

GRAND TOYS INTERNATIONAL INC  
Form 10-K/A  
April 26, 2004

**FORM 10 K/A**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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

For the fiscal year ended: **December 31, 2002**

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OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934 (No Fee Required)

For the transition period from

to

Commission file number **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 Identification No.)

incorporation or organization)

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

(Address of principal executive offices, Zip Code)

Registrant's telephone number, including area code **(514) 685-2180**

\_\_\_\_\_

Securities registered pursuant to Section 12 (b) of the Exchange Act: None

Securities registered pursuant to Section 12 (g) of the Exchange Act: Common Stock \$.001 par value

Check whether the Registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the 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  No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-K contained herein, and no disclosure will be contained to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [  ]

The Registrant's revenues for the year ended December 31, 2002 were \$12,339,930. As of February 28, 2003, the Registrant had 2,762,698 shares of Common Stock outstanding. The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$3,729,642 (as of February 28, 2003).

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**GRAND TOYS INTERNATIONAL, INC.**

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Filed with the Securities and Exchange Commission

Year ended December 31, 2002

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## **PART I**

This Form 10-K of Grand Toys International, Inc. (the Company) contains forward-looking statements within the meaning of the Securities Exchange Act of 1934, which statements are subject to risks and uncertainties. Statements indicating that the Company expects, estimates or believes are forward-looking, as are all other statements concerning future financial results, product offerings or other events that have not yet occurred. There are many important factors that could cause actual results or events to differ materially from those anticipated by the forward-looking statements contained in this Form 10-K.

On September 4, 2001, the Company undertook a one-for-four reverse split of its common stock. All disclosures concerning shares of common stock have been adjusted to give effect to the reverse split.

### **Item 1.**

#### **Description of Business:**

##### *Introduction*

The Company is a Nevada corporation which, by itself and through its subsidiaries, Grand Toys Ltd. and Grand Concepts Inc. (collectively Grand Canada), has been engaged in the toy business for over 42 years. The Company currently develops and distributes a wide variety of toys and fashion accessories throughout Canada and, to a lesser extent, the United States. Grand Canada's business consists of four areas of operation: (i) importing and distributing throughout Canada, on an exclusive and non-exclusive basis, a wide variety of well-known toy and leisure products and fashion accessories including, party goods, stationery and accessories; (ii) selling toy products and fashion accessories featuring popular characters licensed to the Company; (iii) earning commissions on the sale of products, represented by Grand Canada and shipped directly from the overseas vendor to Canadian customers; and (iv) selling proprietary products, such as puzzles, mobiles, and gift-related items.

On January 29, 2002, the Company consolidated all of its Canadian operations into Grand Toys Ltd., and Grand Concepts ceased to exist as an independent entity.

The Company's United States subsidiary, Sababa Toys Inc., which was organized in 2000, distributed proprietary products and developed product concepts to be sold to third parties or developed and distributed by the Company. On June 14, 2002, the Company sold all of the shares of its Sababa Toys, Inc. subsidiary.

Unless the context otherwise requires, references herein to Grand Toys or the Company include Grand Toys International, Inc. and its operating subsidiaries, Grand Toys Ltd., Grand Concepts Inc., and Sababa Toys Inc. The Company's revenues are primarily derived from the operations of Grand Canada. The Company's other United States subsidiary, Ark Creations, Inc., which owned a proprietary line of puzzles, ceased operations during the fiscal year ended December 31, 2000.

### ***Products***

Grand Canada imports into Canada for distribution select toys and fashion accessories from vendors who typically design, develop and sell their products in other countries.

In determining which items to import, Grand Canada examines such factors as consumer acceptance of the particular products in other countries, and Canadian consumer tastes for such products based on similar products distributed previously in Canada. In addition, prior to ordering a product, Grand Canada attempts to predict the potential demand for such product by exhibiting it to Grand Canada's existing customers.

The following table sets forth certain vendors whose products Grand Canada distributes in Canada, the type of products they manufacture, and the price range at which Grand Canada sells such products to retailers.

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**Vendor (Head Office)**

**Products Distributed**

**by the Company**

**Product Price Range (\$)**

Barter (H.K.)

Proprietary Arts & Crafts & licensed products

0.80 - 40.13

Playwell

Pre-School action figures

2.61 - 25.99

Intex Corporation (Taiwan)

Inflatable water toys (licensed & non-licensed)

0.22 - 222.93

Kid Galaxy (U.S.)

Bendos figurines

2.87

P & M Products (U.S.)

Arts & Crafts

1.02 - 15.61

Processed Plastic (U.S.)

Plastic toys, ride-on vehicles, and etc.

0.38 - 16.88

SIC LLC

Snowjacks

50.44



Spectra Star Toys (U.S.)

Kites

1.31 - 11.78

Toy Biz (U.S.)

Male action figures

4.20 - 259.87

Unice S.A. (Spain)

Balls

1.18 - 1.50

Universal

CD Books & Cassettes

3.18 - 76.43

The Company's business and operating results depend largely upon the appeal of its toy products developed and distributed by the Company. 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 products and fashion accessories and to develop, introduce and gain customer acceptance of new toy product. However consumer preferences with respect to toy products and fashion accessories are continuously changing and are difficult to predict.

### ***Design and Development***

As is common in the toy and fashion accessory industries, Grand Canada receives numerous concepts from unaffiliated third parties for new products. Grand Canada does not employ its own inventors of new concepts but if it accepts and develops an inventor's concept for a new product, it will pay royalties to the inventor on sales from that product.

Grand's staff reviews trade and product developments within the recreational sector and determines if there is an opportunity that could be put into development. The Company sources ideas internally. Grand's staff develops the new concepts by attending tradeshows worldwide, reading industry publications and communicating with our existing

vendors and customers.

The Company, through its US subsidiary, Sababa Toys Inc., developed new concepts to be developed internally or by the other subsidiaries within the corporate group, to be sold to third parties. On June 14, 2002, the Company sold all of the shares of its Sababa Toys, Inc. subsidiary.

The Company also develops proprietary products and uses internal staff to develop these products to be sold to third parties.

All safety testing of the Company's products is done by the manufacturers at the manufacturers' factories and is designed to meet safety regulations imposed by the Canadian and United States governmental authorities. The Company also monitors quality assurance procedures of the manufacturers for the Company's products for safety purposes at the Company's warehouse facilities.

#### ***Sources of Product***

Approximately 87% of the Company's gross sales in 2002 were from products supplied by the following five vendors: Toy Biz, P&M Products, Barter, Playwell and SIC LLC. These products accounted for 67%, 8%, 7%, 3% and 2% respectively of 2002 gross sales. Other than the products from the above-mentioned vendors, no products from any other vendor or from the Company's proprietary products accounted for more than 2% of the Company's gross sales in 2002. The Company is continuously sourcing new products and looking at potential acquisitions, although no specific acquisition candidates have been specified. If one or more of the remaining suppliers identified above were to terminate their relationship with the Company, such termination may have a material adverse effect on the Company.

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The Company's products are manufactured for the Company by unaffiliated third parties principally located in China, Hong Kong, Mexico, Spain, the United States and the United Kingdom. The manufacturers are chosen by the vendor on the basis of price, payment terms, product quality, reliability and the ability of a manufacturer to meet delivery requirements. For licensed products, the licensors may have the right to approve the selected manufacturers. The use of third-party manufacturers enables the Company to avoid incurring fixed manufacturing costs, but also reduces its ability to control the timing and quality of the manufacturing process.

The Company does not supervise the day-to-day manufacturing of its products. However, prior to the commencement of manufacturing, the Company, the vendor and the manufacturer work together to design a prototype of the specific product and its packaging. The manufacturer is contractually obligated to manufacture the products in accordance with those prototype specifications. For licensed products, some licensors may be required to approve the prototype prior to production.

All manufacturing services performed overseas are generally paid for by either letter of credit or wire transfer. Payment for such manufacturing is made only upon the proper fulfillment of terms established by the Company, in each purchase order such as adherence to product quality, design, packaging and shipping standards, as well as proper documentation relating thereto. Most product purchases are paid for in U.S. dollars.

Grand Canada is not a party to any long-term supply or requirements agreements with any specific manufacturer. All of the Company's manufacturers may subcontract the manufacture of components of their products to third parties who are not affiliated with the Company.

### ***Materials***

The principal raw materials used in the production and sale of the Company products are plastic, printed fabrics and paper products. These are all currently available at reasonable prices from a variety of sources. Because the Company does not manufacture any of its products on site, it does not own any specialized tools or other production equipment.

### ***Location***

Grand Canada leases a building in suburban Montreal, Quebec, Canada, where the Company's executive and administrative offices are located as well as its distribution center. The Company also has a sales office and showroom in Mississauga, Ontario, Canada. This location was closed as of December 31, 2002 as part of the Company's restructuring efforts.

*Licensing and Distribution Agreements*

**Character Licenses**

The Company's product lines include products featuring well-known character properties created by others. In order to obtain the right to manufacture and sell products featuring such character properties, Grand Canada enters into license agreements with the owners of such properties. Under the terms of the character property license agreements, Grand Canada pays royalties to licensors that generally range from 10% to 15% of net sales of the products carrying these character properties. To the extent that competition increases among companies to obtain character property licenses, Grand Canada may encounter increased difficulty in obtaining certain character licenses and may be required to pay greater minimum guaranteed royalty amounts.

Generally, the Company's character property license agreements provide the Company with the exclusive or non-exclusive right to sell only specific products featuring the particular character. These agreements typically limit the sale of such products to Canada. However, certain agreements allow distribution in the United States. They generally have terms of one to three years and may be renewed upon payment of certain minimum guarantees or the attainment of specified sales levels.

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The following table sets forth some of the Company's character licenses, the licensor for these character properties, the territory of sale, and the types of products that the Company markets featuring these character properties.

<b>Character Property</b>	<b>Licensor (Territory)</b>	<b>Product Featuring Property</b>
Batman	Warner Bros. (CAN)	Kites, Balls
Bear In The Big Blue House	Venture (CAN)	Balls
Catdog	Studio Licensing (CAN)	Kites
Eye Scream	Excel Development (U.S. & CAN)	I-Screme cosmetics
Harry Potter	Warner Bros. (CAN)	Kites, Balls, Stationery
Hello Kitty, Pochacco	Sanrio Co. Ltd. (US & CAN)	Foam Puzzles, Foam Floor Tiles
Monsters, Winnie the Pooh, Toy Story, Standard characters	Disney (CAN)	Kites, Balls
Nintendo	G-Squared (CAN)	Balls
Pooch Patrol	Isovoy Inc. (U.S. & CAN)	Plush Toys
Power Rangers	Venture (CAN)	Balls, Kites
Rugrats	Studio Licensing (CAN)	Kites, Balls
Sesame Street	E.M.G. (CAN)	Balls, Kites
Sonic The Hedge Hog	Venture (CAN)	Balls
Spider-man	Marvel, (CAN)	Ball, Stationery
Power Rangers	Saban Merchandising (U.S.)	Puzzmobiles
Power Rangers	Venture (U.S. & CAN)	Foam Puzzles
Sonic the Hedgehog	Venture (U.S. & CAN)	Foam Puzzles
Spiderman	Marvel (U.S. & CAN)	Foam Puzzles, Foam Floor Tiles
Tonka	Hasbro (U.S. & CAN)	Foam Activity Kits
X-Men	Marvel (U.S. & CAN)	Foam Puzzles, Foam Floor Tiles

No one particular character property license resulted in sales in excess of 1% of Grand Canada's sales revenues for the year ended December 31, 2002, and the loss of any one such license would not have a material adverse effect on the Company's operations.

All costs associated with licensing and distribution are expensed in the period incurred and are shown as royalty expense in the Statements of Operations. Total expense for the year ended December 31, 2002 is \$311,082 (2001 - \$252,506, 2000 - \$250,523).

**License and Distribution Arrangements with Toy Vendors**

Grand Canada selects products from a master product list provided to it by the vendor. The purchase price, depending on the arrangement with the supplier, may consist of a fixed payment per item, specified minimum quantities to be purchased and other conditions, and occasionally a royalty fee.

Pursuant to these agreements, Grand Canada obtains either the exclusive and non-exclusive right to import and distribute throughout Canada the products selected by it. These agreements generally have terms of one to five years and are usually exclusive for a specified product or product line within a specific territory.

Generally, under these agreements, Grand Canada is responsible for paying shipping and other related costs upon the purchase of goods from the vendor. If Grand Canada were to be in default under a license or distribution agreement, such agreement could be terminated and the Company could also incur liability for certain costs and penalties.

Grand Canada's distribution agreement with its largest vendor, Toy Biz Inc, accounted for 67% of the Company's 2002 sales volume. This distribution agreement terminated on December 31, 2001. Grand's contract with this vendor renews on an annual basis.

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 Company's current products or product lines will continue to be popular for any significant period of time; any new products or product lines introduced 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.

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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.

### ***Marketing, Sales and Distribution***

Grand Canada markets its products throughout Canada via its own sales representatives as well as through independent sales agents. Purchasers of the products include retail chain stores, department stores, toy specialty stores and wholesalers.

Grand Canada's four largest customers are: Walmart, Toys 'R Us, Zellers and Sears Canada, which, for the year ended December 31, 2002, accounted for approximately 33%, 17%, 10% and 5%, respectively, of the gross sales for this period. No other customer accounted for more than 5% of gross sales in 2002.

Other than purchase orders from its customers, Grand Canada does not have written agreements with its customers, but rather sells products to customers on open account, with payment terms typically varying from 30 to 90 days. If one or more of the four customers identified above terminated its relationship with Grand Canada, a material adverse effect on the Company may occur.

Retailers can cancel purchase orders for which goods have been purchased. Grand attempts to minimize this possibility by ensuring that customer orders are matched to product purchases.

In addition, pressure by large customers seeking a reduction in prices, financial incentives, a change in other terms of sale or for the Company to bear the risks and the cost of carrying inventory could also adversely affect our business, financial condition and results of operations.

Grand Canada employs a sales and marketing staff of six people, including two senior managers and four sales persons who make on-site visits to customers for the purpose of soliciting orders for products. Grand Canada markets products at major and regional toy trade shows in Canada. In addition, Grand Canada maintains showrooms in its suburban Montreal and until December 31, 2002, Mississauga facilities.

