

GRAND TOYS INTERNATIONAL INC  
Form 10-Q/A  
November 19, 2002

FORM 10-Q

Securities and Exchange Commission

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended: **September 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  No

Indicate the number of shares outstanding of each of the Issuer's classes of common equity, as of November 14, 2002:  
2,685,887

GRAND TOYS INTERNATIONAL, INC.

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Filed with the Securities and Exchange Commission

Period ended September 30, 2002

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GRAND TOYS INTERNATIONAL, INC.

Part I. - Financial Information

Item 1. Financial Statements

Consolidated Balance Sheets

|        | September 30, 2002 | December 31, 2001 |
|--------|--------------------|-------------------|
|        | (Unaudited)        |                   |
|        |                    |                   |
| Assets |                    |                   |

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|  |            |            |
|--|------------|------------|
|  |            |            |
| Current assets:  |            |            |
| Short-term deposit (note 12(c))  | \$ 500,000 | \$ 250,000 |
| Accounts receivable (net of allowance for<br>doubtful accounts of \$12,601; 2001 - \$12,556) | 1,985,985  | 1,183,175  |
| Current portion of loan receivable (note 2)<br>(net of provision Nil; 2001 - \$146,269)      | 208,024    | 194,494    |
| Due from employees and affiliated company  | 1,670      | 2,034      |
| Income taxes recoverable   | -          | 143,668    |
| Inventory  | 2,387,931  | 1,373,094  |
| Prepaid expenses   | 446,053    | 698,597    |
| Current assets of discontinued operation (note 15)   | -          | 752,103    |
| Total current assets   | 5,529,663  | 4,597,165  |
|  |            |            |
| Loan receivable (note 2)   | 390,967    | 548,721    |
|  |            |            |
| Note receivable (note 15)  | 1,060,878  | -          |
|  |            |            |
| Other assets (note 3)  | 44,686     | 133,826    |
|  |            |            |
| Other assets of discontinued operation (note 15)   | -          | 102,610    |
|  |            |            |
| Equipment and leasehold improvements, net (note 4)   | 285,776    | 360,275    |
|  |            |            |

|              |              |              |
|--------------|--------------|--------------|
|              |              |              |
|              |              |              |
| Total assets | \$ 7,311,970 | \$ 5,742,597 |

## GRAND TOYS INTERNATIONAL, INC.

## Consolidated Balance Sheets

|   | September 30, 2002 | December 31, 2001 |
|---|--------------------|-------------------|
|   | (Unaudited)        |                   |
|   |                    |                   |
| Liabilities and Stockholders' Equity                    |                    |                   |
|   |                    |                   |
| Current liabilities:                                    |                    |                   |
| Bank indebtedness (note 5)                              | \$ 1,497,918       | \$ 630,136        |
| Trade accounts payable                                  | 1,758,933          | 1,483,506         |
| Other accounts payable and accrued liabilities          | 600,145            | 297,470           |
| Shortfall on share conversions (note 6)                 | -                  | 581,310           |
| Royalties payable                                       | 22,645             | 8,297             |
| Current liabilities of discontinued operation (note 15) | -                  | 485,275           |
| Total current liabilities                               | 3,879,641          | 3,485,994         |
|   |                    |                   |
| Deferred gain (note 15)                                 | 612,006            | -                 |
|   |                    |                   |
| Minority interest                                       | 100                | 100               |
|   |                    |                   |
| Stockholders' equity:                                   |                    |                   |

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|   |              |              |
|---|--------------|--------------|
| Capital stock (note 7):                         |              |              |
| Voting common stock, \$0.001 par value:         |              |              |
| 12,500,000 shares authorized,                   |              |              |
| 2,685,887 shares issued and outstanding         |              |              |
| (2001 - 1,285,119 shares)                       | 2,686        | 1,285        |
| Series B preferred stock, \$0.001 par value:    |              |              |
| 915,000 shares authorized,                      |              |              |
| Nil shares issued and outstanding               |              |              |
| (2001 - 915,000)                                | -            | 800          |
|   | 2,686        | 2,085        |
|   |              |              |
| Additional paid-in capital                      | 22,481,700   | 21,496,788   |
| Deficit   | (18,694,370) | (18,253,908) |
| Accumulated other comprehensive income-         |              |              |
| cumulative currency translation adjustment      | (969,793)    | (988,462)    |
|   | 2,820,223    | 2,256,503    |
|   |              |              |
| Commitments and contingencies (notes 11 and 12) |              |              |
|   |              |              |
| Total liabilities and stockholders' equity      | \$ 7,311,970 | \$ 5,742,597 |

See accompanying notes to unaudited consolidated financial statements.

GRAND TOYS INTERNATIONAL, INC.

