EXHIBITS 9-13
Exhibit 9
LeapFrog Enterprises

LF Delivers on Q4, Yet Questions Remain; Announces Mgmt. Changes

Reason for Report: Q4 & FY'03 Results

**NEUTRAL**

**Volatility Risk:** HIGH

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**LF; $30.40; C-2-9**

**GAAP EPS (Dec):**
- 2002A $0.86
- 2003A $1.20
- 2004E $1.43

**GAAP P/E (Dec):**
- 2002A 35.3x
- 2003A 25.3x
- 2004E 21.3x

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**Event**

LeapFrog reported a solid Q4'03, with diluted EPS of $0.72/sh, up 43.6% YoY, beating our estimate by $0.04/sh, $0.01/sh below consensus, and within mgmt. guidance of $0.69-$0.76/sh. For the year, EPS grew 40.4% to $1.20/sh vs. $0.86/sh last year, beating our estimate by $0.03/sh, $0.01/sh below consensus, and within mgmt. guidance of $1.17-$1.25/sh. LF issued 2004 guidance, projecting 18-25% rev. growth, 21-31% net income growth and 16-26% EPS growth. In a separate release, LF announced that founder and CEO Michael Wood is stepping down as CEO and taking on the role of Chief Vision & Creative Officer. Tom Kalinske, LF's chairman of the board, will resume his role as CEO, Jerry Perez will join LF as president, & director Steve Fink will become chairman of the board. Conference call at 9am ET on 2/11.

**Analysis**

Q4 revenue grew 33.4% YoY to $331.4MM, near the high end of mgmt.'s guided range of $316-$334MM, and $155MM higher than our estimate. Based on the high accounts receivable position at year end, and high inventory levels we noted in early January at retail, we have some concern that Q4 sales stole from Q1'04. Underscoring our concern about sales late in the quarter is a cash flow statement that suggests that cash and short term investments would not have grown except for the proceeds and tax benefits from stock options. US consumer sales grew 25.1% to $273.4MM ($10MM higher than our est), international sales grew 95.8% to $46.8MM ($2.3MM higher than our est.), and education & training sales grew 84.6% to $11.1MM ($2.7MM higher than our estimate). According to LF, NPD reported that LF was the leading manufacturer of pre-school products in the U.S. in Q4, with market share increasing from 17.5% to 27.5%, although we note that NPD does not include Walmart or Toys R Us data, which in the past have represented roundly 58% of LF sales. Sell-thru at 22 US retailers (96% of LF's US sales) increased 27% for the year in Leappad family platforms and 33% in Leappad family software. We note that sell-through in Q3 was up approximately 35%, with platform sell-through up 40% & software up 80%. This was on a relatively low dollar volume and wasn't limited to just the Leappad family, but we hope to learn more about Q4 sell-through trends on the conference call tomorrow. Q4 gross margins declined 308bps vs. last year to 47.9%, 380bps below our 51.7% projection.

Management attributed the decline to lower margins on Leapster sales, which incurred airfreight costs. Operating expense grew 14.3% in the quarter, below our expectation of 18.9% growth, driven primarily by better than expected SG&A costs and lower depreciation expense. LF noted that advertising (14.3% of sales) was impacted by increased TV ad expense, although it came in slightly below our estimate as a percentage of sales. Operating margins in Q4 were 20.6% vs. our estimate of 21.7%. In the quarter, LF had other income of $1.6MM & booked a reserve due to the KB Toys bankruptcy. The tax rate was 37.1%, yielding net income of $44.2MM, up 50.4% YoY and $1.5MM higher than our projection.

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Investors should assume that Merrill Lynch is seeking or will seek investment banking or other business relationships with the companies in this report.
For the year, revenue grew 27.9% to $680MM, at the high end of mgmt. guidance of $665-$683MM (and higher than the original guidance provided last Feb.), gross margins were 50% vs. mgmt. guidance of 51-52%, operating margins were 16.1%, up 268bps YoY, and net income grew 67.3% to $72.7MM.

Management issued 2004 guidance, projecting revenues of $800-$850MM, or 18-25% year over year growth, a 50% gross margin each quarter, 34% tax rate vs. 37% in '03, net income of $88-$95MM, or 21-31% year over year growth. LF expects 1H'04 sales to each represent approximately 10% of FY sales, with lower sales growth in the first half and higher in the second half. Operating expenses are expected to grow 20-25% for the year, with growth of 10-15% in Q1 '04.

Separately, LF announced a number of management changes. Founder and CEO Michael Wood is stepping down as CEO to take on the role of Chief Vision & Creative Officer. Tom Kalinske, LF's chairman of the board since 1997, will resume his role as CEO, a position he held from 9/97 to 4/02. Jerry Perez will join LF as president. Mr. Perez was previously Executive VP of Fisher-Price. Director Steve Fink will become chairman of the board. Mr. Fink has been a board member since 1999. He is the CEO of Lawrence Investments and is a Vice Chairman of Knowledge Universe. This announcement came as a surprise and we are pleased to learn that although Mike Wood is stepping down as CEO, he will take on a new role at LeapFrog. We believe that Tom Kalinske has been deeply involved in LeapFrog's business and we therefore expect that the transition should be relatively smooth. We do hope to learn more about the motivation for these changes on LF's conference call.

**Recommendation & Investment Thesis**

LF is trading at 25.3x '03A EPS and 21.3x our '04 estimate (which has not yet been revised for today's results). Overall, the Q4 results were strong and it is interesting to note that a year ago, LF was projecting 2003 revenue of $625-$675MM, net income of $55-$62MM, and diluted EPS of $0.91/sh-$1.02/sh. While there have been ups and downs during the year, LF delivered a solid 2003.

We are pleased to see that LF has issued 2004 guidance projecting net income growth of 21-31% and EPS growth of 16-26%, although we note that given that the environment has changed, we are approaching guidance a bit more skeptically than we have in the past.

We maintain our Neutral rating on the shares. If we assume the low end of '04 earnings guidance and assume the low end of EPS growth of 16%, LF is currently trading at a PEG ratio of 1.37x '04 estimates, just below the average of Mattel and Hasbro of 1.41x, suggesting that it is fairly valued. However, if we use the mid-range of EPS guidance, assume 20% growth over the next several years, and discount the PEG ratio to 1.3x, this yields prospective growth of 24%, leading us to believe there is not much downside at this level and that there is potential upside. However, we are not yet ready to move to a more positive stance on the stock as we believe that industry dynamics are changing, creating uncertainty for LF. In 2004, LF will face increased competitive pressure from Fisher-Price as Mattel has already announced that they are committed to the space and are adding more platforms. We would note that in the past LF was able to grow margins as it benefited from having an innovative product in the market for several years before significant competition entered the market. LF will not have the same kind of lead time prospectively, which could hurt the economics of each new product hereafter. In addition, given that the potential impact on pricing due to the market share and price wars between Wal-Mart and other retailers remains to be seen, and that we have not yet seen LF's new products for FY'04 which we look forward to learning more about at Toy Fair, it is difficult to have conviction for the upper end of management guidance. In addition, we do have a concern, that we hope to clarify in tomorrow's conference call, that late quarter sales stole from Q1 sales, as based on our channel checks in January, we have seen high levels of inventory at retailers and as accounts receivable represents an all time high of 85% of Q4 sales.

**Analyst Certification**

I, Lauren Rich Fine, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.
Important Disclosures

Investment Rating Distribution: Education & Training Services Group (as of 31 December 2003)

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* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. VOLATILITY RISK RATINGS, indicators of potential price fluctuation, are: A - Low, B - Medium, and C - High. INVESTMENT RATINGS, indicators of expected total return (price appreciation plus yield) within the 12-month period from the date of the initial rating, are: 1 - Buy (10% or more for Low and Medium Volatility Risk Securities - 20% or more for High Volatility Risk securities); 2 - Neutral (0-10% for Low and Medium Volatility Risk securities - 0-20% for High Volatility Risk securities); 3 - Sell (negative return); 4 - No Rating. INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure); 8 - same/ lower (dividend not considered to be secure); and 9 - pays no cash dividend.

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The analyst(s) responsible for covering the securities in this report receive compensation based upon, among other factors, the overall profitability of Merrill Lynch, including profits derived from investment banking revenues: LeapFrog.

Additional information pursuant to Section 34b of the German Securities Trading Act: Merrill Lynch and/or its affiliates were underwriters in an offering of securities of the issuer in the last five years: LeapFrog.

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Refer to important disclosures on page 3.
Exhibit 10
LeapFrog Enterprises, Inc. Issues Guidance for the First Quarter

EMERYVILLE, Calif., March 10 /PRNewswire-FirstCall/ -- LeapFrog Enterprises, Inc. (NYSE: LF), a leading developer of innovative technology-based educational products, today issued guidance for the first quarter of 2004. Despite positive sell-through data to date in the first quarter, LeapFrog expects net sales in the first quarter to be between $66 million and $72 million. This, coupled with reduced gross margin for the quarter and continued strong investment in research and development and supply chain initiatives, results in an expected net loss for the quarter of between $(0.18) per share and $(0.22) per share.

"The first quarter is a very small portion of our overall year. In fact, we had expected the first quarter to represent just 10 percent of 2004 net sales," said Tom Kalinske, LeapFrog's Chief Executive Officer. "However, the first quarter is particularly vulnerable to trends that impact our net sales, margin and net income, including the shifting of retail orders to later in the year, and the difficult financial position of certain retailers.

"We believe that it is premature to draw conclusions with respect to the entire year based upon our sell-in results to date," added Kalinske. "We are excited about our 2004 line of products, which was met with much enthusiasm at New York Toy Fair. In addition, this will be the first full year for our LittleTouch(TM) LeapPad, LeapPad(R) Plus Writing and Leapster(TM) platforms, each with growing libraries of software titles.

"We remain committed to innovation and improvements in operations that provide superior long-term value to our stockholders," said Kalinske. "In order to finalize products for 2004 and ensure the timely development of exciting new products for 2005, we are maintaining our projected level of spending on research and development this year. We are also beginning to incur significant legal expenses to protect our valuable intellectual property against competitors."

The company believes all of these expenditures are in the best long-term interests of its stockholders and will result in a stronger business. While these investments in the business will result in significantly higher operating expenses in 2004, LeapFrog expects that they will lead to improved margins and reduced costs in the long run.

LeapFrog's guidance is reflective of the company's current expectations, which are based on information available at the time of this release, and are subject to changing conditions, many of which are outside of the company's control.

LeapFrog is not hosting a conference call in conjunction with this announcement. LeapFrog will report on first quarter 2004 earnings after the market closes on April 21st and conduct a conference call at 5:00 PM Eastern time on the same day.

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 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, The LeapFrog Logo, LEAPPAD, LITTLETOUCH, LEAPSTER and LEAPFROG SCHOOLHOUSE are trademarks of LeapFrog Enterprises, Inc.

Forward-Looking Statements
The guidance statements in this release constitute forward-looking information, and actual results could differ materially. Among the factors that could cause results to differ from the guidance are the following: actual orders and shipments in the remaining weeks of the first quarter, consumer demand for the company's products, both in the aggregate and in relation to competitive product offerings; the company's ability to adjust manufacturing and shipments to meet customer demand, particularly late in a quarter; expenses incurred by the company in expediting shipments to customers late in a quarter; the company's ongoing ability to develop, produce, and market new products that appeal to consumers; the company's success in penetrating the educational market; the shelf-space made available for the company's products by retailers; the company's ability to complete its supply chain initiatives on time; seasonal variability in the various markets for the company's products; resellers' changes in their own inventory and stocking models, and the financial condition of the company's customers. These and other factors that could affect the Company's actual financial performance during 2004 are discussed in greater detail in the company's SEC filings, particularly its 2002 annual report on Form 10-K filed on March 28, 2003, and its quarterly report on Form 10-Q filed on November 10, 2003. The guidance in this release represents the company's expectations as of the date of this release. The company disclaims any obligation to update this guidance prior to its announcement of financial results for the first quarter of 2004.

SOURCE LeapFrog Enterprises, Inc.

