



# At a Glance

## Consolidated Key Figures

	Q3/ 2004	Q3/ 2003	Q1-Q3/ 2004	Q1-Q3/ 2003	+/- Q1-Q3 in % <sup>1)</sup>
<b>Income Statement</b>					
Net sales in K€	65,359	79,058	115,071	139,072	- 17
EBITDA in K€	13,693	17,310	17,485	25,337	- 31
EBIT in K€	11,740	15,661	12,186	20,454	- 40
Net income in K€	7,860	10,353	7,231	13,122	- 45
Basic earnings per share in €	1.06	1.30	0.97	1.66	- 41
<b>Balance sheet</b>					
Total assets as of Sep. 30 in K€	n/a	n/a	190,558	178,911	7
Investments in K€	5,074	1,360	8,383	5,942	41
<b>Cash flow</b>					
Net cash flow per share in €	- 1.35	- 0.55	- 4.06	- 1.16	n/a
<b>Stock</b>					
Stock price, high (Xetra) in €	19.37 (July 5)	36.46 (Sep. 8)	23.79 (Feb. 18)	36.46 (Sep. 8)	n/a
Stock price, low (Xetra) in €	14.83 (Sep. 14)	29.70 (July 31)	14.83 (Sep. 14)	24.02 (Mar. 11)	n/a
Stock price, end of period (Xetra) in €	16.00	32.99	16.00	32.99	- 52
Stock price, average (Xetra) in €	16.71	32.62	19.12	30.37	- 37
Average daily trading volume (Xetra, number of shares)	22,239	23,583	32,759	22,558	45
Market capitalization (base: end of period) in € million	128.00	263.92	128.00	263.92	- 52
Number of employees at the closing date (Sep. 30) <sup>2)</sup>	487	545	487	545	- 11

<sup>1)</sup> rounded

<sup>2)</sup> not including management board and trainees

# Quarterly Report 3/2004

During the first nine months of 2004, Zapf Creation AG recorded sales of € 115.1 million. Due to continued sluggish ordering on the part of retailers before the start of the important Christmas business, sales from January through September were lower than for the previous year (2003: € 139.1 million). Earnings before interest and taxes (EBIT) were € 12.2 million (2003: € 20.5 million). At 57%, the company managed to keep the gross margin almost at the previous-year level. At the end of September, the consolidated net income was € 7.2 million (2003: € 13.1 million). Earnings per share were € 0.97 (2003: € 1.66).

## Growth in local currency terms expected for U.S. market in 2004

As of the end of September, Central Europe recorded sales worth € 41.1 million (2003: € 59.5 million), thereby remaining 31% below the previous-year level. This is primarily due to the fact that German retailers will enter the holiday season with considerably lower inventory levels. This was also shown by the sales in play and functional dolls to consumers in Germany, which were up 6.4% in the first nine months of 2004 (source: NPD/Eurotoys). Due to the successful launch of the New BABY born® doll in June of 2004, the doll was among the top 10 German toys from July to September (source: NPD/Eurotoys). As expected, sales for the BABY born® miniworld continued to decline in Germany. However, Zapf Creation is pursuing the objective of maintaining a double-digit market share in the mini doll segment in 2004.

Sales in Northern Europe were up 2% to € 31.7 million (2003: € 31.0 million.) In local currency terms, the growth markets of Great Britain/Ireland even recorded a 10% increase. This development was due to the continued strong sales of the Baby Annabell concept. During the pre-Christmas business, the Baby Annabell doll was once again one of the ten strongest-selling toys (source: NPD/Eurotoys) and also qualified for the top 60 toys for Christmas (source: British Toy and Hobby Association).

At € 14.5 million, sales in Southern Europe were 5% below previous year's level at the end of the third quarter (2003: € 15.3 million).

Due to strong demand in the Russian market, the Eastern Europe business unit continued to exhibit positive growth. Sales were up 52% from € 3.0 million to € 4.5 million.

At USD 22.7 million, sales in the American market in local currency terms were USD 5 million below the previous year. Converted to euros, Zapf Creation recorded sales worth € 18.6 million (2003: € 25.0 million). Due to the successfully initiated change of strategy, the management board still expects a sales increase in local currency terms for this important market as of the end of fiscal year 2004.

At € 4.7 million, sales in Asia/Australia were 13% below the previous-year level (2003: € 5.4 million). For Australia, the single largest market within the business unit, Zapf Creation concluded a sales cooperation agreement with Funtastic Ltd. By having its strong branded play concepts BABY born®, Baby Annabell and CHOU CHOU sold through Funtastic, the number one in the Australian toy market, Zapf Creation is pursuing the objective of strengthening its position and advancing more quickly and more efficiently in this market.

