

GRAND TOYS INTERNATIONAL INC  
Form 10-Q  
May 14, 2004

**FORM 10-Q**

**Securities and Exchange Commission**

**Washington, D.C. 20549**

(Mark One)

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

For the quarterly period ended: **March 31, 2004**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File No. 0-22372.

**GRAND TOYS INTERNATIONAL, INC.**

(Exact Name of Registrant as Specified in its Charter)

Nevada

98-0163743

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization

Identification No.)

**1710 Route Transcanadienne, Dorval, Quebec, Canada, H9P 1H7**

(Address of principal executive offices)

**(514) 685-2180**

(Registrant's telephone number, including Area Code)

(Former name, former address and former fiscal year,

if changed since last report)

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 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

  X  

No \_\_\_\_\_

Indicate the number of shares outstanding of each of the Issuer's classes of common equity, as of May 14, 2004:  
5,355,244



**GRAND TOYS INTERNATIONAL, INC.**

Index to Quarterly Report on Form 10-Q  
Filed with the Securities and Exchange Commission  
**Period ended March 31, 2004**

<b>ITEMS IN FORM 10-Q</b>	<b>PAGE</b>
<b>Part I Financial Information</b>	
Item 1. Consolidated Financial Statements:	
Consolidated Balance Sheets	
At March 31, 2004 (unaudited) and December 31, 2003	2-3
Consolidated Statements of Operations (unaudited)	
For The Three Month Periods ended March 31, 2004 and 2003	4
Consolidated Statements of Stockholders' Equity and Comprehensive Income (unaudited)	5
For the Three Month Period ended March 31, 2004	
Consolidated Statements of Cash Flows(unaudited)	
For The Three Month Periods ended March 31, 2004 and 2003	6
Notes to unaudited Consolidated Financial Statements	7-19
Item 2. Management's Discussion and Analysis	20
Item 3. Quantitative and Qualitative Disclosures About Market Risk	30
Item 4. Controls and Procedures	31
<b>Part II - Other Information</b>	
Item 1. Legal proceedings	31
Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities	32
Item 3. Defaults Upon Senior Securities	32

Edgar Filing: GRAND TOYS INTERNATIONAL INC - Form 10-Q

Item 4. Submission of Matters to a Vote of Security Holders	32
Item 5. Other Information	32
Item 6. Exhibits and Reports on Form 8-K	33
Signatures	34-35
Certifications	36-39

**GRAND TOYS INTERNATIONAL, INC.****Part I. Financial Information*****Item 1. Consolidated Financial Statements***

## Consolidated Balance Sheets

	March 31, 2004 (Unaudited)	December 31, 2003
<b>Assets</b>		
Current assets:		
Cash	\$ 1,064,628	\$ 1,487,318
Short-term deposit (note 14(c))	500,000	500,000
Accounts receivable (net of allowance for doubtful accounts of \$9,603; 2003 - \$9,712)	1,984,671	1,598,907
Due from Playwell International Limited	1,052,897	804,252
Due from employees	3,127	771
Current portion of loan receivable (note 2)	163,881	161,447
Inventory	1,726,062	1,682,298
Prepaid expenses (note 3)	456,909	367,288
Total current assets	6,952,175	6,602,281
Note receivable (note 9)	183,528	286,896
Loan receivable (note 2)	179,069	220,963
Equipment and leasehold improvements, net (note 4)	211,348	219,988
Other assets (note 5)	11,003	13,331
Total assets	\$ 7,537,123	\$ 7,343,459



**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Balance Sheets

	March 31, 2004 (Unaudited)	December 31, 2003
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Bank indebtedness (note 6)	\$ 1,800,050	\$ 1,579,458
Trade accounts payable	978,945	1,047,390
Other accounts payable and accrued liabilities	207,499	217,567
Accrued compensation	59,417	111,085
Accrued legal expenses	55,163	151,711
Total current liabilities	3,101,074	3,107,211
Minority interest	100	100
Stockholders' equity:		
Capital stock (note 7):		
Voting common stock, \$0.001 par value:		
12,500,000 shares authorized,		
5,355,244 shares issued and outstanding		
	5,355	5,355
Additional paid-in capital	22,750,942	22,750,518
Deficit	(17,731,951)	(17,968,179)
Accumulated other comprehensive income-		
cumulative currency translation adjustment	(588,397)	(551,546)
	4,435,949	4,236,148
Commitments and contingencies (notes 13 and 14)		
Total liabilities and stockholders' equity	\$ 7,537,123	\$ 7,343,459

*See accompanying notes to unaudited consolidated financial statements.*





**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Statements of Operations (Unaudited)

	For the three months ended March 31,	
	2004	2003
Net sales	\$ 2,853,615	\$ 2,951,095
Cost of goods sold	1,674,605	1,689,518
Gross profit	1,179,010	1,261,577
Other costs and expenses:		
General and administrative	539,338	572,856
Salaries and fringe benefits	337,889	294,702
Royalties	22,874	69,895
Bad debt expense	12,939	10,601
Depreciation and amortization	13,427	16,419
Interest expense	19,446	20,737
Interest revenue	(14,130)	(14,894)
Foreign exchange loss (gain)	10,999	(59,144)
	942,782	911,172
Earnings before income taxes	236,228	350,405
Income tax expense	-	325
Earnings from continuing operations	236,228	350,080
Gain on sale of discontinued operations	-	103,002
Net earnings applicable to common stockholders	\$ 236,228	\$ 453,082
Earnings per share (note 10):		
Continuing operations:		
Basic	\$ 0.04	\$ 0.13
Diluted	0.04	0.06

Discontinued operations:

Basic	-	0.03
Diluted	-	0.02

Net earnings:

Basic	0.04	0.16
Diluted	\$ 0.04	\$ 0.08

*See accompanying notes to unaudited consolidated financial statements.*

**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Statements of Stockholders' Equity and Comprehensive Income (Unaudited)

	Capital Stock	Additional Paid in Capital	Deficit	Accumulated other comprehensive income	Total
January 1, 2004	\$ 5,355	\$ 22,750,518	\$ (17,968,179)	\$ (551,546)	4,236,148
Net earnings for the period	-	-	236,228	-	236,228
Foreign currency adjustment	-	-	-	(36,851)	(36,851)
Total comprehensive income					199,377
Compensation expense	-	424	-	-	424
March 31, 2004	\$ 5,355	\$ 22,750,942	\$ (17,731,951)	\$ ( 588,397)	4,435,949

*See accompanying notes to unaudited consolidated financial statements.*

**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Statements of Cash Flows (Unaudited)

	For the three months ended March 31,	
	2004	2003
Cash flows from operating activities:		
Net earnings from continuing operations	\$ 236,228	\$ 350,080
Adjustments for:		
Depreciation and amortization	13,427	16,419
Amortization of product development costs	2,164	763
Compensation expense	424	930
Net change in non-cash operating working capital items (note 11)	(1,020,674)	(687,118)
Net cash used for operating activities from continuing operations	(768,431)	(318,926)
Cash flows from financing activities:		
Increase (decrease) in bank indebtedness	211,977	(9,914)
Decrease in loan payable to a director	-	(14,570)
Increase (decrease) in due from employees	(2,348)	442
Other	(1,618)	(2,318)
Net cash provided by (used for) financing activities	208,011	(26,360)
Cash flows from investing activities:		
Loan receivable	39,460	51,409
Proceeds from note receivable	103,368	178,239
Decrease in other assets	2,163	9,056
Additions to equipment and leasehold improvements	(7,261)	(530)
Net cash provided by investing activities	137,730	238,174
Net decrease in cash and cash equivalents	(422,690)	(107,112)
Cash and cash equivalents, beginning of period	1,487,318	540,896
Cash and cash equivalents, end of period	\$ 1,064,628	\$ 433,784

Supplemental disclosure of cash flow information (note 12)

*See accompanying notes to unaudited consolidated financial statements.*

**GRAND TOYS INTERNATIONAL, INC.**

Notes to Unaudited Consolidated Financial Statements

Grand Toys International, Inc. (the Company), a Nasdaq SmallCap listed Company, is organized under the laws of the State of Nevada. Its principal business activity, through its wholly-owned Canadian and US operating subsidiaries, is the distribution of toys and related items.

**1.**

**Significant accounting policies:**

(a)

Principles of consolidation:

These consolidated financial statements, presented in US dollars and in accordance with accounting principles generally accepted in the United States, include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated.