Consolidated Statements of Operations, (Unaudited)

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|  | For the three months ended<br>September 30 |              | For the nine months ended<br>September 30 |              |
|--|--|--------------|---|--------------|
|  | 2002                                       | 2001         | 2002                                      | 2001         |
| Net sales                                  | \$ 3,244,053                               | \$ 1,902,910 | \$ 8,926,608                              | \$ 5,954,769 |
| Cost of goods sold                         | 2,007,983                                  | 1,225,151    | 5,602,170                                 | 4,191,922    |
| Gross profit                               | 1,236,070                                  | 677,759      | 3,324,438                                 | 1,762,847    |
| Operating expenses:                        |  |              |   |              |
| Selling, general and administrative        | 1,081,630                                  | 852,043      | 3,719,419                                 | 3,167,937    |
| Bad debt expense (recovery)                | 9,810                                      | (663)        | 24,532                                    | 36,465       |
| Depreciation and amortization              | 22,836                                     | 28,955       | 67,420                                    | 86,795       |
| Foreign exchange loss                      | 11,896                                     | 18,649       | 16,500                                    | 68,727       |
| Interest expense                           | 19,572                                     | -            | 56,527                                    | -            |
| Interest income                            | (15,940)                                   | (20,919)     | (52,113)                                  | (70,086)     |
| Unusual items                              | -  | (214,089)    | -   | (737,484)    |
|  | 1,129,804                                  | 663,976      | 3,832,285                                 | 2,552,354    |
| Earnings (loss) from continuing operations |  |              |   |              |
| before income taxes                        | 106,266                                    | 13,783       | (507,847)                                 | (789,507)    |
| Income taxes recovery (expense):           | -  | 82,823       | (15,664)                                  | (130,991)    |
| Earnings (loss) from continuing operations | 106,266                                    | 96,606       | (523,511)                                 | (920,498)    |

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|   |            |           |              |              |
|---|------------|-----------|--------------|--------------|
|   |            |           |              |              |
| Discontinued operation (note 15):         |            |           |              |              |
| Loss from discontinued operation          | -          | (38,837)  | (66,492)     | (348,193)    |
| Gain on sale of discontinued operation    | -          | -         | 149,541      | -            |
| Earnings (loss) before extraordinary item | 106,266    | 57,769    | (440,462)    | (1,268,691)  |
|   |            |           |              |              |
| Gain on forgiveness of long term debt,    |            |           |              |              |
| net of deferred income taxes of \$499,585 | -          | -         | -            | 695,538      |
|   |            |           |              |              |
| Net earnings (loss)                       | \$ 106,266 | \$ 57,769 | \$ (440,462) | \$ (573,153) |
|   |            |           |              |              |
| Earnings per share (note 9):              |            |           |              |              |
| Basic and diluted EPS                     |            |           |              |              |
| From continuing operations                | \$ 0.04    | \$ 0.08   | \$ (0.28)    | \$ (0.80)    |
| Discontinued operation                    | -          | (0.03)    | 0.04         | (0.30)       |
| Extraordinary item:                       |            |           |              |              |
| Gain on debt forgiveness                  | -          | -         | -            | 0.61         |
| Basic                                     | 0.04       | 0.05      | (0.24)       | (0.49)       |
|   |            |           |              |              |
| Diluted EPS                               |            |           |              |              |
| From continuing operations                | \$ 0.03    | \$ 0.08   | \$ (0.28)    | \$ (0.80)    |
| Discontinued operation                    | -          | (0.03)    | 0.04         | (0.30)       |
| Extraordinary item:                       |            |           |              |              |



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|                          |      |      |        |        |
|--------------------------|------|------|--------|--------|
| Gain on debt forgiveness | -    | -    | -      | 0.61   |
| Diluted                  | 0.03 | 0.05 | (0.24) | (0.49) |

See accompanying notes to unaudited consolidated financial statements.

GRAND TOYS INTERNATIONAL, INC.

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

|   | Capital Stock | Additional Paid in Capital | Deficit        | Accumulated other comprehensive income | Total       |
|---|---------------|----------------------------|----------------|--|-------------|
| January 1, 2002   | \$J,085       | \$ 21,496,788              | \$(18,253,908) | \$ (988,462)                           | \$2,256,503 |
| Net loss for the period   |               |                            | (440,462)      |  | (440,462)   |
| Foreign currency adjustment   |               |                            |                | 18,669                                 | 18,669      |
| Total comprehensive income  |               |                            |                |  | (421,793)   |
| Share issuance in settlement of shortfall on share conversions (note 7 (c)) | 242           | 581,068                    |                |  | 581,310     |
| Private sale of preferred stock (note 7 (c))                                | 115           | 114,885                    |                |  | 115,000     |

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|                                    |         |              |                |             |             |
|------------------------------------|---------|--------------|----------------|-------------|-------------|
| Share issuance (note 7(c))         | 58      | 61,196       |                |             | 61,254      |
|                                    |         |              |                |             |             |
| Share issuance in settlement of    |         |              |                |             |             |
| outstanding legal fees (note 7(c)) | 186     | 213,447      |                |             | 213,633     |
|                                    |         |              |                |             |             |
| Compensation expense               |         | 14,316       |                |             | 14,316      |
| September 30, 2002                 | \$2,686 | \$22,481,700 | \$(18,694,370) | \$(969,793) | \$2,820,223 |

See accompanying notes to unaudited consolidated financial statements.

