EXHIBITS

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Event Transcript
LF - Q1 2004 LeapFrog Enterprises, Inc. Earnings Conference Call
Event Date/Time: Apr. 21, 2004 / 5:00PM ET
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PRESENTATION
Operator
Good day, and welcome to the LeapFrog Enterprises Incorporated first quarter 2004 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, sir.

Christopher Bunn - LeapFrog Enterprises - Director of Investor Relations

Thank you. Good afternoon and welcome to LeapFrog enterprises conference call for our first quarter of 2004 which ended March 31, 2004. I'm Christopher Bunn, the Director of Investor Relations. After the close of the market today we issued a press release detailing our first quarter results. In a minute Tom Kalinske, our CEO, will discuss LeapFrog's performance in the first quarter and our outlook. Then Jim Curley, our CFO, will discuss these results in detail and finally we'll conduct a question and answer session.

Before we begin the formal remarks I remind you that certain statements made today will include forward-looking statements about management's expectations, strategic objectives, anticipated financial performance and other similar matters. Forward-looking statements during this conference call will include statements regarding anticipated sales, margins, earnings per share and retail shelf space, our ability to invent, develop and produce products and their acceptance in the markets, supply chain management and shipments, capital expenditures, inventory levels, receivables, advertising expense, tax rates, interest income or expense and SG&A expense. In addition we expect that questions posed during the question and answer portion of this call may prompt answers that contain additional forward-looking statements that we have not anticipated or are not contemplated in our prepared statements.

This cautionary language concerning forward-looking statements applies to both our prepared comments and our impromptu answers to questions posed on this conference call. A variety of factors, many of which are beyond our control, affect the operations performance, business strategy and results of LeapFrog and could cause actual results to differ materially from those projected in such forward-looking statements. Some of these factors are described in our 2003 annual report on form 10-K filed with the SEC on March 12th, and with other filings made with the SEC from time to time, as well as LeapFrog's other published statements. LeapFrog does not update forward-looking statements and we expressly disclaim any obligation to do so.

And now I would like to introduce Tom Kalinske.

Tom Kalinske - LeapFrog Enterprises - CEO

Thank you, Chris. Good afternoon. Thank you for joining us for a discussion of our results for the first quarter of 2004. Before we begin, I want to clarify a few things. When we issued first quarter guidance on March 10th, it was our view that at that stage in the quarter we had enough information to warrant an announcement, but not enough information to host a constructive conference call. In hindsight it's apparent to us that a conference call would have been appropriate if for no other
reason than to answer questions and to clarify the information that we felt comfortable in releasing at that time.

Let me assure you that we are committed to the highest standard of communication with analysts and investors and we will be achieving that going forward. In my portion of the call today I have three objectives. One, to topline our first quarter financial results, two, to provide insight into those results, and three, to share our strategies to maximize the year ahead of us. First the financials. Comparing results of the first quarter of 2003 to the results of this quarter of 2004 net sales decreased 7% from 76.7 million last year to 71.6 million this year. Our international and School House divisions grew 44% and 53% respectively, compared with the first quarter of last year, while our U.S. Consumer division declined 22%.

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

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

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

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

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

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

These improvements are essential to our long-term growth and will benefit the U.S. Consumer division in the second half of this year with increasing returns accruing in coming years. We believe our investment and achievement in these operational initiatives bodes well for our execution in the critical second half of this year. Third, we are maximizing our consumer and retailer programs for 2004 and beyond. We are exploring...
exciting new initiatives in the consumer and retail marketing areas and will have more to discuss with you in the coming months. So far, in 2004, our pre-Easter TV advertising worked well to drive our business. Retail sales at our top four retailers are up over 20% so far this year.

And in the three weeks preceding Easter this year, retail sales were up over 25% versus the three weeks preceding Easter last year. This demonstrates continued strong consumer enthusiasm for our products, and will help bring retailers back into a reordering mode faster. Our plans with retailers for this fall significantly exceed what we achieved last year. Specifically, we expect once again double-digit percentage shelf space gain this fall with our top four retailers. Considering our very strong shelf space growth last year, the shelf space growth plan for 2004 is a remarkable achievement for Leapfrog and a strong vote of confidence on the part of our retailers. In addition to shelf space increases, we expect that our retail ad and in store promotional support will increase by a similar percentage.