(b)

Revenue recognition:

Sales are recognized at the time of shipment of products. The Company estimates liabilities and records provisions for customer allowances as a reduction of revenue, when such revenue is recognized.

(c)

Inventory:

Inventory is valued at the lower of cost, determined by the first in, first out method, and net realizable value. The only significant class of inventory is finished goods.

(d)

Prepaid expenses:

Prepaid expenses primarily include insurance, advances on inventory purchases, current portion of royalties and real estate taxes. Insurance costs are written off over the term of the respective policies.

Prepaid royalties relate to licensing agreements for character properties. These contracts can extend for up to three years. Total expense for the three-month period ended March 31, 2004 was \$22,874 (2003 - \$69,895) and is shown as royalty expense in the statements of operations.

Prepaid taxes are amortized on a straight-line basis over the period to which they relate. The amount expected to be recognized in the statement of operations in 2004 is \$86,937.

(e)

Other assets:

Prepaid royalties are capitalized and amortized as earned in relation to product sales, over a period not to exceed the term of the related agreements. The amounts expected to be recognized in the statement of operations during the remainder of 2004 and the year 2005 are \$1,610 and \$12,700, respectively.

Product development costs for proprietary product lines are capitalized and written off over a period of twenty-four months, the estimated life of a new product. If a product is abandoned the related costs are written off immediately.



**GRAND TOYS INTERNATIONAL, INC.**

## Notes to Unaudited Consolidated Financial Statement

**1.****Significant accounting policies (continued):**

(f)

Equipment and leasehold improvements:

Equipment and leasehold improvements are stated at cost less accumulated depreciation.

Depreciation methods and annual rates adopted by the Company are as follows:

Asset	Method	Rate/period
Computer equipment	Declining balance	30%
Machinery and equipment	Declining balance	20%
Furniture and fixtures	Declining balance	20%
Trucks and automobiles	Declining balance	30%
Telephone equipment	Declining balance	30%
Leasehold improvements	Straight-line	Term of lease plus one renewal term

(g)

Incomes taxes:

The Company follows the asset and liability method of accounting for income taxes. Under the asset and liability method, the change in the net deferred tax asset or liability is included in the computation of net income. Deferred tax assets and liabilities are measured using enacted or substantively tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. Deferred tax assets are evaluated and, if realization is not considered to be more likely than not, a valuation allowance is provided.

(h)

Foreign currency translation:

i)

Grand Toys Ltd., a wholly-owned Canadian subsidiary, uses the Canadian dollar as its functional currency. Financial statements of the self-sustaining foreign operation are translated into US dollars using the exchange rate prevailing at

the balance sheet date for assets and liabilities and the average exchange rate for the year for revenues, expenses and cash flows. The resulting currency translation adjustments are accumulated and reported in other comprehensive income.

ii)

Other monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate prevailing at the balance sheet date. Revenues and expenses denominated in foreign currencies are translated at the rate of exchange prevailing at the transaction dates. All exchange gains and losses are included in income.

(i)

Guarantees:

In November 2002, the Financial Accounting Standards Board ( FASB ) Interpretation No.45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, was issued. This Interpretation enhances the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation were applicable to guarantees issued or modified after December 31, 2002 and the disclosure requirements were effective for financial statements of interim or annual periods ending after December 15, 2002. The Company was not a party to any guarantees as at March 31, 2004 and March 31, 2003.

(j)

Earnings per Share:

i)

Basic earnings per share are determined by dividing the weighted average number of common shares outstanding during the period into net earnings.

ii)

Diluted earnings per share give effect to all potentially dilutive common shares that existed at March 31, 2004.

(k)

Advertising and Promotion:

All costs associated with advertising and promoting products are expensed in the period incurred. Total expense for the three-month periods ended March 31, 2004 and 2003 were \$63,312 and \$104,779, respectively. These expenses include media and cooperative advertising and are shown as part of general and administrative expenses in the financial statements.

Slotting fees are recorded as a deduction of gross sales. These fees are determined annually on a customer by customer basis.

(l)

Employee stock option plan:

The Company accounts for its employee stock option plan in accordance with the provisions of Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*. As such, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. Financial Accounting Standards Board ("FASB") Statement No. 123, *Accounting for Stock-Based Compensation*, allows entities to continue to apply the provisions of APB Opinion No. 25 and requires pro-forma net earnings and pro-forma earnings per share disclosures for employee stock option grants as if the fair-value-based method defined in FASB Statement No. 123 had been applied. This disclosure is included in the notes to these financial statements.

(m)

Comprehensive income:

Comprehensive income consists of net income and cumulative currency translation adjustments and is presented in the consolidated statements of stockholders' equity and comprehensive income.

(n)

Use of estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(o)

Cash and cash equivalents:

The Company considers all liquid investments with maturities of three months or less when acquired to be cash equivalents.

**2.**

**Loan receivable:**

The loan receivable is due from Limited Treasures Inc. ("Limited Treasures"). The loan is secured by accounts receivable and inventory and personal guarantees of the stockholders of Limited Treasures.

In June 2001, the Company settled a litigation it had commenced against Limited Treasures. Under the terms of the Settlement Agreement, Limited Treasures agreed to pay \$775,000 over 48 months commencing June 2001 and ending May 2005. Interest, which was charged at the rate of 9.0% per annum under the original loan, was revised to 6.0% per annum in April 2003, reducing the monthly payment.

Details are as follows:

March 31, 2004      December 31, 2003

Amount due repayable in monthly payments of  
principal and interest of \$7,500 until November 30, 2001,

\$21,124 until March 31, 2003 and \$15,000 until

April 2005, with a final payment of \$165,789 in May 2005	\$	342,950	\$	382,410
Less current portion		163,881		161,447
	\$	179,069	\$	220,963

**3.**

**Prepaid expenses:**

		March 31, 2004		December 31, 2003
Prepaid inventory	\$	178,749	\$	66,555
Royalties		14,310		14,821
Insurance		90,359		192,699
Other		173,491		93,213
	\$	456,909	\$	367,288

**4.**

**Equipment and leasehold improvements:**

			March 31, 2004		December 31, 2003
			Accumulated		Accumulated
	Cost		depreciation	Cost	depreciation
Computer equipment	\$ 1,477,393	\$	1,337,965	\$ 1,486,846	\$ 1,342,114
Machinery and equipment	506,320		494,379	512,100	499,387
Furniture and fixtures	551,188		531,857	557,376	536,840
Trucks and automobiles	93,192		92,781	94,256	93,806
Telephone equipment	51,499		45,687	52,086	45,900
Leasehold improvements	287,662		253,237	290,945	255,574
	\$ 2,967,254	\$	2,755,906	\$ 2,993,609	\$ 2,773,621
Net book value		\$	211,348		\$ 219,988

**5.**

**Other assets:**

		March 31, 2004		December 31, 2003
Prepaid royalties	\$	14,310	\$	14,821
Product development costs		11,003		13,331
		25,313		28,152
Less current portion of prepaid royalties, included in prepaid expenses		14,310		14,821
	\$	11,003	\$	13,331

**6.****Bank indebtedness:**

The Company has a line of credit to finance its inventory and accounts receivable for advances of up to \$2,669,000 (CA\$3,500,000). The receivable loan has a discount fee of 2.0% and the inventory loan bears interest at Canadian prime plus 7.5%. The agreement is for a period of one year and is renewed automatically, unless prior notice is given by either party.

The loan is secured by a first lien in the principal amount of \$3,050,000 (CA\$4,000,000) on the universality of all present and future assets of the Company and the assignment of insurance. There are no debt covenants or cross-default provisions.

As at March 31, 2004, the Company had approximately \$869,000 (December 2003 - \$1,120,000) of credit available under this facility, subject to the availability of eligible inventory and accounts receivable.

**7.****Capital stock**

## (a)

Authorized capital also includes 5,000,000, \$0.001 par value preferred shares, issuable in series with such designation, rights and preferences as may be determined from time to time by the Board of Directors. There are no preferred shares issued and outstanding at March 31, 2004.

## (b)

**Share transactions:**

## i)

April 2003:

The 10,144 common shares issued in October 2002 were repurchased for a total consideration of \$12,982, decreasing capital stock by \$10. The shares were subsequently cancelled.