GRAND TOYS INTERNATIONAL, INC.

Consolidated Statements of Cash Flows, (Unaudited)

|   | For the nine months ended September 30, |              |
|---|---|--------------|
|   | 2002                                    | 2001         |
| Cash flows from operating activities:                   |   |              |
| Net loss from continuing operations                     | \$ (523,511)                            | \$ (920,498) |
| Adjustments for:  |   |              |
| Depreciation and amortization                           | 67,420                                  | 86,795       |
| Deferred income taxes                                   | -                                       | 684,996      |
| Extinguishment of long term debt                        | -                                       | (1,195,688)  |
| Gain on forgiveness of long term debt                   | -                                       | 695,538      |
| Consulting expense                                      | 61,254                                  | -            |
| Compensation expense                                    | (9,850)                                 | -            |
| Net change in operating working capital items (note 10) | (635,637)                               | 297,425      |

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|  |             |             |
|--|-------------|-------------|
| Net cash used for continuing operations                | (997,324)   | (351,432)   |
| Net cash provided by (used for) discontinued operation |             |             |
| (note 15)  | 30,466      | (680,821)   |
| Net cash used for operating activities                 | (1,009,858) | (1,032,253) |
|  |             |             |
| Cash flows from financing activities:                  |             |             |
| Increase in bank indebtedness                          | 869,379     | 342,818     |
| Share issuance proceeds                                | 115,000     | -           |
| Proceeds from private sale                             | -           | 500,000     |
| Other  | 16,546      | 988         |
| Net cash provided by financing activities              | 1,000,925   | 843,806     |
|  |             |             |
| Cash flows from investing activities:                  |             |             |
| Purchase of short term deposit(note 12(c))             | (250,000)   | -           |
| Loan receivable  | 144,224     | -           |
| Decrease in other assets                               | 132,962     | -           |
| Additions to equipment and leasehold improvements      | (18,253)    | (23,068)    |
| Net cash provided by (used) for investing activities   | 8,933       | (23,068)    |
|  |             |             |
| Net decrease in cash                                   | -           | (211,515)   |
| Cash, beginning of period                              | -           | 211,515     |
| Cash, end of period                                    | \$ -        | \$ -        |
|  |             |             |
| Supplemental disclosure of cash flow information:      |             |             |

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|   |           |         |
|---|-----------|---------|
| Cash paid during the period for:                    |           |         |
| Interest  | \$ 56,527 | \$ -    |
| 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 |
| Share conversions in settlement of                  |           |         |
| outstanding legal fees                              | 213,633   | -       |
| Reduction in shortfall on share conversions through |           |         |
| the issuance of common stock (note 7(c))            | 581,310   | -       |

See accompanying notes to unaudited 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 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 has incurred operating losses in the last several years and again in the nine months ended September 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. In 2002, the Company increased its borrowing capacity under the credit line, however this financing and the net proceeds from the sale of the Company's common stock and warrants are not sufficient to fully implement the Company's business plan.

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%  |

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|                         |                   |                |
|-------------------------|-------------------|----------------|
| 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 September 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 September 30, 2002 and 2001 amounted to approximately \$386,539 and \$ 213,428. These expenses include media and cooperative advertising and are shown as part of selling, general and administrative expenses in the financial statements.

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 Treasures 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 \$146,269. Details are as follows:

|  |                    |                   |  |
|--|--------------------|-------------------|--|
|  | September 30, 2002 | December 31, 2001 |  |
|--|--------------------|-------------------|--|

|   |            |            |
|---|------------|------------|
| Amount due repayable in monthly payments of principal and |            |            |
| interest of \$21,124 per month                            | \$ 598,991 | \$ 743,215 |
| Less current portion                                      | 208,024    | 194,494    |
|   | \$ 390,967 | \$ 548,721 |

• **Other assets:**

|  |                    |                   |
|--|--------------------|-------------------|
|  | September 30, 2002 | December 31, 2001 |
| Prepaid royalties                                  | \$ 278,071         | \$ 326,262        |
| Product development costs                          | 42,765             | 74,982            |
|  | 320,836            | 401,244           |
| Less current portion, included in prepaid expenses | 276,150            | 267,418           |
|  | \$ 44,686          | \$ 133,826        |

• **Equipment and leasehold improvements:**

|                         | September 30, 2002 |                          | December 31, 2001 |                          |
|-------------------------|--------------------|--------------------------|-------------------|--------------------------|
|                         | Cost               | Accumulated depreciation | Cost              | Accumulated depreciation |
| Computer equipment      | \$ 1,220,499       | \$ 1,038,066             | \$ 1,203,915      | \$ 983,266               |
| Machinery and equipment | 447,292            | 414,145                  | 445,821           | 406,881                  |
| Furniture and fixtures  | 459,806            | 434,887                  | 458,222           | 428,986                  |
| Trucks and automobiles  | 76,993             | 76,413                   | 76,722            | 75,977                   |
| Telephone equipment     | 48,336             | 39,355                   | 42,486            | 37,499                   |
| Leasehold improvements  | 322,614            | 286,898                  | 321,479           | 282,613                  |
|                         | \$ 2,575,540       | \$ 2,289,764             | \$ 2,548,645      | \$ 2,215,222             |



|                                  |            |            |
|----------------------------------|------------|------------|
| Discontinued operation (note 15) | -          | 26,852     |
| Net book value                   | \$ 285,776 | \$ 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 was automatically renewed on the expiration date, August 16, 2002.

