EXHIBITS 14-20
Exhibit 14
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
☑ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2004

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______ to ______

Commission File Number 001–31396

LeapFrog Enterprises, Inc.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State of Incorporation) 95–4652013
(I.R.S. Employer Identification No.)

6401 Hollis Street, Suite 150, Emeryville, California 94608–1071
(Address of Principal Executive Offices, Including Zip Code)

Registrant’s Phone Number, Including Area Code: (510) 420–5000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b–2 of the Exchange Act). Yes ☐ No ☐

The number of shares of Class A common stock, par value $0.0001, and Class B common stock, par value $0.0001, outstanding as of April 30, 2004, was 31,684,384 and 27,881,497, respectively.
increase our shipping costs or cause sales opportunities to be delayed or lost. For example, in the second half of 2003, product within shorter time periods will increase the risk that we fail to meet tight shipping schedules, which could damage our relationships with retailers, suppliers to fill orders promptly and shift a significant portion of inventory risk and carrying costs to suppliers like us. The logistics of supplying more on-hand inventories throughout the year to meet demand. While these techniques reduce retailers' investments in their inventory, they increase pressure on time their orders so that suppliers like us will fill the orders closer to the time of purchase by consumers, thereby reducing their need to maintain larger increase as retailers become more efficient in their control of inventory levels through just-in-time inventory management systems. Generally, retailers approximately 79% of our total net sales occurred during this period. This percentage of total sales may 2003, Sales of consumer electronics and toy products in the retail channel are highly seasonal, causing the substantial majority of our sales to U.S. retailers to occur during the third and fourth quarters. In 2003, approximately 79% of our total net sales occurred during this period. This percentage of total sales may increase as retailers become more efficient in their control of inventory levels through just-in-time inventory management systems. Generally, retailers time their orders so that suppliers like us will fill the orders closer to the time of purchase by consumers, thereby reducing their need to maintain larger on-hand inventories throughout the year to meet demand. While these techniques reduce retailers' investments in their inventory, they increase pressure on suppliers to fill orders promptly and shift a significant portion of inventory risk and carrying costs to suppliers like us. The logistics of supplying more product within shorter time periods will increase the risk that we fail to meet tight shipping schedules, which could damage our relationships with retailers, increase our shipping costs or cause sales opportunities to be delayed or lost. For example, in the second half of 2003, one of our largest retail
customers changed its order pattern to occur later in the holiday season, which we believe delayed a significant portion of our net sales to this customer from the third quarter of 2003 to the fourth quarter of 2003. The seasonal pattern of sales in the retail channel requires significant use of our working capital to manufacture and carry inventory in anticipation of the holiday season, as well as early and accurate forecasting of holiday sales. Failure to predict accurately and respond appropriately to consumer demand on a timely basis to meet seasonal fluctuations, or any disruption of consumer buying habits during this key period, would harm our business and operating results.

We rely on a limited number of manufacturers, virtually all of which are located in China, to produce our finished products, and our reputation and operating results could be harmed if they fail to produce quality products in a timely and cost-effective manner and in sufficient quantities.

We outsource substantially all of our finished goods manufacturing to nine manufacturers, all of whom manufacture our products at facilities in the Guangdong province in the southeastern region of China. In 2003, our LeapPad and Leapster platforms were manufactured by two manufacturers, while our remaining products were sole-sourced. We depend on these manufacturers to produce sufficient volumes of our products in a timely fashion and at satisfactory quality and cost levels. As part of our global sourcing initiative, we have added more resources in Asia to improve operating efficiencies and to work more closely with our suppliers. We generally allow retailers and distributors to return or receive credit for defective or damaged products. If our manufacturers fail to produce quality products on time, at expected cost targets and in sufficient quantities due to capital shortages, late payments from us, political instability, labor shortages, health epidemics, intellectual property disputes, changes in international economic policies, natural disasters, energy shortages, terrorism or other disruptions to their businesses, our reputation and operating results would suffer. In addition, if our manufacturers decide to increase production for their other customers, they may be unable to manufacture sufficient quantities of our products and our business could be harmed.

We currently compete primarily in the infant and toddler and preschool categories and electronic learning aids category of the U.S. toy industry and, to some degree, in the overall U.S. and international toy industry. Our SchoolHouse division competes in the supplemental educational materials market. Each of these markets is very competitive and we expect competition to increase in the future. For example, in July 2003, Mattel, Inc. introduced under its Fisher-Price brand a product called “PowerTouch” having functionality similar to that of our LeapPad platform. We believe that we are beginning to compete, and will increasingly compete in the future, with makers of popular game platforms and smart mobile devices such as personal digital assistants. These companies are well situated to compete effectively in our primary markets. Additionally, we are beginning to cross over into their markets with products such as our Leapster platform and iQuest handheld device. Many of our direct, indirect and potential competitors have significantly longer operating histories, greater brand recognition and substantially greater financial, technical and marketing resources than we do. These competitors may be able to respond more rapidly than we can to changes in consumer requirements or preferences or to new or emerging technologies. They may also devote greater resources to the development, promotion and sale of their products than we do. We cannot assure you that we will be able to compete effectively in our markets.

Our quarterly operating results are susceptible to fluctuations that could cause our stock price to decline.

Historically, our quarterly operating results have fluctuated significantly. For example, our net loss for the first quarter of 2004 was $(11.8) million. Our net income (loss) for the first through fourth quarters of 2003 was $(1.0) million, $(3.9) million, $33.4 million and $44.2 million, respectively. We expect these fluctuations to continue for a number of reasons, including:

- seasonal influences on our sales, such as the holiday shopping season and back–to–school purchasing;
- unpredictable consumer preferences and spending trends;
- the need to increase inventories in advance of our primary selling season;
- timing of new product introductions;
- general economic conditions;
- the financial condition of our retail customers;
- the results of legal proceedings;
- changes in our pricing policies, the pricing policies of our competitors and general pricing trends in consumer electronics and toy markets;
- international sales volume and the mix of such sales among countries with similar or different holidays and school years than the United States;
- the impact of strategic relationships;
- the sales cycle to schools, which may be uneven, depending on budget constraints, the timing of purchases and other seasonal influences; and
Our rapid growth has presented significant challenges to our management systems and resources, and we may experience difficulties managing our growth. Since 2001, we have grown rapidly, both domestically and internationally. Our net sales have grown from $314.2 million in 2001 to $680.0 million in 2003. During this period, the number of different products we offered at retail also increased significantly, and we have opened offices in Canada, France, Macau and Mexico. At December 31, 2001, we had 438 full-time employees and at December 31, 2003, we had 869 full-time employees. In addition, we plan to hire a significant number of new employees in our Asia-based offices in 2004. We are upgrading existing and implementing new operational software systems, including supply chain management systems. Further, in mid-2004, we are planning on consolidating multiple third party distribution warehouses into a single distribution warehouse to handle our needs. This warehouse will be operated by a new third party logistics service provider. This expansion has presented, and continues to present, significant challenges for our management systems and resources. If we fail to develop and maintain management systems and resources sufficient to keep pace with our planned growth, our operating results could suffer.

Changes in economic conditions, which can result in reduced demand for our products or higher prices for necessary commodities, could harm our business and operating results. Recent weak economic conditions in the United States and elsewhere have adversely affected consumer confidence and consumer sales generally. In addition, the September 11, 2001 terrorist attacks significantly and negatively affected general economic conditions. Any future attacks and the responses to such attacks, including military action in the Middle East, or other significant global events could further impact the economy. Further weakening of the economy could damage our sales in our U.S. Consumer and other segments. Other changes in general economic conditions, such as greater demand or higher prices for plastic, electronic components, liquid crystal displays and fuel, may delay manufacture of our products, increase our costs or otherwise harm our margins and operating results.

Earthquakes or other events outside of our control may damage our facilities or the facilities of third parties on which we depend. Our two current primary U.S. distribution centers, our planned distribution center in Fontana, California, our Silicon Valley engineering office and our corporate headquarters are located in California near major earthquake faults that have experienced earthquakes in the past. An earthquake or other natural disasters could disrupt our operations. Additionally, the loss of electric power, such as the temporary loss of power caused by power shortages in the grid servicing our facilities in California, could disrupt operations or impair critical systems. Any of these disruptions or other events outside of our control could impair our distribution of products, damage inventory, interrupt critical functions or otherwise affect our business negatively, harming our operating results. Our existing earthquake insurance relating to our distribution center may be insufficient and does not cover any of our other operations. If the facilities of our third party finished goods or component manufacturers are affected by earthquakes, power shortages, floods, monsoons, terrorism or other events outside of our control, our business could suffer.

We are subject to international, federal, state and local laws and regulations that could impose additional costs on the conduct of our business. In addition to being subject to regulation by the CPSC and similar state regulatory authorities, we must also comply with other laws and regulations. The Children’s Online Privacy Protection Act, as implemented, requires us to obtain verifiable, informed parental consent before we collect, use or disclose personal information from children under the age of 13. Additionally, the Robinson–Patman Act requires us to offer non-discriminatory pricing to similarly situated customers and to offer any promotional allowances and services to competing retailers and distributors within their respective classes of trade on proportionally equal terms. Our SchoolHouse division is affected by a number of laws and regulations regarding education and government funding. We are subject to other various laws, including international and U.S. immigration laws, wage and hour laws and laws regarding the classification of workers. Compliance with these and other laws and regulations impose additional costs on the conduct of our business, and failure to comply with these and other laws and regulations or changes in these and other laws and regulations may impose additional costs on the conduct of our business.

One stockholder controls a majority of our voting power as well as the composition of our board of directors. Holders of our Class A common stock will not be able to affect the outcome of any stockholder vote. Our Class A common stock entitles its holders to one vote per share, and our Class B common stock entitles its holders to ten votes per share on all matters submitted to a vote of our stockholders. As of April 30, 2004, Lawrence J. Ellison and entities controlled by him beneficially owned approximately 17.0 million shares of our Class B common stock, which represents approximately 55% of the combined voting power of our Class A common stock and Class B common stock. As a result, Mr. Ellison controls all stockholder voting power, including with respect to:

- the composition of our board of directors and, through it, any determination with respect to our business direction and policies, including the appointment and removal of officers;
Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LeapFrog Enterprises, Inc.
(Registrant)

/s/ THOMAS J. KALINSKE
Thomas J. Kalinske
Chief Executive Officer (Authorized Officer)

Dated: May 7, 2004

/s/ JAMES P. CORLEY
James P. Corley
Chief Financial Officer
(Principal Financial and Accounting Officer)

Dated: May 7, 2004
Exhibit 15
LeapFrog Enterprises, Inc. Press Release

LeapFrog Reports 2nd Quarter 2004 Results; Net Sales Up 19%

EMERYVILLE, Calif., July 21 /PRNewswire-FirstCall/ -- LeapFrog Enterprises, Inc. (NYSE: LF), a leading developer of innovative technology-based educational products, today reported financial results for the second quarter ended June 30, 2004.

Net Sales

Net sales for the second quarter of 2004 were $80.8 million, compared with $68.0 million in the second quarter of 2003, up 19%.

Segment Results

Net sales from the U.S. Consumer segment were $47.7 million, up 4% from $45.8 million in the second quarter of 2003. Net sales from the International segment were $13.8 million, up 51% from $9.1 million in the second quarter of 2003. Net sales from the Education and Training segment were $19.3 million, up 47% from $13.1 million in the second quarter of 2003. The three segments represented 59%, 17% and 24%, respectively, of consolidated quarterly net sales for the second quarter of 2004, as compared with 67%, 14% and 19% of consolidated quarterly net sales in the second quarter of last year.

Gross Margin

Gross margin was 45.1% in the second quarter of 2004, compared with 52.7% in the second quarter of 2003. Gross margin declined largely due to lower gross profit margins in the U.S. Consumer segment, which saw a shift in the mix of products sold the quarter from higher margin software to newer lower margin platforms. The company expects its gross margins to improve in the second half of the year as new software titles become increasingly available and software sales comprise a larger portion of the company's total sales mix.

Net Loss

The company recorded a net loss for the second quarter of 2004 of $(7.4) million, or $(0.12) per share, compared with a net loss for the second quarter of 2003 of $(3.9) million, or $(0.07) per share.

"We are pleased with our progress in the second quarter and with about 80% of the sales year still ahead of us, we are prepared for the second half of 2004," said Tom Kalinske, Chief Executive Officer. "We are excited about strategically expanding our product line within both our Consumer business and our Education and Training business. Our progress in penetrating the U.S. school market is particularly encouraging and, in a mature business model, will support a more even, year-round selling cycle for us over the long term. On the Consumer side, while the U.S. retail environment remains challenging, we are pleased that our POS data indicates that sell through at retail is up over 20% to date, which should bode well for the busy fall and holiday selling season. We believe that the work we are doing in 2004 to build our brand, company, infrastructure and product line will position LeapFrog to become a universally-recognized global leader in the future."