## Breakdown of sales by business units

	Q1-Q3/2004	Q1-Q3/2003	+/-
	K€	K€	in %
<b>Europe</b>	<b>91,818</b>	<b>108,703</b>	<b>- 16</b>
Central Europe	41,136	59,460	- 31
Northern Europe	31,661	30,952	2
Southern Europe	14,525	15,332	- 5
Eastern Europe	4,496	2,959	52
<b>The Americas</b>	<b>18,557</b>	<b>24,979</b>	<b>- 26</b>
<b>Asia/Australia</b>	<b>4,696</b>	<b>5,390</b>	<b>- 13</b>
<b>Net sales</b>	<b>115,071</b>	<b>139,072</b>	<b>- 17</b>

# Quarterly Report 3/2004

## New "Love me CHOU CHOU" provides positive momentum for the branded play concept

During Q3/2004, CHOU CHOU sales received a positive impulse from the successful launch of the new functional doll "Love me CHOU CHOU". This positive momentum will continue with respect to the entire fiscal year. However, as of September 30, the branded play concept CHOU CHOU recorded a slight decline in sales to € 25.7 million (2003: € 27.5 million).

Recording sales worth € 32.4 million in the first nine months of the year (2003: € 29.0 million), the branded play concept Baby Annabell achieved an increase of 12%.

The BABY born® concept went from € 57.3 million in sales to € 45.6 million as of the end of September. This was mainly due to the weak business development of accessories in the important German market. On the other hand, the introduction of the New BABY born® with as many as eight functions now has led to a positive development for the doll. As a result of a one-off payment to the developer of the BABY born® doll during the third quarter, all commercial property rights have now been transferred to Zapf Creation. Thus no more license payments will have to be made. For the period under review, the termination of the licensing agreement is reflected by an increase of both investments and intangible assets.

## Breakdown of sales by product lines

	Q1-Q3/2004	Q1-Q3/2003	+/-
	K€	K€	in %
<b>Large dolls</b>	<b>107,261</b>	<b>120,967</b>	<b>- 11</b>
BABY born®	45,564	57,284	- 20
Baby Annabell	32,420	29,001	12
CHOU CHOU	25,739	27,499	- 6
Others	3,538	7,183	- 51
<b>Mini dolls</b>	<b>3,233</b>	<b>11,234</b>	<b>- 71</b>
<b>All others</b>	<b>4,577</b>	<b>6,871</b>	<b>- 33</b>
<b>Net sales</b>	<b>115,071</b>	<b>139,072</b>	<b>- 17</b>

## Guarded attitude for the Christmas business...

Even though it looked as if the business development would stabilize after the end of the second quarter, the third quarter lagged behind expectations. Especially in the Central Europe business unit with the important German market, the retail sector continues to exhibit a cautious ordering behavior shortly before the start of the important Christmas business.

On the other hand, we saw German retailers will enter the holiday season with considerably lower inventory levels. This also explains why we recorded an 6.4% increase regarding play and functional doll sales to consumers from January to September (source: NPD/Eurotoys September 2004), although our third-quarter sales in Germany were about 30% lower than the year before.

The negative overall economic situation and the continued difficulties in the retail environment – with regional differences – leave little room for optimism. Based on sales and the orders received until October 2004, we currently expect sales to come in below expectations. As a result, we assume that we will not achieve our sales target of € 190 million.

## ...and outlook on 2005 product novelties

The weak business development in our important German market, where BABY born® has a brand awareness of almost 100%, is directly connected to the downward trend in accessories for the BABY born® concept. As a result, we made the product range of accessories much more attractive for 2005, both with regard to pricing and to themes such as "Swimming and Beach", "Pop Star" or "Fairies", which will be launched over the course of the year.

# The Stock

As part of the brand development, the successful Baby Annabell concept will be refreshed with a new logo and packaging design and will feature a new version of the Baby Annabell doll that will be launched on a worldwide scale for the 2005 Christmas business.

With Yummy CHOU CHOU, we will launch a functional doll within the CHOU CHOU concept whose price will be significantly below the usual price levels. By doing so, we intend to position ourselves with high-quality products in both the high-price and the lower-price segments.

My Model, the concept for creative girls, which comprises styling heads and accessories, will be positioned even more target-group specifically next year. With the launch of My Model "Junior" (ages 3 to 6) and My Model "Professional" (ages 7 to 11), the concept will be tailored even more to the age-specific play patterns of girls and offer a more individualized entry to the world of "styling".

