

Exhibit 2

Stakeholder Beliefs: The Vermont Teddy Bear Co., Inc.

Our customers are the foundation of our business. Exceeding their expectations everyday will form the backbone of our corporate culture. Zealous pursuit of "world class" customer service will build a self-fulfilling cycle of pride, partnership, team spirit, and personal commitment in every player in our company.

Our employees are our internal customers. The philosophy that applies to our external customers extends also to our internal associates. We will cultivate a results-oriented environment that encourages fairness, collaboration, mutual respect, and pride in our organization. Pro-active, positive, open-minded confrontation among well-intentioned colleagues will ensure innovation, reject complacency, and stimulate individual growth. Our company supports employee diversity and provides clear opportunities for each of us to reach our full personal and professional potential.

Our investors provide capital in good faith, and we are accountable for creating a realistic return while protecting the assets of our company. Our financial strength and profitability are essential to fulfilling all of our stakeholder commitments.

Our vendors provide a partnership opportunity for innovative product development, unsurpassed external customer service, and mutual prosperity. This is based on exceeding our customers' expectations for unique, innovative, high-quality communications and products delivered to our customers where and when they want them at a price that reinforces our reputation for perceived value.

Our community deserves our commitment to being ethically, legally, and environmentally responsible while remaining fiscally sound. We will support organizations and individuals with values similar to ours and participate actively in those enterprises that seek to improve local and world conditions for future generations. We will seek to maintain a dynamic balance between meeting our commitment to our community and maintaining the viability of our own enterprise.

Exhibit 2 details Vermont Teddy's statement of Stakeholder Beliefs. The company believed that the quality, variety, and creativity of the company's products, and its commitment to customer service, were essential to its business. Its manufacturing practices were environmentally sound. The company sought to use the best available materials for its bears. Customer service policies rivaled those of L.L. Bean. Each bear was sold with a "Guarantee for Life," under which the company undertook to repair or replace any damaged or defective bear at any time even if eaten by the family dog or destroyed by a lawn mower.³⁴

Products and Services

Vermont Teddy Bear made old-fashioned, handmade, jointed teddy bears ranging from 11 to 72 inches tall, in 6 standard color selections including tan, honey, brown, and black. More than 100 different bear outfits were available for customers to outfit and individualize their bears or to emphasize certain relevant characteristics of the receiver such as policewoman, gardener, doctor, or racing car driver. Some of the more popular outfits included tutus, wedding gowns, tuxedos, business suits, and sports uniforms. Bears could also be dressed in a wide variety of outfits that personalized the bear for significant life events, such as a new baby, get well, birthdays, graduations, weddings, and "I love you." A collection of bears could also be designed for schools, sports teams, businesses, and other organizations. New "edgier" products were added in 1997 such as "Shredder, the Snowboarder Bear," targeted primarily at radio customers. As of June 30, 1998, 40% of the outfits were outsourced to overseas contractors.³⁵ Prices for the bears in standard outfits ranged from \$40 to more than \$200. Custom-made clothing was available at an additional cost.

Until 1997, bear materials were mostly American made, though mohair fur used for the premium bears came from Europe. All other fur was hypoallergenic, plush polyester. Bears were stuffed with virgin Dacron 91, a fire retardant filler for safety. Vermont teddy bears had movable joints, a feature associated with traditional, high-quality teddy bears. These joints were made from recycled Ben & Jerry's ice cream containers. In keeping with the company's attempt to produce the bears with domestic materials, the bears' eyes had come from the only eye maker left in America. Noses and paw pads were ultrasuede, also 100% American made.³⁶ Using American-made materials had been one of the methods by which Vermont Teddy Bear differentiated its products from those of its competitors. The company's 1998 move to the off-shore sourcing of raw materials represented a significant departure from the company's historical position as an American manufacturer using almost exclusively American materials.³⁷

In addition to the products it manufactured, Vermont Teddy Bear sold items related to teddy bears, as well as merchandise from other manufacturers featuring the logo of Vermont Teddy Bear. It did a small amount of licensing with Tyco, Landmark, and a manufacturer of children's and women's sleepwear. Some items such as clothing, jewelry, and accessory ornaments were available primarily at the company's retail stores and through its direct mail catalog. The company also sold stuffed toys that had been manufactured by other companies, such as Gund and Steiff.³⁸ Vermont Teddy Bear planned to alter this strategy in 1999 to focus more attention on the sale of the company's own manufactured products, including those manufactured offshore.

