Zapf Creation AG

Annual Report 2002

Zapf Creation AG
Annual Report
2002

Contents

Consolidated Key Figures

Income statement	2002	2001	2000	Change in %
Net sales in € million	222.7	193.1	164.9	15
EBITDA in € million[1)]	38.3	30.0	25.4	28
EBIT in € million	32.9	26.4	23.4	25
EBIT in % of sales	14.8	13.7	14.2	8
EBT in € million	30.6	23.2	21.4	32
Net income in € million	21.2	16.4	15.3	29
Basic earnings per share in € [2)]	2.70	2.09	1.93	29
Amortization and depreciation in € million[3)]	5.7	4.0	2.4	43

Balance sheet	2002	2001	2000	Change in %
Total assets in € million	139.9	112.0	100.7	25
Long-lived assets (incl. deferred taxes) in € million	30.1	26.7	15.3	13
Investments in € million	9.9	16.1	7.5	– 39
Current assets (incl. prepaid expenses) in € million	109.8	85.4	85.4	29
Stockholders' equity in € million	60.8	47.7	37.7	27
Equity ratio in % [4)]	48.6	47.3	39.7	3
Return on equity before taxes in %	50.4	48.7	56.8	3
Liabilities due to banks in € million	43.2	34.5	31.9	25

Cash flow	2002	2001	2000	Change in %
Net cash flow from operating activities in € million	10.1	29.0	– 10.1	– 65
– per share in € [2)]	1.29	3.68	– 1.28	– 65
Net cash flow in € million	3.6	5.4	0.0	– 33

	2002	2001	2000	Change in %
Number of employees at the closing date (Dec. 31) [5)]	514	498	415	3

[1)] The figure includes depreciation related to operating expenses (excl. production depreciation).

[2)] Based on 7.864 million shares in 2002 and 7.875 million shares in 2001. See also Note 2 "Earnings Per Share".

[3)] According to fixed asset schedule (incl. production depreciation).

[4)] Calculation: $\dfrac{\text{Total stockholders' equity}}{\text{(Total assets – Cash and cash equivalents)}}$

[5)] Not including Management Board and trainees.

Corporate Boards

Supervisory Board
Dr. Dietmar Scheiter (Chairman), Grünwald
Chairman of the Management Board of TA Triumph-Adler AG
Dr. Horst F. Bröcker (Deputy Chairman), Munich
Managing Partner of Egon Zehnder International GmbH
Hans-Gerd Füchtenkort, Rottach-Egern
Businessperson
Dr. Peter Klein, Bendestorf
Managing Partner of DEXTRA GmbH
Dr. Petra Wibbe, Munich
Lawyer
Arnd Wolpers, Ammerland
Managing Director of Capital Management Wolpers GmbH

Management Board
Thomas Eichhorn, Chairman
Strategy & Corporate Development, Sales, Marketing, Investor Relations, Public Relations, Human Resources, Internal Audit
Christian Ewert
Production, Quality Management, Purchasing, Logistics, IT
Angelika Marr
Design, Product Development
Rudolf Winning
Finance, Legal Affairs, Risk Management, Organization, Investor Relations

Rudolf Winning,
Member of the Management Board

Thomas Eichhorn,
Chairman of the Management Board

Angelika Marr,
Member of the Management Board

Christian Ewert,
Member of the Management Board

Foreword of the Management Board

Dear Stockholders, Dear Friends of Zapf Creation AG,

We closed yet another fiscal year on a highly positive note, in spite of the difficult economic and political climate that continues unabated. We even surpassed our goals by boosting sales to € 222.7 million, an increase of 15 percent.

All key earnings figures clearly improved in 2002, earlier than we had anticipated, as a result of our internationalization strategy. EBIT, i.e. earnings before interest and taxes, rose in the past fiscal year by about 25 percent to € 32.9 million. Net income for the year even rose by 29 percent to € 21.2 million.

The ongoing improvement of our logistics chain, with the aim of improving the flow of goods, was one of the core issues in 2002. We achieved this objective in August 2002 with the opening of the expanded central warehouse and our logistics center in Roedental, Germany.

We also finished linking all operating divisions of Zapf Creation AG using the standard software SAP, in order to ensure an integrated and uniform flow of information. These investments in our value-added chain – the “supply chain” – have created the basis for the Group’s continued growth. We thus have devoted a separate chapter of this annual report to our supply chain.

Our product range makes us one of the most successful companies on the international doll market. We believe that, in the long term, our strategies and brands will help to make us the number one company worldwide in the play, functional and mini doll segments. We made significant progress toward this goal in 2002, and we will continue our efforts in the fiscal year 2003 to achieve this vision.

The United States, Canada and Latin America are the key to the attainment of this vision, and all three of these markets developed very well in 2002. We are now listed with the five largest retailers in the United States, a key market, and we have acquired additional new business partners as well. We also successfully launched the second generation of our success story, Baby Annabell, in the United States, which, in its classic version, was the best selling girl's toy in Great Britain, in both 2001 and 2002.

Compared to the previous year, sales in Great Britain/Ireland rose by 9 percent. Our markets in Southern Europe also experienced tremendous growth, posting sales growth of 16 percent in Spain/Portugal and 62 percent in France. With a market share of 61 percent in the play and functional doll segments, including accessories, in Germany sales grew by 5 percent.

We believe that we profited from unmistakable trends in end consumers' buying patterns in the 2002 fiscal year. Parents are increasingly buying high-quality toys with a long useful life for their children, and little girls themselves gladly spend their disposable pocket money on play worlds. We were able to respond to these trends with our branded play concepts, which complement the world of dolls by a comprehensive range of accessories, and by entering the mini doll segment.

In Germany, we already acquired a market share of 25 percent in the mini doll segment in 2002, the year in which we successfully launched BABY born® miniworld. According to the German Association of Toy Retailers, dolls and accessories that fit into bags are highly desirable toys – and not only in school yards. We thus believe that there is significant potential for expanding this market segment. This is particularly true for Germany, where the share of mini dolls in the entire doll market accounts for merely 10 percent, in contrast to other European countries, such as Great Britain, for instance, where the mini doll segment already makes up 22 percent of the doll market. The high level of recognition of BABY born® will help us to achieve our goal of expanding the mini doll segment. 95 percent of all girls between five and seven years of age in Germany know about BABY born®. Eleven years after it was first launched, BABY born® remains the most popular functional doll.

However, the ability to ensure stable growth through continuous innovation is the key to our success. In our field, innovation means introducing new play concepts, technically perfecting the functionality of our dolls, as well as launching new doll fashions and accessories for our brand concepts twice a year, which take their cue from current children's fashions and life style trends. Investments, especially in our brands, are equally essential to our growth. Our branded play concepts – BABY born®, Baby Annabell and CHOU CHOU – are managed globally. Our goal is to continue to expand and strengthen brand recognition, nationally and internationally, through sustained investments.

The long-term strengthening of our market position in each individual country in the 2003 fiscal year thus has absolute priority. In order to achieve this goal, our main focus in 2003 will be on innovations within the product portfolio. The introduction of the new Baby Annabell in Europe for the 2003 Christmas season will be one of the year’s highlights. This popular baby doll, which continues to react to touch as well as to sounds, now features numerous realistic facial expressions, such as movements of the mouth when it is given its bottle.

The play concept, My Model, will be further expanded for creative girls, who enjoy playing with make-up and hair styles. The make-up and hair styling heads in the My Model product range were improved through greater refinement of their features and soft make-up, but we also developed an extensive range of cosmetics and styling products.

There will be several innovations in the mini doll segment, one of our growth segments, in 2003. BABY born® miniworld will be supplemented by new play environments and sets. In addition, our designers have developed a collapsible doll house and a suitcase that can hold a variety of BABY born® miniworld clothes and accessories.

We also plan to further expand this segment by introducing numerous new mini dolls in the CHOU CHOU and Maggie Raggies branded play concepts.

Our strategy made it possible for us to continue our successes in 2002 as well. We will not rest on our laurels, however, and will continue to pursue ambitious goals in order to remain on our growth path for a long time to come.

Our personnel certainly contributed significantly to the positive development of the company in the 2002 fiscal year. We would like to extend our heartfelt thanks to all of our employees.

But our thanks are also due to our young female customers. It is their desires that challenge us each year anew – and we will not disappoint them!

Thomas Eichhorn

Christian Ewert

Angelika Marr

Rudolf Winning

Zapf Creation Stock

New Entry in the MDAX

As expected, Zapf Creation stock had a somewhat slower start in the first quarter of 2002, as it had just been admitted to the MDAX. This performance, which remained slightly below that of the MDAX as a whole until the end of March, was quickly forgotten when Zapf Creation stock soared in the second quarter, reaching € 29.50 (June 21, 2002), the high for the year. At this point in time, Zapf Creation stock was already trading at 25 percentage points above the MDAX. Profit taking at this level and the generally weak climate on the stock market in the second half of the year caused both the MDAX and Zapf Creation stock to fall to their lowest levels for the year in early October (€ 16.80 on October 8, 2002). This was followed by an extraordinary rally of Zapf Creation stock, resulting in an interim high of € 27.80 on December 6, 2002, an increase of 64 percent, 36 percentage points above the MDAX, which continued to remain weak overall. At the end of the year, Zapf Creation stock was 30 points ahead of the MDAX, closing at € 25.54, a price that was almost identical to the initial price of € 25.51 at the beginning of 2002.

Prime Standard and Listing on the MDAX 50

The stable stock price overall and the improved performance of Zapf Creation stock for the year 2002, as well as the fact that it clearly outperformed the MDAX, qualified our stock for the new MDAX which by that time had been reduced to 50 companies.

In the course of restructuring the German stock market, the MDAX, the index for medium-sized businesses, will be reduced by Deutsche Börse AG from the previously 70 companies to 50 companies. Zapf Creation stock will be listed on this higher-valued MDAX from its inception on March 24, 2003, and thus will continue its success story on the stock market. Zapf Creation stock was admitted to the Prime Standard at the beginning of 2003. The company has been satisfying the additional disclosure requirements for years, with the aim of increasing transparency standards vis-à-vis investors.

Corporate Governance

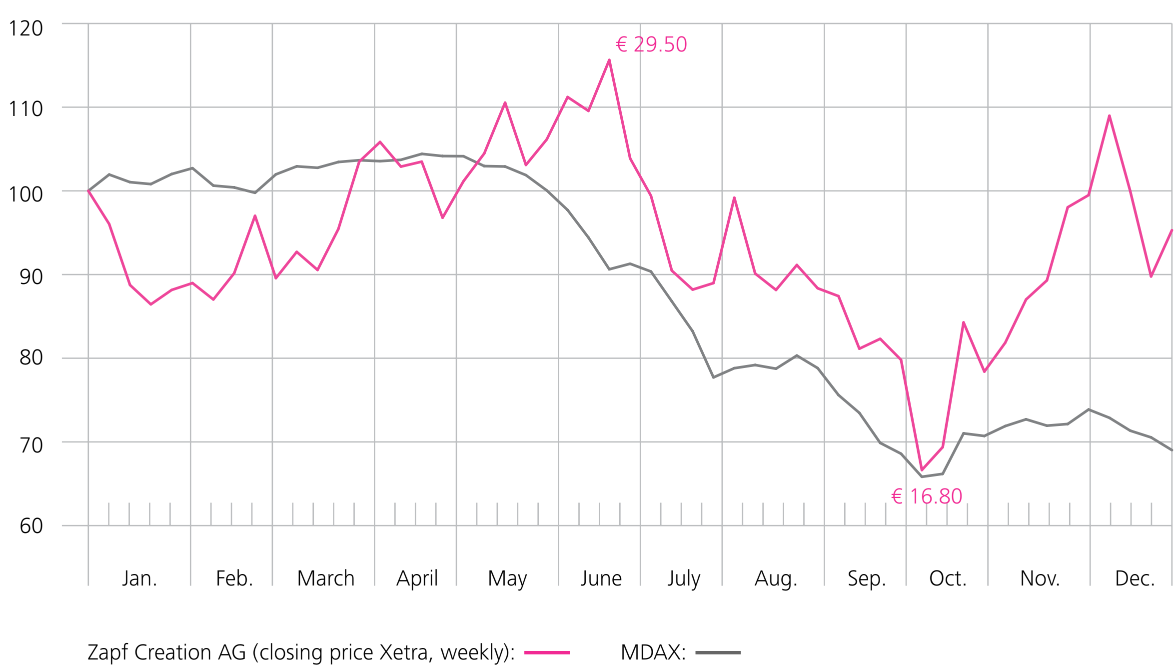
Pursuant to the Act for the Further Reform of the German Stock Corporation and Accounting Law and for Transparency and Disclosure, the Management and Supervisory Boards of Zapf Creation AG declare in accordance with Section 161 German Stock Corporation Act (AktG), in connection with Section 15 to the Introductory Act to the Stock Corporation Act (EGAktG), that the company complies with the recommendations of the Government Commission of the German Corporate Governance Code, as published by the German Ministry of Justice in the official portion of the electronic Federal Gazette, with the exception of items 2.3.1, 3.8, 3.10, 4.2.4, 5.1.2, 5.2, 5.3.1, 5.3.2, 5.4.5, 5.6, 7.2.1.

The company has decided not to explain these differences because some of the recommendations are still being implemented or adapted and because several modifications of the articles of incorporation of Zapf Creation AG must be adopted by the Annual Stockholders' Meeting on May 7, 2003.

This means that numerous deviations from the recommendations will be irrelevant in the future. This will presumably apply to items 2.3.1, 3.10, 4.2.4, 5.1.2, 5.4.5, 5.6, and 7.2.1.

On the issue of corporate governance, Zapf Creation AG created a separate section on the company's Web site (*www.zapf-creation.com*) which contains, in addition to the formal declaration of compliance, information on the Management and Supervisory Boards, the Report of the Supervisory Board, as well as disclosures concerning directors' dealings. Also included are the company's articles of incorporation and risk management report.

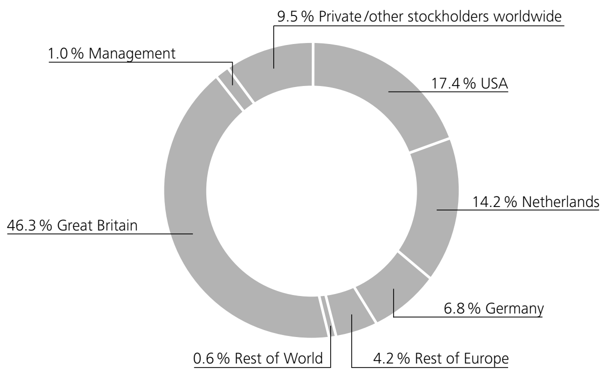
Stock Performance 2002 (Index)



Roughly 90 Percent of Zapf Creation Stock Held by Institutional Investors

Research concerning our stockholder structure as of March 31, 2002, shows that, at a free float of 100 percent, 89.5 percent of all Zapf Creation stock is held by institutional investors, most of them abroad.

