Exhibit 3
Event Transcript

LF - LeapFrog Enterprises, Inc. at ThinkEquity Partners Growth Conference

Event Date/Time: Sep. 17. 2003 / 6:00PM ET
Thank you. Where is the button to push? Oh, I just do like this? Got it. That's me. I'm Tom Kalinske, and I know you're familiar with our forward-looking statements provision. We'd like to start with the LeapFrog vision, and we actually talk a lot about our vision at LeapFrog, 'cause we live it every day. We intend to become the leading brand for technology-based educational products for school or home use for all ages around the world.

We're not there yet. We've got a long way to go. We're not all the way around the world yet. We're not all ages yet and we're just beginning to penetrate the school market. So, why do we say quality-based technology products? We're an unusual consumer products company in that we design our own application-specific chips.

We do this down in our Los Gatos office that's run by two guys who happened to have been roommates at MIT's graduate school of engineering together. And they stayed together through a couple different companies in the high tech business and they are very, very talented guys. And they manage a team of 80 people down in Los Gatos. And why we design our own chips is because then the products do exactly what our educators and our designers want them to do.

We're not left in a position where we have to clooge together somebody's risk chip, somebody's speech chip, somebody's music chip, memory chips and other things, and make them work, because our products do exactly what the desires in [audio gap] large chip.

That same functionality today cost us about $3 ½. So, it's a huge cost advantage for us. It's about education. Everything starts with education in our company. We start with what problem, what educational issue do we need to solve? It's the way we started the company with phonics. We learned a lot about how do you teach phonics.

We actually have an education advisory board run by Dr. Robert Calfee, who was dean at the graduate school of education at Stanford for many years. He's currently the dean at UC Riverside. He runs our advisory board and has a number of noted educators on that advisory board.

But perhaps as importantly, we have about 100 educators on staff in house who have masters or Ph.D.s in education. So, every product we make has curriculum built into it. We figure the curriculum out first and then we determine, how do you make it fun and interesting for kids?

Next slide. We say we're in home use. Obviously we are. We're in about 13 million homes today with our platforms, and we're in about 15,000 classrooms with a different set of products. Our school products are completely different than our home products and we'll get into that in a second.

Next slide. Our ages. A few years ago we entered the infant market. We weren't in the infant market longer than two years ago. The end of last year we already had 10% of all products sold for infants in retail America. So, we think we've been successful with just a few products. We're certainly increasing the number in products that we're bringing out. But at the other end of the spectrum, we have products to help your high schoolers get better grades on their SAT or ACT tests. And, of course, the bulk of our product range is actually in the middle for the 4 to 9-year-old child.

Around the world, well, not quite around the world, but the green stars indicate where we have our own offices and our own companies. This year we're very pleased to have opened offices in France and Mexico. We see those two markets as big growth opportunities for us.

You probably are aware we went into Canada and the U.K. after the United States, obviously. And by the way, in the U.K. everything is done in the Queen's English and is done according to the U.K. system of education. And those are very strong markets for us. Now, obviously they are English speaking even though it's a different English. We're now the number one preschool company in the U.K., and the LeapPad is the number one selling product there. We hope to have the same success in France and Mexico.

We, in other markets, work in a different way. We work through distributors. It's not as ideal a way for us to do business,
but it at least gets our brand name across the world and gets some good business for us. In Japan we work with Vanessa (ph) as a partner in the education market. Vanessa (ph) is the largest home schooling, home tutoring company. I should say, company in the world and we do quite a bit of business with them in that market. And we work with Sega for retail business. Next slide.

Where have we come from? A few years ago, three years ago, we were the seventh largest, if you call us a Tory (ph) company, and people do because so much of our product sold at Tory (ph) retail counters. We've grown into the third largest company and it will be a while before we pass Hasbro and Mattel, given their size.

Are we highly positioned for continued success? Well, we have a big market in front of us, and I talked a little bit about why are parents buying educational products? One reason is we all care about our kids' education. The other is, there is a crisis in public school education and that crisis, in a perverse sort of way, is helping our business because we sell supplemental products for helping with what goes on in the school.

Furthermore, we're a little different than a toy company. Most toy companies have a 3 to 7 age market. We have a 0 to 17 age market, so, there's literally 40 million more folks in our market than the typical toy company. We already have high brand awareness.

In just a few years we've now got, if you go out and do research unaided or aided, we're the number one cited company for educational products. We've become a recognized authority in a relatively short period of time, and this is about what we look like at retail. We have over 100 content titles at retail today.

This year we're entering, we have yet to do it, but we're about to enter the portable handheld, color portable business with a product called the Leapster. This will ship to retail America on November 1st for an early November street date, where hardware and software will all appear magically at all retail stores in America at the same time.

It's a very exciting opportunity for us because now we're not really competing with Gameboy, but we're providing an alternative. Now you can have all educational game content on a handheld device for your 4 to 8-year-old initially and then later we'll go up in age with that market.

As I mentioned, international is a huge opportunity. A lot of our competition does 40% of their business outside the United States. We only did 10% last year, so we have a long way to go there. It's a big opportunity. The school market we still see as a great growth area. What we do well is literacy, early reading scales and assessment. And those are the growth parts of the business.

And then this year we entered another category we're entering and that is educational videos and DVDs. We have two products out, again, in about the November time period, one called the Letter Factory where we have a wonderful animated video where letters learn how to make their sounds and then another one called the Word Factory where the letters learn how to be put together to form words.

Our growth has been very consistent. We have about 82% compounded growth. The green is the U.S. market, the yellow is international, the blue is the school. We'd like to point out that the slope of the blue and the yellow is at a steeper angle than the green U.S. business, and we think that bodes well for our future. We grew pretty well in the U.S. historically and now we see great growth ahead of us internationally and in the school market.

This year we're introducing three new platforms. A lot of our business is hardware platform, software is used on it. Obviously, the biggest one is the LeapPad, which we introduced three years ago, 8 million of those in homes. We have a large software library that goes on the LeapPad.

This year, for infants, we're introducing a product that was called the InfantPad. It's now called the LittleTouchPad. And it's a little different than the LeapPad because it's got a soft cloth bottom with kind of some bean material in it. So, it fits nicely on mom's lap when she's holding baby. The product was designed for 6-month-old to 36-month-old children, very young children. And it's really to introduce them to the love of reading. And so mom reads along with baby, but points at different things on the page using their finger.

We think the finger is appropriate for an interactive device if the child is 6 months old, 8 months old, 12 months old. We don't think it's appropriate if the child is 4 years old. But the content will interact with baby or with mom and the nice sounds, accompaniment, rhythms, rhymes, music, what have you. I've played with the product. It's a lot of fun. Next slide.

It has a library that comes along with it of software, our own titles as well as licensed titles like, Guess How Much I Love You. Next slide.
Normally we'd show commercials here, but we don't have that capability, so we'll skip this. The next new platform for us is the LeapPad Plus Writing. We went around and researched with moms our LeapPad business. We said, what do you like about LeapPad? And they told us lots of wonderful things. And we said, what don't you like? And they said, well, you've done a good job on teaching our kids how to read, but you have not done anything to help us teach our kids how to print or write or form numbers or do simple math and we'd really like it if you would do that for us.

So, we took the LeapPad technology, we added a technology of a retractable pencil with never-ending graphite, if you will, from Type Conderoga (ph) and we now, the stylus can either work with lead or without lead, and when it's got the lead down, so it works in all the old books that didn't require it, it also works with the new software, where the games involve the formation of letters and the spelling of words and the forming of numbers and the doing of simple math.

And of course, the machine now knows whether you've done it correctly or not. So, this is a very exciting new platform for us. It's a little bit more expensive than the regular LeapPads, about $59 retail.

The software is the same price, about $15. And as I said, everything is backward, forward compatible. We shipped in mid-August. It's obviously just reached retail, but it is already selling well as is the infant's LeapPad. So, those are our first two new products.

The third one, oh, here's the software for the LeapPad Plus Writing. You get a quick view of that. A lot of kindergarten and first grade software obviously, 'cause that's where you start to learn how to print and form letters and numbers. Next.

And then I mentioned the Leapster handheld portable product, which is our latest addition to the market, and as I said, it's about a November 3rd street date. Everything, again, starts with curriculum. The games are all highly educational, but you'd be interested, if we demonstrated it for you, to see that some of those games look like Donkey Kong or look like Frogger or look like other forms of games that kids are familiar with. But the interesting thing is, now they're learning math or they're learning how to form words or form sentences or solve problems.

And by the way, they're still an awful lot of fun. We're still just coming into manufacturing on this product. I've had a beta at home with my own children and it's a wonderful product, good alternative to those other platforms. Next slide.

Now, this is a LeapFrog Learning Center. This is what we have at most large retailers in America, something that looks about like that. We think it's important to have a destination where mom knows where to go for, whether it's infant or toddler or preschool or kindergarten or first grade or third grade or high school products. So, that's kind of how that flows, from young to old. Next slide.

Our school division, we're very pleased with how it's growing, about 127 employees, growing rapidly. Again, the curriculum is different - over 500 pages of curriculum already done, interactive curriculum, 15,000 classrooms. We're growing very rapidly. Our first half of this year we did almost as much as we did all of last year. Analysts are saying we'll do somewhere between $30 and $40 million. We're comfortable with that. Not quite double, but good, good growth.

Key district sales are in the big school districts, as you'd expect, but they also tend to test and then order after test results are in. The areas that we emphasize are early literacy, English language development and assessment, obviously. And on that we have a library of curriculum available. The latest product that we've introduced is called the LeapTrack.

The LeapTrack is a great product. It uses a unique pad type device with headphones. So, first day of school, say it's second grade, every child comes in the classroom. They put their headphone on, first day of school. They open the LeapPad, which they're familiar with. They start answering the questions on LeapPad book that deal with the various subject areas. In 40 minutes they've completed it. They take the cartridge out of the LeapPad book. They plug it into a LeapTrack device that's connected to one PC in the classroom, and in seconds it analyzes where each child is in their skill area for reading, math, language arts and science, gives the teacher reports. So, she now knows you're ahead in reading, behind in math. She's the reverse of that.

And importantly, aside from having the report and knowing where everybody is, which is great to have, pushes a button and downloads content that will keep you ahead in reading and catch you up in math or whatever it is, for each child in that classroom. So, each child has an individualized learning path.

And then for 40 minutes a day, for an hour a day the kids can be on this system while the teacher is doing other things and taking care of real severe issues that she might have in that class. So, we've had great test results on this. It's such a wonderful product.
We sort of sit back and wonder why isn't it in every school already? And the answer, of course, is because there's a lot of budgetary constraints in this country and also there's bureaucratic constraints and, every school district doesn't, well Los Angeles doesn't believe. Texas is researching, Texas doesn't believe. Florida is researching. Chicago doesn't believe. Anybody's researching. Everybody's got to do their own for some period of time and that's exactly what's going on. But I think that bodes very well for the future for us because the test results have been phenomenal.

And now I will introduce Jim Curley for financial review.

Jim Curley - LeapFrog Enterprises, Inc. - CFO

Thanks, Tom. I think Tom has demonstrated that LeapFrog is a highly creative and innovative company, but I'd like to demonstrate that we're also a financially disciplined company. You may say, well, how do you get financial discipline in a creative, innovative environment? And I think you have to approach the product innovation with the strong ROI mentality, and that's what we try to do. Here we have consistent sales growth over the last three years, compound annual growth of 82%. The first half of this year a 43%, so it's been consistently growing. Can we go to the next slide?

Even better than the sales growth, I think, is the gross profit margin growth because that means each of the incremental sales is even more profitable. It's just coincidental that we're up 420 basis points in the last, in 2002 we actually were at 51.2% gross profit margin. And this year we're at 52.8 in the first half of this year. So, we've continued it.

The way we got there, three primary areas in order of importance, lower manufacturing costs year-over-year, you'd expect some of that as we get to scale, go from a small company to a middle-sized company. We're getting scale. We're lower on manufacturing costs. But we've got very good engineers and very good operations people that are driving the cost down in the product design. And we've been keeping our retail virtually the same so we're bringing the margin home.

Second thing would be chip cost. Chip cost has been going down. Virtually every one of our products has a chip in it or more, at least one. And that logic, that's the educational piece, we've benefited from the chip woes and it's been beneficial to us.

And the last thing is software has been increasing in the overall product mix. That's the highest profit portion of our product mix. We have platforms, software and standalone products. And standalone would be like a plush that has some educational aspects to it, you know, a doll where you could push and it would talk, but it doesn't have a software component. Next, please.

And so, it's resulted in a strong overall performance. Our operating income has grown, really, over the last two years. We went public off the 2001 numbers because the middle of 2002 that we went public, we were very seasonal as a company. We did 80% of our sales, historically, in the second half. We typically lose money in the first half of the year.

So, when we went public in 2002, the only profitable numbers we had to look back on was 2001. So, that's the numbers we went off on, so we were glad to outperform in 2002. We raised our operating income 335% and our net income went up 349% to $33.4 million.

We report on three business segments, U.S. consumer, that's our most mature business segment. That's through the Wal-Marts and the Toys R Us and the Targets of the U.S. International, similar model. It's a wholesale model as well. We sell it into the best retailers in those respective countries that we're in.

In U.S. schools, the direct to consumer model, that's the earliest stage. So, you can see 86% of our sales last year were in the U.S., 10% international, only 4% in U.S. schools. Those have the highest margin, and that's probably a lower margin over the last three years. We've been running in the low 60%. And again, that's because it's a direct to consumer model.

However, it is burdened because of that with a direct sales force and all the product development that goes into the schools. So, we've been finding that business up till now. It lost money in its first three years of operation. It lost $9 million last year.

But good news though. U.S. School, growing the quickest in the first half of this year, is up 117%, so it did $19.1 million, so almost equal to all of last year's sales. International is growing strong as well, a 36% increase. And even our mature, well, we think it's mature, but we think there's a lot of growth left, U.S. consumer division up 34% in the first half.

So, this highlights, really, our seasonality. First half business, sales increase 43%, even better gross profit margin increase, gross profit dollar increase, 59%. But we still lost money. We felt good we were able to cut the loss significantly and we had $9.10 a
share, but since there's no shares outstanding, the better line to look at is the net loss, 4.9 versus 4.6 last year.

And finally, our balance sheet, $129.1 million in cash and marketable securities at the end of the first half, June 30. We're not a capital intensive company. So, you'll see there's not much property and equipment. We don't capitalize very much at all. But we are a working capital intensive company and we're seasonal with that work in capital.

Accounts receivable and inventory is where we put most of our cash. Accounts receivable will peak at the end of the year because we've got the Christmas receipts in, and that all gets converted to cash in the first quarter of the year. It also will be very high in the third quarter because we ship into the retailers in the third quarter, so we get a good portion of sales in the third quarter. But the fourth quarter is the biggest.

Inventory, that leads going into the strong second half of the year, so it increases significantly at $96.1 million. That was up 55% over last year's position. And here's the word on inventory. We had a lot of great statistics. One of the things we've been taken to task for is our inventory performance coming out of last year-end.

There's a lot of reasons we, if you're not familiar with our story, there was a west coast dock strike last year and we intentionally, since we're so west coast reliant with all our DCs here. We brought in inventory to make sure if the cooling off period didn't work that we would be at least positioned with inventory. And it seemed like a good financial decision because we had plenty of cash. So, it was really a time value issue. And we don't have much obsolescence, really no obsolescence in our product so we didn't think it was risky that way. So, we wanted to preserve our inventory position to handle fill rates.

But still, from an analyst's perspective, 85% increase in inventory year-over-year is very concerning. So, it's come down, it's one line at June 30 that represents about two months of supply because now we're going into our peak time. And on a longer term basis, we're investing in systems. We do have our ways to improve, as far as inventory management, to be at least like our peers. So, we bought M an a g i s t i c s (ph), a supply chain management system. We thought we'd install it this year. It was getting too close to busy season so we really delayed it so we wouldn't disrupt the business, and we're on target for that for next year.

And then on the liability side, no long-term debt and we don't foresee have debt any time in the near future. We have in place a $30 million unsecured credit facility that can increase to $50 million at our option and that's the end of our presentation.

Q U E S T I O N S A N D A N S W E R S

Unidentified Participant

School budget issues, have you mentioned that?

Jim Curley - LeapFrog Enterprises, Inc. - CFO

Yeah.

Unidentified Participant

So, a lot of that really hit this year. So, has that affected your business so far and when you get farther down the road?

Jim Curley - LeapFrog Enterprises, Inc. - CFO

Well, it actually really hasn't negatively impacted us much because we are doing what we thought we would do. It just made it a little more difficult. But it's a relatively short-term issue in that there is federal money available for the kinds of programs that we have. We are supplemental education. Leave No Child Behind has money associated with it. There are a number of literacy programs that have money associated with them and then there's a lot of assessment money available.

So, the problem has really become one of, how do you teach the schools how to access that money? So, we've had to hire grant writers who are helping the school access that money through grant writing. And then we do have this bureaucratic issue of, people just don't believe any other school's results. They have to see it themselves.
And so, people tend to test our products first and I think that's good. So far the results are good and hopefully that will result in kind of a nice annuity flow of business over time for us. But we've been getting by the school budget issue and meeting our goals. So, from that standpoint...

Unidentified Participant

Jim Curley - LeapFrog Enterprises, Inc. - CFO

I think it's getting the research done. It takes time for each of them to get it done. We have some wonderful success stories, which we can talk about in great detail if you want to, but they're literally things like a school in Florida where 65 out of 67 second graders couldn't read at grade level, couldn't do math at grade level, couldn't do anything at all. The only difference in the next year was implementing LeapTrack last October through the end of the school year in May and now 65 out of 67 are at grade level or above in reading math and language arts.

So, that kind of success is so overwhelming and so phenomenal, I think that we will be successful in getting these orders out of these school districts in the future.

Unidentified Participant

Jim Curley - LeapFrog Enterprises, Inc. - CFO

You know, so far I think everything we've done has been different and counter to prevailing opinion. When we formed the company and went after educational products only at retail America, 99% of the buyers said, you guys are crazy. This is a market that others have addressed and have failed at. You're not going to be successful. We've obviously been successful.

As we then, and obviously dealing with the question you raise is, how do you have a consumer brand of educational products and then an in-school brand of educational products? And isn't that a detriment. And we really struggled with that one, and for awhile we thought about having a different brand name completely for the school products and having no LeapFrog association with it.