Grand Canada directly, or through its salespersons, takes written orders for products from customers and arranges for the manufacture of its products. Cancellations are generally made in writing and appropriate steps are taken to notify manufacturers of such cancellations.

Returns are generally not accepted, although consistent with industry practices, exceptions to this policy are made on a case-by-case negotiated basis.

### ***Seasonality***

The Company's business is seasonal, with a majority of retail sales occurring during the period from September through December in anticipation of the holiday season. Therefore its annual operating results will depend, in large part, on its sales during the relatively brief holiday season. Further, this seasonality is increasing as large retailers become more efficient in their control of inventory levels through quick response management techniques. Sales of its toy products at retail are seasonal.

These customers are timing reorders so that they are being filled by suppliers closer to the time of purchase by consumers, which to a large extent occurs during September through December, rather than maintaining large on-hand inventories throughout the year to meet consumer demand. 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 increase the risk that we 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 our under-producing popular items and overproducing less popular items.

### ***Product Liability***

The Company maintains product liability coverage for the Company's operations in the aggregate amount of Canadian \$12,000,000. The Company has not been the subject of any product liability litigation.

### ***Competition***

The industries in which the Company competes are highly competitive. Grand Toys competes with many larger toy companies in the design and development of new toys, the procurement of licenses and for adequate retail shelf space



for its products. The larger toy companies include Hasbro Inc., Mattel Inc., Playmates Inc. and Bandai Co. Many of these competitors have greater financial and other resources than the Company. Grand also faces competition from the retailers who buy directly from the supplier. The Company offers a full service to its customers and therefore remains competitive. The toy industry's highly competitive environment continues to place cost pressures on manufacturers and distributors. Discretionary spending among potential toy consumers is limited and the toy industry competes for those dollars along with the makers of computers and video games. Management believes that strong character and product licenses, the industry reputation and ability of its senior management, the quality of its products and its overhead and operational controls have enabled Grand to compete successfully.

### ***Government Regulation***

The Company is subject to the provisions of various laws, certain of which have been enacted by the Federal Government of Canada and others which have been enacted by the Government of the Province of Quebec and other Canadian provinces, and the various states in the U.S.

#### **Federal**

The laws of the Government of Canada to which the Company is subject include the *Hazardous Products Act* which empowers the Government to protect children from hazardous toys and other articles. Under that legislation the Government has the authority to exclude from the market those articles, which are found to be hazardous. Grand Canada is also subject to the *Consumer Packaging and Labeling Act* enacted by the Government of Canada, whose legislation prohibits the importation of prepackaged items into Canada, as well as the sale, importation, or advertising in Canada of items, which have misleading information on their label.

#### **Provincial**

The legislation enacted by the Government of the Province of Quebec to which Grand Canada is subject includes the *Consumer Protection Act* which prohibits the sale of hazardous toys and other articles, and also requires proper labeling and instructions to be included with the item being sold.

Grand Canada is also subject to the *Charter of the French Language*, which requires that all labeling and instructions appear in the French language, as well as the *Upholstery and Stuffed Articles Act*, which requires that stuffed articles conform to hygienic norms, and obligates companies to take measures against contamination during transportation and storage. Similar laws exist in several cities and provinces throughout Canada and in many jurisdictions throughout the world.

The Company maintains a quality control program to ensure compliance with all applicable laws.

### *Employees*

As of December 31, 2002, the Company employed 28 full-time persons, including two executive officers. The Company believes that its relations with its employees are satisfactory.

### **Item 2.**

#### **Description of Property:**

The Company's principal executive offices are located in an approximately 105,000 square foot facility located at 1710 Route Trans-Canada, Dorval, Quebec, Canada, a suburb of Montreal. The Company uses the facility for offices, showroom, warehousing and distribution.

The lease for the premises expires on September 30, 2004 but Grand Canada has the right to extend the lease for an additional five-year period, to September 30, 2009. The current monthly rent is \$21,000 and during the extension period shall be increased each year by a percentage that is equal to 75% of the percentage increase in the consumer price index for the greater Montreal, Canada area. On October 23, 2002, the Company sub-let 62,000 square feet of this facility in order to reduce operating expenses. The sub-lease ends on November 30, 2008.

Grand Canada also leases, pursuant to a lease expiring on January 1, 2005, approximately 9,000 square feet of showroom and office space at 6427 Northam Drive, Mississauga, Ontario, Canada, a suburb of Toronto, at a current rental rate of approximately \$2,700 per month. The Company terminated this lease effective December 31, 2002.

Sababa Toys Inc. leased 1,610 square feet of office space at 119 W. 23<sup>rd</sup> Street, Suite 505, New York, N.Y., pursuant to a lease expiring November 1, 2003, at a current rental rate of \$4,900 per month. As a result of the sale of this subsidiary, this lease was transferred to the purchaser of Sababa Toys as of June 14, 2002.

The Company believes that its current facilities are satisfactory for its present needs and that insurance coverage is adequate for the premises.

### **Item 3.**

**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 U.S. 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. To date, no other proceedings have occurred in connection with the Bankruptcy.

During the third quarter of 2001, the Company settled the class action lawsuit at a minimal cost to the Company. The parties settlement in the action of Robert R. Van Dyke v. Grand Toys International, Inc., Stephen Altro, David Mars and , Ron Goldenberg., 00 Civ. 2710, was approved by the United States District Court for the Southern District of New York on September 24, 2001. Mssrs. Bier and Ryabakoff were named on the original claim, but the claims against them were subsequently dismissed.

During the quarter ended December 31, 2002, there were no material developments to any legal proceedings, which have been previously reported by the Company. See Note 16 of the Company s Consolidated Financial Statements for the year ended December 31, 2002, which is an exhibit to this report for a complete description of material legal proceedings to which the Company is presently a party.

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

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**Item 4.**

**Submission of Matters to a Vote of Security Holders:**

None.

**PART II**

**Item 5.**

**Market For Common Equity and Related Stockholder Matters:**

The Company's Common Stock is traded on the NASDAQ Small Cap Stock Market (NASDAQ) under the symbol GRIN .

The following table sets forth the range of high and low closing representative bid prices for the Company's Common Stock from January 1, 2001 through December 31, 2002 as reported by NASDAQ.

The figures represent prices between dealers, do not include retail mark-ups, markdowns or commissions and may not represent actual transactions. In addition, the figures reflect the impact of the one-for-four reverse split of September 4, 2001.

<b>Common Stock</b>	<b>Representative</b>	
	<b>Bid Prices</b>	
<b>2001</b>	High (\$)	Low (\$)
First Quarter	2 3/4	1 -
Second Quarter	3 5/32	1 3/4
Third Quarter	2 1/5	1 3/32
Fourth Quarter	4 5/16	3/4
<b>2002</b>		

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First Quarter	2	5/8	1	3/5
Second Quarter	3	1/2	1	1/2
Third Quarter	1	3/16	1	-
Fourth Quarter	1	25/32	1	-

On March 20, 2003, the last reported sales price for the Company's Common Stock on the Nasdaq SmallCap Market was \$1.70 per share.

On January 12, 2001, the Company was advised by Nasdaq that it had failed to meet the requirements for continued listing on the SmallCap market because the stock traded below \$1.00 for a 30-day period.

On April 9, 2001, the Company received a Nasdaq Staff Determination indicating that the Company had failed to comply with each of the net tangible asset, market capitalization and net income requirements for continued listing. The Company further received a Nasdaq Staff Determination on April 16, 2001 indicating that the Company had failed to comply with the \$1.00 minimum bid price requirement for continued listing and that its securities were, therefore, subject to delisting from the Nasdaq SmallCap Market.

The Company requested a hearing before the Nasdaq panel to appeal the delisting determination. This hearing was held on June 6, 2001. As a result of this hearing, on August 2, 2001, the Company was advised by Nasdaq that it would continue to be listed via a temporary exception from the net tangible assets, market capitalization, net income, market value of public float and minimum bid price requirements.

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On November 26, 2002, the Nasdaq panel advised the Company that the temporary exception had become permanent since the Company had complied with the Nasdaq requirement.

There can be no assurance that we will be able to meet the requirements for continued listing or that we could successfully appeal a delisting determination. If our shares were delisted, we might be able to have our shares listed for quotation on the OTC Bulletin Board or other market. However, the failure to have our shares quoted on the Nasdaq market would likely have an adverse impact on the price and liquidity of our shares and our ability to obtain financing in the future.

At February 28, 2003 there were approximately 192 record holders of the Company's Common Stock, however those shares being held at various clearing houses, including Cede & Company have not been broken down. Accordingly, the Company believes there are many more beneficial owners of the Company's Common Stock whose shares are held in street name, not in the name of the individual shareholder.

During the past two years the Company has not paid and has no current plans to pay dividends on its Common Stock. The Company intends to retain earnings, if any, for use in its business. Any dividends for Common Stock that may be declared in the future will be determined by the Board of Directors based upon the Company's financial condition, results of operation, market conditions and other factors that the Board deems relevant.

The following securities were issued by the Company during the last quarter of December 31, 2002, and were not registered under the Securities Act of 1933, as amended (the Act).

On October 1, 2002, 10,144 shares were issued to Claire Collins as a result of the settlement of an outstanding payable in the amount of \$12,982.

On December 18, 2002, 66,667 shares were issued to B.A.R.T.E.R (HK) Ltd as a result of the settlement of an outstanding payable in the amount of \$100,000.

The sale and issuance of securities in the transactions described set forth above were exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act or Regulation S promulgated thereunder as transactions by an issuer not involving a public offering.

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**Item 6.****Selected Financial Data:**

The following selected financial data of the Company has been derived from the Company's annual consolidated financial statements, which appear elsewhere herein, for the fiscal years 2000, 2001 and 2002

For the Twelve Months Ended December 31:

	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
Net sales	\$ 12,339,930	\$ 8,278,335	\$ 12,016,385	\$ 37,260,250	\$ 33,177,529
Gross profit	4,016,390	2,531,889	372,374	10,778,909	11,091,548
Unusual (income) expense	-	(2,033,225)	3,625,055	814,669	-
Loss from continuing operations	(1,024,140)	(940,140)	(9,988,820)	(709,466)	(318,302)
Loss from discontinued operations	197,292	(431,352)	(167,893)	-	-
Net loss applicable to common stockholders	(826,848)	(1,371,492)	(10,156,713)	(709,466)	(318,302)
Loss per share:					
Continuing operations					
Basic and diluted	(0.50)	(0.79)	(12.49)	(1.42)	(0.80)
Discontinued operations					
Basic and diluted	0.10	(0.37)	(0.21)	-	-
Net loss					
Basic and diluted	(0.40)	(1.16)	(12.70)	(1.42)	(0.80)
Weighted average number of common equivalent shares					
Basic and diluted	2,064,465	1,183,992	801,946	533,145	394,409
Working capital	1,574,709	1,111,171	2,804,596	10,788,948	3,374,528
Long term debt	-	-	1,500,000	1,777,778	-
Capital stock	2,763	1,285	3,235	3,135	1,578
Redeemable preferred stock	-	-	500,000	1,000,000	-
Cash dividends - Common Shares	-	-	-	-	-



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Cash dividends	Preferred Shares	-	-	-	25,000	-
Total assets		6,244,467	5,689,225	6,582,383	19,408,405	13,889,317

Unusual items are comprised of the following:

	2001	2000	1999
(Reduction of) provision for a lawsuit (1)	\$ (550,000)	\$	
	550,000	-	
(Reduction of) provision for loan receivable (2)	(288,102)	434,371	-
Gain on forgiveness of debt (4)	(1,195,123)	-	-
Settlement of lawsuit by lessor of certain real estate(3)	-	264,000	-
Write-off of intangibles (4)	-	2,253,516	-
Write-off of deferred acquisition costs (2)	-	123,168	-
Penalty incurred to discontinue a major product line(5)	-	-	382,056
Severance costs, asset write-offs and lease penalties in connection with the closure of the manufacturing facility of Ark Creations, Inc.(5)	-	-	432,613
	\$ (2,033,225)	\$	
	3,625,055	814,669	

1)

The Company was named in a lawsuit for breach of contract in a licensing dispute, for recovery totaling in excess of \$600,000. A defense was filed against the plaintiff, and management had reserved, at December 31, 2000, \$550,000 in the event the results were unfavorable. In March 2001, the Company received a favorable court judgment, and reversed the accrual, in full, by the third quarter of 2001.

2)

In 2000, the Company had written-off \$557,539 as a result of its decision to abandon its proposed acquisition of Limited Treasures, Inc., of which \$123,168 related to acquisition costs and \$434,371, related to a loan receivable. In 2001, the Company was successful in obtaining a judgement against Limited Treasures for the loan receivable and reversed \$288,102 of the provision against the loan.

3)

In May 2000, the Company settled a lawsuit brought by a lessor of certain real estate for \$264,000.

4)

In September 2000, the Company recognized the permanent impairment in value of goodwill and patents from the

acquisition of assets by its Ark Creations subsidiary of \$2,253,516, as a result of its decision to cease operations of this subsidiary. The purpose of the Company's acquisition of Ark Foundation LLC by its subsidiary, Ark Creations Inc., was to give the Company direct access to the US market by acquiring an existing US operating company. Due to disappointing sales results in 2000, the Company closed this operation and transferred the product line to its head office.

In connection with the acquisition, the Company's Ark Creation's subsidiary issued, in partial consideration, a promissory note in the principal amount of \$1,500,000. The note was secured by a pledge of 93,750 shares of the Company's common stock. Upon cessation of the subsidiary's business, it ceased making interest payments on the note and the holder of the note caused the pledged shares to be registered in his name in 2001. As a result, the Company eliminated the liability associated with the note. In accordance with the adoption of SFAS 145, effective January 1, 2003, the gain on forgiveness of debt has been reclassified and is no longer shown as an extraordinary item.

5)

In 1999, the Company discontinued a major product line which resulted in a penalty of \$382,056 and closed the manufacturing facility of Ark Creations Inc. which resulted in costs of \$432,613 in asset write-offs, severances and lease penalties.

#### **Management's Discussion and Analysis:**

The following should be read in conjunction with the consolidated financial statements included in this Annual Report.