Stockholders' Structure (in %)



Active Communications with the Financial Community

Creating transparency for and building trust with our investors, especially centralized communication of current developments within the company, drove our investor relations activities in the 2002 fiscal year. We performed much better than the sales forecasts, which had been lowered in due time, and even surpassed the improved earnings forecasts for 2002 overall.

The third Annual Stockholders' Meeting of Zapf Creation AG took place on June 4, 2002, in the company's new logistics center in Roedental, Germany. A total of 1,606,405 voting shares, i.e. 20.08 percent of all shares, were present.

The management of Zapf Creation AG also devoted much time to ongoing and intensified discussions with all relevant capital markets participants. The Management Board always presented first-hand information – whether in individual conversations during road shows; during individual and worldwide telephone conferences; at analyst, press and investors' conferences; in presentations to banks; as well as at trade shows. The focus was on the financial centers of Europe, the United States and selected regions.

Dividend Rises in 2002

The obvious increase in earnings, compared to the previous year, by about 29 percent to € 21.2 million once again gives the Management and Supervisory Boards an occasion to propose to the Annual Stockholders' Meeting to increase the dividend by about 54 percent, from € 0.65 per share to € 1.00 per share.

The retained earnings reported in the financial statements of Zapf Creation AG for 2002 pursuant to the HGB (German Commercial Code) in the amount of € 29,568,064.31 will be used to pay dividends totaling € 7,873,936.00. The balance of € 21,694,128.31 is to be carried forward.

Key figures regarding Zapf Creation stock			
ISIN	DE 000 780 6002		
Reuters code	ZPF.ETR		
Bloomberg code	ZPF GR		
Number of shares	8 million		
	2002	2001	2000
Market capitalization (based on the year-end price) in € million	204	208	392
High (Xetra) in €	29.50 (June 21)	50.00 (Jan. 5)	79.40 (May 9)
Low (Xetra) in €	16.80 (Oct. 8)	17.61 (Oct. 9)	28.00 (Nov. 30)
Year-end price (Xetra, Dec. 31) in €	25.54	26.00	49.00
Daily trading volume (average no. of shares)	16,478	11,364	5,921
P/E ratio (Xetra, Dec. 31)	9.0	12.5	25.4
EPS in € [1)]	2.70	2.09	1.93
CFPS in €	1.29	3.68	– 1.28
Dividend per share in €	1.00	0.65	0.60
Dividend yield (Xetra, Dec. 31) in %	3.9	2.5	1.2

[1)] Basic, average number of shares outstanding

Research coverage/analyst recommendations		
Cazenove	February 2003	Buy
Bankhaus Lampe	January 2003	Outperform
Berenberg Bank	January 2003	Hold
CAI Cheuvreux	January 2003	Outperform
Commerzbank	January 2003	Buy
Deutsche Bank	January 2003	Buy
ABN Amro	October 2002	Buy
Schroder Salomon Smith Barney	October 2002	Outperform
Dresdner Kleinwort Wasserstein	August 2002	Buy

We Are the Children

– We Are the World

Children know what their favorite toys are, especially when it comes to selecting a doll. A strong bond develops between doll mothers and their babies, as can be seen in the special care these dolls enjoy over many years – anywhere in the world.

Sweet dreams
are made of this!

BABY born® is loved by little girls all over the world and accompanies them through their day. BABY born® is girls' favorite doll. It is the one they take with them to kindergarten and when they go to see their friends. It is also the one they hug when they fall asleep. Almost all German girls are aware of BABY born®. Worldwide, more than ten million BABY born® dolls have found a home in 43 countries. What is so special about BABY born®? The doll gives girls unlimited freedom to use their imagination. Girls playfully learn how to take care of a baby. Yet BABY born® can also be transformed into a ballerina in the blink of an eye, just as their doll mommies, or accompany them to their riding lessons wearing the matching outfit.









Baby, all I want for christmas is you!

Girls who want a doll for Christmas know exactly what brand they want. In line with the different characteristics of baby dolls, however, particular preferences for the range of Zapf Creation's branded play concepts have evolved in individual countries. While **Baby Annabell** tops Christmas wish lists in Great Britain, BABY born® is the winner in Germany.


Baby Annabell

We are the champions!

For young girls, dolls are more than toys that stay at home. Rather, favorite dolls are proudly taken along wherever girls go. These young ladies are very fashion conscious and trendy and know exactly what's hot at any given moment. The doll brand they choose proves that, too. Zapf Creation's branded play concepts take their lead from trends in both children's fashions and general lifestyle products and translate these into dolls' worlds. This explains, in large part, why Zapf Creation already is the largest European manufacturer of play and functional dolls, including accessories, and thus the champion when it comes to a youngster's selection of a doll.

What a wonderful world!


BABY born
miniworld

Last year, Zapf Creation introduced its new branded play concept – **BABY born® miniworld** as an innovation in the mini doll segment. The entire BABY born® world was recreated in miniature form. It can be taken along, it can be collected and exchanged. Girls can use their pocket money to buy lovingly designed play environments or colorful accessories, which they can combine with their friends into complete houses. BABY born® miniworld is fully expandable and can easily be stored in a suitcase or bag.

Successful, popular dolls link tradition and innovation. Some, like **CHOU CHOU,** look very much like real babies. Others come with very trendy clothes and all kinds of accessories that reflect current tastes, such as comfortable seats, rompers, or pacifiers. This pleases mothers and daughters alike, as women recognize themselves in their daughters' desires. It is one of the reasons why white, besides the ever popular pink, is a favorite color for doll clothes and accessories.

Group Management Report

I. The Group

The Zapf Creation Group develops, manufactures and markets doll worlds – in particular, play, functional and mini dolls, including a wide variety of doll accessories. The Group's branded play concepts – BABY born®, Baby Annabell and CHOU CHOU – are successful all over the world and are conceived especially for girls between three and eight years of age, with the aim of encouraging them to engage in mother-child role playing.

The Zapf Creation Group includes wholly-owned subsidiaries in Hong Kong (China), Australia, the United States, Great Britain, France, Spain, Italy, the Czech Republic and Poland.

II. The Market

The global toy market continued to grow moderately in 2002. This development was dominated by end consumers' keen brand and quality consciousness, which benefited the brand manufacturers in the toy industry as a whole, and the Zapf Creation Group, in particular, the leading provider of branded play and functional dolls.

Of the five largest toy markets in Europe – Germany, Great Britain, France, Italy, and Spain – the German toy market was the only one to recede slightly by about 3 percent.

In contrast to the toy market as a whole, the German doll market showed a moderate growth of 1 percent. In Great Britain, Spain and Italy, too, each country's doll market grew stronger than the toy market overall. In spite of strong 4.5 percent growth, the French doll market was the only one that lagged behind the development of the total toy market, which grew by 7.8 percent.

In 2002, Zapf Creation once again succeeded to further expand its worldwide market share in the play and functional doll segment, including accessories. This is underscored by impressive market shares of more than 31 percent in Great Britain, over 19 percent in Spain, about 5 percent in France, and almost 7 percent in the United States. Germany was the only country where Zapf Creation had to accept a slight decline in market share to 61 percent. The successful launch of the mini doll segment, with the introduction of BABY born® miniworld, which achieved a market share of over 25 percent in this segment in its first year, thus was all the more welcome.

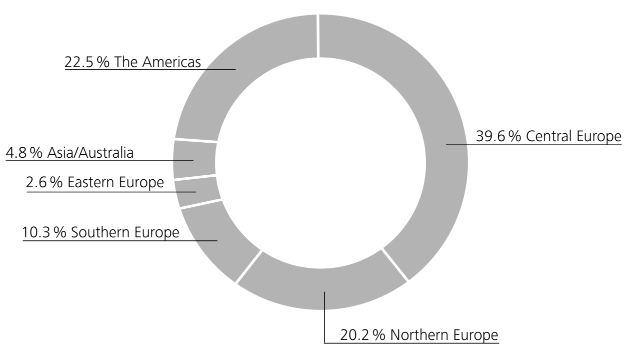
III. Sales

Despite the prevailing difficult economic and political climate, the Zapf Creation Group once again succeeded in heading off general trends by boosting sales to € 222.7 million, an increase of 15 percent.

Foreign markets were the growth drivers in 2002 as well; foreign sales rose by about 21 percent to roughly € 153 million, generating an average growth rate of 26 percent in each of the past three years. The share of foreign sales rose to 69 percent in 2002.

The following picture emerges if sales are considered by region:

Breakdown of Sales by Business Unit 2002



Central Europe – which consists of Germany, Austria, Switzerland, the Netherlands and Luxemburg – recorded a 2-percent growth. In Germany, where Zapf Creation continues to boast a market share of over 60 percent in the play and functional doll segment, sales even rose by 5 percent to 69.6 million (including mini dolls).

At an increase of 6 percent, Northern Europe – which includes Great Britain/Ireland and Scandinavia – made an even greater contribution to the growth of Zapf Creation, due especially to the extremely successful holiday season. This allowed Zapf Creation to further expand its leading position in the play and functional doll segment in Great Britain/Ireland, the Group's third-largest market with sales of € 38.3 million, and to boost its market share to about 31 percent.

At 27 percent growth, the markets in Southern Europe were even more dynamic. In France, being listed by the dominant hypermarkets boosted sales by 62 percent to € 5.2 million. The Spanish/Portuguese market also surpassed Group sales overall, rising 16 percent to € 12.2 million. At a market share of more than 19 percent, the Group succeeded in further reducing the distance to its main local competitor.

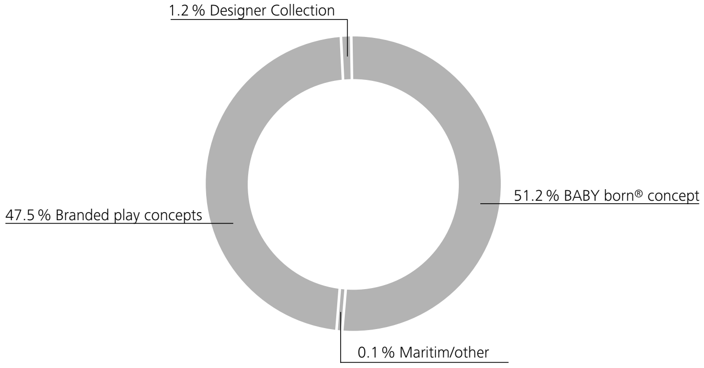
Eastern Europe, a region expected to provide a lot of future growth, achieved remarkable results, posting an increase of 26 percent to € 5.8 million. The Czech Republic, Poland and Russia are the critical countries in this region.

The American markets developed very well. Sales soared yet again by 53 percent to € 50.2 million, which makes the Americas the driving force in the sales growth of the Zapf Creation Group. By gaining a market share of just under 7 percent, Zapf Creation has succeeded in taking a strategically important step forward in the United States. The Group has managed the transition from an insignificant German doll manufacturer to an internationally recognized producer of branded toys.

Asia and Australia developed well, even though this region does not yet possess strategic importance for the Zapf Creation Group. Total sales were € 10.6 million, an increase of more than 22 percent.

A breakdown by product group yields the following picture:

Breakdown of Sales by Product Group 2002



The BABY born® concept, which has been successful for 11 years, rose by 11 percent to € 114.0 million. The successful introduction of BABY born® miniworld was a key contributor to this growth.

The Group's branded play concepts – Baby Annabell, CHOU CHOU, Maggie Raggies and My Model – accounted for sales of roughly € 20 million, i.e. about two-thirds of total growth.

The successful market launch of the second generation of Baby Annabell in the USA and the expansion of the range of accessories for two of the branded play concepts, CHOU CHOU and Baby Annabell, were pivotal to this growth.

The high-value artists' and collectors' dolls in the Designer Collection were affected by the downturn in the consumption of luxury items and fell by 16 percent.

The Group's departure from the maritime segment (inflatable swimming toys) for the last time slowed sales growth by about 1 percent.

IV. Earnings

The Zapf Creation Group posted a consolidated net income of € 21.2 million in the 2002 fiscal year, up from € 16.4 million in the previous year.

The Management and Supervisory Boards will propose to the Annual Stockholders' Meeting to pay a dividend of € 1.00 per share entitled to a dividend payment. This year's dividend represents an increase of about 54 percent compared to the previous year's dividend of € 0.65 per share. It is expected that 7,873,936 shares will be entitled to dividend payments at the time of the 2003 Annual Stockholders' Meeting. The total payout thus will be € 7,873,936.00, approximately 37 percent of the Group's consolidated net income (as of January 31, 2003).

Basic earnings per share were € 2.70 (up from € 2.09 in the previous year), and diluted earnings per share were € 2.69 (compared to € 2.08 in the previous year).

The Income Statement for 2002 for the first time reflects the effects of the new Group structure over an entire fiscal year. The Group was extensively restructured in 2001 by virtue of the establishment of subsidiaries in Australia, Italy and Eastern Europe. Logistics costs, to the extent attributable (outgoing freight, order picking) are included in cost of goods sold, and costs not directly attributable (depreciation and amortization, rent for warehouses, etc.) are now shown as part of the selling and distribution expenses.

Earnings development in the 2002 fiscal year was marked by a significant increase in the gross margin by 5.5 percentage points to 55.4 percent. This rise resulted mainly from the consistent implementation of the umbrella brands strategy introduced in 2001 and thus from our focus on high-margin products belonging to the company's key branded play concepts – BABY born®, Baby Annabell and CHOU CHOU. In addition, 2002 was the first full year in which Zapf Creation billed wholesalers and retailers directly in almost all major markets and did not work through distributors anymore. This approach resulted in both higher gross profit margins and higher operating costs, especially in sales/distribution and marketing, where expenses rose as planned by € 15.5 million over the previous year.

Overall, all relevant margins were improved.

EBITDA (earnings before interest, taxes, depreciation and amortization) rose by about 28 percent, from € 30.0 million to € 38.3 million. Depreciation and amortization already included in the segment figures rose by € 1.8 million to € 5.4 million as a result of scheduled depreciation of the new logistics center, which was opened in July 2002, as well as a full year's amortization of the SAP R/3 software.

Despite the large increase in depreciation and amortization, EBIT (earnings before interest and taxes) soared by almost 25 percent to € 32.9 million. The EBIT margin rose by 1.1 percentage points to 14.8 percent in the 2002 fiscal year, up from 13.7 percent in the previous year.

Earnings before taxes (EBT) rose by 32 percent to € 30.6 million due to 30 percent lower net interest expenses and thus were more than twice the sales growth.