But then a funny thing started happening. As parents were having good results with LeapFrog consumer products in home and teachers were taking their own money and going to Wal-Mart and Toys R Us and buying LeapFrog globes and LeapPads and other educational products for use in the schools, and by the way, we don't count any of that in our school business, so we really don't know what our school business in total is, because that's all ended up being counted in the consumer business. But we know it occurs.

The acceptance of LeapFrog as both a consumer and a school brand has been growing and growing and growing. And now we're hearing from teachers that it's positive that we're a consumer brand and that we advertise educational products for home use. And it, in fact, seems to be positively impacting our school business.

So, we think we're going to be the first one of those, as you mentioned. No one has done it before. We think we're going to be the first one to cross consumer to school with one common brand. Yes, in the back?

Unidentified Participant

Jim Curley - LeapFrog Enterprises, Inc. - CFO

Yes. We have our own salesmen and we also use some manufacturer reps in smaller areas. But where it's a big opportunity and a big market, we have our own direct sales people. Obviously that's an investment. They don't immediately pay their value back to you, and that's part of what this represented up till now, a loss. We think, this year, we're at break even or close to break even in the school division.

As it turns out, as we get around $1 million of business out of a district it warrants having our own rep there, if that opportunity exists. It warrants having our own rep there. So, we'll be continuing to grow our direct number of employees who call on the school districts. Yes?

Unidentified Participant

Jim Curley - LeapFrog Enterprises, Inc. - CFO

(Inaudible).
Jim Curley - LeapFrog Enterprises, Inc. - CFO

Yeah. You know, it's funny. The greatest growth right now is coming from, again, talk about things that aren't supposed to be true. Our greats growth is in the tween and teenage area and in the infant area. And again, common knowledge is, you can't sell anything other than music and video games to tweeners and teenagers and clothes, I guess.

But we're selling a lot of stuff to families with tweeners and teenagers and we get asked a lot, is it just the parent buying that? Sure. But they aren't doing it if the teenager isn't saying, I will use it.

And the fact of the matter is, even teenagers, the younger kids, the 10, 11, 12-year-olds, are so aware of the importance of school and getting good grades and acing next Friday's test that they are accepting and very interested in having educational products in the home. So, while our competition has walked completely away from tweeners and teenagers, for us it's the highest growth area on relatively few products.

In the infant area I guess you'd expect the parents to become more and more concerned. We have to educate our children while they're still in the womb, you know. It presents an opportunity to develop more and more infant educational products. Sir?

Unidentified Participant

Jim Curley - LeapFrog Enterprises, Inc. - CFO

Yes. And, in fact we did. It's subtle, but the name on the tweenage and teenage products is actually the Quantum Pad and the Quantum Leap we use quite a bit and the iQuest. And there's a little LeapFrog logo on it. So, the LeapFrog brand is there, but it's less important than the product name, which is designed to appeal to the tween and teenagers. Yes?

Unidentified Participant

Jim Curley - LeapFrog Enterprises, Inc. - CFO

It really has been discussed. Actually our infant pad, for a while, we thought that some moms might want to start reading to their baby with it on their lap before the baby has entered the world.

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Well, we had a philosophy that we will do licensing and we are. But we want 60% of what we do to be our own characters in our own brand - branded characters - you know, Leap, Lily, Tad and Edison and the group of characters we've created. Forty percent can be from the outside world of. So actually, we licensed Nemo on the i o p h e a d (ph) this year and it's, right now, a fabulous for us. We still have to do all the content ourselves and the curriculum ourselves and make the Nemo title educational. But we are doing outside licensing. We have some product coming along at the end of the year from Dr. - well, with the Dr. Seuss brand name on it. Yes?

Unidentified Participant

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Yes. Big opportunity. We're very proud this year. We're introducing a couple books that are bilingual. They're Spanish and English together. But it's interesting the way we're doing it. One page is the written Spanish. The other page is the written English. And the audio can be whichever one you want to, you know, touch. And so, we're teaching both languages concurrently and we - our educators believe this is the best way to go about bilingual Spanish education. We'll have a much bigger bilingual program next year. It's in R&D right now. Yes?

Unidentified Participant

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Right now we're selling in Japanese, American English, Queen's English for the UK, French and Spanish. Am I missing any? Oh, we have a few Italian. We have a few Italian as well. Italy has not been a hug market for us. We work with a distributor there as opposed to our own company. Maybe some point in the future we'll see enough opportunity to open our own company there.
We are very interested in other markets. We're very interested in Chinese. We've - I think we've publicly stated we believe that our technology is very good for English as a second language. This is a big area of R&D activity for us right now. And we believe, for many different languages, we will have English as a second language in 2005. Yes?

Unidentified Participant

long-term operating margins?

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Jim has.

Jim Curley - LeapFrog Enterprises, Inc. - CFO

Yes. You know, in a steady stay (ph). No timeframe on it. You know, this year, starting off this year, our gross profit margin guidance is 52 to 53%, which, over the long-term we could be at a 55% gross profit margin. And the chief operating income levels at a 20% rate with SG&A leverage.

Unidentified Participant

slightly, given the increasing role or increasing even beyond the possible hardware platforms you guys can up. Shouldn't it be true that those margins could kind of go beyond?

Jim Curley - LeapFrog Enterprises, Inc. - CFO

I would think we're factoring in a more competitive landscape instead of our primary product, you know, we're taking on first head-on competition this year. We think it's going to be a bigger market because they're going to bring more market size to it, but it's also going to be a more competitive market.

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

The other factor impacting that is we do believe we have to keep introducing new platforms. New platforms that do something the old ones didn't. And, you know, every time you introduce a new platform it, unfortunately has a lower gross margin than the software. We are profitable on all our platforms, by the way, and eventually, over time, we get the platforms margins up. But at least in the introductory time period that's a lower margin and because they're generally higher priced, it kind of skews up that revenue. That keeps it from being as high as a normal software company might be.

Unidentified Participant

Has the announcement with your competitors presumably time to kind of take you head-on and that is happening to your sort of shelf space and to major retailers. How have the major retailers responded to those announcements?

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Well, you know, that - because it's Fisher-Price Mattel, the major retails have to carry the products. They really have no choice. But, at the same point, we're getting - we've gotten our 40% shelf space increase this fall with the top five retailers over a year ago fall. So it hasn't negatively impacted us. It probably has negatively impacted somebody, but it hasn't negatively impacted us in terms of shelf space.

And, you know, we're anxious to fight the battle with them. We've seen the product and we really don't believe that the finger is an appropriate device for five, six, seven, eight-year-olds to learn with. We think it's fine for, as we showed, with - for babies and toddlers, but not for four, five, six, seven-year-olds when they have to learn how to hold a stylus. They have to learn how to learn to - beginning to learn to write. For learning phonics, it's very important to be able to scroll across a word and hear each letter correctly pronounced. You can't do that - your finger covers too much of word.

So there are a lot of disadvantages to what they're doing for the older age groups, some advantages for younger age group and we've got a directly competitive product for the younger age group. But we think the real battle will be fought in content and we have 100 title already. We'll have a lot more, obviously, next year. Our titles are all truly educational. We're not just an entertainment company that then applies the alphabet to a license and says it's educational. We go about it quite the reverse, with real curriculum and then make it fun and interesting.

So we think the consumer will appreciate the curriculum and the content that we have. And that that's where the battle will actually be won.

Unidentified Participant

Are you seen outside the U.S. and what are you doing.
Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Yes. We are. We saw quite a bit in China - mainland China itself and with the cooperation of the Chinese government, we were able to stop several different knockoff competitors in China and those products are, near as we know, finished and out of the market today. We have not seen much yet in Europe. But we're anticipating it. We're very aggressive about going after these companies and intend to be in the future. Yes?

Unidentified Participant

last year and ?

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Well, you know, it's hard for us to answer that alone. We know that through the last published reports from all the retailers showed - you know, these are - these are varied (ph) news, you know, through the end of July - showed the total toy industry down 3.5%. The same published data showed sell through up close to 30%. So we're obviously performing better than the industry. We're also performing better than our significant competitors.

We believe the retailers expect us to continue to perform better than the industry and our significant competitors through the Christmas season and that's factored into our numbers and their numbers with us. But we think - the education category will show significant growth this year at retail.

Unidentified Participant

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Yes. All - we are seeing, you know, we're not allowed to say which retail is increasing their ad budget space with us and, you know, those things are all highly competitive and secret within the retail world. But we're seeing significant increases with every major retailer that we're with. I can't think of any exceptions for that. Yes. Sure.

Unidentified Participant

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

We're also planning to do some ourselves because we have a lot of price (ph). We want to make sure retailer - consumers can find everything we have and if it isn't at retail, we want them to find it from us directly. That causes some interesting discussions with your retail partners. You have to be careful about not stepping on their - on their toes and we intend to be careful.

We also, last year, had a way of downloading product into our eyeclip (ph) device for teenagers, specifically. We digitized 220 different textbooks for sixth, seventh, eighth grade math, science and social studies, had that digitized content available online to download into rewriteable cartridges so that a sixth, seventh, eighth grader could review a chapter, be tested on a chapter from our device before they went into Friday's algebra test. That - it - not a lot of people wanted to download last year.

So we took that same digitized content and we now this year made it available at retail. So you can walk into a retail and buy sixth grade math. And literally every sixth grade math book is contained on a cartridge or seventh grade social studies or eighth grade science - same deal. Many more people want to by it retail than download online. We think someday that will change and they'll come back to the - as people become more familiar with downloading online - it will become, again, a business for us in the future. Yes?

Unidentified Participant

What other data points can you share about how help kids perform better?

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Oh, my gosh, sure. Well, we have a lot of research that we have published, some of which we've published on a number of different products. We have a product called the Literacy Center,
again, a school-based product, which was research in L.A. Unified School District and San Rafael School District. And in - I'll probably mess this up, but in one case, we had 135% improvement in reading skills. And in the other case, we have 74% improvement in reading skills versus not using our products in the classrooms. So we thought that was pretty neat.

The Florida case, I think I mentioned to you. Texas has had equally positive results on our products in research. And these results, obviously, the improvement varies depending on the school and how they go about it and the demographics of the school and what have you. But it's never been below - in the mid-40% improvement to as high as 135% improvement.

And then, we had this one school in Orlando, Florida where there were two second-grade classes - 67 kids in total, 30 some per classroom, which isn't a great situation to start with - but 65 of the 67 were not doing anything at grade level a year ago. And today it's the reverse - 65 of 67 are at grade level or better and the only difference in the classroom which, by the way, is a very poor school district - all minority, a couple different languages, English isn't the first language in many cases - a real problem school. But we now have, at the end of one year - one year only - we had - we had 65 out of 67 - whatever percentage that is - at grade level and only two that weren't. So a big change.

Jim Curley - LeapFrog Enterprises, Inc. - CFO

And that promised research. Someone asked the question earlier. Like, what are some of the gaining (ph) items to get, you know, traction and build the business. One of the gaining (ph) items is research. You know, do you need to have efficacy research that, you know, clearly - and it needs to be, you know, different all over. So we're just at the stage where we are gaining traction. We just got a 2.4 million federal grant at one of the UCs to study the efficacy of our products over a four-year period. There's a number of different grants that have been let out.

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

But - and the problem is, of course, to really be efficacious, the educators want these tests to be more than one year. They don't want it to be just a one-year success. They - yes. It's got to be a longitudinal test and so they want it to take a considerable amount of time. They want to follow those kids. So, the process of research is often lengthy, but at least so far the results we've had had been extremely positive.

Jim Curley - LeapFrog Enterprises, Inc. - CFO

And I think that's forced us to also look at our consumer business as well. And we're investing in research, you know, on our consumer products.

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Right. And we can't do it ourselves. We'd have to make sure it's done by outside - reliable outside source. So, in one case, she said UC, California. In another case, it's Stanford. In another case, it's Rutgers in New Jersey doing the research.

Jim Curley - LeapFrog Enterprises, Inc. - CFO

Thank you very much.

Thomas Kalinske - LeapFrog Enterprises, Inc. - Chairman

Thank you.
EXHIBIT 4
Emeryville, Calif. – October 21, 2003 – LeapFrog Enterprises, Inc. (NYSE:LF), a leading developer of innovative technology-based educational products, today reported financial results for the third quarter ended September 30, 2003. The company also increased its sales and earnings guidance for the fourth quarter and reaffirmed its guidance for the full year 2003.

**Net Income Up 25% For 3rd Quarter and Up 102% YTD**

The company recorded increased net income for the third quarter of 2003 of $33.4 million, or $0.55 per share, up 25% from net income of $26.7 million, or $0.50 per share over the same period in 2002. In the first nine months of 2003, net income was $28.5 million, or $0.47 per share, up 102% from net income of $14.1 million, or $0.30 per share, in the first nine months of 2002.

**Net Sales Up 12% For 3rd Quarter and Up 23% YTD**

Net sales for the third quarter of 2003 were $203.9 million, up 12% over the same period in 2002. For the first nine months of 2003, net sales were $348.7 million, up 23% over the same period in 2002.

**Segment Results**

Net sales from the U.S. Consumer segment were $167.1 million in the third quarter, up 4% over the same period in 2002. Net sales from the International segment were $29.5 million in the third quarter, up 86% over the same period in 2002. Net sales from the Education and Training segment (which consists predominantly of the company’s SchoolHouse division) were $7.3 million in the third quarter, up 36% over the same period in 2002.

In the first nine months of 2003, net sales from the U.S. Consumer segment were $272.6 million, up 14% over the same period in 2002. Net sales from the International segment were $49.8 million in the first nine months of 2003, up 68% over the same period in 2002. Net sales from the Education and Training segment were $26.3 million in the first nine months of 2003, up 86% over the same period in 2002.
“While we were satisfied with the sales growth in our International and Education and Training divisions, late building demand from our key retailers resulted in lower net sales growth for the third quarter in our U.S. Consumer business. This resulted in a shift of deliveries from the third quarter to the benefit of the fourth quarter,” said Mike Wood, President and Chief Executive Officer. “Our underlying sell-through at the retail level remained very strong throughout the third quarter. The strength of our U.S. retail sell-through across all of our product lines, coupled with the anticipated fourth quarter launch of our Leapster platform product, has led us to revise our fourth quarter guidance upward and to reiterate our full year guidance.”

“This demand for engaging learning products remains high among children, teachers and parents, and leads us to believe we will have a strong holiday season,” Wood concluded.

**Guidance for the Fourth Quarter and 2003**
The company is increasing its guidance for the final quarter and reaffirming its guidance for full year 2003 as follows:

**Fourth Quarter 2003**
- Net sales $316 million to $334 million
- Net income $42 million to $47 million
- Diluted net income per share $0.69 to $0.76

**Full Year 2003**
- Net sales $665 million to $683 million
- Gross profit margin 51% to 52% of net sales
- Net income $70 million to $75 million
- Fully-diluted share count of 61 million shares
- Diluted net income per share $1.17 to $1.25

**Conference Call**
A conference call will be held tomorrow, Wednesday, October 22 at 9:00 a.m. Eastern time (6:00 a.m. Pacific time) to discuss these announcements and to provide further discussion of results for the quarter and outlook for the remainder of 2003. A live web cast of the conference call will be offered on LeapFrog’s investor relations website at [www.leapfroginvestor.com](http://www.leapfroginvestor.com) and on [www.ccbn.com](http://www.ccbn.com). A replay of the web cast will be available on these websites through February 29, 2004. To participate in the call, please dial (706) 634-0183.

**About LeapFrog**
LeapFrog Enterprises, Inc. (NYSE: LF) 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 nine learning platforms that come to life with more than 90 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 25 countries around the world. The LeapFrog SchoolHouse curriculum programs are currently in over 15,000 classrooms in the U.S. with over 200 interactive books and over 290 skill cards representing more than 5,500 pages of educational content. LeapFrog’s 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.

# # #

LEAPFROG, The LeapFrog Logo, LEAPPAD, LEAPSTER, LEAPTRACK 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 company’s sales, earnings and performance expectations for the quarter ending December 31, 2003, planned new product introductions such as the Leapster platform, and expected market acceptance of the company’s consumer and SchoolHouse learning products, including expected U.S. retail sales. These forward-looking statements involve risks and uncertainties, including the company’s ability to invent, develop, introduce, market and deliver products, the acceptance of the company’s products in U.S. schools and international markets. These and other risks and uncertainties detailed from time to time in the company's SEC filings, including its 2002 annual report on Form 10-K filed on March 28, 2003 and its quarterly report on From 10-Q filed on August 12, 2003, 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 BALANCE SHEETS
(In thousands, except share and per share data)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$ 84,728</td>
<td>$ 57,848</td>
<td>$ 73,327</td>
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<tr>
<td>Short term investments</td>
<td>13,115</td>
<td>-</td>
<td>-</td>
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<td>Accounts receivable, net</td>
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<td>130,137</td>
<td>169,670</td>
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<td>Inventories, net</td>
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<td>84,460</td>
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<td>Prepaid expenses and other current assets</td>
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<td>595</td>
<td>595</td>
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<td>Notes receivable due from related parties</td>
<td>-</td>
<td>9,332</td>
<td>5,889</td>
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<td>Deferred income taxes</td>
<td>26,121</td>
<td>10,201</td>
<td>16,783</td>
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<td>Total current assets</td>
<td>408,766</td>
<td>300,094</td>
<td>348,900</td>
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<td>Property and equipment, net</td>
<td>22,028</td>
<td>20,449</td>
<td>20,239</td>
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<tr>
<td>Other long term assets</td>
<td>185</td>
<td>631</td>
<td>484</td>
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<tr>
<td>Deferred income taxes</td>
<td>9,332</td>
<td>5,889</td>
<td>4,867</td>
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<td>Intangible assets, net</td>
<td>25,359</td>
<td>23,353</td>
<td>23,192</td>
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<tr>
<td>Total assets</td>
<td>$ 465,670</td>
<td>$ 350,416</td>
<td>$ 397,682</td>
</tr>
</tbody>
</table>

| **LIABILITIES AND STOCKHOLDERS’ EQUITY** |                    |                  |
| Current liabilities: |                    |                  |
| Accounts payable | $ 64,230           | $ 68,031         | $ 58,844         |
| Accrued liabilities | 32,700           | 26,106           | 40,533           |
| Deferred revenue | 1,027              | 3,853            | 3,006            |
| Income taxes payable | 2,440             | 13,730           | 21,832           |
| Total current liabilities | 100,397          | 111,720          | 124,215          |
| Long term debt | -                  | -                | -                |
| Deferred rent and other long term liabilities | 575              | 478              | 550              |
| Deferred income taxes | 3,595             | 4,390            | 4,119            |
| Commitments and contingencies | -                | 24,139           | -                |
| Redeemable convertible series A preferred stock | -                |                  | -                |
| Total stockholders’ equity | 361,103          | 209,689          | 268,798          |
| Total liabilities and stockholders’ equity | $ 465,670        | $ 350,416        | $ 397,682        |

(1) Derived from audited financial statements.

