
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

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 or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

6401 Hollis Street, Suite 100, Emeryville, California
(Address of principal executive offices)

94608-1463
(Zip Code)

510-420-5000

(Registrant's telephone number, including area code)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 31, 2013, 64,527,938 shares of Class A common stock, par value \$0.0001 per share, and 4,395,461 shares of Class B common stock, par value \$0.0001 per share, of the registrant were outstanding.

**LEAPFROG ENTERPRISES, INC.
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**PART I.
FINANCIAL INFORMATION**

ITEM 1. FINANCIAL STATEMENTS

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

	September 30,		December 31,
	2013	2012	2012
	(Unaudited)		
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 78,373	\$ 49,427	\$ 120,000
Accounts receivable, net of allowances for doubtful accounts of \$106, \$3,893 and \$292, respectively	184,798	170,106	180,043
Inventories	121,738	115,083	40,311
Prepaid expenses and other current assets	8,727	9,522	8,353
Deferred income taxes	4,248	1,035	9,315
Total current assets	397,884	345,173	358,022
Deferred income taxes	6,181	1,309	13,269
Property and equipment, net	32,233	20,411	23,723
Capitalized product costs, net	15,825	10,935	12,109
Goodwill	19,549	19,549	19,549
Other intangible assets, net	200	1,550	950
Other assets	1,161	1,534	1,283
Total assets	\$ 473,033	\$ 400,461	\$ 428,905
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	\$ 59,086	\$ 82,128	\$ 31,617
Accrued liabilities	35,348	37,546	51,353
Deferred revenue	12,696	8,176	8,516
Income taxes payable	712	414	493
Total current liabilities	107,842	128,264	91,979
Long-term deferred income taxes	3,759	3,798	3,759
Other long-term liabilities	1,824	2,723	3,224
Total liabilities	113,425	134,785	98,962
Commitments and contingencies (Note 11)			
Stockholders' equity:			
Class A Common Stock, par value \$0.0001; Authorized - 139,500 shares; Outstanding: 64,524, 61,905 and 61,970, respectively	6	6	6
Class B Common Stock, par value \$0.0001; Authorized - 40,500 shares; Outstanding: 4,395, 5,715 and 5,715, respectively	1	1	1
Treasury stock	(185)	(185)	(185)
Additional paid-in capital	415,618	403,187	405,078
Accumulated other comprehensive income	124	976	1,071
Accumulated deficit	(55,956)	(138,309)	(76,028)
Total stockholders' equity	359,608	265,676	329,943
Total liabilities and stockholders' equity	\$ 473,033	\$ 400,461	\$ 428,905

See accompanying notes

LEAPFROG ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Net sales	\$ 200,985	\$ 193,072	\$ 366,908	336,562
Cost of sales	121,607	115,771	223,316	200,974
Gross profit	<u>79,378</u>	<u>77,301</u>	<u>143,592</u>	<u>135,588</u>
Operating expenses:				
Selling, general and administrative	18,893	21,257	62,612	65,158
Research and development	7,543	9,164	25,250	26,902
Advertising	7,411	7,179	14,253	13,932
Depreciation and amortization	2,631	2,838	8,041	8,751
Total operating expenses	<u>36,478</u>	<u>40,438</u>	<u>110,156</u>	<u>114,743</u>
Income from operations	<u>42,900</u>	<u>36,863</u>	<u>33,436</u>	<u>20,845</u>
Other income (expense):				
Interest income	12	37	54	226
Interest expense	(9)	(49)	(9)	(49)
Other, net	37	(898)	12	(2,014)
Total other income (expense), net	<u>40</u>	<u>(910)</u>	<u>57</u>	<u>(1,837)</u>
Income before income taxes	42,940	35,953	33,493	19,008
Provision for (benefit from) income taxes	16,567	(5,785)	13,421	(5,163)
Net income	<u>\$ 26,373</u>	<u>\$ 41,738</u>	<u>\$ 20,072</u>	<u>\$ 24,171</u>
Net income per share:				
Class A and B - basic	\$ 0.38	\$ 0.62	\$ 0.29	\$ 0.36
Class A and B - diluted	\$ 0.37	\$ 0.60	\$ 0.28	\$ 0.35
Weighted-average shares used to calculate net income per share:				
Class A and B - basic	68,552	67,400	68,200	66,912
Class A and B - diluted	71,051	69,512	70,744	69,071

See accompanying notes

LEAPFROG ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Net income	\$ 26,373	\$ 41,738	\$ 20,072	\$ 24,171
Other comprehensive income, before tax:				
Currency translation adjustments	558	1,134	(947)	1,291
Transfer of temporary gain on long-term investments	-	-	-	(241)
Total other comprehensive income, before tax	<u>558</u>	<u>1,134</u>	<u>(947)</u>	<u>1,050</u>
Transfer of tax expense allocated to temporary gain on long-term investments	-	-	-	151
Other comprehensive income, net of tax	<u>558</u>	<u>1,134</u>	<u>(947)</u>	<u>1,201</u>
Comprehensive income	<u>\$ 26,931</u>	<u>\$ 42,872</u>	<u>\$ 19,125</u>	<u>\$ 25,372</u>

See accompanying notes

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

	Nine Months Ended September 30,	
	2013	2012
Operating activities:		
Net income	\$ 20,072	\$ 24,171
<i>Adjustments to reconcile net income to net cash used in operating activities:</i>		
Depreciation and amortization	15,241	16,871
Deferred income taxes	12,140	238
Stock-based compensation expense	7,166	5,066
Loss on sale of long-term investments, net of tax	-	91
Loss on disposal of long-term assets	-	2
Allowance for doubtful accounts	(101)	3,371
<i>Other changes in operating assets and liabilities:</i>		
Accounts receivable, net	(5,117)	(15,493)
Inventories	(81,848)	(80,149)
Prepaid expenses and other current assets	(424)	(1,367)
Other assets	122	(414)
Accounts payable	27,509	47,454
Accrued liabilities and deferred revenue	(11,712)	(4,805)
Other long-term liabilities	(1,400)	(6,638)
Income taxes payable	224	37
Net cash used in operating activities	(18,128)	(11,565)
Investing activities:		
Purchases of property and equipment	(17,127)	(10,396)
Capitalization of product costs	(9,605)	(5,623)
Sales of investments	-	2,500
Net cash used in investing activities	(26,732)	(13,519)
Financing activities:		
Proceeds from stock option exercises and employee stock purchase plan	4,499	4,007
Net cash paid for payroll taxes on restricted stock unit releases	(1,126)	(1,513)
Net cash provided by financing activities	3,373	2,494
Effect of exchange rate changes on cash	(140)	154
Net change in cash and cash equivalents	(41,627)	(22,436)
Cash and cash equivalents, beginning of period	120,000	71,863
Cash and cash equivalents, end of period	\$ 78,373	\$ 49,427

See accompanying notes

LEAPFROG ENTERPRISES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)
(Unaudited)

1. Basis of Presentation

In the opinion of management, all normal, recurring adjustments considered necessary for a fair statement of the financial position and interim results of LeapFrog Enterprises, Inc. and its consolidated subsidiaries (collectively, the “Company” or “LeapFrog” unless the context indicates otherwise) as of and for the periods presented have been included. The accompanying unaudited consolidated financial statements and related disclosures have been prepared in accordance with United States generally accepted accounting principles (“U.S. GAAP”) applicable to interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The consolidated financial statements include the accounts of LeapFrog and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

The consolidated balance sheet at December 31, 2012 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The financial information included herein should be read in conjunction with the consolidated financial statements and related notes in the Company’s 2012 Annual Report on Form 10-K filed with the United States (“U.S.”) Securities and Exchange Commission (the “SEC”) on March 11, 2013 (the “2012 Form 10-K”).

The accounting policies used by the Company in its presentation of interim financial results are consistent with those presented in Note 2 to the consolidated financial statements included in the Company’s 2012 Form 10-K.

Due to the seasonality of the Company’s business, the results of operations for interim periods are not necessarily indicative of the operating results for a full year.

Certain amounts in the financial statements for prior periods have been reclassified to conform to the current year presentation.

Accumulated other comprehensive income consists solely of currency translation adjustments.

2. Fair Values of Financial Instruments and Investments

Fair value is defined by authoritative guidance as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. The guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company’s assumptions about the factors market participants would use in valuing the asset or liability. The guidance establishes three levels of inputs that may be used to measure fair value:

- Level 1 includes financial instruments for which quoted market prices for identical instruments are available in active markets. As of September 30, 2013, the Company’s Level 1 assets consist of money market funds with original maturities of three months or less and recorded in cash and cash equivalents. These assets are considered highly liquid and are stated at cost, which approximates market value.
- Level 2 includes financial instruments for which there are inputs other than quoted prices included within Level 1 that are observable for the instrument. Such inputs could be quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets with insufficient volume or infrequent transactions (less-active markets), or model-driven valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data, including market interest rate curves, referenced credit spreads and prepayment rates.

The Company’s Level 2 assets and liabilities consist of outstanding foreign exchange forward contracts used to hedge its exposure to certain foreign currencies, including the British Pound, Canadian Dollar and Euro. The Company’s outstanding foreign exchange forward contracts, all with maturities of approximately one month, had notional values of \$70,665, \$53,577 and \$72,632 at September 30, 2013, December 31, 2012 and September 30, 2012, respectively. The fair market values of these instruments were \$(195), \$(255) and \$(87) and recorded in accrued liabilities as of September 30, 2013, December 31, 2012 and September 30, 2012, respectively.

LEAPFROG ENTERPRISES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)
(Unaudited)

- Level 3 includes financial instruments for which fair value is derived from valuation techniques, including pricing models and discounted cash flow models, in which one or more significant inputs, including the Company's own assumptions, are unobservable. The Company did not hold any Level 3 assets as of September 30, 2013, December 31, 2012 and September 30, 2012.

