

GRAND TOYS INTERNATIONAL INC  
Form 10-K/A  
July 30, 2003

FORM 10 - K/A - 2

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

☒ [X]

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, 2001** \_\_\_\_\_

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**

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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 X 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, 2001 were \$8,887,567. As of February 28, 2002, the Registrant had 1,285,200 shares of Common Stock outstanding. The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$1,593,648 (as of February 28, 2002).

GRAND TOYS INTERNATIONAL, INC.

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Filed with the Securities and Exchange Commission

Year ended December 31, 2001

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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 and 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, of 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, distributes proprietary products and develops product concepts to be sold to third parties or developed and distributed by the Company.

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 developed 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.

|  | Products Distributed<br>by the Company | Product Price<br>Range (\$) |
|--|----------------------------------------|-----------------------------|
|  |                                        |                             |

| Vendor (Head Office)       |                                                 |               |
|----------------------------|-------------------------------------------------|---------------|
| Barter (H.K.)              | Proprietary Arts & Crafts & licensed products   | 0.61 - 77.51  |
| Intex Corporation (Taiwan) | Inflatable water toys (licensed & non-licensed) | 0.27 - 451.14 |
| Kid Galaxy (U.S.)          | 'Bendos' figurines                              | 1.78 - 6.46   |
| P & M Products (U.S.)      | Arts & Crafts                                   | 1.08 - 15.48  |
| Processed Plastic (U.S.)   | Plastic toys, ride-on vehicles, and etc.        | 0.37 - 31.85  |
| Pyramid (U.S.)             | Stationery                                      | 0.74 - 1.52   |
| Spectra Star Toys (U.S.)   | Kites                                           | 0.59 - 12.66  |
| Toy Biz (U.S.)             | Male action figures                             | 3.36 - 95.73  |
| Unice S.A. (Spain)         | Balls                                           | 1.11 - 1.86   |
| Wah Lung (H.K.)            | Proprietary dolls, key chains and games         | 1.50 - 9.00   |

Our business and operating results depend largely upon the appeal of our toy products. A decline in the popularity of our 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 our business, financial condition and results of operations. Our continued success will depend on our ability to redesign, restyle and extend our 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 tradeshow worldwide, reading industry publications and communicating with our existing vendors and customers.

The Company, through its US subsidiary, Sababa Toys Inc., develops new concepts to be developed internally or by the other subsidiaries within the corporate group, to be sold to third parties.

Grand Toys International, Inc. develops proprietary products and uses internal staff to develop the design and development of 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 vendors for the Company's products for safety purposes at its warehouse facilities.

#### Sources of Product

Approximately 77% of the Company's gross sales in 2001 were from products supplied by the following five vendors: Toy Biz, P&M Products, Intex Corporation, Barter and Wah Lung. These products accounted for 45%, 15%, 7%, 5% and 5% respectively of 2001 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 5% of the Company's gross sales in 2001.

Products (stationery and electronics) from Pyramid and Toymax that accounted for 7% of sales in 2001 are no longer a part of the Company's product line, as a result of the Company's decision to focus on more profitable lines. The Company is 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.

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, 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. Sababa Toys Inc. occupies office premises in New York.

## Licensing and Distribution Agreements

### Character Licenses

The Company's product line includes 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 21% 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.

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.

| Character Property         | Licensor (Territory)           | Product Featuring Property                |
|----------------------------|--------------------------------|-------------------------------------------|
| Batman                     | Warner Bros. (CAN)             | Kites, Balls                              |
| Bear In The Big Blue House | Venture (CAN)                  | Balls                                     |
| Catdog                     | Studio Licensing (CAN)         | Kites                                     |
| Donald Duck, Daisy, Goofy, | Disney (CAN)                   | Pools, Kites, Bop Bags, Pool Accessories, |
| Pluto,                     |                                | Plastics                                  |
| Dollhouse                  | Gotham Licensing (U.S. & CAN)  | Dolls                                     |
| Eye Sceam                  | 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            |
| Jordache                   | Jordache Enterprises (U.S.)    | Dolls                                     |
| Mickey Mouse, Minnie Mouse | Disney (CAN)                   | Pools, Kites, Bop Bags, Pool Accessories, |
|                            |                                | Plastics                                  |

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|                     |                                       |                                |
|---------------------|---------------------------------------|--------------------------------|
| Nintendo            | G-Squared (CAN)                       | Balls                          |
| Pooch Patrol        | Isovoy Inc. (U.S. & CAN)              | Plush Toys                     |
| Power Puff Girls    | Warner Bros. (CAN)                    | Stationery, Balls              |
| Power Rangers       | Venture (CAN)                         | Balls, Kites                   |
| Rugrats             | Studio Licensing (CAN)                | Kites, Balls                   |
| Sesame Street       | E.M.G. (CAN)                          | Balls, Kites                   |
| Simpsons            | Fox Licensing (U.S.)                  | Uno Cards                      |
| Sonic The Hedge Hog | Venture (CAN)                         | Balls                          |
| Spider-man          | Marvel, (CAN)                         | Ball, Stationery               |
| Sponge Bob          | Mattel Inc. (U.S.)                    | Uno Cards, Majic 8 Balls       |
| Signature Eggs      | Signature Eggs Company<br>(Worldwide) | Original Trophy Eggs           |
| Winnie The Pooh     | Disney (CAN)                          | Plastics, Kites, Bop Bags      |
| Nick & Nora         | American Genius (U.S. & CAN)          | Dolls                          |
| NSYNC               | Winterland (U.S. & CAN)               | Foam Puzzles                   |
| 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 4% of Grand Canada's sales revenues for the year ended December 31, 2001, and the loss of any one such license would not have a material adverse effect on Grand Canada's operations.

All costs associated with licensing and distribution are expensed in the period incurred and are shown as royalties expense in the Company's Statements of Operations which constitute a part of the Company's Consolidated Financials Statements for the Year Ended December 31, 2001 which are included with this report. Total expense for the year ended December 31, 2001 is \$252,506 (2000 - \$250,523, 1999 - \$280,782).

One of these contracts has a keyman clause tied to one of Grand's employees.

#### License and Distribution Arrangements with Toy Vendors

Grand Canada has entered into distribution agreements with two of its approximately eighteen 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 and expenses. If Grand Canada were to be in default under a license or distribution agreement it may cause such agreement to be terminated as well as result in liability for certain costs and penalties.

Grand Canada's distribution agreement with its largest vendor, Toy Biz Inc, accounting for 45% of the Company's 2001 sales volume, terminated on December 31, 2001. At this time, Grand Canada continues to sell Toy Biz products in accordance with its historical practice. The Company is discussing renewal terms and is currently purchasing and selling their product line with orders placed well into the fall of 2002.

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 our current products or product lines will continue to be popular for any significant period of time; any new products or product lines introduced by us will achieve an adequate degree of market acceptance; or any new product's life cycle will be sufficient to permit us to recover development, manufacturing, marketing or other costs of the product. In the event a new product does not receive sufficient market acceptance, we may be required to sell inventory of such products at a substantial discount. Accordingly, our success is dependent in large part on our 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, we 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 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, Costco and Zellers, which for the year ended December 31, 2001, accounted for approximately 35%, 11%, 10% and 7%, respectively, of the gross sales for this period. No other customer accounted for more than 7% of gross sales in 2001.

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.

In addition, pressure by large customers seeking a reduction in prices, financial incentives, a change in other terms of sale or for us 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 eight people, including two of its senior managers and six sales persons who make on-site visits to customers for the purpose of soliciting orders for products. It markets products at major and regional toy trade shows in Canada. In addition, Grand Canada maintains showrooms in its suburban Montreal and Mississauga facilities.

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

Sababa Toys Inc. had modest sales in 2001, to several retail outlets in the United States.

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

#### Seasonality

Our business is seasonal and therefore our annual operating results will depend, in large part, on our 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 our toy products at retail are seasonal, with a majority of retail sales occurring during the period from September through December in anticipation of the holiday season.

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 occur 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 us to fill orders promptly and shift a significant portion of inventory risk and carrying costs to the supplier. The limited inventory carried by retailers may also reduce or delay retail sales. Additionally, the logistics of supplying more and more product within shorter time periods will increase the risk that we 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. Our failure to accurately predict and respond to consumer demand could result in our underproducing 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 \$15,000,000. The Company has not been the subject of any product liability litigation.

#### Competition

Many other companies involved in the toy distribution industry in Canada and the United States have greater financial resources, larger sales forces, greater name recognition, larger facilities for product development and products that may be more competitively priced than our products. As a result, some of our competitors may be able to obtain a greater volume of and more lucrative distribution contracts than we can. The Company competes with, among others Mattel Inc., Hasbro Inc. and Irwin Toys Ltd. (Canada).

#### 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, 2001, the Company employed 42 full-time persons, including three 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 1, 2004 but Grand Canada has the right to extend the lease for an additional five-year period. 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.

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.

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Sababa Toys Inc. leases 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.

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, Ron Goldenberg, Elliot L. Bier and James B. Rybakoff, 00 Civ. 2710, was approved by the United States District Court for the Southern District of New York on September 24, 2001.

During the quarter ended December 31, 2001, 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, 2001, 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.

### Item 4.

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

On March 14, 2002, The Company held its 2001 annual meeting of stockholders. At the meeting, the following actions took place:

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

| Director Name  | For     | Against | Withheld | Abstain |
|----------------|---------|---------|----------|---------|
|                |         |         |          |         |
| Elliot Bier    | 741,194 | 52      | n/a      | 2,710   |
| James Rybakoff | 741,194 | 52      | n/a      | 2,710   |
| Stephen Altro  | 741,194 | 102     | n/a      | 2,710   |

|            |         |     |     |       |
|------------|---------|-----|-----|-------|
| David Mars | 741,144 | 852 | n/a | 2,710 |
|------------|---------|-----|-----|-------|

- The Stockholders ratified the approval of KPMG LLP to serve as the Company auditors for the fiscal year ending December 31, 2001. 740,570 shares were voted for the appointment, 2,326 shares were voted against the appointment, no shares were withheld and 1,060 shares abstained.