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03/10/2004

/CONTACT:
Jim Cusley, Chief Financial Officer, +1-510-420-5000, or Christopher Bunn, Director, Investor Relations, +1-510-420-5150, both of LeapFrog Enterprises, Inc./

/Web site: http://www.leapfrog.com / (LF)

http://www.prnewswire.com

"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 11
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10–K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2003

☐ 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 or other jurisdiction of incorporation or organization)

95−4652013
(I.R.S. Employer Identification No.)

6401 Hollis Street, Suite 150
Emeryville, CA 94608
(Address of principal executive offices)

(510) 420−5000
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class Name of each exchange on which registered

Class A common stock, par value $0.0001 per share New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S−K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10−K or any amendment to this Form 10−K. ☐

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

The aggregate market value of the common equity held by non−affiliates of the registrant calculated using the market price as of the close of business on June 30, 2003 was approximately $719,166,000. The registrant does not have non−voting common stock outstanding.

The number of shares of Class A common stock and Class B common stock, outstanding as of March 1, 2004, was 31,517,258 and 27,882,817, respectively.

DOCUMENTS INCORPORATED BY REFERENCE
The registrant has incorporated by reference in Part III of this report on Form 10−K portions of its definitive Proxy Statement for the Annual Meeting of Stockholders, to be filed by April 29, 2004.
SPECIAL NOTE ON FORWARD−LOOKING STATEMENTS

This report on Form 10−K, including the sections entitled “Item 1. Business,” and “Item 7. Management’s Discussion and Analysis of Financial Condition and Result of Operations,” contains forward−looking statements. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from any future results, levels of activity, performance or achievements expressed or implied by these forward−looking statements. These risks and other factors include those listed under “Risk Factors That May Affect Our Results and Stock Price” in Item 7 of this Form 10−K and those found elsewhere in this Form 10−K. In some cases, you can identify forward−looking statements by terminology such as “may,” “will,” “should,” “expect,” “intend,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential,” “continue” or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward−looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to update or revise publicly any forward−looking statements, whether as a result of new information, future events or otherwise after the date of this report.

TRADEMARKS AND SERVICE MARKS

“LeapFrog,” the Leapfrog Logo, “LeapPad,” “Above & Beyond,” “Alphabet Pal,” “Hug & Learn,” “Imagination Desk,” “iQuest,” “Leap,” the Leaping Frog Design, “LeapTrack,” “Learning Something New Everyday,” “Learning Friend,” “Mind Station,” “NearTouch,” “Odyssey,” “Phonics Desk,” “Quantum Pad” and “Turbo Twist” are our registered trademarks or our service marks. “Baby Tad,” “Fridge Phonics,” “Great Reader,” “Language First!,” the LeapFrog SchoolHouse design, “Leap’s Pond,” “LeapStart,” “Fun−Damental,” “Ready, Set, Leap!” the green GO circle, and the Bouncing Frog Logo are some of our trademarks or our service marks. This report on Form 10−K also includes other trademarks and service marks, as well as trade dress and trade names of ours. Other trademarks in this report on Form 10−K are property of their respective owners.
LeapPad Plus Writing learning system (ages 4 to 8). Our LeapPad Plus Writing learning system adds a new dimension to the original platform by converting the NearTouch−based stylus into a “magic” pencil that can also write on specially designed interactive books. The dual function stylus/pencil can easily be switched between writing mode and non−writing mode. The entire LeapPad library can be used with LeapPad Plus Writing platforms. The LeapPad Plus Writing learning system was launched in Fall 2003 with an exclusive library of writing activity−enabled books.

Quantum Pad learning system (3rd to 5th grades). Our Quantum Pad learning system incorporates design features intended to appeal to 3rd through 5th grade students. The entire LeapPad library can be used with the Quantum Pad platform. The Quantum Pad learning system uses our proprietary NearTouch technology as well as a “write−on” feature that allows students to write directly on erasable transparent plastic pages. We believe this added feature makes the Quantum Pad system effective for use with more complex math and science concepts. The Quantum Pad series of books is developed in conjunction with our educational experts to focus on subjects children are learning in school, such as science, social science, complex reading comprehension, upper level math and the arts, including the following interactive book series:

- **Fun−Damentals**: Curriculum−based books that focus on development in academic subjects such as geography, math and science and a grade−based series of three books that provides children with information on skills essential to the 3rd, 4th and 5th grades, such as grammar, history, math and science.
- **Great Reader**: Encourages reading and builds on more complex reading skills such as comprehension, plot, theme, characters and opinion.
- **Above and Beyond**: Introduces new subjects to children including the arts, logic, geography, planets and space exploration, movie making, culture and music.

Aggregate sales of our LeapPad, LeapPad Plus Writing and Quantum Pad platforms, each of which are based on our NearTouch technology and can work together with a significant majority of the same interactive books, together with aggregate sales of the interactive books compatible with these three platforms, accounted for approximately 53% of our total net sales in 2001, approximately 56% of our total net sales in 2002 and approximately 47% of our total net sales in 2003.

Currently we have over 100 interactive books available at retail, the significant majority of which are compatible with each of the LeapPad, LeapPad Plus Writing and Quantum Pad platforms.

**Leapster Multimedia Learning System (ages 4 to 8)**

The Leapster multimedia learning system, launched in November 2003, is designed to teach kids in the manner in which they like to play. Similar to handheld video game devices, the Leapster handheld allows children to play action−packed learning games with backlit color animation using a multi−directional control pad and a touch−screen enabled by a built−in stylus. In addition, the Leapster content also allows “players” to read electronic books, create works of art and watch interactive videos. Currently we have eight interactive Leapster titles available at retail, including educational games featuring Dora the Explorer and SpongeBob SquarePants, a digital art title, an educational book on phonics and our interactive *The Letter Factory* video.

**Turbo Twist Handhelds: Spelling, Math, and Vocabulary Versions and BrainQuest Edition (1st through 6th grades)**

Our Turbo Twist handhelds let children twist, pound and press the handheld device while they learn spelling, math, social studies and vocabulary. Using our proprietary technology, each Turbo Twist platform self−adjusts as the child answers questions to deliver content appropriate for his or her individual skill level. Each handheld was developed to reinforce the skills and information children learn in school. Each comes preloaded with spelling, math, social studies or vocabulary questions. Content cartridges for math, spelling and social studies for 1st through 6th grades are available at retail. The Turbo Twist *BrainQuest* edition covers our social studies curricula, and features *BrainQuest* licensed content. In 2004, we expect to introduce a new version of the Turbo Twist handheld that is compatible with grade−specific cartridges containing multiple learning categories.
Our sales team works in conjunction with store buyers from our key retailers to forecast demand for our products, develop the store floor footprint, secure retail shelf space for our products and agree upon pricing components, including cooperative advertising allowances. The large retail chains generally provide us with a preliminary forecast of their expected purchases of our products early in the year. While these and subsequent forecasts are not contractually binding, they provide important feedback that we use in our planning process throughout the year. We work closely with our key retailers during the year to establish and revise our expected demand forecasts and plan our production and delivery needs accordingly. Most retailers issue purchase orders to us, as they need product. Based on these purchase orders, we prepare shipments for delivery through various methods. We sell to smaller retail stores through a combination of sales representatives and direct salespeople.

**International**

Our international strategy includes the creation of LeapFrog products in foreign languages as well as marketing English-language products as tools for learning English as a foreign language. As of December 31, 2003, our products had been marketed and sold in five languages and more than 20 countries, including the United Kingdom, Canada, France, Spain, Mexico, Japan, Australia and Korea. We currently sell our My First LeapPad and LeapPad platforms in countries where we have created content for our platforms in the local language. We have created British English content for the U.K. market and have developed a variety of our content in other languages, including French, Japanese, Korean and Spanish. We sell our LeapPad platform to the consumer market in Japan under the CoCoPad brand name through our relationship with Sega Toys. In addition, Benesse Corporation, a supplemental educational materials company, is currently distributing a co-branded CoCoPad version of our LeapPad platform to preschool to third grade level subscribers of its educational program. We market and sell local language versions of some of our stand-alone products, including French and Spanish versions of the Discovery Ball, Learning Drum and Learning Table. These stand-alone products, with their limited set of content, are typically easier to localize than our platform and content suites. Finally, we sell our English language content internationally through consumer retail and educational channels and believe that significant opportunities exist to market our products as tools to learn English as a foreign language.

**Advertising and Marketing**

Our advertising and marketing strategy is designed to establish LeapFrog as the leading provider of engaging, effective and affordable learning solutions for the infant through high school audience and as a brand that parents and educators will seek to supplement a child's educational needs. We use a variety of advertising and marketing tools to implement our strategy, including network and national cable television advertisements and national print advertisements that feature our LeapFrog brand and our “Learn Something New Every Day” campaign that highlights the educational nature and extended life of our products. We are able to feature our products through cooperative print advertisements in local newspapers with key retail chains. These advertisements, run by our retail partners such as Toys "R" Us, Wal-Mart, Kmart and Target, highlight the availability of particular LeapFrog products at these retail outlets.

In key retail stores, we feature our products via our Learning Center shelf displays, which are designed to highlight our LeapFrog brand as the “one stop” solution for technology-based educational products. We have received additional brand exposure through television appearances by senior management and other television spots showcasing our products, often during the key holiday season.

**Sales and Distribution**

**U.S. Consumer**

We market and sell our products primarily through national and regional mass-market retail stores as well as specialty toy stores. In 2003, sales of our products to Toys "R" Us, Wal-Mart (including Sam’s Club) and Target accounted for over 79% of net sales in our U.S. Consumer segment. Our remaining U.S. Consumer retail sales came from sales of our products to specialty toy stores and, to a lesser extent, to book, electronics and office supply stores and other retailers.

Our sales team works in conjunction with store buyers from our key retailers to forecast demand for our products, develop the store floor footprint, secure retail shelf space for our products and agree upon pricing components, including cooperative advertising allowances. The large retail chains generally provide us with a preliminary forecast of their expected purchases of our products early in the year. While these and subsequent forecasts are not contractually binding, they provide important feedback that we use in our planning process throughout the year. We work closely with our key retailers during the year to establish and revise our expected demand forecasts and plan our production and delivery needs accordingly. Most retailers issue purchase orders to us, as they need product. Based on these purchase orders, we prepare shipments for delivery through various methods. We sell to smaller retail stores through a combination of sales representatives and direct salespeople.
We believe that our ability to establish and maintain long-term relationships with consumers and retailers depends, in part, on the strength of our customer support and service operations. We encourage and utilize frequent communication with and feedback from our customers and retailers to continually improve our products and service. Our consumer service center operates 24 hours a day, 7 days a week, specifically from November through January, and 14 hours on weekdays, and 9 hours on Saturdays during off-peak periods. We offer toll-free telephone support for consumers and retailers who prefer to talk directly with a customer service representative. We also respond to email inquiries received through our website, and we have a team of in-house customer service representatives who oversee and coordinate our customer service activities with our third-party customer service provider. In addition, on our website, we have a knowledge resource link that directs consumers to a frequently asked questions section, which we update as we receive consumer feedback. We also have a dedicated retail sales service team. This team works with our top retailers and provides point-of-sale related analysis for better forecasting and inventory plans. Our service operations are based in our Emeryville, California facility.

**Competition**

We compete primarily in the infant and toddler category, preschool category and the electronic learning aids category of the U.S. toy industry and, to some degree, in the overall U.S. and international toy industries. We believe the principal competitive factors impacting the market for our products in retail stores are brand, design, features, educational soundness, quality and price. We believe that we compare favorably with many of our current competitors with respect to some or all of our products or using some of our trademarks.