The following table presents the Company's fair value hierarchy for assets and liabilities measured at fair value on a recurring basis as of September 30, 2013, December 31, 2012 and September 30, 2012:

	Estimated Fair Value Measurements			
	Carrying Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
September 30, 2013:				
<i>Financial Assets:</i>				
Money market funds	\$ 58,761	\$ 58,761	\$ -	\$ -
<i>Financial Liabilities:</i>				
Forward currency contracts	\$ (195)	\$ -	\$ (195)	\$ -
December 31, 2012:				
<i>Financial Assets:</i>				
Money market funds	\$ 85,003	\$ 85,003	\$ -	\$ -
<i>Financial Liabilities:</i>				
Forward currency contracts	\$ (255)	\$ -	\$ (255)	\$ -
September 30, 2012				
<i>Financial Assets:</i>				
Money market funds	\$ 30,000	\$ 30,000	\$ -	\$ -
<i>Financial Liabilities:</i>				
Forward currency contracts	\$ (87)	\$ -	\$ (87)	\$ -

During the three months ended March 31, 2012, the Company divested its remaining auction rate security ("ARS") investments for \$2,500, resulting in a loss of \$181 recorded in other income (expense) in the consolidated statement of operations during the period then ended. The Company also transferred the temporary gain related to ARS valuation of \$241, previously recorded as other comprehensive income in stockholders' equity, to other income (expense) in the consolidated statement of operations during the three months ended March 31, 2012. In addition, the Company transferred the associated income tax of \$151, previously recorded as other comprehensive loss in stockholders' equity, to the provision for income taxes in the consolidated statement of operations during the same quarter. The proceeds of \$2,500 were received by the Company during the second quarter of 2012.

3. Inventories

Inventories consisted of the following as of September 30, 2013 and 2012, and December 31, 2012:

	September 30,		December 31,
	2013	2012	2012
Raw materials	\$ 5,364	\$ 6,385	\$ 1,243
Finished goods	116,374	108,698	39,068
Total	\$ 121,738	\$ 115,083	\$ 40,311

LEAPFROG ENTERPRISES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)
(Unaudited)

4. Other Intangible Assets

The Company's other intangible assets were as follows as of September 30, 2013 and 2012, and December 31, 2012:

	September 30,		December 31,
	2013	2012	2012
Intellectual property, license agreements and other intangibles	\$ 16,755	\$ 16,755	\$ 16,755
Less: accumulated amortization	(16,555)	(15,205)	(15,805)
Total	\$ 200	\$ 1,550	\$ 950

5. Income Taxes

The Company's provision for (benefit from) income taxes and effective tax rates were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Provision for (benefit from) provision for income taxes	\$ 16,567	\$ (5,785)	\$ 13,421	\$ (5,163)
Income before income taxes	42,940	35,953	33,493	19,008
Effective tax rate	38.6%	(16.1%)	40.1%	(27.2%)

The Company excludes jurisdictions with tax assets for which no benefit can be recognized from the computation of effective tax rate and tax provision. Accordingly, due to the full valuation allowance recorded against the Company's domestic deferred tax as of September 30, 2012, the Company's domestic operations were excluded from the computation of tax benefits for the three and nine months ended September 30, 2012. The tax benefits for the 2012 periods were primarily attributable to the recognition of previously unrecognized tax benefits due to the expiration of statutes of limitations in the Company's foreign jurisdictions, offset by foreign tax expense and certain discrete tax items including amortization of goodwill for tax purposes.

During the fourth quarter of 2012, after considering the relative impact of all evidence, positive and negative, the Company determined, at the required more-likely-than-not level of certainty, that a portion of its domestic deferred tax assets will be realized. Accordingly, for the three and nine months ended September 30, 2013, in addition to tax provisions attributable to its foreign operations, the Company's effective tax rate and income tax provision included tax expense attributable to its domestic operating income for the respective periods.

Current and non-current deferred tax assets were \$4,248 and \$6,181 at September 30, 2013, respectively, as compared to \$1,035 and \$1,309 at September 30, 2012, respectively. The increase is due to the release of a portion of the deferred tax valuation allowance that occurred in the fourth quarter of 2012, partially offset by the realization of tax benefits in the current year.

During the three months ended September 30, 2013, the Company did not recognize any previously unrecognized tax benefits. During the nine months ended September 30, 2013, the Company recognized \$207 of previously unrecognized tax benefits due to the expiration of the statutes of limitations in one of its foreign jurisdictions, and reduced the balance of gross unrecognized tax benefits accordingly. The tax provision for the three months ended September 30, 2013 did not include any release of interest and penalties related to uncertain tax positions. The tax provision for the nine months ended September 30, 2013 included a release of interest and penalties of \$57. The recognition of previously unrecognized tax benefits and the release of associated accrued interest and penalties reduced other long-term tax liabilities. As of September 30, 2013 and 2012, and December 31, 2012, the Company had approximately \$647, \$2,645 and \$625, respectively, of accrued interest and penalties related to uncertain tax positions.

The Company believes it is reasonably possible that the total amount of unrecognized income tax benefit in the future could decrease by up to \$495, excluding potential interest and penalties, related to its foreign operations over the course of the next twelve months ending September 30, 2014 due to expiring statutes of limitations that, if recognized, would affect its effective tax rate.

As of September 30, 2013, the Company had long-term deferred tax liabilities of \$3,759 and other long-term tax liabilities of \$1,003. Both are reported as long-term liabilities on the consolidated balance sheet.

6. Defined Contribution Plan

LeapFrog sponsors a defined contribution plan under Section 401(k) of the Internal Revenue Code. The 401(k) plan allows employees to defer up to 100% of their eligible compensation, not to exceed the Internal Revenue Service (the "IRS") maximum contribution limit. The Company provides a matching opportunity of 100% of eligible contributions up to a maximum of \$3.5 per year per employee, which vests over three years. The Company recorded total compensation expense of \$147 and \$1,294, related to the defined contribution plan, for the three and nine months ended September 30, 2013, respectively,

and \$164 and \$1,087 for the three and nine months ended September 30, 2012, respectively.

LEAPFROG ENTERPRISES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)
(Unaudited)

7. Stock-Based Compensation

The Company currently has outstanding two types of stock-based compensation awards to its employees and directors: stock options and restricted stock units (“RSUs”). Both stock options and RSUs can be used to acquire shares of the Company’s Class A common stock, are exercisable or convertible, as applicable, over a period not to exceed ten years, and are most commonly assigned four-year vesting periods. The Company also has an employee stock purchase plan (“ESPP”).

Stock plan activity

The table below summarizes award activity for the nine months ended September 30, 2013:

	Stock Options	RSUs	Total Awards
Outstanding at December 31, 2012	6,148	1,251	7,399
Grants	2,064	821	2,885
Stock option exercises/vesting RSUs	(827)	(346)	(1,173)
Retired or forfeited	(93)	(39)	(132)
Outstanding at September 30, 2013	<u>7,292</u>	<u>1,687</u>	<u>8,979</u>
Total shares available for future grant at September 30, 2013			<u>6,717</u>

As of September 30, 2013, the total shares available for future grant under the ESPP were 964.

Impact of stock-based compensation

The table below summarizes stock-based compensation expense for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
SG&A:				
Stock options	\$ 1,347	\$ 968	\$ 3,723	\$ 2,096
RSUs	849	746	2,269	2,098
ESPP	97	80	342	244
Total SG&A	<u>2,293</u>	<u>1,794</u>	<u>6,334</u>	<u>4,438</u>
R&D:				
Stock options	215	150	537	388
RSUs	115	83	295	240
Total R&D	<u>330</u>	<u>233</u>	<u>832</u>	<u>628</u>
Total expense	<u>\$ 2,623</u>	<u>\$ 2,027</u>	<u>\$ 7,166</u>	<u>\$ 5,066</u>

Valuation of stock-based compensation

Stock-based compensation expense related to stock options is calculated based on the fair value of each award on the grant date. In general, the fair value for stock option grants is estimated using the Black-Scholes option pricing model with the following weighted-average assumptions for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Expected term (years)	5.18	4.49	4.6	4.49
Volatility	69.9%	74.3%	72.5%	74.3%
Risk-free interest rate	1.51%	0.55%	0.80%	0.72%
Expected dividend yield	-%	-%	-%	-%



LEAPFROG ENTERPRISES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)
(Unaudited)

RSUs are payable in shares of the Company's Class A common stock. The fair value of these stock-based awards is equal to the closing market price of the Company's common stock on the date of grant. The grant-date fair value is recognized on a straight-line basis in compensation expense over the vesting period of these stock-based awards, which is generally four years.

Stock-based compensation expense related to the ESPP is estimated using the Black-Scholes option pricing model with the following assumptions for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Expected term (years)	0.49 - 0.5	0.5	0.48 - 0.5	0.5
Volatility	36.0% - 57.5%	49.9% - 59.8%	36.0% - 57.5%	44.1% - 59.8%
Risk-free interest rate	0.05% - 0.12%	0.13% - 0.14%	0.05%-0.14%	0.05% - 0.14%
Expected dividend yield	- %	- %	- %	- %

8. Derivative Financial Instruments

At September 30, 2013, December 31, 2012 and September 30, 2012, the Company had outstanding foreign exchange forward contracts with notional values of \$70,665, \$53,577 and \$72,632, respectively. The gains and losses on these instruments are recorded in other income (expense) in the consolidated statements of operations. Gains and losses from foreign exchange forward contracts, net of gains and losses on the underlying transactions denominated in foreign currency, for the three and nine months ended September 30, 2013 and 2012 are shown in the table below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Gains (losses) on foreign exchange forward contracts	\$ (1,307)	\$ (1,326)	\$ 203	\$ (1,921)
Gains (losses) on underlying transactions denominated in foreign currency	1,291	587	(786)	495
Net losses	\$ (16)	\$ (739)	\$ (583)	\$ (1,426)

9. Net Income per Share

The following table sets forth the computation of basic and diluted net income per share for three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
<i>(Numerator)</i>				
Net income	\$ 26,373	\$ 41,738	\$ 20,072	\$ 24,171
<i>(Denominator)</i>				
Weighted average shares outstanding during period:				
Class A and B - basic	68,552	67,400	68,200	66,912
Common stock equivalents	2,499	2,112	2,544	2,159
Class A and B - diluted	71,051	69,512	70,744	69,071
Net income per share:				
Class A and B - basic	\$ 0.38	\$ 0.62	\$ 0.29	\$ 0.36
Class A and B - diluted	\$ 0.37	\$ 0.60	\$ 0.28	\$ 0.35

Options to purchase shares of our common stock and RSUs, totaling 3,470 and 2,871 were excluded from the calculation of diluted net income per share for the three and nine months ended September 30, 2013, respectively, as the effect would have been antidilutive. Options to purchase shares of our common stock and RSUs, totaling 2,002 and 1,207 were excluded from the calculation of diluted net income per share for the three and nine months ended September 30, 2012, respectively, as the effect would have been antidilutive.

