapf Creation Logistics GmbH and the pledge of the partnership interest (Kommanditanteile) in Zapf Creation Logistics GmbH & Co. KG entered into between Zapf Creation AG as pledgor, Commerzbank Aktiengesellschaft as security agent and the other finance parties

- Pledge agreement regarding the pledge of bank accounts entered into between Zapf Creation AG and Zapf Creation Logistics GmbH & Co. KG as pledgors, Commerzbank Aktiengesellschaft as security agent and the other finance parties

- Global assignment agreement regarding the assignment of trade receivables entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Global assignment agreement regarding the assignment of trade receivables entered into between Zapf Creation Logistics GmbH & Co. KG as assignor and Commerzbank Aktiengesellschaft as security agent

- Assignment agreement regarding the assignment of trade credit insurance (Warenkreditversicherung) receivables entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Assignment agreement regarding the assignment of export credit insurance receivables entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Global assignment agreement regarding the assignment of present and future receivables arising from central regulation contracts, debt collection contracts and supply contracts entered into between Zapf Creation AG as assignor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of movable assets entered into between Zapf Creation AG as transferor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of movable assets entered into between Zapf Creation AG as transferor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of fixed assets entered into between Zapf Creation AG as transferor and Commerzbank Aktiengesellschaft as security agent

- Security transfer agreement regarding the security transfer of fixed assets entered into between Zapf Creation Logistics GmbH & Co. KG as transferor and Commerzbank Aktiengesellschaft as security agent

- Pledge agreement regarding the pledge of intellectual property rights entered into between Zapf Creation AG as transferor and Commerzbank Aktiengesellschaft as security agent

- Pledge agreement regarding the pledge of patent rights entered into between Zapf Creation AG as transferor and Commerzbank Aktiengesellschaft as security agent

- Land charge of € 4,601,626.92 over the property registered with the land register of the local court of Coburg of Moenchroeden, folio 3657 granted by Zapf Creation Logistics GmbH & Co. KG in favor of Commerzbank Aktiengesellschaft as security agent

- Joint land charge of € 5,000,000.00 registered with the land register of the local court of Coburg of Moenchroeden, folio 2900, 3094, 3527, 3656 and 3657 granted by Zapf Creation AG and Zapf Creation Logistics GmbH & Co. KG in favor of Commerzbank Aktiengesellschaft as security agent

- Undertaking regarding the granting of security rights over movable assets granted by Zapf Creation Auslandsholding GmbH

- Undertaking regarding the granting of security rights over fixed assets granted by Zapf Creation Auslandsholding GmbH

- Undertaking regarding the granting of security rights over receivables granted by Zapf Creation Auslandsholding GmbH

Hong Kong

- Charge of shares regarding the shares in Zapf Creation (H.K.) Ltd. entered into between Zapf Creation AG as chargor and Commerzbank Aktiengesellschaft as chargee

- Debenture granted by Zapf Creation (H.K.) Ltd. as chargor and Commerzbank Aktiengesellschaft as chargee regarding all assets referred to therein

Poland

- Agreement for registered pledge over shares in Zapf Creation (Polska) Sp. z o.o. entered into between Zapf Creation AG as pledgor and Commerzbank Aktiengesellschaft as security agent

- Agreement for the registered pledge over assets and financial pledges over bank accounts entered into between Zapf Creation (Polska) Sp. z o.o. as pledgor and Commerzbank Aktiengesellschaft as security agent

- Statement of submission to enforcement pursuant to Article 777 section 1 para 5 of the German Civil Procedure Code

Spain

- Share pledge agreement regarding the pledge of shares in Zapf Creation (España) S.L. entered into between Zapf Creation Auslandsholding GmbH as pledgor and Commerzbank Aktiengesellschaft as security agent

- Pledge agreement regarding the pledge of receivables against third-party debtors entered into between Zapf Creation (España) S.L. as pledgor and Commerzbank Aktiengesellschaft as security agent

- Negative/positive pledge regarding the granting of security rights over movable assets granted by Zapf Creation (España) S.L.

- Negative/positive pledge regarding the granting of security rights over fixed assets granted by Zapf Creation (España) S.L.

Great Britain

- Mortgage of shares regarding the shares in Zapf Creation (U.K.) Ltd. entered into between Zapf Creation Auslandsholding GmbH as pledgor and Commerzbank Aktiengesellschaft as security agent

- Security agreement regarding security over real property, bank account, plant and machinery, credit balances, book debts, insurances and other contracts entered into between Zapf Creation (U.K.) Ltd. as chargor and Commerzbank Aktiengesellschaft as security agent

- Undertaking regarding the granting of security rights over fixed assets granted by Zapf Creation (U.K.) Ltd.

United States

- Undertaking regarding the granting of security rights over movable assets granted by Zapf Creation (U.S.) Inc.

- Undertaking regarding the granting of security rights over fixed assets granted by Zapf Creation (U.S.) Inc.

Furthermore – unless already contained in the above security documents – pledge agreements or equivalent security documents exist with regard to each bank account of any member of the Zapf Creation Group. This excludes bank accounts of the two Group subsidiaries Zapf Creation (France) S.à.r.l. and Zapf Creation (U.S.) Inc.

The security mentioned below, which existed as part of the previous loan agreement, was released, unless it has been used for the purpose of the new syndicated loan agreement:

- Assignment of all receivables resulting from supplies and services of the following companies: Zapf Creation AG, Zapf Creation (Central Europe) GmbH & Co. KG, Zapf Creation Logistics GmbH & Co. KG, Zapf Creation (U.K.) Ltd., Zapf Creation (España) S.L., Zapf Creation (U.S.) Inc. and Zapf Creation (H.K.) Ltd.

- Security assignment of all current assets or other security rights of the current assets with respect to all warehouses and permanent establishments of the following companies: Zapf Creation AG, Zapf Creation (Central Europe) GmbH & Co. KG, Zapf Creation Logistics GmbH & Co. KG, Zapf Creation (H.K.) Ltd., Zapf Creation (U.S.) Inc. and Zapf Creation (U.K.) Ltd.

- Security assignment of all fixed assets with respect to all warehouses and permanent establishments of the following companies: Zapf Creation AG, Zapf Creation (Central Europe) GmbH & Co. KG and Zapf Creation Logistics GmbH & Co. KG

- Negative/positive pledges with respect to the creation of security rights of the current assets with respect to all warehouses and permanent establishments of the following companies: Zapf Creation (France) S.à.r.l. and Zapf Creation (España) S.L.

- Negative/positive pledges with respect to the creation of security rights of the fixed assets with respect to all warehouses and permanent establishments of the following companies: Zapf Creation (U.K.) Ltd., Zapf Creation (France) S.à.r.l., Zapf Creation (España) S.L., Zapf Creation (H.K.) Ltd. and Zapf Creation (U.S.) Inc.

- Pledges of the shares of Zapf Creation AG in the following companies: Zapf Creation (Central Europe) GmbH & Co. KG, Zapf Creation Logistics GmbH & Co. KG, Zapf Creation (U.K.) Ltd., Zapf Creation (France) S.à.r.l., Zapf Creation (España) S.L., Zapf Creation (H.K.) Ltd. and Zapf Creation (U.S.) Inc.

- Pledges of all rights with respect to all present and future intellectual property rights of Zapf Creation AG

- Pledges of all bank accounts of Zapf Creation (Central Europe) GmbH & Co. KG and Zapf Creation Logistics GmbH & Co. KG (including with banks, which do not form part of the security pool)

- Mortgages in the aggregate amount of € 4,601,626.92 on the property of Zapf Creation Logistics GmbH & Co. KG, registered in the land registry of the local court Coburg of Moenchroeden in part III under no 1–3

- Joint mortgages in the amount of € 5,000,000.00 registered with respect to three properties situated in Germany of Zapf Creation AG, Zapf Creation Logistics GmbH & Co. KG and Zapf Creation (Central Europe) GmbH & Co. KG

- Assignment of all credit insurance claims

The carrying amounts of the securities pledged are as follows as of the balance sheet date:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Cash	23,282	11,710
Trade receivables	49,904	57,375
Inventories	13,473	12,663
Income tax receivables	341	3,824
Other current assets	8,589	3,728
Property, plant and equipment	15,883	17,475
Intangible assets	3,545	4,785
Other non-current assets	10	20
Total	115,027	111,580

The average interest rate for the use of current liabilities to banks in 2007 was 9.61 % (previous year: 7.37 %).

2.3.2. Trade Payables

Trade payables in the reporting period totaled K€ 37,686 (previous year: K€ 35,616). They are essentially comprised of vendor invoices already submitted and still outstanding as of the balance sheet date as well as obligations of the Company from sales deductions granted.

Please also see Section B, item 2.6.3. in regards to maturity ranges.

2.3.3. Income Tax Liabilities

Income tax liabilities are comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Domestic	180	1,245
Abroad	521	473
Income tax liabilities	701	1,718

2.3.4. Other Liabilities

Other current liabilities are comprised as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Original financial liabilities		
Liabilities to shareholders	16,909	0
Financial obligations to employees	416	1,295
Other	147	10
Total	**17,472**	**1,305**
Derivative financial liabilities	**9**	**0**
Other liabilities		
Other taxes and social security payments	1,502	1,292
In-kind obligations to employees	406	335
Other	5	112
Total	**1,913**	**1,739**
Other liabilities	19,394	3,044

Please also see Section B, item 2.6.3. in regards to maturity ranges.

Of the total liabilities to shareholders in the amount of K€ 16,909 (previous year: K€ 0), K€ 11,248 (previous year: K€ 0) are due to MGA Group companies that are related parties of Zapf Creation AG and K€ 5,661 (previous year: K€ 0) are due to Mr. Nicolas Mathys.

Financial obligations vis-à-vis employees as of December 31, 2007, essentially comprise outstanding bonus payments in the amount of K€ 356 (previous year: € 915). Also included is severance pay of K€ 55 (previous year: K€ 196) in connection with ongoing personnel measures of the Zapf Creation Group; these liabilities do not meet the criteria for provisions under IFRS but must be recognized as part of other liabilities.

In-kind obligations vis-à-vis employees in the amount of K€ 406 (previous year: K€ 335) essentially result from their extant vacation claims as of the reporting date.

2.3.5. Provisions

Provisions in the reporting period developed as follows:

	Jan. 1, 2007	Use	Reversal	Addition	Dec. 31, 2007
	K€	K€	K€	K€	K€
Returned goods	3,132	2,674	303	2,050	2,205
Restructuring	2,534	2,028	198	495	803
Other	707	328	18	218	579
Provisions	6,373	5,030	519	2,763	3,587

Returned goods

The provisions for returned goods result from the obligation to take back merchandise that has not been sold by customers.