## ii)

August 2003:

82,609 common shares were issued in settlement of consulting fees, increasing capital stock by \$82.

iii)

November 2003:

2,520,000 warrants were exercised for total consideration of \$25,200, increasing capital stock by \$2,520.

(c)

The number of shares of common stock outstanding is as follows:

There were no transactions in the period presented.

	March 31, 2004	December 31, 2003
Common Stock	5,355,244	5,355,244

## 8.

**Stock options and warrants:**

The Company's amended and restated employee stock option plan (the "Option Plan") provides for the issuance of up to 300,000 options to acquire common shares of the Company. Stock options granted under the Option Plan may be Incentive Stock Options under the requirements of the Internal Revenue Code, or may be Non-statutory Stock Options which do not meet such requirements. Options may be granted under the Option Plan to, in the case of Incentive Stock Options, all employees (including officers) of the Company, or, in the case of Non-statutory Stock Options, all employees (including officers) or non-employee directors of the Company.

Under the Option Plan, the exercise price of each option granted has been equal to the market price of the Company's stock on the grant date and an option's maximum term is ten years.

Changes in options and warrants are as follows:

	Option Plan	Other stock options	Warrants	Total	Weighted-average exercise price per share
January 1, 2004	213,464	196,000	637,143	1,046,607	\$ 1.74
Granted	875	-	-	875	3.02
Options outstanding and exercisable at March 31, 2004	214,339	196,000	637,143	1,047,482	\$ 1.74

The following table summarizes information about options and warrants outstanding and exercisable at March 31, 2004:

Range of exercise prices	Number	Options and warrants outstanding and exercisable Weighted-average exercise price	Weighted-average remaining contractual life (yrs)
\$0.01 - \$1.96	554,214	\$ 0.59	7.69
\$2.12 - \$3.07	476,768	2.20	2.09
\$5.62 - \$11.00	1,000	7.78	6.32
\$16.00 - \$87.60	15,500	28.13	4.11
	1,047,482	\$ 1.74	5.09

Pro-forma information regarding net earnings and earnings per share is required by FASB Statement No. 123, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that statement.



Edgar Filing: GRAND TOYS INTERNATIONAL INC - Form 10-Q

The Company's pro-forma net earnings and earnings per share are as follows:

	March 31, 2004	March 31, 2003
Earnings from continuing operations, as reported	\$ 236,228	\$ 350,080
Add compensation cost resulting from:		
Application of variable accounting to modified awards (APB Opinion No. 25)	424	930
Application of fair value method (FASB Statement No. 123)	(1,873)	(1,418)
Pro-forma earnings from continuing operations	234,779	349,592
Earnings from discontinued operations	-	103,002
Pro-forma net earnings applicable to common stockholders	\$ 234,779	\$ 452,594
 <u>Basic EPS</u>		
Earnings from continuing operations	\$ 0.04	\$ 0.13
Earnings from discontinued operations	-	0.03
Net earnings applicable to common stockholders	\$ 0.04	\$ 0.16
 <u>Diluted EPS</u>		
Earnings from continuing operations	\$ 0.04	\$ 0.06
Earnings from discontinued operations	-	0.02
Net earnings applicable to common stockholders	\$ 0.04	\$ 0.08

The pro-forma amounts include compensation cost as calculated using the Black-Scholes option pricing model with the following assumptions:

	March 31, 2004	March 31, 2003
Weighted average expected life (years)	3.0	3.0
Risk-free interest rate	2.10%	1.98%

Volatility factor of expected market price of Company's common stock	119%	142%
Dividend rate	-	-
	March 31, 2004	March 31, 2003

Weighted average grant date fair value of options and warrants	\$ 2.14	\$ 1.47
--	---------	---------

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect their fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

Compensation expense of \$424 and \$930 was recorded for the three-month periods ended March 31, 2004 and 2003, respectively, as a result of the application of variable accounting to modified awards.

**9.**

**Discontinued operations:**

On June 14, 2002, the Company sold its investment in its wholly-owned subsidiary, Sababa Toys Inc. ("Sababa"), to the subsidiary's management for \$1,065,716. Consideration received by the Company was a promissory note secured by the shares of Sababa. The assets and liabilities of Sababa, together with the sales and expenses for the period to June 14, 2002 and the comparative figures for the year ended December 31, 2001, have been classified as discontinued operations.

The promissory note is being repaid using cash collected on accounts receivable and inventories, net of liabilities existing as at June 14, 2002, and 10% of net sales of inventories acquired after that date. Any balance owing will be due on June 30, 2005.

The Company calculated the cost of its investment in Sababa using the equity method and recorded a gain on the sale of \$761,584 of which \$497,800 was deferred as at December 31, 2002. In 2003, the conditions which existed at the date of sale which required the initial deferral of the gain were removed. As a result, the company recognized the balance of the gain in the statement of operations during the year.

The table below summarizes the periods in which the gain was recorded and cash applied against the note receivable:

	Deferred Gain	Note receivable
Balance, January 01, 2003	\$ 497,800	\$ 884,877
Recorded in 2003	(497,800)	(597,981)

Edgar Filing: GRAND TOYS INTERNATIONAL INC - Form 10-Q

Balance, December 31, 2003		-	286,896
Recorded in 2004		-	103,368
Balance, March 31, 2004	\$	- \$	183,528

**10.****Earnings per share:**

	Income	Shares	Per Share
	(numerator)	(denominator)	Amount
<b>Quarter ended March 31, 2004</b>			
<u>Basic EPS</u>			
Earnings from continuing operations	\$ 236,228	5,355,244	\$ 0.04
Earnings applicable to common stockholders and assumed conversions	236,228	5,355,244	0.04
<u>Diluted EPS</u>			
Earnings from continuing operations	\$ 236,228	5,964,818	\$ 0.04
Earnings applicable to common stockholders and assumed conversions	236,228	5,964,818	0.04
	Income	Shares	Per Share
	(numerator)	(denominator)	Amount
<b>Quarter ended March 31, 2003</b>			
<u>Basic EPS</u>			
Earnings from continuing operations	\$ 350,080	2,762,698	\$ 0.13
Earnings from discontinued operations	103,002	2,762,698	0.03
Earnings applicable to common stockholders and assumed conversions	453,082	2,762,698	0.16
<u>Diluted EPS</u>			
Earnings from continuing operations	\$ 350,080	5,602,889	\$ 0.06
Earnings from discontinued operations	103,002	5,602,889	0.02

Edgar Filing: GRAND TOYS INTERNATIONAL INC - Form 10-Q

Earnings applicable to common stockholders and assumed conversions	453,082	5,602,889	0.08
---	---------	-----------	------

As of March 31, 2004, options and warrants to purchase 16,500 shares (March 2003 378,768) of the Company's common stock were not included in the diluted earnings per share calculation as their effect is anti-dilutive.

**GRAND TOYS INTERNATIONAL, INC.**

## Notes to Unaudited Consolidated Financial Statements

**11.****Net change in non-cash operating working capital items:**

	For the three months ended March 31,	
	2004	2003
Continuing operations:		
Increase in accounts receivable	\$ (402,492)	\$ (22,688)
Increase in amount due from Playwell International Limited	(248,645)	-
Increase in inventory	(62,350)	(525,930)
Increase in prepaid expenses	(93,842)	(14,964)
Decrease in trade accounts payable	(58,739)	(216,672)
(Decrease) increase in other accounts payable and accrued liabilities	(8,067)	87,889
Decrease in accrued compensation	(50,081)	(17,978)
(Decrease) increase in accrued legal expenses	(96,458)	23,225
	\$ (1,020,674)	\$ (687,118)

**12.****Supplemental disclosure of cash flow information:**

	For the three months ended March 31	
	2004	2003
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	\$ 19,446	\$ 20,737
Income taxes	-	325

13.

**Commitments:**

The Company has entered into long-term leases with minimum annual rental payments for the next five years and thereafter approximately as follows:

2004	252,000
2005	349,000
2006	349,000
2007	344,000
2008	340,000
Thereafter	244,000

Rent expense for the period ended March 31, 2004, and 2003 amounted to approximately \$36,218 and \$32,788, respectively.

The Company has entered into a long-term agreement to sub-lease a portion of its warehouse, resulting in a reduction of the minimum annual rental payments presented above of approximately \$135,000 for the remainder of 2004 and \$182,000 annually from 2005 to 2007.

14.