Similar to our shelf space gains, Leapfrog's 2003 retail advertising and promotional plans were some of the strongest in the toy industry and we expect to exceed those this year by a significant margin. The final key to driving our business in the future is that we are continuing to push the envelope when it comes to product innovation. Last year's new platform introductions will continue to have strong second years, including Little Touch LeapPad, Leapster, and the LeapPad Plus Writing. The LeapPad Family Library will get 40 new and refreshed titles this year including key new licenses such as Spiderman 2, Shrek 2, and the Incredibles. We're also launching brand new ways to play and learn on the LeapPad with games and trading card content.

Add to this an entirely new hardware software learning platform, the My Own Learning Leap, this year's introduction into the interactive plush category, and you have a very strong line-up for holiday 2004. We continue to invest heavily in R&D and new technologies and we are excited about our new product directions for 2005. Innovation is the life blood of our business and there is no company in our industry with a greater commitment to it than Leapfrog. Obviously we are disappointed in the first quarter U.S. Consumer performance, yet based on strong retail sales, increased retail shelf space and a great product line, we expect U.S. retail sales to show a nice increase for the year. At the same time we will work through our challenges on the U.S. Consumer side of the business and will also seek to improve our financial performance in two emerging growth areas for Leapfrog, our School House and international divisions.

In School House, net sales were 9.1 million in the first quarter, up 53% from 5.9 million in the first quarter of last year. We are excited about the potential for our School House division for the year and we are investing in our School sales force and improving our supplemental education software offering accordingly. With its direct selling model, the LeapFrog School House is a high margin business segment business for us. And according to Simba Information, LeapFrog is the fastest growing company among the top 10 leading K to 12 instructional software publishers. We had the fastest growth in market share and the fastest growth in dollars in 2003. We strongly believe in the potential of School House, and we expect to turn a profit this year.

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

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

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

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

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

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

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

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

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

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

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

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

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

Tom Kalinske - LeapFrog Enterprises - CEO

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

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

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

Questions and Answers

Operator

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

John Taylor - Anadia - Analyst

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

Tom Kalinske - LeapFrog Enterprises - CEO

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

**Jim Curley - LeapFrog Enterprises - CFO**

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

**John Taylor - Arcadia - Analyst**

Okay. Thank you.

**Jim Curley - LeapFrog Enterprises - CFO**

You’re welcome.

**Operator**

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

**Tom Kalinske - LeapFrog Enterprises - CEO**

Hi, Lauren.

**Lauren Fine - Merrill Lynch - Analyst**

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

**Tom Kalinske - LeapFrog Enterprises - CEO**

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

**Jim Curley - LeapFrog Enterprises - CFO**

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

**Lauren Fine - Merrill Lynch - Analyst**

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

**Jim Curley - LeapFrog Enterprises - CFO**

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

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

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

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

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

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

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

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

Jim Curley - LeapFrog Enterprises - CFO
The ranges?

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

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

Sean McGowan - Gerard Clower Madison - Analyst
Okay.

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

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

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

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

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

Tom Kalinske - LeapFrog Enterprises - CEO
Right.

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

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

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

Tom Kalinske - LeapFrog Enterprises - CEO
Yes, it's all of that. We are getting increased space in aisle, we are also getting end caps, we're also getting space in new sections of the stores.

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

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

Sean McGowan - Gerard Clower Madison - Analyst
Was he looking for a job?

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

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

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

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

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

Jill Krutick - Salomon Smith Barney - Analyst
Good afternoon.

Tom Kalinske - LeapFrog Enterprises - CEO
Hi, Jill.

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

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

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

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

Tom Kalinske - LeapFrog Enterprises - CEO
Hi, Brandon.

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

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

Jim Curley - LeapFrog Enterprises - CFO
Brandon, as we're seeing our concentration of sales move away from traditional toy companies, obviously, seasonality is implicit in doing business. I mean they do a huge amount of their business in the back-end of the year. There's even a trend for the traditional toy companies, and the ordering pattern that we've seen and discussed in the third quarter that materialized with the shift in timing into the fourth quarter, we've heard that from the larger players in our industry, and we would echo that on our end. Tom, I don't know if you want to comment on that.

Tom Kalinske - LeapFrog Enterprises - CEO
No, I mean everybody wants to get the business in closer to when the consumer is going to purchase it, and that just puts increasing pressure on all of us as manufacturers to be smarter and better at what we do.