Restructuring

Restructuring obligations are recognized as liabilities if there is a detailed formal plan for the restructuring and the public announcement or beginning of implementation awakens a justified expectation among the affected parties that the restructuring will actually be carried out. Restructuring provisions are recognized using the value that corresponds to the best possible estimate of all costs directly related to the restructuring. The Company's restructuring obligations as of the balance sheet date contain severance pay of K€ 757 (previous year: K€ 1,961) that the Company must pay but in regards to which no individual contracts had yet been concluded as of the balance sheet date.

Please also see the remarks in Section B, item 1.8.

Other

Other provisions concern personnel obligations, e. g. obligations arising from the granting of share-based compensation, and risk provisions for ongoing processes.

2.4. Non-current Liabilities

2.4.1. Liabilities to Banks

The non-current liabilities to banks are comprised as follows:

	Dec. 31, 2007	Dec. 31, 2006
	K€	K€
Non-current bank loans	38,011	0
Current portion of non-current bank loans	−4,630	0
Liabilities to banks	33,381	0

The average interest rate for the use of non-current liabilities to banks in 2007 was 11.06 %. No non-current liabilities to banks existed as of the previous year's balance sheet date.

With respect to collateral for existing liabilities to banks, please see Section B, item 2.3.1.

2.4.2. Deferred Tax Liabilities

The deferred tax liabilities as of the balance sheet date result from the following items:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Liabilities to banks	568	0
Property, plant and equipment and intangible assets	126	276
Trade receivables	72	39
Other assets	2	37
Other	55	89
Deferred tax liabilities before offsetting	**823**	**441**
Offsetting with deferred tax assets	−739	−265
Deferred tax liabilities	84	176

For more information on deferred tax liabilities, please see Section B, item 1.10.

2.5. Equity

The statement of changes in equity shows the development of each item of shareholders' equity for the 2007 and 2006 financial years; it also reports on the change in outstanding shares in both the reporting period and the same period the previous year.

The individual items of shareholders' equity are explained in detail below:

2.5.1. Issued Capital

The Company's share capital as of December 31, 2007 was € 13,200,000.00 (previous year: € 8,799,998.00). It is divided into 13,200,000 (previous year: 8,799,998) bearer shares of no par value. As in the previous years, all shares issued have been fully paid up as of the balance sheet date.

Authorized Capital I

The Management Board of Zapf Creation AG is authorized, subject to the approval of the Supervisory Board, to increase the Company's share capital, on one or more occasions, until (and including) May 6, 2008, by issuing new shares without par value in exchange for contributions in cash or in kind, in a total amount not to exceed € 4,000,000.00 (Authorized Capital I).

The increase in the Company's issued capital by issuing 4,000,000 new shares from Authorized Capital I was initiated on September 28, 2006; the first stage of this capital increase in the amount of € 799,998.00 involving the issuance of 779,998 new shares at a price of € 7.45 per share was completed once it had been recorded in the Commercial Register on October 19, 2006.

The second stage of the capital increase from Authorized Capital I in the amount of € 3,200,002.00 was executed by issuing 3,200,002 new shares pursuant to the resolution of the Management Board on October 2, 2007, with the approval of the Supervisory Board on October 7, 2007; it was recorded in the Commercial Register on October 31, 2007. This capital increase was subject to shareholders' subscription right. The new shares fully participate in profits as of the 2007 financial year; the subscription right that was granted at a ratio of 13:5 relative to the subscription price of € 3.16 per share applied to all shareholders.

Following the complete utilization of Authorized Capital I, the Company's issued capital as of October 31, 2007, was € 12,000,000.00, denominated in 12,000,000 no-par bearer shares.

Authorized Capital 2007

Article 5 of the Articles of Incorporation of Zapf Creation AG authorizes the following options for executing capital measures once Authorized Capital I has been utilized in full, given the resolution of the Annual Shareholders' Meeting on November 20, 2007:

The Management Board is authorized, subject to the approval of the Supervisory Board, to increase the Company's share capital until November 19, 2012, once or repeatedly, by up to € 6,000,000.00 in return for cash or in-kind contributions by issuing new no-par bearer shares (Authorized Capital 2007).

The Management Board is also authorized, subject to the approval of the Supervisory Board, to exclude shareholders' statutory subscription right in the following cases:

a) In connection with fractional shares;

b) If the capital increase is executed in return for cash contributions and if the pro rata amount of the share capital allocable to the new shares in regards to which shareholders' subscription right has been excluded does not exceed the lesser of [1] € 1,200,000.00 million or [2] 10 % of the Company's share capital extant at the time the new shares are issued and if the issue price for the new shares is not substantially lower – in the sense of Section 203 paras 1 and 2 and Section 186 para 3 sentence 4 German Stock Corporation Act – than the exchange price of previously listed shares of the same class at the time the Management Board finally fixes the issue price; the authorized volume is reduced by the pro rata amount of the share capital allocable to those shares that are issued or sold starting on November 20, 2007, subject to the exclusion of shareholders' subscription right, in connection with the direct or analogous application of Section 186 para 3 sentence 4 German Stock Corporation Act;

c) In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in connection with the acquisition of companies, business units, or stakes in companies; or

d) In the event of capital increases in return for in-kind contributions that are executed for the purpose of issuing shares in return for the transfer to the Company of loan and/or interest receivables from the Company under loans granted to it.

The Management Board is authorized, subject to the approval of the Supervisory Board, to determine additional details pertaining to the execution of the capital increases under Authorized Capital 2007. The Supervisory Board is authorized to amend the Articles of Incorporation subsequent to the full or partial execution of such capital increase under Authorized Capital 2007 or following the expiration of the authorization deadline in accordance with the scope of the capital increase under Authorized Capital 2007.

Participation of new shares in the Company's profit may be determined in derogation of Section 60 para 2 German Stock Corporation Act.

By resolution of the Management Board on November 26, 2007, and with the approval of the Supervisory Board on November 27, 2007, the issued capital of Zapf Creation AG was increased in the 2007 financial year by an additional 1,200,000 new shares from new capital authorized by the Annual Shareholders' Meeting on November 20, 2007 (Authorized Capital 2007) pursuant to Article 5 para 1a of the Company's Articles of Incorporation, subject to the exclusion of shareholders' subscription right. The issue price for the new shares was € 3.10, and the capital increase was recorded in the Commercial Register on December 10, 2007.

Contingent Capital I, II, and III

The contingent capital increase adopted by the Annual Shareholders' Meeting on April 26, 2000 (Contingent Capital I), the contingent capital increase adopted by the Annual Shareholders' Meeting on July 31, 2001 (Contingent Capital II), and the contingent capital increase adopted by the Annual Shareholders' Meeting on May 7, 2003 (Contingent Capital III) were rescinded in full by the Annual Shareholders' Meeting on November 20, 2007.

2.5.2. Capital Reserves

The capital reserves resulted from the premium received from the initial public offering in 1999 upon issuance of the shares less the one-off costs incurred by the initial public offering, taking the income tax consequences into account.

In the 2007 financial year, the Company's capital reserves increased by K€ 8,742 from K€ 12,961 to K€ 21,703 (previous year: increase by K€ 4,909 from K€ 8,052 to K€ 12,961). Of the change in the capital reserves K€ 9,432 (previous year: K€ 5,133) results from the capital increases carried out in the reporting period, which were recorded in the Commercial Register on October 31 and December 10, 2007 (previous year: October 19, 2006), and from a reduction in the capital reserves by K€ 690 (previous year: K€ 224), which was expensed for the preparation of capital increases during the reporting period.

2.5.3. Net Profit or Loss for the Period and Net Profit or Loss Brought Forward

As in 2006, in the 2007 financial year this item includes the net profit or loss for the period and the profit or loss brought forward from the previous year.

There were no dividend payments in the 2007 reporting period.

2.5.4. Other Recognized Income and Expense

As in the previous year, the other recognized income as of December 31, 2007 results exclusively from currency translation differences recognized in equity.

The adjustments from foreign currency translation result from the translation of foreign financial statements from the respective functional currency into the Group's functional and reporting currency, the euro (€). The currency translation differences arising from this process are allocated directly to equity in adjustments from foreign currency translation. Following the disposal of a foreign business, the currency translation differences that have accumulated until such time are either recognized in income or included in income from disposals.

As in the previous year, there was no need as of December 31, 2007 for offsetting entries from derivative financial instruments because the Company terminated its hedge accounting by refinancing its liabilities to banks for the first time in 2006 and by substantially decreasing residual maturities. The remeasurement gains/losses from hedging transactions for hedging against interest rate risks in the form of interest rate swaps and the remeasurement gains/losses from forward exchange transactions and options used as hedging instruments that had to be classified as cash flow hedges that had been recognized directly in equity as of December 31, 2005, were reversed to income in the 2006 financial year. This also applies to the effects of deferred taxes attributable to these amounts.

2.5.5. Treasury Shares

By resolution of the Annual Shareholders' Meeting dated November 20, 2007, the Company is authorized to purchase treasury shares in order to:

a) be able to offer such shares as consideration or part of the consideration in connection with business combinations or the acquisition of companies, business units or participating interests in companies; or

b) issue such shares in return for the transfer to the Company of one or more loan and/or interest receivables from the Company under loans granted to it; or

c) offer such shares as employee shares to employees of the Company or companies considered its affiliates under Section 15 German Stock Corporation Act for purchase or, if employee shares were acquired by way of loans to purchase securities or loans of securities, for purposes of satisfying obligations thereunder; or

d) sell repurchased treasury shares in ways other than on the stock exchange or by means of an offering to all shareholders in return for cash at a price that is not substantially lower than the exchange price of the Company's shares of the same class at the time of the disposal; or

e) retire such shares.

The authorization is limited to the purchase of treasury shares having a pro rata share of 10% in the Company's share capital existing on November 20, 2007, the day on which the Annual Shareholders' Meeting adopts the resolution (€ 12,000,000.00). The treasury shares so acquired – along with other treasury shares that are in the Company's possession or are allocable to it under Section 71a et seq. German Stock Corporation Act – may not, at any time, exceed 10% of the share capital.

The authorization to acquire treasury shares shall remain in effect until May 19, 2009 (inclusive). The authorization to purchase treasury shares that was adopted at the Company's Annual Shareholders' Meeting on August 29, 2006 and that was not exercised, expires at the time this new authorization takes effect. The authorizations contained in the aforementioned resolution of the Company's Annual Shareholders' Meeting on August 29, 2006, regarding the utilization of treasury shares repurchased pursuant thereto remain in place.

The buyback pursuant to this new authorization may also be executed by Group entities dependent on the Company within the meaning of Section 17 German Stock Corporation Act, or for the account of the Company or a Group entity dependent on it within the meaning of Section 17 German Stock Corporation Act.