**Contingencies:**

(a)

A lawsuit for alleged breach of contract has been filed against the Canadian subsidiary by a former sales representative. In the opinion of management, this action has no merit. At this point in time, it is difficult to ascertain or estimate the value of a settlement, if any.

(b)

On May 21, 2003, the Company was named in a lawsuit for alleged defective product causing personal injury and was acting as an agent for the vendor. A defense has been filed denying liability and the claim is covered by insurance. At this point in time, it is difficult to ascertain an estimate of the value of a settlement, if any.

(c)

The Company's Canadian subsidiary is contingently liable for an outstanding letter of credit of \$500,000 as at March 31, 2004. The short-term deposit has been pledged as collateral for this letter of credit.

15.

**Segment information:**

(a)

Operating and geographic information:

The Company operates primarily in one segment which includes the distribution of toys and related items. Nearly all sales are to Canadian customers. The majority of long-lived assets are located in Canada.

(b)

Other information:

	March 31, 2004		March 31, 2003	
	Revenue	%	Revenue	%
Customer A	\$ 713,400	25	\$ 737,800	25
B	627,800	22	590,200	20
C	283,600	10	206,600	7
All others	1,228,815	43	1,416,495	48
\$	2,853,615	100	\$ 2,951,095	100



Sales of toys purchased from the Company's two largest manufacturers and suppliers of toys in aggregate accounted for 89% of gross sales for the quarter ended March 31, 2004. The Company's two largest suppliers accounted for 77% of gross sales for the quarter ended March 31, 2003.

**16.**

**Related party transactions:**

During the period, the Company paid \$23,477 (March 2003 - \$21,204) in consulting fees to two directors/stockholders.

**GRAND TOYS INTERNATIONAL, INC.**

Notes to Unaudited Consolidated Financial Statements

**17.**

**Financial instruments:**

(a)

Fair values:

Fair value estimates are made as of a specific point in time, using available information about the financial instruments. These estimates are subjective in nature and often cannot be determined with precision.

The fair value of the Company's financial assets and liabilities approximates their carrying value due to the immediate or short-term maturity of these financial instruments.

(b)

Credit risk and economic dependence:

For the three-month period ended March 31, 2004, approximately 64% (March 31, 2003 - 61%) of the Company's sales were made to five unrelated companies. Three customers representing approximately 57% (March 31, 2003 - 52%) of total sales, individually accounted for 10% or more (2003 - 7%) of total sales. The Company regularly monitors its credit risk exposure to these and other customers and takes steps to mitigate the risk of loss.

(c)

Interest rate risk:

The company's principal exposure to interest rate risk is with respect to its short-term financing which bears interest at floating rates.

**18.**

**Shareholder's reorganization:**

On November 14, 2003, the Company, Genius Glory Limited, a Hong Kong limited company and a wholly-owned subsidiary of Grand International Limited ("Grand HK"), and Centralink Investments Limited, a British Virgin Islands limited company ("Centralink"), entered into a Subscription and Exchange Agreement (the "Subscription and

Exchange Agreement"), which was subsequently amended in March 2004 and executed on April 6, 2004.

Pursuant to the agreement, which is subject to stockholders' approval, the following transactions, among other matters, will take place:

i)

The Company will undertake a corporate reorganization pursuant to which the Company and its operating subsidiaries will become subsidiaries of Grand HK, with each issued and outstanding share of common stock of the Company being converted into one American Depositary Receipt ("ADRs"), representing one ordinary share of Grand HK, and each outstanding option and warrant to purchase common stock of the Company, being converted into one option or warrant to purchase Grand HK ADRs representing one ordinary share of Grand HK;

ii)

Grand HK will acquire from Centralink all of the issued and outstanding capital stock of Playwell International Limited, a Hong Kong limited company ("Playwell"), in exchange for the issuance to Centralink of 5,000,000 Grand HK ADRs, representing 5,000,000 ordinary shares of Grand HK. Playwell is a holding company which owns four subsidiaries: Hong Kong Toy Center Limited, a trading company which manufactures products designed by customers and Playwell branded items; Gatelink Mould Engineering Limited, a manufacturer of moulds for Playwell; Great Wall Alliance Limited, the holder of Playwell trademarks; and Asian World Enterprises Limited, the holder of licenses from the Walt Disney Company and Crayola branded products.

For accounting purposes Playwell is considered to be the acquirer. As part of the transaction Playwell has agreed to reimburse the Company for its direct costs related to the transaction which amounted to \$804,252 at December 31, 2003.

iii)

In addition to the acquisition of the Playwell shares, pursuant to the Subscription and Exchange Agreement, Centralink will also subscribe for 5,000,000 Grand HK ADRs for cash and other consideration totaling \$11,000,000.

**GRAND TOYS INTERNATIONAL, INC.**

***Item 2. Management's Discussion and Analysis:***

The following should be read in conjunction with the consolidated financial statements included in this Quarterly Report on Form 10-Q and the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

***Overview***

***Forward-looking statements.***

This Form 10-Q contains forward-looking statements about events and circumstances that have not yet occurred. For example, statements including terms such as the Company "expects" or "anticipates" are forward-looking statements. Investors should be aware that the Company's actual results may differ materially from the Company's expressed expectations because of risks and uncertainties about the future. The Company will not necessarily update the information in this Form 10-Q if and when any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect the Company's future results and performance include, but are not limited to, the following: intense competition and pricing pressures in the toy industry; the general consolidation in the toy industry; whether the Company's general strategy with respect to the toy industry and the Company's implementation of that strategy will correctly anticipate key trends in the toy industry; the Company's ability to retain its product lines; the Company's relationships with retailers and other issues with respect to the Company's distribution channels. Additional information about factors that could affect future results and events is included elsewhere in this Form 10-Q, in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003 and in other reports filed with the Securities and Exchange Commission.

For the year ended December 31, 2003 the Company reported net earnings of \$1,112,577. Net losses of \$826,848 and \$1,371,492 were reported for the years ended December 31, 2002 and 2001, respectively. Prior to the year ended December 31, 2003, the Company had not reported an annual profit since December 31, 1997. As a result of the restructuring plan put in place and management's focus on the sale of products with higher profit margins, profitability has been achieved. In spite of this, there can be no assurance that the Company will remain profitable on an annual basis.

On November 14, 2003, Grand, Grand Toys International Limited (formerly Genius Glory Limited), a Hong Kong limited company and a wholly-owned subsidiary of the Company ( "Grand HK" ), and Centralink Investments Limited, a British Virgin Islands company ( "Centralink" ), entered into a Subscription and Exchange Agreement which was

subsequently amended on March 19, 2004 and March 31, 2004 (as so amended, the Subscription and Exchange Agreement ) pursuant to which, among other matters:

The Company will undertake a corporate reorganization pursuant to which the Company and its operating subsidiaries will become subsidiaries of Grand HK, with each issued and outstanding share of Common Stock of Grand being converted into one American Depositary Receipt ( ADRs ) representing one Ordinary Share of Grand HK, and each outstanding option and warrant to purchase the Company's Common Stock being converted into one option or warrant to purchase Grand HK ADRs representing one Ordinary Share of Grand HK;

Grand HK will acquire from Centralink all of the issued and outstanding capital stock of Playwell International Limited, a Hong Kong limited company ( Playwell ), in exchange for the issuance to Centralink of 5,000,000 Grand HK ADRs representing 5,000,000 Ordinary Shares of Grand HK. Playwell is a holding company which owns four subsidiaries: Hong Kong Toy Center Limited, a trading company which manufactures products designed by customers and Playwell branded items; Gatelink Mould Engineering Limited, a manufacturer of moulds for Playwell; Great Wall Alliance Limited, the holder of Playwell trademarks; and Asian World Enterprises Limited, the holder of licenses for Walt Disney Company and Crayola branded products; and

In addition to the acquisition of the Playwell shares, pursuant to the Subscription and Exchange Agreement, Centralink will also subscribe for 5,000,000 Grand HK ADRs for cash and other consideration totaling \$11,000,000.

Net sales consist of sales of products to customers after deduction of customer cash discounts, freight and warehouse allowances, and volume rebate allowances. Sales are recorded when the merchandise is shipped.

The cost of goods sold for products imported as finished goods includes the cost of the product in the appropriate domestic currency, duty and other taxes, and freight and brokerage charges. Royalties payable to the Company's licensor-vendors which are not contingent upon the subsequent sales of the licensor-vendors' products are included in the price paid for such products.