The loan is secured by a first lien on all present and future assets of the Company.

The Company had approximately \$1,194,216 of credit available as at September 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 ranked senior to the common stock. The Series A shares had a cumulative preferred quarterly dividend of 5% per annum of the par value, payable in cash, 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 also 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.

- 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 September 30, 2002.

b. Share transactions:

- January 2001:

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

- February 2001:

In satisfaction of the full payment of the long-term debt 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 were converted to 12,500 common shares, increasing capital stock by \$50.

- November 2001:

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

- ◆ December 2001:

As a result of a private sale of 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 was unpaid at year-end. This transaction increased capital stock by \$800.

- ◆ January 2002:

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

- ◆ February 2002:

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

- ◆ June 2002:

At the June 2002 Annual Meeting, the stockholders approved the issuance of 915,000 shares of Common Stock and warrants to purchase 2,745,000 shares of Common Stock issuable upon the exercise of warrants upon the conversion of 915,000 shares of the Series B

Convertible Redeemable Preferred Stock, which by terms were automatically convertible into Common Stock upon such approval. Accordingly, on such date, the 915,000 shares of Series B Convertible Redeemable Preferred Stock were converted into 915,000 shares of Common Stock and 2,745,000 of warrants.

◆ July 2002

57,787 common shares were issued, increasing capital stock by \$58

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

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                | 93,750    |
| Share conversions   | 25,000    |
| Private sale  | 357,143   |
| Stock options   | 500       |
| December 31, 2001   | 1,285,119 |
| Share issuance on settlement of shortfall on share conversion | 242,213   |
| Share issuance related to private placement                   | 915,000   |
| Share issuance  | 57,787    |
| Share issuance and settlement                                 | 185,768   |
| September 30, 2002  | 2,685,887 |

• 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.

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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            | 90,500      | 20,000              | 2,745,000 | 2,855,500 |   |
| Expired            | (93,783)    | (60,875)            | -         | (154,658) |   |
|                    |             |                     |           |           |   |
| September 30, 2002 | 130,810     | 196,000             | 3,157,143 | 3,483,953 | \$ 0.47                                   |
|                    |             |                     |           |           |   |

• Earnings per share:

|   | Income (numerator) | Shares (denominator) | Per Share Amount |
|---|--------------------|----------------------|------------------|
| Quarter ended September 30, 2002          |                    |                      |                  |
| <u>Basic EPS</u>                          |                    |                      |                  |
| From continuing operations                | \$ 106,266         | 2,619,210            | \$ 0.04          |
| Discontinued operation                    | -                  | 2,619,210            | -                |
| Earnings available to common stockholders | 106,266            | 2,619,210            | 0.04             |
| <u>Diluted EPS</u>                        |                    |                      |                  |

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|   |              |           |           |
|---|--------------|-----------|-----------|
| From continuing operations                | \$ 106,266   | 3,475,804 | \$ 0.03   |
| Discontinued operation                    | -            | 3,475,804 | -         |
| Earnings available to common stockholders |              |           |           |
| and assumed conversions                   | 106,266      | 3,475,804 | 0.03      |
|   |              |           |           |
| Period ended September 30 2002            |              |           |           |
| <u>Basic and diluted EPS</u>              |              |           |           |
| From continuing operations                | \$ (523,762) | 1,851,422 | \$ (0.28) |
| Discontinued operation                    | 83,300       | 1,851,422 | 0.04      |
|   |              |           |           |
| Earnings available to common stockholders | (440,462)    | 1,851,422 | (0.24)    |
|   |              |           |           |
| Quarter ended September 30 2001           |              |           |           |
| <u>Basic and diluted EPS</u>              |              |           |           |
| From continuing operations                | \$ 96,606    | 1,284,619 | \$ 0.08   |
| Discontinued operation                    | (38,837)     | 1,284,619 | (0.03)    |
| Before extraordinary item                 | 57,769       | 1,284,619 | 0.05      |
| Gain on debt extinguishment               | -            | 1,284,619 | -         |
| Earnings available to common stockholders | 57,769       | 1,284,619 | 0.05      |
|   |              |           |           |
|   |              |           |           |
| Period ended September 30 2001            |              |           |           |

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|   |              |           |        |
|---|--------------|-----------|--------|
| <u>Basic and diluted EPS</u>              |              |           |        |
| From continuing operations                | \$ (920,498) | 1,144,329 | (0.80) |
| Discontinued operation                    | (348,193)    | 1,144,329 | (0.30) |
| Before extraordinary item                 | (1,268,691)  | 1,144,329 | (1.10) |
| Gain on debt extinguishment               | 695,538      | 1,144,329 | 0.61   |
| Earnings available to common stockholders | (573,153)    | 1,144,329 | (0.49) |
|   |              |           |        |

For the quarter ended September 30, 2002, options and warrants to purchase 398,768 shares of the Company's common stock outstanding were not included in the diluted earnings per share calculation as their effect is anti-dilutive.