As of December 31, 2007, the new authorization granted by the Annual Shareholders' Meeting on November 20, 2007, to acquire treasury shares had not been exercised.

As of the balance sheet date, the Company continued to have two separate securities deposit accounts for treasury shares, the intended use of which differs as follows:

a) Account no. 1 serves to back the potential future issuance of stock options on the part of the Company. The carrying amount as of December 31, 2007 was K€ 11,262 (previous year: K€ 11,262). As of the balance sheet date, the account included 569,593 treasury shares (previous year: 569,593). This corresponds to 4.32 % of the share capital reported as of the balance sheet date (previous year: 7.12 %).

b) Account no. 2 serves to grant shares to employees based on special performance or based on a positive development of the Company's business. The carrying amount as of December 31, 2007, was K€ 96 (previous year: K€ 96). As of the balance sheet date, the account included 3,085 treasury shares (previous year: 3,085). This corresponds to 0.02 % of the share capital reported as of the balance sheet date (previous year: 0.04 %).

Gains or losses from the sale of treasury shares are recognized directly in equity. There were no changes to either deposit account in the year under review and in the previous year.

The treasury shares acquired by the Company are measured at cost and deducted separately from equity. Cost is not adjusted to fair value.

2.5.6. Share-based Compensation Systems

The compensation system based on phantom shares that was launched in 2006 for the members of the Company's Management Board remained in place in the 2007 financial year. A total of 78,000 (previous year: 113,000) phantom stock options at base prices of € 9.16, € 8.60 and € 4.67 (previous year: € 7.49 and € 7.29) were allocated to these board members in 2007 under this plan; the exercise of these options is not linked to the achievement of specific performance targets. At the time they exercise their phantom stock options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date the phantom stock option is exercised.

The following summary contains details regarding the number and weighted average base prices of the phantom stock options:

	2007		2006	
	Number of options	Weighted average base prices	Number of options	Weighted average base prices
	Number	€	Number	€
Options outstanding at the beginning of the reporting period	113,000	7.43	0	—
Options granted during the reporting period	78,000	7.05	113,000	7.43
Options exercised during the reporting period	0	—	0	—
Options expired during the reporting period	0	—	0	—
Options outstanding at the end of the reporting period	191,000	7.27	113,000	7.43
Options exercisable at the end of the reporting period	0	—	0	—

The consideration payable by the Zapf Creation Group in connection with this compensation system, which is determined on the basis of the stock price, must be recognized as an obligation and expensed over the term of the obligation. The obligation to be reported as of each balance sheet date reflects the newly determined fair value of the phantom options at such date. As of December 31, 2007, this obligation was K€ 65 (previous year: K€ 318); the average fair value per option outstanding as of the balance sheet date was € 0.34 (previous year: € 2.81). Due to the negative share price performance during the reporting period, no options became exercisable as of December 31, 2007, the balance sheet date.

The weighted average of the fair value of the phantom stock options granted during the reporting period as of the measurement date is determined using the Black-Scholes option pricing model. The calculation is based on the following assumptions:

	2007	2006
Risk-free interest rate	4.75 %	4.00 %
Expected volatility	60.81 %	33.01 %
Share price as of December 31	3.39 €	8.90 €
Weighted average base price as of December 31	7.27 €	7.43 €
Weighted average remaining life (rounded)	526 days	822 days

The expected volatility of the share was ascertained based on its historical volatility in the previous 100 days.

As of December 31, 2007, the Group maintained two other compensation schemes based on phantom shares for executives of Zapf Creation AG and its affiliates, in addition to the compensation system that was newly established in the 2006 financial year and outlined above. The 2001/2003 Bonus Plan was set up in the 2001 financial year and the 2003/2005 Bonus Plan in the 2003 financial year.

These two additional compensation systems provide for allocation of phantom stock options to the relevant beneficiaries in several tranches pursuant to individual contracts. Depending on whether performance targets linked to the share price have been achieved and following the expiration of waiting periods contingent on the relevant tranches, the beneficiaries are paid one-time cash consideration per phantom stock option that reflects a particular percentage (20 % for the 2001/2003 Bonus Plan and 30 % for the 2003/2005 Bonus Plan) of the performance target as an additional component of their cash compensation.

With the exception of one bonus unit, the total volume of 300,000 bonus units available under the 2001/2003 Bonus Plan was utilized as of December 31, 2003. The total volume of the 2003/2005 Bonus Plan is 400,000 bonus units. The 247,774 units not granted as of December 31, 2005 were no longer available for grant as of that date as a result of the expiration the granting periods.

The following summary contains details regarding the number and weighted average exercise prices of the phantom stock options:

	2007		2006	
	Number of options	Weighted average exercise prices	Number of options	Weighted average exercise prices
	Number	€	Number	€
Options outstanding at the beginning of the reporting period	114,257	28.18	262,882	27.35
Options granted during the reporting period	0	—	0	—
Options exercised during the reporting period	0	—	0	—
Options expired during the reporting period	67,381	28.24	148,625	26.72
Options outstanding at the end of the reporting period	**46,876**	**28.09**	**114,257**	**28.18**
Options exercisable at the end of the reporting period	**0**	**—**	**0**	**—**

As in the previous year, the exercise prices for the 46,876 phantom stock options (previous year: 114,257) outstanding as of December 31, 2007, range from € 24.00 to € 36.75.

The consideration payable by the Zapf Creation Group in connection with the said compensation systems must be recognized as an obligation and expensed over the term of the obligation. The obligation to be reported as of each balance sheet date reflects the newly determined fair value of the phantom options at such date.

The weighted average of the fair value of the phantom stock options granted during the reporting period as of the measurement date is determined using a binomial option pricing model. The calculation is based on the following assumptions:

	2007	2006
Risk-free interest rate	4.75 %	4.00 %
Expected volatility	60.81 %	33.01 %
Share price as of December 31	3.39 €	8.90 €
Weighted average exercise price as of December 31	28.09 €	28.18 €
Weighted expected remaining life (rounded)	1 year	1 year

The expected volatility of the share was ascertained based on its historical volatility in the previous 100 days.

Given the development of the share price as of the December 31, 2007, balance sheet date, there was no need to recognize a provision for staff costs, as in the previous year. The bonus units outstanding as of the balance sheet date are impaired.

2.6. Disclosures Regarding Financial Instruments

2.6.1. Risk Management Policies and Hedging Strategies

Cash, trade receivables and payables, and liabilities to banks comprise the main original financial instruments the Zapf Creation Group uses in its operating business.

Existing risks from interest rate and foreign currency fluctuations constitute the principal risks the Zapf Creation Group encounters both in its operating business and with regard to its financing. Corporate policy is to exclude or limit these risks by concluding hedging transactions. All hedging measures are coordinated and conducted centrally at the Group's parent company. Primarily derivative financial instruments are employed as hedging measures.

There are corporate guidelines for the interest rate and foreign exchange hedging policies that minimize the risks resulting from the use of financial instruments. These include the separation of the trading, processing, and posting functions, as well as the voluntary restriction to a small defined group of banks with high creditworthiness and the authorization of only a few qualified employees. All derivatives are used solely for hedging purposes.

2.6.2. Explanations of the Risks from Financial Instruments

Interest Rate Risk

Interest rate risks arise from possible fluctuations in the value of, and the resulting cash flows from, original financial instruments due to changes in market rates; this applies particularly to interest-bearing medium- and long-term receivables and liabilities subject to variable interest rates. The Zapf Creation Group employs interest rate swaps as necessary, given the market situation, to hedge its interest rate risk position.

Currency Risks

Currency risks existence in that, over time, exchange rate fluctuations change the values of items posted in foreign currency. To hedge the currency risk, the Zapf Creation Group, as a rule, uses possibilities for balancing out currency risks naturally as well as forward exchange transactions and options. These transactions and options relate to the exchange rate hedging of significant items in foreign currency from the Company's operating activities.

Liquidity Risk

Liquidity risks exist in that the Company may not be able to acquire the funds necessary to pay the obligations entered into in connection with financial instruments. This risk is covered by a liquidity forecast based on a fixed planning horizon taking the existing financing of the Company into account (continuous planning).

Default Risk

The default risk from financial assets exists in that the contractual partner in a transaction involving a financial instrument may not meet its obligations or may not meet them on schedule. The maximum amount of this risk is the positive fair value of the claim from the financial instrument vis-à-vis the respective counterparty. The risk from original financial instruments is taken into account by establishing an allowance for bad debts; in addition, the Company has an appropriate amount of loan insurance. With regard to derivative financial instruments, the actual default risk is low as these instruments are only concluded with selected banks and limits are set for each counterparty as part of the Company's risk management.

2.6.3. Original Financial Instruments

The carrying amounts of the original financial instruments of the Zapf Creation Group as of the balance sheet are as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Financial assets		
Cash	23,282	11,710
Trade receivables	49,904	57,375
Other financial assets	6,454	1,056
of which shown under other current assets	6,444	1,036
of which shown under other non-current assets	10	20
Total	79,640	70,141
Financial liabilities		
Liabilities to banks	39,255	65,055
Trade payables	37,686	35,616
Other financial liabilities	17,472	1,305
of which shown under other current liabilities	17,472	1,305
Total	94,413	101,976

The carrying amounts of cash, trade receivables, other financial assets, trade payables, as well as other financial liabilities, represent a reasonable approximation of their fair values, given the financial instruments' short maturities. The fair value of liabilities to banks (carrying amount as of December 31, 2007: K€ 39,255; previous year: K€ 65,055), as well as of the shareholder loan shown under other financial liabilities (carrying amount as of December 31, 2007: K€ 16,909; previous year: K€ 0), cannot be reliably determined. The carrying amount of K€ 56,358 in financial assets excluding cash and cash equivalents (December 31, 2006: K€ 58,431) represents the Zapf Creation Group's aggregate credit risk position.

The maturity structure of the financial assets that were not impaired as of the reporting date, as well as the due dates of the financial liabilities that were stipulated by contract or based on historical data, follow from the table below, which is organized according to maturity ranges; financial assets already past due as of the reporting date are contained in the amount shown in the category "past due in less than 30 days":

		due in				
	as of Dec. 31, 2007	less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Financial assets	79,640	55,354	11,819	7,605	3,313	1,549
Financial liabilities	94,413	24,567	7,140	2,596	0	60,110

	as of Dec. 31, 2006	due in: less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Financial assets	70,141	49,065	9,963	5,641	4,605	867
Financial liabilities	101,976	16,817	8,682	9,326	10	67,141

There was no indication as of the reporting date that any of the debtors of the liabilities that are not impaired might default.

