GRAND TOYS INTERNATIONAL INC
Form 10-Q
August 14, 2002

FORM 10-Q

Securities and Exchange Commission

Washington, D.C. 20549

(Mark One)

[**X**] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: **June 30, 2002**

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______________ to _______________.

Commission File No. **0-22372.**

GRAND TOYS INTERNATIONAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Nevada

98-0163743

(State or other jurisdiction of (I.R.S. Employer

incorporation or organization Identification No.)

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

(Address of principal executive offices)

(514) 685-2180

(Registrant's telephone number, including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **X** No _____

Indicate the number of shares outstanding of each of the Issuer's classes of common equity, as of August 14, 2002: 2,500,119

GRAND TOYS INTERNATIONAL, INC.

Index to Quarterly Report on Form 10 - Q

Filed with the Securities and Exchange Commission

Period ended June 30, 2002

GRAND TOYS INTERNATIONAL, INC.

Part I. - Financial Information

Item 1. Financial Statements

Consolidated Balance Sheets

	June 30, 2002	December 31, 2001
	(Unaudited)	

Assets		
Current assets:		
Short-term deposit (note 12(c))	$ 500,000	$ 250,000
Accounts receivable (net of allowance for		
doubtful accounts of $13,191; 2001 - $12,556)	1,530,014	1,183,175
Current portion of loan receivable (note 2)	203,412	194,494
Due from employees and affiliated company	2,275	2,034
Income taxes recoverable	1,632	143,668
Inventory	1,841,909	1,373,094
Prepaid expenses	627,929	698,597
Current assets of discontinued operations (note 15)	-	752,103
Total current assets	4,707,171	4,597,165
Loan receivable, (note 2)	444,735	548,721
Loan receivable, (note 15)	1,065,716	-
Other assets (note 3)	51,526	133,826
Other assets of discontinued operation (note 15)	-	102,610
Equipment and leasehold improvements, net (note 4)	322,621	360,275

Total assets	$ 6,591,769	$ 5,742,597

GRAND TOYS INTERNATIONAL, INC.

Consolidated Balance Sheets

	June 30, 2002	December 31, 2001
	(Unaudited)	
Liabilities and Stockholders' Equity		
Current liabilities:		
Bank indebtedness (note 5)	$ 1,202,606	$ 630,136
Trade accounts payable	1,494,645	1,483,506
Other accounts payable and accrued liabilities	797,512	297,470
Shortfall on share conversions (note 6)	-	581,310
Royalties payable	4,073	8,297
Current liabilities of discontinued operation (note 15)	-	485,275
Total current liabilities	3,498,836	3,485,994

Deferred gain (note 15)	612,006	-
Minority interest	100	100
Stockholders' equity:		
Capital stock (note 7):		
Voting common stock, $0.001 par value:		
12,500,000 shares authorized,		
2,442,332 shares issued and outstanding		
(2001 - 1,285,119 shares)	2,442	1,285
Series B preferred stock, $0.001 par value:		
915,000 shares authorized,		
Nil shares issued and outstanding		
(2001 - 915,000)	-	800
	2,442	2,085
Additional paid-in capital	22,200,582	21,496,788
Deficit	(18,800,634)	(18,253,908)
Accumulated other comprehensive income-		
cumulative currency translation adjustment	(921,563)	(988,462)
	2,480,827	2,256,503
Commitments and contingencies (notes 11 and 12)		
Total liabilities and stockholders' equity	$ 6,591,769	$ 5,742,597

See accompanying notes to consolidated financial statements.

grand toys international, inc.

Consolidated Statements of Operations, (Unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2002	2001	2002	2001
Net sales	$3,419,749	$ 1,835,043	$ 5,682,555	$ 4,051,859
Cost of goods sold	2,148,916	1,461,487	3,594,187	2,966,771
Gross profit	1,270,833	373,556	2,088,368	1,085,088
Operating expenses:				
Selling, general and administrative	1,358,503	1,212,433	2,637,789	2,315,896
Bad debt expense(recovery)	(2,023)	19,337	14,722	37,127
Depreciation and amortization	22,880	27,339	44,584	57,839
Foreign exchange (gain) loss	(10,380)	20,733	4,604	50,078
Interest expense	12,108	-	36,955	-
Interest income	(19,015)	(16,181)	(36,175)	(49,167)
Unusual items	-	(523,395)	-	(523,395)
	1,362,073	740,266	2,702,479	1,888,378
Loss from continuing operations				
	(91,240)	(366,710)	(614,111)	(803,290)