**Manufacturing, Logistics and Other Operations**

Our manufacturing and operations strategy is designed to maximize the use of outsourced services particularly with respect to the actual production and physical distribution of our products and to concentrate our internal resources on areas such as engineering, production planning and quality control. We believe our outsourcing strategy also enhances the scalability of our manufacturing efforts. In order to work closely with our manufacturing service providers, we have established offices in Hong Kong and Macau. We use several turnkey contract manufacturers to source components and build finished products to our specifications. We order our products on a purchase order basis from component suppliers and some of the components used to make our products, including our ASICs, currently come from a single supplier. For information as to how this concentration of suppliers could affect our business, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Factors That May Affect Our Results and Stock Price — We do not have long-term agreements with our major suppliers, and they may stop manufacturing our components at any time;” and “— We depend on our suppliers for our components, and our production would be seriously harmed if these suppliers are not able to meet our demand and alternative sources are not available.” We currently use eight contract manufacturers located in mainland China to build our finished products, which are selected based on their technical and production capabilities and are matched to particular products to achieve cost and quality efficiencies. We have our own quality assurance employees on site at each of our contract manufacturers. During the years from 2001 to 2003, Jetta Company Limited, one of our manufacturers in China, supplied 35%, 45% and 32% of our products, respectively, and our top three manufacturers combined supplied a total of 53%, 58% and 48% of our products, respectively. For information as to how this concentration of manufacturing could affect our business, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Factors That May Affect Our Results and Stock Price — 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 manner and in sufficient quantities.” The majority of our products are shipped directly to our contract warehouse in Ontario, California and are later shipped to meet the demands of our major U.S. retailers and other smaller retailers and distributors throughout the United States.

**Information Technology**

Our information technology environment is built around an Oracle system that supports our core order management, distribution, manufacturing and financial operations worldwide. We are also in the process of implementing new applications that are intended to further improve our supply chain management capabilities. These applications include supply chain planning software and warehouse management systems for our new distribution facility that is anticipated to be operational in mid-2004. In addition, we also have software systems that we use for both sales analytics and financial planning.
these factors. Our current principal competitors in the toy industry compete in the preschool category and include Hasbro, Inc., Mattel, Inc. and VTech Corporation. In 2003, Mattel introduced a product under the name “PowerTouch” under Mattel’s Fisher–Price brand, and Publications International, Ltd. introduced a product under the name “ActivePAD,” each having functionality similar to that of some of the platforms in our LeapPad family of platforms. In June 2002, Toshiba Corporation began selling an interactive educational platform product in Japan under the name “Ex−Pad.” We also compete with educational software publishers, such as Knowledge Adventure (a studio of Vivendi Universal Games), whose products have distribution at mass retailers and electronics and toy stores, and with producers of popular handheld game platforms, such as Nintendo Co., Ltd. and Sony Corporation, whose products may compete with our Leapster platform. We believe that producers of smart mobile devices, such as personal digital assistants, non−mobile game platforms and computer−based software may be able to compete effectively in our primary markets by developing engaging educational products that run on their platforms. These companies have significantly larger installed bases than we do. We are also beginning to cross over into their markets with products such as our iQuest handheld device. In addition, a number of major hardware and software makers have developed pen−based portable computers like the Tablet PC that could compete with some of our products, such as our LeapPad family of platforms. Consequently, competitors may include companies like Acer Inc., Apple Computer, Inc., Fujitsu Limited, Hewlett–Packard Company, Microsoft Corporation, NEC Corporation, PalmOne, Inc., PalmSource, Inc., Sega Corporation, and Toshiba. 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.

Our SchoolHouse division competes in the U.S. supplemental educational materials market. We believe the principal competitive factors affecting the market for our products in the school market are educational soundness, proven effectiveness, brand, features and price. Our SchoolHouse division faces competition in the supplemental curriculum market from major textbook publishers such as Harcourt (a division of Reed Elsevier), Houghton Mifflin Company, McGraw−Hill, Pearson plc and Scholastic Corporation, as well as electronic educational material and service providers such as Knowledge Adventure, PLATO Learning, Inc., Renaissance Learning and Riverdeep Group plc. Many of the companies with whom we compete have significantly more experience in the supplemental educational materials market and greater resources than we do.

In the future, large entertainment companies such as Viacom International, Inc. and Walt Disney Co. may begin to target the school markets. For a discussion of the possible effects that competition could have on our business, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Risk Factors That May Affect Our Results and Stock Price — If we are unable to compete effectively with existing or new competitors, our net sales and market share could decline.”

Seasonality
Our business is subject to significant seasonal fluctuations. For more information, see “Seasonality and Quarterly Results of Operations” and “Risk Factors That May Affect Our Results and Stock Price — Our business is seasonal, and therefore our annual operating results will depend, in large part, on sales relating to the brief holiday season” in Item 7 of this Form 10−K.

Employees
As of December 31, 2003, we had 869 full−time employees. We intend to hire additional employees as needed at each of our facilities. We also retain independent contractors to provide various services, primarily in connection with our software development and sales activities. We are not subject to any collective bargaining agreements and we believe that our relationship with our employees is good.

Executive Officers of the Registrant
The following table sets forth information with respect to our executive officers as March 1, 2004:

<table>
<thead>
<tr>
<th>Name</th>
<th>Age</th>
<th>Position Held</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thomas J. Kalinske</td>
<td>59</td>
<td>Chief Executive Officer and Director</td>
</tr>
<tr>
<td>Jerome J. Perez</td>
<td>46</td>
<td>President and Director</td>
</tr>
<tr>
<td>Paul A. Rioux</td>
<td>58</td>
<td>Vice Chairman and Director</td>
</tr>
<tr>
<td>Michael C. Wood</td>
<td>51</td>
<td>Chief Vision &amp; Creative Officer, Vice Chairman and Director</td>
</tr>
<tr>
<td>James P. Curley</td>
<td>48</td>
<td>Chief Financial Officer, Treasurer and Secretary</td>
</tr>
<tr>
<td>G. Frederick Forsyth</td>
<td>59</td>
<td>Chief Operating Officer</td>
</tr>
<tr>
<td>Timothy M. Bender</td>
<td>43</td>
<td>President, Worldwide Consumer Group</td>
</tr>
<tr>
<td>Robert W. Lally</td>
<td>42</td>
<td>President, SchoolHouse Division and Executive Vice President, Education and Training Group</td>
</tr>
<tr>
<td>Mark B. Flowers</td>
<td>44</td>
<td>Executive Vice President, Chief Technology Officer</td>
</tr>
<tr>
<td>L. James Marggraff</td>
<td>45</td>
<td>Executive Vice President, Content</td>
</tr>
<tr>
<td>Madeline T. Schroeder</td>
<td>44</td>
<td>Executive Vice President, Publishing Services</td>
</tr>
</tbody>
</table>
development expenses for our LeapPad Plus Writing, LittleTouch LeapPad and Leapster platforms, each of which were launched in 2003. We largely completed the development and engineering of our website in 2002, and the expenses related to the maintenance of the website are classified as selling, general and administrative expenses beginning in the second quarter of 2003.

We anticipate that in 2004, our overall research and development expenses will continue to increase in dollars primarily due to continued increases in content offerings and research and development of new platforms and stand-alone products, but to remain relatively flat as a percentage of sales.

Advertising Expense

Advertising expense increased by $17.0 million, or 30%, from $56.7 million in 2002 to $73.8 million in 2003. As a percentage of net sales, advertising expense increased from 10.7% in 2002 to 10.8% in 2003. Our U.S. Consumer and International segments accounted for the entire increase in the advertising expense.

The increase in advertising expense was primarily related to increases in television advertising. The increase in television advertising expense was due to a substantial increase in media time used in an effort to strengthen our brand awareness and promote our expanded product line, including the introductions of our Leapster, LeapPad Plus Writing and LittleTouch LeapPad platforms. The increase in our International segment was related primarily to our television and print advertising spending in the United Kingdom and Canada.

We anticipate advertising expenses to increase in dollars but remain relatively flat, as a percentage of net sales, in 2004.

Depreciation and Amortization Expenses (excluding depreciation of tooling and amortization of content development costs, which are included in cost of sales)

Depreciation and amortization expenses increased by $1.0 million, or 16%, from $6.6 million in 2002, to $7.7 million in 2003. As a percentage of net sales, depreciation and amortization expense decreased from 1.3% in 2002 to 1.1% in 2003.

The increase in the depreciation and amortization expense is primarily due to higher depreciation expense of computers and software purchased to support our worldwide expansion, offset by lower amortization of website development expenses. We are no longer capitalizing website development costs as our website design and development was largely completed in 2002.

Income (Loss) From Operations

Our income from operations increased by $38.1 million, or 53%, from $71.4 million in 2002 to $109.5 million in 2003. As a percentage of net sales, our income from operations increased from 13.4% in 2002 to 16.1% in 2003. The improvement was primarily due to increased sales and operating expense leverage.

Income (loss) from operations in dollars and the related percentage of segment net sales were as follows:

<table>
<thead>
<tr>
<th>Segment</th>
<th>Year Ended December 31</th>
<th>2003</th>
<th>% of Segment’s Net Sales</th>
<th>2002</th>
<th>% of Segment’s Net Sales</th>
<th>Change</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Consumer</td>
<td>$ 83.2</td>
<td>15.2%</td>
<td>$72.7p</td>
<td>15.9%</td>
<td>$10.5</td>
<td>15%</td>
<td></td>
</tr>
<tr>
<td>Education and Training</td>
<td>(0.2)</td>
<td>(0.5)%</td>
<td>(9.0)</td>
<td>(44.9)%</td>
<td>8.8</td>
<td>98%</td>
<td></td>
</tr>
<tr>
<td>International</td>
<td>26.4</td>
<td>27.4%</td>
<td>7.7</td>
<td>14.4%</td>
<td>18.7</td>
<td>243%</td>
<td></td>
</tr>
<tr>
<td>Total Company</td>
<td>$109.5</td>
<td>16.1%</td>
<td>$71.4</td>
<td>13.4%</td>
<td>$38.1</td>
<td>53%</td>
<td></td>
</tr>
</tbody>
</table>

(1) In millions.

U.S. Consumer. Our U.S. Consumer segment’s income from operations increased by $10.5 million, or 15%, from $72.7 million in 2002 to $83.2 million in 2003 due largely to strong sales growth. As a percentage of net sales, income from operations decreased from 15.9% in 2002 to 15.2% in 2003. The decline was primarily due to lower gross margin, offset by improved expense leverage.

Education and Training. Our Education and Training segment’s loss from operations improved from a loss of $9.0 million in 2002 to a loss of $0.2 million in 2003. This improvement in operating results was largely due to strong sales growth, increased gross profit margins and operating expense leverage. We anticipate the sales growth to continue, and we expect this segment to generate positive income from operations in 2004, however, we cannot provide any assurances in this regard.
The research and development expenses in our Education and Training segment, which accounted for 12% of the total increase from 2001 to 2002, was due to increased development of content and the LeapTrack assessment system.

The research and development expenses in our International segment, which accounted for 8% of the total increase from 2001 to 2002, was due to expenses associated with the localization of content to foreign cultures.

Advertising Expense
Advertising expense increased by $26.6 million, or 88%, from $30.1 million in 2001 to $56.7 million in 2002. As a percentage of net sales, advertising expense increased from 9.6% in 2001 to 10.7% in 2002.

Our U.S. Consumer accounted for 81% of the increase in the advertising expense, primarily related to increases in television advertising and cooperative advertising with our major retailers. The increase in television advertising expense was due to a substantial increase in media time used in an effort to promote our expanded product line and strengthen our brand awareness. Co-operative advertising agreements with our major retailers were expanded in 2002 to increase our advertising exposure to their large customer bases. The increase in our International segment is related primarily to our television and print advertising spending in the United Kingdom, which increased 295% from 2001 to 2002.

Depreciation and Amortization Expenses (excluding depreciation of tooling and other manufacturing equipment, which is included in cost of sales)
Depreciation and amortization expenses increased by $2.4 million, or 57%, from $4.2 million in 2001, to $6.6 million in 2002. As a percentage of net sales, depreciation and amortization expense remained flat at 1.3%.

Our U.S. Consumer segment’s depreciation and amortization expense increased by $2.4 million or 57%, and accounted for 99% of the total company depreciation and amortization expense. The increase in the depreciation and amortization expense is primarily due to increased depreciation of computers and software, amortization of intangibles and having a full year of amortization for our capitalized website and content development costs.

Income From Operations
Our income from operations increased by $54.9 million, or 334%, from $16.4 million in 2001 to $71.4 million in 2002. As a percentage of net sales, our income from operations increased from 5.2% in 2001 to 13.4% in 2002. Income from operations in dollars and the related percentage of segment net sales were as follows:

<table>
<thead>
<tr>
<th>Segment</th>
<th>2002</th>
<th>2001 Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Consumer</td>
<td>$72.7</td>
<td>$50.9</td>
</tr>
<tr>
<td>Education and Training</td>
<td>(9.0)</td>
<td>(2.3)</td>
</tr>
<tr>
<td>International</td>
<td>7.7</td>
<td>6.4</td>
</tr>
<tr>
<td><strong>Total Company</strong></td>
<td>$71.4</td>
<td>$54.9</td>
</tr>
</tbody>
</table>

(1) In millions.