V. Cash Flow

Cash flow from operating activities of the Zapf Creation Group was roughly € 10.1 million in 2002, down from € 29.0 million in the previous year. Given the strong growth in sales in the fourth quarter, particularly in the United States and in Great Britain/Ireland, receivables rose by approximately € 15.9 million. As payment terms average 60 days in these two markets, these receivables are paid in January and February 2003. After investments and financing activities, liquidity rose by about € 3.6 million, down from € 5.4 million the previous year.

VI. Balance Sheet

The total assets of the Zapf Creation Group rose in the 2002 fiscal year by about € 27.9 million to € 139.9 million. Excluding cash and cash equivalents, the increase was approximately € 24.2 million. This is primarily due to the aforementioned increase in receivables by about € 15.3 million,[1)] as well as to the rise in inventories by about € 4.4 million, which is almost proportionate to sales. Fixed assets rose by about € 3.4 million.

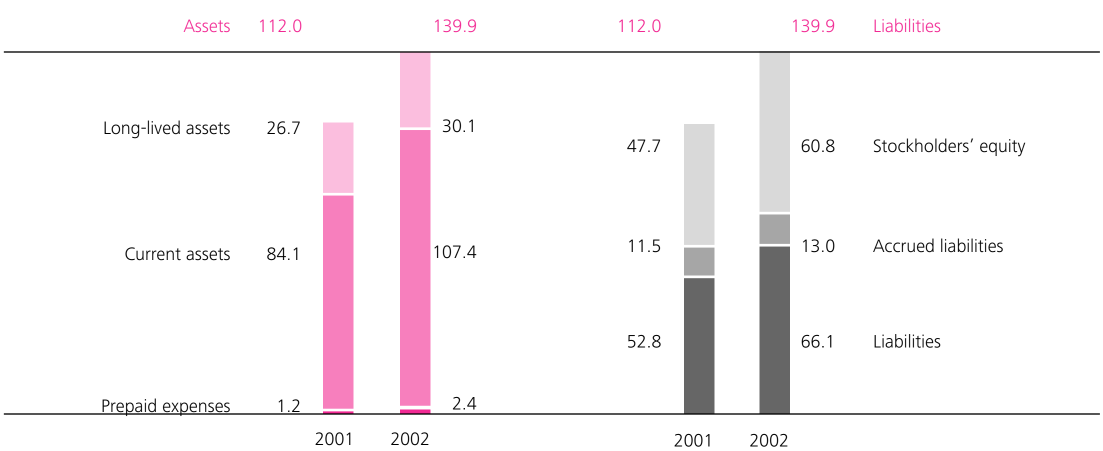
The equity of the Zapf Creation Group before dividend payments rose by about 27 percent to € 60.8 million. In relation to the respective total assets, less cash and cash equivalents, the equity ratio as of the balance sheet date was about 49 percent, up from 47 percent the previous year.

The Group's balance sheet structure thus is as follows:

VII. Investments

The Zapf Creation Group invested a total of € 9.9 million in the 2002 fiscal year. Investments in the asset categories "operating inventory" in the amount of € 3.6 million as well as "buildings" in the amount of € 1.0 million mainly reflect the completion of the logistics center in Roedental, Germany. About € 2.0 million were invested in software, which includes the introduction of SAP in both the United States and Australia. Miscellaneous investments for plant and business furnishings in the amount of € 3.3 million are evenly distributed among the categories mold making, office equipment and vehicle fleets.

Balance Sheet Structure (in € Million)



1) This figure is different from the one given in item "V. Cash Flow" because the cash flow statement accounts for both the data from the statement of changes in financial position and foreign currency translation effects.

VIII. Risk Report

Monitoring and controlling risks is an important part of the management tools used by the Zapf Creation Group, based on the principles of corporate governance codified in the Act for the Further Reform of the German Stock Corporation and Accounting Law and for Transparency and Disclosure.

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

Risk Management System

The risk management system employed by the Zapf Creation Group ensures that existing risks are recorded, analyzed and assessed; the relevant information is then submitted to the Group's decision makers. To this end, the company implemented a software system at the start of the 2000 fiscal year, which serves to systematically record and evaluate individual risks, their probability, as well as anticipated losses. The recording and assessment of risks is updated on a quarterly basis and supplemented, if necessary.

The Management Board and the company's executives usually meet for an executive management session every two weeks, to discuss emerging risks and to duly initiate appropriate countermeasures.

The risk management handbook, which defines responsibilities as well as risk and loss criteria, is a central component of Zapf Creation's risk management system. This risk management manual is continuously updated and adapted, taking into account the company's growth and the constantly changing economic environment.

Internal audits guarantee compliance with all applicable rules and regulations as well as with Group-wide accounting principles. These audit reports are discussed with the respective managers, defects are corrected immediately, and improvements are implemented as soon as possible.

Organization of the Risk Management System

We distinguish the following risks:

- Market risks
- Customer risks
- Bad debt risks
- Liquidity risks
- Operating risks
- Legal and other risks

Market Risks

The Zapf Creation Group is active worldwide in a variety of geographical markets where pricing and factors that influence pricing may differ considerably. The Group's sales and marketing structure provides early and first-hand information on any given market situation, making it possible to initiate countermeasures in a timely manner.

Customer Risks

The top ten customers of the Zapf Creation Group account for roughly 49 percent of its sales. However, this ranking includes only one global customer who accounts for over 10 percent of Group sales.

The specialty retail toy trade has always played a key role in Germany, the Group's domestic market. The Group's largest customers, each of whom account for 5 to 10 percent of total sales, also include several industry associations and central regulators. More than 20 percent of Group sales stem from two buyers, a toy retailer and an industry association. However, there is no dependence on major buyers, given that Zapf Creation AG could at any time begin to deliver directly to specialty retailers.

Bad Debt Risks

The stagnant economy in both Europe and, increasingly, the United States, as well as intensified competition among wholesalers and retailers, increase the default risk due to bankruptcies. Zapf Creation AG uses a comprehensive system for tracking del credere risks. The company always obtains credit histories of new customers before making initial deliveries. Zapf Creation also purchases credit insurance for domestic and foreign customers that do not belong to central industry clearing organizations, provided such policies are available and economically feasible. We regularly review the payment histories of uninsured customers. However, in spite of these precautionary measures, in 2002 allowances for doubtful accounts in the amount of about € 1.4 million were necessary. This is higher than average compared to previous years and most of this is due to the bankruptcy of two U.S. customers.

Liquidity Risks

Zapf Creation AG is linked to its subsidiaries via a central cash management system. This cash management system ensures that all payment transactions within the Group are recorded daily. Further, any effects of the payment transactions on the Group's liquidity are rapidly assessed as part of the daily Group clearing system and countered by timely measures on the money or capital markets.

Operating Risks

The Zapf Creation Group devotes special attention to the maintenance of its operations. This is accomplished by organizational and technical measures. The organizational measures include organizational instructions, employee training and contingency measures. The technical measures are related mainly to the aforementioned risk management system.

Legal and Other Risks

Zapf Creation AG acquires about 95 percent of its entire product portfolio from China. The company has maintained business relations with its three main suppliers for over ten years.

Since 1995, Zapf Creation has actively and continuously endeavored to help improve the working conditions for and the health protection of suppliers' workforces. This has contributed to the rise in employee welfare standards at our on-site suppliers, and we intend to continue pressing for improvements.

In 1995, Zapf Creation was one of the first companies in the German toy industry to develop its own corporate "Code of Conduct" (COC), which defines employee welfare standards and workplace safety measures. The COC defines the working conditions that all of Zapf Creation's suppliers must provide. Only companies that comply with these requirements in advance or that deviate from them in minor ways and suggest improvements are accepted as suppliers. A network of experts reviews compliance through independent auditors. The COC and its compliance are assigned a high priority within the Group. The Group's Chief Operating Officer, Christian Ewert, a team of employees in both Germany and Hong Kong, as well as one COC manager domiciled in China ensure compliance with the COC.

As of October 1, 2002, Zapf Creation has been one of the first companies that has undertaken to comply with the "Code of Business Practices" developed by the International Council of Toy Industries (ICTI). This Code was completed in the summer of 2002 and since that time has served as the basis for business relations between Zapf Creation and its Chinese suppliers. As there was much agreement between Zapf Creation's COC and ICTI's Code of Business Practices, implementing the ICTI Code was easy.

It is the primary goal of Zapf Creation to ensure workplace safety and health protection at its suppliers' plants. In April 2002, Zapf Creation AG was thus the first company in the toy industry to launch a pilot project in cooperation with a renowned, Hong Kong-based Christian organization and one of the company's major suppliers. The workers were trained with regard to workplace safety and health protection issues in the context of this project. The pilot project was successful and additional training sessions will follow in 2003 in direct cooperation with the company's suppliers.

The Management Board of Zapf Creation AG currently does not see any risks that might threaten the existence of the company.

IX. Noteworthy Occurrences

No special events occurred after the close of the fiscal year that would be significant to the evaluation of the assets, financial condition, or operating results of the Zapf Creation Group.

X. Outlook

Given that the company focused on expanding its international distribution and marketing organizations in 2002, fortifying its market share in each individual country will have absolute priority in 2003. The innovations within the product portfolio of Zapf Creation thus will play a central role in the implementation of this strategy. Highlights include the introduction of the new Baby Annabell in Europe in time for the 2003 holiday season. The functionality of this popular baby doll was expanded. It continues to react to touch and sounds, as before, but it now also moves its lips in realistic ways when it is given to drink and blinks its eyelids. Baby Annabell was launched in the United States last year and received an award from well-known toy industry experts for its value as a toy. Numerous accessories now complement the Baby Annabell concept.

While Baby Annabell, BABY born® and CHOU CHOU represent play concepts that encourage classic mother-child role playing, My Model is intended to become the branded play concept for creative girls who enjoy playing with make-up and hairstyles. Refined facial features and soft make-up define the new make-up and hairstyling heads. A wide range of cosmetics and styling products were also added. Zapf Creation obviously takes its cue from current trends. Market research commissioned by the company shows that among three-year old girls, about one in four is already interested in cosmetics and hairstyles.

The BABY born® miniworld concept allowed the company to successfully penetrate the mini doll segment. This segment will be expanded by new play environments, such as the bathroom and the playground set. A collapsible doll house and a suitcase that can be used as a backdrop will be added as special product highlights. Zapf Creation will tap the additional growth potential in the mini doll segment through numerous new mini dolls from the company's branded play concepts CHOU CHOU and Maggie Raggies.

All Around the World

We develop new fashion and accessory collections for each of our successful branded play concepts twice a year. Following the hottest trends, we frequently plan more than a year ahead. However, it takes only 12 weeks, on the average, from the start of production until the merchandise arrives in stores. This requires an integrated supply chain which guarantees that all processes, from the purchasing of raw materials to the delivery of the completed dolls and accessories, run smoothly. The story of how our products come into being along the supply chain reveals how the dreams of little girls come true.


Road
P
THE LEE GARDENS

TUESDAY
SEPTEMBER 3, 2002
2:30 P.M.
ZAPF CREATION OFFICE
HONG KONG, CHINA

The current Hong Kong subsidiary of Zapf Creation was established in 1991. It is led by Tim Kremer, Director of Sales and Marketing, and Stephen Cheung, Director of Finance and Administration. Our Chinese branch is where the value-added chain – our supply chain – begins, and it is the central purchasing entity for our suppliers. In close cooperation between Europe and Asia, this office develops new products and designs, and it stays in constant touch with our local suppliers.

TUESDAY
SEPTEMBER 3, 2002
3:00 P.M.
EXECUTIVE SESSION
HONG KONG, CHINA


The inception of a new product is marked by conferences, discussions, development decisions, pricing plans and negotiations, as well as several other complex issues that must be solved. Budgets and volume projections are drawn up and distributed.

FRIDAY
SEPTEMBER 6, 2002
3:55 P.M.
PRODUCT DEVELOPMENT
HONG KONG, CHINA

This is where little girls' dreams begin to take shape. Products are developed with a lot of attention to detail. Our designers and engineers use their technological expertise in creative and innovative ways. They integrate modern high tech into soft dolls' bodies, perfectly and invisibly, paying attention to high quality so that our young consumers will enjoy their toys for a long time.

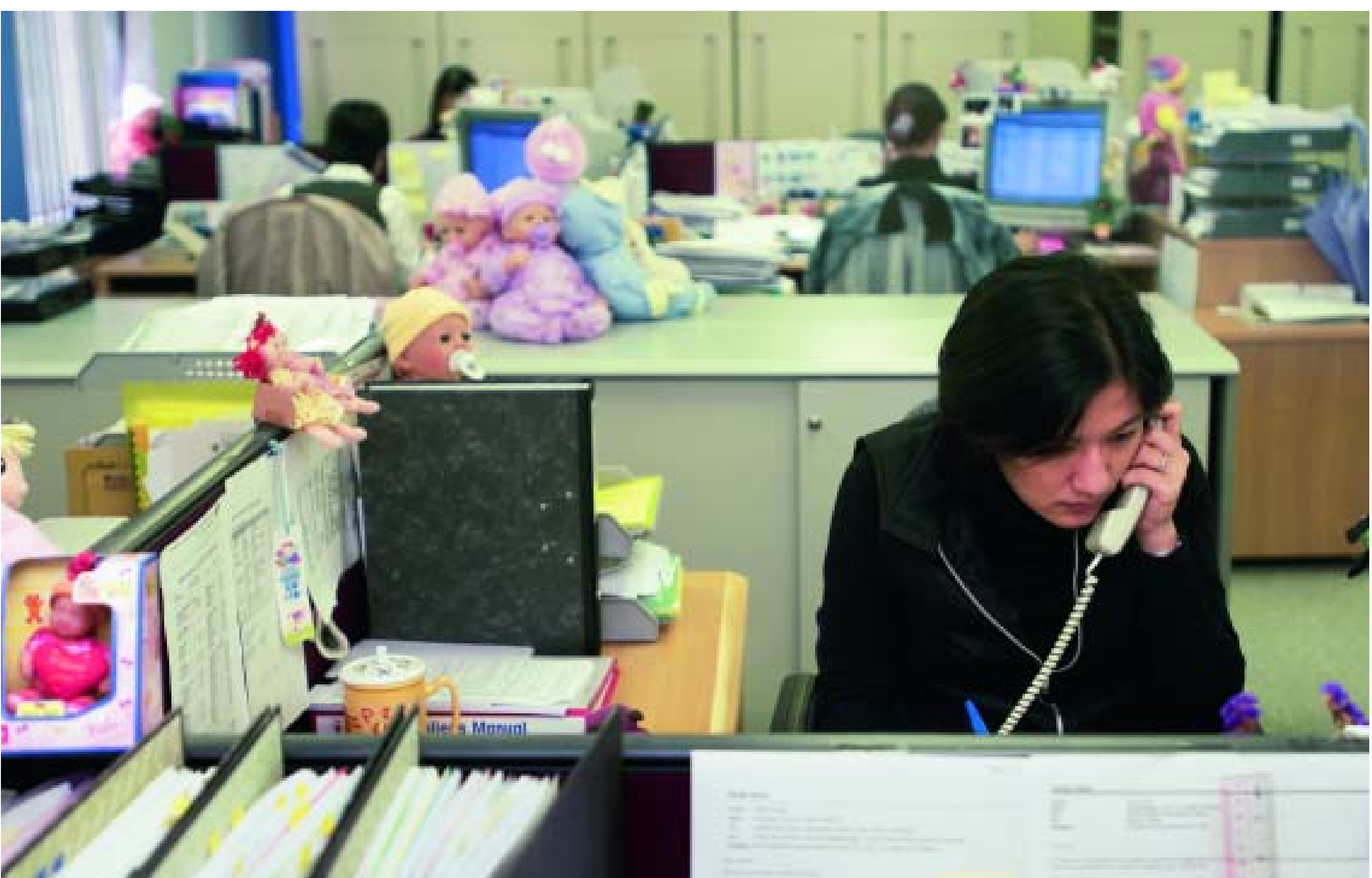
Doll mommies know exactly what is hot and want their dolls to be dressed in the newest fashions, too. This means that the designers of our doll fashions must introduce current colors, cuts and trendy materials into the world of Baby Annabell, CHOU CHOU, BABY born®, etc. several times a year. But this must be done in a manner that integrates typical aspects of these brands, such as the yellow duck or the soft sheep that make each accessory unique. Adorable details and pink, the favorite color of all little girls, are always in vogue!