## 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, 2000 through December 31, 2001 as reported by Nasdaq.

The figures represent prices between dealers, do not include retail mark-ups, mark-downs 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.

| Common Stock   | Representative<br>Bid Prices |          |
|----------------|------------------------------|----------|
|                | High (\$)                    | Low (\$) |
| 2000           |                              |          |
| First Quarter  | 27 1/2                       | 10 -     |
| Second Quarter | 14 5/8                       | 5/8      |
| Third Quarter  | 21 1/2                       | 5 -      |
| Fourth Quarter | 8 1/4                        | 1/2      |
| 2001           |                              |          |
| 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      |

On March 20, 2002, the last reported sales price for the Common Stock on the Nasdaq SmallCap Market was \$2.50 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 an exception from the net tangible assets, market capitalization, net income, market value of public float and minimum bid price requirements.

The Company was given a temporary exception from these standards subject to Grand Toys International, Inc. meeting the following conditions by November 15, 2001:

- Grand's closing bid price had to be at least \$1.00 per share on or before September 4, 2001 and for a minimum of ten consecutive trading days thereafter.
- ◆ The market value of the public float had to be at least \$1,000,000 on or before September 4, 2001 and for a minimum of ten consecutive trading days thereafter.
- ◆ On or before August 15, 2001, Grand had to demonstrate that it had net tangible assets of at least \$2,000,000 or total shareholders' equity of at least \$2,500,000. Grand had to also continue to demonstrate compliance with this requirement on November 15, 2001.

On September 4, 2001, The Company undertook a one-for-four reverse split of the Company's Common Stock in order to regain compliance with the minimum bid price required Grand had complied with the net tangible asset requirements on August 15, 2001 and November 15, 2001, however on November 27, 2001, Nasdaq advised that it would be extending this exception to April 1, 2002 to include the fourth quarter of 2001.

On January 30, 2002, a "C" was added to the Company's trading symbol as a result of the Company's failure to solicit proxies and hold its 2000 Annual Meeting of Shareholders. The exception was removed after March 15, 2002. Grand held its Annual Meeting on March 14, 2002.

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. However, the failure to have our shares quoted on the SmallCap 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, 2002 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.

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During the past two years the Company has not paid and has no current plans to pay dividends on its Common Stock or Preferred 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 between January 1, 2000 to December 31, 2001, and were not registered under the Securities Act of 1933, as amended (the "Act").

On each of January 1, 2000, July 17, 2000, January 2, 2001 and August 2, 2001 the Company issued 50,000 shares of Common Stock upon the conversion of 200,000 shares of Series A Stock into Common Stock. Refer to Note 8 of the 2001 consolidated financial statements.

On February 1, 2001, in satisfaction of the full payment of the long-term debt of its US subsidiary, Ark Creations Inc. (which ceased operations in 2000), 93,750 common shares were issued.

On March 31, 2001, the Company sold Common Stock, 357,143 common shares and 357,143 warrants were issued, resulting in gross proceeds of \$500,000.

On or about December 20, 2001, the Company issued Series B convertible redeemable preferred stock for gross proceeds of \$915,000 of which \$800,000 was received by December 31, 2001 and the remainder in January 2002.

The Company has:

|                          | Authorized | Outstanding |
|--------------------------|------------|-------------|
|                          |            |             |
| Series A Preferred Stock | Nil        | Nil         |
| Series B Preferred Stock | 915,000    | 915,000     |
| Common Stock             | 12,500,000 | 1,285,119   |

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.

Item 6.

Selected Financial Data:

The following selected financial data of the Company has been derived from our annual consolidated financial statements at December 31, 2001 and 2000, which appear elsewhere herein.

For the Twelve Months Ended December 31:

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|                            | 2001         | 2000          | 1999          | 1998          | 1997          |
|----------------------------|--------------|---------------|---------------|---------------|---------------|
|                            |              |               |               |               |               |
| Net sales                  | \$ 8,887,567 | \$ 12,017,885 | \$ 37,260,250 | \$ 33,177,529 | \$ 37,299,525 |
| Gross profit               | 2,822,523    | 360,170       | 10,778,909    | 11,091,548    | 14,699,141    |
| Unusual items              | (838,102)    | 3,625,055     | 814,669       | —             | —             |
| Net (loss) earnings        | (1,371,492)  | (10,187,963)  | (759,466)     | (318,302)     | 1,575,169     |
| (Loss) earnings per share: |              |               |               |               |               |
| Basic and diluted before   |              |               |               |               |               |
| extraordinary item         | (1.75)       | (12.70)       | (1.42)        | (0.80)        | 4.00          |
| Extraordinary item         | 0.59         | —             | —             | —             | —             |
| Basic                      | (1.16)       | (12.70)       | (1.42)        | (0.80)        | 4.00          |
| Diluted                    | (1.16)       | (12.70)       | (1.42)        | (0.80)        | 3.60          |
| Weighted average number of |              |               |               |               |               |
| common equivalent shares   | 1,183,992    | 801,946       | 533,145       | 394,409       | 394,409       |
|                            |              |               |               |               |               |
| Working capital            | 1,111,171    | 2,804,596     | 10,788,948    | 3,374,528     | 3,452,266     |
|                            |              |               |               |               |               |
| Long term debt             | —            | 1,500,000     | 1,777,778     | —             | —             |
| Redeemable preferred stock | —            | 500,000       | 1,000,000     | —             | —             |
| Cash dividends             | —            | —             | 25,000        | —             | —             |
| Total assets               | 5,742,598    | 6,582,383     | 19,408,405    | 13,889,317    | 12,187,404    |

## Management's Discussion and Analysis:

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

## Overview

In our audited financial statements for the years ended December 31, 2001 and 2000 we recognized that we had certain issues which raised substantial doubt about the Company's ability to continue as a going concern. The reasons cited were our recurring losses and the cancellation of our line of credit in 2000. This was noted in KPMG's audit report on those financial statements. In 2001, we implemented a plan to stem our losses and return to profitability and secured lines of credit. However, these lines of credit are not sufficient to meet all of our financial needs and we might not be able to successfully implement our new operational plan. If doubts about our ability to continue as a going concern persist, it may have an adverse impact on investors' willingness to invest in our stock which would negatively impact the price and liquidity of our shares.

We incurred net losses of \$10,156,713 for the year ended December 31, 2000, \$709,466 for the year ended December 31, 1999. We have not reported an annual profit since December 31, 1997. We have recently begun to implement a plan to return to profitability. Over the course of 2001 we have focused on products with higher profit margins and have reduced expenses. This has resulted in improved performance but we have not achieved profitability for the year ending December 31, 2001 and, in spite of these efforts, there can be no assurance that we 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 our goods is affected by the price we obtain from our vendors (Cost of Goods Sold) and therefore dictates the selling price we can charge our customers. Other factors that influence our 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,

|                                     | 2001    | 2000    | 1999   |
|-------------------------------------|---------|---------|--------|
|                                     | %       | %       | %      |
| Net sales                           | 100.00  | 100.00  | 100.00 |
| Cost of goods sold                  | 68.24   | 97.00   | 71.07  |
| Gross profit                        | 31.76   | 3.00    | 28.93  |
| Operating expenses:                 |         |         |        |
| Selling, general and administrative | 62.26   | 54.07   | 27.14  |
| Foreign exchange loss (gain)        | .99     | .22     | (.48)  |
| Interest on long-term debt          | -       | .91     | .23    |
| Interest revenue                    | (1.14)  | (1.11)  | -      |
| Interest expense                    | .53     | 6.48    | 1.23   |
| Bad debt expense                    | 1.66    | .78     | .23    |
| Depreciation and amortization       | 1.38    | 2.36    | 1.09   |
| Unusual items                       | (9.43)  | 30.16   | 2.18   |
| Total operating expenses            | 56.25   | 93.87   | 31.62  |
| Gain on forgiveness of debt         | 7.83    | -       | -      |
| Loss before income taxes            | (16.67) | (90.87) | (2.69) |
| Net loss                            | (15.43) | (84.51) | (1.90) |

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, 2001 to the year ended December 31, 2000

Net Loss:

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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 2007 to be able to apply unutilized tax losses against future taxable income.

### Net Sales:

Net sales decreased by \$3,130,318 or by 26.05% to \$8,887,567 from \$12,017,885 for 2000. For the year 2001, the decrease in Grand's net sales resulted from the termination by Grand of its distribution of the Toymax product line. This line represented 12% of 2000 Net Sales.

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 \$2,462,353. As a percentage of sales, gross profit increased from 3.00% to 31.76%. 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. 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 \$576,005 to \$3,595,413 in 2001, from \$4,171,418 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 non-recurring expenses offset the overall reduction:

#### Expense category:

|                              |            |
|------------------------------|------------|
| Legal fees \$                | \$ 318,536 |
| Financing charges            | 203,080    |
| Severance & placement fees   | 137,777    |
| Consulting                   | 92,790     |
| Other                        | 86,379     |
| Total Non-Recurring 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.

Selling, general and administrative expenses as a percentage of sales, were higher in 2001, a 7.83% 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 16 of the Consolidated Financial Statement)
- 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, presented as an offset to the Gain on forgiveness of debt
- ◆ September 2001 - \$ 185,411, written off due to recurring losses in the US companies.

Comparison of the year ended December 31, 2000 to the year ended December 31, 1999:

Net Loss

Net loss for 2000 was \$10,187,963 or \$12.70 loss per share as compared to a net loss of \$759,466 or \$1.42 loss per share in 1999. The decrease was mainly due to the unusual charge of \$3,625,055 consisting mainly of prepaid and

intangible write-offs and the decrease in sales and the reduced margins on those sales during the year. In addition, while the Company did endeavor to reduce selling, general and administrative expenses for the year, those deductions did not match, as a percentage, the reduction of the sales volume.

The net loss was further increased by the restriction of income tax recoveries of a subsidiary to the amount that can be recovered from taxes paid in prior years. The Company will have until 2007 to be able to apply unutilized tax losses against future taxable income.

#### Net Sales

Net sales in 2000 decreased to \$12,017,885 from \$37,260,250 for 1999. The lower net sales volume was attributed to the loss, in 2000, of two significant product lines, Tiger Electronics and Majorette. Hasbro acquired Tiger Electronics Inc. in February, 1999 and terminated the distribution of Tiger products by Grand Canada effective December 31, 1999. Grand Canada discontinued its distribution of the Majorette products line due to the non-performance of the product line.

The significant softening of the retail market for the types of products distributed by the Company resulted in significantly higher customer markdowns, which negatively impacted net sales. Further, a decrease in the Company's commission revenue contributed to the decrease.

#### Gross Profit

Due to the loss of two significant product lines, the lower margins relating to the 2000 sales volume, and the recording of \$1,861,681 as an inventory reserve, of which \$263,497 was recorded in the fourth quarter, due to the decline in market demand for such items as WWF, WCW, Star Wars and Pokemon products, the gross profit decreased significantly.