The company's published guidance for the full 2004 year remains unchanged as follows:

Outlook for 2004
-- Net sales of $770 to $800 million
-- Gross profit margin of 48% to 49% of net sales
-- Operating expenses of 33% to 35% of net sales
-- Fully diluted share count of approximately 63 million
-- Diluted net income per share of $1.18 to $1.28

Conference Call

A conference call will be held today, Wednesday, July 21 at 5:00 p.m. Eastern time (2:00 p.m. Pacific time) to discuss these announcements and to provide further discussion of results for the quarter and outlook for 2004. A live web cast of the conference call will be offered on LeapFrog's investor relations website at www.leapfroginvestor.com and on www.ccbn.com. A...
LeapFrog Enterprises, Inc. is a leading designer, developer and marketer of innovative, technology-based learning products and related proprietary content, dedicated to making learning effective and engaging for all ages, at home and in schools, around the world. The company was founded in 1995 and is based in Emeryville, California. LeapFrog has developed a family of learning platforms that come to life with more than 100 interactive software titles, covering important subjects such as phonics, reading, math, music, geography, social studies, spelling, vocabulary and science. In addition, the company has created more than 35 stand-alone educational products for ages from six months to 16 years. LeapFrog's award-winning U.S. consumer products are available at major retailers in more than 20 countries around the world. The LeapFrog SchoolHouse curriculum programs are currently in classrooms across the United States with over 200 interactive books and over 450 skill cards representing more than 6,000 pages of educational content. LeapFrog SchoolHouse products have won numerous awards from the education industry, including the Golden Lamp Award and Distinguished Achievement Award from the Association of Educational Publishers, the Award of Excellence from Technology & Learning magazine and the Teacher's Choice Award from Learning magazine.

NOTE: LEAPFROG and The LeapFrog Logo are trademarks of LeapFrog Enterprises, Inc.

Forward-Looking Statements

Cautionary Statement Under The Private Securities Litigation Reform Act Of 1995:

Except for the historical information contained herein, this news release contains forward-looking statements, including the financial guidance in the section entitled "Outlook for 2004" and other statements regarding the company's anticipated gross margin improvements, product introductions and availability, expected sales to U.S. schools, future sales to retailers based on retailers' sales to consumers, and anticipated infrastructure improvements. These forward-looking statements involve risks and uncertainties, including the mix of our products purchased by retailers and consumers, changes in budgets and product review cycles of schools and other educational programs, reseller's changes in their own inventory and stocking models, the financial condition of retailers of the company's products, the company's ability to implement planned distribution and supply chain initiatives on time, the company's ability to invent, develop, introduce and market products in a timely and cost-effective manner, the shelf space allocated to the company by its retail customers, the seasonality of the consumer electronics and toy business at retail, and the acceptance of the company's products by consumers in the United States and internationally. These and other risks and uncertainties detailed from time to time in the company's SEC filings, including its quarterly report on Form 10-Q filed on May 10, 2004, could cause the company's actual results to differ materially from those discussed in this release. All forward-looking statements are based on information available to the company on the date hereof, and the company assumes no obligation to update such statements.

CONTACT:

Jim Curley Cherie Stewart
Chief Financial Officer Sr. Director, Corporate Communications
510-420-5000 510-596-3343

LEAPFROG ENTERPRISES, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

<table>
<thead>
<tr>
<th>June 30, 2004</th>
<th>December 31, 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Unaudited)</td>
<td>(Audited)</td>
</tr>
</tbody>
</table>

**ASSETS**

- **Current assets:**
  - Cash and cash equivalents: $103,474, $105,256, $69,844
  - Short term investments: 57,019, 23,824, 42,759
  - Restricted cash: 8,918, --, --
  - Accounts receivable, net: 65,328, 55,174, 281,792
  - Inventories, net: 177,404, 96,135, 90,897
  - Prepaid expenses and other current assets: 9,162, 16,134, 8,370
  - Deferred income taxes: 21,696, 11,270, 11,735
  - Total current assets: 443,001, 307,793, 505,397

- Property and equipment, net: 23,780, 21,210, 20,547

- Investments in affiliates and related

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### Consolidated Balance Sheet

**ASSETS**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Intangible assets, net</td>
<td>30,476</td>
<td>25,670</td>
<td>25,048</td>
<td></td>
</tr>
<tr>
<td>Other assets</td>
<td>8,720</td>
<td>172</td>
<td>1,048</td>
<td></td>
</tr>
<tr>
<td>Total assets</td>
<td>$506,553</td>
<td>$371,079</td>
<td>$552,659</td>
<td></td>
</tr>
</tbody>
</table>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

**Current liabilities:**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>72,576</td>
<td>36,727</td>
<td>86,161</td>
<td></td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>27,338</td>
<td>20,795</td>
<td>44,634</td>
<td></td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>228</td>
<td>1,520</td>
<td>1,417</td>
<td></td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>--</td>
<td>--</td>
<td>4,729</td>
<td></td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>100,142</td>
<td>59,042</td>
<td>136,941</td>
<td></td>
</tr>
</tbody>
</table>

**Deferred rent and other long term liabilities**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>496</th>
<th>579</th>
<th>572</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred income taxes</td>
<td>31</td>
<td>2,787</td>
<td>--</td>
<td></td>
</tr>
</tbody>
</table>

**Total stockholders' equity**

| Particulars            | $405,884      | $308,671      | $415,146      |               |

**Total liabilities and stockholders' equity**

| Particulars            | $506,553      | $371,079      | $552,659      |               |

### Consolidated Statements of Operations

**Unaudited**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Three Months Ended</th>
<th>Six Months Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>June 30, 2004</td>
<td>June 30, 2003</td>
</tr>
<tr>
<td><strong>Net sales</strong></td>
<td>$80,814</td>
<td>$68,010</td>
</tr>
<tr>
<td><strong>Cost of sales</strong></td>
<td>44,347</td>
<td>32,209</td>
</tr>
<tr>
<td><strong>Gross profit</strong></td>
<td>36,467</td>
<td>35,811</td>
</tr>
</tbody>
</table>

**Operating expenses:**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Three Months Ended</th>
<th>Six Months Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling, general and administrative</td>
<td>27,378</td>
<td>21,904</td>
</tr>
<tr>
<td>Research and development</td>
<td>13,469</td>
<td>13,272</td>
</tr>
<tr>
<td>Advertising</td>
<td>6,330</td>
<td>14,226</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>2,573</td>
<td>3,536</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>48,130</td>
<td>43,763</td>
</tr>
</tbody>
</table>

**Loss from operations**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Three Months Ended</th>
<th>Six Months Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest expense</td>
<td>(3)</td>
<td>(2)</td>
</tr>
<tr>
<td>Interest income</td>
<td>500</td>
<td>382</td>
</tr>
<tr>
<td>Other income</td>
<td>(70)</td>
<td>1,018</td>
</tr>
</tbody>
</table>

**Total operating expenses**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Three Months Ended</th>
<th>Six Months Ended</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss before provision for income taxes</td>
<td>(11,663)</td>
<td>(7,942)</td>
</tr>
<tr>
<td>Benefit for income taxes</td>
<td>(11,236)</td>
<td>(6,544)</td>
</tr>
<tr>
<td>Net loss</td>
<td>(5,407)</td>
<td>(3,926)</td>
</tr>
<tr>
<td>Net loss per common share: basic and diluted</td>
<td>(0.12)</td>
<td>(0.07)</td>
</tr>
<tr>
<td>Shares used in calculating net loss per common share - basic and diluted</td>
<td>59,620</td>
<td>56,837</td>
</tr>
<tr>
<td>Shares used in calculating net loss per common share - diluted</td>
<td>59,620</td>
<td>56,837</td>
</tr>
</tbody>
</table>
## LeapFrog Enterprises, Inc.

### CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net loss</strong></td>
<td>$(19,230)</td>
<td>$(4,895)</td>
</tr>
</tbody>
</table>

**Adjustments to reconcile net income to net cash provided by operating activities:**

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depreciation and amortization</td>
<td>8,257</td>
<td>8,165</td>
</tr>
<tr>
<td>Loss on disposal of property and equipment</td>
<td>--</td>
<td>18</td>
</tr>
<tr>
<td>Provision for allowances for accounts receivable</td>
<td>18,032</td>
<td>5,184</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>(9,887)</td>
<td>(6,906)</td>
</tr>
<tr>
<td>Deferred rent</td>
<td>(76)</td>
<td>29</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>(1,189)</td>
<td>(1,486)</td>
</tr>
<tr>
<td>Amortization of deferred compensation</td>
<td>920</td>
<td>1,101</td>
</tr>
<tr>
<td>Stock option compensation related to nonemployees</td>
<td>278</td>
<td>454</td>
</tr>
<tr>
<td>Tax benefit from exercise of stock options and other</td>
<td>4,109</td>
<td>24,445</td>
</tr>
<tr>
<td>Amortization of bond premium</td>
<td>106</td>
<td>83</td>
</tr>
</tbody>
</table>

**Other changes in operating assets and liabilities:**

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>198,432</td>
<td>109,312</td>
</tr>
<tr>
<td>Inventories</td>
<td>(86,507)</td>
<td>(11,675)</td>
</tr>
<tr>
<td>Prepaid expenses and other current assets</td>
<td>(792)</td>
<td>(12,069)</td>
</tr>
<tr>
<td>Notes receivable due from related parties</td>
<td>--</td>
<td>595</td>
</tr>
<tr>
<td>Other assets</td>
<td>(295)</td>
<td>112</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>(13,585)</td>
<td>(22,116)</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>(17,296)</td>
<td>(19,738)</td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>(4,729)</td>
<td>(21,832)</td>
</tr>
</tbody>
</table>

**Net cash provided by operating activities** | 76,548 | 48,701 |

**Investing activities:**

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchases of property and equipment</td>
<td>(10,618)</td>
<td>(8,632)</td>
</tr>
<tr>
<td>Purchase of intangible assets</td>
<td>(6,300)</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Purchases of investments</td>
<td>(66,982)</td>
<td>(25,532)</td>
</tr>
<tr>
<td>Sale of short term investments</td>
<td>36,321</td>
<td>4,125</td>
</tr>
</tbody>
</table>

**Net cash used in investing activities** | (47,579) | (33,039) |

**Financing activities:**

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from the payment of notes receivable from stockholders</td>
<td>--</td>
<td>2,624</td>
</tr>
<tr>
<td>Proceeds from the exercise of stock options and employee stock purchase plan</td>
<td>4,778</td>
<td>16,170</td>
</tr>
</tbody>
</table>

**Net cash provided by financing activities** | 4,778 | 18,794 |

**Effect of exchange rate changes on cash** | *(117)* | *(27)* |
Increase in cash and cash equivalents 33,630  34,429
Cash and cash equivalents at beginning of year 69,844  70,827
Cash and cash equivalents at end of period $103,474  $106,256

SOURCE
LeapFrog Enterprises, Inc.
-0-
07/21/2004

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"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995: Statements in this press release regarding LeapFrog Enterprises, Inc.'s business which are not historical facts are "forward-looking statements" that involve risks and uncertainties. For a discussion of such risks and uncertainties, which could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" in the Company's Annual Report or Form 10-K for the most recently ended fiscal year.
Exhibit 16
MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Tamara, and I will be your conference facilitator today. At this time I would like to welcome everyone to LeapFrog Enterprises Second Quarter Earnings Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer period. If you would like to ask a question during this time, simply press ***, then the number “1” on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you. Cherie Stewart, Senior Director of Corporate Communications, you may begin your conference.

Cherie Stewart, Senior Director of Corporate Communications

Good afternoon, everyone, and welcome to LeapFrog Enterprises conference call for our second quarter 2004, which ended June 30th. I'm Cherie Stewart, Senior Director of Corporate Communications. After the close of market today, we issued a press release detailing our second quarter results. In a minute, Tom Kalinske, our CEO, will discuss LeapFrog's performance in the second quarter and our outlook. Bob Lally, President of our SchoolHouse Division, will discuss results from our Education and Training group. And then Jim Curley, our CFO, will discuss our financial results in detail. And finally, we will conduct a question and answer session.

Before we begin our formal remarks, I remind you that certain statements made today will include forward-looking statements about management’s expectations, strategic objectives, anticipated financial performance, and other similar matters. Forward-looking statements during this conference call will include statements regarding anticipated sales, margins, expenses, earnings, share counts, and retail shelf space, our ability to invent, develop, and produce products and their acceptance in the markets, planned supply chain and other business initiatives, and expected capital expenditures, inventory levels, receivables, and tax rates.