Total interest income from original financial assets in the reporting period was K€ 863 (previous year: K€ 655) while total interest expense related to original financial liabilities in the 2007 financial year was K€ 3,977 (previous year: K€ 3,931).

The aging structure of trade receivables that are past due and not impaired as of the reporting date is as follows:

	as of Dec. 31, 2007	past due: less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Trade receivables	14,057	9,296	2,065	1,664	425	607

	as of Dec. 31, 2006	past due: less than 30 days	30 to 60 days	60 to 90 days	90 to 120 days	more than 120 days
	K€	K€	K€	K€	K€	K€
Trade receivables	17,090	10,435	2,411	2,548	188	1,508

2.6.4. Derivative Financial Instruments

The following derivative financial instruments exist as of the balance sheet date:

	Dec. 31, 2007		Dec. 31, 2006	
	Nominal volume	Market values = Carrying amounts	Nominal volume	Market values = Carrying amounts
	K€	K€	K€	K€
Interest rate swaps (term > one year)	0	0	29,641	94
Interest rate swaps (term < one year)	24,801	−9	7,100	26
Total	24,801	−9	36,741	120

Interest Rate Risk

Interest rate risks were hedged in connection with the repaid syndicated loan; please also see Section B, item 2.3.1. As of December 31, 2007, the Zapf Creation Group held interest rate swaps with a nominal volume of K€ 24,801 (previous year: K€ 36,741); this includes USD-denominated interest rate swaps with a nominal volume of K$ 10,000 (previous year: K$ 8,750). The decline of K€ 11,940 in the nominal volume as of December 31, 2007, as compared to the previous year, results from the expiration (K€ 7,100) and contractually agreed reductions (K€ 4,840) of existing financial instruments in the 2007 financial year.

As part of its new financing concept, Zapf Creation AG has been hedging interest rate risks by means of derivative financial instruments from the 2008 financial year.

Currency Risks

As in the previous year, no option transactions were carried out to hedge currency risks in the 2007 financial year.

As part of its new financing concept, Zapf Creation AG has been hedging selected currency risks by means of derivative financial instruments from the 2008 financial year.

2.6.5. Risk Sensitivities

As part of our risk management, risks are initially described in qualitative terms and subsequently subject to approximate quantification using sensitivity analyses. The relevant risk assessment assumes that a parallel shift of the interest rate curve by 100 basis points (one percentage point) has occurred, as well as a gain or loss of 10 % in the euro (€) against the relevant foreign currency. The consequences deduced therefrom for the consolidated income statement as well as for Group equity might deviate substantially from the effects of actual market developments.

An interest rate sensitivity analysis must be performed for liabilities subject to variable interest rates. Liabilities to banks are contractually subject to a fixed interest rate until May 30, 2008 (EURIBOR plus a fixed margin); the interest rate for these liabilities will be reset after May 30, 2008, in accordance with the changes in the EURIBOR. As of 31 December 2007, the annualized cash flow interest rate risk is K€ 374, assuming that the EURIBOR rises by 100 basis points; this would trigger a corresponding decline in the net income of the Zapf Creation Group for the 2008 financial year and consequently Group equity. The Zapf Creation Group does not have any other liabilities that are subject to variable interest rates.

The foreign currency sensitivity analysis is performed by aggregating the Group's net currency position using the US dollar as the determinant. If the value of the US dollar had declined by 10 % as of December 31, 2007, net payments received would have fallen by K€ 133; this would trigger a corresponding decline in the net income of the Zapf Creation Group for the 2008 financial year and consequently Group equity.

2.7. Capital Management Disclosures

The liabilities, equity and total assets of the Company as of the balance sheet date were as follows:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€	Change in %
Current liabilities	66,612	111,806	—
Non-current liabilities	34,095	176	—
Liabilities	100,707	111,982	–10%
in percentage of total liabilities and equity	87%	97%	—
Equity	14,430	3,578	303%
in percentage of total liabilities and equity	13%	3%	—
Total liabilities and equity	115,137	115,560	—

The Company's liabilities declined by a total of 10% year on year.

In the 2007 financial year, the Company's equity soared by 303% year on year. This increase essentially resulted from the capital measures executed in the reporting period, which raised the Company's issued capital and its capital reserves by € 13.1 million, taking into account the expenses that are directly attributable to these capital measures and thus directly reduce the capital reserves; insofar please also see Section B, items 2.5.1. and 2.5.2.

Hence equity rose to 13% of total assets during the reporting period, compared to 3% as of the previous year's balance sheet date; the Company's liabilities fell from 97% of total liabilities and equity as of December 31, 2006, to 87% as of December 31, 2007.

The Articles of Incorporation of Zapf Creation AG do not prescribe specific capital requirements.

We plan to carry out additional capital measures in the 2008 financial year pursuant to the financing concept that was put in place during the 2007 financial year in order to enhance the Company's equity. In particular, the envisioned capital measures include converting the shareholder loans into equity; insofar please also see Section B, items 2.3.1. and 2.3.4.

3. Explanation of the Items in the Cash Flow Statement

The cash flow statement is broken down by cash flows from operating, investing and financing activities.

The cash flow from operating activities is determined using the indirect method.

Interest paid and received is allocated to cash flows from financing activities.

The cash funds in the cash flow statement comprise the cash disclosed in the balance sheet.

The changes in the balance sheet items that are used to prepare the cash flow statement cannot be derived directly from the balance sheet because non-cash exchange rate effects must be eliminated.

Regarding cash flows from discontinued operations please see Section B, item 1.11.

4. Explanation of the Items in Segment Reporting

The segment report is attached to these notes as Appendix 3.

The activities of the Zapf Creation Group are described in the segment reporting, taking the requirements of IAS 14 ("Segment Reporting") into account.

The structure of segment reporting in the Zapf Creation Group arises from the Group's organizational structure and takes into account its internal reporting structure, both of which are oriented on the main origin and type of the Company's risks and income. The primary reporting format is therefore determined by geographical segments. The allocation of external sales is determined by the customers' business domicile.

The segments are delineated as follows in accordance with the Company's internal controlling and reporting: Central Europe, Northern Europe, Southern Europe, Eastern Europe, the Americas, and Asia/Australia.

The delineation of the European segments is based on the following allocation of countries (significant countries):

Central Europe	Germany, Austria, Switzerland, the Netherlands and Luxembourg
Northern Europe	Great Britain, Ireland and Scandinavia
Southern Europe	Spain, France, Belgium and Italy
Eastern Europe	Russia, Poland, Czech Republic and Slovakia

In the previous year, the Central Europe sales region was primarily supplied through the German subsidiary Zapf Creation (Central Europe) GmbH & Co. KG. Effective January 1, 2007, sales and distribution for this region has been taken over directly by Zapf Creation AG as a result of the German sales subsidiary's integration by way of accrual into the Group's parent company. In this context, we refer to the disclosures regarding the basis of consolidation in Section A, item 2.2.2.

The Northern European market is serviced by the sales company Zapf Creation (U.K.) Ltd.

The Southern European markets are supplied through our own subsidiaries Zapf Creation (España) S.L. and Zapf Creation (France) S.à.r.l. Distribution in the Italian market, which was still assigned to the Group subsidiary, Zapf Creation AG (Italia) S.R.L., in 2006, was transferred back to Zapf Creation AG in the 2007 financial year. Zapf Creation AG (Italia) S.R.L. is still being consolidated; insofar please also see the disclosures in Section A, item 2.2.2., regarding the basis of consolidation.

In the 2007 financial year, goods for the Eastern European market were supplied through Zapf Creation (Polska) Sp. z o.o. and Zapf Creation AG (previous year: Zapf Creation (Polska) Sp. z o.o. and Zapf Creation (Central Europe) GmbH & Co. KG). In this geographical market segment, the sales and distribution tasks previously carried out by the German company Zapf Creation (Central Europe) GmbH & Co. KG were taken over directly by Zapf Creation AG on January 1, 2007. The liquidation of the subsidiary Zapf Creation (CZ) s.r.o., which previously was responsible for this segment, was completed in the 2006 financial year; insofar please also see the disclosures in Section A, item 2.2.2., regarding the basis of consolidation.

In the previous year, the subsidiary Zapf Creation (U.S.) Inc. was responsible for the entire American market. The active operations of this subsidiary were discontinued at the end of December 31, 2006; insofar please also see the disclosures in Section A, item 2.2.2., regarding the basis of consolidation. MGA Entertainment, Inc., Van Nuys, California, USA, alone has been in charge of the entire American market via a strategic partnership effective January 1, 2007.

The Asia/Australia region was serviced by Zapf Creation (H.K.) Ltd. in the 2007 and 2006 financial years.

The secondary reporting format is defined by the business segments (product lines), which are oriented on the structure of the product portfolio.

All disclosures in segment reporting are generally subject to the same recognition and measurement methods as the consolidated financial statements of the Zapf Creation Group. Inter-segment receivables and liabilities, provisions, as well as expenses and income, are eliminated in the segment reporting consolidation column. All transactions between segments are executed at market rates. The column "Other" contains figures not allocable to individual segments.

The sales generated by the relevant segments are separated into internal and external sales. This item includes revenue and other segment income allocable to the relevant segment's operating business.

Segment assets include the carrying amount of the assets that have contributed to achieving the segment result and are allocable to the segments, directly or reasonably.

The item Investments reflects investments in non-current segment assets, i. e. property, plant and equipment, as well as intangible assets.

The item Segment Liabilities comprises all liabilities directly or reasonably allocable to the segments, inasmuch as they stem from the relevant segment's operating activities.

The segment result shows earnings before interest, taxes, depreciation, and amortization (EBITDA).

Depreciation and amortization includes the amount of straight-line depreciation on property, plant and equipment, and straight-line amortization on intangible assets attributable to a particular segment.

Additions to the provisions constitute the main item under non-cash expenses.

C. Other Disclosures Regarding the Consolidated Financial Statements

1. Other Financial Obligations

The following table shows the Company's future minimum liabilities from financial obligations:

	Dec. 31, 2007 K€	Dec. 31, 2006 K€
2007	—	3,758
2008	6,906	677
2009 and beyond	20,249	633
Financial obligations	27,155	5,068

As of the balance sheet date, the Company had various lease and rental agreements (operating leases). The agreements cover the use of warehouse, office and presentation space as well as the use of furniture, fixtures and office equipment in connection with the Company's operations.

The obligations stemming from non-current lease and rental agreements total K€ 5,211 (previous year: K€ 2,720). Of these, K€ 1,752 are attributable to 2008 (previous year: 2007, K€ 1,606), K€ 1,257 are attributable to 2009 (previous year: 2008, K€ 516), K€ 1,072 are attributable to 2010 (previous year: 2009, K€ 310), and K€ 1,130 are attributable to 2011 and beyond (previous year: 2010 and beyond, K€ 288). The contractual obligations as of December 31, 2007, expire no later than in 2015 (previous year: 2015).