#### General and Administrative

General and administrative expenses in 2000 decreased to \$4,171,418 from \$5,937,093 in 1999. However, these costs, as a percentage of sales, were significantly higher compared to 1999 due to the much lower sales base. The Company, in anticipation of the sales volume decline, implemented a cost control program during the year. Decreases in salary expense, cooperative advertising rebates to customers, and administrative expense comprised the majority of the total decrease.

#### Unusual Items

These expenses are comprised of the following items:

- a. The Company settled a lawsuit by a lessor of certain real estate for \$264,000.
- b. The Company recognized the permanent impairment in value of goodwill and patents from the acquisition of the assets by its Ark Creations subsidiary of \$2,253,516, as a result of its decision to cease operations of its subsidiary. The purpose of Grand's acquisition of Ark Foundation LLC by its subsidiary, Ark Creations Inc., was to give Grand direct access to the US market by acquiring an existing US operating company. Due to disappointing sales results in 2000, Grand closed this operation and transferred the product line to its head office.
- c. The company's credit line, which was scheduled to expire in 2001, was terminated in January 2001. As a result, the Company has taken a charge against earnings of the full amount of the deferred financing charges of \$535,109, which is included in other interest expense.

- d. The Company has written off \$557,539 as a result of its decision to abandon its proposed acquisition of Limited Treasures, Inc. and providing for an allowance on a loan receivable from Limited Treasures.
- e. The Company has reserved \$550,000 to cover a lawsuit commenced by a supplier against Grand Canada for breach of contract.

#### Liquidity and Capital Resources

The Company generally finances its operations through borrowings with its Montcap Financial Inc., by cash flow from operations, and sales of equity securities. The inflow of funds in 1999, due to options and warrants being exercised resulted in virtually all short-term bank debt being eliminated by December 31, 1999 and a cash position maintained through June 30, 2001, as a result of a private sale of common stock and the receipt of income taxes recoverable.

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.

In October 2001, the Company increased its credit facility up 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.

During 2001, we secured a new line of credit to finance our inventory and accounts receivable and we also realized net proceeds from the sale of our common stock and warrants. This source of financing, however, will not be sufficient to fully implement our business plan. To the extent that we will be required to fund operating losses, our financial position will deteriorate. There can be no assurance that we will be able to find significant additional financing at all or on terms favorable to us. If equity securities are issued in connection with a financing, dilution to our stockholders may result, and if additional funds are raised through the incurrence of debt, we may be subject to restrictions on our operations and finances. Furthermore, if we do incur additional debt, we may be limiting our ability to repurchase capital stock, engage in mergers, consolidations, acquisitions and asset sales, or alter our lines of business or accounting methods, even though these actions would otherwise benefit our business.

Accounts receivable at December 31, 2001 were \$1,386,333 compared to \$1,498,999 at December 31, 2000. The sales were mainly to mass retailers. Inventory at December 31, 2001 decreased to \$1,838,770 from \$1,991,918 at December 31, 2000. Management's focus on maintaining manageable and current inventory levels led to a lower inventory value as at December 31, 2001.

Working capital decreased from \$2,804,596 at December 31, 2000 to \$1,111,171 at December 31, 2001. Net cash used for operating activities was \$1,622,103 in 2001 compared to net cash provided by operating activities of \$2,275,773 in 2000. Cash for additions to equipment and leasehold improvements was \$47,433 in 2001 compared to \$140,586 for 2000.

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 for 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.

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

#### 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

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#### New Accounting Pronouncements

The Company has determined that the new pronouncements that will come into effect in the year 2002 will not have an 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.

**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.

#### Item 8.

#### Selected Quarterly Financial Data:

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For the fiscal year 2001:

|                                            | March 31     | June 30      | September 30 | December 31  |
|--------------------------------------------|--------------|--------------|--------------|--------------|
|                                            |              |              |              |              |
| Net sales                                  | \$ 2,216,816 | \$ 1,835,043 | \$ 2,089,612 | \$ 2,746,096 |
| Gross profit                               | 702,215      | 367,340      | 822,358      | 930,611      |
| Unusual items                              | —            | (523,395)    | (214,089)    | (100,617)    |
| (Loss) income before<br>extraordinary item | (585,117)    | (741,343)    | 57,769       | (798,339)    |
| Gain on forgiveness of debt                | —            | 695,538      | —            | —            |
| Net (loss) earnings                        | (585,117)    | (45,805)     | 57,769       | (798,339)    |
| (Loss) earnings per share:                 |              |              |              |              |
| Basic before extraordinary item            | (0.72)       | (0.60)       | 0.04         | (0.62)       |
| Extraordinary item                         | —            | 0.56         | —            | —            |
| Basic                                      | (0.72)       | (0.04)       | 0.04         | (0.62)       |
| Diluted                                    | (0.72)       | (0.04)       | 0.04         | (0.62)       |

For the fiscal year 2000:

|                                            | March 31     | June 30      | September 30 | December 31  |
|--------------------------------------------|--------------|--------------|--------------|--------------|
|                                            |              |              |              |              |
| Net sales                                  | \$ 3,491,867 | \$ 2,153,727 | \$ 4,592,192 | \$ 1,780,099 |
| Gross profit                               | 478,547      | (325,818)    | 838,656      | (631,215)    |
| Unusual items                              | —            | 264,000      | 2,379,674    | 446,272      |
| (Loss) income before<br>extraordinary item | (823,094)    | (1,481,098)  | (3,578,978)  | (4,273,544)  |

|                                 |           |             |             |             |
|---------------------------------|-----------|-------------|-------------|-------------|
| Net (loss) earnings             | (823,094) | (1,481,098) | (3,578,978) | (4,273,544) |
|                                 |           |             |             |             |
| Preferred stock dividends       | 9,375     | 9,375       | 6,250       | 6,250       |
|                                 |           |             |             |             |
| Net (loss) applicable to        |           |             |             |             |
| common stockholders             | (832,469) | (1,490,473) | (3,585,228) | (4,279,793) |
|                                 |           |             |             |             |
| (Loss) earnings per share:      |           |             |             |             |
| Basic before extraordinary item | (1.05)    | (1.89)      | (4.44)      | (5.33)      |
| Extraordinary item              | –         | –           | –           | –           |
| Basic                           | (1.05)    | (1.89)      | (4.44)      | (5.33)      |
| Diluted                         | (1.05)    | (1.89)      | (4.44)      | (5.33)      |

## 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

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

Not applicable

## PART III

## Item 10.

## Directors and Executive Officers

Pursuant to the Bylaws of the Company, the number of directors constituting the full Board of Directors has been fixed by the Board at four (4). At the Annual Meeting, four (4) individuals will be elected to serve as directors until the next annual meeting and until their successors are duly elected, appointed and qualified.

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Set forth below is the name, age, principal occupation during the past five years and other information concerning each nominee.

| <u>Name</u>       | <u>Position with Company</u> | <u>Age</u> | <u>Director Since</u> |
|-------------------|------------------------------|------------|-----------------------|
| Elliot Bier       | Director, Chairman           | 52         | July 1993             |
| Stephen Altro     | Director                     | 64         | July 1993             |
| David Mars        | Director                     | 64         | July 1993             |
| James B. Rybakoff | Director                     | 35         | May 1996              |

### 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.

### 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.

### 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.

Directors are elected annually by the shareholders and hold office until the next annual meeting and until their respective successors are elected and qualified. There are no family relationships among any of the Company's directors and executive officers.

Each of Messrs. Altro and Mars were executive officers of Grand Group Inc., the Company's former United States Operating Company ("Grand Group"). On January 4, 1996, an order for relief under Chapter 7 of the United States Bankruptcy Code was entered against Grand Group, at which time a trustee was appointed to supervise its liquidation.

Directors do not get paid any compensation for attendance at directors' meetings or for attending or participating in any committee meetings, but are eligible to participate in our Stock Option Plan. Directors who are also officers are not paid any compensation for attendance at directors' meetings or for attending or participating in any committee meetings. Non-employee directors are compensated for their services and attendance at meetings through the automatic quarterly grant of 125 options pursuant to our Stock Option Plan.

In 2001, Elliot Bier received \$42,000 as compensation for performing his duties of Chairman, and 36,000 options granted in October 2001.

## THE BOARD OF DIRECTORS AND COMMITTEES OF THE BOARD OF DIRECTORS

### Meetings of the Board of Directors

During the fiscal year ended December 31, 2001, the Board of Directors held three meetings and each of the Directors attended all of the meetings.

### Audit Committee

The Audit Committee consists of two directors, Elliot L. Bier and James B. Rybakoff . 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 our examination reports prepared by regulatory authorities, and (iii) provides the Board with such assistance as is necessary with respect to our 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. A copy of the Audit Committee's Charter is attached as an Exhibit to the proxy statement for the 2001 Annual Meeting of Shareholders. During the fiscal year ended December 31, 2001, the Audit Committee did not hold any meetings, but took action by written consent two times. See "Audit Committee Report."

### Compensation Committee

The Compensation Committee consists of two directors: Elliot L. Bier and James B. Rybakoff. The Compensation Committee reviews and approves the compensation for our senior management, officers and directors. It also administers the Company's Stock Option Plan. During the fiscal year ended December 31, 2001, 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

During the fiscal year ended December 31, 2001, Elliot L. Bier and James B. Rybakoff served as the members of our Compensation Committee. None of the members of our Compensation Committee was, during the fiscal year ended December 31, 2001, one of our officers or employees, or one of our former officers.

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

## EXECUTIVE OFFICERS AND KEY EMPLOYEES

### Executive Officers

Our executive officers are:

|                |                                       |
|----------------|---------------------------------------|
| R. Ian Bradley | President and Chief Executive Officer |
|----------------|---------------------------------------|

|                 |                                                      |
|-----------------|------------------------------------------------------|
| Tania M. Clarke | Executive Vice President and Chief Financial Officer |
|-----------------|------------------------------------------------------|

Mr. Bradley, 56 years old, began with the Company on January 16, 2001. Mr. Bradley has extensive experience in the toy and retailing industries, having served in various executive positions with Mattel Canada Inc. from 1983 to 1997, where he was President from 1990 to 1997, and as Vice President Finance & Administration of Dylex Limited, a leading Canadian retailer, from 1999 to 2000. During 1998, Mr. Bradley was a consultant for Dylex Limited and Baldwin Paper. From August 2000 to January 2001, he was Chief Financial Officer of Forbes Meditech.