- More -
LEAPFROG ENTERPRISES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(Unaudited)

<table>
<thead>
<tr>
<th></th>
<th>Three Months Ended Sep 30,</th>
<th>Nine Months Ended Sep 30,</th>
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<tr>
<td></td>
<td>2003</td>
<td>2002</td>
</tr>
<tr>
<td>Net sales</td>
<td>$203,888</td>
<td>$182,127</td>
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<td>Cost of sales</td>
<td>99,066</td>
<td>87,071</td>
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<td>Gross profit</td>
<td>104,822</td>
<td>95,056</td>
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<td>Operating expenses:</td>
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<td>Selling, general and administrative</td>
<td>22,750</td>
<td>22,865</td>
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<td>Research and development</td>
<td>14,003</td>
<td>14,137</td>
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<td>Advertising</td>
<td>13,545</td>
<td>11,925</td>
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<td>Depreciation and amortization</td>
<td>1,943</td>
<td>1,751</td>
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<td>Total operating expenses</td>
<td>52,241</td>
<td>50,678</td>
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<td>Income from operations</td>
<td>52,581</td>
<td>44,378</td>
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<td>Interest expense</td>
<td>(3)</td>
<td>(127)</td>
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<td>Interest income</td>
<td>250</td>
<td>259</td>
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<tr>
<td>Other income (expense)</td>
<td>412</td>
<td>(38)</td>
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<tr>
<td>Income before provision for income taxes</td>
<td>53,240</td>
<td>44,472</td>
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<tr>
<td>Provision for income taxes</td>
<td>19,836</td>
<td>17,799</td>
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<tr>
<td>Net Income</td>
<td>$33,404</td>
<td>$26,683</td>
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<td>Net income per common share - basic</td>
<td>$0.58</td>
<td>$0.65</td>
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<td>Net income per common share - diluted</td>
<td>$0.55</td>
<td>$0.50</td>
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<td>Shares used in calculating net income per share - basic</td>
<td>58,045,325</td>
<td>41,274,608</td>
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<tr>
<td>Shares used in calculating net income per share - diluted</td>
<td>61,086,489</td>
<td>53,384,455</td>
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-More-
LEAPFROG ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

<table>
<thead>
<tr>
<th>Nine Months Ended September 30,</th>
<th>2003</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income</td>
<td>$ 28,509</td>
<td>$ 14,083</td>
</tr>
<tr>
<td>Adjustments to reconcile net income to net cash provided by operating activities:</td>
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<tr>
<td>Depreciation and Amortization</td>
<td>12,208</td>
<td>8,245</td>
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<td>Other noncash items</td>
<td>32,411</td>
<td>10,744</td>
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<td>Other changes in operating assets and liabilities:</td>
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<tr>
<td>Accounts receivable</td>
<td>3,556</td>
<td>(24,619)</td>
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<tr>
<td>Inventory</td>
<td>(35,048)</td>
<td>(46,234)</td>
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<tr>
<td>Prepaid and other current assets</td>
<td>(5,782)</td>
<td>(6,918)</td>
</tr>
<tr>
<td>Notes receivable due from related parties</td>
<td>595</td>
<td>94</td>
</tr>
<tr>
<td>Other assets</td>
<td>99</td>
<td>(283)</td>
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<tr>
<td>Accounts payable</td>
<td>5,386</td>
<td>33,620</td>
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<td>Accrued liabilities</td>
<td>(7,833)</td>
<td>12,317</td>
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<tr>
<td>Income taxes payable</td>
<td>(19,392)</td>
<td>4,096</td>
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<tr>
<td>Net cash provided by operating activities</td>
<td>14,709</td>
<td>5,145</td>
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<tr>
<td>Investing activities:</td>
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</tr>
<tr>
<td>Purchases of property and equipment</td>
<td>(13,183)</td>
<td>(11,368)</td>
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<tr>
<td>Purchase of intangible assets</td>
<td>(3,000)</td>
<td>(250)</td>
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<tr>
<td>Purchases of short term investments</td>
<td>(19,738)</td>
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<tr>
<td>Sale of short term investments</td>
<td>6,510</td>
<td>-</td>
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<td>Investment in related party</td>
<td>181</td>
<td>-</td>
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<tr>
<td>Net cash used for investing activities</td>
<td>(29,230)</td>
<td>(11,618)</td>
</tr>
<tr>
<td>Financing activities:</td>
<td></td>
<td></td>
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<tr>
<td>Borrowings under credit agreement</td>
<td>-</td>
<td>182,000</td>
</tr>
<tr>
<td>Repayments under credit agreement</td>
<td>-</td>
<td>(243,163)</td>
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<td>Proceeds from the payment of notes receivable from stockholders</td>
<td>2,624</td>
<td>505</td>
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<tr>
<td>Proceeds from the exercise of stock options and employee stock purchase plan</td>
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<td>1,501</td>
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<tr>
<td>Proceeds from the issuance of common stock</td>
<td>-</td>
<td>115,116</td>
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<tr>
<td>Net cash provided by financing activities</td>
<td>25,823</td>
<td>55,959</td>
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<tr>
<td>Effect of exchange rate changes on cash</td>
<td>99</td>
<td>93</td>
</tr>
<tr>
<td>Increase in cash and cash equivalents</td>
<td>11,401</td>
<td>49,579</td>
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<tr>
<td>Cash and cash equivalents at beginning of year</td>
<td>73,327</td>
<td>8,269</td>
</tr>
<tr>
<td>Cash and cash equivalents at end of period</td>
<td>$ 84,728</td>
<td>$ 57,848</td>
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</tbody>
</table>

###
Exhibit 5
CCBN StreetEvents Conference Call Transcript

LF - Q3 2003 LeapFrog Enterprises, Inc. Earnings Conference Call

Event Date/Time: Oct. 22, 2003 / 6:00AM PT
Event Duration: N/A
PRESENTATION

Operator

Good day and welcome to the LeapFrog Enterprises Third Quarter 2003 Earnings Results Conference Call. Today's call is being recorded. With us today from the company is the Director of Investor Relations, Mr. Christopher Bunn. Please go ahead.

Christopher Bunn - LeapFrog Enterprises, Inc. - Director of Investor Relations

Thank you. Good morning and welcome to LeapFrog Enterprises conference call for our third quarter 2003 which ended September 30th. I'm Christopher Bunn, the Director of Investor Relations. After the close of the market yesterday, we issued a press release detailing our third quarter results. In a minute, Mike Wood, our President and CEO, will discuss leapfrog's performance in the third 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 our formal remarks, I'll remind you that certain statements made today may include forward-looking statements about management's expectations, strategic objectives, anticipated financial performance and other similar matters. Forward-looking statements made during this conference call may include statements regarding anticipated growth in sales, operating margins, earnings per share, and retail shelf space, our ability to invent, develop, and produce products and their acceptance in the market, 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 and 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 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 2002 annual report on Form 10-K filed with the SEC and other filings made with the SEC from time to time as well as LeapFrog's other published statements. LeapFrog does not update forward-looking statement and we expressly disclaim any obligation to do so.

Now I'd like to introduce Mike Wood.
Thank you, Chris. Thank you all for joining us and good morning. Before I delve into our miss on U.S. consumer sales projections, bear with me while I briefly outline the good news. And there's lots of it.

First, year-to-date, our net income is up 102%, on net sales growth of 23%. Second, for the third quarter, our international sales are up 86%, education and training net sales are up 36%, making for education and training year-to-date net sales up 86%. Third, and I believe this is important, our U.S. sell-through at retail, which was up above 30% at the end of the second quarter, remained above 30% for the third quarter, and therefore year-to-date. This confirms that moms, dads, and our other consumers continue to purchase LeapFrog products at a pace significantly above last year.

We believe third quarter sell-through is an important indicator of the strength of our fall line. In essence, in the fall reset, LeapFrog and all of our competitors put out our fall lines, and we get the first read on how we stack up competitively for the holiday season.

In fact, our third quarter retail sell-through by category is even more insightful. Our retail sell-through, that is, our consumer demand for platforms, in the third quarter was up over 40%, software up over 80%, and stand-alone up over 15%.

Of course, third quarter sell-through is a small sample, and can be affected by promotions, TV advertising, product availability and late launches. Nevertheless we're very encouraged by the continued strength of our third quarter sell-through which reflects the success of both our ongoing line and also the very encouraging sales of our new line, including the launch of our new Little Touch LeapPad and LeapPad Plus writing platforms, as well as several other new product launches.

We are also very excited about the upcoming launch of our Leapster multimedia learning system and new learning videos. As a reminder the Leapster multimedia learning system allows kids to play interactive educational games, interactive educational videos, interactive educational books, and even an interactive arts studio.

In light of these factors we believe our shortfall in U.S. sales in the third quarter was primarily timing, and that those sales not recognized in the third quarter will be recognized in the fourth quarter. As a result, we've increased our fourth quarter guidance and are reiterating our full year guidance. So I look forward to what we believe will be a very strong fourth quarter in both sell-through and sell-in.

Now I will turn the call over to Jim Curley.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

Thank you, Mike, and thank you all for joining us today.

Net sales for the third quarter of 2003 were up 12% to $204 million. Net sales from our U.S. consumer segment were up 4% to $167 million. U.S. consumer sales for the quarter represented 82% of company-wide net sales versus 88% last year.

Third quarter net sales from our international segment were up 86% to 30 million and up 68% year-to-date. International net sales represented 14% of our third quarter company-wide net sales versus 9% last year. The foreign currency translation effect for the third quarter was positive, although not significant, and increased the international segment net sales by 9% and total company net sales by 1%.

Our third quarter education and training, or SchoolHouse segment net sales were up 36% compared with last year. For the year-to-date SchoolHouse net sales were up 86%.

Our consolidated gross profit margin was 51.4% in the third quarter, down 80 basis points from last year. The decline in gross profit margin was due to higher royalties expense and increased air freight, ocean freight, and higher warehouse expenses. These higher expenses offset favorable product costs for the quarter.

Our third quarter operating expenses were very well controlled and allowed us to mitigate to a great extent the sales shift. Total third quarter operating expenses were $52.2 million, 3% above last year. As a percent of net sales operating expenses decreased from 27.8% last year to 25.6% in this year's third quarter. The improved leverage came from a 140-basis point improvement in SG&A and a 90-basis point improvement in R&D.

We had net interest income from the third quarter of $247,000, compared with $132,000 last year. Additionally, we had $412,000 of other income for the quarter, primarily related to favorable foreign exchange gains. Net income for the third quarter of 2003 was up 25% to $33.4 million as compared with 26.7 million in the third quarter of 2002. Our year-to-date net income was up 102% to 28.5 million from $14.1 million in the same period last year. Our third quarter fully diluted net income per share was 55 cents compared with 50 cents per share in last year's third quarter. Finally, our year to debt net income per diluted share was 47 cents versus 30 cents per share in the same period last year.

Let's now turn to the balance sheet.

Cash in short-term investments at September 30, 2003 were $97.8 million, an increase of $40 million from last year's third quarter end. Accounts receivable at September 30, 2003 were $155.4 million, up $25 million from last year's position. At quarter end there were 68 days sales outstanding versus 64 DSO's last year. Net inventory at September 30, 2003 was $119.5 million up 29%
from last year. This represents a seasonally appropriate level going into the fourth quarter. We are debt-free and year-to-date we experienced positive cash flow from operations of $15 million compared with $5 million in last year's comparable period.

Before we start our Q and A session I would like to address going forward guidance. We are raising our fourth quarter guidance as follows. Net sales, we're guiding you towards $316 million to $334 million for the fourth quarter, net income in a range of $42 to $47 million, and diluted net income per share of 69 cents to 76 cents.

A few more insights in our fourth quarter thinking: As I said previously we had good leverage in SG&A and R&D expense in the third quarter. We are forecasting continued fourth quarter leverage on SG&A and R&D expenses, but higher advertising expense. We are guiding advertising expense at 15% of net sales in the fourth quarter.

Our new fourth quarter guidance results in full year guidance of the following. Net sales in a range of $665 million to $683 million. Gross profit margin of 51% to 52% of net sales. Net income in a range of $70 million to $75 million. A fully diluted share count of 61 million shares, and a diluted net income per share range of $1.17 to $1.25.

This concludes the review of our third quarter financial performance. Now operator, let's begin the question and answer portion of the call.

### QUESTION AND ANSWER

**Operator**

At this time I would like to inform everyone if you would like 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 and A roster. Your first question comes from Jill Krutick.

**Jill Krutick - Salomon Smith Barney - Analyst**

Thank you very much. Good morning. From Smith Barney. Mike, I was hoping you could give us a flavor for your supply chain, your distribution process, your logistics, how would you sort of describe where you are, where you expected to be, and your order fill rates, when did the orders come in for these sort of last sales that are being translated into the fourth quarter, when did those orders come in, how were they filled, and what kind of management systems you have in place to be monitoring this very closely. Thank you.

**Mike Wood - LeapFrog Enterprises, Inc. - President**

Thank you, Jill. Well, as we mentioned last time, we work through, I believe it's seven factories in China. We have four warehouses in Los Angeles, we use manugistics. We have an extensive and experienced operating team, many of whom have been with Tom Kalinske and Paul Rioux for over 20 years.

Having said all of that, there are lots of areas of improvement within LeapFrog and operations is clearly one of them, which is why we hired Fred Forsyth as COO about two months ago and Fred spent the last two months in Asia and down in our warehouse and throughout the operations looking for ways to improve so that we can become best of breed in operations.

Having said that, your question is the orders, when did they come in and how did they translate into fourth quarter sales. Two things: We had what we felt was an extraordinary number of orders that came in, that is dollar volume in order, essentially the last ten days of the quarter. We shipped as quickly as we could, and the net result was what we announced, $203 million.

We've done some soul searching in terms of could we have done better in terms of shipping. The answer is yes, but I don't want to use that as an excuse. Suffice it to say that we're in position to take the orders that we have and the orders which we're projecting in our guidance and to ship those efficiently in the fourth quarter.

**Jill Krutick - Salomon Smith Barney - Analyst**

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If I could just follow up, perhaps you could share with us some changes that you've made to avoid any sort of replay of missed shipments perhaps even in the fourth quarter for the holiday season. Thank you.

Mike Wood - LeapFrog Enterprises, Inc. - President

Jill, I don't -- I think for -- perhaps we're giving a mis-impression. The orders that we missed shipped, when you have lots and lots of orders, no one can ship 100% of the orders that they get every single day, so there was some natural carry-over. We did, though, however, having left some orders on the table, scrutinize down, and we've buttressed up the team and we've actually increased the warehousing and distribution capability for the fourth quarter.

Jill Krutick - Salomon Smith Barney - Analyst

Thank you.

Lauren Fine - Merrill Lynch - Analyst

Okay. And then, you know, looking -- I'm wondering, Jim, if you could maybe break down the revenues, as you have done in the past, on the U.S. consumer between platform software, stand alone, and give us a sense of their growth rates.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

Okay. The platforms… For the U.S. consumer, I’ll give you the three categories we report on, for the quarter, we are down 5% in platforms -- minus 5%. We're up 7% in software. This is all sell-in. And we're up 20% in stand-alone products. And those totals comprise the 4% U.S. consumer total increase. On a year-to-date basis for U.S. consumer, platforms are up 2%, software is up 21%, and stand-alone products up 28%, for a total of 14% increase in U.S. consumer sell-in year-to-date.

Lauren Fine - Merrill Lynch - Analyst

Okay. Then also just one last clean-up. The increase in shipping and air costs, is that because of the last minute, trying to get orders out, and is that something that should continue into the fourth quarter?

Mike Wood - LeapFrog Enterprises, Inc. - President

Well, it wasn't something we planned for. But we always seem to incur it, so it does relate to activities in prior year. Last year we had a dock strike, this year we have other challenges. The improvements in the future, yes, I think this is definitely something we can avoid. Clearly the air freight. The ocean freight, we had planned for an ocean freight increase, it came in about double what we had expected. We would expect that to be going forward.

To give you a little more granularity, our product cost improvement, you know, was more what you would have expected from us. We had about 160-basis point lower, product cost. Those were all offset by the extra expenses and a higher royalty expense.

Lauren Fine - Merrill Lynch - Analyst

Thank you.

Mike Wood - LeapFrog Enterprises, Inc. - President

Thank you, Lauren.
Hi.

Howard Block - Banc of America Securities - Analyst

Good morning everybody. First question, Mike, why didn't you pre-announce the revenue short-fall?

Mike Wood - LeapFrog Enterprises, Inc. - President

So two things. First of all, Howard, part of it relates to when did we know, and that is although we knew we'd missed the revenue at the end of the quarter, we believed at the time we were still within our earnings per share range, and it wasn't until we closed the books late last week that we finalized our actual revenue and our EPS. Furthermore, we believe then and we believe now that the miss on revenue was really related to timing. So we didn't have the final numbers until late last week.

Our EPS was in the range, our demand remained strong, and we believe that the revenue was largely timing. We haven't pre-announced in the past when we significantly exceeded revenues and EPS. We thought about pre-announcing and made the decision not to, and that will be something we will do on a case-by-case basis going forward.

Howard Block - Banc of America Securities - Analyst

Okay. And then with regards to your comments about sell-through, in the second quarter, I believe what we had said was that sell-through to date at our top ten customers was up 35%.

Mike Wood - LeapFrog Enterprises, Inc. - President

Right.

Howard Block - Banc of America Securities - Analyst

Is the opening comments this morning sort of the comparable retailers, comparable level of sell-through?

Mike Wood - LeapFrog Enterprises, Inc. - President

Exactly. I said above 30%. In fact, it was 35% and continues to be at 35%.

Howard Block - Banc of America Securities - Analyst

Okay. And then with regards to, I guess, again, the short-fall in revenue, are you willing, perhaps, to try to quantify how much of the short-fall was attributable to inability to ship versus this deferral, as you said earlier, into the first half of the fourth quarter?