In addition to manufacturing and selling bears and bear-related merchandise to individual consumers, the company's Corporate Division provided unique and original customized products for corporations. Vermont Teddy also silk-screened or embroidered bears on clothing with the customer's logo, slogan, or team name. In 1998, the company planned to offer a line of offshore-manufactured ancillary products for corporate customers and outlets such as QVC.³⁹ Information about products offered through the company's Corporate and Wholesale Programs could be found on the company's Web site.

Marketing Strategies and Distribution Methods

Vice President of Sales was Katie Camardo. Robert D. Delsandro was appointed Vice President of Marketing and Design in May 1998. He had been employed by The Vermont Teddy Bear Company as Creative Director since 1996 and had been responsible for developing a completely new look for the company's products, retail stores, printed promotional materials, and catalog. He was credited with creating the new "edgier" look of Vermont Teddy Bear.⁴⁰

Although many teddy bear producers defined their product as a toy and marketed solely to children, Vermont Teddy Bear marketed its bears as an attractive gift or collectible for both children and adults. The company defined its target market as "children between the ages of 1 to 100."⁴¹

The company was primarily known for its Bear-Gram delivery service. Bear-Grams were personalized teddy bears that were delivered directly to recipients as gifts for holidays and special occasions. Bear-Grams were gift boxed in unique containers complete with "air-holes" for the bear. The bears were accompanied by a personal greeting from the sender.

Orders for Bear-Grams were generally placed by calling a toll-free number (1-800-829-BEAR) and speaking with company sales representatives called "Bear Counselors." Customers could also visit the company's Web site <www.vtbear.com> and place their orders online. "Bear Counselors" entered an order on a computer, which was part of the company's computer network of approximately 250 workstations that linked order entry with sales and accounting systems. The company had plans to upgrade, expand, and integrate its computer systems, including the purchase of an inventory control system. In 1994, the company

installed a new telephone system, which improved its telemarketing operations and was designed to accommodate future growth in telephone call volume. The company strove to provide rapid response to customer orders. Orders placed by 4 P.M. EST (3 P.M. on the Internet) could be shipped the same day. Packages were delivered primarily by UPS and other carriers by next day air or ground delivery service.⁴² The company also sought to respond promptly to customer complaints. The company believed that, as a result of the quality of its products and service, it had established a loyal customer base.

The company attributed its success to this direct-marketing strategy. Since 1990, when the Bear-Gram was introduced to prime-time and rush-hour audiences in the New York City market, the company had continued to rely primarily on Bear-Gram advertising. It had also continued to focus its advertising on morning rush-hour radio spots, with well-known personalities such as Don Imus and Howard Stern, promoting the bears.

For the fiscal year ending June 30, 1998, Bear-Grams accounted for 70.2% of net revenues of \$17.2 million. The percent of net revenues for the company's primary distribution methods can be seen in Exhibit 3. Included in Bear-Gram revenues were sales from the company's Internet Web site. Other principal avenues of distribution included company-owned retail stores, direct mail catalogs, and licensing and wholesale agreements. The company's sales were heavily seasonal, with Valentine's Day, Christmas, and Mother's Day as the company's largest sales seasons.⁴³ For Valentine's Day 1998, more than 47,000 bears were sent out by people across the country who wished to say "I love you."⁴⁴

During the summer of 1997, Vermont Teddy Bear Company began doing business on the Internet with a new Web site designed to inform and entertain Internet subscribers. The Web site provided a low-cost visual presence and was developed for the purpose of supporting the radio advertising of Bear-Grams. Pictures of the product and other information could be accessed. A total of 396,000 hits to the Web site were recorded during fiscal 1998, more than double the 195,000 hits recorded during fiscal 1997.⁴⁵ By August 1998, 10 to 20% of Vermont Teddy's business was being handled online.⁴⁶ All radio advertisements were tagged with a reference to the Web site, which, in turn, provided visual support for the radio advertising and the opportunity for customers to place orders online.⁴⁷

Since 1990, the company had extended its Bear-Gram marketing strategy beyond New York City to include other metropolitan areas and syndicated radio programs across the United States. During the fiscal year 1998, the company regularly placed advertising on a total of 44 radio stations in 12 of the 20 largest market areas in the United States.⁴⁸ Exhibit 4 shows the company's largest markets. Exhibit 5 shows the most frequent reasons given by customers for purchasing a Vermont Teddy Bear-Gram. The company was featured on Dateline NBC, Tuesday, December 17, 1996. Newsbroadcaster Stone Phillips interviewed R. Patrick Burns, President and CEO, on the subject of American companies that manufactured products in the United States.⁴⁹

Exhibit 3

Primary Distribution Methods: The Vermont Teddy Bear Co., Inc.