In addition, we expect that questions posed during the question and answer portion of this call may prompt answers that contain additional forward-looking statements that we have not discussed in our prepared statements. This cautionary language concerning forward-looking statements applies to both our prepared comments and our impromptu answers to questions posed on this conference call. A variety of factors, many of which are beyond our control, affect our operations, performance, business strategy and results, and could cause actual results to differ materially from those projected in forward-looking statements. Some of these factors are described in the 2004 Annual Report filed with the SEC on March 12th, as well as LeapFrog's other published statements and SEC filings. LeapFrog does not update forward-looking statements, and we expressly disclaim any obligation to do so.

Now I would like to introduce LeapFrog's CEO, Tom Kalinske.

Thomas J. Kalinske, Chief Executive Officer

Thank you, Cherie. Thank you all for joining us. Good afternoon. I'm pleased to share with you the results of our second quarter. Let me begin by framing our results this quarter. We believe the growth and success of both our business groups, Consumer, and Education and Training, supports our vision to become a diversified learning company. Many of you are familiar with our success at retail, and as we will discuss today, our school business is really gaining momentum too. This afternoon I'm going to briefly cover high-level financial results for the total company, and then we'll discuss highlights from our Consumer business, both domestically and internationally. I'll then turn
the call over to Bob Lally, who will provide an update on our Education and Training business, focusing on the SchoolHouse success.

But first, let's turn to the highlights of our company-wide performance improvements for the second quarter. As you will see, gains in our Consumer business are supported by an over 20% increase in over-the-counter US sales year to date, and continued strong sales expansion internationally. We are also very excited to share that our SchoolHouse division was profitable for the first half of 2004, and we expect this business to be profitable for the full year.

The specific results of the second quarter of 2004 compared with the second quarter of 2003 were: for the entire company, total net sales up 19%. Each division had record sales during Q2. For the Consumer business, US consumer net sales were up 4%. International net sales increased 51%. For our Education and Training business, SchoolHouse net sales grew 47%.

While our gross margin in the quarter improved slightly, to 45.1% from 44.6% in the first quarter of 2004, we fully expect further improvement in the second half of this year, as our new software titles are released, as retailers restock their software sections with our new packaging, and we begin to realize expected efficiencies in producing our new learning platform products.

In an update from our last call, I would like to report that we are making progress with improvements to our supply chain management initiatives. Several of our new supply chain management software programs are up and running. We are also continuing to consolidate our distribution centers, and will complete our move into our new warehouse and begin shipping from it at the end of this month. We will maintain a level of redundancy with our warehouses until the new facility has been fully tested.

Last year we believed that too little available inventory resulted in lost opportunity with our retailers. Consequently, we have planned thoroughly and provided for contingencies, including redundant shipping capacity and a larger amount of inventory entering the third quarter. We are focused on improving our delivery and our fulfillment performance in the critical second half of this year. Next year, we will shed this warehouse redundancy and the need for an inventory buffer, and expect to reap additional operational performance benefits.

Next I would like to highlight some of the initiatives and accomplishments we are particularly excited about in our Consumer group, both domestically and internationally. First, let's focus on the US. With about 80% of the sales year still ahead of us, we have several strong key marketing initiatives launching in early fall. This includes an enhancement of our ongoing advertising campaign that just received the highest honor in marketing, the GRAND EFFIE award. In addition to winning the category of Best Marketing Campaign for Children's Products, LeapFrog also won the GRAND EFFIE for the Most Effective US Advertising Campaign of the Year for all companies. The GRAND EFFIE is not simply for creativity, it's based on proven sales results and share of market increases. Having been measured against some of the most prominent successful companies in many industries, including past winners such as IBM, Apple, Nissan, and Reebok, we believe this is a noteworthy affirmation of the strength and long-term viability of LeapFrog as a global learning brand.

We have several innovative marketing campaigns teed up that focus on supporting software sales, and we will be unveiling them over the next coming months. One of the programs I can share with you is the complete revamping of the packaging for our LeapPad family software. We have conducted extensive testing to improve package communication, and we know that parents are thrilled with the new packaging because it also serves as a simple storage case for the books and cartridges. We also know that our key retailers are excited about this program. In addition, early reads on over 30 new learning titles across all our learning platforms are very good, and include several successful presale programs by our retailers.
Demand and excitement do not simply surround our new software titles. We have actually secured an over 10% shelf space increase this fall with our top retailers, and this space will include our best-selling LittleTouch LeapPad, LeapPad Plus Writing, and Leapster platforms, as well as our brand new learning platforms, several standalone learning products, and our entirely new juvenile product line for the littlest learner.

As you know, last year we successfully introduced the LittleTouch LeapPad and LeapPad Plus Writing Learning System to the LeapPad family. This year we have another new platform to add to our LeapPad line, the Read Aloud LeapPad Plus Microphone, which begins shipping this week. In addition, we have two new play patterns for the LeapPad, including interactive cards and multiplayer learning games, and over 20 new titles, including Dr. Seuss, Shrek 2, Spiderman, and The Incredibles.

We are also energized about introducing an entirely new innovative learning platform, My Own Learning Leap. This is the first ever soft and huggable learning platform and software from LeapFrog that introduces preschoolers to an entirely new curriculum - new curriculum category for the company, that is, social skills, emotional development, and life lessons. From personalized potty training to phonics, Leap engages and teaches each child with personalized, interactive lessons based on their own learning levels and individual interests.

Our Leapster multimedia learning system continues to make both parents and kids happy, and we regularly receive letters and comments raving about this product. The Leapster library will total 18 interactive learning titles for the holidays, including Finding Nemo, Disney Princesses, Spiderman, and The Incredibles.

Let me now turn to the International segment of our consumer group. We are equally pleased with the current growth and potential of this segment, with sales up 51% in the second quarter. We expect this upward trend to continue as we launch even more new learning products into our international markets.

For the first half of the year, Canada net sales are up 12%, UK net sales are up 99%, Australia net sales are up 188%, and we continue to build our business in Mexico, and this effort is complemented north of the border with the launch of a Hispanic line of LeapFrog learning products that will be placed in over 500 major US retail stores. As many of you know, 1 in 5 births in the US are to Hispanic women, and this will be an increasingly important market in the near future.

The three learning platforms that were launched so successfully in the US last year, the Leapster, the LeapPad Plus Writing, and the LittleTouch LeapPad, will be introduced into many of these international markets by year-end, and a full line of LeapFrog learning products, including these three platforms, will be launched for the first time into the German-speaking markets of Europe this fall, with our partner Stadlbauer.

I would like now to turn to our SchoolHouse Division, which is part of our Education and Training group. We have invested a great deal in this division because we knew it had great potential from a revenue side, but equally important is the value this division brings to our overall global learning brand. The SchoolHouse Division is actually growing at a faster rate than our consumer business did in its first 5 years.

Let me turn the call over to Bob Lally, a co-founder of LeapFrog and President of our SchoolHouse Division, to highlight some of the achievements and potential of the SchoolHouse Division. Bob?
Robert W. Lally, Executive Vice President, Education and Training Group, and President of the SchoolHouse Division

Thank you, Tom. I’m pleased to announce a breakthrough quarter for LeapFrog SchoolHouse, in which we achieved $19.3 million in net sales, a 47% increase from last year, and we generated an operating profit of 7.2 million, an increase of 279% over last year. Fueling the success is a significant increase in large district implementations, including 3 in excess of $1 million. Unlike LeapFrog’s Consumer business, slow buying cycles, a long evaluation process, and lengthy budgeting and funding cycles characterize the school marketplace. Many school districts test trial new programs for 1 to 2 years before making large-scale investments. The pilots that LeapFrog SchoolHouse has been conducting over the past several years with school districts throughout the country are beginning to pay off by generating larger purchases, from both existing and new customers. For example, earlier this month we announced a $1 million contract with Prince George’s County, Maryland, where our LeapTrack system will be installed in every Title-I kindergarten classroom, together with a one-to-one ratio of LeapPad platforms to students. This one-to-one ratio with extend learning from the classroom to the family room by allowing students to take their own LeapPad platforms home for more focused practice and instruction.

Additionally, we are gaining traction with teachers and with school administrators with our flagship product, the LeapTrack system, which recently won the Inaugural Technology Leadership Award from the Association of Educational Publishers and AOL at School. For those of you not familiar with this learning system, it enables teachers to administer formative, diagnostic assessments for each student in reading, language arts, and math, grades K through 5. The LeapTrack system helps students master critical learning skills by delivering personalized instruction based on the results of the assessment that leverages LeapFrog’s personal learning tools, or PLTs. This system not only promotes student achievement, but also facilitates classroom management with test results available at the student, classroom, and district level. All of which facilitate data-driven instruction decisions, a key aspect of the No Child Left Behind Act.

I would like to highlight the fact that the SchoolHouse Division was formed in 1999 in response to requests from educators who were using LeapFrog Consumer products in their schools and needed additional features, curriculum, and teacher support to make them most effective in the classroom environment. After having shipped our first curriculum product in April 2000, the SchoolHouse Division has since built an entire line of products that are customized exclusively for the pre-K through 8th grade classroom, focusing on early child development, reading instruction and intervention, assessment in individualized learning, and English as a second language. Since our debut, we have sold approximately $100 million in SchoolHouse materials through Q2 ’04, and our products are an estimated 40,000-plus classrooms throughout all 50 states. In fact, in 2003 we emerged as the fastest growing K-12 educational software provider of the top 10 companies in the supplemental education industry, as reported by Simba.

As we move forward, the Education and Training group at LeapFrog will continue to combine LeapFrog’s innovative, affordable, technology-based PLTs with our educational curriculum and expertise, where we believe we offer superior learning solutions compared to traditional print materials or more expensive computer-based programs. We believe these strategic advantages will help us to continue to expand the reach of the LeapFrog brand in schools, as well as to lead us to additional education and training opportunities beyond the classroom.

Now I would like to turn the call over to Jim Curley, our CFO, for a review of our financial performance in the second quarter.
Thank you, Bob and thank you all for joining us today. Net sales for the second quarter of 2004 were 80.8 million, up 19% from last year's 68 million performance. Our business segment sales results for the second quarter were: US Consumer segment net sales 47.7 million, up 4% from last year, and International segment net sales, 13.8 million, up 51% from last year. In our Education and Training business, the SchoolHouse Division had net sales of 19.3 million, up 47% from last year. Total company sales mix was 59% US Consumer, 17% International, and 24% SchoolHouse. A highlight of the quarter was the strength shown by the Education and Training business, with their SchoolHouse Division showing a record operating profit of 7.2 million for the June quarter. This is a business that is much less seasonal than our Consumer business, and as Bob just discussed, we think that this performance means we are gaining momentum on that side of our total business.

Second quarter 2004 total company gross profit margin was 45.1%, compared with 52.7% last year. Gross margin declined largely due to lower gross profit margins in the US Consumer segment. We saw a shift in the mix of products sold in the quarter, from higher margin software to newer, lower margin platforms. For the US Consumer segment, platform sales increased 9%, while software sales decreased 14%, and standalone product sales increased 9%. The Company expects its gross margins to improve in the second half of the year as new software titles and new software packaging become increasingly available, and software sales comprise a larger portion of the company's total sales mix.

Second quarter operating expenses were 48.1 million, up 4.4 million, or 10% from last year. SG&A expenses were up about 5.5 million over last year, due to increased international spending, higher commissions, increased legal, Sarbanes-Oxley, and facilities expenses. Our operating loss for the quarter was 11.7 million, compared with a 7.9 million operating loss last year. The net loss for the second quarter of 2004 was 7.4 million, as compared with a 3.9 million net loss in the prior year. And our second quarter net loss per share was 12 cents, compared with last year's 7-cent loss.

Now let's discuss the balance sheet. Our cash and short-term investments at June 30, 2004 were 169 million, that's up 31% from last year's 129 million level. Accounts receivable at June 30, 2004 were 65.3 million, up 18% from 55.2 million last year. Our day sales outstanding improved by about 14 days from the first quarter of this year. So our DSOs were flat at 73 days for both second quarter of 2004 and the prior year.

Our net inventory at June 30, 2004 was 177.4 million, up 85% from 96.1 million last year. A couple of comments overall on inventory levels, and then I’ll give you some details. In hindsight, we feel that we had too little inventory entering the second half of last year, and last year's second half proved to be quite challenging. We found ourselves chasing to keep up with retailer demand, and incurred a significant amount of expedited freight and handling costs. To avoid that situation repeating itself, we have flowed manufacturing and finished goods earlier this year, and ramped up our raw materials inventory. This is especially important because we are seeing significantly increased ordering lead times on many of our critical electronic raw materials such as ASICs, ROMs, and LCD touch screens. While this earlier inventory build is a short-term drain on cash flow, we feel that it's the smart thing to do, and the payback in increased availability for our key retail customers should be very compelling.