Major components of selling, general and administrative expenses include: payroll and fringe benefits; advertising expense, which includes the cost of production of television commercials and the cost of air time; advertising allowances paid to customers for cooperative advertising programs; and royalty expenses. Royalties include payments by Grand Canada to licensors of character properties and to manufacturers of toy products if such payments are contingent upon subsequent sales of the products. Royalties are usually a percentage of the price at which the product is sold and are payable once a sale is made.

The pricing of the Company's goods is affected by the price it obtains from its vendors (Cost of Goods Sold) and therefore dictates the selling price the Company can charge its customers. Other factors that influence the Company's setting of the selling price is the condition of the current market and the nature of the item itself.

From a selling, general and administrative aspect, the pricing will impact selling (commission expense) and general and administrative (advertising expense). In addition, if a lower selling price is set then the related margin on the product will be reduced and therefore the Company will look to rationalize other expenses, i.e. customer term packages.

Edgar Filing: GRAND TOYS INTERNATIONAL INC - Form 10-Q

Accounts receivable are receivables net of an allowance for doubtful accounts. The allowance is adjusted periodically to reflect the current status of receivables. Management believes that current reserves for doubtful accounts are adequate. Sales of products to retailers and distributors are on an irrevocable basis. Consistent with industry practices, Grand Canada may make exceptions to this policy on a case-by-case negotiated basis. Inventory is comprised of finished goods at landed cost.

*All amounts are in US Dollars (\$) unless otherwise noted.*

**Results of Operations**

The following table sets forth consolidated operations data as a percentage of net sales for the periods indicated:

	<b>For the Three Months Ended March 31,</b>	
	<b>2004</b>	<b>2003</b>
	%	%
	%	%
Net sales	100.00	100.00
Cost of goods sold	58.67	57.25
Gross profit	41.33	42.75
Operating expenses:		
General and administrative	18.92	19.41
Salaries and fringe benefits	11.83	9.99
Royalties	0.80	2.37
Bad debt expense	0.45	0.36
Depreciation and amortization	0.47	0.56
Interest expense	0.68	0.70
Interest revenue	(0.50)	(0.50)
Foreign exchange (gain) loss	0.39	(2.00)
Total operating expenses	33.04	30.89
Earnings before income taxes	8.29	11.86
Earnings from continuing operations	8.29	11.86
Gain on sale of discontinued operations	-	3.49
Net earnings applicable to common stockholders	8.29	15.35

On a monthly basis management reviews its inventory of products and makes an assessment of its realizable value. The factors considered include current market prices, the demand for and the seasonality of its products. If circumstances change (i.e. unexpected shift in market demand, pricing, trends etc.) there could be a material impact on the net realizable value of inventory.

***Comparison of the three months ended March 31, 2004 to the three months ended March 31, 2003:***

**Net Earnings:**

Net earnings for the first quarter of 2004 were \$236,228, or \$0.04 per share, as compared to a net earnings of \$453,082, or \$0.16 per share, for the first quarter of 2003. Without the gain on discontinued operations, net earnings in the first quarter of 2003 would have been \$350,080 or \$0.13 per share.

Net earnings decreased during the quarter ended March 31, 2004 by \$216,854 compared with the first quarter of 2003 as a result of decreases in net sales and gross margins, increases in expenses, and the absence of a gain on discontinued operations.

**Net Sales:**

Net sales decreased for the first three months of 2004 by \$97,480, or by 3.30%, to \$2,853,615 from \$2,951,095 for the first quarter of 2003 due to the decrease in sales of the AstroJax product line.

**Gross Profit:**

Gross profit for the Company decreased during the first three months of 2004 by \$82,567 compared to the prior quarter. As a percentage of sales, gross profit decreased from 42.75% in the first quarter of 2003 to 41.33% in the first quarter of 2004.

Gross profit decreased as a result of the sales and product mix in the first quarter of 2004, which is primarily due to the decrease in sales in 2004 of higher margin product lines.

**General and Administrative Expenses:**

General and administrative expenses decreased by \$33,518 to \$539,338, in the first quarter of 2004, from \$572,856 in the first quarter, of 2003. The decrease is consistent with management's emphasis on controlling costs.

**Salaries and Fringe benefits:**



Salaries and fringe benefits expenses increased by 14.51%, from \$294,702 for the quarter ended March 31, 2003 to \$337,889 for the quarter ended March 31, 2004.

The increase is due to a general increase in salaries of the Company's employees.

**Royalties Expense:**

Royalties expense decreased by 67.27%, from \$69,895 for March 31, 2003 to \$22,874, for the quarter ended March 31, 2004, as a result of the decrease in the sales of the Astrojax licensed product.

**Bad Debts Expense:**

The increase in bad debts expense of \$2,338 from \$10,601 for March 31, 2003 to \$12,939 in the quarter ended March 31, 2004 is due to the increase in the credit insurance rates premium.

**Foreign Exchange (gain) loss:**

As a result of the decline of the Canadian dollar in the first quarter of 2004, the Company reported a foreign exchange loss of \$10,999 as compared to a gain of \$59,144 in the first quarter of 2003.

**Gain on Discontinued Operation:**

On June 14, 2002, the Company sold all of the shares of its Sababa Toys, Inc. subsidiary. Sababa Toys, Inc. distributes proprietary products and develops product concepts to be sold to third parties. In consideration for the purchase of the shares, the Company received a note in the principal amount of \$1,065,716. Payments under the note are to be made quarterly until June 30, 2005 when the unpaid principal balance is due.

As of June 14, 2002 the Company recognized a gain on the sale of \$761,584. As of December 31, 2002, \$263,784 was recorded in the Statement of Operations, the balance deferred. For the first quarter 2003, the Company recorded

a gain of \$103,002. As of December 31, 2003 the balance of the gain has been fully recorded in income.

*Comparison of the three months ended March 31, 2003 to the three month ended March 31, 2002*

**Net Earnings:**

Net earnings for the first quarter of 2003 were \$453,082, or \$0.16 per share, as compared to a net loss of \$570,464, or \$0.42 per share, for the first quarter of 2002.

Net earnings increased by \$1,023,546 as a result of increases in net sales, gross margins, reduction in expenses and the recognition of a gain on discontinued operations. Without this gain, the Company would have net earnings of \$350,080 or \$0.13 per share.

**Net Sales:**

Net sales increased for the first three months of 2003 by \$688,289, or by 30.42%, to \$2,951,095 from \$2,262,806 for the first quarter of 2002. During the quarter, gross profit also increased as a result of the Company's emphasis on profitable sales and tighter inventory control, from 36.13% in 2002 to 42.75% in 2003, a 6.62% increase.

The increase in the current quarter is due to the AstroJax, Spider-Man, Hulk, and Marvel Legends product lines.

**Gross Profit:**

Gross profit for the Company increased during the first three months of 2003 by \$444,042 compared to the prior quarter. As a percentage of sales, gross profit increased from 36.13% in the first quarter of 2002 to 42.75% in the first quarter of 2003.

Gross profit increased as a result of the sales and product mix in the first quarter 2003, which is primarily due to the addition of higher margin product lines. The Company's continued emphasis on higher margin sales and minimized sales of discontinued products by tighter inventory control further contributed to this increase in gross margins.

**General and Administrative Expenses:**

The decrease of 27% in general and administrative expenses of \$208,862 to \$572,856, in the first quarter of 2003, from \$781,718 in the first quarter, of 2002, was due to an overall decrease in overhead accounts as a result of the restructuring plan implemented in 2002.

Expense reductions were realized in overhead expenses as a result of the closure of the Company's two locations in 2002. Travel and entertainment expenses were reduced as a result of head count reductions.

**Salaries and Fringe benefits:**

As result of the restructuring plan in 2002, salaries and fringe benefits expenses were reduced by 34%, from \$447,744 for March 31, 2002 to \$294,702 for the current period.

The reduction is due to the reduction of head count as a result of the closing of the Company's two locations.

**Foreign Exchange (gain) loss:**

As a result of the strengthening of the Canadian dollar in the first quarter of 2003, the Company reported a gain of \$59,144 as compared to a loss of \$14,984 in the first quarter of 2002.