Brandon Dobell - Credit Suisse First Boston - Analyst
And then maybe a little bit of clarification there. As we're modeling Q3 and Q4, obviously in the context of what the new guidance looks like, shifting dollars from Q3 to Q4, even versus what happened last year, would that be the right way to think about it? Just kind of even back weighting the year more than what we saw last year, or is it still going to have the same kind of feel between Q3 and Q4?

Jim Curley - LeapFrog Enterprises - CFO
We think last year's Q3 and Q4 phasing would be a good indication. I don't think we need to go any more drastic than that.

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

Jim Curley - LeapFrog Enterprises - CFO
Okay.

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

Tom Kalinske - LeapFrog Enterprises - CEO
Hi.

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

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

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

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

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

Jim Curley - LeapFrog Enterprises - CFO
Thanks, Raj.

Operator
Your next question comes from the line of Gary Cooper with Banc of America Securities.

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

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

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

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

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

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

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

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

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

Gary Cooper - Banc of America Securities - Analyst
Okay.

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

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

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

Tony Gikas - Piper Jaffray - Analyst

Thanks.

Operator

Your next question comes from the line of Mike Wallace.

Tom Kalinske - LeapFrog Enterprises - CEO

Hi Mike.

Mike Wallace - - Analyst

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

Mike Wallace - - Analyst

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

Tom Kalinske - LeapFrog Enterprises - CEO

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

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

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

Jennifer Childe - Bear Stearns - Analyst
Thank you. I was hoping you could give us further color on the revenue breakdown between the three segments in your guidance.

Jim Curley - LeapFrog Enterprises - CFO
Jennifer, really, giving guidance is something that not everyone is following right now. We've stepped away from quarterly guidance. We've also amplified our guidance a little bit over what we initially had given out back on February 10th, give a few more line items, especially gross profit margin, because we felt people needed more insight into that, but we really don't want to put the pressure on individual segments, we want to do what's right for the business, so we're going to keep it at a consolidated level. I think the way you phased it, the street consensus seems to phase it pretty well on their own, and we're going to leave it that way.

Jennifer Childe - Bear Stearns - Analyst
What gives you confidence in your forward guidance. What would have to go right for you to hit the numbers. Alternatively, what could go really, really wrong.

Tom Kalinske - LeapFrog Enterprises - CEO
Well, obviously the fact that we are one of the few that has this over 20% consumer sell through right now, gives us some reassurance that our guidance is correct. Having said that, things can change. But we are very happy with our retail sell through right now. We believe our retail partners are. We're happy with the space we're getting. We know the new product line, most of which, or 90-some percent of, has not yet shipped is very well regarded by both retail trade, and more importantly by the consumers, so we have a very good expectation on the new products that we're introducing, and all of those things give us some reassurance on our guidance to you. Now, things can
always go wrong. I mean, the economy can turn around or go the other way. Right now, the economy seems to be getting stronger, so I think that's working in our favor. Obviously, we need a healthy retail channel and we need that retail channel to remain strong, and we're all anxiously waiting to see how that resolves itself over the next few months, but we would like to see it healthier than it is today. Other things that could go wrong. I think we're in pretty good shape on all of our parts and components and engineering and schedules, but you can always have negative things happen to you there, and I think you're aware of that but we're trying to give you a range in our guidance that we're be comfortable with, and I think we're done that.

Christopher Bunn - LeapFrog Enterprises - Director of Investor Relations

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

Operator

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

Christopher Bunn - LeapFrog Enterprises - Director of Investor Relations

Thank you.

Operator

You'll welcome, one moment.

John Taylor - Arcadia - Analyst

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

Tom Kalinske - LeapFrog Enterprises - CEO

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

John Taylor - Arcadia - Analyst

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

Tom Kalinske - LeapFrog Enterprises - CEO

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

John Taylor - Arcadia - Analyst

Okay, great. Thank you.

Tom Kalinske - LeapFrog Enterprises - CEO

Thank you very much.