A lot of sensitivity is required for choosing the right fabrics and designs for the doll fashion collections that young girls expect. This is why many new designs are based on the latest fashion trends.

Our dolls are a part of young girls' lives for many years and accompany them through an untold number of sandboxes and wild afternoons at play. It is for this reason that Zapf Creation lends particular importance to the quality and safety of its products. Extensive quality control measures and tests ensure that girls will enjoy their dolls and doll accessories for a long time – the issue that decides whether a toy is worth playing with.

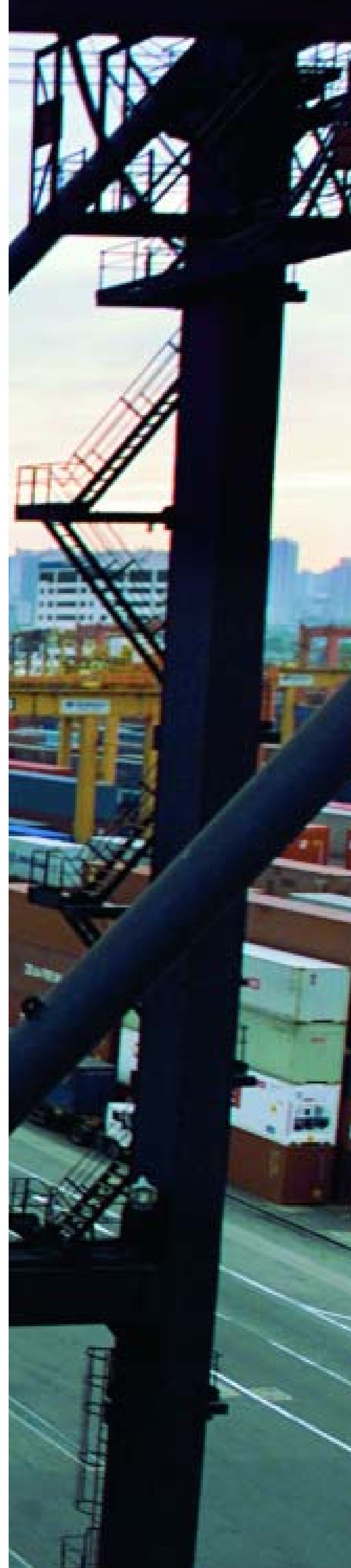
THURSDAY
SEPTEMBER 12, 2002
9:30 A.M.
PRODUCT DEVELOPMENT/ SHIPPING
HONG KONG, CHINA

This is the communications interface between Chinese suppliers, product development and shippers. This office organizes 3,100 40ft containers for shipment per year, orders approximately 26.5 million individual parts and plans innumerable production processes.



MONDAY
OCTOBER 7, 2002
8:30 A.M.
CONTAINER PORT
HONG KONG, CHINA

Approximately 95 percent of all of the dolls and accessories sold by Zapf Creation Group begin their journey in the ports of Hong Kong and Yantian, China. These two Chinese ports thus are at the heart of the Group's supply chain. The merchandise that is loaded onto ships here is delivered either directly to our major customers or to the logistics center in Roedental, Germany.



FRIDAY
NOVEMBER 8, 2002
7:00 A.M.
LOGISTICS CENTER, ZAPF CREATION
ROEDENTAL, GERMANY

In the main season, between August and early December, merchandise from Asia is delivered to and stored in the high-bay warehouse of our Roedental logistics center in three shifts, 24 hours a day.

Inside the state-of-the-art high-bay warehouse, computerized fork-lifts move up and down the long rows and ensure rapid access to the roughly 21,000 pallets. The central logistics system, which operates the entire warehouse, gives all the necessary commands. IT systems enable comprehensive tracking of all merchandise until it reaches its destination.

The new logistics center is pivotal to deliveries to our European customers. It also guarantees just-in-time deliveries in the high season (August through December). That is an important aspect of Zapf Creation's services and strengthens customer loyalty.

In the high season, about 900 pallets, loaded with all kinds of products, are shipped daily from the logistics center in Roedental to the company’s customers throughout Europe.

Roughly 110,000 orders per year are prepared and packed just in time in Roedental.


Zapf Creation
ZAPF CREATION
ART. NO. 785003
DESC.BABY ANNABELL 46CM
QTY.: 4 PCS
CTN. NO.
CE


norfolkline
JOHN VAN LOON
DAF
10

MONDAY
DECEMBER 9, 2002
3:00 P.M.
DEPARTMENT STORE
HAMBURG, GERMANY

Innumerable little girls all over the world love our dolls. That's why we must make sure that the presentation of our products conveys this emotion.


BABY born
BABY born
BABY born
CHOU CHOU
Baby Annabell

My Model make-up and hairstyling heads were shipped in Hong Kong, China, about six weeks ago, to satisfy particular desires here in Hamburg, Germany. Zapf Creation has developed My Model specifically for girls who enjoy applying their creativity to make-up and hairstyles.

The company’s designers got their idea for this very special clothes hanger from the BABY born® CLUB. A cute cartoon illustrates all kinds of stories about Germany’s most popular doll, BABY born®. Our young consumers know immediately that the hanger signifies that the newest fashions for their favorite doll have arrived.


My Model

Consolidated Financial Statements and Notes

Consolidated Income Statement

of Zapf Creation AG, Roedental, for the period from January 1 through December 31, 2002

	2002 K€	2001 K€
Net sales	222,720	193,097
Cost of goods sold	– 99,237	– 96,808
Gross profit	**123,483**	**96,289**
Selling and distribution expenses	– 34,852	– 26,252
Marketing expenses	– 29,833	– 22,959
Administrative expenses, net	– 25,909	– 20,649
Operating profit before interest and taxes	**32,889**	**26,429**
Interest income	779	112
Interest expense	– 3,044	– 3,340
Profit before income tax expense	**30,624**	**23,201**
Income tax expense	– 9,387	– 6,765
Net income	**21,237**	**16,436**
Earnings per share		
Basic €	2.70	2.09
Diluted €	2.69	2.08

The accompanying Notes are an integral part of the Consolidated Financial Statements.

Consolidated Balance Sheet

of Zapf Creation AG, Roedental, as of December 31, 2002

Assets		Dec. 31, 2002 K€	Dec. 31, 2001 K€
Cash and cash equivalents		14,850	11,234
Accounts receivable (net of allowance for doubtful accounts of € 1,408,267 and € 693,437 at December 31, 2002 and 2001 respectively)		57,674	42,368
Inventories	Note 2	29,682	25,279
Prepaid expenses	Note 3	2,444	1,194
Other current assets	Note 4	2,618	4,363
Deferred tax assets (short term)	Note 5	2,487	950
Total current assets		**109,755**	**85,388**
Property, plant, equipment and software, net	Note 2	28,523	24,677
Intangible assets, net	Note 2	1,425	1,664
Deferred tax assets (long term)	Note 5	182	316
Total long-lived assets		**30,130**	**26,657**
		139,885	112,045

Liabilities and stockholders' equity		Dec. 31, 2002 K€	Dec. 31, 2001 K€
Current portion of long-term debt and short-term borrowings		22,914	17,516
Accounts payable		15,689	13,046
Accrued liabilities	Note 10	12,998	11,483
Income taxes payable		4,819	3,888
Deferred tax liabilities (short term)	Note 5	1,320	274
Total current liabilities		**57,740**	**46,207**
Long-term debt	Note 6	20,317	16,994
Other long-term liabilities		68	54
Deferred tax liabilities (long term)	Note 5	973	1,103
Commitments and contingencies	Note 8		
Long-term liabilities		**21,358**	**18,151**
Stockholders' equity	Note 7		
Common stock 11,630,000 shares authorized 8,000,000 shares issued 7,873,836 shares outstanding at December 31, 2002 7,851,609 shares outstanding at December 31, 2001		8,000	8,000
Additional paid-in capital		8,406	8,437
Treasury stock		– 4,181	– 4,698
Accumulated other comprehensive income		– 1,987	1,530
Retained earnings		50,549	34,418
Total stockholders' equity		**60,787**	**47,687**
		139,885	112,045

The accompanying Notes are an integral part of the Consolidated Financial Statements.

Consolidated Statement of Cash Flows

of Zapf Creation AG, Roedental

	2002 K€	2001 K€
Cash flow from operating activities		
Net income	21,237	16,436
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation and amortization	5,743	4,007
Loss (gain) on sale of property, plant, equipment and software	– 82	26
Stock-based compensation expense	344	– 224
Increase (decrease) from changes in assets and liabilities:		
Accounts receivable	– 15,929	9,039
Inventories	– 4,557	– 3,058
Prepaid expenses and other assets	– 299	454
Accounts payable and accrued liabilities and other liabilities	3,243	612
Income taxes payable	920	1,095
Deferred taxes	– 487	603
Net cash flow from operating activities	**10,133**	**28,990**
Cash flow from investing activities		
Proceeds from sale of property, plant, equipment and software	417	232
Capital expenditures	– 9,899	– 16,103
Net cash flow from investing activities	**– 9,482**	**– 15,871**
Cash flow from financing activities		
Net borrowings under short-term debt agreements	2,655	– 10,992
Net borrowings under long-term debt agreements	6,080	10,278
Purchases of treasury stock	0	– 2,708
Proceeds from issuance of treasury stock	486	235
Payment of dividends	– 5,107	– 4,704
Net cash flow from financing activities	**4,114**	**– 7,891**
Effect of foreign exchange rate changes on cash	– 1,149	209
Net increase in cash	**3,616**	**5,437**
Cash at beginning of year	11,234	5,797
Cash at end of year	14,850	11,234

The accompanying Notes are an integral part of the Consolidated Financial Statements.

Consolidated Statement of Stockholders' Equity

of Zapf Creation AG, Roedental

	Shares outstanding	Common stock
	number (thsds.)	K€
Balance at December 31, 2000:	7,927	8,000
Comprehensive income		
Net income		
Accumulated other comprehensive income		
Total comprehensive income		
Dividend payments		
Purchase of treasury stock	– 87	
Issuance of treasury stock	12	
Balance at December 31, 2001:	7,852	8,000
Comprehensive income		
Net income		
Accumulated other comprehensive income		
Total comprehensive income		
Dividend payments		
Purchase of treasury stock		
Issuance of treasury stock	22	
Balance at December 31, 2002:	7,874	8,000

The accompanying Notes are an integral part of the Consolidated Financial Statements.

Consolidated Statement of Fixed Assets

of Zapf Creation AG, Roedental

	Movements of costs						
	Jan. 1, 2002	Translation effect previous year[1]	Translation effect average exchange rate[2]	Reclassifications	Additions	Disposals	Dec. 31, 2002
	K€	K€	K€	K€	K€	K€	K€
Intangible assets	**2,208**	**– 20**	**0**	**0**	**0**	**0**	**2,188**
Property, plant and equipment							
1. Land and buildings	10,735	0	0	597	1,105	0	12,437
2. Technical installations and machinery	1,465	0	0	0	19	454	1,030
3. Other installations, plant, furnitures and fixtures	30,533	– 382	0	– 597	8,775	1,045	37,284
	42,733	**– 382**	**0**	**0**	**9,899**	**1,499**	**50,751**
	44,941	– 402	0	0	9,899	1,499	52,939

[1] Translation effect: from different exchange rates in 2001 and 2002.
[2] Translation effect: from differences between average exchange rate and exchange rate on reporting date.

Additional paid-in capital K€	Treasury stock K€	Retained earnings K€	Accumulated other comprehensive income K€	Total equity K€
8,460	**– 2,248**	**22,686**	**775**	**37,673**
		16,436		16,436
			755	755
		16,436	**755**	**17,191**
		– 4,704		– 4,704
	– 2,708			– 2,708
– 23	258			235
8,437	**– 4,698**	**34,418**	**1,530**	**47,687**
		21,237		21,237
			– 3,517	– 3,517
		21,237	**– 3,517**	**17,720**
		– 5,106		– 5,106
				0
– 31	517			486
8,406	– 4,181	50,549	– 1,987	60,787

Movements of depreciation						Net book value	
Jan. 1, 2002 K€	Translation effect previous year[1] K€	Translation effect average exchange rate[2] K€	Additions K€	Disposals K€	Dec. 31, 2002 K€	Dec. 31, 2002 K€	Dec. 31, 2001 K€
544	**0**	**– 2**	**221**	**0**	**763**	**1,425**	**1,664**
5,339	0	0	248	0	5,587	6,850	5,396
1,207	0	0	80	454	833	197	258
11,510	– 59	– 127	5,194	710	15,808	21,476	19,023
18,056	**– 59**	**– 127**	**5,522**	**1,164**	**22,228**	**28,523**	**24,677**
18,600	– 59	– 129	5,743	1,164	22,991	29,948	26,341

Notes

Note 1: Nature of the Business

Zapf Creation AG (hereinafter also called "the Company") is Europe's largest distributor of play dolls and functional dolls including doll accessories and stands for branded products that fulfill the highest quality and safety requirements. Due to its consistently implemented umbrella brand strategy, the Company has established itself as a provider of quality brands in all of its segments – from inexpensive play dolls to exclusive collectors' dolls for adults.