10. Segment Reporting

The Company's business is organized, operated and assessed in two geographic segments: U.S. and International.

The Company attributes sales to non-U.S. countries on the basis of sales billed by each of its foreign subsidiaries to its customers. Additionally, the Company attributes sales to non-U.S. countries if the product is shipped from Asia or one of its leased warehouses in the U.S. to a distributor in a foreign country. Certain corporate-level operating expenses associated with sales and marketing, product support, human resources, legal, finance, information technology, corporate development, procurement activities, research and development expenses, legal settlements and other corporate costs are charged entirely to the Company's U.S. segment and are not allocated to its International segment.

LEAPFROG ENTERPRISES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)
(Unaudited)

The primary business of the two operating segments is as follows:

- The U.S. segment is responsible for the development, design, sales and marketing of the Company's multimedia learning platforms, related content and learning toys, which are sold primarily through retailers, distributors, and directly to consumers via the leapfrog.com online store and the LeapFrog App Center ("App Center") in the U.S.
- The International segment is responsible for the localization, sales and marketing of multimedia learning platforms, related content and learning toys, originally developed for the U.S., sold primarily through retailers, distributors outside of the U.S., and directly to consumers via online stores and App Centers directed to certain international jurisdictions.

The table below shows certain information by segment for the three and nine months ended September 30, 2013 and 2012:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Net sales:				
United States	\$ 146,831	\$ 145,691	\$ 263,285	\$ 247,050
International	54,154	47,381	103,623	89,512
Totals	<u>\$ 200,985</u>	<u>\$ 193,072</u>	<u>\$ 366,908</u>	<u>\$ 336,562</u>
Income from operations:				
United States	\$ 29,652	\$ 24,781	\$ 10,186	\$ 2,059
International	13,248	12,082	23,250	18,786
Totals	<u>\$ 42,900</u>	<u>\$ 36,863</u>	<u>\$ 33,436</u>	<u>\$ 20,845</u>

For all periods presented, no countries other than the U.S. accounted for more than 10% of the Company's consolidated net sales, respectively.

11. Commitments and Contingencies

From time to time, the Company is subject to legal proceedings and claims in the ordinary course of business, including claims of alleged infringement of patents and other intellectual property rights, claims related to breach of contract, employment matters and a variety of other claims. Unsettled matters are in various stages of litigation and their outcome is currently not determinable. However, in the opinion of management, based on current knowledge, none of the pending legal proceedings or claims is likely to have a material adverse effect on the Company's financial position, results of operations or cash flows. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense costs, diversion of management resources and other factors. In addition, although management considers the likelihood of such an outcome to be remote, if one or more of these legal matters were resolved against the Company in a particular reporting period for amounts in excess of management's expectations, the Company's consolidated financial statements of the same reporting period could be materially adversely affected.

In addition, as of September 30, 2013, the Company had outstanding off-balance sheet commitments for outsourced manufacturing and component purchases of \$791.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements about management's expectations, including, without limitation, the release of a considerable portion of our domestic deferred tax valuation allowance and the associated effect on net income, the normalization of our effective tax rates in periods following the release and the associated effect on net income, the indefinite reinvestment of the undistributed earnings of our foreign subsidiaries, our intention not to repatriate any foreign earnings to the U.S., expectations regarding the effect of our net operating loss or tax credit carryforwards on any tax liability associated with the repatriation of cash held by our foreign subsidiaries, the anticipated impact of our accumulated deficit, the funding, nature and amount of future capital expenditures, the future funding of our working capital needs, and the timing, seasonality and expectations of cash flows from operations. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "expect," "intend," "plan," "anticipate," "believe," "future," "potential," or the negative of these terms or other comparable terminology. Our actual results, levels of activity, performance, achievements or the timing of events may differ materially from those expressed or implied by such forward-looking statements. The risks that could cause our results to differ include, without limitation, deterioration of global economic conditions, our ability to correctly predict highly changeable consumer preferences and product trends, our ability to continue to develop new products and services, our reliance on a small group of retailers for the majority of our gross sales, our ability to compete effectively with competitors, the seasonality of our business, consumer acceptance of downloadable content and data collection, system failures in our online services or web store, our dependence on our suppliers for our components and raw materials, our reliance on a limited number of manufacturers, our ability to maintain sufficient inventory levels, our ability to maintain or acquire licenses, third parties who claim we are infringing on their intellectual property rights, errors or defects in our products, the sufficiency of our liquidity, the risk associated with international operations, costs or changes associated with compliance with laws and regulations, negative political developments, natural disasters, armed hostilities, terrorism, labor strikes or public health issues, the loss of members of our executive management team, continued ownership by a few stockholders of a significant percentage of the voting power in the company, and the volatility of our stock price. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, achievements or the timing of any events. We make these statements as of the date of this Quarterly Report on Form 10-Q and undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise after the date of this report, except as required by law.

The following management's discussion and analysis of financial condition and results of operations ("MD&A") is intended to help the reader understand the results of operations and financial condition of LeapFrog Enterprises, Inc. ("LeapFrog," "we," "us" or "our"). This MD&A is provided as a supplement to, and should be read in conjunction with, our Consolidated Financial Statements and the accompanying Notes to the Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Our Business

LeapFrog, founded in 1995 and incorporated in 1997 in the State of Delaware, is a leading developer and distributor of educational entertainment for children. Our product portfolio consists of multimedia learning platforms and related content and learning toys. We have developed a number of learning platforms, including the LeapPad family of learning tablets, the Leapster family of handheld learning game systems, the LeapReader reading and writing systems, and the Tag and Tag Junior reading systems, all of which support a broad library of content titles. We have created hundreds of interactive content titles for our platforms, covering subjects such as phonics, reading, writing and math. In addition, we have a broad line of stand-alone learning toys. Many of our products connect to our proprietary online LeapFrog Learning Path, which provides personalized feedback on a child's learning progress and offers product recommendations to enhance each child's learning experience. Our products are available in four languages and are sold globally through retailers, distributors and directly to consumers via the leapfrog.com online store and LeapFrog App Center.

Due to the seasonality of our business, our results of operations for interim periods are not necessarily indicative of the operating results for a full year.

Consolidated Results of Operations

	Three Months Ended September 30,		Change 2013 vs. 2012	Nine Months Ended September 30,		Change 2013 vs. 2012
	2013	2012		2013	2012	
(Dollars in millions, except per share data)						
Net sales	\$ 201.0	\$ 193.1	4%	\$ 366.9	\$ 336.6	9%
Cost of sales	121.6	115.8	5%	223.3	201.0	11%
Gross margin *	39.5%	40.0%	(0.5)**	39.1%	40.3%	(1.2)**
Operating expenses	36.5	40.4	(10%)	110.2	114.7	(4%)
Operating expenses as a percent of net sales	18%	21%	(3)**	30%	34%	(4)**
Income from operations	42.9	36.9	16%	33.4	20.8	60%
Net income per share - basic	\$ 0.38	\$ 0.62	\$(0.24)***	\$ 0.29	\$ 0.36	\$(0.07)***
Net income per share - diluted	\$ 0.37	\$ 0.60	\$(0.23)***	\$ 0.28	\$ 0.35	\$(0.07)***

* Gross profit as a percentage of net sales

** Percentage point change

*** Dollar change

Net sales for the three months ended September 30, 2013 increased 4% as compared to the same period in 2012, largely driven by sales of multimedia learning platforms, including LeapPad2 Power, LeapPad Ultra and LeapReader, which launched in the second quarter of 2013. Net sales for the nine months ended September 30, 2013 increased 9% as compared to the same period in 2012, largely driven by higher sales in LeapPad2, LeapPad2 Power, LeapPad Ultra, LeapReader and learning toys, partially offset by higher trade allowances and discounts as a percentage of net sales. Net sales for the three months ended September 30, 2013 included a 1% negative impact from changes in currency exchange rates. Net sales for the nine months ended September 30, 2013 were not materially affected by foreign currency exchange rates.

Cost of sales for the three and nine months ended September 30, 2013 increased 5% and 11%, respectively, as compared to the same periods in 2012, primarily driven by higher sales volume, higher product costs resulting from a change in sales mix with proportionally higher sales of lower-margin hardware and higher royalty costs resulting from an increase in sales of licensed content.

Consolidated gross margin for the three and nine months ended September 30, 2013 was 39.5% and 39.1%, respectively, a decrease of 0.5 and 1.2 percentage points, respectively, as compared to the same periods of 2012, primarily driven by changes in product mix with proportionally higher sales of lower-margin hardware, higher trade allowances and discounts as a percentage of net sales, and higher royalty costs resulting from an increase in sales of licensed content. The decreases were partially offset by lower inventory allowances and higher sales volume which reduced the impact of fixed logistic costs.