Operator

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

Tom Kalinske - LeapFrog Enterprises - CEO

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

Operator

This now conclude's today's conference. You may now disconnect.
EXHIBIT 2
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 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 95–4652013
(State of Incorporation) (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 August 1, 2003, was 26,274,504 and 31,598,738, respectively.
We conduct our corporate operations from leased facilities and lease some equipment under operating leases. Generally, our leased facilities and operating leases have initial lease periods of three to ten years and contain provisions for renewal options of five years at market rates.

We estimate that our capital expenditures for 2003 will be between $15.0 million and $20.0 million, as compared to $14.8 million in 2002. The increase in our 2003 estimate over our actual 2002 capital expenditures is primarily related to increased capitalization of externally developed content for our platforms and manufacturing tools related to increased production levels and new product designs. We review our capital expenditure program periodically and modify it as required to meet current business needs.

We believe the cash raised from future seasonal borrowings, if any, and anticipated cash flow from operations will be sufficient to meet our working capital and capital requirements through at least 2004.

RISK FACTORS THAT MAY AFFECT OUR RESULTS AND STOCK PRICE

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

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

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

Our business is seasonal, and therefore our annual operating results 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 time their orders so that suppliers like us will fill the orders closer to the time of purchase by consumers, thereby reducing their need to maintain larger on-hand inventories throughout the year to meet demand. While these techniques reduce retailers' investments in their inventory, they increase pressure on suppliers to fill orders promptly and shift a significant portion of inventory risk and carrying costs to suppliers like us. The logistics of supplying more product within shorter time periods will increase the risk that we fail to meet tight shipping schedules, which could damage our relationships with retailers, increase our shipping costs or cause sales opportunities to be delayed or lost. The seasonal pattern of sales in the retail channel requires significant use of our working capital to manufacture and carry inventory in anticipation of the holiday season, as well as early and accurate forecasting of holiday sales. Failure to predict accurately and respond appropriately to consumer demand on a timely basis to meet seasonal fluctuations, or any disruption of consumer buying habits during this key period, would harm our business and operating results.

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

We outsource substantially all of our finished goods manufacturing to eight manufacturers, all of whom manufacture our products at facilities in the Guangdong province in the southeastern region of China. For example, Jetta
Company Limited was the sole manufacturer of all our LeapPad platforms in 2002. We depend on these manufacturers to produce sufficient volumes of our products in a timely fashion and at satisfactory quality levels. We generally allow retailers and distributors to return or receive credit for defective or damaged products. If our manufacturers fail to produce quality products on time and in sufficient quantities due to capital shortages, late payments from us, political instability, labor shortages, intellectual property disputes, natural disasters, energy shortages, terrorism or other disruptions to their businesses, our reputation and operating results would suffer. In addition, if our manufacturers decide to increase production for their other customers, they may be unable to manufacture sufficient quantities of our products and our business could be harmed.

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

The SARS outbreak has 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.

In order to minimize the potential risks of SARS affecting our current manufacturing processes, we may seek to establish additional manufacturing relationships in different geographical locations. Establishing new manufacturing facilities would result in production yield issues; increased tooling, personnel, travel and shipping costs; and disruption of existing manufacturing and sourcing activities. Also, these new facilities may not be operational in time for us to fulfill the seasonal demands of our customers. If we are unable to establish alternative manufacturing operations efficiently or on a timely basis, our business 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 "Power Touch" 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 iQuest handheld device and our Leapster platform, which is expected to be released by the end of 2003. Many of our direct, indirect and potential competitors have significantly longer operating histories, greater brand recognition and substantially greater financial, technical and marketing resources than we do. These competitors may be able to respond more rapidly than we can to changes in consumer requirements or preferences or to new or emerging technologies. They may also devote greater resources to the development, promotion and sale of their products than we do. We cannot assure you that we will be able to compete effectively in our markets.

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

Historically, our quarterly operating results have fluctuated significantly. For example, our net income (loss) for the first through fourth quarters of 2002 was $(5.1) million, $(7.5) million, $26.7 million and $29.4 million, respectively.
Our net income (loss) for the first and second quarters of 2003 was $(1.0) million and $(3.9) million, respectively. We expect these fluctuations to continue for a number of reasons, including:

- seasonal influences on our sales, such as the holiday shopping season and back-to-school purchasing;
- unpredictable consumer preferences and spending trends;
- the need to increase inventories in advance of our primary selling season;
- timing of new product introductions;
- general economic conditions;
- changes in our pricing policies, the pricing policies of our competitors and general pricing trends in consumer electronics and toy markets;
- international sales volume and the mix of such sales among countries with similar or different holidays and school years than the United States;
- the impact of strategic relationships;
- the sales cycle to schools, which may be uneven depending on budget constraints, the timing of purchases and other seasonal influences; and
- the timing of orders by our customers.