Income from operations in the U.S. consumer segment increased by $50.9 million, or 234%, from 2001 to 2002. The increase is largely due to strong sales growth and our increased gross profit margins.

Our Education and Training segment experienced an operating loss of $9.0 million compared to an operating loss of $6.7 million in 2001. This increase in operating loss was due primarily to higher operating expenses and lower capitalization of content costs as compared to the prior year. This segment is in the early stage of growth, and our decision to invest in operations, personnel and product development is based on what we believe to be a large opportunity in the U.S. school market. Income from operations in our international segment increased by $6.4 million or 476% from 2001 to 2002, primarily due to increased sales and gross profit margins.
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’ 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 manner and in sufficient quantities.

We outsource substantially all of our finished goods manufacturing to eight manufacturers, all of whom manufacture our products at facilities in the Guangdong province in the southeastern region of China. One of these manufacturers, Jetta Company Limited, was the sole manufacturer of all our LeapPad platforms in 2002. We depend on these manufacturers to produce sufficient volumes of our products in a timely fashion and at satisfactory quality levels. 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 and in sufficient quantities due to capital shortages, late payments from us, political instability, labor shortages, intellectual property disputes, 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.

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 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 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. Our net income (loss) for the first through fourth quarters of 2002 was $(5.1) million, $(7.5) million, $26.7 million and $29.4 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;
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- Rapid increases in production levels to meet unanticipated demand could result in increased manufacturing errors, as well as higher component, manufacturing and shipping costs, all of which could reduce our profit margins and harm our relationships with retailers and consumers.

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. 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 2004. We are upgrading existing and implementing new operational software systems, including supply chain management systems. Further, we are planning on consolidating multiple third party distribution warehouses into a single distribution warehouse to handle our needs. 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 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 primary U.S. distribution centers, 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.
SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LEAPFROG ENTERPRISES, INC.

By: /s/ James P. Curley

James P. Curley,
Chief Financial Officer

Date: March 10, 2004

POWER OF ATTORNEY

Each individual whose signature appears below constitutes and appoints Thomas J. Kalinske and James P. Curley, and each of them, his or her true and lawful attorneys-in-fact and agents with full power of substitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this report on Form 10-K, and to file the same, with all exhibits thereto and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or his, her or their substitute or substitutes, may lawfully do or cause to be done or by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<table>
<thead>
<tr>
<th>Signatures</th>
<th>Title</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>/s/ Thomas J. Kalinske</td>
<td>Chief Executive Officer (Principal Executive Officer)</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Thomas J. Kalinske</td>
<td></td>
<td></td>
</tr>
<tr>
<td>/s/ James P. Curley</td>
<td>Chief Financial Officer (Principal Financial and Accounting Officer)</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>James P. Curley</td>
<td></td>
<td></td>
</tr>
<tr>
<td>/s/ Steven B. Fink</td>
<td>Chairman and Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Steven B. Fink</td>
<td></td>
<td></td>
</tr>
<tr>
<td>/s/ Michael C. Wood</td>
<td>Chief Creative and Vision Officer, Vice Chairman and Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Michael C. Wood</td>
<td></td>
<td></td>
</tr>
<tr>
<td>/s/ Paul A. Rioux</td>
<td>Vice Chairman and Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Paul A. Rioux</td>
<td></td>
<td></td>
</tr>
<tr>
<td>/s/ Jerome J. Perez</td>
<td>President and Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Jerome J. Perez</td>
<td></td>
<td></td>
</tr>
<tr>
<td>/s/ Jeffrey Berg</td>
<td>Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Jeffrey Berg</td>
<td></td>
<td></td>
</tr>
<tr>
<td>/s/ Stanley E. Maron</td>
<td>Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Stanley E. Maron</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Name</td>
<td>Title</td>
<td>Date</td>
</tr>
<tr>
<td>------------------</td>
<td>-----------</td>
<td>------------</td>
</tr>
<tr>
<td>E. Stanton McKee</td>
<td>Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Barry Munitz</td>
<td>Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Stewart A. Resnick</td>
<td>Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Sarina D. Simon</td>
<td>Director</td>
<td>March 10, 2004</td>
</tr>
<tr>
<td>Year Ended December 31,</td>
<td>2003</td>
<td>2002</td>
</tr>
<tr>
<td>------------------------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td><strong>Net sales</strong></td>
<td>$680,012</td>
<td>$531,772</td>
</tr>
<tr>
<td><strong>Cost of sales</strong></td>
<td>339,868</td>
<td>261,731</td>
</tr>
<tr>
<td><strong>Gross profit</strong></td>
<td>340,144</td>
<td>270,041</td>
</tr>
<tr>
<td><strong>Operating expenses:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Selling, general and administrative</td>
<td>91,619</td>
<td>80,915</td>
</tr>
<tr>
<td>Research and development</td>
<td>57,605</td>
<td>54,405</td>
</tr>
<tr>
<td>Advertising</td>
<td>73,765</td>
<td>56,722</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>7,697</td>
<td>6,648</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>230,686</td>
<td>198,690</td>
</tr>
<tr>
<td><strong>Income from operations</strong></td>
<td>109,458</td>
<td>71,351</td>
</tr>
<tr>
<td><strong>Interest expense</strong></td>
<td>(10)</td>
<td>(823)</td>
</tr>
<tr>
<td><strong>Interest income</strong></td>
<td>1,191</td>
<td>694</td>
</tr>
<tr>
<td><strong>Other income, net</strong></td>
<td>4,656</td>
<td>1,051</td>
</tr>
<tr>
<td><strong>Income before provision for income taxes</strong></td>
<td>115,295</td>
<td>72,273</td>
</tr>
<tr>
<td><strong>Provision for income taxes</strong></td>
<td>42,620</td>
<td>28,829</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>$ 72,675</td>
<td>$ 43,444</td>
</tr>
</tbody>
</table>

**Net income per common share:**

<table>
<thead>
<tr>
<th></th>
<th>Basic</th>
<th></th>
<th>Diluted</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Basic</strong></td>
<td>$ 1.27</td>
<td>$ 1.09</td>
<td>$ 0.29</td>
</tr>
<tr>
<td><strong>Diluted</strong></td>
<td>$ 1.20</td>
<td>$ 0.86</td>
<td>$ 0.25</td>
</tr>
</tbody>
</table>

**Shares used in calculating net income per common share:**

<table>
<thead>
<tr>
<th></th>
<th>Basic</th>
<th></th>
<th>Diluted</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Basic</strong></td>
<td>57,246</td>
<td>39,695</td>
<td>33,449</td>
</tr>
<tr>
<td><strong>Diluted</strong></td>
<td>60,548</td>
<td>50,744</td>
<td>38,470</td>
</tr>
</tbody>
</table>

See accompanying notes

F−4
Exhibit 12
Press Release

LeapFrog Reports 1st Quarter Results

EMERYVILLE, Calif., April 21 /PRNewswire-FirstCall/ -- LeapFrog Enterprises, Inc. (NYSE: LF), a leading developer of innovative technology-based educational products, today reported financial results for the first quarter ended March 31, 2004.

Net Sales

Net sales for the first quarter of 2004 were $71.6 million, compared with $76.7 million in the first quarter of 2003, down 7%.

Segment Results

Net sales from the U.S. Consumer segment were $46.5 million, down 22% from $59.7 million in the first quarter of 2003. Net sales from the international segment were $16.0 million, up 44% from $11.1 million in the first quarter of 2003. Net sales from the Education and Training segment were $9.1 million, up 53% from $5.9 million in the first quarter of 2003. The three segments represented 66%, 22%, and 12% of consolidated quarterly net sales for the first quarter of 2004, as compared with 78%, 14%, and 8% of consolidated quarterly net sales in the first quarter of last year.

Gross Margin

Gross margin was 44.6% in the first quarter of 2004, down from 53.0% in the first quarter of 2003. Gross margin declined largely due to a shift in the mix of products sold in the quarter from higher margin software to platforms and standalone products and a loss of sales leverage against fixed costs.

Net Loss

The company recorded a net loss for the first quarter of 2004 of $(11.8) million, or $(0.20) per share, compared with a net loss for the first quarter of 2003 of $(969,000), or $(0.02) per share.

Balance Sheet - Record Cash Flow From Operations

The company's balance sheet strengthened significantly in the first quarter as cash and short-term investments increased to an all-time high of $201 million, up 57% compared with last year's first quarter. Net cash provided by operating activities increased to $108.3 million, up 116% from last year's first quarter, largely due to the collection of year-end accounts receivable.

"While we are disappointed in the low sales in the first quarter, we are very pleased that retail consumer sales for our top four retailers (representing over 80% of our U.S. Consumer net sales) are up over 20% year-to-date," said Tom Kalinske, chief executive officer. "Clearly retailer orders in this quarter do not match our strong consumer over-the-counter sales. We also have new research that reports that the consumer ownership software-to-hardware tie-ratio for our LeapPad family (My First LeapPad, LeapPad, Quantum Pad, and LeapPad Plus Writing) has increased from a year ago, indicating a healthy business.

"This year we are actively engaged in a number of projects that bode well for the long term success of the company. We are investing in increasing our installed base of platform products, expanding our software offering, increasing our software marketing efforts, and improving our operations and systems infrastructure. We believe these steps are important to our company's market leadership in 2004 and beyond as we continue to provide enjoyable and effective learning products for all stages of a child's life."

The company is revising its published guidance to incorporate first quarter actual results and revised full year expectations based on more conservative expectations for the remainder of the year, as follows:

1. 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, April 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 the remainder of 2004. A live webcast 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 webcast will be available on these websites through June 30, 2004. To participate in the call, please dial 706-634-0183.

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 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: QUEST, MY FIRST LEAPPAD, MY OWN LEARNING LEAP, LEAPFROG, The LeapFrog Logo, LEAPPAD, LEAPPAD PLUS WRITING, TURBO-TWIST, and QUANTUM PAD 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 product introductions, intent to increase the installed base of platform products, expansion of the company's software offering, future product mix ratios and anticipated infrastructure improvements. These forward-looking statements involve risks and uncertainties, including: consumer demand for the company's products, both in the aggregate and in relation to competitive offerings; the company's ability to adjust manufacturing and shipments to meet shifting customer demand; expenses incurred by the company in expediting shipments to customers; 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 develop, introduce and market products in a timely and cost-effective manner; the company's ability to penetrate the U.S. education market and retail markets internationally; 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 2003 annual report on Form 10-K filed on March 12, 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.

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

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Unaudited)</td>
<td>(1)</td>
</tr>
<tr>
<td>ASSETS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$126,545</td>
<td>$107,807</td>
</tr>
<tr>
<td>Short term investments</td>
<td>74,124</td>
<td>20,211</td>
</tr>
<tr>
<td></td>
<td>$199,670</td>
<td>$128,017</td>
</tr>
</tbody>
</table>

### Accounts Receivable, Inventories, Prepaid Expenses and Other Current Assets

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable, net</td>
<td>69,170</td>
<td>57,989</td>
<td>281,792</td>
</tr>
<tr>
<td>Inventories, net</td>
<td>115,063</td>
<td>81,872</td>
<td>90,897</td>
</tr>
<tr>
<td>Prepaid expenses and other current assets</td>
<td>17,239</td>
<td>6,923</td>
<td>8,370</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>18,774</td>
<td>9,671</td>
<td>11,735</td>
</tr>
<tr>
<td>Total current assets</td>
<td>420,915</td>
<td>284,473</td>
<td>505,197</td>
</tr>
</tbody>
</table>

### Property and Equipment, Other Assets, Intangible Assets, and Total Assets

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property and equipment, net</td>
<td>20,923</td>
<td>20,541</td>
<td>20,547</td>
</tr>
<tr>
<td>Other assets</td>
<td>6,318</td>
<td>332</td>
<td>1,048</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>553</td>
<td>10,573</td>
<td>619</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>30,555</td>
<td>26,031</td>
<td>25,048</td>
</tr>
<tr>
<td>Total assets</td>
<td>$479,264</td>
<td>$341,950</td>
<td>$552,659</td>
</tr>
</tbody>
</table>

### Liabilities and Stockholders' Equity

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current liabilities:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$38,607</td>
<td>$23,237</td>
<td>$86,161</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>26,294</td>
<td>21,201</td>
<td>44,634</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>240</td>
<td>2,186</td>
<td>1,417</td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>3,069</td>
<td>4,729</td>
<td></td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>68,210</td>
<td>46,624</td>
<td>136,941</td>
</tr>
</tbody>
</table>

#### Deferred Rent and Other Long Term Liabilities

- **Liabilities:** 540
- **Deferred income taxes:** 31

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total stockholders' equity</td>
<td>410,483</td>
<td>291,409</td>
<td>415,146</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total liabilities and stockholders' equity</td>
<td>$479,264</td>
<td>$341,950</td>
<td>$552,659</td>
</tr>
</tbody>
</table>

(1) Derived from audited financial statements.