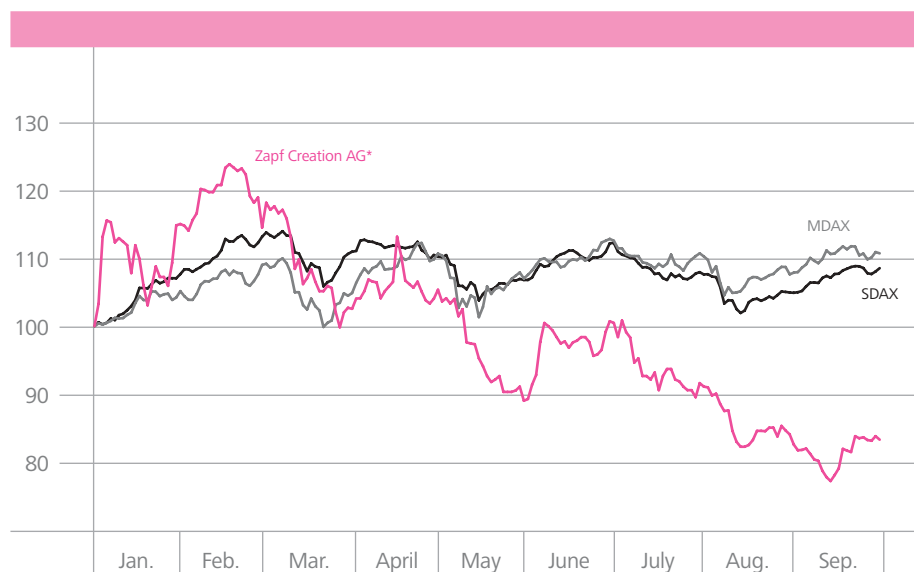
## Zapf Creation stock

In the third quarter, the price of Zapf Creation stock continued its downward trend and reached a low of € 14.83 on September 14, 2004. On September 30, 2004, the stock sold at € 16, down 17% compared to the closing price at the end of the second quarter.

Effective September 20, 2004, Zapf Creation stock was relegated from the MDAX to the SDAX Small-Cap-Index. This decision of the stock exchange is due to the lower market capitalization of Zapf Creation. The calculation of the market capitalization as of August 31, 2004, was based on the average price of the stock on the 20 previous trading days.

The inclusion of Zapf Creation stock in the SDAX as of September 20, 2004, will have no impact on the quality of the investor relations work. Investor relations will continue to be given high priority by the company.

## Stock performance 2004 (Index)



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

\*Closing price Xetra, daily

# The Stock

## Research coverage/Analyst recommendations

Analyst	Date	Recommendation
Berenberg Bank	October 2004	Hold
HypoVereinsbank	October 2004	Neutral
Hamburger Sparkasse	August 2004	Hold
ABN Amro	July 2004	Reduce
Bankhaus Lampe	July 2004	Hold
Bayerische Landesbank	July 2004	Neutral
Cazenove	July 2004	Hold
Deutsche Bank	July 2004	Buy
Dresdner Kleinwort Wasserstein	July 2004	Hold
DZ Bank	July 2004	Buy
HSBC Trinkaus & Burkhardt	July 2004	Reduce
CAI Cheuvreux	June 2004	Underperform
Commerzbank	April 2004	Equal weight

## Directors' dealing

During the period from July 1 to September 30, 2004, the officers and directors of the Company did not engage in any dealings as defined by § 15a of the German Securities Trading Act (WpHG).

## Financial calendar

Date	Event	Place
October 26, 2004	Release of third quarter figures 2004; Release of nine months report 2004	
October 26, 2004, 4:00 p.m.	Global Conference Call	
October 28/29, 2004	Roadshow Northern Europe	London, Edinburgh
November 4/5, 2004	Roadshow USA	New York
November 24, 2004	"Deutsches Eigenkapitalforum" of Deutsche Börse AG	Frankfurt
May 11, 2005, 10:00 a.m.	6th Annual Shareholders' Meeting (AGM)	Roedental
May 31, 2005	8th German Corporate Conference (GCC) Deutsche Bank	Frankfurt

## Treasury stock

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

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

Portfolio No. 2 includes shares which in the past were frequently offered to employees at preferred prices because of the positive development of the Company's business or in connection with successfully completed projects.

There were no changes regarding the securities portfolios as compared to December 31, 2003.