Mike Wood - LeapFrog Enterprises, Inc. - President

Yes, although I -- I want to put quotes around inability to ship. We were in a position, if we had shipped literally every order to hit our mid-range guidance. However, it doesn't matter who you are, no one is going to be able to ship every order they get in up to the last moment. And so that, really, in order to have shipped mid-range in guidance we would have needed more orders earlier in order to have shipped to that mid range. As you can see, part of it is that the orders came in late. Certainly I wish we had been able to execute better, although -- well, better than we did. And finally, based upon, as I said, the demand, we fully anticipate that the orders that we didn't have will continue to flow and be shipped throughout this fourth quarter.

Howard Block - Banc of America Securities - Analyst

Okay. Then the last question is, I was just struggling a little bit to reconcile the fact, it appears as though the inventory balances, at least I think relative to guidance, and certainly relative to our model, were not that excessive, and one would have thought that if you had anticipated a stronger shipment level as well as sell-in and you weren't able to achieve it that your own inventories would have looked a little more bloated than they were.
Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

Let me go back and give you a correction on what I just said. I said 800 basis points. I meant 80. I'll give you each of the line items. Royalties of 80 basis points of the gross margin miss, warehousing also another 80 basis points. Okay, so that corrects what I said at 800 basis points. 80 basis points on each of those.

Howard Block - Banc of America Securities - Analyst

But, anyway, Jim, just to clarify, then I'll jump back in the queue, is there any -- I mean, your own inventory guidance I think you came pretty close to where you guided to in the second quarter conference call.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

That's right.

Howard Block - Banc of America Securities - Analyst

Wouldn't we have thought your own inventories would have been more bloated if you were unable to ship certain orders at the end of quarter?

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

Inventory availability wasn't the issue, it was the demand arising late. As Mike said, in order to have shipped what we needed, we needed to get that demand in earlier so we could process it through our logistics system.

Howard Block - Banc of America Securities - Analyst

Okay. So you hadn't taken product yet to sit in your own warehouses, it was sort of your own distribution challenges as well as fulfillment?

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

Yes, that would be right.

Howard Block - Banc of America Securities - Analyst

Okay. Thank you.

Christopher Bunn - LeapFrog Enterprises, Inc. - Director of Investor Relations

You're welcome.

Operator

Your next question comes from Tony Gikas.

Tony Gikas - Piper Jaffrey - Analyst

Good morning. Piper Jaffray. Would you characterize any of the revenue miss in the quarter as permanent to the year? It sounds like it's a timing issue but is there ten, twenty, thirty million that could slip out of the year? Couple other quick questions. Was pricing a challenge during the quarter? Did that account for any of the revenue miss? Do you anticipate lowering the pricing on any of the hardware systems? And did competition factor into any of the revenue miss during the quarter?

Mike Wood - LeapFrog Enterprises, Inc. - President

Tony, let me do all three. First of all, do we think any of the revenue miss was permanent to the year, the answer is no. Otherwise, we would not have maintained our full year guidance. So we think that the revenue shift is literally a shift into the fourth quarter. Just to contextualize this, our miss on revenue, on U.S. revenue, was about 11%, $27 million to our mid-range, which is about one week of shipping at that time of the year, and what we anticipate is some of that is stuff that we had that we shipped right away, as I mentioned, and some of it is going to be -- is being made up and will be made up over the next, you know, ten weeks, really, from the end of the quarter through the last shipments for this holiday period.

Your second question is was pricing a challenge and do we anticipate lowering pricing on our hardware. The answer is no on both.

The third is, do we think competition affected demand. And so first of all, of course, competition is always going to affect sales. It has always, will always, but I want to reiterate, you know, our platform sell-through, that is, at the end of the day, the retailers don't dictate demand, the consumers dictate demand, and retailers are going to ultimately place orders to make sure that their shelves are full with the hottest moving products. So in the third quarter our platform sales sell-through was up 40%, and that was despite whatever all of the competition that was entered in the third quarter in the fall sets, and as I said, our stand-alone's were up over 15%.
Part of what happened in the third quarter, or let me put it slightly differently, there are four major new platforms being launched this year in the learning category. There's the Little Touch, which is said we're having a very strong, in fact, surprisingly strong launch to us. We'll be chasing that inventory all year. The LeapPad Plus Writing, where kids took the stylus and can write with it, the Fisher Price Power Touch, and the platform I'm personally most excited about, because it's so new and novel, the Leapster, but that hasn't even launched yet.

So do I think competition had an effect? Of course I did. But net-net of the effect I've just given you, the increase on the demand in our product in the third quarter.

Tony Gikas  
_Piper Jaffrey - Analyst_

Thanks, guys.

Mike Wood  
_LeapFrog Enterprises, Inc. - President_

You're welcome.

Operator

Your next question comes from Sean McGowan.

Mike Wood  
_LeapFrog Enterprises, Inc. - President_

Hi, Sean.

Sean McGowan  
_Gerard Klauer Mattison - Analyst_

Hi, guys. I want to come back to a question about the air freight, because I'd like some more discussion on that. If you didn't get a lot of orders until late in the quarter, why would you need to air freight them? That seems like you're bearing the expense for an order that was placed late by a retailer. If you could just get that product out in time for the holiday season why would you want to incur that extra expense?

Mike Wood  
_LeapFrog Enterprises, Inc. - President_

Two things happened. You're exactly right. We certainly weren't flying in for the last minute because the last-minute demand occurred so quickly we couldn't fly it anyway. The air freight was primarily around getting our new items in for the fall set. Also, some of the items sold so quickly, the Little Touch and some others, that in order to meet -- there were some advertising and promotions, we had to fly those in. So to a certain extent it was getting stuff there in the fall sets, which that would have been anticipated, what wasn't anticipated in Little Touch and the others, the take-off and demand was so rapid and we had some ads that hit that we had to fly in to meet those demands.

Sean McGowan  
_Gerard Klauer Mattison - Analyst_

So you weren't scrambling at the end there.

Mike Wood  
_LeapFrog Enterprises, Inc. - President_

Your air freight on orders that come in the last week, it doesn't -- you can't fly them in to meet them. The logistics just don't work.

Sean McGowan  
_Gerard Klauer Mattison - Analyst_

The second question I had, can you talk a little bit about how you managed to grow sales but keep SG&A so tight? There's really no increase there but lots of leverage on the operating line. Were you planning that? Were you cutting it throughout the quarter? Just seems that's a pretty good expense management in the face of expected growth.

Jim Curley  
_LeapFrog Enterprises, Inc. - Chief Financial Officer_

Yeah, we were very focused on our expenses. You can see in the first two quarters we had good SG&A and R&D leverage. We did not bring down expectation on those line items because we viewed them as our safety against the top line.

Throughout the year, back in the third quarter, or rather in the first quarter, we put additional budget revisions in place to really focus the company on being as lean and mean as we could be. We've been successful, obviously, and just a couple of comments on SG&A, how we got there. It was lower compensation expense, all in. That gave us the biggest piece. Also last year it was burdened with significant litigation expense.

You recall after going public we had six major lawsuits. We've settled every one of those. That had a significant savings year-over-year on a relative basis. So that was a big help.

Sean McGowan  
_Gerard Klauer Mattison - Analyst_

And now you just have one lawsuit.

Mike Wood  
_LeapFrog Enterprises, Inc. - President_

Right. And we get to control the pace of the spending.

Jim Curley  
_LeapFrog Enterprises, Inc. - Chief Financial Officer_
That's self-initiated by us. The other benefit really against last year's numbers, last year we had an $800,000 write-off of the K-Mart exposure in the SG&A line. We didn't have such a experience this year, so that was favorable. Then in R&D, R&D we've made -- was really planned all along, but we're cautious about it, it was lower content development expense, primarily in the SchoolHouse division, which was part of their plan to get, you know, close to operating profit this year. They had front-loaded their content development, so this year it had come down significantly.

Sean McGowan - Gerard Klauer Mattison - Analyst

Could you then comment on which of the items you see there might have been there in the fourth quarter of last year that might not recur? I know there are always things that come along and surprise you both ways, but did you write down additional K-Mart stuff in the fourth quarter? Was there litigation stuff in the fourth quarter that's not going to be there?

Mike Wood - LeapFrog Enterprises, Inc. - President

There was continued litigation, so, you know, to ratify the savings that we've had in the third quarter, really to identify that they're not one-time isolated to just third quarter, is, you know, our guidance really has SG&A and R&D, having strong leverage in the fourth quarter.

Some specifics, you know, last year we air-freighted to the tune of $3 million in the fourth quarter, related to the dock strike. Obviously, we don't anticipate that recurring. On the expense saving side, litigation would continue to be a save for us. In the overall expense savings that we put in, we expect to get continued leverage that in the fourth quarter.

Sean McGowan - Gerard Klauer Mattison - Analyst

Thank you.

Operator

Your next question comes from Jeetil Patel.

Jeetil Patel - Deutsche Banc - Analyst

Hi, guys. Couple of questions. Can you characterize the impact of the shift-out, any particular product or areas that were particularly hit hard, the platform, software, or stand-alone side? Secondly, if you look at just kind of the guidance going into the third quarter, call it around $235 million or so, yeah, that would imply that you would have done, on the current expense base, about 80 cents in earnings, which on a flow-through on incremental revenue verse a year ago would be about 40% margin. Do you think that this is the level of kind of flow-through on margins that we should expect going forward considering that it's historically been running around 30% to 32%? I just want to get your take on that. Then the advertising expense going forward, for Q4, which is increasing, is that mainly to support some of the newer platforms that you're launching, specifically Leapster?

Mike Wood - LeapFrog Enterprises, Inc. - President

So let me answer the first and the third part of your question. This is Mike. Then I'll turn it over to Jim on your question about guidance and earnings. First of all, the impact of the shift, as I mentioned, based upon our increase in sell-through in the third quarter on platforms and software, we think that a lot of the deferred purchases will be in our hardware and software. The sell-in versus the sell-through on the stand-alone's was much more highly correlated. The ad expense, we will certainly have ads on our new items, but we're heavily weighted on the ads towards all of our platforms. So it's My First LeapPad, it's LeapPad, LeapPad Plus Writing, Quantum Pad, the Turbo's, and it's the I-Quest, and, of course, a lot of advertising on Leapster. There are also a few new stand-alone items that we're launching through TV, so that's -- pardon me? And also, I'm reminded, we've got a very strong content campaign across all of those platforms also.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

Jeetil, can you repeat your question on guidance?

Jeetil Patel - Deutsche Banc - Analyst

If you look at the second quarter call and what you talked about for the third quarter, based on what you would have done if you had not seen the revenue slip from Q3 to Q4 you would have done, call it, about $235 million revenue, roughly, and maybe about 80 cents on the current expense base, about a 50% gross margin. That kind of computes to about a 40% flow-through on incremental revenue, so basically take a net which I think if you had done $235 million versus a year ago and the incremental profitability on that incremental revenue. So kind of got to a 40% number, and historically you've been running around 30%. Is this a change that we should expect going forward, even for Q4, that we should see about 40% margins on the incremental revenues year to year that you're picking up in the business?

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

Well, our guidance is pretty specific for the fourth quarter, Jeetil. I would stay with that guidance. You can calculate the percentage increase. You're right, we didn't miss on two pieces. We had much
stronger expense control over what was out there as published
guidance that offset the sales miss to some extent. Had we made
the sales number we would have had a huge over-performance.

Jeetil Patel - Deutsche Banc - Analyst

Yeah. Jim, isn't the primary difference in that we were under
budget on advertising in the third quarter, and as you mentioned in
your opening comments, our advertising in the fourth quarter will
be about 15%?

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial
Officer

Right.

Jeetil Patel - Deutsche Banc - Analyst

And that's why you don't anticipate a 40% carry-forward into the
fourth quarter?

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial
Officer

Well, we have lower margins, you know, and plus we are getting
better operating expense leverage than what we had published
previously and we carried that forward into the guidance.

Jeetil Patel - Deutsche Banc - Analyst

Great. Thank you.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial
Officer

You're welcome.

Operator

Your next question comes from Natalie Walrond.

Natalie Walrond - Pacific Growth Securities - Analyst

Couple of questions. Start with SchoolHouse. I know in the press
release you comment that you were comfortable with the
SchoolHouse performance but on a sequential basis it was very
negative. Do you want to reset expectations on SchoolHouse in
terms of, you know, can you talk about what's going on with
revenue there?

Mike Wood - LeapFrog Enterprises, Inc. - President

Yes. Do you want to -- do you want to list all of your questions or
do you want me to do them serially?

Natalie Walrond - Pacific Growth Securities - Analyst

We can do them serially.

Mike Wood - LeapFrog Enterprises, Inc. - President

Let me start with that. Our year-to-date trend in -- our year-to-date
net sales in SchoolHouse were up 86%, you're right, to 36% in the
third quarter is significantly below that. We don't think that reflects
a trend. I've spent a lot of time with Bob Lally and the sales team
and reviewing their pipeline and we're all confident that the
pipeline will reflect a return to a significantly better rate of sales
than reflected in the third quarter.

Natalie Walrond - Pacific Growth Securities - Analyst

I'm sorry, can you just say a little bit more about that? Because all
of the K through 12 companies we're talking about, all of the
channel checks, indicate that the selling environment is just getting
tougher and tougher. Can you just say a little bit more about what
gives you confidence that their pipeline is going to hold up?

Mike Wood - LeapFrog Enterprises, Inc. - President

Yes, it is in part that our products are in one of the few remaining
areas in which both federal and state funding has not been
significantly decreased, and that's the early -- primarily the early
literacy program and the assessment and accountability, so that
we're fortunate in that our two strengths and the majority of our
product line are in those areas in which there continues to be
access to funding. One of the things that did happen this quarter,
and you may have heard this, in this particular category, that the
funding itself, although it's available, it's taking longer to trickle
down to the actual purchasers, but the funding itself continues to
be available in the areas in which we've got a product line.

Natalie Walrond - Pacific Growth Securities - Analyst

Then the next question, I guess would be on insider selling. Can
you just clarify for us how much of the recent selling was part of a
10-B-5 program where it was sort of determined in advance and
how much wasn't?

Mike Wood - LeapFrog Enterprises, Inc. - President

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written consent of CCBN.com, Inc.
So I can't speak for anyone else's sales. I can say that at least my sales, this is Mike Wood, all year have been entirely 10-B-5-1.

Natalie Walrond - Pacific Growth Securities - Analyst

Not to beat a dead horse, but I'm really struggling to understand how this order shift thing works. It seems to me, I would guess at the beginning of the year when you look at your guidance and expectations for revenue, it's going to be driven primarily by what you're expecting the end-user to do, what you're expecting the consumer to do. And if you expected the consumer to provide a certain level of sales for the fourth quarter, then the fact that orders shifted from third quarter into fourth quarter, for you to add that over and above what we were originally estimating must mean that you're expecting stronger than originally expected demand. Is that right?

Mike Wood - LeapFrog Enterprises, Inc. - President

No, no. Let me give you an explanation, then let me get to the exact specific question you've asked.

First of all, so why did we miss guidance? Obviously, first of all, we did hit the low end of the EPS range, but as I mentioned we missed the U.S. consumer guidance by approximately $26 million. And as I also mentioned, it's approximately one week of shifting.

So then the question is, if we were right on our demand, which ultimately is going to dictate this, why were we off by essentially a one week in shipping. And we've done a lot of soul searching on this. An increment of it may be having orders and not shipping, but I'm more inclined to think that the primary factor is two things: One, maybe a slight misjudgment on us in terms of looking at our historical performance, particularly last year. In hindsight what, we realized is that we -- there was plenty of retailer demand at the end of the third quarter because everyone wanted products in their warehouses in anticipation of the West Coast Dock Strike. And it's conceivable that that shift in demand may have accounted for two or three days worth of the shift. The second thing that we believe is happening is that the retailers made a conscious decision, if they could defer their inventory buildup by, you know, a half week or a week and not miss any sales, they'd push the risk back down to us.

That's why I feel good in the guidance on the full year that our demand is strong and remains strong, that the retailers are ultimately going to order consistent with demand, and that what happened was we essentially -- our shipping and to a certain extent their orders, were deferred by approximately a week, net a week.

Now, we don't need to show increased demand fourth quarter over third quarter, and, in fact, if you look at the numbers, the sell-through rate actually goes down, and that would be consistent with the projections that we've given. So the demand in the third quarter, and if it continued at this level in the fourth quarter, is more than enough to increase -- to increase the shipments and to allow us to give the projections that remain consistent on a full-year basis.

Okay. That's very helpful. Thank you.

You're welcome.

Your next question comes from Margaret Whitfield.

Good morning. I wanted to tell you what I saw during the quarter, which was a lot of LeapPad inventory, then when it was marked down to $39 it appeared to move. I was wondering, to what extent did the retailers want to have the inventory work down before the LeapPad Plus came in because most likely it might cannibalize the LeapPad itself. If you could first comment on that.

Mike Wood - LeapFrog Enterprises, Inc. - President

First of all, one thing that's sort of interesting, as you probably have observed, in each, I think, the last three years, the retailers have virtually all marked down the LeapPad to -- I shouldn't say marked down, that's the wrong term, but they created an every day retail price of $39.95, and that happened three years ago when the
LeapPad was the hottest item in the industry. It just happens whenever you have a hot item everyone uses that as a price driver to drive traffic. It turns out, sure, counter-intuitively, this year at least one of the major retailers waited much longer than last year to mark the price down to $39.95, so it actually, in some ways, we thought, deferred demand in sell-through, vis-a-vis last year, but I certainly can't complain since the sell-through was up 40%.

So I don't think that they marked -- I don't think that they marked it down when they did to make room for the LeapPad Plus Writing. In fact, they marked it down net later than they did last year.

So I think what -- I think what the retailers are anticipating, certainly has been what we've seen, is that each of these niches, in terms of our platforms, are working. As I said, the Little Touch is actually exceeding our expectations. My First LeapPad is up. LeapPad looks like it has a very strong niche in the LeapPad and LeapPad Pink, at that price point, and the LeapPad Plus are at or above our expectations.

So it appears to me we're all managing our inventory appropriately, although it does -- this deferral by a week does shift slightly the risk to us in terms of, you know, the timing of us making our shipments to the retailers. But I think that may just be a fact of life going forward.

So you don't see any unusual cannibalization at this stage by the Plus?

Well, hold on. Unusual cannibalization, just by background, we were very concerned that My First LeapPad would cannibalize the LeapPad, and in fact turns out it may have, but we increased sales of the LeapPad and the My First LeapPad last year.