Operating expenses for the three months ended September 30, 2013 decreased 10% as compared to the same period of 2012, primarily driven by a decrease in the provision for incentive compensation expense, partially offset by higher expenses due to an increase in headcount to support our strategic initiatives and slightly higher advertising expense. Operating expenses for the nine months ended September 30, 2013 decreased 4% as compared to the same period of 2012, primarily due to bad debt expense of \$3.1 million in the prior year period related to an isolated customer bankruptcy, and a decrease in the provision for incentive compensation expense, largely offset by higher expenses due to an increase in headcount to support our strategic initiatives and slightly higher advertising expense. Operating expenses as a percentage of net sales declined by 3 percentage points and 4 percentage points for the three and nine months ended September 30, 2013, respectively, as higher sales volume reduced the impact of fixed costs.

Income from operations for the three and nine months ended September 30, 2013 increased 16% and 60%, respectively, as compared to the same periods in 2012, due to the increase in net sales and lower operating expenses, partially offset by lower gross margin.

Basic and diluted net income per share for the three and nine months ended September 30, 2013 decreased by \$0.24 and \$0.23, respectively, as compared to the same periods of 2012. Basic and diluted net income per share for the three and nine months ended September 30, 2013 included \$0.22 and \$0.17 of tax expense attributable to our U.S. operations, which were excluded in prior year periods due to the full valuation allowance recorded against our domestic deferred tax as of September 30, 2012. Basic and diluted net income per share for the same periods of 2012 included \$0.10 and \$0.09 of tax benefit, respectively, attributable to the recognition of tax benefits previously unrecognized due to the expiration of statutes of limitations in our foreign jurisdictions.

Operating Expenses

Selling, General and Administrative Expenses

Selling, general and administrative (“SG&A”) expenses consist primarily of salaries and related employee benefits, including stock-based compensation expense and other headcount-related expenses associated with executive management, finance, information technology, supply chain, facilities, human resources, other administrative headcount, legal and other professional fees, indirect selling expenses, systems costs, rent, office equipment and supplies.

	Three Months Ended September 30,		% Change 2013 vs. 2012	Nine Months Ended September 30,		% Change 2013 vs. 2012
	2013	2012		2013	2012	
(Dollars in millions)						
SG&A expenses	\$ 18.9	\$ 21.3	(11%)	\$ 62.6	\$ 65.2	(4%)
As a percent of net sales	9%	11%	(2)*	17%	19%	(2)*

* Percentage point change

SG&A expenses for the three months ended September 30, 2013 decreased 11% as compared to the same period in 2012, primarily due to a decrease in the provision for incentive compensation expense, largely offset by higher infrastructure and professional services spending, and higher expenses due to an increase in headcount. SG&A expenses for the nine months ended September 30, 2013 decreased 4% as compared to the same period in 2012, primarily due to bad debt expense of \$3.1 million in 2012 related to an isolated customer bankruptcy, and a decrease in the provision for incentive compensation expense, largely offset by higher infrastructure and professional services spending, and higher expenses due to an increase in headcount.

Research and Development Expenses

Research and development (“R&D”) expenses consist primarily of salaries, employee benefits, stock-based compensation and other headcount-related expenses associated with content development, product development, product engineering, third-party development and programming and localization costs to translate content for international markets. We capitalize external third-party costs related to content development, which are subsequently amortized into cost of sales in the statements of operations.

	Three Months Ended September 30,		% Change 2013 vs. 2012	Nine Months Ended September 30,		% Change 2013 vs. 2012
	2013	2012		2013	2012	
(Dollars in millions)						
R&D expenses	\$ 7.5	\$ 9.2	(18%)	\$ 25.3	\$ 26.9	(6%)
As a percent of net sales	4%	5%	(1)*	7%	8%	(1)*

* Percentage point change

R&D expenses for the three and nine months ended September 30, 2013 decreased 18% and 6%, respectively, as compared to the same periods in 2012, primarily due to a decrease in the provision for incentive compensation expense, partially offset by higher expenses due to an increase in headcount to support our strategic initiatives.

Advertising Expense

Advertising expense consists of costs associated with marketing, advertising and promoting our products, including customer-related discounts and promotional allowances.

	Three Months Ended September 30,		% Change 2013 vs. 2012	Nine Months Ended September 30,		% Change 2013 vs. 2012
	2013	2012		2013	2012	
(Dollars in millions)						
Advertising expenses	\$ 7.4	\$ 7.2	3%	\$ 14.3	\$ 13.9	2%
As a percent of net sales	4%	4%	_*	4%	4%	_*

* Percentage point change

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Advertising expense for the three months ended September 30, 2013 increased 3% as compared to the same period in 2012, primarily due to an increase in marketing materials, social and search spending, partially offset by lower online advertising, and lower media and production spending. Advertising expense for the nine months ended September 30, 2013 increased 2% as compared to the same period in 2012, primarily due to an increase in cooperative print advertising to drive higher retail sales, an increase in marketing materials, social and search advertising spending, partially offset by a planned reduction in television commercial spending, lower online advertising, and lower media and production spending in the current period.

Depreciation and Amortization Expenses

	Three Months Ended September 30,		% Change 2013 vs.	Nine Months Ended September 30,		% Change 2013 vs.
	2013	2012	2012	2013	2012	2012
	(Dollars in millions)					
Depreciation and amortization	\$ 2.6	\$ 2.8	(7%)	\$ 8.0	\$ 8.8	(8%)
As a percent of net sales	1%	1%	.*	2%	3%	(1)*

* Percentage point change

Depreciation and amortization expenses for the three and nine months ended September 30, 2013 decreased 7% and 8%, respectively, as compared to the same period in 2012, primarily due to a reduction in amortization of other intangible assets as a result of certain assets reaching their full amortization during the first quarter of 2012, partially offset by an increase in depreciation of property and equipment as a result of an increase in capital expenditures in the current year period.

Other income (expense), net

Other income (expense) for the three and nine months ended September 30, 2013 improved \$0.9 million and \$1.8 million, respectively, as compared to the same periods in 2012, resulting primarily from our foreign currency activity. Other income (expense) for the nine months ended September 30, 2013 also included a one-time settlement of a dispute with a supplier.

Income Taxes

Our provision for (benefit from) income taxes and effective tax rates were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Provision for (benefit from) provision for income taxes	\$ 16,567	\$ (5,785)	\$ 13,421	\$ (5,163)
Income before income taxes	42,940	35,953	33,493	19,008
Effective tax rate	38.6%	(16.1%)	40.1%	(27.2%)

We exclude jurisdictions with tax assets for which no benefit can be recognized from the computation of effective tax rate and tax provision. Accordingly, due to the full valuation allowance recorded against our domestic deferred tax as of September 30, 2012, our domestic operations were excluded from the computation of tax benefits for the three and nine months ended September 30, 2012. The tax benefits for the 2012 periods were primarily attributable to the recognition of previously unrecognized tax benefits due to the expiration of statutes of limitations in our foreign jurisdictions, offset by foreign tax expense and certain discrete tax items including amortization of goodwill for tax purposes.

During the fourth quarter of 2012, after considering the relative impact of all evidence, positive and negative, we determined, at the required more-likely-than-not level of certainty, that a portion of our domestic deferred tax assets will be realized. Accordingly, for the three and nine months ended September 30, 2013, in addition to tax provisions attributable to our foreign operations, our effective tax rate and income tax provision included tax expense attributable to our domestic operating income for the respective periods.

We maintain a valuation allowance of \$70,385 as of September 30, 2013 against our deferred tax assets related to various net operating loss carry forwards, tax credits, and loss carry forwards that are capital in nature. Continued improvement in operating results could lead to a release of a portion of our remaining domestic valuation allowance, as early as the fourth quarter of 2013. However, the exact timing and the portion of the valuation allowance released are subject to change based on the level of profitability in the remainder of 2013, and our visibility into future period results. We expect that a considerable portion of the valuation allowance release will be recorded as an income tax benefit, which may significantly increase our net income. We expect our effective tax rate in periods following the release to be normalized, which may negatively impact our net income. Any valuation allowance release will not affect the amount of cash paid for income taxes.

Results of Operations by Segment

We organize, operate and assess our business in two primary operating segments: U.S. and International. This presentation is consistent with how our chief operating decision maker reviews performance, allocates resources and manages the business.

U.S. Segment

The U.S. segment includes net sales and related expenses directly associated with selling our products to national and regional mass-market and specialty retailers, other retail stores, distributors, resellers, and online channels including our online store and App Center. Certain corporate-level operating expenses associated with sales and marketing, product support, human resources, legal, finance, information technology, corporate development, procurement activities, R&D, legal settlements and other corporate costs are charged entirely to our U.S. segment.

	Three Months Ended September 30,		% Change 2013 vs. 2012	Nine Months Ended September 30,		% Change 2013 vs. 2012
	2013	2012		2013	2012	
(Dollars in millions)						
Net sales	\$ 146.8	\$ 145.7	1%	\$ 263.3	\$ 247.1	7%
Cost of sales	86.9	86.5	-%	158.9	146.2	9%
Gross margin *	40.8%	40.6%	0.2**	39.7%	40.8%	(1.1)**
Operating expenses	30.3	34.4	(12%)	94.2	98.8	(5%)
Operating expenses as a percent of net sales	21%	24%	(3)**	36%	40%	(4)**
Income from operations	\$ 29.7	\$ 24.8	20%	\$ 10.2	\$ 2.1	395%

* Gross profit as a percentage of net sales

** Percentage point change

Net sales for the three months ended September 30, 2013 increased 1% as compared to the same period in 2012, largely driven by sales of multimedia learning platforms, including LeapPad2 Power, LeapPad Ultra and LeapReader, which launched in the second quarter of 2013, and lower trade allowances and discounts. The increases were partially offset by lower sales in learning toys. Net sales for the nine months ended September 30, 2013 increased 7% as compared to the same period in 2012, largely driven by sales of multimedia learning platforms, partially offset by higher trade allowances and discounts.

Cost of sales for the three months ended September 30, 2013 remained relatively flat as compared to the same period in 2012. Cost of sales for the nine months ended September 30, 2013 increased 9% as compared to the same period in 2012, primarily driven by higher sales volume, higher product costs resulting from a change in sales mix with proportionally higher sales of lower-margin hardware, and higher royalty costs resulting from an increase in sales of licensed content.