As of the balance sheet date, the Company was a contractual partner in several license agreements with external developers in order to be able to utilize technical solutions created by these developers for its own products. Some of these agreements contain provisions for payment of a guaranteed annual minimum license payment if the license fees payable based on the sale of the licensed item remains below a certain guaranteed amount. Although these obligations exist for an unlimited period or time, they become inapplicable until final expiration of the agreement, if the license agreement is terminated prior to a specified cutoff date. The Company's annual minimum license payments totaled K€ 17 (previous year: K€ 27).

As shown below, total liabilities from purchase order commitments were K€ 21,927 (previous year: K€ 2,321), mainly from purchase obligations for services under the agreements in connection with the strategic partnership with MGA Group companies that are related parties of the Company, from purchase obligations for goods, from obligations under maintenance contracts, and from legal and consulting services.

As of December 31, 2007, the Company had a purchase obligation for services in connection with the strategic partnership with MGA Group companies that are related parties of Zapf Creation AG totaling K€ 18,814 (previous year: K€ 0). The extent of the service fee is contingent on both the purchasing volume and the exchange rate between the Hong Kong dollar (HKS) and the euro (€). Given an unchanged purchasing volume, Zapf Creation AG assumes that the Company's purchase obligation will be K€ 2,090 in each year from 2008 to 2010, and K€ 12,544 in 2011 and beyond.

As of December 31, 2007, the Company had a purchase obligation for goods, which is allocable to the ongoing purchasing process with suppliers in China. In this connection, the Company, beginning with the month of September of each reporting period, orders goods that are scheduled for delivery to customers in the first quarter of the respective following year. Total purchase order commitments as of December 31, 2007, were K€ 2,561 (previous year: K€ 1,501).

As of December 31, 2007, the Company had a purchase obligation for ongoing maintenance services totaling K€ 396 (previous year: K€ 136) resulting from several maintenance contracts signed by the Company. Of the purchase obligation, K€ 330 relate to the 2008 calendar year, K€ 58 relate to the 2009 calendar year, and K€ 8 relate to the 2009 calendar year (previous year: 2007, K€ 121; 2008, K€ 15).

As of December 31, 2007, the Company had a purchase obligation for ongoing legal consulting services totaling K€ 22 (previous year: K€ 188), the total amount of which relates to the 2008 calendar year (previous year: 2007, K€ 158; 2008, K€ 30). The financial obligations arising from legal consultancy services, which end on March 31, 2008, result from a consulting agreement signed by the Company on February 12, 2005, which became effective April 1, 2005, and has a term of three years.

As of December 31, 2007, the Company had a purchase obligation for other consulting services totaling K€ 110, all of which is attributable to the 2008 calendar year (previous year: K€ 75; the full obligation related to the 2007 calendar year). Furthermore, the Company has other financial obligations arising from orders placed totaling K€ 24 (previous year: K€ 421), all of which is attributable to 2008 (previous year: 2007, K€ 270; 2008, K€ 116; 2009, K€ 23; 2010 and beyond, K€ 12).

2. Litigation

The Company is involved in various lawsuits in connection with its business. However, the outcome of these lawsuits will probably not have any significant adverse effect on the Company’s business, financial position or results of operations. The Company creates appropriate provisions for legal disputes pending beyond year’s end.

As in the previous year, there were no other contingent liabilities requiring disclosure as of the balance sheet date.

3. Related Party Relationships

Disclosures of relationships and business transactions with related parties, as well as of open accounts with related parties, are all subject to IAS 24 (“Related Party Disclosures“).

IAS 24 defines a related party as a person capable of controlling or significantly influencing another person, either alone or together with a third party, or as a person on whom such control or significant influence can be exercised. This definition of related parties covers companies and natural persons. In our case, the Company’s Management Board and Supervisory Board and the companies of the MGA Group that are related parties of the Company have been identified as related parties.

All transactions involving deliveries and services from and to related parties that occur in the ordinary course of Zapf Creation’s business are executed at market rates.

3.1. Management Board

The total compensation of K€ 503 (previous year: K€ 976) paid to the Management Board comprises all cash compensation due, as well as all monetary benefits from in-kind compensation. It includes both fixed and variable components but excludes the one-time consideration paid to former members of the Management Board.

Below is an overview of the compensation paid to each individual member of the Management Board in the 2007 financial year:

	Short-term compensation		Share-based	Total
	Fixed compensation	Bonus	compensation	compensation
	K€	K€	K€	K€
Thomas Pfau	200	63	36	299
Jens U. Keil	161	41	2	204
Total	361	104	38	503
Percentage in 2007		92.44 %	7.56 %	100.00 %

	Short-term compensation	Share-based compensation	Total compensation
	K€	K€	K€
Total compensation in 2006	658	318	976

In addition to the monetary base compensation, the fixed compensation granted to the members of the Company's Management Board also comprises benefits such as the use of company cars and allowances for accident insurance, individual pension plan, and other insurance policies.

The compensation system based on phantom shares that was launched in 2006 for the members of the Company's Management Board remained in place in the 2007 financial year. A total of 78,000 (previous year: 113,000) phantom stock options at base prices of € 9.16, € 8.60 and € 4.67 (previous year: € 7.49 and € 7.29) were allocated to these board members in 2007 under this plan; the exercise of these options is not linked to achievement of specific performance targets. At the time they exercise their options, beneficiaries are paid the difference per exercised option between the closing price of the share on its issue date and on the date the phantom stock option is exercised. Mr. Thomas Pfau was granted 30,000 phantom options at a base price of € 8.60 and 33,000 phantom options at a base price of € 4.67. Mr. Jens U. Keil was granted 15,000 phantom options at a base price of € 9.16. A total of K€ 38 was expensed for options granted in the 2007 financial year in connection with provisions for liabilities under this compensation system based on phantom shares; K€ 291 of the provision was reversed to profit and loss during the reporting year. The provision for liabilities under the aforementioned phantom options as of December 31, 2007, was K€ 65 (previous year: K€ 318); of this amount, K€ 48 (previous year: K€ 101) is attributable to Mr. Thomas Pfau and K€ 2 (previous year: K€ 0) to Mr. Jens U. Keil. Provisions of K€ 15 (previous year: K€ 217) were attributable to the former Management Board member, Dr. Georg Kellinghusen, as of December 31, 2007. The rights granted to Mr. Thomas Pfau will be void on September 1, 2009, or January 2, 2010, respectively, if none of them are exercised by that date. The options granted to Mr. Jens U. Keil will be canceled unless they are exercised by April 1, 2009. The phantom options granted to Dr. Georg Kellinghusen will be canceled unless they are exercised by February 15, 2009.

With respect to further disclosures regarding the plans, please see Section A, item 2.3.13. and Section B, item 2.5.6.

No one-off compensation was paid to former board members in the 2007 financial year (previous year: K€ 313).

One former member of the Management Board was granted a variable credit line in the maximum amount of K€ 625 (previous year: K€ 625) until December 31, 2007, which had already been fully utilized as of the previous year's balance sheet date. The agreed interest rate is 4.25 %. It was fixed until December 31, 2007, the loan's due date. As in the previous year, no repayments were made and no new loans were extended in the 2007 financial year. Because of interest receivables totaling K€ 46, the total amount due to the Company as of the December 31, 2007 balance sheet date increased to K€ 671 (previous year: K€ 645). The loan is secured by a mortgage in the amount of K€ 200 (previous year: K€ 200); as in the previous year, it was written off including the interest receivables.

3.2. Supervisory Board

The compensation of the Supervisory Board is determined by the Annual Shareholders' Meeting, on recommendation of the Management Board and the Supervisory Board. It is regulated by Article 20 of the Articles of Incorporation of Zapf Creation AG. The cash compensation includes a fixed and a dividend-based component, as well as compensation linked to the long-term success of the Company.

The fixed component of the compensation paid to the members of the Supervisory Board was modified most recently as follows by resolution dated August 29, 2006: The chairman of the Supervisory Board will be paid fixed annual compensation of K€ 35 net (previously: K€ 28), the vice chairman K€ 26.25 net (previously: K€ 21), and all other members of the Supervisory Board K€ 17.50 net (previously: K€ 14). The compensation paid to Supervisory Board members who were not in office for a full financial year is pro rated in accordance with the duration of their membership on the Supervisory Board. No change was made to the compensation of the Supervisory Board in the 2007 financial year. The two Supervisory Board members Mr. Isaac Larian and Mr. Ron Brawer waived the compensation to which they are entitled under the Articles of Incorporation in the 2006 financial year; expenses were reimbursed. In the 2007 financial year, Mr. Isaac Larian continued to waive the compensation to which he is entitled under the Articles of Incorporation; expenses were reimbursed.

As before, under the resolution adopted May 7, 2003, the variable compensation paid to the Supervisory Board members will be € 100.00 for each € 0.01 in excess of € 0.50 in dividends per no-par value share distributed to the shareholders for the financial year just ended. In addition, the members of the Supervisory Board are entitled to annual compensation based on the Company's long-term performance. This compensation entails payment of K€ 1 per K€ 1,000 in consolidated net annual income that exceeds an average consolidated annual income of K€ 22,237 for the last three financial years. As in the previous year, in the financial year just ended no provisions for the variable component of the compensation were recognized because no payment obligation arises from the Company's performance.

The total obligation for the compensation of the Supervisory Board in the 2007 financial year was K€ 112 (previous year: K€ 97).

There were no loans to members of the Supervisory Board in the past two financial years.

3.3. Related Companies of the MGA Group

The inclusion of MGA Group companies into the group of related parties of Zapf Creation AG is due to the close partnership that has been implemented on an operational level in several areas since the beginning of the 2007 financial year. The details of this partnership are as follows:

Since the beginning of 2007, MGA Entertainment, Inc., Van Nuys, California, USA, has been solely responsible as a licensee for selling Zapf Creation's products in the Americas (North, Central and South); MGA guarantees that the sales volume will exceed the revenue generated by Zapf Creation's own subsidiaries in this region by more than 50 % (Agreement 1: "Distribution Agreement"). In return, the parties agreed that the Zapf Creation Group will sell MGA products in particular European markets in exchange for payment of a distribution fee (Agreement 2: "Consignment and Services Agreement"). The Zapf Creation Group expects this activity to improve the utilization of its sales team and of its logistics center (Agreement 3: "Logistics Service Agreement"). Furthermore, in 2007 MGA took over the entire process of selecting and monitoring the Asian suppliers of Zapf Creation products, the coordination and handling of merchandise shipments to the sales units, and technical product development (Agreement 4: "Hong Kong / China Services Agreement"). For this purpose, essential elements of the respective procurement organization of the Zapf Creation Group in Hong Kong were transferred to MGA Entertainment (HK) Ltd. The Zapf Creation Group has bundled the design operations for its products at its Roedental headquarters. Furthermore, Zapf Creation AG granted MGA Entertainment, Inc., Van Nuys, California, USA, against payment of a license fee, the exclusive right and the exclusive license to utilize and exploit both the products and the intellectual property of Zapf Creation AG, including the right to grant sublicenses (Agreement 5: "Merchandising Licence Agreement").