We anticipate that there will be some cannibalization of the LeapPad by the LeapPad Plus this year. That is, people are now going to have a direct choice of the same age group. Do I want to buy the LeapPad, which is a lower price but doesn't have the interactive writing and math, or do I want to pay more for the LeapPad Plus. And I'm sure that some people who last year would have bought the LeapPad are going to opt to upgrade to LeapPad Plus Writing. We think that some people who've already had the LeapPad are going to buy the LeapPad Plus because they want that additional functionality. But there's no question we will be -- we think we're increasing the overall market but there will be some cannibalization. But what we've seen so far is consistent with our expectations.

Two other questions for Jim. Where do you think you'll end the year with inventories? Could you give us some commentary on the outlook for fourth quarter gross margins, and did the international segment, the sales growth there, in some ways take away from Q4 or is it exactly where you thought it would be?

Okay. Inventories, we'd guide you in a range of $85 to $100 million. 85 million would put us flat with last year. Then gross margin guidance would be in a range of 51 to 52% in the full year. And about 50 to 52% in the fourth quarter. Between the high and low range.

And the international sales growth, which was up sharply?

We don't break out guidance for the individual segments, but it's been healthy all year. I think that's a good indicator. We'd prefer not to go into individual segment sales.

Anything unusual in the timing for the third quarter that you reported today, any timing issues there? Did you ship earlier than expected, or was it about where you thought it would be?

I think we're better safe. Number one, we did not see the same deferral on inventory buildup. I guess that should be obvious with the increase in sales. And we think that the increase in sell-in is consistent with what we're seeing in terms of increased sell-through.

Thank you.

Your next question comes from Jennifer Childs.
Mike Wood - LeapFrog Enterprises, Inc. - President

Hi, Jennifer.

Jennifer Childe - Bear Stearns - Analyst

Hi, good morning. I have three questions. Number one, I was a little confused about your answer to Howard’s question about inventory. If you have merchandise that didn’t ship, wouldn’t it be reflected in higher inventory levels? I’ll just run through the questions. Number two, did mark-downs or promotions affect the top line at all? Number three, is there a chance that you’ll have to air-freight the Leapster?

Mike Wood - LeapFrog Enterprises, Inc. - President

Let me answer those in reverse order. One, there’s not a chance, there’s a certainty that we will be air-freighting Leapster, and we will be -- we’ve been anticipating that from the beginning.

Secondly, did mark-downs or promotions affect the top line. The answer is no. There was very little mark-down -- there's two forms of mark-downs. Very little mark-down in terms of discontinued items, and that mark-down was a very small increment of the -- of our third quarter sales. The rate of sales is affected by the timing of the retailers’ decisions to lower their prices on particularly hot items. And I suppose you could say that there was some effect because one of the major retailers maintained LeapPad price at $49.95 significantly longer than they did last year, but I wouldn't blame our shipment on that.

Again, the problem with our shipments wasn't for lack of sell-through at retail. And I've already gone through, and you're probably getting tired of hearing, at least why I believe the deferrals and -- that there was a shift in timing.

Your last question was inventory, and your answer is right. Those items which we had, which we did not ship, remained in our inventory, and, in fact, if we had shipped them, and, again, we could not -- just want to make it clear. I don't want this to be an excuse. We could not have shipped 100% of all orders that we received up to the last day. But if we had been more efficient in our shipping, that clearly would have lowered our inventory and our inventory would have at the end of the quarter been lower than we had projected.

Jennifer Childe - Bear Stearns - Analyst

Okay. Thank you.

Jennifer Childe - Bear Stearns - Analyst

Mike Wood - LeapFrog Enterprises, Inc. - President

Steve Mortimer - Analyst

Hi, guys. Couple of questions. Sorry, I jumped on a little late, if you did address them. I was wondering if you could clarify whether that sell-through number you stated was for U.S. consumer or for global.

Mike Wood - LeapFrog Enterprises, Inc. - President

The numbers we gave were for U.S. consumer.

Steve Mortimer - Analyst

Then, if that sell-in had matched the sell-through for U.S. consumer, would sales have been up in that division, instead of 4%, at least the 40%, matching platforms, or potentially somewhere between the 40 and the 80?

Mike Wood - LeapFrog Enterprises, Inc. - President

Well, yes, if they had -- matched identically -- if sell-in had matched identically sell-through, they would have been up, although the net number wouldn't be up 40 to 80, but on those numbers, just by definition, if the platform sell-through was up 40%, if sell-in was up the same percentage, they would have gone up.

As a practical matter, I just want to calibrate this, when we give third quarter sell-through, it is indicative of the strength of those

Right. And if you will recall, at the first and second quarter calls, the primary focus to us was why is your inventory so high, so we have, and one could say arguably, over-reacted in terms of inventory management. So our inventory is low, in part because we made a concerted effort to try and align inventory as closely as possible, and as I said, I think that people would -- there would be a lot of praise if we actually shipped that full amount and our inventories were even lower than we had projected.
products, and we can certainly use it as an indicator on where we think we'll go in the fourth quarter. But the dollar amount of the sell-through in the third quarter is relatively low, and certainly it's relatively low to the sell-in. The sell-in is not primarily dictated by getting product in the third quarter to sell-in the third quarter. It's getting product in the channel to be available in the fourth quarter when those trends accelerate into the heavy buying season.

So the literal answer is, if sell-in had matched sell-through they would have been up a lot higher, but generally in the third quarter you don't get a perfect correlation because, as I said, it's not -- the purpose is not to literally -- the retailers are not literally buying one to replace the one that sold through. They're buying a lot more than is selling through because they're looking at the trends and trying to build inventory in anticipation of as those trends go forward.

Steve Mortimer Analyst

That makes sense. Lastly, did I hear you correctly that, given your guidance for Q4 you are actually assuming in that guidance a decline in the year to year sell-through at retail, so if trends did continue that guidance would prove quite conservative?

Mike Wood - LeapFrog Enterprises, Inc. - President

Yeah, I do not want to be in a position where we are considered to be giving conservative guidance. I personally think that the fourth quarter is going to be very competitive across the industry and within our subsegment. So, yes, what I said was, if you just sort of do the math, I'm anticipating that the -- obviously, that our net increase in sales for the U.S., I think it's net for the year is about 22%, and to the extent that it correlates in the long run with sell-through, that's a decrease in sell-through. And, again, I think that it's prudent for us to plan that way, prudent for us to guide that way, and prudent for us all to take seriously this guidance in light of what I mentioned – That is, I think that it will be a very competitive fourth quarter.

Steve Mortimer Analyst

And Power Touch is the main reason?

Mike Wood - LeapFrog Enterprises, Inc. - President

No, just to calibrate something. Power Touch is one item for one purchaser of one of our platforms. We've got substantial infant/toddler items, substantial preschool items, substantial ELA items, platforms for kids under 3, Quantum Pads for kids in the third, fourth, fifth grade, Turbo Twist for kids in the first, second, third, fourth, fifth grades, I-quest in the fifth, sixth, seventh and eighth grade, so certainly Power Touch is one of our competitors but there is competition for parents and relatives' dollars for every one of their kids in every category.

Steve Mortimer Analyst

Then lastly, I guess, if sales had met your original high end of the expectations would SG&A have been also correspondingly higher or would it also have been flat still year to year?

Mike Wood - LeapFrog Enterprises, Inc. - President

There are variable expenses, it would have gone up, but our leverage would have been even greater with higher sales.

Steve Mortimer Analyst

Thanks, guys.

Mike Wood - LeapFrog Enterprises, Inc. - President

Thank you. Is it one more question, Chris?

Christopher Bunn - LeapFrog Enterprises, Inc. - Director of Investor Relations

Yes. Operator, we'd like to take one more question, please.

Operator

You do have a follow-up question from Lauren Fine.

Mike Wood - LeapFrog Enterprises, Inc. - President

Hi, Lauren.

Lauren Fine - Merrill Lynch - Analyst

Hi there. Thanks. I'm wondering if you could give us a sense of what the gross margins were on the product lines and whether you think SchoolHouse will be profitable for the year, then finally in terms of the deferred orders was there any particular retailer that sort of postponed or deferred more so than others, like a Wal-Mart or anybody like that?

Mike Wood - LeapFrog Enterprises, Inc. - President

So you asked three questions. The first deferred, yes, but we would -- we will not disclose the buying strategies of our retailers. It just wouldn't be appropriate. And what were the first two questions, Lauren? The gross margin?
Lauren Fine - Merrill Lynch - Analyst

Looking for the gross margin by product line and SchoolHouse profitability.

Mike Wood - LeapFrog Enterprises, Inc. - President

Okay. So we still believe that SchoolHouse will reach the break-even point this year and, Jim, I'll let you address the gross margin issue.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

The only thing we've given on gross margin by product line, if you're talking platform software and stand alone, you know, had been broad range, we haven't broken out any clearer than that. I can reiterate those from the past. You know, our platforms, in a 40 to 50% gross profit margin, the most mature platforms being at the high end of that range, obviously the LeapPad. Software, 60 to 70% gross profit margins. And stand-alone, 35 to 45%.

Lauren Fine - Merrill Lynch - Analyst

And I guess actually what I was really also hoping for was more of a U.S. consumer/international on SchoolHouse, tied into that question on break even. Any sort of gross margins differences across there?

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

SchoolHouse is the strongest gross profit margins. We do break that out. I can give you that. The SchoolHouse gross profit margin for the full year-to-date, 59.2%, you know, versus 53.7% last year. That's in line with what we said. We target them since they're a consumer-direct business, at about 60%.

Lauren Fine - Merrill Lynch - Analyst

And U.S. consumer, then?

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

U.S. consumer on a year-to-date basis, is at 51.2%. That compares with 51.5% last year.

Lauren Fine - Merrill Lynch - Analyst

Then I think international is the missing piece.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

International, very strong at 52.8% year-to-date versus 41.5 percent last year.

Lauren Fine - Merrill Lynch - Analyst

Great. Thank you.

Jim Curley - LeapFrog Enterprises, Inc. - Chief Financial Officer

You're welcome.

Mike Wood - LeapFrog Enterprises, Inc. - President

Thank you everyone. Our next conference call covering the December quarter will be in February. I actually look forward to that conference call and thank you for joining us today.

Operator

Thank you for participating in today's conference call. You may now disconnect.
Exhibit 6
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2003

OR

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

Commission File Number 001-31396

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

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

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

Registrant's Phone Number, Including Area Code: (510) 420-5000

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

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

The number of shares of Class A common stock, par value $0.0001, and Class B common stock, par value $0.0001, outstanding as of November 4, 2003, was 29,919,720 and 28,882,817, respectively.
LEAPFROG ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(Unaudited)

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<tr>
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<td>Other income (expense), net</td>
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<td>Income before provision for income taxes</td>
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<td>Provision for income taxes</td>
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<tr>
<td>Diluted</td>
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<td>Shares used in calculating net income per common share:</td>
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<tr>
<td>Basic</td>
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<tr>
<td>Diluted</td>
<td>61,086,489</td>
<td>53,384,455</td>
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See accompanying notes.
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Education and Training. Our Education and Training segment’s gross profit increased by $1.3 million, or 52%, from $2.4 million in the third quarter of 2002 to $3.7 million in the third quarter of 2003. Gross profit margin increased from 45.9% in the third quarter of 2002 to 51.4% in the second quarter of 2003. The increase in gross profit margin in this segment was primarily due to lower product costs, partially offset by higher freight and warehousing expenses.

International. Our International segment’s gross profit increased by $8.8 million, or 116%, from $7.5 million in the third quarter of 2002 to $16.3 million in the third quarter of 2003. Gross profit margin increased from 47.7% in the third quarter of 2002 to 55.1% in the third quarter of 2003. The increase in gross profit margin in this segment was primarily due to lower product cost and the fact that higher-margin software sales comprised a larger percentage of the product mix.

Selling, General and Administrative Expenses
Selling, general and administrative expenses decreased by $0.1 million, or 1%, from $22.9 million in the third quarter of 2002 to $22.8 million in the third quarter of 2003. As a percentage of net sales, selling, general and administrative expenses decreased from 12.6% in the third quarter of 2002 to 11.2% in the second quarter of 2003. The dollar decrease year-over-year was primarily due to lower incentive compensation, litigation, and bad debt expenses, offset by increased fixed compensation expenses. Decreased incentive compensation expense was due to reduced employee incentive and commission expenses related to lower sales performance as compared to internal goals. Litigation expenses were lower in the third quarter of 2003 compared to the same period in 2002, primarily due to the settlement, in the second quarter of 2003, of most of our outstanding litigation matters. Bad debt expense was lower than last year due to the loss incurred on the sale of the remaining Kmart pre-petition bankruptcy receivables in the prior year. The higher fixed compensation expense resulted from our emphasis on building internal sales and marketing teams and infrastructure to support our projected worldwide growth. On a full-year basis, we anticipate selling, general and administrative expenses to increase in dollars but to decrease as a percentage of net sales as compared to 2002.

Research and Development Expenses
Research and development expenses, which include content and product development expenses, decreased by $0.1 million, or 1%, from $14.1 million in the third quarter of 2002 to $14.0 million in the third quarter of 2003. As a percentage of net sales, research and development expenses decreased from 7.8% in the third quarter of 2002 to 6.9% in the third quarter of 2003.

Content development expense increased by $0.4 million, or 6%, from $6.9 million in the third quarter of 2002 to $7.3 million in the third quarter of 2003. As a percentage of net sales, content development expenses decreased from 3.8% in 2002 to 3.6% in 2003. Spending on development of software products increased by 8% over the third quarter of 2002, but was fully offset by lower spending on Internet content. We anticipate content development expenses to increase in dollars year-over-year, but to decrease as a percentage of net sales.

Product development and engineering expenses decreased by $0.6 million, or 8%, from $7.3 million in the third quarter of 2002, to $6.7 million in the third quarter of 2003. As a percentage of net sales, product development and engineering expenses decreased from 4.0% in 2002 to 3.3% in 2003. Spending on the development and engineering of new platforms and stand-alone products increased by 11% over the third quarter of 2002, but was fully offset by decreased website engineering expenses. 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. We anticipate product development and engineering expenses to increase in dollars year over year, but to decrease as a percentage of net sales.

Advertising Expense
Advertising expense increased by $1.6 million, or 14%, from $11.9 million in the third quarter of 2002 to $13.5 million in the third quarter of 2003. As a percentage of net sales, advertising expense increased from 6.5% in 2002 to 6.6% in 2003. The increase in advertising expense was primarily due to increased television advertising to promote brand awareness for the upcoming holiday season. We anticipate this dollar increase to continue in the fourth quarter of 2003 compared to the same period last year.

Depreciation and Amortization Expenses
Depreciation and amortization expenses, which exclude depreciation of tooling and amortization of content development costs included in cost of sales, increased by $0.1 million, or 11%, from $1.8 million in the third quarter of 2002, to $1.9 million in the third quarter of 2003. As a percentage of net sales, depreciation and amortization expense was
Gross profit for each segment and the related percentage of segment net sales were as follows:

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<tr>
<td></td>
<td>$139.4</td>
<td>$123.4</td>
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<td>U.S. Consumer</td>
<td>51.2%</td>
<td>51.5%</td>
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<td>Education and Training</td>
<td>15.6</td>
<td>7.6</td>
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<tr>
<td>International</td>
<td>59.2%</td>
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<td></td>
<td>52.8%</td>
<td>41.5%</td>
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<tr>
<td>Total Company</td>
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<td></td>
<td>52.0%</td>
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U.S. Consumer. Our U.S. Consumer segment’s gross profit increased by $16.0 million, or 13%, from $123.4 million in 2002 to $139.4 million in 2003. Gross profit margin decreased from 51.5% in 2002 to 51.2% in 2003. This segment represented 42% of the total company gross profit increase. The decrease in gross profit margin in this segment was primarily due to higher royalty and warehousing expenses, partially offset by lower product costs.

Education and Training. Our Education and Training segment’s gross profit increased by $8.0 million, or 106%, from $7.6 million in 2002 to $15.6 million in 2003. Gross profit margin increased from 53.7% in 2002 to 59.2% in 2003. This segment represented 21% of the total company gross profit increase. The increase in gross profit margin in this segment was primarily due to lower product cost, partially offset by higher warehousing expenses.

International. Our International segment’s gross profit increased by $14.0 million, or 113%, from $12.3 million 2002 to $26.3 million in 2003. Gross profit margin increased from 41.5% in 2002 to 52.8% in 2003. This segment represented 37% of the total company gross profit margin increase. The increase in gross profit margin in this segment was primarily due to lower product cost.

Selling, General and Administrative Expenses
Selling, general and administrative expenses increased by $12.2 million, or 23%, from $54.0 million in 2002 to $66.2 million in 2003. As a percentage of net sales, selling, general and administrative expenses remained flat at 19.0%. The dollar increase year over year is primarily due to higher fixed compensation expenses resulting from our worldwide expansion, offset by lower incentive compensation expenses.

Research and Development Expenses
Research and development expenses, which include content and product development expenses, increased by $1.9 million, or 5%, from $39.8 million in 2002 to $41.7 million in 2003. As a percentage of net sales, research and development expenses decreased from 14.1% in 2002 to 12.0% in 2003.

Content development expenses increased by $1.9 million, or 9%, from $21.3 million in 2002 to $23.2 million in 2003. However, as a percentage of net sales, content development expenses decreased from 7.5% in 2002 to 6.6% in 2003. The dollar increase in our content development expenses was primarily due to our expanded assortment of content for use with our existing and new platforms.

Product development and engineering expenses remained flat at $18.5 million. As a percentage of net sales, product development and engineering expenses decreased from 6.5% in 2002 to 5.3% in 2003. Our core product development expenses increased by $3.8 million, or 28%. The increase in core product development expenses year over year is primarily due to the development costs of our new platforms scheduled to be released in the fall of 2003, offset by decreased website engineering expenses.

Advertising Expense
Advertising expense increased by $5.3 million, or 25%, from $21.0 million in 2002 to $26.2 million in 2003. As a percentage of net sales, advertising expense increased from 7.4% in 2002 to 7.5% in 2003 due to higher television advertising and higher advertising agency fees.

The increase in dollars year over year is primarily due to increased print and television media advertising to promote brand awareness as a result of our worldwide expansion.
Our business is seasonal, and therefore our annual operating results will 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 2002, approximately 81% 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 place orders so that suppliers like us will fill the orders closer to the time of purchase by consumers, thereby reducing their need to maintain larger on-hand inventories throughout the year to meet demand. While these techniques reduce retailers’ investments in their inventory, they increase pressure on suppliers to fill orders promptly and shift a significant portion of inventory risk and carrying costs to suppliers like us. The logistics of supplying more product within shorter time periods will increase the risk that we fail to meet tight shipping schedules, which could damage our relationships with retailers, increase our shipping costs or cause sales opportunities to be delayed or lost. The seasonality 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. For example, Jetta Company Limited was the sole manufacturer of 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.