Gross margin for the three months ended September 30, 2013 increased 0.2 percentage points as compared to the same period of 2012, primarily driven by lower inventory allowances, and lower trade allowances and discounts as a percentage of net sales. The increases were largely offset by changes in product mix with proportionally higher sales of lower-margin hardware and higher royalty costs resulting from an increase in sales of licensed content. Gross margin for the nine months ended September 30, 2013 decreased 1.1 percentage points as compared to the same period of 2012, primarily driven by changes in product mix with proportionally higher sales of lower-margin hardware, higher royalty costs resulting from an increase in sales of licensed content, and slightly higher trade allowances and discounts as a percentage of net sales. The decreases were partially offset by lower inventory allowances and higher sales volume which reduced the impact of fixed logistic costs.

Operating expenses for the three months ended September 30, 2013 decreased 12% as compared to the same period of 2012, primarily driven by a decrease in the provision for incentive compensation expense and a decrease in advertising expense attributable to lower cooperative print advertising, lower online advertising, and lower media and production spending. The decreases were partially offset by higher expenses due to an increase in headcount to support our strategic initiatives. Operating expenses for the nine months ended September 30, 2013 decreased 5% as compared to the same period of 2012, primarily due to bad debt expense of \$3.1 million in the prior year period related to an isolated customer bankruptcy, a decrease in the provision for incentive compensation expense, and lower advertising expenses attributable to a planned reduction in television commercial spending. The decreases were partially offset by higher expenses due to increased headcount in 2013 to support our strategic initiatives. Operating expenses as a percentage of net sales declined by 3 percentage points and 4 percentage points for the three and nine months periods, respectively, as higher sales volume leveraged costs.

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Income from operations for the three months ended September 30, 2013 increased 20% as compared to the same periods in 2012, primarily due to the increase in net sales and decrease in operating expenses, partially offset by lower gross margin. Income from operations for the nine months ended September 30, 2013 increased 395% as compared to the same periods in 2012, due to the increase in net sales and decrease in operating expenses, partially offset by lower gross margin.

International Segment

The International segment includes the net sales and related expenses directly associated with selling our products to national and regional mass-market and specialty retailers and other outlets through our offices in the United Kingdom, France and Canada and through distributors in markets such as Australia, Mexico, South Africa and Spain, as well as through our online channels including App Centers and online stores directed to certain international jurisdictions. Certain corporate-level operating expenses associated with sales and marketing, product support, human resources, legal, finance, information technology, corporate development, procurement activities, research and development, legal settlements and other corporate costs are allocated to our U.S. segment and not allocated to our International segment.

	Three Months Ended September 30,		% Change 2013 vs.	Nine Months Ended September 30,		% Change 2013 vs.
	2013	2012	2012	2013	2012	2012
(Dollars in millions)						
Net sales	\$ 54.2	\$ 47.4	14%	\$ 103.6	\$ 89.5	16%
Cost of sales	34.7	29.3	18%	64.4	54.8	18%
Gross margin *	35.9%	38.2%	(2.3)**	37.8%	38.8%	(1.0)
Operating expenses	6.2	6.0	3%	15.9	16.0	- %
Operating expenses as a percent of net sales	11%	13%	(1)**	15%	18%	(3)
Income from operations	\$ 13.2	\$ 12.1	10%	\$ 23.3	\$ 18.8	24%

* Gross profit as a percentage of net sales

** Percentage point change

Net sales for the three and nine months ended September 30, 2013 increased 14% and 16%, respectively, as compared to the same periods in 2012, largely driven by sales of multimedia learning platforms, including LeapPad2 Power, LeapPad Ultra and LeapReader, which launched in the second quarter of 2013, partially offset by higher trade allowances and discounts. Net sales for the nine months ended September 30, 2013 were also negatively impacted by higher trade allowances and discounts. Net sales for the three and nine months ended September 30, 2013 included a 3% and 1% negative impact from changes in currency exchange rates, respectively.

Cost of sales increased 18% for both the three and nine months ended September 30, 2013 as compared to the same periods in 2012, primarily driven by higher sales volume, higher product costs resulting from a change in sales mix with proportionally higher sales of lower-margin hardware, and higher royalty costs resulting from an increase in sales of licensed content.

Gross margin for the three and nine months ended September 30, 2013 decreased 2.3 and 1.0 percentage points, respectively, as compared to the same periods of 2012, primarily driven by changes in product mix with proportionally higher sales of lower-margin hardware, higher trade allowances and discounts as a percentage of net sales, and higher royalty costs resulting from proportionally higher sales of licensed content.

Operating expenses for the three months ended September 30, 2013 increased 3% as compared to the same period in 2012, primarily driven by higher advertising spending attributable to cooperative print advertising to drive higher retail sales and higher television commercial spending in the current period as compared to the prior year period. Operating expenses for the nine months ended September 30, 2013 remained relatively flat as compared to the same period in 2012. Operating expenses as a percentage of net sales declined by 1 and 3 percentage points, respectively, for the three and nine months ended September 30, 2013, as higher sales volume reduced the impact of fixed costs.

Income from operations for the three and nine months ended September 30, 2013 increased 10% and 24%, respectively, as compared to the same periods in 2012, primarily due to the increase in net sales, partially offset by decreased gross margin percentage and higher operating expenses.

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Liquidity and Capital Resources

Financial Condition

Cash and cash equivalents totaled \$78.4 million and \$49.4 million at September 30, 2013 and 2012, respectively. The increase in cash and cash equivalents was primarily due to an increase in cash provided by accounts receivable collection and improved operating results. Cash and cash equivalents held by our foreign subsidiaries totaled \$13.3 million and \$11.4 million at September 30, 2013 and 2012, respectively. In line with our investment policy, all cash equivalents were invested in high-grade short-term money market funds as of September 30, 2013.

We consider the undistributed earnings of our foreign subsidiaries as of September 30, 2013 to be indefinitely reinvested, and accordingly, no U.S. income taxes have been provided thereon. We do not currently intend to repatriate any foreign earnings to the U.S. to satisfy domestic liquidity needs arising in the ordinary course of business. However, if we were to repatriate these amounts, any associated tax liability would be fully offset by our net operating loss or tax credit carry forwards for the foreseeable future.

We have an asset-based revolving credit facility (the “revolving credit facility”) with a potential borrowing availability of \$75.0 million for the months of September through December and \$50.0 million for the remaining months. The borrowing availability varies according to the levels of our accounts receivable and cash and investment securities deposited in secured accounts with the lenders. Borrowing availability under this revolving credit facility was \$75.0 million as of September 30, 2013. There were no borrowings outstanding on our revolving credit facility at September 30, 2013.

Our accumulated deficit of \$56.0 million at September 30, 2013 is not expected to have an impact on our future ability to operate, given our anticipated cash flows from operations, strong cash position and the availability of our revolving credit facility.

Future capital expenditures are primarily planned for new product development and purchases related to the upgrading of our information technology capabilities. We expect that capital expenditures for the remainder of 2013, including those for capitalized content and website development costs, will be funded with cash flows generated by operations. Capital expenditures were \$26.7 million for the nine months ended September 30, 2013 and \$16.0 million for the same period of 2012. We expect capital expenditures to be in the range of \$30.0 million to \$35.0 million for the year ending December 31, 2013.

We believe that cash on hand, cash flow from operations and amounts available under our revolving credit facility will provide adequate funds for our working capital needs and planned capital expenditures over the next twelve months. Our ability to fund our working capital needs and planned capital expenditures, as well as our ability to comply with all of the financial covenants of our revolving credit facility, depend on our future operating performance and cash flows, which in turn are subject to prevailing economic conditions.

Cash Sources and Uses

The table below shows our sources and uses of cash for the nine months ended September 30, 2013 as compared to the same period in 2012:

	<u>Nine Months Ended September 30,</u>		<u>% Change</u>
	<u>2013</u>	<u>2012</u>	<u>2013 vs.</u>
	<u>(Dollars in millions)</u>		<u>2012</u>
Cash flows provided by (used in):			
Operating activities	\$ (18.1)	\$ (11.6)	(57%)
Investing activities	(26.7)	(13.5)	(98%)
Financing activities	3.4	2.5	35%
Effect of exchange rate fluctuations on cash	(0.1)	0.2	N/M
Increase in cash and cash equivalents	<u>\$ (41.6)</u>	<u>\$ (22.4)</u>	<u>86%</u>

Cash flow used in operations for the nine months ended September 30, 2013 increased \$6.5 million as compared to the same period in 2012, primarily due to a lower accounts payable balance attributable to timing of purchases, higher inventory levels and higher incentive compensation payouts, partially offset by an increase in cash provided by accounts receivable collection, and improved net income related to operating activities.

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Net cash used in investing activities for the nine months ended September 30, 2013 increased \$13.2 million as compared to the same period of 2012, primarily due to an increase in computer hardware and software purchases to upgrade our information technology capabilities.

Net cash provided by financing activities for the nine months ended September 30, 2013 increased \$0.9 million as compared to the same period of 2012, primarily due to lower payroll taxes paid related to a decrease in the number of vested employee RSUs, and an increase in proceeds from stock option exercises and employee stock purchase plan purchases.

Seasonal Patterns of Cash Provided By or Used in Operations

Generally, our cash flow provided by operations is highest in the first quarter of the year when we collect the majority of our accounts receivable booked in the fourth quarter of the prior year. Cash flow used in operations tends to be highest in our third quarter and early fourth quarter, as collections from prior accounts receivables taper off and we invest heavily in inventory in preparation for the fourth quarter holiday season. Cash flow generally turns positive again late in the fourth quarter as we start to collect on the accounts receivables associated with the holiday season. However, these seasonal patterns may vary depending upon general economic conditions and other factors.

Contractual Obligations and Commitments

We have had no material changes outside the ordinary course of our business in our contractual obligations during the three and nine months ended September 30, 2013.