We expect that we will continue to incur losses during the first and second quarters of each year for the foreseeable future. We do not have sufficient operating experience to predict the overall effect of various seasonal factors and their effect on our future quarterly operating results. If we fail to meet our projected net sales or other projected operating results, or if we fail to meet analysts’ or investors’ expectations, the market price of our Class A common stock could fall.

We currently rely, and expect to continue to rely, on our LeapPad platform and related interactive books for a significant portion of our sales.

Our LeapPad platform and related interactive books accounted for approximately 48% of our net sales in 2002. No other product line, together with its related software, accounted for more than approximately 10% of our net sales 2002. A significant portion of our future sales will depend on the continued commercial success of our LeapPad platform and related interactive books. If the sales for our LeapPad platform are below expected sales or if sales of our LeapPad interactive books do not grow as we anticipate, sales of our other products may not be able to compensate for these shortfalls and our overall sales would suffer.

Our business depends on three retailers that together accounted for approximately 69% of our net sales in 2002, and our dependence upon a small group of retailers may increase.

Wal-Mart (including Sam’s Club), Toys “R” Us, and Target accounted in the aggregate for approximately 69% of our net sales in 2002. We expect that a small number of large retailers will continue to account for a significant majority of our sales and that our sales to these retailers may increase as a percentage of our total sales. At December 31, 2002, Wal-Mart (including Sam’s Club) accounted for approximately 33% of our accounts receivable and Toys “R” Us accounted for approximately 30% of our accounts receivable. If any of these retailers experience significant financial difficulty in the future or otherwise fail to satisfy their accounts payable, our allowance for doubtful accounts receivable could be insufficient. If any of these retailers reduce their purchases from us, change the terms on which we conduct business with them or experience a future downturn in their business, our business and operating results could be harmed.

We do not have long-term agreements with our retailers and changes in our relationships with retailers could significantly harm our business and operating results.

We do not have long-term agreements with any of our retailers. As a result, agreements with respect to pricing, shelf space, cooperative advertising or special promotions, among other things, are subject to periodic negotiation with each retailer. Retailers make no binding long-term commitments to us regarding purchase volumes and make all purchases by delivering one-time purchase orders. If the number of our products increases as we have planned or the roll out of versions of our Learning Center shelf displays in selected retail stores proceeds as we anticipate, we will require more retail shelf space to display our various products. Any retailer could reduce its overall purchases of our products, reduce the number and variety of our products that it carries and the shelf space allotted for our products, decide not to incorporate versions of our Learning Center shelf displays in its stores or otherwise materially change the terms of our current relationship at any time. Any such change could significantly harm our business and operating results.

Our future growth will depend in part on our SchoolHouse division, which may not be successful.

We launched our SchoolHouse division in June 1999, and to date the division, which accounts for substantially all of the results of our Education and Training segment, has incurred cumulative losses. Although the division reported an
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.

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 $1.1 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 2003. 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 recent 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 the U.S. Consumer and other segments. Other changes in general economic conditions, such as greater demand or higher prices for plastic, electronic components, liquid crystal displays and fuel, may delay manufacture of our products, increase our costs or otherwise harm our margins and operating results.

Earthquakes or other events outside of our control may damage our facilities or the facilities of third parties on which we depend.
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: August 11, 2003

/s/ JAMES P. CURLEY

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

Dated: August 11, 2003
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

LeapFrog Enterprises, Inc.

Commission File Number 001-31396

Delaware

95-4652013

(State of Incorporation)

(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.
On December 31, 2002, we entered into a $30.0 million three-year unsecured senior credit facility, with an option to increase the facility to $50.0 million, for working capital purposes. The agreement requires that we comply with certain financial covenants, including the maintenance of a minimum quick ratio on a quarterly basis and a minimum level of "earnings before interest, tax, depreciation and amortization" or EBITDA, as such term is defined in the credit facility agreement, on a rolling quarterly basis. We were in compliance with these covenants at September 30, 2003. The level of a certain financial ratio maintained by us determines the interest rates on borrowings. The interest rate will be between prime and prime plus 0.25% or LIBOR plus 1.25% and LIBOR plus 2.00%. At September 30, 2003 and 2002, we had outstanding letters of credit of $0.3 million and $1.7 million, respectively. At September 30, 2003, $29.7 million of unused borrowings were available to us.