#

## *Overview*

In the Company's audited financial statements for the years ended December 31, 2002, and 2001, the Company recognized that it had certain issues which raised substantial doubt about the Company's ability to continue as a going concern. The reasons cited were the Company's recurring losses and the cancellation of its line of credit in 2000. This was noted in KPMG's audit report on those financial statements.

In 2002, the Company increased its credit facility, reduced its losses, and implemented a restructuring plan to return to profitability. As part of its restructuring plan, the Company has significantly reduced its operating costs, by closing one of its Canadian locations, sub-letting a portion of the Company's main facility and consolidating its U.S. operations into the Canadian subsidiary. In addition, the Company continues to add profitable new product lines, and focuses on strong retail sell-through. At this time, based on 2003 forecasts, the current credit facility appears to be sufficient to meet the Company's working capital needs.

The Company incurred net losses of \$826,848 for the year ended December 31, 2002, \$1,371,492 for the year ended December 31, 2001 and \$10,156,713 for the year ended December 31, 2000. The Company has not reported an annual profit since December 31, 1997. The Company has recently begun to implement a plan to return to profitability. Over the course of 2002 the Company has focused on products with higher profit margins and have reduced expenses. This has resulted in improved performance but it has not achieved profitability for the year ending December 31, 2002 and, in spite of these efforts, there can be no assurance that the Company will become profitable on an annual basis.

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 to Grand Canada suppliers not contingent upon the subsequent sales of the suppliers' 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 expense. 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 packages.

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:

**For the Twelve Months Ended  
December 31,**

	<b>2002</b>	<b>2001</b>	<b>2000</b>
	%	%	%
Net sales	100.00	100.00	100.00
Cost of goods sold	67.45	69.42	96.90
Gross profit	32.55	30.58	3.10
Other costs and expenses:			
General and administrative	23.14	34.79	33.43
Salaries and fringe benefits	13.65	20.36	17.27
Royalties	2.52	3.05	2.08
Bad debt expense	0.28	1.78	.78
Depreciation and amortization	0.73	1.40	2.36
Foreign exchange loss	0.33	1.07	.22
Interest on long-term debt	-	-	.91
Interest expense	0.65	0.57	6.48
Interest revenue	(0.57)	(1.22)	(1.11)
Unusual items	-	(24.56)	30.16
Total operating expenses	40.73	37.24	92.58
Loss before income taxes and extraordinary item	(8.18)	(6.65)	(89.48)
Loss from continuing operations	(8.30)	(11.36)	(83.13)
Discontinued operations:			
Loss from discontinued operations	(0.54)	(5.21)	(1.40)
Gain on sale of discontinued operations	2.14	-	-
Earnings (loss) from discontinued operations	1.60	(5.21)	(1.40)
Net loss applicable to common stockholders	(6.70)	(16.57)	(84.53)

On a quarterly 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 year ended December 31, 2002 to the year ended December 31, 2001*

**Net Loss:**

Net loss for 2002 was \$826,848, or \$(0.40) loss per share, as compared to a net loss of \$1,371,492, or \$(1.16) loss per share in 2001. However, net loss for the year ended December 31, 2002, included a gain of \$263,784 on the sale of discontinued operations, offset by a \$66,492 loss from the operations of discontinued operations. Without this gain, the Company would have incurred a net loss of \$(1,024,140) or \$(0.50) per share.

Increased gross profit and the recognition of the gain on the sale of Sababa Toys Inc., resulted in the significant decrease in the net loss for the year as compared to 2001. The Company will have until 2008 to be able to apply unutilized tax losses against future taxable income.

#

**Net Sales:**

Net sales increased by \$4,061,595, or by 49.06%, to \$12,339,930 from \$8,278,335 for 2001. Net sales increased primarily as a result of the success in the following product lines: Spiderman and Lord of the Rings (Toybiz and Playwell), Blopens

(P & M Products Ltd.).

**Gross Profit:**

Gross profit for the Company in 2002 increased by \$1,484,501. As a percentage of sales, gross profit increased in 2002 from 30.58% to 32.55% as a result of the sales mix in the product line. The increased gross profit in 2002 also was attributable to the Company's continued emphasis on higher margin sales.

As part of the Company's 2002 restructuring plan, the Company abandoned the manufacturing and selling of certain of its proprietary product lines. In doing so the Company incurred \$125,247 in expenses relating to write-offs of deferred product development and \$94,350 in negative margin due to reduced selling prices as a result of the decrease in customer interest.

In addition, commissions on FOB sales increased as compared to the same period of 2001, by 7.25% because our sales relating to the product line, Toys Biz increased by 169% over the same period in 2001.

**General and Administrative Expenses:**

General and administrative expenses decreased by \$23,858 to \$2,856,116, in 2002 from \$2,879,974 in 2001. As a percentage of sales, general and administrative expenses decreased by 11.65% from 34.79% in 2001 to 23.14% in 2002.

One time charges incurred as a result of the implementation of the Company's restructuring plan resulted in a total expense of \$516,479. In 2002, the Company closed two locations and reduced head count through employee and contract terminations. In line with the restructuring plan, the Company discontinued the manufacture of certain proprietary licensed products.

One time restructuring expenses were:

Write-off discontinued lines	\$
	172,864
Consulting	111,469
Legal fees	98,985
Severance & terminations	71,749
Location closing	<u>61,412</u>
	\$
	<u>516,479</u>

In 2002, the Company incurred \$412,350 in bank financing expenses as a result of the high cost of financing through the Company's lender. In addition, the Company incurred significant legal charges of \$246,758, relating to the settlement of legal issues, the filing of registration statements, financing documents and handling the NASDAQ de-listing issue.

Based on the above, the Company has determined that of the total general and administrative expenses, \$516,479 are of an infrequent nature. The reasons for reclassifying these items as infrequent was based on the fact that these items were not previously incurred and related to, in Management's opinion, events that would not recur.

**Salaries and Fringe benefits:**

In 2002, the slight decrease of \$1,295 in the salaries and fringe benefits expense was a result of the downsizing efforts. The impact was minimal due to the severance costs of \$71,749 recorded. Without the downsizing efforts implemented, the Company would have incurred an additional expense of \$78,071 in the last five months of the year. At December 31, 2002, there were no severance payments outstanding.

**Royalty Expense:**



Royalty expense increased by \$58,576 largely due to write-off of a non-performing license.

**Bad Debt Expense:**

A decrease in bad debt expense of \$112,653 was a result of a receivable write-off of \$104,534 in 2001 and a reduction in credit insurance premiums for 2002.

**Depreciation and Amortization:**

Depreciation and amortization decreased by \$26,671 in 2002 as a result of the declining balance method of depreciation and amortization used on most assets.

**Foreign Exchange Loss:**

The loss in 2002 decreased due to the strengthening of the Canadian dollar.

**Interest Expense:**

The increase of \$32,759 is due to the higher financing cost associated with the Company's current lender as compared to 2001.

**Interest Revenue:**

Interest revenue decreased by \$31,052 in 2002 due to a reduction in the interest charges on a receivable to reflect reductions in the prime rate.

**Unusual Items:**

There were no unusual items in 2002.

**Income tax Expense (recovery):**

Income tax expense for 2002 is the actual tax expense incurred by the Company for 2002. The 2001 income tax recovery includes the reversal of an accrual of \$309,345 as a result of a successful resolution, in the Company's favor, of a tax case and offset by the write-off of \$185,411 due to recurring losses in the US companies and a refund of \$13,713 of taxes, overpaid in a prior year.

**Gain on Discontinued Operation:**

On June 14, 2002, the Company sold all of the shares of its Sababa Toys, Inc. subsidiary to Sababa Global Consumer Products, LLC. 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. The Company recognized a gain on the sale of \$761,584, of which \$263,784 has been recorded in the Statement of Operations. 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.

***Comparison of the year ended December 31, 2001 to the year ended December 31, 2000***

**Net Loss:**

Net loss for 2001 was \$1,371,492 or \$1.16 loss per share as compared to a net loss of \$10,156,713 or \$12.70 loss per share in 2000.

Increased gross profit, a total dollar decrease in operating expenses and the recognition of the gain on the forgiveness of debt resulted in the significant decrease in the net loss for the year as compared to 2000. The net loss was increased by the write-off of deferred income taxes in 2001. The Company will have until 2008 to be able to apply unutilized tax losses against future taxable income.

**Net Sales:**

Net sales decreased by \$3,738,050 or by 31.11% to \$8,278,335 from \$12,016,385 for 2000. During the year, net sales decreased, however gross profit increased, as a result of the Company's emphasis on profitable sales and tighter inventory control. The current economic environment and retailers' just in time inventory practices contributed to the decrease in sales in 2001.

**Gross Profit:**

Gross profit for the Company increased by \$2,159,515. As a percentage of sales, gross profit increased from 3.10% to 30.58%. Despite the decrease in net sales, gross profit increased as a result of the sales mix in the product line.

The increased gross profit in 2001 resulted from the Company's continued emphasis on higher margin sales and minimized sales of discontinued products by tighter inventory control.

In addition commissions on FOB sales increased as compared to the same period of 2000 due to an increase in customer demand for our Toy Biz and Intex product lines. In 2000, the lower gross profit percentage was associated with the recording of significant inventory write-downs.

**General and Administrative Expenses:**

The decrease in general and administrative expenses of \$1,136,709 to \$2,879,974, in 2001, from \$4,016,683 in 2000, was due to an overall decrease in the expenses in this category, as a result of Company efforts to reduce expenses. However, the following material expenses offset the overall reduction:

Expense:

Legal fees	\$	
		\$ 318,536
Financing charges		203,080
Severance & placement fees		137,777
Consulting		92,790
Other		86,379
Total expenses	\$	

838,562

Due to the fact that the Company faced several legal issues (refer to Note 15 of the 2000 consolidated financial statements) at the beginning of 2001, legal expense was higher than the Company experienced in prior years. In addition, as a result of the Company's recurring losses, the financing charges are higher since the Company has only been able to obtain financing from a high risk lender which charges high rates. In an effort to down-size the organization, the Company was required to make severance payments. During March 2001, the Company engaged consultants to assist in the reorganization of the Company.

General and administrative expenses as a percentage of sales, were higher in 2001, a 1.36% increase, as compared to 2000 as a result of the lower sales base. The Company continues to conduct reviews of all aspects of its operations to reduce costs and improve profitability.

**Unusual Items:**

a) The Company, as a result of receiving a favorable court judgment in March 2001, reversed the accrual of \$550,000 set up in December 31, 2000. (see note 15 of the Consolidated Financial Statements)

b) The Company was successful in obtaining a settlement of litigation against Limited Treasures, Inc. in June 2001, and has reduced the provision against the receivable by \$288,102. At December 31, 2000, the Company had recorded a provision against the receivable of \$434,371. (See Note 3 of the Consolidated Financial Statements).

**Gain on forgiveness of debt:**

As a result of the cessation of the business of the Company's subsidiary, Ark Creations and the foreclosure of shares of the Company's common stock which were pledged to secure Ark Creation's indebtedness to the sellers of the assets of Ark Creations, the Company eliminated the liability associated with the promissory note in June 2001. The Company recognized \$1,195,123 as a gain on forgiveness of the debt equal to the difference between the principal amount of the promissory note and the value of the pledged shares. See Note 7 of the consolidated financial statements.

**Income Taxes**

(a) Current recovery:

The Company reversed \$149,538 in the third quarter of 2001 as a result of the determination that only one tax jurisdiction could recover taxes owing from the Company in a tax case which began in 1996. In the fourth quarter, the Company reversed the accrual of \$159,807 as a result of the successful resolution, in the Company's favor, of this tax case.

The Company recorded an expense of \$13,713 for U.S. tax liability.

(b) Deferred

The Company wrote off the following amounts during the year:

- June 2001 - \$499,585, resulting from utilization of losses to offset the gain on forgiveness of debt
- September 2001 - \$ 185,411, written off due to recurring losses in the US companies.

### ***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 from time to time supplemented those sources through the sales of equity securities.

In March 2001, the Company received gross proceeds of \$500,000 from a private sale of its Common Stock and warrants.

In June 2001, the Company secured a line of credit up to \$627,825 with drawdowns based upon specified percentages of its accounts receivable. The line of credit was secured by the accounts receivable of the Company.

At this time, based on 2003 forecasts, management believes that the current credit facility will be sufficient to meet the Company's working capital needs through at least December 31, 2003. In October 2001, the Company increased the maximum availability under its line of credit to \$1,569,563 with drawdowns based upon specified percentages of accounts receivable and inventory and the value of its equipment. All the assets of the Company secure the line of credit.

In December 2001, the Company issued Series B convertible redeemable preferred stock for a total of \$915,000 of which \$800,000 was received in December 2001, and the balance in January 2002.

In May 2002, the Company increased the maximum availability under its lines of credit to \$2,218,560 from \$1,569,563.

Accounts receivable at December 31, 2002 were \$1,866,110 compared to \$1,183,175 at December 31, 2001. The sales were mainly to mass retailers. Inventory at December 31, 2002 decreased to \$1,148,220 from \$1,373,094 at December 31, 2001. Management's focus on maintaining manageable and current inventory levels led to a lower inventory value as at December 31, 2002.

Working capital increased to \$1,574,709 at December 31, 2002 from \$1,111,171 at December 31, 2001. Net cash used for operating activities was \$1,115,683 in 2002 compared to \$1,461,657 in 2001. Cash for additions to equipment and leasehold improvements was \$20,161 in 2002 compared to \$39,151 in 2001.

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. Sources of such funding include cash flow from operations, drawings on the financing facilities, or sales of additional equity or debt securities by the Company.

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.

The company believe 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.

***Off-Balance Sheet Arrangements and Contractual Obligations***

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

<b>Contractual Obligations</b>	<b>1-3 years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Operating lease obligations	\$ 802,000	\$ 517,000	\$ 475,000

***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 that will come into effect in the year 2002 will not have a significant impact on the financial statements.

**Item 7a.**

**Quantitative and Qualitative Disclosures About Market Risk:**

The Company is exposed to certain market risks, which arise from transactions entered into in 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. The Company believes that its exposure is not significant.