In addition to continuing its globally successful umbrella brand strategy, Zapf Creation AG was also able to successfully enter the mini doll segment in the past fiscal year. With the newly developed BABY born® miniworld play concept, a mini doll with its own play and entertainment world, Zapf Creation has also become a leading supplier in this sector in Germany. BABY born® miniworld was first introduced to the general public at the 2002 Nuremberg Toy Fair.

Like in the world of fashion, the most popular brands of Zapf Creation AG, such as BABY born®, CHOU CHOU, Baby Annabell and the My Model make-up head are subject to constant change. Permanent updating of these products ensures trendy products that correspond to the demands of the fashion-conscious young target audience.

Focusing on the 3In Strategy (investments in brands, innovation and internationalization) strengthens the Company's position as a distributor of integrated branded play concepts whose products have to meet the highest requirements in terms of quality, safety and play value. Following exacting standards, both internally and externally, is a stable foundation for the European market leadership achieved by Zapf Creation.

The Company must address intensive competition on a global scale and is subject to the seasonal fluctuations that are typical of the toy industry. Its activities therefore focus on the Easter and Christmas seasons, which are the highlights of the year.

Zapf Creation AG, as the company is currently known, was originally established in 1932 by Max Zapf and his wife Rosa as "Max Zapf Puppen- und Spielwarenfabrik". Following a number of changes in the Company's legal status, it finally went public on April 26, 1999. The Company is headquartered in Mönchrödener Strasse 13, 96472 Rödental, Germany/Upper Franconia.

Note 2:
Summary of Significant Policies

Principles of Consolidation

The Consolidated Financial Statements include the financial statements of Zapf Creation AG ("the Parent Company") and of each of its nine wholly-owned subsidiaries. All companies are thus fully consolidated.

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

In the course of expense and earnings consolidation, all internal sales, intercompany profits and other intra-group earnings are offset against the respective costs.

The financial statements of each subsidiary are included in the Parent Company's Consolidated Financial Statements under the purchase method, whereby the acquisition costs are offset against stockholders' equity as of the respective purchase date.

Main Differences Between German and US Accounting Principles

Introduction

In the Consolidated Financial Statements presented here, Zapf Creation AG is availing itself of the possibilities of exemption under Section 292a HGB (Handelsgesetzbuch – German Commercial Code).

According to this provision, the Company does not have to prepare consolidated financial statements under German law (HGB), if the consolidated financial statements are prepared according to internationally recognized accounting principles (in this case: US GAAP).

In order to be able to take advantage of this exemption, the Company must describe the significant differences between the accounting principles that were actually applied (US GAAP) and the corresponding German rules (HGB). These differences are presented below:

Main Differences

The accounting principles under US GAAP and HGB (the German Commercial Code) follow different objectives. While financial statements prepared according to US GAAP are primarily aimed at providing corporate information relevant to decision making on the part of investors and other interest groups, financial statements prepared under HGB are primarily aimed at protecting creditors and thus are characterized by a cautionary approach. In the final analysis, however, US GAAP accords much greater significance to comparability in time and the determination of a company's actual performance than HGB.

Foreign Currency Translation

It is mandatory under US GAAP to show unrealized gains and losses on foreign currency transactions. Such a procedure is prohibited under HGB.

Deferred Income Taxes

Under US GAAP, deferred income tax assets and liabilities related to the future differences between the value stated for tax purposes and the value stated in the financial statements according to US GAAP must be taken into account.

Accruals

US GAAP requires the creation of a provision for a liability only when it is highly probable that such a liability exists and when its amount can be reasonably estimated. It must be noted that US GAAP does not permit the accrual of internal commitments.

Initial Public Offering Costs

Under US GAAP, the direct one-time costs of an IPO that are incurred by the Company are offset against stockholders' equity. These external costs are thus directly deducted from additional paid-in capital.

Stock Options

Under US GAAP, expenses that are incurred in connection with the issuance of stock options must be recorded if certain conditions apply.

Treasury Stock

Under US GAAP, profits and losses related to the acquisition or the subsequent re-issuance of treasury stock are shown as stockholders' equity under the item "additional paid-in capital". Pursuant to US GAAP, treasury stock must always be recorded at its acquisition cost and offset against stockholders' equity as a capitalized asset.

In contrast, the valuation of treasury stock under HGB rules is subject to the strict lower-of-cost-or-market principle so that a comparison of the current valuation (average price) with the closing price of the stock on the stock exchange as of the balance sheet date may result in a write-off, if the stock price as of the respective balance sheet date is lower than the book value. Profits or losses from the sale of treasury stock are treated under HGB as other operating income or expenses.

Software Development Costs

Different rules exist in US GAAP and HGB with regard to the capitalization of costs incurred for the development of software, including the permission under US GAAP to capitalize certain personnel expenses.

Interest Costs as Acquisition or Production Costs for Construction in Progress

Under certain circumstances, interest costs must be capitalized under US GAAP as a part of the acquisition or production costs related to unfinished construction or to the acquisition or production of an asset. Such capitalization ends when the asset begins to serve its purpose.

Financial Statement Classifications

There are also differences between US GAAP and HGB regarding the classification of items in the balance sheet and the income statement.

Notes On the Income Statement

Selling and distribution expenses comprise the direct costs of supporting and maintaining the Company's sales network. This includes personnel costs and depreciation costs incurred by the sales department, as well as commissions paid to sales representatives and compensation paid to independent sales agents. Included are also license fees, advertising allowances and costs in connection with the management of accounts receivable as well as POS activities[1]. This category also comprises costs for logistics centers such as salaries and wages, depreciations on the Company's own warehouses, warehouse rents and maintenance costs.[2]

In addition to TV advertising, *marketing expenses* include a variety of measures directed at the trade, such as, for instance, participation in trade fairs and expenses for the development of a comprehensive communication strategy, such as packaging, catalogues and flyers, printed advertising in trade journals and magazines. This item also covers costs related to communication with end users, such as, for instance, mini catalogues, sweepstakes and competitions and the BABY born® CLUB. Personnel expenses and depreciation related to

[1] POS = point of sale. This comprises all advertising activities at the point of sale, including shelf and store decoration and ceiling hangers.

[2] The classification of items on the income statement was changed for the first time in fiscal year 2002. Freight (without internal freight), premium payments for transport insurance, penalties, order picking, agency logistics personnel and transport insurance payments are no longer comprised under "logistics expenses" but are included in the production costs. To enable a comparison with the previous year, the figures for the previous fiscal year were adjusted accordingly. This resulted in a reduction of the margin for the previous year. The adjusted figure for fiscal year 2001 is K€ 6,599. The remaining logistics expenses (e.g. internal freight, warehouse rent, maintenance costs for logistics equipment etc.) and the selling expenses now comprise the expense item "selling and distribution expenses".

the Company's marketing department are also included in the marketing expenses.[3)]

The item *other administrative expenses*, can be divided into finance, IT and other administrative expenses. Other administrative expenses include personnel expenses, depreciation in relation to the sub-categories and expenses for in-house product development.[4)]

US GAAP requires that expenses must be offset against earnings from the same category. This means that all expenses must be shown net, i.e. after all attributable earnings have been deducted. For this reason, the consolidated income statement does not contain a separate item stating other income.

Interest expenses of K€ 3,044 (previous year: K€ 3,340) comprise the following:

- checking account interest and interest on loans
- fees related to notes
- forfeiture costs.

However, the initial interest expenses were reduced by capitalizing K€ 326 (previous year: K€ 202) in financing costs for the high-bay warehouse, which is permitted by US GAAP. The quarterly reports already showed the interest expenses net of capitalizable portions.

Information pursuant to FAS 34:

	2002 K€	2001 K€
Interest expenses, gross	3,370	3,542
Capitalization of interest costs for assets under construction	326	202
Interest expenses, net	**3,044**	**3,340**

[3)] The Company now shows public relations expenses under "other administrative expenses". The 2001 figures were adjusted accordingly by K€ 1,210.

[4)] See footnote 3.

Estimates and Assumptions

The preparation of financial statements requires estimates and assumptions that may affect the reported amounts of assets, liabilities and contingent liabilities as of the balance sheet date, as well as the reported amounts of revenues and expenses during the reporting period. Actual amounts may differ from estimates and assumptions.

Fiscal Year

The Company's fiscal year corresponds to the calendar year and thus comprises the period from January 1 to December 31 of any given year. The fiscal year of each subsidiary is identical to that of the Parent Company.

Scope of Consolidation

The scope of consolidation covers both Zapf Creation AG, which is domiciled in Roedental, Germany, and all of its subsidiaries.

Changes in the scope of consolidation are shown in the following table:

Fully consolidated subsidiaries	Domestic	Foreign	Total
December 31, 2001	0	8	8
Additions	0	1	1
Disposals	0	0	0
December 31, 2002	**0**	**9**	**9**

The former permanent establishment in Spain, which was included as a legally dependent branch in the financial statements of the Company until December 2001, was transformed into a legally independent subsidiary as of January 1, 2002.

Affiliated companies as of December 31, 2002						
Name	Headquarters	Date of formation	Percentage owned by parent company	Book value Dec. 31, 2002	Net income¹⁾ 2002	Equity¹⁾ 2002
Zapf Creation (H.K.), Ltd.	Causeway Bay, Hong Kong	Apr. 30, 1991	100 %	€ 785,472.15	HKD 36,159,218.72	HKD 147,735,143.74
Zapf Creation (U.S.), Inc.	Orlando, Florida, USA	Apr. 15, 1999	100 %	€ 93.40	USD 1,246,564.49	USD 543,135.91
Zapf Creation (France), S.a.r.l.	Lyon, France	Jan. 1, 2000	100 %	€ 50,000.00	€ 130,543.63	€ – 173,358.63
Zapf Creation (U.K.), Ltd.	Corby, Northants, GB	Jan. 1, 2000	100 %	€ 153,964.00	GBP 4,555,309.62	GBP 4,655,309.62
Zapf Creation (Australia), Pty. Ltd.	Melbourne, Australia	Mar. 5, 2001	100 %	€ 263,573.54	AUD 302,172.96	AUD 923,118.14
Zapf Creation (CZ), s.r.o.	Prague, Czech Republic	Jul. 26, 2001	100 %	€ 11,904.76	CZK 1,026,498.13	CZK 6,835,094.19
Zapf Creation (Italia), S.R.L.	Gallarate, Italy	Jul. 31, 2001	100 %	€ 50,000.00	€ – 150,276.39	€ – 230,689.39
Zapf Creation (Polska), Sp. z o.o.	Gliwice, Poland	Aug. 9, 2001	100 %	€ 13,794.62	PLN – 267,634.32	PLN – 188,662.16
Zapf Creation (España), S.L.	Alicante, Spain	Jan. 1, 2002	100 %	€ 129,075.13	€ 826,448.46	€ 955,524.01
				€ 1,457,877.60		

1) According to US GAAP

Foreign Currency Translation

During consolidation, the assets and liabilities of the Company's foreign subsidiaries are translated into euros (€), the Group's currency, at exchange rates prevailing at the end of the fiscal year. In contrast, both the income statement and the cash flow statement are translated into euros at average annual exchange rates. The resulting currency translation differences between the balance sheet and the income statement are posted directly against stockholders' equity in the item "accumulated other comprehensive income". This item is shown separately in the Consolidated Statement of Stockholders' Equity.

In contrast, the stockholders' equity of subsidiaries is converted into euros as follows: The subscribed capital of the Company's foreign subsidiaries is translated into euros prior to consolidation at the exchange rates as of the respective company's founding date. Profits brought forward, however, are translated into euros at the average exchange rate since the company's founding date. The resulting currency translation profits and losses are shown as part of the "accumulated other comprehensive income".

Transactions in foreign currencies, as reported in the Consolidated Income Statement of Zapf Creation AG, include foreign exchange gains (+) and foreign exchange losses (–) in the amount of K€ 1,783 in 2002 and K€ –198 in 2001, respectively. Such currency gains and losses are included in the Consolidated Income Statement of Zapf Creation AG in accordance with the related expense and revenue items. For example, foreign exchange gains and losses from the valuation of accounts payable as of the balance sheet date are shown under costs of goods sold, while foreign exchange gains and losses from the valuation of accounts receivable as of the balance sheet date are recorded under revenues.

Cash and Cash Equivalents

Liquid assets consist of both cash and cash equivalents (term deposits), i.e. cash and highly liquid financial investments with an original maturity of up to 90 days.

Inventories

Inventories are stated at the historical acquisition or manufacturing cost, or at the lower fair value as of the balance sheet date.

Assets acquired from third parties for the inventories are valued at moving-average prices. Products manufactured wholly or partially by the Company are stated at a calculated standard price which reflects the costs of manufacturing the products.

To minimize risk, the Company evaluates inventory levels on a periodic basis in terms of the need for depreciation allowances. Such a need is based on the analysis of the anticipated sales, among other things.

Appropriate valuation allowances are used to account for developments in the market, which cause the value of the inventories to fall below the acquisition or manufacturing cost, taking into account anticipated selling expenses.

The Company did not make use of extraordinary depreciations of inventories in the reporting year.

	2002 K€	2001 K€
Finished products and goods	26,856	21,887
Unfinished products	173	670
Raw materials and supplies	2,653	2,722
Inventories	29,682	25,279

Fair Value of Financial Instruments

Based on discounted borrowing rates currently available to the Company for loans with similar terms, the book value of notes payable and of capital lease transactions are stated at their fair value. All other financial instruments are stated at their approximate fair value due to their short maturities.

Property, Plant and Equipment

Property, plant and equipment are stated at acquisition cost and are depreciated over their estimated useful lives using the straight-line method.

	Useful life of property, plant and equipment
Buildings	40 years
Technical installations and machinery	5 to 10 years
Plant, furnitures and fixtures	5 to 15 years
Computer hardware	3 years
Software	3 to 4[2] years

[2] Depending on the term of lease agreement

The depreciation period on property and equipment held by the Company under capital leases or under leasehold improvements always begins at the time the property or equipment is taken into service. The depreciation period corresponds to the duration of the rental or lease agreements.

Depreciation of property, plant, equipment and software in 2002 amounted to K€ 5,522 (previous year: K€ 3,815)). Upon retirement or sale, the cost of the disposed assets is offset against the related accumulated depreciation. The resulting profit or loss, respectively, is posted to other administrative income or expenses, taking into account any gains on disposal.

There was no need for extraordinary depreciation in the years under review.

	2002 K€	2001 K€
Land and buildings	12,437	10,735
Technical installations and machinery	1,030	1,465
Other installations, software, plant, furnitures and fixtures	37,284	30,533
	50,751	**42,733**
Less accumulated depreciation	– 22,228	– 18,056
Property, plant, equipment and software, net	**28,523**	**24,677**

Zapf Creation AG shows the cost of maintenance and repairs that only insignificantly extend the life of a tangible asset as operating expenses. These were K€ 656 in 2002 and K€ 318 in 2001.