We conduct our corporate operations from leased facilities and lease some equipment under operating leases. Generally, our leased facilities and operating leases have initial lease periods of three to ten years and contain provisions for renewal options of five years at market rates.

We estimate that our capital expenditures for 2003 will be between $15.0 million and $17.0 million, as compared to $14.8 million in 2002. Capital expenditures, in both years, consist primarily of manufacturing tools, computers and software, and capitalization of external costs of developing content for our platforms. We review our capital expenditure program periodically and modify it as required to meet current business needs.

We believe our existing cash and short term investments and anticipated cash flow from operations will be sufficient to meet our working capital and capital requirements through at least 2004.

**RISK FACTORS THAT MAY AFFECT OUR RESULTS AND STOCK PRICE**

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

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

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

**Our business is seasonal, and therefore our annual operating results 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 time their orders so that suppliers like us will fill the orders closer to the time of purchase by consumers, thereby reducing their need to maintain larger on-hand inventories throughout the year to meet demand. While these techniques reduce retailers' investments in their inventory, they increase pressure on suppliers to fill orders promptly and shift a significant portion of inventory risk and carrying costs to suppliers like us. The logistics of supplying more product within shorter time periods will increase the risk that we fail to meet tight shipping schedules, which could damage our relationships with retailers, increase our shipping costs or cause sales opportunities to be delayed or lost. The seasonal pattern of sales in the retail channel requires significant use of our working capital to manufacture and carry inventory in anticipation of the holiday season, as well as early and accurate forecasting of holiday sales. Failure to predict accurately and respond appropriately to consumer demand on a timely basis to meet seasonal fluctuations, or any disruption of consumer buying habits during this key period, would harm our business and operating results.
We rely on a limited number of manufacturers, virtually all of which are located in China, to produce our finished products, and our reputation and operating results could be harmed if they fail to produce quality products in a timely manner and in sufficient quantities.

We outsource substantially all of our finished goods manufacturing to eight manufacturers, all of whom manufacture our products at facilities in the Guangdong province in the southeastern region of China. For example, Jetta Company Limited was the sole manufacturer of all our LeapPad platforms in 2002. We depend on these manufacturers to produce sufficient volumes of our products in a timely fashion and at satisfactory quality levels. We generally allow retailers and distributors to return or receive credit for defective or damaged products. If our manufacturers fail to produce quality products on time and in sufficient quantities due to capital shortages, late payments from us, political instability, labor shortages, intellectual property disputes, natural disasters, energy shortages, terrorism or other disruptions to their businesses, our reputation and operating results would suffer. In addition, if our manufacturers decide to increase production for their other customers, they may be unable to manufacture sufficient quantities of our products and our business could be harmed.

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

Historically, our quarterly operating results have fluctuated significantly. For example, our net income (loss) for the first through fourth quarters of 2002 was $(5.1) million, $(7.5) million, $26.7 million and $29.4 million, respectively. Our net income (loss) for the first through third quarters of 2003 was $(1.0) million, $(3.9) million and $33.4 million, respectively. We expect these fluctuations to continue for a number of reasons, including:

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

We expect that we will continue to incur losses during the first and second quarters of each year for the foreseeable future. We do not have sufficient operating experience to predict the overall effect of various seasonal factors and their effect on our future quarterly operating results. If we fail to meet our projected net sales or other projected operating results, or if we fail to meet analysts’ or investors’ expectations, the market price of our Class A common stock could decrease.

We currently rely, and expect to continue to rely, on our LeapPad platform and related interactive books for a significant portion of our sales. Our LeapPad platform and related interactive books accounted for approximately 48% of our net sales in 2002. No other product line, together with its related software, accounted for more than approximately 10% of our net sales in 2002. A significant portion of our future sales will depend on the continued commercial success of our LeapPad platform and related interactive books. If the sales for our LeapPad platform are below expected sales or if sales of our LeapPad interactive books do not grow as we anticipate, sales of our other products may not be able to compensate for these shortfalls and our overall sales would suffer.