---

**LEAPFROG ENTERPRISES, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

(UNAUDITED)

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Three Months Ended Mar. 31, 2004</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net sales</td>
<td>$71,632</td>
<td>$76,733</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>39,684</td>
<td>36,092</td>
</tr>
<tr>
<td>Gross profit</td>
<td>31,948</td>
<td>40,641</td>
</tr>
</tbody>
</table>

**Operating expenses:**

- **Selling, general and administrative:** 26,769 21,521
- **Research and development:** 13,946 14,404
- **Advertising:** 8,685 6,355
- **Depreciation and amortization:** 1,793 1,903

<table>
<thead>
<tr>
<th>Description</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total operating expenses</td>
<td>51,194</td>
<td>44,183</td>
</tr>
</tbody>
</table>

**Loss from operations**

- **(19,246)** (3,542)

**Interest income, net**

- **245** 323

**Other income**

- **1,014** 1,604

**Loss before provision for income taxes**

- **(17,987)** (1,615)

**Benefit for income taxes**

- **(6,164)** (646)

**Net loss**

- **$(11,823)** $(969)

**Net loss per common share - basic and diluted**

- **$(0.20)** $(0.02)

**Shares used in calculating net loss per common share - basic and diluted**

- **59,373** 55,162

---

LEAPFROG ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

Three Months Ended March 31, 2004  2003

<table>
<thead>
<tr>
<th>Item</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net loss</td>
<td>$(11,823)</td>
<td>$(969)</td>
</tr>
<tr>
<td>Adjustments to reconcile net loss to net cash provided by operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>4,248</td>
<td>3,867</td>
</tr>
<tr>
<td>Allowances for accounts receivable</td>
<td>6,833</td>
<td>3,173</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>(6,942)</td>
<td>631</td>
</tr>
<tr>
<td>Deferred rent</td>
<td>(32)</td>
<td>23</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>(1,177)</td>
<td>(820)</td>
</tr>
<tr>
<td>Amortization of deferred compensation</td>
<td>481</td>
<td>557</td>
</tr>
<tr>
<td>Stock option compensation related to nonemployees</td>
<td>135</td>
<td>220</td>
</tr>
<tr>
<td>Tax benefit from exercise of stock options and other</td>
<td>3,179</td>
<td>11,194</td>
</tr>
<tr>
<td>Amortization of bond premium</td>
<td>50</td>
<td>(18)</td>
</tr>
<tr>
<td>Other changes in operating assets and liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>205,789</td>
<td>108,508</td>
</tr>
<tr>
<td>Inventories</td>
<td>(24,166)</td>
<td>2,588</td>
</tr>
<tr>
<td>Prepaid expenses and other current assets</td>
<td>(451)</td>
<td>(2,539)</td>
</tr>
<tr>
<td>Notes receivable due from related parties</td>
<td>--</td>
<td>276</td>
</tr>
<tr>
<td>Other assets</td>
<td>(270)</td>
<td>152</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>(47,554)</td>
<td>(35,606)</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>(18,340)</td>
<td>(19,332)</td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>(1,660)</td>
<td>(21,832)</td>
</tr>
<tr>
<td>Net cash provided by operating activities</td>
<td>108,300</td>
<td>50,073</td>
</tr>
<tr>
<td>Investing activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases of property and equipment</td>
<td>(4,131)</td>
<td>(4,009)</td>
</tr>
<tr>
<td>Purchase of intangible assets</td>
<td>(6,000)</td>
<td>(3,000)</td>
</tr>
<tr>
<td>Purchase of short term investments</td>
<td>(60,854)</td>
<td>(20,193)</td>
</tr>
<tr>
<td>Sale of short term investments</td>
<td>16,021</td>
<td>--</td>
</tr>
<tr>
<td>Net cash used in investing activities</td>
<td>(54,964)</td>
<td>(27,202)</td>
</tr>
<tr>
<td>Financing activities:</td>
<td></td>
<td></td>
</tr>
<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>3,410</td>
<td>9,042</td>
</tr>
<tr>
<td>Net cash provided by financing activities</td>
<td>3,410</td>
<td>11,666</td>
</tr>
<tr>
<td>Effect of exchange rate changes on cash</td>
<td>(45)</td>
<td>(57)</td>
</tr>
<tr>
<td>Increase in cash and cash equivalents</td>
<td>56,701</td>
<td>34,480</td>
</tr>
<tr>
<td>Cash and cash equivalents at beginning of year</td>
<td>69,844</td>
<td>73,327</td>
</tr>
<tr>
<td>Cash and cash equivalents at end of period</td>
<td>$126,545</td>
<td>$107,807</td>
</tr>
</tbody>
</table>

SOURCE LeapFrog Enterprises, Inc.

-0-
04/21/2004 /CONTACT:
Jim Curley, Chief Financial Officer, +1-510-420-5000, or
Christopher Bunn, Director, Investor Relations, +1-510-420-5150,
both of LeapFrog Enterprises, Inc./

/Website: http://www.leapfrog.com/ (LF)http://www.prnewswire.com

"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.

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Exhibit 13
Event Transcript

LF - Q1 2004 LeapFrog Enterprises, Inc. Earnings Conference Call

Event Date/Time: Apr. 21, 2004 / 5:00PM ET
ended March 31, 2004. I'm Christopher Bunn, the Director of Investor Relations. After the close of the market today we issued a press release detailing our first quarter results. In a minute Tom Kalinske, our CEO, will discuss LeapFrog's performance in the first quarter and our outlook. Then Jim Curley, our CFO, will discuss these results in detail and finally we'll conduct a question and answer session.

Before we begin the 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, earnings per share and retail shelf space, our ability to invent, develop and produce products and their acceptance in the markets, supply chain management and shipments, capital expenditures, inventory levels, receivables, advertising expense, tax rates, interest income or expense and SG&A expense. 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 anticipated or are not contemplated 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 the operations performance, business strategy and results of LeapFrog and could cause actual results to differ materially from those projected in such forward-looking statements. Some of these factors are described in our 2003 annual report on form 10-K filed with the SEC on March 12th, and with other filings made with the SEC from time to time, as well as LeapFrog's other published statements. LeapFrog does not update forward-looking statements and we expressly disclaim any obligation to do so. And now I would like to introduce Tom Kalinske.

Tom Kalinske - LeapFrog Enterprises - CEO

Thank you, Chris. Good afternoon. Thank you for joining us for a discussion of our results for the first quarter of 2004. Before we begin, I want to clarify a few things. When we issued first quarter guidance on March 10th, it was our view that at that stage in the quarter we had enough information to warrant an announcement, but not enough information to host a constructive conference call. In hindsight it's apparent to us that a conference call would have been appropriate if for no other
Let me assure you that we are committed to the highest standard of communication with analysts and investors and we will be achieving that going forward. In my portion of the call today I have three objectives. One, to topline our first quarter financial results, two, to provided insight into those results, and three, to share our strategies to maximize the year ahead of us. First the financials. Comparing results of the first quarter of 2003 to the results of this quarter of 2004 net sales decreased 7% from 76.7 million last year to 71.6 million this year. Our international and School House divisions grew 44% and 53% respectively, compared with the first quarter of last year, while our U.S. Consumer division declined 22%.

We are very pleased with our international and School House results, businesses that hold very strong promise for the future. The U.S. business is an interesting dichotomy. Our sell-in to retailers was weak in the quarter. However, sell-through to consumers was very strong, and based on information we have gathered in the weeks since February's fourth quarter call, we believe three main factors contributed to the first quarter sales decline in U.S. Consumer. First, retailers have been reluctant to place orders in the first quarter and to take on additional inventory.

Second, there are fewer healthy retailers with both FAO and KB Toys and others experiencing difficulties. Those two, FAO and KB, accounts made up almost 11% of LeapFrog's shipments in the first quarter of 2003. We do believe that first quarter business was lost due to the financial difficulties of some retailers, and we believe it will be partially regained by other retailers but not until the fourth quarter. Third, there is a continuing shift toward increasing seasonality out of the first half of the year and into the second.

There's no question it was a tough quarter in the U.S. retail market with much uncertainty. However, let us give you some insight as to how we as a new management team plan to lead the company in the right direction. In doing this, I cannot emphasize enough that we are building on a very strong foundation, our solid education brand. The brand equity study we conduct each year recently revealed that we have taken huge leaps in brand recognition. Our unaided brand awareness as The educational toy brand is at 52%, literally twice that of our nearest competitor. Our aided brand awareness is at 98%.

When it comes to educational heritage all you have to do is talk to a few mothers to understand the incredible relationship consumers have with our brand. We are committed to taking this company, which has come so far so fast, to the next level by focusing on the following four business initiatives. First, we are driving our high margin software business across platforms by continuing to expand our libraries and increasing our software marketing efforts. The software side of the business and our improving consumer tie ratio are the most direct tools we have for bolstering our gross margin. We expect that gross margin will improve in subsequent quarters as retailers sell through the current retail inventory, and as we more aggressively market software to customers and sell more in.

We have new proprietary research that indicates that the software to hardware tie ratio improves the longer the LeapPad has been in the home. The same research revealed that consumer software tie ratios to the installed base of LeapPad platforms, and I’m including the classic LeapPad, the LeapPad Plus Writing, the My First LeapPad and the Quantum Pad, has increased from 5.1 to 6.5 to 1 over the last year. This indicates to us that moms and dads are satisfied with the software purchase and that kids continue to use their LeapPads for years after the initial purchase. This is further confirmation that our consumer brand is strong, that consumer take away is high, and that our marketing initiatives can deliver the desired results. And it confirms that our installed base of platforms is working for us.

As part of our plan, we strategically reduced wholesale prices on our older classic LeapPad and My First Leap Pad platforms this year in order to achieve lower retail prices and drive future sales of hardware and software. This contributed to our gross margin pressure in the first quarter as, Jim will detail, but we believe that positioning our older platform products this way differentiates them from our new premium priced platform products, such as the LeapPad Plus Writing and the LeapFrog with Microphone, and that this helps drive sales of our high margin software. Our second initiative focuses on improving our internal systems in the areas of supply chain and information technology. Specifically, we are implementing supply chain information management systems in a new consolidated warehouse. All aspects of these initiatives are on track to be fully operational at the end of the second quarter, and our new supply chain management system is up and running as we speak.

These improvements are essential to our long-term growth and will benefit the U.S. Consumer division in the second half of this year with increasing returns accruing in coming years. We believe our investment and achievement in these operational initiatives bodes well for our execution in the critical second half of this year. Third, we are maximizing our consumer and retailer programs for 2004 and beyond. We are exploring
In School House, net sales were 9.1 million in the first quarter, up 53% from 5.9 million in the first quarter of last year. We are excited about the potential for our School House division for the year and we are investing in our School sales force and improving our supplemental education software offering accordingly. With it's direct selling model, the LeapFrog School House is a high margin business segment for us. And according to Simba Information, LeapFrog is the fastest growing company among the top 10 leading K to 12 instructional software publishers. We had the fastest growth in market share and the fastest growth in dollars in 2003. We strongly believe this year.