before income taxes				
Income taxes recovery (expense):	161	(183,278)	(15,664)	(213,816)
Loss from continuing operations	(91,079)	(549,988)	(629,775)	(1,017,106)
Discontinued operations (note 15):				
Loss from discontinued operation	(34,724)	(191,355)	(66,492)	(309,354)
Gain on sale of discontinued operation	149,541	-	149,541	-
Income/(loss) before extraordinary item	23,738	(741,343)	(546,726)	(1,326,460)
Gain on forgiveness of long term debt,				
net of deferred income taxes of $499,585	-	695,538	-	695,538
Net income (loss)	$ 23,738	$ (45,805)	$ (546,726)	$ (630,922)
Earnings per share (note 9):				
Basic EPS				
From continuing operations	$ (0.06)	$ (0.43)	$ (0.43)	$ (1.01)
Discontinued operations	0.08	(0.15)	0.06	(0.31)
Extraordinary item:				
Gain on debt forgiveness	-	0.54	-	0.69
Basic	0.02	(0.04)	(0.37)	(0.63)
Diluted EPS				
From continuing operations	$ (0.03)	$ (0.43)	$ (0.43)	$ (1.01)
Discontinued operation	0.04	(0.15)	0.06	(0.31)

Extraordinary item:				
Gain on debt forgiveness	-	0.54	-	0.69
Diluted	0.01	(0.04)	(0.37)	(0.63)

See accompanying notes to consolidated financial statements.

GRAND TOYS INTERNATIONAL, INC.

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

	Capital Stock	Additional Paid in Capital	Deficit	Accumulated other comprehensive income	Total
January 1, 2002	$J,085	$ 21,496,788	$(18,253,908)	$ (988,462)	$2,256,503
Net loss for the period			(546,726)		(546,726)
Foreign currency adjustment				66,899	66,899
Total comprehensive income					(479,827)
Share issuance in settlement of shortfall on share					
conversions (note 7 (c))	242	581,068			581,310

Private sale of common stock (note 7 (c))	115	114,885			115,000
Compensation expense		7,841			7,841
June 30, 2002	$2,442	$22,200,582	$(18,800,634)	$(921,563)	$2,480,827

See accompanying notes to consolidated financial statements.

GRAND TOYS INTERNATIONAL, INC.

Consolidated Statements of Cash Flows, (Unaudited)

	For the six months ended June 30,	
	2002	2001
Cash flows from operating activities:		
Net loss from continuing operations	$ (629,775)	$ (1,017,106)
Adjustments for:		
Depreciation and amortization	44,584	57,839
Deferred income taxes	-	684,996
Extinguishment of long term debt	-	(1,195,123)
Gain on forgiveness of long term debt	-	695,538
Discontinued operation (note 15)	83,049	(309,354)
Compensation expense	(11,444)	-
Net change in operating working capital items (note 10)	(4,604)	615,196
Net cash used for continuing operations	(518,190)	(468,014)

Net cash used for discontinued operation (note 15)	(57,422)	(26,197)
Net cash used for operating activities	(575,612)	(494,211)
Cash flows from financing activities:		
Increase in bank indebtedness	541,212	-
Share issuance proceeds	115,000	-
Proceeds from private sale	-	500,000
Other	16,543	1,820
Net cash provided by financing activities	672,755	501,820
Cash flows from investing activities:		
Purchase of short term deposit(note 12(c))	(250,000)	-
Loan receivable	95,068	-
Decrease in other assets	77,214	-
Additions to equipment and leasehold improvements	(19,425)	(15,754)
Net cash provided by (used for) investing activities	(97,143)	(15,754)
Net decrease in cash	-	(8,145)
Cash, beginning of period	-	211,515
Cash, end of period	$ -	$ 203,370
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 36,955	$ -
Income taxes	15,664	18,582

Private placement proceeds included in accounts		
receivable	-	169,000
Non-cash transactions:		
Share conversions	-	250,000
Shortfall on share conversions	-	232,810
Reduction in shortfall on share conversions through		
the issuance of common stock (note 7(c))	581,310	-

See accompanying notes to consolidated financial statements.

GRAND TOYS INTERNATIONAL, INC.

Notes to Consolidated Financial Statements

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 again incurred an operating loss for the year ended December 31, 2001 and for the six months ended June 30, 2002.

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.

e. Prepaid expenses:

Prepaid expenses primarily include insurance, advances on inventory purchases and current portion of royalties and product development costs.

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 twenty four months.

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., which ceased operations on January 29, 2002, 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 June 30, 2002.

k. Advertising and promotion:

All costs associated with advertising and promoting products are expensed in the period incurred. Total expense for the period ended June 30, 2002 and 2001 amounted to approximately $273,386 and $ 203,008.