For the nine months ended September 30, 2002, options and warrants to purchase 3,483,953 shares of the Company's common stock outstanding (December 2001 - 783,111) 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 nine months ended September 30, |              |
|---|---|--------------|
|   | 2002                                    | 2001         |
| Increase in accounts receivable                       | \$ (805,630)                            | \$ (155,296) |
| Decrease in due from employees and affiliated company | 376                                     | 16,853       |
| (Increase) decrease in inventory                      | (1,020,987)                             | 42,438       |
| Decrease in income taxes recoverable                  | 145,692                                 | 551,702      |
| Decrease in prepaid expenses                          | 234,632                                 | 59,481       |
| Increase in trade accounts payable                    | 490,590                                 | 476,496      |
|   | 305,375                                 | (684,146)    |

|   |              |            |
|---|--------------|------------|
| Increase (decrease) in other accounts payable and accrued liabilities |              |            |
| Increase/(decrease) in royalties payable                              | 14,315       | (10,103)   |
|   | \$ (635,637) | \$ 297,425 |

- Commitments:

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

|      |            |
|------|------------|
| 2002 | \$ 76,000  |
| 2003 | 305,000    |
| 2004 | 237,000    |
| 2005 | 8,000      |
| 2006 | 8,000      |
|      | \$ 634,000 |

Rent expense for the period ended September 30, 2002, and 2001 amounted to approximately \$118,564 and \$171,023, respectively.

- Contingencies

:

- Lawsuits for alleged breach of contract have been filed against the Company's Canadian subsidiary by two former sales representatives and an employee. 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 September 30, 2002 (\$250,000 as at December 31, 2001). The short-term deposit has been pledged as collateral for this letter of credit.

13. 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 September 30, 2002. The Company's two largest suppliers accounted for 55% of gross sales for the period ended September 30, 2001.

14. 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 September 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 September 30, 2002, approximately 52% (September 30, 2001 - 47%) of the Company's sales were made to two unrelated companies, as detailed below.

|  | September 30, 2002 |   | September 30, 2001 |   |
|--|--------------------|---|--------------------|---|
|  | Net Sales          | % | Net Sales          | % |



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|            |           |    |              |    |
|------------|-----------|----|--------------|----|
| Customer A | 3,124,000 | 35 | \$ 2,084,000 | 35 |
| Customer B | 1,518,000 | 17 | 715,000      | 12 |

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 nine month period ended |            |
|--|----------------------------------|------------|---------------------------------|------------|
|  | September 30                     |            | September 30                    |            |
|  | 2002                             | 2001       | 2002                            | 2001       |
| Net sales                                  | \$ -                             | \$ 186,702 | \$ 536,120                      | \$ 186,702 |
| Cost of goods sold                         | -                                | 42,102     | 238,979                         | 57,637     |
| Selling, general & administrative expenses | -                                | 183,437    | 363,633                         | 477,258    |
|  |                                  |            |                                 |            |
| Loss from discontinued operations          | \$ -                             | \$ 38,837  | \$ 66,492                       | \$ 348,193 |

No income taxes were paid or deferred on the discontinued operation.

Assets and liabilities of the discontinued operation are as follows:

|  |                   |
|--|-------------------|
|  | December 31, 2001 |
|--|-------------------|

|   |            |
|---|------------|
| Current assets                            | \$ 752,103 |
| Other assets                              | 102,610    |
| Equipment and leasehold improvements, net | 26,852     |
| Total assets                              | 881,565    |
|   |            |
| Current liabilities                       | 485,275    |
| Net assets of discontinued operation      | \$ 396,290 |

- Comparative figures:

Certain of the 2001 comparative figures have been reclassified to conform to the basis of presentation adopted in the current period.

#### GRAND TOYS INTERNATIONAL, INC.

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

The following should be read in conjunction with the consolidated financial statements included in this 10-Q and the December 31, 2001 Annual Report.

#### Overview

#### Forward-looking statements

This Form 10-Q contains forward-looking statements about events and circumstances that have not yet occurred. For example, statements including terms such as the Company "expects" or "anticipates" are forward-looking statements. Investors should be aware that the Company's actual results may differ materially from the Company's expressed expectations because of risks and uncertainties about the future. The Company will not necessarily update the information in this Form 10-Q if and when any forward-looking statement later turns out to be inaccurate. Risks and uncertainties that may affect the Company's future results and performance include, but are not limited to, the following: intense competition and pricing pressures in the toy industry; the general consolidation in the toy industry; whether the Company's general strategy with respect to the toy industry and the Company's implementation of that strategy will correctly anticipate key trends in the toy industry; the Company's ability to retain its product lines; including without limitation, its Toy Biz line; the Company's relationships with retailers and other issues with respect to the Company's distribution channels. Additional information about factors that could affect future results and events is included elsewhere in this Form 10-Q, in the Company's Form 10-K for the year ended December 31, 2001 and in other reports filed by the Company with the Securities and Exchange Commission.