In addition, as of September 30, 2013, we had outstanding off-balance sheet commitments for outsourced manufacturing and component purchases of \$0.8 million.

Critical Accounting Policies

In the ordinary course of business, we make a number of estimates and assumptions relating to the reporting of results of operations and financial position in the preparation of our consolidated financial statements in conformity with U.S. generally accepted accounting principles. Actual results could differ significantly from those estimates under different assumptions and conditions. We included in our 2012 Form 10-K a discussion of our critical accounting policies that are particularly important to the portrayal of our financial position and results of operations and that require the use of our management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

We have made no material changes to any of the critical accounting policies discussed in our 2012 Form 10-K through September 30, 2013.

Recently Adopted Accounting Guidance

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Updates ("ASU") 2013-11, *Income Taxes (Topic 740)*. The objective of this guidance is to eliminate the diversity in practice in the presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance is effective for reporting periods beginning after December 15, 2013, with early adoption permitted. We adopted this guidance during the three months ended September 30, 2013. The adoption of this guidance did not result in any material impact to our consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, *Comprehensive Income (Topic 220)*. The objective of this guidance is to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. This guidance became effective prospectively for reporting periods beginning after December 15, 2012. We adopted this guidance on January 1, 2013. The adoption of this guidance did not result in any material impact to our consolidated financial statements.

In July 2012, the FASB issued ASU 2012-02, *Intangibles—Goodwill and Other (Topic 350)*. The objective of this guidance is to simplify how an entity tests indefinite-lived intangible assets other than goodwill for impairment by providing entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. This guidance became effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. We adopted this guidance on January 1, 2013. The adoption of this guidance did not result in any material impact to our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risk disclosures set forth in Item 7A of our 2012 Form 10-K have not changed materially for our quarter ended September 30, 2013.

We develop products in the U.S. and market our products primarily in North America and, to a lesser extent, in Europe and the rest of the world. We are billed by and pay our third-party manufacturers in U.S. dollars. Sales to our international customers are transacted primarily in the country's local currency. As a result, our financial results could be affected by factors such as changes in foreign currency rates or weak economic conditions in foreign markets.

We manage our foreign currency transaction exposure by entering into short-term forward contracts. The purpose of this hedging program is to minimize the foreign currency exchange gain or loss reported in our financial statements, but the program, when properly executed, may not always eliminate our exposure to movements of currency exchange rates. The results of our hedging program for the three and nine months ended September 30, 2013 and 2012 are summarized in the table below:

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
	(Dollars in thousands)			
Gains (losses) on foreign exchange forward contracts	\$ (1,307)	\$ (1,326)	\$ 203	\$ (1,921)
Gains (losses) on underlying transactions denominated in foreign currency	1,291	587	(786)	495
Net losses	<u>\$ (16)</u>	<u>\$ (739)</u>	<u>\$ (583)</u>	<u>\$ (1,426)</u>

Our foreign exchange forward contracts generally have original maturities of one month or less. A summary of all foreign exchange forward contracts outstanding as of September 30, 2013 is as follows:

	<u>As of September 30, 2013</u>		
	<u>Average Forward Exchange Rate</u>	<u>Notional Amount in Local Currency</u> (1)	<u>Fair Value of Instruments in USD</u> (2)
Currencies:			
British Pound (GBP/USD)	1.611	23,131	\$ (117)
Euro (Euro/USD)	1.347	11,724	(61)
Canadian Dollar (USD/CAD)	<u>1.033</u>	<u>18,190</u>	<u>(17)</u>
Total fair value of instruments in USD			<u>\$ (195)</u>

(1) In thousands of local currency

(2) In thousands of USD

Cash equivalents are presented at fair value on our consolidated balance sheet. We invest our excess cash in accordance with our investment policy. As of September 30, 2013 and December 31, 2012 and September 30, 2012, our excess cash was invested in high-grade money market funds. Any adverse changes in interest rates or securities prices may decrease the value of our investments and operating results.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. This evaluation was performed under the supervision and with the participation of management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported, within the time periods specified in the U.S. SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

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The evaluation of our disclosure controls and procedures included a review of the controls' objectives and design, our implementation of the controls and the effect of the controls on the information generated for use in our reports. In the course of the controls evaluation, we reviewed any identified data errors and control problems and sought to confirm that appropriate corrective actions, including process improvements, were undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of management, including our CEO and CFO, concerning the effectiveness of the disclosure controls and procedures can be reported in our periodic reports filed with the U.S. SEC on Forms 10-Q, 10-K, and others as may be required from time to time.

Based upon the evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that our disclosure controls and procedures were effective as of September 30, 2013.

Inherent Limitations on Effectiveness of Controls

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Accordingly, our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the objectives of our disclosure system are met.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the three months ended September 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II.
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 11—"Commitments and Contingencies" in our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors disclosed under Part I, Item 1A. "Risk Factors" in our 2012 Form 10-K.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Original Exhibit Number	Filing Date	
3.01	Amended and Restated Certificate of Incorporation	S-1/A	333-86898	3.03	7/22/2002	
3.02	Amended and Restated Bylaws	8-K	001-31396	3.01	11/20/2012	
4.01	Form of Specimen Class A Common Stock Certificate	10-Q	001-31396	4.01	11/3/2011	
4.02	Fourth Amended and Restated Stockholders Agreement, dated as of May 30, 2003, by and among LeapFrog Enterprises, Inc. and the other persons named therein	10-Q	001-31396	4.02	8/12/2003	
10.01	Employment Agreement, dated as of August 13, 2013, between LeapFrog Enterprises, Inc. and Michael Dodd					X
31.01	Certification of the Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.02	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.01	Certification of the Chief Executive Officer and the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101	The following materials from the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in eXtensible Business Reporting Language (XBRL), include: (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows, and (v) Notes to the Consolidated Financial Statements					X

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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/ John Barbour

John Barbour
Chief Executive Officer
(Principal Executive Officer)

Date: November 6, 2013

/s/ Raymond L. Arthur

Raymond L. Arthur
Chief Financial Officer
(Principal Financial Officer)

Date: November 6, 2013

LeapFrog Enterprises, Inc.

EMPLOYMENT AGREEMENT

This Employment Agreement (the "Agreement"), dated August 13, 2013 (the "Date of Execution"), is entered into by and between LeapFrog Enterprises, Inc., a Delaware corporation (the "Company"), and Michael Dodd ("Employee").

RECITALS

WHEREAS, Employee will assume a new position on an interim basis as an advisor to the Company's chief executive officer ("CEO") to ensure a smooth transition of the Company's supply chain, product development and engineering functions; and

WHEREAS, Employee will remain employed by the Company in this new position from August 14, 2013 (the "Effective Date") until no later than December 31, 2014;

NOW, THEREFORE, in consideration of the covenants, promises and representations set forth herein, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

I. POSITION AND RESPONSIBILITIES

A. Position. As of the Effective Date, Employee shall be employed by the Company for the Period of Employment (as defined in Section I.D) to render services to the Company as an advisor to the CEO for the supply chain, product development and engineering functions. No employees will report to Employee. Employee will not be an officer or Leadership Team member; however, as determined by the Company, attendance at Leadership Team meetings may be required. During the Period of Employment, Employee shall perform such duties and responsibilities as are normally related to such position in accordance with the standards of the industry and any additional duties commensurate with such position now or hereafter assigned to Employee by the Company. Employee shall abide by the verbal or written directions of the CEO and other appointed officers, as well as written rules, regulations, and practices as adopted or modified from time to time in the Company's sole discretion that have been made available to Employee.

B. Other Activities. Except upon the prior written consent of the Company, Employee will not, during the term of this Agreement, (i) accept any other employment, or (ii) engage, directly or indirectly, in any other business activity (whether or not pursued for pecuniary advantage) that might interfere with Employee's duties and responsibilities hereunder or create a conflict of interest with the Company.

C. No Conflict. Employee represents and warrants that Employee's execution of this Agreement, employment with the Company, and the performance of Employee's proposed duties under this Agreement shall not violate any obligations Employee may have to any other employer, person or entity, including any obligations with respect to proprietary or confidential information of any other person or entity.

D. Period of Employment. Provided this Agreement is executed in writing by both Employee and Company and becomes effective, the "Period of Employment" shall be a period beginning July 1, 2013 and ending at the close of business on December 31, 2014. Notwithstanding the foregoing, the Period of Employment is subject to earlier termination as provided below in this Agreement.

E. Hours and Location. Employee's employment will be full-time. As required by the Company, a minimum of fifty percent (50%) of Employee's time shall be spent in the Company's offices, or contract manufacturer offices/manufacturing facilities, as approved in advance by the Company. Employee will have use of a drop-in office in Emeryville, subject to space availability, and shared administrative support, subject to availability.

II. COMPENSATION AND BENEFITS

A. Base Salary. In consideration of the services to be rendered under this Agreement, during the Period of Employment, the Company shall pay Employee a salary at the rate of four hundred eight thousand Dollars (\$408,000) per year ("Base Salary") less standard payroll deductions and tax withholdings. The Base Salary shall be paid in accordance with the Company's regularly established payroll practice.

B. Bonus. During the Period of Employment, Employee shall be eligible to receive a discretionary annual bonus (the "Bonus"). The annual target opportunity level of the Bonus shall be 75% of the base salary actually paid during the calendar year. The bonus is in the Company's discretion and is based upon the Company's attainment of financial goals and Employee's achievement of individual goals and objectives and is subject to continued employment during the applicable period and on the date the Company pays the bonus, if any, to employees.

C. Benefits. Employee shall accrue twenty-two (22) vacation days per year, with no more than eleven (11) days of vacation taken out of time required to be spent in Company offices, and CM offices/manufacturing facilities. Employee shall be eligible for group health and 401(k) benefits in accordance with the benefit plans and policies established by the Company. Although Employee will not be an officer of the Company, solely for purposes of eligibility for benefits and compliance with the Company's policies, Employee's position will be treated as a Senior Vice President level position.