Year Ending June 30	1998	1997	1996	1995
Bear-Grams	72.0%	70.0%	75.8%	78.7%
Retail Operations	18.0%	17.7%	12.9%	9.2%
Direct Mail	9.2%	10.9%	7.2%	8.8%
Other	0.8%	1.4%	4.1%	3.3%

Note:

1. Excludes Bear-Gram revenues from retail operations.

Source: The Vermont Teddy Bear Co., Inc., 1998 Annual Report, p. 3.

Exhibit 4

Vermont Teddy Bear's Largest Markets
(Percentage of Bear-Grams for the 12 months ending June 30)

Markets	1998	1997	1996	1995
New York City	37.8%	40.8%	35.5%	38.6%
Boston	13.4%	13.2%	9.5%	9.5%
Philadelphia	8.9%	11.6%	8.9%	7.3%
Chicago	6.5%	8.9%	7.3%	8.5%
Los Angeles	6.3%	5.8%	4.0%	3.8%

Source: The Vermont Teddy Bear Company, Inc., 1998 Annual Report, p. 4.

In 1998, the company was planning to expand its radio advertisements into new markets including Minneapolis, Dallas, and Milwaukee and to examine opportunities to consolidate radio advertising buys through annual contracts with major stations.⁵⁰

The company had explored additional methods to market Bear-Grams and to publicize its toll-free telephone number. In June 1993, the company's toll-free number was listed for the first time in the AT&T toll-free telephone directory. Before then, the toll-free number was not readily available to customers, except in radio advertisements. Vermont Teddy Bear also expanded its listings in metropolitan phone book Yellow Pages and initiated the use of print advertising in magazines and newspapers, as well as advertising on billboards and mass transit panels.

Vermont Teddy Bear believed that the popularity of Bear-Grams created an opportunity for catalog sales. For the fiscal year ending June 30, 1998, direct mail accounted for 9.2% of net revenues.⁵¹ In addition, repeat buyers represented 33% of sales, giving the company an opportunity to use its customer database in excess of 1,500,000 names.⁵² The company introduced its first catalog for Christmas in 1992. By 1994, catalog sales accounted for 16.7% of sales.⁵³ Vermont Teddy planned to prepare three catalogs in 1995, but the management shakeup that resulted in Patrick Burns's becoming CEO caused the company to scale back its plans. Instead it mailed just 165,000 copies of an eight-page book to previous customers. The small-size book kept up the company's presence but did not have the pages nor the product range to boost holiday sales. Quarterly sales dropped 24% below December 1994 levels.⁵⁴

In 1996, to compensate for the decline in radio advertisement effectiveness, the company increased December 1996 catalog circulation to approximately one million. To increase its catalog circulation, Vermont Teddy Bear acquired additional mailing lists from prominent catalog companies, including Disney, FAO Schwarz, Hammacher-Schlemmer, Saks Fifth Avenue,

Exhibit 5

Most Frequent Reasons for Purchasing Bear-Grams: Vermont Teddy Bear Co., Inc.
(Percentage of Bear-Grams for the 12 months ending June 30)

Reasons for Purchases	1998	1997	1996	1995
Valentine's Day	27.7%	22.1%	20.8%	19.2%
Birthdays	11.8%	11.6%	13.4%	15.9%
New Births	11.6%	10.3%	12.8%	9.9%
Get Wells	11.0%	9.7%	12.0%	10.4%
Christmas	8.4%	5.6%	8.6%	10.4%

Source: The Vermont Teddy Bear Company, Inc., 1998 Annual Report, p. 4.

and Harry & David. To strengthen its retail and catalog offerings, Vermont Teddy broadened the scope of its product line. New items included lower priced teddy bears, company-designed apparel, toys, books, and jewelry, as well as plush animals from other manufacturers such as Gund and Steiff.

Its Valentine mailing in 1997 amounted to 600,000 catalogs. Direct mail revenues increased from 1996, but they did not meet expectations due to the poor performance of rented mailing lists. In addition, the company incurred higher than anticipated costs due to the outsourcing of the order fulfillment process and was left with inflated inventories due to lower than expected sales.