Looking forward, we are pleased that the School business is not only high margin, it's a wonderfully sticky business. While it might take longer to grow than the consumer market, School House customers make long-term commitments as they are not as prone to the changes and trends that characterize our consumer businesses. We expect the development of School House will provide us with strong stable earnings stream overtime and also lend even more educational credibility to our consumer efforts. Our international division was another bright spot for the first quarter. Net sales in our international division were up 44% compared with the first quarter of 2003. We continue to enjoy strong growth in Australia, Canada, France, and the UK, where in fact LeapPad is the number one selling product in the UK preschool electronic learning market.

We are excited about the launch of German language products in Europe in the second half of this year when our partnership with Studdlbauer(ph) commences. Our first quarter results indicate that consumers in global markets share the same commitment to their children's learning and that our business model is clearly replicable outside of the U.S. We are succeeding in our mission of global greening, the extension of the LeapFrog brand throughout the world and we have a strong commitment to international moving ahead. It's opens up vast new revenue streams for us and allows us to amortize our investment in R&D over a larger revenue base. It is also one of our long term solutions to the customer concentration issue. Our competitors do a greater portion of their business in markets that are dominated by different retailers than the U.S. Consumer market.

We believe we can grow our International business from 14% of our total net sales in '03 to about 30 to 40% in the longer term. Now, before we get into the Q&A session, I would like to give the floor to Jim Curley to discuss our financial results and expectations in detail. Jim.
Jim Curley - LeapFrog Enterprises - CFO

Thank you, Tom, and thank you all for joining us today. We achieved the high end of our March 10th revised Q1 net sales guidance of 66 to 72 million. Net sales for the first quarter of 2004 were 71.6 million, down 7% from last year's 76.7 million performance.

Our business segment sales results for the first quarter were: U.S. Consumer 46.5 million, down 22% from last year, International 16 million, up 44% from last year and School House 9.1 million, up 53% from last year. The segment sales mix was 65% for the U.S. Consumer segment, 22% for international, and 13% for School House. As Tom discussed in detail, the disappointment for the quarter was the year-over-year performance in the U.S. Consumer segment. In hindsight, we had a difficult comparison with last year's first quarter performance when the U.S. Consumer segment net sales were up 32% and were paced by a 95% increase in software sales. This quarter we experienced a 17% decline in platform sales, a 26% decline in software sales, and a 16% decline in standalone sales.

I want to note, however, that our revised full year guidance reflects positive growth in all three of these categories, platform, software, and standalone. Now our net sales mix for the U.S. Consumer segment was 28% platforms, 45% software, and 26% standalone products. The first quarter 2004 gross profit margin decreased by 840 basis points to 44.6%, from 53% last year. The decrease came from a lower margin sales mix largely due to a higher percentage of sales coming from the lower margin new platforms and a reduction in our software sales. This mix change accounted for about half of the gross profit margin decrease.

As Tom mentioned, we initiated planned price reductions to the trade on certain mature platforms, and this accounted for approximately a 100 basis point impact. And the balance of the decrease came from higher other cost of goods, largely fixed warehousing, freight, amortization and tooling depreciation expense. Additionally the lower sales for the quarter resulted in a loss of margin leverage on the fixed costs and costs of goods. Our first quarter operating expenses were 51.2 million, that's up 7 million, or 16% from last year. SG&A expenses were about 5.2 million over last year due to higher salaries, insurance, and sales commissions.

Advertising expense increased 2.3 million due to increased expenses related to in-store Leapster merchandising displays, an increase use of television advertising, and the timing of our advertising for the earlier Easter season. Our operating loss for the quarter was 19.2 million compared with a 3.5 million loss last year. Net loss for the first quarter of 2004 was 11.8 million as compared with a 1 million loss in the prior year's first quarter. In our first quarter net loss per share was 20 cents compared with last year's loss of 2 cents. Let's now discuss the balance sheet.

Cash and short term investments at March 31, 2004 were 201 million up 57% from last year's 128 million level. Accounts receivable at March 31st were 69.2 million, up 19% from 58 million last year. You know there was a lot of concern over the size of our year end accounts receivable position. At year end 2003 accounts receivable was 282 million and represented half of our total assets. We've collected the bulk of those year end receivables and accounts receivable represents just 14% of total assets at March 31, 2004. A few trends to note. Our day sales outstanding increased about 19 days year-over-year.

We've seen a pattern of slower paying by the larger retailers. Additionally, the School House receivables tend to take longer to collect. Though while schools can be slow payers, we've never had a default from them. Our net inventory of March 31, 2004 was 115.1 million, up 41% from 81.9 million last year. About 7 million of the increase came from our lower than expected first quarter sales. The balance of the increase is due to increasing ordering lead times in our manufacturing process. Our operations group has seen increased ordering lead times for chips, ASIC and LCD touch-screens. This has caused to us to increase inventory earlier in the cycle as we ramp our manufacturing for the fall.

We feel that our earlier investment in inventory is prudent in light of the our supply chain initiatives. We are insuring that inventory is in place earlier than last year to maximize customer fill rates and take the pressure off the automated supply chain through the transition period. We're debt free and our cash flow was very strong in the first quarter of 2004. Our net cash provided by operating activities was 108.3 million, up 116% from the 50.1 million in the first quarter of last year. The large increase in cash flow from operations was due to the collection of the year-end accounts receivable. We are financially well positioned to execute on all the initiatives Tom has outlined. Now, before we start our Q&A session, I would like to address going forward guidance.

This guidance incorporates both our first quarter actual results and revised full year expectations based on more conservative expectations for the remainder of the year. We are estimating net sales of 770 to 800 million, a gross profit margin for the full year of 48 to 49% of net sales, operating expenses of 33 to 35%
of net sales, a fully-diluted share count of approximately 63 million, and diluted net income per share of $1.18 to $1.28. The revised guidance for the year contemplates the sales lost in the first quarter, the increasingly difficult retailer environment, and the increased shift in seasonality. We expect our gross margin to improve as the year progresses as manufacturing volume increases and we begin to realize lower costs of production, particularly on the three new platform products introduced in the second half of 2003.

They were the Little Touch, LeapPad Plus Writing, and the Leapster. Finally, concerning expenses. As we said in March we remain committed to investing in our technology and our product line for 2004 and beyond. In addition we are investing in infrastructure and system improvements this year that we expect to benefit business for many years to come. This concludes the review of our recent financial performance and our guidance. I will now turn the call back to Tom.

**Tom Kalinske - LeapFrog Enterprises - CEO**

Thanks, Jim. We appreciate the constructive feedback all of you have given us in the past few weeks, particularly regarding our first quarter guidance announcement. We also know that the best thing we can do for you is to deliver strong results as we have done in the past. And we're focused on doing exactly that.

We're making long term investments in our ability to manage our business, our inventory, and meeting consumer needs, and developing and delivering great educational products for the future. Remember, we had a net sales compounded annual growth rate of over 75% over the past four years, and a net income compounded annual growth rate of 162% during the sale period. A company that grows this fast is likely to have a few growing pains to work through. This year we are building our infrastructure to catch up with this growth. We are laying a new foundation to provide the base for the next phase of LeapFrog growth. We are very excited about the management team we are building at LeapFrog, we are assembling a team of leaders who specialize in the areas we need to address to get this company through our next stage of growth.

We have a very exciting product line for 2004. Not many companies can boast 20% plus over-the-counter sales growth at this stage of 2004. Our strong POS and improving consumer tie ratios confirm that consumer demand for our products remain strong. Consumers recognize the LeapFrog brand, and expect products with the LeapFrog label to be engaging and deliver educational value. We're really proud of the difference we make in the lives of children and we hear from happy parents every day. We are committed to building an education brand that kids, parents, and teachers value and to building a company that delivers strong return to its stockholders. Now operator, let's begin the question and answer portion of the call.

**Questions and Answers**

**Operator**

At this time, I would like to inform everyone in order to ask a question, please press star then the number one on your telephone keypad. We will pause for just a moment to compile the Q&A roster. Please hold for your first question. Your first question comes from the line of John Taylor.

**John Taylor - Arcadia - Analyst**

Hi. I've got a couple of questions. Let me see. First I want to touch on the chip lead times. Could you expand on that a little bit. How long have you been aware that things are tightening up, and is this likely, from your perspective, to become something that we're going to be hearing about as we go through the year? That's the first question. And then the software mix. You've got Spiderman, Shrek, some other licensed product in there, can you give us a sense of what percentage of software dollar sales externally licensed software were last year and what you expect it to look like this year? And then finally, Tom, I was interested in your comments about cumulative tie ratios. Have you got any studies that might indicate how much of that comes from a platform being used by multiple kids and kind of being handed down, and just becoming part of the family for a number of years, and work it through that way. Thanks.

**Tom Kalinske - LeapFrog Enterprises - CEO**

Thanks, JT. Let me try take them in order. On the chip lead times and touch-screen LCD lead times, I believe we became aware of the need for longer lead times in this first quarter, and in way, it benefits us, because by making longer term commitments, we can keep our costs in line, and I think some other people might be having some difficult on chips and touch-screen LCDs, so I think it's beneficial to us to take those parts and components in earlier. On the software mix in sales this year versus next, I'm going to have to turn that over back to Jim, if you can find that in the info. I'm not Jim handle that in a second. On the tie ratios, we just completed this study that gave us, actually, very complete information on tie ratios, and
there probable is data in there on the handed down versus single child user, but I really cannot recall it. I will tell you that one of the other encouraging parts of that study was that there is a group of heavy users of LeapPad products and software who have extremely high tie ratios, much higher than the 6.5 to 1 that I mentioned, and we think that is also very encouraging for us. And let me see if Jim has an answer on our software mix question, now.

Jim Curley - LeapFrog Enterprises - CFO

On the licensed titles versus nonlicensed, for the last few years, we've really provided guidance that we target about 40% licensed and 60% nonlicensed. I think that's a good guide to use going forward. Certainly with the Leapster we're seeing licensed titles selling very strong. That may lead to increase in the mix there on the Leapster platform, but overall, I think 40% license is still a good percentage to use.

John Taylor - Arcadia - Analyst

Okay. Thank you.

Jim Curley - LeapFrog Enterprises - CFO

You're welcome.

Operator

Your next question comes from the line of Lauren Fine with Merrill Lynch.

Tom Kalinske - LeapFrog Enterprises - CEO

Hi, Lauren.

Lauren Fine - Merrill Lynch - Analyst

Hi, there. I've got a few questions as well. On the shelf space, I'm wondering if you could comment, does that increase also incorporate the expansion into other areas of the store, such as the infant area? Secondly, I wondering if Jim could provide us with the gross margins for the three segments, and maybe your outlook on those gross margins for the rest of the year. I guess I'm also wondering if you could help us understand the year ago impact of the retailers that are under pressure right now, such as KB and FAO Schwartz, so that we can anticipate that in future quarters, which I guess leads to another one which is the shift at seasonality. Should we assume that the second quarter will be weak as well as more shifts to the second half, and does that account for the change in revenue guidance that goes beyond the shortfall in the first quarter?

Tom Kalinske - LeapFrog Enterprises - CEO

Well, I'm writing fast, Lauren, thanks. On the first question, yes, the shelf space increase, actually the shelf space increased this spring, doesn't include much for infant or JP, because we haven't shipped the JP product line yet, but in the fall, the shelf space increase does incorporate getting some space in the JP product area. And by the way, we think that's all very, very positive for us. It also includes a little bit of space for our video products and DVD products, as well. I'll turn this back to Jim on the gross margin question in a second. On the year ago impact of KB and FAO, we mentioned on the call already, that they were about 10% of our business in the first quarter. That is the largest percentage of our total business in a quarter they amounted to through the year. I think, again, I'll let Jim answer for the full year, but it was not anywhere near that significant as the year went on, but they were heavy purchasers in the first quarter last year. We aren't really commenting specifically on the second quarter. I think all of you have already provided estimates for the second quarter. But clearly we've taking down guidance for the whole year, and so some portion of that would have to come out of the second quarter. So let me turn that back to Jim now on the gross margin question.

Jim Curley - LeapFrog Enterprises - CFO

Yes, Lauren, we will give you the gross margin by segment. In the first quarter, U.S. Consumer was 41.9%, international 45.1%, and School House 57.3%.