That being said, a few specific insights. Of the 81 million inventory increase, about 36 million is finished goods, 24 million is raw materials, and 21 million is work in process. Our finished goods inventory days of supply are about 86 days, compared with 73 days last year. Again, this increase relates to better seasonal timing of our inventory for meeting customer demand in the second half. The raw materials inventory increase is related to the higher levels of ASICs, ROMs, and LCD screens that we planned.
We are debt-free and our cash flow is very strong in the first half of 2004. Our net cash provided by operating activities was 76.5 million, up 57% from 48.7 million in the first half of last year. The increase in cash flow from operations was due primarily to the collection of year-end accounts receivable.

And now before we start the Q&A session, I would like to address going forward guidance. Our full year 2004 guidance remains unchanged and is as follows: for 2004 full year, net sales of 770 to 800 million; gross profit margin of 48% to 49% of net sales; operating expenses of 33% to 35% of net sales. We assume a fully diluted share count of approximately 63 million, and diluted net income per share in the range of $1.18 to $1.28.

This concludes the review of our recent financial performance and our guidance. I'll now turn the call back over to Tom.

Thomas J. Kalinske, Chief Executive Officer

Thanks, Jim. In closing, let me emphasize that not many companies can boast year to date 20%-plus consumer sell-through growth at point of sale, and a 10%-plus shelf space gain for this coming fall over fall. We've experienced this very strong POS growth sale in 2004, even with most of our new products and marketing programs not reaching retail until this coming September. We continue to strategically expand our product line within both our Consumer group and our Education and Training group. Our progress in penetrating the public school market and the beginnings of our adult learning efforts are particularly encouraging, and in a mature business model, will support a more even year-round selling cycle over the longer term.

We believe we are improving our infrastructure to become a world-class supplier of learning products around the world, and we're looking forward to completing our infrastructure upgrades, and we're working hard to respond to a tightening raw material market. We believe we have done appropriate contingency planning to make this a successful year for LeapFrog. We're committed to delivering solid second half, with well-managed inventory, good cash flow, and a strong balance sheet at the end of the year.

We are pleased with our progress in the second quarter, and with about 80% of the sales year still ahead of us, we're prepared for the second half of the year. We at LeapFrog are building a complete line of learning products for kids and adults around the world. It's a big job, and we are not done yet. We believe the work we're doing in 2004 to build our brand, company, infrastructure, and product line will position LeapFrog to become a globally recognized education leader in the future, and increase our value.

Now, operator, let's begin the question and answer portion of the call.
Your first question comes from Lauren Fine [Merrill Lynch].

<Q – Lauren Fine>: Thank you, very much. Couple of questions for you. In the guidance that you’ve provided what kind of expectations for Toys R Us store closures are built into that? And then I'll ask my follow-up.

<A – Thomas Kalinske>: Okay. Hi, Lauren. Obviously, we know no more than anyone else does about what Toys R Us is going to do. We're enjoying a good relationship with Toys R Us year to date. And I would say that we're not going to reveal what we have built into our guidance regarding Toys R Us as we would not on - comments on any other specific retailer.

<Q – Lauren Fine>: Well then let me rephrase. Have you built something in for a potential reorganization there?

<A – Thomas Kalinske>: We've made assumptions in light with - working with the buying and merchandising staff there.

<Q – Lauren Fine>: Okay. And then I'm wondering, on the shelf space gains that you're talking about, for some reason I remember you having said double digit before. Maybe you all had meant 10% when you said double digit. But has there been a change in the shelf space outlook?

<A – Thomas Kalinske>: Not really. I said 10% to 15% before and we're now – we just rephrased it to 10%-plus, I believe.

<Q – Lauren Fine>: Okay. And then, Jim, I guess predictably I'm going to ask if you can tell us what percent of Consumer was platform software and standalone and if you could share the margins on those businesses, and also the gross and operating margins by the US Consumer, International, and Education and Training?

<A – James Curley>: Okay. For US Consumer platforms, you want to know what the mix is?

<Q – Lauren Fine>: Yeah.

<A – James Curley>: 56% platforms, 16% software, and 28% standalone.

<Q – Lauren Fine>: Okay. And then the margins, gross margins on those businesses?


<Q – Lauren Fine>: Last one I'll throw in, and turn it over to somebody else. If you can tell us what impact foreign exchange had on revenues and earnings? And you also didn't comment on trends in France and Japan.

<A – James Curley>: Okay. On the foreign exchange, the impact on sales to our International segment was about 4.6%. On total company, it was slightly under 1%. It was about 0.8% on sales and was positively impacting sales. On net income, for total company, it was about 3.6% favorable.
By the way, Lauren, I didn't mention France just because it's smaller as a market than the others, but it has a big increase as well. I don't remember the percentage but it's a large increase.

And was anything of note in Japan?

Yes. Of note in Japan is that the Japanese retail side of our business isn't particularly strong as, I guess as most aren't in Japan, and the other side of our business, the home tutoring school business is quite strong.

Thank you very much.

You're welcome.

Hi, Sean.

Hi, guys. Two questions if I can. One goes back to comments I think that the Company made earlier in the year regarding expectations for higher spending in R&D. So I was a little surprised to see that line not up more. Can you talk a little bit about whether there was a change, or what we can expect for the balance of the year? And secondly, on inventory what -- for the balance of the year, you know, you made comments about having some redundancies and wanting to be in a better position relative to last year. When do you think we can expect to see a more, a closer relationship between inventory and -- increasing inventory and increasing sales? Can we expect that to be, kind of, balance of third quarter or year-end or first quarter of next year?

Let me comment, and then turn it over to Jim. Firstly on the R&D, we still are expecting to show a significant increase. I think this has been timing on R&D, and Jim will comment on that. And on inventory I think we -- as Jim and I both said, we were really low on inventory entering third quarter last year and that caused us some issues. So I think we'll see a better situation perhaps relative to total sales expectations the rest of this year, after the third and fourth -- and into the third and fourth quarter. Jim?

On R&D, we are expecting full year increase in R&D, and that's in our guidance. On a full year basis, we're expecting actually to be up low double digits in R&D spending. A lot of that comes in the form of 2005 products that we have to spend for in second half of 2004.

Okay. Then, just kind of bouncing back to the inventory question. I understand what you're saying Tom about having too little, so I guess that another way to ask the question is at what point do you feel like you no longer had too little and were chasing things? Was that just the beginning of this year?

You mean on our books, Sean?

Yeah. Relative to what you needed to have to meet retailers' demands.

Well, you know, I broke it out in the section when I talked about, you know, what our days of supply were on finished goods. We have kind of an interesting model. We have so much -- every product we have has electronics in it. So, the lead times have gone out -- what we would have told you two quarters ago has already changed. And our LCD screen lead times have gone from 13 weeks to 26 weeks. That's half a year. So we have been scrambling to add that to our models. So right now, we could actually use more chips. We're very fortunate that we have started to plan, take some of the pressure off the supply chain system changes that we're going
through in the second half. We wanted to get as much inventory in, take some of the pressure off of that. So I mean, I think, clearly where we are right now, while it looks like a big increase, to frame it, it's got two components: it's compared against a small base last year, that we know is very problematic for us, so we didn't want to make that mistake again. And then the second piece is, most of our inventory increase is in raw materials and work in progress. So we're ahead of the game this year, and that's good because last year we couldn't meet the demand that started in the third quarter.

I think to frame it, we're targeting for the end of the year, which I think is the best metric of – it's one thing to have a lot of inventory going into the, you know, your strong selling season. It's another thing to end the year, after Christmas is over, with too much inventory. So our guidance for the full year would be that we're going to look to have inventories at year-end no more than 100 million at cost, which would be comparable to the 91 million we had last year.

<Q – Sean McGowan>: Okay. That's helpful. Could I ask what's causing this dramatic increase in lead times? What reasons are they giving you?

<A – James Curley>: Really, the biggest reason they're giving us is the phone industry, you know, putting pressure on the chip market, and foundries not having capacity.

<A – Thomas Kalinske>: There's also a large increase in demand for color LCD screens, and particularly touch LCD screens.

<Q – Sean McGowan>: Okay. Thank you.

<A – Thomas Kalinske>: Sure, Sean.

Operator: Again to ask a question, please press “*”, then the number “1” on your telephone keypad. Your next question comes from Jill Krutick [Salomon Smith Barney].

<A – Thomas Kalinske>: Hi, Jill.

Operator: Ms. Krutick, your line is now open.

<Q – Jill Krutick>: Hi, sorry, can you hear me?

<A – Thomas Kalinske>: Hi, Jill.

<Q – Jill Krutick>: Hi there. I had a couple of questions. You know, obviously the industry continues to evolve, and the differential you see between over-the-counter sales and the rate of shipments into the channel, you know historically it's a catch-up in the third quarter, but you know increasingly it doesn't ever seem to be catching up. Can you talk about why you expect your 20% sell-through to really be reflected in your shipments? And within that light, maybe talk a little bit about the inventory that you're seeing at retail and the competitive landscape that you continue to see, you know, evolving?

<A – James Curley>: Okay. Well, Jill, I think you're aware that the – while we don't consider ourselves just a, competing in the toy market, but the toy market is down 4% to 5% year to date. Our business is up over 20% year to date. So obviously we're - two things are happening. We're depleting the inventory that we had in the market from the end of last year, and that, obviously, we've shipped so far this year, and we're gaining share. I don't know how else I can, you know, comment on it. I mean, obviously that's a good sign and good trends, and we're doing fine relative to the market. We rely mostly, this time of year, on the over-the-counter sales data we get from almost every retailer. So we know exactly how our business is doing with consumers. The less-
precise data, of course, comes from NPD, and we don't really rely on that, but even that would show the same trends, and show us gaining share of market.

<Q – Jill Krutick>: But in that light, how are you measuring retail at, you know, inventories at the retail level? How would you sort of characterize those, and have you seen any measurable change in the competitive landscape in products similar to yours? I know you're indicating rising market share, but if retailers perceive it to become more competitive in the second half, they may be disinclined to sort of restock at that faster rate?

<A – James Curley>: Yeah, right. Well, clearly we are gaining share of market because you know our competition is not growing at the same rate we are. So by any standard of measurement, we would have to be gaining share of market. In terms of the – and that's occurring on both the platform side and the standalone side, and the software side. In terms of the software side, I would like to make one comment. You know, we have been quiet about this, but we have been doing a large packaging change on software. So if you were a US retailer in April, May and June, you did not have any incentive to purchase software from us, because we were about to implement the change of new packaging, which isn't available until August to ship into the market. So we have clearly been depleting our inventory of software in the marketplace up until now, and start changing that situation as we go into August. In terms of competitive product, I really can't comment any more on it, other than what I've said, we're gaining share of market and they aren't.

<Q – Jill Krutick>: Sure. In terms of full year targets for hardware and software, can you give us a sense of where you're thinking those will go? And also on pricing on software and hardware, what kind of trends are you seeing?

<A – James Curley>: In our guidance, we're looking for positive sales in all three categories, platforms, software, and standalone. Haven't given specific guidance, we're going to stay away from that, but that assumes software especially is going to increase significantly.

<Q – Jill Krutick>: And finally, Bob, I was curious about the repetitive nature of school purchases, and as you build in a base of business, is there naturally a recycling of that same kind of level of business going forward, or is it much more challenging than that?

<A – Robert Lally>: It is more expansion into additional classrooms. As I noted, our contract with Prince George's County was covering just their Title-1 kindergarten classrooms, with a program that has K-5 capacity. And so many of these schools will start in selected grade levels with selected schools, depending upon funding resources, and they will grow into expanding more systems in more classrooms.

<Q – Jill Krutick>: Thank you very much.

<A – Thomas Kalinske>: Thanks, Jill.

Operator: Your next question comes from Jennifer Childe [Bear Stearns].

<Q – Jennifer Childe>: Thank you. Couple of questions. First, I was wondering why your advertising expense was so low. Is it a timing issue or a change in strategy? And then, secondly, with respect to the gross margins, I'm wondering what you didn't anticipate and what gives you confidence that you'll be able to meet the full year guidance in light of this quarter's miss. Thanks.

<A – Thomas Kalinske>: Jim will answer those.

<A – James Curley>: The advertising was really just timing. We had the Easter shift this year, so we spent – we were over in the first quarter, under in the second. On a full year basis, I think we were up 12% in advertising for the year to date. And what was –
<A – Thomas Kalinske>: Gross margin.

<A – James Curley>: What was the question on gross margin?

<Q – Jennifer Childe>: What didn't you anticipate, relative to your guidance? And what gives you confidence that you'll be able to meet the full year guidance?