During fiscal 1998, more than 15 million circulated pages were mailed to prospective customers. CEO Robert believed that Vermont Teddy's in-house list, which stood at 1.4 million names, would be a profitable future source of business. The company planned to increase the number of circulated pages during 1999, primarily through renting and exchanging of additional names from other catalogs and mailing to more names on the in-house mailing list.⁵⁵ It planned to handle all catalog fulfillment at company facilities in Shelburne. It also planned to continue to develop its own internal systems to adapt to the requirements of its catalog customers as the catalog business grew.⁵⁶

During fiscal 1998, sales from retail operations accounted for 18.0% of net revenues.⁵⁷ Due to the continued unprofitability in its retail stores, the company reversed its retail expansion strategy in fiscal 1998. Vermont Teddy Bear's New York City retail outlet was closed to the public on December 7, 1997, due to structural problems. A sales profile for the store reaffirmed the company's core market. Bear-Grams accounted for 60 to 70% of the store's purchases—the same product that was being sold through the radio advertisements, without the overhead of New York rents.⁵⁸

The company planned to close its retail location in Freeport, Maine, in August 1998 and its North Conway, New Hampshire, store in October 1998. CEO Robert commented, "After two successful holidays at Valentine's Day and Mother's Day, it is more clear than ever, that focusing on radio Bear-Grams is the right strategy. Retail apart from our highly successful factory store here in Shelburne, is not a distribution channel that fits our current business. We are in the Bear-Gram business, offering a convenient, creative and expressive gift delivery service. It makes no sense to ship out a Bear-Gram from an expensive retail store front."⁵⁹

The Shelburne factory store had continued to be successful as the company added new merchandise. To make the store more entertaining and interactive, the company invested \$100,000 in its renovation in 1996.⁶⁰ Programs such as "Make a Friend for Life," which enabled customers to stuff, dress, and personalize their own bear and "virtual" factory tours, using video and theatrical demonstrations of teddy bear making received favorable responses from customers.⁶¹

In November 1996, the company announced that it had joined forces with Gary Burghoff to produce a video that promoted the company's new "Make a Friend for Life" products.⁶² Burghoff was known for playing the character Radar O'Reilly in the *M*A*S*H* television show and was famous for his relationship with his teddy bear.

Vermont Teddy Bear had also targeted children's literature as a way of generating name recognition. A children's book, *How Teddy Bears Are Made: A Visit to the Vermont Teddy Bear Factory*, was available for purchase and could be found at libraries. The company also began to publish other children's books in order to develop characters for their teddy bears.

Beginning September 1, 1997, The Vermont Teddy Bear Co., Inc., introduced nationally a line of officially licensed NFL Teddy Bears. The NFL Bear was offered in 14 different teams and wore NFL Properties' uniforms and gear, including officially licensed jerseys, pants, and Riddell helmets.⁶³ NFL Properties, Inc., was the licensing and publishing arm of the National

Football League. To advertise this new product, Vermont Teddy enlisted Wayne Chrebet, wide receiver for the NY Jets, and Mark Chmura, tight end for the Green Bay Packers, to be spokespeople for the NFL Teddy Bears. Chrebet and Chmura were featured in radio and print advertisements in New York and Milwaukee, respectively. The company believed that officially licensed NFL Bears would be a popular choice for sports fans, especially during the football and Christmas seasons. The company advertised the bear on sports-talk radio in metropolitan areas around the country.⁶⁴

Vermont Teddy Bear conducted business almost exclusively in the United States. Bears could be shipped abroad, but it was very expensive. Some bears were shipped into Canada, and some radio advertising was done in Montreal. The added shipping charges, along with unfavorable exchange rates, caused price resistance to the products in Canada. In 1995, the company test marketed both the Bear-Gram and the use of the 800 number via radio advertising in the United Kingdom. Test results indicated that both were successful, but the program had to be eliminated because the company did not have the corporate infrastructure or the financial resources to support it.⁶⁵ The company had some trademarks registered in Great Britain and Japan and had discussions with companies in both of these countries. According to Robert, "These are the two countries that seem to have the most interest in Vermont Teddy's products."⁶⁶

Vermont Teddy Bear's management believed that there were a number of opportunities to increase company sales. The company's strategy for future growth included increasing sales of Bear-Grams in existing markets, expanding sales of Bear-Grams in new market areas, increasing direct-mail marketing of teddy bears through mail-order catalogs and similar marketing techniques, increasing sales of premium teddy bears through wholesale channels to unaffiliated retail stores, and increasing the company's retail store sales through increased factory tours and visits.⁶⁷ Management was also interested in expanding sales through its Corporate Division.