D. Expenses. The Company shall reimburse Employee for reasonable business expenses incurred in the performance of Employee's duties hereunder in accordance with the Company's expense reimbursement guidelines

E. Equity Grant. The Company will recommend to the Company's board of directors (the "Board") that it grant Employee stock options to purchase ninety thousand (90,000) shares ("Options") and restricted stock units covering forty thousand (40,000) shares ("RSUs"). These Options and RSUs will each vest as to one-third of the shares on December 31, 2013, and as to two-thirds of the shares on December 31, 2014, subject to continuous employment. The equity grant dates shall be in accordance with the Company's grant date policy as established by the Board and the grants shall be subject to the terms of the equity plan and applicable award agreements.

III. TERMINATION OF EMPLOYMENT

A. Termination by Company. Employee's employment by the Company, and the Period of Employment, may be terminated by the Company at any time for any reason upon sixty (60) days' written notice. In that event, Employee will be entitled to the Accrued Obligations (as defined below).

B. Termination by Employee. Employee's employment by the Company, and the Period of Employment, may be terminated by Employee upon sixty (60) days' written notice to the Company. In that event, Employee will be entitled to the Accrued Obligations. In that event, equity vesting and bonus eligibility shall cease on the effective date of termination.

C. Benefits upon Termination by the Company. If the Company terminates Employee's employment during the Period of Employment for Cause (as defined in Section III.F), all equity vesting and bonus eligibility shall cease upon the termination of Employee's employment. If the Company terminates Employee's employment during the Period of Employment without Cause, in addition to the Accrued Obligations and subject to delivery and non-revocation by Employee of a release of claims acceptable to the Company (as set forth in Section III.D), Employee shall be entitled to:

1. A pro-rata portion of the Company Component, as defined under the Company's then-current annual bonus plan for non-sales employees, of the bonus Employee would have received for the year in which termination occurs based on the portion of the calendar year completed prior to termination. Any such bonus earned will be paid at the same time as when executive bonuses are generally paid and will be based on actual Company performance under the applicable annual bonus plan as determined by the Board in its sole discretion.

2. If the termination of Employee's employment occurs in 2013, vesting of a pro-rata portion of the Options and RSUs scheduled to vest in 2013 (as set forth in Section II.E) based on the portion of the period of time between the Effective Date and December 31, 2013 completed prior to termination; and

3. If the termination of Employee's employment occurs in 2014, vesting of a pro-rata portion of the Options and RSUs scheduled to vest in 2014 (set forth in Section II.E) based on the portion of the calendar year 2014 completed prior to termination.

D. Release for Payment of Severance. As a condition precedent to any Company obligation to Employee pursuant to Section III.C (other than an obligation to pay the Accrued Obligations), Employee shall, within the sixty (60) notice day period, provide the Company with a valid, executed general release agreement (the "Release") (a form of which is attached hereto as Exhibit A), and the Release shall have not been revoked by Employee pursuant to any revocation rights afforded by applicable law. This Section III.D shall apply notwithstanding anything else contained in this Agreement or any stock option or other equity-based award agreement to the contrary.

E. Release of Prior Severance and Change in Control Benefits and Prior Claims.

1. Upon execution of the Agreement, Employee hereby irrevocably waives and releases all rights and benefits under Employee's Executive Management Severance and Change in Control Agreement, including without limitation the rights and benefits under the Executive Management Severance and Change in Control Agreement described in the letters to Employee dated December 19, 2007 and September 29, 2010. This Section III.E.1 shall apply notwithstanding anything else contained in this Agreement or any stock option or other equity-based award agreement to the contrary.

2. In addition, Employee is concurrent herewith executing a release in the form attached hereto as Exhibit B.

F. Certain Defined Terms.

1. As used herein, "Accrued Obligations" means:

a. any Base Salary that had accrued but had not been paid (including accrued and unpaid vacation time) on or before the Severance Date; and

b. any reimbursement due to Employee pursuant to Section II.D for expenses incurred by Employee on or before the Severance Date.

2. As used herein, "Cause" shall mean: (i) the Employee's misconduct or negligence in the performance of the Employee's duties to the Company; (ii) the Employee's failure to perform the Employee's duties to the Company or to follow the lawful directives of the Board or any executive to which the Employee reports which failure remains uncured for five (5) days; (iii) indictment for, conviction of, or pleading of guilty or nolo contendere to, a felony or any crime involving moral turpitude; (iv) the Employee's failure to cooperate in any audit or investigation of the business or financial practices of the Company or any of its subsidiaries; (v) the Employee's performance of any act of theft, embezzlement, fraud, malfeasance, dishonesty or misappropriation of the Company's property; or (vi) breach of this Agreement or any other agreement with the Company, or a violation of the Company's code of conduct or other written policy.

IV. TERMINATION OBLIGATIONS

A. Return of Property. Employee agrees that all property (including without limitation all equipment, tangible proprietary information, documents, records, notes, contracts and computer-generated materials) furnished to or created or prepared by Employee incident to Employee's employment belongs to the Company and shall be promptly returned to the Company upon termination of Employee's employment.

B. Resignation and Cooperation. Upon termination of Employee's employment, Employee shall be deemed to have resigned from all offices and directorships then held with the Company. Following any termination of employment, Employee shall cooperate with the Company in the winding up of pending work on behalf of the Company and the orderly transfer of work to other employees. Employee shall also cooperate with the Company in the defense of any action brought by any third party against the Company that relates to Employee's employment by the Company.

V. PROHIBITION ON THIRD PARTY INFORMATION

A. Employee Confidentiality Agreement. Executive agrees that he continues to be bound by the terms of the Employee Proprietary Information and Inventions Agreement dated April 18, 2005 (the "Proprietary Information Agreement").

B. Non-Solicitation. Employee acknowledges that because of Employee's position in the Company, Employee will have access to material intellectual property and confidential information. During the term of Employee's employment and for one year thereafter, in addition to Employee's other obligations hereunder or under the Proprietary Information Agreement, Employee shall not, for Employee or any third party, directly or indirectly (i) solicit, induce, recruit or encourage any person employed by the Company to terminate his or her employment; or (ii) divert or attempt to divert from the Company any business with any customer, client, member, business partner or supplier about which Employee obtained confidential information during his employment with the Company, by using the Company's trade secrets or by otherwise engaging in conduct that amounts to unfair competition. Nothing in this Section V.B shall alter or diminish Employee's obligations pursuant to the Proprietary Information Agreement and any other restrictive covenants between or among Employee and the Company.

VI. AMENDMENTS; WAIVERS; REMEDIES

This Agreement may not be amended or waived except by a writing signed by Employee and by the CEO or the Board. Failure to exercise any right under this Agreement shall not constitute a waiver of such right. Any waiver of any breach of this Agreement shall not operate as a waiver of any subsequent breaches. All rights or remedies specified for a party herein shall be cumulative and in addition to all other rights and remedies of the party hereunder or under applicable law.

VII. ASSIGNMENT; BINDING EFFECT

A. Assignment. The performance of Employee is personal hereunder, and Employee agrees that Employee shall have no right to assign and shall not assign or purport to assign any rights or obligations under this Agreement. This Agreement may be assigned or transferred by the Company; and nothing in this Agreement shall prevent the consolidation, merger or sale of the Company or a sale of any or all or substantially all of its assets.

B. Binding Effect. Subject to the foregoing restriction on assignment by Employee, this Agreement shall inure to the benefit of and be binding upon each of the parties; the affiliates, officers, directors, agents, successors and assigns of the Company; and the heirs, devisees, spouses, legal representatives and successors of Employee.

VIII. NOTICES

All notices or other communications required or permitted hereunder shall be made in writing and shall be deemed to have been duly given if delivered: (a) by hand; (b) by a nationally recognized overnight courier service; or (c) by United States first class registered or certified mail, return receipt requested, to the principal address of the other party, as set forth below. The date of notice shall be deemed to be the earlier of (i) actual receipt of notice by any permitted means, or (ii) five business days following dispatch by overnight delivery service or the United States Mail. Employee shall be obligated to notify the Company in writing of any change in Employee's address. Notice of change of address shall be effective only when done in accordance with this paragraph.

Company's Notice Address:

LeapFrog Enterprises, Inc.
6401 Hollis Street, Suite 100
Emeryville, CA 94608-1071
Attention: General Counsel

Employee's Notice Address:

The last personal address provided to the Company.

IX. SEVERABILITY

If any provision of this Agreement shall be held by a court or arbitrator to be invalid, unenforceable, or void, such provision shall be enforced to the fullest extent permitted by law, and the remainder of this Agreement shall remain in full force and effect. In the event that the time period or scope of any provision is declared by a court or arbitrator of competent jurisdiction to exceed the maximum time period or scope that such court or arbitrator deems enforceable, then such court or arbitrator shall reduce the time period or scope to the maximum time period or scope permitted by law.

X. TAXES

All amounts paid under this Agreement shall be paid less all applicable state and federal tax withholdings (if any) and any other withholdings required by any applicable jurisdiction or authorized by Employee. Notwithstanding any other provision of this Agreement whatsoever, the Company, in its sole discretion, shall have the right to provide for the application and effects of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), and the final regulations and any guidance promulgated thereunder ("Section 409A") (relating to deferred compensation arrangements) and any related administrative guidance issued by the Internal Revenue Service. Notwithstanding anything to the contrary in this Agreement, if Employee is a "specified employee" within the meaning of Section 409A at the time of Employee's termination (other than due to death), then the cash severance benefits payable to Employee under this Agreement, if any, and any other severance payments or separation benefits that may be considered deferred compensation under Section 409A (together, the "Deferred Compensation Separation Benefits") otherwise due to Employee on or within the six (6) month period following Employee's termination shall accrue during such six (6) month period and shall become payable in a lump sum payment on the date six (6) months and one (1) day following the date of Employee's termination of employment. All subsequent payments, if any, shall be payable in accordance with the payment schedule applicable to each payment or benefit. Notwithstanding anything herein to the contrary, if Employee dies following his termination but prior to the six (6) month anniversary of his termination, then any payments delayed in accordance with this Section shall be payable in a lump sum as soon as administratively practicable after the date of Employee's death and all other Deferred Compensation Separation Benefits shall be payable in accordance with the payment schedule applicable to each payment or benefit.