<A – James Curley>: In the guidance, you know, clearly the thing that we didn't anticipate was the sales mix. We have seen weaker software sales this year than we were initially anticipating, but that's pretty much explained by the packaging change that we're going out to retail with. Our whole second half initiatives are very exciting. And they're largely targeted around software, because that's really the key to driving the margins and the tie ratio. So we shared with retailers what new packaging was going to look like. We had an old blister pack that took more space up on the pegs, and resulted in less productive space than the new design. The new design is a package that allows - you're hearing this from the finance guy, but a package that allows for a storage container to be reused by the customer. It allows selling tips in there for parents so they can keep and look at what other titles, if they like this one, might be appropriate for their kids. And when the retailers saw the quality of this new package design, most of them held off on their software orders, we feel, to look at getting that as soon as it's available. And most of it's come available right now with new line space.

<Q – Jennifer Childe>: So would you say that software inventory at retail is pretty late?

<A – James Curley>: I would say the demand for software is very grave right now from us, especially the new titles. Leapster has got an excellent tie ratio. But we only have 5 titles at retail. We're coming out with triple that. People are waiting for that to happen. So that, you know, we're waiting to be able to ship those, and they're just starting to come online. LittleTouch as well. We're going to double the LittleTouch library. That's a big opportunity. So I'd say the demand is very great. That's probably the biggest demand for our products right now is software.

<Q – Jennifer Childe>: Thank you.

<A – James Curley>: And welcome back.

<Q – Jennifer Childe>: Thank you.

Operator: At this time, there are no further questions. Mr. Kalinske, are there any closing remarks?

Thomas J. Kalinske, Chief Executive Officer

Yes, thank you. Our next conference call covering the third quarter of 2004 will be in October. Thank all of you for joining us today. Have a good summer.

Operator: This concludes today's LeapFrog Enterprise conference call. You may now disconnect.
Exhibit 17
LeapFrog Enterprises, Inc.

(Exact Name of Registrant, As Specified in Its Charter)

6401 Hollis Street, Suite 150, Emeryville, California 94608-1071
(Address of Principal Executive Offices, Including Zip Code)

Registrant’s Phone Number, Including Area Code: (510) 420–5000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.  Yes ☑  No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b–2 of the Exchange Act).  Yes ☑  No ☐

The number of shares of Class A common stock, par value $0.0001, and Class B common stock, par value $0.0001, outstanding as of July 30, 2004, was 32,169,632 and 27,671,804, respectively.
December 31, 2003. The increase in accrued liabilities from June 30, 2003 to June 30, 2004 consisted of $3.0 million in payments due by December 2004 for the purchase of a technology license and the overall increase in operating and warehousing expenses in the second quarter of 2004.

Income taxes payable

Income taxes payable was $0 at June 30, 2004 and 2003 and $4.7 million at December 31, 2003. Essentially all of our income tax payments are made in December and March due to the seasonality of our business. In the first half of 2004, $0.6 million in income tax payments were made compared to $14.1 million in the first half of 2003. The lower income tax payments were primarily due to the tax deduction received for the exercise of stock options, which resulted in a reduction of income taxes payments of approximately $16.0 million in 2004. We expect this benefit to be lower in the future.

Investing activities

Net cash used in investing activities was $47.6 million in the six months ended June 30, 2004, compared to $33.6 million for the same period in 2003. The primary components of net cash used in investing activities for the first half of 2004 compared to the first half of 2003 were:

- Purchase of property and equipment of $10.6 million in 2004, primarily related to our supply chain initiatives and manufacturing tools. In 2003, we used $8.6 million for purchases of property and equipment related primarily to computers and software and manufacturing tools.
- Purchase of intangible assets of $6.3 million, primarily related to a technology license agreement we entered into in the first quarter of 2004. In 2003, we used $3.0 million for the purchase of intangible assets for certain trademark rights in connection with the settlement of a lawsuit.

Financing activities

Net cash provided by financing activities was $4.8 million in the six months ended June 30, 2004 compared to $18.8 million for the same period in 2003. The primary component of cash provided by financing activities in both years was proceeds received from the exercise of stock options and purchases of our common stock pursuant to our employee stock purchase plan. Included in 2003 is the receipt of $2.6 million from the payment of notes receivable from stockholders.

Financial Condition

We believe our current cash and short-term investments and anticipated cash flow from operations will be sufficient to meet our working capital and capital requirements through the end of 2005.

We estimate that our capital expenditures for 2004 will be between $19.0 million and $24.0 million, as compared to $15.8 million in 2003. The increase in our 2004 estimate over 2003 is primarily related to additional purchases of computers and software and leasehold improvements related to our supply chain initiatives and additional manufacturing tool purchases for use in the production of both existing and new products.

We have access to an unsecured credit line to fund our operations if needed. This unsecured credit facility of $30 million was entered into on December 31, 2002, with an option to increase the facility to $50 million, for working capital purposes. This agreement was amended in February 2004 to raise the allowable limit of investment in our foreign subsidiaries. The agreement requires that we comply with certain financial covenants, including the maintenance of a minimum quick ratio on a quarterly basis and a minimum level of EBITDA on a rolling quarterly basis. We were in compliance with these covenants at June 30, 2004. The level of a certain financial ratio maintained by us determines interest rates on borrowings. The interest rate will be between prime and prime plus 0.25% or LIBOR plus 1.25% and LIBOR plus 2.00%. We had outstanding letters of credit of $14.1 million as of June 30, 2004, of which $13.9 million was cash collateralized and $0.2 million was secured by our credit line. Our outstanding letters of credit at June 30, 2003 were $0.3 million. At June 30, 2004, $29.8 million of unused borrowings were available to us.

Commitments

We have provided irrevocable standby letters of credit to several of our inventory manufacturers and one technology partner. The standby letters of credit guarantee performance of the obligations of certain of our foreign subsidiaries to pay for trade payables and contractual obligations of up to $13.9 million and are fully secured by cash deposits with the issuer. Of the $13.9 million in outstanding letters of credit, $8.9 million expires in January 2005 and $5.0 million expires in December 2005. The cash collateral related to the $8.9 million is classified in “restricted cash” and the $5.0 million is included in “other assets” on our balance sheet.
In April 2004, we entered into a lease for a distribution center located in Fontana, California. The lease is for a building with approximately 600,000 square feet and has a term of 77 months. Our minimum lease obligations over the term of the lease are $13.9 million.

Risk Factors That May Affect Our Results and Stock Price

Our business and our stock price are subject to many risks and uncertainties that may affect our future financial performance. Some of the risks and uncertainties that may cause our operating results to vary or that may materially and adversely affect our operating results are as follows:

If we fail to predict consumer preferences and trends accurately, develop and introduce new products rapidly or enhance and extend our existing core products, our sales will suffer.

Sales of our platforms, related software and stand-alone products typically have grown in the periods following initial introduction, but we expect sales of specific products to decrease as they mature. The introduction of new products and the enhancement and extension of existing products, through the introduction of additional software or by other means, are critical to our future sales growth. For example, in December 2003, we introduced a line of educational videos, and in 2004, we plan to enter the juvenile products category. The successful development of new products and the enhancement and extension of our current products will require us to anticipate the needs and preferences of consumers and educators and to forecast market and technological trends accurately. Consumer preferences, and particularly children's preferences, are continuously changing and are difficult to predict. In addition, educational curricula change as states adopt new standards. The development of new interactive learning products requires high levels of innovation and this process can be lengthy and costly. To remain competitive, we must continue to develop enhancements of our NearTouch and other technologies successfully, as well as successfully integrate third party technology with our own. In 2004, we intend to introduce a number of new platforms, stand-alone products and interactive books and other software for each of our three business segments. We cannot assure you that these or other future products will be introduced or, if introduced, will be successful. The failure to enhance and extend our existing products or to develop and introduce new products that achieve and sustain market acceptance and produce acceptable margins would harm our business and operating results.

Our business is seasonal, and therefore our annual operating results depend, in large part, on sales relating to the brief holiday season.

Sales of consumer electronics and toy products in the retail channel are highly seasonal, causing the substantial majority of our sales to U.S. retailers to occur during the third and fourth quarters. In 2003, approximately 79% of our total net sales occurred during this period. This percentage of total sales may increase as retailers become more efficient in their control of inventory levels through just-in-time inventory management systems. Generally, retailers time their orders so that suppliers like us will fill the orders closer to the time of purchase by consumers, thereby reducing their need to maintain larger on-hand inventories throughout the year to meet demand. While these techniques reduce retailers' investments in their inventory, they increase pressure on suppliers to fill orders promptly and shift a significant portion of inventory risk and carrying costs to suppliers like us. The logistics of supplying more products within shorter time periods will increase the risk that we fail to meet tight shipping schedules, which could damage our relationships with retailers, increase our shipping costs or cause sales opportunities to be delayed or lost. In addition, in the second half of 2003, one of our largest retail customers changed its order pattern to occur later in the holiday season, which we believe delayed a significant portion of our net sales to this customer from the third quarter of 2003 to the fourth quarter of 2003. The seasonal pattern of sales in the retail channel requires significant use of our working capital to manufacture and carry inventory in anticipation of the holiday season, as well as early and accurate forecasting of holiday sales. Failure to predict accurately and respond appropriately to consumer demand on a timely basis to meet seasonal fluctuations, or any disruption of consumer buying habits during this key period, would harm our business and operating results.

We rely on a limited number of manufacturers, virtually all of which are located in China, to produce our finished products, and our reputation and operating results could be harmed if they fail to produce quality products in a timely and cost-effective manner and in sufficient quantities.

We outsource substantially all of our finished goods assembly manufacturing to nine manufacturers, all of whom manufacture our products at facilities in the Guangdong province in the southeastern region of China. Our Learning Drum stand-alone product and our Classic LeapPad and Leapster platforms are manufactured by two manufacturers, while our remaining products are sole-sourced. While we have initiated a supply chain management project in 2004 to strengthen our finished goods production capabilities by expanding our operations in Asia and formalizing relationships with our third party manufacturers, we depend on these manufacturers to produce sufficient volumes of our
finished products in a timely fashion and at satisfactory quality and cost levels. We generally allow retailers and distributors to return or receive credit for defective or damaged products. If our manufacturers fail to produce quality finished products on time, at expected cost targets and in sufficient quantities due to capital shortages, late payments from us, political instability, labor shortages, health epidemics, intellectual property disputes, changes in international economic policies, natural disasters, energy shortages, terrorism or other disruptions to their businesses, our reputation and operating results would suffer. In addition, if our manufacturers decide to increase production for their other customers, they may be unable to manufacture sufficient quantities of our finished products and our business could be harmed.

If we are unable to compete effectively with existing or new competitors, our sales and market share could decline.

We currently compete primarily in the infant and toddler category, preschool category and electronic learning aids category of the U.S. toy industry and, to some degree, in the overall U.S. and international toy industry. Our SchoolHouse division competes in the U.S. supplemental educational materials market. Each of these markets is very competitive and we expect competition to increase in the future. For example, Mattel, Inc. sells under its Fisher-Price brand a product called “PowerTouch” having functionality similar to that of our LeapPad platform. We believe that we are beginning to compete, and will increasingly compete in the future, with makers of popular game platforms and smart mobile devices such as personal digital assistants. These companies are well situated to compete effectively in our primary markets. Additionally, we are beginning to cross over into their markets with products such as our Leapster platform and iQuest handheld device. Many of our direct, indirect and potential competitors have significantly longer operating histories, greater brand recognition and substantially greater financial, technical and marketing resources than we do. These competitors may be able to respond more rapidly than we can to changes in consumer requirements or preferences or to new or emerging technologies. They may also devote greater resources to the development, promotion and sale of their products than we do. We cannot assure you that we will be able to compete effectively in our markets.

Our quarterly operating results are susceptible to fluctuations that could cause our stock price to decline.

Historically, our quarterly operating results have fluctuated significantly. For example, our net loss for the first and second quarters of 2004 was $(11.8) million and $(7.4) million, respectively. Our net income (loss) for the first through fourth quarters of 2003 was $(1.0) million, $(3.9) million, $33.4 million and $44.2 million, respectively. We expect these fluctuations to continue for a number of reasons, including:

- seasonal influences on our sales, such as the holiday shopping season and back-to-school purchasing;
- the mix of higher and lower margin products purchased by our customers and consumers;
- unpredictable consumer preferences and spending trends;
- the need to increase inventories in advance of our primary selling season;
- timing of new product introductions;
- general economic conditions;
- the availability and cost of key components of our products;
- the financial condition of our retail customers;
- the results of legal proceedings;
- changes in our pricing policies, the pricing policies of our competitors and general pricing trends in consumer electronics and toy markets;
- international sales volume and the mix of such sales among countries with similar or different holidays and school years than the United States;
- the impact of strategic relationships;
- the sales cycle to schools, which may be uneven, depending on budget constraints, the timing of purchases and other seasonal influences; and
- the timing of orders by our customers and our ability to fulfill those orders in a timely manner, or at all.