"Other installations, software, plant and business furnishings" include assets under construction worth K€ 420 (previous year: K€ 6,757) and down payments for as yet incomplete projects in connection with the SAP-R/3 implementation in the amount of K€ 581 for 2002 and K€ 35 for 2001.

Intangible Assets

Intangible assets consist primarily of capitalized licenses aimed at protecting brand names. They are amortized over ten years. Accumulated amortization was K€ 763 as of December 31, 2002, and K€ 544 as of December 31, 2001.

The goodwill capitalized by Zapf Creation (Australia) Pty. Ltd. is also included in the intangible assets. It is amortized over ten years. Accumulated amortization was K€ 29 as of December 31, 2002, and K€ 0 as of December 31, 2001.

Research and Development

The Company always expenses research and development costs at the time they are incurred. The external R&D costs were K€ 392 in 2002 and K€ 163 in 2001; they are recorded as part of "other administrative expenses".

Both the development department of Zapf Creation AG and external inventors and designers are responsible for product development. The importance the Company attaches to product design is evidenced by its in-house design and technical development department, which has continuously grown over the years. At both locations – at the Company's headquarters and in Hong Kong – more than 30 employees work continuously on new product concepts and on improving and redesigning existing products. The internal costs for this department (e.g. wages and salaries, depreciation) are also included in "other administrative expenses".

Customer Concentration

The Company transacts most of its business with major customers. Even though this results in a potential default risk from the sale of products, the actual risk determined by the Company is low, because the Company maintains worldwide insurance coverage for all major customers and because, in the past, the default rate of uninsured, smaller customers has been insignificant.

Comprehensive Income

The translation of the individual financial statements of the Company's foreign subsidiaries into euros results in gains and losses that are shown under stockholders' equity in the item "accumulated other comprehensive income".

Revenue Recognition

Revenue from product sales is recognized upon shipment or delivery to customer. Provisions for sales deductions and returns of defective products are recognized in the necessary amounts at the time the corresponding revenue is recognized but no later than at the time of closing the respective monthly accounts. The values determined in such a way are based on historical values or contractual agreements. The amount of these provisions may vary, depending on the existing circumstances. The shipping and processing fees billed to customers are also recognized as revenue by the Company.

Advertising

Zapf Creation AG treats the cost of producing and broadcasting TV commercials as an operating expense in the fiscal year in which a TV spot is first aired. The costs of other advertising, promotional and marketing campaigns are expensed in the fiscal year in which they are incurred. The cost of developing product catalogues and the like are treated as operating expenses as soon as these catalogues are issued, i.e. the Company always treats these costs as prepaid expenses until such date. Nonpersonal expenses in this sector (i.e. excluding personnel expenses and depreciation in the marketing department) were K€ 26,278 in 2002 and K€ 20,207 in 2001.[1)]

Earnings Per Share

Basic earnings per share are calculated by using the following formula:

$$\frac{\text{Net income}}{\text{average number of shares and equivalent shares outstanding during the fiscal year}}$$

Diluted earnings per share are based on the following formulas:

1. If the market price of exercised stock options is higher than the exercise price:

$$\frac{\text{Net income}}{\text{average number of shares and equivalent shares outstanding during the fiscal year} + \text{shares from the option plan}}$$

2. If the Company was able to purchase the stock by using the related proceeds:

$$\frac{\text{Net income}}{\text{average number of shares and equivalent shares outstanding during the fiscal year} - \text{the number of shares purchased during the fiscal year}}$$

1) Change of the original value published in the 2001 annual report from K€ 21,290 to K€ 20,207 because the PR expenses were transferred from marketing expenses to administrative expenses (see also Notes on the Income Statement).

The calculation of earnings per share in detail:

		2002		2001	
		Basic	Diluted	Basic	Diluted
Net income	K€	21,237	21,237	16,436	16,436
Effect of dilutive securities	K€	0	0	0	0
Adjusted net income	K€	21,237	21,237	16,436	16,436
Average number of shares outstanding	thsds.	7,864	7,864	7,875	7,875
Effect of dilutive securities	thsds.	0	0	0	0
Options and warrants	thsds.	0	24	0	30
Equivalent shares	thsds.	7,864	7,888	7,875	7,905
Earnings per share	€	2.70	2.69	2.09	2.08

In fiscal year 2002, stock options to purchase 254,240 shares of common stock were outstanding. However, of this amount 95,000 shares were excluded from the computation of the diluted earnings per share because their effect was anti-dilutive.

Impairment

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate a permanent decrease in value. The recoverability of assets is measured by comparing the book value of an asset to future undiscounted revenue streams which the asset in question is expected to generate. If such assets were considered to be impaired, the Company would write down the asset in an amount equivalent to the amount by which the book value of the asset exceeds its repurchase value.

The fair value is determined, depending on the nature of the asset involved, pursuant to either the discounted cash flow method or by way of appraisals. Assets to be disposed of are valued at the lower of the book or market value, less disposal costs.

Income Taxes

The Company uses the asset and liability method to calculate taxes.

New Accounting Pronouncements

SFAS 143

In June 2001, the Financial Accounting Standards Board ("FASB") published the Statement of Financial Accounting Standard ("SFAS") 143, "Accounting for Asset Retirement Obligations". This statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. SFAS 143 is applicable for fiscal years beginning after June 15, 2002. The Company does not expect the application of this standard to have a significant impact on the Consolidated Balance Sheet, the Consolidated Income Statement or the Consolidated Statement of Cash Flows.

SFAS 144

In August 2001, the Financial Accounting Standards Board ("FASB") published the Statement of Financial Accounting Standard ("SFAS") 144, "Accounting for the Impairment or Disposal of Long-Lived Assets to be Disposed of". This standard establishes a single accounting model for long-lived assets to be disposed of by sale. Furthermore, the standard adjusted some criteria of Statement of Financial Accounting Standard SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed" in relation to the realization and valuation of impairments of long-lived assets. SFAS 144 thus supersedes SFAS 121 and is applicable for fiscal years beginning after December 15, 2001. The application of this standard does not have a significant impact on the Consolidated Balance Sheet, the Consolidated Income Statement or the Consolidated Statement of Cash Flows.

SFAS 145

In April 2002, the Financial Accounting Standards Board ("FASB") published the Statement of Financial Accounting Standard ("SFAS") 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections". In addition to rescinding SFAS 4, SFAS 44 and SFAS 64, and to amending SFAS 13, this new standard makes amendments to other existing pronouncements. The standard is applicable from fiscal year 2003. The Company does not expect the application of this standard to have a significant impact on the Consolidated Balance Sheet, the Consolidated Income Statement or the Consolidated Statement of Cash Flows.

SFAS 146

In June 2002, the Financial Accounting Standards Board ("FASB") published the Statement of Financial Accounting Standard ("SFAS") 146, "Accounting for Costs Associated with Exit or Disposal Activities". This standard addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force ("EITF") 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". This standard is applicable for fiscal years beginning after December 31, 2002. The Company does not expect the application of this standard to have a significant impact on the Consolidated Balance Sheet, the Consolidated Income Statement or the Consolidated Statement of Cash Flows.

SFAS 147

In October 2002, the Financial Accounting Standards Board ("FASB") published the Statement of Financial Accounting Standard ("SFAS") 147, "Acquisitions of Certain Financial Institutions – an Amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9". Due to the nature of the Company's business activities, this standard is not applicable.

SFAS 148

In December 2002, the Financial Accounting Standards Board ("FASB") published the Statement of Financial Accounting Standard ("SFAS") 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123". This standard amends FASB Statement No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this standard establishes further disclosure requirements in both annual and interim financial statements. This standard is applicable for fiscal years ending after December 15, 2002.

EITF 01-09

In November 2001, the Emerging Issues Task Force ("EITF") published the pronouncement EITF 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)". This pronouncement addresses the recognition, characterization, time of realization and classification in vendor income statements of certain consideration given to a customer in connection with the sale of vendor products. The application of this standard does not have an impact on the classification of revenues and expenses in the Consolidated Income Statement.

Note 3: Prepaid Expenses

Prepaid expenses primarily consist of prepaid selling and distribution expenses, marketing expenses, other administrative expenses, personnel expenses and factoring expenses.

Note 4: Other Assets

Other assets comprise the following:

	2002 K€	2001 K€
Tax receivables due from the tax office	1,532	3,881
Other receivables	573	298
Employee loans	500	0
Payments on account	13	184
	2,618	4,363

Note 5: Income Taxes

The expenses for current and deferred income taxes consist of the following:

	2002 K€	2001 K€
Current taxes		
Germany	2,981	2,387
Foreign	7,148	3,925
	10,129	**6,312**
Deferred income taxes		
Germany	919	974
Foreign	– 1,661	– 521
	– 742	**453**
	9,387	6,765

The following table shows the Company's deferred income tax assets and liabilities:

	2002 K€	2001 K€
Deferred tax assets		
Operating loss carryforwards	264	299
Valuation allowances	1,184	577
Licenses	695	0
Other	526	390
Gross deferred tax assets	**2,669**	**1,266**
Deferred tax liabilities		
Net unrealized foreign exchange gains	– 958	– 203
Property, plant, equipment and software	– 780	– 1,028
Other	– 555	– 146
Gross deferred tax liabilities	**– 2,293**	**– 1,377**
	376	– 111

The difference between income tax expenses under German tax laws and the income tax expenses shown in the Consolidated Income Statement is as follows:

	2002 K€	2001 K€
Provision at federal statutory rates	11,331	8,584
Foreign earnings taxed at different rates	– 1,905	– 1,902
Federal trade and solidarity taxes	1,071	811
Non-deductible stock option expenses	– 20	– 175
Other	– 1,090	– 553
	9,387	6,765

As of December 31, 2002, the Company had net loss carryforwards from its foreign businesses totaling K€ 694. Portions of these operating net loss carryforwards in the amount of K€ 238 can be offset against corresponding earnings until 2005.

Note 6: Short-Term and Long-Term Bank Debts

Short-Term Financing

The Company can draw on unsecured lines of credit in the amount of approximately € 64 million. Most of the short-term bank debts as of December 31, 2002, result from borrowings under the aforementioned lines of credit; the average interest rate in 2002 for the credit lines was 4.6 percent. The aforementioned credit lines fully ensure that the Company's working capital needs are met.

Forward Exchange Contracts

In the course of any given year, Zapf Creation uses foreign currency futures with maturities of up to 12 months to hedge against adverse exchange rate fluctuations in connection with the Company's foreign business activities. These OTC contracts, which hedge future inventory purchases and other transactions, are primarily denominated in United States and Hong Kong dollars, as well as in British pounds.

As of the balance sheet date, however, there were no currency futures denominated in foreign currencies outstanding; the same applies to the previous year.

Development of long-term and short-term bank debts as of December 31, 2002

	Borrowing limit K€	Lending rate %	Due date	Status as of Jan. 1, 2002 €	Additions 2002 €
Long-term debts					
1st bank loan		4.95	2004	817,145.07	
2nd bank loan		5.00	2006	287,601.70	
3rd bank loan		5.00	2006	1,725,610.08	
4th bank loan		4.45	2008	894,760.78	
5th bank loan		4.35	2011	5,000,000.00	
6th bank loan		4.35	2011	5,000,000.00	
7th bank loan		4.49	2006	0.00	9,000,000.00
8th bank loan		6.60	2003	71,580.84	
9th bank loan		4.65	2004	490,840.21	
10th bank loan		5.00	2005	1,022,583.76	
11th bank loan		5.95	2007	306,775.10	
12th bank loan		4.99	2004	2,849,737.52	
13th bank loan		6.35	2004	2,296,650.70	
Disagio			2011	– 441,295.41	
				20,321,990.35	**9,000,000.00**
Less current portion of long-term debts (without disagio)				3,327,735.76	
Long-term debts				**16,994,254.59**	
Lines of credit				**14,187,760.85**	
Overdraft	15,339	6.75	unlimited	2,630,152.43	
Overdraft	2,500	5.65	June 18, 2003	2,749.29	
Overdraft	15,339	6.80	unlimited	8,584,895.75	
Overdraft	15,000	6.65	unlimited	0.00	
Overdraft/Other	15,556	6.75	in part limited until July 31, 2003	2,969,963.38	
Current portion of long-term debts (without disagio)				3,327,735.76	
Short-term borrowings				**17,515,496.61**	

Redemption 2002 €	Status as of Dec. 31, 2002 €	Redemption 2003 €	2004 €	2005 €	2006 €	2007 €	2008+ €
314,673.44	502,471.63	330,608.11	171,863.52	0.00	0.00	0.00	0.00
63,911.48	223,690.22	63,911.48	63,911.48	63,911.48	31,955.78	0.00	0.00
383,468.92	1,342,141.16	383,468.92	383,468.92	383,468.92	191,734.40	0.00	0.00
127,822.98	766,937.80	127,822.97	127,822.97	127,822.97	127,822.97	127,822.97	127,822.95
0.00	5,000,000.00	0.00	312,500.00	312,500.00	312,500.00	312,500.00	3,750,000.00
0.00	5,000,000.00	312,500.00	312,500.00	312,500.00	312,500.00	312,500.00	3,437,500.00
0.00	9,000,000.00	2,250,000.00	2,250,000.00	2,250,000.00	2,250,000.00	0.00	0.00
40,903.36	30,677.48	30,677.48	0.00	0.00	0.00	0.00	0.00
163,613.40	327,226.81	163,613.40	163,613.41	0.00	0.00	0.00	0.00
255,645.94	766,937.82	255,645.94	255,645.94	255,645.94	0.00	0.00	0.00
51,129.20	255,645.90	51,129.20	51,129.20	51,129.20	51,129.20	51,129.10	0.00
851,450.10	1,998,287.42	974,271.91	1,024,015.51	0.00	0.00	0.00	0.00
740,121.81	1,556,528.89	788,514.18	768,014.71	0.00	0.00	0.00	0.00
58,662.16	– 382,633.25	– 58,662.15	– 58,662.16	– 58,662.15	– 43,323.40	– 43,323.39	– 120,000.00
3,051,402.79	**26,387,911.88**	**5,673,501.44**	**5,825,823.50**	**3,698,316.36**	**3,234,318.95**	**760,628.68**	**7,195,322.95**
	6,071,210.04						
	20,316,701.84						
	16,842,614.23						
	0.00						
	2,313,993.12						
	6,849,199.82						
	0.00						
	7,679,421.29						
	6,071,210.04						
	22,913,824.27						

Breakdown of the disagio amount related to each individual bank loan:

3rd bank loan	
Status as of December 31, 2002, gross	1,342,141.16
Disagio[1)]	– 27,609.76
Status as of December 31, 2002, net	**1,314,531.40**

1) Life/remaining life: 10/3 years

4th bank loan	
Status as of December 31, 2002, gross	766,937.80
Disagio[2)]	– 16,616.99
Status as of December 31, 2002, net	**750,320.81**

2) Life/remaining life: 10/5 years

5th bank loan	
Status as of December 31, 2002, gross	5,000,000.00
Disagio[3)]	– 160,000.00
Status as of December 31, 2002, net	**4,840,000.00**

3) Life/remaining life: 10/8 years

6th bank loan	
Status as of December 31, 2002, gross	5,000,000.00
Disagio[4)]	– 160,000.00
Status as of December 31, 2002, net	**4,840,000.00**

4) Life/remaining life: 10/8 years

10th bank loan	
Status as of December 31, 2002, gross	766,937.82
Disagio[5)]	– 18,406.50
Status as of December 31, 2002, net	**748,531.32**

5) Life/remaining life: 10/3 years

Disagio Total	– 382,633.25

Long-term liabilities toward banks as of the end of fiscal year 2002 were secured by mortgages in the amount of K€ 11,798 (drawn up upon in 2002: K€ 6,485).