	Stock Number	Book value K€	Percentage of share capital in %
Portfolio No. 1	569,593	11,262	7.12
Portfolio No. 2	3,085	96	0.04
<b>Total</b>	<b>572,678</b>	<b>11,358</b>	<b>7.16</b>

# Financial Statements

## Consolidated Income Statement

of Zapf Creation AG, Roedental, for the period from January 1 through September 30, 2004 (US GAAP)

	Q3/2004	Q3/2003	Q1-Q3/2004	Q1-Q3/2003	+/- Q1-Q3
	K€	K€	K€	K€	in % <sup>1)</sup>
Net sales	65,359	79,058	115,071	139,072	- 17
Cost of goods sold	- 27,490	- 33,138	- 48,946	- 58,420	- 16
<b>Gross profit</b>	<b>37,869</b>	<b>45,920</b>	<b>66,125</b>	<b>80,652</b>	<b>- 18</b>
Selling and distribution expenses	- 11,437	- 11,128	- 21,592	- 20,990	3
Marketing expenses	- 9,641	- 11,667	- 16,951	- 18,853	- 10
Administrative expenses, net	- 5,051	- 7,464	- 15,396	- 20,355	- 24
<b>EBIT – Operating profit before interest and taxes</b>	<b>11,740</b>	<b>15,661</b>	<b>12,186</b>	<b>20,454</b>	<b>- 40</b>
Interest income	69	31	198	101	96
Interest expense	- 561	- 926	- 2,046	- 2,222	- 8
<b>EBT – Profit before income tax expense</b>	<b>11,248</b>	<b>14,766</b>	<b>10,338</b>	<b>18,333</b>	<b>- 44</b>
Income tax expense	- 3,388	- 4,413	- 3,107	- 5,211	- 40
<b>Net income</b>	<b>7,860</b>	<b>10,353</b>	<b>7,231</b>	<b>13,122</b>	<b>- 45</b>
Gross margin in %	57.9	58.1	57.5	58.0	- 1

	Q3/2004	Q3/2003	Q1-Q3/2004	Q1-Q3/2003	+/- Q1-Q3
	K€	K€	K€	K€	in % <sup>1)</sup>
<b>Breakdown of personnel expenses<sup>2)</sup></b>					
Sales and distribution department	3,408	1,967	7,380	6,120	21
Marketing department	755	497	2,400	1,693	42
Administrative department	2,262	3,413	7,923	9,080	- 13
<b>Total</b>	<b>6,425</b>	<b>5,877</b>	<b>17,703</b>	<b>16,893</b>	<b>5</b>

<sup>1)</sup> rounded

<sup>2)</sup> already included in operating expenses

# Financial Statements

## Consolidated Balance Sheet

of Zapf Creation AG, Roedental, as of September 30, 2004 (US GAAP)

	Sep. 30, 2004 K€	Sep. 30, 2003 K€	Dec. 31, 2003 K€
<b>Assets</b>			
Cash and cash equivalents	11,339	20,903	15,342
Accounts receivable	80,307	74,722	47,899
Inventories	45,801	43,268	29,118
Prepaid expenses	5,579	3,901	5,700
Other current assets	5,704	3,083	3,470
Deferred tax assets (short-term)	8,061	2,378	1,625
<b>Total current assets</b>	<b>156,791</b>	<b>148,255</b>	<b>103,154</b>
Property, plant, equipment and software, net	27,720	27,817	28,428
Intangible assets, net	5,732	2,580	2,494
Deferred tax assets (long-term)	265	259	347
Other long-term receivables	50	0	0
<b>Total long-lived assets</b>	<b>33,767</b>	<b>30,656</b>	<b>31,269</b>
	<b>190,558</b>	<b>178,911</b>	<b>134,423</b>
<b>Liabilities and stockholders' equity</b>			
Current portion of long-term debt and short-term borrowings	85,396	53,141	40,506
Accounts payable	20,251	19,877	10,088
Accrued liabilities	11,816	15,824	11,346
Income taxes payable	5,996	3,682	1,463
Deferred tax liabilities (short-term)	499	1,370	497
<b>Total current liabilities</b>	<b>123,958</b>	<b>93,894</b>	<b>63,900</b>
Long-term debt	11,190	16,831	14,780
Other long-term liabilities	41	54	67
Deferred tax liabilities (long-term)	585	973	585
<b>Total long-term liabilities</b>	<b>11,816</b>	<b>17,858</b>	<b>15,432</b>
Common stock	8,000	8,000	8,000
Additional paid-in capital	8,052	8,816	8,052
Treasury stock	- 11,358	- 1,829	- 11,358
Accumulated other comprehensive income (loss)	- 4,415	- 3,575	- 4,304
Retained earnings	54,505	55,747	54,701
<b>Total stockholders' equity</b>	<b>54,784</b>	<b>67,159</b>	<b>55,091</b>
	<b>190,558</b>	<b>178,911</b>	<b>134,423</b>