The following income and expenses resulted from this partnership in the 2007 financial year:

Cooperation agreements	**2007** **K€**	**2006** **K€**
Agreement 1: "Distribution Agreement"; Income from Agreement 1	2,193	0
Agreement 2: "Consignment and Services Agreement"; Income from Agreement 2	1,560	0
Agreement 3: "Logistics Service Agreement"; Income from Agreement 3	2,068	0
Agreement 4: "Hong Kong / China Services Agreement"; Expenses from Agreement 4	2,258	0
Agreement 5: "Merchandising Licence Agreement"; Income from Agreement 5	29	0

In addition to the business transactions resulting from the cooperation agreements mentioned above (in the narrow sense), the following services were provided between the companies of the Zapf Creation Group and the related parties belonging to the MGA Group:

Cross charges	**2007** **K€**	**2006** **K€**
Income from cross charges	4,031	0
Expenses from cross charges	2,989	0

Cross charges are charges between the companies of the Zapf Creation Group and the related companies belonging to the MGA Group that arise from the mutual provision of services – above and beyond the cooperation agreements mentioned above (in the narrow sense); this essentially concerns income and expenses from shared company resources (staff, offices etc.).

Merchandise procurement	2007 K€	2006 K€
Merchandise procurement in the reporting period	44,195	0

Merchandise procurement in the reporting period results from the purchase of goods at MGA Entertainment (HK) Ltd. made by the sales subsidiaries of the Zapf Creation Group.

Other services received directly	2007 K€	2006 K€
Income from direct services	1,834	0

The income of the Zapf Creation AG from other services received directly from or delivered directly to the related companies of the MGA Group in the reporting period results from the sale of remaining inventories of the Company's US subsidiary to MGA Entertainment, Inc., Van Nuys, California, USA, which has been responsible for serving the American market under a strategic partnership since January 1, 2007; insofar please also see the disclosures regarding discontinued operations in Section B, item 1.11.

Other business transactions were as follows:

As of the December 31, 2007 balance sheet date, Zapf Creation AG drew a total of € 16.2 million from the subordinated shareholder loans that are an integral part of the Company's financing concept. The share attributable to related parties is € 10.8 million. It is subject to interest of 22 %, which is commensurate with market conditions. Zapf Creation AG has undertaken in writing to release MGA Entertainment, Inc., Van Nuys, California, USA, from paying a portion of the legal consultancy costs that were incurred in connection with the granting of shareholder loans under "Financing Agreement II". The legal consultancy costs to be assumed by the Company amount to K€ 100. Please also see Section B, item. 2.3.1.

The receivables and liabilities of the Zapf Creation Group that result from the partnership with related parties of the MGA Group as of December 31, 2007 are as follows:

Balances as of the balance sheet date	Dec. 31, 2007 K€	Dec. 31, 2006 K€
Receivables from related parties	6,518	0
Liabilities to related parties	19,349	0

Total liabilities to related parties in the amount of K€ 19,349 as of December 31, 2007 (previous year: K€ 0) contain a loan of € 10.8 million to the Company as part of the aforementioned financing component; these liabilities also include € 0.4 million in interest outstanding as of the balance sheet date.

4. Events after the Balance Sheet Date

In IFRS accounting, the recording and reporting of events after the balance sheet date is governed by IAS 10 ("Events after the Balance Sheet Date").

The following significant events occurred as of February 28, 2008, the date on which the consolidated financial statements as of December 31, 2007, were disclosed by the Management Board to the Supervisory Board:

Zapf Creation AG announced on February 28, 2008, that the Management Board had resolved on February 22, 2008, with the approval of the Supervisory Board on February 27, 2008, to convert € 12.9 million of the subordinated shareholder loans into equity by means of a non-cash capital increase, as planned and previously announced. The Company will issue 4.8 million new shares to this end, fully utilizing authorized capital. The amount in shareholder loans to be contributed per new share is € 2.69. This non-cash capital increase will further enhance the Company's equity base. As a result, the share capital of Zapf Creation AG will rise from € 13.2 million by € 4.8 million to € 18.0 million. In addition, this measure will help to significantly reduce the Group's future interest expense.

The Roedental warehouse of the French subsidiary of Zapf Creation AG was eliminated completely in connection with the security provided for the new syndicated loan. The existing inventory of goods of Zapf Creation (France) S.à.r.l. was sold in its entirety to Zapf Creation AG on January 31, 2008. The inventory was sold at its net carrying amount.

5. Disclosures Pursuant to Section 315 a German Commercial Code

5.1. Shareholdings

With regard to the investment structure in the Zapf Creation Group, please see the presentation of Group subsidiaries, which is attached to these notes as Appendix 1.

5.2. Management Board

Composition
The Company's Management Board is comprised as follows:

Jens U. Keil, member of the Management Board, appointed until February 28, 2010
- Finance, Capital Market (Investor Relations), Human Resources, IT, Logistics, Internal Audit, Risk Management, Legal Affairs and Organization

Thomas Pfau, member of the Management Board, appointed until August 28, 2009
- Marketing, Sales, Design and Product Development, Supply Chain Operations, Quality Management, Strategy and Corporate Development

In addition, these two members of the Management Board are responsible for the following tasks above and beyond the areas specifically assigned to them:

- Manage both the independent and the dependent offices of Zapf Creation AG; coordinate the Company's strategic business goals; control and monitor the offices' business activities; and manage both corporate data protection policies and public relations.

Changes
The following changes with regard to the composition of the Management Board occurred during the period under review:

On January 16, 2007, the Supervisory Board of Zapf Creation AG appointed Mr. Jens U. Keil as the Company's new chief financial officer for a term of three years. Mr. Keil assumed his post as of March 1, 2007, and was initially responsible for Finance, Capital Market, Restructuring, Human Resources, IT, Logistics and Supply Chain Operations. The responsibilities within the Management Board were redistributed in the 2007 financial year. The position now held by Mr. Keil had been vacant since the resignation of Dr. Georg Kellinghusen, who had served as both chairman of the Management Board and chief financial officer, on December 20, 2006.

Disclosures Regarding Compensation

Please see the related party disclosures in Section C, item 3.1. for information on the compensation of the Management Board.

Disclosures Pursuant to Section 15 a German Securities Trading Act

The Company was not notified of any transactions made by members of the Management Board, their spouses or immediate relatives requiring disclosure pursuant to Section 15 a German Securities Trading Act. All members of the Management Board have been informed in detail regarding the disclosure requirement.

5.3. Supervisory Board

Composition

The Company's Supervisory Board is comprised as follows:

Dr. Harald Rieger, chairman of the Supervisory Board since February 27, 2007, regular member since February 12, 2007
- Main occupation: Lawyer
- No further offices.

Francesc Robert, vice chairman since July 28, 2006, member since May 11, 2005
- Main occupation: Chief executive officer and chairman of the Supervisory Board, Octapris Investments S.L.
- Further offices: Daren Motorsport S.L., chairman; Irbe Xarxa 2001 S.L., chairman, Ingenia Capital, SCR, regular member, Nominalia Internet S.L., vice chairman, Centric Software S.L., regular member, Kroopier S.L., regular member, USAP S.A., regular member, Angels Business & Financial Corporation, chairman, Vsaladis System SA, regular member

Gustavo Perez, regular member, vice chairman until July 28, 2006, member since May 11, 2005
- Main occupation: Chief executive officer, Betham Capital Investment
- No further offices.

Miguel Perez-Carballo Villar, regular member since September 14, 2005, chairman of the Supervisory Board from July 28, 2006, to February 27, 2007
- Main occupation: Chief executive officer and managing director, Norte Motor S.A., and managing director, Uria Motor S.A.
- No further offices.

Isaac Larian, regular member since August 24, 2006
- Main occupation: Chief executive officer, MGA Entertainment, Inc.
- Further offices: Hielx (USA), member of the board

Ron Brawer, regular member since August 24, 2006
- Main occupation: President Europe, MGA Entertainment, Inc.
- No further offices.

The Company was not notified of further offices, changes in the offices listed above, or main occupations of the members of the Supervisory Board. All members of the Supervisory Board have been informed in detail regarding the disclosure requirement.

Changes
The following change with regard to the composition of the Supervisory Board occurred during the period under review:

On February 27, 2007, Dr. Harald Rieger, lawyer, domiciled in Bad Homburg, Germany, who had been appointed a regular member of the Supervisory Board by order dated February 12, 2007, of the Coburg local court, was elected chairman of the Supervisory Board. The previous chairman of the Supervisory Board, Mr. Miguel Perez-Carballo Villar, has been serving as a regular member of Supervisory Board since that date.

Disclosures Regarding Compensation
Please see the related party disclosures in Section C, item 3.2. for information on the compensation of the Supervisory Board.

Disclosures Pursuant to Section 15 a German Securities Trading Act
Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 6, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on March 5, 2007, it had purchased a total of 2,000 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 9.00 per share for a total transaction volume of € 18,000.00.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 21, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on March 19, 2007, it had purchased a total of 751 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 8.95 per share for a total transaction volume of € 6,721.45.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on March 21, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on March 20, 2007, it had purchased a total of 3,586 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 9.05 per share for a total transaction volume of € 32,453.30.

Attorneys for the Isaac and Angela Larian Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on July 23, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on July 18, 2007, it had purchased a total of 119,988 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.59 per share for a total transaction volume of € 551,104.88.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 12, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 8, 2007, it had purchased a total of 10,487 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.23 per share for a total transaction volume of € 44,360.01.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 15, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 10, 2007, it had purchased a total of 11,500 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.25 per share for a total transaction volume of € 48,875.00.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 16, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 11, 2007, it had purchased a total of 67,769 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 4.50 per share for a total transaction volume of € 304,960.50.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 492,585 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 1,556,568.60.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 9 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 28.44.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 249,250 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 787,630.00.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 8 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 25.28.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 39,050 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 123,398.00.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 39,050 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 123,398.32.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 31,345 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 99,050.20.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for Ron Brawer, a member of the Supervisory Board, notified Zapf Creation AG on October 26, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 9,615 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 30,383.40.