Tania M. Clarke, 34 years old, has been the Executive Vice-President and Chief Financial Officer of the Company since December 4, 2000, and has been employed by the Company in various other financial capacities since May 3, 1993. Prior thereto, Ms. Clarke was employed by KPMG LLP, as an external auditor for 3 years. Ms. Clarke is a Canadian Chartered Accountant and a U.S. Certified Public Accountant.

### Key Employees

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

#### Robert Herbst

has been the *Vice-President of Operations*. 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 1, 2001. Prior thereto he worked at Tucker Plastics and the Home Depot.

#### Glennis Carey

has been the *Director of Marketing* for Grand Canada for 20 years. Prior thereto, Ms. Carey worked for Mattel International, Inc., in marketing for ten years.

### 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, 2001, with the following exception: Elliot Bier, Chairman, Secretary and a Director, filed a form 4 transaction late, covering the grant of options to purchase 36,000 shares of Common Stock.

### 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, 1999, 2000 and 2001, respectively, to the Company's Chief Executive Officer and each of the four most highly compensated executive officers other than the CEO who served in

such capacity at the end of fiscal 2001 whose total annual salary and bonus for each of the three years ended December 31, 2001, 2000 and 1999 exceeded \$100,000 (collectively, the "Named Executive Officers").

## Summary Compensation Table

| Name and<br>Principal<br>Position | Annual Compensation |             |           |                                      | Long-term Compensation Awards              |                                   |
|-----------------------------------|---------------------|-------------|-----------|--------------------------------------|--------------------------------------------|-----------------------------------|
|                                   | Year                | Salary (\$) | Bonus(\$) | Other Annual<br>Compensation<br>(\$) | Securities<br>Underlying<br>Options<br>(#) | All Other<br>Compensation<br>(\$) |
| Ian Bradley                       | 2001                | 112,051(2)  | -         | 10,500(3)                            | 37,500                                     | -                                 |
| C h i e f<br>Executive            | 2000                | -           | -         | -                                    | -                                          | -                                 |
| Officer and                       | 1999                | -           | -         | -                                    | -                                          | -                                 |
| President (1)                     |                     |             |           |                                      |                                            |                                   |

- Mr. Bradley joined the Company on January 16, 2001.

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

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

The following table sets forth further information regarding the stock option grants during fiscal 2001 to the officers named in the Summary Compensation Table above.

## Option Grants in 2001

|  | Options | % of Total<br>Options<br>Granted to | Exercise or |  | Potential Realizable Value<br>at Assumed Annual Rates of<br>Stock Price Appreciation |
|--|---------|-------------------------------------|-------------|--|--------------------------------------------------------------------------------------|
|  |         |                                     |             |  |                                                                                      |
|  |         |                                     |             |  |                                                                                      |

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| Name        | Granted<br>(#) | Employees | Base Price<br>(\$/Share) | Expiration<br>Date | for 10 year Option Term |          |
|-------------|----------------|-----------|--------------------------|--------------------|-------------------------|----------|
|             |                |           |                          |                    | 5% (\$)                 | 10% (\$) |
| Ian Bradley | 37,500         | 22.0      | 2.50                     | January 2011       | 0.54                    | 1.16     |

All of the Options granted during 2001 were granted independent of our amended and restated stock option plans.

Aggregated Option Exercises in Fiscal Year 2001 and Option Values as of December 31, 2001

The following table sets forth certain information concerning the exercise of options by each of the Named Executive Officers during fiscal 2001, including the aggregate amount of gains on the date of exercise. In addition, the table includes the number of shares underlying both exercisable and unexercisable stock options as of December 31, 2001. Also reported are 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, 2001, as determined by the closing price of our Common Stock on that date as reported by NASDAQ.

| Name        | Shares<br>Acquired<br>On<br>Exercise<br>(#) | Value<br>Realized<br>\$(1) | Number of Securities<br>Underlying Unexercised<br>Options at Fiscal Year-End<br>(#) |               | Value of Unexercised<br>In-the-Money<br>Options<br>At Fiscal Year-End<br>(\$) |               |
|-------------|---------------------------------------------|----------------------------|-------------------------------------------------------------------------------------|---------------|-------------------------------------------------------------------------------|---------------|
|             |                                             |                            | Exercisable                                                                         | Unexercisable | Exercisable<br>(2)                                                            | Unexercisable |
| Ian Bradley | -                                           | -                          | 37,500                                                                              | -             | \$93,750                                                                      | -             |

1. "Value Realized" represents the fair market value of the shares of Common Stock underlying the option on the date of exercise less the aggregate exercise price of the option.

1. Closing stock price on December 31, 2001 was \$2.99.

Board 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 is employed as Chief Executive Officer and President, and has 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. \$118,000 as of December 31, 2001).

#### 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 2001 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.

Generally, the Compensation Committee reserves the right to pay compensation to our executives in amounts it deems appropriate regardless of whether such compensation is deductible for federal income tax purposes. Options granted to

executives in fiscal 1997 are potentially subject to limits on permitted federal income tax deductions upon exercise of such options, including under current treasury regulations concerning the \$1,000,000 cap on executive compensation deductions under Section 162(m) of the Internal Revenue Code of 1986, as amended. The Committee determined to recommend the grants of options to executives in July 1997 despite such options potentially being subject to the \$1,000,000 cap on executive compensation. The Committee determined that such grants were more important to us than the potential loss of related compensation deductions upon exercise of the options.

#### 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, 2001, we contributed approximately \$17,000 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. 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

Elliot L. Bier

#### Compensation Committee Interlocks and Insider Participation

As noted above, the members of the Compensation Committee during fiscal 2001 were Messrs. Rybakoff and Bier. For a description of the business relationship between each of them and the Company see "Certain Relationships and Related Transactions." Mr. Rybakoff has never been an officer or employee of the Company. Mr. Bier was appointed Chairman of the Board of the Company on November 16, 2000. None of the executive officers of the Company served as a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of such committee, the entire board of directors) of another entity during 2001.

#### 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.*

Item 12.

#### Security Ownership of Certain Beneficial Owners and Management

The following table sets forth certain information regarding beneficial ownership of our common stock as of March 27, 2002 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 our Named Executive Officers (as defined below) and (iv) all of our 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 Owner                                       | Number of Shares Beneficially Owned | Percent of Class and Voting Power (1) |
|----------------------------------------------------------------------------|-------------------------------------|---------------------------------------|
| David Mars<br>1710 Rte. Transcanadienne<br>Dorval, QC, Canada H9P 1H7      | 1,034,080 (2)                       | 33%                                   |
| Stephen Altro<br>1710 Rte. Transcanadienne<br>Dorval, QC, Canada, H9P 1H7  | 988,366 (3)                         | 32%                                   |
| Ofer Nissim<br>65 High Ridge Road, Suite 500<br>Stanford, CT, 06905        | 348,463 (4)                         | 11%                                   |
| R. Ian Bradley<br>1710 Rte. Transcanadienne<br>Dorval, QC, Canada, H9P 1H7 | 112,500 (5)                         | 4%                                    |
| James B. Rybakoff<br>780 Third Avenue<br>New York, NY 10017                | 56,250 (6)                          | 2%                                    |
| Elliot L. Bier                                                             |                                     |                                       |

999 Boul. de Maisonneuve Ouest

Montreal, QC, Canada H3A 3L4

37,250 (7)

1%

All Executive officers and directors

as a group (six persons)

2,576,909 (8)

72%

- Computed on the basis of 1,285,200 shares of Common Stock and, with respect to those persons holding convertible 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.

2) Includes 37,500 shares of common stock held by Amgo Investments, Inc, a company controlled by David Mars and Stephen Altro ("Amgo"), 457,142 shares held by 136012 Canada Inc. 157,142 shares held by 2884330 Canada Inc., and 280,000 shares held by Mr. Mars, in addition to 12,188 shares of Common Stock issuable upon exercise of stock options held by Mr. Mars. Mr. Mars' interest in Amgo is owned of record by 2884330 Canada Inc., a privately held corporation controlled by Mr. Mars, and of which his wife and children are the only other stockholders. Mr. Mars disclaims beneficial ownership of 18,750 shares of common stock owned by Amgo and beneficially owned by Mr. Altro. Mr. Mars is a director of Grand.

3. Includes 37,500 shares of common stock held by Amgo, 323,714 shares held by 2870304 Canada Inc. and 323,714 shares held by 136011 Canada Inc., and 304,000 shares held by Mr. Altro in addition to 12,188 shares of Common Stock issuable upon exercise of stock options held by Mr. Altro. Mr. Altro's interest in Amgo is owned of record by 2870304 Canada Inc., a privately-held corporation controlled by Mr. Altro, and of which his wife and children are the only other stockholders. Mr. Altro disclaims beneficial ownership of 18,750 shares of common stock owned by Amgo and beneficially owned by Mr. Mars. Mr. Altro is a director of Grand.

4. Includes options to purchase 12,500 shares of common stock executed within sixty (60) days. Mr. Nissim's holdings of 93,750 shares is held indirectly through Knox Security Engineering Corp. and Ark Foundation LLC and 242,213 shares issued as part of a settlement agreement.

5) Represents currently exercisable options to purchase 37,500 shares of common stock issued pursuant to our Amended and Restated 1993 Stock Option Plan (the "Stock Option Plan") and 75,000 shares held by Mr. Bradley.

6. Includes currently exercisable 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 currently exercisable options to purchase 1,250 shares of common stock issued pursuant to our Stock Option Plan. Mr. Rybakoff is the controlling member of Akin Bay, and is a director of Grand.

7. Represents currently exercisable options to purchase 1,250 shares of Common Stock issued pursuant to our Stock Option Plan, and 36,000 shares issued upon exercise of options granted outside the stock option plan. Mr. Bier is a director of Grand.

- See Footnotes (1) - (7).

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, 2001, we paid Adessky, Poulin an aggregate of \$40,352 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 in the Orient. All transactions of Grand Toys (H.K.) are performed on behalf of the Company at cost.

Item 14.

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, 2001 and December 31, 2000

Consolidated Statements of Operations for the Years Ended December 31, 2001, 2000 and 1999

Consolidated Statements of Stockholders' Equity and Comprehensive Income for the Years Ended December 31, 2001, 2000 and 1999

Consolidated Statements of Stockholders' Equity and Comprehensive Income for the Years Ended December 31, 2001, 2000 and 1999

Consolidated Statements of Cash Flows for the Years Ended December 31, 2001, 2000, and 1999

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                                                  |
| ####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                                                                          |

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

c. Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended December 31, 2001.