**Gain on Discontinued Operation:**

On June 14, 2002, the Company sold all of the shares of its Sababa Toys, Inc. subsidiary. Sababa Toys, Inc. distributes proprietary products and develops product concepts to be sold to third parties. In consideration for the purchase of the shares, the Company received a note in the principal amount of \$1,065,716. Payments under the note are to be made quarterly until June 30, 2005 when the unpaid principal balance is due.

As of June 14, 2002 the Company recognized a gain on the sale of \$761,584. As of December 31, 2002, \$263,784 was recorded in the Statement of Operations. For the first quarter 2003, the Company recorded a gain of \$103,002. The balance of the gain has been deferred and will be recorded in income on a proportionate basis as the proceeds from the note receivable are received

### *Liquidity and Capital Resources*

The Company generally finances its operations through borrowings under its line of credit facility with Montcap Financial Inc., and by cash flow from operations. In the past, it has also supplemented those sources through the sales of equity securities.

Accounts receivable at March 31, 2004 were \$1,984,671 compared to \$1,598,907 at December 31, 2003. The sales were mainly to mass retailers. Inventory at March 31, 2004 increased to \$1,726,062 from \$1,682,298 at December 31, 2003.

Working capital increased from \$3,495,070 at December 31, 2003 to \$3,851,101 at March 31, 2004. Net cash used for operating activities was \$768,431 in 2004 compared to net cash used for operating activities of \$318,926 in 2003. Cash for additions to equipment and leasehold improvements was \$7,261 in 2004 compared to \$530 for 2003.

The Company's accounts receivable level is subject to significant seasonal variations due to the seasonality of sales. As a result, the Company's working capital requirements are greatest during its third and fourth quarters. In addition, to the extent accounts receivable, inventories, guarantees and advance payments increase as a result of growth of the Company's business, the Company could require additional working capital to fund its operations.

If the funds available to the Company from current cash and cash equivalents are not sufficient to meet the Company's cash needs, the Company may from time to time seek to raise capital from additional sources, including project-specific financing, additional public or private debt or equity financing.

Based on 2004 forecasts, the current credit facility appears to be sufficient to meet the Company's financial needs.

The Company believes that in order to achieve its long-term expansion objectives and to enhance its competitive position in the U.S. market, it will need additional financial resources over the next several years. The precise amount and timing of the Company's future financing needs cannot be determined at this time and will depend upon a number of factors, including the demand for its products and the management of its working capital. The Company may not be able to obtain additional financing on acceptable terms or at all. If the Company is unable to obtain sufficient capital, it could be required to curtail its expansion.

**Contractual Obligations**

The Company has entered into long-term leases with minimum annual rental payments approximately as follows:

The amounts of the operating lease obligations reflect the lease for the premises and the office equipment.

<b>Contractual Obligations</b>	<b>Less than</b>			<b>More than 5</b>
	<b>1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>years</b>
Operating lease obligations	\$ 252,000	\$ 1,042,000	\$ 584,000	\$ -

***Risk Factors***

**A few customers account for a large portion of the Company's net sales and a substantial reduction in or termination of orders from its large customers could adversely affect its business, financial condition and results of operations**

The Company's three largest customers accounted for approximately 57% and 49% of its net sales in the first quarter of 2004 and for the year ended December 31, 2003, respectively. Except for outstanding purchase orders for specific products, the Company does not have written contracts with or commitments from any of its customers. A substantial reduction in or termination of orders from any of its largest customers could adversely affect its business, financial condition and results of operations. In addition, pressure by large customers seeking a reduction in prices, financial incentives, a change in other terms of sale or on the Company to bear the risks and the cost of carrying inventory could also adversely affect the Company's business, financial condition and results of operations.

**The loss of the Company's right to distribute Toy Biz products would have a material adverse effect on its business, financial condition and results of operations**

The Company has operated without a written distribution agreement with Toy Biz Worldwide Ltd. ( Toy Biz ) since 2001. However, it has continued to distribute the product lines carried by Toy Biz during 2002 and 2003 and has accepted orders from Toy Biz in 2004. Because Toy Biz is affiliated with Playwell, the Company's management believes that its relationship with Toy Biz will continue past 2004 if the Playwell acquisition is consummated.

However, if the Playwell acquisition is consummated, or even if it is not, there can be no assurance that the Company will be able to retain the right to distribute the Toy Biz product line or, even if the Company does retain this right, that any of the products in this branded product line will retain their current popularity. The loss of the Company's distribution rights for any of these product lines or the decrease in the popularity of any one of these branded product

lines would adversely affect its business, financial condition and results of operations.

**The Company has a history of losses which makes sustained profitability uncertain**

Although the Company had net earnings of \$236,228 and \$1,112,577 for the first quarter 2004 and for the year ended December 31, 2003, it incurred a net loss of \$826,848 for the year ended December 31, 2002 and prior to the fiscal year ended December 31, 2003, and had not reported an annual profit since the year ended December 31, 1997. The Company believes that its return to profitability in 2003 resulted from its recent focus on the distribution of products with higher profit margins and the reduction in expenses. Although these efforts were successful in the first quarter of 2004 and for the year ended December 31, 2003, the Company cannot be sure that its efforts will result in continued profitability on an annual basis in the future.

**An inability to obtain additional financing could adversely impact the Company's ability to expand into the U.S. market**

The Company believes that in order to achieve its long-term expansion objectives and to enhance its competitive position in the U.S. market, it will need additional financial resources over the next several years. The precise amount and timing of its future financing needs cannot be determined at this time and will depend upon a number of factors, including the demand for its products and the management of its working capital. The Company may not be able to obtain additional financing on acceptable terms, or at all. If the Company is unable to obtain sufficient capital, it could be required to curtail its expansion plans.

**The Company's shares may not continue to be listed on the Nasdaq Small Cap Stock Market which could adversely affect the price and liquidity of its stock and its ability to obtain financing in the future**

On January 9, 2004, the Company was advised by Nasdaq that it failed to meet the requirements for continued listing on Nasdaq for failure to hold its 2003 Annual meeting by December 31, 2003, and that its securities were therefore subject to delisting from the Nasdaq SmallCap Stock Market. The Company successfully appealed the Nasdaq Staff Determination and the Company's shares will continue to be listed on the Nasdaq SmallCap Stock Market. However, the Company's most recent appeal was the second time in the last three years that it was subject to potential delisting. There can be no assurance that the Company will be able to continue to meet the requirements for continued listing or that the Company could successfully appeal a delisting determination. If the Company's shares were delisted, the Company might be able to have its shares listed for quotation on the OTC Bulletin Board or other market. However, the failure to have the Company's shares quoted on the Nasdaq market would likely have an adverse impact on the price and liquidity of the Company's shares and the Company's ability to obtain financing in the future.

**The Company's management exercises substantial control over its business**

As of February 2, 2004, the Company's directors and executive officers beneficially owned, in the aggregate, 2,032,823 shares of the Company's common stock, representing approximately 38% of the common stock outstanding. Accordingly, if these persons act together, they exercise significant control over matters requiring approval of our stockholders, including the election of the Company's board of directors.

**The Company may not be able to retain the key personnel it needs to succeed**

The Company's success is dependent on the expertise, experience and continued services of its senior management employees. Most decisions concerning the Company's business are made or significantly influenced by them. The Company does not maintain "key man" insurance on the life of any of these persons. In the event of the loss of any of its senior management employees, no assurances can be given that the Company will be able to obtain the services of an adequate replacement.

**The issuance of shares of common stock upon the exercise of options and warrants will cause dilution to the Company's current stockholders and the prevailing market price for its common stock may be materially and adversely affected by the addition of a substantial number of shares**

The Company is authorized to issue 12,500,000 shares of common stock, of which 5,355,244 shares are outstanding. In addition:

(a)

214,339 shares are issuable upon the exercise of currently outstanding options granted under the Company's Amended and Restated 1993 Stock Option Plan the sale of a portion of which have been registered on a registration statement on Form S-8;

(b)

196,000 shares are issuable upon the exercise of options granted outside our 1993 Stock Option Plan; and

(c)

637,143 shares are issuable upon the exercise of currently outstanding warrants.

If and when these options are exercised, the new shares will cause the percentage of common stock owned by each stockholder to be diluted. Moreover, the prevailing market price for the common stock may be materially and adversely affected by the addition of a substantial number of shares, into the market.