**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 U.S. dollars, most transactions among the suppliers and subcontractors are effected in HK dollars. 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. 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 the conversion rate may have an impact on the Company. The Company may use derivative financial instruments solely to hedge the effects of such currency fluctuations.

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**Item 8.****Selected Quarterly Financial Data:**

For the fiscal year 2002:

	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
Net sales	\$ 2,262,806	\$3,419,749	\$ 3,244,053	\$ 3,413,322
Gross profit	817,535	1,270,833	1,236,070	691,952
Unusual items	-	-	-	-
(Loss) earnings from continuing operations	(538,696)	(91,079)	106,266	(500,629)
Discontinued operations	(31,768)	114,817	-	114,243
Net (loss) earnings applicable to common stockholders	(570,464)	23,738	106,266	(386,386)
(Loss) earnings per share:				
Basic from continued operations	\$ (0.39)	\$ (0.06)	\$ 0.04	\$ (0.19)
Diluted from continued operations	(0.39)	(0.03)	0.03	(0.19)
Basic from discontinued operations	(0.03)	0.08	-	0.04
Diluted from discontinued operations	(0.03)	0.04	-	0.04
Basic	(0.42)	0.02	0.04	(0.15)
Diluted	(0.42)	0.01	0.03	(0.15)

For the fiscal year 2001:

	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
Net sales	\$ 2,216,816	\$ 1,835,043	\$ 1,902,910	\$ 2,323,566
Gross profit	711,532	373,557	677,759	769,041
Unusual items	-	(523,395)	(214,089)	(100,617)
(Loss) earnings before extraordinary item	(467,118)	(741,343)	96,606	(715,178)

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Gain on forgiveness of debt	-	695,538	-	-
(Loss) earnings from continuing operations	(467,118)	145,550	96,606	(715,178)
Discontinued operations	(117,999)	(191,355)	(38,837)	(83,161)
Net (loss) earnings applicable to common stockholders	(585,117)	(45,805)	57,769	(798,339)
 (Loss) earnings per share:				
Basic and diluted from continuing operations	\$	\$	\$	\$
	(0.57)	(0.43)	0.08	(0.56)
Extraordinary item basic and diluted	-	0.54	-	-
Discontinued operations				
Basic and diluted	(0.15)	(0.15)	(0.03)	(0.06)
Basic	(0.72)	(0.04)	0.05	(0.62)
Diluted	(0.72)	(0.04)	0.05	(0.62)

**Financial Statements:**

The consolidated financial statements of the Company, including the notes thereto, together with the report of independent chartered accountants thereon, are presented beginning at page F-1.

#

**Item 9.**

**Changes in, and Disagreements with Accountants on Accounting and Financial Disclosure:**

Not applicable

**PART III**

**Item 10.**

**DIRECTORS AND DIRECTOR NOMINEES**

Set forth below is the name, age, principal occupation during the past five years and other information concerning each director and nominee. The information presented with respect to each director nominee has been furnished by that person.

<b>NAME</b>	<b>AGE</b>	<b>DIRECTOR SINCE</b>
Elliot Bier	52	July 1993
Stephen Altro	64	July 1993
David Mars	64	July 1993
James B. Rybakoff	35	May 1996
Michael Kron	39	June 2002
Earl Azimov	40	June 2002
Michael Seltzer	52	June 2002

**Elliot L. Bier** has been a practicing attorney in Montreal for the last 24 years. He has been a senior partner in Adessky Poulin, the Company's Canadian legal counsel for the last 10 years. Since November 16, 2000, Mr. Bier has served as Chairman of the Company. Since May 2001, Mr. Bier has served as the Chief Operating Officer of Polystar Inc., a Montreal-based plastics company.

**Stephen Altro** has held executive positions with Grand Canada, the Company's Canadian operating subsidiary, for over 41 years. From July 20, 1993 to June 30, 2000, Mr. Altro served as Chairman, President and Chief Executive

Officer of the Company. Mr. Altro co-founded Grand Canada with David Mars in 1961. Since June 30, 2000, Mr. Altro has been engaged as a consultant to the Company.

**David Mars** has held executive positions with Grand Canada for over 41 years. From July 20, 1993 to June 30, 2000, Mr. Mars served as Vice-Chairman of the Company. Mr. Mars co-founded Grand Canada with Stephen Altro in 1961. Since June 30, 2000, Mr. Mars has been engaged as a consultant to the Company.

**James B. Rybakoff** is also the President of Akin Bay Company, L.L.C., a NASD member investment bank and brokerage firm, which Mr. Rybakoff co-founded in 1990.

**Michael Kron** is co-founder and has served as Chief Operating Officer of Miazzi Ventures Inc., an investment company located in Montreal Canada since 1992. Mr. Kron is a Canadian Chartered Accountant.

**Earl Azimov** is co-founder and has served as Chief Executive Officer of Miazzi Ventures Inc., an investment company located in Montreal Canada since 1992. From 1992 to 1995, Mr. Azimov was President of Zellers Optical Centers.

**Michael Seltzer** Chairman of Sam Seltzer's Steak Houses of America since 1997. Since February 2002, Mr. Seltzer has also served as of President Sam Seltzer's Steak Houses of America.

Directors are elected annually by the shareholders and hold office until the next Annual Meeting and until their successors are elected and qualified. Executive officers are elected by and serve at the discretion of the Board of Directors. There are no family relationships among any of our directors and executive officers.

### **Director Compensation**

Directors who are also officers of the Company are not paid any compensation for attendance at directors' meetings or for attending or participating in any committee meetings but are eligible to participate in the Company's Stock Option Plan. Non-employee Directors of the Company are compensated for their services and attendance at meetings through the automatic grant of 125 options per quarter pursuant to the Company's Stock Option Plan. The exercise price of options granted to non-employees directors is the market price of the Company's common stock on the first day of each quarter.

During the year 2002, Elliott Bier received an amount of \$27,000 for chairman fees and Steve Altro and David Mars each received an amount of \$33,000 for consulting fees.

### **Meetings of the Board of Directors**

During the fiscal year ended December 31, 2002, the Board of Directors held six meetings and each of the Directors attended all of the meetings.

### **Audit Committee**

The Audit Committee consists of Michael Kron, Earl Azimov and Michael Seltzer. The Audit Committee (i) recommends to the Board the conditions, compensation and term of appointment of independent chartered accountants for the audit of our financial statements, (ii) reviews the Company's examination reports prepared by regulatory authorities, and (iii) provides the Board with such assistance as is necessary with respect to the Company's corporate and reporting practices. The Audit Committee may also from time to time confer with the auditors to exchange views relating to the scope and results of the audit. The Audit Committee operates through a written charter. During the fiscal year ended December 31, 2002, the Audit Committee did not hold any meetings, but took action by written consent two times.

### **Compensation Committee**

The Compensation Committee consists of three directors: Michael Kron, Earl Azimov and Michael Seltzer. The Compensation Committee reviews and approves the compensation for the Company's senior management, officers and directors. It also administers the Company's Stock Option Plan. During the fiscal year ended December 31, 2002, the Compensation Committee did not hold any meetings, but took action by written consent two times.

The Board of Directors does not have a standing nominating committee or one performing similar functions.

#

## Compensation Committee Interlocks and Insider Participation

Until June 28<sup>th</sup>, 2002, Elliot L. Bier and James B. Rybakoff served as the members of the Company's Compensation Committee. None of the members of the Company's Compensation Committee was, during the fiscal year ended December 31, 2002, one of our officers or employees, or one of our former officers, except that Mr. Bier served as our Chairman in a non-employee capacity. Other than as described in the preceding sentence, no executive officer of the Company (i) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served on the Company's Compensation Committee, (ii) served as a director of another entity, one of whose executive officers served on the Company's Compensation Committee or (iii) served as a member of the compensation committee (or other board committee performing similar functions or, in the absence of any such committee, the board of directors) of another entity, one of whose executive officers served as a director of the Company.

## EXECUTIVE OFFICERS AND KEY EMPLOYEES

### Executive Officers

Our executive officer is:

Tania M. Clarke                      Executive Vice President and Chief Financial Officer

Tania M. Clarke, 34 years old, has served as the Executive Vice-President and Chief Financial Officer of the Company and Grand Canada since December 4, 2000, and has been employed by the Company and its subsidiaries in various other financial capacities since May 3, 1993. Ms. Clarke held the positions of Assistant-Controller and Controller prior to accepting the position of Executive Vice-President and Chief Financial Officer at the Company. Prior thereto, Ms. Clarke was employed by KPMG LLP, as an external auditor for 3 years. Ms. Clarke is a Canadian Chartered Accountant (C.A.) and a U.S. Certified Public Accountant (C.P.A.).

### Key Employees

Our management regards the following persons, although not executive officers, as key employees:

**Robert Herbst** has been the Vice-President of Operations of Grand Canada since May 2001. Prior thereto, Mr. Herbst worked at Grand Canada in various capacities for 26 years.

**Terry Maddison** has been the Director of Sales for Grand Canada since October 10, 2001. Prior thereto Mr. Maddison worked at Tucker Plastics and the Home Depot.

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**Item 11.****Executive Compensation**

The following table summarizes certain information regarding compensation awarded, paid or accrued by the Company for the fiscal years ended December 31, 2000, 2001 and 2002, respectively, to Ian Bradley who was the only person to serve as the Company's Chief Executive Officer during the year ended December 31, 2002. No other executive officer or key employee who served in such capacity at December 31, 2002 had total annual salary and bonus for the year ended December 31, 2002, 2001 and 2000 in excess of \$100,000.

**Summary Compensation Table**

Name and Principal Position	Year	Annual Compensation			Long-term Compensation Awards	
		Salary (\$)	Bonus(\$)	Other Annual Compensation (\$)	Securities Underlying Options (#)	All Other Compensation (\$)
Stephen Altro Acting President and Chief Executive Officer (1)	2002	33,000 (3)	-	-	-	-
	2001	34,000 (4)	-	-	-	-
	2000	102,000 (5)	-	46,000 (8)	-	-
Ian Bradley Chief Executive Officer and President (2)	2002	82,711 (3)	-	6,600 (6)	-	-
	2001	112,051 (4)	-	10,500(7)	37,500	-
	2000	-	-	-	-	-

1)

Mr. Stephen Altro has been the Company's acting President since June 8, 2002.

2)

Mr. Bradley joined the Company on January 16, 2001, and resigned on June 7, 2002.



3)

Such amounts are based upon an exchange rate Canadian \$1.57 to United States \$1.00 (the exchange rate on December 31, 2002).

4)

Such amounts are based upon an exchange rate Canadian \$1.55 to United States \$1.00 (the exchange rate on December 31, 2001).

5)

Such amounts are based upon an exchange rate Canadian \$1.48 to United States \$1.00 (the exchange rate on December 31, 2000).

6)

Other annual compensation for Mr. Bradley consists of \$4,000 for car benefits and \$2,600 disability insurance.

7)

Other annual compensation for Mr. Bradley consists of \$6,000 for car benefits and \$4,500 disability insurance.

8)

Other annual Compensations for Mr. Altro consists of \$14,000 for car lease payments, \$12,000 for annual country club dues and \$20,000 for life insurance premiums.

The following table sets forth further information regarding the stock option grants during fiscal 2002 to the officers named in the Summary Compensation Table above.

#### **Option Grants in 2002**

No options were granted to the Executives named in the Summary Compensation table above.

#### **Aggregated Option Exercises in Fiscal Year 2002 and Option Values as of December 31, 2002**

Mr. Bradley did not exercise any options during the year ended December 31, 2002.

The following table provides information about stock option exercises by the Named Executive Officers during fiscal year 2002 and stock options held by each of them at fiscal year-end. Values for "in-the-money" options that represent the positive spread between the respective exercise prices of outstanding stock options and the fair market value of our common stock as of December 31, 2002, as determined by the closing price of our Common Stock on that date as reported by NASDAQ.

Name	Shares Acquired On Exercise	Value Realized (\$)	Value of Unexercised			
			Number of Securities Underlying Unexercised Options at Fiscal Year-End		In-the-Money Options At Fiscal Year-End	
			Exercisable (#)	Unexercisable (#)	Exercisable (2) (\$)	Unexercisable (\$)
Ian Bradley	-	-	37,500	-	\$93,750	-

2)

Closing stock price on December 31, 2002 was \$1.00.

### Employment Agreements

Except for stock option agreements, the Company does not currently have any agreements with its executive officers regarding the terms of their employment.

### Compensation Committee Report on Executive Compensation

*General.* The Compensation Committee is composed of non-employee Directors who review recommendations as to senior executive officer compensation which, upon the approval of the Compensation Committee, are submitted to the Board of Directors. The members of the Compensation Committee also administer the Stock Option Plan of the Company under which options have been granted on a discretionary basis to senior executive officers. The Compensation Committee's overall compensation policy applicable to executive officers is to provide a compensation package that is intended to attract and retain qualified executives for us and to provide them with incentives to achieve our goals and increase shareholder value. The Compensation Committee implements this policy through salaries, bonuses, stock options, a retirement savings plan, and employment agreements and miscellaneous personal benefits.

*CEO Compensation.* Mr. Bradley was employed as Chief Executive Officer and President, and had agreed to devote his full time and efforts to our business. We agreed to pay Mr. Bradley a base salary of Canadian \$182,500 (approximately U.S. \$116,000 as of December 31, 2002). Mr. Bradley resigned on June 7, 2002.

*Salaries.* The Compensation Committee's policy is to provide salaries (i) that are approximately at the median of the salaries paid to similar executive officers in similar companies, adjusted in the Compensation Committee's subjective judgment to reflect differences in duties of the officers and differences in the size and stage of development of the companies, in order to attract and retain qualified executives and (ii) that compensate individual employees for their individual contributions and performance.

The Compensation Committee determines comparable salaries paid by other companies similar to us through its subjective evaluation of its members' knowledge of salaries paid by other companies, salary requests of individuals interviewed by us for open positions and recommendations of management.

*Bonuses.* The Compensation Committee's policy is to recommend bonuses that compensate executive officers for achieving our goals. In addition, the Compensation Committee's policy is to pay discretionary bonuses, determined near the end of the fiscal year, to compensate executive officers for performance or achievements during the fiscal year not covered by bonuses paid earlier in the year.