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Exhibits to

Form 10 - K/A

of

GRAND TOYS INTERNATIONAL, INC.

For the Fiscal Year Ended December 31, 2001

Schedule

**11**

## VALUATION AND QUALIFYING ACCOUNTS AND ALLOWANCES

| Balance                         |            |               |              |           |
|---------------------------------|------------|---------------|--------------|-----------|
| At                              | Additions  |               | Balance      |           |
| Beginning                       | Charged to | Net           | At           |           |
| Of Year                         | Operations | Deductions(a) | End          | Of        |
|                                 |            |               | Year         | Year      |
| Allowance for Doubtful Accounts |            |               |              |           |
| Year Ended December 31, 2001    |            | \$ 24,008     | \$ (158,890) | \$ 12,556 |
|                                 |            |               | \$147,438    |           |
| Year Ended December 31, 2000    |            | 90,805        | 94,072       | 24,008    |
| Year Ended December 31, 1999    |            | 43,143        | 84,294       | 90,805    |
| Provision for Loan Receivable   |            |               |              |           |
| 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.

**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.

Exhibit 23

INDEPENDENT AUDITORS' CONSENT

The Board of Directors

Grand Toys International, Inc.

We consent to incorporation by reference in the registration statement (No. 333-68957) on Form S-8 and registration statement (No. 333-81526) on Form S-3 of Grand Toys International, Inc. of our report dated March 1, 2002, relating to the consolidated balance sheets of Grand Toys International, Inc. as of December 31, 2001 and 2000, and the related 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, 2001, and related schedules which report appears in the December 31, 2001 annual report on Form 10-K/A of Grand Toys International, Inc.

Our report dated March 1, 2002 contains an explanatory paragraph that states that the Company has suffered recurring losses, which raise substantial doubt about its ability to continue as a going concern. The consolidated financial statements and financial statement schedules do not include any adjustments that might result from the outcome of that uncertainty.

(signed) KPMG LLP

Chartered Accountants

Montreal, Canada

July 7, 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 29, 2002 | GRAND TOYS INTERNATIONAL, INC. |
|                       |                                |
|                       | By: /S/ R. Ian Bradley         |
|                       | R. Ian Bradley                 |
|                       | President and CEO              |
|                       |                                |

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     | Chairman and Director                           | March 29, 2002 |
| Elliot Bier         |                                                 |                |
|                     |                                                 |                |
|                     |                                                 |                |
| /S/ R. Ian Bradley  | President and CEO (Principal Executive Officer) | March 29, 2002 |
| R. Ian Bradley      |                                                 |                |
|                     |                                                 |                |
|                     |                                                 |                |
| /S/ Tania M. Clarke | Executive Vice President and CFO                |                |
| Tania M. Clarke     | (Principal Financial and Accounting Officer)    | March 29, 2002 |
|                     |                                                 |                |

|                    |          |                |
|--------------------|----------|----------------|
|                    |          |                |
| /S/ James Rybakoff | Director | March 29, 2002 |
| James Rybakoff     |          |                |
|                    |          |                |
|                    |          |                |
| /S/ David Mars     | Director | March 29, 2002 |
| David Mars         |          |                |
|                    |          |                |
|                    |          |                |
| /S/ Stephen Altro  | Director | March 29, 2002 |
| Stephen Altro      |          |                |
|                    |          |                |
|                    |          |                |

Consolidated Financial Statements of

GRAND TOYS INTERNATIONAL, INC

Years ended December 31, 2001, 2000 and 1999

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, 2001 and 2000 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, 2001. 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 an audit to obtain reasonable assurance 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.

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, 2001 and 2000 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2001, 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 1, 2002

GRAND TOYS INTERNATIONAL, INC.

Consolidated Financial Statements

Years ended December 31, 2001, 2000 and 1999

Financial Statements

|                                                                          |     |
|--------------------------------------------------------------------------|-----|
| Consolidated Balance Sheets.                                             | F-4 |
| Consolidated Statements of operations                                    | F-6 |
| Consolidated Statements of Stockholders' Equity and Comprehensive Income | F-7 |
| Consolidated Statements of Cash Flows                                    | F-8 |

## GRAND TOYS INTERNATIONAL, INC.

## Consolidated Balance Sheets

Years ended December 31, 2001, 2000 and 1999

|                                                    | 2001      | 2000       |
|----------------------------------------------------|-----------|------------|
|                                                    |           |            |
| Assets                                             |           |            |
|                                                    |           |            |
| Current assets:                                    |           |            |
| Cash                                               | \$ -      | \$ 211,515 |
| Short-term deposit (note 16(d))                    | 250,000   | -          |
| Accounts receivable (net of allowance for          |           |            |
| doubtful accounts of \$12,556;<br>2000 - \$24,008) | 1,386,333 | 1,535,327  |
| Current portion of loan receivable (note 3)        |           |            |

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|                                                    |              |              |
|----------------------------------------------------|--------------|--------------|
| (net of provision of nil; 2000 - \$434,371)        | 194,494      | 434,371      |
| Due from employees and affiliated company          | 2,034        | 40,551       |
| Income taxes recoverable                           | 143,668      | 464,455      |
| Inventory                                          | 1,838,770    | 1,991,918    |
| Prepaid expenses (note 4(a))                       | 781,867      | 762,234      |
| Total current assets                               | 4,597,166    | 5,440,371    |
|                                                    |              |              |
| Loan receivable, (note 3)                          | 548,721      | -            |
|                                                    |              |              |
| Other assets (note 4)                              | 236,436      | -            |
|                                                    |              |              |
| Deferred income taxes (note 12 (c))                | -            | 684,996      |
|                                                    |              |              |
|                                                    |              |              |
| Equipment and leasehold improvements, net (note 5) | 360,275      | 457,016      |
|                                                    |              |              |
|                                                    |              |              |
|                                                    |              |              |
| Total assets                                       | \$ 5,742,598 | \$ 6,582,383 |

|                                      |      |      |
|--------------------------------------|------|------|
|                                      | 2001 | 2000 |
|                                      |      |      |
| Liabilities and Stockholders' Equity |      |      |
|                                      |      |      |
| Current liabilities:                 |      |      |

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|                                                 |            |           |
|-------------------------------------------------|------------|-----------|
| Bank indebtedness (note 6)                      | \$ 602,577 | \$ -      |
| Trade accounts payable                          | 1,974,030  | 1,610,029 |
| Other accounts payable and accrued liabilities  | 307,974    | 334,318   |
| Provision for lawsuit (note 16 (c))             | -          | 550,000   |
| Shortfall on share conversions (note 8)         | 581,310    | 118,000   |
| Royalties payable                               | 20,104     | 23,428    |
| Total current liabilities                       | 3,485,995  | 2,635,775 |
|                                                 |            |           |
| Long term debt (note 7)                         | -          | 1,500,000 |
|                                                 |            |           |
| Minority interest                               | 100        | 100       |
|                                                 |            |           |
| Convertible Redeemable preferred stock (note 8) | -          | 500,000   |
|                                                 |            |           |
| Stockholders' equity:                           |            |           |
| Capital stock (note 9):                         |            |           |
| Voting common stock, \$0.001 par value:         |            |           |
| 12,500,000 shares authorized,                   |            |           |
| 1,285,119 shares issued and outstanding         |            |           |
| (2000 - 808, 726 shares)                        | 1,285      | 3,235     |
| Series B preferred stock, \$0.001 par value:    |            |           |
| 915,000 shares authorized,                      |            |           |
| 915,000 shares issued and outstanding           |            |           |
| (2000 - nil shares)                             | 800        | -         |
|                                                 | 2,085      | 3,235     |

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|                                                 |              |              |
|-------------------------------------------------|--------------|--------------|
| Additional paid-in capital                      | 21,496,788   | 19,696,577   |
| Deficit                                         | (18,253,908) | (16,882,416) |
| Accumulated other comprehensive income-         |              |              |
| cumulative currency translation adjustment      | (988,462)    | (870,888)    |
|                                                 | 2,256,503    | 1,946,508    |
| Commitments and contingencies (notes 15 and 16) |              |              |
|                                                 |              |              |
| Total liabilities and stockholders' equity      | \$ 5,742,598 | \$ 6,582,383 |

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

|                                | 2001         | 2000          | 1999          |
|--------------------------------|--------------|---------------|---------------|
|                                |              |               |               |
| Net sales                      | \$ 8,887,567 | \$ 12,017,885 | \$ 37,260,250 |
|                                |              |               |               |
| Cost of goods sold (note 1(d)) | 6,065,044    | 11,657,715    | 26,481,341    |
|                                |              |               |               |
| Gross profit                   | 2,822,523    | 360,170       | 10,778,909    |
|                                |              |               |               |
| Operating expenses:            |              |               |               |

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|                                                  |                |                 |              |
|--------------------------------------------------|----------------|-----------------|--------------|
| General and administrative                       | 3,595,413      | 4,171,418       | 5,937,093    |
| Salaries and fringe benefits                     | 1,685,409      | 2,075,736       | 3,893,546    |
| Royalties                                        | 252,506        | 250,523         | 280,782      |
| Bad debt expense                                 | 147,438        | 94,072          | 84,294       |
| Depreciation and amortization                    | 122,952        | 283,340         | 405,804      |
| Foreign exchange loss (gain)                     | 88,270         | 26,667          | (177,982)    |
| Interest on long term debt                       | -              | 109,800         | 87,192       |
| Other interest expense                           | 47,271         | 778,305         | 457,061      |
| Interest revenue                                 | (101,383)      | (134,072)       | -            |
| Unusual items (note 11)                          | (838,102)      | 3,625,055       | 814,669      |
|                                                  | 4,999,774      | 11,280,844      | 11,782,459   |
| Loss before income taxes and extraordinary item  | (2,177,251)    | (10,920,674)    | (1,003,550)  |
|                                                  |                |                 |              |
| Income taxes recovery (expense) (note 12):       |                |                 |              |
| Current                                          | 295,632        | 763,961         | (390,912)    |
| Deferred                                         | (185,411)      | -               | 684,996      |
|                                                  | 110,221        | 763,961         | 294,084      |
| Loss before extraordinary item                   | (2,067,030)    | (10,156,713)    | (709,466)    |
| Extraordinary item:                              |                |                 |              |
| Gain on forgiveness of long-term debt            |                |                 |              |
| net of deferred income taxes of 499,585 (note 7) | 695,538        | -               | -            |
|                                                  |                |                 |              |
| Net loss                                         | \$ (1,371,492) | \$ (10,156,713) | \$ (709,466) |
|                                                  |                |                 |              |

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|                                             |             |              |           |
|---------------------------------------------|-------------|--------------|-----------|
| Preferred stock dividends                   | -           | 31,250       | 50,000    |
| Net loss applicable to                      |             |              |           |
| common stockholders                         | (1,371,492) | (10,187,963) | (759,466) |
|                                             |             |              |           |
| Earnings per share (notes 1 (j) and 13):    |             |              |           |
| Basic and diluted before extraordinary item | \$ (1.75)   | \$ (12.70)   | \$ (1.42) |
| Extraordinary item-basic and diluted        | 0.59        | -            | -         |
| Basic                                       | (1.16)      | (12.70)      | (1.42)    |
| Diluted                                     | (1.16)      | (12.70)      | (1.42)    |
|                                             |             |              |           |

See accompanying notes to consolidated financial statements.