Lauren Fine - Merrill Lynch - Analyst

And a sense for the year of how those might play out?

Jim Curley - LeapFrog Enterprises - CFO

I would give you little broader ranges, but U.S. Consumer 46 to 47%, International 50 to 51 and School House, 64 to 66%.
Great. And if I could just slip in one other. What was the impact of foreign exchange on revenues in the quarter?

Jim Curley - LeapFrog Enterprises - CFO
It was 2% on the total company and 9% on the international segment's sales.

Lauren Fine - Merrill Lynch - Analyst
Terrific. Thank you very much.

Jim Curley - LeapFrog Enterprises - CFO
You're welcome.

Operator
Your next question comes from the line of Sean McGowan, with Gerard Clower Madison.

Sean McGowan - Gerard Clower Madison - Analyst
The old names, Gerard Clower. Hi, guys.

Tom Kalinske - LeapFrog Enterprises - CEO
Hey, Sean, how are you?

Sean McGowan - Gerard Clower Madison - Analyst
A couple of questions, and Jim if I could ask you just to repeat those gross margin figures that you just gave for U.S. you said 40, 44?

Jim Curley - LeapFrog Enterprises - CFO
The ranges?

Sean McGowan - Gerard Clower Madison - Analyst
No no, what it was in the quarter.

Jim Curley - LeapFrog Enterprises - CFO
Oh, for the actual quarter, the first quarter. It was 41.9% for U.S. Consumer, 45.1% for international.

Sean McGowan - Gerard Clower Madison - Analyst
Okay.

Jim Curley - LeapFrog Enterprises - CFO
And 57.3% for School House.

Sean McGowan - Gerard Clower Madison - Analyst
Okay. I had a question for Tom. Looking at how much inventory you have now and the fact that there was a fair amount of Leapster that -- you couldn't find Leapster before Christmas, you could find it after Christmas. It suggests that was shipments of Leapster going on very late in December, and I'm just wondering what drove that decision knowing that it's an $80 product with $20 plus software. Why wouldn't you have held off on those late December shipments.

Tom Kalinske - LeapFrog Enterprises - CEO
I think I've mentioned this before to others. I think Leapster was one of the most unusual phenomenons I've ever lived through in 35 years of this business. We had demand, unrelenting demand, unrelenting pressure from our retailers very late in December that we had to ship them the product or else and so we did And one could argue now in hindsight whether that was the smartest thing in the world to do or not, but we did it, and we did it: not because we were forcing it down anyone's throat. It was quite in the reverse of that. They were forcing us to step up and continue to ship after Christmas.

Sean McGowan - Gerard Clower Madison - Analyst
So they thought the product would sell well out of season?

Tom Kalinske - LeapFrog Enterprises - CEO
Apparently so. And by the way, it hasn't sold badly, it's sold very well.
Right, relative to the time of year, it's just that you couldn't keep it on the shelves before Christmas, and a little easier now.

Regarding your comments on shelf space, it would appear that certainly at the moment at many retailers, it's less than it was in November. For example, at Toys 'R' Us, looks like they've wedged their own private label educational electronic products deep into the LeapFrog territory there. How do you expect that shelf space increase to play out. You had a whole aisle at Target, for example, how are you going to get more. You had pretty much that whole corner at Toys "R" Us, how's that going to look?

As you know, from the October, November, December period of time all of toy space decreases for us to the spring period of time. And as we commented, our spring space this year is up double digits, very nice double digits, high double digits, versus year ago spring. However, it's down considerably from where it was in November and December, and that's just one of these phenomenon that happens to us. And so if we're at 32 feet in a national discount retail store in December, and we drop to 16 feet for the spring set, in that 16 feet is a 15% increase over a year ago, it's still really hard to fit 32 feet into 16 feet if there is anything left on the shelves at all. So it obviously has an impact on us. Now, to your question are we going to get it back? Yes, we are. We're getting it back and more at Toys "R" Us and at everyone else.

If you look at the Target reference that I think you're referring to, where is it going to show up if you had basically the whole run, that whole 32 foot run? Is it going to show up in a different aisle, or an end cap, or what are the economics of all that?

Two other questions, one quick. I don't know if Jim has these numbers, can you give us an update on whatever your best guess is of market share, and maybe the second question there is more for you, Tom. Can you talk about efforts you have under way for the medium and longer term to address the tweens, teens and maybe even adults. If we're going to be an education company, how far up can we go in age.

Sean, let me take the market share one, too. We relade market share information to everyone the end of last year, when we had very good data on it. The problem with the first quarter, as you know, Sean, probably better than most of us on this call, is there isn't any more real good industry wide data on market share. The President of MPD was here today, and we were sort of moaning over the fact that their -

Was he looking for a job?

No, no, that's very funny. Their first quarter information, I mean, frankly, you can't use it, because it's a panel that has responded -- e-mails go out, 30,000 e-mails go out, and some people respond on what their purchases were over the last seven days. Obviously they don't get a lot of response in the spring or summer time. The data becomes relevant and becomes important and becomes statistically accurate in the heavy season, in the fall and Christmas seasons. So we don't have a share of market data, but you know we gained substantial share of market in the preschool category, in the ELA category, and in the infant category over all of last year. And those share gains, in our minds, still remain in effect, because we are, I think, the only one who still has something like a 20% plus increase in over-the-counter movements. So it would be very hard for our share to have declined. Having said that, now you asked a question about teens and tweens. That is an area of emphasis for us. As you know this year we've refreshed a couple of our products, the
iQuest, in particular, and the Quantum Pad, and we also introduced a new Turbo Twist Extreme platform for the tweens. We believe that they will be successful in '04, but more importantly it is an area of emphasis going forward in '05, and we have in the works some very exciting tween and teenage products for '05 and even beyond.

Sean McGowan - Gerard Clower Madison - Analyst
Would you think we'd expect to see some of that late '04 introduction? I mean not introduction to the trade, but demonstrations (inaudible) Toy Fair?

Tom Kalinske - LeapFrog Enterprises - CEO
Yes, we will demonstrate it, probably, in the October period of time.

Sean McGowan - Gerard Clower Madison - Analyst
Okay. Thank you.

Operator
Your next question comes from the line of Jill Krutick with Salomon Smith Barney.

Jill Krutick - Salomon Smith Barney - Analyst
Good afternoon.

Tom Kalinske - LeapFrog Enterprises - CEO
Hi, Jill.

Jill Krutick - Salomon Smith Barney - Analyst
Hi. Could you maybe elaborate a bit on the operating and systems infrastructure developments that are occurring and the investments you're making in key areas you're focusing on there? Secondly, could you provided a little bit more detail on the price reduction strategy, perhaps give us a sense of how much the decreases were among the platforms and has it affected the software, as well. I'm also curious if you can give us a sense on the sell through, how it performed hardware versus the software year-to-date that similar growth rate that you provided overall, and finally, I'm just curious, Tom, given an industry that historically has been a pretty slow growth industry, LeapFrog's performance this year clearly is sort of an off trend kind of performance. What do you think is a realistic sort of growth trajectory for revenues on the consumer business specifically for LeapFrog. Thank you.

Tom Kalinske - LeapFrog Enterprises - CEO
Thanks, Jill. Let me take them a little built out of order because I'm thinking as I'm writing your questions down here. On the pricing strategy, this is not any different, or very different, than what we've been doing. If you recall, the Basic LeapPad when we first introduced it, its first year, was $59 retail. We then reduced price to the trade the next year, while maintaining, I believe, both our own margin and their margin, and had a $49 platform for the next year. Last year, we did the same thing and had a $39 retail priced platform last year. So I don't think this is anything out of the ordinary for us. I mean it pretty much coincides with what goes on in other platform businesses. I believe the PlayStation 2 is considerably lower in price today than it was when it was introduced. And obviously you do these things as you achieve cost reductions and you do it to try to provide margin for your retail partners and you do it because you're going to get more hardware out and you're going to sell more software. So I don't think it's anything out of the ordinary. Specifically, we're now at a price where I believe we'll see LeapPad, Basic LeapPad, at 34.95. I suspect some folks might, on promotion, go lower than that in the fall. And My First LeapPad is probably $29.95. I'm trying to remember the rest of your questions. On the operating system side, what we are doing is really three main components of our supply chain. We are in the middle of our supply planning system implementation, and as I indicated in my notes, that's up and running, and we're working with it. Now, obviously, when I say that, it is working and people are being trained and at the same time we're utilizing our older system simultaneously so we don't have any glitches, but it is running and we're all happy with that. There are other aspects of our supply chain that need to be put into effect. One is demand planning. That's a custom system that we're working on and that also is very far along in its development. And then a purchased allocation planning system that will be up and running by the second quarter. On top of that, we're putting in a new warehouse management system. Well, we're putting in a new warehouse, to start with. I guess that's perhaps more important. We're consolidating four warehouses into one much more efficient warehouse and we're putting in a new warehouse management system to help us, obviously, manage all that goes on there in the way of purchases, parts, finished goods, and logistics, so that's basically what we're
doing there. Your other question was sell through? By component, I'm not sure we ever break that out. Do we? My colleagues are saying we don't break that information out.

Operator
Your next question comes from the line of Brandon Dobell with Credit Suisse First Boston.

Brandon Dobell - Credit Suisse First Boston - Analyst
Hi, guys.

Tom Kalinske - LeapFrog Enterprises - CEO
Hi, Brandon.

Brandon Dobell - Credit Suisse First Boston - Analyst
A couple of things. Maybe you could talk a little bit bigger picture on the progression on platforms. How the gross margins kind of start out and where they get to over a two or three year period, given the kind of the pig in a python, here we've got a bunch of platforms coming through back part of '03 into '04. Just want to get a sense for how we should think about how those margins progress into '05. Also want to get a sense on shelf space. As you get closer and closer to the fall, how much variance do you end up seeing around original plans. Do retailers say look I want to do X% more, and then as you get closer to September, as they're building out their fall sets, it's X plus 5, or X minus 5? Just trying to get a sense on that. And then finally, I think, Jim, you mentioned in your comments about a potential shift in seasonality. I think that question might have been asked before but I didn't catch the answer. Just want to follow back on it. Still a little more color on what you mean by that comment. And that'll be it. Thanks a lot.

Tom Kalinske - LeapFrog Enterprises - CEO
Okay, thanks, Brandon. Obviously our platforms always start with lower gross margin than they achieve later in their life cycle, even though we often do take the effective retail price to the consumer down over that life cycle. We've been fortunate in that some of our platforms have, after a few years, been in the 50% gross margin range, but not all. This last year, the two that we mentioned previously as being particularly low in gross margin were the Little Touch LeapPad, and of course the Leapster, which we, I think, announced as our lowest gross margin platform. By the way, it is a positive gross margin, it's certainly not break even or negative. And we expect both of those to increase over time. We aren't expecting as much of an increase in gross margin on Leapster this year as we would in future years, we are expecting a fairly significant increase in the
Little Touch over this year. And I don't think I can get too much more specific than that, but they obviously do improve over the years, and every one of them have. In terms of shelf space, we tend to simplify an awful lot of these things. I think one of the major retailers actually with us has something like, depending on the size and productivity of the stores, they have something like 9 or 10 different layouts for our product line at retail. So when we give you numbers, we often are averaging these things, so it's a bit more complex than it sounds. However, having said that, once management of retail decides, and they make those decisions, they just made them very recently for the fall on their commitments to different manufacturers on space for the fall, those things are pretty solid. Sure, there could be some change to them, but they're pretty solid, so we're not going to shift from having this double-digit increase to having a double digit decrease. That is not going to happen. Will there be shifts in some of these modules depending on the type of store? Certainly. But it isn't going to be that dramatic. And your last question was for Jim, on seasonality.

Brandon Dobell - Credit Suisse First Boston - Analyst
Okay, appreciate it. Thanks a lot.

Jim Curley - LeapFrog Enterprises - CFO
Okay.

Operator
Your next question comes from the line of Raj Sharma with Merriman Curhan Ford & Co.

Tom Kalinske - LeapFrog Enterprises - CEO
Hi.