Attorneys for Ron Brawer, a member of the Supervisory Board, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 24, 2007, it had purchased a total of 2 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 6.32.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 26, 2007, it had purchased a total of 171,751 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 542,733.16.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 26, 2007, it had purchased a total of 86,911 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 274,638.76.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 26, 2007, it had purchased a total of 91,644 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 289,595.04.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 26, 2007, it had purchased a total of 91,644 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 289,595.04.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on October 29, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on October 26, 2007, it had purchased a total of 73,574 shares of Zapf Creation AG stock (ISIN DE 000A0TGNS0) at a price of € 3.16 per share for a total transaction volume of € 232,493.84.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 21, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on November 16, 2007, it had purchased a total of 1,904 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.15 per share for a total transaction volume of € 5,997.60.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on November 21, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on November 19, 2007, it had purchased a total of 7,963 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 3.15 per share for a total transaction volume of € 25,083.45.

Attorneys for the Isaac Larian Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on December 7, 2007, it had purchased a total of 434,624 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 1,347,334.40.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on December 7, 2007, it had purchased a total of 219,904 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 681,702.40.

Attorneys for the Shirin Larian Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on December 7, 2007, it had purchased a total of 51,904 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 160,902.40.

Attorneys for the Jahangir Eli Makabi Annuity Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on December 7, 2007, it had purchased a total of 51,904 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 160,902.40.

Attorneys for the Shirin and Jahangir Eli Makabi Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on December 11, 2007, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on December 7, 2007, it had purchased a total of 41,664 shares of Zapf Creation AG stock (ISIN DE 000A0PNPM2) at a price of € 3.10 per share for a total transaction volume of € 129,158.40.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on January 21, 2008, it had purchased a total of 63,335 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.7255 per share for a total transaction volume of € 172,619.54.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on January 22, 2008, it had purchased a total of 29,938 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.59 per share for a total transaction volume of € 77,539.42.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 25, 2008, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on January 23, 2008, it had purchased a total of 29,730 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.61 per share for a total transaction volume of € 77,654.76.

Attorneys for the Isaac and Angela Larian Living Trust, a company belonging to the Supervisory Board member Isaac Larian, notified Zapf Creation AG on January 28, 2008, in accordance with Section 15 a German Securities Trading Act (Wertpapierhandelsgesetz) that on January 25, 2008, it had purchased a total of 3,568 shares of Zapf Creation AG stock (ISIN DE 0007806002) at a price of € 2.70 per share for a total transaction volume of € 9,633.60.

The Company was not notified of any other transactions requiring disclosure made by members of the Supervisory Board, their spouses or immediate relatives. All members of the Supervisory Board have been informed in detail regarding the disclosure requirement.

5.4. Disclosure of the Auditor's Fee

As in the previous year, KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Nuremberg, Germany, is the auditor of the consolidated financial statements of Zapf Creation AG.

The following auditor's fees were recognized in the reporting period:

	2007 K€	2006 K€
Audits of financial statements	269	192
Other auditing and valuation services	87	0
Tax consultancy services	0	0
Other services	127	621
Auditor's fee	483	813

5.5. Declaration of Compliance Regarding the German Corporate Governance Code

The Company points out that it has issued the Declaration of Compliance for 2007 regarding the recommendations of the Government Commission German Corporate Governance Code as required by Section 161 of the German Stock Corporation Act and made this declaration permanently available to the shareholders on the Company's website.

6. Disclosures Pursuant to Section 264 b German Commercial Code

The Group subsidiary Zapf Creation Logistics GmbH & Co. KG, domiciled in Roedental, Germany, avails itself of the exemption provisions of Section 264 b German Commercial Code. Under this provision, the company is exempt from preparing and publishing annual financial statements and a management report in accordance with the provisions of Section 264 et seq. German Commercial Code governing stock corporations, and from having such annual financial statements and the management report audited.

Nevertheless, the company subjects itself to a voluntary audit of its annual financial statements.

Roedental, Germany, February 28, 2008

Jens U. Keil
Member of the Management Board

Thomas Pfau
Member of the Management Board

Appendix 1
Group Subsidiaries of Zapf Creation

as of December 31, 2007

Company	Headquarters on December 31, 2007	Date of formation
Zapf Creation (H.K.) Ltd.	Kowloon, Hong Kong	April 30, 1991
Zapf Creation (U.S.) Inc.	Orlando, Florida, USA	April 15, 1999
Zapf Creation (France) S.à.r.l.	Rungis, France	January 1, 2000
Zapf Creation (U.K.) Ltd.	Corby, Northants, GB	January 1, 2000
Zapf Creation (Italia) S.R.L.	Milan, Italy	July 31, 2001
Zapf Creation (Polska) Sp. z o.o.	Warsaw, Poland	August 9, 2001
Zapf Creation (España) S.L.	Madrid, Spain	January 1, 2002
Zapf Creation (Central Europe) Verwaltungs GmbH	Roedental, Germany	March 24, 2003
Zapf Creation Logistics GmbH & Co. KG	Roedental, Germany	March 24, 2003
Zapf Creation Logistics Beteiligungs GmbH	Roedental, Germany	March 24, 2003
Zapf Creation Auslandsholding GmbH	Roedental, Germany	September 15, 2006

The results for the 2007 accounting period and the resulting equity as of December 31, 2007 are based on IFRS.
Zapf Creation AG has held an indirect share in the Group subsidiaries Zapf Creation (U.K.) Ltd. and Zapf Creation (España) S.L. through Zapf Creation Auslandsholding GmbH, Roedental, Germany, since September 2006.

Percentage held in issued capital	Carrying amounts of Zapf Creation AG as of Dec. 31, 2007 after allowance	Net profit or loss for the period, 2007	Equity as at Dec. 31, 2007
		Local currency	Local currency
100 %	795,979.77 €	8,880,739.56 HKD	−13,361,348.55 HKD
100 %	93.40 €	−134,837.30 USD	−6,419,336.98 USD
100 %	0.00 €	−3,065,101.50 €	−5,669,934.75 €
100 %	0.00 €	604,445.24 GBP	2,010,129.65 GBP
100 %	0.00 €	−3,231.04 €	−86,373.60 €
100 %	13,794.62 €	594,899.07 PLN	4,366,398.44 PLN
100 %	0.00 €	558,824.90 €	3,443,317.80 €
100 %	25,000.00 €	−3,239.15 €	16,970.60 €
100 %	2,965,852.09 €	450,212.69 €	3,447,097.49 €
100 %	25,000.00 €	−2,273.62 €	18,122.05 €
100 %	9,227,600.00 €	−5,676.03 €	9,217,323.97 €
	13,053,319.88 €		

Appendix 2
Statement of Changes in Property, Plant and Equipment and Intangible Assets of Zapf Creation

from January 1 to December 31, 2007

	Cost					
	Jan. 1, 2007	Additions	Disposals	Transfers	Currency translation	Dec. 31, 2007
	K€	K€	K€	K€	K€	K€
Property, plant and equipment						
Land and buildings	13,345	0	73	0	−21	13,251
Machinery	4,523	654	0	293	−443	5,027
Motor vehicles, furniture and fixtures, and office equipment	25,009	612	3,722	11	−73	21,837
Assets under construction	267	249	0	−304	−13	199
	43,144	1,515	3,795	0	−550	40,314
Intangible assets						
Patents, brand names and licenses	7,177	0	0	0	0	7,177
Computer software	10,035	79	46	108	−19	10,157
Assets under construction	35	98	0	−108	0	25
	17,247	177	46	0	−19	17,359

from January 1 to December 31, 2006

	Cost					
	Jan. 1, 2006	Additions	Disposals	Transfers	Currency translation	Dec. 31, 2006
	K€	K€	K€	K€	K€	K€
Property, plant and equipment						
Land and buildings	13,503	13	142	0	−29	13,345
Machinery	3,914	587	31	415	−362	4,523
Motor vehicles, furniture and fixtures, and office equipment	25,736	688	1,407	53	−61	25,009
Assets under construction	366	402	0	−468	−33	267
	43,519	1,690	1,580	0	−485	43,144
Intangible assets						
Patents, brand names and licenses	7,177	0	0	0	0	7,177
Computer software	10,523	58	656	134	−24	10,035
Assets under construction	106	75	12	−134	0	35
	17,806	133	668	0	−24	17,247

Depreciation/amortization						Residual values	
Jan. 1, 2007	Additions	Disposals	Transfers	Currency translation	Dec. 31, 2007	Dec. 31, 2007	Dec. 31, 2006
K€	K€	K€	K€	K€	K€	K€	K€
7,115	275	73	0	−20	7,297	5,954	6,230
3,772	792	0	0	−374	4,190	837	751
14,782	1,629	3,403	0	−64	12,944	8,893	10,227
0	0	0	0	0	0	199	267
25,669	2,696	3,476	0	−458	24,431	15,883	17,475
3,321	754	0	0	0	4,075	3,102	3,856
9,141	657	44	0	−15	9,739	418	894
0	0	0	0	0	0	25	35
12,462	1,411	44	0	−15	13,814	3,545	4,785

Depreciation/amortization						Residual values	
Jan. 1, 2006	Additions	Disposals	Transfers	Currency translation	Dec. 31, 2006	Dec. 31, 2006	Dec. 31, 2005
K€	K€	K€	K€	K€	K€	K€	K€
6,821	342	22	0	−26	7,115	6,230	6,682
2,905	1,167	1	−30	−269	3,772	751	1,009
13,599	2,170	979	30	−38	14,782	10,227	12,137
0	0	0	0	0	0	267	366
23,325	3,679	1,002	0	−333	25,669	17,475	20,194
2,567	754	0	0	0	3,321	3,856	4,610
8,716	902	462	0	−15	9,141	894	1,807
0	0	0	0	0	0	35	106
11,283	1,656	462	0	−15	12,462	4,785	6,523

Appendix 3
Consolidated Segment Reporting of Zapf Creation

as of December 31, 2007

Segment Reporting by Region

	Central Europe		Northern Europe		Southern Europe		Eastern Europe		The Americas	
	2007 K€	2006 K€	2007 K€	2006 K€	2007 K€	2006 K€	2007 K€	2006 K€	2007 K€	2006 K€
External revenue	36,152	38,241	34,884	37,889	16,160	20,999	20,800	15,884	1,915	10,610
Internal revenue	1,438	19,407	1,982	14,828	1,149	10,705	466	1,504	0	6,248
Total segment revenue	37,590	57,648	36,866	52,717	17,309	31,704	21,266	17,388	1,915	16,858
Segment assets	61,885	53,709	13,653	16,031	20,085	22,647	7,189	3,978	1,910	8,920
Investments in property, plant and equipment and intangible assets	1,090	537	11	54	109	111	80	50	0	24
Segment liabilities*	24,111	21,543	7,352	7,595	13,220	18,343	5,282	3,201	6,608	3,689
Earnings before interest, taxes, depreciation and amortization (EBITDA)	4,739	4,543	3,964	3,522	529	604	5,101	3,404	124	−5,139
Depreciation/amortization	−3,064	−3,616	−101	−148	−74	−89	−43	−33	0	−45
Financial result	—	—	—	—	—	—	—	—	—	—
Taxes on income	—	—	—	—	—	—	—	—	—	—
Net profit or loss for the period	—	—	—	—	—	—	—	—	—	—
Non-cash expenses	994	2,033	481	452	695	986	98	195	0	173

*Columns "Other" and "Group" including shareholders' equity.