*Stock Options.* The Compensation Committee's policy is to award stock options to each of our officers, employees and directors in amounts reflecting the participant's position and ability to influence our overall performance, determined based on the Committee's subjective judgment after reviewing the number of options previously granted to such person, the number of options granted to persons in similar positions both with us and at other companies deemed comparable to us (based on the members' knowledge of options granted by other companies), the number of options remaining available for grant and management's recommendations.

Options are intended to provide participants with an increased incentive to make contributions to our long-term performance and growth, to join the interests of participants with the interests of our shareholders and to attract and retain qualified employees. The number of options granted to an executive in 2002 were granted as an inducement for employment.

The Compensation Committee's policy is to grant options with a term of ten years to provide a long-term incentive and to fix the exercise price of the options at the fair market value of the underlying shares on the date of grant. Such options only provide compensation if the price of the underlying shares increases. The Committee's policy is also to provide new executives with options to attract them to us based on negotiations with new executives, management's recommendations and the Committee's subjective judgment primarily after reviewing the number of options granted to similar executives.

Section 162(m) of the Internal Revenue Code of 1986, as amended, generally provides that publicly held companies may not deduct compensation paid to certain of its top executive officers to the extent such compensation exceeds \$1 million per officer in any year. However, pursuant to regulations issued by the Treasury Department, certain limited

exemptions to Section 162(m) apply with respect to "qualified performance-based compensation." The Company is currently monitoring the applicability of Section 162(m) to its ongoing compensation arrangements. The Company does not expect that amounts of

compensation paid to its executive officers will fail to be deductible by reason of Section 162(m).

*Retirement Savings Plan.* We have adopted a group retirement savings plan for our Canadian employees. We contribute to this plan the lesser of (a) 50% of the employee's contribution to this plan; (b) 3% of the employee's gross earnings; or (c) Canadian \$3,000 per employee. During the year ended December 31, 2002, we contributed approximately \$12,000 to the plan.

*Employment Agreements and Miscellaneous Personal Benefits.* The Compensation Committee's policy has been to have employment agreements with each of its executive officers to provide them with specified minimum positions, periods of employment, salaries, fringe benefits and severance benefits, although there are no agreements at this time. These benefits are intended to permit the executive officer to focus his attention on performing his duties to us, rather than on the security of his employment, and to provide the officer with benefits deemed by the Compensation Committee to be suitable for the executive's office.

This report is provided in accordance with federal securities law requirements and is not intended to create any contractually binding employment rights for the benefit of any employee of the Company or its subsidiaries.

By the Compensation Committee

James B. Rybakoff

Michael Kron

#

## Performance Graph

The following graph tracks an assumed investment of \$100 on the last trading day of the calendar year indicated below in our Common Stock, the NASDAQ Stock Market and the NASDAQ Non-Financial Stocks sector, assuming full reinvestment of dividends. *Past performance is not necessarily indicative of future performance.*

## Section 16(a) Beneficial Ownership Reporting Compliance

The directors and executive officers of the Company, and the owners of more than ten (10%) percent of the Company's outstanding Common Stock, are required to file reports with the Securities and Exchange Commission and with NASDAQ, reporting changes in the number of shares of the Company's Common Stock beneficially owned by them and provide the Company with copies of all such reports. Based solely on its review of the copies of such reports furnished to the Company and written representations from the executive officers and directors, the Company believes that all reports were timely made for the year ended December 31, 2002, with the exception of the following:

During the fiscal 2002, the following individuals were late with their Form 4 filings: Each of Messrs. Elliot Bier, Stephen Altro, David Mars, James B. Rybakoff, Michael Kron, Earl Azimov and Michael Seltzer were required to file a Statement of Changes in Beneficial Ownership in connection with automatic grants of 125 options per quarter to non-employee directors of Registrant pursuant to the Company's Stock Option Plan. As of the date of this report, none of the foregoing persons has filed a Form 4 receipt of the automatic quarterly option grants.

## Item 12.

### Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding beneficial ownership of the Company's common stock as of January 15, 2003 by (i) each person (or group of affiliated persons) who is known by the Company to own beneficially more than 5% of the outstanding shares of the Company's common stock, (ii) each of the Company's directors and director nominees, (iii) each of the Company's Named Executive Officers (as defined below) and (iv) all of the Company's executive officers and directors as a group. Except as indicated in the footnotes to this table, the Company believes that the persons named in this table have sole voting and investment power with respect to such shares.

Name and Address of Beneficial Own-er	Number of Shares Beneficially Owned	Percent of Class and Voting Power (1)
<p><b>David Mars</b> 1710 Rte. Transcanadienne Dorval, QC, Canada H9P 1H7</p>	916,606 (2)	27.45%
<p><b>Stephen Altro</b> 1710 Rte. Transcanadienne Dorval, QC, Canada, H9P 1H7</p>	930,768 (3)	27.60%
<p><b>Ofer Nissim</b> 65 High Ridge Road, Suite 500 Stanford, CT, 06905</p>	406,250(4)	15.00%
<p><b>R. Ian Bradley</b> 1710 Rte. Transcanadienne Dorval, QC, Canada, H9P 1H7</p>	300,000 (5)	10.27%
<p><b>Livescore Finance Company Ltd.</b> C/o Insinger Trust Standard Charter Bank Bld.,</p>		

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4-4A Des Voeux, Hong Kong <b>Robenham Inc.</b>	472,500 (6)	15.44%
C/o Insinger Trust		
Standard Charter Bank Bld.,		
4-4A Des Voeux, Hong Kong <b>Faxfleet Holdings Ltd.</b>	472,500 (7)	15.44%
C/o Insinger Trust		
Standard Charter Bank Bld.,		
4-4A Des Voeux, Hong Kong <b>Spellord Inc.</b>	452,500 (8)	14.86%
C/o Insinger Trust		
Standard Charter Bank Bld.,		
4-4A Des Voeux, Hong Kong <b>James B. Rybakoff</b>	452,500 (9)	14.86%
780 Third Avenue		
New York, NY 10017	56,750 (10)	2.06%
<b>Elliot L. Bier</b>	37,750 (11)	1.38%
999 Boul. de Maisonneuve Ouest		
Montreal, QC, Canada H3A 3L4 <b>Michael Kron</b>		
6950 Cote-St Luc Rd., #1111		
Montreal, QC, Canada H4V 2Z9 <b>Earl Azimov</b>	375	-
5603 Parkhaven Avenue		
Cote St-Luc, QC, Canada H4W 1X2 <b>Michael Seltzer</b>	375	-
10101 Collins Ave., Pent. #14		
Bal Harbour, FL 33514 <b>All Executive officers and directors</b>	375	-

**as a group (five persons)**

4,371,749 (12)

75.66%

1)

Computed on the basis of 2,696,112 shares of Common Stock and, with respect to those persons holding shares of Series B Convertible Redeemable Preferred Stock, warrants or options to purchase Common Stock exercisable within sixty (60) days, the number of shares of Common Stock that are issuable upon the exercise thereof.

1)

Includes 457,144 shares and warrants held by 136012 Canada Inc. (controlled by Mr. Mars), 145,962 shares and warrants held by 2884330 Canada Inc., and 313,500 shares, warrants and options to purchase Common Stock held by Mr. Mars. The company, 2884330 Canada Inc., is a privately held corporation controlled by Mr. Mars, and of which his wife and children are the only other stockholders.

2)

Includes 302,054 shares and warrants held by 2870304 Canada Inc., 323,714 shares and warrants held by 136011 Canada Inc. (controlled by Mr. Altro), and 305,000 shares, warrants and options to purchase commons stock held by Mr. Altro. The company, 2870304 Canada Inc., is a privately-held corporation controlled by Mr. Altro, and of which his wife and children are the only other stockholders.

3)

Includes options to purchase 12,500 shares of Common Stock. Mr. Nissim's holding of 393,750 shares is held indirectly through Knox Security Engineering Corp. and Ark Foundation LLC.

4)

Represents 75,000 shares and 225,000 warrants to purchase Common Stock issuable upon conversion of our Series B Convertible Redeemable Preferred Stock.

5)

Includes 42,500 warrants to purchase Common Stock and 107,500 shares and 322,500 warrants to purchase Common Stock issuable upon conversion of our Series B Convertible Redeemable Preferred Stock.

6)

Includes 42,500 warrants to purchase Common Stock and 107,500 shares and 322,500 warrants to purchase Common Stock issuable upon conversion of our Series B Convertible Redeemable Preferred Stock.

7)

Includes 42,500 warrants to purchase Common Stock and 102,500 shares and 307,500 warrants to purchase Common Stock issuable upon conversion of our Series B Convertible Redeemable Preferred Stock.

8)



Includes 42,500 warrants to purchase Common Stock and 102,500 shares and 307,500 warrants to purchase Common Stock issuable upon conversion of our Series B Convertible Redeemable Preferred Stock.

9)

Includes warrants to purchase 55,000 shares of Common Stock issuable to Akin Bay Company LLC pursuant to that certain Warrant Agreement dated August 1999, and options to purchase 1,750 shares of Common Stock issued pursuant to our Stock Option Plan. Mr. Rybakoff is the controlling member of Akin Bay.

10)

Includes options to purchase 37,750 shares of Common Stock .

11)

See Footnotes (1) (11).

### **Item 13.**

#### **Certain Business Relationships and Related Transactions**

Mr. Bier, a Director of the Company, is a senior partner at Adessky, Poulin, which performs legal services for us in Canada. During the fiscal year ended December 31, 2002, we paid Adessky, Poulin an aggregate of \$21,000 for legal fees and related disbursements.

Grand Toys (H.K.), an affiliate of the Company owned by Mr. Altro and Mr. Mars, assists the Company in obtaining competitive sourcing of products in Asia. All transactions of Grand Toys (H.K.) are performed on behalf of the Company at cost. The dollar value of the transactions was \$121,000 for the year ended December 31, 2002 and \$155,000 for the year ended December 31, 2001.

In December 2001, David Mars and Stephen Altro purchased shares of Series B Convertible Redeemable Preferred Stock. David Mars invested \$195,000 and received 195,000 shares at \$1.00 each and 585,000 warrants to purchase Common Stock at an exercise price of \$0.01 each. In March 2002, Mr. Mars invested an additional \$200,000 and received 200,000 shares at \$1.00 each and 600,000 warrants to purchase Common Stock at an exercise price of \$0.01 each. Stephen Altro invested \$200,000 and received 200,000 shares at \$1.00 each and 600,000 warrants to purchase Common Stock at an exercise price of \$0.01 each.

The terms of these transactions are as favorable to the Company as could be obtained with unrelated third parties.

## **PART IV**

### **Item 14.**

#### **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 fourth quarter of the fiscal year ended December 31, 2002 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

### **Item 15.**

#### **Financial Statements, Exhibits and Reports on Form 8-K**

(a) Financial Statements:

Report of Independent Auditors

Index to Financial statements

Consolidated Financial Statements:

Consolidated Balance Sheets - December 31, 2002 and December 31, 2001

Consolidated Statements of Operations for the Years Ended December 31, 2002, 2001 and 2000

Consolidated Statements of Stockholders' Equity and Comprehensive Income for the Years Ended December 31, 2002, 2001 and 2000

Consolidated Statements of Stockholders' Equity and Comprehensive Income for the Years Ended December 31, 2002, 2001 and 2000

Consolidated Statements of Cash Flows for the Years Ended December 31, 2002, 2001, and 2000

Notes to Consolidated Financial Statements

Consents of Independent Auditors to incorporation by reference of financial statements

## Exhibits

The exhibits were filed with the original filing

**3.1	Articles of Incorporation, as amended
### 3.2	Certificate of Designations of Series A 5% Cumulative Convertible Redeemable Preferred Stock
***3.3	Amended and Restated By-Laws
***3.4	Certificate of Amendment for Reverse Split
#####3.5	Certificate of Amendment for Reverse Split (2001)
#####3.6	Certificate of Designation of Series B Convertible Redeemable Preferred Stock
#####3.7	Form of Warrant for 1201 Private Placement
**4.1	Form of certificate evidencing shares of Common Stock
####4.3	Form of Common Stock Warrant
####4.4	Form of Regulation S Common Stock Subscription Agreement
#####4.5	Form of Regulation S Preferred Stock Subscription Agreement
#10.3	Amended and Restated 1993 Stock Option Plan

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####10.9	Lease of Dorval, Canada facility
####10.10	Lease of Mississauga, Canada facility
#####10.14	Factoring Agreement between Montcap Financial and Grand
#####10.15	Inventory and Equipment Loan Agreement between Montcap Financial and Grand
#####10.16	Limited Treasures Settlement Agreement
#####10.17	Nissim Settlement Agreement
*11	Valuation and Qualifying Accounts and Allowances
*21	List of Subsidiaries of the Company
*23	Consent of KMPG LLP
*99.1	Certification of Stephen Altro pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*99.2	Certification of Tania M. Clarke pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*99.3	Certification of Principal Executive Officer pursuant to 18 U.S.C. 1350, Section 906 of the Sarbanes-Oxley Act of 2002.
*99.4	Certification of Principal Financial Officer pursuant to 18 U.S.C. 1350, Section 906 of the Sarbanes-Oxley Act of 2002.

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Legend:

*	Filed herewith
**	Filed as an Exhibit to either the company's Registration Statement (the Registration Statement) on Form SB-2, dated January 27, 1994, or Amendment No. 1 or Amendment No. 2 to such Registration Statement.
***	Filed as an Exhibit to the Company's Registration Statement of Form S-3 dated December 23, 1996.
****	Filed as an Exhibit to the Company's Registration Statement of Form S-3 dated January 26, 2002.
#	Filed as an Exhibit to the Company's Registration Statement on Form 8-A dated September 7, 1993 and incorporated herein by reference.
##	Filed as an Exhibit to the Company's Proxy Statement on Form Pre 14A dated August 3, 2000.
###	Filed as an Exhibit to the Company's 10-K for the year ended December 31, 1998.

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#### Filed as an Exhibit to the Company s 10-K for the year ended December 31, 2000.

##### Filed as an Exhibit to the Company s 10-K for the year ended December 31, 2001.

(a)

Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended December 31, 2002.