Outbreaks of Severe Acute Respiratory Syndrome, or SARS, may adversely impact our business or the operations of our contract manufacturers or our suppliers.

In the past, outbreaks of SARS have been significantly focused on Asia, particularly in Hong Kong, where we have an office, and in the Guangdong province of China, where almost all of our finished goods manufacturers are located. The design, development and manufacture of our products could suffer if a significant number of our employees or the employees of our manufacturers or their suppliers contract SARS or otherwise are unable to fulfill their responsibilities. In the event of any significant outbreak, quarantine or other disruption, we may be unable to quickly identify or secure alternate suppliers or manufacturing facilities and our results of operations would be adversely affected.

Our products are shipped from China and any disruption of shipping could harm our business.

We rely on four contract ocean carriers to ship virtually all of the products that we import to our primary distribution centers in California. Retailers that take delivery of our products in China rely on a variety of carriers to import those products. Any disruption or slowdown of service on importation of products caused by SARS-related issues, labor disputes, terrorism, international incidents, quarantines, lack of available shipping containers or otherwise could significantly harm our business and reputation. For example, in 2002, a key collective bargaining agreement between the Pacific Maritime Association and the International Longshore and Warehouse Union affecting shipping of products to the Western United States, including our products, expired and, after a temporary extension, resulted in an eleven–day cessation of work at West Coast docks. This cessation of work cost us approximately $3.0 million in additional freight expenses. Although the Pacific Maritime Association and International Longshore and Warehouse Union have entered into a new collective bargaining agreement, any further disruption or slowdown of service on importation of products caused by labor disputes, terrorism, international incidents, lack of available shipping containers or otherwise could significantly harm our business and reputation.

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.
production to meet that demand. However, the demand for our products depends on many factors such as consumer preferences, including children's preferences, and the introduction or adoption of new hardware platforms for interactive educational products, and can be difficult to forecast. We expect that it will become more difficult to forecast demand for specific products as we introduce and support additional products, enter additional markets and as competition in our markets intensifies. If we misjudge the demand for our products, we could face the following problems in our operations, each of which could harm our operating results:

- If our forecasts of demand are too high, we may accumulate excess inventories of components and finished products, which could lead to markdown allowances or write-offs affecting some or all of such excess inventories. We may also have to adjust the prices of our existing products to reduce such excess inventories.

- If demand for specific products increases beyond what we forecast, our suppliers and third-party manufacturers may not be able to increase production rapidly enough to meet the demand. Our failure to meet market demand would lead to missed opportunities to increase our base of users, damage our relationships with retailers and harm our business.

- 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 regulation by the Consumer Product Safety Commission, or CPSC, and similar state regulatory authorities, and 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 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 the introduction of our first platform, we have grown rapidly, both domestically and internationally. Our net sales have grown from $71.9 million in 1999 to $531.8 million in 2002. During this period, the number of different products we offered at retail also increased significantly. At December 31, 1999, we had 85 employees and at December 31, 2002, we had 690 employees. In addition, we plan to hire a significant number of new employees in 2004. 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.
SIGNATURES

Pursuant to the requirements 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.
(Registrant)

/s/ Michael C. Wood

Michael C. Wood
Chief Executive Officer and President
(Authorized Officer)

Dated: November 10, 2003

/s/ James P. Curley

James P. Curley
Chief Financial Officer
(Principal Financial and Accounting Officer)

Dated: November 10, 2003
Exhibit 7
Press Release

LeapFrog Enterprises, Inc. Reports 2003 Net Income Up 67% on Sales Increase of 28%
LeapFrog Becomes Market Leader in Entire US Preschool Category in Critical Fourth Quarter

EMERYVILLE, Calif., Feb. 10 /PRNewswire-FirstCall/ -- LeapFrog Enterprises, Inc. (NYSE: LF), a leading developer of innovative technology-based educational products, today reported financial results for the fourth quarter and year ended December 31, 2003.

Net Income up 67% for Full Year, Up 50% In Fourth Quarter

Net income for 2003 increased 67% to $72.7 million compared with net income of $43.4 million for the year ended December 31, 2002. Net income per fully-diluted share increased to $1.20 compared with $0.86 per fully-diluted share in the prior year.

The company recorded net income for the fourth quarter ended December 31, 2003 of $44.2 million, up 50% compared with net income of $29.4 million for the fourth quarter of 2002. Net income per fully-diluted share was $0.72 in the fourth quarter of 2003, compared with $0.50 per fully-diluted share in the fourth quarter of 2002. The company achieved these results despite a reserve necessitated by the KB Toys bankruptcy and airfreight expenses related to late, stronger-than-expected demand for several key platform products, including the Leapster multimedia handheld learning system.

Net Sales up 28% for Full Year, Up 33% in Fourth Quarter

Net sales for 2003 were $680.0 million, up 28% compared with $531.8 million for 2002. Net sales for the fourth quarter of '03 were $331.3 million, up 33% compared with $248.4 million in the fourth quarter of 2002.

Market Share Increases from 17.5% to 27.5% in the Fourth Quarter

According to The NPD Group, Inc., LeapFrog was the leading manufacturer of pre-school products in the U.S. market in the fourth quarter of 2003. "We are extremely proud of our market share gains in the U.S. pre-school markets," said Wood. "We hope to build on this success with an expanding line of engaging, educational products for pre-school children in the U.S. and abroad."

Segment Results

For 2003, net sales from the U.S. Consumer segment were $546.0 million, up 19% from 2002. Net sales from the International segment were $96.6 million, up 80% from 2002. Net sales from the Education and Training segment were $37.4 million, up 86% from 2002.

For the fourth quarter of 2003, net sales from the U.S. Consumer segment were $273.4 million, up 25% from the fourth quarter of 2002. Net sales from the International segment were $46.8 million, up 96% from the fourth quarter of 2002. Net sales from the Education and Training segment were $11.1 million, up 85% from the fourth quarter of 2002.

Gross Margin

For 2003, gross profit margin was 50.0%, down 80 basis points compared with 50.8% in 2002. For the fourth quarter of 2003, gross profit margin was 47.9%, down 310 basis points from 51.0% in the fourth quarter of 2002. The gross profit margin decrease for the fourth quarter and all of 2003 can be attributed primarily to the lower margin on the sales of the Leapster platform, which was introduced at the end of October 2003 and which included in its cost of sales the airfreight incurred in the holiday season.

Increased Leverage from Operating Expenses

For 2003, operating expenses were 33.9% of net sales, a 350 basis point improvement in leverage over 37.4% in 2002. For the fourth quarter of 2003, operating expenses were 27.3% of net sales, a 460 basis point improvement in leverage over...
31.9% in the fourth quarter of 2002. The company's 2003 fourth quarter operating expenses reflect improved leverage in selling, general and administration, and research and development expense offset by increased television advertising expense.

"We expected, strong holiday sales of our new platform and software learning products produced solid results and growth in 2003," said Mike Wood, President and Chief Executive Officer of LeapFrog. "We are very pleased that our fourth quarter results soundly verified what we said on our third quarter conference call. Namely, while the retail toy industry appears to be shifting its ordering practices more toward the back end of the year, consumer demand for our learning products is more vibrant than ever. Parents, teachers and children around the world are eagerly embracing our engaging, effective and fun learning products.

"In the Fall of 2003, we launched three learning platform products, the LittleTouch LeapPad learning system, the LeapPad Plus Writing learning system and the Leapster multimedia handheld. The LittleTouch and the LeapPad Plus Writing platforms are the newest members of the LeapPad family of products. The success of these new platforms, combined with the ongoing success of the continuing LeapPad family platform products resulted in a 27% annual increase in LeapPad family platform and a 33% annual increase in LeapPad family software net retail sell-through in 22 U.S. retail accounts, which accounted for 96% of our total U.S. sales in 2003. We are particularly proud of these accomplishments in light of a challenging retail environment and increased competition."

The Leapster platform, LeapFrog's new animated handheld learning system, received much popular acclaim despite an introduction late in the holiday selling season. In particular, the Leapster was awarded Toy Wishes Magazine's 2003 All Star award in the education and learning category, and was named to the Toy Wishes Hot Dozen list for 2003.

"We have sold more than 23 million platform products from 1998 when we introduced our first learning platform, the LeapPad system, through the end of 2003. This year, we will renew our effort to expand our installed base of platform products," said Wood. "In 2004 and beyond, we also intend to focus on further development of engaging, educational content to offer the broadest line of high quality content for our customers."

Outlook for 2004

LeapFrog offers financial guidance to investors to promote understanding of its business outlook. The company operates in a highly seasonal industry with a significant dependence on a few large customers. Forecasting quarterly performance is subject to a high degree of uncertainty, hence the company will no longer provide full financial guidance on a quarterly basis, but will instead focus its guidance on full-year results. LeapFrog's full-year guidance for 2004 is as follows:

- Net sales of $800 to $850 million
- Effective tax rate of approximately 34% for all of 2004
- Net Income of $88 to $95 million
- Fully diluted share count of approximately 63 million shares
- Diluted net income per share of $1.39 to $1.51

In addition, the company provides the following discussion to assist in understanding the seasonality anticipated during the year:

Consistent with reported trends, the company expects that its 2004 sales growth will be lower in the first half and higher in the second half, as compared to 2003. The company expects 2004 sales seasonality to be about 20% of full year sales in the first half, spread equally between the first two quarters. Gross profit margin is expected to be approximately 50% in each quarter in 2004. Operating expenses are expected to grow approximately 20% to 25% for the full year, but the rate of growth of operating expenses in the first quarter of 2004 is expected to be 10% to 15% over the first quarter of 2003.

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.

Conference Call

A conference call will be held tomorrow, Wednesday, February 11 at 9:00 a.m. Eastern time (6:00 a.m. Pacific time) to discuss these announcements and to provide further discussion of results for the 2003 fourth quarter and outlook for 2004. A live web cast of the conference call will be offered on LeapFrog's investor relations website at www.leapfroginvestor.com and on www.ccbn.com. A replay of the web cast will be available on these websites through April 30, 2004. To participate in the call, please dial 706-634-0183.

Out 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 electronics, reading, math, music, geography, social studies, spelling, vocabulary and science. In addition, the company has added 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 25 countries around the world. The LeapFrog SchoolHouse curriculum programs are currently in classrooms across the U.S. with over 200 interactive books and over 450 skill cards representing more than 6,000 pages of educational content. LeapFrog SchoolHouse 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, LEAPSTER, LEAPFROG SCHOOLHOUSE and LITTLETOUCH are trademarks of LeapFrog Enterprises, Inc.

Forward-Looking Statements

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

The statements in the section entitled "Outlook for 2004" and elsewhere 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: 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; seasonal variability in the various markets for the company's products; resellers' changes in their own inventory and stocking models, and health epidemics affecting the regions in which our products are manufactured. 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 targets as of the date of this release. The company disclaims any obligation to update this guidance prior to the completion of the first quarter of 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.

LEAPFROG ENTERPRISES, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands, except per share data)

December 31,
2003    2002

ASSETS
Current assets:
Cash and cash equivalents $69,844 $70,827
Short term investments  42,759  2,500
Accounts receivable, net  281,792  169,670
Inventories, net  90,897  84,460
Prepaid expenses and other current assets  8,370  4,065
Notes receivable due from related parties --  595
Deferred income taxes  11,735  16,783
Total current assets  505,397  348,900
Property and equipment, net  20,547  20,239
Other long term assets  1,048  484
Deferred income taxes  619  4,867
Intangible assets, net  25,048  23,192
Total assets  552,659  397,682

LIABILITIES AND STOCKHOLDERS' EQUITY
Current liabilities:
Accounts payable  $58,844  $86,161
Accrued liabilities  40,533  44,634
Deferred revenue  3,006  1,417
Income taxes payable  21,832  4,729

LeapFrog Enterprises, Inc.
Press Release

<table>
<thead>
<tr>
<th>Total current liabilities</th>
<th>136,941</th>
<th>124,215</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred rent and other long term liabilities</td>
<td>572</td>
<td>550</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>--</td>
<td>4,119</td>
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Commitments and contingencies

Stockholders' equity:
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<thead>
<tr>
<th>Total stockholders' equity</th>
<th>415,146</th>
<th>268,798</th>
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<tbody>
<tr>
<td>Total liabilities and stockholders' equity</td>
<td>$552,659</td>
<td>$397,682</td>
</tr>
</tbody>
</table>

**LEAPFROG ENTERPRISES, INC.**

CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

<table>
<thead>
<tr>
<th>Three Months</th>
<th>Year Ended Dec. 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2003</td>
</tr>
<tr>
<td>Net sales</td>
<td>$331,361</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>172,501</td>
</tr>
<tr>
<td>Gross profit</td>
<td>158,860</td>
</tr>
<tr>
<td>Operating expenses:</td>
<td></td>
</tr>
<tr>
<td>Sellings, general and administrative</td>
<td>25,444</td>
</tr>
<tr>
<td>Research and development</td>
<td>15,926</td>
</tr>
<tr>
<td>Advertising</td>
<td>47,535</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>1,594</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>90,499</td>
</tr>
<tr>
<td>Income from operations</td>
<td>68,361</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(2)</td>
</tr>
<tr>
<td>Interest income</td>
<td>233</td>
</tr>
<tr>
<td>Other income</td>
<td>1,622</td>
</tr>
<tr>
<td>Income before provision for income taxes</td>
<td>70,214</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>26,048</td>
</tr>
<tr>
<td>Net income</td>
<td>$44,166</td>
</tr>
<tr>
<td>Net income per common share</td>
<td></td>
</tr>
<tr>
<td>- Basic</td>
<td>$0.75</td>
</tr>
<tr>
<td>- Diluted</td>
<td>$0.72</td>
</tr>
<tr>
<td>Shares used in calculating net income</td>
<td></td>
</tr>
<tr>
<td>- Basic</td>
<td>58,892</td>
</tr>
<tr>
<td>- Diluted</td>
<td>61,549</td>
</tr>
</tbody>
</table>

**LEAPFROG ENTERPRISES, INC.**

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)

<table>
<thead>
<tr>
<th>Year Ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>Net income</td>
</tr>
</tbody>
</table>

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

Depreciation and Amortization 16,625 11,904
Provision for allowances for accounts receivable 40,165 25,178
Tax benefit from exercise of stock options and other 39,130 4,908
Other noncash items 7,088 (6,584)

Other changes in operating assets and liabilities:
Accounts receivable (152,287) (79,349)
Inventory (6,437) (38,357)
Prepaid and other current assets (4,305) (2,007)
Notes receivable due from related parties 595 94
Other assets (764) (136)
Accounts payable 27,317 24,433
Accrued liabilities 4,101 26,744
Income taxes payable (17,103) 12,198

Net cash provided by operating activities 26,800 22,470

Investing activities:
Purchases of property and equipment (15,810) (14,832)
Purchase of intangible assets (3,000) (250)
Purchases of short term investments (76,136) (2,500)
Sale of short term investments 35,735 --
Sale of investment in related party 181 --

Net cash used in investing activities (59,030) (17,582)

Financing activities:
Borrowings under credit agreement -- 182,000
Repayments under credit agreement -- (243,163)
Proceeds from the payment of notes receivable from stockholders 2,624 1,741
Proceeds from the issuance of common stock -- 115,116
Proceeds from the exercise of stock options and employee stock purchase plan 27,960 1,822

Net cash provided by financing activities 30,584 57,516

Effect of exchange rate changes on cash 663 154
Increase (decrease) in cash and cash equivalents (983) 62,558
Cash and cash equivalents at beginning of year 70,827 8,269
Cash and cash equivalents at end of period $69,844 $70,827

SOURCE LeapFrog Enterprises, Inc.
"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.
Event Transcript

LF - Q4 2003 LeapFrog Enterprises, Inc. Earnings Conference Call

Event Date/Time: Feb. 11, 2004 / 9:00AM ET
Please stand by. The event is about to begin. good day, and welcome to the LeapFrog Enterprises, Inc. fourth quarter fiscal year 2003 earnings conference call. Today's call is being recorded. With us from the company is the director of investor relations. Please go ahead, sir.

Unknown Speaker*

Good morning and welcome to LeapFrog's conference call for fourth quarter fiscal year 2003 which ended December 31, 2003. I am Christopher bond, the director of investor relations. After the close of the market yesterday we issued a press release detailing our fourth quarter and year results. Woo -- Mike Wood will discuss our performance shortly and our -- Jeff Curley will outline expectations for the year 2004. Finally, we will conduct a question and answer session. Before I begin with formal remarks, certain statements may include forward-looking statements about management's expectation, strategic objectives, anticipated financial performance and other similar matters. Forward-looking statements during this conference call may anticipate sales, operating margins, earnings -- earnings per share, shelf space, ability to develop markets, cap -- interest income and expense and SG&A expense. In addition, we expect the question and answers posed during the Q&A portion of this call may prompt answers that contain additional forward-looking statements that we have not anticipated and are not contemplated in our prepared statements. This cautionary language concerning forward-looking statements applies to both our prepared comments and our answers on this conference call. A variety of factors beyond the control affect the business strategy and performance of LeapFrog and could cause results to differ materially from the forward-looking statements. Some of these factors are described in our 2002 10K ended with the S.E.C. on March 28 and other filings made with the S.E.C. 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. Now I would like to introduce Mike Wood.

Unknown Speaker*

Thank you,
Chris.