Raj Sharma - Merriman Curhan Ford & Co - Analyst
Hi, guys. I wanted to ask you some color on potential legal costs this year, and could you talk a little bit about any developments in the class action lawsuits, and also against Mattel. Second question, any efforts on expanding your retail distribution outlet away from the top 4? And then I have a more sort of long term question about your plans to use your technology platform. You have a really good platform do you plan to use it in other modes for adult education or looking at it purely as an educational company?

Tom Kalinske - LeapFrog Enterprises - CEO
Thanks, Raj. On the legal front, our lawsuit is proceeding, if that's what you're referring to, against Fisher Price Mattel, and we really can't comment on it other than that, in terms of what it's costing. In terms of distribution plans, yes, we have fairly good distribution in a number of other areas. We're one of the few that have some distribution in book stores. We have very good distribution in electronic retailers, such as Best Buy and
Circuit City, and those will be increasing this year, and we have distribution in some of the office supply firms, as well. We have not gone to places like grocery and drug, yet. That is a possibility. We’ve been concerned that we need to make certain we can keep our current group of retailers happy before we expend a whole lot further in distribution. In terms of the platform use by older age consumers, yes, that’s very much in the plans. We do have in some initiatives underway this year. We will be able to talk more about those, oh, I would guess in the late summer. For this year, they won’t amount to too much revenue, but they are quite interesting and hopefully they will grow into more revenue in the future, but we agree with you, our technology and our platforms do have use in other areas of education and training for older audiences.

Raj Sharna - Merriman Curhan Ford & Co - Analyst
And then I just have one last question. We’ve been hearing a lot about shipping issues and about infrastructure in general in China sort of bursting at the seams, is there any concern that your manufacturing or your shipping could get affected?

Tom Kalinske - LeapFrog Enterprises - CEO
Well, you always have the concerns with China and the way we mitigate those concerns is by more than dual sourcing every product and every component so that if there is any issue in any particular vendor or any particularly port that we have some coverage for those issues, and that’s how we plan around it. But I have not heard anything that would indicate that there’s anything on the horizon for at least this year that’s abnormal or out of the ordinary, and also, thank god, there is no indication there would be a dock strike or anything like that that would affect us on importing from China.

Raj Sharna - Merriman Curhan Ford & Co - Analyst
Thank you. My questions have been answered.

Tom Kalinske - LeapFrog Enterprises - CEO
I’ll start, because I’m only going to answer your one on the double digit space. That was, in fact, thank you for clarifying that, that was with the top 4 retailers. I actually don’t have a comparable measurement for everybody else, but for the U.S., they are over 80% of our business, so it’s pretty relevant, and Jim will answer the DSO and other question.

Jim Curley - LeapFrog Enterprises - CFO
Yeah, Gary, on DSOs, yes, internationals, primarily France and the UK. We've adopted what are local customs on the dating. However, most of the business is still in letters of credit, so we’re pretty secure, but it does bring out the days longer than the 60 days that some of the larger U.S. retailers would take. And what was your question again on slow paying?

Gary Cooper - Banc of America Securities - Analyst
Just wondering if that has to do with the time of the year, or if we should expect DSOs to be up in the remaining three quarters, as they’re going to be slow paying from this point forward.

Jim Curley - LeapFrog Enterprises - CFO
That’s a good question. I said we were up about 19 days, which is, fortunately the receivable balance is very, very small at this
time of year, so from an exposure standpoint, nothing like being up at the end of the year. Actually, it changes pretty dramatically. DSOs were up 12 days over last year as we speak this week, so it can swing pretty widely. Since we're concentrated so much with the big customers, it's great that they're very credit worthy. We adopt the squeaky wheel gets the oil. I mean that's really the best we can do and we push to make sure if they have any documentation questions like delivery proof, we get that to them as fast as possible. I think it's hard to predict, but we do have a system too that tracks how quickly they pay, and how many days past due they are, so we try to stay on top of that and communicate and escalate it. I would say the indication now is 19 seems extreme. I would expect it to be lower than that, but certainly higher seems to be the pattern everyone is taking than last year, so probably a margin of 5 to 10 days on last year's levels.

Tom Kalinske - LeapFrog Enterprises - CEO
You had a question on operating expenses.

Gary Cooper - Banc of America Securities - Analyst
Yeah, as per the guidance of the Q4 conference call.

Jim Curley - LeapFrog Enterprises - CFO
You mean our previous guidance on operating expenses?

Gary Cooper - Banc of America Securities - Analyst
Yeah. So, for instance, if I keep the operating expenses sort of flat on a dollar basis with that guidance, I come up with a lower EPS, you're providing guidance to a higher number. It looks like something's ticked down and you mention the Mattel situation, you can't comment on that, I'm just wondering if it's advertising dollars, or if something else has been brought down in the budget.

Jim Curley - LeapFrog Enterprises - CFO
Believe me, we've put a lot of focus on what we say we're continuing to invest in R&D and in longer term projects. We've put a lot of scrutiny on our expense line, and you're correct, in that we've been able to come out with more leverage on our SG&A. I mean, that's our intention. I think I would steer you away from the previous guidance. What we just published now at 33 to 35% on the sales range are the correct numbers to use. We gave 20 to 25% increases previously, use the 33 to 35% that we just put in this press release. Okay?

Gary Cooper - Banc of America Securities - Analyst
Okay.

Operator
Your next question comes from the line of Tony Gikas with Piper Jaffray. Hi, Tony. Good afternoon, guys.

Tony Gikas - Piper Jaffray - Analyst
A few questions here. Not to beat the supply chain initiatives to death, but maybe you could just characterize for us where we are with these new initiatives. Are we in the third inning here and where will we be come September, October, do we get these initiatives all the way there this calendar year. Second question, the first half of the year, Q1 and 2, are typically characterized by higher tie ratios on the software side of the business. It's not really clear that we're experiencing that right now. Maybe you could elaborate on that if there is something going on there we should be aware of. And then the third question, does your current guidance account for reduced orders from Toys 'R' Us, or if there should be a change in the store count with them over the next handful of months, could that change your guidance for the year?

Tom Kalinske - LeapFrog Enterprises - CEO
Okay. I thought I answered the supply chain one, but I'll try again. We're well into this. I don't know which inning you would call it, but it's certainly not the third, maybe it's the 7th, and we expect that we will be fully operational and utilizing all of these things at the end of the second quarter, and yes, it will have a positive impact on us for the heavy fall season and will be completed this year, obviously. Hopefully that answers that. The Q1 Q2 tie ratio, I think what you're speaking of is a different, I don't want to confuse everybody on the call, but I think you're speaking of tie ratio on our shipments into retail, and what I was speaking of when I gave the numbers on tie ratios was actually families experience in home, what they believe their tie ratio is using the LeapPad and the LeapPad family of products, and that's when I said 6.5 to 1, that's what it has increased to from a year ago when it was 5.1 to 1, so we saw a full one over one point increase in our tie ratio over the
last year, which we consider very, very encouraging. By the way it ties in with previous research we've had which indicated that moms thought that on average they would use something like 7 titles with their LeapPad for the child in the home. In terms of the current guidance, yes, we obviously are being a hair more conservative and we are attempting to account for -- we obviously do not know what Toys 'R' Us is going to do, but we are attempting to account for whatever Toys 'R' Us might do.

Tony Gikas - Piper Jaffray - Analyst

Thanks.

Operator

Your next question comes from the line of Mike Wallace.

Tom Kalinske - LeapFrog Enterprises - CEO

Hi Mike.

Mike Wallace - Analyst

Hi guys. A couple of questions. First, question on the tie ratio,Tom. You said 6.5 to 1. You're not talking about actual sell through. Are you defining a tie ratio by software sold in a year compared to one platform in a year? Or are you looking at life time platforms?

Tom Kalinske - LeapFrog Enterprises - CEO

Yeah, we're looking at life time. So for an average home that has a LeapPad, they now have 6.5 titles in the home, as compared to the same home had 5.1 a year ago.

Mike Wallace - Analyst

Okay. Do you know what it is on an annual basis? I'm trying to get at per year with each LeapPad. How many pieces of software purchased?

Tom Kalinske - LeapFrog Enterprises - CEO

I didn't bring the full study into this room with me. I'm sure we do have that and I can get back to you with that.
moms are purchasing more than one LeapPad if there are siblings in the home, because the product is apparently being used so much or maybe they want a pink one for their daughter and the classic green one for the son. What was your other question.

Mike Wallace - Analyst

I just have one more follow up on the DSO question. Intuitively slow selling and strong sell-through, as you characterized it, that would mean I would think materially lower, not higher DSOs, and does this imply that there is a lot of channel inventory out there? Because if the DSOs are this high and not a lot of new product was sold in, that would tell me that there's probably still some Christmas stuff out there in the channel that hasn't been paid for. Am I looking at this the wrong way?

Jim Curley - LeapFrog Enterprises - CFO

I think, yeah, that's not how we would evaluate it, Mike. Clearly, when we started this quarter off, when I look at last year's first quarter, the bulk of the sales came in February and March for us this year. January started off slower. That gives a certain factor to DSOs, because if you do more sales at the end of the quarter. Those payments are not actually due until the next quarter, so we definitely had that factor, but as to trying to correlate increased DSOs, to me it's a pattern of slower paying that we're seeing pretty much across the different retailers, and like I said, School House represented a part of it. We had a very large sale, if you want to get more specific, it was the largest sale in School House's history in December to the LA Unified School District and since it involved 250 schools, we're still working with the school districts to providing proofs of delivery and we'll get paid on that but it will be in the second quarter. So I don't see anything other than a pattern of slow paying.

Mike Wallace - Analyst

Okay.

Tom Kalinske - LeapFrog Enterprises - CEO

Mike, the other thing is, as Jim mentioned, the DSOs was 19 days up over a year ago at the end of the quarter, but as of today it's up 11 days or something like that, so it's come down.
always go wrong. I mean, the economy can turn around or go the other way. Right now, the economy seems to be getting stronger, so I think that's working in our favor. Obviously, we need a healthy retail channel and we need that retail channel to remain strong, and we're all anxiously waiting to see how that resolves itself over the next few months, but we would like to see it healthier than it is today. Other things that could go wrong. I think we're in pretty good shape on all of our parts and components and engineering and schedules, but you can always have negative things happen to you there, and I think you're aware of that but we're trying to give you a range in our guidance that we're be comfortable with, and I think we're done with that.

Christopher Bunn - LeapFrog Enterprises - Director of Investor Relations

Operator, if there's one more question, we would like to take that.

Operator

Yes, sir, we do have a followup from John Taylor with Arcadia.

Christopher Bunn - LeapFrog Enterprises - Director of Investor Relations

Thank you.

Operator

You'll welcome, one moment.

John Taylor - Arcadia - Analyst

Keep this nice and short, maybe. There's going to be a lot of streaming video coming out on portable platforms, I wonder if you could talk a little bit about what you're thinking about along those lines. Thank you. Thanks, JT.

Tom Kalinske - LeapFrog Enterprises - CEO

Yes, on our Leapster, we have the capability of using full color streaming video, and we will be doing so in some of the new products that are coming out this falling. Now, most of what we will do will have educational content in between streaming video elements. So in other words if we have a licensed title and we're showing some movie footage from a well known popular soon to be released children's movie, in between that footage we will have some lessons and some educational value included and it will go back and forth between educational content and streaming video. On the other hand, for our own videos, where it's completely educational, in other words our Talking Words Factory DVD, which is one of the better selling children's videos today, we will have it soon available on the Leapster, and you can just put the cartridge in and watch the entire 30 minute show on your Leapster just as you would on a television.

John Taylor - Arcadia - Analyst

Have you decided on where the pricing is going to be for the streaming video, the entertainment plus education.

Tom Kalinske - LeapFrog Enterprises - CEO

Yeah, it's going to be the same as our current Leapster software pricing.

John Taylor - Arcadia - Analyst

Okay, great. Thank you.

Tom Kalinske - LeapFrog Enterprises - CEO

Thank you very much.

Operator

This now concludes the question-and-answer session, I will now turn the conference back over to Tom Kalinske.

Tom Kalinske - LeapFrog Enterprises - CEO

Okay. Thank you for joining us today and this afternoon. Our next quarterly conference call will be during the week of July 18th. Thanks again.

Operator

This now concludes today's conference. You may now disconnect.