Segment Reporting by Product line

	Play and functional dolls							
	BABY born®		Baby Annabell®		CHOU CHOU		Other play and functional dolls	
	2007 K€	2006 K€	2007 K€	2006 K€	2007 K€	2006 K€	2007 K€	2006 K€
External revenue from continued operations	59,653	53,689	28,468	36,269	14,791	18,116	203	799
Segment assets	62,180	53,437	29,674	36,098	15,418	18,031	212	795
Investments in property, plant and equipment and intangible assets	914	844	436	569	227	284	3	13

Asia / Australia		Other		Consolidation		Group		Discontinued operations		Continued operations	
2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€	K€
2,461	3,093	0	0	0	0	112,372	126,716	1,915	10,610	110,457	116,106
0	61	0	0	−5,035	−52,753	0	0	0	0	0	0
2,461	3,154	0	0	−5,035	−52,753	112,372	126,716	1,915	10,610	110,457	116,106
2,884	7,337	78,479	108,801	−70,948	−105,863	115,137	115,560	—	—	—	—
402	1,047	0	0	0	0	1,692	1,823	—	—	—	—
3,512	7,260	103,756	110,506	−48,704	−56,577	115,137	115,560	—	—	—	—
−4,181	1,696	−365	−8,140	0	0	9,911	490	124	−4,304	9,787	4,794
−825	−1,404	0	0	0	0	−4,107	−5,335	0	−45	−4,107	−5,290
—	—	—	—	—	—	−3,801	−8,050	−271	−1,744	−3,530	−6,306
—	—	—	—	—	—	−4,751	222	48	−54	−4,799	276
—	—	—	—	—	—	−2,748	−12,673	−99	−6,147	−2,649	−6,526
0	0	495	6,386	0	−3,852	2,763	6,373	—	—	—	—

Mini dolls		Other		Group		Continued operations	
2007	2006	2007	2006	2007	2006	2007	2006
K€	K€	K€	K€	K€	K€	K€	K€
464	2,761	6,878	4,472	—	—	110,457	116,106
484	2,748	7,169	4,451	115,137	115,560	—	—
7	43	105	70	1,692	1,823	—	—

Auditor's Opinion

We have audited the consolidated financial statements comprising the balance sheet, income statement, statement of changes in equity, statement of cash flows and notes to the financial statements, of Zapf Creation AG, Roedental, and their report on the position of the Company and the Group for the business year from January 1 to December 31, 2007. The preparation of the consolidated financial statements and group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315 a (1) HGB are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB [Handelsgesetzbuch: German Commercial Code] and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the financial statements of the companies included in consolidation, the determination of the companies to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the executive board, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315 a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable understanding of the Group's position and suitably presents the opportunities and risks of future development.

Nuremberg, Germany, February 29, 2008

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Dankert
Wirtschaftsprüfer
(German Public Auditor)

Dr. Kelle
Wirtschaftsprüfer
(German Public Auditor)

Responsibility Statement

Responsibility Statement Regarding the Consolidated Financial Statements as of December 31, 2007, and the Group Management Report of Zapf Creation AG, Roedental

"To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the group, and the group management report includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal opportunities and risks associated with the expected development of the group."

Darmstadt, Germany, March 12, 2008

Jens U. Keil	Thomas Pfau
Member of the Management Board	Member of the Management Board

Annual Financial Statements of Zapf Creation AG According to the German Commercial Code (HGB)

The full single-entity financial statements of Zapf Creation AG according to the German Commercial Code (HGB) are available on request.

Income Statement of Zapf Creation AG

for the Financial Year from January 1 to December 31, 2007

		2007 €	2006 €
1.	Sales	48,910,999.59	497,330.24
2.	Cost of sales	– 24,529,522.48	– 504,172.34
3.	**Gross profit (loss)**	**24,381,477.11**	**– 6,842.10**
4.	Distribution costs	– 26,135,124.57	– 6,361,511.59
5.	General administration expenses	– 15,225,746.29	– 11,150,549.69
6.	Other operating income	21,751,645.88	22,084,455.49
7.	Other operating expenses	– 11,225,637.04	– 4,027,914.69
8.	Income from investments	0.00	3,000,000.00
	– of which from affiliated companies: € 0.00 (previous year: € 3,000,000.00)		
9.	Income from lending financial assets	1,092,340.47	711,960.01
	– of which from affiliated companies: € 1,092,340.47 (previous year: € 711,960.01)		
10.	Income from investments in cooperative societies	11,169.92	0.00
11.	Other interest and similar income	1,236,681.91	620,611.02
	– of which from affiliated companies: € 299,517.90 (previous year: € 180,395.38)		
12.	Write-downs on financial assets and marketable securities	– 3,205,455.78	0.00
13.	Interest and similar expenses	– 5,385,006.82	– 5,416,637.78
	– of which payable to affiliated companies: € 879.00 (previous year: € 685,310.55)		
14.	**Profit on ordinary activities before taxes**	**– 12,703,655.21**	**– 546,429.33**
15.	Extraordinary profit (loss)		
	– of which income: € 1,652,973.47 (previous year: € 9,113,946.15) – of which expense: € – 96,146.60 (previous year: € – 15,002,047.41)	1,556,826.87	– 5,888,101.26
	– of which from affiliated companies: € 370,722.58 (previous year: € – 4,731,685.20)		
16.	Taxes on income	– 305,761.19	– 789,910.56
17.	Other taxes	– 40,222.13	– 11,735.51
18.	**Net loss**	**– 11,492,811.66**	**– 7,236,176.66**
19.	Loss brought forward	– 14,290,201.81	– 6,441,259.69
20.	Withdrawal from reserve for treasury shares	3,155,455.78	0.00
21.	Transfer to reserve for treasury shares	0.00	– 612,765.46
22.	**Accumulated deficit**	**– 22,627,557.69**	**– 14,290,201.81**

Balance Sheet of Zapf Creation AG

as of December 31, 2007

	Dec. 31, 2007		Dec. 31, 2006	
	€	€	€	€
Assets				
A. Fixed assets		**41,661,873.03**		**73,998,105.41**
I. Intangible assets				
1. Concessions, patents, licenses, trademarks and similar rights and assets	3,270,065.10		4,018,119.15	
2. Prepayments	26,684.99	**3,296,750.09**	36,684.99	**4,054,804.14**
II. Property, plant and equipment				
1. Land and buildings	1,394,874.54		406,174.20	
2. Plant and machinery	5,912.50		4.00	
3. Fixtures, fittings, tools and equipment	1,689,832.00		786,879.50	
4. Prepayments and assets under construction	167,689.04	**3,258,308.08**	8,378.85	**1,201,436.55**
III. Financial assets				
1. Investments in affiliated companies	13,053,319.88		43,017,729.89	
2. Loans to affiliated companies	22,042,974.98		25,703,874.83	
3. Investments in cooperative societies	520.00		260.00	
4. Other loans	10,000.00	**35,106,814.86**	20,000.00	**68,741,864.72**
B. Current assets		**59,899,753.99**		**23,998,984.64**
I. Inventories				
1. Raw materials and supplies	60,220.23		0.00	
2. Finished goods and merchandise	6,333,846.31	**6,394,066.54**	388.49	**388.49**
II. Receivables and other assets				
1. Trade receivables	14,412,676.23		0.00	
2. Amounts owed by affiliated companies	17,412,005.23		14,433,780.35	
3. Other assets	6,674,165.10	**38,498,846.56**	3,079,571.09	**17,513,351.44**
III. Securities				
Treasury shares		**1,941,378.42**		**5,096,834.20**
IV. Cash at bank and on hand		**13,065,462.47**		**1,388,410.51**
C. Prepaid expenses		**479,997.65**		**236,547.08**
Total assets		**102,041,624.67**		**98,233,637.13**

	Dec. 31, 2007		Dec. 31, 2006	
	€	€	€	€
Liabilities				
A. Shareholders' equity		**16,430,812.15**		**14,091,617.49**
I. Subscribed capital		**13,200,000.00**		**8,799,998.00**
II. Capital reserves		**23,916,991.42**		**14,484,987.10**
III. Revenue reserves				
Reserve for treasury shares		**1,941,378.42**		**5,096,834.20**
IV. Accumulated deficit		**−22,627,557.69**		**−14,290,201.81**
B. Provisions		**13,690,519.11**		**13,718,344.09**
1. Tax provisions	101,885.00		1,208,000.00	
2. Other provisions	13,588,634.11	**13,690,519.11**	12,510,344.09	**13,718,344.09**
C. Payables		**71,920,293.41**		**70,423,675.55**
1. Due to banks	40,317,449.99		52,208,295.22	
2. Trade payables	12,905,790.62		1,561,155.86	
3. Payables to affiliated companies	1,578,207.99		16,622,367.11	
4. Other payables	17,118,844.81	**71,920,293.41**	31,857.36	**70,423,675.55**
– of which from taxes: € 94,676.61 (previous year: € 30,853.86)				
– of which from social security: € 0.00 (previous year: € 1,003.50)				
Total liabilities		**102,041,624.67**		**98,233,637.13**

Financial Calendar

Date	Event	Place
February 25, 2008	Publication of preliminary unaudited financial figures for 2007	Roedental
March 31, 2008	Publication of financial statements, Annual Report 2007 as PDF	Roedental
March 31, 2008	Financial statements press conference	Munich
March 31, 2008	Analysts' conference	Frankfurt/Main
May 15, 2008	Results Q1/3 months 2008	Roedental
May 27, 2008	9th Annual Shareholders' Meeting	Roedental
August 15, 2008	Results Q2/half-year 2008	Roedental
August 25 to 27, 2008	SCC Small Cap Conference of DVFA	Frankfurt/Main
November 7, 2008	Results Q3/9 months 2008	Roedental
November 10 to 12, 2008	German Equity Forum 2008	Frankfurt/Main

Contact

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Note:
Dieser Geschäftsbericht liegt auch in deutscher Sprache vor.
This Annual Report is also available in German.

...come and join us!

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