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

The Company incurred net losses for the nine months ended September 30, 2002 of \$440,462; \$1,371,492 for the year ended December 31, 2001; and \$10,156,713 for the year ended December 31, 2000. The Company has not reported an annual profit since December 31, 1997. In order to return to profitability, beginning in 2001 the Company has focused on products with higher profit margins and has reduced expenses. This has resulted in improved performance and the Company have achieved profitability for the quarter ended September 30, 2002. In spite of these efforts, there can be no assurance that the Company will become profitable on an annual basis.

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

The cost of goods sold for products imported as finished goods includes the cost of the product in the appropriate domestic currency, duty and other taxes, and freight and brokerage charges. Royalties to supplier of Grand Toys Ltd., the Company's Canadian operating subsidiary ("Grand Canada"), which are 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.

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 Three Months | For the Nine Months |
|--|----------------------|---------------------|
|  |                      |                     |

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|  | ended September 30, |         | ended September 30, |         |
|--|---------------------|---------|---------------------|---------|
|  | 2002                | 2001    | 2002                | 2001    |
|  | %                   | %       | %                   | %       |
| Net sales                                  | 100.00              | 100.00  | 100.00              | 100.00  |
| Cost of goods sold                         | 61.90               | 64.38   | 62.76               | 70.40   |
| Gross profit                               | 38.10               | 35.62   | 37.24               | 29.60   |
| Operating expenses:                        |                     |         |                     |         |
| Selling, general and administrative        | 33.35               | 44.78   | 41.67               | 53.20   |
| Bad debt (recovery) expense                | 0.30                | (0.03)  | 0.27                | 0.61    |
| Depreciation and amortization              | 0.70                | 1.52    | 0.76                | 1.46    |
| Foreign exchange (gain) loss               | 0.37                | 0.98    | 0.19                | 1.15    |
| Interest expense                           | 0.60                | -       | 0.63                | -       |
| Interest income                            | (0.49)              | (1.10)  | (0.58)              | (1.18)  |
| Unusual item                               | -                   | (11.25) | -                   | (12.38) |
| Total operating expenses                   | 34.83               | 34.90   | 42.94               | 42.86   |
| Earnings (loss) from continuing operations |                     |         |                     |         |
| before income taxes                        | 3.27                | 0.72    | (5.7)               | (13.26) |
| Earnings (loss) from continuing operations | 3.27                | 5.08    | (5.87)              | (15.46) |
| Discontinued operation:                    |                     |         |                     |         |

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|   |      |        |        |         |
|---|------|--------|--------|---------|
| Loss from discontinued operation          | -    | (2.04) | (0.75) | (5.85)  |
| Gain on sale of discontinued operation    | -    | -      | 1.68   | -       |
| Earnings (loss) before extraordinary item | 3.27 | 3.04   | (4.94) | (21.31) |
|   |      |        |        |         |
| Gain on forgiveness of long term debt     | -    | -      | -      | 11.68   |
|   |      |        |        |         |
| Net Earnings (loss)                       | 3.27 | 3.04   | (4.94) | (9.63)  |

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.

The 2001 comparative results exclude the operations of Sababa Toys, Inc., the shares of which were sold in June 2002.

Comparison of the three months ended September 30, 2002 to the three months ended September 30, 2001

Net Earnings:

Net income for the third quarter of 2002 was \$106,266, or \$0.04, per share as compared to a net income of \$57,769, or \$0.05, per share for the third quarter of 2001.

The increase in the net income is attributed to the increases in net sales (70.48%) and gross profit (2.48%) These increases were offset by the increase in selling, general and administrative expenses, as a result of restructuring expenses and certain non-recurring expenses. The income per share was reduced as a result of the private offering of shares in December 2001 and January 2002 as well as other stock issuances made by the Company during 2002.

Net Sales:

Net sales increased for the third quarter of 2002 by \$1,341,143, or by 70.48%, to \$3,244,053 from \$1,902,910 for the third quarter of 2001. During the quarter, gross profit also increased as a result of the Company's emphasis on profitable sales and tighter inventory control.

The increase in net sales during the quarter is primarily due to the Spider-Man, Lord of the Rings and Disney/Universal product lines. In particular, Spider-Man, the evergreen, perennially popular line of action adventure figures from the classic comic book hero has been dramatically enhanced by the release of Spider-Man the movie and additional lines of product based on the movie characters.

Similarly, sales of Lord of the Rings action figure toys based on the characters J.R.R. Tolkien's classic novel line increased as the successful movie adaptation captured the imagination of children.