# Financial Statements

## Consolidated Statement of Cash Flows

of Zapf Creation AG, Roedental

	Q1-Q3/2004 K€	Q1-Q3/2003 K€
<b>Cash flow from operating activities:</b>		
Net income	7,231	13,122
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation and amortization	5,293	5,035
Loss (gain) on sale of property, plant, equipment and software	- 59	- 3
Stock-based compensation expense	0	309
Increase (decrease) from changes in assets and liabilities:		
Accounts receivable	- 32,466	- 17,280
Inventories	- 16,731	- 13,623
Prepaid expenses and other assets	- 2,163	- 1,922
Accounts payable, accrued liabilities and other liabilities	10,526	6,224
Income taxes payable	4,532	- 1,146
Deferred taxes	- 6,351	81
<b>Net cash flow from operating activities</b>	<b>- 30,188</b>	<b>- 9,203</b>
<b>Cash flow from investing activities:</b>		
Proceeds from sale of property, plant, equipment and software	667	363
Capital expenditures	- 8,383	- 5,942
<b>Net cash flow from investing activities</b>	<b>- 7,716</b>	<b>- 5,579</b>
<b>Cash flow from financing activities:</b>		
Net borrowings under short- and long-term debt agreements	41,274	26,727
Purchases of treasury stock/proceeds from issuance of treasury stock	0	2,762
Payment of dividends	- 7,427	- 7,924
<b>Net cash flow from financing activities</b>	<b>33,847</b>	<b>21,565</b>
Effect of foreign exchange rate changes on cash	54	- 730
<b>Net increase in cash</b>	<b>- 4,003</b>	<b>6,053</b>
Cash at beginning of period	15,342	14,850
Cash at end of period	11,339	20,903

# Financial Statements

## Consolidated Statement of Stockholders' Equity

of Zapf Creation AG, Roedental

	Shares outstanding number (thsd.)	Common stock K€	Additional paid-in capital K€
<b>Balance at December 31, 2002:</b>	<b>7,874</b>	<b>8,000</b>	<b>8,406</b>
Net income			
Other comprehensive income (loss)			
<b>Total comprehensive income (loss)</b>			
Dividend payments			
Purchase of treasury stock			
Issuance of treasury stock	91		410
<b>Balance at September 30, 2003:</b>	<b>7,965</b>	<b>8,000</b>	<b>8,816</b>
Net income			
Other comprehensive income (loss)			
<b>Total comprehensive income (loss)</b>			
Dividend payments			
Purchase of treasury stock	- 542		
Issuance of treasury stock	4		- 764
<b>Balance at December 31, 2003:</b>	<b>7,427</b>	<b>8,000</b>	<b>8,052</b>
Net income			
Other comprehensive income (loss)			
<b>Total comprehensive income (loss)</b>			
Dividend payments			
Purchase of treasury stock			
Issuance of treasury stock			
<b>Balance at September 30, 2004:</b>	<b>7,427</b>	<b>8,000</b>	<b>8,052</b>

## Notes

The Consolidated Financial Statements of the Company and its subsidiaries were prepared in accordance with the "United States Generally Accepted Accounting Principles" (US GAAP). All amounts are stated in euros ("€").

For the period from January 1 to September 30, 2004, no changes regarding the scope of consolidation, the principles of consolidation and the currency translation have to be noted as compared to the consolidated financial statements for fiscal year 2003. The accounting principles also remained the same.

Accumulated other comprehensive income (loss)					
Treasury stock K€	Retained earnings K€	Adjustments to currency translation K€	Derivative financial instruments K€		Total equity K€
- 4,181	50,549	- 1,987	0		60,787
	13,122				13,122
		- 1,588			- 1,588
	13,122	- 1,588	0		11,534
	- 7,924				- 7,924
					0
2,352					2,762
- 1,829	55,747	- 3,575	0		67,159
	- 1,046				- 1,046
		- 743	14		- 729
	- 1,046	- 743	14		- 1,775
					0
- 10,415					- 10,415
886					122
- 11,358	54,701	- 4,318	14		55,091
	7,231				7,231
		55	- 166		- 111
	7,231	55	- 166		7,120
	- 7,427				- 7,427
					0
					0
- 11,358	54,505	- 4,263	- 152		54,784

As of June 30, 2004, the company no longer discloses costs incurred in connection with the SAP software under "other administrative expenses" but assigns them to the users from the areas which cause these costs to be incurred.

The figures shown in the consolidated balance sheet, income statement, cash flow statement and development of stockholders' equity reflect the ordinary course of business at Zapf Creation AG and do not include extraordinary items. No significant events took place after the closing date.



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