**The Company's attempts to acquire other companies may not prove fruitful and could have an adverse effect on its liquidity and earnings**

The Company may, at times, become involved in discussions about acquiring other companies. Its experience in the past has been that this process takes a significant amount of management time and effort. New acquisition discussions will likely distract the Company's management from its day-to-day operations. Even if the Company does find companies that are worth acquiring, such as its pending acquisition of Playwell, it may be extremely difficult to integrate their operations into its existing operations. In addition, there is no guaranty that its acquisitions will be successfully completed or, if completed will be financially successful. Thus, any such acquisition could have an adverse effect on its liquidity and earnings.

**The life cycle for toy products is usually very short and the Company's business may be adversely affected by its inability to secure the right to distribute new products**

As a result of changing consumer preferences, many toy products are successfully marketed for only one or two years. There can be no assurances that

•

any of the current products or product lines distributed by the Company will continue to be popular for any significant period of time;

•

any new products or product lines subsequently distribute by the Company will achieve an adequate degree of market acceptance; or

•

any new product's life cycle will be sufficient to permit the Company to recover development, manufacturing, marketing or other costs of the product.

In the event a new product does not receive sufficient market acceptance, the Company may be required to sell inventory of such products at a substantial discount. Accordingly, the Company's success is dependent in large part on its ability to secure the rights to distribute new products and to secure new character and well-known brand name licenses for existing or new product lines, which cannot be assured. Therefore, the Company cannot assume that any new products will be successful or meet with the same success as existing products.



**Consumer preferences are difficult to predict and the introduction of new products is critical to the toy industry**

The Company's business and operating results depend largely upon the appeal of its toy products. A decline in the popularity of its existing products and product lines or the failure of new products and product lines to achieve and sustain market acceptance could result in reduced overall revenues and margins, which could have a material adverse effect on the Company's business, financial condition and results of operations. The Company's continued success will depend on its ability to redesign, restyle and extend its existing toy and fashion accessory products and to develop, introduce and gain customer acceptance of new products. However consumer preferences with respect to toy products and fashion accessories are continuously changing and are difficult to predict.

**Certain relationships among the Company's management and affiliates create various potential and actual conflicts of interest and could adversely affect the Company's business**

Although it is the Company's policy that all transactions with and loans to its affiliates be made on similar terms to those that can be obtained from unaffiliated third parties and for such transactions to be approved by a majority of the Company's directors who do not have an interest in the transaction, certain situations may arise in the future where an interested party would be required to vote on actions that could benefit such person and negatively impact the Company, or vice versa.

**Non-compliance with certain Canadian government regulations could seriously harm our business**

Most of the Company's business is currently conducted in Canada. The Company is subject to the provisions of various laws, certain of which have been enacted by the federal government of Canada, the Province of Quebec and other Canadian provinces. The laws of Canada include the Hazardous Products Act which empowers the Canadian government to protect children from hazardous toys and other articles. Under that legislation, the government has the authority to exclude from the market those products which are found to be hazardous. The Company is also subject to the Consumer Packaging and Labeling Act enacted by the government of Canada. This legislation prohibits the importation of prepackaged items and the sale or importation or advertising of items which have misleading information on their labels. As a result, if any of these Canadian governmental entities should allege that any of the Company's products are hazardous to children or the packaging is misleading, whether or not such items are dangerous or misleading, the Company could be precluded from distributing entire lines of toys until a full investigation is completed. In such case, even if the Company prevails, a significant portion of the value of the entire line could be lost during a time-consuming investigation because, as discussed above, the life cycle for toy products is usually very short.

**The Company faces substantial competition in the toy distribution industry**

Many other companies involved in the toy distribution industry in Canada and the United States have greater financial resources, larger sales forces, greater name recognition, larger facilities for product development and products that may be more competitively priced than the Company's products. As a result, some of the Company's competitors may be able to obtain a greater volume of and more lucrative distribution contracts than the Company can.

**The Company may be adversely effected by the seasonal aspect of its business**

The Company's business is seasonal and, therefore, its annual operating results will depend, in large part, on its sales during the relatively brief holiday season from September through December when the majority of its sales take place.

Further, the impact of seasonality is increasing as large retailers become more efficient in their control of inventory levels through quick response management techniques. Rather than maintaining large on-hand inventories throughout the year to meet consumer demand, these customers are timing reorders so that they are being filled by suppliers closer to the time of purchase by retail customers, which to a large extent occur during September through December.

While these techniques reduce a retailer's investment in inventory, they increase pressure on suppliers like the Company to fill orders promptly and shift a significant portion of inventory risk and carrying costs to the supplier.

The limited inventory carried by retailers may also reduce or delay retail sales. Additionally, the logistics of supplying more and more product within shorter time periods will increase the risk that the Company may fail to achieve tight and compressed shipping schedules. This seasonal pattern requires significant use of working capital mainly to manufacture inventory during the year, prior to the holiday season, and requires accurate forecasting of demand for products during the holiday season. The Company's failure to accurately predict and respond to consumer demand could result in its under-producing popular items and overproducing less popular items.

**The market price of the Company's common stock has been and will continue to be volatile**

Market prices of the securities of toy companies are often volatile and the Company's historical stock price has reflected this volatility. The market price of the Company's common stock may be affected by many factors, including: fluctuations in our financial results; the actions of its customers and competitors (including new product line announcements and introductions); new regulations affecting foreign manufacturing; other factors affecting the toy industry in general; and sales of its common stock into the public market. In addition, the stock market periodically has experienced significant price and volume fluctuations, which may be unrelated to the operating performance of particular companies.

**The issuance of blank check preferred stock may also impact the value of the Company's shares**

The Company is authorized to issue 5,000,000 shares of blank check preferred stock, which is preferred stock that may be issued from time to time in such classes or series and with such terms, rights and preferences as the board of directors may choose. All of these shares may be issued at the discretion of the Company's board of directors, without the approval of its stockholders, with dividend, liquidation, conversion, voting or other rights, which could negatively affect the voting power or other rights of owners of the Company's common stock or other series of preferred stock.

**The Company's ability to issue blank check preferred stock could prevent or delay takeovers**

The Company's preferred stock can be designated in a manner that could delay or impede a merger, tender offer or other transactions resulting in a change in control, even if such a transaction would have significant benefits to the Company's stockholders. As a result, these provisions could limit the price that certain investors might be willing to pay in the future for shares of the Company's common stock.

**The Company does not expect to pay dividends on its stock**

The Company has not paid any cash or other dividends on its common stock and does not expect to declare or pay any cash dividends in the foreseeable future. In addition, its current credit agreement with its bank restricts the payment of any dividends without the bank's prior consent.

***Effects Of Inflation***

The Company does not believe that inflation has had a significant impact on its financial position or results of operations in the past three years.

***New Accounting Pronouncements***

The Company has determined that the new pronouncements effective in the year 2003 will not have an impact on the financial statements.

***Item 3. Quantitative and Qualitative Disclosures About Market Risk***

The Company is exposed to certain market risks, which arise from transactions entered into the normal course of business. The Company's primary exposures are changes in interest rates with respect to its debt and foreign currency exchange fluctuations.

**INTEREST RATE RISK** The interest payable on the Company's revolving lines-of-credit are variable based on the prime rate, and therefore, affected by changes in market interest rates. The Company does not use derivative financial instruments.

#### **FOREIGN CURRENCY RISK**

While the Company's product purchases are transacted in United States dollars; most transactions among the suppliers and subcontractors are effected in Hong Kong dollars, where most of the Company's products are manufactured. Accordingly, fluctuations in Hong Kong monetary rates may have an impact on the Company's cost of goods. Furthermore, appreciation of Chinese currency values relative to the Hong Kong dollar could increase the cost to the Company of the products manufactured in the People's Republic of China, and thereby have a negative impact on the Company. As well since the majority of the Company's sales are in Canadian dollars, the Company is at risk with regards to the conversion of Canadian dollars to US dollars to pay its suppliers. Therefore, fluctuations in conversion rates may have an impact on the Company. The Company may use derivative financial instruments solely to hedge the effects of such currency fluctuations.