## GRAND TOYS INTERNATIONAL, INC.

## Consolidated Statements of Stockholders' Equity and Comprehensive Income

Years ended December 31

|                                | Capital<br>Stock | Additional<br>paid in<br>capital | Deficit        | Accumulated<br>other<br>comprehensive<br>income | Total        |
|--------------------------------|------------------|----------------------------------|----------------|-------------------------------------------------|--------------|
| January 1, 1999                | \$ 1,578         | \$ 10,599,559                    | \$ (5,991,237) | \$ (648,173)                                    | \$ 3,961,727 |
|                                |                  |                                  |                |                                                 |              |
| Net loss for the year          | -                | -                                | (709,466)      | -                                               | (709,466)    |
| Foreign currency<br>adjustment | -                | -                                | -              | 59,847                                          | 59,847       |
|                                | -                | -                                | -              | -                                               | (649,619)    |

|                                         |         |              |                |             |              |
|-----------------------------------------|---------|--------------|----------------|-------------|--------------|
| Total comprehensive income              |         |              |                |             |              |
|                                         |         |              |                |             |              |
| Dividends                               | -       | -            | (25,000)       | -           | (25,000)     |
|                                         |         |              |                |             |              |
| Stock options                           | 1,557   | 8,440,118    | -              | -           | 8,441,675    |
|                                         |         |              |                |             |              |
| Warrants                                | -       | 275,000      | -              | -           | 275,000      |
| December 31, 1999                       | 3,135   | 19,314,677   | (6,725,703)    | (588,326)   | 12,003,783   |
|                                         |         |              |                |             |              |
| 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 conversion (note 9 (c))           | 100     | 499,900      | -              | -           | 500,000      |
|                                         |         |              |                |             |              |
| Shortfall on share conversions (note 8) | -       | (118,000)    | -              | -           | (118,000)    |
| December 31, 2000                       | \$3,235 | \$19,696,577 | \$(16,882,416) | \$(870,888) | \$1,946,508  |
| 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 9 (c))          | 100     | 499,900      | -              | -           | 500,000      |
|                                         | -       | (463,310)    | -              | -           | (463,310)    |

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|                                                                    |          |              |                |             |              |
|--------------------------------------------------------------------|----------|--------------|----------------|-------------|--------------|
| Shortfall on share conversions (note 8)                            |          |              |                |             |              |
| Share issuance in settlement of long- term debt (notes 7 and 9(c)) | 375      | 304,312      | -              | -           | 304,687      |
| Private Sale of common stock (note 9 (c))                          | 1,428    | 498,572      | -              | -           | 500,000      |
| Reverse stock split (note 9)                                       | (3,854)  | 3,854        | -              | -           | -            |
| Stock options (note 9 (c))                                         | 1        | 682          | -              | -           | 683          |
| Private sale of preferred stock (note 9 (c))                       | 800      | 799,200      | -              | -           | 800,000      |
| Compensation expense (note 10)                                     | -        | 157,001      | -              | -           | 157,001      |
| December 31, 2001                                                  | \$ 2,085 | \$21,496,788 | \$(18,253,908) | \$(988,462) | \$ 2,256,503 |

See accompanying notes to consolidated financial statements.

GRAND TOYS INTERNATIONAL, INC.

Consolidated Statements of Cash Flows

Years ended December 31

|                                               | 2001          | 2000           | 1999        |
|-----------------------------------------------|---------------|----------------|-------------|
| Cash flows from operating activities:         |               |                |             |
| Net loss                                      | \$(1,371,492) | \$(10,156,713) | \$(709,466) |
| Adjustments for:                              |               |                |             |
| Depreciation and amortization                 | 122,952       | 496,059        | 511,404     |
| Compensation expense                          | 68,735        | -              | -           |
| Gain on forgiveness of long-term debt         | (1,195,123)   | -              | -           |
| Deferred income taxes                         | 684,996       | -              | (684,996)   |
| (Reduction of ) provision for loan receivable | (288,102)     | 434,371        | -           |

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|                                                      |             |             |             |
|------------------------------------------------------|-------------|-------------|-------------|
| 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   | -           |
| Write-off of equipment and leasehold improvements    | -           | -           | 267,613     |
| Loss on disposal of equipment                        | -           | 3,470       |             |
| Net change in operating working capital              |             |             |             |
| items (note 14)                                      | 318,744     | 6,730,159   | (691,250)   |
| Net cash (used for) provided by operating activities | (1,659,290) | 2,280,820   | (1,306,695) |
| Cash flows from financing activities:                |             |             |             |
| Increase (decrease) increase in bank indebtedness    | 605,819     | (426,299)   | (6,520,705) |
| Increase in deferred financing charges               | -           | (26,460)    | (511,034)   |
| (Decrease) increase in long term debt                | -           | (444,444)   | 444,444     |
| Share issuance proceeds (note 9 (c))                 | 1,300,683   | -           | 8,441,675   |
| Decrease(increase) in due from employees             |             |             |             |
| and affiliated company                               | 37,187      | (5,047)     | (22,408)    |
| Other                                                | -           | 278         | (20,359)    |
| Net cash provided by (used for) financing activities | 1,943,689   | (901,972)   | 1,811,613   |
| Cash flows from investing activities:                |             |             |             |
| Purchase of short-term deposit (note 16 (d))         | (250,000)   | -           | -           |
| Loan receivable                                      | (177,739)   | (1,052,169) | -           |
| Increase in other assets                             | (20,742)    | -           | -           |

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|                                                             |           |             |            |
|-------------------------------------------------------------|-----------|-------------|------------|
| Additions to equipment and leasehold improvements           | (47,433)  | (140,586)   | (570,081)  |
| Proceeds on disposal of equipment                           | -         | 25,422      | -          |
| Acquisition of assets                                       | -         | -           | 90,163     |
| Dividends paid                                              | -         | -           | (25,000)   |
| Net cash used for investing activities                      | (495,914) | (1,167,333) | (504,918)  |
| Net (decrease) increase in cash                             | (211,515) | 211,515     | -          |
| Cash, beginning of year                                     | 211,515   | -           | -          |
| Cash, end of year                                           | \$ -      | \$ 211,515  | \$ -       |
| Supplemental disclosure of cash flow information:           |           |             |            |
| Cash paid during the year for:                              |           |             |            |
| Interest                                                    | \$ 47,271 | \$ 109,800  | \$ 438,653 |
| Income taxes                                                | 29,800    | 467,900     | 148,962    |
| Non-cash transactions:                                      |           |             |            |
| Share conversions                                           | 500,000   | 500,000     | -          |
| Shortfall on share conversions                              | 463,310   | 118,000     | -          |
| See accompanying notes to consolidated financial statements |           |             |            |

GRAND TOYS INTERNATIONAL, INC.

Notes to Consolidated Financial Statements

Years ended December 31, 2001, 2000 and 1999

Grand Toys International, Inc., 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 a significant operating loss in fiscal 2000 primarily as a result of the loss of one of its major product lines and the reduced market demand for certain other products. The Company has again incurred an operating loss in the year ended December 31, 2001.

In 2001, the Company secured a line of credit to finance its inventory and accounts receivable and also realized net proceeds from the sale of capital stock and warrants. This financing however is not sufficient and the Company will require additional financing before the end of the 2002 fiscal year.

The above matters raise substantial doubt 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 obtaining additional financing and 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 recognized.

(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.

During the year ended December 31, 2000, Grand wrote down the slow-moving items that were not selling, such as WWF, WCW, Star Wars and Pokemon products. The amount written off was \$1,861,681. Such amount is included in Cost of Goods Sold.

(e) Prepaid expenses:

Prepaid expenses primarily include insurance, advances on inventory purchases and current portion of royalties and product development costs. Insurance costs are written off over the term of the respective policies on a straight-line basis.

Prepaid royalties relate to licensing agreements for character properties. These contracts can extend up to three years.

## (f) Other assets:

Prepaid royalties are capitalized and written off over the term of the related agreements.

Product development costs for proprietary product lines are capitalized and written off over a period of nineteen months on a straight-line basis.

Total expense for the year ended December 31, 2001 is \$63,318 (2000 - \$71,420, 1999 - \$159,522) and it is shown as part of cost of goods sold in the Statements of Operations.

## 1. Significant accounting policies (continued)

):

## (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           |
|-------------------------|-------------------|----------------|
|                         |                   |                |
| 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) Impairment of long-lived assets and long-lived assets to be disposed of:

Management reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows, undiscounted and without interest charges, expected to be

generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(i) Foreign currency translation:

(i) Grand Toys Ltd. and Grand Concepts Inc., wholly-owned Canadian subsidiaries, use the Canadian dollar as their functional currency and translate their 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.

(j) 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 give effect to all potentially dilutive common shares that existed at December 31, 2001.

1. Significant accounting policies (continued

):

k) Advertising and promotion:

All costs associated with advertising and promoting products are expensed in the period incurred. Total expense for the year is \$637,661 (2000 - \$720,556; 1999 - \$746,189). These expenses include media and cooperative advertising and are shown as part of Selling, 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.

(l) Employee stock option plan:

The Company accounts for its employee stock option plan in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees. As such, compensation expense is recorded on the date of grant only if the current market price of the

underlying stock exceeds the exercise price. Financial Accounting Standards Board ("FASB") Statement No. 123, Accounting for Stock-Based Compensation, allows entities to continue to apply the provisions of APB Opinion No. 25 and requires pro-forma net earnings and pro-forma earnings per share disclosures for employee stock option grants as if the fair-value-based method defined in FASB Statement No. 123 had been applied. This disclosure is included in the notes to these statements.