#

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**Exhibits to**

**Form 10 K**

**of**

**GRAND TOYS INTERNATIONAL, INC.**

**For the Fiscal Year Ended December 31, 2002**

**#**

## Schedule 11

## VALUATION AND QUALIFYING ACCOUNTS AND ALLOWANCES

Balance At Beginning Of Year	Additions Charged to Operations	Net Deductions (a)	Balance At End Of Year
Allowance for Doubtful Accounts:			
Year Ended December 31, 2002	\$ 12,556	\$ 34,785	\$ (34,664) 12,677
Year Ended December 31, 2001		24,008	147,438 (158,890) 12,556
Year Ended December 31, 2000		90,805	94,072 (160,869) 24,008
Provision for Loan Receivable:			
Year Ended December 31, 2002	\$ -	\$ -	\$ -
Year Ended December 31, 2001	-	434,371	(434,371) \$
Year Ended December 31, 2000		-	434,371 - 434,371

(a)

Includes write-offs, recoveries of previous write-offs and currency translation adjustments.

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# Exhibit 21

The following is a list of the Company's subsidiaries:

**Grand Toys (U.S.) Ltd.**

**Grand Toys Ltd.**

**Grand Concepts, Inc.** (dissolved on January 29, 2002)

**Ark Creations, Inc.** (ceased operations in 2000)

**Sababa Toys, Inc.** (sold on June 14, 2002)

#

**Exhibit 99.1**

**Certification of Principal Executive Officer**

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

1. I have reviewed this annual report on Form 10-K of Grand Toys International, Inc.
  
2. Based on my knowledge, this annual 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 year covered by this annual report;
  
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the years presented in this annual report;
  
4. The registrant's other certifying officers 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 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 annual report is being prepared;
  
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, 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 in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Stephen Altro  
Stephen Altro

Date: March 31, 2003

#

**Exhibit 99.2**

**Certification of Principal Financial Officer**

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

1. I have reviewed this annual report on Form 10-K 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 year covered by this annual report;
  
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the years presented in this annual report;
  
4. The registrant's other certifying officers 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 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 annual report is being prepared;
  
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, 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 in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Tania M. Clarke

Tania M. Clarke

Date: March 31, 2003

#

**Exhibit 99.3**

**Certification of Principal Executive Officer**

**Pursuant to 18 U.S.C. 1350**

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

I, Stephen Altro, Interim President and Chief Executive Officer (principal executive officer) of Grand Toys International, Inc. (the Registrant ), certifies that to the best of my knowledge, based upon an audit of the Annual Report on Form 10-K for the year ended December 31, 2002 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:

March 31, 2003

#

**Exhibit 99.4**

**Certification of Principal Financial Officer**

**Pursuant to 18 U.S.C. 1350**

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

I, Tania Clarke, Chief Financial Officer (principal financial officer) of Grand Toys International, Inc. (the Registrant ), certifies that to the best of my knowledge, based upon an audit of the Annual Report on Form 10-K for the year ended December 31, 2002 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:

March 31, 2003

#

**GRAND TOYS INTERNATIONAL, INC.**

Signatures Years ended December 31

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: March 31, 2003

**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)

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/ Elliot Bier Elliot Bier	Chairman and Director	April 23, 2004
/s/ Tania M. Clarke Tania M. Clarke	Executive Vice President and CFO (Principal Financial and Accounting Officer)	April 23, 2004



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/s/ James Rybakoff                      Director                                      April 23, 2004  
James Rybakoff

/s/ David Mars                              Director                                      April 23, 2004  
David Mars

/s/ Stephen Altro                          Director                                      April 23, 2004  
Stephen Altro

/s/Michael Kron                          Director                                      April 23, 2004  
Michael Kron

/s/Earl Azimov                              Director                                      April 23, 2004  
Earl Azimov

/s/Michael Seltzer                          Director                                      April 23, 2004  
Michael Seltzer

Consolidated Financial Statements of

**GRAND TOYS INTERNATIONAL, INC.**

Years ended December 31, 2002, 2001 and 2000

## INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders  
Grand Toys International, Inc.

We have audited the consolidated balance sheets of Grand Toys International, Inc. as at December 31, 2002 and 2001 and the consolidated statements of operations, stockholders' equity and comprehensive income and cash flows for each of the years in the three-year period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Grand Toys International, Inc. and subsidiaries as at December 31, 2002 and 2001 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in note 1 (a) to the consolidated financial statements, the Company has suffered recurring losses, which raise substantial doubt about its ability to continue as a going concern. These consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/S/ KPMG LLP

Chartered Accountants

Montréal, Canada

March 7, 2003



**GRAND TOYS INTERNATIONAL, INC.**

Consolidated Financial Statements

Years ended December 31, 2002, 2001 and 2000

**Financial Statements**

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**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Balance Sheets

Years ended December 31, 2002, 2001 and 2000

	2002	2001
<b>Assets</b>		
Current assets:		
Cash	\$ 540,896	\$ 431,903
Short-term deposit (note 16(b))	500,000	250,000
Accounts receivable (net of allowance for doubtful accounts of \$12,677; 2001 - \$12,556)	1,866,110	1,183,175
Current portion of loan receivable (note 2)	212,739	194,494
Due from employees	7,595	2,034
Income taxes receivable	-	143,668
Inventory	1,148,220	1,373,094
Prepaid expenses (note 3)	451,027	698,597
Net assets of discontinued operations (note 12)	-	266,828
Total current assets	4,726,587	4,543,793
Note receivable (note 12)	884,877	-
Loan receivable (note 2)	335,981	548,721
Equipment and leasehold improvements, net (note 5)	252,854	333,423
Other assets (note 4)	44,168	133,827
Other assets of discontinued operations (note 12)	-	129,461
Total assets	\$ 6,244,467	\$ 5,689,225



	2002	2001
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Bank indebtedness (note 6)	\$1,671,641	\$1,062,039
Trade accounts payable	880,028	1,483,506
Other accounts payable and accrued liabilities	335,157	297,470
Shortfall on share conversions (note 7)	-	581,310
Royalties payable	15,052	8,297
Loan payable to a director (note 16 (b))	250,000	-
Total current liabilities	3,151,878	3,432,622
Deferred gain (note 12)	497,800	-
Minority interest	100	100
Stockholders' equity:		
Capital stock (note 8):		
Voting common stock, \$0.001 par value:		
12,500,000 shares authorized,		
2,762,698 shares issued and outstanding		
(2001 1,285,119 shares)	2,763	1,285
Series B preferred stock, \$0.001 par value:		
915,000 shares authorized,		
nil shares issued and outstanding		
(2001 915,000 shares)	-	800
	2,763	2,085
Additional paid-in capital	22,634,617	21,496,788
Deficit	(19,080,756)	(18,253,908)
Accumulated other comprehensive income-		
cumulative currency translation adjustment	(961,935)	(988,462)
	2,594,689	2,256,503
Commitments and contingencies (notes 15 and 16)		
Total liabilities and stockholders' equity	\$	\$
	6,244,467	5,689,225



See accompanying notes to consolidated financial statements.

On behalf of the Board:

\_\_\_\_\_ Director

\_\_\_\_\_ Director

**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Statements of Operations

Years ended December 31

	2002	2001	2000
Net sales	\$ 12,339,930	\$ 8,278,335	\$ 12,016,385
Cost of goods sold	8,323,540	5,746,446	11,644,011
Gross profit	4,016,390	2,531,889	372,374
Other costs and expenses:			
General and administrative	2,856,116	2,879,974	4,016,683
Salaries and fringe benefits	1,684,114	1,685,409	2,075,736
Royalties	311,082	252,506	250,523
Bad debt expense	34,785	147,438	94,072
Depreciation and amortization	89,690	116,361	282,386
Foreign exchange loss	40,894	88,270	26,667
Interest on long term debt	-	-	109,800
Other interest expense	80,030	47,271	778,305
Interest revenue	(70,287)	(101,339)	(134,072)
Unusual items (note 10)	-	(838,102)	3,625,055
	5,026,424	4,277,788	11,125,155
Loss before income taxes and extraordinary item	(1,010,034)	(1,745,899)	(10,752,781)
Income tax recovery (expense) (note 11):			
Current	(14,106)	295,632	763,961
Deferred	-	(185,411)	-
	(14,106)	110,221	763,961
Loss before extraordinary item	(1,024,140)	(1,635,678)	(9,988,820)
Extraordinary item:			
Gain on forgiveness of long-term debt net of deferred income taxes of 499,585 (note 7)	-	695,538	-

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Loss from continuing operations	\$	\$	\$
	(1,024,140)	(940,140)	(9,988,820)
Discontinued operations (note 12)			
Gain on sale of discontinued operations	263,784	-	-
Loss from discontinued operations	(66,492)	(431,352)	(167,893)
	197,292	(431,352)	(167,893)
Net loss	(826,848)	(1,371,492)	(10,156,713)
Preferred stock dividends	-	-	(31,250)
Net loss applicable to common stockholders	\$	\$	\$
	(826,848)	(1,371,492)	(10,187,963)
Earnings per share (notes 1 (i) and 13):			
Basic and diluted from continuing operations	\$	\$	\$
	(0.50)	(1.38)	(12.49)
Extraordinary item-basic and diluted	-	0.59	-
Discontinued operations-basic and diluted	0.10	(0.37)	(0.21)
Basic	(0.40)	(1.16)	(12.70)
Diluted	(0.40)	(1.16)	(12.70)

See accompanying notes to consolidated financial statements.

**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Statements of Stockholders' Equity and Comprehensive Income

Years ended December 31

	Capital Stock		Additional paid in capital	Deficit	Accumulated other comprehensive income	Total
	Preferred	Common				
January 1, 2000	\$1,000,000	\$3,135	\$19,314,677	(6,725,703)	\$ (588,326)	\$13,003,783
Net loss for the year	-	-	-	(10,156,713)	-	(10,156,713)
Foreign currency adjustment	-	-	-	-	(282,562)	(282,562)
Total comprehensive income						(10,439,275)
Share conversions	(500,000)	100	499,900	-	-	-
Shortfall on share conversions	-	-	(118,000)	-	-	(118,000)
December 31, 2000	500,000	\$3,235	\$19,696,579	(16,882,416)	\$(870,888)	\$2,446,508
Net loss for the year	-	-	-	(1,371,492)	-	(1,371,492)
Foreign currency adjustment	-	-	-	-	(117,574)	(117,574)
Total comprehensive income						(1,489,066)
Share conversions (note 8(c))	(500,000)	100	499,900	-	-	-
Shortfall on share conversions (note 7)	-	-	(463,310)	-	-	(463,310)
Share issuance in settlement of long- term debt (notes 7 and 8(c))	-	375	304,312	-	-	304,687
Private Sale of common stock (note 8 (c))	-	1,428	498,572	-	-	500,000
Reverse stock split (note 8)	-	(3,854)	3,854	-	-	-
Stock options (note 8 (c))	-	1	682	-	-	683
Private sale of preferred stock (note 8 (c))	800	-	799,200	-	-	800,000

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Compensation expense (note 9)	-	-	157,001	-	-	157,001
December 31, 2001	800	\$1,285	\$21,496,788	\$(18,253,908)	\$ (988,462)	\$2,256,503
Net loss for the year	-	-	-	(826,848)	-	(826,848)
Foreign currency adjustment	-	-	-	-	26,527	26,527
Total comprehensive income						(800,321)
Share issuance in settlement of shortfall on share conversions (note 8 (c))	-	242	581,068	-	-	581,310
Private sale of preferred stock (note 8 (c))	115	-	114,885	-	-	115,000
Conversion of preferred stock(note 8(c))	(915)	915	-	-	-	-
Share issuance in settlement of consulting fees (note 8(c))	-	58	61,196	-	-	61,254
Share issuance in settlement of outstanding legal fees (note 8(c))		186	213,447	-	-	213,633
Share issuance in settlement of outstanding payables (note 8 (c))		77	112,906	-	-	112,983
Compensation expense (note 9)		-	54,327	-	-	54,327
December 31, 2002	-	\$2,763	\$22,634,617	\$(19,080,756)	\$(961,935)	\$2,594,689

See accompanying notes to consolidated financial statements.



**GRAND TOYS INTERNATIONAL, INC.**

## Consolidated Statements of Cash Flows

Years ended December 31

	2002	2001	2000
Cash flows from operating activities:			
Net loss from continuing operations	\$(1,024,140)	\$(940,140)	\$(9,988,820)
Adjustments for:			
Depreciation and amortization	89,690	116,361	495,105
Amortization of prepaid royalties	20,281	-	-
Consulting fees	61,254	-	-
Compensation expense	25,281	68,735	-
Gain on forgiveness of long term debt	-	(1,195,123)	-
Deferred income taxes	-	684,996	-
(Reduction of ) provision for loan receivable	-	(288,102)	434,371
Amortization of product development costs	77,101	19,896	-
Write-off of product development costs	21,715	-	-
Write-off of intangibles	-	-	2,253,516
Write-off of deferred acquisition costs	-	-	123,168
Write-off of deferred financing costs	-	-	535,109
Write-down of inventory	-	-	1,861,681
Loss on disposal of equipment	13,034	-	3,470
Net change in operating working capital items (note 14)	(388,077)	752,968	6,712,943
Net cash (used for) provided by operating activities from continuing operations	(1,103,861)	(780,409)	2,430,543
Net cash used for operating activities from discontinued operations	(11,822)	(681,248)	(149,723)
Net cash (used for) provided by operating activities	(1,115,683)	(1,461,657)	2,280,820
Cash flows from financing activities:			
Increase (decrease) in bank indebtedness	603,764	1,037,722	(426,299)
Proceeds of loan payable to a director	250,000	-	-
Increase in deferred financing charges	-	-	(26,460)
Decrease in long term debt	-	-	(444,444)
Share issuance proceeds (note 8 (c))	115,000	1,300,683	-
(Increase) decrease in due from employees and affiliated company	(5,568)	37,187	(5,047)
Other	16,607	-	278
Net cash provided by (used for) financing activities	979,803	2,375,592	(901,972)
Cash flows from investing activities:			
Purchase of short-term deposit	(250,000)	(250,000)	-

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Loan receivable	194,495	(177,739)	(1,052,169)
Proceeds of note receivable	180,839	-	-
Decrease (increase) in other assets	110,926	(20,742)	-
Additions to equipment and leasehold improvements	(20,161)	(39,151)	(114,471)
Increase in product development costs	(9,987)	(95,024)	-
Proceeds on disposal of equipment	1,274	-	25,422
Net cash provided by (used for) investing activities from continuing operations	207,386	(582,656)	(1,141,218)
Net cash provided by (used for) investing activities from discontinued operations	37,487	(110,891)	(26,115)
Net cash provided by (used for) investing activities	244,873	(693,547)	(1,167,333)
Net increase in cash and cash equivalents	108,993	220,338	211,515
Cash and cash equivalents, beginning of year	431,903	211,515	-
Cash and cash equivalents, end of year	\$540,896	\$431,903	\$211,515

*See accompanying notes to Consolidated Financial Statements*



## **GRAND TOYS INTERNATIONAL, INC.**

### Notes to 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)

##### **Basis of presentation:**

The accompanying financial statements have been prepared on a going concern basis which contemplates continuity of operations, realization of assets and liquidation of liabilities in the ordinary course of business and do not reflect adjustments that might result if the Company cannot continue as a going concern. The Company incurred operating losses in fiscal 2000 and 2001 primarily as a result of the loss of one of its major product lines and the reduced market demand for certain other products. In 2002, the company increased its credit facility, reduced its losses, and implemented a restructuring plan to return to profitability. As part of its restructuring plan, the Company has significantly reduced its operating costs, by closing one of its Canadian locations, sub-letting a portion of the Company's main facility and consolidating its U.S. operations into the Canadian subsidiary. In addition, the Company continues to add profitable new product lines, and focuses on strong retail sell-through. At this time, based on 2003 forecasts, the current credit facility appears to be sufficient to meet the company's financial needs.