Our business depends on three retailers that together accounted for approximately 69% of our net sales in 2002, and our dependence upon a small group of retailers may increase.

Wal-Mart (including Sam’s Club), Toys “R” Us and Target accounted in the aggregate for approximately 69% of our net sales in 2002. We expect that a small number of large retailers will continue to account for a significant majority of our sales and that our sales to these retailers may increase as a percentage of our total sales. At December 31, 2002, Wal-Mart (including Sam’s Club) accounted for approximately 33% of our accounts receivable and Toys “R” Us accounted for approximately 30% of our accounts receivable. If any of these retailers experience significant financial difficulty in the future or otherwise fail to satisfy their accounts payable, our allowance for doubtful accounts receivable could be insufficient. If any of these retailers reduce their purchases from us, change the terms on which we conduct business with them or experience a future downturn in their business, our business and operating results could be harmed.

We do not have long-term agreements with our retailers and changes in our relationships with retailers could significantly harm our business and operating results.

We do not have long-term agreements with any of our retailers. As a result, agreements with respect to pricing, shelf space, cooperative advertising or special promotions, among other things, are subject to periodic negotiation with each retailer. Retailers make no binding long-term commitments to us regarding purchase volumes and make all purchases by delivering one-time purchase orders. If the number of our products increases as we have planned or the roll out of versions of our Learning Center shelf displays in selected retail stores proceeds as we anticipate, we will require more retail shelf space to display our various products. Any retailer could reduce its overall purchases of our products, reduce the number and variety of our products that it carries and the shelf space allotted for our products, decide not to incorporate versions of our Learning Center shelf displays in its stores or otherwise materially change the terms of our current relationship at any time. Any such change could significantly harm our business and operating results.

Our future growth will depend in part on our SchoolHouse division, which may not be successful.

We launched our SchoolHouse division in June 1999, and to date the division, which accounts for substantially all of the results of our Education and Training segment, has incurred cumulative losses. Although the division reported an
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 $1.1 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
LeapFrog Earns $0.55 per share in Third Quarter, Net Income up 25%
Increases Sales and Earnings Guidance for Fourth Quarter and Reaffirms Full Year Guidance

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.