For example, FAO, Inc. filed for bankruptcy protection in December 2003 and KB Toys, Inc. filed for bankruptcy in January 2004. These and other retailers may elect to close a significant number of stores in 2004, and such actions would affect the timing and amounts of orders of our products from these retailers. For example, Toys R Us, one of our key customers, is currently undergoing an announced strategic evaluation of its worldwide operations and assets that may affect its buying patterns, buying levels and number of total retail outlets. In turn, the effects of any changes in orders from Toys R Us or other retailers could have a material effect on our quarterly operating results.

We expect that we will continue to incur losses during the first and second quarters of each year for the foreseeable future. If we fail to meet our projected net sales or other projected operating results, or if we fail to meet analysts’ or investors’ expectations, the market price of our Class A common stock could decrease.
In the past, outbreaks of SARS have been significantly focused on Asia, particularly Hong Kong, where we do business or the operations of our contract manufacturers or our suppliers. Outbreaks of health epidemics, such as Severe Acute Respiratory Syndrome, or SARS, and the so-called "Asian bird flu" may adversely impact systems and resources sufficient to keep pace with our planned growth, our operating results could suffer. We have presented, and continue to present, significant challenges for our management systems and resources. If we fail to develop and maintain management software systems, including supply chain management systems. Further, in July 2004, we began consolidating multiple third party distribution warehouses into a single distribution warehouse to handle our needs. This warehouse is being operated by a new third party logistics service provider. This expansion has presented, and continues to present, significant challenges for our management systems and resources. If we fail to develop and maintain management software systems, including supply chain management systems.

Any errors or defects contained in our products, or our failure to comply with applicable safety standards, could result in delayed shipments or rejection of our products, damage to our reputation and expose us to regulatory or other legal action. We have experienced, and in the future may experience, delays in releasing some models and versions of our products due to defects or errors in our products. Our products may contain errors or defects after commercial shipments have begun, which could result in the rejection of our products by our retailers, damage to our reputation, lost sales, diverted development resources and increased customer service and support costs and warranty claims, any of which could harm our business. Children could sustain injuries from our products, and we may be subject to claims or lawsuits resulting from such injuries. There is a risk that these claims or liabilities may exceed, or fall outside the scope of, our insurance coverage. Moreover, we may be unable to retain adequate liability insurance in the future. We are subject to the Federal Hazardous Substances Act, the Flammable Fabrics Act, regulation by the Consumer Product Safety Commission, or CPSC, and other similar federal and state rules and regulatory authorities. Our products could be subject to involuntary recalls and other actions by such authorities. Concerns about potential liability may lead us to recall voluntarily selected products. For example, in December 2000, the CPSC announced our voluntary repair program for the approximately 900,000 units of our Alphabet Pal product sold prior to that date. We had instituted the repair proceedings with the CPSC because we were concerned that the product could cause injury. Our costs in connection with the repair were approximately $1.1 million. Any recalls or post-manufacture repairs of our products could harm our reputation, increase our costs or reduce our net sales.

Our rapid growth has presented significant challenges to our management systems and resources, and we may experience difficulties managing our growth. Since 2001, we have grown rapidly, both domestically and internationally. Our net sales have grown from $314.2 million in 2001 to $680.0 million in 2003. During this period, the number of different products we offered at retail also increased significantly, and we have opened offices in Canada, France, Macau and Mexico. At December 31, 2001, we had 438 full-time employees and at December 31, 2003, we had 869 full-time employees. In addition, we plan to hire a significant number of new employees in our Asia-based offices in 2004. We are upgrading existing and implementing new operational software systems, including supply chain management systems. Further, in July 2004, we began consolidating multiple third party distribution warehouses into a single distribution warehouse to handle our needs. This warehouse is being operated by a new third party logistics service provider. This expansion has presented, and continues to present, significant challenges for our management systems and resources. If we fail to develop and maintain management systems and resources sufficient to keep pace with our planned growth, our operating results could suffer.

Outbreaks of health epidemics, such as Severe Acute Respiratory Syndrome, or SARS, and the so-called "Asian bird flu" may adversely impact our business or the operations of our contract manufacturers or our suppliers. In the past, outbreaks of SARS have been significantly focused on Asia, particularly in Hong Kong, where we...
SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LeapFrog Enterprises, Inc.
(Registrant)

/s/ Thomas J. Kalinske

Thomas J. Kalinske
Chief Executive Officer
(Authorized Officer)
Dated: August 6, 2004

/s/ James P. Curley

James P. Curley
Chief Financial Officer
(Principal Financial and Accounting Officer)
Dated: August 6, 2004
Exhibit 18
LeapFrog Provides Revised Outlook for 2004 and Preliminary Results for Third Quarter
EMERYVILLE, Calif., Oct. 18 /PRNewswire-FirstCall/ -- LeapFrog Enterprises, Inc. (NYSE: LF), a leading developer of innovative technology-based educational products, today announced its revised full year financial outlook for 2004 and preliminary results for the third quarter of 2004.

"The operating climate in the United States is tougher than we anticipated, and we expect to see this continue through the Holiday season," said LeapFrog Chief Executive Officer Tom Kalinske. "In addition, we are experiencing softness in our basic LeapPad business in the United States, and we have had several challenges getting our new distribution center and supply chain systems up and running smoothly during this peak season."

"As a result, we believe that it is prudent to adjust our outlook for 2004 accordingly," continued Kalinske. "While we had a more optimistic view of the second half of the year three months ago, we believe that 2004 will be less profitable than we had previously expected. Clearly, this is not acceptable to us and we are taking immediate action to ensure a healthy company and a strong product line for 2005."

Preliminary Results for Third Quarter of 2004

The company also announced that it expects to report net sales for the September quarter 2004 of approximately $225 to $230 million on gross margins of 40% to 41% and operating expenses of 27% to 28%. Based on a fully diluted share count of approximately 61.5 million, the company also expects to report earnings per share on a fully diluted basis of approximately $0.32 to $0.34 per share. Complete financial results for the third quarter of 2004 will be released on October 27.

Outlook for 2004

The company's published guidance for the full 2004 year is revised as follows:

- Net sales of $690 to $710 million
- Gross profit margin of 42% to 43% of net sales
- Operating expenses of 36% to 37% of net sales
- Fully diluted share count of approximately 61.5 million
- Diluted net income per share of $0.40 to $0.60

Conference Call for Today's Announcement

A conference call will be held today, Monday, October 18 at 5:00 p.m. Eastern time (2:00 p.m. Pacific time) to discuss this announcement and to provide further discussion of the outlook for 2004. A live web cast of the conference call will be offered on LeapFrog's investor relations website at www.leapfroginvestor.com and on www.ccbn.com. A replay of the web cast will be available on these websites through December 31, 2004. To participate in the call, please dial 706-634-0183.

Third Quarter 2004 Conference Call

As previously scheduled, the company will hold its quarterly conference call to discuss third quarter earnings results on Wednesday, October 27, 2004, at 5:00 p.m. Eastern Time (2:00 p.m. Pacific Time).

The conference call will be web cast and can be accessed at LeapFrog's investor web site at www.leapfroginvestor.com and on www.ccbn.com.

About LeapFrog

LeapFrog Enterprises, Inc. is a leading designer, developer and marketer of innovative, technology-based learning products and related proprietary content, dedicated to making learning effective and engaging for all ages, at home and in schools, around the world. The company was founded in 1995 and is based in Emeryville, California. LeapFrog has developed a family of learning platforms that come to life with more than 100 interactive software titles, covering important subjects such as...
LeapFrog's award-winning U.S. consumer products are available in six languages at major retailers in more than 25 countries around the world. The LeapFrog Schoolhouse-curriculum programs are currently in classrooms across the U.S. with over 200 interactive books and over 450 skill cards representing more than 6,000 pages of educational content. LeapFrog Schoolhouse (TM) products have won numerous awards from the education industry, including the Golden Lamp Award and Distinguished Achievement Award from the Association of Educational Publishers, the Award of Excellence from Technology & Learning magazine and the Teacher's Choice Award from Learning magazine.

NOTE: LEAPFROG, LEAPPAD and the LeapFrog logo are trademarks or registered trademarks of LeapFrog Enterprises, Inc.

Forward-Looking Statements

Cautionary Statement Under The Private Securities Litigation Reform Act Of 1995:

Except for the historical information contained herein, this news release contains forward-looking statements, including the financial guidance in the section entitled "Preliminary Results for Third Quarter of 2004" and "Outlook for 2004," as well as other statements regarding the company's anticipated net sales, gross margins, earnings, product introductions and availability, expected sales to U.S. schools, future sales to retailers based on retailers' sales to consumers, and anticipated infrastructure and expense improvements. These forward-looking statements involve risks and uncertainties, including changes in budgets and product review cycles of schools and other educational programs, reseller's changes in their own inventory and stocking models, the financial condition of retailers of the company's products, the company's ability to implement planned distribution and supply chain initiatives on time, the company's ability to invent, develop, introduce and market products in a timely and cost-effective manner, the cost and availability of components and materials, the shelf space allocated to the company by its retail customers, the seasonality of the consumer electronics and toy business at retail, and the acceptance of the company's products by consumers in the United States and internationally. These and other risks and uncertainties detailed from time to time in the company's SEC filings, including its quarterly report on Form 10-Q filed on August 6, 2004, could cause the company's actual results to differ materially from those discussed in this release. All forward-looking statements are based on information available to the company on the date hereof, and the company assumes no obligation to update such statements.

CONTACT: media, Cherie Stewart, +1-510-596-3343, or cstewart@leapfrog.com, or investors, Jim Curley, +1-510-420-4882, or jcurley@leapfrog.com, both of LeapFrog Enterprises, Inc.

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"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995: Statements in this press release regarding LeapFrog Enterprises, Inc.'s business which are not historical facts are "forward-looking statements" that involve risks and uncertainties. For a discussion of such risks and uncertainties, which could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" in the Company's Annual Report or Form 10-K for the most recently ended fiscal year.
Exhibit 19
LeapFrog Provides Revised Outlook for 2004 and Preliminary Results for Third Quarter - Final
6,671 words
18 October 2004
FD (FAIR DISCLOSURE) WIRE
English
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OPERATOR: Good afternoon, and welcome to today's Leapfrog Guidance Conference Call. All lines have been placed on mute to prevent any background noise. [Operator Instructions] At this time, I would like to introduce Ms. [Sherry Stuart], Senior Director of Corporate Communications. Ms. Stuart, please go ahead.

SHERRY STUART, SENIOR DIRECTOR OF CORPORATE COMMUNICATIONS, LEAPFROG: Thank you, Kelly. Good afternoon and welcome to Leapfrog Enterprise's conference call outlining updated full-year guidance for 2004. I'm Sherry Stuart, Senior Director of Corporate Communications. After the close of the market today, we issued a press release detailing new full-year guidance for 2004. In a moment, Tom Kalinske, our CEO, will discuss our current business environment, outlining both the challenges we face and the actions we're taking to respond. Then Jim Curley, our CFO, will discuss the 2004 revised guidance and preliminary results for the third quarter. And finally, we will conduct a question and answer session.

Before we begin with formal remarks, I remind you that certain statements made today will include forward-looking statements about management's expectations, strategic objectives, anticipated financial performance, and other similar matters. Forward-looking statements during the conference call will include statements regarding anticipated sales, margins, expenses, earnings, share count, and retail shelf space, our ability to invent, develop, and produce products and their acceptance in the market, planned supply chain and other business initiatives, and expected capital expenditures, inventory levels, receivables, and tax rates. In addition, we expect the questions posed during the question and answer portion of this call may prompt answers that contain additional forward-looking statements that we have not discussed in our prepared statements. This cautionary language concerning forward-looking statements applies to both our prepared comments and our impromptu answers to questions posed on this conference call. A variety of factors, many of which are beyond our control, affect our operations, performance, business strategy, and results, and could cause actual results to differ materially from those projected in such forward-looking statements. Some of these factors are described in 2004 annual report filed with the SEC on March 12th and subsequent quarterly reports, as well as Leapfrog's other published statements and SEC filings. Leapfrog does not update forward-looking statements and we expressly disclaim any obligation to do so.

Now I'd like to turn the call over to CEO Tom Kalinske.

TOM KALINSKE, CEO, LEAPFROG: Thank you, Sherry. Thank you all for joining us. Good afternoon. By now you've seen our press release that lays out our revised 2004 guidance. During this call, we will highlight the issues we currently face and then outline the actions that the Leapfrog executive team is taking to address these challenges. We will be discussing our third quarter 2004 financial performance in more detail on October 27th. However, we have provided a preliminary look at our expectations for the third quarter.