Although primarily due to the above noted reasons the Company has incurred a loss in 2002 and substantial doubt remains about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern will depend on its return to profitable operations.

(b)

##### **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.

(c)

##### **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 recognize.

(d)

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.

(e)

Prepaid expenses:

Prepaid expenses primarily include insurance, advances on inventory purchases, current portion of royalties, product development costs 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 up to three years. Total expense for the year ended December 31, 2002 is \$311,082 (2001 - \$252,506, 2000 - \$250,523) and it 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 2003 is \$3,821.

(f)

Other assets:

Prepaid royalties are capitalized and amortized as earned in relation to actual 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 for 2003, 2004 and 2005 are, respectively, \$119,637, \$2,217 and \$19,213.

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.

(g)

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

(h)

Foreign currency translation:

(i) Grand Toys Ltd., a wholly-owned Canadian subsidiary, uses the Canadian dollar as its functional currency and translates its assets and liabilities into US dollars at the exchange rates prevailing at the balance sheet date and sales, expenses and cash flows are translated at the average exchange rate for the year. 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 rates prevailing at the balance sheet date. Revenues and expenses denominated in foreign currencies are translated at the rates of exchange prevailing at the transaction dates. All exchange gains and losses are included in income.

(i)

Earnings per share:

(i) On September 4, 2001, the Company completed a one-for-four reverse stock split. For purposes of earnings per share calculations and all share amounts, the comparative numbers of shares have been restated to reflect the reverse split.

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

(iii) Diluted earnings per share gives effect to all potentially dilutive common shares that existed at December 31, 2002.

(j)

Advertising and promotion:

All costs associated with advertising and promoting products are expensed in the period incurred. Total expense for the year is \$337,310 (2001 - \$637,661; 2000 - \$720,556). 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 to gross sales. These fees are determined annually on a customer by customer basis.

(k)

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 statements.

(l)

**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.

(m)

**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.

(n)

**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 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.

(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"), a company which was an acquisition target in 1999. The loan is secured by accounts receivable and inventory and personal guarantees of the shareholders of Limited Treasures. In 2000, the Company recorded a 50% provision or \$434,371 against the loan because of difficulty in recovering the amount due (see note 10).

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In June 2001, the Company was successful in obtaining judgment against Limited Treasures for \$775,000 repayable over 42 months commencing June 30, 2001. Interest is charged at a rate of 9% per annum.

Details are as follows:

	2002	2001
Amount due repayable in monthly payments of principal and interest of \$7,500 until November 30, 2001 and \$21,124 per month thereafter	\$548,720	\$743,215
Less current portion	212,739	194,494
	\$335,981	\$548,721

3.

**Prepaid expenses:**

	2002	2001
Prepaid inventory	\$16,580	\$161,676
Royalties	141,067	269,327
Insurance	269,060	232,092
Other	24,320	35,502
	\$451,027	\$698,597

4.

**Other assets:**

	2002	2001
Prepaid royalties	\$179,630	\$387,630
Product development costs	5,605	79,951
	185,235	467,581
Less current portion, included in prepaid expenses	141,067	333,754
	\$44,168	\$133,827

5.

**Equipment and leasehold improvements:**

	2002		2001	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Computer equipment	\$1,214,122	\$1,054,679	\$1,213,935	\$985,304
Machinery and equipment	449,837	418,560	445,821	406,881
Furniture and fixtures	459,682	437,709	448,201	426,947
Trucks and automobiles	77,461	76,935	76,722	75,977
Telephone equipment	48,595	40,183	42,486	37,499
Leasehold improvements	239,106	207,883	321,479	282,613
	\$2,488,803	\$2,235,949	\$2,548,644	\$2,215,221

Net book value	\$252,854	\$333,423
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**6.****Bank indebtedness:**

The Company has a line of credit to finance its inventory and accounts receivable providing for advances of up to \$2,171,019 (Cdn\$3,425,000). An additional amount of \$47,541 (Cdn\$75,000) was advanced in 2001 to the Company based on the value of certain of its equipment. The receivable loan has a discount fee of 2% and both the inventory loan and the equipment loan bear interest at Canadian prime plus 7.5%. The latter is being repaid through monthly capital repayments of \$1,190 (Cdn\$1,875). 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 ranking movable hypothec in the principal amount of \$2,500,000 (Cdn \$4,000,000) on the universality of all present and future assets of the Company and the assignment of insurance.

The Company had approximately \$554,784 of credit available as at December 31, 2002, subject to the availability of eligible inventory and accounts receivable.

There are no debt covenants or cross-default provisions.

**7.****Long term debt and Series A cumulative redeemable preferred shares:**

In connection with the acquisition by a subsidiary in 1999 of all the assets of Ark Foundation LLC, the Company issued 200,000 non-voting Series A convertible preferred shares having a stated value of \$5.00 per share or \$1,000,000 in total and an interest bearing promissory note of the subsidiary in the principal amount of \$1,500,000.

The note was secured by the pledge of 93,750 shares of the Company's common stock. In 2000, the Company terminated the operations of the subsidiary after it was determined that it was not financially viable and recognized the permanent impairment in the value of goodwill and intangibles of \$2,253,516 (see note 10).

As a result of the cessation of the subsidiary's business, it ceased making the interest payments required under the note.

As a result of the default by the subsidiary, the holder of the note caused the 93,750 pledged shares to be registered in its name in February 2001. As a result of these events, the company eliminated the liability associated with the promissory note in June 2001, and recognized \$1,195,123 as a gain on forgiveness of long term debt equal to the difference between the principal amount of the promissory note and the value of the pledged shares.

The Series A shares rank senior to the common stock. The Series A shares had a cumulative preferred quarterly dividend of 5% per annum of the par value, payable in cash, contingent upon Company declaration. The Series A shares were redeemable and convertible at determinable prices on determinable dates. The Series A shares were convertible into shares of the Company's common stock on a one for one basis. Beginning on January 1, 2000, a maximum of 12,500 shares could be converted during any six month period. If upon conversion, the market value of the common stock of the Company was less than \$5.00 per share, the Company was obligated to make up the difference between the market price on the conversion date and \$5.00 in cash.

All of the shares were converted into common stock on January 2000, July 2000, January 2001 and August 2001 (see

note 8 (c) below). Because the market price of the common stock was below \$5.00 per share in July 2000, January 2001 and August 2001, the Company recorded shortfalls of \$118,000 in the year 2000 and \$463,310 in the year 2001.

On February 26, 2002, the Company entered into a settlement agreement with the seller of the assets of Ark Foundation LLC and certain other parties, which settled all outstanding matters resulting from the purchase of the assets. Pursuant to the settlement agreement, the Company issued 242,213 shares of its common stock in settlement of the outstanding shortfalls noted above. The Company agreed to remove the legend on the shares which had previously been pledged to secure Ark Creations \$1,500,000 note payable and granted the seller an option to purchase the remaining assets of Ark Creations.

There are no debt covenants or cross-default provisions.

## 8.

### Capital stock:

The number of common shares has been adjusted for transactions that occurred prior to September 4, 2001, to give effect to the one-for-four reverse stock split, which reduced the number of outstanding common shares to 1,284,619 at that date.

(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 shares issued and outstanding at December 31, 2002.

(b)

Each Series B preferred share will automatically be converted, upon approval by the stockholders, into one share of the Company's common stock at an exercise price of \$1.00 per share and a warrant to purchase three shares of the Company's common stock at an exercise price of \$0.01 per share

(c)

Share transactions:

.

January 2001

50,000 Series A preferred shares were converted to 12,500 common shares, increasing capital stock by \$50.

.

February 2001

In satisfaction of the full payment of the long-term debt, referred in note 7, 93,750 common shares were issued, increasing capital stock by \$375.

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March 2001

As a result of a private sale of common stock by the Company, 357,143 common shares and 357,143 warrants were issued, increasing capital stock by \$1,428.

.

August 2001

50,000 Series A preferred shares were converted to 12,500 common shares, increasing capital stock by \$50.

.

November 2001

500 options were exercised for total proceeds of \$683, increasing the number of common shares outstanding by 500 and capital stock by \$1.

.

December 2001

As a result of a private sale of convertible preferred stock by the Company, 915,000 convertible preferred shares were issued for a total consideration of \$915,000, of which \$115,000 was unpaid at year-end. This transaction increased capital stock by \$800.

.

January 2002

115,000 shares of Series B convertible redeemable preferred stock were issued pursuant to the December 2001 private sale of convertible preferred stock for a total consideration of \$115,000, increasing capital stock by \$115.

.

February 2002

As a result of the settlement of the outstanding shortfall on share conversions, 242,213 common shares were issued, increasing capital stock by \$242.

.

June 2002

At the June 2002 Annual Meeting, the stockholders approved the issuance of 915,000 shares of Common Stock and warrants to purchase 2,745,000 shares of Common Stock issuable upon the exercise of warrants upon the conversion of 915,000 shares of the Series B Convertible Redeemable Preferred Stock, which by terms were automatically convertible into Common Stock upon such approval. Accordingly, on such date, the 915,000 shares of Series B Convertible Redeemable Preferred Stock were converted into 915,000 shares of Common Stock and 2,745,000 of warrants.

July 2002

57,787 common shares were issued, on settlement of consulting fees, increasing capital stock by \$58

185,768 common shares were issued in partial satisfaction for outstanding legal fees, increasing capital stock by \$186.

October 2002

10,144 shares were issued as a result of the settlement of an outstanding payable, increasing capital stock by \$10

December 2002

66,667 shares were issued as a result of the settlement of an outstanding payable, increasing capital stock by \$67

(d)

A summary of the number of shares of common stock outstanding and share transactions since January 1, 2001 is as follows:

	Preferred Stock	Common Stock
January 1, 2001	25,000	808,726
Share issuance on settlement of long-term debt (notes 7 and 8 (c))	-	93,750
Share conversions, Series A (note 8 (c))	(25,000)	25,000
Private sale (note 8 (c))	-	357,143
Private sale of preferred stock note(8 (c))	800,000	-
Stock options (note 8 (c))	-	500
December 31, 2001	800,000	1,285,119
Share issuance on settlement of shortfall on share conversion	-	242,213
Private sale of preferred stock	115,000	-
Conversion of preferred stock (note 8(c))	(915,000)	915,000
Share issuance on settlement of consulting fees	-	57,787
Share issuance on settlement of outstanding liabilities	-	262,579
December 31, 2002	-	2,762,698

## 9.

**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 (150,000 as at December 31, 2001) to acquire common stock 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	Other stock options	Warrants	Total	Weighted-average exercise price per share
January 1, 2000	1,350	43,875	55,000	100,225	\$15.21
Reclassified	500	(500)	-	-	-
Granted	134,893	-	-	134,893	6.96
Cancelled	(400)	(5,000)	-	(5,400)	27.96
December 31, 2000	136,343	38,375	55,000	229,718	9.22
Granted	1,000	198,500	357,143	556,643	1.82
Exercised	(500)	-	-	(500)	1.37
Cancelled	(2,750)	-	-	(2,750)	3.63
December 31, 2001	134,093	236,875	412,143	783,111	\$3.72
Granted	89,625	20,000	2,745,000	2,854,625	0.03
Cancelled	(98,783)	(60,875)	-	(159,658)	9.07
Options outstanding at December 31, 2002	124,935	196,000	3,157,143	3,478,078	\$0.46

Options exercisable

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at December 31, 2002            7,575            126,000            55,000            188,575            \$3.26

The following table summarizes information about options and warrants outstanding and exercisable at December 31, 2002:

Range of exercise prices	Options outstanding			Options exercisable	
	Number	Weighted-average exercise price	Weighted-average remaining contractual life (yrs)	Number	Weighted-average exercise price
\$0.01 - \$1.96	3,079,685	\$0.12	8.89	171,075	\$0.98
\$2.12 - \$2.99	381,893	2.12	1.73	1,000	2.83
\$5.62 - \$11.00	1,000	7.78	7.57	1,000	7.78
\$16.00 - \$87.60	15,500	28.13	5.36	15,500	28.13
	3,478,078	\$0.46	8.09	188,575	\$3.26

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.