#### ***Item 4.***

##### ***Controls and Procedures.***

The Company's senior management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934 (the Exchange Act)) designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In accordance with Exchange Act Rules 13a-15 and 15d-15, the Company carried out an evaluation, with the participation of the Chief Executive Officer and Chief Financial Officer, as well as other key members of the Company's management, of the effectiveness of the Company's disclosure and procedures as of the end of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective, as of the end of the period covered by this report, to provide reasonable assurance that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

No change occurred in the Company's internal controls concerning financial reporting during the first quarter of 2004 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

**Part II: Other Information**

***Item 1. Legal proceedings***

On November 30, 1995, an involuntary petition under Chapter 7 of the United States Bankruptcy Code was filed against Grand Group Inc, a United States subsidiary, in the United States Bankruptcy Court for the Southern District of New York (the Bankruptcy Proceeding ). On January 4, 1996, the Court entered an order for relief under Chapter 7 of the United States Bankruptcy Code and a trustee was appointed to supervise the liquidation of Grand Group Inc. On November 21, 2003, the bankruptcy was discharged.

During the quarter ended March 31, 2004, there were no other material developments to any legal proceedings which have been previously reported by the Company.

Other than discussed above or in Note 16 to the Company's December 31, 2003 Consolidated Financial Statements, the Company is not a party to, nor is it aware of, any other pending litigation of a material nature.

**Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities**

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Submission of Matters to a Vote of Security Holders**

On March 23, 2004, The Company held its 2003 annual meeting of stockholders. At the meeting, the following actions took place:

1.

The stockholders re-elected Stephen Altro, David Mars, Elliot Bier, James Rybakoff, Michael Kron, Earl Azimov and Michael Seltzer as directors of the Company. The number of votes for and against each of them was as follows:

Director Name	For	Against	Withheld	Abstain
Stephen Altro	3,794,785	5,285	n/a	3,184
David Mars	3,794,785	5,285	n/a	3,184
Elliot Bier	3,794,807	5,263	n/a	3,184
James Rybakoff	3,799,995	75	n/a	3,184
Michael Kron	3,799,995	75	n/a	3,184
Earl Azimov	3,799,995	75	n/a	3,184
Michael Seltzer	3,799,995	75	n/a	3,184

2.

The Stockholders ratified the approval of KPMG LLP to serve as the Company auditors for the fiscal year ending December 31, 2003. 3,800,607 shares were voted for the appointment, 1,434 shares were voted against the

appointment, no shares were withheld and 1,213 shares abstained.

***Item 5. Other Information***

(a)

Nominating Committee. In 2004, the Board established a Nominating Committee composed entirely of independent directors. The charter for the Nominating Committee will be provided upon written request to Tania M. Clarke, 1710 Route Transcanadienne, Dorval, Quebec, Canada, H9P 1H7.

Nominating Committee is comprised of two independent directors: Michael Kron and Earl Azimov. In accordance with the new listing requirements of The NASDAQ Stock Market, the Nominating Committee determines nominees for election to the Board of Directors.

The Nominating Committee believes that candidates for Board membership must exhibit certain minimum characteristics: good business judgment and an even temperament, high ethical standards, and a healthy view of the relative responsibilities of a board member and management. Board members shall be independent thinkers, articulate and intelligent. The Nominating Committee's Charter sets forth additional criteria that the Committee considers important, including experience as a board member of another publicly traded company, experience in industries or with technologies relevant to the Company, accounting or financial reporting experience, or such other professional experience as the Committee shall determine shall qualify an individual for Board service.

In selecting candidates and approving nominees for open Board positions, the Nominating Committee will make every effort to ensure that the Board and its committees include at least the minimum number of independent directors, as that term is defined and as may be required by the Sarbanes-Oxley Act and applicable standards promulgated by The NASDAQ Stock Market and the SEC, and any other applicable requirements.

In addition, the Nominating Committee shall make every effort to ensure that at least one director be a financial expert, as that term is defined by the Sarbanes-Oxley Act and applicable standards promulgated by The NASDAQ Stock Market and the SEC.

The Nominating Committee will consider candidates for the Board from any reasonable source, including stockholder recommendations. The Nominating Committee does not evaluate candidates differently based on who has made the proposal. Stockholders who wish to suggest qualified candidates should write to Earl Azimov, Chair of the Nominating Committee, at Grand's headquarters address. These recommendations should include detailed biographical information concerning the nominee, his or her qualifications to become a member of the Board, and a description of any relationship the nominee has to the stockholder making the recommendation or to other stockholders of the

Company. A written statement from the candidate consenting to be named as a candidate and, if nominated and elected, to serve as a director, subject to the candidate's due diligence of Grand, should accompany any such recommendation. Stockholders who wish to nominate a director for election at an annual meeting of stockholders of the Company must comply with the Company's By-Laws regarding stockholder proposals and nominations.

(b)

Stockholder Communications.

Any stockholder or other interested party who desires to communicate with the Company's Board of Directors or any other members of the Board of Directors may do so by writing to the Chairman of the Board of Directors at 1710 Route Transcanadienne, Dorval, Quebec, Canada, H9P 1H7, who shall determine, in his discretion, considering the identity of the submitting stockholder and the materiality and appropriateness of the communication, whether, and to whom within the Company, to forward the communication.

***Item 6. Exhibits and Reports on Form 8-K***

(a)

Exhibits.

- 31.1 Certification of Stephen Altro pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Tania M. Clarke pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. 1350, Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350, Section 906 of the Sarbanes-Oxley Act of 2002.

(b)

Reports on Form 8-K.

Two reports on Form 8-K were filed during the quarter ended March 31, 2004.





**GRAND TOYS INTERNATIONAL, INC.**

**Signatures**

Pursuant to the requirements of the Security Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 14, 2004

**GRAND TOYS INTERNATIONAL, INC.**

By: /s/ Stephen Altro

Stephen Altro  
Interim President and Chief Executive Officer

By: /s/ Tania M. Clarke

Tania M. Clarke  
Executive Vice President and CFO  
(Principal Financial and Accounting Officer)

**GRAND TOYS INTERNATIONAL, INC.**

**Signatures**

Pursuant to the requirements of the Security Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 14, 2004

**GRAND TOYS INTERNATIONAL, INC.**

By: /s/ Stephen Altro

Stephen Altro  
Interim President and Chief Executive Officer

By: /s/ Tania M. Clarke

Tania M. Clarke  
Executive Vice President and CFO  
(Principal Financial and Accounting Officer)

**Exhibit 31.1**

**Certification of Principal Executive Officer**

(Section 302 of the Sarbanes-Oxley Act of 2002)

I, Stephen Altro, Acting President and Chief Executive Officer (principal executive officer) of Grand Toys International, Inc. (the Registrant ), certifies that:

1. I have reviewed this quarterly report on Form 10-Q of Grand Toys International , Inc.
  
2. Based on my knowledge, this quarterly 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 quarterly report;
  
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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-14 and 15d-14) for the registrant and we 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) 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
  
  - c) 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 registrant's board of directors (or persons performing the equivalent function):

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.

/s/ Stephen Altro

Stephen Altro

Date: May 14, 2004

**Exhibit 31.2**

**Certification of Principal Financial Officer**

(Section 302 of the Sarbanes-Oxley Act of 2002)

I, Tania M. Clarke, Chief Financial Officer (principal financial officer) of Grand Toys International, Inc. (the Registrant ), certifies that:

1. I have reviewed this quarterly report on Form 10-Q of Grand Toys International , Inc.
  
2. Based on my knowledge, this quarterly 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 quarterly report;
  
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly 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-14 and 15d-14) for the registrant and we 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) 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
  
  - c) 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 registrant's board of directors (or persons performing the equivalent function):

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.

/s/ Tania M. Clarke

Tania M. Clarke

Date: May 14, 2004

EXHIBIT 32.1

**Certification of Principal Executive Officer**

Pursuant to 18 U.S.C. 1350

(Section 906 of the Sarbanes-Oxley Act of 2002)

I, Stephen Altro, Acting President and Chief Executive Officer (principal executive officer) of Grand Toys International, Inc. (the Registrant ), certify that to the best of my knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended March 31, 2004 of the Registrant (the Report ):

(1)

The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and

(2)

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Stephen Altro

Name: Stephen Altro

Date: May 14, 2004



EXHIBIT 32.2

**Certification of Principal Financial Officer**

Pursuant to 18 U.S.C. 1350

(Section 906 of the Sarbanes-Oxley Act of 2002)

I, Tania M. Clarke, Chief Financial Officer (principal financial officer) of Grand Toys International, Inc. (the Registrant ), certify that to the best of my knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended March 31, 2004 of the Registrant (the Report ):

(1)

The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and

(2)

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

/s/ Tania M. Clarke

Name: Tania M. Clarke

Date: May 14, 2004

#