Unknown Speaker*

2003 was a remarkable year for LeapFrog. Worldwide net sales grew 28% to 680 million. Net income grew 67% to 72.7 million, and net income per share grew 40% to $1.20 per share. We achieved these results with strong performances in each of our three divisions, U.S. customer net sales were up 19%, international net sales were up 80% and education and training net sales were up 86%. I would like to discuss the performance of each of these divisions briefly. I will begin with our U.S. customer division. According to the NPD, the U.S. toy industry was down nearly 3% in 2003. Against this backdrop, our net sales were up 19%, and our sell through was up 22%. At the 22 accounts, including our top four retail partners, which report their sell through results to us. I will refer to these as our 22 reporting accounts. These 22 reporting accounts represented 93% of our sales in 2002, and 96% of our sales in 2003. Our success in 2003 is reflected in the NPD full-year report. According to NPD, our market share in the preschool category grew from 18% to 22% for the full year. More importantly, in the critical fourth quarter our preschool market share grew to 27.5%. As a result, in the fourth quarter, for the first time ever, LeapFrog became the market share leader in the entire U.S. preschool category. We believe this is a major statement of the accelerating strength of the LeapFrog brand and our educational products. In the preschool electronic learning, a subcategory of preschool, NPD reported that our market share grew from 72.1% to 76.4% for the year, and grew to 77.9% in the fourth quarter. This reflects the remarkable on going strength of the My First LeapPad, basic LeapFrog and LeapFrog plus writing platforms against all competition in this category. In the infant category, which is distinct from the preschool category, NPD reported that our market share more than doubled from 8.3% to 17.2% for the full year, and was 21.2% in the fourth quarter. This remarkable growth reflects the success of our launch of the little touch LeapPad platform and its software in this category. LeapFrog now is number 2 in market share in the infant category and closing fast on number one. In the nonpreschool ELA category, which includes our Quantum Pad and iQuest, NPD
reported our market share share decline slightly from 68.5 to 64.1% for the year and our market share in the fourth quarter was 64.8%. We are going to do something about that this year. Now, I would like to turn to U.S. sales of the LeapPad family, which includes our little touch LeapPad, any any -- My First LeapPad, our classic LeapPad, leap plus writing and the Quantum Pad. Sell through of the LeapPad family in our 22 reporting accounts was up 27% for the year, and sell through of our LeapPad family software in those accounts was up 33% for the year, another remarkable result for the LeapPad family. For 2004, the LeapPad family will become even more dynamic and engaging. This year we plan to introduce over 40 new software titles for the LeapPad family. We are also launching three new LeapPad interactive educational games and LeapPad interactive educational playing cards, which will turn the LeapPad, LeapPad plus writing, our new LeapPad plus microphone and full tie media learning player platforms. I would like to discuss a -- in more detail the results of the three new platforms which we launched in 2003. The sales of each new platform which we launched significantly exceeded our expectations. We launched a little touch LeapPad platform so parents could introduce their infants and toddlers to a love of reading. We know that the more infants and toddlers are exposed to reading, the more likely they will become good readers. We launched little touch with five software titles. From its launch, we could not keep up with demand. Our efforts to chase that demand were reported on the front page of the "Wall Street Journal" on December 18 of last year. For 2004, we will be launching three new little touch titles, including Dr. SEUSS and the classics, "where the wild things are" and the "little engine that could." We launched a LeapPad plus writing platform because we know that kids learn to read and to write at roughly the same stage, and that the process of learning to read and learning to write compliment each other. We were able to turn the LeapPad magic pen into the LeapPad magic writing pen. The LeapPad plus writing was the most successful first-year launch of any platform we have ever introduced at LeapFrog. In 2004, we are introducing exciting new writing recognition software for the LeapPad plus writing which we believe will elevate this platform to a whole new level. We will unveil this at toy fair. In addition, we plan to launch five new LeapPad plus software writing titles. Of course, all 56 of our classic LeapPad titles will also run on the LeapPad plus writing platform. Finally, the launch of leap -- LEAPSTER. Kids in the United States spend an inordinate amount of what some would call unproductive time playing hand held games. A couple of years ago LeapFrog made a commitment to see if we could create a hand-held multimedia platform built around making learning as exciting and engaging as games built around stealing cars. I know this goal seems I am problemable -- I am problem able but recall with me that LeapFrog was committed five-years ago to creating a platform that would make reading fun and engaging and this goal seemed equally I am problem able five-year -- year as. Our first problem was to develop software that would enable interactive games, books and an art studio. As you know we built a 4-inch color back lit display that runs on a 32-bit processor with 8 channel and you had and dual input touch screen and directional pad. This is one of the advantages of having your own in-house technology group. We called the leap STER a multimedia learning system because we have developed interactive educational games, interactive educational books, interactive educational videos and an interactive art . -- stood I don't -- studio, and our goal was achieved. I would like to quote from Amazon.com. "I bought the system for Christmas for my son. He has not let it go he opened his gift. I was having trouble during school reading time trying to make tens but now with the leap STER, he just gets words and is overjoyed. I am so pleased with this product. The painting section is a delight, the pictures come to life with the animation and sound is wonderful. I am going to buy another for his sister, because they just can't seem to get their hands off it. PS. Thank you very much, LeapFrog. You really scored with this one. Ms. DEE, Brooklyn, New York." we launched it with four titles and in 2004 we plan to launch an additional four titles, including JUNIE Jones, Spiderman and justice league. All of which are built around PEDAGOGY and school. We will also expand titles that will offer content from preK to third grade grade of the leap STER. Finally, I am very proud of our learning videos. We launched our learning video line because we believe that individual I don'ts and DVDs for kids can be fun and really educational. Again, we subbing ed. He is a quote, another quote from Amazon.com. Several months ago my 4-year-old daughter began asking me to teach her to read. As we all know, sound recognition are learning blocks to read. I spent the last four-months rather successfully teaching her how letters are made. I bought the letter factory. After watching the DVD three times she now knows 95% of all the letter sounds. I am not kidding. Please
come out with more DVDs of this nature. Gale C, Salisbury, North Carolina. in 2004 we plan to double the size of our video line. Finally, in the U.S. in addition to all of our other initiatives, we are entering a new category, the juvenile product line, with four new products. Now I will turn to our international division where we increased net sales for the year, 80% to 96 million. In the United Kingdom, in 2003, Leapfrog sold its 1 million LeapFrog, according to NPD, my first books and LeapPad were the top three toys in the category for the year. In December LeapPad books were the top two books selling in the British industry, and for the year, LeapFrog became the market share leader in bring in the preschool -- bring in -- for the Canadian industry report LeapFrog market share in the preschool category grew from 13% to 24%. The LeapPad, My First LeapPad and pink LeapPad were the top three selling toys in the Canadian preschool category. In Korea, our sales were up 278%. In France our sales were up 242% and we successful successfully opened our own office and launched LeapFrog learning centers in Mexico. We are proud that our model is working, not only in English-speaking countries, but also in French, Spanish and Asian language speaking countries. In addition we are entering the German-speaking markets in 2004 through our partnership. We anticipate a very strong 2004 with international division, as we launch little touch, LeapPad plus writing and leap STER in various international markets and continue to grow our localized software titles. I will now turn to the education and training division which grew 80% to 37.5 million infant 2003. We had major sales in the Los Angeles, Chicago, Dallas and Las Vegas school districts. We anticipate a very strong 2004 as we add to our educational sales team and introduce our fourth generation leap, a LeapPad summer reading program and a Spanish version of our links program. In summary, looking forward to 2004 in the U.S. we plan to launch two new platforms, the Turbo Twist extreme and LeapPad plus my row phone. We are sing -- our little touch software and introducing LeapPad plus writing and redesigning the hardware and software of the iQuest and the Quantum Pad hardware platform. We are excited about the opportunities which lie ahead of us in 2004 and beyond. We are especially excited about our platform products and our new product line for 2004. We believe that when we do our job producing and throwing educational products for home and cool, kids, parents and teachers all win. Let me now turn the call over to Jim Curley.

Unknown Speaker*

Thank you, Mike, and thank you all for joining us today. Net sales for the fourth quarter of 2003 were up 33% to 331.4 million as compared with 248.4 million in the fourth quarter of 2002. Each of our business segments had solid increases. Net sales from our U.S. customer segment were up 25% to 273.4 million as compared with 218.5 million in the fourth quarter of 2002. Net sales from our international segment were up 96% to 46.8 million as compared with 23.9 million of net sales in last year's fourth quarter education and training segment net sales 89% as compared to 11.1 Persian Gulf as compared to the fourth quarter of 2002. Regarding our segment sales mix for the fourth quarter, the U.S. customer segment was 83% of our revenue, the international segment was 14% of our revenue, and the education and training segment was 3% of our quarterly revenue. This is the same segment sales mix as last year's fourth quarter. In the fourth quarter, our platform sales increased 30% versus last year. Software sales increased 33% and standard software sales increased 39%. The particularly strong growth in both platforms and software sales attest to the strength of our hardware/software model. Our fourth quarter sales mix was as follows. Hardware comprised 41, -- % of the total, software 33% and stand alone, 25%. And for comparison, last year's sales mix was fairly close at 42% for the hardware, 33% for software and stand alone at 24%. Our fourth quarter fourth quarter gross profit was up to 159 million. Our gross profit margin was 47 boy 9% in the quarter, down 310 basis points from 51% last year. We estimate that leap STER had a 330 basis point negative impact on consolidated fourth quarter gross profit margin which included the cost of air freight to expedite delivery of our new platform late in the quarter. Fourth quarter operating expenses were 90.5 million, only 14.3% higher than last year. As a percent of sales, fourth quarter operating expenses decreased from 31.9% last year to 27.3% this year. A 460 basis point improvement. Our advertising expense increased significantly in dollars. As expected, both SG&A and R&D declined as a percent of sales. Our operating income for the quarter was 68.4 million or 20.6% of sales, up 140 basis points from last year's fourth quarter. Interest income for the fourth quarter was essentially flat at 233,000 compared with the fourth quarter of 2002. Other income increased 1.6 million in the fourth quarter compared with 966,000 in the fourth quarter of 2002 due to foreign currency exchange gains. Net income for the fourth quarter of 2003 was up 50% to 44.2 million as compared with
29.4 million in the fourth quarter of last year, and our fourth quarter net income per share was 72 cents compared with last year's 50 cents, a 44% increase. Now I would like to recap the full year 2003 net sales 680 million up 25.1% of 38 million for for 2002 for full year 2003 our U.S. U.S. customer segment up 19%, international segment up 80% and education and training segment was up 86%. Our full-year gross profit margin was 50.0% versus 50.8% in 2002. We achieved 350 basis points of leverage on our operating expenses with 2003 expenses of 33.9% of sales compared with 37.4% in the prior year. 2003 operating income was 109.5 million, up 53.4% over last year's 71.4 million. This operating income for the full year was 16.1% of sales, up 270 basis points from 2002. And our net income for 2003 was 272.7 million, up 67% from 43.4 million in 2002. Our 2003 net income per share was $1.20 versus 86 cents last year, up 40%. Let's now turn to the balance sheet. Cash and cash equivalents at December 31, 2003, totaled $12.6 million, an increase of $39.3 million from last year's position. We achieved positive cash flow from operations of 26.8 million for the full year of 2003. Additionally, the shift in sales from the third quarter to the fourth quarter negatively affected full-year cash flow as we ended the year with high-end accounts receivable. This is the short-term timinging -- timing effect and the collection of these receivables will positively impact fourth quarter -- first quarter 2004 cash flow. 281.8 million, accounts receivable, increase of $12.8 million from last year's end position. On a percentage basis accounts receivable increased 66% over last year. At quarter end, we were 77 day sales outstanding compared to 61 days outstanding last year. The increase is primarily related to the timing of sales occurring later in the fourth quarter of 2003 versus last year's fourth quarter of 2002. Our net inventory of December 31 was 90.9 million, up 6.4 million from the same period last year, or up 8% year over year, and we are debt free as of December 1, 2003, as we were all of last year. And before I turn the call over to Mike Wood, I would like to review our guidance for the 2004 fiscal year. As stated in the press release the company's financial guidance for 2004 is as follows. Net sales of 800 to 850 million, effective tax rate of 34%, net income of 88 to 95 million, fully- diluted share count from approximately 63 million shares and diluted net income per share of $1.39 to $1.51. Consistent with reported trends, we expect that our 2004 sales growth will be lower in the first half and higher in the second half as compared to 2003. We are guiding 2004 sales seasonality to about 22% of full-year sales in the first half spread equally in the first two quarters. Gross profit margin will be approximately 50% in each of the quarters. Operating expenses will grow approximately 20 to 25% for the full year, but the rate of growth of operating expenses in the first quarter of 2004 is expected to be 10 to 15% over the first quarter of 2003. Remember that this 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 the company's control. This include is the review of our recent financial performance and our guidance. I will now turn the call back to Mike Wood.

Unknown Speaker*

Thanks, Jim. Before we start our question and answer session, I want to say thanks again to all of you joining us and participating in our earnings call. I have another announcement. Today we are announcing some management changes that our board of directors approved on Monday of this week. I will become the company's chief executive officer and work full time on strategic initiatives and product development. Tom Kalinske will take over the CEO duties, and we have hired Jerry PEREZ to be our new president. Steve Fink, a board member since 1999, will be our new chairman of the board. I believe these moves will make LeapFrog an even better company. I have had a friend says if I can nine years as founder, president and CEO. It is clear to me that this is the best interests of the company to get the two best people in the industry to take over the role of CEO and president, and I believe they are Tom Kalinske and and y PEREZ. It is better for the company to have two talented people taking these roles rather than one, a combined 50 years of leadership experience with Tom judge Jerry. Our leaders have a strong vision that I hope will take this company to the next level, and I am confident that they will. I would like to share some personal thoughts. I take lots of pride and satisfaction on working on vision and product development. Right now, I have been spending approximately 90% of my time on management, and 10% of my time in the area where I think I can have the most productive impact. This change will allow me to put 100% of my personal focus I think I can have the biggest impact and the most fun. When preparing a company for the next growth phase, you want to make sure you have the right management team in place. There is also a question with a high growth startup company, when it is time for the founder to pass the REINS to some of the management experts in the company. The timing is right with our great great great momentum. I believe the company has never been in better shape. We have these fantastic
platform launches in the past two quarters, 2003 was a remarkable year in many respects. We have lots of exciting initiatives. School house and international have never been better. In my opinion, content development creative active -- creative has never been stronger, the LeapFrog brand has never been stronger. This is the right time to make a change. I couldn't be more proud of what we have done. I couldn't be more excited about what we are planning to do and I could not be more pleased with the management team that we are putting in place, the team that will take us to the next level. I will now turn it over to our new CEO, Tom Kalinske.

Unknown Speaker*

Thanks, Mike. I look forward to assuming my new duties and I want to thank Mike for his great leadership, the tremendous job he has done and for turning over a company with such great momentum and promise. First, let me say that to increase shareholder value faster, it is absolutely correct to allow Mike to return to spending 100% of his time on creative product development and thinking about future strategies. As he said, while he has been president and CEO he could probably only spend about 10% of his time in that capacity and 90% of management, finance, investor relations, tasks he was not as passionate about. So this change is better for Mike and for the company. I am happy and excited to be back in the CEO hot seat, because I am convinced with as strong as as a year as we had last year, we are just beginning on our path to lead in technology-based education products for home and school in the U.S. and around the world. Remember, we have come from nothing to 680 million in nine years, but I am convinced that far more growth opportunities still lie ahead of us. My focus is getting ready, is getting LeapFrog ready to become a truly world class company in terms of internal business processes, planning, systems, management, long- term strategies and execution. I am very pleased with the strength of our management team, with Jim Curley as CFO with his great retail experience background, with Fred as COO, cities wished -- distinguished background at GE, Tim as marketing leader coming from LEGO. Bob, our educational institutional leader and now we are adding Jerry PEREZ to the senior management team. I have known Jerry for several years and admire what he has accomplished. He brings to LeapFrog 22 years of brand, marketing and customer product experience from quaker oats -- and most recently as executive vice president of marketing, sales and design at Fisher-Price. We have also recently had the privilege of getting to know Jerry closer, as a consultant to LeapFrog. And in that capacity, we have learned that Jerry is a very capable leader who knows the business of children's products well, and that he appreciates the unique opportunities that we have at LeapFrog for creating and marketing great educational products. In the short time that Jerry has been with us, he has already made a strong contribution to LeapFrog. I am pleased that Jerry has agreed to join us full time in the role of president of LeapFrog. Jerry is president today, it is my pleasure to introduce him to you. LeapFrog really is positioned to the next level of growth. Jerry.

Unknown Speaker*

Thanks, Tom. First of all, let me say that I am very excited to be a permanent part of LeapFrog. The time that that I have spent here has convinced me this is an incredible company with significant opportunities to grow, fueled by an incredibly strong brand, terrific market momentum and exceptional resources. With a key understanding of how kids learn, LeapFrog is uniquely positioned to continue to lead the field of education on -- educational learning products. It is also apparent to me that LeapFrog's unique brand promise that a positive learning experience is within the grasp of every child -- grasp of every child has never been more child. With school systems and an increasing desire of parents to supplement their parent -- children's education, we have both the vision and the means necessary for continued success. LeapFrog began the learning phenomenon and will continue to lead it and my focus in working with this senior management team will be on continuing to develop this great brand with effective business planning, increased global reach, innovative products, and exciting new marketing and sales initiatives to help LeapFrog reap the rewards of future promises. I am excited to be working closely with Tom and Mike and I look forward to an exciting time for LeapFrog and our shareholders.

Unknown Speaker*

Thank you, Jerry. We are in good hands. Now, operator, let's begin with question and answer -- Q&A portion of the call. ++++.
Unknown Speaker*

At this time, I would like to inform everyone, in order to ask a question please press star then the number 1 on your telephone key pad. We will pause for just a moment to compile the Q&A roster. Your first question comes from Merrill Lynch.

Unknown Speaker*

Thank you very much. I guess, you know, given the surge in receivables at the end of the year, and the cash flow really not improving barring exercise of stock option proceeds, it has the feel that sales were very, very late in the quarter, and I am wondering if you could address this from the scope of the first quarter given your guidance of equal revenue second quarter which has not been the historic pattern, and then I have a followup question.

Unknown Speaker*

Why don't we split that answer in two parts. Jim, why don't you discuss the first half and I will address the second half.

Unknown Speaker*

Yes. The increase in receivables, you know, and specifically, how it equates down to DSOs, really does relate solely to the timing of both sales shipped in the third quarter and into the fourth quarter, the fourth quarter much bigger. But then since our terms are less than the 90 days of the fourth quarter, it really happened within the quarter. There was a shift in sales later in the quarter, especially leap STER product, that put, you know, a bigger shift year over year at the back end of the fourth quarter. That is just timing, and it will be collected, you know, in the first quarter of next year. And so of the 15 days increase in day sales outstanding, you know, I calculated about 12 days of the increase was just about related to that timing. We had another day related to KB, which is still included in our receivables, and obviously that is not getting paid, you know, at current and we had about two days of shipping issue auto -- issues that that are working through this time of year but are pretty normal leverage to customers. Aging standpoint, we actually had a more current receivable balance this year at year end than we did last year. When you look at receivables over one day past due, and so I feel very good about our receivable balance and collect. It did impact cash flow in the current year, but if you look at the collection through the, you know, the whole collection into the first quarter, we are going to have very, very strong cash flows next year because of this carryover. Lauren, as the second part of your question, is it affecting first quarter sales, and we believe that the primary effect on first quarter sales is the consolidation and contraction of KB and the the closure of FAO Schwartz. The orders of retailers in those two last year were significant and won't be in the first quarter of this year, although they will be reallocated, we believe, as the industry assimilates this in the following three quarters. But that's, that's really the primary first quarter tore factor in the first quarter of sales guidance.