It is the intent of this Agreement to comply with the requirements of Section 409A so that none of the severance payments and benefits to be provided hereunder shall be subject to the additional tax imposed under Section 409A , and any ambiguities herein shall be interpreted to so comply.

XI. GOVERNING LAW

This Agreement shall be governed by and construed in accordance with the laws of the State of California.

XII. INTERPRETATION

Each party recognizes that this is a legally binding contract and acknowledges and agrees that they have had the opportunity to consult with legal counsel of their choice. This Agreement shall be construed as a whole, according to its fair meaning, and not in favor of or against any party. Employee agrees and acknowledges that he has read and understands this Agreement, is entering into it freely and voluntarily, and has been advised to seek counsel prior to entering into this Agreement and has had ample opportunity to do so. Sections and section headings contained in this Agreement are for reference purposes only, and shall not affect in any manner the meaning or interpretation of this Agreement. Whenever the context requires, references to the singular shall include the plural and the plural the singular.

XIII. OBLIGATIONS SURVIVE TERMINATION OF EMPLOYMENT

Employee agrees that any and all of Employee's obligations under this agreement shall survive the termination of employment and the termination of this Agreement.

XIV. COUNTERPARTS

This Agreement may be executed in any number of counterparts, each of which shall be deemed an original of this Agreement, but all of which together shall constitute one and the same instrument.

XV. AUTHORITY

Each party represents and warrants that such party has the right, power and authority to enter into and execute this Agreement and to perform and discharge all of the obligations hereunder; and that this Agreement constitutes the valid and legally binding agreement and obligation of such party and is enforceable in accordance with its terms.

XVI. ENTIRE AGREEMENT

This Agreement is intended to be the final, complete, and exclusive statement of the terms of Employee's employment by the Company and may not be contradicted by evidence of any prior or contemporaneous statements or agreements. This Agreement supersedes all prior and contemporaneous agreements of the parties hereto that directly or indirectly bears upon the subject matter hereof, including without limitation the letters to Employee dated December 19, 2007 and September 29, 2010 regarding Employee's prior compensation and severance benefits and Employee's offer letter dated March 31, 2005. To the extent that the practices, policies or procedures of the Company, now or in the future, apply to Employee and are inconsistent with the terms of this Agreement, the provisions of this Agreement shall control. Any subsequent change in Employee's duties, position, or compensation will not affect the validity or scope of this Agreement.

XVII. EMPLOYEE ACKNOWLEDGEMENT

EMPLOYEE ACKNOWLEDGES EMPLOYEE HAS HAD THE OPPORTUNITY TO CONSULT LEGAL COUNSEL CONCERNING THIS AGREEMENT, THAT EMPLOYEE HAS READ AND UNDERSTANDS THE AGREEMENT, THAT EMPLOYEE IS FULLY AWARE OF ITS LEGAL EFFECT, AND THAT EMPLOYEE HAS ENTERED INTO IT FREELY BASED ON EMPLOYEE'S OWN JUDGMENT AND NOT ON ANY REPRESENTATIONS OR PROMISES OTHER THAN THOSE CONTAINED IN THIS AGREEMENT.

In Witness Whereof, the parties have duly executed this Agreement as of the date first written above.

LEAPFROG ENTERPRISES, INC.

MICHAEL DODD

/s/ John Barbour

Signature

/s/ Michael Dodd

Signature

Chief Executive Officer

Title:

August 12, 2013

Date:

August 13, 2013

Date:

EXHIBIT A

GENERAL RELEASE

Michael Dodd ("Employee") and LeapFrog Enterprises, Inc. (the "Company") have agreed to enter into this General Release ("Release") on the following terms:

Effective [**Separation Date**], Employee's employment at the Company shall be terminated. Subject to the effectiveness of this Release and any delay required to avoid the imposition of additional taxes under Internal Revenue Code Section 409A, Employee will begin receiving the severance benefits set forth in Section III.C of Employment Agreement dated _____, 2013 ("Agreement"), in accordance with the terms of that Agreement.

In exchange for the foregoing Severance, Employee completely releases the Company, its affiliated, related, parent or subsidiary corporations, and its and their present and former directors, officers, and employees from, and agrees not to file, cause to be filed, or otherwise pursue, any and all claims Employee may now have or has ever had against any of them, including but not limited to claims for compensation, bonuses, severance pay, equity, and all claims arising from Employee's employment or the termination of that employment (including, without limitation, any claims arising under the Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act, the WARN Act or any state counterpart, the California Fair Employment and Housing Act, or any other claims for violation of any federal, state, or municipal statutes), and any and all claims for attorneys' fees and costs. This release does not extend to any severance obligations or Accrued Obligations due Employee under the Agreement. Nothing in this Agreement waives Employee's rights to indemnification or any payments under any fiduciary insurance policy, if any, provided by any act or agreement of the Company, state or federal law or policy of insurance.

Employee agrees that because this Release specifically covers known and unknown claims, Employee waives any rights under Section 1542 of the California Civil Code, or under any comparable law of any other jurisdiction. Section 1542 states: "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."

Employee acknowledges that Employee has 21 days to consider this Release (but may elect to sign it at any time beforehand), and may consult an attorney in doing so. Employee also acknowledges that he or she may revoke this Release within 7 days of signing it by sending a certified letter to that effect to [**name and address**]. Employee understands and agrees that this Release shall not become effective or enforceable and no payments or benefits will be provided until the 7-day revocation period has expired.

Employee acknowledges that the Agreement and this Release represent the entire agreement and understanding between the parties, supersede and replace any and all prior agreements and understandings between them, and shall not be modified in any way except in writing executed by both parties. Employee also agrees that if any term or portion contained herein shall be found to be unenforceable under applicable law, such finding shall not invalidate the whole Release, but the Release shall be construed as not containing the particular term or portion held to be invalid and the rights and obligations of the parties shall be construed and enforced accordingly.

Employee acknowledges that Employee has read this Release, fully understands all of its provisions and the consequences of signing it, and agrees to all of its conditions.

Michael Dodd

[Name of Company Signatory]
LeapFrog Enterprises, Inc.

Date: _____

Date: _____

EXHIBIT B
GENERAL RELEASE

Michael Dodd ("Employee") and LeapFrog Enterprises, Inc. (the "Company") have agreed to enter into this General Release ("Release") on the following terms:

Effective August 14, 2013 Employee's employment with the Company pursuant to an Employment Agreement shall begin.

In exchange for the benefits under the Employment Agreement, Employee completely releases the Company, its affiliated, related, parent or subsidiary corporations, and its and their present and former directors, officers, and employees from, and agrees not to file, cause to be filed, or otherwise pursue, any and all claims Employee may now have or has ever had against any of them, including but not limited to claims for compensation, bonuses, severance pay, equity, and all claims arising from Employee's employment or the termination of that employment (including, without limitation, any claims arising under the Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act, the WARN Act or any state counterpart, the California Fair Employment and Housing Act, or any other claims for violation of any federal, state, or municipal statutes), and any and all claims for attorneys' fees and costs. This release does not extend to any severance obligations or Accrued Obligations due Employee under the Agreement. Nothing in this Agreement waives Employee's rights to indemnification or any payments under any fiduciary insurance policy, if any, provided by any act or agreement of the Company, state or federal law or policy of insurance.

Employee agrees that because this Release specifically covers known and unknown claims, Employee waives any rights under Section 1542 of the California Civil Code, or under any comparable law of any other jurisdiction. Section 1542 states: "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."

Employee acknowledges that the Agreement and this Release represent the entire agreement and understanding between the parties, supersede and replace any and all prior agreements and understandings between them, and shall not be modified in any way except in writing executed by both parties. Employee also agrees that if any term or portion contained herein shall be found to be unenforceable under applicable law, such finding shall not invalidate the whole Release, but the Release shall be construed as not containing the particular term or portion held to be invalid and the rights and obligations of the parties shall be construed and enforced accordingly.

Employee acknowledges that Employee has read this Release, fully understands all of its provisions and the consequences of signing it, and agrees to all of its conditions.

/s/ Michael Dodd
Michael Dodd

Date: August 12, 2013

/s/ John Barbour
LeapFrog Enterprises, Inc.

Title: Chief Executive Officer

Date: August 13, 2013

CERTIFICATION

I, John Barbour, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of LeapFrog Enterprises, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2013

/s/ John Barbour

John Barbour
Chief Executive Officer

CERTIFICATION

I, Raymond L. Arthur, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of LeapFrog Enterprises, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2013

/s/ Raymond L. Arthur
Raymond L. Arthur
Chief Financial Officer

**Certifications of Chief Executive Officer and Chief Financial Officer
Pursuant to 18 U.S.C. Section 1350**

Pursuant to the requirements set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, John Barbour, the Chief Executive Officer of LeapFrog Enterprises, Inc. (the "Company"), and Raymond L. Arthur, the Chief Financial Officer of the Company, each hereby certifies as of the date hereof and solely for purposes of Title 18, Chapter 63, Section 1350 of the United States Code that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, to which this Certification is attached as Exhibit 32.01 (the "Quarterly Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act, as applicable; and
2. The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Quarterly Report and results of operations of the Company for the periods covered in the financial statements in the Quarterly Report.

Dated: November 6, 2013

/s/ John Barbour

John Barbour
Chief Executive Officer

/s/ Raymond L. Arthur

Raymond L. Arthur
Chief Financial Officer

Note: This certification accompanies the Quarterly Report pursuant to 18 U.S.C. Section 1350 and shall not be deemed "filed" by the Company for purposes of Section 18 of the Exchange Act, or incorporated by reference into any filing of the Company under the Exchange Act or the Securities Act of 1933, as amended, whether made before or after the date hereof and irrespective of any general incorporation language contained in such filing.