The Disney/Universal line consists of records and audiotapes. The Company acquired the right to distribute these products in Canada in January 2002. The addition of this line represents 2% of the total net sales increase of 70.48%

over the same quarter of 2001.

#### Gross Profit:

Gross profit for the Company increased during the third quarter of 2002 by \$558,311, compared to the same quarter of 2001. As a percentage of sales, gross profit increased from 35.62% in the third quarter of 2001 to 38.10% in the third quarter of 2002. Gross profit increased as a result of the sales and product mix in the third quarter 2002. In addition the increased gross profit in the third quarter of 2002 resulted from the Company's continued emphasis on higher margin sales and minimized sales of discontinued products by tighter inventory control.

#### Selling, General and Administrative Expenses:

The increase in selling, general and administrative expenses of \$229,587 to \$1,081,630 in the third quarter of 2002, from \$852,043 in the third quarter of 2001, was primarily due to increases in advertising and cooperative advertising (\$109,374), royalties (\$67,740) and consulting expenses (\$64,120).

Other material expenses in the quarter were:

|                |            |
|----------------|------------|
| Bank financing | \$ 81,574  |
| Consulting     | 64,120     |
| Severance      | 3,670      |
|                | \$ 149,364 |

Of the above expenses, \$119,924 is of a non-recurring nature.

Selling, general and administrative expenses as a percentage of sales, were 11.43% lower in 2002 than during the comparable period in 2001. The Company continues to conduct reviews of all aspects of its operations to reduce costs and improve profitability.

Comparison of the nine months ended September 30, 2002 to the nine months ended September 30, 2001.

#### Net Earnings:

Net loss was \$440,462, or \$(0.24) per share, for the first nine months of 2002 compared to net loss of \$573,153, or \$(0.49), per share for the same period last year. However, net loss for the nine months ended September 30, 2002 included a gain of \$149,541 from the sale of Sababa Toys, Inc. Without this gain, the Company would have incurred a net loss of \$590,212, or \$(0.32) per share.

The decrease in the net loss of \$132,482 is attributed to the increases in net sales (50.00%), gross profit (88.58%) and the recognition of the gain on sale of the discontinued operations. These increases were offset by the increase in expenses, as a result of restructuring expenses and certain non-recurring expenses. The increase in the loss per share was also attributable to increased number of issued and outstanding shares as a result of the private offering of shares in December 2001 and January 2002 as well as other stock issuances made by the Company during 2002.

#### Net Sales:

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Net sales increased for the third quarter of 2002 by \$2,971,839, or by 50.00%, to \$8,926,608 from \$5,954,769 for the first nine months of 2001. During the period, gross profit also increased as a result of the Company's emphasis on profitable sales and tighter inventory control.

The increase in the current period is due to the Spider-Man, Lord of the Rings and Disney/Universal product lines. In particular, Spider-Man, the evergreen, perennially popular line of action adventure figures from the classic comic book hero has been dramatically enhanced by the release of Spider-Man the movie and additional lines of product based on the movie characters.

Similarly, sales of Lord of the Rings action figure toys based on the characters of J.R.R. Tolkien's classic novel line increased as the successful movie adaptation captured the imagination of children.

The Disney/Universal line consists of records and audiotapes. The Company acquired the right to distribute these products in Canada in January 2002. The addition of this line represents 4% of the total net sales increase of 50.00% over the same period of 2001.

Gross Profit:

Gross profit for the Company increased by \$1,561,591 from \$1,762,847 in 2001 to \$3,324,438 in 2002. As a percentage of sales, gross profit increased from 29.60% to 37.24%. 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 2002 results from the Company's continued emphasis on higher margin sales and minimized sales of discontinued products by tighter inventory control. Retailers continue to be cautious in placing fall orders but retail offtake is encouraging.

Selling, General and Administrative Expenses:

The increase in selling, general and administrative expenses of \$551,482 compared to the first nine months of 2001 was primarily due to increases in advertising and cooperative advertising (\$187,253), royalty (\$118,257), insurance (\$44,815) and compensation (\$113,736) expenses.

As a percentage of sales, selling, general and administrative expenses decreased by 11.53% from 53.20% for the first nine months of 2001 to 41.67% for the same period of 2002.

Other material expenses for the nine-month period ended September 30, 2002 were:

|                |            |
|----------------|------------|
| Bank financing | \$ 263,432 |
| Legal expenses | 206,846    |
| Recruiting     | 33,000     |
| Severance      | 32,380     |
| Consulting     | 81,216     |
|                | \$ 616,874 |

Of the above expenses, \$298,480 is of a non-recurring nature.

Gain on discontinued operation:

On June 14, 2002, the Company sold all of the shares of its Sababa Toys, Inc. subsidiary to Sababa Global Consumer Products, LLC. Sababa Toys, Inc. distributes proprietary products and develops product concepts to be sold to third parties. In consideration for the purchase of the shares, the Company received a note in the principal amount of \$1,065,716. Payments under the note are to be made quarterly until June 30, 2005 when the unpaid principal balance is due. The Company recognized a gain on the sale of \$761,547, 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.