As of December 31, 2002, the Company forfaited receivables and wrote off the respective amount against the receivables shown in the balance sheet.

Forfaiting is comprised as follows:

	2002 K€	2001 K€
Domestic	9,760	0
Foreign	18,098	27,568
	27,858	27,568

Note 7: Stockholders’ Equity

Common Stock

The Company’s share capital is € 8,000,000 (eight million euros). It is divided into 8,000,000 bearer shares of no par value. The bearers of common stock are entitled to a dividend, provided the payment of dividends is permitted under the law, the Management Board has declared that a dividend will be paid, and the respective issue does not violate the preference rights of the holders of all shares outstanding.

Section 5 of the articles of incorporation of Zapf Creation AG authorizes the following capital increases:

1. The Management Board is authorized, subject to the approval of the Supervisory Board, to increase the Company’s share capital, on one or more occasions, until March 15, 2004, by issuing new common stock in exchange for contributions in cash or in kind, in a total amount not to exceed € 2,500,000 (Authorized Capital I). The Management Board is authorized, subject to the approval of the Supervisory Board,

a) to exempt fractional shares from the subscription right, and,

b) to exclude the subscription right of stockholders if new shares are issued in exchange for in-kind contributions.

2. The Management Board is authorized, subject to the approval of the Supervisory Board, to

increase the Company's share capital, on one or more occasions, until March 15, 2004, by issuing new common stock in exchange for contributions in cash or in kind, by a total amount not to exceed € 750,000 (Authorized Capital II). The subscription rights of stockholders may be fully excluded if the issue price of the new shares is not significantly below the market price of shares of the same class already quoted at the time the issue price is finally fixed.

3. The share capital may be increased by up to € 80,000 by issuing up to 80,000 bearer shares of common stock in the context of a contingent capital increase (Contingent Capital I). Said contingent capital increase shall be carried out only to the extent that holders of options which have been issued pursuant to the authorization resolution of the Company's Annual Stockholders' Meeting of April 26, 2000, under the Company's stock option plan exercise their subscription rights and if the Company does not grant treasury stock to fulfill such stock options. The new shares arising from the aforementioned exercise of stock options shall participate in the Company's profits as of the beginning of the fiscal year in which the shares are issued.

4. The share capital may be increased by up to € 300,000 by issuing up to 300,000 bearer shares of common stock in the context of a contingent capital increase (Contingent Capital II). Said contingent capital increase shall be carried out only to the extent that holders of options which have been issued pursuant to the authorization resolution of the Company's Annual Stockholders' Meeting of July 31, 2001, under the Company's stock option program exercise their subscription rights and if the Company does not grant treasury stock to fulfill the stock options. The new shares arising from the aforementioned exercise of stock options shall participate in the Company's profits as of the beginning of the fiscal year in which the shares are issued.

The Supervisory Board is authorized to amend the articles of incorporation to reflect the capital increase from Authorized and Contingent Capital.

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; its book value as of December 31, 2002 was K€ 2,532. Portfolio No. 1 as of December 31, 2002, comprised 72,979 shares of treasury stock, equaling 0.91 percent of the share capital.

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. The book value is K€ 1,649. The number of shares in the portfolio (53,185) equals 0.67 percent of the share capital as of December 31, 2002. The related costs recognized under personnel expenses in 2002 amount to K€ 67 (previous year: K€ 61). Treasury stock was acquired only from 1999 to 2001.

Stock Option Plan

In April 1999, the Supervisory Board and the Management Board recommended a stock option plan, which was approved by the Company's stockholders at its Extraordinary Stockholders' Meeting of April 1999. This plan linked the exercise of stock options to a market index. The Company amended the plan upon approval by the Company's stockholders in April 2000. Under the modified plan, premium price options may be granted to officers and other key employees of the Company. The total stock option volume may not exceed 380,000 shares.

The stock option plan was initially limited to 40,000 shares when it was launched in 1999. Beginning in fiscal 2000, the group of employees entitled to participate in the plan was significantly expanded to include international executives. Since that time, 95,000 shares have been made available each year, on average, for the stock option plan, totaling 380,000 shares over four years, plus 40,000 shares in 1999.

The stock options under the plan may only be granted once a year within four weeks of determining the Company's net income. The exercise price for these options is 20 percent above the Company's closing price on the date the stock option is granted. The vesting of the options increases annually at a rate of 33 percent, beginning with the onset of the second year, so that the options become fully vested as of the fourth anniversary of the date they were granted. The premium may be reimbursed to the buyers of such options under certain circumstances. The right to exercise the options expires five years from the grant date. The options may only be exercised within two weeks of the second day of the Company's Annual Stockholders' Meeting, the publication of the half-year report or the publication of the quarterly report as of September 30 of each year, respectively.

The following schedule provides information on the stock options issued and the weighted average exercise prices:

	2002		2001	
	Number shares	Price €	Number shares	Price €
Outstanding at January 1	224,171	45.95	135,000	60.19
Options granted	117,300	28.01	99,240	24.31
Options exercised	– 14,252	23.58	– 10,069	23.58
Options canceled	–	–	–	–
Options outstanding at December 31	**327,219**	**40.49**	**224,171**	**45.95**
Exercisable at December 31	–	–	–	–
Available for grant at December 31	68,460	–	185,760	–

The following table contains information about the remaining contractual life (in years) of and exercise prices for the stock options outstanding as of December 31, 2002:

Exercise price €	Number shares	Remaining life in years
23.58	15,679	1.3
75.60	95,000	2.3
24.31	99,240	3.7
28.01	117,300	4.2
40.49	327,219	3.4

As permitted by Statement of Financial Accounting Standard No. 123 ("SFAS 123"), the Company continues to apply the Accounting Principles Board Opinion No. 25 ("APB 25") in accounting for its stock option plan. Accruals for the stock option plan were K€ 107 in 2002 and K€ 163 in 2001.

Had personnel costs under the stock option plan been posted pursuant to SFAS 123, the effect thereof on the Company's earnings and earnings per share would have been as follows:

		2002	2001
Reported net income	K€	21,237	16,436
Pro forma compensation expense, net of tax	K€	– 78	– 777
Pro forma net income	**K€**	**21,159**	**15,659**
Earnings per share			
Basic	€	2.70	2.09
Basic – pro forma	€	2.69	1.99
Diluted	€	2.69	2.08
Diluted – pro forma	€	2.68	1.98

The Black-Scholes Model is used to determine the fair value of stock options issued. The calculation makes the following assumptions:

		2002	2001
Expected life in years		4.0	4.0
Risk-free interest rate	%	4.9	4.9
Volatility factor	%	36.0	36.0
Dividend yield	%	1.5	1.5

The market value of the issued options is € 5.67 per share for the 2000 stock option plan and € 22.50 for the 1999 stock option plan.

Bonus Plan for Executives

In fiscal years 2001 and 2002, a separate bonus plan for executives was implemented. The bonus plan is designed similar to the implemented stock option plan. However, the beneficiaries of the bonus plan are compensated directly by way of a cash payment.

The bonus units under the plan may only be granted once a year within four weeks of determining the Company's net income. The bonus units shall only be paid if the average of the opening and closing price of Zapf Creation stock in Xetra trading on the last trading day before a payment date is at least 20 percent higher than the reference price. The reference price equals the average closing price of Zapf Creation stock in Xetra trading during the last ten days before the day on which the bonus units are granted.

The bonus units shall be payable on the second day of the Company's Annual Stockholders' Meeting, on the publication date of the half-year report or the publication date of the quarterly report as of September 30 of each year, respectively. The period required to elapse until payment shall apply separately for each tranche. After two years, 33 percent shall become eligible for payment and after three years a further 33 percent so that on the fourth anniversary all bonus units, in principle, are available for payment. If the requirements regarding the waiting period and the performance goals are fulfilled for the first time on a payment date, the beneficiary shall receive a one-time cash payment amounting to 20 percent of the reference price for every bonus unit.

Based on this bonus plan, a total of 117,300 and 99,240 bonus units were issued to members of the Management Board and executives in 2002 and 2001, respectively.

Due to the stock price development, a provision of K€ 170 and K€ 0 had to be set up in 2002 and 2001, respectively, which affected personnel expenses. The maximum additional personnel expenses of the bonus units issued until December 31, 2002, can amount to K€ 950 for the full term of the bonus plan.

Note 8: Commitments and Contingencies

Dependence On Suppliers

The principal suppliers of the goods purchased by Zapf Creation AG are located exclusively in the People's Republic of China. The business relationships with Asian suppliers, which were initiated in the mid-1980s, were and continue to be strengthened by Zapf Creation (H.K.), Ltd. Although the Company relies on external Asian suppliers, it retains the ability and flexibility to use alternative sources of supply because no long-term, mutually binding purchase obligations towards the suppliers exist. However, any extended interruptions or disruptions of these business relationships might impact the Company's financial situation and its results of operations.

Dependence On Product Lines and Major Customers

The Company's most profitable and successful product to date, BABY born®, accounted for 51 percent of total sales in 2002 (previous year: 53 percent). The decline in this share compared to the previous year shows the success of the Company's strategy to establish further brands such as CHOU CHOU, Baby Annabell on the markets as independent concepts in addition to its main product BABY born®.

The Company's sales to its two main customers accounted for 21 percent of total consolidated sales in 2002 (previous year: 20 percent). Sales to all top ten customers accounted for 49 percent of total consolidated sales in 2002 (previous year: 46 percent). The share of receivables attributable to these major customers in comparison to total receivables is 27 percent before forfaiting. This share is reduced to a net share of 3 percent as of the end of the fiscal year due to the forfaiting transactions affected.

Leasing Contracts and Leases

In the normal course of business, the Company concludes a multitude of leasing contracts and leases for office facilities and warehouses, as well as for plant and equipment.

The expenses recognized under such contracts were K€ 2,201 in fiscal year 2002 (previous year: K€ 1,825).

The following table shows the future minimum obligations of Zapf Creation AG under leasing contracts and leases in K€.

	Operating leases K€
2003	4,207
2004	3,054
2005	891
2006	146
2007	112
Thereafter	351
	8,761

Obligations stemming from long-term leasing contracts expire no later than in 2011. The Company's management expects expiring leasing contracts and leases to be renewed or replaced as necessary in the normal course of business.

Other Financial Obligations

The Company had unused open letters of credit in the amount of K€ 882 as of December 31, 2002 (previous year: K€ 1,375).

Zapf Creation routinely concludes license agreements with external inventors with the aim of using their technical designs for the Company's products. A small number of agreements contain provisions for payment of a guaranteed minimum annual license fee, should the revenues from the sale of the product(s) remain under a guaranteed fixed amount. Although these agreements were concluded for an unlimited period of time, they may be terminated if certain conditions apply. The licensing agreements will continue to be valid regardless of any such termination.

The Company's management has proven that the expected revenue from product sales under these agreements will exceed the stipulated minimum amounts and that there will be no realization of contingent liabilities.

The cost of product license agreements was K€ 5,019 in 2002 and K€ 4,076 in 2001. The increase in licensing fees results from the concomitant increase in sales and from the amendment of license agreements with the licensors.

Litigation

The Company is involved in various lawsuits incidental to its business. The Management Board believes, however, that the resolution of these matters will not have any adverse effect on the Company's business, financial condition, or results of operations. Zapf Creation creates appropriate provisions for any legal disputes pending beyond year's end.

Relationships With Related Parties

Loans totaling K€ 500 were granted to members of the Management Board. The fixed term of these loans ends December 31, 2003. The interest rate for the loan, which is at 4.75 percent, is determined quarterly in advance.

Note 9: Segment Reporting

Given the structure of the Zapf Creation Group, all subsidiaries (also called "business units") are responsible for their respective markets. The Company markets only branded play concepts and does not have product segments that are subject to reporting requirements. Therefore, this segment report focuses on the various subsidiaries and their respective markets. Segment performance is measured at the operating profit level, prior to consolidation.

Compared to its subsidiaries, Zapf Creation AG has a different role because it assumes a number of centralized corporate functions and also invoices customers (through the Central Europe and Eastern Europe business units). The parent company thus accounts for the majority of operating expenses and assets in its financial statements.

Inter-company sales and expenses are shown in amounts which, in the view of the Company's management, are appropriate for arm's length transactions.

The parent company and all subsidiaries apply the accounting policies of the Group. See also Note 2.