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.

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. 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.

In June 2001, the Company entered into a settlement agreement with Limited Treasurers pursuant to which the Company would receive $775,000 over 42 months commencing June 30, 2001, together with interest at a rate of 9% per annum. As a result of the settlement agreement the provision against the loan was reduced to $146,269Details are as follows:

	June 30, 2002	December 31, 2001
Amount due repayable in monthly payments of principal and		
interest of $21,124 per month	$ 648,147	$ 743,215
Less current portion	203,412	194,494
	$ 444,735	$ 548,721

- **Other assets:**

	June 30, 2002	December 31, 2001
Prepaid royalties	$ 291,828	$ 326,262
Product development costs	62,344	74,982
	354,172	401,244
Less current portion, included in prepaid expenses	302,646	267,418
	$ 51,526	$ 133,826

- Equipment and leasehold improvements:

	June 30, 2002		December 31, 2001	
	Cost	Accumulated depreciation	Cost	Accumulated depreciation
Computer equipment	$ 1,278,842	$ 1,068,487	$ 1,203,915	$ 983,266
Machinery and equipment	466,880	431,099	445,821	406,881
Furniture and fixtures	480,912	453,551	458,222	428,986
Trucks and automobiles	80,598	79,933	76,722	75,977
Telephone equipment	50,328	40,405	42,486	37,499
Leasehold improvements	337,721	299,185	321,479	282,613
	$ 2,695,281	$ 2,372,660	$ 2,548,645	$ 2,215,222
Discontinued operation (note 15)				26,852
Net book value		$ 322,621		$ 360,275

- Bank indebtedness:

In 2001, the Company secured a line of credit to finance its inventory and accounts receivable providing for advances of 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. In May 2002, the Company increased its total credit facility to $2,308,000 (Cdn$3,500,000), representing an increase in borrowing capacity of $660,000 (Cdn$1,000,000). 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 expiring on August 16, 2002 and is renewed automatically, unless prior notice is given by either party.

The loan is secured by a first lien in the principal amount of $2,500,000 (Cdn$4,000,000) on all present and future assets of the Company and the assignment of insurance.

The Company has approximately $961,000 of credit available as at June 30, 2002.

- Shortfall on share conversions:

In connection with the acquisition of the assets of Ark Foundation LLC, in January 1999, 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, if, as and when declared. 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

7. 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 and the number of authorized shares from 50,000,000 to 12,500,000.

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 June 30, 2002.

b. Share transactions:

- 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 2000, 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 Series B convertible redeemable 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.

♦ January 2002:

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

♦ February 2002:

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

♦ June 2002:

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

c. Summary of common stock outstanding:

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

January 1, 2001	808,726
Share issuance in settlement of long-term debt (note 7(c))	93,750
Share conversions (note 7(c))	25,000
Private sale (note 7(c))	357,143
Stock options (note 7(c))	500
December 31, 2001	1,285,119
Share issuance on settlement of shortfall on share conversion (note 7(c))	242,213
Share issuance related to private placement	915,000
June 30, 2002	2,442,332

- Stock options and warrants:

The Company's amended and restated employee stock option plan (the "Option Plan") provides for the issuance of up to 300,000 options (150,000 as at December 31, 2001) to acquire common stock of the Company. Stock options granted under the Option Plan may be Incentive Stock Options under the requirements of the Internal Revenue Code, or may be Non-statutory Stock Options, which do not meet such requirements. Options may be granted under the Option Plan to, in the case of Incentive Stock Options, all employees (including officers) of the Company, or, in the case of Non-statutory Stock Options, all employees (including officers) or non-employee directors of the Company.

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

Changes in options and warrants are as follows:

	Option Plan	Other stock options	Warrants	Total	Weighted-average exercise price per share
January 1, 2002	134,093	236,875	412,143	783,111	$ 3.72
Granted	12,500	-	2,745,000	2,757,500	
Expired	(93,783)	(37,500)	-	(131,283)	

June 30, 2002	52,810	199,375	3,157,143	3,409,328	$ 0.60

• **Earnings per share:**

	Income (numerator)	Shares (denominator)	Per Share Amount
Quarter ended June 30, 2002			
Basic EPS			
From continuing operations	$ (91,079)	1,547,442	$ (0.06)
Discontinued operations	114,817	1,547,442	0.08
Earnings available to common stockholders	23,738	1,547,442	0.02
Diluted EPS			
From continuing operations	(91,079)	2,603,137	(0.03)
Discontinued operations	114,817	2,603,137	0.04
Earnings available to common stockholders			
and assumed conversions	23,738	2,603,137	0.01
Period ended June 30 2002			
Basic and Diluted EPS			
From continuing operations	$ (629,775)	1,461,165	$ (0.43)
Disontinued operations	83,049	1,461,165	0.06