(m) Comprehensive income:

Comprehensive income consists of net income and cumulative currency translation adjustments and is presented in the consolidated statements of stockholders'equity and comprehensive income. The statement requires only additional disclosures in the consolidated financial statements; it does not affect the Company's financial position or results of operations.

(n) Use of estimates:

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

## 2. Acquisition:

On January 1, 1999, Ark Creations Inc. ("Ark Creations"), a wholly-owned subsidiary, acquired all of the assets of Ark Foundation LLC, for an aggregate of \$2,500,000, consisting of the Company's convertible preferred stock having a stated value of \$1,000,000 (see note 8) and an interest bearing promissory note of Ark Creations in the principal amount of \$1,500,000 (see note 7). The Company accounted for the acquisition under the purchase method of accounting.

The Company terminated the operations of Ark Creations during 2000 and recognized the permanent impairment in the value of goodwill and patents of \$2,253,516. The impairment is included in the caption, unusual items, in the Consolidated Statements of Operations (see note 11).

## 3. 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 11).

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%.

Details are as follows:

|                                                                               |            |
|-------------------------------------------------------------------------------|------------|
| Amount due repayable in monthly payments of principal and                     |            |
| interest of \$7,500 until November 30, 2001 and \$21,124 per month thereafter | \$ 743,215 |

|                      |            |
|----------------------|------------|
|                      |            |
| Less current portion | 194,494    |
|                      | \$ 548,721 |

**4. Other assets:**

|                                                    | 2001       | 2000       |
|----------------------------------------------------|------------|------------|
|                                                    |            |            |
| Prepaid royalties                                  | \$ 387,630 | \$ 207,987 |
| Product development costs                          | 182,560    | -          |
|                                                    | 570,190    | 207,987    |
|                                                    |            |            |
| Less current portion, included in prepaid expenses | 333,754    | 207,987    |
|                                                    | \$ 236,436 | \$ -       |

**(a) Prepaids**

|           | 2001       | 2000       |
|-----------|------------|------------|
|           |            |            |
| Royalties | \$ 333,754 | \$ 207,987 |
| Insurance | 234,534    | 173,386    |
| Inventory | 156,583    | 323,970    |
| Other     | 56,996     | 56,981     |
|           | \$ 781,867 | \$ 762,234 |

- Equipment and leasehold improvements:

|                         | 2001         |                          | 2000         |                          |
|-------------------------|--------------|--------------------------|--------------|--------------------------|
|                         | Cost         | Accumulated depreciation | Cost         | Accumulated depreciation |
| Computer equipment      | \$ 1,213,935 | \$ 985,304               | \$ 1,259,425 | \$ 952,836               |
| Machinery and equipment | 445,821      | 406,881                  | 464,258      | 422,610                  |
| Furniture and fixtures  | 482,598      | 434,492                  | 509,616      | 448,742                  |
| Trucks and automobiles  | 76,722       | 75,977                   | 81,494       | 80,365                   |
| Telephone equipment     | 42,486       | 37,499                   | 44,770       | 37,851                   |
| Leasehold improvements  | 321,479      | 282,613                  | 369,451      | 329,594                  |
|                         | \$ 2,583,041 | \$ 2,222,766             | \$ 2,729,014 | \$ 2,271,998             |
|                         |              |                          |              |                          |
| Net book value          | \$ 360,275   |                          | \$ 457,016   |                          |

- Bank indebtedness:

In 2001, the Company secured a line of credit to finance its inventory and accounts receivable for an amount up to \$1,500,000 (Cdn\$2,425,000). An additional amount of \$47,000 (Cdn\$75,000) was advanced 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 \$1,100 (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 has approximately \$540,000 of credit available as at December 31, 2001.

There Company's lines of credit do not contain debt covenants or cross-default provisions.

- Long term debt:

The Company's subsidiary, Ark Creations, incurred long-term indebtedness in the form of an interest bearing subordinated promissory note in the aggregate principal amount of \$1,500,000 in connection with the acquisition by Ark Creations of the assets of Ark Foundation, LLC (see note 2). Pursuant to the terms of the promissory note, interest was payable quarterly at a rate of 9.76% per annum until the first principal installment of \$500,000 was paid, and 5.76% per annum thereafter to maturity. A principal installment of \$500,000 was payable upon the achievement of certain sales targets, with a second installment of \$500,000 due six months thereafter, and a final installment of

\$500,000 due nine months after the first installment. The note was secured by a pledge by the Company of 93,750 shares of the Company's common stock.

Ark Creations ceased operations on March 30, 2000 after it was determined that it was not financially viable. As a result of the cessation of Ark Creation's business, it ceased making the interest payments required under the note. As a result of the default by Ark Creations, the holder of the note caused the 93,750 pledged shares to be registered in its name in February 2001.

As a result of the closing of Ark Creations and the registration and issuance of the pledged shares, 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.

- Convertible Redeemable preferred stock:

#### Series A Cumulative Convertible Redeemable Preferred Shares:

In connection with the acquisition of the assets of Ark Foundation LLC, the Company created and issued a class of 200,000 shares of non-voting Series A Convertible Redeemable Preferred Shares ("Series A shares") with a stated value of \$5.00 per share. The Series A shares rank senior to the common stock. The Series A shares have 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. 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 between January 2000 and August 2001. Because the market price of the common stock was below \$5.00 per share on certain of the conversion dates, the Company recorded shortfalls of \$118,000 in 2000 and \$463,310 in 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.

#### 9. 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 year-end.

(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 2000:

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

- July 2000:

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

- January 2001:

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

- February 2001:

In satisfaction of the full payment of the long-term debt of its US subsidiary, Ark Creations, which ceased operations in 2002, 93,750 common shares were issued, increasing capital stock by \$375.

- 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 converted to 12,500 common shares, increasing capital stock by \$50.

- November 2001:

500 options 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 is unpaid at year-end. This transaction increased capital stock by \$800.

(d) Summary of common stock outstanding:

A summary of the number of shares of common stock outstanding and share transactions since January 1, 2000 is as follows:

|                                                  |         |
|--------------------------------------------------|---------|
| January 1, 1999                                  | 394,408 |
| Issued on exercise of stock options and warrants | 389,318 |

|                                                                    |           |
|--------------------------------------------------------------------|-----------|
| December 31, 1999                                                  | 783,726   |
| Preferred share conversion (note 9 (c))                            | 25,000    |
| December 31, 2000                                                  | 808,726   |
| Share issuance on settlement of long-term debt (notes 7 and 9 (c)) | 93,750    |
| Share conversions (note 9 (c))                                     | 25,000    |
| Private sale (note 9 (c))                                          | 357,143   |
| Stock options (note 9 (c))                                         | 500       |
| December 31, 2001                                                  | 1,285,119 |

- Stock options and warrants

The Company's amended and restated employee stock option plan (the "Option Plan") provides for the issuance of up to 150,000 options 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<br>Plan | Other<br>stock<br>options | Warrants | Total    | Weighted-average<br>exercise<br>price<br>per share |
|-----------------|----------------|---------------------------|----------|----------|----------------------------------------------------|
| January 1, 1999 | 7,525          | 448,443                   | 67,500   | 560,968  | \$ 21.48                                           |
|                 |                |                           |          |          |                                                    |
| Granted         | -              | 36,875                    | 55,500   | 93,875   |                                                    |
| Forfeited       | -              | (70,000)                  | -        | (70,000) |                                                    |

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|                           |         |           |          |           |         |
|---------------------------|---------|-----------|----------|-----------|---------|
| Exercised                 | (4,625) | (370,443) | (55,500) | (432,068) |         |
| Expired                   | (1,550) | (1,000)   | (12,500) | (52,550)  |         |
| December 31,<br>1999      | 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,<br>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    |
| Options<br>outstanding at |         |           |          |           |         |
| December 31,<br>2001      | 134,093 | 236,875   | 412,143  | 783,111   | \$ 3.72 |
|                           |         |           |          |           |         |
| Options<br>exercisable at |         |           |          |           |         |
| December 31,<br>2001      | 27,950  | 186,875   | 55,000   | 269,825   | \$ 5.55 |

The following table summarizes information about options and warrants outstanding and exercisable at December 31, 2001:

|  |                     |                     |
|--|---------------------|---------------------|
|  | Options outstanding | Options exercisable |
|--|---------------------|---------------------|

| Range of exercise prices | Number  | Weighted-average exercise price | Weighted-average remaining contractual life (yrs) | Number  | Weighted-average exercise price |
|--------------------------|---------|---------------------------------|---------------------------------------------------|---------|---------------------------------|
|                          |         |                                 |                                                   |         |                                 |
| \$0.95 - \$1.96          | 269,843 | \$ 1.04                         | 9.19                                              | 167,450 | \$ 0.97                         |
| \$2.12 - \$2.99          | 398,643 | 2.16                            | 2.95                                              | 37,750  | 2.50                            |
| \$5.62 - \$11.00         | 75,750  | 10.61                           | 8.65                                              | 25,750  | 10.56                           |
| 16.00 - \$87.60          | 38,875  | 24.89                           | 7.32                                              | 38,875  | 24.89                           |
|                          |         |                                 |                                                   |         |                                 |
|                          | 783,111 | \$ 3.72                         | 5.87                                              | 269,825 | \$ 5.55                         |

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 pro-forma losses utilizing the fair value assumptions above for the years 2001, 2000 and 1999 would be \$1,831,049, \$10,347,760 and \$1,302,196, respectively. Furthermore, pro-forma loss per share would be \$1.55, \$12.90 and \$2.44, respectively.

The fair value for options granted to employees and non-employees was estimated at the grant date using a Black-Scholes option pricing model with the following weighted average assumptions: risk-free interest rate of 2.57% (5.19% in 2000, and 6.29% in 1999) volatility factor of the expected market price of the Company's common stock of 154% (164% in 2000 and 138% in 1999) and a weighted average expected life of the option of 3 years, (3 years in 2000 and 1999), with no dividends. The weighted-average grant date fair values of options and warrants granted in 2001, 2000 and 1999 are \$1.14, \$0.37 and \$1.08, respectively.

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.

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Modifications were also made 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. Compensation was also recorded in the financial statements in relation to options granted to a non-employee. 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.