Facilities and Operations

In the summer of 1995, in an effort to consolidate locations and improve manufacturing efficiency, the company relocated its offices, retail store, and manufacturing, sales, and distribution facilities to a newly constructed 62,000-square-foot building on 57 acres in Shelburne, Vermont. The new site was approximately 10 miles south of Burlington, the state's largest city. The new buildings were designed as a small village, the Teddy Bear Common, to promote a warm and friendly atmosphere for customers as well as employees. The new facility was estimated to have cost \$7,900,00.⁶⁸ The company intended to minimize lease costs by subleasing any unused space. On September 26, 1995, the company had entered into a \$3.5 million commercial loan with the Vermont National Bank. Repayment of the mortgage loan was based on a 30-year fixed-principal payment schedule, with a balloon payment due on September 26, 1997.⁶⁹

On July 18, 1997, Vermont Teddy completed a sale-leaseback transaction with W. P. Carey and Co., Inc., a New York-based investment banking firm, involving its factory headquarters and a portion of its property located in Shelburne. W. P. Carey bought the 62,000-square-foot headquarters facility and its 15-acre site, leaving the company with ownership of the additional land. W. P. Carey was not interested in acquiring the other building lots on the site due to their zoning restrictions. This financing replaced the company's mortgage and line of credit, which was about to come due on September 26, 1997.⁷⁰

The company had a three-year lease on 10,000 square feet of inventory space at a separate location in Shelburne for \$56,000 annually.⁷¹ The company also had the following lease agreements for its retail stores:⁷²

Location	Square Footage	Annual Rent	1999 Rent Obligation	End of Lease Obligation
North Conway, NH	6,000	\$ 49,608	\$ 28,938	1/31/1999
New York City, NY	2,600	\$300,000	\$300,000	10/23/2006
Freeport, ME	6,000	\$240,000	\$ 25,644	8/6/1998

For in-house manufacturers, all production occurred in the Shelburne manufacturing space, which included state-of-the-art packing and shipping equipment. The plant manager was Brad Allen. Visitors and guests were given the opportunity to take guided or self-directed tours that encompassed the entire teddy bear making process. The factory tour had become such a popular tourist attraction that approximately 129,000 visitors toured the factory and retail store in fiscal 1998. Since moving to its new location in 1995, more than 390,000 visitors had toured the facilities.⁷³

In 1994, when the company was looking for a new location, it purchased only the 15-acre parcel it built on in Shelburne. Then the company bought the surrounding property because it wanted some control in the kind of neighbors it would have. As of June 30, 1998, plans to sell or lease the other lots had not been successful due to stringent zoning restrictions on the site. The zoning restrictions required that less than a quarter of the space be devoted to retail, effectively ruling out any kind of direct retail or outlet mall approach, which is the kind of business that could take advantage of the visitor traffic to the teddy bear factory. The company proposed a project for this unused space involving an attempt to bring together up to 50 Vermont manufacturers in a cooperative manufacturing, demonstration, and marketing setting—a made-in-Vermont manufacturing/exhibition park. Investors expressed concerns about the capital investment requirement.⁷⁴

Vermont Teddy Bear began using Sealed Air Corp's Rapid Fill air-filled packaging (air bags) system to protect its teddy bears from damage during shipping in 1997. Previously it had used corrugated cardboard seat belt inserts to package the bears during shipping, but found that there were drawbacks, including minor damage to the products and the high cost of postage. Sealed Air's inflatable plastic bags were lighter than the corrugated inserts resulting in savings in postage costs and the plastic bags did not damage the bears with plush fur. Vermont Teddy Bear saved \$150,000 in postage costs in 1997 and could realize \$30,000 to \$40,000 in additional savings in 1998.⁷⁵

Vice President of Data Processing was Bonnie West. According to CEO Robert, Vermont Teddy Bear's desktop computers were in need of updating. However, West believed the company's call centers had state-of-the-art technologies, including PC terminals and very-high-tech telephone switching equipment that allowed the company to handle significant call volume. The company also had a high-tech shipping system, including state-of-the-art multicarrier software so that if a major carrier like UPS went on strike, it could immediately make adjustments.