Earnings available to common stockholders	(546,726)	1,461,165	(0.37)
Quarter ended June 30 2001			
Basic and Diluted EPS			
From continuing operations	$ (549,988)	1,272,119	$ (0.43)
Discontinued operations	(191,355)	1,272,119	(0.15)
Before extraordinary item	(741,343)	1,272,119	(0.58)
Gain on debt extinguishment	695,538	1,272,119	0.54
Earnings available to common stockholders	(45,805)	1,272,119	(0.04)
Period ended June 30 2001			
Basic and Diluted EPS			
From continuing operations	$ (1,017,106)	1,002,774	(1.01)
Discontinued operations	(309,354)	1,002,774	(0.31)
Before extraordinary item	(1,326,460)	1,002,774	(1.32)
Gain on debt extinguishment	695,538	1,002,774	0.69
Earnings available to common stockholders	(630,922)	1,002,774	(0.63)

Options and warrants to purchase 511,768 shares for the quarter ended June 30, 2002 of the Company's common stock were not included in the diluted earnings per share calculation as their effect is anti-dilutive.

Options and warrants to purchase 3,409,328 shares for the period ended June 30, 2002 (December 2001 - 783,111) of the Company's common stock were not included in the diluted earnings per share calculation as their effect is anti-dilutive.

• Net change in operating working capital items:

	For the six months ended June 30,	
	2002	2001
(Increase) decrease in accounts receivable	$ (282,321)	$ L64,025
(Increase) decrease in due from employees and affiliated company	(133)	17,212
(Increase) decrease in inventory	(398,840)	382,051
Decrease in income taxes recoverable	146,924	348,347
Decrease in prepaid expenses	107,793	11,886
Decrease in trade accounts payable	(43,541)	(148,619)
Increase (decrease) in other accounts payable and accrued liabilities	473,195	(630,886)
Decrease in royalties payable	(4,469)	(3,875)
(Decrease) increase in income taxes payable	(3,212)	175,055
	$ (4,604)	$ 615,196

• Commitments:

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

2002	$ 152,000
2003	304,000
2004	236,000

2005	8,000
2006	8,000
	$ 708,000

Rent expense for the period ended June 30, 2002, and 2001 amounted to approximately $86,325 and $56,758 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.

- 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 is also contingently liable for an outstanding letter of credit of $500,000 as at June 30, 2002 ($250,000 as at December 31, 2001). The short-term deposit has been pledged as collateral for this letter of credit.

7. Segment information:

- Operating and geographic information:

The Company operates primarily in one segment which includes the distribution of toys and related items. Approximately 96% of total sales are to Canadian customers. The majority of long-lived assets are located in Canada.

b. Other information:

Sales of toys purchased from the Company's two largest manufacturers and suppliers of toys in aggregate accounted for 76% of gross sales for the period ended June 30, 2002. The Company's two largest suppliers accounted for 55% of gross sales for the period ended June 30, 2001.

13. 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 June 30, 2002, the Company had no contracts to purchase US dollars.

b. Fair values:

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

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

c. Credit risk and economic dependence:

For the period ended June 30, 2002, approximately 57% (June 30, 2001 - 53%) of the Company's sales were made to two unrelated companies, as detailed below.

	June 30, 2002		June 30, 2001	
	Net Sales	%	Net Sales	%
Customer A	$ 2,273,000	40	$ 1,702,000	42
Customer B	966,000	17	446,000	11

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 a floating rate.

15. Discontinued operation:

On June 14, 2002, the Company sold all of the shares of its Sababa Toys, Inc. subsidiary to Sababa Global Consumer Products, LLC. Sababa Toys, Inc. distributes proprietary products and develops product concepts to be sold to third parties. In consideration for the purchase of the shares, the Company received a note in the principal amount of $1,065,716. Payments under the note are to be made quarterly until June 30,2005 when the unpaid principal balance is due. The Company recognized a gain on the sale of $761,547, of which $149,541 has been recorded in the Statement of Operations. The balance of the gain has been deferred and will be recorded in income on a proportionate basis as the proceeds from the note receivable are received.

The Company's financial statements have been presented to reflect Sababa Toys, Inc. as a discontinued operation for all periods. Operating results of the discontinued operation are summarized below.

	For the three month period ended		For the six month period ended	
	June 30, 2002	June 30, 2001	June 30, 2002	June 30, 2001