• Unusual items:

These items comprised the following items:

|                                                                                             | 2001         | 2000         | 1999       |
|---------------------------------------------------------------------------------------------|--------------|--------------|------------|
| (Reduction of) provision for a lawsuit (note 16(c))                                         | \$ (550,000) | \$ 550,000   | \$ -       |
| (Reduction of) provision for loan receivable (note 3)                                       | (288,102)    | 434,371      | -          |
| Settlement of lawsuit by lessor of certain real estate                                      | -            | 264,000      | -          |
| Write-off intangibles (note 2)                                                              | -            | 2,253,516    | -          |
| Write-off of deferred acquisition costs                                                     | -            | 123,168      | -          |
| Penalty incurred to discontinue a major product line                                        | -            | -            | 382,056    |
| Severance costs, asset write offs and lease penalties in connection with the closure of the |              |              |            |
| manufacturing facility of Ark Creations, Inc                                                | -            | -            | 432,613    |
|                                                                                             |              |              |            |
|                                                                                             | \$ (838,102) | \$ 3,625,055 | \$ 814,669 |

Included in other interest expense, representing additional unusual items, are \$747,828 and \$105,600 in 2000 and 1999 respectively, of amortization and write-off of deferred financing costs.

• Income taxes:

(a) Income tax expense (recovery) consists of:

|                               | Current   | Deferred   | Total      |
|-------------------------------|-----------|------------|------------|
| Year ended December 31, 1999: |           |            |            |
| US                            | \$ -      | \$ 684,996 | \$ 684,996 |
| Canada                        | (390,912) | -          | (390,912)  |

|                               |              |              |              |
|-------------------------------|--------------|--------------|--------------|
|                               | \$ (390,912) | \$ 684,996   | \$ 294,084   |
| 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   |

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

|                                                 |        |        |        |
|-------------------------------------------------|--------|--------|--------|
|                                                 | 2001   | 2000   | 1999   |
|                                                 | (%)    | (%)    | (%)    |
|                                                 |        |        |        |
| U.S. Federal statutory tax rate                 | 35.0   | 35.0   | 35.0   |
|                                                 |        |        |        |
| Changes to US tax rate resulting from:          |        |        |        |
| Expenses producing no tax benefit               | 2.8    | 0.8    | (20.8) |
| Tax benefit of utilization of loss carryforward | -      | (20.9) | -      |
| Reversal of excess provision                    | (8.1)  | -      | -      |
| Other                                           | (24.6) | (7.8)  | 15.1   |
|                                                 | (32.7) | (27.9) | (5.7)  |
|                                                 |        |        |        |
| Effective tax rate                              | 5.1    | 7.1    | 29.3   |

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The Company has not provided for income taxes on foreign subsidiaries' undistributed earnings as of December 31, 2001 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, 2001 are presented below:

|                                   | 2001         | 2000         |
|-----------------------------------|--------------|--------------|
| Non-current:                      |              |              |
| Net operating loss carry forwards | \$ 5,350,791 | \$ 4,454,423 |
| Valuation allowance               | 5,350,791    | 3,769,427    |
|                                   |              |              |
| Total net deferred tax asset      | \$ -         | \$ 684,996   |

The valuation allowance increased in 2001 by \$1,581,364 due to the current year's loss (2000 increase of \$ 2,129,423).

As of December 31, 2001, the Company has \$ 10,740,000 (2000 - \$ 8,350,000) of net operating losses available for tax purposes to reduce future taxable income in the United States, beginning to expire in 2009.

• **Earnings per share:**

|                       | Income<br>(numerator) | Shares<br>(denominator) | Per Share<br>Amount |
|-----------------------|-----------------------|-------------------------|---------------------|
| December 31, 1999     |                       |                         |                     |
| <u>Basic EPS</u>      |                       |                         |                     |
| Earnings available to |                       |                         |                     |
| common stockholders   | \$ (759,466)          | 533,145                 | \$ (1.42)           |
| <u>Diluted EPS</u>    |                       |                         |                     |
| Earnings available to |                       |                         |                     |
| common stockholders   |                       |                         |                     |

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|                         |           |         |        |
|-------------------------|-----------|---------|--------|
| and assumed conversions | (759,466) | 533,145 | (1.42) |
|-------------------------|-----------|---------|--------|

|                         |                 |         |            |
|-------------------------|-----------------|---------|------------|
| December 31, 2000       |                 |         |            |
| <u>Basic EPS</u>        |                 |         |            |
| Earnings available to   |                 |         |            |
| common stockholders     | \$ (10,187,963) | 801,946 | \$ (12.70) |
| <u>Diluted EPS</u>      |                 |         |            |
| Earnings available to   |                 |         |            |
| common stockholders     |                 |         |            |
| and assumed conversions | (10,187,963)    | 801,946 | (12.70)    |

|                           | Income<br>(numerator) | Shares<br>(denominator) | Per Share<br>Amount |
|---------------------------|-----------------------|-------------------------|---------------------|
| December 31, 2001         |                       |                         |                     |
| <u>Basic EPS</u>          |                       |                         |                     |
| Before extraordinary item | \$ (2,067,030)        | 1,183,992               | \$ (1.75)           |
| Extraordinary item        | 695,538               | 1,183,992               | 0.59                |
| Earnings available to     |                       |                         |                     |
| common stockholders       | (1,371,492)           | 1,183,992               | (1.16)              |
| <u>Diluted EPS</u>        |                       |                         |                     |

|                         |             |           |        |
|-------------------------|-------------|-----------|--------|
| Earnings available to   |             |           |        |
| common stockholders     |             |           |        |
| and assumed conversions | (1,371,492) | 1,183,992 | (1.16) |

Options and warrants to purchase 783,111 shares (2000 - 229,718) 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:

|                                                 | 2001       | 2000         | 1999         |
|-------------------------------------------------|------------|--------------|--------------|
|                                                 |            |              |              |
| Decrease in accounts receivable                 | \$ 35,763  | \$ 6,584,004 | \$ 6,843     |
| Decrease (increase) in inventory                | 62,438     | 2,058,123    | (1,503,618)  |
| Decrease (increase) in income taxes recoverable | 302,067    | (469,707)    | -            |
| (Increase) decrease in prepaid expenses         | (11,880)   | (278,799)    | 362,085      |
| Increase (decrease) in trade accounts payable   | 432,516    | (518,932)    | 428,568      |
| Increase (decrease) in other accounts payable   |            |              |              |
| and accrued liabilities                         | 50,264     | 33,965       | (237,011)    |
| Decrease in provision for lawsuit               | (550,000)  | -            | -            |
| (Decrease) increase in royalties payable        | (2,424)    | 21,433       | (59,920)     |
| (Decrease) increase in income taxes payable     | -          | (699,928)    | 311,803      |
|                                                 | \$ 318,744 | \$ 6,730,159 | \$ (691,250) |

• Commitments:

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

|      |           |
|------|-----------|
| 2002 | \$372,000 |
| 2003 | 358,000   |
| 2004 | 240,000   |
| 2005 | 8,000     |
| 2006 | 8,000     |
|      | \$986,000 |

Rent expense for the years ended December 31, 2001, 2000 and 1999 amounted to approximately \$243,000, \$526,000 and \$420,000 respectively.

- Contingencies

:

- 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. On or about April 7, 2000, an action against the Company and certain of its current directors and a former director was filed in the United States District Court for the Southern District of New York by Robert Van Dyke, purportedly representing himself and a class of similarly situated purchasers of the Company's common stock. The class-action complaint sought damages and rescission and alleged that the Company's August 4, 1999 press release announcing an exclusive license to manufacture and distribute products in Canada based upon the "Pokemon" video game and television series was misleading because the license had not yet been executed and, when ultimately executed three weeks later, was non-exclusive.

The complaint further alleged that this affected the market price of the Company's stock during the three-week period. On November 7, 2000 the action was dismissed against two of the Company's directors.

Grand has not recorded an accrual related to the class-action complaint at December 31, 2000 as the case was not resolved and management could not predict the outcome of the litigation and the potential cost, if any.

On June 5, 2001, the Company and the plaintiffs signed a stipulation of settlement, which settled the suit for \$1,975,000. On September 24, 2001, the settlement was finalized.

The settlement resulted in minimal cost to the Company as a result of coverage under the Company's directors and officers (D & O) liability insurance policy.

- 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.

- The Company's Canadian subsidiary, Grand Toys Limited, is also contingently liable for an outstanding letter of credit of \$250,000 as at December 31, 2001. The short-term deposit has been pledged as collateral for this letter of credit.

- Employee benefit plans:

The Company has a 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 \$17,000 (2000 - \$20,000; 1999 - \$27,000) to the retirement savings plan for its Canadian employees.

- Segment information:

(a) Operating and geographic information:

The Company operates primarily in one segment which includes the distribution of toys and related items. Approximately 95% of total sales are to Canadian customers. The majority of long-lived assets are located in Canada.

(b) Other information:

|            |              | 2001 |               | 2000 |               | 1999 |
|------------|--------------|------|---------------|------|---------------|------|
|            | Revenue      | %    | Revenue       | %    | Revenue       | %    |
| Customer A | \$ 3,111,000 | 35   | \$ 2,404,000  | 20   | \$ 6,707,000  | 18   |
| B          | 978,000      | 11   | 2,043,000     | 17   | 6,334,000     | 17   |
| C          | 978,000      | 11   | 2,043,000     | 17   | 5,589,000     | 15   |
| D          | 622,000      | 7    | 1,442,000     | 11   | 3,353,000     | 9    |
| E          | 267,000      | 3    | 481,000       | 5    | 1,863,000     | 5    |
| All others | 2,931,567    | 33   | 3,604,885     | 30   | 13,414,250    | 36   |
|            | \$ 8,887,567 | 100  | \$ 12,017,885 | 100  | \$ 37,260,250 | 100  |

Sales of toys purchased from the Company's two largest manufacturers and suppliers of toys in aggregate accounted for 60% of gross sales for 2001. The Company's two largest suppliers accounted for 49% and 68% of gross sales for 2000 and 1999 respectively.

19. Financial instruments:

(a) Foreign currency risk management:

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 which they are intended to hedge.

At December 31, 2001, 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, 2001, approximately 67% (December 2000 - 69%; 1999 - 64%) of the Company's sales were made to five unrelated companies. Three customers representing approximately 57% (December 2000 - 53%; 1999 - 50%) of total sales individually accounted for more than 10% (2000 - 17%; 1999 - 10%) 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 rate.

20. Comparative Figures:

Certain of the 2000 comparative figures have been reclassified to conform with the basis of presentation adopted in the current year.