Information by segment and the reconciliation to the amounts reported in the Consolidated Financial Statements are as follows:

	Net sales from external customers K€	Affiliate revenues[1)] K€	Depreciation and amortization expense K€
2002			
Zapf Creation AG	90,490	24,957	4,727
Zapf Creation (España), S.L.	12,257	11	99
Zapf Creation (France), S.a.r.l.	9,281	132	33
Zapf Creation (U.K.), Ltd.	44,190	0	102
Zapf Creation (H.K.), Ltd.	5,226	76,910	468
Zapf Creation (U.S.), Inc.	50,160	63	135
Zapf Creation (Australia), Pty. Ltd.	7,809	0	116
Zapf Creation (Italia), S.R.L.	895	0	24
Zapf Creation (CZ), s.r.o.	2,412	0	39
Zapf Creation (Polska), Sp. z o.o.	0	623	0
Consolidation	**0**	**– 102,696**	**0**
Consolidated total	222,720	0	5,743

	Net sales from external customers K€	Affiliate revenues[1)] K€	Depreciation and amortization expense K€
2001			
Zapf Creation Deutschland	98,379	16,946	3,251
Zapf Creation España	10,490	71	101
Zapf Creation (France), S.a.r.l.	5,289	35	9
Zapf Creation (U.K.), Ltd.	32,614	689	61
Zapf Creation (H.K.), Ltd.	7,255	68,973	357
Zapf Creation (U.S.), Inc.	32,069	185	178
Zapf Creation (Australia), Pty. Ltd.	5,537	15	34
Zapf Creation (Italia), S.R.L.	49	0	5
Zapf Creation (CZ), s.r.o.	1,415	0	11
Zapf Creation (Polska), Sp. z o.o.	0	390	0
Consolidation	**0**	**– 87,304**	**0**
Consolidated total	193,097	0	4,007

[1)] Excludes inter-company interest income

Tax expense (Income: –) K€	Operating profit K€	Capital expenditures K€	Long-lived assets (net of deferred taxes) K€	Total assets K€
3,901	2,411	8,286	28,602	111,917
433	2,876	56	275	8,122
104	1,492	91	135	6,370
3,126	16,048	198	326	20,338
937	– 1,009	765	729	23,704
836	9,510	282	647	29,940
90	1,163	102	483	3,920
– 96	– 111	34	60	1,531
56	388	85	149	2,442
0	327	0	0	987
0	**– 206**	**0**	**– 1,458**	**– 69,386**
9,387	32,889	9,899	29,948	139,885
3,362	8,017	14,234	25,086	93,074
250	1,397	146	318	7,681
112	866	66	77	4,626
2,413	11,796	163	261	19,692
719	– 120	566	660	20,561
– 271	3,892	194	597	10,583
31	738	567	533	4,583
– 87	– 212	55	50	333
62	427	112	100	2,046
0	– 382	0	0	523
174	**10**	**0**	**– 1,341**	**– 51,657**
6,765	26,429	16,103	26,341	112,045

Note 10:
Supplemental Financial Information

	2002 K€	2001 K€
Supplemental disclosure of cash flow information		
Cash paid during the year for:		
Interest	2,784 [1]	3,252 [2]
Income taxes	3,976	7,640

[1] Interest expenses totaling K€ 326 and K€ 202 were capitalized in fiscal year 2002 and 2001, respectively.
[2] See also the previous footnote.

Some of the changes in financial position shown in the cash flow statement cannot be compared with the figures reported in the current or previous year's consolidated balance sheet, given that the changes shown in the cash flow statement also take into account the effect of varying foreign exchange rates on cash and cash equivalents.

	2002 K€	2001 K€
Accrued liabilities		
Advertising and public relations	6,117	2,511
Other accrued liabilities	2,412	1,965
Management bonuses	1,537	672
Tax liabilities (VAT, other)	1,286	2,445
Other liabilities employees	562	559
Commissions	475	525
License fees	332	1,686
Labor expenses (stock option)	277	163
Customer bonuses [3]	0	957
	12,998	11,483

[3] Starting in fiscal year 2002, all deferred revenue reductions (cash discounts, bonuses etc.) are shown as part of capitalized deductions from trade receivables.

Supplemental Information According to Section 292a HGB

As permitted under Section 292a HGB (German Commercial Code), the financial statements of the Zapf Creation Group are prepared in accordance with the Generally Accepted Accounting Principles of the United States ("US GAAP").

To make use of the exemption provisions under Section 292a HGB, the following additional information must be provided:

The Company further points out that it has issued the Declaration of Compliance with the Corporate Governance Code that is required by Section 161 of the German Stock Corporation Act (AktG) and made this declaration available to the stockholders.

1) Consolidated Statement of Fixed Assets for Zapf Creation AG, Roedental, Germany

The overview is given on pages 70/71.

2) Sales

The following table shows the development of sales in the different product lines:

	2002 K€	2001 K€
BABY born® concept	113,963	102,401
Branded play concepts	105,888	86,325
Designer Collection	2,596	3,094
Maritim/other	273	1,277
Net sales	222,720	193,097

Breakdown of net sales by business unit is as follows:[4)]

	2002 K€	2001 K€
Europe	**161,965**	**151,583**
Central Europe	88,134	86,443
thereof Germany	69,622	66,125
Northern Europe	44,978	42,378
thereof Great Britain/Ireland	38,272	35,062
Southern Europe	23,033	18,141
thereof Spain/Portugal	12,188	10,491
thereof France	5,205	3,220
Eastern Europe	5,820	4,621
The Americas	**50,160**	**32,808**
Asia/Australia	**10,595**	**8,706**
Net sales	222,720	193,097

4) Previous year's figures were adjusted accordingly as the current structure was not implemented in the Zapf Creation Group until January 1, 2002.

The overview of billings by business unit can be found on pages 96/97.

3) Liabilities With Remaining Terms of More Than Five Years

In 2002, the Company had liabilities with remaining terms of more than five years in the amount of K€ 7,315 (previous year: K€ 8,055).

4) Disclosure of the Cost of Materials and Personnel According to HGB

The cost of materials in 2002 and 2001 according to HGB was K€ 89,411 and K€ 87,653, respectively. The cost of materials comprises the cost of raw materials and supplies in the amount of K€ 4,543 (previous year: K€ 4,541) and the cost of goods purchased in the amount of K€ 84,868 (previous year: K€ 83,112).

Consolidated personnel expenses were K€ 26,430 (previous year: K€ 18,715). Besides salaries and wages of K€ 23,433 (previous year: K€ 16,060), this amount also includes social security contributions and benefits of K€ 2,997 (previous year: K€ 2,655).

5) Annual Average Number of Employees

	2002	2001
Employees	326	265
Industrial workforce	186	196
Home workers	6	6
	518	467

Billings by Business Units:

	Zapf Creation AG K€	Zapf Creation (España), S.L. K€	Zapf Creation (H.K.), Ltd. K€	Zapf Creation (U.S.), Inc. K€	Zapf Creation (U.K.), Ltd. K€
2002					
Europe	**89,942**	**12,257**	**2,988**	**0**	**44,190**
Central Europe	85,410		2,721		
thereof Germany	67,039		2,583		
Northern Europe	542		246		44,190
thereof Great Britain/Ireland	18		246		38,008
Southern Europe	582	12,257	21		
thereof Spain/Portugal	– 31	12,219			
thereof France	6				
Eastern Europe	3,408				
The Americas	**0**	**0**	**0**	**50,160**	**0**
Asia/Australia	**548**	**0**	**2,238**	**0**	**0**
Net sales	90,490	12,257	5,226	50,160	44,190

	Zapf Creation AG K€	Zapf Creation (España), S.L. K€	Zapf Creation (H.K.), Ltd. K€	Zapf Creation (U.S.), Inc. K€	Zapf Creation (U.K.), Ltd. K€
2001					
Europe	**97,614**	**10,490**	**4,112**		**32,614**
Central Europe	83,263		3,180		
thereof Germany	63,100		3,025		
Northern Europe	8,978		786		32,614
thereof Great Britain/Ireland	1,662		786		32,614
Southern Europe	2,167	10,490	146		
thereof Spain/Portugal		10,490	1		
thereof France			143		
Eastern Europe	3,206				
The Americas	**0**	**0**	**739**	**32,069**	**0**
Asia/Australia	**765**	**0**	**2,404**	**0**	**0**
Net sales	98,379	10,490	7,255	32,069	32,614

Zapf Creation (France), S.a.r.l. K€	Zapf Creation (Australia), Pty. Ltd. K€	Zapf Creation (Italia), S.R.L. K€	Zapf Creation (CZ), s.r.o. K€	Zapf Creation (Polska), Sp. z o.o. K€	Total net sales K€
9,281	0	895	2,412	0	161,965
3					88,134
					69,622
					44,978
					38,272
9,278		895			23,033
					12,188
5,199					5,205
			2,412		5,820
0	0	0	0	0	50,160
0	7,809	0	0	0	10,595
9,281	7,809	895	2,412	0	222,720
5,289	0	49	1,415	0	151,583
					86,443
					66,125
					42,378
					35,062
5,289		49			18,141
					10,491
3,077					3,220
			1,415		4,621
0	0	0	0	0	32,808
0	5,537	0	0	0	8,706
5,289	5,537	49	1,415	0	193,097

6) Supervisory Board

The Supervisory Board of Zapf Creation AG consists of the following members:

Name	Member since	Function	Principal occupation	Further supervisory board membership
Dr. Dietmar Scheiter	March 18, 1999	Chairman	Businessperson	no further memberships
Dr. Horst F. Bröcker	March 18, 1999	Deputy chairman	Businessperson	no further memberships
Dr. Petra Wibbe	March 18, 1999	Full member	Lawyer	TA Triumph-Adler AG, Nuremberg Full member
Arnd Wolpers	March 18, 1999	Full member	Businessperson	Articon-Integralis AG, Ismaning Chairman Motion Picture Manufacturers AG, Munich Full member
Dr. Peter Klein	April 15, 1999	Full member	Businessperson	GetAhead AG, Hamburg Chairman PlanOrg AG, Cologne Full member Done AG, Hamburg Chairman
Hans-Gerd Füchtenkort	July 31, 2001	Full member	Businessperson	no further memberships

Provisions of K€ 58 were set up in 2002 to cover the expenses of the Supervisory Board.

7) Management Board

The following table lists the members of the Management Board of Zapf Creation AG and their areas of responsibility. Mr. Christian Ewert was appointed to the Management Board in 2002 for the first time. The members of the Management Board are jointly responsible for managing the Company. This responsibility includes the management of Zapf Creation AG and all independent and dependent subsidiaries.

Name	Function	Term of office	Area of responsibility
Thomas Eichhorn	Chairman	December 31, 2004	Strategy & Corporate Development, Sales/Distribution, Marketing, Investor Relations, Public Relations, Human Resources, Internal Audit
Christian Ewert	Full member	December 31, 2004	Production, Quality Management, Purchasing, Logistics, IT
Angelika Marr	Full member	December 31, 2004	Design, Product Development
Rudolf Winning	Full member	December 31, 2004	Finance, Legal Affairs, Risk Management, Organization, Investor Relations

Total compensation of the Company's Management Board in 2002 was K€ 1,108, the variable portion of which equaled 43 percent. The members of the Management Board ware granted 20,000 stock options for 1999, 35,000 stock options for 2000, 42,000 stock options for 2001 and 54,600 stock options for 2002. So far, a total of 13,334 options were exercised.

Loans totaling K€ 500 were granted to members of the Management Board. The fixed term of these loans ends December 31, 2003. The interest rate for the loans, which is at 4.75 percent, is determined quarterly in advance.

Members of the Supervisory Board did not take up any loan.

Independent Auditors' Report

We have audited the consolidated financial statements of Zapf Creation AG for the fiscal year from January 1, 2002 to December 31, 2002, comprising the balance sheet, the income statement, the statement of changes in equity, the cash flow statement and the notes to the consolidated financial statements.

The preparation of the consolidated financial statements and the their contents are the responsibility of the company's management. Our responsibility is to express an opinion whether the consolidated financial statements are in conformity with United States Generally Accepted Accounting Principles (US GAAP) based on our audit.

We conducted our audit of the consolidated annual financial statements in accordance with the generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland (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 are detected with reasonable assurance. The effectiveness of the internal control system and the evidence supporting the disclosures in the consolidated financial statements are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with United States Generally Accepted Accounting Principles (US GAAP) of proper accounting.

Our audit, whose scope also extends to the group management report by the management for the period from January 1, 2002 to December 31, 2002, has not led to any reservations. On the whole, the group management report provides a suitable understanding of the Group's position and suitably presents the risk of future development. Furthermore, we confirm that the consolidated financial statements and the group management report for the fiscal year beginning January 1, 2002 and ending December 31, 2002 fulfill the requirements for exempting the company from the necessity of preparing consolidated financial statements and a consolidated group management report according to German law.

Nuremberg, Germany, February 18, 2003

Rödl & Partner GmbH
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Kastl	Schäfer
Certified public accountant	Certified public accountant

Report of the Supervisory Board

Ladies and Gentlemen,

There were no changes regarding the composition of the Supervisory Board of Zapf Creation AG in fiscal year 2002.

In that year, the Management Board of Zapf Creation AG was expanded by one member. Mr. Christian Ewert was appointed to the Company's Management Board by resolution of the Supervisory Board of June 4, 2002, for a term ending December 31, 2004.

The Supervisory Board carried out its duties as provided by law and the Company's articles of incorporation in a total of four meetings. At these meetings, the Management Board of Zapf Creation AG informed the Supervisory Board of the current state of business and the development of the Company, both verbally and in writing. The status of the international introduction of the SAP standard software and the logistics expansion at the Roedental site continued to be key issues at all meetings. A further core issue was the implementation of the Corporate Governance Code. In addition, the chairman of the Supervisory Board and the chairman of the Management Board usually met once a month for in-depth discussions of current issues. The Supervisory Board was thus informed comprehensively and in a timely manner of all essential business transactions.

The present Financial Statements for fiscal year 2002 and the Management Report including the accounts were audited by the auditors, Dr. Rödl & Partner GmbH, Wirtschaftsprüfungsgesellschaft, Nuremberg, which were elected by the Annual Stockholders' Meeting and appointed by the Supervisory Board. The auditors issued an unqualified audit certificate.

The auditors presented their audit report to the Supervisory Board. The Supervisory Board agrees with the auditors' findings. At its meeting on March 12, 2003, the Supervisory Board extensively discussed, examined and approved the Financial Statements and the Management Report prepared by the Management Board. The auditors were present during this meeting. The Financial Statements are therefore final. The Supervisory Board also reviewed and approved the proposal of the Management Board regarding the appropriation of profits.

At its meeting on March 12, 2003, the Supervisory Board also thoroughly reviewed and approved the Consolidated Financial Statements as of December 31, 2002, which received an unqualified audit certificate from Dr. Rödl & Partner GmbH, Wirtschaftsprüfungsgesellschaft, Nuremberg, and the Group Management Report.

The Supervisory Board wishes to thank the Management Board and the Company's employees for their extraordinary commitment and their special achievements in the past fiscal year.

Munich, Germany, March 12, 2003
For the Supervisory Board

Dr. Dietmar Scheiter
Chairman

Financial Calendar

Event	Date	Place
Financial statements press conference FY 2002	March 18, 2003, 10:00 a.m.	Munich
DVFA analyst conference	March 18, 2003, 4:00 p.m.	Frankfurt/Main
Global conference call	March 18, 2003, 6:00 p.m.	
Road show	March 2003	Europe
Annual Stockholders' Meeting	May 7, 2003	Roedental
Results Q1/2003	May 7, 2003	
Dividend payment[1)]	May 8, 2003	
European smaller companies conference	May 8, 2003	London
Press conference H1/2003	End of July 2003	Munich
Global conference call	End of July 2003	
Results Q3/2003	End of October 2003	
Global conference call	End of October 2003	

1) Subject to approval by the Annual Stockholders' Meeting

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This Annual Report is also available in German.

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