Current data shows sell-in is up 11% year-to-date and sell-through is up 10% year-to-date. We had expected greater increases and thus had a more optimistic view of the second half of the year three months ago, based on retail momentum and programs we launched to drive margin and sales. It is now clear to us that the full year 2004 will be less profitable than we had previously expected, and we wanted to use this call to provide our updated expectations as soon as possible. The three most significant factors that will affect our outlook for 2004 are, first, the operating climate in the U.S. is tougher than we expected, and we believe this will continue through the 2004 holiday season. Commodity prices, including chips, plastics, and transportation costs, have increased higher than planned, and on the retail front, the most recent MPD data has reported that toy sales are down approximately 3.5% this year.

Second, while our international and schoolhouse segments will show very strong growth in sales and profits this year, and demand for our LittleTouch LeapPad, My First LeapPad, LeapPad Plus Writing, and our stand-alone infant and preschool products continues to increase, we are experiencing a softness in our basic U.S. LeapPad business. This situation is having a significant impact on profitability, as LeapPad is one of our most lucrative
businesses, and is not being fully offset by growth in the other categories, so we are selling more products than last year, but the mix is skewed to the lower margin products.

And third, we have experienced several challenges getting our new distribution center up and running smoothly. As you will recall, we consolidated our distribution centers into one, newer, larger facility this past July. At the same time, we also launched a number of new information management systems to build out our supply chain. In addition, we hired a new third-party logistics venture, Commodity Logistics, Inc., to implement these operations. However, getting all this up and running during this peak time has been challenging and we have experienced negative financial ramifications through this transition, ultimately impacting margin.

Despite these tough circumstances, our management team is putting in place strategic and tactical programs to address these challenges, which we believe will take better advantage of our leadership position in the marketplace and the curricular and technological superiority of our learning systems.

But this is not business as usual and I can assure you we are taking the aggressive steps necessary to improve our business. The following are three key areas on which we are currently focusing.

First, we are immediately embarking on a focused program of process improvements and expense reductions to make our operations more efficient and to improve profitability. We have tasked each of our functional areas to meet these objectives through specific goals. In addition, we are working with outside guidance to help us streamline our operations and simplify and rationalize our business. We expect these efforts to generate some improvements this year and significant improvements as we move into 2005.

Second, we are working to improve product orchestration in the U.S. consumer segment. We are implementing programs that will revitalize the LeapPad business and at the same time, we are investing in research and development to support the introduction of an innovative new growth platform and other compelling products for next year. Innovative technology and engaging curriculum continues to be a core strength for Leapfrog, as we plan for the future.

We will also continue investing in targeted marketing programs to drive our higher margin software sales to the installed based of platforms and to reduce retail inventory, including aggressive traditional television and print advertising to promote our strong brand, as well as several creative direct and integrated marketing programs.

Third, we are working closely with our distribution partner, Commodity Logistics, Inc., to significantly improve and strengthen our supply chain management at our new consolidated warehouse, using our new IT systems, so that we may effectively deliver and efficiently deliver our products to our U.S. retail partners. We have also brought in outside consultants, such as Accenture, to help us through these changes. All in all, we know that we are going to have to work very hard to restore faith with our key retail customers.

We're working to improve and perfect our organization, processes, and infrastructure to properly support this new phase of our company's growth. Leapfrog is a business that has grown astronomically over the last several years. During that time, the emphasis was on feeding that rapid growth with new products delivered to market as quickly as possible. As we enter a new phase of our company's growth, this management team is focused on building the infrastructure necessary for future success, including developing an efficient, team-oriented organization implementing internal systems designed to give us better visibility and control over our businesses and developing business planning processes to ensure consistent future growth and profitability.

Before I turn the call over to Leapfrog's CFO, Jim Curley, let me say that clearly this performance is not acceptable to us and we are taking immediate action to ensure a healthy company and a strong product line for 2005. Now Jim will review our adjusted guidance and preliminary results for the third quarter.

JIM CURLEY, CFO, LEAPFROG: Thank you, Tom. Our preliminary expectations for our third quarter and full year 2004 guidance are as follows. And I must say, while we're in the process of closing and reviewing our third quarter results, our expectations for the third quarter are just that -- expectations. We'll put out our final numbers on October 27th, as planned. But for now, we're publishing a net sales guidance range for the third quarter of $225m to $230m. Gross profit margin of 40% to 41% of net sales, operating expenses at a rate of 27% to 28% of net sales, and using a fully diluted share count of approximately 61.5 million results in diluted net income per share of 32 cents to 34 cents for the quarter.

The company's published guidance for the full 2004 year is revised as follows. For the full 2004, net sales of
$680m to $710m. Gross profit margin of 42% to 43% of net sales. Operating expenses of 36% to 37% of net sales. The fully diluted share count of approximately $61.5mr results in a diluted net income per share range of 40 to 60 cents.

To recap, while our third quarter net sales increase was up 12% over last year, the major challenge to our business is lower gross profit margins in the U.S. consumer segment. About one quarter of the reduction in margins is due to the extra expenses from our major supply chain initiatives. These higher expenses are not all permanent but we are forecasting these higher expenses to continue into the fourth quarter.

The balance of our gross profit margin reduction is due to lower sales of our core LeapPad family line. Fortunately, our new LittleTouch LeapPad and Leapster Learning System lines have offset much of the sales decline. However, at lower gross profit margins. We are focused on improving our gross profit margins in the future, and we are taking steps to reduce our fixed expense overhead to ensure improved profitability. I'll now turn the call back over to Tom for our conclusion and Q&A.

TOM KAUNSKY: Thanks, Jim. In closing, let me say that we are extremely disappointed in these revised results. However, we believe the issues we face can and are being addressed and fixed with our strategic and tactical programs. I cannot emphasize enough and how strongly be believe in the power and potential of the Leapfrog brand and what we have to offer consumers around the world. We believe Leapfrog has a strong future, based on our expanding global integrated educational offering for kids and adults around the world. And finally, we are committed to communicating with you throughout this process. Our standing Q3 earnings call will be held on October 27th, and we expect to be able to discuss our results in more detail to provide perspective on the positive results and strength in both our education and training and international consumer segments. I would now like to open the lines for our question and answer portion of the call. Please keep in mind that without final confirmed numbers for Q3, we may not be able to address all of your questions. Now operator, let's begin the Q&A portion of the call.

OPERATOR: [Operator Instructions] Your first question comes from Lauren Fine.

LAUREN FINE, ANALYST, MERRILL LYNCH: Thank you. I'm wondering if you can give us a little bit more color on a couple of things. First of all, on the LeapPad, why do you think there has been this change in terms of, I guess, product sales? Is it the competitive environment, in terms of Fischer-Price and other products? Is it the change in the retail environment and that you're seeing a different buying pattern among the different retailers? And then also, I'm wondering if you could give us a little bit more color on the breakdown of sales that you're expecting for the third quarter in terms of how much of the change in expectations is coming just domestically? You indicated that international and schoolhouse are still strong, but any additional quantification of that would be helpful.

TOM KAUNSKY: OK, as you know, the LeapPad was the first of family of-- hello, is everybody there? There was some interference. I don't know if you can still hear me. There was-- the LeapPad was the first of the family of LeapPad products, so it is the oldest and the-- a lot of static here.

LAUREN FINE: You just went out, Tom.

TOM KAUNSKY: Operator, can you fix this static? Lauren, I don't know, maybe it's something to do with the cellphone somewhere or something. We're obviously on a Polycom here. But let me keep going. So as the oldest of the oldest of the products, we did certainly anticipate a decline in that business this year, but the decline has been greater than our expectation, and I think the other part of it is we expected the software to, of course, remain strong, because the software is also usable in the LeapPad Plus Writing, and that platform continues to perform very, very well for us. And the software sales are a disappointment, and that's one of the primary reasons why we're taking the guidance down.

The retail buying pattern, of course, has been, as we reported before, there's been a tendency to push it later, but in our case, given some of the difficulties we faced in shipping, I'm not sure that was a major factor for us.

In terms of more color on the international and schoolhouse, or education and training segment, all I can say is, their increases are very, very significant and they continue to be so. I think we will be able to provide more details for you on October 27th, but the-- we're now in something like over 44,000 schoolrooms and certainly lots of children are experiencing our products and learning from them, and lots of parents are seeing them there.
OPERATOR: Yes, sir? I had to close Lauren's line because of the background noise that was coming from it. That was the static.

TOM KALINSKE: I see.

OPERATOR: And your next question now will come from Sean McGowan.

SEAN MCGOWAN, ANALYST, GERARD KLAUER MATTISON: I'm wondering if you could address on question regarding kind of your seasonality of your business? Typically you're a bit more concentrated in the second half than you know maybe some of the other competitors that sell products to Target, Wal-Mart, and Toys R Us. Looking at the performance now in the second half of this year and kind of looking out to the early part of '05, when, you know, maybe some of the new platforms that you'll be launching next year aren't going to really show up until later in the year, what- how quickly do you think the improvements you've made in the supply chain and other initiatives can kick in, or are we looking at pretty fallow period in the first part of '05 as well?

TOM KALINSKE: Well, we believe 90% of the improvements in the supply chain are now in hand. We still have some work to do, but we've come over the main hurdles, I would say, in the middle of September, the end of September, and the issues that we faced there. So I think it's certainly, the supply chain issue, should be behind us by 2005. However, as was the case in the past, our most significant new products will be available for the fall season. In other words, they will be shipable in the July/August time period of next year, so I don't think we're going to change the way the year breaks out, seasonality-wise.

SEAN MCGOWAN: OK, thank you.

OPERATOR: Your next comes from [Brendan Dobel].

BRENDAN DOBEL, ANALYST: Hi, guys.

TOM KALINSKE: Hi, Brendan.

BRENDAN DOBEL: A couple of different questions, actually. First, does what's going have any relation to, in particular, what Toys R Us is going through, or is just more of a general industry thing? And I can't remember back to the previous conference calls, if you had included or not what the potential impact could be from what Toys R Us eventually does? And then second question is varied-- kind of different, would be, just in your comments, Tom, you mentioned a lot of a lot of the initiatives to kind of change maybe the advertising and marketing, target more software, different promotional activities. How should we think about modeling some of the selling and marketing or some of the G&A expenses, relative to sales or relative to historical amounts? Just trying to get a feel for, you know, is what you're going to spend a lot more, a little more, is it going to be more [tracked to] revenues, just as we think about our longer-term target model?

TOM KALINSKE: Yeah, well, let me say that we obviously can't or don't comment on specific customers, retailers, and home much we shipped or haven't shipped to them, but I think you're all aware that we're sort of still waiting to see what's going to happen with Toys R Us and how they will end up changing their model.

On your question on how we'll-- how you can model us better, let me turn that back over to Jim in terms of comments on that. I really think we're probably going to be better prepared to give modeling questions when we really do the full third quarter call, but let me let Jim have a crack at it now.

JIM CURLEY: Well, I mean, clearly we've given point of sale information in the past and we've always believed that is the best indicator of what our business is going to do. When we saw 20%, you know, north of 20% experience in the first half of the year, that still gave us confidence that even though sell-in wasn't, you know, matching that, that eventually that would kick in. You know, we experienced a significant amount of disruption in the third quarter. Just-- we had the demand from the retailers, we had the inventory, and our supply chain, you know, problems did cause us not to be able ship the full demand that was out there. And it was significant. But unlike last year, where we missed the third quarter and made it all up in the fourth quarter, this year we're very focused on where we end the year as far as the level of inventory on the retailers, our customers' books, and you know, we look again to POS, and POS is what's telling us -- that's the big indicator right now -- that we
have to take a conservative stance for the fourth quarter. So we're very focused or not overshipping. I think the retailers, as well, are very conservative on inventory. The retailer you mentioned is, you know, particularly being cautious, and you know, all that rolls up into an effect right now.

So, when you have a channel that's changing, there's going to be some disruption, and it does take away some of the predictability that might be there otherwise. But at the end of the day, we think the consumer is still a fan of Leapfrog products, we're going to be focused on driving gross profit margin, and we'll have to think more about how we give assistance, whether guidance the way we've done up to now, is the right way. We might have to look more towards qualitative things and bring you in as partners to understand, you know, our strong product expectations, longer-term.

BRENDAN DOBEL: OK, that's fair. I was wondering if you could-- in terms of advertising, historically you've done some co-op advertising with some of the stores, some media. Is what happened here-- or is what the toy industry is going through right now, is that going to change how you guys look at advertising? Is that going to change maybe how maybe your retail partners look to you to do advertising? Again, it's more for the longer-term perspective, trying to get a better sense of how we look at that advertising line, relative to what the U.S. consumer segment is doing for revenues?