Unknown Speaker*

Thanks, Jim?

Unknown Speaker*

Okay. The U.S. customer, the mix for the quarter, platforms, up 25%, software, up 31%, stand alone, up 18%. For the year, U.S. customer platforms up 12%, if software up 26%, stand alone up 23%.

Unknown Speaker*

Net sell in.

Unknown Speaker*

Net sell in.

Unknown Speaker*

Thanks, Jim.
Unknown Speaker*
Okay, and the gross margin, if you could? By segment?

Unknown Speaker*
Right. By segment, for the quarter, U.S. gross profit, 46.3%, international, 53.6%, and education and training, 63.7%.

Unknown Speaker*
Great, thank you.

Unknown Speaker*
You are welcome.

Unknown Speaker*
Your next question comes from David with ham securities — burn ham securities.

Unknown Speaker*
Hello.

Unknown Speaker*
Hi, David.

Unknown Speaker*
Two questions, totally related to each other. What is the school house number right now, the number of classrooms you are in in the U.S. year over year?

Unknown Speaker*
Right — I believe it is up to 25,000.

Unknown Speaker*
And then internationally?

Unknown Speaker*
None.

Unknown Speaker*
Okay. Second of all, can you update us on the status of the litigation against Mattel's competing products?

Unknown Speaker*
David, we don't, we don't comment on the status of litigation. It's public record that we are in litigation with them in a Delaware court. But aside from that, it is and will be our policy not to comment on that.

Unknown Speaker*
Okay. And following up there, have you indicated what you expect your legal costs might be on the totality of the action and appeals if necessary?

Unknown Speaker*
We have not, we have not specifically given guidance on the allocation to legal fees.

Unknown Speaker*
No.

Unknown Speaker*
Okay.

Unknown Speaker*
They are substantial and they are included in our estimated guidance for growth and operating expenses.
Unknown Speaker*
Also, with the two big bankruptcies, well, FAO isn’t a big bankruptcy, but KB, did you have enough reserved in your markdown money and other allocations, or did that come on top of the moneys that you had already set aside?

Unknown Speaker*
Yes. We reserved approximately 50% of our exposure and that impacted the quarter by 1 cent.

Unknown Speaker*
And is it going to be an impact into this year as well?

Unknown Speaker*
We have additional reserves, so we think we are provided for, you know, the remaining exposure, and we think there will be some collect of some portion of that amount.

Unknown Speaker*
Also, in giving the figures, and I may have missed this, did you indicate how much the weakness of the dollar helped your overseas sales and what it meant for both top and bottom line for last year?

Unknown Speaker*
You know, Q4 sales benefitted in the international segment by 10%, and it was 1% on a total consolidated basis.

Unknown Speaker*
And the EPS side of the ledger?

Unknown Speaker*
You know, in the 1% range.

Unknown Speaker*
Okay. And, lastly, there have been questions raised by those who seem to be nonpositively on their outlook for the company, that returns were very high last year on software, and, B, you would be getting less shelf space this year than last year. Does management have any comment to try to refute those statements or are they inaccurate?

Unknown Speaker*
Yes, neither of them are accurate.

Unknown Speaker*
Okay. And, is it going to be an if well?

Unknown Speaker*
Yes. Thanks for bringing that up. That is very good news. Last year, you know on 20 million in sales we lost 9 million, operating loss of 9 million on the education and training segment. This year, on the 37.5 million in sales, we actually had a small loss of 200,000, so just about break even. So it was a huge success in education and training.

Unknown Speaker*
You know, in the 1% range.

Unknown Speaker*
How did we do in the fourth quarter?
Unknown Speaker*

In the fourth quarter, we actually had our second, you know, profitable quarter of the year for education and training. 11 million of sales, actually made 1.1 million and operating income versus last year loss of 2.9 million at the operating level.

Unknown Speaker*

Let me just calculate that. If you have another question while I calculate that, we will get back to you on that.

Unknown Speaker*

Sure. Can you talk at all about new incremental categories, specifically age groups, that you will be targeting, you know, you talked about redesigning iQuest and Quantum, can you talk about how you are going after the older or middle schooler kids?

Unknown Speaker*

) Let me address this more broadly. In the instant category, I will go up the line, where -- where we doubled market share, we think we are poised for -- poised for a lot more growth, we will have first full year of little touch LeapPad plus the software plus the additional software. In the preschool category, we feel like we are poised for growth, we have a LeapPad microphone platform, watch wear software, interactive games, interactive playing cards, and a new writing wreck mission around the LeapPad plus writing. And, obviously, the leap STER, we feel, that may be the largest impact of all of our new offerings because we get a full year of that, so we feel we are poised for for growth in the preschool category. In the older age category, we did a new platform, turbo extreme, new platform, new software, which we think will be a significant new offering. We have redesigned the iQuest and redesigned the operating software within the iQuest, which we think is a substantial improvement, and it is a very cool looking product, which is increasingly important for kids that age. And, finally, the new Quantum Pad has a whole new sleek look, and I can’t wait to share that with you, Sean, at toy fair. So we think that the two younger areas where we have got lots of momentum, he have been accelerate that momentum, and in the ELA category, where are, you know, significant market leader, I think we are doing things to continue that growth and domination. The other thing, Sean, just one other thing. The other thing -- significant commitment that we have made, and it’s really because of feedback that we have received from customers and customers and retailers, we are introducing now second and third grade software on the leap STER. It turns out that lots of second and third graders were
playing with their little brothers and little sisters leap STERs, and their parents can't wait for us to to get educational quality engaging software for that age group.

Unknown Speaker*
Will the redesigned iQuest be in the market in '04?

Unknown Speaker*
Yes. All of this. Everything, everything is '04, Sean.

Unknown Speaker*
Okay, thank you.

Unknown Speaker*
Sean, just to follow up on your air freight question. We have to be careful, because giving pro forma information what it would have been is something we have to steer away from right now. But just to quantify, in the fourth quarter on a total consolidated basis, air freight cost Sol — accounted for about 210 basis points at expense line.

Unknown Speaker*
Okay, thank you.

Unknown Speaker*
You are welcome. Thanks, Sean.

Unknown Speaker*
Your next question comes with John Taylor of Arcadia.

Unknown Speaker*
Hi.

John.

Unknown Speaker*
Hi, good morning, and welcome to your new position, Tom.

Unknown Speaker*
Thanks.

Unknown Speaker*
I have three questions. Could you, one, within your guidance for revenue growth, could you segment that by region for us or by, you know, by the three major categories. The second question is, talk about tie ratio trends which you saw in '03 versus '02, and then focusing on the ad budget for the year. I wonder if you could kind of give us a sense of what you expect that to grow by and how you are going to segment it by age or category, just give us a sense of where the increase is really going to be concentrated. Thank you.

Unknown Speaker*
So, John, let me start with, in terms of guidance, we are not going to be more granular than we have already been. That's a per -- PERILOUS TURF. On the ad budget, there are a lot of people who would like to know, and that's something that we are going to keep in house. As to the tie ratio, what I am going to say, it is such a complex formula, that is, it depends upon the platforms, how many years the platforms have been in place, what the installed base is, what the trailing year installed base is, etc. Not withstanding that, the best indication that we can give you overall on tie ratio, is the information I gave at the beginning, in my comments, which is to say that in 2003 of the 22 reporting accounts, and that is 96% of our business, our hardware platform sales grew 37 -- 27% and our software sales grew 33%. So from that you can deduce that our tie ratio is accelerating in a positive direction.

Unknown Speaker*
Okay. Thank you. And ther, on the -- you are talking about doing some redesign work on hardware and software. Do you expect that to affect average selling prices at retail once it's all said and done?
Unknown Speaker*

No. The average selling prices should not be affected by the design work or the rework. It will be affected by other factors in the market, but not what we are doing in terms of the design and improvements in software.

Unknown Speaker*

Well, have you realized any meaningful sort of cost savings that would allow you to go on wholesale prices as you go forward?

Unknown Speaker*

In general, as we have said in the past, as platforms mature, we are generally able to achieve cost savings, and that continues to be true, although when we do a redesign, sometimes we will give back some of those savings.

Unknown Speaker*

Okay, and then last question, in terms of sell through at retail, how are you feeling about retail inventories and are there any concentrated issues out there in terms of products, individual products?

Unknown Speaker*

Yes, two things. We are comfortable with the level of inventory at retail. Obviously, and, as will always be true, there are some pockets of some products in sum -- some retailers that those retailers are working through. The good news is that our products, when they address those, move through quickly. On a broader level, and I am reluctant to get into too much detail on this, because we are only five weeks into the quarter, and, of course, what I am going to tell you is affected by retailer's attempts to move through merchandise, our POS numbers are very good. In fact, comparable to last year's numbers at the same time.

Unknown Speaker*

Okay. Thank you.

Unknown Speaker*

Your next question comes from Tony with Piper Jaffray.

Unknown Speaker*

Hi.

Unknown Speaker*

Hi, Tony.

Unknown Speaker*

Mike, guys, I just want to say outstanding job. Congratulations. It's been great working with you the last couple of years.

Unknown Speaker*

Thanks, Tony. I feel for myself with the company, we are just at the beginning.

so, thanks.

Unknown Speaker*

Tom, I will jump in here, will you be spending 100% of your time at LeapFrog or are there other obligations? Second question, your forecasting gross margin is relatively flat on a year over year basis. Could you talk a little bit about the mix and maybe just touch on pricing as well for 2004?

Unknown Speaker*

Sure. Yes, I am going to be spending 100% time, and my only other knowledge universe obligation is a couple of boards that I see -- serve on that meet four times a year, so not much, so I am pretty much 100% here. In terms of gross margin, I think I think we already commented that there is obviously some impact from the increasing portion of leap STER that will be in the number and we will aggressively go after leap STER, this year,
so that will be a big part of the impact. I don’t think we want to get into any other mix issues. In terms of pricing, our pricing is, you know, normal to the marketplace, where we are competitive, where we have cost improvements. We have improved our price to retailers. But other than that, I don’t want to talk about pricing on this call, because every time we talk about something on this call, one of our competitors does exactly what we are doing.

**Unknown Speaker**

Just one followup with Tom. The reason that we are willing to enter this leap STER and adversely affect the gross margin, is that in the long run, the leap STER software is our highest margin software, and we believe we believe we have opportunity to increase the tie ratio for leap STER above our other platforms. So this is a strong go forward initiative, where we think the implications of getting substantial installed lays of -- base of leap STERs will be positive for us in our total margin as we move forward.

**Unknown Speaker**

Should we assume that the mix of stand alone software is similar in ’04 to ’03 or will there be similar moves.

**Unknown Speaker**

Again, Tony, I would rather not get to that level of granularity.

**Unknown Speaker**

Any sell changes changes in 2004 that you can talk to at this point?

**Unknown Speaker**

Well, we anticipate continued increases in shelf spaces in the first half of the year, and although this is confirmed in the spring set, in the fall set we are still working through the retailers but the signs are encouraging. As you would expect, if you look at what we did in market share, you would anticipate that the retailers with their allocation would take that into consideration.

**Unknown Speaker**

Could you characterize that change a little more? I mean historically, you have done a little bit more, 40% in shelf space for the holidays last year. Are there any more parameters that you can put on it?

**Unknown Speaker**

No, I am going to stick with the general guidance.

I just gave, although two encouraging things, we will have incremental shelf space around the juvenile product lines which we are launching and obviously things like the video line, which are outside of our traditional space. We are encouraged about the opportunity and space there.

**Unknown Speaker**

Okay, thanks. Tom, welcome aboard.

**Unknown Speaker**

Thank you, Tony.

**Unknown Speaker**

Your next question comes from Mr. Parachini tell of Deutsche Banc security -- Mr. PATEL On bank securities.

**Unknown Speaker**

Hi, guys, I had a couple of questions. You had about a 19% growth in the U.S. customer business in ’03. Can you give us a sense of, you know, how fast the U.S. customer business grows in ’04. Is it probably within the same level of growth that you saw in the period. Second, can you give us a sense of what the
top sellers were, just by list, you know, in terms of revenue or anything, but just trying to get a, -- qualitative list of the top versus the second tier down. Finally if you look at the 4 to 8-year-old segment, LeapPad, LeapPad plus, can you talk about whether that 4 to 8-year-old segment growth was, was that flat, or up, can you comment on how much it was up, say, in the fourth quarter in '03 and in general?

Unknown Speaker*

Yes, a -- you asked a lot of questions. The first one, in terms of U.S. growth. I am not -- we are not going to give any further guidance, except as you have seen our overall growth guidelines, you know what we did last year in the U.S. You can put certain parameters around the growth on international and school house, because they are a much smaller number and you can work back backwards on getting a general idea of the continued strong growth that we anticipate in the U.S. in the U.S. customer division. In terms of top sellers, as you can see, we remain strong across all three of our, the way we would characterize those. Our hardware, our software and our, and our stand alone platforms. Are the most notable of our successes are really our three new platform launches, the little touch, which we think was constrained by our inability to meet demand, the LeapPad plus writing, and the leap STER. Obviously we had very strong experience with the My First LeapPad, and we were pleased with the continuing strength of the classic LeapPad, not withstanding the fact, obviously, that it is affected by both the LeapPad growth on the plus side and the LeapPad plus writing growth on the other side. In terms of growth in the 4 to 8-year-olds, would you mind repeating the question for me?

Unknown Speaker*

I am just trying to find out, LeapPad category, just LeapPad and LeapPad plus, you know, did that grow? How much did that grow, say, in 2003 or Q4 in general versus a year ago, and I -- if I just take LeapPad and LeapPad plus software platform together?

Unknown Speaker*

We haven't ever broken that down. In fact, the only statistics that I have were statistics that we gave you and that is on a sell through basis, the LeapPad family was up 27% for the year over the prior year.

Unknown Speaker*

But, Tony, most of that, most of that is in the 4 to 8 age range because that is where the LeapPad family lies. So the 27% hardware growth and the 33% software growth is largely in that age group.

Unknown Speaker*

The only exception would be the little touch LeapPad but relative to the rest of the family, that's a relatively small amount.

Unknown Speaker*

Thanks.

Unknown Speaker*

Your next question comes from Jennifer child's of -- childs of Bear Stearns.

Unknown Speaker*

Hi, Jennifer.

Unknown Speaker*

Hi, two questions, are you pleased with your distribution channels and do you expect to enter any new ones this year and secondly why such a wide range of operating guidance, shouldn't some of that be broken down?

Unknown Speaker*

Let me address two and Jim why don't you address the new channels and --
Sure, when we are talking about new channel, we are talking about things we had mentioned before, general bookstore category, electronic retailer category and office supply category. I don't want to break them down specifically, again for competitive reasons, but, yes, we are pleased with what has gone on there. We had good growth there. Now, having said that, they represent only 4 or 5% of our overall business. So it is still a relatively small part but we are happy with what occurred there. In terms of the earnings per share. Well

EPS, well, Jim.

Unknown Speaker*

What I would like to repeat, we are sort of burdened by our own success. That is, as we continue to have substantial shelf space increases in the Wal-Marts and the targets and the Toys "R" Us, etc., it is very difficult for the alternative channels in which we had growth last year to gain percentage market share. But that's not bad news, that is actually a reflection of the good news in the strength and larger channels. Jim, you were going to talk about the change of guidance on the EPS on the EPS.

Unknown Speaker*

Yes, Jennifer, we gave an 11% range last year on EPS guidance. We think that the range we have we have out there right now is -- is a fair and representative range, starting at the outset of the year, you know during the year it tightened, at this stage, we are going to be comfortable with that broader range.

Unknown Speaker*

Okay. Maybe, let me ask another way. The low end of your guidance you are actually projecting margin deterioration, shouldn't your supply chain initiatives and the mix shift improve your margins Sr. -- or is that offset by maybe retail pricing pressure?

Unknown Speaker*

On the operating expense side, we are planning, you know, for significantly higher legal over '03 in the '04 guidance. We have higher R&D with so many opportunities, we are, you know, moving ahead with more spending in those key categories, we will have a great ROI in the future, and then, you know, growth internationally is also, you know, finally building some SG&A growth. I think the range we have out there is indicative of all of those factors and gives us, you know, ample room to deliver with them.

Unknown Speaker*

I think we have time for just one more question, please.

Unknown Speaker*

Your next question comes from Sara with Merrill Lynch.

Unknown Speaker*

Good morning.

Unknown Speaker*

Hi, Sara.

Unknown Speaker*

I just had what I think are a couple of quick numbers. First, the sell through numbers that you gave for the entire year for 2003, I know those were for the LeapPad family only. But when I look at those versus the sell through numbers that you have given in in Q3 or platform sales being up 40% and software up 80%. I wonder if you could help us reconcile the difference in those numbers to help us what sell through will look like in Q4

Unknown Speaker*

Sure, I believe a macro level what we said -- sell through for the third quarter was up 35% and for the year it was up 22% of -- 22%. That reflects a very strong fourth quarter, although the sell through is lower, the significant majority of our
sales are obviously in the fourth quarter. But we anticipated it in our guidance, we anticipated it internally. We met our internal projections, and in the — and the retailers were obviously very happy with our sell through. And the most important thing is you can see with the sell through we had in the fourth quarter, that was what was reflected in the significant market share gains reported by NPD. But, so, we had, you know, sing can’t sell through growth in the fourth quarter and multiplied by the percentage of our annual sells which is sell through, which is really fourth quarter heavily weighted. That is what gives you a blended percentage of the 22%.

Unknown Speaker*
Okay, but in Q4, would that imply that that number would be below the 35%?

Unknown Speaker*
Of course.

Unknown Speaker*
Okay.

Unknown Speaker*
In fact, it’s our percentage, which you know about 75% fourth quarter on sell through times, times the increase in sell through, times, plus the 35%, times the sell through in the first three quarters, and that weighted average gets you the 22%.

Unknown Speaker*
Okay, thank you. And then can you talk about what the LeapPad family was as a percentage of sales for the quarter during the year?

Unknown Speaker*
Have you calculated that, Jim?
look forward to seeing many of you at toy fair. I think it will be another very exciting trip through our toy fair show room, and I hope you will participate in our next quarterly earnings conference call in April. thank you for participating in today’s conference call. You may now disconnect.