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

	2002	2001	2000
Loss from continuing operations, as reported	\$ (1,024,140)	\$ (940,140)	\$ (10,020,070)
Add (deduct) compensation cost resulting from:			
Application of variable accounting to modified awards (APB Opinion No. 25)	(9,919)	-	-
Application of fair value method (FASB Statement No. 123)	(4,162,134)	(459,557)	(159,797)
Pro-forma loss from continuing operations	(5,196,193)	(1,399,697)	(10,179,867)
Earnings (loss) from discontinued operations	197,292	(431,352)	(167,893)

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Pro-forma net loss applicable to common stockholders	\$ (4,998,901)	\$ (1,831,049)	\$ (10,347,760)
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Basic EPS

Loss from continuing operations	\$ (2.52)	\$ (1.18)	\$ (12.69)
Earnings (loss) from discontinued operations	0.10	(0.37)	(0.21)
Net loss applicable to common stockholders	\$ (2.42)	\$ (1.55)	\$ (12.90)

Diluted EPS

Loss from continuing operations	\$ (2.52)	\$ (1.18)	\$ (12.69)
Earnings (loss) from discontinued operations	0.10	(0.37)	(0.21)
Net loss applicable to common stockholders	\$ (2.42)	\$ (1.55)	\$ (12.90)

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

	2002	2001	2000
Weighted average expected life (years)	3.0	3.0	3.0
Risk-free interest rate	5.63%	2.57%	5.19%
Volatility factor of expected market price of Company's common stock	149%	154%	164%
Dividend rate	-	-	-
	2002	2001	2000
Weighted average grant date fair value			
Of options and warrants	\$ 1.47	\$ 1.14	\$ 0.37

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.

For most options outstanding at the time of the reverse stock split, modifications were made to the exercise price and to the number of shares, such that the option holder's economic position be maintained. However, certain warrants issued by the Company were designed so that only their exercise price be modified in the case of stock splits or stock combinations. This modification resulted in additional compensation expense being recorded in the financial statements in the amount of \$37,340 in 2001.

Modifications were also made in 2001 to reduce the exercise price of certain awards. Compensation expense of \$31,396 was recorded as a result of the changes made to the terms of these awards. The entire amount of \$88,266 was capitalized as part of prepaid royalties and will be written off over the term of the related agreements.

In 2002, compensation expense in the amount of \$35,200 was recorded relating to options granted to a non-employee.

**10.****Unusual items:**

Unusual items are comprised of the following:

	2002	2001	2000
(Reduction of) provision for a lawsuit	\$-	\$(550,000)	\$550,000
(Reduction of) provision for loan receivable (note 2)	-	(288,102)	434,371
Settlement of lawsuit by lessor of certain real estate	-	-	264,000
Write-off intangibles (note 7)	-	-	2,253,516
Write-off of deferred acquisition costs	-	-	123,168
	\$-	\$(838,102)	\$3,625,055

Included in other interest expense in 2000, representing an additional unusual item is \$747,828 of amortization and write-off of deferred financing costs.

**11.****Income taxes:**

(a)

Income tax recovery (expense) consists of:

	Current	Deferred	Total
Year ended December 31, 2000:			
US	\$(12,308)	\$-	\$(12,308)
Canada	776,269	-	776,269
	\$763,961	\$-	\$763,961
Year ended December 31, 2001:			
US	\$(13,713)	\$(185,411)	\$(199,124)
Canada	309,345	-	309,345
	\$295,632	\$(185,411)	\$110,221
Year ended December 31, 2002:			
US	\$14,106	\$-	\$14,106
Canada	-	-	-
	\$14,106	\$-	\$14,106

## 11.

**Income taxes, (continued):**

(b) The effective tax rate for the Company is reconcilable to statutory tax rates as follows:

	2002	2001	2000
	(%)	(%)	(%)
U.S. Federal statutory tax rate	35%	35.0	35.0
Changes to US tax rate resulting from:			
Expenses producing no tax benefit	3.6	2.8	0.8
Tax benefit of utilization of loss carry forward	(21.6)	-	(20.9)
Reversal of excess provision	-	(8.1)	-
Other	(17.0)	(24.6)	(7.8)
	-	(32.7)	(27.9)
Effective tax rate	-	5.1	7.1

The Company has not provided for income taxes on foreign subsidiaries undistributed earnings as of December 31, 2002 because the investments in the foreign subsidiaries are essentially permanent in duration.

(c) The tax effects of temporary differences that give rise to deferred tax assets at December 31, 2002 are presented below:

	2002	2001
Non-current:		
Net operating loss carry forwards	\$ 3,138,000	\$ 6,838,791
Valuation allowance	(3,138,000)	(6,838,791)
Total net deferred tax asset	\$ -	\$ -



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The valuation allowance decreased in 2002 by \$3,700,791 due to the utilization of losses by the Canadian subsidiary net of the current year's loss (2001 increase of \$1,581,364). The estimated impact of ownership changes for income tax purposes is reflected in the above numbers.

As of December 31, 2002, the Company has \$ 11,335,000 (2001 - \$ 10,740,000) of net operating losses available for tax purposes to reduce future taxable income in the United States, beginning to expire in 2009.

The Company's Canadian subsidiary has approximately \$4,100,000 (Cdn\$6,400,000) (2001-\$4,650,000 (Cdn\$7,200,000) of losses carried forward, which can be used to reduce future taxable income.

These losses expire as follows:

2007	\$2,700,000
2008	\$1,400,000
(d)	

The Company's Canadian subsidiary has received a re-assessment from the taxation authorities of approximately \$92,000 (Cdn. \$145,000) relating to employee training tax of a prior year. Management filed a notice of objection to this assessment and for taxes previously paid on a related item. This notice of objection, if successful could lead to a potential recovery of approximately \$280,000 (Cdn.\$442,000). No provision has been recorded for this item in the financial statements.

**12.**

**Discontinued operations:**

On June 14, 2002, the Company sold its wholly-owned subsidiary, Sababa Toys Inc. ("Sababa"), to the subsidiary's management for \$1,065,716. The payment of the purchase price is evidenced by a promissory note and is secured by a pledge of the shares of Sababa and a first lien on certain other assets. 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.

The table below summarizes the gain recorded and the cash applied against the note receivable:

	Deferred Gain	Note receivable
Balance, June 14, 2002	\$ 761,584	\$ 1,065,716
Recorded in 2002	(263,784)	(180,839)
Balance, December 31, 2002	497,800	884,877

Net Assets of Sababa consist of the following:

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	June 14, 2002	December 31, 2001
Net current assets:		
Accounts receivable	\$206,554	\$203,158
Inventory	167,244	465,676
Prepaid expenses and deposits	77,619	83,269
Accounts payable and accrued liabilities	(284,442)	(485,275)
	\$166,975	\$266,828

Non-current assets:

Prepaid development costs	\$62,722	\$102,852
Furniture and equipment	25,971	26,609
	\$88,693	\$129,461

Details of the statement of operations of Sababa are as follows:

	2002	2001	2000
	(6 months)	(12 months)	(4 months)
Net sales	\$536,120	\$ 609,232	\$1,500
Cost of goods sold	238,979	318,598	13,704
	297,141	290,634	(12,204)
Expenses:			
Operating	\$359,736	\$715,439	\$154,735
Depreciation	3,281	6,591	954
Interest	616	(44)	-
	363,633	721,986	155,689
Net loss	\$(66,492)	\$(431,352)	\$(167,893)

13.

**Earnings per share:**

	Income	Shares	Per Share
	(numerator)	(denominator)	Amount
<b>December 31, 2000</b>			
<u>Basic EPS</u>			
Loss from continuing operations	\$(10,020,070)	\$801,946	\$(12.49)
Loss from discontinued operations	(167,893)	801,946	(0.21)
Loss applicable to common stockholders	(10,187,963)	801,946	(12.70)
<u>Diluted EPS</u>			
Loss from continuing operations	(10,020,070)	801,946	(12.49)
Loss applicable to common stockholders and assumed conversions	(10,187,963)	801,946	(12.70)
	Income	Shares	Per Share
	(numerator)	(denominator)	Amount
<b>December 31, 2001</b>			
<u>Basic EPS</u>			
Loss from continuing operations	\$(1,635,678)	1,183,992	\$(1.38)
Extraordinary item	695,538	1,183,992	0.59
Loss from discontinued operations	(431,352)	1,183,992	(0.37)
Loss applicable to common stockholders	(1,371,492)	1,183,992	(1.16)
<u>Diluted EPS</u>			

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Loss from continuing operations	(2,135,263)	1,183,992	(1.80)
Extraordinary item	1,195,123	1,183,992	1.01
Loss from discontinued operations	(431,352)	1,183,992	(0.37)
Loss applicable to common stockholders and assumed conversions	(1,371,492)	1,183,992	(1.16)

**13.****Earnings per share, (continued):**

	Income	Shares	Per Share
	(numerator)	(denominator)	Amount
<b>December 31, 2002</b>			
<u>Basic EPS</u>			
Loss from continuing operations	\$(1,024,140)	\$2,064,465	\$(0.50)
Net gain on discontinued operation	197,292	2,064,465	(0.10)
Loss applicable to common stockholders	(826,848)	2,064,465	(0.40)
<u>Diluted EPS</u>			
Loss from continuing operations	(1,024,140)	2,064,465	(0.50)
Net gain from discontinued operation	197,292	2,064,465	0.10
Loss applicable to common stockholders and assumed conversions	(826,848)	2,064,465	(0.40)

Options and warrants to purchase 3,478,078 shares (2001 783,111) of the Company's common stock were not included in the diluted earnings per share calculation as their effect is anti-dilutive.

**14.****Changes in operating working capital items:**

	2002	2001	2000
Continuing operations:			
(Increase) decrease in accounts receivable	\$(674,761)	\$238,921	\$6,584,004
Decrease in inventory	236,619	528,114	2,058,123
Decrease (increase) in income taxes receivable	145,752	302,067	(469,707)

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Decrease (increase) in prepaid expenses	149,392	234,637	(264,309)
Increase in trade accounts payable	(288,999)	(48,611)	(550,638)
Increase in other accounts payable and accrued liabilities	37,284	50,264	33,965
Decrease in provision for lawsuit	-	(550,000)	-
Increase (decrease) in royalties payable	6,636	(2,424)	21,433
Decrease in income taxes payable	-	-	(699,928)
	\$(388,077)	\$752,968	\$6,712,943

**15.**

**Commitments:**

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

2003	\$272,000
2004	267,000
2005	263,000
2006	262,000
2007	255,000
Thereafter	475,000
	\$1,794,000

Rent expense for the years ended December 31, 2002, 2001 and 2000 amounted to approximately \$186,472, \$243,000 and \$526,000 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 \$107,255 in 2002, \$157,000 in 2003 and \$182,000 annually from 2004 to 2007.

**16.**

**Contingencies:**

(a) Lawsuits for alleged breach of contract have been filed against the Canadian subsidiary by two former sales representatives. In the opinion of management, these actions have no merit. At this point in time it is difficult to ascertain or estimate the value of a settlement, if any.

(b) The Company's Canadian subsidiary, is contingently liable for an outstanding letter of credit of \$500,000 as at December 31, 2002. The short-term deposit has been pledged as collateral for this letter of credit.

To increase the short-term deposit to the required level, the Company borrowed \$250,000 from a director. The loan bears interest at 6% per annum and is payable on demand.

**17.**

**Employee benefit plans:**

The Company has a defined contribution group retirement savings plan for its Canadian employees. The Company contributes to this plan the lesser of (a) 50% of the employee's contribution to this plan; (b) 3% of the employee's gross earnings; or (c) Cdn.\$3,000 per employee. During the year, the Company contributed approximately \$12,000 (2001 - \$17,000; 2000 - \$20,000) to the retirement savings plan for its Canadian employees.

**18.**

**Segment information:**

(a)

Operating and geographic information:

The Company operates primarily in one segment which includes the distribution of toys and related items. Approximately 97% of total sales are to Canadian customers. The majority of long-lived assets are located in Canada.

(b)

Other information:

	2002		2001		2000	
	Revenue	%	Revenue	%	Revenue	%
Customer A	\$4,072,000	33	\$3,111,000	35	\$2,404,000	20
B	2,098,000	17	978,000	11	2,043,000	17
C	1,234,000	10	978,000	11	2,043,000	17
D	617,000	5	622,000	7	1,442,000	12
All others	4,318,930	35	2,589,335	36	4,084,385	34
	\$12,339,930	100	\$8,278,335	100	\$12,016,385	100

**18.****Segment information, (continued)**

Sales of toys purchased from the Company's two largest manufacturers and suppliers of toys in aggregate accounted for 75% of gross sales for 2002. The Company's two largest suppliers accounted for 60% and 49% of gross sales for 2001 and 2000 respectively.

**19.****Related party transactions:**

During the year, the Company paid \$66,238 (2001 - \$67,184) in consulting fees to two shareholders.



20.

**Financial instruments:**

(a)

Foreign currency risk management:

From time to time the Company enters into forward foreign exchange contracts to minimize its foreign currency exposure on purchases. The contracts oblige the Company to buy US dollars in the future at predetermined exchange rates. The contracts are not used for trading purposes. The Company's policy is to enter into forward foreign exchange contracts on a portion of its purchases anticipated in the next selling season. Gains and losses on forward exchange contracts are recorded in income and generally offset transaction gains or losses on the foreign currency cash flows.

At December 31, 2002, the Company had no contracts to purchase US dollars.

(b)

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 accounts receivable, due from affiliated companies, bank indebtedness, trade and other payables approximate their carrying value due to the immediate or short-term maturity of these financial instruments.

(c)

Credit risk and economic dependence:

For the year ended December 31, 2002, approximately 65% (December 2001 - 64%; 2000 - 66%) of the Company's sales were made to four unrelated companies. Three (2000 - four) customers representing approximately 60% (December 2001 - 57%; 2000 - 54%) of total sales, individually accounted for 10% or more (2001 - 11%; 2000 - 12%) 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.

(d)

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.

## 21.

**Supplemental disclosure of cash flow information:**

	2002	2001	2000
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	\$80,030	\$47,271	\$109,800
Income taxes	14,106	29,800	467,900
Non-cash transactions:			
Share conversions	-	500,000	500,000
Shortfall on share conversions	-	463,310	118,000
Note receivable received in consideration of sale of discontinued operations	1,065,716	-	-
Share conversions in settlement of outstanding legal fees	213,633	-	-
Reduction in shortfall on share conversion through the insurance of common stock	581,310	-	-
Share conversions in settlement of outstanding payables	112,983	-	-