TOM KAUNSKE: Well, you know, clearly, it is a combination. We still are expected, by our retailers, to drive consumers to the shelves to look for our products, and we will continue to do that, through a variety of different means. Hopefully, some of those means will be new and improved means. But we intend to continue, certainly the rest of this year, with strong television and strong print support behind our products. At the same time, we have good commitments from the retailers on co-op advertising and on their flyers and on displays at retail. So we do think all that's going to continue.

The issue that I think Jim was outlining and I was trying to outline is that, you know, when the first half of the year you see your sales over the counter are up 20%, and then in the third quarter, they fall to only up 8%, you have to be a little more cautious about what's going to happen for the rest of the year, and so that's one of the other reasons for taking the guidance down, as well as the large profit miss we experienced ourselves in the third quarter.

So, I don't know if I'm completely answering your question, but we will be utilizing some new techniques, we will be doing more directly to consumers, we will be using the Internet more in reaching consumers, but certainly television and print still continue to be an important part of the advertising mix.

BRENDAN DOBEL: OK, thanks, I appreciate it.

OPERATOR: Your next question is from Raj Sharma.

RAJ SHARMA, ANALYST, MERRIMAN CURHAN FORD: Hi, I just wanted to ask you, get some more clarity on the sell-throughs -- you know, when did they change, what's happening there? And secondly, on LeapPad, is down from expectations. Is it down from expectations and overall, the platform and how are they performing at retail? And also sort of-- does it mean then [unsold] as well into the fourth quarter, for the Christmas season?

JIM CURLEY: I'd like to just go over one point on the financial side of LeapPad being down. We're talking, in terms of dollars, we're down more in dollars than in units. You know, we shared with everyone that we brought down, at the beginning of this year, our three most mature platforms -- the LeapPad, My First LeapPad, and the Quantum Pad, and those price reductions have definitely, you know, impacted us. The retailers are lowering price now in the fall season. You know, it still remains to be seen what kind of elasticity there is, you know, when they come all the way down, you know. But we didn't bank on that. You know, I think we feel internally that we shouldn't have taken, you know, prices down. It would have been better-- people want to pay for the quality of the Leapfrog learning experience, and the LeapPad is the established player in the market. And that would be our-- but that damage is done so now it's about focusing on how we drive software sales, which have the full margin, and focus on, you know, turning that part of the business around.

TOM KAUNSKE: Yeah, Raj, the LeapPad family of products, depending on how one defines family, generally we don't put the LittleTouch into the family, the infant product, but we do include the others, and it is still an enormous business, and an enormous business that's quite healthy, except for the oldest parts of the business, which are the LeapPad itself and the Quantum Pad and the software on those systems. Those problems, though, are obviously fairly large and the successes of the Plus Writing and the My First LeapPad can't offset those...
declines at this point, but we're still talking about a very substantial category, even in our reforecasted business for the year and for the fourth quarter. It's just lower than what we had anticipated it to be.

RAJ SHARMA: So just wanted to get, I guess, better clarity into when the sell-throughs changed, you know, from plus 20 to down? And then second part is the lower guidance primarily because you're not selling enough into the channel, or is it internally, your costs have sort of gone up, or is it a mix of both? Can you provide more guidance-- provide--

TOM KALINSKE: Sure. The change, through the end-- you know, we get data weekly and the literally, through the probably through August, we were looking at 20% increases in our sell-through. And then it changed. And now the problem you have there is-- you could say, 'Well, gee, but you had 7, 8 months of these big numbers, so what's-- why do you react so strongly to a change in September/October?' And the reason is because you're starting to see the seasonality of the business kick in and as we've stated before, because the seasonality of the business is so skewed to the back end, when you see a change in September or October, you have to react to it. And the fact we were only up 8% overall in September is a telling factor.

It's not-- it's certainly not due to the supply chain issues on the LeapPad itself. It's due to consumer sell-through and off-take on the LeapPad and its software.

RAJ SHARMA: So are you- versus the competition, how is it performing?

TOM KALINSKE: Yeah, we still are gaining share. I mean, I think you heard some calls this morning where guys were talking about their business being down several percentage points in the U.S., whereas our business is up 11 percentage points year-to-date in the U.S. So, you know, it's-- we're taking share of market away. Is competition hurting us? I always believe any competitive product hurts us, but I think we're doing better than our competition, given those statistics that I cited.

RAJ SHARMA: OK, thanks.

OPERATOR: Your next question comes from Richard [Close].

RICHARD CLOSE, ANALYST: Yes; I was wondering if you could give us a little bit more clarity on the software? You know, that was, when we take a look back at the, you know, the second quarter conference call, or guidance, you guys really talked about, you know, that was going to be one of the main drivers in obtaining your goals. Can you just give a little bit more clarity -- is it just the LeapPad? Are you selling software products for the other platforms? And then the newer-- second question here -- the new platforms that you've rolled out over the past year or so, when do you expect those to begin to make positive margin contributions rather than drag the overall margin down?

TOM KALINSKE: OK, let me try to provide that clarity. The software on the LeapPad is the primary issue. Software on LittleTouch is selling through very, very well-- selling and selling through very well versus year-ago. Certainly Leapster is all plus business because it really wasn't in the marketplace last year at this time. So, our newest platforms, LittleTouch and Leapster, are obviously positive to our numbers at this point. And the software, by a substantial amount, in the case of both LittleTouch and Leapster. My First is all-- My First LeapPad is also performing very, very well, and that's an older platform, not as old as the basic LeapPad or the Quantum Pad are. So both of those are-- I don't want you to get the impression those aren't profitable businesses. Those are profitable businesses, it's just that higher than expected hardware is a lot less profitable and in the case of LittleTouch, the software, while profitable, is a lower profit margin than the very high margin we have on LeapPad or on Leapster software. So that's kind of what's going on, on there.

RICHARD CLOSE: Does it ever get to the higher profitability, or are we seeing-- is it just not going to get there at all?

TOM KALINSKE: The LittleTouch is not designed and priced to be high 50s or 60% gross margin software, the way that Leapster or LeapPad was. It won't get there, but Leapster certainly is. The change on clarity on software, or the question on clarity on software, yeah, we certainly intended to drive software, and we still intend to attempt to drive software this year, and we've done a lot of things. We changed the packaging. I still think it's the right thing to have done. It caused us some gaps in the market, but it still was the right thing to do, based on the parent research. We are disappointed that it has not resulted in better over-the-counter sales.
We're also still trying to drive software sales through advertising and media. And hopefully, that will kick in. But again, when you see results that we've seen for the last four weeks or six weeks, you really have to change your forecast for the year. You have to react to it, you can't just assume you'll make it better in November and December.

RICHARD CLOSE: And then on the LeapPad, is it-- so it's primarily the shortfall related on the LeapPad, and is that all software or is that the platform and software, maybe--

TOM KALINSKE: It's both; it's both software and platform, in that case, and it's relative to- we knew, given the age of the platform, that it would be coming down in terms of the hardware, but it's coming down more significantly than we had thought. By the way, the numbers are still fairly large, but it's still is less than what we had anticipated.

RICHARD CLOSE: So, as you head into next year, what's going to take the place? I mean, where are in the-- you know, product--

TOM KALINSKE: Well, we're going-- as we indicated in our comments, we're re-orchestrating the product line and we have some ideas on what we can do on the LeapPad line that we're showing, just starting to show here in New York to retailers, and certainly the same thing on software. The key is, we have to make it simpler for the consumer to shop the product and purchase the product, and we have to be able to effectively market it. At the same time, we are not going to stand still. We are introducing significant new products into the market for '05, and we won't be talking about those new products yet. There are probably more details that we can go over with you on the 27th, on this situation. But there's quite a bit of change going on, on both the LeapPad line and then certainly we have many new products for '05 and significant new platforms.

RICHARD CLOSE: OK, and one final one -- have you ever laid out, or if you could just refresh me in terms of what was the long-term sort of operating model for you guys? I know Brendan asked, you know, maybe for a little bit more guidance on that, but what was it previously? I guess you'll update us on what your thoughts are going forward, on your conference call, but if you could just give us a sort of snapshot of what it previously was?

TOM KALINSKE: Jim, do you recall what we've said on the long-term operating model forecast?

JIM CURLEY: Yeah, long-term-- I mean, long-term, without putting any time parameters around it, you know, we felt we could be a, you know, a 50% gross profit margin business. You know, not linearly, but you know, over time. We felt we could definitely leverage our expense structure and R&D over time, advertising holding steady. You know, we look to be-- you know, we peaked last year at 16.1% operating income. We felt we had momentum up towards 20% in the future, as an operating income level. We're going to come, you know, clearly off of that this year, but there's a lot of positives in this situation. Right now, we haven't-- I'll give you a little clarity. Schoolhouse is up over-- in the high 90% as far as growth rate in the numbers. International is growing at greater than 50%, and you know, we had a small 3%, approximately, increase in the U.S. consumer segment. You know, we've talked, we've made some, you know, pricing miscues that we'd like to change in the future. We think we've done some things and how we've included software in our platforms free to the consumer that, you know, give us opportunity to redo that in the future, and we've got a lot of, you know, potential. I mean, I think the whole company, I think, is focused on gross profit margin and the new product direction to try to drive that.

SHERRY STUART: Operator, we're going to take one more call.

OPERATOR: Your final question comes from Elizabeth [Osier].

JILL KRUTICK, ANALYST, SMITH BARNEY: Hi, this is Jill Krutick at Smith Barney. I was hoping you could basically talk to us a little bit about the retail inventory levels, how they compare at the end of the third quarter versus what you saw at the end of the second quarter or beginning of the year, some frame of reference, if you could, in terms of retail inventories of your products? And Jim, I know you had talked about several different investment initiatives. Can you give us a sense, even short run, just in terms of new consultant hires and so on, what kind of expenses we should be expecting here for the short run? Thank you.

TOM KALINSKE: Thanks, Jill. Retail inventory, right now, at this moment, remember, we still are looking at a reasonable increase in shelf space, somewhere around 10% increase in shelf space, so we essentially have to have more inventory at retail right now than we had a year ago. Also, we've just shipped in more than we
shipped in a year ago, so at this moment of time, there clearly has to be more inventory at retail than there was a year ago. Our intent, as Jim mentioned, is to manage to that retail, or to help our retailers manage that retail inventory, and we certainly want to be in a cleaner position after Christmas than we were a year ago, and that is one of our goals, and I hope we are able to achieve that.

Your other question was on short-term expenses. Going into the fourth quarter, I gather, Jill? Jim?

JIM CURLEY: Right. I guess to frame it, in the third quarter, you know, we had about $6m in additional costs related to-- most of it in cost of goods sold, but some of it in SG&A related to duplicate expense, running the different distribution centers, at the same we brought the new distribution center online, the additional system cost. A lot of, you know, the third-party logistics providers overlapping with, you know, our prior third-party logistics providers, and a lot of freight movement of product back and forth. And as we started getting into our supply chain system, we also identified, you know, inventory-- excess component inventory that we never had visibility clearly on before, but now that we've, you know, have a system that's not manual, it's giving us longer-term visibility. So, you know, addressing those expenses result in about $6m in the third quarter. We think we've turned some corner on that, and we definitely don't have the duplicate facilities, because we've left our prior distribution center, the large one. I would say, you know, we're probably talking $3m to $4m in additional cost of goods sold in the fourth quarter that we would then-- that should be the end of it. And then next year, in '05, we should start getting an ROI on the spending and effort, you know, with Manugistics, with our warehouse management system, with having a third-party logistics provider, where the bugs are out of it, and we get through the slow season and be prepared to, you know, turn our inventory quicker and it's really, where we're going to get the ROI in and achieve a fill rate that we weren't able to do this third quarter. That would be about the clarity I'd give right at this point in time.

JILL KRUTICK: OK, thank you, Jim.

JIM CURLEY: You're welcome.

TOM KALINSKE: OK, thank you all. Our next conference call will be on the real, final numbers for the third quarter on Wednesday, October 27th, at 2 p.m. Pacific, 5 p.m. Eastern Time. Thank you for joining us. I'm sorry to have you taken you away. I hear in New York here there's some kind of a baseball game going on. I'm sorry I caused you to miss that.

OPERATOR: This concludes today's Leapfrog Conference Call. You may now disconnect.

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Exhibit 20
Leapfrog Book Tie Ratio

Ratio of Books Shipped per Year to Platforms Shipped per Year

Books per Platform

1999 2000 2001 2002 2003 2004

0.7 1.6 2.4 3.9 3.7 2.9

LeapPad

0.9 1.1 1.8 2.6

My First LeapPad

Source: TLP LF-DEL 0412650-652, LF-DEL 041431-57