Liquidity and Capital Resources

The Company generally finances its operations through borrowings from its credit facility with Montcap Financial Inc., by cash flow from operations, and sales of equity securities.

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

In June 2001, the Company secured a line of credit with Montcap Financial 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.

In May 2002, the Company increased its borrowing capacity to \$2,308,403 from \$1,569,563.

The Company's available borrowings under the Montcap credit facility and the net proceeds from the sale of the Company's common stock and warrants are not sufficient to fully implement the Company's business plan. To the extent that the Company will be required to fund operating losses, the Company's financial position will deteriorate. There can be no assurance that the Company will be able to find significant additional financing at all or on terms favorable to it. If equity securities are issued in connection with a financing, dilution to the Company's stockholders may result, and if additional funds are raised through the incurrence of debt, the Company may be subject to restrictions on our operations and finances. Furthermore, if the Company does incur additional debt, it may be limiting its ability to repurchase capital stock, engage in mergers, consolidations, acquisitions and asset sales, or alter its lines of business or accounting methods, even though these actions would otherwise benefit the Company's business

Accounts receivable at September 30, 2002 were \$1,985,985 compared to \$1,183,175 at December 31, 2001. The sales were mainly to mass retailers. Inventory at September 30, 2002 increased to \$2,387,931 from \$1,373,094 at December 31, 2001.

Working capital increased from \$1,111,171 at December 31, 2001 to \$1,650,022 at September 30, 2002. Net cash used for operating activities was \$1,009,858 in 2002 compared to net cash used by operating activities of \$494,211 in 2001. Cash for additions to equipment and leasehold improvements was \$18,253 in 2002 compared to \$23,068 for 2001.



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

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

If the funds available to the Company 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.

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

#### Certain Business Relationships and Related Transactions

None

#### 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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The Company has determined that the new pronouncements that will come into effect in the year 2002 will not have a significant impact on the financial statements.

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

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

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

**FOREIGN CURRENCY RISK** While the Company's product purchases are transacted in United States dollars, most transactions among the suppliers and subcontractors are effected in 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. As well since the majority of the Company's sales are in Canadian dollars, the Company is at risk with regards to the conversion of Canadian dollars to US dollars to pay its suppliers. Therefore, fluctuations in 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 4. Controls and Procedures.

Within the 90 days prior to the date of filing this Quarterly Report on Form 10-Q, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in the Company's periodic SEC filings.

Subsequent to the date of that evaluation, there have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls, nor were any corrective actions required with regard to significant deficiencies and material weaknesses

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Part II: Other Information

Item 1. Legal proceedings

During the quarter ended September 30, 2002, there were no other material developments to any legal proceedings, which have been previously reported by the Company.

Other than discussed above or in Note 12 to the Company's December 31, 2001 Consolidated Financial Statements, the Company is not a party to, nor is it aware of, any other pending litigation of a material nature.

Item 2. Changes in Securities and Use of Proceeds

In July 2002, 243,555 common shares were issued in partial satisfaction for outstanding legal fees and settlement negotiation.

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

99.1 Certification of Stephen Altro pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.2 Certification of Tania M. Clarke pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K.

None

GRAND TOYS INTERNATIONAL, INC.

Signatures

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

Dated: November 14, 2002      **GRAND TOYS INTERNATIONAL, INC.**

By: /s/ Stephen Altro

Stephen Altro

Interim President and Chief Executive Officer

By: /s/ Tania M. Clarke

Tania M. Clarke

Executive Vice President and CFO

(Principal Financial and Accounting Officer)

Certification of Principal Executive Officer

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

1. I have reviewed this quarterly report on Form 10-Q of Grand Toys International , Inc.
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4

. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
- b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
- c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6.

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

Date: .....

\_\_\_\_\_  
/s/ Stephen Altro

Date: November 14, 2002

Certification of Principal Financial Officer

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

1. I have reviewed this quarterly report on Form 10-Q of Grand Toys International , Inc.
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4

. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

- a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
- b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
- c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

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

Date: .....

\_\_\_\_\_  
/s/ Tania Clarke

Date: November 14, 2002

Exhibit 99.1

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Certification of Principal Executive Officer

Pursuant to 18 U.S.C. 1350

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

I, Stephen Altro, Interim - President and Chief Executive Officer (principal executive officer) of Grand Toys International, Inc. (the "Registrant"), certifies that to the best of my knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended September 30, 2002 of the Registrant (the "Report"):

- (1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

\_\_\_\_\_  
Name: /s/ Stephen Altro

Date: November 14, 2002

EXHIBIT 99.2

Certification of Principal Financial Officer

Pursuant to 18 U.S.C. 1350

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

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I, Tania Clarke, Chief Financial Officer (principal financial officer) of Grand Toys International, Inc. (the "Registrant"), certifies that to the best of my knowledge, based upon a review of the Quarterly Report on Form 10-Q for the period ended September 30, 2002 of the Registrant (the "Report"):

- (1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

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Name: /s/ Tania M. Clarke

Date: November 14, 2002