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**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 Form 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>
</tr>
<tr>
<td>Short term investments</td>
<td>$13,115</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Accounts receivable, net</td>
<td>$155,447</td>
<td>$130,137</td>
<td>$169,670</td>
</tr>
<tr>
<td>Inventories, net</td>
<td>$119,508</td>
<td>$92,337</td>
<td>$84,460</td>
</tr>
<tr>
<td>Prepaid expenses and other current assets</td>
<td>$9,847</td>
<td>$595</td>
<td>595</td>
</tr>
<tr>
<td>Notes receivable due from related parties</td>
<td>-</td>
<td>$595</td>
<td>595</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>$26,121</td>
<td>$10,201</td>
<td>$16,783</td>
</tr>
<tr>
<td>Total current assets</td>
<td>$408,766</td>
<td>$300,094</td>
<td>$348,900</td>
</tr>
<tr>
<td>Property and equipment, net</td>
<td>$22,028</td>
<td>$20,449</td>
<td>$20,239</td>
</tr>
<tr>
<td>Other long term assets</td>
<td>$185</td>
<td>$631</td>
<td>$484</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>$9,332</td>
<td>$5,889</td>
<td>$4,867</td>
</tr>
<tr>
<td>Intangible assets, net</td>
<td>$25,359</td>
<td>$23,353</td>
<td>$23,192</td>
</tr>
<tr>
<td><strong>Total assets</strong></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              |                   |                   |                  |
| Redeemable convertible series A preferred stock | -        | $24,139        | -                |
| **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.
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></th>
<th>Nine Months Ended Sep 30,</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2003</td>
<td>2002</td>
<td>2003</td>
<td>2002</td>
</tr>
<tr>
<td>Net sales</td>
<td>$203,888</td>
<td>$182,127</td>
<td>$348,651</td>
<td>$283,325</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>99,066</td>
<td>87,071</td>
<td>167,367</td>
<td>140,050</td>
</tr>
<tr>
<td>Gross profit</td>
<td>104,822</td>
<td>95,056</td>
<td>181,284</td>
<td>143,275</td>
</tr>
<tr>
<td>Operating expenses:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Selling, general and administrative</td>
<td>22,750</td>
<td>22,865</td>
<td>66,175</td>
<td>53,958</td>
</tr>
<tr>
<td>Research and development</td>
<td>14,003</td>
<td>14,137</td>
<td>41,679</td>
<td>39,810</td>
</tr>
<tr>
<td>Advertising</td>
<td>13,545</td>
<td>11,925</td>
<td>26,230</td>
<td>20,953</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>1,943</td>
<td>1,751</td>
<td>6,103</td>
<td>4,804</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>52,241</td>
<td>50,678</td>
<td>140,187</td>
<td>119,525</td>
</tr>
<tr>
<td>Income from operations</td>
<td>52,581</td>
<td>44,378</td>
<td>41,097</td>
<td>23,750</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(3)</td>
<td>(127)</td>
<td>(8)</td>
<td>(822)</td>
</tr>
<tr>
<td>Interest income</td>
<td>250</td>
<td>259</td>
<td>958</td>
<td>459</td>
</tr>
<tr>
<td>Other income (expense)</td>
<td>412</td>
<td>(38)</td>
<td>3,034</td>
<td>85</td>
</tr>
<tr>
<td>Income before provision for income taxes</td>
<td>53,240</td>
<td>44,472</td>
<td>45,081</td>
<td>23,472</td>
</tr>
<tr>
<td>Provision for income taxes</td>
<td>19,836</td>
<td>17,799</td>
<td>16,572</td>
<td>9,389</td>
</tr>
<tr>
<td>Net Income</td>
<td>$33,404</td>
<td>$26,683</td>
<td>$28,509</td>
<td>$14,083</td>
</tr>
<tr>
<td>Net income per common share - basic</td>
<td>$0.58</td>
<td>$0.65</td>
<td>$0.50</td>
<td>$0.39</td>
</tr>
<tr>
<td>Net income per common share - diluted</td>
<td>$0.55</td>
<td>$0.50</td>
<td>$0.47</td>
<td>$0.30</td>
</tr>
<tr>
<td>Shares used in calculating net income per share - basic</td>
<td>58,045,325</td>
<td>41,274,608</td>
<td>56,691,770</td>
<td>36,275,667</td>
</tr>
<tr>
<td>Shares used in calculating net income per share - diluted</td>
<td>61,086,489</td>
<td>53,384,455</td>
<td>60,168,609</td>
<td>47,221,080</td>
</tr>
</tbody>
</table>
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>
</tbody>
</table>

Adjustments to reconcile net income to net cash provided by operating activities:
- Depreciation and Amortization: 12,208 vs. 8,245
- Other noncash items: 32,411 vs. 10,744

Other changes in operating assets and liabilities:
- Accounts receivable: 3,556 vs. (24,619)
- Inventory: (35,048) vs. (46,234)
- Prepaid and other current assets: (5,782) vs. (6,918)
- Notes receivable due from related parties: 595 vs. 94
- Other assets: 99 vs. (283)
- Accounts payable: 5,386 vs. 33,620
- Accrued liabilities: (19,392) vs. 4,096
- Income taxes payable: (7,833) vs. 12,317

Net cash provided by operating activities: 14,709 vs. 5,145

Investing activities:
- Purchases of property and equipment: (13,183) vs. (11,368)
- Purchase of intangible assets: (3,000) vs. (250)
- Purchases of short term investments: (19,738) vs. -
- Sale of short term investments: 6,510 vs. -
- Investment in related party: 181 vs. -

Net cash used for investing activities: (29,230) vs. (11,618)

Financing activities:
- Borrowings under credit agreement: - vs. 182,000
- Repayments under credit agreement: - vs. (243,163)
- Proceeds from the payment of notes receivable from stockholders: 2,624 vs. 505
- Proceeds from the exercise of stock options and employee stock purchase plan: 23,199 vs. 1,501
- Proceeds from the issuance of common stock: - vs. 115,116

Net cash provided by financing activities: 25,823 vs. 55,959

Effect of exchange rate changes on cash: 99 vs. 93
Increase in cash and cash equivalents: 11,401 vs. 49,579
Cash and cash equivalents at beginning of year: 73,327 vs. 8,269
Cash and cash equivalents at end of period: $ 84,728 vs. $ 57,848

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